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THE ECONOMIC DEVELOPMENT POLICY
IN
THE TRANSITION TOWARD
A MARKET-ORIENTED ECONOMY
IN
THE SOCIALIST REPUBLIC OF VIETNAM

FINAL REPORT

FISCAL AND MONETARY POLICIES

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JAPAN INTERNATIONAL
COOPERATION AGENCY

MINISTRY OF PLANNING AND INVESTMENT
THE SOCIALIST REPUBLIC OF VIET NAM

THE ECONOMIC DEVELOPMENT POLICY IN THE TRANSITION TOWARD A MARKET-ORIENTED ECONOMY IN THE SOCIALIST REPUBLIC OF VIET NAM

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DAIWA INSTITUTE OF RESEARCH LTD.
THE JAPAN ECONOMIC RESEARCH INSTITUTE
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CURRENCY EQUIVALENTS

March 1996	Currency Equivalent
	11,000VND / USD 1.00
	102.88 円 / USD 1.00

Abbreviations

AFTA	ASEAN Free Trade Area
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
BIDV	The Bank of Investment and Development of Viet Nam
CMEA	Council for Mutual Economic Assistance
FDI	Foreign Direct Investment
MOF	Ministry of Finance
ODA	Official Development Assistance
SOEs	State-Owned Enterprises
SMEs	Small and Medium Enterprises
WTO	World Trading Organization

Executive Summary

Viet Nam needs substantial amounts of investment and development funds to industrialize and modernize its economy. The capital accumulation mechanism has shifted from physical planning to fiscal and monetary measures with the adoption of a market economy mechanism. The present capital formation is implemented in a two-tier system of public investment and private investment (including commercially viable investment by state-owned enterprises). Public investment funds are expected to be raised relatively smoothly, however the funds system for private investment has not developed fully nor functioned properly.

Tax and fee revenue, the major source of public investment funds, has grown to 24% of GDP in 1994, which is above the target figure in the 5-year plan for 1996-2000. Thus the issue now is to structurally reform the tax system to secure tax revenues in the long-term rather than to increase the tax amount per se. It is imperative to reduce the heavy tax burden on the business sector, which is due mainly to turnover tax and has discouraged business expansion through investment. Then the government has to develop special consumption tax and personal income tax as new sources. These will be needed to compensate the tariff rate reduction that is required for AFTA participation.

As to the relationship between central and local government, both wealthy and poor districts have little incentive to raise taxes because of the current fiscal system in which local revenue increase is not tied with local expenditure increase. Therefore local governments do not raise the tax revenue that could be raised with proper incentive. It is important to give local governments this incentive by clarifying the rules for sharing tax revenue between the central and local government.

Medium- to long-term funds are indispensable for developing industries with international competitive advantages. Not only is there a demand for investment funds to build plants and purchase machinery but also for long-term working capital needs in emerging labor-intensive manufacturing industries such as textiles and footwear. Foreign companies also have demand for domestic currency funds as a hedge against exchange rate risk. The ratio of domestic credit outstanding to GDP shows the extremely low level of financial intermediation in Viet Nam. The need to establish a direct finance market is understandable, but accounting, audit and related legal systems have just started to be developed in Viet Nam. The priority at present must be given to developing the functions of the indirect finance market, the banking system.

Bank deposits are increasing. However depositors are only those who seek high interest rates. Banks are not willing to accept deposits at such high interest rates because they cannot find enough borrowers to compensate these rates. The majority of the public still do not trust the banking system. There is still a large fear of inflation and in 1990 many credit unions went bankrupt. In order to regain the public trust, improved banking services and macroeconomic stability are indispensable. Banks must provide basic services such as the opening of deposit accounts without delay, the withdrawal of deposits with neither inquiries nor delay and the observance of client privacy.

Bank credits for the private sector are increasing, but they are mostly in the short term and with high interest rates. Banks must analyze the credit standing of the clients' business instead of relying on collateral lending. Financial institutions for medium- and long-term funds, needed for industrial growth, have not been developed. Banks must acquire credit analysis ability in order to provide medium- and long-term funds for investment projects. However, it is neither plausible nor economically efficient for every financial institution to attain this ability. Accordingly a special financial institution for medium- and long-term funds may need to be established.

Foreign savings complement the scarcity of domestic savings. FDI on a contract base has grown to the level equivalent with GDP, and FDI is expected to keep growing. FDI is by nature, cost sensitive and volatile. It must be noted that there would be FDI flight if domestic reform began to be neglected.

The Vietnamese government is conscious about the possibility that the high dong, caused by the foreign currency inflow accompanying FDI, could hinder export competitiveness and accordingly enlarge the trade deficit. It is probable that the dong's real effective exchange rate, which is the weighted average of currencies of all trading partners by trade volume, has not appreciated as much as its exchange rate against the dollar. Gradual appreciation of the real effective exchange rate would promote not only rationalization of expoit industries but also conversion of domestic dollars into dong. Dollar purchasing operations to prevent excessive appreciation is proper policy but the dong must be sterilized.

II. Fiscal and Monetary Policies

Abbreviations
Executive Summary

Chapter 1. Overall Suggestions for the 5-year Plan

1-1. Sources of Funds for Development & Investment and Their Management:

It is vital that Viet Nam continues to invest in the development of social and industrial infrastructure and facilities in order to maintain and further accelerate its economic growth. As such, Viet Nam's ability to raise medium- to long-term funding is of primary concern. Although more foreign financing is expected, since Viet Nam is already heavily burdened with foreign debts, a more important issue is how to raise the level of national savings and manage foreign debts. The investment required for the five years 1996-2000 is estimated at US$41-42 billion. The investment/GDP ratio and accordingly the savings ratio have to be increased from the 19% of 1991-1994 to 30%. Of the funds, half is expected from foreign sources and the rest from domestic savings. (see Table II-1-1, 2)

The Vietnamese government hopes to attain economic growth without high inflation, a prerequisite of which is fiscal reform and financial sector development that enables appropriate fiscal and monetary policies. A part of the development includes the funds flow from the household sector as well as the informal sector to the industrial sector through formal financial sectors such as banks and securities markets. It is important to create an integrated tax system, savings system and credit system.

1-2. Mobilization of Domestic Funds:

Tax revenue and domestic savings are expected to increase as economic growth pushes up the level of national income. Nevertheless, economic development could be impeded by the lack of medium- to long-term funds due to some structural factors as well as to the government policies that render the present savings rate low. Some of the factors seem deeply rooted in the socio-economic system and need long-term measures for correction. Educating the public about tax payment, savings and bookkeeping at school and community activities is most effective in the long term. Even though the government would not see results in the short term, it should start such education immediately.

(1) Fiscal Mobilization:

Taxation is being reformed to establish a more rational system. However, disincentives prevail for both tax payers and collectors. Business enterprises face heavy tax burdens mainly due to the turnover tax, which makes it difficult for them to retain their earnings for re-investment. Frequent changes made to the tax system and the way it is applied also discourage tax payment. It is necessary to build a tax system that promotes rather than impedes business and economic growth.

Tax burdens are not equally shared among economic sectors. The industrial sector bears a heavier burden. On the other hand, the household and commercial sectors pay minimal or small amounts of tax. The base of personal income tax should be broadened and the tax collection from the commercial sector should be rationalized. It is a part of the integrated framework which channels funds to the industrial sector. The clarification and rationalization of the accounting system is a prerequisite for a fair and stable tax system.

Unlike a planned economy, a market economy that allows profit and wealth maximization requires that government redistribute income in order to maintain social justice. In this respect, the issue of how to raise a sense of duty toward the payment of taxes within the community deserves some consideration.

(2) Private Savings Mobilization:

In Viet Nam, a large part of bank transactions, both deposits and loans, are made with state enterprises. Ordinary people basically do not have accounts. Therefore, it is important to get these people to deposit their hoarded money (in gold and dollars) with the banks. In this respect, it is of great importance to regain or create a sense of trust in financial institutions. Although informal financing plays a certain role in the private sector, it is limited in terms of contributions to economic growth and industrial development.

We suggest that Viet Nam creates a fund raising mechanisms from the household sector and the informal sector. Postal savings should be considered for collecting deposits from the public in urban areas. Membership of credit unions seem appropriate for the small- and micro- business sectors, which collect deposits and provide small working capital loans. In both schemes, funds are transferred to a central organization to provide industrial loans.

For all of the fund mobilizing measures it is prerequisite that the government maintain the value of the dong. The inflation rate must be under control and the foreign exchange rate must be stabilized.

1-3. Mobilization of Foreign Funds:

Fund raising through foreign sources such as ODA and FDI is favorable at the moment, although there are still problems on the receiving side that render the actual realization rate low. In fact, the Vietnamese government puts more emphasis on debt management and related foreign exchange rate management. The government, however, should promote FDI for the long term in order to compete with neighboring countries. In this regard, the foreign bank function concerning FDI should not be neglected.

Sources of foreign funds have diversified. It is necessary to effectively utilize foreign funds by matching the profitability of projects and the cost of foreign funds. It should be noted that the concessionary conditions of ODA will be changed significantly as the funds flow in. It is also important to take into consideration a unified management of ODA. The financial viability, the ability to repay the debt, of the practical implementers of projects has to be grasped by the concerned parties.

Foreign exchange rate management is a complicated task. It has to be balanced among policy priorities such as inflation prevention, savings promotion, export promotion and FDI inducement. The foreign exchange rate alone cannot solve all the issues. The government should be equipped with multiple policy tools to attain multiple policy objectives.

1-4. Provision of Medium- and Long-term Funds:

(1) Conversion of Terms:

The scarce funds that can be raised are mostly very short term at high interest rates. It is inappropriate to utilize such funds for long-term investments. In the process of transferring funds from the local network to the central organization in the above scheme, the conversion of terms could be possible. In addition, financial institutions could convert short-term deposits into long-term loans with sufficient credit analysis but the role of the government may be necessary. Bond issues may also provide a means of resolving this situation.

(2) Financial Institutions for Medium- and Long-term Fund:

In order to effectively utilize the long-term funds, financial institutions are required to equip themselves with strong credit analysis capabilities. It is necessary in order to avoid an increase in bad loans and an eventual breakdown of the financial system. There are very few financial institutions which provide medium- to long-term funds in Viet Nam. At present, the General Department for Investment and Development of the MOF and the Bank for Investment and Development of Viet Nam are the main providers of medium- and long-term loans. The financial decision making by such government and state-owned organizations is susceptible to high risks of bending to political pressure. In addition, most of their funds are provided to the state sector including SOEs. A system that will supply funds to the private sector should be constructed.

Table II-1-1 Investment Figures of the 5-year Plan (1)

(in billions of 1995 US$)

	1991-1995		1996-2000	
Investment	18.0	100.0	41-42.0	100.0
(State)	(7.7)	(43.0)	(15.6)	(37.1)
(FDI)	(4.9)	(27.0)	(14.0)	(33.3)
(Private)	(5.4)	(30.0)	(12.4)	(29.5)
Fund Sources	18.0	100.0	41-42.0	100.0
(ODA)	*(2.0)	(11.1)	(8.0)	(19.0)
(FDI)	(4.5)	(24.7)	(14.0)	(33.3)
(Domestic)	*(11.5)	(63.9)	(21.0)	(50.0)
#Eurobond	-	-	1.0	-
#ICOR	2.0-2.5	-	3.0-3.3	-
#Inv/GDP	**19.1	-	30.0	-

(Government Report to CG) * based on rough disbursement figures

** calculated for 1991-94 using IMF data

Table II-1-2 Investment Figures of the 5-year Plan (2)

(in billions of 1995 US$)

Investment		Sources of Funds	
Public Investment	15.6	Budget	8.1
		ODA	7.5
(Government)	(8.7)	-	
(SOEs)	(6.9)	-	
SOE Commercial	5.9	Domestic	5.9
Private	19.9	FDI	13.0
		Domestic	6.9
Total	41.4	Total	41.4

(Government PIP report)

Chapter 2. Fiscal Mobilization

2-1 Fiscal Mobilization and the 5-year Plan

(1) The 5-year Plan

In the 5-year socio-economic plan, the roles of the state budget are underscored and the budget structure is required to be more stable. The tax revenue is targeted to mobilize funds at 21-22% of GDP and the fiscal deficit is targeted to be kept under 4.5% of GDP. The budget should allocate fiscal savings* of a significant level to public investment projects after servicing current expenditure and at the same time should contribute to contain the inflation rate at under 10%. The size of investment and development necessary for 1996- 2000 is estimated at US$ 41-42 billion, of which public investment is projected at US$ 15.6 billion. The public investment ratio to GDP has to be raised to 10% during 1996-2000 from the current 7% level. Provided that foreign grants are at the 1993-94 level of 1% of GDP, current expenditure has to be reduced to 16.5-17.5% of GDP, equivalent to the 1990-1991 level (see Table II-2-3). With prudent policies on government debt, interest and principle repayments will not have a large share in the current expenditure during 1996-2000.

*defined here as fiscal revenue minus current expenditure

Thus the government's task in the fiscal area, in terms of GDP share, is to maintain the tax revenue level, increase public investment spending, cut down the fiscal expenditure and keep the fiscal deficit under control. Naturally the focus is on the tax revenue increase/maintenance and the 5-year plan lists the agenda such as further tax reform, simplification of customs duties, and efficient tax collection. In order for the tax revenue increase to be meaningful, the expenditure side should be managed efficiently. Hence the 5-year plan also urges tight budget control.

(2) Contents of this Chapter

Based on the above mentioned orientation of the 5-year plan, analysis of the status quo and suggestions for fiscal policies and measures are given in the following order. Major emphasis is on the probability of fiscal revenue increase. At first, fiscal structure is analyzed from the viewpoint of fiscal role, size and soundness. Then the tax revenue structure and tax system reform are analyzed from the viewpoint of what are the main sources of tax revenue and what are the prospective future sources of tax revenue. In addition, the central and local budget allocation issue is considered in terms of the tax system.

The contents of public investment need to be studied. The objective of mobilizing funds, including taxes, is to supply sufficient funds to investment projects. If the investment projects were not productive, all the efforts would end up in vain. The contents of current expenditures also need to be studied. However, in this research we only study the implementation process of public investment, state owned enterprise (SOE) investment, and the social insurance system management.

Our consistent theme is that the growth of business entities through capital formation or plant and equipment investment is the core factor of economic development and the associated tax revenue increase. In our research and analysis, we include comparative analysis with the experience of Japan and of other ASEAN countries, especially with regard to industrial development.

2-2 Current Status of Fiscal Structure

(1) Fiscal Revenue

Fiscal revenue has increased along with the economic growth, especially since 1992. The GDP ratio has risen rapidly from 13% in 1991 to 25% in 1994. Fiscal revenue depends on two sectors of the economy, SOEs and trade. The sum of taxes and contributions from SOEs has always been the major revenue source. After dropping to 7.7% in 1988, it was up to 12% in 1994. Tax on trade has rapidly increased from 1% in 1991 to 6% in 1994, contributing about 30% of fiscal revenue increase (see Table II-2-2).

These figures correspond with specific trends in GDP composition. The state sector share in GDP hit bottom in 1990 at 32.5% and moved up to 40.2% in 1994. Agriculture, the major component of the non-state sector, after rising to 44.8% in 1988 went down to 27.7 % in 1994. On the other hand, industry gained from a low of 23.9% in 1990 to 30.7% in 1994 owing to the state sector increase. In services, both the state and private sectors gained shares (see Table II-2-4). Imports share in GDP increased 28.5% in 1991 to 36.6% in 1994. Further analysis of the following points may provide clues to the effective taxation: (a) breakdown of SOE tax revenues into foreign direct investment (FDI)-related SOEs and domestic SOEs, (b) breakdown of trade tax into export tax and import tax, then breakdown of import tax revenues by goods and by business sectors.

The depreciation allowance of SOEs was an important source of the fiscal revenues and shared 9.3% of the total revenues in 1992-94 (see Table II-2-5). The government has stopped charging depreciation fees since 1995 in order to encourage SOE reinvestment. According to the MPI data, the fiscal revenues increased to 25.8% of GDP in 1995 in spite of the loss of revenue from depreciation. Detailed data will prove the mechanism of revenue increase.

Oil-related fiscal revenue has contributed significantly to the budget, especially easing the fiscal crisis in 1990-91. Relative dependence on oil, however, is decreasing from 20.8% of fiscal revenue in 1991 to 12.4% in 1994. Crude oil production is targeted at 20 million tons by the year 2000. Although the breakdown of oil-related fiscal revenue is not available, this level of oil production can be roughly calculated to bring fiscal revenue equal to 6 % of GDP, up from the current 3% level. (see Table II-2-6)

(2) Fiscal Expenditure

Fiscal expenditure has been pressured by the nature of expansion, especially the need for social services. It seems that the capital expenditure was tailored to the fiscal revenue. However, except for 1991, about 25% of the expenditure was constantly spent on capital formation (Table II-2-5). The fiscal savings figure has been positive since 1992 and the fiscal deficit has been controlled at around 5% after capital expenditure. Various fiscal reforms and measures have been implemented to contain expenditure during the last decade. Subsidies for food procurement, production and exports were terminated in 1988, most of which had gone to SOEs. Net funds flow from SOEs has been positive since 1989. Military personnel were reduced and military expenses decreased. The expenditure, however, probably changed form i.e. to veterans pensions, and caused an increase in social service expenditure (no detailed statistics are available). Further thrift is necessary to attain the 5-year plan.

(3) Fiscal Deficit

Investment funds from the budget are comprised of two sources, one is tax revenue and the other is the deficit finance generally in the form of government bonds. The Vietnamese government issues three types of bonds, Treasury Bills, Treasury Bonds and Project Bonds, to cover its fiscal deficit. Since the current balance has been kept positive, it is reasonable to consider that these bonds are issued for investment and development purposes. Most of the funds raised, however, are short- term with high interest rates*, not appropriate for public investment. Thus investment funds from the budget at present do not necessarily have preferential terms.

*According to the State Treasury, most of them are T-Bills and one-year bonds, which were issued at a 21% interest rate in 1995.

All of the current external debt is government debt, and new borrowings for the time being will be either by the government itself or with the guarantee of the government. Thus uniform management of external debt and domestic government debt is necessary for properly understanding future cash flows and needs.

2-3 Current Tax System and Tax Reform

(1) Tax Reforms So Far and Tax Revenues

Before the Doi Moi started in 1986, the major fiscal function was to channel funds from and to SOEs. The role of tax up to that period was very limited. A series of Phase I tax reforms were implemented during 1986-1995 to adapt to a market economy system as well as to increase government revenue to overcome the fiscal crisis. Among the important changes implemented in 1990 were: (a) the national tax policies for all economic sectors were unified, (b) tax collection organizations were unified and (c) the first Vietnamese tax laws were enacted. These reforms contributed not only to increasing fiscal revenue but also to promoting SOE reform by clarifying the financial status of SOEs. Funds flow was changed from fiscal-oriented to banking-oriented. Since banks will not lend money to loss-making enterprises, only profit-making and tax-paying SOEs can continue to operate. The current tax system is summarized in Table II-2-7.

The current tax system is characterized by heavy dependence on a few tax items such as *turnover tax*, *corporate profit tax* and *import and export tax*. As shown in Table II-2-8, the total share of these three in the total tax revenues was 61.9, 68.4, and 69.7 in 1993, 1994, and 1995 respectively. If *excises* are added to these figures, the four tax items cover three-fourths of the total revenue (70%, 74.9%, 76.4% in 1993, 1994, 1995 respectively). As we noted above, these figures correspond with the fact that SOEs and foreign goods are the major sources of tax revenues. The major emphasis of tax system reform, then, should be naturally on how to deal with these tax items and which sectors will be prospective tax sources.

By sectors, the SOE sector is still dominant in government revenues although tax reform changed the main revenue source from the transfer of SOE operating surplus to tax revenue. On the other hand, collection from the non-state (private) sector has been low. The low-income agricultural sector is the dominant part of the non-state sector and cannot be expected to contribute further to the budget. It is the service sector which may be a prospective tax source. Private activities have a significant share of the service sector, which has relatively high income. It is probable that the service sector has not contributed to tax revenue as much as it can afford. (see Table II-2-10). In addition tax evasion and smuggling are reportedly high.

In Viet Nam, the financial system is not yet developed enough to earn the popular trust and an informal economy exists. People would rather hoard their money in gold and US dollars or exchange money for imported luxuries such as motorbikes and automobiles than keep it in bank accounts. In such a situation, the government has to rely on import and excise taxes whose bases consist largely of imported luxuries. Differentiated data is not available, but combined import-export tax has been the highest component of tax revenue in the past few years (24.8%, 30.8%, 34.0% in 1993, 1994, 1995 respectively).

The direct tax share of total tax revenues in Viet Nam is low compared with other countries (see Table II-2-9). Personal income tax played a peripheral role in tax revenues in 1995 (1.0%). The elasticity of indirect tax to income is lower than that of direct tax. The low direct tax ratio implies that the tax revenues would not grow as the economy grows. The income redistribution function is also low.

The tax revenue ratio to GDP of Viet Nam has risen to the 20% level. The ratio generally increases with the economic development of countries, as they require increased social security spending. (see Figure II-2-1) Viet Nam seems to be situated at a slightly higher position relative to its economic development stage. This is clearer in comparison Viet Nam with ASEAN countries. In terms of the 5-year Plan, the targeted tax revenues of 21-22% of GDP were already attained in 1994. Thus tax policy may focus on changing the quality of the tax structure from the current overall collection level. In particular, a tax system that promotes business growth and shifts sources of tax revenues merits consideration.

(2) Tax on Business

1) Tax on Business in General

Effective tax rates for business activities are considerably higher in Viet Nam than in neighboring ASEAN countries. Comparative computations using a simple case prove the relative position of Vietnamese taxation. The comparisons in Tables II-2-12 and II-2-13 show that the effective tax rates for both domestic companies and foreign companies in Viet Nam are higher than in other ASEAN countries. The big difference in effective tax rates is mainly due to turnover tax. All the ASEAN countries listed above except Viet Nam have already adopted the value added tax (VAT) system. Viet Nam still applies turnover tax instead. From table II-2-15, there are cases of unprofitable but decent business in other countries that may not be able to survive in Viet Nam. Comparing the VAT rates among the ASEAN countries, Singapore applies the lowest i.e. 3% rate. The other countries have set the rate at between 7 and 10%.

If Viet Nam were to change its present profit tax to an unified corporate tax (33%) and the present turnover tax to VAT (say 10%), the effective rate of tax would be equivalent to that of the Philippines, Thailand and Malaysia. However, the adoption of a VAT system is not so simple. It requires the establishment of a solid accounting system.

In short, the current tax policy is to take as much as possible from those who can afford it and are easily caught. The policy is inevitable and practical from a tax collection viewpoint, but on the other hand this policy hinders the growth incentive of the business sector.

The following are some other problems of current tax practices: The tax system and its codes are frequently changed by circulars or through notification by the government. In addition, the changes are often enforced without a grace period and enforcement dates are even often unclear. In practice, taxes are imposed using the different rules of the various local tax offices. Interpretation of codes and notification is not consistent throughout the national organization. In profit computation, tax offices often set such ceilings as ratio to sales on deductible cost items and sometimes merely tax a certain set amount especially for small-size businesses. This practice is probably due to both insufficient accounting on the business side and insufficient audit on the tax office side.

Export promotion is a national priority. In taxation, production for export is exempted from turnover tax in order to promote export operations. Trading companies usually intervene in export operations. Sales to the trading companies are sometimes treated as domestic sales and are accordingly imposed turnover tax. The existence of an export tax contradicts the export promotion policy. Control for rice exports may be a major factor in this regard, but this could be accomplished by different measures.

2) Tax on SOEs

Before 1990, transfer funds from SOEs were collected in various forms; state payment, price difference payment, profit transfer and depreciation transfer.

Though the SOE sector is a major contributor to fiscal revenue, their adopted accounting systems and practices have not been clear. In particular, the notions of assets, liabilities and capital are different from the Western standards.

In 1990, the government began to collect a capital user fee on government capital. This was to attain equal footing between SOEs and private companies as well as to manage the SOEs. At the same time, depreciation was also collected because the assets of SOEs were owned by the government. Since 1995, depreciation has been retained within SOEs for reinvestment. The depreciation charge is 8% of asset value. In this regard, taxation on SOEs has been changed to promote reinvestment.

3) Tax on Banking

Heavy taxes have been imposed on the banking business: turnover tax (15% on interest spread, 25% on foreign exchange earnings and 6% on transfer/ collection fees) and profit tax

(45% and in the case of foreign banks 25%). Although the turnover tax on interest spread has been removed since Jan. 1996, it is still levied on other fees and charges.

Unlike other businesses, foreign banks are liable to taxes from the first year of their investment. Foreign banks tend to extend loans to foreign investors outside Viet Nam to avoid the high taxes. They generally extend loans to foreign parent companies instead of to Vietnamese subsidiaries including joint ventures. In the past, Korea was developed through use of the funds brought in by foreign banks which were given preferential status. Currently Myanmar imposes no tax on foreign banks.

4) Tax on FDI

Taxes on foreign investors, including joint-venture partners and foreign partners of Business Cooperation Contract (BCC), are regulated by the Law on Foreign Investment in Viet Nam.

To promote FDI, the government provides several preferential tax measures. (a) The basic profit tax rate is lower than the 25% for domestic corporations. Depending on the priority of the projects, either 10%, 15% or 20% is applied. (b) Tax holiday or exemption from profit tax may be available for up to four years after first recording a profit and a 50% reduction is allowable for up to four more years. (c) Import tax is exempted on machinery, equipment and materials. (d) Profit tax is returned provided the foreign investor reinvest in the business for three consecutive years. However, a repatriation tax of 10% is imposed on foreign investors when they transfer profits abroad. In some cases a preferential rate of 5 or 7% is applied based on the size of FDI.

When no tax treaty exists between Viet Nam and the mother country of a foreign investor, the tax exemption in Viet Nam transfers to the mother country not to the investor.

(3) New Tax Reform

Further tax reforms, Phase II, are being prepared or planned. The main objective of the new reforms is to industrialize and modernize the economy and to conform the tax system to an open market policy, namely to participate in ASEAN and the Asian Free Trade Area (AFTA). The guiding policy is to move toward a unified and simple tax system. Following are major reform plans that are either already prepared for deliberation at National Assembly or are under study.

1) VAT (turnover tax)

Turnover tax is considered to be replaced with VAT. In the transition period, the number of turnover tax rates will initially be reduced from 18 to 11. An accounting system as well as bookkeeping or invoice exchange practices are the basis of VAT. A majority of retail business in Viet Nam are very small scale where implementation of VAT is practically impossible. It is practical that small business continue to pay turnover tax instead of VAT.

The kind of turnover tax adopted in Viet Nam used to be implemented widely, not only in the ASEAN countries, but in European countries such as the former West Germany, Austria, Luxembourg, and Holland. However, all eventually abolished the turnover tax and adopted the value added tax system instead. The VAT system has become the most accepted sales tax in the world and is currently used in over 70 countries in Europe, Asia, Africa, and Latin America.

2) Corporate Income Tax (profit tax)

Different profit tax rates are currently imposed on three business sectors, 25% on heavy industry, 35% on light industry and 45% on trade and service. Foreign investors pay lower rates of 10-25%. With the introduction of a new accounting systems, corporate income tax will supersede the profit tax that is imposed on any person who has Viet Nam-source profit. Also corporate income tax rates will be integrated to one rate to make taxation neutral to economic activities. The rate will be 33%, matching the other ASEAN countries' level. The basic principle is correct in terms of equity and simplicity. It is, however, also economically justified for the government to have economic and industrial policies placing priority on certain sectors.

3) Personal Income Tax (income tax for high income earner)

At present, only someone with a high income are levied personal income tax. The tax base is too narrowly defined and tax payers are limited to a few Vietnamese and foreign expatriates. Consolidated taxation on personal income seems difficult due to a progressive tax system with a limited base that should be a less progressive tax system with a broadened base so as to cover all income brackets. Myanmar's past experience in this regard is useful for Viet Nam. Before fiscal 1990, the income tax composition in the total tax revenue of Myanmar was small, since the majority of people were below the minimum line. Income tax expanded remarkably to become the second largest part of the composition right after Myanmar abolished the income limit and broadened the tax base to include all income brackets.

4) Tax on FDI

The preferential profit tax rates for foreign investors are being considered for termination in accordance with corporate tax reform at the end of 1996. The tax on profit repatriation abroad may also be terminated. Domestic discussion is that current preferential treatment discriminates against and discourages domestic investment and that equalizing the tax rates between domestic and foreign companies is necessary. Tax is an important cost for foreign investors who can choose which country to invest in. It seems too early for Viet Nam to abolish FDI promotion measures at this point, considering the competitive environment. Considering FDI contribution, priority should be on the introduction of funds into Viet Nam, not on tax income.

5) AFTA Related Tax

Import and export taxes are the largest tax items in Viet Nam. However, as a member of AFTA, Viet Nam agreed to reduce tariff rates on general items to 0-5% by the year 2006 (see Table II-2-16). The government is now considering compensation of the revenue loss by hiking the rates of excise taxes (special consumption tax) on imported luxuries such as tobacco, alcohol, fireworks, gasoline and automobiles. These goods are not included in the Common Effective Preferential Tariff (CEPT) list submitted by the government. This kind of temporary measure is required if Viet Nam is to secure tax revenues.(see Table II-2-17 and more detailed discussion in Appendix II-2-1)

The roles of the import tax are two fold i.e. revenue raising and domestic industry protection. Although the former is of primary concern to the government, it is also important to find ways to protect immature domestic industries other than setting high import duty rates.

(4) Tax Collection System

Though there have not been local taxes, all taxes were collected by local governments prior to the 1990 reform. The General Department of Taxation (GDT) was established under the Ministry of Finance in October 1990 by integrating three tax departments: one for SOE taxes, one for non-state taxes and one for agricultural taxes. Since then a uniform tax policy and collection system has been in place.

The local network was reorganized to place the 53 provincial tax departments at the Peoples' committees and 500 district tax offices under the direct control of the GDT. The employment system was also unified, and all tax officers throughout the nation have become central government employees.

There was no tax law before the 1990 tax reform. Contents of Ordinances and Decrees were/are vague and application practices were/are discretionary. Thus relative to those conditions, tax collection has become efficient through reform. Tax contents were clarified by the enactment of laws and the organization and management of tax collection has become centralized.

Although tax policies are studied and planned by the GDT, the General Department of Customs (GDC), which is under the management of the Government Office, is responsible for collecting customs duties through its local network. The placement of the GDC under the direct control of the MOF is being considered.

The 40,000 Vietnamese tax personnel is slightly higher per capita than the Japanese national tax apparatus of 57,000. The government has to be careful that the reinforcement of tax collection does not end up with increased personnel and cost. As we noted, the emphasis should be on the quality of tax revenues not on the volume *per se*.

(5) Central-Local Allocation

In Viet Nam local tax does not exist and all taxes are collected by the centralized organization as noted above. Theoretically all of the local governments' revenues are transferred from the central government. It is worthwhile to see, however, the actual funds flow between central and local governments. In 1992, 22 provinces were net contributors of fiscal revenues to the central government and 31 provinces were net receivers (WB 1995c). In net, local governments transferred 2,536 billion VND, 12% of the state budget, to the central government. Three regions, the Red River Delta, the Southeast and the Mekong River Delta contributed 3,307 billion VND and the rest of the country received 771 billion VND. (Table II-2-18)

According to the People's committee of Ho Chi Minh City, the city raises 25% of national tax revenues, but can retain only 20% of the revenue. Taxes designated as fixed-local revenue sources provide 80% of the city budget, the remaining 20% is shared with the central government. Dongnai Province retains 50 - 60% of its collected tax revenue.

According to the central government, there exists, at the local government level, some revenue leakage or some revenues not controlled by the central government. Earlier tax and SOE surplus were collected by local governments and SOEs are still strongly influenced by local governments. The centralized tax system does not seem to have functioned efficiently yet. Since local investment and development projects have to be authorized by the central government, the extra revenues raised by local governments are probably spent on current expenditures. Scarce resources, i.e. possible tax revenues, are not managed and accounted properly. From the local government's viewpoint, their revenues are taken to the central government and they lack funds to meet local needs. Local endeavors to raise funds from the business sector often contradict the tax revenue plans of the central government (Table II-2-7).

A tax sharing rule between central and local governments exists but in practice it is very flexible and ambiguous. Taxes are divided into three categories: (a) fixed as a local revenue source, (b) shared between central and local government and (c) fixed as a central revenue source. If tax (a) is enough for the expenditure, then tax (b) is not shared with local government and any surplus is transferred to the central government.

According to the MOF, the proposed Budget Law will introduce a fixed tax sharing system to promote local government incentive to collect taxes. Its draft was previously submitted to the National Assembly, but national consensus was not attained. It will again be presented at the next assembly in March.

Since tax revenue sources are over-concentrated in Ho Chi Minh and Hanoi, income redistribution by the central government is indispensable. The Centralized tax system is also economically reasonable with lower collection cost, provided that the morale of tax officers is high. The Japanese tax system may serve as a reference. It has two types of tax transfers from the central to local governments, which also have their own local taxes. One is the local transfer tax, which is automatically transferred to local governments based on predefined rules. The other is the local allocation tax, which is once pooled at the central government and is then allocated to local governments based on the central government's policies.

2-4 Rationalization of Fiscal Expenditure

(1) Public Investment

Public investment projects have to be classified by the economic nature of projects, by responsible implementers of the projects and by corresponding sources of funds, so that only necessary and viable projects are carried out efficiently by proper implementers. (Table II-2-19)

Overall design and selection of projects is drawn in the Public Investment Program. As to the investment decision-making of individual projects, government regulations* prescribe the authority and the decision-making process for public investment projects as well as for commercial investment projects. The same decision-making process is taken regardless of economic nature, implementer sources of funds for a project.

The budgetary responsibility would become smaller if some of the public investment projects could be carried out on a commercial basis. The budget would not have to allocate funds. In the case of SOE investment, the possible future burden on the budget to pay bad debts would also be smaller. Projects are assessed on a commercial basis both by the implementers and by banks and accordingly more careful scrutiny is placed on the project profitability. Social and economic necessity govern public-sector-type investment. Profitability governs private-sector-type investment.

Public investments in Viet Nam are carried out either directly by the government or by SOEs, but the difference between them is unclear. Since SOEs are state-owned, they are a part of the government. State capital means more than just a source of funds. Ownership and management separation has not yet been made clear. Combined with the decision-making process, the non-separation discourages SOE investment in future growth.

The Bank for Investment and Development of Viet Nam (BIDV) provided public investment funds as one of its activities until December 1994. BIDV just channeled the state budget to investment and development projects. Those projects are implemented either by the government itself or by SOEs. This function of BIDV was transferred to GDID.

As to the finance of public investment projects, clear distinction between capital investment and loans should be made. Projects with higher policy priorities and with very low or no profitability should be recognized as such and funded by capital investment. Separation of the financing operation from the government itself is recommended.

A major source of public investment finance is ODA. Donor countries have their own policies on ODA as well as limitations on available resources. The selection, priority and implementation timing of projects are not necessarily as Viet Nam desires, and the nature and terms of ODA funds are not necessarily appropriate for specific projects.

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*Government regulations on the management of investment and construction were issued together with Decree 177 (Oct. 1994). The regulation prescribes the authority and the decision-making process for public investment projects as well as commercial investment projects. Investment projects are classified into A, B and C groups according to their fields and sizes.

The decision-making process for major public investments which belong to group A is as follows. (a) A project manager of a certain ministry drafts a project plan. (b) The minister authorizes the plan. (c) The plan is submitted to the MPI. (d) An evaluation officer of the MPI examines the plan. (e) The plan is submitted to the evaluation committee, which is chaired by the Minster of the MPI and consists of the Minister of Finance, the Minister of Construction, the Minister of Science, Technology and Environment and the Minister of Government Office. (f) The council decides unanimously the implementation of the plan.(g) The MPI notifies the MOF of the decision. (h) The General Department for Investment and Development (GDID) under the MOF allocates funds to the project.

Group B and C, small-scale public investment and most SOE projects, are approved by the MPI and Line Ministries respectively, based on size. The MPI has to be informed eventually and its practical authorization is necessary, especially for funding. In the process, general corporations can evaluate investment projects under US$ 10 million. Approval by the MPI and the MOF is also necessary. The MPI directly evaluates projects of US$ 10 million or more.

(2) SOE Reform and Investment

The governmental control or management of SOEs has been changing toward the autonomy of SOEs and at the same time toward the integrated management of SOEs. SOEs have been under the complete management of line ministries or local governments. Authorities of personnel, organization, finance, investment and operation have been in the hands of line ministries and local governments.

1) The General Dept. for State Capital and Assets Management (GDSCAM) was established in January 1995 under the MOF to manage government capital and to finance all SOEs. The government ownership is now represented by GDSCAM, not by line ministries nor local governments. Thus the differences between centrally controlled SOEs and locally controlled SOEs have also been reduced.

2) Line ministries have been separated from the daily business operation of SOEs and made to focus on policy formation. Establishment of *General Corporation* is promoting the separation by having a management board which is capable of business operations and represents the government. There are three levels of General Corporations: State, Ministerial and Provincial. At state level, 17 General Corporations have been established since January 1995: Electric Power, Cement, Steel, Petroleum, Postal Service, Food, Garment, Airline, Marine etc.

3) Several ministries were merged to have integrated policies on SOEs: the Ministry of Light Industry and the Ministry of Heavy Industry were merged into the Ministry of Industry, the Ministry of Agriculture was formed by integrating several ministries.

Investment planning was principally transferred from line ministries to SOEs. The decision-making authority, however, is still on ministries. In addition, the ownership and management separation has not yet been made clear. In this regard, the assets of SOEs are state-owned, and the authority to manage them is on the government. This way of thinking encourages SOEs to invest for immediate profit and not for future growth.

Equitization is considered as a measure to mobilize funds away from the private sector, but it has not been sought after seriously. Availability of financial information for prospective investors is a prerequisite for the equitization which has not been prepared by the SOE sector yet. Several SOEs have issued bonds, which is considered as one step to the equitization of SOEs. In this regard, it is necessary to clarify the notion of corporatization, equitization and privatization beforehand. Without the corporatization and equitization of SOEs, privatization cannot happen.

The fiscal funds flows to and from SOEs have been transformed to tax payment and the financial funds flow from the banking system. Subsidies in particular have been terminated from the budget. SOEs now have to borrow necessary funds for business operation from banks. Only profit making SOEs can survive. It is difficult, as can be seen by the Chinese experience, not to loan to badly managed SOEs. Thus fund flows among government, SOCBs and SOEs have to be watched carefully so that the reform will not end up in vain.

(3) Social Insurance System

Discussion here is limited to the social insurance system instead of the entire social security program. Social safety is discussed in the Macroeconomy Section from the viewpoint of poverty alleviation. The social insurance system is a potentially larger issue than the status quo, as important as the tax system. In the Japanese case, the ratios of tax burden and social insurance burden to National Income are 24% and 14% respectively. Careful consideration has to be given to the system from two viewpoints, (a) the insurance payment is and will be an inflexible burden of the budget and (b) the insurance premium, on the other hand, can be a source of medium- to long-term funds.

The social insurance system in Viet Nam is under the management of the Ministry of Invalids and Social Affairs (MISA). The system used to only cover the public sector, i.e. the central and local government officials, SOE employees and military personnel. The system was reformed in January 1995 to include the private sector. Now private companies with 10 employees or more have to participate in the system. According to the MISA, the private sector share of the insurance premium is still minimal. A pilot project has been geared toward farmer participation, but it has been difficult to formulate the conditions of their premiums due to their low incomes.

The benefits of the system are comprised of (a) paid sick leave, (b) paid maternity leave, (c) workmen's accident compensation, (d) retirement pension and (e) death compensation. Unemployment insurance and health (medical) insurance are not included in the system. Health insurance has just begun to be sold by casualty insurance companies. The retirement pension is 75% of the average wage for the five years prior to retirement.

The funds flow of the system is as follows. Each enterprise or individual proprietorship pays 20% of its wage budget to the social insurance fund. The employer pays 15% and 5% is paid from employees' wages. The employees' 5% contribution is a result of the reform. Out of the 20% premium, 5% is paid to (a) through (c) above, and 15% is paid to (d) and (e). According to the MISA, prior to the reform, the insurance premium covered only 20-30 % of the payment and the budget compensated for the rest. Even excluding retirees prior to January 1995, the insurance premium can cover only 60 of the 75% in pension payment and thus the 15% difference must eventually come from the budget.

The social insurance fund is a prospective source for medium- to long-term funds. Future funds flow can be projected with such data as age structure of the current pensioners and active employees. In regard to the younger structure of the Vietnamese population and economic growth prospect, the funds flow will become surplus in the future. Proper management of the system is necessary from now on. The social insurance premium is different from taxes in that it has to be repaid in the future. The fund has to be managed safely and conservatively. In most countries, these funds are managed by investing in government bonds and low-risk portfolio funds.

Introduction of an unemployment insurance system is recommended. The insurance is necessary not only for public welfare and security but also for business management. In order for companies, SOEs or private companies, to have flexible personnel management, unemployment insurance is necessary. Under the SOE reform, SOE management has gained the liberty of firing employees to rationalize their business operation. In practice, it is rather difficult to discard employees without any support system. Considering the huge population in the agricultural sector, however, the effectiveness of the insurance may be limited.

2-5 Additional Suggestions for Tax Policies

(1) Suggestions for the Current Tax System

Equity, neutrality and simplicity are generally agreed upon taxation principles. In practice, it is widely accepted to impose tax according to one's ability to pay. The current tax system of Viet Nam is intended to raise immediate tax revenue and the business sector shares a heavier burden. The effective tax rates for business are higher with the export-import tax, turnover tax and profit tax.

On the other hand, tax evasion is reportedly high in the small business sector as well as in the household sector. As we noted above, it is imperative for Viet Nam to create funds flow to the goods-producing industrial sector from the household sector as well as from the small-scale retail sector. Small-scale funds circulating within the sectors provide neither developmental tools nor a prospective future. The tax system may match the savings system in circulating funds from the household sector to the business sector.

The following steps are necessary to increase the tax coverage. First of all, detailed data, development of tax revenues as well as collection costs, is necessary to correctly understand tax resources as well as collection efficiency. The introduction of a proper accounting system, a self-reporting system, and corporatization of business operations may be effective. The accounting knowledge and ethical qualities of the tax officers, as well as their morale, must be improved. In emphasizing tax collection, however, there is a risk of just increasing collection costs as has been the case in Turkey.

Reflecting the economic development stage in Viet Nam, the taxation on assets is minimal. The following social equity issues, however, merit consideration. (1) The land-use right became transferable in 1988 and has accordingly been an economic asset. Land prices in central areas of some cities have reached considerably high levels. According to our interview survey, registration of the land-use right does not seem to have been carried through thoroughly and many of the citizens do not pay. (2) Some of the population has already become rich enough to justify the introduction of inheritance tax.

The following are additional comments on current taxes.

Turnover tax is a heavy tax with a cascading effect. The business sector has difficulty retaining its profits, and this discourages the growth of business. Replacing turnover tax with VAT is under consideration, but the implementation will be difficult under the current situation where most of the companies do not keep their books. It is necessary to find ways to ensure a smooth transition to VAT.

Profit tax rates will be unified to attain economic neutrality of the taxation. The basic principle is correct in terms of equity and simplicity. But it is also justified for the government to have economic and industrial policies that place priority on certain sectors.

Business (patent) tax is currently paid by all legal entities between 20,000 to 650,000 VND per year. The amount raised is negligible. It may be redefined as local income tax or simply be abandoned.

Rent tax rates are based on the *Agricultural land use tax*. The rent tax rates are 1-32 times the rates of the agricultural land use tax. These two tax items can be unified to form a general Land use tax. In regard to foreign companies investing in Viet Nam, it is pointed out that recent land prices have been heightened intentionally to increase investments. For joint ventures with foreign companies, the Vietnamese side usually contributes in the form of land use rights.

The income tax base for high income earners is too narrowly defined and tax payers are limited to a very few rich Vietnamese and foreign expatriates. The progressive tax system is necessary but the tax base should be broadened so as to cover all income brackets.

Import and export taxes is the single largest tax item in Viet Nam. However, as a member of AFTA, Viet Nam should eventually lower these tax rates below 5%. The government is now considering to compensate the revenue loss by hiking the rates of excises on imported luxuries such as tobacco, alcohol, fireworks, gasoline and automobiles. This kind of temporary measure is required for Viet Nam to secure tax revenues.

The import luxury goods are also subject to *special consumption tax (excise tax)*, which is incompatible with international practice. It is necessary to identify the excise elements in the current tariff structure. The roles of the import tax are two fold i.e. revenue raising and domestic industry protection. Although the former is of primary concern to the government, it is also important to find ways to protect immature domestic industries other than setting high import duty rates. It might be necessary for Viet Nam to postpone the targeted year of 2006 for achieving 0-5% duties.

It is important to apply excises on specific goods irrespective of origin imported or domestically produced - in order to ensure the uniformity of treatment. It is also important to recognize that applying a uniform and low tax rate will make smuggling costly, and that implies a possibility for increased tax revenue.

(2) Increase Tax Revenue from Medium- to Long-term Viewpoint

Short-term gain sometimes jeopardizes the base for long-term gain. The base for long-term economic development is the growth of industrial and business entities. The growth promotion of industrial and business entities is vital for tax revenue increase in the long term. The current high tax rates not only discourage business expansion but also promote tax evasion. The government may reduce effective tax rates for business activities to promote their business expansion.

It is important to promote investments in the business sector as noted above. Japan and ASEAN countries have investment-promotion taxation, i.e. tax exemption or reduction, lower tax rates, accelerated depreciation. The tax system alone, however, may not effective. Investment is implemented based on ROI, of which capital cost comprises a major factor.

The government needs to promote tax payment as a public obligation. The public needs to be informed of the roles of government in economic development and income redistribution. It is nonsense and anti-social for the mass public to evade taxes, since they are the beneficiaries of income redistribution and are usually given tax exemptions and/or low tax rates.

In order to spread accounting knowledge and practice nationwide, we recommend that accounting schools at the high school level be established. Accounting knowledge is necessary for sound management, not only at the management level, but also at the clerical level. In Japan, a large part of the accounting jobs are performed by vocational school graduates. This recommendation seems to fit the Vietnamese national culture which highly appreciates the education of children.

Table II-2-1 Macro and State Budget Data

(in billions of current VND)

	1986		1987		1988		1989		1990		1991		1992		1993		1994		1995	
GDP const.					25,885		28,093		29,526		31,286		33,991		36,735		39,982			
GDP current	599	100.0	2870	100.0	14,428	100.0	28,093	100.0	41,955	100.0	76,707	100.0	110,535	100.0	136,571	100.0	170,258	100.0	217,000	100.0
Consumption									35,507	84.6	64,052	83.5	88,910	80.4	116,168	85.1	141,456	83.1		
Capital Formation									6,350	15.1	11,588	15.1	18,806	17.0	26,542	19.4	37,572	22.1		
Government									2,126	5.1	2,135	2.8	6,450	5.8	9,600	7.0	11,300	6.6		
Private									4,224	10.1	9,453	12.3	12,356	11.2	16,942	12.4	26,272	15.4		
Trade Balance									98	0.2	1,067	1.4	2,819	2.6	-6,139	-4.5	-8,770	-5.2		
Export											22,915	29.9	35,767	32.4	38,538	28.2	53,606	31.5		
Import											21,851	28.5	32,957	29.8	44,677	32.7	62,377	36.6		
Cap Frm + Tr Bal									6,448	15.4	12,655	16.5	21,625	19.6	20,403	14.9	28,802	16.9		
State Budget																				
Revenue	84	14.0	379	13.2	1,740	12.1	3,899	13.9	6,153	14.7	10,353	13.5	21,023	19.0	30,500	22.3	42,125	24.7	52,770	24.3
Total Expenditure	121	20.2	515	17.9	2,840	19.7	6,781	24.1	9,522	22.7	13,196	17.2	25,120	22.7	38,975	28.5	46,212	27.1	55,970	25.8
Current Exp.	83	13.9	395	13.8	2,167	15.0	5,155	18.3	7,398	17.6	11,061	14.4	18,670	16.9	29,375	21.5	34,497	20.3	40,120	18.5
Current Balance	1	0.2	-16	-0.6	-427	-3.0	-1,256	-4.5	-1,245	-3.0	-708	-0.9	2,353	2.1	1,125	0.8	7,628	4.5	12,650	5.8
Capital Exp.	38	6.3	120	4.2	673	4.7	1,626	5.8	2,124	5.1	2,135	2.8	6,450	5.8	9,600	7.0	11,715	6.9	14,860	6.8
Overall Balance	-37	-6.2	-136	-4.7	-1,100	-7.6	-2,882	-10.3	-3,369	-8.0	-2,843	-3.7	-4,097	-3.7	-8,475	-6.2	-4,087	-2.4	-3,200	-1.5
Interest Arrears	1	0.2	2	0.1	26	0.2	769	2.7	932	2.2	1,683	2.2	2,218	2.0	1,965	1.4	1,142	0.7		0.0
Financing	35	5.8	134	4.7	1,074	7.4	2,113	7.5	2,437	5.8	1,160	1.5	1,879	1.7	6,510	4.8	2,945	1.7	3,200	1.5
Banking	23	3.8	89	3.1	450	3.1	1,931	6.9	832	2.0	144	0.2	-2,208	-2.0	2,044	1.5	633	0.4		0.0
Nonbank	0	0.0	3	0.1	17	0.1	-231	-0.8	341	0.8	249	0.3	1,414	1.3	2,541	1.9	1,690	1.0	2,000	0.9
Foreign	14	2.3	43	1.5	370	2.6	413	1.5	1,264	3.0	767	1.0	2,673	2.4	1,925	1.4	622	0.4	1,200	0.6

Source: IMF 1995b
WB 1995c

91-94 inv/gdp
94508
494071
19.1

Table II-2-2 Budget Operation

	1986		1987		1988		1989		1990		1991		1992		1993		1994		1995	
GDP const.					25,885	5	28,093	8.5	29,526	5.1	31,286	6.0	33,991	8.6	36,735	8.1	39,982	8.8		
GDP current.	599	100	2870	100	14,428	100	28,093	100	41,955	100	76,707	100	110,535	100	136,571	100	170,258	100	217,000	100
State Budget																				
Total Revenue	**84**	**14.0**	**379**	**13.2**	**1,740**	**12.1**	**3,899**	**13.9**	**6,153**	**14.7**	**10,353**	**13.5**	**21,023**	**19.0**	**30,500**	**22.3**	**42,125**	**24.7**	**52,770**	**24.3**
Tax Revenue	18	3.0	68	2.4	451	3.1	1,099	3.9	1,698	4.0	8,119	10.6	14,586	13.2	23,701	17.4	32,403	19.0	44,800	20.6
SOE Tax	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0	5,305	6.9	9,106	8.2	12,685	9.3	15,557	9.1	20,150	9.3
Tax on Trade	6	1.0	17	0.6	131	0.9	363	1.3	733	1.7	1,099	1.4	2,194	2.0	5,900	4.3	10,012	5.9	15,250	7.0
Non-agri Private	8	1.3	38	1.3	184	1.3	428	1.5	667	1.6	1,008	1.3	1,992	1.8	3,376	2.5	4,512	2.7	6,450	3.0
Agri Tax	4	0.7	12	0.4	136	0.9	308	1.1	298	0.7	707	0.9	1,294	1.2	1,351	1.0	1,107	0.7	1,350	0.6
Non Tax Revenue	65	10.9	312	10.9	1,289	8.9	2,800	10.0	3,344	8.0	1,964	2.6	5,589	5.1	5,801	4.2	8,522	5.0	6,770	3.1
SOE Transfer	60	10.0	285	9.9	1,110	7.7	2,244	8.0	3,620	8.6	884	1.2	2,807	2.5	3,400	2.5	5,000	2.9	2,920	1.3
Grant	0	0.0	0	0.0	0	0.0	0	0.0	0	0.0	270	0.4	848	0.8	1,000	0.7	1,200	0.7	1,200	0.6
(Oil Revenue)							280	1.0	850	2.0	2,158	2.8	4,195	3.8	4,800	3.5	5,215	3.1	5,900	2.7
Total Expenditure	**121**	**20.2**	**515**	**17.9**	**2,840**	**19.7**	**6,781**	**24.1**	**9,522**	**22.7**	**13,196**	**17.2**	**25,120**	**22.7**	**38,975**	**28.5**	**46,570**	**27.4**	**55,970**	**25.8**
Current Exp.	83	13.9	395	13.8	2,167	15.0	5,155	18.3	7,398	17.6	11,061	14.4	18,670	16.9	29,375	21.5	34,855	20.5	40,120	18.5
General Administr.	5	0.8	19	0.7	144	1.0	460	1.6	676	1.6	1,290	1.7	2,404	2.2	3,245	2.4	3,850	2.3	4,330	2.0
Economic Service	20	3.3	58	2.0	149	1.0	389	1.4	523	1.2	784	1.0	1,495	1.4	2,997	2.2	3,230	1.9	4,200	1.9
Social Service	19	3.2	71	2.5	345	2.4	1,252	4.5	1,998	4.8	3,343	4.4	6,245	5.6	10,854	7.9	13,601	8.0	17,735	8.2
Others	39	6.5	245	8.5	1,503	10.4	2,237	8.0	2,959	7.1	3,311	4.3	5,314	4.8	8,604	6.3	10,440	6.1	11,875	5.5
Interest	1	0.2	2	0.1	3	0.0	817	2.9	1,242	3.0	2,333	3.0	3,218	2.9	3,675	2.7	3,734	2.2	2,970	1.4
Current Balance	**1**	**0.2**	**-16**	**-0.6**	**-427**	**-3.0**	**-1,256**	**-4.5**	**-1,245**	**-3.0**	**-708**	**-0.9**	**2,353**	**2.1**	**1,125**	**0.8**	**7,270**	**4.3**	**12,650**	**5.8**
Capital Exp.	38	6.3	120	4.2	673	4.7	1,626	5.8	2,124	5.1	2,135	2.8	6,450	5.8	9,600	7.0	11,715	6.9	14,860	6.8
Overall Balance	**-37**	**-6.2**	**-136**	**-4.7**	**-1,100**	**-7.6**	**-2,882**	**-10.3**	**-3,369**	**-8.0**	**-2,843**	**-3.7**	**-4,097**	**-3.7**	**-8,475**	**-6.2**	**-4,445**	**-2.6**	**-3,200**	**-1.5**

Source: IMF 1995b
WB 1995c

Table II-2-3 Fiscal Role in the 5-Year Plan

(% of GDP)

	1993-1994	1996-2000 CG Report	Assumptions	1996-2000 Draft
(a) Fiscal Revenue	23.7	26-27	(b)+(c)	22-23
(b) Tax Revenue	18.3	21-22	the 5-year plan	21-22
(c) Non-tax Revenue	4.7	5	1993-94 level	1
(d) Total Expenditure	27.9	30-31	(a)-(g)	26.5-27.5
(e) Current Expenditure	20.9	20-21	(d)-(f)	16.5-17.5
(f) Capital Expenditure	6.9	11	the 5-year plan 30%*15.6/42	10
(d) Overall Balance	-4.2	-5	the 5-year plan	-4.5

(Computed based on Table II-3-2 and Draft 5-year Plan)

Table II-2-4 Sectoral Shares in GDP

(%)

	1988	1989	1990	1991	1992	1993	1994
Total	100	100	100	100	100	100	100
State	32.5	33.2	32.5	33.3	36.2	39.2	40.2
Non-state	67.5	66.8	67.5	66.7	63.8	60.8	59.8
Agriculture	44.8	40.8	37.5	39.5	33.0	28.8	27.7
(Non-state)	(43.3)	(39.5)	(36.4)	(38.4)	(32.1)	(28.0)	(26.9)
Industry	25.5	24.2	23.9	24.8	28.2	30.0	30.7
(State)	(15.3)	(14.5)	(14.4)	(15.2)	(17.7)	(19.1)	(19.4)
Service	29.7	35.0	38.6	35.7	38.8	41.2	41.6
(Non-state)	(14.1)	(17.7)	(21.5)	(18.7)	(21.2)	(21.9)	(21.6)
Trade	9.8	11.8	13.0	12.7	13.8	12.8	13.6
(Non-state)	(4.8)	(6.0)	(8.7)	(9.1)	(10.2)	(9.9)	(10.1)

(WB 1995c)

Table II-2-5 SOE and Budget

	1987		1988		1989		1990		1991		1992		1993		1994	
Total Expenditure	515	100.0	2,840	100.0	6,781	100.0	9,522	100.0	13,196	100.0	25,120	100.0	38,975	100.0	46,212	100.0
Current Expenditure	395	76.7	2,167	76.3	5,155	76.0	7,398	77.7	11,061	83.8	18,670	74.3	29,375	75.4	34,855	75.4
Transfer to SOEs	**213**	**41.4**	**1,230**	**43.3**	**1,275**	**18.8**	**1,093**	**11.5**	**801**	**6.1**	**1,019**	**4.1**	**880**	**2.3**	**816**	**1.8**
Subsidies	130	25.2	715	25.2	137	2.0	0	0.0	42	0.3	200	0.8	200	0.5	250	0.5
Food procurement	83	16.1	389	13.7	-	-	-	-	-	-	-	-	-	-	-	
Production	8	1.6	51	1.8	-	-	-	-	-	-	-	-	-	-	-	
Export	38	7.4	275	9.7	-	-	-	-	-	-	-	-	-	-	-	
Working Capital SOE	14	2.7	88	3.1	128	1.9	110	1.2	220	1.7	819	3.3	680	1.7	566	1.2
Capital Transfer	69	13.4	427	15.0	1,010	14.9	983	10.3	539	4.1	0	0.0	0	0.0	0	0.0
Capital Expenditure	120	23.3	673	23.7	1,626	24.0	2,124	22.3	2,135	16.2	6,450	25.7	9,600	24.6	11,715	25.4
Overall Balance	-136	-26.4	-1,100	-38.7	-2,822	-41.6	-3,369	-35.4	-2,843	-21.5	-4,097	-16.3	-8,475	-21.7	-4,445	-9.6
Total Revenue	379	73.6	1,740	61.3	3,899	57.5	6,153	64.6	10,353	78.5	21,023	83.7	30,500	78.3	42,135	91.2
		100.0		*100.0*		*100.0*		*100.0*		*100.0*		*100.0*		*100.0*		*100.0*
Transfer to the Budget	**293**	**56.9**	**1,146**	**40.4**	**2,244**	**33.1**	**3,620**	**38.0**	**6,189**	**46.9**	**11,913**	**47.4**	**16,085**	**41.3**	**20,557**	**44.5**
Taxes									5,305	40.2	9,106	36.3	12,685	32.5	15,557	33.7
Transfers	293	56.9	1,146	40.4	2,244	33.1	3,620	38.0	884	6.7	2,807	11.2	3,400	8.7	5,000	10.8
Operating surplus	278	54.0	1,064	37.5	2,029	29.9	3,112	32.7								
Depreciation allowance	15	2.9	82	2.9	215	3.2	508	5.3	622	4.7	2,277	9.1	2,594	6.7	3,826	8.3
		4.0		*4.7*		*5.5*		*8.3*		*6.0*		*10.8*		*8.5*		*9.1*
Capital user fee									262	2.0	530	2.1	806	2.1	1,174	2.5
Net transfers to the budget	80	15.5	-84	-3.0	969	14.3	2,527	26.5	5,388	40.8	11,894	47.3	15,205	39.0	19,741	42.7

Source: IMF 1995b
WB 1995c

Table II-2-6　　Oil Production and Related Budget Revenue

		1994	1995	2000	Assumptions
(a)GDP	billion VND	170,25 8	214,397	337,500	9.5% growth rate
(b)Crude Oil Production	million ton	7.0	7.7	20	target
(c)Export Value	million $	866	1,040	2,700	'95 oil price
(d) Related Budget Revenue	billion VND	5,215	5,900	19,900	4% VND depreciation Budget/Export=55%
(e) (d) / (a)	%	3.1%	2.7%	5.9%	

(Computed based on Table II-3-1 and the assumptions)

Table II-2-7 Current Tax System

Tax items	Tax Payers and Coverage	Tax Rates	Tax shares btw. the Central and Local gov.	Reforms
Business tax	All businesses in the territory of Vietnam.	Independent-accounting businesses: VND425,000-650,000 per annum Individuals doing business: VND20,000-650,000 per annum	Local government share: 100%	
Profit tax Law on Corporate Income Tax 6/30/90	Net income of all businesses (except those established and operating under the Foreign Investment Law) earning profits from business activities and other benefits in Vietnam.	Heavy industry and mining: 25% Light industry: 35% Trade and services: 45%	Divided between central and local governments	Replace with Company Income Tax that will ensure equal taxation between foreign and domestic businesses. A single tax rate of around 35% for all industries will be applied.
Agricultural land-use tax Law on Agricultural Land Use /94	All organizations, individuals (except those businesses conducting agricultural production under the Foreign Investment Law) using arable land, water surface, and forest land.	Tax rates are estimated in terms of paddies and paid in cash based on land qualities.	Divided between central and local governments	The existing Tax Law on Agricultural Land Use and Tax Ordinance on Land and Housing will be replaced by Tax Law on Land Use.
Natural resources tax Ordinance on Natural Resources Tax 3/30/90	Any organization, individuals who exploit the natural resources of Vietnam in any way.	Metal minerals: 2-10% (eg. gold) Coal: 1-10% Oil, gas: c.f. Oil and Gas Law Non-metal minerals: 5-12% Natural forest products: 1-10% Other resources: 1-10%	Local government share: 100%	Ordinance on natural resources tax will be upgraded to the Law level.

Tax items	Tax Payers and Coverage	Tax Rates	Tax shares btw. the Central and Local gov.	Reforms
Rent tax	All organizations, individuals (except those businesses established under the Foreign Investment Law) having right to use house, housing and construction land.	1 - 32 times the rates of agricultural land use tax depending on land qualities.	Local government share: 100%	
Income tax for high income earners Ordinance on Income Tax on High Income Earners 5/19/94	Regular income (eg. wage, payment, allowances, bonus) and irregular incomes (eg. income originating from technology transfer, lotteries, etc.) of all Vietnamese and foreign individuals.	*Regular income:* Vietnamese: 7 tax rates; 0%-60%. Minimum amount subject to tax payment is VND1.2 million /month. Foreigners living in Vietnam (over 183 days) and Vietnamese working abroad: 6 tax rates; 0% - 50%. Minimum amount; VND5 million/month. *Irregular income:* 6 tax rates; 0%-30%. Initial amount; VND 2 million/time.	Local government share: 100%	Replace with Resident Income Tax in order to broaden the tax base from high income earners to all Vietnamese citizens and foreign people living in Vietnam with income from all sources, and so that foreign people who do not live in Vietnam but have income generated in Vietnam will become subject to income taxes.
Import and export tax Law on Export and Import duties 12/91	All organizations, individuals conducting export and import of goods through border ports of Vietnam.	Export taxes include 11 tariff rates: 0%-45% Import taxes include 34 tariff rates: 0%-80%. (Import taxes after Jan. 1996: tobacco, wine, beer, fireworks, automobiles; all 60%, gas; 50%)	Central government share: 100%	Import duty rates for luxuries consist of excise tax, which is incompatible with international practice. As a member of AFTA, Vietnam will reduce these import tax rates to the maximum of 60% from Jan. 1996. Export tax will be applied to materials only.
Special consumption (excise) tax Law on Special Sales Tax 6/30/90	Luxuries (cigarettes, spirits, beer, firecrackers) except those for exports.	Cigarettes: 32-70%, Spirits: 15-90%, Beer: 75-90%, Firecrackers: 100% (After Jan. 1996: Tobacco; 112%, Wine; 120%, Beer; 112%, Fireworks; 160%, Automobiles; 160%, Gas; 22.5%)	Central government share: 100%	In order to supplement the revenue loss from the decrease in import duty rates, imported luxuries will become subject to a special consumption tax.

Tax items	Tax Payers and Coverage	Tax Rates	Tax shares btw. the Central and Local gov.	Reforms
Turnover tax Law on Trunover tax 6/30/90	Gross sales of all businesses having revenue in Vietnam, excluding agricultural production, credit activities of banking, crediting organizations and financial corporations, etc.	0%-30% depending on professions, activities and kinds of traded goods. Taxed on monthly revenue.	Divided between central and local governments	In order to solve the problem of tax duplication, a value added tax (VAT) is to be introduced in 1998. Small business households will continue to pay the current turnover tax. *Coverage* : value added of domestic and foreign goods & services *Tax rates* : 3-4 tax rates (5-20%) including zero rate applicable for exports.
Tax on transfer of land-use right Law on Land Use Right Transfer /94	Those who transfer land-use rights to others.	With no land-use payment at the receipt of land: 10% for agricultural and forest land, land used for salt production, aqua-cultural productions; 20% for land used for housing, constructions and others. With land-use payment: 5%.	Local government share: 100%	
Slaughter tax			Local government share: 100%	
License tax			Local government share: 100%	
Registration tax			Local government share: 100%	
Certification tax			Local government share: 100%	
Capital User fee	SOEs	8% of asset value	Central government 100%	

Table II-2-8 Current Tax Revenue Structures:

(unit: billions of dong)

	1993	%	1994 Prel.	%	1995 Budget	%
Profit tax	4,612	19.4	6,485	20.0	8,300	18.5
SEs	4,019	16.9	5,585	17.2	6,850	15.2
Nonagricultural private sector	593	2.5	900	2.7	1,450	3.2
Agricultural land-use tax	1,351	5.7	1,107	3.4	1,350	3.0
Natural resources tax	1,809	7.6	1,934	5.9	2,450	5.4
Income tax for high income earners	184	0.7	336	1.0	350	0.7
Rent (land) tax	180	0.7	220	0.6	250	0.5
Turnover tax	4,196	17.7	5,720	17.6	7,710	17.2
SEs	3,333	14.0	4,402	13.5	5,750	12.8
Nonagricultural private	863	3.6	1,318	4.0	1,960	4.3
Taxes on Joint Ventures	389	1.6	1,215	3.7	1,600	3.5
Import and export tax	5,900	24.8	10,012	30.8	15,250	34.0
Excises	1,924	8.1	2,128	6.5	3,030	6.7
Special Consumption tax	1,908	8.0	2,120	6.5	3,020	6.7
Commodity tax	16	0.0	8	0.0	10	0.0
License tax	119	0.5	149	0.4	171	0.3
SEs	7	0.0	7	0.0	6	0.0
Nonagricultural private sector	112	0.4	142	0.4	165	0.3
Slaughter tax	52	0.2	69	0.2	90	0.2
Other	2,985	12.5	3,028	9.3	4,249	9.4
Total tax revenue	23,701	100.0 (80.3)	32,403	100.0 (79.2)	44,800	100.0 (86.9)
Total govt. revenue	29,502	(100.0)	40,925	(100.0)	51,570	(100.0)

Source: Ministry of Finance, and staff estimates

Table II-2-9 Direct Tax Share in Tax Revenues

(unit: %)

	Viet Nam	Singapore	Thailand	Indonesia	Malaysia	The Philippines
Direct tax share	31	56	31	48	54	34
	Japan	U.S.A.	U.K.	Germany	France	
Direct tax share	67	90	54	48	40	

Viet Nam: Direct taxes include profit tax, agricultural land tax, natural resources tax, income tax and rent tax excluding those of foreign companies (based on 1994 preliminary data, MOF data); Singapore: Direct taxes include income tax and real estate tax (based on 1994 estimates, Economic Survey of Singapore); Thailand:

Direct taxes include corporate and personal incomes taxes (based on 1993, Bank of Thailand Quarterly Bulletin); Indonesia: Direct taxes include income tax, tax on fixed assets (based on fiscal 1994 data, MOF); Malaysia: Direct taxes include corporate and personal income taxes and income tax on oil companies (based on 1994 data, MOF, Economic report 1995/96), The Philippines: (based on 1992 data, IMF Government Financial Statistics).

Table II-2-10 Tax Payment by Sector in 1994

(in trillions of VND, millions of persons)

	GDP		Tax		Total Revenue		Employ-ment*	GDP/ Employ
Total	170.3	100.0	32.4	100.0	42.1	100.0	31.8	5.3
State	68.5	40.2	**15.6	48.0	20.6	49.0	3.0	22.8
Non State	101.8	59.8	**6.8	21.0	10.3	24.5	28.8	3.5
Agri- Forest	47.1	27.7	***1.1	3.4	-	-	23.2	2.0
Indtry- Const	52.3	30.7			-	-	4.3	12.2
Service	70.9	41.6			-	-	4.3	16.5

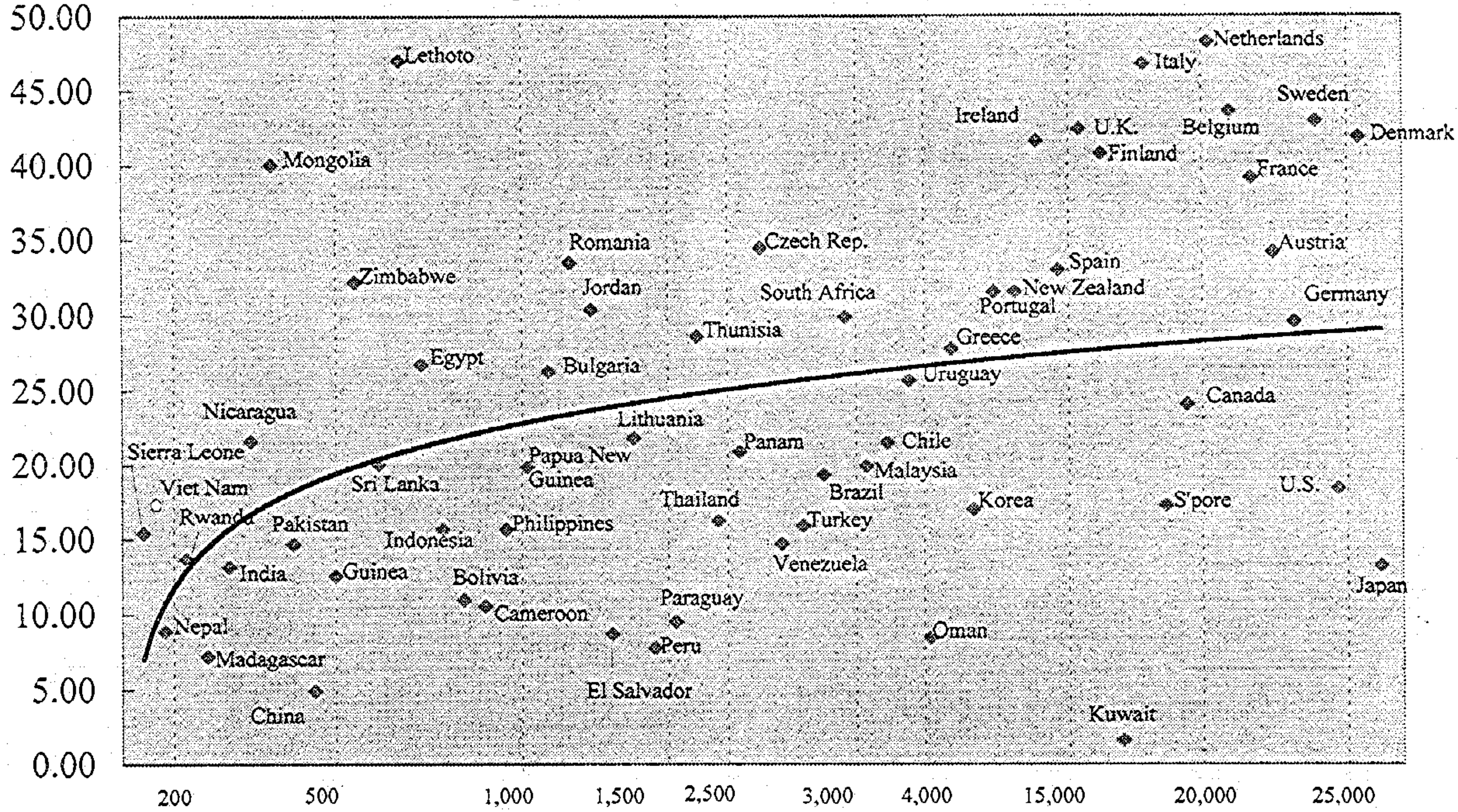
sources: IMF 1995b, WB 1995c

*Employment figures are for 1992.

**Taxes on Trade is not included

***Only agricultural tax is listed

Figure II-2-1 Tax Revenue/GDP (1993)



Note1:All the figures are based on 1993 data except those for Japan which are based on 1992 data provided in the WB Report 1995.
Note2:GNP per capita is in US dollars.

Table II-2-11 Business Taxation System of ASEAN Countries:

Summary

	Singapore	Thailand	Indonesia	Malaysia	The Philippines	Viet Nam
(1) Corporate Tax: Tax payers and coverage	Resident corporations(corporations managed and controlled within the boundary of Singapore): Taxed on incomes from domestic sources and those of foreign sources received in Singapore. Non-resident corporations: Taxed on incomes from domestic sources (according to the Singapore-Japan Tax Treaty, branch companies are taxed only on the incomes that are derived from each branch)	Domestic corporations (corporations established in Thailand): Taxed on incomes from all sources (incomes from both domestic and foreign sources) Foreign corporations: Taxed on incomes from domestic sources (as left)	Resident corporations (corporations established in Indonesia and/or holding Indonesian addresses): Taxed on incomes from all sources Non-resident corporations: Taxed on incomes from domestic sources (as left)	Resident corporations (corporations managed and controlled within Malaysia): Taxed on incomes from domestic sources and those from foreign sources received in Malaysia (Banking, insurance and marine transport businesses are subject to incomes from all sources) Non-resident corporations: Taxed on incomes from domestic sources	Domestic corporations (corporations established in the Philippines): Taxed on incomes from all sources Foreign corporations: Taxed on incomes from domestic sources (as left)	**Profit tax** Domestic Corporations Taxed on incomes from all sources Foreign corporations: Taxed on incomes from domestic sources
Taxable Year	Calendar year (Jan. 1st-Dec. 31st) Corporate fiscal year can be approved	Corporate fiscal year (12 months)	Calendar year (Jan. 1st- Dec. 31st) Corporate fiscal year (under 12 months is also approved)	Calendar year (Jan. 1st- Dec. 31st) Corporate fiscal year (under 12 months is also approved)	Calendar year (Jan. 1st- Dec. 31st) Corporate fiscal year (under 12 months is also approved)	Calendar year (Jan. 1st- Dec. 31st)
Tax Deduction for Carry-Over Losses	No time limits for tax deduction (except in cases where more than 50% of shareholders have changed)	Deductions permitted within 5-year period	Deductions permitted within 5-year period	No time limits for tax deduction	Deductions permitted within 5-year period	Deductions permitted within 5-year period (only for foreign companies)
Tax Rates	27% (Planning to lower the rate to 25%)	35% (listed companies 30%) For branches of foreign corporations, profit remittance to their head offices are subject to additional 20% tax.	under 10 million rupiah: 15% 10 to 50 million rupiah: 25% over 50 million rupiah: 35%	30%	35%	Heavy industry and mining: 25% Light industry: 35% Trade and services: 45% Foreign corp: 10-25%
(2) Individual Income Tax: Tax payers and coverage	Residents (individuals living in Singapore): Taxed on incomes from domestic sources and those from foreign sources received in Singapore. Non-residents (less than 183 days): Taxed on incomes from domestic sources (tax exemption applicable under certain conditions for short-term visitors)	Residents (individuals living in Thailand): Taxed on incomes from domestic sources and those from foreign sources brought into country) Non-residents (less than 180 days): Taxed on incomes from domestic sources	Residents (individuals living in Indonesia): Taxed on incomes from all sources Non-residents (less than 184 days): Taxed on incomes from domestic sources	Residents (individuals living in Malaysia): Taxed on incomes from domestic sources and those from foreign sources received in Malaysia Non-residents (less than 182 days): Taxed on incomes from domestic sources (as left)	Residents (individuals living in the Philippines): Taxed on incomes from all sources Non-residents (less than 183 days): Taxed on incomes from domestic sources (as left)	**Income tax for high income earners*:** Vietnamese, Vietnamese abroad and foreigners living in Viet Nam (over 183 days): Taxed on regular income (wage, payment, allowances, bonus) and irregular income (technology transfer, lotteries)

	Singapore	Thailand	Indonesia	Malaysia	The Philippines	Viet Nam
Tax Rates	Residents: 2.5%-30% Non-residents: 15% or 30%	7%-50%	under 10 million rupiah: 15% 10 to 50 million rupiah: 25% over 50 million rupiah: 35%	Residents: 5-40% Non-residents: 15%, 20%, 35% depending on the kinds of incomes	0-35%	Regular income: Vietnamese; 0-60%, Foreigners in Vietnam and Vietnamese abroad; 0-50% Irregular income: 0-30%
(3) Withholding Income Tax for Resident (Foreign) Companies in Int'l Transactions (Tax reductions according to Tax Treaty with Japan)	Interest payment: 27% (15% tax exemption for those derived from corporate bonds and lending. 10% btw. controlling and controlled companies) Dividend payment: exempted from tax Royalty payment: 27% (10%)	Interest payment: 25% (10% for those received by financial institutions from individuals involved in industrial activities) Dividend payment: 20% (25%, 20% for individuals involved in industrial businesses, 15% btw. controlling and controlled companies) Royalty payment: 25% (15%)	Interest payment: 20% (10%) Dividend payment: 20% (10% btw. controlling and controlled companies, 15% for others) Royalty payment: 20% (10%)	Interest payment: 20% (10% for those received from the individuals involved in industrial businesses) Dividend payment: tax exempted Royalty payment: 20% (10%)	Interest payment: 15% (15%, 10% for those from pioneer companies) Dividend payment: 25% or 15% (25%, 10% btw. controlling and controlled companies) Royalty payment: 35% (25%, 10% for those from pioneer companies)	Profit (dividend) repatriation: 5-10% over US$10million: 5% US$ 5-10 million: 7% less than US$ 5million: 10% Interest payment: (maximum of 10%) Dividend payment: (maximum of 10%) Royalty payment: 10-15% (maximum of 10%)
(4) Other Taxes	Technology development fund tax, Estate tax, Fixed assets tax, Customs duties and excise tax, Stamp tax, Consumption tax, Foreign labor tax	Special business tax, Stamp tax, Excise tax, Customs duties, Value added tax	Value added tax, Turnover tax on luxuries, Stamp tax, Taxes on land and buildings, Import taxes, Tax on exit	Oil income tax, Estate tax, Turnover tax, Customs duties and excise tax, Game tax	Capital gains tax, Value added tax, Percentage tax, Excise tax, Stamp tax, Transfer tax	Turnover tax, Business tax, Agricultural land use tax, natural resources tax, rent tax, import and export tax, excise tax, etc.
(5) Tax Incentives for Investments	Preferential tax rates are provided for financial and trade businesses listed in the Economic Expansion Incentives Law	For the promotion of specific industries, corporate tax, business tax, import duties exemptions and other tax incentives are provided for those companies approved by the Board of Investment (BOI).	Import duties exemption and other tax incentives provided for foreign joint projects and investments within the country.	According to the 1986 Investment Promotion Law, income deductions are permitted for incomes from investment and industrial structural adjustment activities.	For the BOI registered companies, tax exemptions such as income tax exemption and business tax exemption are provided, and customs clearance processes are simplified for these companies.	FDI (irrespective of foreign shares) is granted with (a) special profit tax: tax rates between 10 and 25%, and the first 4 years of tax exemption, and additional 4 years of 50% tax reductions, (b) import tax exemption for industrial inputs (materials and machinery), and (c) lower land-use tax**

*Regular income: minimum amount subject to tax payment is VND 1.2 million/month for Vietnamese, and for foreigners in Viet Nam, it is VND 5 million/ month. Irregular income: minimun amount is VND 2million/time.

** These incentives will be abolished at the end of 1996 by the establishment of the new corporate tax.

Table II-2-12 Comparison of Tax Systems among ASEAN Countries:
Case of a Foreign Resident Corporation:

<Assumptions>

Sales	US$500 million
Gross profit (Taxable income)	US$100 million
Profit expatriation to the controlling company abroad	50% of profit after tax

(millions of US dollars)

Viet Nam		Singapore	
Sales	500	Gross profit	100
Gross profit	100	GST (3%)	3
Turnover tax (10% of sales)	50	Profit after paying GST	97
Profit after paying turnover tax	50	Corporate tax (27%)	26.2
Profit tax (25% of the above)	12.5	Profit after tax	70.8
Profit after tax	37.5	Profit repatriation amount	35.4
Profit repatriation amount	18.75	Tax on profit repatriation (0%)	0
Tax on profit repatriation (10%)	1.875	Total amount of tax paid	29.2
Total amount of tax paid	64.375		
Effective tax rate	**64%**	**Effective tax rate**	**29%**

(millions of US dollars)

Thailand		Indonesia	
Gross profit	100	Gross profit	100
VAT (7%)	7	VAT (10%)	10
Profit after paying VAT	93	Profit after paying VAT	90
Corporate tax (30%)	27.9	Corporate tax (20%)	18
Profit after tax	65.1	Profit after tax	72
Profit repatriation amount	32.55	Profit repatriation amount	36
Tax on profit repatriation (10%)	3.255	Tax on profit repatriation (10%)	3.6
Total amount of tax paid	38.155	Total amount of tax paid	31.6
Effective tax rate	**38%**	**Effective tax rate**	**32%**

(millions of US dollars)

Malaysia		The Philippines	
Gross profit	100	Gross profit	100
VAT (10%)	10	VAT (10%)	10
Profit after paying VAT	90	Profit after paying VAT	90
Corporate tax (30%)	27	Corporate tax (35%)	31.5
Profit after tax	63	Profit after tax	58.5
Profit repatriation amount	31.5	Profit repatriation amount	29.25
Tax on profit repatriation (0%)	0	Tax on profit repatriation (10%)	2.925
Total amount of tax paid	37	Total amount of tax paid	44.425
Effective tax rate	**37%**	**Effective tax rate**	**44%**

Table II-2-13 Case of a Domestic Corporation

<Assumptions>

Sales	US$500 million
Gross profit (Taxable income*)	US$100 million

* Taxable income in Viet Nam, Thailand and the Philippines differs between domestic and foreign corporations, and in Singapore, Indonesia and Malaysia, the differentiation is made between resident and non-resident companies. In sum, for resident and domestic companies, incomes from both domestic and foreign sources are taxed. For non-resident and foreign companies, only incomes from domestic sources are taxed.

(millions of US dollars)

Viet Nam		Singapore	
Sales	500	Gross profit	100
Gross profit	100	GST (3%)	3
Turnover tax (10% of sales)	50	Profit after paying GST	97
Profit after paying turnover tax	50	Corporate tax (27%)	26.2
Profit tax (35%* of the above)	17.5	Profit after tax	70.8
Profit after tax	32.5	Total amount of tax paid	29.2
Total amount of tax paid	67.5		
Effective tax rate	**68%**	**Effective tax rate**	**29%**

* Profit tax rate for heavy industry and mining; 25%, light industry; 35%, and trade and services; 45%.

(millions of US dollars)

Thailand		Indonesia	
Gross profit	100	Gross profit	100
VAT (7%)	7	VAT (10%)	10
Profit after paying VAT	93	Profit after paying VAT	90
Corporate tax (30%)	27.9	Corporate tax (20%)	18
Profit after tax	65.1	Profit after tax	72
Total amount of tax paid	34.9	Total amount of tax paid	28
Effective tax rate	**35%**	**Effective tax rate**	**28%**

(millions of US dollars)

Malaysia		The Philippines	
Gross profit	100	Gross profit	100
VAT (10%)	10	VAT (10%)	10
Profit after paying VAT	90	Profit after paying VAT	90
Corporate tax (30%)	27	Corporate tax (35%)	31.5
Profit after tax	63	Profit after tax	58.5
Total amount of tax paid	37	Total amount of tax paid	41.5
Effective tax rate	**37%**	**Effective tax rate**	**42%**

Table II-2-14 · Case of a Domestic Corporation (2)

<Assumptions>

Sales	US$500 million
Gross profit ratio	50%
Operating cost ratio	25%

(millions of US dollars)

Viet Nam		Singapore	
Sales	500	Sales	500
Gross profit	250	Gross profit	250
Turnover tax (10% of sales)	50	GST (3%)	7.5
Operating cost	125	Operating cost	125
Profit before tax	75	Profit before tax	117.5
Profit tax (35%* of the above)	26.3	Corporate tax (27%)	31.7
Profit after tax	48.7	Profit after tax	85.8
Total amount of tax paid	**76.3**	**Total amount of tax paid**	**39.2**
Net profit ratio	**9.6%**	**Net profit ratio**	**17.2%**

(millions of US dollars)

Thailand		Indonesia	
Sales	500	Sales	500
Gross profit	250	Gross profit	250
VAT (7%)	17.5	VAT (10%)	25
Operating cost	125	Operating cost	125
Profit before tax	107.5	Profit before tax	100
Corporate tax (30%)	32.3	Corporate tax (20%)	20
Profit after tax	75.2	Profit after tax	80
Total amount of tax paid	**49.8**	**Total amount of tax paid**	**45**
Net profit ratio	**15.0%**	**Net profit ratio**	**16.0%**

(millions of US dollars)

Malaysia		The Philippines	
Sales	500	Sales	500
Gross profit	250	Gross profit	250
VAT (10%)	25	VAT (10%)	25
Operating cost	125	Operating cost	125
Profit before tax	100	Profit before tax	100
Corporate tax (30%)	30	Corporate tax (35%)	35
Profit after tax	70	Profit after tax	65
Total amount of tax paid	**55**	**Total amount of tax paid**	**60**
Net profit ratio	**14.0%**	**Net profit ratio**	**13.0%**

Table II-2-15 Case of a Domestic Corporation (3)

<*Assumptions*>

Sales	US$500 million
Gross profit ratio	20%
Operating cost ratio	10%

(millions of US dollars)

Viet Nam		Singapore	
Sales	500	Sales	500
Gross profit	100	Gross profit	100
Turnover tax (10%)	50	GST (3%)	3
Operating cost	50	Operating cost	50
Profit before tax	0	Profit before tax	47
Profit tax (35%* of the above)	0	Corporate tax (27%)	12.7
Profit after tax	0	Profit after tax	34.3
Total amount of tax paid	**50**	**Total amount of tax paid**	**15.7**
Net profit ratio	**0%**	**Net profit ratio**	**6.8%**

(millions of US dollars)

Thailand		Indonesia	
Sales	500	Sales	500
Gross profit	100	Gross profit	100
VAT (7%)	7	VAT (10%)	10
Operating cost	50	Operating cost	50
Profit before tax	43	Profit before tax	40
Corporate tax (30%)	12.9	Corporate tax (20%)	8
Profit after tax	30.1	Profit after tax	32
Total amount of tax paid	**19.9**	**Total amount of tax paid**	**18**
Net profit ratio	**6.0%**	**Net profit ratio**	**3.6%**

(millions of US dollars)

Malaysia		The Philippines	
Sales	500	Sales	500
Gross profit	100	Gross profit	100
VAT (10%)	10	VAT (10%)	10
Operating cost	50	Operating cost	50
Profit before tax	40	Profit before tax	40
Corporate tax (30%)	12	Corporate tax (35%)	14
Profit after tax	28	Profit after tax	26
Total amount of tax paid	**22**	**Total amount of tax paid**	**24**
Net profit ratio	**5.6%**	**Net profit ratio**	**5.2%**

Table II-2-16 Chronological Table of AFTA and Viet Nam

	Viet Nam	AFTA
1993. 1		AFTA was inaugurated. CEPT treaty to reduce tariff to 0-5% by 2008. Singapore began to reduce tariff.
1994. 1		Member countries began to reduce tariff.
1994. 9		Agreed to speedup tariff reduction by 2003.
1995. 3		Began to study the coordination with Australia and New Zealand.
1995. 4		Agreed on gradual reduction of preferential treatment by BBC and AIJV.
1995. 7	Became a member of ASEAN.	
1995. 9		Agreed on Viet Nam's tariff reduction from Jan 1996. Agreed to increase items of tariff reduction by 2000.
1995.12	Submit CEPT list, 853 items excluding key products such as iron & steel, cement, automobiles. Agreed to abolish non-tariff impediments in 5 years.	Agreed to the framework treaty on intellectual right and service.
1996. 1	Became a member of AFTA. Will reduce tariff on general items to 0-5% by 2006. All items by 2010.	Members began to reduce tariff on agricultural products

(Articles of Nihon Keizai Shimbun)

Table II-2-17 Excise Tax on Imported Luxuries

(%)

	Tariff rate	Revised Tariff rate	Excise tax
Tabacco	120	60	112
Spirits	120	60	120
Beer	150	60	112
Firecrackers	70	60	160
Automobiles	200	60	160
Gasoline	70	50	22.5

(Articles of Nihon Keizai Shimbun)

Table II-2-18 Central- Local Fiscal Operation

Fiscal 1992 (in billion of VND)

	Revenue Raised	Transferred	Expenditure
Three Regions	8,289	-3,307	4,982
The Rest	2,652	771	3,423
Local Total	10,941	-2,536	8,405
State Budget	21,023	-	25,120

(WB 1995a)

Fiscal 1995

	Revenue Raised	Transferred	Expenditure
Three Regions	32,244	-22,478	9,766
The Rest	6,542	1,676	8,218
Local Total	38,786	-20,802	17,894
State Budget	54,150	-	na

(MPI)

Table II-2-19 Classification of Medium- to Long-Term Fund Needs

Investment entities	Nature of investment	Sources
Government	Public	State budget ODA
SOEs	Public	State budget ODA
	Mixed	State budget ODA
	Commercial	Short term revolving Retained earnings
Private	Commercial	Short term revolving Retained earnings Informal
Bad debts of SOEs	-	State budget
Long term WC	-	Short term revolving

Appendix II-2-1 Tax Adjustments Required by AFTA Agreement:

(1) ASEAN Free Trade Area (AFTA)

Mandate: ASEAN countries aim to create a free-trade market covering the grouping within 15 years starting from January 1, 1993. Reduction of tariffs to 0-5% by 2003 and elimination of non-tariff barriers are scheduled.

Vehicle: Common Effective Preferential Tariff (CEPT) Plan

Products subject to the plan: All products produced in ASEAN with 40% or more local contents.

Schedule: "Fast-Track" schedule: For the 15 items (note 1), which consist of about 37% of the intra-ASEAN trade, tariffs currently above 20% will be reduced to 0-5% by 2003 and for those below 20% by 2000.

"Normal-Track" schedule: All tariffs currently below 20% will be reduced to 0-5% by 2003. For those currently above 20%, tariff will be reduced first to maximum 20% within 5-8 years and then to 0-5% level by 2008.

* Each country will retain the right to keep some sensitive agricultural products out of AFTA.

* A temporary list of excluded goods (originally subject to a review after eight years) will be formally phased out over five years beginning in 1996.

(2) The Current Situation

At the fifth leader's summit in Bangkok on Dec. 15, ASEAN member economies vowed to speed up the realization of AFTA even before the target date of 2003 by (a) maximizing the number of items whose tariffs can be reduced to 0-5% by the year 2000, and by (b) expanding the number of products whose tariffs can be reduced to zero percent by the same year.

ASEAN leaders agreed to broaden its coverage and accelerate its pace of implementation based on a consensus that unless it gives a boost to its free-trade agenda, its relevance may be eclipsed by bigger forces such as the Asia-Pacific Economic Cooperation (APEC) forum that could snatch the lead in trade policy or by trade itself as the world liberalizes.

However, seven members - Brunei, Indonesia, Malaysia, the Philippines, Singapore, Thailand and Viet Nam - do not have equal enthusiasm for trade liberalization. Singapore and Brunei are eager to hasten the schedule since they have the most open markets and have nothing to lose (Brunei because its economy is largely tied to oil and gas). Thailand lobby groups more of deepening and widening of AFTA's scope rather than hastening the schedule, and it is willing to include liberalization of services including telecommunications, transport, tourism and financial services. It is less resistant than other ASEAN members in liberalizing non-processed agricultural goods. However, Thailand still fears liberalization will widen the country's trade deficit. Indonesia and the Philippines harbor strong lobbyists for continued protection of areas of their economies deemed vulnerable to competition. At the Brunei meeting in Sept. 1995, Indonesia insisted that 14 food-related items be transferred from a temporary exclusion list to a more permanent "sensitive" list. It is concerned about opening up its markets to unprocessed agricultural goods. Malaysia, wanting to extend protection of its strategic primary products, also transferred some items to the sensitive list.

(3) An Ordinary Pattern of Tariff Reduction

Through ASEAN, about 687 tariff lines will be lowered in 1996 and 2,496 others in the next four years. Average tariff rates will subsequently be brought down from 7.73% in 1996 to 4.03% by 2000 and 2.90% by 2003 (Jan. 1, 1996, Asian Economic News).

Note 1: Edible oil, cement, chemical products, pharmaceuticals, fertilizers, plastics, rubber products, leather products, pulp, fabrics, ceramics and glass products, jewelry, electronic products, wooden and rattan furniture, etc.

(A) "Fast-Track" Tax Reduction Pattern:

(a) Item with tariff rates above 20%:

(%)

	Country	Current Tariff Rates(*)	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
1	Brunei		No items above 20 % tariff rates										
2	Indonesia	40	40	40	30	30	20	20	15	15	10	10	0-5
		30											
		25											
3	Malaysia	50	45.5	41.0	36.5	32.0	27.5	23.0	18.5	14.0	9.5	5.0	
		40	36.5	33.0	29.5	26.0	22.5	19.0	15.5	12.0	8.5	5.0	
		30	27.5	25.0	22.5	20.0	17.5	15.0	12.5	10.0	7.5	5.0	
4	Philippines	46-50	45	40	35	30	25	20	15	0-5			
		41-45				40	35	30	25	20	15	10	0-5
		36-40				35	30	25	20	15	10	10	0-5
		31-35				30	25	20	20	15	15	10	0-5
		26-30				25	25	20	20	15	15	10	0-5
		21-25				20	20	15	15	15	10	10	0-5
5	Singapore	Above 20	0	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
6	Thailand	above 30	30	30	25	25	20	20	15	15	10	10	0-5
		26-30			25	25	20	20	15	15	10	10	0-5
		21-25			20	20	15	15	10	10	0-5		

* Tariff rates applied within ASEAN (Non-PTA items as of Jan. 1, 1992 and PTA items as of Dec. 31, 1992).

Note: Figures for Malaysia are reduction rates.

(b) Items with tariff rates below 20%:

(%)

	Country	Current Tariff Rates(*)	1993	1994	1995	1996	1997	1998	1999 (**)	2000 (***)
1	Brunei	20	20	20	15	15	15	10	10	0-5
		15	15	15	10	10	10	10	10	0-5
		10	10	10	5	5	5	5	5	0-5
2	Indonesia	20	20	20	15	15	10	10	10	0-5
		15	15	15	10	10	5	5	5	0-5
		10	10	10	5	5	5	5	5	0-5
3	Malaysia	20	17.86	15.72	13.58	11.44	9.30	7.16	5.02	
		10	9.30	8.60	7.90	7.20	6.50	5.80	5.00	
4	Philippines	16-20				15	15	10	10	0-5
		11-15				10	10	0-5	0-5	0-5
		6-10				0-5	0-5			
		0-5				0-5	0-5			
						0-5				
5	Singapore	0-2.5	0	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
6	Thailand	20	20	20	15	15	10	10	10	0-5
		15-19	15	15	15	10	10	0-5		
		10-14			10	10	10	0-5		
		5-9			0-5					
		below 5	0-5							

* Tariff rates applied within ASEAN (Non-PTA items as of Jan. 1, 1992 and PTA items as of Dec. 31, 1992).

** Starting from Jan. 1, 1999.

*** Starting from Jan. 1, 2000.

Note: Figures for Malaysia are reduction rates

(B) "Normal-Track" Tax Reduction Pattern:

(a) Item with tariff rates above 20%:

(%)

	CTR *	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	3004	2005	2006	2007	2008
1	30	30	28	26	24	22	20	15	15	10	10	10	0-5				
2	50 40 30 25	50 40 30 25	50 40 30 25	50 40 30 25	50 40 30 25	50 40 30 25	40 30 20 20	30 30 20 20	30 30 20 20	20 20 20 20	20 20 20 20	20 20 20 20	15 15 15 15	15 15 15 15	10 10 10 10	10 10 10 10	0-5 0-5 0-5 0-5
3	50 30	46.2 5 28.7 5	42.5 0 27.5 0	38.7 5 26.2 5	35.0 0 25.0 0	31.2 5 23.7 5	27.5 22.5 0	23.7 5 21.2 5	20.0 0 20.0 0			15.0 0 15.0 0		10.0 0 10.0 0		5.00 5.00	
4	46- 50 41- 45 36- 40 31- 35 26- 30 21- 25				45 40 35 30 25 20	40 35 30 30 25 20	35 30 25 25 25 20	30 25 25 25 25 20	20 20 20 20 20 20	20 20 20 20 20 20	20 15 20 20 15 20	15 15 15 15 15 15	15 10 15 15 10 10	10 10 10 10 10 10	10 0-5 10 10 0-5 0-5	0-5 0-5 0-5	
5	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
6	30- 26- 30 21- 25	30**	30	30	30	30	25 25	25 25	20 20 20	20 20 20	20 20 20	20 20 20	15 15 15	15 15 15	10 10 10	10 10 10	0-5 0-5 0-5

* Tariff rates applied within ASEAN (Non-PTA items as of Jan. 1, 1992 and PTA items as of Dec. 31, 1992).

** Most are manufactured products

Note: Figures for Malaysia are reduction rates

(b) Items with tariff rates below 20%:

(%)

	Country	Current Tariff Rates(*)	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
1	Brunei	20	20	20	20	15	15	15	10	10	10	0-5	
		15	15	15	15	10	10	10	5	5	5	0-5	
		10	10	10	10	5	5	5	5	5	5	0-5	
2	Indonesia	20	20	20	20	15	15	15	10	10	5	5	0-5
		15	15	15	15	10	10	10	5	5	5	5	0-5
		10	10	10	10	5	5	5	5	5	5	5	0-5
3	Malaysia	20	18.5	17.0	15.5	14.4	12.5	11.0	9.5	8.0	6.5	5.5	
		10	9.5	9.0	8.5	8.0	7.5	7.0	6.5	6.0	5.5	5.5	
4	Philippines	16-20				15	15	15	15	10	10	10	0-5
		11-15				10	10	10	10	10	10	0-5	0-5
		6-10				0-5	0-5	0-5	0-5	0-5			
		0-5	0-5	0-5	0-5	0-5	0-5	0-5	0-5	0-5			
5	Singapore	0-2.5	0	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
6	Thailand	20				20	20	20	15	15	10	10	0-5
		15-19							15	15	10	10	0-5
		10-14							10	10	0-5		
		5-9							0-5				
		below 5	0-5										

* Tariff rates applied within ASEAN (Non-PTA items as of Jan. 1, 1992 and PTA items as of Dec. 31, 1992).

** Starting from Jan. 1, 1999.

*** Starting from Jan 1, 2000.

Note: Figures for Malaysia are reduction rates.

Since Viet Nam joined AFTA Jan. 1, 1996, it is granted a three year longer deadline than the other member countries i.e. to reduce tariff to 0-5% by 2006 for fast-track items. It has also agreed to catch up with other countries by 2010 for all items including agricultural products. An imaginary reduction schedule for Viet Nam can be shown as below:

"Fast-Track" Tax Reduction Pattern: Item with tariff rates above 20%: (%)

Current Tariff Rates	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
56-60	55	50	45	40	35	30	25	20	15	10	0-5
51-55	50	45	40	35	30	25	20	20	15	10	0-5
46-50	45	40	35	30	25	25	20	20	15	10	0-5
41-45				40	35	30	25	20	15	10	0-5
36-40				35	30	25	20	15	10	10	0-5
31-35				30	25	20	20	15	15	10	0-5
26-30				25	25	20	20	15	15	10	0-5
21-25				20	20	15	15	15	10	10	0-5

"Normal-Track" Tax Reduction Pattern: Item with tariff rates above 20%: (%)

	1996	1997	1998	1999	2000	2001	2002	2003	3004	2005	2006	2007	2008	2009	2010
56-60	55	50	45	40	35	30	30	30	20	20	15	15	10	10	0-5
51-55		50	45	40	35	30	30	30	20	20	15	15	10	10	0-5
46-50			45	40	35	30	30	20	20	20	15	15	10	10	0-5
41-45			40	35	30	25	20	20	20	15	15	10	10	10	0-5
36-40			35	30	25	25	20	20	20	15	15	15	10	10	0-5
31-35			30	30	25	25	20	20	20	15	15	15	10	10	0-5
26-30			25	25	25	25	20	20	15	15	15	10	10	10	0-5
21-25			20	20	20	20	20	20	20	15	15	10	10	10	0-5

(4) Problems with regard to the tax system in the implementation of the CEPT plan

The effect of tariff reductions on government revenue: All ASEAN countries except Singapore and Brunei, are highly dependent on tax revenue from international trade and transactions, especially from import taxes. Therefore, in order to offset the revenue loss caused by the tariff reduction, many countries had to strengthen the revenue from internal taxes such as taxes on incomes and domestic goods & services. At the same time, in order to maximize the revenue from import tax at lower rates, it is necessary to reduce costs involved in collection of import taxes. For this purpose, drastic fiscal reforms are required in which all out-dated accounting, legal and political systems as well as the government administration system must be modernized and rationalized. Many attempts have been made in this respect in each ASEAN country over the past few years. The major example is the transition to the VAT system.

For example in Thailand, a transition from turnover tax to the VAT system took place in January 1992. This was to replace the old turnover tax, which was criticized for both its cascading nature and its high administrative costs involved in tax adjustments for international transactions of goods. Thailand is among the most aggressive countries that pursue reductions in import tariff rates and at the same time is trying to simplify tax collecting administration. Since the Tariff Simplification Plan was approved at the Cabinet in September 1992, by which tariff rates were simplified into six (0%, 1%, 5%, 10%, 20%, 30%) categories, the government has been drastically implementing a series of tariff reductions and a broadening of coverage. However, at the same time, Thailand has not changed its stance in persisting on the high tariff rates on imported goods that can be produced domestically and those on luxuries including cars. The purpose is to protect domestic industries and secure tax revenue. Although Thailand is still highly dependent on indirect taxes for its fiscal revenue, the direct tax portion of the composition has improved in recent years (1991:29.7%, 1992: 30.4%, 1993: 31.2%). This is a reflection of the revenue increase from corporate tax. To increase tax revenue more effectively, it is necessary for Thailand to further increase the percentage of direct tax revenue, in both corporate and personal income, since the higher income elasticity of direct taxes will be effective in increasing revenue at the stage of economic expansion. In this regard, Thailand already implemented income tax reforms in January 1992: (a) adopted uniform corporate tax rate of 30%; and (b) reduced the maximum tax rate from 50% to 37%, simplified progressive tax rates from six to five, and expanded the amount of income allowances on personal incomes. In Thailand, as in Viet Nam, about half of the corporations are not making profits and those making profits are still not earning much. In this scenario corporate income tax revenue is heavily dependent on SOEs. Tax revenue from personal income consists of only about 10% of the total due largely to the fact that about 60% of the income earners are in the agricultural sector where the income level is still very low. Thus, the above mentioned tax reforms are considered necessary to effectively broaden the tax base and eventually increase the government tax revenue in the long run.

It will take some time to see whether the aggressive tax reforms carried out by Thailand will be successful or not in increasing tax revenue and creating more effective tax administration. Nevertheless, the above mentioned attempts made by Thailand give us some important insights in finding realistic and reasonable ways to reform Viet Nam's tax system since the two countries have many similarities regarding taxes. In order to increase tax revenue at this point, it is highly recommended that Viet Nam, which has the lowest direct tax rates among ASEAN countries, (a) lessen its dependency on indirect taxes such as import and export tax, turnover tax, and excises, and (b) increase direct tax collection by broadening its tax base. The following administrative reform measures will be helpful in stimulating tax collection and increasing revenue; a change from turnover tax to VAT, a reduction in tariffs in accordance with AFTA, temporary high excise taxes to protect strategic infant industries and cover lost revenue from import tax rate cuts, and a reduction and simplification of tax rates on personal and corporate income.

Chapter 3. Private Savings Mobilization

3-1. Private Savings Mobilization to Achieve the 5-Year Plan

The Viet Nam government has been preparing a 5-year plan for socio-economic development and investment in Viet Nam. The government aims to raise 41-42 billion USD for the investment. About half of this amount, is expected to be mobilized through external sources. The other half is expected from domestic sources. It is estimated that one-third of the domestic portion will be through government taxes and two-thirds will be mobilized from individuals and enterprises via the banking system.

According to a World Bank report (Viet Nam Financial Sector Review, March 1995), the national gross savings ratio to GDP in Viet Nam was 7.4% in 1990, 13.1% in 1991, 16.3% in 1992, and 11.2% in 1993. The savings ratio in Viet Nam is lower than the average ratio in ASEAN and other East Asian countries. So far, the low savings ratio has been a bottleneck to future economic development in Viet Nam.

However, as the Viet Nam Living Standards Survey indicates, there are large financial savings in gold, cash, and foreign currency.

In order to achieve high growth, the financial system has to be expanded to provide the needed money. According to Professor Watanabe of the International University of Japan, the nominal GDP in 2000 is estimated to be 543,568 million VND. The average ratio of total deposits to GDP from 1991 to 1994 was 14.9%. Therefore, roughly speaking, 80,991 billion VND, or about 6 billion USD in deposits outstanding can be maintained by the end of the year 2000 (13,383 VND/1USD). However, in order to achieve high growth, about 14 billion USD in deposits must be maintained. To that end, the financial system needs to be improved and confidence in banks needs to be restored by improving their services. The financial system will have a crucial role to play in the transition to the market-oriented economy.

3-2. Status of Financial Reform and Mobilization of Domestic Private Savings

(1) Outline of the Development of Financial Reform

There has been significant improvement in the financial system in Viet Nam. In parallel with the general transformation from a centrally-planned to a market-oriented economy under the open-door policy, the organization and operation of Viet Nam's financial system has been drastically reformed. In 1990, the government of Viet Nam issued two decrees; one on the state banking system and the other on the commercial banking system, credit cooperatives and financial companies. These were important advances in the legalization of banking operations which are designed to renovate Viet Nam's financial system.

The organization of the banking system has in effect changed from a one-tier to a two-tier banking system. Clear distinctions have been made between state management functions in all credit and monetary operations: supply, regulation and circulation of the currencies, stabilization of the value of the currencies in the State Bank and the business functions of the commercial banks.

The commercial banking system has expanded from a one-tier system which mainly served the state-owned enterprises, to an operational network that serves all economic sectors. The credit structure has changed in line with the increase in loans provided to state-owned and non-state-owned enterprises. This change has been a gradual increase in the percentage of medium- and long-term funds in the outstanding debt. The state-owned commercial banks have been stabilized, and rural and urban credits have again started developing since the crises of 1989-1990. Stock banks, joint-venture banks with foreign countries, have been established and the number of foreign banks that are allowed to establish branches and representative offices in Viet Nam is increasing. So far, the financial and credit system has been expanded in terms of number and quality of operation (Appendix II-3-1).

One of the significant developments of the financial system in Viet Nam is increased entry into banking sectors. The structure of the financial system in Viet Nam includes: the State Bank of Viet Nam, four state-owned commercial banks, a bank for poor people, one gold and precious stones company, 48 commercial stock banks, 75 credit cooperatives, 479 people's credit funds, two financial companies, 19 foreign bank branches, four joint-venture banks, and 45 representative offices.

(2) Monetary Policy

Monetary policy in Viet Nam has been developed mainly based on credit policy, including interest rate policy.

The improvement in interest rates has been through the establishment of a framework and an implementation of positive interest rate policy since 1989. This interest rate policy has been continually adjusted up to the present. The State Bank has implemented the management of interest rates by stipulating ceiling rates for loans and a minimum interest rate for savings. In the period of 1992-1995, the State Bank adjusted the ceiling rates. Since January 1, 1996, the management of Central Bank interest rates has been more flexible. The Central Bank only decides the highest loan amount. The average difference between the lending rate and the deposit interest rate is 0.35%, one more step towards the liberalization of interest rates.

In 1990-1991, there was strong inflationary pressure and the rate of increase of the money supply was nearly equal to the rate of inflation, 67.4%. This had an adverse impact on economic activities. The State Bank intends to reform and regulate some policies on credit, interest rates, management of foreign exchange, and the budget. It aims to implement tight monetary policy to stabilize the internal and external value of the Vietnamese dong. The result of the inflation-control program was to push back the inflation rate from 67.6% at the end of 1991 to 17.6% in 1992, 5.2% in 1993, 14.4% in 1994, and 12.7% in 1995, while maintaining a high economic growth rate.

As a new monetary policy instrument, a credit ceiling was applied to four state commercial banks in 1994 and was expanded to include five joint-stock commercial banks in 1995. The State Bank intends to use credit ceilings to a wider extent.

There are some basic interest rate changes in the refinancing investment of the Central

Bank; from applying different to applying the same interest rates for all commercial banks. The purpose is to increase the effectiveness of the investment refinancing tools in the period when Central Bank monetary policy is implemented. Commercial banks were not refinanced in 1995.

Required reserve policy has been implemented since the banking decree was introduced. Change has been made to apply a uniform required reserve ratio of 10% on all time and demand deposits.

While monetary policy continues to rely on direct investments, progress is being made toward more efficient indirect monetary management. As a first step, a trial auction for treasury bills was held in 1994, and regular auctions have been held since last year. Since the treasury bill market is new, open market operations have not yet been initiated.

(3) Trend of Bank Deposits and Credits

Due to declining inflation rates, stabilization of the dong against the U.S. dollar, and high interest rates for dong deposits, the mobilization of domestic savings is steadily progressing. According to State Bank's annual reports for 1994, the total deposits were 13,881 billion VND (1991), 16,564 billion VND (1992), 18,071 billion VND (1993), and 22,622 billion VND (1994). However the percentage of total deposits to GDP has been low and has not been increasing. The ratio was 18.1% (1991), 15.0% (1992), 13.2% (1993), and 13.3% (1994).

Appendix II-3-2 shows the monetary deposit data for state-owned commercial banks and 16 non-state commercial banks. Total deposits have been gradually increasing from 13,573 billion VND in 1991 to 21,111 billion VND in 1994 (Sept.). The percentage of dong deposits to total deposits has been rapidly increasing from 38.5% in 1991 to 59.3% in 1994 (Sept.). The percentage of deposits in state-owned commercial banks to total deposits has been gradually decreasing from 93.3% in 1991 to 86.0% in 1994 (Sept.), but their shares are still high and they are powerful.

Appendix II-3-3 shows the credit data of monetary deposit banks. Total credits have been rapidly increasing from 10,051 billion VND in 1991 to 27,621 billion VND in 1994 (Sept.). The percentage of credits by state-owned commercial banks to total credits has been decreasing a little bit from 94.6% in 1991 to 89.4% in 1994 (Sept.). As a lender, the power of the state-owned commercial banks is outstanding. Most bank credits are short-term while the percentage of short-term deposits to total credits has been gradually decreasing from 84.5% in 1991 to 72.1% in 1994 (Sept.).

Appendix II-3-3 also shows borrowers of bank loans. The percentage of state enterprise borrowers to total bank loans has been rapidly decreasing from 90.0% in 1991 to 63.0% in 1994 (Sept.). The percentage of private sector borrowers to total bank loans has been rapidly increasing from 4.8% to 28.3% over the same period. This means that the private sector is emerging as one of the major players in Viet Nam's economy.

Appendix II-3-4 shows the ratio of borrowers in each state-owned commercial bank. In the Viet Nam Bank for Agriculture (Agribank), the percentage of credits to the private sector has been rapidly increasing from 12.5% (1991) to 36.3% (1992), 64.0% (1993), and 66.6% (1994), because state-owned farms were converted into private farms. In the Industrial and

Commercial Bank (Incombank), the percentage of the private sector has also been increasing from 3.4% (1991) to 28.2% (1994). On the other hand, the respective percentages in the Industrial and Development Bank (BIDB) and the Bank for Foreign Trade of Viet Nam (Vietcombank) are 3.1% and 3.0% in 1994 and their credits to state-owned enterprises are still outstanding.

(4) Fund Mobilization in the Form of Bonds and Stocks

In addition to bank deposits, bonds and stocks are important measures for mobilizing domestic savings. In recent years, bonds issued by the State, commercial banks and state-owned enterprises and stocks issued by companies were available.

The State issued three kinds of bonds. State treasury bills are short-term bonds with a maturity of less than one year and were issued to all financial institutions by auction in 1995. State treasury bonds are medium-term and long-term bonds issued to cover the state budget deficit. At present, the maturity of the issued bonds is 1-3 years. Project bonds are state bonds issued for government construction projects. Recently, the bonds were issued for the construction of Tat Thanh Road in Ho Chi Minh City.

State-owned commercial bank bonds have also been issued to mobilize capital since 1992 and the maturity is usually 1-3 years. Bond issuance by the state-owned commercial banks has been rapidly increasing and is becoming one of the major mobilization methods for domestic savings. The outstanding amounts of bonds issued were 249 billion VND in 1992, 2,467 billion VND in 1993, and 4,271 billion VND in 1994, and Agribank and Incombank are the major issuers. However, the state-owned commercial banks' bonds play a role of substituting for bank deposits rather than providing long-term capital.

State-owned enterprise bonds are issued to mobilize capital for production expansion and technological upgrade and they must be government approved. Two state-owned cement enterprises issued bonds with maturities of 3 years.

Stocks are issued by companies. About 100 companies have issued stocks. But the shares are few and the number of shareholders is limited. In addition, some state-owned enterprises issued equity.

The features of the above securities are as follows. a) There is only a primary market and that is the issuing market. There are no secondary markets in which investors can buy and sell previously issued bonds and stocks. b) The scale of the market is too small. The total value of payments is about 4% of GDP, the total value of stocks is only about 1% of GDP, and they were not sold publicly. c) The maturities of the bonds are short. About 90% of the maturities are one year and only 10% 1-3 years. d) There is no comprehensive system of laws and regulations relating to disclosure, accounting and auditing. e) Recently, inflation has caused some difficulties in the development of the capital markets in Viet Nam.

In June 1995, the prime minister approved a decision on the establishment of a securities steering committee for the preparation of a securities market in Viet Nam. The steering committee was composed of the State Planning Committee, the Ministry of Justice, the Ministry of Finance and the State Bank of Viet Nam. The establishment of the securities market is currently in the preparation phase. A legal framework and other necessary conditions for the securities markets are being prepared by the ministries.

Securities markets will serve to provide people with a variety of savings methods and to mobilize domestic funds. It will also provide the State Bank with means of open market operations and will attract foreign investment. Since the establishment of securities markets is significant, preparations should be accelerated. As a first stage, a bond market should be established. It is also important to disseminate proper knowledge about stocks before establishing a stock market.

3-3. The Environment Surrounding Commercial Banks

The following description is mainly based on interviews and research analysis on existing reports. Although there may be some objection and misunderstanding of the fact, the description is thought to reveal several aspects of the financial system in Viet Nam on the whole.

(1) Current Status of Commercial Bank as Financial Intermediaries

According to Price Waterhouse's "VIET NAM: A Guide for the Foreign Investor," it is thought that still only a small (albeit growing) fraction of Viet Nam's hard currency circulates in the official banking system. Estimates of the value of hard currency and gold hoarded in Viet Nam are as high as half a billion dollars. Considerable hoarding of the local currency, the Vietnamese dong, also exists. By the Government's own estimates, around 10 billion USD may be "lying idle" outside the banking system.

Cash is the major means of payment. Although checks are available, they are not commonly used at present. Although the payment system has been improved recently, it is not always sufficient. A project for a national inter-bank payment clearing and settlement system is currently being developed through preferential credits of the World Bank. The State Bank of Viet Nam and several commercial banks are implementing a project to modernize the payments system. This is important in renovating banking technology.

Due to monetary policy that guides short-term interest rates higher than medium- and long-term interest rates, deposits for medium- and long-term lending cannot be mobilized. Some banks say that they do not want to increase deposits because interest rates are high and they do not want to take medium-term deposits because there is a risk that interest rates may fall. Under this situation, short-term loans will surge.

Financial institutions mainly lend short-term money in response to economic and political risks.

Lending to state-owned enterprises is preferred to lending to the private sector, although both are legally equal. State-owned commercial banks do not always require collateral from state-owned enterprises, but they do in the private sector and the collateral value is set lower than real value. State-owned commercial banks also lend money to state-owned enterprises with lower interest rates. Therefore, the private sector usually raises funds through private financing such as borrowing from friends. Preferences to state-owned enterprises will obstruct the expansion of the private sector that is very important to the development of Viet Nam's economy.

Competitive conditions between state-owned commercial banks and private joint-stock banks are not equal. State commercial banks have the advantages of large capital, many branches, many clients, and high consumer confidence due to their long existence. Joint-stock banks generally have shorter histories, less capital, older machines, less staff, and few branches, so they can't compete. Because state-owned commercial banks have power, the Viet Nam government has treated them well. The government allows them to value their capital reserves to inflation from profit before taxes, while the private joint-stock banks must calculate from profit after taxes. The state-owned commercial banks are informed of interest rate policy in advance, but private joint-stock banks get just two days' notice.

There seems to be a requirement that companies must open an account at one of the four state-owned commercial banks. That will not encourage more competition.

Financial statements are not made based on international accounting standards. Therefore it is very difficult to understand financial performance. When developing international banking activity, disclosure based on international standards is important. Recently state-owned commercial banks have been audited, which is a huge step forward.

Loan evaluation is not sufficient. Credit analysis to determine future profitability based on financial data is not common. Data needed for the analysis such as past financial data, and information about the industry that the company is in are not available. Many banks seem to mainly look at a client's collateral when they decide whether or not to lend money.

Due to an imperfection of law, it is difficult to use assets and land-use rights as collateral. The execution of collateral is also very difficult. Usually a building can be utilized as collateral. This obstructs efficient lending operations.

Financial institutions have heavy tax burdens such as turnover tax and profits tax. Turnover tax is applied to income from banking and credit, foreign exchange and stock trading, gold, silver and gems trading and other banking-related services and passed on to depositors and borrowers in one form or another as intermediation costs. High taxes on banks reduce incentives to mobilize domestic savings needed for the investment. Regarding profits tax, a matter of particular concern to branches of foreign banks is that interest on branch capital is generally considered to be non-deductible for tax purposes by the Vietnamese authorities and that provisions for bad debts are also non-deductible. With foreign banks, some transactions may be carried out overseas, not in Viet Nam, to avoid high taxes. It is said that foreign banks have found it difficult to grant loans in Viet Nam, owning to difficulties in obtaining adequate information and collateral. Foreign savings mobilization that is necessary for future development of Viet Nam's economy cannot be easily realized. A part of turnover tax on credit activities of banks is exempted as of January 1996 and that is a vast improvement.

One of the major problems is the existence of a large overdue figure. According to the World Bank report, total overdues as of September 1994 were 3.3 trillion VND. The vast portion of overdue - 96% in 1994 - is held by the state-owned commercial banks, and 63% was owed by the state-owned enterprises. The private sector's share of overdue credits rose to more than 27% in 1994 from 6% in 1991, with the bulk concentrated in Agribank. If non-performing assets were calculated using international accounting standards that include estimates of substandard or doubtful assets, they would be much higher than the recorded amount - in the region of 5-6 trillion VND or well over 25% of outstanding loans and twice the capital and reserve of banks.

(2) Current Status of the General Public as Money Provider

In 1990, there were many credit association collapses. In 1995, a joint-stock bank was rumored to use a large part of its deposits for its manager's family companies. As a result, there is a credit problem and the general public does not trust banks. Few households use banking services.

The difficulties in making cash withdrawals from banks is thought to be one factor behind the lack of trust. According to the World Bank report, delays of two or three weeks are sometimes experienced at the provincial level in actually converting funds from a bank account into cash. Therefore, the general public prefers cash to deposits. Easier cash withdrawals would improve bank' services and it is very important for banks to gain the trust of the general public.

Some people worry about questions concerning their deposits. Several years ago, depositors were often asked where they got the money. It is said that they are no longer asked those kinds of questions but whether it is true or not, that is one reason why banks are not trusted.

Recently there has been a consumption boom. In major cities, a lot of merchandise is on sale. People ride motor bikes and have radio cassettes and TVs. On the other hand, most people in rural areas are poor and cannot afford to make bank deposits.

It is said that since the general public does not trust banks, they place gold and cash under pillows instead of in banks. The Viet Nam Living Standards Survey supports the fact that people have large financial savings in gold, cash, and foreign currency. According to the Economist (July 22, 1995), ordinary Vietnamese are believed to be hoarding as much as 10 billion USD-worth of gold, or around 140 USD per head and large compared with per-capita GDP of 250 USD. This does not allow the national economy to grow as it would with greater bank deposits.

It's also said that the rich distinguish between money that is reserved as gold and money that is used for making money. As regards the former, it may be difficult to mobilize money in the form of bank deposits because they do not expect interest. As to the latter, its not easy to mobilize money into deposits because investments in real estate and private finance are profitable.

The general public puts its money in short-term deposits due to high interest rates, but, gold is more attractive than deposits for medium- and long-term savings. Since the general public has not forgotten when inflation rates were high and since they do not think the inflation rate will be stable in the near future, they are inclined to keep gold. As a result, fund mobilization can't be realized sufficiently.

Due to the frequent use of the U.S. dollar, the general public has a tendency to keep it as a currency.

(3) Current Status of Enterprises as Money Borrowers

According to the enterprise survey that the Overseas Economic Cooperation Fund (OECF) commissioned to SPC, business activities and development are restricted by a lack of access to funds, by old and obsolete equipment and machines, by underdeveloped transportation and other infrastructure, and by insufficient knowledge and technology in marketing and business administration. Complicated loan procedures and requirement of mortgages are the problem in accessing funds. Insufficient funds account for the old and obsolete state of equipment. Private enterprises are in a more disadvantageous position than state-owned enterprises in the acquisition of assets, in mortgage, and in access to funds. Many private enterprises are operating businesses with their own funds.

It is very difficult to get bank loans for enterprises that have high potential growth but no collateral. It is also difficult to get loans for those enterprises that export merchandise processed using much labor. They need more working capital because their business cycles are longer and they have to pay wages to their employees, but they cannot get bank loans because they usually do not have enough collateral. Bank lending based mainly on collateral will become a big obstacle to the promotion of employment and export that will play an important role in economic development.

In addition to bank loans, enterprises often make use of private finance that requires a higher interest rate but does not require collateral or a specified repayment term. Private finance satisfies the fund demands of enterprises that need medium- and long-term money but do not have enough collateral except for their buildings.

Because of high interest rates, some enterprises cannot use bank loans and cannot expand their business.

Financial statements of enterprises do not reveal their real condition. Some enterprises are likely to record smaller profit in order to evade taxation. Other enterprises try to make their assets smaller to reduce the fee that is calculated based on the value of assets. It is said that the accruals concept and the concept of provisions are now generally understood and applied in place of the former cash accounting basis. Since January of 1996, a new accounting system based on international standards has been applied. This will advance the disclosure of real conditions. But it will take a long time for enterprises to fully understand and use the new standard properly.

Although the number of state enterprises decreased to about 6,000 from 12,000 through merger and consolidations, there is also a need for the rationalization of management.

(4) The Existence of an Informal Credit Market

In response to the high demand for capital by the population, an informal market has taken shape in Viet Nam. The market developed rapidly during 1989-1992, when a banking system had not yet been developed, in order to solve the requirements of the demand for and the supply of capital in the renovation process. The two main informal credit markets are loans between individuals or illegal mutual funds of some individual, "Ho" and "Hui". Specific traits of the market are short-term loans, high interest rates, simple procedure, illegality and high risk. In fact, in the period 1991-1993, there was a crisis in the market, because of the collapse of "Ho" and "Hui." Causes of the collapse were that the borrower had either lost repayment ability or had run away. At present, the market scope has been restricted because the banking system has been developed.

On the other hand, it is also said in the World Bank report that Viet Nam's trade and industry derives its finance from the banking system and informal credit markets. According to the report, as foreign borrowing is not available and given the banking system's preference for lending to state-owned enterprises, the organized private sector must rely on small private shareholding banks that provide some term lending in the form of rolled-over short-term loans, or tap into the informal financial sector, which charges higher interest rates than the formal market. The private sector's resurgence has been sustained by entrepreneurial savings - together with the savings of their families and friends - and informal credit markets. The main components of the informal financial markets are (1) groups of money lenders, mainly in Ho Chi Minh City and (2) numerous rotating savings and credit associations or Hui Societies in the North and South. In the former, despite high interest rates, merchants prefer this facility for meeting working capital requirements. In the latter, no data exists as to the total volume of the savings/credit facility, but it is believed that almost all merchant and entrepreneurs participate routinely in Hui.

3-4. Experiences of Boosting Domestic Savings During the High Growth Period in Asian Countries

(1) Problems Facing Developing Economies

1) Shortfall of Savings

Asian experiences suggest that savings tend to lag behind investments during high-growth periods, particularly when growth is politically stimulated. For most of the high-performing economies in Asia, the investment ratio (gross capital formation/GDP) accounts for 30～35%, while the savings ratio (gross savings/ GDP) is around 30%, resulting in a negative I-S balance. As this deficit is equal to the international deficit, it has to be compensated by any means of international finance. Nevertheless, it is necessary for any nation to stimulate domestic savings in order to reduce international borrowings as much as possible.

2) Industrial Policy and Financial System

Economic growth is often promoted by economic and industrial policies in order to modernize some strategic sectors. However, these sectors may not necessarily match the economic structures and requirements of the nation. Consequently, such sectors may have to be given various concessions, including priority borrowings with lower interest rates. Of course, this type of credit forms a part of the policy package, and has to be extended through recognized financial institutions, either private or state-owned.

Hong Kong is probably the only successful exception in Asia. Hong Kong has been able to prosper economically without these industrial and financial policies. The tiny colony's prosperity is quite often attributable to its size, geographical advantage and minimal intervention by the government. However, is of little relevance to other independent nations. Furthermore, the government aimed at developing internationally competitive financial institutions, rather than considering the financial function as a mere intermediary for channeling savings through to investments.

3) "Informal" Financial Sector

The concessional system, once established, creates some distortions in the overall financial system. As the concessional lending rates are in general very low, interest rates on other loans tend to be raised beyond equilibrium. However, the "formal" sector is normally under strict control by the authorities, including the control of interest rates. Thus the "formal" sector tends to find it difficult to charge and offer even reasonable interest rates determined by market forces.

Consequently, the "informal" sector tends to grow as it offers very high interest rates to depositors, and channels the funds through to smaller corporations that are facing difficulties satisfying their financial needs through "formal" intermediaries. Thus, where a concessional credit system is established, a two-tier financial system tends to develop. The basic problem here is that the "informal" follows market principles, and gains some importance in the nation's financial system.

The "informal" sector takes varying forms. In some cases, rich people lend money to smaller enterprises. Another is a bit more organized, and several families contribute to form a fund which is lent out to the members or to third parties. While the "formal" financial institutions have not gained trust of the public, the latter tend to rely upon local community for informal finance.

4) Provision of Long-Term Credit

In developing economics, the availability of long-term credit is particularly limited.

A. Limited size of wealth creates its only highly liquid financial assets.

B. Permanent inflationary pressure creates uncertainty regarding long-term saving instruments, particularly when rates of return are fixed.

(2) Asian Experience

Asian authorities have tried to tackle these savings shortfall problems through various measures. We can categorize them roughly into two; (a) providing depositors with high, or at least reasonable returns, and (b) establishing institutions to promote small savings. The first category tries to promote savings by stimulating economic motives, while the second aims mainly to stimulate small savings by establishing convenient and locally reliable savings units. Table II-3-1 and Table II-3-2 show the methods for boosting domestic savings in Asian countries and their effectiveness.

Table II-3-1 Boosting Domestic Savings in Asian Countries

	Malaysia	Thailand	Philippines	Indonesia	China
① Savings institutions for small depositors					
Post office	D	D	D	D	B
Agricultural institution	D	BAAC (C)	Agricultural banks (C)	C	B
Others	Savings banks etc. (C)	GSB (B)	D	D	D
② Compulsory savings					
Life insurance, Pension	EPF (B)	C	GSIS, SSS (B)	B	Just established (C)
Others	D	D	D	D	D
③ Capital markets					
Equities	B	C	B	C	C
Bonds	C	C	C	C	B
Investment trusts	C	C	C	C	D
④ Economic incentives					
Interest rates	C	C	C	C	B
Taxes	C	C	C	C	Overall taxation just implemented

A : Very effective
B : Effective
C : Ineffective
D : Non-existent

Table II-3-2 Boosting Domestic Savings in Asian Countries

	Japan	Korea	Taiwan	Singapore
① Saving institutions for small depositors				
Post office	A	C	C	A
Agricultural institution	B	C	C	D
Others	Regional banks etc. (B)	National banks etc. (B)	Credit co-operatives etc. (B)	D
② Compulsory Savings				
Life Insurance,Pension	C	C	C	A
Others	D	D	D	D
③ Capital markets				
Equities	B	C	B	B
Bonds	C	B	C	B
Investment trusts	C	B	C	C
④ Economic incentives				
Interest rates	C	C	C	B
Taxes	C	C	C	B

A : Very effective
B : Effective
C : Ineffective
D : Non-existent

1) Providing Depositors with High Returns

An ideal way to promote savings is to leave everything to the market forces by a round of deregulation, including interest rates. By this method, interest rates automatically adjust to the changes in the financial and economic environment.

However, full liberalization may be difficult for developing countries who are trying to promote certain industrial sectors. This industrial policy creates some distortion in the financial market, and tends to create an "informal" market where much higher rates are offered than by the "formal" intermediaries. Where this type of market exists, deregulation within the "formal" sector only produces a shift of savings within the "formal" institutions.

In addition to this, the "informal" financial sector tends to grow not only because of economic motives, but also because they offer convenience and reliability to depositors. In an economy where the level of absolute income stays low, relatively higher priority is given to factors such as liquidity and reliability. Under such fundamental conditions, depositors tend to prefer "informal" savings groups which normally consist of local community members.

Asian experiences suggest that an important breakthrough in financial deregulation only takes place when the economy reaches a certain stage. At least two conditions have to be met in this respect. (1) The "informal" sector is successfully attacked and its importance is at least substantially reduced. (2) Inflation, or the expectation of inflation, is substantially reduced, and the reluctance to save is reduced. Actually, in Japan and other Asian nations, financial deregulation only started in the second half of 1980s.

In many nations, certain types of deposits can enjoy tax incentives (reduction or elimination). However, this method may only produce a shift within the "formal" sector, and may have little impact on savings promotion or combating the "informal" sector.

Financial deregulation is difficult to adopt in developing countries, and China has tried to stimulate savings by different methods with other nations. First, the government allowed banks to add some lottery factors to deposits. A depositor who wins the lottery is awarded money or luxury goods such as a house or a car, in addition to the normal interest. This is an incentive which only a limited number of lucky depositors can enjoy, while the second incentive is equally distributed among all depositors. The second method is a compensation of interest rates on long-term deposits and bonds when real interest rates are negative. Whenever such a situation arises, the central bank follows a set formula to calculate the compensation rates and publishes them.

This unique experience in China is considered to have had an impact on savings promotion. However, this may be somewhat effective because the "informal" sector is considered to be minimal. Further consideration has to be given to the irregular pattern of interest rate determination. This is, in theory, a very dangerous pattern for the economy, as this compensation system is not applied to bank lending and the balance between the compensated deposit rate and the lending rate places a burden on the government budget. Another risk of this system is that returns are not determined until maturity. This creates some distortion in the bond market, and adversely affects the development of capital markets. All in all, this system, is not a desirable one, and specific aspects should be adopted for only the short term and on a limited scale.

2) Establishment of Institutions to Promote Small Savings

As was discussed above, convenience and reliability of savings are the other determinants of savings. Almost all Asian nations have established some form of institution to mainly promote small savings.

A. Postal Savings System

Both in Japan and Singapore, where the agricultural populations are small, the postal savings system provides the local community with a very convenient and reliable savings vehicle. Japan's post office network is probably the largest single savings institution in the world, with about 200 trillion yen (about 2 trillion USD) of total assets, and Singapore's counterpart is a very important savings institution domestically compared with the size of the economy.

The funds deposited with the post-office network are centrally managed for investment and lending. In Singapore, the Post Office Savings Bank (POSB) has been one of the stable investors in government bond, and in Japan the funds form part of the special budget (Scheme for Fiscal Investment and Lending) and are invested and lent to semi-governmental financial organizations. There are several factors for the success of this system. The main point is that the convenience is provided by the nation-wide network. Also, the nature of the government-run business helps create trustworthiness of the system. In the case of Japan, this is enhanced by the fact that the "designated post office" system is run by influential and prestigious persons.

In other countries, similar types of saving institutions have been developed, namely national savings banks, etc.

B. Agricultural Savings System

Where a bulk of the population resides in agricultural areas, and population density is quite low, the above system may not be efficient, but some form of local agricultural savings unit could be formed. In Japan and several other countries, agricultural co-operatives are given this financial function, whereas specialized savings units are created in other countries, like agricultural trust groups in China.

Agricultural co-operatives were originally created for the purpose of developing efficiency and modernization through collective purchases, sales and investment in machinery. Thus the co-operatives have played a vital role in the local community. Naturally, the addition of a deposit-taking function to these organizations could help promote agricultural savings.

In essence, the postal savings system and agricultural savings system play the same role in promoting small savings. Roughly speaking, the former is supposed to be effective in the cities and the latter in agricultural areas.

There have been other factors behind the success of these organizations. Convenience is created by large numbers of small local units. This situation tends to lead to inefficient operation, however, this disadvantage was tackled by a number of methods. In the case of Japan and several other nations, some other existing organizations, such as the post-office network and agricultural co-operatives, have been utilized. The characteristics of multi-function units have helped make operations more efficient.

Japan's and Singapore's success have particularly proved the importance of the formation of a national network, and the establishment of a specialized central organization. If each unit operates as an independent financial intermediary without a national network and a central organization, they have to equip themselves with a full-set of intermediary functions. They have to identify borrowers (probably small), and also set up their own loan assessment department, etc. On the other hand, they can confine themselves to specialized deposit-taking units, leaving the other functions to the central organization, with a national network and a central organization. Thus, the network can operate more efficiently as a single nationwide financial intermediary.

C. Compulsory Savings System

The benchmark example of this system is the CPF (Central Provident Fund) of Singapore. This is, essentially, a compulsory retirement pension scheme to which each employee and employer are obliged to contribute at predetermined rates. Each employee is allowed to make withdrawals on limited occasions, such as for retirement, or severe handicap, or for purchasing a house, or investing in designated stocks. These limitations on withdrawals have given the savings a very illiquid nature, and the fund itself can be managed, consequently, as long-term investment assets.

There are some conditions to successfully run this type of compulsory savings system. First of all, it has to be operated as a governmental, or at least quasi-governmental organization, under the control of specific law. Second, the bulk of the population has to work for corporations, rather than as independent farmers.

Actually, CPF has functioned much better than its Malaysian counterpart, the EPF (Employees Provident Fund). But ven in the cases of other developing nations with larger chunks of agricultural population, similar organizations can be introduced in order to utilize all the possible saving resources.

A variation of the compulsory savings scheme is provided by the experience of China. The government allocated government bonds to its employees, by substituting a part of their monthly payment with bonds. Thus the employees had no option but to accept them. This method is compulsory saving, and is a very easy way to attract private savings. However, one disadvantage of this methods is that private investors may barely realize a profit arising from holding the bonds. As small investors, they tend to feel that absolute returns are small. A number of private investors may have lost the bonds, and cannot recover the investment. Furthermore, the bonds are illiquid and cannot satisfy the urgent financial necessities of the investors as a secondary market is virtually non-existent. Thus some investment advantages may be lost.

D. Capital Markets

The establishment of a national stock exchange, or regional stock exchange, is advisable as it helps with the privatization of government-owned enterprises. This is advisable even if the limited wealth leads to inactive trading in the exchange. The importance of the market may be limited in an economy during the initial stages. However, this does not necessarily mean that bonds, in general, are not important in these countries. Instead, for example, Singapore owes much to government bonds for financing its budget deficit. This is because the bonds are underwritten and held mostly to maturity by giant institutions like CPF, the POSB, the commercial banks, etc., not directly by private investors. Even so, the trading market is required to allow these institutions to liquidate a portion of their holdings in order to satisfy sudden financial needs.

In this regard, Korea may be able to provide a good example in an effort to develop capital markets. The government enacted the "Securities Investment Trust Act" in 1969, which allowed a collective investment scheme to be introduced in the Korean stock market. The Korea Investment Corporation first introduced an equities type investment trust in 1970. For several years in the initial stages, all the schemes were of the equities type. Another investment trust company, jointly created by the securities companies introduced a bond type scheme in 1974. Since then, the bond-type schemes have grown rapidly, and have become far more important than the equities type. The establishment and rapid growth of the bond type investment have contributed substantially to the development of the corporate bond market, and to financing the budget deficit.

3-5. Methods for Domestic Savings Mobilization

First, we must mention that several suggestions follow but because of restrictions of time and data these suggestions serve merely to show the basic idea and direction of domestic savings mobilization. We could look at neither the details of major matters nor the feasibility of suggestions.

(1) Toward Growth without High Inflation

Growth without high inflation is the biggest challenge to achieve in the future five-year plan for socio-economic development and investment in Viet Nam. A crucial issue is how to expand the domestic banking system. First, in order to grow, money supply should exceed money demand. Second, a system in which the central bank can influence the money supply should be established.

There has been a big gap in Viet Nam. People are inclined to keep gold rather than bank deposits and the dollar is used as well as the dong. As the percentage of Vietnamese with bank deposits is low, the portion of money supply determinants that the central bank cannot control is large. Here, two problems exist. One problem is that the money cannot be used for growth. The other problem is that credit creation to support the growth is small.

In the past, the general public experienced high inflation. When they made deposits, they were often asked where they got the money. Interest rates for bank deposits were not always higher than other means. These explain why savings are low. Next let us examine bank use by merchants. Interest rates on loans are high and collateral is also required. It is not easy for merchants to borrow money from banks. Borrowing and payment transactions have been traditionally made in cash. Notes and checks are not used.

In addition to that, the interest policy of banks is far from a market mechanism. In a sense, it is patchwork and therefore unlikely to achieve the desired effect. For example, when interest rates rise, bank clients do not want to borrow money from banks due to high interest and collateral requirements. When interest rates go down, there are substitutes for bank deposits such as gold and private finance. So the dilemma exists that if interest rates are maintained high, money will be left in banks and if interest rates are maintained low, money will be withdrawn. Money cannot flow easily from depositors to borrowers.

The central bank's function is not strong enough. The central bank cannot sufficiently control the amount of money through banks because there are no effective measures like a money market. The market rate itself seems to be determined rather arbitrarily.

Finally the most important thing for future high growth and a healthy financial system is to stabilize the Vietnamese economy.

(2) Strengthening of Commercial Banks

1) Improvement of Bank Services

In order to overcome the current situation and to achieve growth without high inflation, several measures for banks need to be adopted. First, banks themselves should establish a structure in which they can restore customer confidence and build client bases. For that purpose, they need to improve bank services and establish a system in which money can easily flow from depositors to borrowers.

When customers open a new account at a bank, it must be approved and then the depositor is issued a bankbook. In this process banks need not check the sources of the deposits. Banks must issue bankbooks properly. Depositors should be able to withdraw money easily and quickly. To that end, banks must develop their operations, procedural manuals for dealing with customers and construct a computer-based system for customer services.

Banks should provide their customers with savings incentives in the form of new financial products such as deposits linked to the inflation index, long-term deposits with large prizes, and housing deposits.

Tax incentives such as tax reduction should be considered to encourage people to make deposits. For the time being, interest should not be taxed. If there is withholding tax on interest on deposits and bonds there should be an exemption up to at least a certain amount of deposits and bonds.

Promotion measures for bank use should be introduced. Salary payments to employees of state-owned enterprises should be forcibly changed from cash delivery to bank transfers.

As further promotion measures for bank use, commercial notes and discounting of the notes by banks should also be introduced. It is very important to establish a banking system in which merchants can easily exchange the notes that they receive from other merchants for cash.

Training bank employees is also important in order to improve the quality of their service.

In order to improve international financial skills, financial institutions should learn through international co-operation or co-operation with foreign banks.

It is also important to standardize the structure of bank loans and to educate employees. In addition to collateral, the borrowers themselves should be considered when making loans. The evaluation methods used in the United States and other countries may not be adequate, because data for the evaluation is not always correct or available. It is better to learn the evaluation methods from Japan's local banks that mainly operate in local regions and have a close relationship with the local economy.

It is important to solve the collateral problem. Laws and regulations should be changed to ensure fair treatment and use of collateral. A market for buying and selling land-use rights should also be considered. Furthermore, inventory should be used as collateral.

On the other hand, money flow into deposit substitutes should be closed. Drastic measures such as a moratorium on private debt should be considered. Or as a penalty a high profit tax rate could be applied to private financing.

2) Development of a Savings Promotion Campaign

The government should encourage people to make bank deposits and develop a savings campaign with a slogan promoting future growth and development of Viet Nam.

In order to encourage national deposits, the government needs to give the general public some guarantee. The government should declare that the sources of national deposits will not be checked, pursued or confiscated by public safety officers if the deposit is made within a certain term, for example two years. If stashed money is found after two years, it will be taxed. Some kind of award should be given to those who make large national deposit.

3) Making Banks Sounder

One of the keys is to make banks much sounder. As we mentioned earlier, banks especially state-owned commercial banks in Viet Nam seem to have irrecoverable loans and the amounts in reality seem to be accumulating. Experiences in China are helpful to Viet Nam. In China a large number of state-owned enterprises operate in the red and bank loans to these enterprises become bad loans. Since banks do not have enough strength to write off the bad loan, they face money shortages and financial crises. As a result, banks will not be able to realize profits and pay taxes to the government.

Bad loans should be disposed of as soon as possible. For example, bad loans should be released from banks and placed in a special government account. Since the government cannot afford to pay off the loans immediately, the issuance of a government bond with a ten-year maturity should be considered. Discount sales of bank loans including bad loans in bulk to foreigners should also be considered.

The existence of bad loans will also make bank finance in the international capital markets more difficult. Banks are given lower credit ratings if they have bad loans, and the finance cost of bond issuance rises. So in some circumstances, banks cannot always raise the required funds.

(3) Introduction of Institutions to Promote Small Savings

1) Systematization of Informal Finance

In parallel with the above measures, several institutional banking structures should be designed and implemented by pilot projects.

One example is to set up many merchant only credit unions with a centralized bank to absorb surplus money (Table II-3-3). The major function of the credit union is to provide mutual financing for union members only. The objective is to try to get private mutual financing among merchants who cannot borrow money from commercial banks into the public financial system. If a merchant does not participate, then he cannot get the advantages of: borrowing working capital, free exchange of notes into cash, tax incentives and some assistance by the government. The tax rate applied to the credit unions should be low.

At first, merchants must invest money in order to set up a credit union. The credit union hires its employees and places a noted person of the region in the position of director. When merchants need money such as working capital, the credit union lends money to those merchants who have more than a certain amount of deposit outstanding. Merchants can feel assured, because they know the members who borrow the money from the credit union very well. When there is excessive money, it is transferred to the central organization and is invested by financial professionals. The central organization should be controlled by the State bank.

The other function of the credit union is to accept deposits from its members. Collection of deposits is made face to face. That is, employees of the credit union go to the merchants, make friends with them and collect small amounts of money every month.

In addition to that, a new type of installment savings should be introduced so that installment deposits with a small amount of money in the long term can provide benefits to depositors. Even small amounts of money bear some interest because it is collected and put into deposits. Unless the money is used for deposits, it will sleep as cash or be spent. When merchants continue to put small amounts of money into monthly deposits over the long term (for example five years), they can also obtain educational loans for their children at low interest rates from the credit union. The important points are to provide attractive incentives for those who make long-term deposits and to make depositing easy for monthly savings and installment savings.

2) Introduction of a Postal Savings System

From the point of providing medium- and long-term funds, the introduction of a postal savings system should be considered.

Postal savings have been introduced in several countries in Asia and play a major role. Due to the convenience provided by a nationwide network that banks cannot cover as well as the nature of government-run business, the postal savings system is successful in collecting small sums of money from the general public. The deposits collected through the network of post offices are centrally managed for investment and lending. In Singapore, POSB has been a stable investors in the government bond. In Japan, the deposits form part of a special budget (Scheme for Fiscal Investment and Lending) and are invested and lent to semi-governmental financial organizations. The success of Japan and Singapore have particularly proved the importance of a formation of a national network, and establishment of specialized central organization.

In Viet Nam, the general public in both rural and urban areas does not have convenient access to banks. The postal savings system should be considered as a method for expanding a new network for fund mobilization and a tool for providing medium- and long-term funds (Table II-3-4).

Table II-3-3 Concept of Institution to Promote Small Savings

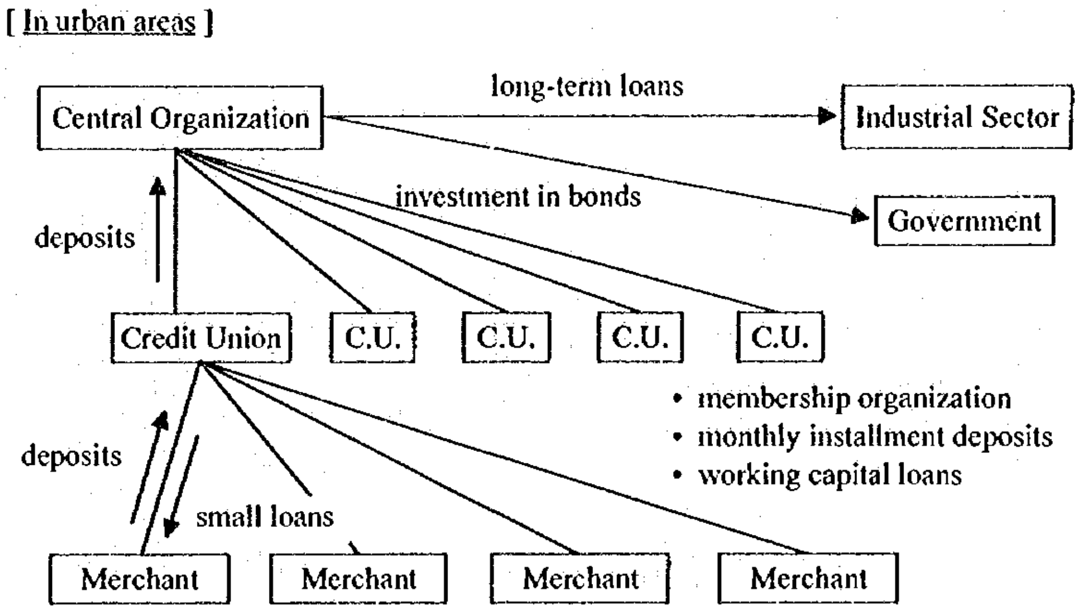
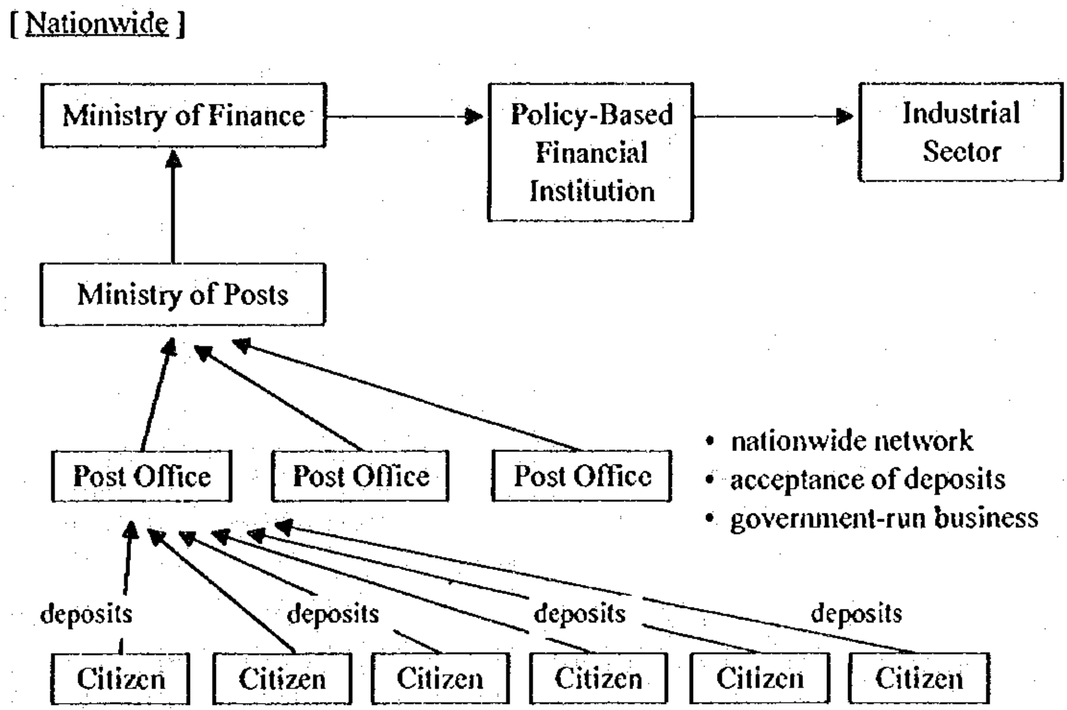


Table II-3-4 Concept of Postal Saving System



3) Effective Use of a Pension Fund

Pension funds are a compulsory savings system and an effective measure to provide medium-and long-term funds. The typical example is CPF of Singapore. As already mentioned, this is essentially a compulsory retirement pension scheme to which each employee and employer are obliged to contribute at pre-determined rates. Each employee is allowed to make withdrawals on limited occasions such as retirement, severe handicap, the purchase of a house, or investment in designated stocks. These limitations on withdrawals have given the savings a very illiquid nature, and the funds themselves can consequently be managed, as long-term investment assets.

In Viet Nam the Social Insurance Fund was established in 1995. Contributions to the fund are 15% from the employer and 5% from the employee for a total at 20% of salary. Although at present, the scale of the fund is very small, it will grow in the long term with the proportional increase of young people the population. The fund should be used effectively like the CPF.

(4) Strengthening the Financial System

1) Development of the Money Market

In order to control inflation, the central bank needs to implement measures to control the money supply. As a new tool of monetary policy, a short-term money market such as a treasury bill market should be developed as soon as possible.

2) Interest Rate Policy

Basically the interest rate policy should be to maintain low interest rates. Low interest rates enable banks to provide low-cost money to clients and thereby bring profits to both banks and clients. Such a mechanism should be established. The premise is to contain inflation. If inflation is restrained within a certain level, people will not complain about low interest rates.

As regards lending, several policy-oriented interest rates should be applied. It is better to classify lending by priority, provide interest incentive, and set up several lending rates. However, deposit interest rates should be low.

3) Response to Holding of Gold

Gold is hoarded under pillows. Mechanisms for getting gold into the money markets should be examined. If the situation is left as it is, gold will remain hoarded. The premise for that is to contain inflation. The incentive to hoard gold should be reduced by for example, taxing the buying and selling of gold or by providing deposits linked to the gold price that have the same effect as holding gold.

4) Development of Securities Markets

So far, the scale of securities markets is small and there is no secondary market. But, bonds and stocks, in addition to deposits will be major sources for domestic savings mobilization in the near future. They are especially effective in financing medium- to long-term capital.

In order to raise money by issuing medium- and long-term bonds, it is necessary for a secondary bond market to be established. If bonds are issued without the existence of a secondary market, nobody will be willing to buy them because there will be no way to exchange them for cash before maturity. A bond market should be established as soon as possible. It is better to start with a pilot project.

As we mentioned before, the creation of a national stock exchange, or regional stock exchange, is advisable. The importance of the market may be limited in an economy during the initial stages, but, because it helps with the privatization of state-owned enterprises. It is advisable even if the limited wealth results in inactive trading on the exchange.

However, the concept of stocks and stock company are not understood very well. Stocks are not popular in Viet Nam. It is first important to disseminate information about stocks to the general public. In parallel with this, the preparation for the establishment of a stock market should be accelerated with the assistance of foreign countries including Japan.

(5) Education

The importance of a financial system under a market economy and the role of deposits should be taught in schools.

The meaning of stock and the role of securities markets in raising mainly medium- and long-term funds and at the same time providing the general public with a variety of savings means should be taught in schools.

High schools should teach accounting.

Appendix II-3-1 Structure of the Financial System (December, 1994)

Institutions	Assets	Number	Branches	Capital & Reserves
State Bank of Vietnam	43.7 trillion VND		53 provincial	500 billion VND
Commercial Banks	48.4 trillion VND			Minimum capital each bank 20 billion VND
1. State-owned banks	43.3 trillion VND			2,114 billion VND
				Actual capital & reserves
Foreign Trade Bank	16.1 trillion VND		14 provincial	485 billion VND
Agricultural Bank	9.6 trillion VND		56 provincial 500 district	597 billion VND
Bank of Investment and Development	7.6 trillion VND		53 provincial 41 district	658 billion VND
Bank of Industry and Commerce	10.1 trillion VND		50 provincial 37 district	374 billion VND
2. Other reporting banks	5.1 trillion VND	16		673 billion VND
a. Joint-stock banks Urban		30		Minimum capital 20 billion VND 50 billion VND for banks in Hanoi 70 billion VND for banks in HCMC
Rural		16		1 billion VND,(w/o) branches 3 billion VND,(with branches)
b. Joint-venture banks		3		US$ 10 million
c. Foreign bank branches (licensed, 9 operating)		13		US$ 15 million
3. Credit cooperatives		69		300 million VND
4. People's Credit Funds (licensed)		153		
5. Finance companies		2		10 billion VND
6. Insurance companies		1		

Source: World Bank, Viet Nam Financial Sector Review (March, 1995)

Appendix II-3-2 Deposit Data of Monetary Deposit Banks

(billions of VND)

	1991			1992			1993			1994 (Sept.)		
	State Bks	Others	Total	State Bks	Others	Total	State Bks	Others	Total	State Bks	Others	Total
Total deposits	12,667	906	13,573	14,658	1,647	16,305	15,932	2,064	17,996	18,161	2,950	21,111
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Dong deposits	4,942	277	5,219	7,435	657	8,092	9,645	945	10,590	11,062	1,455	12,517
	39.0%	30.6%	38.5%	50.7%	39.9%	49.6%	60.5%	45.8%	58.8%	60.9%	49.3%	59.3%
Foreign currency deposits	7,725	629	8,354	7,223	990	8,213	6,287	1,119	7,406	7,099	1,495	8,594
	61.0%	69.4%	61.5%	49.3%	60.1%	50.4%	39.5%	54.2%	41.2%	39.1%	50.7%	40.7%

Source: World Bank, Viet Nam Financial Sector Review (March,1995)

Appendix II-3-3 Credit Data of Monetary Deposit Banks

(billions of VND, %)

	1991		1992		1993		1994(Sept.)	
Total	10,051	100.0%	15,093	100.0%	23,180	100.0%	27,621	100.0%
Lender								
Agri Bank	2,850	28.4%	4,000	26.5%	6,127	26.4%	7,090	25.7%
BIDB	1,430	14.2%	2,060	13.6%	3,725	16.1%	4,686	17.0%
Incom Bank	3,032	30.2%	4,190	27.8%	6,189	26.7%	6,746	24.4%
Vietcom Bank	2,192	21.8%	3,619	24.0%	4,976	21.5%	6,175	22.4%
(SOCBs)	(9,504)	(94.6%)	(13,869)	(91.9%)	(21,017)	(90.7%)	(24,697)	(89.4%)
Others	547	5.4%	1,224	8.1%	2,163	9.3%	2,924	10.6%
Borrower								
State enterprises	9,049	90.0%	12,350	81.8%	15,511	66.9%	17,404	63.0%
Private sector	487	4.8%	2,120	14.0%	6,285	27.1%	7,829	28.3%
Other sectors	515	5.1%	623	4.1%	1,384	6.0%	2,388	8.6%
Term of credit								
Short-term credit	8,498	84.5%	12,563	83.2%	17,450	75.3%	19,902	72.1%
Long-term credit	1,553	15.5%	2,530	16.8%	5,730	24.7%	7,719	27.9%

Source: World Bank, Viet Nam Financial Sector Review (March,1995)

Appendix II-3-4 Credit Data 2 of Monetary Deposit Banks

	1991						1992					
	Agri-B	BIDB	Incom	Vietcom	Others	Total	Agri-B	BIDB	Incom	Vietcom	Others	Total
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
State enterprises	77.9	98.8	92.2	96.6	91.8	90.0	55.9	98.7	85.9	97.6	77.5	81.8
Private sector	12.5	0.3	3.4	0.0	4.6	4.8	36.3	0.7	9.7	0.1	20.0	14.0
Other sectors	9.7	0.8	4.4	3.4	3.7	5.1	7.8	0.6	4.3	2.3	2.5	4.1
Short-term credit	95.3	25.9	95.9	89.9	97.6	84.5	94.7	23.3	93.4	88.0	97.9	83.2
Long-term credit	4.7	74.1	4.1	10.1	2.4	15.5	5.3	76.7	6.6	12.0	2.1	16.8
(Foreign currency)	0.4	0.0	1.4	67.8	59.8	18.6	0.9	0.4	7.9	80.3	56.9	26.3

	1993						1994 (Sept.)					
	Agri-B	BIDB	Incom	Vietcom	Others	Total	Agri-B	BIDB	Incom	Vietcom	Others	Total
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
State enterprises	31.8	97.3	66.9	93.8	52.2	66.9	27.9	95.6	61.5	89.6	43.2	63.0
Private sector	64.0	2.0	26.1	1.9	26.6	27.1	66.6	3.1	28.2	3.0	29.9	28.3
Other sectors	4.1	0.7	7.0	4.4	21.1	6.0	5.5	1.3	10.3	7.4	26.9	8.6
Short-term credit	83.5	23.4	87.6	80.5	94.0	75.3	78.2	25.7	87.0	74.7	91.5	72.1
Long-term credit	16.5	76.6	12.4	19.5	6.0	24.7	21.8	74.3	13.0	25.3	8.5	27.9
(Foreign currency)	10.6	22.4	15.2	77.9	51.5	32.0	15.9	39.0	11.8	73.1	49.3	35.1

Source: World Bank, Viet Nam Financial Sector Review (March, 1995)

Chapter 4. Foreign Savings Mobilization

4-1. Characteristics of Available Foreign Savings

The external long-term sources available to Viet Nam are mainly as follows. Different sources have different characteristics in respect to terms, conditions and eligible projects (see Appendix 1).

(1) Sources

1) Loans

A. Funds from multilateral sources (The World Bank, ADB, IFC etc.)

B. Funds from bilateral sources (OECF etc.)

C. Export credit for exporters to Viet Nam (J-EXIM)

D. Commercial loans

These funds are major external funds in terms of volume. Except for commercial loans and export credit, which have ceilings, they are quite reliable in respect to volume of financing for the long term. OECF committed about $500 million to Viet Nam with a concessional interest rate. ADB has committed $1.5 billion over the next four years.

2) Grant

A. Funds from multilateral sources (UN related agencies etc.)

B. Funds from bilateral sources (Japan, France, Sweden, other European countries.)

C. NGO

These funds are normally provided for building intangible asset types of projects (human resource development) and/or for smaller projects for equipment and facility installation.

In Viet Nam, grants have so far made a remarkable contribution although the number of individual projects is rather small.

The volume has recently surged from USD257.9 million in 1992 to USD405.2 million in 1994. The number of the donors reaches over 30 including a UN-related organization.

3) Risk Insurance

The World Bank offers partial risk guarantees as well as partial credit guarantees. It is also available for limited resource financing such as BOT type projects. The Multilateral Investment Guarantee Agency (MIGA) is also a political risk insurance provider for commercial bank financing. It is open to Viet Nam but has not been utilized yet.

It will require government counter-guarantees for dong convertibility covering. The guaranteed amount for an individual project is limited to $50 million.

4) FDI

This is on a totally commercial basis, and the amount of inflow depends on the recipient government's favorable treatment and / or economic advantage such as cheap costs and market potential (Further discussion will be made below).

5) External Bond Issue

The sources of funds for economic development are diversifying significantly in Asian nations. The portion of external bond issuance, however, is still small. Bank loans are declining while FDI and bonds are increasing. One of the plausible reason for that can be found in FDI. According to interviews with foreign bankers in Hong Kong as well as in Viet Nam, they would rather lend to parent companies of investors than to less credible JVs in FDI recipient countries.

In addition, commercial banks have recently taken sovereign risk more seriously than before. For this reason, bond issuance may be preferred by borrowers, who do not need to access the risk sensitive commercial banks.

Table II-4-1 Capital Flows in the Asian Region

(in billion USD)

Category Year/Item	*90*	*91*	*92*	*93*	*94*
Long-term net capital inflow (1)	*39.4*	*45.9*	*59.9*	*85.7*	*109.3*
ODA	16.3	17.4	15.3	16.9	16.3
FDI	11.6	14.4	21.5	37.3	43.6
Portfolio Sec.	2.4	1.1	5.5	20.1	25.3
Bank loans	6.3	6.2	8.3	-0.3	n.a.
Bonds	0.7	5	2.7	8.7	n.a.
Others	2.1	1.8	6.6	3	n.a.
Short-term inflow	8.8	12	8.6	11.9	10.9
Non-debt/(1)	35.5%	33.7%	45.1%	67.1%	63.0%
Private capital/(1)	58.6%	62.2%	74.4%	80.3%	85.0%

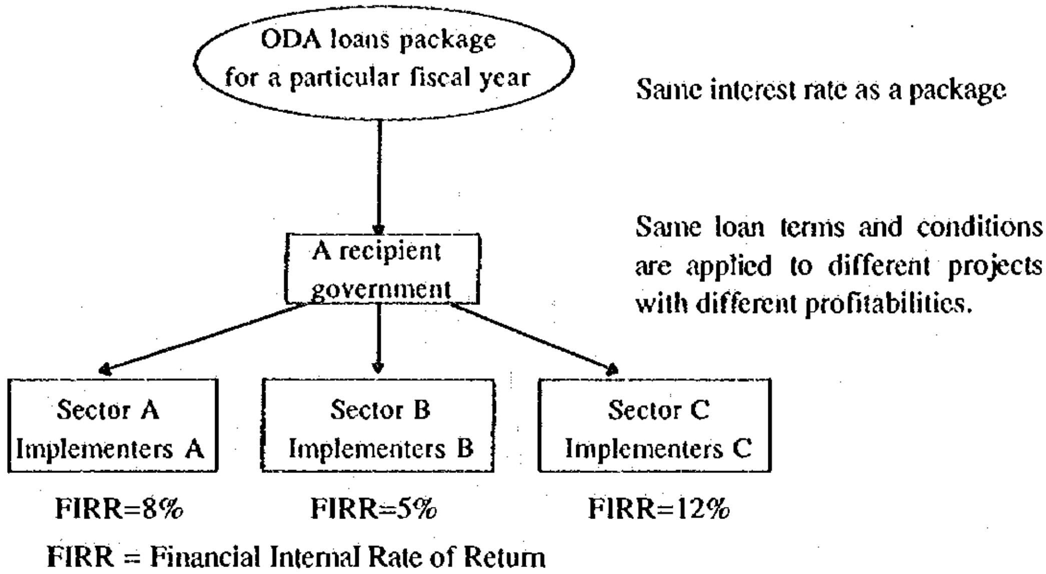
Note: Asian region includes East and South Asia and Oceania.

Source: ADB, *Asian Development Outlook in 1995 and 1996 and Others*

(2) Pros and Cons of the External Sources

ODA is a stable source. The only con is that the interest rates are fixed depending on the foreign policy of donors and not based on the profitability and nature of the specific project for which the source is used. This is particularly true in the case of bilateral ODA lending. Due to this the same interest rate and the same repayment terms are applied to, for example, thermal power projects and irrigation projects, which have different and unique profitability (See the figure shown below and Table II-4-2).

Figure II-4-1: Example of Interest Rate Application in the Case of Package ODA Loans



In addition, the important point is how to implement ODA projects, in many recipient countries as in Viet Nam, disbursement (actual injection of funds) is delayed due to several typical reasons such as a shortage of budgeting for the local cost portion, immature skill of different sources and frequent changes in project specification .

FDI is a good source for the host countries since it is not accompanied with a future burden of repayment. The risk is mostly born by the foreign investors. However, the annual inflows of FDI fluctuate significantly, sometimes dramatically (see Appendix 2).

Previous experience shows that FDI flees relatively easily from one country to another once more favorable conditions are offered.

4-2. Constraints of Foreign Savings Mobilization

(1) Unsettled Debt Negotiation and External Pressure

1) Unsettled External Debt Negotiation

Debt negotiations with some of the external creditors shown below have not been settled. The foreign financial sources, particularly commercial lenders are limited due to the situation.

A. The non-transferable ruble debt to Russia and Eastern Europe

B. The debt to non-Paris club countries (Middle East etc.)

C. Commercial debt to Japanese financial institutions etc. (London Club)

2) IMF Recommendation

The IMF recommended that the Vietnamese government set an external commercial credit ceiling of $ 350 million in autumn 1995. The domestic commercial bank debt in the form of letters of credit used for international trading (L /C), however, is rather difficult to control. Some commercial L/C for external trades are not settled before their expiration. In this connection, It is better for the monetary authorities to have a more conservative attitude toward external debt outstanding.

3) World Bank's Recommendation

Eurobond issuance of $ 100-150 million should be postponed until London club negotiation is settled. According to the Vietnamese experts, the estimated interest rate on the bond is as high as around 11%, quite an expensive fund for the current Vietnamese economy.

(See Appendices 3 and 4 as related tables for this section.)

(2) Macroeconomic Issues Related to Foreign Savings Mobilization

1) Twin Deficits and Foreign Exchange

A. Trade deficit and opinions for the dong devaluation

Recently the trade deficit has increased. In spite of that, the Vietnamese government views on foreign exchange rate management seem quite diversified. There seem to be various opinions for bringing down the Vietnamese dong's value vis-à-vis the US dollar to accelerate export and eliminate the trade deficit while there are other experts in opposition to that, worrying about future inflation and an increased burden of foreign debt.

As will be elaborated on later, devaluation of the local currency does not have medium-to long-term effectiveness in terms of export-acceleration. On the contrary, a negative effect, larger debt in terms of foreign exchange will definitely remain for repayment of foreign debt. In the process of economic development, local currency (if it is not hard currency) can be devaluated relatively easily because the developing country generally faces economic difficulties. Appreciation of currency, however, is very difficult once the devaluation has taken place.

B. State budget deficit

If we consider the state budget including investment, it falls short of the necessary amount. Future state revenue is unclear since the tax system is in the transition stage. The government (Ministry of Finance and state-owned enterprises) or state banks (including four state commercial banks), however, continue to play as 'the borrower' or 'guarantor' of ODA borrowing and external debt in many cases since the external lenders seek 'sovereign' risk to secure future pay-back.

In the case of commercial borrowing including external bonds, if there is no improvement, this kind of budgetary condition may undermine the credibility of the government, resulting in expensive financial costs.

2) GDP, Inflation and Circumstance Around Foreign Funds

Economic figures have recently been becoming good. Gross domestic product growth in 1995 was 9.5 % and inflation appears to have been under control at 12.7 % .This is in a generally good direction toward future economic development. To keep it on the right track, the importance of FDI without debt burden is becoming larger.

3) Inflow of Foreign Exchange

Foreign exchange mainly comes to Viet Nam as follows:

A. Remittance from overseas Vietnamese and foreign companies

B. Travelers' money for expenses in Viet Nam

C. Settlement for export

D. Direct investment from abroad and external borrowings

Since the inflows are, so far, continuously increasing due to increases in FDI and travelers, it seems that a huge amount of foreign exchange circulates in cities. People tend to keep foreign exchange under their pillows due to the low credibility of financial institutions. In addition, the central bank (the State Bank of Viet Nam) can mandate that state-owned enterprises receive in VND but cannot force this on other business entities and individuals. Therefore, foreign exchange is widely distributed as a means of exchange which makes it difficult for the central bank to control money supply.

(3) Circumstance Around External Donors

1) Major Donors' Budget Constraint

Because of donor budgetary constraints and an enlarged eligible area for ODA, future ODA for respective recipient countries will be very uncertain and limited. This is quite commonly understood by donor countries

2) Diversified and complicated procedures

Because of rapid changes in financial and information technology on the donor side, the availability of various external fund sources, might lead to inefficient implementation by the recipient side. This is another constraint on foreign savings mobilization. Even if enough commitment is available, implementation of the funding may not go smoothly due to highly diversified and sophisticated (complicated) procedures of the recent ODA scheme.

(4) FDI - Acceleration and Bottleneck-

1) The General Picture of FDI

The accumulated FDI in Viet Nam is becoming larger and larger on a disbursement basis as well as on a commitment basis. However, more and more potential investors are reneging and the gap between commitment and disbursement has been expanding. The government should be more concerned about the disbursement ratio (Appendix 2).

There are many countries which have newly opened their economies to the world and have tried to adopt market-oriented economic systems. Viet Nam with its advantage in costs seems to be succeeding in inducing FDI, particularly through lower labor related costs and the government's preferential treatment of foreign investment.

Rivalry among Asian countries (Viet Nam, the Philippines, Burma, Coastal China, India etc.) has already become keen since many have newly opened or re-opened their doors to foreign investors by offering favorable treatment. The foreign investors, particularly cost-conscious manufacturers, tend to shop around countries seeking lower manufacturing costs. Viet Nam has a competitive edge in a cheap and talented labor force. However, cheap labor is just a part of the whole attractive feature. The policies of neighboring nations also affect future Vietnamese FDI inducements.

2) Difficulties of BOT Projects

BOT investment is another form of FDI, and it especially contributes to infrastructure development in projects such as highways, thermal power plants, ports. A typical dispute concerning the introduction of BOT is whether or not the host government guarantees a return on investment for the foreign investors until the assets are turned over to the host government.

An executive of one of the largest group companies in Hong Kong, which is very famous for BOT investment in South China and ASEAN countries, pointed out the following critical points which should be secured by host governments.

A. Guarantee of Return on Investment over the contract period
B. Exchange of a part of profit to hard currency and transfer abroad, which is mostly used by investors to repay commercial banks
C. Clarification of law concerning the ownership of tangible and intangible assets
D. Stable policy in controlling foreign exchange rates with local currency
E. Commitment on avoiding hyper inflation in economic policy management
F. No critical change of project scope or specification affecting investors financial long-term funding

4-3. Foreign Debt Policy

(1) The Current Government Foreign Debt Policy

The foreign debt policy of the government can be summarized as follows:

1) The past settlement

Write off the old foreign debt (target write-off rate is 50%)

Accordingly, the ODA debt relating to the Paris Club was written off by 50% on a net present value basis in 1994.

2) Dutch disease and external debt- easy reliance on oil

ODA funds with concessional interest rates should come first in priority. Minimization of commercial borrowing is emphasized for the time being because heavy reliance on commercial loans is risky since they are unstable in terms of world economy fluctuations. However, some specialists in Viet Nam have very rosy prospects about future oil export revenue as a fund source for repayment of foreign debt.

This dependence on oil is a risky attitude toward external debt which is historically found in other heavy debtors like Latin-American countries.

3) Opinions on foreign bond issuance

In addition, while there are some opinions favoring external bond issuance we also recognize strong opposition to the measure. In our opinion the measure should come after inducing ODA and FDI, and after settlement of London Club negotiation, in that order. In the medium or long term, however, it makes sense that the Vietnamese government pursues bond issuing in foreign markets such as in Eurobonds. This action can diversify and secure foreign sources of funds like those of other ASEAN countries.

(2) Overseas Historical Lessons

1) Basic policy on foreign borrowings

Foreign borrowings should basically be used for asset-building, that is, investment in social and industrial infrastructure. This helps the recipient countries get on a right track for long-term economic development and to generate funds for future repayment.

2) Looking back at history

Historically speaking, however foreign savings mobilization does not always lead to an investment increase in asset-building. It sometimes only increases the consumption portion of the balance of payments.

(3) Latin-America's Case

From the late 1970s to the early 1980s, Latin-American countries such as Argentina, Mexico, and Brazil preferred commercial loans from Western countries to official development assistance from international financial organizations. International financial organizations' conditions for ODA constrained government policy management.

Using the commercial loans with higher interest rates, the governments failed in breeding competitive export-oriented business and heavily relied on export revenue from natural resources. Western commercial banks were also optimistic about the risks since the loans were mainly for governments, state-owned enterprises and private sectors guaranteed by the governments.

In 1982, the US and Western developed countries faced recession, the prices of natural resources fell, and the current accounts of developing countries came up seriously deficit.

Also, the new capital inflow decreased dramatically. Those countries faced serious difficulties in international financial liquidity. It behooves the Vietnamese government to take this lesson into consideration in spite of its promising oil industry described below.

Dutch disease: According to an expert, as well as trustworthy newspaper in Viet Nam, the country's oil industry aims to produce 20 million tons of crude oil by the year 2000. In the next decade after 2000, as much as 30-40 million tons is expected. Petro Viet Nam, the state-owned enterprise monopolizing this sector, intends to invest at least USD 5 billion by the year 2000 for the achievement of the target. Last year, the White Tiger and Big Bear oil fields produced 7.7 million tons of crude oil for export valued at USD1.04 billion. This was a 17 % increase over the previous year and represented 20% of total export turnover. In addition, the oil and gas quality is evaluated relatively high by world standards. Revenue from the export of oil is expected to be secured by at least next decade according to even relatively conservative estimates.

(4) South Korea's Case

South Korea's domestic savings mobilization accounted for only 1% of its GDP in the 1960s. In addition, due to the inflow of foreign savings, its currency was sometimes overvalued in spite of inflation and a trade deficit.

The government, however, stuck to aggressive export and overcame the disadvantage. The government heavily supported large export-oriented companies in various sectors and developed industrial infrastructure using foreign savings such as ODA. The investment opportunity and profitability of export-oriented industries improved smoothly and led to an increase in domestic savings mobilization. This mobilization finally jumped up to about 40% of GDP at the end of the 80s.

Then in the middle of the 1980s, the government shifted its focus from the utilization of foreign savings to the breeding of small and medium domestic businesses to improve the living standards of a majority of the people and to strengthen industrial potential.

Furthermore, the government induced foreign funds through the Korean branches of foreign commercial banks which were attracted to Korea by the government's favorable treatment. The government continued the policy for seven to eight years. Foreign banks enjoyed the treatment and enlarged their operation to a large scale. This enabled them to lend to domestic companies that were running out of funds in that stage of rapidly expanding business.

(5) Consistency Between Debt Policy and Development Strategy

In Latin-America's case, even though a recipient country induces foreign savings for industry-related investment, the returns on such investment are significantly lower, and eventually, foreign savings mobilization (particularly funds mobilized through foreign bond issuance and foreign commercial loans) flee in favor of consumption. Promising industrializing countries sometimes get in a trap similar to the above mentioned Latin American case.

South Korea's case shows the importance of central government policy on the purpose for utilizing foreign savings. South Korea in 1960-70s succeeded in avoiding the trap while Latin American countries failed in 1970-80s.

From the view point of the Latin-American countries' development policy, we can point out more about their policy failures as follows:

1) Excessive protection of domestic industries in the name of ' import substitution'
2) Expensive financial cost for domestic savings mobilization
3) Overvaluation of the domestic currency
4) Expensive real labor cost relative to competitiveness in the international market
5) Inefficient and excessive investment in state-owned enterprises and subsidies from the central government

They missed the importance of strengthening the competitiveness in manufacturing agriculture-related products and labor-intensive products in which they originally had competitive edges in the international market. The funds inflow from expensive commercial loans went to the inefficient public sectors and also contributed to raise consumption to a high level. When recession came, the money from Western banks fled home dramatically. This left huge deficits in government budgets as well as in the national current account. Mexico, in particular, got stuck seriously in the financial crisis because the government had expanded huge public investment using foreign commercial loans. Mexico had shown Western financial institutions a rosy prospect of a large oil ceiling.

4-4. Critical Issues on Existing Foreign Debt

(1) Negotiation on Foreign Debt

1) London Club

The Vietnamese government is still locked in tough talks with its commercial creditors almost a year after negotiation began. Some Western analysts surmise that several debt-related issues are putting pressures on the government to quickly reach agreement on rescheduling its $800 million in arrears.

Most of the money is owed to Japanese banks and trading houses dating from the late 1970s. The Vietnamese government has no previous experience in debt negotiations and is seeking a one-time rescheduling of the entire amount with a 50% write-off.

Currently, Vietnamese debt is traded on the secondary market at a relatively high 65 - 73 cents. The London Club is likely to forgive, at most, only accrued and penalty interest, which account for half of the $800 million owed.

Viet Nam's negotiating position stems partly from a provision in an agreement reached with the multilateral Paris Club donors in 1994. This club recommends that Hanoi seek a 50% write - down (net present value) at the London Club, represented by the Bank of Tokyo, the principal creditor, and with the Australia and New Zealand Banking Group (ANZ).

Vietnamese officials recently were talking publicly about a Eurobond issue. The issue could be successful, if Viet Nam does not mind the expensive financial costs.

2) Non Transferable Ruble Debt

Viet Nam cannot afford additional debt service obligations while its overall arrears, including a huge ruble debt owed to the former Soviet Union, are still unresolved. The point of the negotiation is on the effective exchange rate of the ruble vis-à-vis the USD. The most recent round of difficult negotiations just finished in January 1996.

There has been some agreement for a debt-equity swap- type resolution for a portion of the debt.

Negotiations on non-transferable debt to Eastern European countries has been mostly successful. Some of the debt has been forgiven and some has been transferred to equity. A 1 USD = 5.5 Ruble exchange rate is said to be the agreed upon effective rate concerning Hungary and Viet Nam.

3) Other External Debt

The negotiation on the debt to Middle Eastern countries is also stacked. Iraq, for example requires a one time payback while the Vietnamese side offers goods payment such as rice.

(See Appendix 5 as related material on the historical resolution of heavy external debt.)

(2) Institutional Issues on Foreign Debt Management

1) Demarcation Among Ministries on Debt

Three government departments related to foreign savings mobilization (the MPI, the Ministry of Finance, the State Bank of Viet Nam) usually check foreign debt from different angles and responsibility. To this degree, the diversified and effective management of foreign debt can be secured to some extent.

The MPI is the "window" agency for applying ODA funds (loans and grants) and for supervising the implementation of the projects based on national development plans. The Ministry is concerned with inducement and allocation of concessional foreign funds as well as domestic funds. The Ministry of Finance almost always acts as a borrower and is mainly concerned with debt accumulation and fund-arrangements for repayment. The State Bank of Viet Nam, the central bank is sometimes borrows from the IMF or the World Bank, and sometimes functions as the guarantor for World Bank loans to four state-owned commercial banks. The bank is responsible for the management of foreign exchange reserves as a fund source for repayment.

2) Necessity of Proactive and Systematic Debt Management

Toward the year 2000, the government plans to induce a large amount of money with different and complicated characteristics from more diversified foreign sources. In this event, the following more sophisticated way of management will be needed.

Expensive foreign debt should be geared toward profitable projects. A certain guideline for efficient usage of foreign debt should be set up, for example as shown below. In addition, a committee or section for post evaluation of the effectiveness of the foreign debt project should be set up to improve debt management technique in the future.

Figure II-4-2: An Example of Source-sector Selection

High ← Profitability (FIRR) ← Low

Source / Sector	Power	Highway	Water supply	Irrigation	Human Res. Dev.
P. Sources (commercial)					
W.B.					
IDA					
GRANT (non-commercial)					

Note: P. Source including bank loans, bonds and BOT.

Different fund sources are equipped with different procedures, terms and conditions (interest rates, grace periods, repayment periods, etc.) and different policies (eligibility for procurement of machinery and consultants etc.). Accordingly, the sections of Vietnamese ministries in charge of foreign debt should be diversified and specialized by different major donor categories for effectiveness and efficiency. For example, section A is for W.B., section B for ADB, section C for OECF and section D for commercial debt etc. (We cannot find out whether or not this kind of arrangement has already been made within the ministries concerned).

To manage outstanding foreign-debt easily, special budgetary accounts for ODA may be useful (we could not find out whether or not this kind of arrangement has already been made in the state budgeting system during our field research.).

4-5. Foreign Exchange Rate Management

(1) Theoretical Discussion and Vietnamese Reality

1) Basic Discussion

Theoretically speaking, some simple macroeconomic principles such as interest rate parity, purchasing power parity and the international Fisher effect are talked about as foreign exchange determinants. The following factors are also influential on exchange rates;

* a balance of payments
* b future economic prospects
* c national rate of inflation
* d growth in money supply
* e national business cycle

* f a decline in foreign currency reserve
* g increased spread between official and "free rates" of exchange
* h excessive government spending

2) Interpretation of the Vietnamese Case

In the Vietnamese case, as in other economies in transition to market economies, due to * a, *c and * h, the Vietnamese dong sometimes receives pressure towards appreciation, even though the general trend is expected to go downwards (depreciation against the USD). In the past couple of years, the central bank of Viet Nam has taken several large-scale intervention measures in the foreign currency market at very critical points in time. It more often sold Vietnamese dong to keep it from appreciating.

3) Effectiveness of Foreign Exchange Control for the Policy Target

According to a research official of the central bank, the government's recent concern lies in the local currency which sometimes fluctuates in an upward direction due to an accelerated inflow of foreign exchange, or overvaluation vis-à-vis the USD. On these occasions, the central bank, has made small-scale intervention by selling dong and buying dollars to avoid the loss of export competitiveness.

The important points in discussing exchange rate control are (a) what is its purpose in terms of developing the national economy and (b) what are the expected costs and benefits of the control. This would be of little use to exports and this stance is supported by the above mentioned South Korean case. The country overcame the disadvantage of its overvalued currency by strengthening the competitiveness of export products.

4) The IMF's Experience

From its long experience, the IMF has actually suggested that exchange rate control is the anchor that has been most successful in economies undergoing very high inflation and undertaking credible programs of fiscal adjustment. The anchor, however, has been somewhat less successful against chronic inflation. But there is no consensus about the effectiveness of bringing down a particular currency's value in order to accelerate exports. (IMF Survey, November 20, 1995)

Income policy and a substantial stock of official reserve was rather useful as a supplementary anchor to stabilize inflation according to the experience of IMF.

5) Costs and Side Effects from Heavy Reliance on Foreign Exchange Control

In addition, a significant cost will be born on foreign currency market. The monetary base (high-powered money) is affected by purchasing and selling foreign currencies. It may sometimes result in strong constraint on monetary policies by the government. It may also affect the government's foreign exchange reserve. This might hinder the stability and independence of monetary policy.

6) Long-term perspective

As a consequence, a stable exchange rate is most important, not only for controlling inflation but also for influencing the decision making of foreign investors, domestic depositors and domestic business executives.

(2) Other Issues on Foreign Exchange Management

The Vietnamese central bank took in the past and will take in the future the various measures shown below for stabilizing the exchange rate within a certain range, according to an official of the bank. However, it will become rather difficult to undertake some measures in the context of the development plan toward the year 2000. Here, we would like to mention some issues.

1) Trade Volume Adjustment

One of the measures is trade volume adjustment. As the trade deficit increases, the government tries to reduce imports. This measure, however, hinders economic development under a market-oriented system in the long run. This measure will particularly affect developing enterprises.

2) Fine Tuning of Money Supply

The second measure is money supply adjustment. A government official said, "Once the inflation rate reaches a certain level, the government reduces the domestic money supply in terms of credit volume for commercial banks. The point is to maintain the dong's value by avoiding inflation. This measure may not be effective if the convertibility of VN dong with USD and gold were terminated.

3) Interest Rate Adjustment

Once the Vietnamese dong value vis-à-vis the USD depreciates to a certain extent, the central bank (the state bank) increases the discount rate of local currency lending relative to the USD. However, according to several executives of private enterprises, "the interest rates level is too high to borrow "and " it's already far beyond a tolerable level for commercial borrowers." Heavy reliance on this measure will harm the fostering of the private sector which definitely plays a critical role towards a market - oriented economy.

4) State Budget Control

This is also a measure for protecting the dong's value as well as for bringing down inflation. According to an official, the government is cutting expenditure particularly for the public sector. This is the normal way to do it. However, they should be careful not to discourage government officials who have to play important roles towards economic reform.

Table II-4-2 Targeted Foreign Exchange Rate

Year	Dong / 1 USD
1990-91	8,000 dong
1992	14,000
1993	9,500
1994	10,800
1995	10,900-11,050
1996	11,000 (Target)

(Source: Interview at SBV)

4-6. Suggestions

(1) Foreign Debt Management

1) Necessity of Proactive and Systematic Foreign Debt Management

The Vietnamese government's estimations for future amounts of ODA and FDI are not unrealistic considering improving economic and diplomatic relations with the rest of the world. One of the most important problems, however, lies in disbursement. How to accelerate disbursement, and how to avoid cancellation of the commitment amount is a very critical point. The government should improve internal technical schemes to apply and implement the projects. Otherwise, even if the government succeeds in procuring the targeted amount, 21 billion USD to 22 billion USD, the realized benefits over the next 5-year plan will be smaller. (See simple simulation concerning this point in Appendix 6.)

Foreign grants which do not need to be repaid should be used for unprofitable but socially indispensable projects. On the other hand, foreign debt should be injected into export-oriented or infrastructure industries where the implementers are financially sound enough to pay back the loans after a grace period. The ministries concerned should put emphasis on carefully selecting the implementers as well as the projects that are eligible for external debt borrowing including ODA loans.

Different external ODA funds (loans) have different terms and conditions including interest rate, repayment term, finance portion, and eligible sectors to finance. Bilateral ODA loans are often the same interest rate and payment terms to projects with different profitabilities and / or benefits.

For that reason, one suggestion is to set up internal guidelines for offering and administering external loans. Another is to establish teams with experts specializing in different kinds of ODA (World Bank loans, ADB loans, OECF's Yen loans). This will be beneficial by providing more sophisticated and more efficient foreign debt management.

Setting-up a Special Account for external debt is also recommended. It will contribute to efficient management of external debt to classify and keep record of them according to the nature of the fund, interests, payment-terms, and characteristics of lenders.

Expensive commercial loans from abroad should be avoided until settlement of the negotiation in London Club.

Issuing Eurobonds will be useful in terms of expanding financial sources and learning the skills of international direct financing. The timing and the purpose for the funding, however, should be carefully studied since the financial costs for this type of fund are expensive.

2) Importance of FDI Acceleration

One tactic to induce foreign-direct investment may be favorite treatment for foreign-related commercial banks. This will bring foreign funds to Viet Nam as well as act as a bridge to connect foreign investors with domestic enterprises. In this respect, the South Korean experience of temporarily providing foreign banks with favorable treatment at the beginning stages of FDI acceleration policy is helpful as a general idea.

(2) Foreign Exchange Rate Management

1) Exchange rate management is currently well-performed. Importance should be placed on maintaining the stability and the credibility of the VN dong. However, there are some discussions for artificially devaluating (through intervention by the government) the dong to the level somewhere between 11500 and 16000 vis-à-vis the USD over the next 5 years.

2) Bringing down the VN Dong value vis-à-vis foreign currencies for accelerating export in a short period of time is rather risky. It would take some time before competitive exporting industries could develop and utilize the advantage of the cheap VND.

3) Too frequent intervention into the foreign currency market, buying USD and selling dong, could decrease the monetary base and undermine money supply, which leads to a slow-down of economic development. It also means a flight of foreign exchange reserves from the government balance sheet.

4) Artificial devaluation of local currency is very risky since it causes a rise in the inflation rate. Once hyper inflation makes its appearance, interest rates should naturally rise. This will be tremendously harmful for sustainable economic development. Many bankers we interviewed seemed to be ready for an interest rate cut for customers if the inflation rate is kept at the current level.

(3) Inducement of FDI

The utilization of foreign financial institutions, requires the establishment of incentive measures to induce FDI inflow. The following measures will be appreciated by those financial institutions.

1) Further acceptance of establishing joint-venture banks in Viet Nam
2) Significant loans to local enterprises motivated by tax incentive, by tax incentive, deregulation of the operation field, and improved accessibility to business information
3) Improvement in the legal infrastructure to make it understandable by foreign businessmen.

4) Utilization of highly efficient Asian financial institutions and construction of closer ties to the networks in neighboring ASEAN financial markets. The markets in Singapore and Hong Kong have a lot of experience to support a developing Asian economy.

5) Elimination of information asymmetry on economic activities

Appendix II-4-1 ODA Disbursement by Country and Organization

Grant Donors | *Loan Donors* | *(Mil. USD, Net)*

Country	1992	1993	1994	Country	1992	1993	1994
Australia	23.2	33.7	45.7	Australia			
Belgium	0.5	0.1	8.4	Belgium			
Canada	3.4	4	6.5	Canada			
Denmark	1.1	7.9	19.5	Denmark			
Finland	12.4	8	9.8	Finland			
France	21.2	30.3	39.5	France			1.9
Germany	0.9	1.1	2.4	Germany			
Italy	1.7			Italy	14.5	27.5	7.8
Japan	0.9	21.6	90	Japan	358.6	-10.1	-10.1
S.Korea	0.3	1.3	2.3	S.Korea			
Kuwait				Kuwait		2.5	6.6
Holland	18.1	10.6	20.7	Holland			
Norway	0.5	0.7	5.7	Norway			
Sweden	49.2	26.8	19.1	Sweden			
Switzerland	0.3	2.1	3.9	Switzerland			
Thailand	0.7	0.6	1	Thailand			
U.K.	4.2	8.5		U.K.			
U.S.	2.8	3.7	2.7	U.S.			
Sub. Total	141.4	161	277.2	**Sub. Total**	373.1	19.9	6.2
ADB	0	3.9	1	ADB			3
E.U.	37.3	50.5	37.8	E.U.			
FAO	0.4	0.6	0.4	FAO			
IFAD				IFAD		1	1.3
IMF				IMF	105.1	175.3	91.6
NGO	7.6	10.2	11.3	NGO			
UNICEF	11.6	17.1	16.4	UNICEF			
UNDP	20.6	19.6	15.4	UNDP			
UNIDPC			0.1	UNIDPC			
UNHCR	12.7	14.7	10.5	UNHCR			
UNIDO	6.8	3.3	2.7	UNIDO			
UNPF	3.6	4.2	10.8	UNPF			
W. Bank			3.6	W. Bank		3.6	172.5
W.F.P.	13.8	20	14.8	W.F.P.			
WHO	2.1	3.1	3.2	WHO			
Sub. Total	116.5	147.2	128	**Sub. Total**	105.1	179.9	268.4
Grand Total	257.9	308.2	405.2	**Grand Total**	478.2	199.8	274.6

Sources: *Vietnam's Development Partners* (MPI, UNDP)

Appendix II-4-2 Historical Features of FDI to Vietnam (excl. oil & gas)

(mil. USD)

Year	1988	1989	1990	1991	1992	1993	1994	1995	Avg.'88-95
FDI (Annual capital amount)									
Gross license capital (a)	366	539	596	1,388	2,117	2,887	4,071	6,600	2,321
Canceled-capital (b)	136	226	293	220	150	123	52	0	150
Net license capital (a-b)	230	313	303	1,168	1,967	2,764	4,019	6,600	2,171
Net-Gross license rate (a-b)/(a)	62.8%	58.1%	50.8%	84.1%	92.9%	95.7%	98.7%	100.0%	80.4%
Disbursement (c)	240	298	384	823	982	1,065	1,500	2,000	912
Unused outstanding (a-b-c)	-10	15	-81	345	985	1,699	2,519	4,600	1,259
Disbursement rate (c) /(a-b)	65.6%	55.3%	64.4%	59.3%	46.4%	36.9%	36.8%	30.3%	49.4%
FDI (Accumulated capital amount)									
Gross license capital (a)	366	905	1,501	2,889	5,006	7,893	11,964	18,564	-
Canceled-capital (b)	136	362	655	875	1,025	1,148	1,200	1,200	-
Net license capital (a-b)	230	543	846	2,014	3,981	6,745	10,764	17,364	-
Net-gross license rate (a-b)/(a)	62.8%	60.0%	56.4%	69.7%	79.5%	85.5%	90.0%	93.5%	-
Disbursement (c)	240	538	922	1,745	2,727	3,792	5,292	7,292	-
Unused outstanding (a-b-c)	-10	5	-76	269	1,254	2,953	5,472	10,072	-
Disbursement rate (c) /(a-b)	65.6%	59.4%	61.4%	60.4%	54.5%	48.0%	44.2%	39.3%	-
FDI (# of Projects)									
Annual basis	37	70	111	155	193	272	362	394	1,594
Accumulated basis	37	107	218	373	566	838	1,200	1,594	4,933

Source: MPI, Staff estimate

Appendix II-4-3 Foreign Debt Negotiation

Negotiation is continuing. It is hard to anticipate when the debts to Russia and to Western commercial banks can be settled. Details about the current situation are as follow;

(1) Non-transferable ruble debt

1) Former Soviet Union

The second round of negotiations about the transferable ruble debt with Russia was just finished January 13, 1996. Russia was invited to the CG meeting last year for the first time.

A. Debt Outstanding

a. 9.5 billion rubles

B. Negotiation Point

a. *Exchange Rate*
- VN Side: 1 USD = 5-7 rubles
- Russia Side : 1 USD = 0.65 rubles

b. Debt-Equity Swap (Example)
- Coffee Processing Plant
- Rubber Processing Plant at Song Be province

c. Trading in the Secondary Market
- Saigon Leather Plant : 5.4 million rubles in debt to Russia's International Investment Bank (IIB) at 50% discount (August 1994)
- IIB sold the debt to a dozen Vietnamese enterprises, $ 50.7 million to the State Bank of Viet Nam (June 1994)

d. Internal Payment Scheme
- VN government pays for SOE exports to Russia by VN dong (1990 exchange rate)
- VN government pays for PE exports to Russia by VN dong (1995 exchange rate)

2) Former East European Governments

A. Outstanding Debt: 0.5 billion rubles

B. Negotiation point : write-off

C. Hungary (largest creditor among East European countries) has agreed to a 50% write-off. The agreed exchange rate is 1 USD = 5.5 rubles.

D. Germany is also compromising on more than a 50% write-off.

E. Poland has agreed to write off some portion of its credit with Viet Nam.

(2) Paris Club nations

The debt negotiation was settled in 1994. Holland, Denmark, Switzerland, Germany, Spain, France, Belgium, Norway, and Britain have accepted rescheduling of the debt through December 2023.

Holland ($13 million. Eventually, Viet Nam will have no debt to Holland dating prior to 1994. Holland also, donated $5 million as a balance of payments support for 1995 and committed several projects for environmental protection. The total amount of aid disbursement to Viet Nam is expected to be $28 million in 1995, which is $8 million more than 1994.-Viet Nam News December 23, 1995), Denmark wrote off the debt for Viet Nam in 1995. In addition to that, Belgium changed debt to a grant in 1995.

(3) Commercial Debt (London Club)

Negotiation is not expected to result in agreement in the near future. The commercial banks, particularly Japanese banks, do not want to compromise. The sharp appreciation of the JPY from the latter half of the 80s to present, has made the debt to Japanese commercial banks heavy burdens for the Vietnamese economy. It is reported by a Western newspaper that the banks are expected to forgive half of the accrued and penalty interest but the Vietnamese government is insisting on an additional pardoning of 50% of the debt.

Since there are no hopes for easy settlement, the negotiation at the World Bank is centered on a Eurobond issue. Viet Nam's response to its expanding trade deficit is also a reason why foreign commercial bankers are worrying. On the other hand, joining ASEAN is a positive.

(4) The debt and credit between Viet Nam and the US

According to a Vietnamese government official, negotiation about former South Viet Nam's $3 million debt with the US government was held in Washington in December 1995. This was expected to go rather smoothly since the negotiation had only been delayed because of no official diplomatic relationship between the two countries until last year. Another official said, as a result of scrutinizing the debt - the credit amount between Viet Nam and the US, netted only $1.5 million on the Vietnamese side. The transaction to settle this was made at of the end of 1995.

(5) The debt to Middle East Countries

Iraq requests that Viet Nam pay back the whole of the debt outstanding in a short period of time. The Vietnamese side, on the other hand, proposes partly rescheduling or making payment in terms of goods such as rice.

Appendix II-4-4

Fluctuated Disbursement from Foreign Sources (Mil. USD)

Year	1990	1991	1992	1993	1994	1995*
Bilateral		295	280	166	283	265
Multilateral		69	67	81	284	201
IMF		0	0	0	87	0
Non-UN		2	2	29	29	13
Private						
Short-term						
NGO		8	8	10	11	10
Total	0	374	357	286	607	489
Increase	-	-	-4.5%	-19.9%	112.2%	-19.4%

External Debt in Convertible Currencies (Mil. USD)

Year	1988	1989	1990	1991	1992	1993	1994
Bilateral	1,411	1,454	1,515	1,557	2,351	2,658	2,679
Multilateral	287	290	298	283	312	241	548
Private	738	797	891	899	1,112	1,125	1,240
Total	2,436	2,541	2,704	2,739	3,775	4,024	4,467

Source: IMF

Note: Debt relief 883 in 1993.

Official Reserve and Debt Service Ratio (Mil. USD)

Year	1989	1990	1991	1992	1993	1994
Reserves	111	24	27	465	404	876
In weeks of import	3.5	0.7	0.7	9.5	6	10.1
D/S ratio (%)	42.3	29.9	20.2	22.4	26.8	20.4
Export	1,320	1,731	2,042	2,475	2,850	3,600
Due amount*	558	518	412	554	764	734

Source: JICA study team staff estimate based on IMF statistical report

External Debt in Non-convertible Currencies

Year	1989	1990	1991	1992	1993	1994
M&L Loans	9,771	10,119	9,979	9,936	9,998	9,962
Fomer Soviet U	8,856	9,201	9,256	9,157	9,457	9,441
Bulgaria	122	117	111	111	87	77
Cuba		6	7	8	8	8
Czechoslovakia	143	140	148	74	90	90
Hungary	260	289	295	301	297	287
Germany	214	208		221		
Poland	95	77	81	4	3	3
Romania	81	81	81	60	56	56
S-Loan (IBEC)	820	320				
Total	10,591	10,439	9,979	9,936	9,998	9,962

Source: IMF

(in millions of transferable rubles, at end of period)

Appendix II-4-5

Historical Examples of External Debt Resolution

Mexico (Feb. 1990)	• Principle write-off : Exchange the debt at 65% of the original price for USD denominated zero-coupon bonds with interest of LIBOR + 13/16% • Interest relief: Exchange the debt for USD bond for the original price • New money lending: 25% of the existing exposure with LIBOR + 13/16% • Money source: IMF, W.B., Japan, Self- mobilization
Philippines (Jan.-Feb. 1990)	• Principle write-off : Buy-back of original debt with 50% discount • Rescheduling: LIBOR + 13/16% • New money lending: LIBOR + 13/16% • Money source : IMF, W.B. Japan, Self-mobilization
Costa Rica (May 1990)	• Principle write-off : Buy-back of original debt with 84% discount • Interest Relief : Exchange the bond with fixed interest of 6.25% at the original price (exchange the overdue interest portion for the bond with LIBOR + 13/16%
Venezuela (Aug. 1990)	• Money source : Self mobilization, Others • Principle write-off : Buy-back of original debt with 55% discount and exchange for the USD-denominated bond with LIBOR + 13/16 % at the discount rate of 30% • Interest Relief : Exchange for bonds with fixed interest of 6.25% and temporarily exchange for other bonds with lower interest rates • New money mobilization : Issuance of new money bond with interest rate of LIBOR + 1% and exchange for new money convertible bond with the interest rate of LIBOR + 1%

Source : World Bank, World debt table 1990-1991

Appendix II-4-6 Projection

A Projection of External Funds (Commitment and/or License) (Bil. USD)

Year	1996	1997	1998	1999	2000	Total	Target	Diff.
ODA Loans	1.5	1.5	1.5	1.5	1.5	7.5	-	-
OECF	*0.7*	*0.7*	*0.7*	*0.7*	*0.7*	*3.5*	-	-
W.B.	*0.5*	*0.5*	*0.5*	*0.5*	*0.5*	*2.5*	-	-
ADB	*0.3*	*0.3*	*0.3*	*0.3*	*0.3*	*1.5*	-	-
ODA Grants	0.4	0.4	0.4	0.4	0.4	2	-	-
ODA Total	1.9	1.9	1.9	1.9	1.9	9.5	7.5	2
FDI Total	2.2	2.2	2.2	2.2	2.2	11	13.5	-2.5
Grand Total	4.1	4.1	4.1	4.1	4.1	20.5	21	-0.5

Schedule of Disbursement and Implementation of Foreign Funds (Case A) (Bil. USD)

Year	1996	1997	1998	1999	2000	Total	Target	Diff.	Assumption
ODA Total	0.19	0.57	1.33	1.71	1.9	5.7	7.5	-1.8	ODA dis. table
FDI Total	1.1	2.2	2.2	2.2	2.2	9.9	13.5	-3.6	FDI dis. table A
Grand Total	1.29	2.77	3.53	3.91	4.1	15.6	21	-5.4	

Schedule of Disbursement or Implementation of Foreign Funds (Case B) (Bil. USD)

Year	1996	1997	1998	1999	2000	Total	Target	Diff.	Assumption
ODA Total	0.19	0.57	1.33	1.71	1.9	5.7	7.5	-1.8	ODA dis. table
FDI Total	0.66	1.32	2.2	2.2	2.2	8.58	13.5	-4.92	FDI dis. table B
Grand Total	0.85	1.89	3.53	3.91	4.1	14.28	21	-6.72	

Schedule of Disbursement or Implementation of Foreign Funds (Case C) (Bil. USD)

Year	1996	1997	1998	1999	2000	Total	Target	Diff.	Assumption
ODA Total	0.19	0.57	1.33	1.71	1.9	5.7	7.5	-1.8	ODA dis. table
FDI Total	0.55	1.1	1.65	2.2	2.2	7.7	13.5	-5.8	FDI dis. table C
Grand Total	0.74	1.67	2.98	3.91	4.1	13.4	21	-7.6	

Assumptions:

1 OECF annually commits about 0.7bil. USD at C.G. Nov. 1995.
2 ADB has committed 1.5 bil. USD for the coming four years. We spread the amount over five years ('96-2000).
3 The World Bank has annually committed at least 0.5 bil. (most recent C.G. meeting).
4 Total amount of grant remains around the amount of year 1994.
5 The accumulated net commitment of FDI (excl. oil & gas sector) is 1.8 bil. as of the end of 1995.
Therefore, disbursement will be made from the commitment over the period of this projection.
The disbursement is excluded from this projection.
6 The disbursement pattern from the ODA pipeline amount comes from the assumed ODA dis. table below.
7 The disbursement amount from the existing ODA commitment is also excluded.
8 IMF credit and commercial loans are excluded.
9 Since we have unused ODA left, which is committed before 1996, we can expect more disbursement from the pipeline.

ODA Dis. Table: Assumed ODA Disbursement Pattern

Com/Year	Y1	Y1	Y3	Y4	Y5	Y6	Y7	Y8	Y9	Y10
Y1 = 100	10	20	40	20	10					
Y2 = 100		10	20	40	20	10				
Y3 = 100			10	20	40	20	10			
Y4 = 100				10	20	40	20	10		
Y5 = 100					10	20	40	20	10	
Rate of Dis.	0.1	0.15	0.233	0.225	0.2	0.18	0.14	0.06	0.02	0

FDI Dis. Table A: Assumed FID Disbursement Pattern (in the case of 2 years)

Com/Year	Y1	Y1	Y3	Y4	Y5	Y6	Y7	Y8	Y9	Y10
Y1 = 100	50	50								
Y2 = 100		50	50							
Y3 = 100			50	50						
Y4 = 100				50	50					
Y5 = 100					50	50				
Rate of Dis.	0.500	0.500	0.500	0.500	0.500	0.5	0	0	0	0

FDI Dis. Table B: Assumed FID Disbursement Pattern (in the case of 3 years)

Com/Year	Y1	Y1	Y3	Y4	Y5	Y6	Y7	Y8	Y9	Y10
Y1 = 100	30	30	40							
Y2 = 100		30	30	40						
Y3 = 100			30	30	40					
Y4 = 100				30	30	40				
Y5 = 100					30	30	40			
Rate of Dis.	0.300	0.300	0.333	0.333	0.333	0.14	0.08	0	0	0

FDI Dis. Table C: Assumed FID Disbursement Pattern (in the case of 4 years)

Com/Year	Y1	Y1	Y3	Y4	Y5	Y6	Y7	Y8	Y9	Y10
Y1 = 100	25	25	25	25						
Y2 = 100		25	25	25	25					
Y3 = 100			25	25	25	25				
Y4 = 100				25	25	25	25			
Y5 = 100					25	25	25	25		
Rate of Dis.	0.250	0.250	0.250	0.250	0.250	0.15	0.1	0.05	0	0

Chapter 5. Medium to Long- Term Funds in Viet Nam

5-1. Demand for Medium to Long -Term Funds

Demand for investment and development funds is quite large in Viet Nam, and mobilization of such funds is the critical issue for the Vietnamese Government. The volume of investment necessary for 1996- 2000 is estimated at US$ 41- 42 billion in the next 5- Year Plan. Public investment, FDI and private investment are $15.6 billion, $14 billion and $12.4 billion respectively in the plan. The government is also preparing the Public Investment Program (PIP), which covers all projects expected to be funded by the state budget, for 1996-2000. The PIP lists investment projects amounting to US$ 17 billion. The figure is almost equivalent with the public investment in the 5- Year Plan (see Table 1,2)

Investment projects can be classified by investor (executioner) and by economic nature of investment as in Table 3. It is essential for the government to differentiate investment projects into public sector type, private sector type and mixed (public and private) sector type in order to fund each project properly. Social and economic necessity governs public sector type and profitability governs private sector type. The description by the government on state owned enterprises (SOEs) investment is sometimes ambiguous in terms of economic nature and accordingly the guiding policy is also ambiguous. Attention must be given to the confusion of public investment with SOE investment and the probability of crowding out the private sector investment by SOEs.

According to a macroeconomic projection of the government, private sector business investment as well as commercially viable investments of SOEs seem to have considerable size of US$ 12.8 billion (see Table 2). Through our interview with business entities, we also noticed the funds needed to make commercially viable investments in SOEs as well as in small and medium private enterprises (SMEs). We recommend that the government undertake an investment needs survey of the business sector by questionnaire to grasp the magnitude and contents of commercially viable investment projects.

Aside from investment projects, medium- to long- term funds are also needed for SOE bad debt settlement as well as for long- term working capital. It is imperative to manage bad debt properly and save scarce funds so as not to jeopardize new investment opportunities. Working capital needs for medium- to long- term are also important in Viet Nam. An emerging export sector is labor- intensive industries such as textile and food processing. These industries need more working capital for labor and material cost rather than investment capital.

In general, long- term investment in Viet Nam is still regarded as risky by the business sector. Their concern is uncertainty about inflation, the foreign exchange rate, economic growth, policy changes and so on. Thus the private sector, including foreign investors, tends to invest in projects with short- term returns such as hotels, restaurants and real estate. In addition, the current bank lending rates are considerably high for the industrial sector, which needs long- term investment by long-term business perspective. As a rather new phenomenon, the high interest rates entice funds from the private sector into bank deposits rather than into business investment (see Table 4). Although the industrial sector has fund needs for expanding business, high interest rates are suppressing their needs.

Autonomous management of SOEs has made progress in terms of pricing, materials purchasing and personnel management. Investment decision making, however, is still under government control as described in Government Decree 177. Viewpoints of government and business entities on investment projects are and should be different. Policy priority tends to not go along with profitability. The current investment decision making system may suppress SOE investment opportunities.

5-2. Medium- to Long - Term Fund Raising

Availability of medium- to long- term funds is very limited in Viet Nam. In addition in Viet Nam they are generally shorter than the international standard (medium- term is 1 - 3 years and long term is 3 - 5 years). Foreign funds such as ODA and FDI have become important sources of medium- to long- term funds and are expected to play a major role for 1996-2000 (see Table 1, 2). A large gap, however, has already grown between commitment amount and disbursement amount.

Domestic funds for the medium to long term mostly come from the state budget, which is also heavily constrained. Fiscal savings, defined as fiscal revenue minus current expenditure, has been positive and covering a part of capital expenditure since 1992 (see Table 5). However, the savings is as small as US$ 0.7 billion in 1994 and most of the capital expenditures are financed by fiscal borrowings. The main sources of fiscal deficit finance are ODA and government bonds, which have to be repaid. A major portion of the government bonds are short term, Treasury bills and Treasury bonds of one year maturity. As a new endeavor the government has issued a project bond with one, two and three year maturities to specifically finance the North-South electric line project, to which mostly SOEs subscribed.

Contradicting official data up to 1994, both the banking sector and the business sector stated that bank deposits were increasing (To date we have not been provided even 1995 data). As an example, a joint- stock bank we visited proves how deposits are growing (see Table 6). The Government endeavors with high interest rates finally succeeded in enticing domestic savings to the banks. Most of the deposits, however, are short- term. The majority of term deposits are for 6 months. With the perceived uncertainty, depositors do not want to deposit in the long term. Nor do banks want to receive deposits with such high interest rate as having no borrowing demands. A major portion of deposits is still from SOEs.

Other than deposits, state owned commercial banks (SOCBs) issue bank bonds with one year maturities. The Bank for Investment and Development of Viet Nam (BIDV) issues one-, three- and five- year bonds. SOCBs also borrow from foreign banks. Some SOEs issued corporate bonds in 1995. The composition of SOCB liabilities varies from institution to institution, reflecting the differences in business, which in turn provide the possibility of gaining from other institutions' experience (see Table 7).

Private companies do not have easy access to bank loans. Funds available for private companies are mostly short- term (See Table 8, 9). For investment funds, private companies have to rely on their internal funds and informal finance as well as short- term revolving funds. Informal finance from acquaintances sometimes provides better terms than banks. The financial situation confronting the private sector, however, generally hinders or postpones the investment opportunity. Furthermore the current tax system featuring high effective tax rates for business sector, does not promote internal savings and reinvestment.

The Social Insurance Fund is a possible source of medium- to long- term funds. The Social insurance system, which was supported by the state budget, was reformed in 1995. The fund is now responsible for the pension payments to those who retired after January 1995. For the pension system as a whole, however, governmental subsidies are indispensable for paying pensions for the immediate future. In view of the large percentage of the young population and the potential of future economic growth, the fund will have surplus funds play an important role as medium- and long-term funds. The premiums of casualty insurance companies are another possible source. Though the term of casualty insurance is one year, growing premium payments would enable long- term investment. As the economy grows, people would need life insurance, which is a more suitable source of medium- to long- term funds.

Another possibility is to issue medium- to long- term bonds to savings banks.

5-3. Financial Intermediaries and Medium- to Long- Term Funds

The BIDV and the General Department for Investment and Development (GDID) of the MOF are major suppliers of medium- to long- term funds in Viet Nam. GDID provides funds from the state budget to the government's public investment projects and to specifically authorized projects of SOEs. BIDV formerly functioned as the provider of funds from the state budget, which GDID has taken over since Jan. 1995. BIDV is now the main provider of medium- to long- term funds on a commercial basis.

The National Investment Assistance Fund (NIAF) was established under the administration of GDID in December 1995. Though the responsibility of the NIAF is not completely clear yet, it will provide low or no interest loans to SOEs with specific investment projects. We have not yet seen clear demarcation of funds flow among these organizations.

It is not efficient for a government section to provide loans to business entities. Policy priority and credit judgment are different and sometimes contradictory. If credit judgment cannot override policy judgment, repayment of loans will be dubious. Projects with the highest policy priority should be financed by the budget, not by loans.

The share of medium- to long- term credit is increasing, but the loans are mostly to SOEs (see Table 8). It is the State Bank of Viet Nam (SBV)'s policy to increase private sector credit by SOCBs, but mostly in the short term. Private sector banks are more hesitant to provide medium- to long- term funds under uncertain economic conditions. The main flow of medium- to long- term funds is from SOCBs to SOEs. Conversion of short- term deposits to medium- to long- term loans is minimal. According to the SBV, only about 10% of deposits are long- term and 15% of short- term deposits are converted to medium- to long- term loans.

The reverse interest rate structure, where the long- term rate is lower than the short- term rate, has been a major deterrent for banks to lend long term. Vietnamese government has come a long way to equalize the short- term and long- term lending rates. Investment funds were given to SOEs by the government before the reform. A sense of borrower's responsibility was and still is scarce at SOEs. This leads to confusion on the part of SOEs regarding the difference between assets, equity capital and debt.

Credit analysis practice seems to vary from institution to institution, and is inadequate at most financial institutions. Financial data is inadequate in all sectors, especially in the private sector where tax is routinely evaded. The financial system does not function properly without appropriate financial data. It is not plausible that every financial institution is capable of credit analysis, especially of long- term investment projects. It is true even in light of experience in banking sectors of some advanced countries where most banks are incapable of sufficient project appraisal. This capability, however, is critical not only for sound banking but for Viet Nam's negotiation with foreign investors and lenders.

Collateral lending is the general practice, which has limitations and may lead to the situation where the banks' checks, if any, on the creditworthiness of their clients are insufficient. Leasing has become active and applied in various types of business. SOCBs established joint venture leasing companies as well as wholly owned subsidiaries. Leasing is promising in terms of not facing the collateral problem. In ASEAN countries, leasing has supplemented the inadequate supply of medium- to long term- funds, especially in the manufacturing sector.

A possible alternative to efficiently utilize scarce medium- to long- term funds is to reorganize BIDV as a specialized institution for medium- to long- term loans. BIDV is financially viable with large capital and reserves and seems to have staff with credit analysis expertise. And for small and medium enterprises, joint- stock banks can be a good partner. Small banks are usually well versed with the business of their clients. After checking the credit analysis capability, BIDV makes wholesale loans of medium- to long- term funds to certain joint- stock banks.

East and South-East Asian countries invariably established policy based finance institutions to utilize scarce medium- to long- term funds focusing on priority sectors. Commercial banks neglected to finance medium- and long-term funds needed for industrial development. The areas in which they are involved and their performances are varied partly due to the different levels of government intervention in the economy. However autonomous decision making on loans is a crucial factor in not incurring accumulated bad debt. Government should play the role in the policy formulation and should leave the loan decision on individual projects to financial institutions.

Foreign banks including joint venture banks now regard only well performing SOEs as possible clients. The private sector has not matured yet and the exercising of collateral rights on SOE assets is difficult in practice. Thus many foreign banks focus their business in wholesale on SOCBs. Foreign banks can be vital for bringing external funds into Viet Nam, but they are currently in low profile due to restrictions and a high tax rate.

Table II-5-1 Investment Figures of the 5-year Plan (1)

(in billions of 1995 US$)

	1991-1995		1996-2000	
Investment	18.0	100.0	41-42.0	100.0
(State)	(7.7)	(43.0)	(15.6)	(37.1)
(FDI)	(4.9)	(27.0)	(14.0)	(33.3)
(Private)	(5.4)	(30.0)	(12.4)	(29.5)
Fund Sources	18.0	100.0	41-42.0	100.0
(ODA)	*(2.0)	(11.1)	(8.0)	(19.0)
(FDI)	(4.5)	(24.7)	(14.0)	(33.3)
(Domestic)	*(11.5)	(63.9)	(21.0)	(50.0)
#Eurobond	-	-	1.0	-
#ICOR	2.0-2.5	-	3.0-3.3	-
#Inv/GDP	**19.1	-	30.0	-

(Government Report to CG) * based on rough disbursement figures

** calculated for 1991-94 using IMF data

Table II-5-2 Investment Figures of the 5-year Plan (2)

(in billions of 1995 US$)

Investment		Sources of Funds	
Public Investment	15.6	Budget	8.1
		ODA	7.5
(Government)	(8.7)	-	
(SOEs)	(6.9)	-	
SOE Commercial	5.9	Domestic	5.9
Private	19.9	FDI	13.0
		Domestic	6.9
Total	41.4	Total	41.4

(Government PIP report)

Table II-5-3 Classification of Medium to Long Term Fund Needs

Investment entities	Nature of investment	Sources
Government	Public	State budget ODA
SOEs	Public	State budget ODA
	Mixed	State budget ODA
	Commercial	Short term revolving Retained earnings
Private	Commercial	Short term revolving Retained earnings Informal
Bad debts of SOEs	-	State budget
Long term Working Capital	-	Short term revolving

Table II-5-4 Selected Monthly Interest Rates

(%)

	Long term lending	Short term lending	Spread	6 month deposit rate	Inflation rate**
Oct. 93	1.2(14.4) *	2.1(15.2)	0.9 (10.8)	1.7(20.4)	5.2
Aug. 94	1.7(20.4)	2.1(15.2)	0.4 (4.8)	1.7(20.4)	14.4
Dec. 95	1.7(20.4)	1.75(21.0)	0.05(0.6)	1.7(20.4)	12.7

(SBV) * in parenthesis annual rate calculated at simple interest
** inflation rates are for calendar years 1993, 94 and 95

Table II-5-5 Macro and State Budget Data

(in billions of current VND)

	1986		1987		1988		1989		1990		1991		1992		1993		1994		1995		
GDP const.					25,885		28,093		29,526		31,286		33,991		36,735		39,982				
GDP current.	599	100.0	2870	100.0	14,428	100.0	28,093	100.0	41,955	100.0	76,707	100.0	110,535	100.0	136,571	100.0	170,258	100.0	217,000	100.0	
Consumption									35,507	84.6	64,052	83.5	88,910	80.4	116,168	85.1	141,456	83.1			
Capital Formation									6,350	15.1	11,588	15.1	18,806	17.0	26,542	19.4	37,572	22.1			91-94 inv/gdp
Government									2,126	5.1	2,135	2.8	6,450	5.8	9,600	7.0	11,300	6.6			94508
Private									4,224	10.1	9,453	12.3	12,356	11.2	16,942	12.4	26,272	15.4			494071
Trade Balance									98	0.2	1,067	1.4	2,819	2.6	-6,139	-4.5	-8,770	-5.2			19.1
Export											22,915	29.9	35,767	32.4	38,538	28.2	53,606	31.5			
Import											21,851	28.5	32,957	29.8	44,677	32.7	62,377	36.6			
Cap Frm + Tr Bal									6,448	15.4	12,655	16.5	21,625	19.6	20,403	14.9	28,802	16.9			
State Budget																					
Revenue	84	14.0	379	13.2	1,740	12.1	3,899	13.9	6,153	14.7	10,353	13.5	21,023	19.0	30,500	22.3	42,125	24.7	52,770	24.3	
Total Expenditure	121	20.2	515	17.9	2,840	19.7	6,781	24.1	9,522	22.7	13,196	17.2	25,120	22.7	38,975	28.5	46,212	27.1	55,970	25.8	
Current Exp.	83	13.9	395	13.8	2,167	15.0	5,155	18.3	7,398	17.6	11,061	14.4	18,670	16.9	29,375	21.5	34,497	20.3	40,120	18.5	
Current Balance	1	0.2	-16	-0.6	-427	-3.0	-1,256	-4.5	-1,245	-3.0	-708	-0.9	2,353	2.1	1,125	0.8	7,628	4.5	12,650	5.8	
Capital Exp.	38	6.3	120	4.2	673	4.7	1,626	5.8	2,124	5.1	2,135	2.8	6,450	5.8	9,600	7.0	11,715	6.9	14,860	6.8	
Overall Balance	-37	-6.2	-136	-4.7	-1,100	-7.6	-2,882	-10.3	-3,369	-8.0	-2,843	-3.7	-4,097	-3.7	-8,475	-6.2	-4,087	-2.4	-3,200	-1.5	
Interest Arrears	1	0.2	2	0.1	26	0.2	769	2.7	932	2.2	1,683	2.2	2,218	2.0	1,965	1.4	1,142	0.7		0.0	
Financing	35	5.8	134	4.7	1,074	7.4	2,113	7.5	2,437	5.8	1,160	1.5	1,879	1.7	6,510	4.8	2,945	1.7	3,200	1.5	
Banking	23	3.8	89	3.1	450	3.1	1,931	6.9	832	2.0	144	0.2	-2,208	-2.0	2,044	1.5	633	0.4		0.0	
.2+	0	0.0	3	0.1	17	0.1	-231	-0.8	341	0.8	249	0.3	1,414	1.3	2,541	1.9	1,690	1.0	2,000	0.9	
Foreign	14	2.3	43	1.5	370	2.6	413	1.5	1,264	3.0	767	1.0	2,673	2.4	1,925	1.4	622	0.4	1,200	0.6	

Source: IMF 1995b
WB 1995c

Table II-5-6 Bank Deposits

(in billions of VND)

	1991	1992	1993	1994
Total Deposit	13881	16564	18071	22622
Dong Deposit	5527	8351	10665	14429
Total/GDP	18.1	15.0	13.2	13.3
Dong/GDP	7.2	7.6	7.8	8.5

(SBV)

	12/93	12/94	9/95	12/95
Total Deposit	1.6	20.3	115.7	226.4

(Annual report of a Joint Stock Bank in Hanoi)

Table II-5-7 Composition of Liabilities of SOCBs as of Dec. 1994

(in billions of VND)

	Agri Bk	%	BIDV	%	Income Bk	%	Vietcom	%
Deposit	3029	25.3	1230	14.2	5453	51.2	11921	71.3
Bond	3644		151	1.7	2217	20.8	167	1.0
Bank brrwng		30.4	1160	13.4	260	2.4	412	2.5
State bank	2533	21.1	913	10.5	641	6.0	58	0.3
Capital	1961	16.3	3415	39.4	477	4.5	526	3.1
Others	831	6.9	1793	20.7	1607	15.1	3643	21.8
Total	11998	100	8662	100	10655	100	16727	100

(Annual reports) *Preliminary unconfirmed classification included

Table II-5-8 Shares of Long- Term Credit / Total Credits

(%)

	1991	1992	1993	Sep.1994	*private
Agri Bk	4.7	5.3	16.5	21.8	35.3
BIDV	74.1	76.7	82.5	74.3	0.7
Incom Bk	4.1	6.6	12.4	13.0	21.1
Vietcom Bk	10.1	12.0	19.5	25.2	2.6
Others	2.4	2.1	6.0	8.5	10.4
Total	15.5	16.8	24.7	27.9	10.7

(WB) * private share of total long- term credit

Table II-5-9 Credit to Private Sector / Total Credit Outstanding

(%)

	1991	1992	1993	1994
Agri Bk	11.8	36.3	64.0	66.6
BIDV	0.3	0.7	2.0	3.1
Incom Bk	3.4	9.7	26.1	28.2
Vietcom Bk	0.0	0.1	1.9	3.0
Others	4.6	20.0	26.6	29.9
Total	4.8	14.0	27.1	28.0

(WB) *Figures for 1994 are as of Sep. 1994 except Total