Study on Economic Development Policy in the Transition Toward a Market-oriented Economy in Viet Nam (Phase 2)

FINAL REPORT

VOL. 1 General Comments / Agricultural and Rural Development

February 1998

Ministry of Planning and Investment
The Socialist Republic of Viet Nam

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Foreword

This study entitled "Economic Development Policy in the Transition toward a Market-oriented Economy in Viet Nam" was conducted within the framework of the technical cooperation program of the Government of Japan, in response to a request from the Government of the Socialist Republic of Viet Nam.

The study was carried out as joint research by professionals specializing in economic policy from both Japan and Viet Nam. The research groups headed by Prof. Shigeru Ishikawa, Professor Emeritus of Hitotsubashi University, for the Japanese side, and by Dr. Nguyen Quang Thai, Vice President, Development Strategy Institute, Ministry of Planning and Investment, for the Vietnamese side were set up in each country, assisted by consultant teams consisting of leading research institutes in both countries.

The research groups and consultant teams held a series of discussions, and conducted several field surveys. This report was prepared jointly by the Japanese and Vietnamese research groups based on a mutual understanding.

I hope that the useful suggestions presented in this report will contribute to the formulation of policies for economic transition and sustainable development of Viet Nam, and it would be my great pleasure if the report would be used practically by concerned organizations, officials and experts.

I wish to express my sincere appreciation to Professor Ishikawa, Dr. Thai and each research member for their close cooperation in the study, and to the officials concerned for their valuable opinions.

February 1998

Kimio Fujita

Kimio Fujita
President
Japan International Cooperation Agency

Preface

This Final Report of the project on the Study on Economic Development Policy in the Transition toward a Market-oriented Economy in Viet Nam (Phase 2) aims at collecting all the important reports on the research results and policy suggestions which have been produced on the subjects of the title during September 1996 and November 1997, and thereby concluding the Phase 2 study. Moreover, the Final Report of Phase 2 combines with the Final Report of Phase 1 which was published in August 1996 in five separate volumes, to conclude all the formal research activities of the whole study project. The project itself was decided on April 1995 on the basis of the consultations between the governments of Japan and Viet Nam during 1994 and 1995, and was implemented under the Social Development Studies Program of the Japan International Cooperation Agency (JICA). The project was formally inaugurated in August 1995.

Under the agreement, the project was to be conducted in two phases. The general purpose of Phase 1 was to study the "Five-year Plan for Social and Economic Development in Viet Nam" (1996 - 2000), which was then being drafted for consideration by the Eighth Congress of the Vietnamese Communist Party. The phase 1 was brought to a close by the submission to the government of Viet Nam of a "Summary Report" in June 1996 and a "Final Report"[1] in that August. The general purpose of Phase 2 that followed Phase 1 has been to research the implementation of the "Five-year Plan" and the new issues raised during the course of it.

The agreement also stipulated that this was to be a joint Japanese and Vietnamese project. To accomplish this, research groups consisting of scholars and high-ranking experts were organized and worked under the direction of relevant steering committees on both sides. The general leaders of the research group were Professor Shigeru Ishikawa of Japan and Dr. Nguyen Quang Thai of Viet Nam. The project consisted of Subgroups to research selected priority topics, to which both Japanese and Vietnamese researchers were assigned. Both Phase 1 and Phase 2 had four priority topics, though the topics themselves changed a bit between the phases:

Phase 1:

Macro economic growth and its relationship with inflation and stability

Capital mobilization policies in the fiscal and monetary sectors

Industrial policy and industrialization

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1 Ministry of Planning and Investment, the Socialist Republic of Viet Nam = Japan International Cooperation Agency, "Summary Report — Study on Economic Development Policy in the Transition toward a Market-oriented Economy in Viet Nam Phase 1, Opinions on the Draft New Five-year Plan for Social and Economic Development in Viet Nam (1996-2000)," June 1996, Hanoi and Tokyo.

Agriculture and rural development

Phase 2:

Agriculture and rural development

Participation in AFTA, APEC, and the WTO, and industrial policy

Fiscal and monetary policy

State enterprise

As for the concrete procedures for implementing the joint research, the general leaders from both sides met together for consultations at the start of each phase and draw up minutes of those meetings,[2] thereby ensuring that the project does become a real "joint research."

To ensure that joint research was fruitful, opinions were exchanged, materials and literature provided for each other, joint field studies and interviews conducted, and research findings discussed closely at the overall project level, the subgroup level, and the individual researcher level. At the overall project level there were five workshops held during Phase I and three during Phase 2, in either Tokyo or Hanoi.[3]

The results of the joint research can be seen, first and foremost, from the research findings themselves. In many aspects, the Vietnamese economy suffers from a lack of basic data, statistics, and information, which combined with the complexities involved in the transition from a centrally planned economy to a market economy (this overlaps the problems found in the process of rehabilitation and reconstruction from an economy long on a wartime footing) to produce the many inadequacies that remain in our research. But these details aside, during Phase I we were able to elucidate four problems in the Vietnamese economy and advise that they be taken note of in the drafting of the Five-year Plan.

The four points we called attention to were: 1) restraining an excessively high growth rate; 2) improving domestic savings rates; 3) recognizing that the development of agriculture and rural economy (including rural industrialization) was a major prerequisite to industrialization; and 4) recognizing that it was desirable to take a dualistic economy approach to industrialization, having a modern industrial sector with modern industrial technology and equipment existing side by side with a small industry sector using traditional technologies and facilities.

The importance of these four points was in no way diminished during Phase 2. However, new conditions that emerged or became apparent in the Vietnamese economy in 1996 and

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2 August 30, 1995, "Minutes on Guiding Principles of Joint Studies"; August 9, 1996, "Minutes on the Conduct of Vietnamese-Japanese Joint Studies for Phase 2."

3 Phase 1: 1) Hanoi Preparatory Meeting (May 1995, Hanoi); 2) First Hanoi Workshop (August 28-29, 1995, Hanoi); 3) Consultations on the work plan for joint research (November 27-28, 1995, Tokyo); 4) First Tokyo Workshop (January 28-29, 1996, Tokyo); 5) Second Hanoi Workshop (March 1-2, 1996, Hanoi).
Phase 2: 1) First Tokyo Workshop (March 22-23, 1997, Tokyo); 2) Consultations on the progress of joint research and announcement of results (May 22-23, 1997, Tokyo); 3) First Hanoi Workshop (June 6-7, 1997, Hanoi).

after resulted in the addition of a new research priority, namely new issues of the Vietnamese economy emerged in its international economic dimension. The priority here was to consider how Viet Nam should draft and implement its trade and investment policies in the circumstance that Viet Nam have joined AFTA and applied for membership in the WTO and APEC. This, by way of conjunction, also raised new issues directly and indirectly in state enterprise reform, industrial policy, fiscal and monetary policy, and agriculture and rural policy.

The second result of the joint research can be found in the evolution of the mechanism for joint research itself. This mechanism was devised experientially as a means of furthering the cooperative relationship between developed and developing countries concerning industrialization for economic development. It was obviously anticipated that there would be many difficulties in the realization of this mechanism, but as a matter of fact, the results outweighed the difficulties. In a word, a relationship of mutual trust has begun to take root between Japan and Viet Nam at all levels of the joint research. In the process of researching topics together, we were able to understand the sincerity and good faith of our counterparts. Naturally, differences of approach sometimes remain regarding analysis and policy options, but both sides understand the arguments behind these differences and indeed the background that has produced them, and from that have developed trust and confidence in one another.

In proceeding with this study project, we have obtained profound support from a wide circle of the people. We would like to acknowledge this with warmest gratitude.

The Japanese side of the joint research project feel extremely fortunate to have been given many opportunities to meet with Secretary-General Do Muoi and other Vietnamese leaders and seek their opinions. These opportunities were instrumental in bringing depth and strength to our findings.

The Vietnamese side of the project expresses sincere thanks to JICA and its Vietnam Office for supporting its research activities particularly in Japan.

In addition to submitting this Final Report to the leaders of Viet Nam, we will be providing it to other interested parties in order to seek comments and opinions.

February 1998, Hanoi and Tokyo

Thai

Shigeru Ishikawa

Nguyen Quang Thai
Vietnamese Cochair of
the Research Group
Doctor of Economics

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Japanese Cochair of
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Doctor of Economics

General Comments

1

Introduction

1-A: A "New Stage" of Vietnamese Economy and Industrialization*

Shigeru Ishikawa
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Ⅰ. Preface: The Significance of "New Stage"

This joint Japanese-Vietnamese Study aimed, at its Phase I, to offer our opinions on the draft of Vietnamese new Five-year Plan of Social and Economic Development (1996-2000) which was at that phase in the process of formulation. The study for this purpose was conducted on a comprehensive and basic level, except for special topics such as on certain specific industry studies. This is partly due to the fact that on the side of the Japanese counterpart, the knowledge on the Vietnamese economy was not yet accumulated sufficiently at that time. The overall frame of the Study was broadly structured in line with the "four comments" made on the initial draft of the Five-year Plan and presented at the Hanoi Workshop in August 1995. (Ministry of Planning and Investment (Viet Nam) and Japan International Cooperation Agency, *the Economic Development Policy in the Transition toward a Market-Oriented Economy in the Socialist Republic of Viet Nam, Phase I, Final Report, Vol.1, General Comments*, August 1996, pp.21-39.) Namely, (1) restraining the desire for an excessively high growth rate, (2) substantially raising domestic saving rates, (3) recognizing that the development of agriculture and rural economy is a major prerequisite to industrialization and (4) recognizing that it is desirable to take the approach of a dualistic economy development to industrialization, having a modern industrial sector with modern industrial technology and equipment side by side with a small and medium industry sector using more traditional technology and facilities.

These comments were derived with focus mainly on the issues of the domestic aspect of development process. This reflected the situation at that period in which, due to the successful implementation of Doi Moi Policy (1986-), the Vietnamese economy emerged from 'crisis' conditions which lasted until the early nineties, and completed the reconstruction of wartime damage, enabling it

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* Although this chapter is written on my own responsibility, it in fact is a product from a continuous exchange of ideas and discussions with my Vietnamese colleagues at the Joint Viet Nam-Japanese Study Project. I wish to mention in this respect the names of Dr. Nguyen Quang Thai and Dr. Le Dang Doanh, particularly. I received useful advice and guidance about the matters in the legal aspect of WTO and AFTA from Professor Tamotsu Takase and Mr. Etsuji Uno. I also received important informational help at ASEAN Secretariat Office, especially form Professor Chee Peng Lim, Mr. Raymond W. M. Yee, Dr. Pham The Vinh and Dr. Robert R. The Jr., and at ASEAN Economic Research Unit, Institute of Southeast Asian Studies from Dr. Joseph Tan. I would like to acknowledge all of this assistance with sincere gratitude. I also wish gratefully note the research help form Mr. Yoshikuni Kobayashi, Senior Adviser, The Overseas Coastal Area Development Institute of Japan. Boxes 1 to 3 were prepared by him.

to enter the stage of long-term development. It was in the adoption of the Five-year Plan (1996-2000) by the Eighth Congress of the Viet Nam Communist Party (June, 1996), including a longer-range outlook for the nation's economic development with a target of 2020, that the policies and their projection of this long-term development were described specifically.

Phase II started with the purpose of the study on the implementation of the new Five-year Plan and the new issues emerging while it is implemented. In the process of the actual study, it has become gradually clear that in this new stage of development, Vietnamese economy is encountering a "new challenge" in two senses.

(1) In one sense, Viet Nam exhibited such achievements as a rise in the rate of growth and the domestic saving rate, the recovery of equilibrium in international balance of payment and fiscal balance and suppression of rampant inflation after the period of economic recovery (included in it were, independence from the reliance on the former COMECON countries, enforcement of drastic disinflation policies and the preliminary steps for conversion of the planned economic system into the market economy system). But, staring from 1996 there emerged diminishing or even declining signs for all of their variables. Among these, especially notable are an increase in the excess deficit in the international trade balances, to the extent of more than ten percent of GDP, and in the counterbalancing items in the international capital account, the amount of diminishing gross disburse of ODA, stagnation of FDI amount and "uncontrolled" utilization of short-term foreign credit for investment.

It should also be noted that behind the fact of increasingly large trade account deficit, there is an inflexible foreign trade mechanism working in which foreign capital-involved companies (the major companies dealing with manufactured exports and imports) are importing raw materials and parts from the industrial countries and exporting light industrial products and assembled components manufactured on the basis of these imports. These issues tend to accompany the new policy problems for control over foreign exchange rate, rates of interest and inflation. Overall, a new challenge is relating to the task of a higher-level macroeconomic control than ever before to address all of these trends and issues.

Meanwhile, beginning from early this July, a currency instability issue or financial crises occurred in Thailand and spread over most countries in Southeast Asia. Among the underlying causes it is easy to identify the facts and issues which are also working in Viet Nam as causes of its new challenges. For Viet Nam it is desirable to study the development of still on-going issue of financial instability in neighboring countries and to learn from their experiences for addressing its own challenge of the macroeconomic control.

(2) In another sense the challenge is the issue of the Vietnamese economic system reform in its external economy aspect. At the same time, it is the issue of constraints which Viet Nam's commitments for internationalization of its policy have placed upon the enforcement of Viet Nam's long term economic development, especially industrialization. This can be elaborated in the following three headings.

1) During the first half of 1994, "industrialization and modernization" were taken up and made a long-term development target. Now, to this target is added a new content, namely "internationalization," or the transition to "an open door economy that would integrate the Vietnamese economy with the regional and world economies." The specific steps to be taken in this are, simply, accession to AFTA (the ASEAN Free Trade Area), and application for membership in the WTO (World Trade Organization) and APEC (Asia Pacific Economic Cooperation), with the

acceptance of the international commitments and promises these steps would entail.
2) In order for Viet Nam to enjoy the enormous benefits that "internationalization" would bring to the Vietnamese economy (*i.e.*, in the short run, introducing competitive discipline to the domestic industry and enterprises, and in the longer run, to promote expansion of foreign trade and investment), Viet Nam would have to face severe challenges in other aspects of its economy. Namely, it will have to remove all the non-trade barriers (NTB) and to reduce the import tariff rates of almost all imports up to 0-5% for the ASEAN regional trade by the year 2006 at the latest, as an obligation emerged with the participation in AFTA. As a result, Viet Nam will not have enough time to enjoy the opportunities to protect infant industries that other developing countries coming before it were able to enjoy (nor will it have enough time to use the tool of "import substitution" for its industrialization), and will have to develop and strengthen within a very short time period its export industries, and thereby to achieve equilibrium in its balance of payments. On the other hand, most of the exports of Viet Nam destinated to the AFTA countries consist of crude oil and unprocessed agricultural products, which are outside of the range of products under the tariff reduction scheme to the 0-5 percent by 2006. Therefore, Viet Nam would become a beneficiary of AFTA tariff reduction only after its industrialization will achieve progress to some extent.
3) An additional challenge in internationalization will be to cultivate, by the same last target year, the capability of the major units among Viet Nam's state enterprises to survive, compete and develop within the environment of international competition created by the liberalization of trade and investment.

The purpose of Part 1 is to outline the general research findings and remaining tasks from Phase I and Phase II, focusing on the developments of the economic system reform. In this part, the "new challenges" will emerge as direct and supremely important issues.

The "system reform analysis" of Phase I was performed by using China's blueprint for transition to the market economy (revealed in the "Decision Regarding Several Issues in the Establishment of a Socialist Market System" adopted by the Party Central Committee in November 1993) as Viet Nam's reference framework for considering the future course of systemic reform. This method is considered permissible because China has begun the transition from a socialist economy to a market economy earlier than Viet Nam, and its productive forces and economic system are fairly similar to those of the Vietnamese economy.

To refer to the several observations that were made in Phase I (the reference is expanded and revised as warranted by subsequent conditions and findings), leaving aside those areas of macroeconomic reform for which a drastic change was attempted between the year of the decision on *Doi Moi* (1986) and the year 1989, and in which there were clear successes --- such as prices, distribution, budgeting, and credit, reforms to most other areas of systems and organizations remained in the "test" stage with no firm scenario for system reform yet published.

As one example, there has been no clear guideline on the rebuilding of the organizations for agricultural production, distribution, and financing above the level of the individual farm household, though this has been deemed indispensable to the rebuilding of Viet Nam's agriculture and farm economy. In addition, reforms designed to restructure state enterprises as independent business entities have been remarkably slow in moving forward.

Similar observations can be made of China as well, but China was able to continue moving forward with industrialization even though its state enterprises were relatively stagnant. This was due to the fact that the process of rebuilding the agricultural economy resulted in the emergence of "Township and Village Enterprises" and other "collectively owned enterprises," and that the establishment of "Special

Economic Zones," "Coastal Open Economic Zones," and other areas where special incentives were given to foreign direct investment brought about the rise of the large number of the foreign capital funded companies (including joint ventures); therefore despite the relative stagnancy of the state enterprise sector, the pace of industrialization was steady. In Viet Nam, these non-state sectors are not yet grown up.

Under the planned economy, the fiscal and financial systems were little more than supplementary systems subordinated to a capital accumulation mechanism that relied on sectorial allocations of capital goods by the state. In a market system, however, they must be reborn as autonomous systems that monetarily lead capital accumulation. Unfortunately, however, neither the fiscal nor the financial system has been able to eliminate the interference from line ministries and politicians, or wean themselves of their dependence on the ministries and politicians to become sufficiently independent. The domestic savings rate is still low. Banks have replaced the state finance as the major organ in allocating domestic investments, but their financial intermediation has been slow to develop. One manifestation of this is the serious problem of the banks' holding of increasing amount of bad debt of state enterprises.

During Phase I we took up the performances achieved in rebuilding productive capacity as an issue that was deeply related to these characteristics in systemic reform. Among these performances are noted that (1)while brilliant results had been achieved in overcoming the crisis and embarking on the rebuilding and reconstruction of the economy, there were not seen sufficient signs of sustainable growth in agriculture and the farm economy where the primary energy for reconstruction of the entire economy should be found; that (2)Viet Nam failed to pay sufficient attention to the lessons of economic history that the industrialization process (including rural industrialization) of the late-coming developing countries needs to be along the path of a dualistic structure of large-scale, modern industries and small enterprises using more traditional technologies and resources; and that (3)in the field of modern industry Viet Nam did not make sufficient efforts to develop a scenario for industrial development that focused on inter-industry linkages and time-sequencing of industrial staring up in. We therefore thought the best option for Vietnamese industrial policy is to start from a basic assumption that in Viet Nam industrialization is in its very initial stage and modern, large-scale factories are sparsely located in the country.

Looking back from the current vantage point it appears that the observations and consequent policy options of Phase I still apply. On the other hand, however, the perspective for those observations was exclusively from the domestic economy that was shut off from international market competition with main attention put on the potential and speed of a market economy transformation. We did not consider the issues that would be brought to the fore by "internationalization" of the economy which marketization would sooner or later come across.

This is not to say that reforms to the Vietnamese system have avoided dealing with external economic dimension. It is true that steps have been taken to liberalize organization, planning and regulation in various areas of foreign trade, exchange and investment. But the important fact not to be overlooked is that Vietnamese industrialization was in the initial stage and there have not yet emerged industrial sectors that required protection as infant industries. Hence the tariff rates on most of the products from these sectors were near zero. On the other hand, many of these products were essential production goods and low tariffs helped to encourage their importation. The decisive problems would manifest themselves as Vietnamese industrialization progresses and new infant industries emerge. This is one of the "new challenges" that we must address in Phase II.

As already summarized, Viet Nam's membership in AFTA and other international economic organizations has become a topic for the Japan-Viet Nam Joint Research Project in Phase II. The formal decision to include this topic was made in August 1996, but the topic had been informally offered at the coordination meeting held immediately after the Hanoi Workshop (Phase I) in March 1996. Note that Viet Nam affiliated with ASEAN in July 1995 and accordingly joined AFTA in January 1996. Given the timing involved, one may well wonder if the joint research project was not a bit late in tackling the potential shocks to the Vietnamese economy which might come from becoming membership in institutions like AFTA that seeks rapid liberalization. We do not have an adequate response to such a question. To be frank, we have only become aware of the importance of this issue gradually in the course of our learning about the Vietnamese economy. The issues involved are deep and complex and in this paper we will only provide preliminary analyses and suggestions.

In the pages that follow we discuss the issues in economic reform under the "new conditions," focusing on the formulation of Vietnamese trade and investment policy in conjunction with membership in AFTA, WTO, and APEC.

II. Membership in International Economic Organizations and Viet Nam's Response

Among the questions it behooves us to ask are, first, what procedures international economic organizations like AFTA, WTO, and APEC intend to use to achieve the trade and investment liberalization goals, and what policy challenges this will present to Viet Nam; and second, how the government of Viet Nam is dealing with these challenges.

As for the first question, we have already submitted to the government of Viet Nam the opinions of the chief researcher on the Japanese side in a paper called "Vietnamese Membership in International Economic Organizations and Japan's Experiences," which was prepared at the request of the Vietnamese side (February 6, 1997) and recorded as a background document to the Tokyo Workshop of March 23, 1997. For the second question, we were given an unofficial briefing on Vietnamese guidelines by the chief researcher and the chief of the State Enterprises Study Group on the Vietnamese side during the Japan-Viet Nam Coordination Meeting held on May 22 and 23, 1997. The chief researcher on the Japanese side presented a memorandum to the Hanoi Workshop in support of these guidelines ("Japan-Viet Nam Joint Research 'So Far' and 'From Here on Out'"). Outlines of these documents are presented below.

Outline of the February document : AFTA is an organization for regional integration for ASEAN members that is based on the GATT Enabling Clause (1979). Members have promised to achieve almost complete liberalization of intraregional mutual trade (elimination of non-tariff barriers and reduction of import tariffs to 0-5%) with a ten year preparatory period from the time of establishment (by 2003, but for Viet Nam by 2006 since it joined three years later). The CEPT (common effective preferential tariffs) principle establishes the procedures for AFTA tariff reductions and provides for "General Exceptions" (in Viet Nam's case, 146 items), an "Inclusion List" (857 items) and a "Temporary Exclusion List" (1,189 items). Annual reduction plans took effect immediately in 1996 for the items in the inclusion list but since Viet Nam has almost no infant industries requiring protection, the tariffs on most goods are already in the 0-5% range, except for those goods where tariffs are used to earn custom revenues. Just listing up these goods fills the inclusion list.

As can be seen from Table 1, other AFTA members are steadily lowering their average tariffs from year to year during the 1996-2000 period, but Viet Nam's average rate will remain constant at 0.88% throughout the entire period. The items in the temporary exclusion list have a great variance of tariffs of up to 60%, but virtually all these tariffs are aimed at providing tax revenues. Under CEPT, countries must move the temporary exclusion list items to the inclusion list over a five year period beginning in

1996 (1999 for Viet Nam) and ultimately (the last target year is 2006) reduce their tariffs to the 0-5% range. Under the "new conditions," the high tariffs that had been allowed in the past (as well as the allowed reduction period) are taken to be usable for the essential protectionist tools.

The WTO takes over for the GATT and attempts as before to achieve the goal of liberalizing trade and investment on a global scale. The priorities here are rather on removing quantitative restrictions and other non-tariff barriers to trade than on tariff reduction. All these barriers are intended to be converted to the tariff of a relevant level (tariffcation) and only after that subjecting general efforts to reduce those tariffs. GATT Article 18 : C and D allow developing countries to use import restrictions when necessary for overcoming balance of payments problems or protecting infant industries, but it is becoming harder to qualify for these provisions, which must be negotiated individually on a case-by-case basis. On the other hand, the tariff concession negotiations that new applicants enter into will probably take account of the need for developing countries to use protective tariffs for their infant industries (ceiling bind or upper bind).

APEC is a forum for economic cooperation that includes the ASEAN countries and also the advanced and newly industrialized countries of the Pacific rim. Developed countries are expected to have liberalization complete by 2010, developing countries by 2020. This liberalization is very flexible, however, and will take place according to voluntary plans drafted and implemented by members themselves. As the slogan of "open regionalism" indicates, the liberalization will not be an exclusive within-region, members-only affair. This has caused some to consider the "individual action plans" for trade and investment liberalization voluntarily submitted by members since 1995 to be ineffective and without binding force. However, others argue that mutual monitoring has been effective in quelling the "free rider" tendencies that might otherwise be manifest in such a situation, and APEC will therefore play a leading role in effective regional liberalization.

Viet Nam has three options for dealing with these three organizations, and particularly AFTA. The first is to continue to move along the liberalization schedule already committed to AFTA and attempt to maximize the benefits that this is likely to bring to Viet Nam (*i.e.* the benefits due to membership in an international system and the introduction of competitive disciplines to the Vietnamese domestic economy). The second is to attempt to secure and realize the policy option of protecting the development of internationally recognized infant industries, an option that is accepted widely in the theory of international trade and is supported as legitimate in the GATT rules. This option will be largely denied once the first option is chosen. These two options are not mutually exclusive. The third option is to seek an optimal mix of the first two.

Preliminary suggestions from Hanoi : During the coordination meeting held in Tokyo in May we were given an unofficial briefing on the policy lines of the government of Viet Nam towards the problems relating to the membership in international economic organizations. First, for AFTA Viet Nam will be adhering to existing policies (however, these appear in fact to be close to Option 3, as will be shown shortly) and for industrial policy in Viet Nam will put priority on export-oriented industrialization. (As we know, government policies since July 1994 had placed equal weight on export-oriented industrialization and import-substitution industrialization). Both of these are resolute decisions based on an understanding of internationalization trends and a willingness to stake the dignity and prestige of the state on the fulfillment of obligations. In that, we have the utmost respect for them. However, in order to consider in detail the contents and significance of these decisions, we also need to know the observations and opinions of Vietnamese experts.

Let us start by referring to the following opinion voiced by a Vietnamese expert official who was involved in AFTA membership and was the only person we interviewed in Viet Nam who provided us with concrete data.

1) Viet Nam will cooperate with trade and investment liberalization within AFTA, but will also utilize protectionist trade policies, endeavoring both to prevent declines in tariff revenue and to protect domestic industry.
2) The AFTA/CEPT tariff reduction program will be dealt with by categorizing Vietnamese industry into three classes according to competitiveness and development potential:

① Industries that have comparatively high export competitiveness. Tariffs will be reduced quickly. They include rice, coffee, tea, peanuts and other agricultural processed goods, processed fish products, textiles, and clothing.
② Industries that are not competitive and could not withstand the competition from imports without protection. Theses industries will be protected for a certain period. CEPT tariff reductions will need to be delayed. They include vegetables and other agricultural processed goods, electronic and electrical machinery, and shipbuilding.
③ Capital-intensive industries in which Viet Nam is now at a comparative disadvantage position. CEPT adoption will need to be delayed for the longest period for these industries. They include paper products, cement, and steel.

3) There are possibilities of taking other protection measures in addition to tariff policy, for instance, various binds of non-tariff barriers, investment inducement policies, and potential protective measures through the use of taxation, fiscal and financial policy instrument.

Below is a summary of the paper prepared for the Hanoi Workshop ("Strong Export Oriented Industrial Development in Viet Nam") by Phan Quang Ham, the chief of the Industrial Policy Group of the Japan-Viet Nam Joint Research Project on the Viet Nam side and the head of the Industry Bureau of DSI-MPI.

1) In accordance with the decision of the Eighth Party Congress, Viet Nam is building an open economy that is integrated with the regional and world economies. This will entail a strong export orientation and efforts to develop substitutes for imports. The following three types of industries will be important in this:

① Export-oriented industries
② Basic industries: not only they will encourage growth in many other industries but they will also help to create strong export-oriented industries.
③ New industries: Industries that must be developed and strengthened in order to maintain Viet Nam's comparative advantages in the future. Up to 2010 this will mean labor-intensive export industries that do not require much capital and will be able to recover capital quickly; for example, textiles, garments, shoes, electronic assembly, agricultural processing, and other light industry. As the economy begins to gain strength after 2010, this will mean mechanical and electronic products, export parts, chemicals, petrochemicals, and other industries capable of producing and exporting high value-added goods.

2) Protection policies will be necessary until the Vietnamese economy is fully integrated with the world economy. This protection must not violate commercial liberalization or the international treaties and agreements signed by the government of Viet Nam.
3) To exploit the advantages currently possessed by Viet Nam in natural resources and labor, Viet Nam will need to attract investment capital from both members and non-members of AFTA. This will require that it create an investment environment that is superior to that of other ASEAN countries. Important in this will be improvements to the electric power, water, transportation, and posts and communications infrastructure, and construction of industrial parks and export processing

zones in appropriate areas.

III. The "Strait Gate" for Countries Seeking Industrialization from Now

Having heard the general policy lines and more detailed requirements for Viet Nam's new trade and investment policies, we think the next challenge before us is to consider the systems, orientations, and implementation tools that will be required for Vietnamese trade and investment policy as it attempts to meet the new "challenges" before it. Before delving into this, however, we must draw the reader's attention to the fact that, given the new international conditions, the "feasible area" for industrial strategizing will be far more narrow for countries like Viet Nam that are just starting to industrialize than they were for countries that industrialized earlier.

(1) Until very recently, it was considered appropriate policy for developing countries to engage in a sequencing of their industrialization, beginning first with efforts towards "import substitution industrialization" (ISI) and then later moving to "export promotion industrialization" (EPI). This was equivalent to recognizing that in both the ISI and EPI stages, developing countries were justified in adopting policies to protect infant industries prior to the adoption of the trade policies based on the principle of comparative advantage.

The ASEAN countries provide the classic example of countries going through the ISI stage before entering EPI. The experiences of Thailand referred to in the "March document" are one case in point. Thailand clearly made the transition from ISI to EPI in the early seventies. One representative example of its ISI period comes from 1962 when it hiked tariffs on all cotton cloths in order to develop a cotton weaving industry that used imported cotton yarns. In 1968 it decided to develop its spinning industry, so it created new tariffs on cotton yarns and raised the tariffs on cotton cloths by a corresponding rates. However, it is often the case that there are no clear distinctions between the ISI and EPI periods.

South Korea and Taiwan are thought to have completed the transition from ISI to EPI in the early fifties, but when one examines the rapid industrial development of the EPI period, one finds that there was growth both for labor-intensive export sectors and capital-intensive intermediate sectors. The first Japanese research to call attention to this fact (Imaoka, Ohno, and Yokoyama eds., *Industrial Development of the Middle Income Countries: Theory and Empirical Verification of Multi-track Growth*, Institutes of Developing Economics (in Japanese), 1985), labeled this "multi-track" growth. Many similar phenomena can be seen from Japanese trade and investment liberalization in the sixties and seventies, which was pursued rapidly under the "external pressure" of the GATT, IMF, and OECD.

(2) However, international trends in recent years made it much more difficult to use ISI to prepare the preconditions that are necessary for EPI. The new international trend has made farther less accommodating on the period of ISI tolerance. In addition, the period for which EPI is tolerated is also short when it involves the payment of subsidies for the development of specific export industries, or even when it does not discriminate among industries, when there is a chance that it will distort the allocation of resources for the economy as a whole. If a developing country attempts to engage in EPI beyond that period, it will frequently find itself embroiled in "trade friction" with developed industrial countries.

One factor in the internationalization trends that are shortening the period of ISI tolerance is the final agreement reached by the Uruguay Round in April 1994. Members will be required to implement the tariff reductions they committed to at a steady rate for the four-year period between January 1995 and January 1999. We have already noted above that the AFTA/CEPT agreement is also strictly committal in this regard. The only occasion for which international institutions now recommend EPI is for cases where subsidies need to be paid out and other incentives given for export-oriented production in order to remove the anti-export bias in the domestic pricing system among exportable goods, import-substitution goods, and non-trade goods, which was the result of the distortions caused by ISI. The only cases for which this need is recognized involve developing countries which still do not have developed market economies in place. As a market economy develops, price mechanisms will work to make possible the readjustment of misallocations of resources. This is what "trade liberalization" seeks. EPI is permitted as a tool to promote this in the stages leading up to trade liberalization.

Ari Koko, an international economist at the Stockholm School of Economics has recently published a paper on Vietnamese trade policy ("Managing the Transition to Free Trade: Vietnamese Trade Policy for the 21st Century," 18 May 1997 (mim.)) in which he argued that the government of Viet Nam has not paid interest in EPI. He recommended the government to complete export promotion industrialization over the next ten years and therefore move on to the stage of trade liberalization. Note that the period of tolerance for EPI has been set short in this case as well.

(3) The experiences of ASEAN countries and China indicate that simultaneously to trade liberalization, or in some cases, even in advance of it, there is a liberalization of investment by foreigners in the country. One example of this investment liberalization comes from China, which began a bold program to attract foreign capital by establishing "special economic zones" and "open economic zones" in specific, limited regions right at the starting period of its reform and open door policies. In the ASEAN countries, this trend began to be observed in 1985. As a background, there arose at that period the need of Japan and the NIEs to shift their production bases offshore. In response, the "latecomer" developing country group allowed foreign direct investment (FDI) companies to establish wholly-owned subsidiaries when they moved in, and to provide tax breaks and other incentives. They thus competed with each other to attract investment. FDI did not stop just with the transfer of smaller companies but came to include an increasing number of large multinationals (MNC: companies engaged in production and sales activities in a multiple number of countries with foreign investment strategies to align them together) (see Box 3). However, in order for Viet Nam to make these experiences of investment liberalization as its useful lessons, studies of the sufficient degree should be conducted for distinguishing different forms of investment liberalization and for each form for clarifying whether or not investment liberalization will be promotive of trade liberalization.

As for these trends in investment liberalization, there is a necessity for late comer developing countries in that they need urgently to draw on the capital, technology, and managerial skills of FDI in order to pursue ISI and EPI under the conditions we have described in headings (1) and (2). We must also point out that, however temporarily, the strong distrust by developing country peoples of the FDI from developed countries, with the root in the colonial history, has been put aside. This psychological change certainly has facilitated to bring the new trend in investment liberalization. However, the decisive factor determining the interrelationship between trade liberalization and investment liberalization seems to be provided by the nature of the individual form of FDI. The studies on this question constitutes a main component of the topic for Subgroup on Industrial Policy. The summary of the study of this Subgroup is provided in Chapter 2 of Part 2. As an example, by the 1970s, most of FDI toward the developing countries were done benefiting from the protective tariff wall established by the host countries which were the former export markets for the investors. In other words, the aim of these FDI was maintenance of their export markets. FDI in the 1980s are, despite its new outlook, likely to be similar to the above case for the previous periods, insofar as their investment inducement depends on the tariff and non-tariff protection. To the extent that this is the case, therefore, this type of investment liberalization is antagonistic to trade liberalization. Even with regard to the industries like garments, textiles and electric appliances, which are considered most promising export industries, once their production would expand sufficiently large to induce the manufacturers to consider new investment into the mid-stream and even the upper stream branches of the same industry, they are likely to seek tariff and no-tariff protection. However, the period which allows FDI in Viet Nam to benefit from such protection is very short, only up until 2006.

On the other hand, in the case of industries like automotives and electronics consisting of multi-processes and multi- sectors, trade liberalization on the basis of regional integration of countries is likely to be complementary with investment liberalization concerning MNCs in these industries, as these MNCs tend to have strategies for intra-regional division of labor among different production processes.

With regard to all of the main types of FDI in the ASEAN region, we have yet to study their relative importance in terms of their own amount and their effect on trade liberalization and expansion, both at present and in the forthcoming decades.

(4) The latest-coming developing countries that are only now starting down the road to industrialization may find that the condition of trade liberalization that is placed on ISI and EPI to be a new and heretofore unseen barrier to development. On the other hand, there is also the new trend towards investment liberalization discussed above. We think that a means of assisting developing countries in overcoming this new barrier may be found in learning how to get along well with foreign investors, especially MNC.

One could also interpret the trade liberalization condition that has been placed on ISI and EPI not as a new barrier to developing countries but as a path to more effective development promotion. This is an interpretation, for instance, taken by neoclassical free trade theory. From this standpoint, it would be desirable that policymakers distinguish as early as possible between the import-substitution sectors that are not competitive and have little chance of survival over the long run and the sectors that are almost certain to survive over the long term and that ought to be developed in the direction of export promotion. The economy would, in accordance with this, shift their investments from the former to the latter, which would mean that import substitution industries would contract and the capital and human resources freed up by this from the important substituting industries would be able to be transferred into export industries with relatively little pain.

Our concern with this interpretation is whether or not it will be possible for resource allocations to proceed so smoothly just with government guideposts in countries with underdeveloped domestic market conditions. We must also point out that victory in today's competitive international markets depends not just on selecting industries in which one has a comparative advantage as dictated by simple domestic factor endowments, but also on how great the opportunities are to take advantage of economies of scale, learning effects, R&D, and other elements. The governments of developing countries still bear heavy responsibilities that they cannot leave entirely up to the markets.

IV. Towards More Systematic Trade and Investment Policy

Much preparation will be required before the trade and investment policy options under the "new conditions" can be considered. There must first be determination of a basic policy stance. Here, we will take tentatively as our stance the position of Option 3 in 2 above, —namely liberalization will be the foundation, but mitigated for the protection of infant industries. Having taken this stance, however, we still require that an analytical model be drafted from which one can deduce the concrete options available, that the massive amounts of additional research materials to be used for this purpose can be assembled, and that the work of analysis and policy findings moves forward. This is a job that will be only capable of being accomplished by government-sized organization and staffing. Below we have provided a few notes on approaches for formulating comprehensive trade and investment policy options. They should not be considered anything more than notes, however.

(1) ***Integration of the individual industries approach*** : One of the questions frequently raised at this time is how to group current export and import products (groups) into: (i) those that are already internationally competitive or are likely to become so and therefore have no problem under a 0-5% tariff in 2006), (ii) those that could stand on their own if protected through 2006, and (iii) those that

will not be able to stand on their own by 2006 because they lack sufficient domestic demand by that time. The purpose of our Industrial Policy Group is to investigate the conditions for starting up those industries which are designated by the government of Viet Nam, and it has taken this grouping approach in lacking with questions related to AFTA. However, most of those who take this approach reserve comment on the question of what to do with those industries which were found to be in the third category (which includes blast-furnace integrated steel production, petrochemicals, and upstream textile sectors according to the Industrial Policy Group). From an analytical standpoint, this is a static approach in that it takes current technology and market demand as givens. In addition, its range of industrial coverage is narrow. Its remaining task relates to the fact that it did not take into account the infant industries that might emerge as Vietnamese industrialization would progress.

(2) ***Discovery of infant industries that might emerge*** : This approach attempts to discover an infant industry group for Viet Nam by using cross-section comparisons of eight East Asian countries (GDP growth rates, item-by-item industrial export growth rates etc.). The reasons can be found in Kenichi Ohno's paper for the General Comment Group ("Trade Liberalization Strategy for Latecomer Development Countries: The Case of Viet Nam in AFTA," background paper for the Hanoi workshop). From an analytical perspective, however, this too is a static approach.

(3) ***AFTA domain vs. WTO domain*** : while the discussions in the above two items concern the measures for addressing the AFTA problems (i.e. the problems of industrial structure adjustment which emerged as a result of Viet Nam's participation in AFTA), this section will consider related problems which have not yet taken up, namely the problems whether and how the AFTA problems will be affected by Viet Nam's participation in WTO when it is realized. Table 3 shows statistics indicating the export and import structure by destinations of Viet Nam. We will take out from this statistics the figures on the proportions of total exports and imports which are occupied by those of ASEAN 5 and other areas of destination. Taking these proportions as a starting point of the study, the investigations will be made as to how these proportions would be affected by the enforcement of the AFTA scheme and the possible admittance to WTO in the near future.

1) Imports of Viet Nam

① AFTA domain (in the case participation in WTO are not materialized)

In 1995, the proportions of total imports of Viet Nam which was occupied by the AFTA region (represented by ASEAN 5) and the outside of AFTA area, were 26% and 74%, respectively. How these proportions would be changed when the import tariff rate reduction scheme will have been completed? We will consider only the effect of reduction of import tariff rates from the AFTA countries, assuming other things being unchanged. For simplicity, we will let Thailand represent the AFTA countries other than Viet Nam, and Japan represent the outside of AFTA countries. T denotes the FOB import price for Viet Nam when there is no trade barrier. t denotes the target import tariff rates, 0-5%, in the AFTA scheme. Therefore, total import of AFTA products in 2006 is equal to T(1+t). The corresponding notations are J and j (the non-preferential import tariff rate). Total import from Japan is J(1+j). By assumption, the values of J and j are constant during the year 1995-2006.

[Case 1, where J(1+j)>T(1+t)]

Imports from Japan is converted to Thailand. The proportion of imports from the AFTA region, 26%, will diminish, while that of imports from the non AFTA area, 74%, will expand. (In time-dimension, this diminution or expansion is to be realized gradually between 1999-

2006.)

[Case 2, where J(1+j)<T(1+t)]

The conversion which would take place in Case 1 will not arise. The proportions in imports of both areas remain unchanged. The import trade with the AFTA area, 26% of total imports, will be bound formally by the AFTA rule, but in reality the rule and the tariff rate stipulated in it will not be effective.

② The relation with the WTO constraints in the case Viet Nam is admitted to WTO

There are two kinds of concession tariff rats of Viet Nam at the time it is admitted to WTO (see Box 1). One is the kind which the existing general tariff schedule is used for WTO concession rate. The other is the case of setting "ceiling bind" over and above the general tariff rate, with the intention of reserving the right to use protective tariff rate for infant industry in the future. (In 1995, the average rate for the former was 17%. The rate for "ceiling bind" was 40% in the case of the Philippines and Indonesians.) Regardless of whichever kind Viet Nam will take, the tariff reduction will be taken place according to the agreement to be reached with the WTO members. As for the questions suggested in the title of this heading, a broad answer may be provided as follows:

i) Conceivably, the WTO rule and the WTO concession tariff rate are applied to the imports from most countries in the non-AFTA area. The actual rates at the start and after their reduction seem in fact to be higher than the AFTA/CEPT tariff rates.

ii) In the case where the WTO tariff rate reduction starts from the existing general tariff rate, the conversion of the imports from Japan to the imports from Thailand (which was examined in Case 1 of (a)) would become gradually harder after a certain period of time. This is because the reduction of WTO tariff rates would make the competitiveness of the outside of AFTA area products increasingly stronger. In the case of setting of "ceiling bind" too, as far as it is not activated. The situation will be the same.

iii) If and when Viet Nam intends to activate its "ceiling bind" relating to certain specific products to be protected as infant industries, and further to raise them to be made domestically producible products, what would be the result? If these products would be those included in the AFTA tariff rate reduction scheme, is it not likely that the above action violates the AFTA rule? The answers to these questions are not explicitly stipulated in the AFTA Agreement. But the opinion of the AFTA Secretariat is that these will not pose a problem, so long as Viet Nam will adhere to the import tariff rates under the AFTA/CEPT tariff reduction scheme in making import from other AFTA countries.

2) Export from Viet Nam

The regional structure of exports from Viet Nam (by destination) is, in terms of the total value of exports, 19% for the AFTA area and 81% for the non AFTA area. If the by-commodity structure of exports of Viet Nam were the same as that of the earlier-comer developing countries in the AFTA region, the direction of the effect that the participation in AFTA would exert upon Viet Nam could be broadly understood by hypothetically placing Viet Nam on Thailand's position in the above analysis of 1)-i). But as Viet Nam's exports to the AFTA countries in fact consists largely of primary goods, this exercise does not work.

Namely, Viet Nam's exports to the AFTA region include crude oil, rice, been, rubber, maize, cashew nuts, pepper, fresh vegetables and fruits, aquatic products, steel, timber, coal, zinc, leather, and handicraft products. Of these, a very small proportion is eligible for AFTA preferential tariff. Notably, crude oil and unprocessed agricultural products are outside of the list for tariff reduction (Vo Dai Luoc, "Vietnam's Policy of Trade and Investment," Institute of World Economy, Hanoi, 1996 (mim.)). It is only after the period in which Viet Nam's industrialization will have proceeded to a considerable extent that the participation in AFTA will become beneficial to Vietnamese exports.

Finally, the development of FDI would affect the changes in the regional foreign trade structure variously depending on the FDI patterns, and through these effects also affect the relative importance of AFTA and WTO in Viet Nam's foreign trade. Further studies are omitted, however.

(4) *How much help has FDI been at present?* : This problems relates to the second problem of the last item. A policy issue which is left as a result of examining this second problem is whether the AFTA member countries will make a favorable assessment over the effect which the acceptance of FDI or of the MNC's regional production strategy is likely to bring about to them, and on the bases of that assessment establish and proceed the consistent policy of accepting or even inducing FDI. If the answer is positive, then the investigation should be extended further on the relationship between foreign direct investment and foreign trade (i.e., either complement any or substitutable and either positive or negative) and in particular on the internationalization strategies of MNCs. On the basis of these investigations, Viet Nam might develop a strategy for coexisting but at the same time skillfully negotiating with MNCs. However, all we can do at this time is simply to point out a few facts regarding the direct investment coming into Viet Nam as seen from recent surveys by the National Statistics Bureau.

① According to balance of payments statistics, the scale of FDI has been rising rapidly since 1990 and served as an offset to a similarly rapid rise in the trade balance (deficit). This has become more difficult, however, since 1994 (see Table 4). In addition, the scale of FDI is still small compared to China.

② This difference is reflected in the difference in the weight of FDI companies in total industrial sales (or total industrial production value), or in total capital and production stock, as seen in national surveys of industrial enterprises (see Table 5, 6).

③ The government of Viet Nam hopes that FDI will contribute to an increase in industrial production for exports, but macroeconomic statistics suggest that this result is still small. Total industrial exports by FDI companies in Viet Nam account for only 7.8% (1996) of total exports; only when crude oil exports are counted in does it reach 24.5%. By comparison, FDI companies in China accounted for 40.7% total exports in 1996 (see Table 7, 8).

④ Studies of the foreign investment sector by the government of Viet Nam indicate many examples in which foreign invested companies and, in particular, joint ventures are performing at levels unsatisfactorily to the government of Viet Nam (GSO, "Report on the Performance of Foreign Invested Economic Sector, Hanoi, Jan. 1997 (mim.)). With regard to these examples, there are many issues which remain to be considered, but at the very least these indicate that the government of Viet Nam has not yet learned how to coexist well with foreign direct investment.

(5) *Export industry promotion program* : The designing and implementation of this program should be the top priority among all of Viet Nam government activities related to trade and investment policies. The paper by Mr. Ham referred to above indicates that this work is already in progress within the government. His paper indicates that export industry promotion should cover not only directly exporting industries, but also basic supporting industries, and that the above directly exporting industries, includes "new industries" like machinery, electronics, parts, chemicals, and

petrochemicals that should be developed after 2010. Such a program would require attracting FDI, and for that purpose building of infrastructure, industrial parks and export processing zones.

The justification for the government being involved in these programs is, as described above, on the desirability to neutralize the anti-export bias in the current price systems and supplement the still underdeveloped market economy, during the period prior to trade liberalization. Therefore, the determination of industries to be encouraged and the selection of the means to encourage them will need to be made according to certain criteria that are in line with this goal. The problem is how to establish these criteria in a form that will be internationally palatable, and how to design programs based on these criteria that will maximize the goal of export promotion.

The answer to this question will come from reexamining and expanding upon the debate that has taken place in the nineties, mostly centering at international aid institutions, on the relationship of the roles of the state and markets in economic development. Empirical studies on trade and industry policy in East Asia (Japan, South Korea, and ASEAN countries) that have taken place in relation to it constitute part of the debate. One of the results of this debate is that the World Bank has rethought the "laissez-faire" doctrine that it had advocated once (during the 1970s) as a principle for economic development policy in developing countries, and as a result it can now accept the idea of using market incentives to make adjustments and coordination in the case of "market failures," or even to use measures of "non-market coordination" for this purpose.

However, the World Bank puts conditions on approval of the use of "non-market coordination": there must be "contest-based competition" even if it is not mediated by the market (for example, giving those who win in the export promotion contest bank loans at confessional interest rates or priority in foreign exchange allocations), there must be an able bureaucracy, and there must be checks and balances so that "non-market coordination" does not lead to "government failure" (World Bank, *The East Asian Miracle*, 1993). These conditions can be considered the World Bank's standards for creating export promotion plans, and will be a valuable reference in addressing the challenges that confront Viet Nam.

In the above, we have studied the issues of new trade and investment policies and, in particular, the problem of the steps toward the trade and investment liberalization, the decision of which is considered urgent as a result of the emergence of the issues of Vietnamese participation in international economic organizations. One of the conclusions is that it may be necessary to formulate as early as possible a program for export promotion industries, so that the commitment to realize rapid liberalization may have a positive result and, relatingly, to devise the policy to utilize a more systematic and positive policy of utilizing FDI. These are in fact the activities in which Vietnamese government has already started to engage, and we are heartily in support of the effort.

However, we wish to emphasize the fact that with regard to the effect that the participation of Viet Nam in AFTA will have on Viet Nam's future trade and investment policies, there remain still many uncertainties. As one of them, there is a problem of whether or not the implementation of AFTA scheme results in any trade diversion inside the AFTA region (as we see in the above 4.(3)) and, in what form and extent? This could be answered more accurately as a result of the future studies. There are also factors relating to the AFTA rules and their practices, which include the issues of whether and how to remove NTB (the State Owned Enterprise is among such issues) and of how to deal with the case of trade diversion when it occurs. There is a possibility that the future scenario of the Vietnamese trade and investment policy will be affected seriously depending upon how these uncertain factors are resolved. It will be necessary to carefully monitor how they develop.

V. Reform of Domestic Systems

This final topic relates to one aspect of what was studied by the four Groups in Phase II. Arguments and findings thereof will be provided in each Group's chapter. In the below, while touching on these arguments and findings, we will investigate the situation in which trade and investment liberalization will have the effect of shortening the schedule for domestic reform and requiring more rigorous reforms to be undertaken. Next, we would argue, as a more important aspect, that the success of Viet Nam's challenging task of reforming trade and investment will depend to a great extent on its ability to move forward resolutely with domestic reforms. Below is a bare outline of the argument.

(1) *Trade liberalization promises and reforms to domestic systems* : The most direct impact on the domestic reform schedule from promises of trade liberalization will be in the area of state enterprise reform. The issues in state enterprise reform are nearly equivalent to the microeconomic issues that will determine Viet Nam's success at keeping its liberalization promises. That is why some argue that the year 2006 question is very much one of whether state enterprises will be able to successfully complete the reforms on which their survival depends. One of the most important issues in state enterprise reform is enterprises' low domestic and international competitiveness, which was caused by the disputes between the government and enterprises over management rights, age-old production facilities and technology and low levels of managerial and organizational skill. The difficulties in enterprise management and finance is one manifestation of this. Crisis was temporarily averted in 1991 with the elimination of poorly performing enterprises in the re-registration and review campaign. But the underlying problems in the above must be resolved if the mechanisms for reinflaming the crisis are to be cut.

The topics assigned to the Industrial Policy Group are deeply connected to liberalization issues. This Group has since Phase I been researching the conditions for starting up specific industrial branches that interest the government of Viet Nam. During Phase II they are also trying to generalize this research in an attempt to formulate a scenario for the development of Vietnamese industry as a whole. Research into small and medium sized enterprises was performed in parallel to this. The export promotion plan, which will obviously be the focus of the new trade and investment policies, must be built, using this research results of the individual industries, and the findings on small and medium sized enterprises, as some of the important materials.

The Fiscal and Monetary Policy Group analyzed the transition process for the fiscal and monetary systems and the issues they face. Under the planned economy, the fiscal and monetary systems played a subsidiary, and passive role within a material-based capital accumulation mechanism, but during the transition period it must play an autonomous, and leading role in the mobilization and allocation of capital in monetary form. This mechanism is modeled on the mechanisms seen in market economies, but Viet Nam does not have a well-developed market economy in place yet, and in addition, their income and savings are at low levels. Hence, it will experience many problems in its transition process. The liberalization program will directly and indirectly require that most of these problems be quickly resolved. There are also the problems of funding for the export industry promotion program and write-offs of bad debts defaulted on by state enterprises. In relation to macroeconomic management, there are issues of an excessive reliance on foreign capital because of low savings rates and insufficiency of export capacity, and also of a lack of funding for enterprises because of strict bank credit regulations.

The Agricultural Development Group considers that the high growth which Vietnamese agriculture has exhibited so far is the high growth typically seen in any economy's "reconstruction" stage, largely depending on existing production facilities, transportation, and marketing infrastructure. It hence considers that a substantial amount of new investments would be necessary if this area was to achieve sustained, long-term growth and development. This led to studies and recommendations on the construction for flood control and irrigation facilities and the improvement of agricultural product marketing. Studies and recommendations were made also on the role of the territorial agricultural cooperatives and the rebuilding of the agricultural credit system, both of which form the institutional foundation for long-term development. In terms of the need to accelerate the schedule in order to prepare for trade liberalization, this area may not be as urgent as those dealt with by other Groups.

(2) *Domestic base for successful trade liberalization* : The argument that the success of trade and investment liberalization will depend to a great extent on the success of system reforms can be explained in terms of a five-sector model of the Chinese economy developed by one of our members several years ago in studying the results of China's reform and open door policies. (Shigeru Ishikawa, "China's Open Door and Internal Development in Perspective of the Twenty - First Century," in Fumio Itoh ed., *China in the Twenty-First Century,* United Nations University Press, Tokyo, 1997.) The five sectors used in the model were (1) state enterprises, (2) private enterprises (including Township and Village Enterprises and other collective enterprises), (3) agriculture, (4) foreign trade (state and non-state foreign trade enterprises and foreign capital invested companies), and (5) external (foreign economies).

In the Chinese economy of the eighties and nineties, the center of the growth dynamism was in the agriculture and foreign trade sectors. Technological breakthroughs like hybrid rice strains increased agricultural production, which led to a higher agricultural product surplus available to be sold on the market, and improvement in farm household savings. These in turn triggered expansion for Township and Village Enterprises and private enterprises in the surrounding areas. These also increased the supply of agricultural products to the urban areas, which brought more income to urban households and furthered the development of urban industries.

The foreign trade sector was quick to perceive the dynamic changes occurring in the external sector, particularly Japan, USA, the NIEs, and the ASEAN countries (namely, the changes toward the shift of labor and skills-intensive industries like clothing, electrical machinery, and electronic assembly components to low-wage countries) and communicated them to the domestic sectors. In the early stages, the domestic vehicles for accepting this shift were the Township and Village Enterprises, collectively owned enterprises, and other private enterprises (medium- and small-sized enterprise sector) in the "special economic zones" and various "open economic zones." But while it began with the private, small-enterprise sector, more and more of this was taken over by foreign-invested companies and eventually multinationals (MNC) located in the major cities (Table 8). The spread effects from these two growth dynamism ultimately converged in the dualistic private enterprise sector, bringing growth to both tiers of the structure. As a result, although the reform of state enterprises, and eventually their production and exports, was relatively stagnant, overall Chinese economic growth did not wane.

If Viet Nam is assumed to have the same 5-sector structure, then it lacks both of the focal points for growth dynamism that China had. To use the example of China as its model, Viet Nam must first seek "breakthroughs" in one of the centers, *i.e.* agriculture, and then develop both tiers of the dualistic private sector. In the other center, *i.e.*, the foreign trade sector, it is desirable that Viet Nam, in conjunction with the restructuring of state trade, makes the innovations necessary for the bold acceptance of foreign-invested companies. The domestic acceptance vehicle will be formed during the growth spread process from these two centers of dynamism. Viet Nam might also accelerate the reform of its state enterprise sector in order to meet the schedule for trade liberalization. Reforms might take the form of a re-registration of state enterprises, particularly the smaller ones. Fiscal and monetary reforms might play the role of catalysts facilitating these structural changes.

Table 1 AFTA schedule for new CEPT tariff reduction for all sectors (%)

Country	Number Tariff lines	1996	1997	1998	1999	2000	2001	2002	2003
Brunei	6,112	2.02	2.02	1.64	1.64	1.38	1.38	1.38	1.38
Indonesia	7,910	11.56	10.56	8.80	7.87	5.83	5.68	5.00	4.25
Malaysia	10,494	6.11	5.38	4.66	3.92	3.23	3.03	2.86	2.58
Philippines	4,694	8.24	7.50	6.48	5.86	4.85	4.37	4.36	3.28
Singapore	5,708	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Thailand	8,867	14.14	12.73	10.18	9.31	7.03	6.99	5.80	4.62
Viet Nam	857	0.88	0.88	0.88	0.88	0.88	0.88	0.88	0.88
ASEAN	44,642	7.66	6.95	5.76	5.19	4.02	3.89	3.47	2.89

Source *AFTA Reader*, Vol. IV, Sept. 1996

Remarks The number in the table indicates the number of tariff lines measured on sectoral basis, i.e., at HS6 level.

Table 2 Exports and imports by special areas in China 1996

	Exports US$ million	%	% of total exports	Imports US$ million	%	% of total imports
1 Special Economic Zone	17,692	24.0	11.7	17,827	25.5	18.8
2 Econ. & Tech. Dev. Area & Special Open Area	9,726	13.2	6.4	11,096	15.8	8.0
3 High-Tech Industrial	873	1.2	0.6	1,469	2.1	1.1
4 Bonded House	1,455	2.0	1.0	2,813	4.0	2.0
5 Coastal Open City	43,970	59.6	29.1	36,820	52.6	20.5
6 Total	73,716	100.0	48.8	70,025	100.0	50.4

Source China's Custom Statistics, December 1996

Table 3 Composition of Vietnamese trade by region

(Unit : million US dollar, %)

	1989	1990	1991	1992	1993	1994	*1995
Export							
World Total	2,471	2,524	2,189	2,918	2,985	4,054	5,471
NIES Total	179	494	757	765	790	1,096	-
ASEAN4 Total	119	267	514	552	531	791	603
Japan	261	340	719	834	937	1,179	1,560
	percent distribution						
World Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
NIES Total	7.2	19.6	34.6	26.2	26.5	27.0	-
ASEAN4 Total	4.8	10.6	23.5	18.9	17.8	19.5	11.0
ASEAN5 Total	7.7	18.3	42.9	32.7	30.5	34.1	18.5
Japan	10.6	13.5	32.8	28.6	31.4	29.1	28.5
Import							
World Total	3,031	2,841	2,483	3,027	8,924	5,826	11,586
NIES Total	161	788	1,128	1,249	1,903	2,581	5,277
ASEAN4 Total	13	26	55	87	135	335	1,035
Japan	106	169	158	289	452	586	1,014
	percent distribution						
World Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
NIES Total	5.3	27.7	45.4	41.3	48.5	44.3	45.5
ASEAN4 Total	0.4	0.9	2.2	2.9	3.4	5.8	8.9
ASEAN5 Total	1.8	18.4	31.3	30.0	30.4	25.4	25.9
Japan	3.5	5.9	6.4	7.9	11.5	10.1	8.8

Note * : 1995; Tentative ASEAN 5 ASEAN 4 and Singapore

Source IMF; Direction of Trade Statistics Yearbook 1996

Table 4 Economic importance of foreign direct investment (FDI): Viet Nam and China

	Viet Nam				China			
	FDI	Trade balance	GDP	FDI / GDP	FDI	Trade balance	GDP	FDI / GDP
	million US$			%	million US$			%
1988	0	−679	--		5,297	−7,750	401,072	*1.3*
1989	100	−350	−		5,600	−6,600	449,008	*1.2*
1990	120	−41	−		6,596	8,740	387,723	*1.7*
1991	220	−63	8,271	*2.7*	11,977	8,050	406,220	*2.9*
1992	260	−60	9,913	*2.6*	58,124	4,350	483,021	*12.0*
1993	832	−547	12,836	*6.5*	111,436	−12,220	601,093	*18.5*
1994	1,048	−1,191	15,542	*6.7*	82,680	5,400	540,970	*15.3*
1995	1,781	−2,345	20,314	*8.8*	91,820	16,690	691,364	*13.3*
1996	2,700	−3,900 (est.)	23,574	*11.5*				
1997	3,000	−4,000 (for)						
1998								

Sources
Viet Nam -- GSO/ Processing by Dr. Nguyen Quang Thai, Hanoi, 5/1997
GSO, *Statistical Yearbook 1997.*
China--SSB, *China Statistical Yearbook 1996.*

Table 5 Viet Nam : Structure of total turnover of entire enterprises by ownership and by industry—GSO survey on entire enterprise, 1994

(Unit : billion VND)

	Enterprise industries	%	Manufacturing	%	Mine exploitation	%
1. Total enterprise	240,713	100.0	56,621	100.0	12,330	100.0
2. Enterprise with domestic capital	220,088	91.4	49,597	87.6	2,407	19.5
·State enterprises	182,419	75.8	41,926	74.0	2,348	19.1
of which, central	105,278	43.7	26,756	47.3	1,709	13.9
local	77,141	32.0	15,169	26.8	640	5.2
·Collective enterprises	3,804	1.6	1,168	2.1	28	0.2
·Private enterprises	11,420	4.7	2,239	4.0	15	0.1
·Joint stock companies	2,743	1.1	415	0.7	—	—
·Limited liability companies	19,703	8.2	3,849	6.8	18	0.1
3. enterprises with foreign investment	20,625	8.6	7,024	12.4	9,722	80.5
·100% foreign invested capital	2,013	0.8	1,766	3.1	3	neg.
·Joint venture with state sector	17,395	7.2	4,652	8.2	9,915	80.4
·Joint venture with collective sector	0.8	neg.	neg.	neg.	—	—
·Joint venture with private sector	455	0.2	378	0.7	3	neg.
·Joint venture with mixed economy sector	323	0.1	213	0.4	0.7	neg.
·Cooperation	437	0.2	16	neg.	—	—

Source GSO, "Result of economic, administrative enterprises survey in 1995," Hanoi, 1996

Remarks Capital of the "enterprises with foreign investment" consists of both foreign and Vietnamese capital. The attached table below indicates the proportion of the two magnitudes and the component items of capital for both.

Contribution of legal capital in foreign owned capital enterprises by nationality and by capital items: accumulated total from 1988 to June 1996

(Unit : million USD)

	Total	Foreign	Vietnamese
Cash	4,565.8	4,331.9	233.9
Materials	213.6	209.7	3.8
Equipment, machines, parts	943.9	866.7	77.2
Premises	304.1	–	304.1
Natural resources	797.4	--	797.4
Right to use land and water surface	1,110.8	–	1,110.8
Other	279.9	237.7	42.2
Total	8,215.5	5,646.0	2,569.4

Source General Statistical Office, "Report on the Performance of the Foreign Invested Economic Sector," Jan. 1997, Hanoi (mim.)

Table 6 China: Structure of gross output of total enterprises by ownership, State Statistical Bureau data 1995

(Unit : billion Renmin yuan)

	Manufacturing, mining and electricity, gas and water	%
Total enterprises	5,494.7[2]	100.0[2]
State-owned enterprises	2,589.0	47.1
Collective-owned enterprises	1,583.9	28.8
Share-holding enterprises	272.7	5.0
Foreign-funded enterprises	474.5[1]	8.6
of which,	(532.6)[1]	(9.7)
Joint owned economic units	408.8	7.4
Cooperative economic units	41.4	0.8
100% foreign funded units	82.4	1.5
Oversea Chinese (H.K, Macao, Taiwan) funded enterprises	486.8[1]	8.9
of which,	(538.8)[1]	(9.8)
Joint owned economic units	389.1	7.1
Cooperative economic units	54.9	1.0
100% overseas Chinese funded units	94.8	1.7

Notes

1) In the source, different values are provided for the same variates.

2) This total is a little bit smaller than the total sum of output values of all the broken-down items below. This is due probably to the misprints. All the figures are shown without adjustment.

Source SSB, Chinese Statistical Yearbook 1996

Remarks

1) "Manufacturing, mining and electricity, gas and water" together constitute "industry" of the definition of the former USSR statistics. In Chinese statistics, only a combined figures of "industry" is available for this table.

2) Sum of the percentage of foreign-funded enterprises and the percentage of Overseas Chinese funded enterprises (namely 17.5% or 19.5%) corresponds to the percentage of enterprises with foreign investment in table 4.

Table 7 Viet Nam: Contribution of the foreign invested sector to annual export turnover (including export of crude oil)

	FDI sector's export (US$ million)	% of to total exports
1994	1,100	*27.1*
1995	1,350	*24.7*
1996	1,740	*24.5*
	of which, crude oil	*16.7*
	garment, leather and textile,	*5.3*
	and services	*0.6*

Source GSO, "Report on the Performance of the Foreign Invested Economic Sector," Hanoi, Jan. 1997(mim)

Table 8 Exports and imports by type of enterprises: China 1995

	Exports		Imports	
	US$ million	%	US$ million	%
Total	151,066	*100.0*	138,838	*100.0*
SOE	86,058	*57.0*	59,164	*42.6*
Foreign-invested enterprise	61,506	*40.7*	75,604	*54.5*
Contractual joint venture	7,949	*5.3*	9,230	*6.7*
Equity joint venture	29,750	*19.7*	41,094	*29.6*
Foreign-owned enterprises	23,807	*15.8*	25,219	*18.2*
Collective enterprises	3,073	*2.0*	1,804	*1.3*
Others	429	*0.3*	2,266	*1.6*

Source China's Custom Statistics, December 1996

Box 1
Three tariff systems of Viet Nam

When Viet Nam will be admitted as a WTO member country, in addition to the participation in APEC, Viet Nam will have three kinds of tariff systems, as shown below.

	General tariffs: A	WTO concession tariffs: B	CEPT tariffs: C
Nature	General tariffs set by Vietnamese domestic law	Tariffs for which a promise was given to WTO members that they would not be raised above preset levels.	Mutual preferential tariffs granted to ASEAN countries under the AFTA agreement.
Bind	Can be changed by domestic law	Internationally bound by ceilings.	Internationally bound tariff rates (0-5% in 2006)
Applicable countries	General	WTO members	ASEAN members
Applicable items	All	WTO concession items	CEPT items

WTO is, just like GATT which was succeeded by WTO, the reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers of trade and to the elimination of discriminatory treatment in international commerce. Its highest goal is the realization of universal trade liberalization. Concession tariffs denote the tariffs which are reduced in line with this goal.

The procedure of determining the concession tariff rates is, in the case for the existing contracting parties (WTO member countries), first to decide the tariff reduction concession among the contracting parties primarily concerned according to GATT article 24 and next to make this concession results shared by all other contracting parties by GATT article 1 on general most-favored-nation clause. In the case of newly joining countries, the procedure is described in Box 2.

1. In Viet Nam's case, tariff levels will generally follow the pattern: B > A > C.
2. Tariffs applied to WTO members (for concession items):
   If A < B then A, If A > B then B.
   Tariffs applied to AFTA members: C as with the transition to CEPT.
   Tariffs applied to non-WTO/non-AFTA members: A.
3. If Viet Nam joins APEC, it will be asked to create an individual action plan that includes a voluntary reduction in base tariffs (A).

Box 2
Tariff concessions made in conjunction with WTO accession

1. When joining WTO, two works are carried out simultaneously.

(1) Working group (checks the external trade system and domestic laws for compatibility with WTO rules and prepares an "Accession Protocol" outlining the conditions for accession).

(2) Bilateral negotiations (negotiations to reduce or remove tariff and non-tariff barriers; the creation of a "Schedules of Concessions ").

Note: The "Schedules of Concessions" is a list of the "concessions" given to existing members by the new member as a result of negotiations. It consists of three parts: "table of most-favored-nation tariff rates," "table of preferential tariff rates," and "concessions on non-tariff barriers." The discussion below focuses on the most-favored-nation tariff rates.

2. Two elements of tariff concessions

Negotiations proceed by the existing countries submitting requests and the applicant submitting counter-offers. The two major elements of negotiations are 1) identifying items for which concessions will be granted, and 2) setting their tariff levels. Both are fixed as a result of negotiations.

3. The Uruguay Round has widened the items covered and increased the burdens involved.

(1) The "bind rate" is one index of the number of items covered by concessions. The developed countries were bound for virtually all industrial products prior to the Uruguay Round. With the exception of Hong Kong, the developing countries were also bound for a relatively large number of items (70-90%) during the Uruguay Round. This indicates that Viet Nam will be asked for concessions on a very wide range of items during its accession negotiations.

(2) As can be seen from the table below, the average concession tariff rate was reduced substantially by the Uruguay Round, though developing country levels are still high in comparison to those of developed countries.

Percentage of industrial goods		Japan	USA	EC	Canada	Aus-tralia	South Korea	Hong Kong	Singa-pore	Malay-sia	Indo-nesia	Thai-land
Bind rate*	Before	98	99	100	100	36	24	1	0	2	30	12
	After	100	100	100	100	96	89	23	73	79	92	70
Average tariff**	Before	3.8	5.4	5.7	9.0	20.0	18.0	0.0	12.4	10.2	20.4	37.3
	After	1.5	3.5	3.6	4.8	13.2	8.3	0.0	5.1	9.1	36.9	28.0

* : Bind rate = import value of concession items / total import value

** : Average concession tariff rate = total of (import value of concession items×concession tariff rate) / Total value of imports of concession items

4. Three forms of tariff concession

During the accession negotiations, Viet Nam will receive requests form existing members based on its current base tariffs. Viet Nam will be expected to make counter offers in one of the following three forms.

(1) Concessions on most-favored-nation tariff rates that are "lower than the current base tariffs."

(2) Concessions on most-favored-nation tariff rates that "keep them at the same level as current base tariffs," but with a promise that they will not be raised in the future.

(3) Setting of most-favored-nation tariff rates at "levels higher than current base tariffs," but with a promise that WTO members will be charged no more than the most-favored-nation rate even if there are future hikes in the base rate (called an "upper bind" or "ceiling bind").

(4) Which form of agreement is ultimately reached for the tariffs on concession items will be decided in the process of negotiations. No generalizations can be made.

(5) Example of Indonesia's ceiling bind in the Uruguay Round

As can be seen from the table, Indonesia's average concession tariff rates were higher after the Uruguay Round than before. The reason is that Indonesia negotiated a flat 40% ceiling bind (with some exceptions), while new binds on many of the items were not bound prior to the Uruguay Round.

Box 3
Investment strategy to Asian region of Japanese manufacturing companies in ASEAN countries : 1995 survey

(Number of companies : multi-answer)

	Total	Thai-land	Malay-sia	Philip-pines	Indo-nesia	Singa-pore
Have a investment strategic plan to Asia region	548	165	165	40	102	76
a To transfer production base on the spot to another countries	**162**	**34**	**57**	**11**	**21**	**39**
b To sift production base to the spot from Japan and/or another countries	139	54	43	6	23	13
c To diversify products on the spot	289	87	71	26	70	35
d To strengthen R & D function on the spot	93	27	25	10	10	21
Don't Have a investment strategic plan to Asia region	388	140	98	38	86	26
Total	936	305	263	78	188	102
(Percentage in Total)						
Have a investment strategic plan to Asia region	58.5	54.1	62.7	51.3	54.3	74.5
a To transfer production base on the spot to another countries	**17.3**	**11.1**	**21.7**	**14.1**	**11.2**	**38.2**
b To sift production base to the spot from Japan and/or another countries	14.9	17.7	16.3	7.7	12.2	12.7
c To diversify products on the spot	30.9	28.5	27.0	33.3	37.2	34.3
d To strengthen R & D function on the spot	9.9	8.9	9.5	12.8	5.3	20.6
Don't Have a investment strategic plan to Asia region	41.5	45.9	37.3	48.7	45.7	25.5
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0

Source Japan External Trade Organization, "State of affairs on Japanese manufacturing company's activities in ASEAN countries, 1996"

The above table is from the 9th survey results to the Japanese manufacturing companies in ASEAN 5 countries. For example, in the case of Malaysia, 263 companies filled out a questionnaire, of which 57 have some plans to transfer their production bases in Malaysia to another Asian countries (a). On the other hand, 43 companies have some investment strategies to strengthen their Malaysian production bases by moving their own production function from Japan and/or another Asian countries (b).

1-B: Moving Towards the Sustainable Development

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For the past 7 years of carrying out "Strategy on Socio-economic stabilization and development until 2000," Viet Nam has gained important achievements with the annual GDP growth rate averaged at 8.5% which is the highest level in South East Asia. As many countries and organizations have noted, even in the condition of the on-going financial-monetary crisis in the region, Viet Nam is still capable of maintaining a relatively high growth rate or more, provided that appropriate policy adjustments are undertaken in the coming years. However, it should also be noted that rapid growth rate in the time to come is not a certainty or unconditional. This means that it is necessary to have sound assessment of the reality, identify both advantages and hidden challenges threatening the achievements of Doi Moi and put forth policy options.

I. Achievements and Potentials Need to be Exploited

(1) Obtaining rapid growth, raising savings rate and creating premises for the relatively high development against countries in the region.

As mentioned above, the high growth rate results in the rise in the population's income in general. If counted by the US dollar, the income increase in even higher due to fact that the exchange rate change occurred more slowly than the inflation rate. By this way, annual income growth rate mounted to 15-20%, particularly in 1997 when this rate was still high, though there had substantial adjustment of the exchange rate which was only the same as compared to the inflation rate. The average income growth rate in the past 7 years in the US dollar was double against that of the constant price (the 1989 price). This reflects more clearly the level of economic development and, on the other hand, helps avoid the "subsidized" price board in the past so as to be closer to the current price[1] (see the table below of the General Department of Statistics).

[1] Especially in the condition that the prices of some input material such as electricity, coal, petroleum are dictated much lower than the international ones. In the context that it is not yet possible to increase domestic prices for these goods, price adjustment or "dumping" would have certain impacts on the effectiveness of business and production due to the change in the components of production costs in some past years, the state even at times had to intervene not to appreciate the currency. This also happened in some other East Asian countries in the process of rapid growth coupled with the opening of the economy.

(% p.a.)

Year	GDP Growth (A)	Inflation (B)	Vietnamese dong depreciation against US dollar (C)	GDP Growth in US dollar (A)+(B)−(C)
1991	6.0	72.5	80.7	−2.2
1992	8.6	32.6	20.2	21.0
1993	8.1	14.3	−4.6	17.0
1994	8.8	14.5	3.0	20.3
1995	9.5	19.5	0.1	28.9
1996	9.3	6.1	1.2	14.2
1997	9.0	6.0	6.0	9.0
Average	8.5	23.6	15.2	15.2

It is the developed size of the economy, especially the firm growth of food production and agricultural sector that constitutes the decisive factor for the general stability. Factors other than that are:

- The coming into effect of big investments into socio-economic infrastructure with the mobilization of domestic savings (currently above 20%) and the externally-raised funds.
- The high growth rate of foreign-invested sectors of over 20% with high quality of goods and competitiveness
- The more advantageous business environment owing to the gradual completion of the legal framework and the execution of administrative reform, etc.

That picture shows that the economy has factors which guarantee continuous rapid growth in comparison with countries in the region.

(2) The rapid increase of income has helped maintain the balance between income and distribution - the decisive factor to remove the obstacles of social problems entailed by the rapid growth and side-effects of externalities:

In the context of rapid economic growth, the living conditions of different population strata are improved at different levels. The GINI index and other indexes on the income structure reflect the "equity" in income distribution in Viet Nam is much better than that of many countries in the region, including China, and narrowly less than that of Indonesia. The Vietnamese income gap is just over half of that of Malaysia- the country having the highest level of income disparity in the region.

Rather Even Distribution of Income

	① GINI Coefficient	② 20% lowest income	③ 20% highest income	④ disparity (times) ③/②	⑤ 10% lowest income	⑥ 10% highest income	⑦ disparity (times) ⑥/⑤
Viet Nam	35.7	7.8	44.0	5.6 (2)	3.5	29.0	8.3 (2)
China	41.5	5.5	47.5	8.6 (4)	2.2	30.9	14.0 (4)
Indonesia	31.7	8.7	40.7	4.7 (1)	3.9	25.6	6.6 (1)
Philippines	40.7	6.5	47.8	7.4 (3)	2.8	32.1	11.5 (3)
Thailand	46.2	5.6	52.7	9.4 (5)	2.5	37.1	14.8 (5)
Malaysia	48.4	4.6	53.7	11.7 (6)	1.9	37.9	19.9 (6)

Source World Development Report 1997, WB, pp. 222-223.

The recent 3 years statistics show that the income gap between the 20% poorest and 20% richest has tended to widen from 6 times 3 years ago to nearly 7 times at present. However this is still lower than that of China, Thailand, the Philippines or Malaysia. This in fact has created the impetus for economic growth at the beginning of economic restoration and development after many successive years of war. This has also left enough rooms for further acceptable unevenness of income while created impetus but not too wide gap of income.

(3) We still enjoy certain comparative advantage in term of labor and human resource development though these advantages are declining.

Since the average income of the countries in the region is much higher than that of Viet Nam, their wage is thus higher than Vietnamese workers'. This consequently makes investment into Viet Nam more attractive. The World Bank's "World Development Report - 1997" indicated that the average income of Viet Nam in 1995 was lower than that of the regional countries. In addition, according to the UNDP as shown in its "Human Development Report - 1997" the human development index of Viet Nam is also higher than other countries in the region if compared to Viet Nam's rank in terms of GDP as estimated by the purchasing power parity (PPP):

	Average GDP in 1995	HDI's rank compared to that of GDP (how much higher)
Viet Nam	240(1 time)	26
China	620(2.58 times)	3
Indonesia	980(4.08 times)	−7
Philippines	1,050(4.38 times)	12
Thailand	2,740(11.42 times)	−8
Malaysia	3,890(16.21 times)	−13

In Japan, the work force in the electronic is mainly women, including laborers from the rural areas who do part-time jobs. In Viet Nam, we can also use young female labor force (from 18 to 20 years of age) as professional workers (while male laborers can be used at night). Moreover, our wage level is very attractive(current exchange rate: 1yen=80 -100 dong)

Engineer or technician (yen/month)

Japan	258,000 yen or 20-25 million dong/month
Singapore	70,000 yen or 5-7 million dong/month
Malaysia	20,000-24,000 yen or 2 million dong/month
Thailand	20,000 yen or 2 million dong/month
China	12,000-18,000 yen or 1-1.5 million dong/month
Indonesia	10,000 yen or 1 million dong/month
Viet Nam	80 US$ or 1 million dong/month

Source NRI, Vol. 3, April, 1995

Thailand is at present facing a lot of difficulties in developing its electronics and information technology partly because of its shortage of workers of high skill.

However, if the labor productivity is counted, the labor costs for one value-added unit will be decreased to some extent. But the comparative advantage still exists. A favorable investment environment, if created, will constitute a comparative advantage for at least five years to come.

(4) Political stability, reforms which are positively under way have become a comparative advantage while countries in the region are being plunged into crisis.

The cause of renovation (Doi Moi) of Viet Nam has been carried out with the wide support from almost people and international public opinion. The fact that investors, donors continue to extend their assistance to Viet Nam and the London Club has just accepted the debt-handling solution stands as a great support for Viet Nam. Despite the impact excited by the on-going financial and monetary crisis in the region to some extent of which its pressures are likely to intensify Viet Nam is proving to be capable of standing firmly and maintaining growth.

These advantages of Viet Nam converge creating a combined attractiveness, which however could not be regarded as everlasting ones. Moreover, as the situation is changing so rapidly that these advantages are just relative ones. In case the cause of renovation continues to be accelerated as mentioned in resolutions which are being actively implemented under the Program of Action of the new Government, these "advantages" even given the consideration of evolution nature will be able to brought into full play in the future.

II. Challenges and Difficulties which Need to be Overcome

The above-mentioned advantages, (favorable conditions and potentials), however, remain uncertain. Besides, negative factors and new difficulties have also emerged which need to be addressed. Following are some difficulties and weaknesses:

(1) Low competitiveness (high costs of products and services which are not commensurate with the quality, low efficiency of business and production activities, limited access to market that make the already-low competitiveness of the goods more vulnerable the "shock").

The aforesaid practice is not confined to commodities like cement, sugar, steel, automobile, etc., of which their costs are about twice higher than the imported ones. Moreover, the environment for business, production, and investment activities, in some aspects, is getting worse, included in such factors as:

- Policy in which the local currency is overvalued in the face of the recent developments in the region due to the lack of prompt flexible adjustment.
- Legal framework which is not compatible due to the transition process and the management and administration machinery which is of low efficiency due to the serious bureaucracy and corruption. Government's new policies are paving the way for new prospects. The efficiency, however, will depend upon the management capacity of the existing machinery.

(2) Prolonged imbalance at macro level, a hidden source of instability, may induce signs of concern.

Rapid development often comes with huge imbalance in certain areas. In the case of Viet Nam, imbalance is indicated in the monetary, financial and export-import areas. Trade and current account deficit standing at around 10% is a great danger. The deficit still stands as a factor of concern if the export-import proportion of FDI projects is taken out (Which is not quite true). Budget deficit accounting for 4-5% of GDP is high and the situation, if not properly controlled, may cause shocks in the economy. The Government's persistent policy to closely control short-term credits, especially not to allow the provision of this loan to investment projects in the recent two years proved to proceed in the right track. However, solutions in the areas mentioned above often prove to be less effective since SOEs reform is still delayed while private businesses are unable to access to the long-term loans.

(3) Reforms must be accelerated and more synchronized.

Renovation policies implemented in Viet Nam since 1986, especially since the adoption of the new Constitution in 1992, as well as the guidelines stated at 8th National Party Congress and the party's Central Plenums are of great importance. Nevertheless given the fact that legal documents on implementing those policies were promulgated in various periods and hence are not synchronized with each other. Moreover administrative reform is not accelerated sufficiently to facilitate the reform process. As a result, in quite a few cases it is necessary to further intensify the reform with the creation of a more competitive investment and business environment.

(4) Complex developments of the financial and monetary situation from the outside.

Difficulties become more serious as the impact of the financial and monetary crisis in the region has been exerted on all countries including Viet Nam. Therefore comparative advantages must be reconsidered under the new circumstances. Once the economy suffers a slow-down, the import capacity becomes limited which therefore affects the country's competitiveness of commodities, services and capitalization. The reform is thus required to be further intensified.

Under these circumstances, proposed scenarios and policies are necessary for taking measures to quickly respond to the situation.

III. Policy Selection

There are many policies that need to be selected in the years to come. The selection should be based on the following targets:

(1) To enhance the country's competivIveness, along with the competitiveness of specific goods and services, to facilitate the enhancing of economic, business and production efficiency.

To increase competitiveness not only by existing "static" comparative advantages but also by creating "dynamic" advantages thanks to a more open investment and business environment and creating comparative advantages to other countries in the region. To ensure the enhancement of the business and production efficiency of the State economic sector and to create favorable conditions for non-State economic sectors and foreign private businesses.

(2) To increase transparency in the policy system in combination with administrative reform, anti-corruption and anti-bureaucratic struggle.

A number of promulgated laws have been amended to be more flexible but implementing regulations are not clear and often cause misunderstanding and free application. This does not appear in formal documents but still happens to domestic and foreign individuals and business people. To enhance management efficiency, time is needed to perfect the legal framework and accelerate administrative reform. However this cannot be delayed which otherwise would be an big impediment for sustainable development. Solutions on democracy expansion in the socio-economic life that are underway also need to be developed in the future.

(3) Economic and social development as well as narrowing enormous gap among regions.

Developing the economy, accelerating industrialization and modernization under the circumstances that 80% of the country's population live in the rural area is a great difficulty which requires policies aimed at developing the agricultural sector and transforming the rural economic structure. These policies would not only facilitate production development but also help achieve socio-economic targets.

Other employment issues under the condition of young population and SOE reform to create jobs for more than one million youths turning to working age each year and to ensure equal development between regions are extremely important and urgent matters which need to be addressed.

(4) Open-door policy and protection

Integration is a common trend which is not only an opportunity but also a challenge for Viet Nam. Viet Nam's integration into the ASEAN Free Trade Area (AFTA) and ASEAN Investment Area (AIA), the opening up of industries within ASEAN as well as its commitments to APEC and WTO require a more transparent policy to reasonably protect infant industries so as to ensure efficiency in business and production while maintaining the economy's competitiveness.

To this end, the Government has recently taken an important measure to establish the External Relations Committee, an agency directly headed by a deputy Prime Minister with an aim to quickly and comprehensively deal with arising issues.

(5) Addressing imbalance at macro level

Imbalance at macro level indicated by trade and current account deficit, budget deficit, low foreign-exchange reserve and so on are the issues that have become serious when the crisis in the region is exerting adverse impacts on export-import balance. Real capital inflow to Viet Nam tends to sharply reduce in several years to come unless strong reform is taken including a more flexible exchange rate policy. These issues are being addressed by a Government-level task-force team and are directly reported to the Prime Minister.

All such issues, which have been mentioned by the two countries' research groups, need to be further studied in the future.

2

Vietnamese Participation in Economic Organizations: Japan's Experiences*

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I. Preface: The Locus of the Issues

Viet Nam joined ASEAN in July 1995 and became a member of AFTA (the ASEAN Free Trade Area) in January 1996. It has also applied for membership in APEC (Asia Pacific Economic Cooperation) and the WTO (World Trade Organization). The question it behooves us to ask is what membership or application for membership in these international economic organizations will mean for the industry and trade of Viet Nam, a country that is in the initial stages of industrialization.

AFTA is an organization for regional integration for ASEAN members that is based on the GATT (General Agreement on Tariffs and Trade) Enabling Clause (1979). It has a goal of having common preferential tariffs in place within the region by a target of 2003 (2006 for Viet Nam). These tariffs will cover almost all industrial and agricultural products and will be phased down to 0-5%. The procedures for doing this are in the CEPT (Common Effective Preferential Tariff) policy. Viet Nam has, in accordance with this policy, submitted an initial tariff reductions list in January 1996.

AFTA is an organization with member countries consisting of the late comer developing countries in East Asia, though mostly characterized by higher levels of industrialization than Viet Nam. By comparison, APEC includes most of the major industrialized countries of East Asia and the Pacific Rim, in addition to most of the countries in the AFTA region, and seeks, as priority goals, trade and investment liberalization and facilitation as well as economic and technological cooperation among its membership. The goal for full liberalization in APEC is the year 2010 for industrialized countries and the year 2020 for developing countries. Though its concept of liberalization is the same as AFTA's, APEC's method of achieving it is more flexible and involves member countries voluntarily and concertedly designing and implementing liberalization plans, the method which is characterized by "concerted unilateral liberalization." APEC is also different from AFTA in that it seeks what it calls "open regionalism." Its liberalization measures will not be applied exclusively within the region only.

The WTO, which was inaugurated in January 1995, is the successor organization to the GATT. The WTO Agreement itself is made up of only sixteen articles. It only define the process of accession for new-comer countries and regions and the process for decision-making. More important from the view

* In preparing this report, I received a useful collaboration from Mr. Yoshikuni Kobayashi. Subsections 1 and 2 of section III are in fact written by him. I also wish to acknowledge the useful advice from Mr. Koichiro Fukui, The Japan Economic Research Institute and Mr. Seiichi Masuyama, Nomura Research Institute, Ltd. For these I wish to express my sincere appreciation.

of actually governing its activities are the annexes to the WTO Agreement, for instance the General Agreement on Tariffs and Trade (GATT).

The GATT seeks mutual and beneficial arrangements to substantially reduce tariffs and other barriers to trade, and to eliminate discriminatory treatment from international trade. In other words, it is founded on the three principles of liberalization, non-discrimination, and mutual benefit. GATT Article I describes most-favored-nation status and mandates that, in principle, it be applied on a global scale to all "contracting parties." Article 3, "National Treatment," bans in principle all taxation and regulation that discriminates between domestic and imported goods. Article XI, "General Ban on Quantitative Restrictions," bans in principle all import restrictions except tariffs or other surcharges. However, there is little reason to believed that members, particularly developing countries, will always be able to meet all of these principles. Article XVIII therefore recognizes that countries may violate certain provisions of the Agreement when their economies are unable to maintain minimum standards of living and they are in the initial stages of development. They may also, with some conditions attached, invoke quantitative restrictions when necessary for balance of payments reasons.

The GATT does not, however, provide clear criteria as to what sort of countries are able to invoke these provisions, so problems are generally negotiated on a case-by-case basis. This point recently appears to be given particular stress by the existing membership of the WTO (for example, in discussions of Chinese accession). A common phrase heard is that of being "promoted" from an "Article XVIII country" to an "Article XI" country. In the past, new members from the developing countries have generally been given the benefits of Article XVIII and similar clauses, but the more recent tendency is to deny them.

Before we can understand the significance of Viet Nam's membership in these international economic organizations, we must understand how AFTA, APEC, and the WTO differ in terms of their discrimination and rigor in pursuing the same objectives of trade and investment liberalization and facilitation. This includes the geographical scope over which they apply. It is important to note that the composition of their membership "mixes" countries at differing levels of economic development in different proportions. We must also seek to understand the problems that will be brought by membership in these three organizations, whether membership is entered into one at a time or simultaneously (though the actual dates of accession may be different).

This report contains a preliminary description of our opinions and views on these issues at the present time. We must emphasize the word "preliminary" in this as there has not been time to make a sufficiently thorough study.

In this report, we reach two *preliminary* conclusions. The first is that membership in these three organizations could cause Viet Nam to lose the chance to promote industrialization through protection of infant industries at a stage when its industrialization has progressed a bit further than it has at this point. Viet Nam is a low-income country that has still only just begun its industrialization efforts; it is the least developed country even in AFTA. To deal with the possibility of losing its opportunity to protect infant industries, Viet Nam should arrive at a successful industrialization scenario as quickly as possible, formulate development and industrialization policies on the step-by-step basis in line with this scenario, and develop a phased-in policy for trade liberalization that conforms to them. In doing this, it will need to negotiate with international economic organizations, obtaining transitional measures from them based on guarantees that liberalization will be pursued with medium- and long-term targets.

The second conclusion is that the trade and investment liberalization and facilitation that all of these international economic organizations seek has important benefits for developing countries in that it will intensify competition and therefore encourage the healthy growth of industries and companies. When enacting the policies to protect infant industries discussed in the previous paragraph, Viet Nam should take care to impair these benefits as little as possible. Should it fail to make this effort, it runs the risk of preserving in perpetuity inefficient industries and companies in the name of infant industry protection. That would do far more damage than jumping the gun a bit on liberalization.

In the two sections that follow we discuss the impact[1] on the Vietnamese economy of membership in these three organizations in light of Provisional Conclusion 1. Most of this will focus on AFTA and CEPT, organizations and programs of which Viet Nam is already a member and for which there is a wealth of material and information available. Section 3 discusses Japan's experiences with membership in the GATT, IMF, and OECD in relation to the issues that are brought up.

Ⅱ. Participation in AFTA, APEC, and WTO and the Obligations of Membership

1. The Mechanisms of AFTA and CEPT

Let us begin by considering the liberalization mechanisms provided for by AFTA. First, the CEPT seeks to lower the import duties of AFTA members to the 0-5% range for almost 100% of all goods by the target year. However, while all import items are in principle subject to tariff reductions (the items actually subject to reduction are those on the "Inclusion List"), CEPT provides at the initial stages for two categories of items that are excluded from this: the Temporary Exclusion List and the General Exclusion List. The latter contains exceptions that will be held indefinitely, generally for reasons of national defense. Its weight is low, however. The former contains items that are only temporarily excluded and must be brought into the Inclusion List at a steady rate over a period of five years beginning 1999, at which time they will be subject to tariff reductions. Similar steps are also taken for the liberalization of quantitative restrictions.

2. CEPT and Viet Nam

Table 1 shows how, in terms of numbers, Viet Nam had broken down its imports into the three categories as of January 1, 1996. Table 2 shows the tariff reduction plans for the 1996-2003 period for items in the Inclusion List. Both tables provide figures for other AFTA members for comparison.

To provide some additional explanations for Viet Nam, imports duties are scattered between 0 and 60%, with an average tariff rate of 19% in 1995; 15-16% in 1996. Of the 857 items in the inclusion list, 548 are 9% items, 309 are 1-5% items. Below is a breakdown of these 857 items according to sector:

Machinery and electrical equipment	39%
Basic metals and metal products	17%
Mineral products	8%
Textiles and apparel	5%
Optical and musical instruments	5%
Miscellaneous	25%

[1] International economics uses the concepts of "trade creation effect" and "trade transformation effect" to analyze the impact on a region's growth and welfare of attempts at regional integration. This research project has already produced an analysis of AFTA and APEC membership utilizing this framework and this paper has nothing in particular to add to the comments therein. The reader is therefore referred to Ken'ichi Ohno's "Viet Nam's Participation on in AFTA, APEC, and WTO: Commitment to Free Trade vs, the Need to Promote Industries" in The Economic Development Policy in the Transition Toward A Market-oriented Economy in the Social Republic of Viet Nam, Phase I Final Report, Vol. 4 : Industrial Policy (1996)

3. The Problem of Low Import Tariffs and Infant Industries

Below are some provisional observations and points of concern regarding Viet Nam based on the information above.

1) The average nominal tariff for items on the Inclusion List was 0.88% at the beginning of 1996. Viet Nam has thus already achieved the target of reductions to 0-5% and does not plan any additional reductions before 2003. This is in stark contrast to all other AFTA members except Singapore.

2) We do not have sufficient information on the criteria with which AFTA selects and tolerates the items on the Temporary Exclusion List. However, given the fact that most of these items carry tariffs of 5-60%, it is clear that the basic objectives of tariffs are to contribute to fiscal revenues and to channel domestic consumption. In other words, there may be a large number of items on the exceptions list, but reductions in their tariffs might not have all that strong a bearing on the protection of infant industries.

3) Items in the 0-5% include many important production materials and mechanical facilities, things which Viet Nam cannot at present produce but which are necessary for industrialization and for the maintenance of its national living standards. The fact that there are so many of these items (other information says they account for more than half of all CEPT items) is indicative of the country's extremely low level of industrialization. Therefore, as industrialization progresses and new infant industries emerge, Viet Nam can expect to see calls and pressure for hikes in the tariffs on the 0-5% group.

4. The Experiences of Thailand: Industrialization and Changes in Tariffs

The experiences of Thailand in the seventies provide a good example of skillful use of protectionist tariffs in the process of growing infant industries. Table 3 contains a breakdown by category of the tariff structure of Thai imports. Thailand began using import-substitution industrialization programs as early as the sixties so that by this period of time import tariffs were low for raw materials, intermediates, and machinery, but high for goods with higher degrees of processing. This structure is known as "tariff escalation," and it became more pronounced from year to year. This becomes clear when the "effective rate of protection" is considered rather than the "nominal rate of protection" (nominal tariff rate). The effective rate of protection expresses the ratio of import tariffs to added value. It is used because comparability is lost when national tariff rates are calculated for products made from raw materials for which duties were paid upon importation.

Table 4 gives a more detailed picture of how Thailand manipulated its protective tariff programs for textile goods. The government of Thailand made a sharp hike in the import duties of imported cotton cloth in 1962 in order to foster its cotton textile industry, which was using imported cotton yarn. In 1968, it set up tariffs for cotton yarn in order to foster its cotton spinning industry, and raised import duties for cotton textiles by a corresponding amount. That same year it hiked the tariffs on synthetic fiber textiles in order to begin fostering its synthetic fiber textiles industry, which used imported synthetic fiber threads.

We would express one caveat in this connection. The reason that Thailand was able to use protectionist tariff policies in this manner to form a system of escalated tariffs was because doing so was in line with the international policy trends of the times. In the early seventies, the World Bank was advocating import substitution policies as its preferred development policy. Certainly these sorts of policies excelled in the protection of infant industries, but they also ran the risk that, with just a single false step, they could end up protecting in perpetuity industries and companies that were inefficient. In today's international atmosphere of liberalization, it is possible to develop more modest, flexible, and yet calculated infant industry protection policies through constructive and coordinated dialog, and indeed, this is what must be done.

5. APEC and Individual Action Plans

Let us now consider the international obligations that Viet Nam will incur in exchange for the benefits of membership in APEC. One of the keys to understanding this will come from understanding the nature of the Individual Action Plans for trade and investment liberalization and facilitation submitted by APEC members to the Osaka (1995) and Manila (1996) meetings. As was noted earlier, APEC operates under the principle of "coordinated, voluntary liberalization." This is useful in seeking the participation of as many developing countries as possible, but it also carries the risk of giving benefits to free riders should there be countries that are noticeably tardy in liberalizing. To prevent this, the Individual Action Plans voluntarily submitted by individual countries are cross-checked by other member countries and must receive their moral support. This is necessary to enforce the "open regionalism" that is one of APEC's cardinal principles, and to enable APEC to play a leading role in the global multilateral free trading system. "If liberalization within the region is to be applied unconditionally to countries from outside the region, then it is no different from liberalization under the GATT/WTO most-favored-nation principle. But in this case, it will be applied to countries from outside the region that do not liberalize, which raises the problem of free riders," says Yoko Sasanami.[2] On the other hand, "If application to countries outside of the region is conditional on reciprocity, there are some countries that will find themselves left out of liberalization all together." This is what "open regionalism" entails and it is in substance no difference from the "free trade areas" described in GATT Article II. To achieve this ideal of "open regionalism," steady progress must be made within APEC on "coordinated, voluntary liberalization."

If Viet Nam is approved for APEC membership, it will be asked to immediately create and submit an Individual Action Plan. In light of the above, the content of this plan must be serious, and it also must be in line with Viet Nam's CEPT obligations.

6. The Experiences of China

As an example of an Individual Action Plan, let us consider the actions of the government of China. During the 1995 summit in Osaka, Jian Ze-min highlighted five items in trade and investment liberalization:

1) Substantial reductions (by more than 30%) of import tariffs on 4,000 items.
2) Elimination of quotas and licensing on more than 170 items, and elimination of import restraint measures.
3) Experiments in Shanghai and other cities with foreign trade joint ventures between China and foreign companies.
4) Wider experimentation with Chinese-foreign joint ventures in retailing.
5) Integration of the foreign exchange transactions of foreign-investment companies within the transfer, payments, and sales services offered by banks.

These promises were fleshed out in the liberalization programs implemented in 1996:

1) Reduction in the average import tariff on 4,994 items from 36% to 23% (reduction of about

[2] "Trade and Investment Liberalization and Facilitation: the Need for an APEC Framework," *Ajiken World Trend*, Vol.7 (November 1995)

36%).

2) Elimination of import quotas and licensing for 176 items, including automobile bodies, copy machines, air-conditioners, and chemical and industrial products. (As a result, quotas and licensing remain for 384 items, giving China an import liberalization rate of 95%).

3) Expansion of pilot Chinese-foreign joint ventures in foreign trade from Shanghai to Shenzhen, and publication of "review and permit rules" for the pilot program. Also with this was an expansion in the authority of interior provinces and autonomous regions to review and permit foreign investment projects worth up to $30 million rather than the previous ceiling of ¥10 million.

4) The foreign exchange transactions of SANSHI companies were integrated into the banking system, and at the end of the year, the yuan became freely convertible for current transactions.

The Chinese Individual Action Plan for the 1996 summit in Manila promised that the arithmetical average tariff rate would be reduced from 23% to 15% by 2000, that more areas would be opened to foreign investment, that intellectual property rights laws would be amended, and that an antimonopoly law would be put in place.

7. WTO Membership

We shall next consider the international obligations that Viet Nam will incur with membership in the WTO, the cardinal principals of which are liberalization, non-discrimination, and mutual benefit. Leaving aside the explicit conditions for accession, which are well known, the largest uncertainty for Viet Nam will be to what extent it is given transitional benefits as a developing country under Article XVIII of the GATT and other provisions when its membership is approved. In negotiating for its WTO membership, China demanded "all developing country benefits as a package," but the WTO refused, saying that each would have to be negotiated separately. We have already discussed this above. However, even if a "package" is impossible, there is still room to negotiate individual benefits, especially those that are relatively common. What comes out of these negotiations depends on the efforts of the government of Viet Nam. That in turn will have a strong influence on the strategies that it is desirable for the government of Viet Nam to take with regards AFTA and APEC. In this connection, the experiences of Japan described in the next section should prove valuable.

III. The Experiences of Japan

Japan's experiences are relevant to Viet Nam's participation in international economic organizations for the period of economic reconstruction directly following the second world war, through the "high growth period when Japan began running a surplus on its balance of payments and on until the mid-seventies when it more or less completed the liberalization of its foreign trade, foreign exchange, and capital movements. As we review Japan's experiences over this period we must, of course, keep in mind that there are differences in the initial conditions at work in the two countries. Japan had already completed industrialization prior to the war so that during the period that we will be comparing its industry, technology, and managerial bases had already attained to considerable levels. Likewise, both government and the private sector were able to draw on skilled labor. Still, given the destruction sustained by Japan during the war and the economic gap that emerged between it and the industrialized countries of Europe and North America, postwar Japan was, in its start-up, in very much the same position as developing countries are today, one of extreme difficulty. The condition that Japan participate in international economic organizations as an industrialized country (that it make the transition to GATT Article XI and IMF Article 8, and that it join the OECD) was one that was imposed on it from outside.

All of these organizations seek global-scale liberalization, and membership in them had untold benefits for the development of Japanese industry and trade. Liberalization was the international obligation to be discharged (the price to be paid) in exchange for that. At any rate, the initial task was to deal with "foreign pressure," so the government of Japan enlisted the cooperation of the business community in creating a scenario to justify industrial policy and a program for phased-in liberalization. After repeated and often heated negotiations with the other industrialized countries, Japan was able to achieve its aims of membership, and this is one of the most important aspects of the Japanese experience for Viet Nam.

Below is an outline of Japanese industrial policy and liberalization plans during this period, presented in roughly chronological order. (This section was prepared by Mr. Yoshikuni Kobayashi.)

1. Pre-liberalization Industrial Policy (through the fifties)

The first technique used for postwar industrial reconstruction was the "Preferential Production Plan." Japan increased its output of coal and allocated it preferentially to the steel industry. The increased steel output that resulted was then allocated preferentially to the coal industry. These two industries, coal and steel, thus helped each other to expand and in the process boosted industrial production levels as a whole (1946-1948). The principal techniques used to accomplish this involved direct control: 1) priority allocations of materials, 2) loans from the Bank for Reconstruction Finance, 3) price controls, 4) price gap subsidies, and 5) allocation of imported materials.

The year 1949 saw the enacting of the "Dodge Line," a powerful program for economic stability. The Dodge Line was able to quell postwar hyperinflation and establish a fixed exchange rate of ¥360 to the dollar. From this time until the mid-fifties, many industries—chief among them steel, coal, maritime transportation, electric power, synthetic fibers, and chemical fertilizers—invested heavily in new equipment to rationalize their operations. Policy support was given to rationalization investments in priority industries in the form of 1) tax breaks, and 2) preferential access to the Fiscal Investment and Loan Program.

During this same period on the international front Japan joined the IMF and World Bank in 1952, paving the way for accession to the GATT in 1955.[3]

Beginning about the mid-fifties, the Japanese economy was launched on the path to high growth. Subsequent industrial policy therefore added the construction of industrial infrastructure, the development and promotion of new growth industries, and the protection and adjustment of waning industries to the previous focus of industrial rationalization. Examples of promising new growth industries at this time include synthetic textiles, petrochemicals, machinery parts, industrial machinery, electronics, aircraft, and nuclear power. Some industries were given special legal provisions, for example, the "Law Concerning Special Ad Hoc Measures for the Promotion of the Machinery Industry." Other programs to develop and foster industry from this period include: 1) special tax breaks, 2) loans from the Japan Development Bank, 3) permission to import foreign technology, and 4) import restrictions.

This led to Japan recording, in 1959, its first net export surplus on its trade balance with the United

[3] Article XXVIII: 2 of the GATT requires countries to enter into tariff negotiations as part of the accession process. Japan entered into negotiations with seventeen countries in 1995, including the United States, West Germany, and Italy. These negotiations resulted in Japan giving concessions on 248 items and receiving concessions on 288. The protocol of accession reserves application of "Part 2 of the Agreement." In other words, it is different than the unconditional application of Parts 1 and 3 of the Agreement in that the protocol mandates application of the provisions of Part 2 of the General Agreement "to the maximum extent that does not violate the laws and ordinances of Japan in effect on the date on which this protocol is dated."

States of the postwar period. Already by the end of 1958 the countries of Western Europe had liberalized their currencies and recovered their exchangeability against the dollar, which resulted in their lifting many of their discriminatory restrictions on imports from the US. Japan therefore saw the pressure for trade and foreign exchange liberalization mount rapidly.[4]

2. The Period of Liberalization (through the mid-seventies)

In 1960 Japan decided on a "Trade and Foreign Exchange Liberalization Plan" and began to liberalize its economy. Liberalization of trade and foreign exchange was followed by liberalization of capital in 1973; the process therefore required well over a decade to complete. Meanwhile, industrial policy worked to cautiously phase in trade and capital liberalization so as not to do fatal damage to industry. At the same time, industrial policy was also concerned with building an industrial system better adapted to liberalization.

There were three main thrusts of the Liberalization Plan: 1) to raise the import liberalization rate from what was then only about 40% to about 80% in three years time (by April 1963); 2) to in principle eliminate all restrictions on foreign exchange for current transactions in two years time; and 3) to gradually loosen the restrictions on capital transactions. Under the plan, liberalization went forward both rapidly and cautiously between 1960 and 1963. During the period 1,837 items were liberalized leaving only 192 items subject to restrictions by the end of 1963 (see Table 5). Foreign exchange liberalization also moved forward and the plan was generally fulfilled (see Tables 5 and 6).

The year after the "Liberalization Plan" was drafted (1961) saw major revisions in tariff rates. The aims of the revisions were: 1) to establish a modern tariff system, and 2) to lay the groundwork for pursuing subsequent import liberalization. This gave the revisions a somewhat protectionist tenor. For example, rates were set as low as possible for primary goods, but rose the greater the degree of processing involved. The products of industries that had a promising future, especially new industries, were subject to high tariff rates. In other words, Japan resorted to "tariff escalation."[5] These revisions resulted in a renegotiation of tariffs with the United States and West Germany under the provisions of GATT Article XXVIII:1. Japan provided compensatory tariff concessions in exchange for modifications to the concessions for 36 items.

In 1963, after the first phase of liberalization had more or less come to an end, Japan made the transition to GATT Article XI status. The following year, 1964, it made the transition to IMF Article 8 status and joined the OECD. That same year, 1964, also saw the beginning of the Kennedy Round of GATT negotiations. Japan started off very negative towards the Kennedy Round, but as the negotiations dragged on its industries became more internationally competitive. This caused Japanese policies to become more positive towards the Round in recognition of the effect that it would have on expanding exports. As a result of the Kennedy Round, Japan made a 50% across-the-board cut in tariffs on industrial goods in 1968.

Japanese import liberalization made little progress during the Kennedy Round years of 1964-1968. Only 35 items were liberalized during that time. In the three years following the conclusion of the Kennedy Round, 1969-1972, liberalization received a second burst of momentum as 88 items were freed up.

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[4] In 1960, liberalization rates for the dollar region (the percentage of total customs-cleared import values accounted for products for which imports had been liberalized) was 94% for the UK ad West Germany, and 90% for France and Italy. By contrast, it only 41% for Japan.

[5] The tariff revisions of 1961 resulted in new tariff rates for 2,233 items, of which 1,596 remained the same, 386 were lowered, 251 raised, and 77 given advalorem taxes. The overall effect was to raise tariff levels and to create a new and unusual tariff system to serve as a counterweight to import liberalization.

The only remaining hurdle was the liberalization of capital transactions, an obligation that Japan undertook with its membership in the OECD. The recruitment of foreign capital was a technique that Japan used to make up for its capital shortages during the postwar reconstruction and development periods, but it was also felt that direct participation in domestic markets by resource-rich foreign companies would impeded the growth of Japanese industry and domestic technology. Capital liberalization therefore did not get under way in an significant manner until 1967, and even then was phased in so that full liberalization was only reached in 1973. This period saw major mergers in the steel and automotive industries, and time was still required for the liberalization of important industrial sectors like automobiles and computers.

Table 1 Comparison of old and new package of CEPT products list

Country	Inclusion List			Temporary Exclusion List			General Exception		
	Old	New	%change	Old	New	%change	Old	New	%change
Brunei	6,079	6,112	0.54	208		(100.00)	201	209	3.98
Indonesia	7,355	7,910	7.55	1,654	1,317	(20.37)	50	47	(6.00)
Malaysia	8,777	10,494	19.56	627	470	(25.04)	98	83	(15.31)
Philippines	4,451	4,694	5.46	714	562	(21.29)	28	28	
Singapore	5,722	5,708	(0.24)				120	123	2.50
Thailand	8,763	8,867	1.19	118	147	24.58	26	30	15.38
Viet Nam		857			1,189			146	
Total	41,147	44,642	8.49	3,321	3,685	10.96	523	666	27.34

Source *AFTA Reader*, Vol. IV, Sept. 1996.
Remarks The number in the table indicates the number of tariff lines measured on sectoral basis, i.e., at HS6 level.

Table 2 New CEPT tariff reduction for all sectors (%)

Country	Number Tariff lines	Year 1996	1997	1998	1999	2000	2001	2002	2003
Brunei	6,112	2.02	2.02	1.64	1.64	1.38	1.38	1.38	1.38
Indonesia	7,910	11.56	10.56	8.80	7.87	5.83	5.68	5.00	4.25
Malaysia	10,494	6.11	5.38	4.66	3.92	3.23	3.03	2.86	2.58
Philippines	4,694	8.24	7.50	6.48	5.86	4.85	4.37	4.36	3.28
Singapore	5,708	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Thailand	8,867	14.14	12.73	10.18	9.31	7.03	6.99	5.80	4.62
Viet Nam	857	0.88	0.88	0.88	0.88	0.88	0.88	0.88	0.88
ASEAN	44,642	7.66	6.95	5.76	5.19	4.02	3.89	3.47	2.89

Source the same as Table 1

Table 3 Average rates of protection in Thailand (%)

	Nominal rates of protection			Effective rates of protection		
	1971	1974	1978	1971	1974	1978
Processed foods	50.9	5.8	9.0	205.9	-46.4	78.5
Beverages and tobacco	116.5	150.1	69.1	439.2	946.2	4.0
Construction materials	21.3	32.9	12.2	23.4	49.3	91.7
Intermediate products I	11.4	0.3	14.8	15.3	-6.7	16.2
Intermediate products II	36.1	30.0	19.2	50.3	75.4	55.3
Non-durable consumer goods	44.9	39.8	64.6	57.4	134.6	212.4
Consumer durables	45.0	48.2	57.3	93.2	136.2	495.6
Machinery	10.2	28.0	21.4	7.6	23.7	58.3
Transport equipment	58.8	37.9	80.5	146.5	135.0	417.2
All industries	n.a.	30.8	27.3	87.2	18.6	70.2
All industries excluding food, beverages and tobacco	n.a.	n.a.	36.4	44.2	45.9	90.3
Non-import-competing	71.2	34.6	50.8	175.0	39.7	99.6
Import-competing	33.6	24.8	35.7	56.1	44.8	85.9
Export	-7.4	-6.5	13.7	-24.3	-39.9	40.3

Source IBRD, Industrial Development Strategy in Thailand, 1980, Table 7

Table 4 Rates of protection for fabrics in Thailand (%)

		1960-62	62-65	65-68	68-71	71-78	1978~
cotton yarn	nominal			25.0	25.0	25.0	25.0
	effective	3.2	3.2	3.2	77.6	77.6	77.6
polyestel/cotton yarn	nominal	20.0	20.0	20.0	20.0	20.0	20.0
	effective	25.9	25.9	25.9	25.9	25.9	25.9
polyestel/rayon yarn	nominal	20.0	20.0	20.0	20.0	20.0	20.0
	effective	20.0	20.0	20.0	20.0	20.0	20.0
cotton textile	nominal	22.0	35.0	35.0	60.0	60.0	80.0
	effective	53.7	114.3	114.3	70.7	70.7	390.9
polyestel/cotton textile	nominal	37.0	37.0	40.0	60.0	60.0	80.0
	effective	80.1	80.1	94.8	265.8	265.8	1051.7
polyestel/rayon textile	nominal	37.0	37.0	40.0	60.0	60.0	80.0
	effective	78.6	78.6	92.9	254.3	254.3	913.4
outer garment	nominal	27.5	27.5	30.0	40.0	60.0	100.0
undergarment cotton	nominal	27.5	27.5	30.0	60.0	60.0	100.0
synthetic	nominal	37.0	37.0	40.0	60.0	60.0	100.0

Source Yamazawa, Ippei. Thai sen-isangyou yushutsuka no bunseki (The Analysis on the export strategy of Thai fabric industry), Hitotsubashi Daigaku Kenkyu Nenpo Keizaigaku Kenkyu. No.23, 1953.

Table 5 Outline of trade liberalization policies1960-86

Year/ Month	Liberaliz-ation rate	Items liberalized	Remarks (Liberalized items listed)
1960/4	41%	1,443	Trade and Foreign Exchange Liberalization Plan approved in June 1960) Coffee beans, home sewing machines, ceramks, steel scrap, beef tallow
1960/7	42%	1,504	Cow leather
1960/10	44%	1,985	Pig Iron, cocoa beans
1961/4	62%	2,645	Raw silk, raw wool, radios, motorcycles, ordinary steel materials, bicycles, buses, trucks
1961/7	65%	2,757	(Trade and Foreign Exchange Liberalization Promotion Plan approved in September 1961) Soy beans, instant coffee
1961/10	68%	3,257	Silver, nickel, wrist watches
1961/12	70%	3,427	Stainless steel, ordinary plate glass, apparel
1962/4		Transition from the "positive" system of SITC tariff headings (total of 4,120) to the "negative" system of Brussels tariff headings.	

		Number of remaining items subject to import			Number of non-liberalized items	Remarks
		Total	Industrial goods	Agricultural goods		
1962/4	73%	466			492	Ordinary plate glass
1962/10	88%	232			292	Crude oil, paper and pulp, graphite
1963/4	89%	197			229	Steel blocks, caustic soda
1963/8	92%	155	87	68	192	Raw sugar
1964/1		152	84	68	189	Koryan
1964/4	93% or less	136	69	67	174	(Transition to IMF Article 8) Color television sets
1964/5		136	69	67	174	Lemons (raw only)
1964/10		123	56	67	162	Ammonium chloride, ammonium sulfate, bulldozers
1965/10	93% or less	122	55	67	161	Passenger cars
1966/4		120	54	66	159	Cocoa powders, synthetic fibers and other long-fiber threads
1968/4		122	54	68	165	Cosmetics
1969/4		120	52	68	163	Polished plate glass
1969/10		118	50	68	161	Industrial sewing machines
1970/2	94% or less	109	45	64	152	(Grape) wine
1970/4		98	39	59	141	Boilers, coffee, machine tool
1971/1		80	31	49	123	Whiskey, color film
1971/6	94% or less	60	20	40	106	Tae
1971/10	95% or less	40	12	28	87	Pork
1972/4	97% or less	33	9	24	79	Amendment to the Tariffs Law reduces by 1 item)Ham, bacon, diesel and heavy oil, computer peripherals, aircraft radar
1973/4	Last calculation	32	8	24	83	High-end calculators, computers, integratedircuits (up to 200 elements)
1973/11		31	8	23	82	Dates, non-edible seaweed, modified dates
1974/10		30	8	22	84	Malt
1974/12		29	7	22	83	Integrated circuits (200 or more elements)
1975/4		29	7	22	84	(Amendment to Labor Safety and Sanitation Law increases by 1 item)
1975/12		27	5	22	82	Computers and peripherals
1977/4		27	5	22	80	(Liberalization of non-residual item subject to import restrictions [tobacco products]) Tobacco products
1978/4		27	5	22	79	Canned ham and bacon
1980/1		27	5	22	73	Gold ore, light bulbs, dirigibles
1980/5		27	5	22	78	(Ratification of the "Washington Treaty" on international trade in animals and plants threatenedwith extinction adds 5 items)
1981/10		27	5	22	79	(1 item added among DDT and chemical substances)
1982/3		27	5	22	79	Private aircraft, private aircraft engines and their parts
1984/5		27	5	22	80	Parts for machines for measurement and detection of alphaand beta waves (only for those containing nuclear fuels) and ancillary items (only for those containing nuclear fuels)
1984/7		27	5	22	80	High-taste molasses, other sugars
1985/4		27	5	22	80	Pork processed products
1986/4		27	5	22	76	Leather and shoes

Source Taro Komiya, Modern Japanese Economy, University of Tokyo Press 1995

Table 6 Foreign exchange liberalization

Year/ month	Description
1959/ 1	Relaxation of currency restrictions for standard settlement methods
1959/ 4	Expansion of designated currencies from 9 to 14
1959/ 9	Liberalization of US dollar market. Establishment of trading bands of 1/2% deviation from median for spots, full liberalization of futures trading
1960/ 2	Expansion of offsetting to all trading houses
1960/ 4	Establishment of trading house position concentration limits
1960/ 7	Establishment of non-resident free yen accounts
1960/ 8	Liberalization of overseas activities of trading houses
	Liberalization of local ending and unsecured borrowings of foreign exchange banks
1960/11	Relaxation of short-term foreign capital borrowing standards for Japanese companies
	Elimination of restrictions in import usance items, extension of time frames
1961/ 2	Full liberalization on transfers of dividends on shares acquired prior to the war
1961/ 5	Across-the-board shortening of transfer periods for securities principal
1962/ 1	Elimination of restrictions on currencies for foreign payments, elimination of restrictions on currencies held by foreign exchange banks
1962/ 6	Initiation of foreign exchange reserve deposit system at foreign exchange banks
1962/ 8	Shortening of period for which transfer of equity principal is restricted
1963/ 1	Hike in reserve rats for foreign currency reserve deposits
1963/ 4	Full elimination f holding period for equity principal
	Expansion of foreign exchange trading band to 0.75% on either side of the median price; introduction of foreign exchange equilibrium restoration operations

Source Annual Economic Report, 1963.

Table 7 Liberalization of capital transactions

Year/ month	Description
1961/ 4	Joined OECD. Undertook obligations of "Disciplines on Liberalization of Capital Movements."
1967/ 7	Phase 1 of capital liberalization. Approved 33 sectors, including pharmaceuticals, for Class 1 (50% capital liberalized industries); 17, including steel and shipbuilding, for Class 2 (100% liberalization)
1969/ 3	Phase 2 of capital liberalization. Approved 160 sectors for Class 1; 44 for Class 2.
1970/ 9	Phase 3 of capital liberalization. Approved 447 sectors for Class 1; 77 for Class 2. This resulted in liberalization of 70-80% of all industry; 75% of manufacturing (by shipping values).
1971/ 4	Liberalization of automotive industry.
1971/ 8	Phase 4 of capital liberalization. All but 7 industries (negative list) approved for Class 1; 151 industries approved for Class 2.
1973/ 5	Full liberalization applied in principle to Class 2.
1974/ 8	Among sectors on the negative list, 50% liberalization approved for the computer industry.
1974/ 12	Among sectors on the negative list, 50% liberalization approved for the computer processing industry.
1975/ 5	Among sectors on the negative list, 100% liberalization approved for the real estate industry.
1975/ 6	Among sectors on the negative list, 50% liberalization approved for the small retailing industry.
1975/ 12	Among sectors on the negative list, 100% liberalization approved for the computer industry.
1976/ 4	Among sectors on the negative list, 100% liberalization approved for the information processing industry. This left only 4 non-liberalized sectors: agricultural, forestry and fishing; mining, petroleum, and leather and leather products.

Source Economic Planning Agency, Development of the Modern Japanese Economy