Vietnam’s integration into the global economy. Achievements and challenges

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Abstract

Aspiring to further integrate into the global economy Vietnam is confronted with tremendous political, economic and institutional challenges. Issues to be addressed are not only technical questions such as tariff reductions, abolishing quantitative restrictions, the investment regime or the gradual giving up of the foreign trade monopoly. Much was achieved but more challenges are laying ahead. If trade is to continue to serve as an engine of growth, Vietnam must develop a multidimensional strategy for trade expansion, which fits into an appropriate macroeconomic environment. Institutional reforms and improvements in the legal system are as important as human capacity building and an appropriate infrastructure for attracting FDI and expanding exports. Three prominent economic integration projects facilitate the process. They are a severe test of Hanoi’s administrative and governance capacity but also demonstrate the government’s obligation to restructure the national economy.

Introduction

Vietnam’s transition towards a market economy has been a bright success story so far. After one and a half decade of deliberate and cautious reform measures that became popular under the Vietnamese word “doi moi” (renovation) the economy still flourishes with annual growth rates hovering around 7 percent. More than 20 million Vietnamese have been lifted above the poverty line of one Dollar a day, indicating the government’s spectacular performance in reaching its development goals.

The reform process, however, is not without frictions. Since Vietnam must solve a transformation as well as a development problem and, moreover, economic integration clears up the roles to be played by national stakeholders, strengthening an economic system that leaves behind the legacy of a centrally

1For instance: government, the Communist Party of Vietnam (CPV), parliament, the business community, research institutes etc.
planned economy and follows market principles more strictly still poses a great challenge.

Reforming the foreign trade regime

Foreign trade monopoly

A key feature of socialist planned economies is the foreign trade monopoly. All functions and tasks of foreign trade are at direct disposition of only one administrative entity, thus cementing the strict economic and institutional separation of production and external economic relations.

In Vietnam more than two dozen specialized Foreign Trade Organizations (FTO) managed all import and export activities under guidance of the Ministry of Trade (MoT). The gradual fading out of that principle was initiated years before the Council of Mutual Economic Assistance (CMEA) collapsed in 1990/91 and marks an important step towards trade liberalization. In the course of the 1988 reorganization of the Ministry of Trade most the 33 FTO were selected and placed under direct authority of other line ministries. Subsequently, some state-owned enterprises (SOE) were provided with the right to apply for an import and export license at the MoT. As a consequence, the number of economic agents legally able to conduct direct import and export activities rose significantly. In addition, the small private sector was given the right to obtain import licenses and the application procedures were simplified. Between 1990 and 1995 the number of Vietnamese companies and institutions technically able to conduct cross-border transactions increased from 580 to 1923 (Schmidt 1999).

At the beginning however, only few licensees engaged in foreign trade. The weak purchasing power of the Vietnamese as well as the lack of exportable products made licenses more or less an option for future business that had to be secured during those early days of reform. In January 1998 the revised Commercial Law came into force without substantially reforming licensing procedures. A full decentralization of trading rights was postponed.

Under the impression of the Asian Economic Crisis and for the sake of “national interest” Vietnam codified the trade monopoly for a number of “strategic products”. Export of crude oil and of rice, for example, as well as import of key products such as fuel, steel and fertilizer remained restricted. In September 1998 relief was given by Decree No. 57/1998/ND-CP which abolished – in principle - the general export licensing requirement. Domestic enterprises, irrespective of ownership structure (state or private), business scope (production or trade) and size of capital (no minimum working capital requirements) were allowed to trade direct and freely with foreign clients.

Regarding the liberalization for trading rights of foreign invested enterprises (FIE) the Vietnamese government applied a different approach. Until the end of the nineties FIE’s trade activities were confined to those products mentioned in their Business Registration License; basically production inputs not available in Vietnam and items originally produced by the company. The importation of consumer goods for distribution in Vietnam was not allowed.

It took about a decade to liberalize imports. Decree No. 10/1998/ND-CP of January 1998 leveled somewhat the playing field between Vietnamese
companies and FIEs. It permitted foreign invested enterprises to purchase domestically produced goods and to export them, provided selling overseas was not restricted by other domestic regulation (mainly for safety, health, environmental or cultural heritage purposes). However, since Vietnam did not encourage foreign investment in pure trading without a local manufacturing base, for about a decade only few “pioneering” foreign trading companies enjoyed the preferential right to supply the domestic market with foreign goods. In September 2000 the privilege eroded when branches of foreign traders were permitted\(^2\) to purchase certain agricultural and light industry goods for direct exportation and to import – under certain conditions – products specified in a license issued by MoT.

Tariff regime

In socialist trade regimes tariffs are of minor importance. Since public revenues are generated by profits from state-owned enterprises and, moreover, because local companies have no direct access to foreign markets or suppliers, there is no need for a well differentiated tariff scheme as a predictable source of revenue or as an instrument for (infant) industry protection.

Correspondingly, in pre-reform Vietnam tariffs played no significant role. Until 1987/88 customs duties were only imposed on non-commercial imports such as donations from relatives abroad. But due to the growing autonomy of public enterprises and the foreseeable decline in revenues the need emerged to tap other sources of government revenues. The new “Law on Export & Import Duties on Commercial Goods” of December 1987 was based on a simple tariff scheme that followed the Brussels Tariff Nomenclature. Customs duties were levied on about 30 export products – ranging from 2–15% – and on approximately 130 import products with duties from 5–55% (Schmidt, 1999).

The legal basis of the tariff regime was modified in 1991, 1993 and 1998. Subordinate regulations, however, made cross-border transactions increasingly complex and time-consuming. In the mid-nineties Vietnam applied 26 different import tariff rates ranging from 0 to 60%. But although Vietnam’s tariff scheme was tailored several times to the country’s development needs, the basic concept was not changed: duties on consumer goods are high while capital and investment goods are taxed moderately or even low. In order to substitute imports, certain domestic products classified as “potentially competitive” are protected by high tariffs. The dispersed tariff structure, however, is made even more complicated by a wide spread of tariffs for similar industrial products. For instance, until the mid nineties 18 different categories of tires were subject to tariff rates between 5 and 50%. Although such incoherence has been remedied for tires, other locally manufactured goods like electric motors or paper still face considerable tariff dispersion.

Another - still unsolved - problem is the customs valuation procedure for imported and exported goods. Regulations of the Ministry of Finance to implement the Law on Import and Export Duties state that the levy should be calculated in principle on the “contract price”, i.e. the c.i.f. value. Since more

\(^2\) Cf. Decree No. 45/2000/ND-CP.
and more manipulated invoices appeared at customs offices the State Pricing Committee fixed “Minimum Import Prices” for initially 15 commodity groups, and adjusted them periodically according to origin and by taking into account fluctuations of world market prices.

In order to improve transparency of its trade regime, recently Vietnam has aimed at applying a uniform and consistent import tariff regime. The number of tariff rates has been reduced to 12 (and is to be brought down to 6), duties imposed on imports shall not exceed 50%. The share of duty free import items is about one third and the simple average tariff rate of about 16% indicates a comparably moderate taxation. Since 1 January 2000 tariff rates comply with the Harmonized System Convention (HS96). Moreover, rates for preferential, most-favored nation (MFN) and “normal” (non-MFN) treatment were introduced.

Quota regulations

International trade agreements recognize that countries may wish to protect their industries from foreign competition, but urge them to provide protection only through (reasonable) tariffs. Article XI of the General Agreement on Tariffs and Trade (GATT) reinforces this principle by prohibiting members to use quantitative restrictions (QRs) on imports.

However, so far eight years of negotiations on WTO accession have not prevented Vietnam from maintaining quantitative restrictions in its trade regime. After temporarily relaxing QRs in the very first phase of economic reforms regulations were tightened again under the impression of political changes in Eastern Europe. Concerned about a shortage of major trading goods, the Ministry of Trade imposed quantitative import and export restrictions for “strategic goods” that were based on the declared demand of provincial and central trade authorities.

In 1994 the Ministry of Trade began to publish “guideline data” for the cross-border trade of “elementary products”. So-called “focal point traders” were chosen to manage 50–100% of the calculated target quantity. If the selected enterprises indicated “sufficient capacity” to handle “unused entitlements” of other enterprises, they were permitted to “seize opportunities” on foreign markets. Practically, the regulation granted a preference to Foreign Trade Organizations of line ministries, hence excluding again the nascent private sector from the lucrative trade.

After some years of gradually relaxing the strict quota regime, the Asian Economic Crises provoked again a rise of level of protection and the imposition of new quantitative restrictions. Imports of certain consumer goods and of major industrial products such as petroleum products, steel, cement, sugar, fertilizer, paper were subject to strict import quotas (Schmidt, 1999). Since the impact of the Asian Crisis on Vietnam’s economy turned out to be less severe than expected, in 1998 the Ministry of Trade converted some of the

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3Only preferential rates for imports originating from ASEAN member countries were introduced.
imposed import restrictions to tariff equivalents and opened the allocation of quotas to non-state enterprises. Local private companies were allowed to import fertilizers and later they participated successfully in the annual auction of rice export quotas. Meanwhile, export quotas for rice have been eliminated.

In order to gradually liberalize the trade regime Vietnam has relaxed the importation of some goods. The number of product categories subject to quantitative restrictions was reduced from 19 to 11 in 2000 and to 4 in 2001. At the end of 2002 only the importation of sugar, petroleum products, some steel products, motorbikes, trucks and passenger cars remained restricted. A timetable envisaging also the complete phasing out of QRs was developed by the Ministry of Trade, but needs to be reviewed and fine-tuned.

Foreign investment law

The passing of the “Law on Foreign Direct Investment” in December 1987 constituted the legal framework for FDI in Vietnam. At the time of enactment it was considered to be one of the most liberal pieces of FDI legislation in Asia since it permitted the establishment of 100% subsidiaries. Moreover, foreign investors received comprehensive import facilitation, tax benefits and the unlimited right to repatriate profits. With its amendments of 1990, 1992, 1996 and 2000 the law encouraged investment into almost all economic areas. In some sectors such as construction, telecommunication, exploitation and processing of mineral resources, certain transportation services (air, railways, sea, public passenger transport), investment is only allowed in the form of joint venture or a business cooperation contract.

After the Asian crises and the dwindling inflow of foreign investment capital (the peak value of 8 billion USD registered capital in 1996 remained unsurpassed so far) Vietnam made some headway in 1998 to improve the investment climate and permitted in principle foreign invested enterprises to export products not manufactured or processed by themselves.

In spring 2000 a fundamental review of the investment legislation passed the National Assembly. The new law eased the supply with foreign currency and eliminated foreign currency balancing requirements. The obligation to surrender foreign exchange has gradually fallen from 80% (1998) to zero by the end of 2003. Moreover, the law clarified the criteria for the issuance of investment licenses and enlarged the group of (export-oriented) projects subject to registration only (instead of an – often tedious – approval procedure).

Due to increasing difficulties of local manufacturers and traders to overcome entry barriers in key markets and to sell Vietnamese products abroad, partly caused by declining world market prices, the remaining export restrictions for enterprises under foreign (co-)ownership were further relaxed in December 2001. Foreign invested companies are now permitted to export coffee, some minerals, certain wood products, textiles as well as garments. Thus, it can be expected that the share of FIEs in Vietnam’s total exports will continue to expand rapidly (1995: 8 %, 2001: 44,6 %), making companies with

\[\text{Cf. GSO, various issues.}\]
Foreign ownership the driving force of an export-orientated modernization strategy.

**Foreign exchange rate regime**

Vietnam has followed a gradual approach in fixing the exchange rate. In order to integrate circulating US-Dollars into the formal monetary system, the Vietnamese government initiated a fundamental reform of its exchange rate policy in 1988. The fixed and multiple exchange rates of the overvalued local currency, the Vietnamese Dong, were equalized and gradually raised close to the level of the parallel or “black market”.

Until fall 1991, the State Bank pursued an exchange rate system of managed floating, i.e. the price for one US-Dollar in local currency was adjusted in irregular intervals, whereas the spread towards the parallel market served as a benchmark for incremental devaluation.

In order to establish a more effective mechanism, in 1991 the State Bank set up “Foreign Currency Exchange Centers” in Hanoi and Ho Chi Minh City, where authorized traders purchased by auction US-Dollars against Vietnamese Dong twice a week. In diversifying the system and allowing more “real time” adjustments, the State Bank introduced an inter-bank market in 1994 that ran parallel to the opening hours of commercial banks and traded other hard currencies too. Average transaction exchange rates were published on a daily basis. The State Bank monitored the foreign exchange reserves position and intervened in the market as necessary.

As one result of the increasingly flexible exchange rate mechanism, the Vietnamese Dong has depreciated comparably moderately since 1991/92. The local currency depreciated from 11,000 VND per US-$ in 1995 to 15,650 VND in December 2003. Since imports surge - the trade deficit may exceed 4.5 billion US-$ in 2003 - and local companies still prefer US-Dollars for their business transactions, the exchange rate become more under pressure. Although the trade deficit has been offset by other sources of external revenue, e.g. rising disbursements under official development assistance (ODA) or increased overseas remittances by Vietnamese living abroad, it remains unclear whether those inflows remain high and stable enough to cover the widening trade deficit.

**Interim result**

Vietnam’s success in economic integration becomes obvious when compared to the index-based trade performance of former CMEA economies. While almost all transition economies in Eastern and Middle Europe suffered from severe adaptation problems at the beginning of the nineties and, moreover, the dissolution of the former Soviet Union contributed much to aggravating their economic difficulties, Vietnam was able to swiftly explore new markets and to dramatically increase the trade volume. It is obvious that Vietnam has outperformed – together with China – all other transition economies in trade terms and was able to cope with the challenges of economic integration.

Vietnam’s foreign trade reorientation after CMEA disintegration is noteworthy. In 1987/88 about three-quarters of Vietnam’s foreign trade went to
CMEA countries. A few years later, in 1991, the share plunged to 10 percent and shrank further to 5 percent in 1992. Correspondingly, trade with countries in the region (Singapore, Hong Kong, Taiwan, Japan, South Korea) and some advanced economies in Europe (France, Germany) surged. Although those trading partners have lost somewhat their importance, they still determine – together with the “newcomers” China and United States – Vietnam’s foreign trade flows.

For a sense of perspective it can be noted that Vietnam’s balance of payments reveals the overall sound performance in current and capital accounts over the past 15 years. Since the General Statistical Office’s yearbook still does not contain a balance of payments sheet, corresponding information have to be culled from data provided to and published by the Asian Development Bank (ADB).

The trade deficit narrowed from 1.3 billion USD in 1987 to 50 million USD in 1992. The devaluation of the Dong, together with CMEA’s decision to switch internal transfer prices to convertible currencies in 1991 resulted in higher bills for the supply with raw-material, other production inputs and consumer goods. So imports shrank. Assets replacements, expansion of production capacities and a surge of imports in consumer goods meanwhile have contributed to an again widening trade deficit.

Against the backdrop of perceived imbalances and further motivated by the Asian Economic Crisis, the Ministry of Trade took measures to restrict imports. The effect was staggering. The trade deficit dropped to 1.4 billion USD within a year and shrunk further to 990 million USD in 1998. For the next few years Vietnam’s trade balance showed a surplus (at least according to ADB statistics).

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6Cf. GSO, various issues.
The balance of services developed unevenly during the past two decades. Diluted by statistical shortcomings and lacking data, the published deficit leveled out at about 1 billion US$ per year during the end of the nineties. The increasing number of tourists provides some relief and has turned, together with considerable capital inflows (ODA and remittances of overseas Vietnamese) the balance on current account into a surplus.

Table 1. Balance of payments in convertible currency (Mio. US$)

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<tr>
<td>Current account</td>
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<td>-587</td>
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<td>-767</td>
<td>-1868</td>
<td>-2418</td>
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<td>-1074</td>
<td>1177</td>
<td>1106</td>
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<td>-350</td>
<td>-63</td>
<td>-547</td>
<td>-2345</td>
<td>-3150</td>
<td>-1358</td>
<td>-989</td>
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<td>375</td>
<td>481</td>
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<td>Unrequited transfer</td>
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<td>90</td>
<td>264</td>
<td>627</td>
<td>1200</td>
<td>885</td>
<td>1122</td>
<td>1181</td>
<td>1732</td>
<td>1250</td>
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<td>Capital account</td>
<td>299</td>
<td>-59</td>
<td>-180</td>
<td>1807</td>
<td>2306</td>
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<td>2362</td>
<td>1296</td>
<td>1364</td>
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<td>Direct investment</td>
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<td>220</td>
<td>300</td>
<td>1780</td>
<td>1803</td>
<td>2100</td>
<td>1671</td>
<td>1412</td>
<td>1298</td>
<td>1300</td>
<td>-</td>
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<td>Portfolio investment</td>
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<tr>
<td>Other long-term</td>
<td>-</td>
<td>-191</td>
<td>-597</td>
<td>-284</td>
<td>279</td>
<td>392</td>
<td>950</td>
<td>2</td>
<td>134</td>
<td>-</td>
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<tr>
<td>Capital</td>
<td>412</td>
<td>-</td>
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<td>-</td>
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<tr>
<td>Other short-term</td>
<td>-213</td>
<td>-88</td>
<td>117</td>
<td>311</td>
<td>224</td>
<td>-520</td>
<td>-259</td>
<td>-118</td>
<td>-68</td>
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<tr>
<td>Capital</td>
<td>-</td>
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<td>-</td>
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<tr>
<td>Errors and omissions</td>
<td>1379</td>
<td>1673</td>
<td>1858</td>
<td>2101</td>
<td>3423</td>
<td>3510</td>
<td>3765</td>
<td>-</td>
<td>-</td>
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</tr>
</tbody>
</table>

Note: For 1988 to 1990 non-convertible trade was valued at transferable Rouble 2.4 = 1 USD.
Source: Asian Development Bank: Key Indicators, various volumes, Manila, own calculations

The balance of services developed unevenly during the past two decades. Diluted by statistical shortcomings and lacking data, the published deficit leveled out at about 1 billion US$ per year during the end of the nineties. The increasing number of tourists provides some relief and has turned, together with considerable capital inflows (ODA and remittances of overseas Vietnamese) the balance on current account into a surplus.

Table 2. Vietnam’s trade balance and performance (1989–2001)

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<tbody>
<tr>
<td>Export</td>
<td>746</td>
<td>1731</td>
<td>2042</td>
<td>2985</td>
<td>5198</td>
<td>9300</td>
<td>11540</td>
<td>14449</td>
<td>15027</td>
<td>13842</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Import</td>
<td>1590</td>
<td>1722</td>
<td>2105</td>
<td>3532</td>
<td>7543</td>
<td>10080</td>
<td>11622</td>
<td>15635</td>
<td>16162</td>
<td>16035</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Trade balance (Mn. USD)</td>
<td>-844</td>
<td>-41</td>
<td>-63</td>
<td>-547</td>
<td>-2345</td>
<td>-780</td>
<td>-82</td>
<td>-1186</td>
<td>-1135</td>
<td>-2193</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Export ratio (as % of GDP)</td>
<td>14.3</td>
<td>26.7</td>
<td>26.7</td>
<td>22.6</td>
<td>25.1</td>
<td>31.4</td>
<td>39.8</td>
<td>46.1</td>
<td>45.7</td>
<td>40.2</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Import ratio (as % of GDP)</td>
<td>30.5</td>
<td>27.3</td>
<td>27.5</td>
<td>26.7</td>
<td>30.4</td>
<td>34.0</td>
<td>40.1</td>
<td>49.9</td>
<td>49.2</td>
<td>46.6</td>
<td>-</td>
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</tr>
</tbody>
</table>

Source: General Customs Department, Hanoi, own calculations
In capital accounts the net influx of venture capital is noteworthy. After passing the Law on Foreign Direct Investment in December 1987 Vietnam built up a sound reputation as an emerging market and attractive location for FDI. Consequently, annual net foreign investment surged from 100 million USD in 1989 to about 2 billion USD during the mid nineties.

The decline after 1998 can only partially be attributed to Asia’s financial crisis. Corruption, red-tape, discretionary decisions of an inefficient, over-regulated administration, weak legal authorities and a general lack of transparency became a permanent annoyance to foreign businessmen, thus undermining the credibility of Vietnam’s reform efforts and making the country a less attractive location for FDI.

Portfolio investments are not permitted in Vietnam and thus do not appear in the balance of payments. After a long and predominantly ideological debate Vietnam’s first stock exchange opened in Ho Chi Minh City in summer 2000 but has failed to fulfill its promise. Less than 20 enterprises are listed, only three of them have a registered capital of more than 18 million USD. A second stock exchange, supposed to open in Hanoi in 2001, still awaits official approval, indicating that the full liberalization of capital movements takes time in Vietnam.

No clear tendency can be figured out for other short-term and long-term capital flows. Periods of net inflow alternate with years of net capital outflow. Significant changes were caused by the reduction of Soviet economic aid, the resumption of IMF borrowing at the early nineties that coincided with the repayments of debts accumulated prior to 1978. Nevertheless, insufficient statistical data make it difficult to determine, whether, where and to what extent the public sector and local commercial banks borrowed from abroad.

Variation of capital and current account balance are reflected in adjustments of foreign reserves. Although available data are not flawless, strong indications exist that the sharp increase in reserves continued in 2003. According to recent figures of the World Bank Office in Hanoi foreign reserves are expected to rise to about 4.6 billion US$ (World Bank, 2003).

Considering all aspects, Vietnam performs quite well in integrating into the global economy. Taking the “openness” as a yardstick, i.e. calculating imports plus exports as percentage of the gross domestic product (GDP), it is obvious that Vietnam’s export diversification manifests itself in rising foreign trade ratios: from 44.9 percent (1985) to 61.5% in 1995 and 86.8% in 2002.7

Vietnam’s foreign trade pattern continues to change rapidly, as evident in Table 3. Since 1988 the share of imports under Chapter 3 (mineral fuels) declined from 26 percent to 8.4% (1998), and was only temporarily pushed up by price hikes on crude oil markets. Decisive for the long-term trend is the diminishing importance of mineral fuel imports as other national energy sources like hydropower went on-stream. Moreover, the progressing industrial development has asked for other inputs than energy to strengthen the competitiveness of Vietnam’s exports.

Thus it is not surprising that the import of machines, electrical tools and devices as well as of transportation equipment (SITC 7) rose significantly.

7According to preliminary calculations of the Ministry of Trade, exports are expected to rise to 19.5 billion USD and import may reach 24.0 billion USD in 2003.
Whereas the Soviet Union had the biggest share in the importation of capital goods until 1991, the on-going major overhaul and expansion of Vietnam’s productive capacity together with an increasing standard of living implies growing imports of capital and high-priced consumer goods from other sources. New suppliers from the region (Japan, South-Korea) filled the gap that opened up after the collapse of the Soviet Union and equipped Vietnam with Honda motorbikes, Toyota cars, TV and video-sets made by Samsung and refrigerators originating from Korea’s LG (Lucky Goldstar). Imports of semi-finished products and components for the burgeoning electronics industry are also increasing.

The prevailing trends of SITC chapters 6 and 8 points into the same direction. Those categories contain the booming footwear, textiles and garment industry. Vietnamese companies enter into subcontracting agreements with foreign partners, where the latter generally provide design, most of the
necessary materials and distribution channels. The so-called “cut, make and trim” (CMT) production induces the importation of semi-finished textile products. In both SITC chapters the share remained stable or slightly increased whereas the total import volume multiplied between 1988–2000.

The SITC structure of Vietnam’s exports also indicates interesting developments. The dominant role of food exports (SITC 0) remained unchallenged until the second half of the nineties. Although Vietnam’s capacity as major supplier of agricultural and maritime products is not fully tapped, the impact of surging agricultural exports upon international commodity markets is striking. Since the country emerged as a prominent exporter of shrimps, rice, coffee, cashew nuts and pepper in the nineties, prices declined or even plunged on already saturated markets. The attempt to compensate losses by expanding the area under cultivation has of course not solved the problem. Prices fell faster than volumes increased, hence impacting upon the share of these commodities in Vietnam’s total exports.

Since 1988 the importance of industrial commodities (SITC 2) in Vietnam’s exports has dropped dramatically from 22.4% to 2.3% (2000). The temporary catching-up at the beginning of the nineties was a consequence of growing exports in tin concentrate, chromate and natural rubber but could not cope with the over-proportional export surplus of other sectors.

The same can be observed for Vietnam’s crude oil exports (SITC 3). Although seasonal or artificial supply shortages have frequently generated windfall profits, primary energy exports lost importance since the mid-nineties. In 2000 a recovery took place because OPEC was able to keep the prices for crude oil high. Meanwhile the share of crude exports has weakened again.

Striking gains are recorded for electro-technical goods, a category that is subsumed under SITC chapter 7. The export of electric products such as computers (and components) or basic electric devices (e.g. fans) rose from 0.2% in 1988 to 8.6% in 1998. The shrinking trade in IT products – a consequence from the bursting bubble in information and communication technologies in 1999/2000 – together with a general slowdown in business after September 11th impacted on Vietnam’s IT exports. Sales went down and thus IT exports’ share diminished until 2003 (cf. Table 4).

Exports of other manufactured products (SITC 8), such as textiles, footwear, furniture, and household articles, grew at considerable rates. The weakening performance in recent years may be a transitional phenomenon caused by initial difficulties with the more sophisticated HS96 tariff classification scheme, as the surging share of unclassified goods in 1999 and 2000 suggests.

To sum it up, Vietnam’s foreign trade undergoes a comprehensive and profound process of restructuring. Labeling SITC exports 0–4 as “basic commodities” and subsuming SITC categories 5–8 under “manufactures” it is obvious that the trade pattern gradually shifts to Vietnam’s comparative advantages. Exportation of unprocessed goods declined from about 70% in 1988 to little more than 50% in 2000. Labor-intensive manufactures have gained more importance and exports of know-how and capital intensive products rises due to the increasing role Vietnam plays as a platform for export-oriented FDI.
Vietnam’s commitments to liberalize its trade policy

Considering timing and sequencing of Vietnam’s trade liberalization, the impression is that external shocks (collapse of the CMEA, Asia’s financial crisis) always led to temporary reform retrogression. Achieved progress was abandoned when powerful lobby groups pressed for more protection.

If trade is to continue to serve as an engine of growth helping to achieve the ambitious goal of becoming an industrialized country by 2020, Vietnam must understand that a rational and predictable trade policy is an integral part of any comprehensive development framework. Since relapses into the command economy are difficult to anticipate and, moreover, load foreign trade activities with additional transaction costs, swift integration is an effective remedy to

Table 4. Major export and Import Products 1999–2003

|---------------|===============|--------------|---------------|--------------|---------------|--------------|---------------|--------------|--------------------------|--------------|
| Export        |               |              |               |              |               |              |               |              |                          |              |
| Crude oil     | 11,540        | 14,449       | 15,027        | 16,530       | 18,289        |              |               |              |                          |              |
| Seafood and   |               |              |               |              |               |              |               |              |                          |              |
| maritime      | 951           | 8.2          | 1,479         | 1,778        | 11.8          | 2,024        | 12.2          | 2,091        | 11.4                     |              |
| Textiles and  | 1,747         | 15.1         | 1,892         | 1,975        | 13.1          | 2,710        | 16.4          | 3,360        | 18.4                     |              |
| garments      |               |              |               |              |              |              |              |              |                          |              |
| Footwear and  | 1,392         | 12.1         | 1,465         | 1,560        | 10.1          | 1,828        | 11.1          | 1,996        | 10.9                     |              |
| other leather |               |              |               |              |              |              |              |              |                          |              |
| products      | 585           | 5.1          | 783           | 5.4          | 596           | 4.0          | 505           | 3.1          | 627                      | 3.4          |
| Electronics,  |               |              |               |              |              |              |              |              |                          |              |
| computer and  | Rice           | 1,025        | 8.9           | 667          | 4.6           | 625          | 4.2           | 726          | 4.4                      | 729          |
| components    | Coffee         | 585          | 5.1           | 501          | 3.5           | 391          | 2.6           | 317          | 1.9                      | 408          |
| Latex         | N.A.          | –            | 170           | 1.2          | 161           | 1.1          | 263           | 1.6          | 352                      | 1.9          |
| Import        | 11,622        | 15,635       | 16,162        | 19,300       | 22,648        |              |               |              |                          |              |
| Machinery and | 2,005         | 17.3         | 2,571         | 16.4         | 2,741         | 17.0         | 3,700         | 19.2         | 4,960                    | 21.9         |
| spare parts   | Petroleum      | 1,054        | 9.1           | 2,058        | 13.2          | 1,828        | 11.3          | 2,017        | 10.5                     | 2,180        |
| Textiles and  | 1,600         | 13.8         | 1,470         | 9.4          | 1,590         | 9.8          | 1,781         | 9.2          | 1,841                    | 8.1          |
| garment       |               |              |               |              |              |              |              |              |                          |              |
| materials     | 630           | 5.4          | 882           | 5.6          | 163           | 1.0          | 689           | 3.4          | 855                      | 3.8          |
| and parts     | Motorbikes     | 399          | 3.4           | 787          | 5.0           | 668          | 4.1           | 356          | 1.8                      | 272          |
| (IKD & CKD)   | Steel and      | 587          | 5.1           | 812          | 5.2           | 965          | 6.0           | 1,317        | 6.8                      | 1,503        |
| steel billets | Fertilizer     | 464          | 4.0           | 509          | 3.3           | 404          | 2.5           | 464          | 2.4                      | 542          |
| Plastics      | 346           | 3.0          | 480           | 3.1          | 495           | 3.1          | 615           | 3.2          | 700                      | 3.1          |
| Automobiles   | 128           | 1.1          | 219           | 1.4          | 427           | 2.6          | 576           | 3.0          | 739                      | 3.3          |

Note: Figures are not comparable to those provided by Asian Development Bank.
Source: General Department of Customs, own calculations

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prevent sliding back in reforms and to shape local manufacturers’ competitiveness. Three prominent integration projects are in the making and would facilitate the process:

ASEAN/AFTA

In July 1995 Vietnam became the seventh member of the Association of Southeast Asian Nations (ASEAN) and at the same time committed itself to implement a comprehensive tariff reduction scheme that was agreed among members in 1992. Most of the changes induced by the ASEAN Free Trade Agreement (AFTA) require the removal of trade restrictions and the easing of market access among members. The main instrument for achieving tariff reductions is CEPT, the Common Effective Preferential Tariff. Under CEPT members are requested to reduce tariffs to rates between 0 and 5% for a wide range of products traded within the region. For the initial six signatories the final year of tariff reduction schedules was moved up to 2002; for the new members of ASEAN it depends on the date when implementation of CEPT obligations started, i.e. in the case of Vietnam commitments have to be put into effect by 2006.

The CEPT reduction schedule affects four categories of products/items summarized in (1) the Inclusion List, IL, (2) the Temporary Exclusion List, TEL, (3) the Sensitive List, SL, and (4) the General Exception List, GE. Major goods on Vietnam’s TEL have been automobiles with more than 16 seats, household appliances, bicycles, toys, cosmetics, textiles/garments, iron and steel products. The SL contains 26 items, basically unprocessed agricultural goods such as livestock, meat, fish products, eggs, brown rice and sugar that are protected by quantitative import restrictions.

About 196 products are covered by the GEL. Their importation is restricted for reasons of environmental protection, national security, public moral and health.

To implement its commitments, Vietnam has reduced tariffs for almost 84% of all products. In the last of four equal installments the remaining 757 items have been transferred from the Temporary Exclusion List to the Inclusion List by 1 July 2003 (cf. Table 5).

An accelerated tariff reduction is being implemented since 2003 (cf. Table 6). The simple average tariff rate is brought down rapidly from 9.3 to 3.0%, covering also many items which are currently produced in Vietnam. For many years Vietnam listed only those items in the Inclusion List that were not produced domestically. Correspondingly, the Temporary Exclusion List contained most products with a strong domestic production base. Moreover, Vietnam’s General Exception List appears not to comply with Article XX of GATT (restricting exceptions to the protection of national security, human,

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8Products in the IL undergo tariff rate reductions until the agreed limit of 0–5% is reached. TEL items comprise products which are shielded for a temporary period of time; they have to be transferred to the IL later. The SL contains unprocessed agricultural products for which tariff reduction commitments (as well as the phasing out of other non-tariff barriers) are due by 2010 (for original AFTA members and by 2013 for Vietnam). Products under GE List are permanently excluded from liberalization commitments under CEPT.
animal or plant life, public morals etc.), since it includes items such as fuels, broadcasting and receiving equipment, switchboards, cigarettes/tobacco, motorbikes, vehicles with less than 16 seats, etc., i.e. again items where Vietnam has strong interests in protection, and revenue objectives.9

The approach towards fulfilling AFTA/CEPT obligations, however, has fostered domestic enterprises’ illusion that Vietnam’s liberalization commitments are abstract and that implementation would be protracted by the government for a long time to come, i.e. as long as possible. Being published as late as June 2001, for many years Hanoi’s obligations for tariff reductions were administered in a very opaque way by the Ministry of Trade. They shielded particular, short-term vested interests of some lobby groups. Consequently, domestic enterprises will have less time for preparing and adjusting to stiffer competition from Asian neighbor states and to secure their current level of employment. Although it is rather an academic remark, a deliberate and comprehensive enterprise preparation program 10 for potentially competitive sectors, launched years ago (!), would have contributed much to reducing the risk of economic and social problems developing because of rising unemployment in the wake of trade liberalization.

### Bilateral trade agreement with the US

The US-Vietnam Bilateral Trade Agreement (BTA), which became effective on 10 December 2001, is perceived to be a milestone of Vietnam’s progressing

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10Practical advice in accounting/daily business operations, human resource management, market research, exploration of new distribution channels, marketing issues etc.
economic integration. In the US Vietnamese manufactures are now subject to the same low tariff rates as imports originating in WTO member countries; i.e. Vietnam receives essential benefits of WTO membership without having completed the accession procedure. Reducing the average import tariff rate from about 40% to 3% has boosted the competitiveness of Vietnamese products on the US market. After receiving MFN status Vietnam recorded a dramatic increase in its textiles and apparel sales to the United States. In the first nine months of 2003 total exports to US soared by 30%, predominantly due to growing garment exports. Further growth, however, is constrained by US import quotas imposed under a bilateral textile agreement that was officially signed in July 2003. 11

In exchange for the liberalized market access of Vietnamese goods to the US, Hanoi has granted American companies and service providers better access to the domestic market. The main commitments are to:

• guarantee Most-favored Nation (MFN) and national treatment to US goods and services upon ratification (including customs levies & charges, internal taxes, transportation, distribution and storage of products etc.),
• eliminate import quotas over a period of 3 to 7 years after ratification,
• cut tariffs by 30–50% on approximately 250 products, most of them agricultural goods, (phase-in period of up to 6 years),
• abolish import-licensing requirements (gradually over 3 to 6 years),
• apply WTO provisions on customs valuation, technical standards & sanitary and phytosanitary measures,
• allow investment in service industries, including legal services, accounting, tax-counseling, integrated engineering, computer software, advertising, management consulting, telecommunication, construction, distribution, education, insurance, banking, and tourism,
• facilitate US investment by protection against expropriation, clear provision on profit repatriation, eliminating the 30 %minimum capital requirement for US stakes in a joint venture, and phasing out provisions inconsistent with the WTO Agreement on Trade-related Investment Measures (TRIMs).

But the key features of the BTA are the many legal and technical procedures anticipating core WTO obligations that have made negotiations so cumbersome and tedious. The BTA, being one of the most comprehensive bilateral trade agreement so far concluded by the United States Trade Representative (USTR), covers WTO disciplines on trade in goods, trade in services and trade-related aspects of intellectual property rights, various international conventions on intellectual property, 12 and refers to the Basic Telecom Reference Paper negotiated under WTO. The Agreement contains important provisions for the settlement of private commercial disputes, guarantees nondiscriminatory access to courts and administrative bodies and encourages the arbitration under internationally recognized rules.

11The agreement limits textile exports of 38 categories of textiles and garment at an estimated 1.7 billion USD in 2003. The agreed quotas will grow by 7% per year (2% for wool products).
12Berne Convention (Literary and Artistic Works), Paris Convention (Industrial Property), New Varieties of Plant Protection, Brussels Convention (Satellite Signals), Geneva Convention (Phonograms).
The BTA calls for a comprehensive review and – where inconsistencies with agreed regulations are ascertained – an overhaul of Vietnam’s trade regime and legal system. Thus, the U.S.-Vietnam Trade Council (USVTC)\(^{13}\) has devoted much effort to catalogue legislation and regulatory efforts made in areas relating to the BTA and in accordance with international trade and investment standards. Although the US legal experts do not indicate in detail linkages to other non-trade reform sectors, their BTA roadmap is a deliberate approximation for indicating adjustment requirements for full WTO membership.

Accession to the WTO

By becoming a WTO member Vietnam will have to accept four principles of the multilateral trading system for its own trade and investment regime:

- **Non discrimination**: Market access restrictions are equally applicable to all WTO members. The famous most-favored nation (MFN) clause means that trade benefits granted to one country must be immediately and unconditionally extended to the like products of other countries. The national treatment rule, that complements the MFN principle, prohibits a member to discriminate between imported products/services and domestically produced goods and services.\(^{14}\)

- **Transparency**: The predictability of national trade policy has to be improved by the binding commitment to apply only those policies and measures that are consistent with WTO rules. Violations can be submitted to the dispute settlement mechanism.

- **Protection for domestic industry through tariffs only**: The use of quantitative restrictions is prohibited, except in a limited number of well defined situations.

- **Continued Liberalization**: remaining barriers to trade are to be dismantled through rounds of multilateral negotiations.

Vietnam submitted its application for WTO membership in 1995 and has started to negotiate its conditions of accession. The tedious process ensures that the applicant’s trade regime will be in conformity with WTO rules and that bilaterally granted market access commitments apply later equally to all WTO members. In other words, accession negotiations determine the “price” the applicant has to pay in exchange for the benefits of membership, i.e. the ability to trade with other members under conditions of fair competition.

Judging from the experiences of some new WTO members, Vietnam must be prepared to enter into binding commitments beyond obligatory WTO provisions, e.g. about privatizing state-owned enterprises, transparent and non-discriminatory tender procedures for procurement of government entities (Schmidt, 2003)

\(^{13}\)The USVTC is a non-profit organization founded in 1989. Chairman of the Board of Directors is now the former US Ambassador to Vietnam, Mr. P. Peterson.

\(^{14}\)However, some well-defined exemptions from the MFN principle and the national treatment rule are provided for regional preferential trade agreements and for the trade in services.
Vietnam has made great progress in informing other WTO members about its trade regime. In the so-called fact finding phase the government applying for WTO membership has to describe all aspects of its economic and trade policy that have a bearing on WTO agreements. Vietnam’s “Memorandum on Foreign Trade Policy” was submitted in August 1996 to the WTO and thereafter was examined by the Working Party (WP), a group of member countries dealing with Vietnam’s application. In return, Hanoi has received a list of – up to now – more than 2000 questions, which aim at clarifying further details of current administrative and legal practices.

So far six WP meetings have contributed to create a higher degree of transparency of Vietnam’s foreign trade regime and, moreover, discussed obligations for bringing her legislation into conformity with WTO rules. Initial offers for the trade in goods and in services were submitted prior to the 5th WP meeting in April 2002. A team of high-ranking government officials has started to negotiate bilaterally with interested WTO members about tariff rates and specific market access commitments. The talks, which are bilateral because different countries have different trade interests, lead to bilateral trade agreements (BTA) like the one concluded with the US. So far Vietnam has received more than 25 requests for bilateral consultations. At the end of the negotiation phase, i.e. when all BTA with members of the working party are finalized, the WTO secretariat compiles a general “schedule of concessions” from the bilateral market access commitments which become an integral part of the protocol of accession. Since the applicant’s commitments must apply equally to all WTO members upon accession, any bilaterally agreed market access advantage ends when Vietnam accomplishes the application procedure; i.e. a concession granted out of economic or political considerations to one trading partner then has to be extended to all WTO members because of the MFN clause.

Thus negotiations with WTO members call for a deliberate bargaining strategy as well as for a trustful and effective cooperation between affected entities. In order to facilitate interaction among public entities, the Vietnamese government set up a “National Committee for International Economic Cooperation” (NCIEC) in 1998. Its primary task is “to assist the Prime Minister in supplying concrete guidance and coordinating activities of Ministries and local governments in Vietnam’s participation in trade-economic activities within ASEAN, ASEM, APEC; and in negotiating to access and participate in the WTO and other international, regional trade-economic organizations.” As a coordinating and advisory body, the NCIEC is located between the Prime Minister and the ministries. It is chaired by a Deputy Prime Minister, Mr. Vu Khoan. Each of the 20 member ministries is represented by a vice minister. Representatives of the Communist Party’s Economic Commission attend the bimonthly meetings, too. The Minister of Trade is vice chairman. Attached to the NCIEC is Vietnam’s WTO negotiation team under Trade Vice Minister Tu. Since Vietnam has signaled its willingness to accelerate the country’s integration into the global trading system and recently asked for three additional Working Party meetings in 2004 to achieve membership by 1 January 2005, the demand for WTO-related interaction

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between ministries, public and business entities will further increase and emphasize the coordination function of the NCIEC.

Other integration projects

The setting for Vietnam’s economic integration stretches by two more regional trade agreements which Hanoi will have to implement in the future. Under the Asia Pacific Economic Cooperation Forum (APEC) Vietnam committed itself to liberalize its trade regime by 2020. Regularly updated Individual Action Plans (IAP) describe voluntary and not-binding liberalization measures which APEC countries undertake in order to dismantle trade and investment barriers among its members.\(^{16}\)

Less gradual effects may be triggered by the ASEAN-China Free Trade Area (ACFTA), formally launched by a framework agreement in November 2002. Even though newer ASEAN member states receive a five year extra adjustment period for achieving the final stage of liberalization (2015 instead of 2010), an “Early Harvest Program” that commits ASEAN-6 and China to reduce tariffs for certain products within three years makes it difficult for Vietnamese companies to meet the challenge of competing successfully in a market of about 1.7 billion consumers.

Although commitments overlap across agreements and partly anticipate WTO provisions, the liberalization of Vietnam’s trade regime will be less advanced by those two integration projects. Already agreed tariff reductions of AFTA/CEPT forestall some menacing effects of ACFTA. Further their time frame for dismantling intra-regional barriers to trade and investment is well beyond even pessimistic forecasts of Vietnam’s date of accession to the WTO. Consequently, the Ministry of Trade pays more attention to the current negotiations with WTO members.

**Conclusion**

Gradual world market integration and the intensification of international trade relations have become a central pillar of Vietnam’s economic policy. The accession to WTO, implementing ASEAN/AFTA as well as US BTA liberalization commitments and the emerging obligations from APEC or ACFTA determine timing and sequencing of the country’s foreign trade reforms.

Within this process Hanoi’s turning away from the paradigm of self-reliance is particularly notable. Historic lessons have fuelled the fear of a modernization course that is dominated by foreign economic interests, undermaring sovereignty, stability and the peaceful development of Vietnam. Therefore the communist party has always tried to avoid too much “capitalist exposure” and pursued the development path of a “socialist market economy” where state enterprises receive preferential treatment from the government.

But in recent years some political leaders have gained importance and acceptance who perceive the West and its economies not as a threat or, at best,\(^{16}\)See http://www.apecsec.org.sg for more details.
as a “milk cow” for capital (FDI) and pirated technology but who understand the importance of overseas markets for Vietnamese manufacturers. As the new generation takes over, backstage frictions and distortions among prominent political stakeholders will not disappear over night, but a more rational approach towards trade liberalization is becoming apparent. Realizing that market access is a two-way street and that overhauling the economy will not succeed when urgent reforms are further delayed, the government has become more ready to get involved with international norms and conventions such as the WTO.

Spurred into action by China’s accession to the WTO in 2001 and the perspective of falling behind the prosperous northern neighbor’s economic growth rate, Vietnam is rethinking its reform agenda and processes (Schmidt 2003). Pressing issues are:

- **Taxation:** foreseeable tariff reductions may require to rethink fiscal and budgetary policy (broadening the base for all taxes, i.e. reducing tax privileges as well as budget consolidation by drying out “undue” subsidization of SOEs).
- **Legal system:** Shaping the legal system calls for skills and decisiveness, since reforms require improving the independent status of courts and judges as well as the systematic public release of all legal documents and court decisions.
- **SOE reform:** Obligations on the privatization of state-owned enterprises have become compulsory for new (transition) members of the WTO, thus demanding binding commitments to transfer public ownership rights to private hands and to establish a level playing field for the nascent private sector.
- **Intellectual property rights (IPR):** The private character of intellectual property rights must be codified by establishing and maintaining minimum standards of protection for a wide range of IPRs such as patents, copyrights and related rights, trademarks, industrial designs etc.
- **Competition policy:** The National Treatment Principle of WTO should be anchored in domestic competition policy by setting up effective anti-trust regulations and authorities.
- **Safeguarding commercial interests:** The business community – (private) enterprises & business associations – must be prepared (and permitted!) to take over their essential role in co-determining national trade policy by articulating needs and concerns.
- **Special social safety net arrangements** may be required for softening undue hardship for redundant labor at the early stages of economic integration (frictional unemployment).

Until 1995, Vietnam’s trade liberalization was basically unilateral and thus reversible. International obligations, which tied reforms to distinct schedules or implied binding liberalization measures have been avoided because of ideological reasons. Neo-mercantilistic thinking prevailed during that phase. A staggered barrier of tariff and non-tariff measures protected domestic industry and shielded also some FIEs who had been able to expand their market share

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with approval of the government. These trade-barriers were supposed to last until competitiveness of domestic enterprises was strengthened sufficiently to resist the onslaught of foreign companies and service providers. External shocks, such as the collapse of the CMES, triggered protectionist reflexes.

The second, although initially not very effective, period began in 1995 when Vietnam submitted its request for WTO membership and signed the ASEAN/AFTA agreement as well. The bilateral trade agreement with the US is the peak of that phase for the time being, since the BTA fixes the range and schedule of arduous economic reforms in return for provided access to the lucrative US market. Evading BTA commitments has such a high price that Hanoi has no other option than to pursue with gradual liberalization. The progress procedure for becoming a full WTO member will impose further obligations far beyond the trade agenda and thus impact upon Vietnam’s economy and society in the long run.

While moving to Phase Two Vietnam’s trade policy is still highly discretionary. Frequent tariff modifications, considerable room to maneuver for the handling of customs valuation procedures, and other non-tariff barriers have been the means to prevent foreign companies from dominating those sectors where the government identified a strategic interest for maintaining national production or service capacities.

Although such practices have become less important, Vietnam is still far from applying a transparent and predictable trade policy. Some other obstacles, that are not specific to Vietnam, can be summarized under the three “C’s”, namely (1) coherence, (2) communication and (3) coordination (Schmidt 2003):

- Deficits in implementing the legislative framework because of inadequate administrative structures.
- Limited knowledge of the requirements for formulating WTO-consistent laws and regulations.
- Lack of information and consultation among experts in line ministries for preparing bargaining strategies.
- Conflicts among domestic ministries and their subordinate units, and a general lack of willingness by “participating” institutions and organizations to discuss freely their tasks, functions, structure, etc.
- Obstruction by administrative authorities at provincial level, which bypass WTO-consistent provisions of the central government by making their own decisions regardless of integration commitments.

Hence economic integration turns out to be a severe test for Hanoi’s administrative and governance capacity (Schmidt 2002). The need to bring national legislation into conformity with international trade rules, negotiating and implementing concessions on market access for trade in goods and in services, notification requirements, emerging new trade issues and the necessity to consult and consider viewpoints of all relevant national stakeholders places heavy burdens on each applicant that not infrequently

18 Toyota, Honda (motorbikes) and some other foreign companies (steel, cement industry) advocate for a “careful” liberalization policy to secure their capital-intensive investment and thus encouraged protective trends.
exceed its institutional capacity for formulating policy options or negotiation strategies.

Since reaping maximum benefits from membership in regional or international trade agreements requires identifying and formulating domestic interests inside as well as those outside the national government, ministries and other interest groups must overcome exaggerated institutional egoism and develop sufficient capacities for aligning divergent positions in order to achieve an integration result that above all serves the national interest. Hence, it is not an exaggeration to emphasize that Vietnam’s bilateral and multilateral integration projects are a summary statement of the commitment to economic reform. AFTA, US BTA and WTO accession constitute a deliberate road map for economic reforms in the next decade and demonstrate Hanoi’s obligation to restructure the national economy.

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