

THE CHALLENGE OF REGIONAL ECONOMIC INTEGRATION: THE VIETNAMESE PERSPECTIVE

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INTRODUCTION

DESPITE financial and economic crisis, 1997 was still a momentous year, as it marked the thirtieth anniversary of the founding of the Association of South East Asian Nations (ASEAN). Since its founding in 1967, ASEAN has made a number of achievements both in the political and economic sphere; but the two most noteworthy must be the 1992 decision to establish an ASEAN Free Trade Area (AFTA) and the recent expansion of ASEAN membership to include the transitional economies of Vietnam, Laos, and Myanmar, taking one step closer to realizing the vision of an ultimate ASEAN10.¹

Vietnam officially became the seventh member of ASEAN on July 28, 1995. As a consequence of its membership, Vietnam has agreed to join with other ASEAN countries to form an AFTA.² Much has been written about Vietnam's recent eco-

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¹ ASEAN, comprising originally Indonesia, Malaysia, the Philippines, Singapore, and Thailand, was formed for political and economic reasons. Brunei joined the group later in 1984; Vietnam in 1995, and Laos and Myanmar in 1997. Until 1992 the ASEAN members were mainly concerned with political issues affecting the region. The 1992 Summit (Meeting of the ASEAN Heads of Government), in which the vision of establishing an AFTA was adopted, can be considered as a watershed, because it signified a shift of orientation from political to economic cooperation. For further reading on the founding and evolution of ASEAN, see Sandhu et al. (1992).

² Vietnam acceded formally to AFTA by signing three documents: the Singapore Declaration of 1992, the Framework Agreement on Enhancing ASEAN Economic Cooperation, and the Agreement on the Common Effective Preferential Tariff Scheme for the ASEAN Free Trade Area. Vietnam's membership is considered a significant regional development because what was seen by some analysts as a military and ideological threat in Southeast Asia is now throwing its lot on the side of reconciliation, cooperation, and mutual reciprocity.

conomic transition towards a market economy and its attempts to integrate itself with the rest of the world;³ but no attempt has yet been made to address the relevant question of whether or not Vietnam will be able to meet its obligations under AFTA. Some doubt has emerged about Vietnam's ability to implement its AFTA commitment, with the recently observed ambivalence among Vietnamese policymakers over what appropriate strategy Vietnam should adopt in meeting the AFTA challenge. The popular view seems to be that Vietnam's relatively low level of economic development and less internationally competitive industries will force it to carry out its obligations under AFTA in a way that will assure the highest degree of protection possible (Vietnam 1996, p. 3). One specific example of such a view was the recent introduction of special sales taxes on imported beverages, cars, and other commodities.⁴ The idea was to develop its industrial base under as much government assistance and protection as possible before 2006, the year when Vietnam is expected to liberalize its trade regime under AFTA. This view seems inconsistent with its commitment to comprehensive trade liberalization under AFTA, which calls for an adoption of a liberal trade strategy and avoidance of selective industrial trade policy.⁵ Selective interventionism sounds reasonable enough and is similar to the import-substitution policies successfully employed by Japan in the 1960s, by the Republic of Korea in the 1970s and 1980s, and later by other countries in Southeast Asia, including Malaysia, Indonesia, Thailand, and the Philippines. However, there is a danger that this policy will make protected industries perpetual infants substantially reliant on government assistance. The experiences of the Philippines in the 1970s and early 1980s attest to this danger, for one of the major factors behind its failure to join the ranks of fast-growing economies of ASEAN was its inability to make a timely switch from an import-substitution policy to an export-oriented one, due mainly to bureaucratic inefficiencies saddled with rent-seeking and political patronage.

The objective of this paper is to assess how Vietnam has so far performed its AFTA obligations and then point to an observed ambivalence by highlighting the economic difficulties Vietnam is currently facing as it tries to fulfill its commitment to AFTA. It will be argued that unless Vietnam can find ways of resolving these difficulties, it will be unlikely to adopt a liberal trade policy and thus, may abandon part or all of its AFTA obligations.

³ See for example Dollar (1996), Nadal De Simone (1995), and Chin and Ng (1996).

⁴ Effective January 1, 1996, Vietnam has introduced a special sales tax on six imported commodities (namely, tobacco, beverages, firecrackers, automobile, petrol, and naphtha) at rates varying from 15 to 100 per cent.

⁵ This view is shared by Kokko (1997). A delayed implementation of AFTA commitments can lead to the "bunching of tariff rates," which the AFTA Council has required all members to avoid in the process of tariff reduction. Selective interventionism runs counter to AFTA's principle of neutrality and market-oriented development strategies.

The paper is organized as follows: Section I discusses the rationale and objectives of AFTA, followed by a brief summary of Vietnam's motives for joining; Section II assesses the progress made by Vietnam in implementing its commitment and obligations; and Section III explains the potential conflict between Vietnam's domestic and international strategic policies by highlighting the economic difficulties it is currently facing and its prospects for eventual implementation of AFTA commitments. In Section IV, a set of recommendations to deal with the possible adverse effects of joining AFTA will be presented.

I. RATIONALE, OBJECTIVES, AND THE AFTA CHALLENGE

The historic 1992 decision to establish an AFTA is by far the best reflection of the determination on the part of the ASEAN6 (i.e., Brunei, Indonesia, Malaysia, the Philippines, Singapore, and Thailand) to deepen their level of economic cooperation. Furthermore, it was an appropriate decision, given the current global trend towards regional integration, increasing international competition, and the need to maintain international competitiveness and economic dynamism through full liberalization of trade and investment in the region. Thus, the AFTA vision is to integrate the markets of ASEAN individual members by reducing intra-ASEAN tariffs to 0–5 per cent and eliminating quantitative restrictions and other non-tariff barriers among themselves by a target date, which has again been brought forward in response to new economic challenges. The decision made by the political leaders of the ASEAN founding members at the Sixth Summit held in December 1998 to advance the target date from 2003 to 2002 is the latest move to accelerate the realization of AFTA. Vietnam, which joined the grouping later in 1995, has been granted extra time to achieve trade liberalization.

To realize this vision, individual member countries are obliged to formulate various lists of commodities eligible for trade liberalization under the Common Effective Preferential Tariff (CEPT) scheme,⁶ design and implement tariff reduction programs, eliminate non-tariff barriers (including harmonization of technical barriers), and comply with other obligations under the ASEAN trade facilitation

⁶ They are required to submit five different lists: the Inclusion List (IL), Temporary Exclusion List (TEL), Highly Sensitive List (HSL), Sensitive List (SL), and the General Exceptions List (GEL). The Inclusion List includes products that are immediately eligible for preferential access. The Temporary Exclusion List includes products that are temporarily excluded from tariff concessions, but are required to be phased into the Inclusion List on five equal installments. The Sensitive List includes products that are also temporarily excluded from tariff concessions, but are to be given more time before they are phased into the Inclusion List because of their political and strategic importance to the countries concerned. The General Exceptions List includes products permanently exempted from trade liberalization for national security, protection of health and morals, and other special reasons. For more detailed discussion of these various lists, see ASEAN Secretariat (various issues).

scheme, such as the adoption of common ASEAN tariff nomenclature, the General Agreement on Tariffs and Trade (GATT)-based customs valuation system, harmonized clearance procedures, and a Green Lane System to speed up the process of customs clearance for goods eligible under the AFTA preferential tariff scheme. There are also ongoing initiatives to liberalize trade in services and investment within ASEAN and to forge agreements on competition policies and transport. The ASEAN countries are now in the process of formulating the detailed aspects of these initiatives.

Vietnam, due to its late membership and emergence as a new market-oriented economy, is not required to meet all the AFTA obligations until the year 2006; and the timetable for the phasing in of its Temporary Exclusion List (TEL) has been adjusted accordingly. In particular, the phasing in of its TEL for manufactured products on five equal installments will commence on January 1, 1999, ending January 1, 2003, while the phasing in of its TEL for unprocessed agricultural products will begin on January 1, 2000. However, according to the agreement reached at the last summit, Vietnam is committed to maximize its tariff lines between 0 and 5 per cent by 2003, and to expand the number of tariff lines in the 0 per cent category by 2006 (ASEAN Secretariat 1999).

AFTA poses itself as a tremendous challenge to Vietnam, given that its trade regime is still highly restrictive. It is a trade regime characterized by a complex set of nontransparent, non-tariff barriers, in addition to a wide-ranging and changeable tariff structure, which is a reflection of its previous economic orientation and thus has strong elements of government control and regulation. Despite recent tariff reforms, which resulted in the slashing of the maximum rates and increased proportion of tariff lines subject to 0 per cent duty, its tariff structure remains basically the same: that is, tariff rates increase with the stage of production, resulting in much higher effective rates of protection,⁷ a wider variety of rates ranging from 0 to 100 per cent, and highly restrictive rate with an increase in the proportion of tariff lines subject to the 30–60 per cent range. This point is illustrated in Table I, which shows a comparative assessment of various tariff lines by nominal tariff rates for 1992, before Vietnam's membership in AFTA, and 1996, the latest year for which data are available after Vietnam's membership in AFTA. The items that are still attracting high tariffs include alcohol (60 per cent), motor vehicles (55 per cent), petroleum (55 per cent), beverages (50 per cent), air conditioners and refrigerators (40 per cent), and electrical home appliances (30 per cent). A high incidence of smuggling is one of the consequences of Vietnam's high and complex tariff rate system.

⁷ The nominal tariffs on imported inputs are lower than those on final goods. Thus, the effective rate of protection remains higher than its nominal rate. Formally, the effective rate of protection accorded to industry j , $EP_j = (V_j^* - V_j) / V_j$, where V_j^* is the value added to the final product j at tariff-distorted prices and V_j is the value added to product j at free trade prices. Due to data constraints, the effective rates of protection for Vietnam cannot be calculated.

TABLE I
IMPORT/EXPORT TAX RATES IN VIETNAM, 1992 AND 1996

Import					Export			
Tax Rates	Number of Tariff Codes		Percentage of Tariff Codes		Tax Rates	Number of Tariff Codes		Percentage of Tariff Codes 1992
	1992	1996	1992	1996		1992	1996	
0	818	1,035	30.65	32.0	0	25	—	36.23
0.5	0	1	0.0	0.0	1	10	—	14.49
1	422	352	15.81	11.0	2	8	—	11.59
2	57	63	2.14	2.0	3	3	—	4.35
3	9	10	0.34	0.0	4	2	—	2.90
4	0	2	0.0	0.0	5	3	—	4.35
5	215	326	8.06	10.0	10	7	—	10.14
6	1	1	0.04	0.0	15	1	—	1.45
7	76	54	2.85	2.0	20	2	—	2.90
8	0	4	0.0	0.0	35	1	—	1.45
9	0	1	0.0	0.0	45	7	—	10.14
10	198	254	7.42	8.0				
12	0	2	0.0	0.0				
15	79	84	2.96	3.0				
16	0	1	0.0	0.0				
18	0	1	0.0	0.0				
20	333	315	12.48	10.0				
22	0	4	0.0	0.0				
24	0	1	0.0	0.0				
25	21	38	0.79	1.0				
30	202	280	7.57	9.0				
32	1	0	0.04	0.0				
35	48	51	1.80	2.0				
38	0	1	0.0	0.0				
40	123	162	4.61	5.0				
45	0	20	0.0	1.0				
50	44	108	1.65	3.0				
55	1	6	0.04	0.0				
60	1	34	0.04	1.0				
70	7	2	0.26	0.0				
80	3	2	0.11	0.0				
85	1	0	0.04	0.0				
100	6	1	0.22	0.0				
120	3	0	0.11	0.0				
Total	2,669	3,216	100.0	100.0		69	58	

Sources: Statistics for 1992 from Foreign Trade Development Centre, *List of Import-Export Tax Rates, Vietnam* (Ho Chi Minh, 1992); 1996 statistics from CIE (1997, Table 3.2).

Notes: 1. All other goods not specified in the list are subject to zero export tax.
2. — means "not available."

However, the use of non-tariff barriers has dominated Vietnam's restrictive trade regime and includes quotas, customs surcharges, import licenses, special sales taxes, and reference pricing.⁸ The Vietnamese government has done little to reduce these types of trade barriers. The granting of authority to export and import is now solely based on whether an enterprise has prospects for receiving an export order. Similarly, export permit and shipment licensing requirements have been lifted for all items, except oil, rice, and wood products; but the current system of non-tariff barriers has remained highly restrictive and complex with a lack of transparency and a significant scope for discretion. Vietnam's current system of quantitative restrictions and non-tariff barriers are summarized in Table II.

Thus, the AFTA challenge for Vietnam is formidable, but the potential benefits Vietnam can derive from joining ASEAN and AFTA are enormous both in political and economic terms. In political terms, Vietnam shares similar security and political interests with the other ASEAN countries. Vietnam considered joining ASEAN as an opportunity to make friends with other countries in the region and thus contribute to the creation of a more friendly environment conducive to economic development. Vietnam also needs ASEAN to obtain a more significant and influential voice in the international arena. In addition, membership is necessary in order to maintain the balance of power in the region. The emergence of China with its potential to become a super military power must be balanced in order to avoid any dominance by one country in the region. The superpower vacuum that has been created in the region with the end of the cold war must not be filled. Vietnam's entry into ASEAN is also necessary as an important step in its transition from a centrally planned to a market economy and ultimate integration into the world community.

The potential economic benefits are more contentious and difficult to identify than the political benefits. Theories of economic integration, based on the works of Viner (1950), Meade (1955), Lipsey (1957), and others, have predicted two opposite outcomes, arguing that in the short run, trade creation effects must outweigh trade diversion effects in order to achieve beneficial trade liberalization. However, apart from short-run economic benefits, there are the long-run and dynamic, yet hard-to-quantify, benefits such as greater technical efficiency due to greater competition, larger markets, higher consumer surpluses, and more foreign investment flows.⁹ A greater inflow of foreign direct investment, induced by lower or elimi-

⁸ Reference pricing is a practice which involves setting prices for certain imports, mostly consumer goods, which are different from the actual prices paid or declared by importers. Since the rationale for the use of reference pricing is to combat under-invoicing of imports, the tariff is based on the declared import value only if the reference price is lower. For a more detailed discussion of Vietnam's trade regime, see CIE (1997).

⁹ There is an extensive empirical literature on the link between export expansion and economic growth. See for example Michalopoulos and Jay (1973), Michaely (1977), Tyler (1981), Feder (1983), Kavoussi (1984), Balassa (1981), and Esfahani (1991).

TABLE II
SUMMARY OF MAJOR QUANTITATIVE RESTRICTIONS AND NON-TARIFF BARRIERS TO TRADE IN VIETNAM, 1997

Banned for Export & Import	Restricted License Required for Each Consignment	License Valid for Six Months	Export/Import by State & Authorized Exporter/Importer Only	Quantitative Restrictions
<p>Export: Arms, antiques, drugs, timber, rattan, rare/wild animals.</p> <p>Import: Weapons, drugs, pornographic materials, cigarettes (except for personal use), firecrackers, used consumer goods (except cars of under-12 seats, motor cycles transferred assets & personal effects), used spare parts of automobiles.</p> <p>Recent bans on imports (May 10, 1997): Construction steel, construction glass & cement, electric fans, confectionery, beer, soft drinks, paper, tourist vans (under-12 seats), motorbikes & bicycles.</p>	<p>Export: Cultural items.</p> <p>Import: Only for imports subject to other forms of regulation, e.g., wireless apparatus, cultural items, medicines, medical instrument, animals, plants, medicine for animals & animals, complete equipment.</p> <p>Authorization by specialized agencies for certain commodities.</p>	<p>Export: Clam, oyster, snail, vegetables, flowers, fruits, roots, confectionery, noodles, sauce, eggs, sand, stone, gravel, lime, perfume, bleaching & washing substance, hair, wig, stationery, paper, mat, carpet, blind, bamboo, coconut, charcoal, shoes, sandals, hat, handkerchief, umbrella, stick, fishing rod, cosmetics, porcelain, brick, glass, nail, screw, hand tools, lock, hook, bolt, rattan & bamboo items, toys, musical instrument, books & newspapers.</p> <p>Import: Books, newspapers, magazines, painting, pictures, stamp, prefabrication items.</p>	<p>Export by the state only: crude oil, rice.</p> <p>Import by the state only: gasoline, fertilizer.</p> <p>Import by cigarette manufacturers only: raw materials for cigarette.</p>	<p>Export: Rice, ready-made clothes & textile to EEC, Norway, Turkey, Canada.</p> <p>Import: Petroleum (excluding lubricants), sugar, cement, construction steel, construction glass, trucks & passenger cars, fertilizer, motorbikes, spare parts for assembling automobiles & motorcycles, other consumer goods (20 per cent of the preceding year's export value) such TV, radio, cassette recorder, etc.</p> <p>Foreign exchange controls.</p>

Sources: Vietnam Trade Office, 1993, quoted in Chin and Ng (1996, p. 541); World Trade Organization, "Accession of Vietnam," WT/ACC/VNM/2 (Geneva, 1996); CIE (1997).

Note: There are also special taxes introduced since 1996 on certain imported commodities. Tariff rates and other measures can change frequently when the need arises. Since February 1, 1996 Vietnam has removed shipment licenses for almost all imports. For more details, refer to Decree No. 28/TTg, Circular No. 02/TM/XNK, Circular No. 03/TM/XML, and Decree No. 89/CP.

nated intra-ASEAN trade barriers and by economic complementarity with other ASEAN countries, is particularly important to Vietnam because of its lack of adequate domestic capital required for a sustainable economic growth. The inclusion of Laos and Myanmar and later Cambodia into ASEAN will also benefit Vietnam, since a much larger ASEAN market will be created, allowing firms to exploit economies of scale and foster greater intra-industry trade. Furthermore, the resulting inflow of foreign capital and increased exports will enhance considerably Vietnam's growth potential by reducing the foreign exchange constraint faced typically by developing countries, and thereby facilitate the import of capital and technology.¹⁰

The main factors largely responsible for making free trade beneficial (i.e., trade creation effects greater than trade diversion effects) are (1) the degree of complementarity among the member countries, (2) ability of the member countries to respond to the opportunities offered in a larger and liberal market, and (3) the degree of their trade links with nonmember countries.

Concerning the first two factors, it is fair to say that relative to their ASEAN neighbors, Vietnam enjoys a comparative advantage in the production of such mineral products as oil and gas, primary commodities such as rice, marine products, and soybeans, and low skill-intensive and labor-intensive manufacturing. These products are enjoying increasing demand in the fast-growing resource-poor economies of Asia.

As pointed out earlier, AFTA will further reinforce investment flows into areas of economic complementarity, such as tourism, infrastructural projects, trade, and banking, within these economies from firms seeking a cheaper source of raw materials and labor. Manufacturing opportunities can be obtained in agricultural and marine processing, textile production, and assembly of electrical and labor-intensive electronic components.

Regarding the third factor, Vietnam's trade links with its old allies are on the decline, but trade with its ASEAN neighbors has grown in recent years by leaps and bounds, for example from U.S.\$163.2 million in 1989 (two years after its economic transformation started) to U.S.\$4,732.3 million in 1996. Vietnam's exports to ASEAN as a proportion of its total exports increased significantly after 1994. In 1995, exports to ASEAN accounted for about 19 per cent of total exports, and in 1996 accounted for about 25 per cent. Singapore is Vietnam's main ASEAN export market, as exports to Singapore increased about tenfold during the period 1985–93.

¹⁰ This is based on the two-gaps model, which argues that one obstacle faced by developing countries is their insufficiency of foreign exchange required to buy the necessary capital and other inputs for their industrial development. The two gaps referred to here are the gap between domestic savings and investment, and the gap between exports and imports. In terms of national accounting, the excess of investment over savings is equivalent to a surplus of imports over exports. This theory emphasizes the role of imports and foreign exchange in the development process, because many goods necessary for growth cannot be produced by the developing countries themselves and must therefore be imported. For further reading of this theory, see Thirlwall (1989, pp. 294–306).

Le (1995) has shown that from the time that Vietnam embarked on economic liberalization, its total volume of exports has grown rapidly, averaging 20 per cent annually for the period 1990–95. Its trade deficit has also declined during the same period, from U.S.\$1.5 billion in 1987 to U.S.\$600 million in 1989. The trade deficit further declined in 1992, but has increased since 1993, due largely to the government's expansionary policy and greater inflow of capital and intermediate goods.

II. PROGRESS IN IMPLEMENTING VIETNAM'S AFTA OBLIGATIONS

Table III provides an overview of Vietnam's progress in implementing its obligations under AFTA, as contained in the aforementioned agreements signed by Vietnam, the mandates issued by the AFTA Council,¹¹ and decisions made at meetings of relevant committees involved in AFTA implementation. It also suggests a number of actions required to ensure that its obligations are met on time.

Principle of nondiscrimination. Vietnam currently extends the most favored nation (MFN) and national treatment regarding turnover tax, luxury tax, exchange rate determination, foreign exchange control, the price stabilization fund, and other measures to imports regardless of origin. The Common Effective Preferential Tariff (CEPT) list submitted by Vietnam for 1996 and 1997 has tariff rates equal to its general rates. This similarity of rates has in effect reduced the effectiveness of the CEPT scheme as a tool for preferential trade. As long as Vietnam remains outside of the World Trade Organization (WTO), it will not have to have a separate MFN tariff schedule. This will become a necessity once Vietnam is admitted into the WTO. To prepare for its eventual WTO membership, Vietnam is now considering the issue of whether its current general tariff rates should also be its MFN rates. It is interesting to see whether its CEPT rates will be lower than its general tariff rates when the government issues its tariff reduction program in relation to those products subject to more than 5 per cent tariff rates on the CEPT list.

Determination of the Inclusion List. Decree 91/CP was issued in December 1995 promulgating the first list of products for 1996, a total of 857 tariff lines, to which preferential rates would apply. This decree was followed by the Ministry of Finance Circular 16T/TCT on March 5, 1996 in which the guidelines for the implementation of Decree 91 were specified. In this first package, 548 items have zero tariffs, while the remaining 309 are in the 1–5 per cent range. For 1997, 640 tariff items more were added to its 1996 Inclusion List (IL), accompanied by legal enactment under Decree 82/CP issued on December 13, 1996, creating a total of 1,497

¹¹ One of the major developments in the ASEAN institutional structure during the 1992 Summit was the ASEAN decision to establish an AFTA Council, whose function is to supervise, coordinate, and assess the implementation of the CEPT agreement. It consists of representative ministers of member countries and the ASEAN Secretariat.

TABLE III
VIETNAM: PROGRESS OF IMPLEMENTATION AND RECOMMENDATIONS MATRIX

Vietnam's Major Obligations	Status	Actions Required
Extend MFN and national treatment status on a reciprocal basis to ASEAN countries.	Vietnam has met this obligation; no legal enactment; no separate MFN tariff schedule; CEPT = general tariff rates.	Determine MFN rates in preparation for its eventual WTO membership and in context of AFTA commitments.
Determine products to be classified into the Inclusion List (IL), Temporary Exclusion List (TEL), Sensitive List (SL), and General Exceptions List (GEL) with accompanying legal enactment.	All lists submitted for 1997. IL of 1,497 products submitted and legally enacted under Decree 91/CP, Circular 16TC/TCT, and Decree 82/CP. The list is shorter than the 1995 original list due to existence of quantitative restrictions (QRs). No planned phasing in and no officially announced tariff reduction plans for TEL and SL.	Expand IL. Announce planned tariff reduction schedule for products > 5% in IL. Determine whether tariff reduction will be made on MFN or preferential basis.
Provide tariff reduction plans for these categories with phasing in plans for its TEL and SL.	No legal enactment; longest GEL submitted.	Work on detailed plans for TEL before 1999 and require directive or implementation guidelines. Avoid bunching of tariff rates. Review GEL. Assign tariff codes.
Provide a list of its QRs & NTBs by 1998.	List of QRs submitted with legal enactment under Decision No. 28/TTg and Circular 02/TM/XNK, but list of NTBs not yet submitted.	Identify NTBs as soon as possible.
Eliminate customs surcharges.	Only 2 surcharges remaining. No timetable given for elimination of remaining surcharges.	Specify the date for elimination of customs surcharges.
Harmonize technical standards.	Technical barriers more in terms of sanitary and phytosanitary standards; most of priority products for harmonization are in Vietnam's TEL and GEL. Technical standards in manufactures are more an impediment to Vietnam's exports.	Improve technical standards via ASEAN assistance. Eliminate remaining technical standards in IL.
Improve its Green Lane System.	Implemented since 1996 under legal enactment of Dispatch No. 1884/TCHQ-QSQL and 2599/TCHQ-KTTT. Ineffective.	Publicity campaign and simplification of customs procedures.

TABLE III (Continued)

Vietnam's Major Obligations	Status	Actions Required
Adopt an ASEAN 8-digit Harmonized Commodity Description and Coding System (HS) by 2000.	Still working on harmonization. No completion date given. Using 11,000 tariff lines as model.	Use 6000 tariff lines as model and complete by 1998.
Improve its customs guidebook.	No significant changes since. Waiting for the passing of a new customs law.	Must now start revising.
Adopt the ASEAN Common Declaration	Unable due to lack of nationwide coding system and insufficient management capacity.	Must improve its coding system, management, and data collection system.
Adopt the GATT valuation method by 2000. Form.	Not adopted; no timetable for adoption. Difficult to adopt due to referencing pricing.	Study ways of dealing with fraud under this valuation method, reduce reliance on customs duties as source of revenue.
Simplify legal procedures.	Only legal enactment issued annually pending finalization of ASEAN Harmonized Classification System (AHTN).	Finalize tariff harmonization and prepare a single legal enactment for entire tariff reduction program.

tariff lines. Although Vietnam has determined its IL, its commodity composition is made up mainly of products with pre-CEPT tariff rates ranging from 0 to 5 per cent and products with high tariff rates; for which Vietnam has an export capacity and considerable international competitiveness. Further, the CEPT rates for 1997 are the same as their pre-CEPT rates, and the IL covers only about half of the total number of tariff lines. This is less significant compared to commitments made by other ASEAN countries, with an average inclusion rate of about 85 per cent. Tariff reduction plans for products currently subject to more than 5 per cent tariff rates are yet to be announced, as part of this obligation.

Determination of the Temporary Exclusion List. Vietnam has determined its Temporary Exclusion List (TEL), but now needs to work on its five-installment phasing-in program (that is, determining commodity composition for each of the five installments from 1999 and planned tariff reduction schedules). Most of its TEL products are consumer and strategically important goods including cement, fertilizers, pulp and paper, which are highly protected by quantitative restrictions and non-tariff barriers. Vietnam is further obliged to remove its quantitative restrictions as soon as these products are included in the IL, and the non-tariff barriers within a period of five years from the time these products are included.

Determination of the Sensitive List. Vietnam has detailed a list of twenty-six unprocessed agricultural products on its Sensitive List (SL). This list, which includes meat and other animal products, poultry, eggs, fruits, and paddy rice, requires protection for political and strategic reasons. However, Vietnam will have to phase this list into the IL between 2001 and 2010, consistent with its obligations under AFTA.

Determination of the General Exceptions List. Vietnam has already determined this list, which is the longest General Exceptions List (GEL) of all the ASEAN countries (as a proportion of total tariff lines), because a number of product items in the electrical machinery category (such as computers, radar apparatus, radio, cars and other passenger vehicles) and such products as milk, petrol, used clothing and used sewing machines, which do not strictly satisfy the criteria for GEL, are included on the basis of national security. There are also quite a few product lines in the beverages, spirits, and vinegar category, which are included because they are considered as a threat to human health. The inclusion of these commodities seems to be inconsistent with Article XX of GATT, which is the basis for drawing criteria for the AFTA General Exception List. In this light, Vietnam needs to review its current GEL to ensure that it is consistent with GATT and AFTA principles.

Submission of lists and elimination of quantitative restrictions and non-tariff barriers. As mentioned previously, the CEPT agreement requires ASEAN members to list and eliminate immediately quantitative restrictions (QRs) for the products in its Inclusion List and non-tariff barriers (NTBs) within five years from inclusion. Since Vietnam's CEPT list was drawn up in 1996, it means that the elimi-

nation of NTBs must be completed by the end of 2000. Vietnam has submitted a list of QRs with legal enactment under Decision No. 28/TTg and Circular 02/TM/XNK, but has not yet submitted its list of NTBs by commodity as required by the AFTA Council. Eliminating NTBs is a much more difficult task than reducing tariffs, because of the dominant role of these measures as Vietnam's instrument of industry protection. As shown in Table II, its system of NTBs is complex and highly discretionary.

The most prevalent NTBs among the ASEAN countries are customs surcharges and technical standards. In line with the AFTA vision, all member countries were required to come up with a schedule for the elimination of customs surcharges by the end of 1996 in conformity with the CEPT schedule, and to announce their respective policies on standards and recognize each other's tests and certificates of quality. All ASEAN countries, except Vietnam, have already eliminated all customs surcharges from their CEPT lists. In the case of Vietnam, however, there are still two commodity groups that are subject to customs surcharges: imports of construction steel and exports of cashew nuts. According to Vietnam's General Department of Customs, these remaining surcharges are expected to be removed in the future, but no target has been set for removal.

In the area of harmonizing technical standards, progress in implementation has been slower, as expected. Vietnam has not yet eliminated its health and environmental technical barriers applicable to some commodities in its current Inclusion List. Further, most of the priority products for harmonization are in its Temporary Exclusion List and General Exception List. Slow progress in this area has been partly due to strong opposition from industries with vested interests in maintaining the level of protection they have been enjoying. Different, and often conflicting, agendas and interests among related ministries have also contributed to the delay.

Improving the Green Lane System. In recognition of the importance of trade facilitation in the AFTA process, ASEAN has agreed to implement measures to simplify and harmonize the customs aspects of trade. These measures include the introduction of a Green Lane System and harmonization of tariff nomenclature, customs valuation systems, and customs procedures.

The objective of the Green Lane System is to reduce the transaction costs to trade in ASEAN for CEPT products and expedite their customs clearance. It generally involves random checking/examination and creation of a special lane/counter for eligible consignments. To qualify for the system, the products must be eligible for CEPT concessions and must have the CEPT certificate of origin (Form D) and the other normal documentation required at customs (e.g., declaration forms, bill of lading, invoices, etc.). Due to poor utilization of this system, the AFTA Council has mandated all member countries to improve the utilization of the system for the benefit of importers and exporters.

Vietnam implemented its Green Lane System in January 1996, at the same time

as the other ASEAN countries. Since its introduction, the proportion of trade flowing through the Green Lane, however, has been marginal, which can be attributed largely to the lack of awareness of the advantages, procedures, and rules for enjoying the system, and insufficient incentives. Since there has been no difference between Vietnam's CEPT rates and general tariff rates, there is less incentive for importers and exporters to use the Green Lane System. Unless Vietnam can modify its CEPT rates, there is little that can be done to improve utilization. Further, Vietnam should increase public awareness by engaging in a publicity campaign to highlight the Green Lane System's advantages. Procedures and documentary requirements also need to be further simplified.

Harmonization of tariff nomenclature. Vietnam has a legal obligation to revise its tariff classification system in accordance with Article 4 of the ASEAN Agreement on Customs Cooperation.¹² It is also committed to create and implement a simplified ASEAN Harmonized Classification System (AHTN-6000), including 6,000 tariff lines by the year 2000, based on the guidelines agreed upon at the last AFTA Council meeting in 1996 and the fifth meeting of the ASEAN Directors-General of Customs in 1997. Tariff nomenclature harmonization is necessary to ease the process of making products comparable under AFTA, where CEPT concessions are accorded to goods on a reciprocal basis.

Vietnam is currently working on revising its tariff classification based on the agreed eight-digit harmonized system and in conformity of the ASEAN Draft (which includes roughly 11,000 tariff items), and aims to complete it by the end of 1998. This is well ahead of 2000, the target date recommended for the application of the new tariff code for all trade. The aim to complete the work by the end of 1998 is commendable, but Vietnam should make the revision based on the most recently agreed AHTN-6000, rather than the ASEAN Draft containing 11,000 tariff lines. Further, this should be considered as one of its top priorities, due to such difficulties as poor management capability, a shortage of skilled staff to translate the AHTN-6000 into Vietnamese, and poor institutional support.

Simplification and harmonization of customs procedures. Customs procedures represent another important administrative aspect of international trade. Intra-ASEAN trade is not only governed by various inconsistent and less transparent customs clearance procedures, but is also burdened by additional requirements including the determination of the origin of products. Therefore, it is necessary to publicize, simplify, and harmonize customs procedures within ASEAN to facilitate trade. Towards this end, the ASEAN countries have agreed to publish an ASEAN

¹² It states that the ASEAN Harmonized Tariff Nomenclature shall be based on the six-digit Harmonized Commodity Description and Coding System (HS) of the World Customs Organization (WCO) and the amendments thereto. Member countries shall, for tariff purposes, use a common tariff nomenclature at the eight-digit level. ASEAN Harmonized Tariff Nomenclature beyond the eight-digit level may be used for statistical and other purposes.

guidebook on customs regulations and procedures for each member country, adopt an ASEAN common declaration form, and harmonize other areas of customs procedures. They have also agreed to follow international standards for customs procedures when formulating them.

Vietnam completed and submitted its draft book on customs regulations and procedures at the end of 1996, after encountering many difficulties in meeting its content requirements. The contents of the book include information on its institutions, product and tax policies, export-import duties, and other areas of customs procedures; but, since Vietnam is in the process of reforming its tax regime and trade policies in line with its commitment to AFTA, this book needs to be updated as soon as the tax and trade policy reforms are completed.

With respect to the application of the ASEAN common declaration form, Vietnam has not yet done so, due to the lack of a complete nationwide coding system (commodity codes, country codes, and others) and an inadequate control system. Vietnam, therefore, needs to improve its coding system, train its customs personnel about the new system, and improve its management, in order to be able to use the ASEAN common declaration form.

Adoption of a common valuation method. The ASEAN countries have agreed to adopt a customs valuation method based on GATT Transactions Value (GTV) in conformity with Article 7 of GATT 1994, by the end of 1997. Vietnam has been allowed to adopt the ASEAN-prescribed method from the year 2000. Vietnam is currently employing a different method (a combination of the Brussels and GTV methods).¹³ Moreover, implementing the prescribed valuation method has been quite difficult for Vietnam, which relied on a reference pricing method for certain groups of commodities to limit tax evasion (and thus avoid a loss of tax revenue), unfair competition, and market failure. In light of the prevalence of fraudulent activities and massive tax evasion, it is most likely that Vietnam will not implement the ASEAN-prescribed method until the government is satisfied that it would not cause significant revenue loss. Given the importance of this obligation, Vietnam should submit its detailed plan of implementation before the year 2000 and indicate whatever technical assistance is required from other more experienced members of ASEAN. Indonesia has taken the lead in assisting other ASEAN countries in implementing GTV, since it has already gained some experience from early imple-

¹³ There are three methods of customs valuation traditionally practiced by the ASEAN countries. The Brussels Definition of Value (BDV), used by most ASEAN countries, defines the normal price of the goods to be valued as the price the goods would fetch at the time duty becomes payable on sale in their own markets between a buyer and a seller, independent of each other, and not influenced by any commercial, financial, or any other relationship between the seller and buyer other than that created by the sale itself. The GATT Transactions Value (GTV) is based on the price actually paid or payable for the goods being valued, as reflected in the seller's invoice or other documents against which payment is made. The Home Consumption Value (HCV), used by the Philippines, considers the value at the port of origin vis-à-vis export as the basis for valuation.

mentation. Quite recently, WTO and ASEAN have conducted a training seminar on this method and on ways of dealing with possible under-invoicing for ASEAN customs personnel. Similar seminars should be organized for Vietnam.

Simplification of legal procedures. To simplify tariff reductions under AFTA and to create greater confidence among the private sector, the ASEAN countries have agreed to issue one legal enactment for tariff reductions for the entire period up to the year 2003, or 2006 in the case of Vietnam. To date, Vietnam has only issued legal enactments annually pending the finalization of the ASEAN harmonized tariff nomenclature.

III. COSTS OF AFTA AND VIETNAM'S CURRENT STRATEGY

It is encouraging to see from the above review some progress being made in Vietnam meeting its AFTA commitment: It has submitted the various categories of products to be eligible for tariff concessions and has implemented some measures to comply with the other obligations under AFTA. However, timetables for trade liberalization of products in the Temporary Exclusion List and Sensitive List have yet to be announced for removal of the remaining quantitative restrictions and non-tariff barriers and the issuance of a single legal enactment for the whole period of trade liberalization as required under AFTA. The drawing up of its General Exceptions List also seems to be rather inconsistent with Article 20 of the GATT, and thus requires a thorough review.

There are further signs of hesitation and ambivalence. Certain government directives recently issued seem to be inconsistent with AFTA's spirit of openness and free market orientation. Despite introducing a new set of special taxes on certain imports, the Vietnamese government has issued a decree banning the import of motorcycles. Most recently, it is reported that Vietnam's Ministry of Trade is coordinating with other ministries and general departments to draft a plan "reasonably" protecting domestic production. This move is designed to boost domestic production and increase international competitiveness against foreign products in fifty sectors, including construction steel, black cement, construction ceramics and pottery, passenger cars, vehicles with under-twelve seats, motorcycles, bicycles, sugar, confectioneries, milk, liquor, beer, soft drinks, electric fans, audio and video equipment, refrigerators, batteries, and paint (*Saigon Times Weekly* 1997, p. 9). These recent developments seem to indicate that Vietnam's current strategy in preparation for AFTA is to protect certain sectors against international competition before the year 2006 hoping that by the deadline year these protected and assisted sectors will become internationally competitive.

Such reluctance and ambivalence is not surprising. The fear of having to bear the considerable economic and social costs of AFTA, especially in the light of Vietnam's peculiar situation, is understandable. Vietnam is one of the least devel-

TABLE IV
SHARE OF DIFFERENT SOURCES IN TOTAL GOVERNMENT REVENUE, 1991–94

	(%)			
	1991	1992	1993	1994
Turnover taxes	20.3	16.7	14.7	16.4
Excise taxes	8.2	7.3	6.9	6.6
Trade taxes	11.2	13.6	21.1	28.8
Profit taxes	10.4	13.5	17.9	17.5
Resources taxes	0.3	9.4	6.6	5.3
Land & housing taxes	7.3	7.1	5.3	3.7
Income taxes	0.6	0.8	0.7	0.9
Other fees & duties	2.5	10.1	8.4	6.3

Source: Unpublished data provided by Vietnam's Ministry of Finance, 1995.

oped members of ASEAN and has just recently opened its markets to the world. Vietnam's major sources of concern which help explain its ambivalence in meeting its AFTA commitment may be summarized as follows.

1. *Fiscal revenue loss*

The first major source of concern to the Vietnamese authorities is the perceived potential loss of fiscal revenue. The role of taxes from international trade as a major source of government revenue will lose its significance as import tariffs are substantially reduced or abolished under AFTA. Unless alternative sources of revenue can be found, this could create financial problems for the government with wide social implications. Revenue from international trade currently accounts for about 26–27 per cent of Vietnam's total national budget. As Table IV shows, since 1993 trade taxation has become the biggest single item in total revenue, and accounting for 29 per cent in 1994. This share is significant, compared to the 16 percentage share of trade revenue in Thailand, and is almost similar to trade revenue's 31 percentage share in Indonesia.¹⁴

In light of the declining importance of international trade revenue under AFTA, the government of Vietnam is considering alternative sources of government revenue. It intends to introduce a value-added tax (VAT) in 1999, and seeks to make better use of its existing indirect excise tax, sales tax, and turnover tax.

¹⁴ The potential revenue loss is probably more than these numbers indicate, because the bulk of Vietnam's tariff revenue has come from imports of petroleum products, which are mostly imported from other ASEAN countries. But this fear of revenue loss still seems to be exaggerated, since Vietnam's imports from other ASEAN countries only account for about a quarter of its total imports. Furthermore, this estimation does not consider the revenue-generating dynamic effects (such as improved efficiency, economic growth, and reduced incidence of smuggling) of regional economic integration.

TABLE V
VIETNAM'S CURRENT ACCOUNT BALANCE, 1990-96

	(U.S.\$ Million)						
	1990	1991	1992	1993	1994	1995	1996 Estimate
Trade balance	-41	-63	-60	-547	-1,190	-2,345	-3,150
Exports f.o.b.	1,731	2,042	2,475	2,985	4,054	5,198	7,330
Imports	-1,772	-2,105	-2,535	-3,532	-5,244	-7,543	-10,480
Factor services (net)	-411	-339	-382	-560	-297	-236	-269
Receipts	28	42	43	30	27	96	140
Payments	-439	-381	-425	-590	-324	-332	-409
Of which:							
Scheduled interest	-237	-248	-282	-330	-198	-262	-288
Non-factor services (net)	55	179	311	76	19	159	61
Receipts	55	450	724	772	1,283	2,074	2,243
Payments	0	-271	-413	-696	-1,264	-1,915	-2,304
Transfers (net)	138	90	123	264	302	290	1,186
Private	0	35	59	70	170	140	1,050
Official	138	55	64	194	132	150	136
Current account	-259	-133	-8	-767	-1,166	-2,132	-2,294
Excluding official transfers	-397	-188	-72	-961	-1,298	-2,282	-2,430

Source: Kokko (1997).

2. *Current account problem*

Secondly, although Vietnam has significantly reduced its current account deficit from 17 per cent of its GDP over the 1980-86 period to 6.1 per cent of its GDP over the 1987-94 period, since 1993 Vietnam has continuously experienced trade and current account deficits, with the trade deficit reaching an alarming 15 per cent of GDP in 1996 (see Table V). Huge and persistent external imbalances will result in real exchange rate overvaluation and instability, thereby making trade liberalization more difficult and less sustainable. Countries with severe current account deficits usually have a high real exchange rate variability and overvalued currency, which in turn produces balance-of-payments crises. Exchange rate misalignments may hamper integration by distorting the functioning of clearing and payments systems (Nadal De Simone 1995).

Having current account deficits is not bad per se, especially when the excessive rise in imports is due to imports of necessary inputs for production capacity expansion and long-term growth. Kokko (1997, p. 11) in his analysis of Vietnam's composition of imports has revealed that, although the bulk of imports have been in the form of raw materials and capital goods used for investment and production, the destination of these imports has been import-substituting industries, with the struc-

ture of imports determined by trade policy rather than by pure market forces. Vietnam's trade policy has specifically aimed at restricting consumer-goods imports to provide captive markets for local producers. One consequence of this policy structure has been widespread illegal import of consumer goods.

3. *Unemployment effects*

Thirdly, another major cause for concern in the context of AFTA is the short-term adjustment cost of trade liberalization in terms of unemployment in those industries where Vietnam has a comparative disadvantage. Unemployment has already emerged as a serious problem in the process of its transition. The World Bank (1996) has reported that unemployment is rising, especially in the urban areas where some 2.2 million are out of work, while underemployment is high in the rural areas, where arable land per capita is one of the lowest in Southeast Asia. In addition to the impact of the recent repatriation of Vietnamese refugees and the restructuring of state-owned enterprises, there will be further laying-off of workers in weaker industries in the face of greater international competition, particularly in skill-intensive and capital-intensive industries such as vehicles, electronics, petroleum products, chemicals, machinery, and consumer items.

A corollary to this is the issue of division of costs. There is fear in certain circles that AFTA would only benefit the more developed countries at the expense of surrendering its national autonomy in policymaking. Since economic integration under AFTA requires liberalization and harmonization of trade and investment policies among the member countries, this implies that countries with higher levels of protection like Vietnam will have to give up more in terms of tariff revenue loss and sacrifices of national priorities than countries with lower levels of protection, like Singapore. This leads to the perception that AFTA entails an uneven distribution of costs of economic integration. The perceived fiscal revenue loss for Vietnam is, however, likely to be transitional. It must be recognized that the volume of trade under a liberalized regime is inevitably greater than under a restricted one. Thus, while import tax rates are lower, the volume of trade is higher, so that the effect on revenue is unclear. Furthermore, if an open economy can grow faster, then in the long run an open economy will have greater income and generate greater revenue for the government than a closed one. Trade liberalization will also shift resources from the highly protected capital-intensive sectors to labor-intensive sectors and thus create more jobs. Thus, Vietnam would benefit overall from greater integration with ASEAN and the world economy in general, which more than compensates for the short-run costs of economic integration.

There is also the question of mutuality of trade and investment gains from AFTA. Unlike the European Union where intra-trade accounts for a substantial portion of each member's total trade, intra-ASEAN trade accounts for only about 20 per cent of any country's total trade. The non-ASEAN countries are still a major

TABLE VI
VIETNAM'S GROSS OUTPUT OF INDUSTRY BY OWNERSHIP TYPES

	(%)					
	1990	1991	1992	1993	1994	1995
Industry total	100.0	100.0	100.0	100.0	100.0	100.0
State	67.6	68.5	70.5	71.3	72.4	72.4
Non-state	32.4	31.5	29.5	28.7	27.6	27.6
Of which:						
Cooperative	9.1	4.8	2.8	2.1	1.1	n.a.
Private	1.0	1.5	2.9	4.5	5.1	n.a.
Household	22.3	25.2	23.8	22.1	21.4	n.a.

Source: Vietnam, General Statistical Office, *Statistical Yearbook* (Hanoi), 1993 and 1995 eds.

market for ASEAN exports and a major source of foreign capital. Under harmonized trade and investment policies, intra-ASEAN competition for exports to and foreign investments from non-ASEAN countries raises the problem of how to distribute these gains among the member countries. Thus, without any agreed program of compensation for those members most adversely affected and in the absence of fair rules for distributing benefits, the less developed members like Vietnam are likely to implement their AFTA commitments more slowly, if not ambivalently.

IV. SUGGESTED STRATEGIES TO MINIMIZE THE COSTS OF AFTA

To minimize the costs of AFTA, Vietnam needs to further develop an internationally competitive private sector. Under the competitive environment of AFTA, to have a developed private sector is important, given that the performance of its state sector has so far been poor based on economic criteria. The preparedness of the Vietnamese economy for the AFTA challenge is, therefore, partly tied to how the government can create an environment conducive to the development of an efficient private sector.

As Vietnam's state-owned enterprises face the problem of restructuring due to inefficiency and lack of financial resources accompanied by cuts in employment, the private sector can provide the answer to both the output and unemployment problems. Table VI shows the distribution of industrial output by various ownership types in Vietnam for selected years.

The state sector, consisting of state-owned enterprises (SOEs) and large and medium joint state-private enterprises (JSPEs), account for about 70 per cent, on average, of the gross industry output, whereas the non-state contribution, largely attributed to the private household sector, accounts for less, and its share has been

TABLE VII
ROLE OF THE PRIVATE SECTOR IN VIETNAM'S ECONOMY

	1990	1991	1992	1993	1994	1995
	(%)					
Total labor employed	100.00	100.00	100.00	100.00	100.00	100.00
—in state sector	11.28	10.12	9.36	9.05	8.70	8.66
—in private sector	88.72	89.88	90.64	90.95	91.30	91.34
Share of state sector in GDP	32.50	33.30	36.20	39.20	40.20	42.20
Share of private sector in GDP	67.50	66.70	63.80	60.80	59.80	57.80
Share of agro-forest & fisheries in GDP	38.70	40.50	33.90	29.90	28.70	27.50
Share of industry, construction in GDP	22.70	23.80	27.30	28.90	29.60	30.10
Share of services in GDP	38.60	35.70	38.80	41.20	41.70	42.40

Source: Provided by Vietnam's General Department of Statistics, 1996.

declining. However, within the non-state sector, the percentage change in gross output for the private sector has generally increased, while that of the cooperative has declined, which means that the rate of expansion of the private sector has been generally above that of other sectors, signifying its growth potential.

In terms of employment, the private sector has accounted for a larger portion of national employment, with the dominant portion of total private employment being in the agricultural, forestry, and construction sectors in that order. However, agriculture's share of GDP is decreasing consistent with the normal pattern of development (see Table VII).

The capital/labor ratio of the private sector is less than that of the state sector, which means that the same amount of capital in the private sector can provide more employment opportunities than in the state sector (Ronnas 1992).¹⁵ Since the private sector is more labor-intensive and less capital-intensive than the state sector, it has a greater capacity for generating employment than the latter.

While the promotion of an internationally competitive private sector should be given top priority, the important role of SOEs in Vietnam's economic development should not be ignored. The reformation of SOEs should continue to make them more efficient and internationally competitive. Vietnam has earmarked some SOEs for privatization with the help of foreign financial institutions, indicating the present government's intention to stop the draining of public funds, promote competition, increase state revenues, and move towards the reintroduction of private ownership. However, the authorities have been slow and cautious. There is a grow-

¹⁵ Ronnas (1992, pp. 21–23) estimates the value of total assets per worker in the state sector to be U.S.\$23,909, compared to only U.S.\$1,754 in the private (non-state) sector. He has also found labor productivity to be several times higher in the state sector (U.S.\$4,011 versus U.S.\$702), although this is not reflected in wage levels.

ing concern that such moves could lead to more job cuts and worry that the government may lose control of the economy. In this case the government should be selective and adopt an effective regulatory scheme. It should be pointed out that the mere transfer of assets and service functions to the private sector is not a sufficient condition for the establishment of an internationally competitive private sector. Privatization must result in greater competition to become effective. An introduction of market-oriented policies and incentives, where success is based on merits and hard work is appropriately rewarded, is essential.

To make its policies work, Vietnam needs institutional capacity: an appropriate and adequate legal, political, and regulatory framework. If this framework is deficient, investment and other risk-taking activities (such as business ventures and adoption of technological advances) will be reduced. Indicators of institutional environment include quality of bureaucracy, degree of corruption in government, presence/absence of guarantees against expropriation of private investments and repudiation of contracts by government, and infrastructure quality.

The principal consequence of an inadequate institutional environment is insecure property rights (which can be broadly defined as the rights of a firm or individual to assets, revenue streams generated by assets, and any other contractual obligations). Inadequate protection of property rights adversely affects the development of an internationally competitive private sector. Competitiveness requires the adoption of new technologies, which are usually embodied in highly expensive capital assets. Local and foreign entrepreneurs will be reluctant to invest in these assets in an environment where property rights are uncertain. The great risks implied by the long-term nature of investment are likely to encourage entrepreneurs to engage in short-term investment.

It is obvious from the above that the private sector has great potential to become Vietnam's engine of growth, but there have to be sound policies and a supportive environment before it can effectively play a significant role in the country's economic transformation. A legal and contractual framework needs to be further developed to facilitate transactions and protect private property. Since Vietnam decided to move away from a centrally planned model to a market-oriented model of development, it has enacted a number of changes in legal infrastructure to meet the new demands of the market economy. New laws enacted during 1987–90 in specific areas such as foreign investment, contracts, companies, and private enterprises were followed by a new constitution in 1992, which clarified and protected the right of private ownership. Since then, other specialized laws have been enacted in such fields as land law, bankruptcy law, and environmental protection (1993), and a labor code and domestic investment promotion law was passed in 1994. Efforts are continuing to develop further both the civil code and commercial law.

There are, however, a few implementation issues that need further clarification

and development: procedures and, in the case of foreigners, the right to mortgage land-use rights; simplification of rules and creation of a level playing field among economic actors; development and nurturing of a new dispute resolution mechanism; and development of the legal profession. There is a need in particular to encourage the development of the private sector by adopting proactive policies and market incentives, such as the granting of more tax relief, assistance in the procurement of capital, and making banking credit available to the private sector. Although Vietnam has already launched a number of initiatives to ensure protection of property rights, there is still some feeling of insecurity, to the extent that political and legal institutions can still make unilateral decisions that reassign rights. What is needed are independent judiciaries and well-defined administrative procedures to make firms and individuals feel secure that their property rights will not be violated.

Finally, one factor that explains the economic success of many newly industrialized countries in Asia is efficient, competent, and effective government intervention particularly in the area of implementing required policy reforms. Vietnam seems to be deficient in this respect. Corruption, red tape, and inefficiencies in the process of implementation are largely responsible for the failure of many countries to achieve sustainable growth and development.

CONCLUSION

There are benefits as well as costs associated with being a member of a free trade area. Vietnam, by joining ASEAN and announcing its intention to become an AFTA member, has indicated its determination to be economically integrated with its Southeast Asian neighbors and showed some optimism that its AFTA membership will generate net benefits and opportunities.

This paper has attempted to assess the progress of Vietnam's implementation of its AFTA obligations, highlighting the current ambivalence and lack of consistency in Vietnam's policy formulation. I have argued that unless Vietnam can find ways to deal with its difficulties, it is unlikely that it can meet all its obligations under AFTA and thus, benefit from greater regional integration. The ongoing Asian crisis has only reinforced Vietnam's current ambivalence. Despite its recent official agreement to accelerate AFTA implementation under the impact of the current regional crisis, there are indications that the pace of implementation of its liberalization commitments has further slowed. Vietnam's economic strategy for 1999 emphasizes agricultural development with domestic market orientation and the importance of state-owned enterprises. It makes no reference to its efforts to join the World Trade Organization or to any commitment to reduce tariffs (*Economist* 1998). Vietnamese officials have admitted that the regional crisis has slowed their economic reforms and forced them to be more inward-looking (*Dow Jones Inter-*

national News 1999). This paper has also suggested a strategy to minimize the costs of joining AFTA. This strategy calls for developing an internationally competitive private sector to take advantage of economies of scale and a larger market in the face of greater competition. Although some degree of complementarity exists between Vietnam and its other ASEAN partners, some degree of substitution and hence a fair degree of competition is also expected. Crucial to the development of the private sector is the provision of an adequate and appropriate institutional environment. Vietnam must consolidate its economic reform process and meet the criteria for macroeconomic stability, and find ways to deal with a reduction in revenue from international trade taxation and the expected unemployment impacts of AFTA. It follows that until its private sector is ready to face the challenge of AFTA, the Vietnamese government will not feel confident that it will benefit from its integration with other ASEAN countries. Thus, it is likely to maintain its current ambivalent trade policy. Although the policy of selective government intervention based on the infant industry argument is appealing and politically palatable, there is a danger that it could send the wrong message to the private sector. The government's commitment to trade liberalization and cooperation under AFTA can be clearly enunciated by implementing a clear and comprehensive program of trade liberalization and economic reform. Otherwise, there is a real risk that, if the current strategy continues, it will become increasingly difficult for Vietnam to meet the AFTA challenge. Vietnam's experience in this regard raises an important issue of conflict between domestic policy and international strategic policy, in this context of the difficulty of adopting appropriate economic policies to benefit from regional integration. Perhaps some lessons can be drawn from Vietnam's experience for any similarly less developed, former centrally planned economy contemplating to participate in a regional trading arrangement.

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