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# The AFTA impact on Vietnam's economy

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## 1. Introduction

Globalisation is an interrelationship between nations, which concerns most societies, governments and organisations, as well as individuals. This process has also significantly narrowed the economic disparity between countries, demonopolised the economy and encouraged an open market at both regional and global scale.

In recent years, developments of world trade, infrastructure upgrade with a focus on transportation, and a boom in information technology have necessitated trade liberalisation and a transition of economic structure. Particularly, Vietnam's integration into the regional and global economy is indeed a "must". On 28 July 1995 Vietnam officially joined ASEAN. So far, together with other ASEAN members, Vietnam has put a lot of effort in attempting to establish a free trade area of ASEAN (AFTA). After ten years of "Doi moi", it is the first time Vietnam took part in a regional economic cooperation.

In January 1992, at the 4th ASEAN Summit in Singapore, the ASEAN heads of government formally agreed to establish an ASEAN Free Trade Area. Unlike the EU and NAFTA, activity schedules of AFTA are prepared and gradually completed along the realisation process. Furthermore, timetables for the implementation of AFTA at individual countries differ, depending on specific conditions of each member state.

AFTA was scheduled to be fully achieved over a 15-year period through a schedule of tariff reductions under the Common Effective Preferential Tariff (CEPT) scheme commencing January 1, 1993. In September 1994, however, the 26th ASEAN Minister’s Meeting in Chiang Mai, Thailand, agreed to shorten the timeframe for the realisation of AFTA from 15 to 10 years, ending by 1 January 2003 instead of 2008, through accelerating the CEPT. Key issues of the CEPT are as follows:

- The CEPT scheme is the core mechanism for the implementation of AFTA. The CEPT Agreement requires that tariff rates levied on a wide range of products traded within the region are reduced to 0-5% over a 10-year period. CEPT covers all capital goods, manufactured goods and processed agricultural products. Importantly, at the same time, CEPT allows each country to exclude certain products that meet the “6-X formula” from CEPT coverage.
- In September 1992, ASEAN inaugurated the AFTA Council to speed up, supervise and revise the implementation of AFTA. The AFTA Council approved two programmes of tariff reductions under the CEPT scheme: the Fast Track Programme and the Normal Track Programme.
- Products covered by the fast track scheme will see a lowering of tariffs to 0-5% within 5-7 years. Tariffs above 20% will be reduced to 0-5% within 7 years (by 1 January 2000). Tariffs at 20% and below will be reduced to 0-5% within 5 years (by 1 January 1998).
- Products under the normal track will see their tariffs reduced over a period between 7-10 years. Tariffs above 20% will be reduced in two stages: (1) first, to 20% within 5 years (by 1 January 1998); and subsequently, from 20% to 0-5% in 5 years (by 1 January 2003); (2) Tariffs of 20% and lower will be reduced to 0-5% within 7 years (by 1 January 2000).

Under the CEPT Agreement, ASEAN members have to remove all quantitative restrictions such as quotas and import licenses, and gradually abolish non-tariff barriers. Moreover, products that belong to the CEPT package must have at least 40% of ASEAN content (40% of the value of products originating from any one or more member states).

On 22 December 1992, the original six ASEAN member countries declared their list of items for tariff reductions. Timetables for starting tariff reductions vary between countries. Singapore and Malaysia started in 1993. As to products having tariffs above 20% Brunei started in 1994, the Philippines in 1996, Indonesia and Thailand in 1998. As to products having tariffs of 20% and below Indonesia, Brunei and the Philippines started in 1998, and Thailand in 1999. All these countries have to complete the tariff reductions by 1 January 2003. Joining AFTA in 1995, Vietnam's commitment to reduce tariffs, remove quantitative restrictions and other non-tariff barriers is extended up to the year 2006. Laos and Myanmar joined in 1997, Cambodia in 1999; they have up to 2008 to meet the deadline.

## 2. The implementation of AFTA in Vietnam

### 2.1 Initial conditions

AFTA was officially agreed in 1992 under a favourable regional and global environment. When joining AFTA, Vietnam clearly identified and balanced possible advantages and difficulties it might have to cope with during the realisation of AFTA. According to many researchers, the phasing in of Vietnam into AFTA enjoyed a quite advantageous context. Some reasons for this assessment are as follows:

First, as a result of the "Doi moi" policy, Vietnam is in transition to a market-based economy with a socialist orientation under State control. As a result, Vietnam has actively advocated diversification and intensification of external economic relations.

Furthermore, macroeconomic development has shown a positive trend. The achieved growth rate of GDP in the 1990-1995 period was relatively high, compared to other countries in the region (a growth rate of 9% in 1995 compared to an average growth rate of ASEAN of 5.2-8.9%). During the period of 1985-1995, the rate of exports of Vietnam was also higher than that of other ASEAN members (32% per year compared to 29%).

Vietnam also has a supportive administrative environment for the commitment to AFTA. Among the more than 3000 items in the inclusion list, 52% of these have tariffs at 0-5%, meeting the standards of the CEPT Agreement. This percentage is high compared to this of other ASEAN members at the start of AFTA: 9% for Indonesia, 27% for Thailand and 32% for the Philippines. In addition, Vietnam has considerably eliminated quota restrictions to exports and imports. Therefore, Vietnam’s market is seen as a relatively highly open market in the region.

### 2.2 Implementation process

In institutional terms, Vietnam has established an AFTA Unit at the Ministry of Finance. The AFTA Unit is an important organisation, a bridge between Vietnam and the AFTA Council, the ASEAN Secretariat Board and ASEAN Units of other ASEAN members. In the short-term, this unit is necessary since the tariff reduction programme is regarded as the most crucial issue of AFTA. However, during the elimination of quantitative restrictions and non-tariff barriers in a later period, Vietnam has to undertake a set of changes to appropriately update this arrangement in harmony with changes in its economic structure and policies.

In terms of performance, Vietnam has submitted annually its lists for tariff reductions to the ASEAN Secretariat. In December 1995, the first Inclusion List comprising 1633 items was approved. Most of the products included in this list had relatively low tariffs; only a few showing nominal tariffs above 20%. In July 1997, Vietnam submitted its Inclusion List, Temporary Exclusion List, General Exception List and Sensitive List. On that basis, Vietnam proposed the 1998 CEPT package to include 1719 lines. The Inclusion List captured approximately 53% of total tariff lines. Up to present, Vietnam has reduced tariffs on 4230 lines according to the CEPT Agreement, resulting in the fall of the average tariff rate from 19% in 1995 to 10% at present.

In a subsequent period, the removal of all quantitative restrictions and non-tariff barriers will serve as an essential AFTA requirement for Vietnam after the country completes tariff reductions. This requirement will challenge Vietnam in terms of effort, time and institutional reforms that address hot current issues such as economic adjustments and subsidies. This cannot be simply considered as technicalities.

## 2.3 Some interesting economic reforms

During the realisation of AFTA over the last few years, Vietnam has put a lot of effort in macroeconomic reforms in the hope of earning benefits from trade liberalisation. Vietnam has realised that an increasingly severe competition in both domestic and regional markets serves as the biggest challenge to Vietnam enterprises. As a result, Vietnam has concentrated on the establishment of a proper institutional environment in order to protect property rights of enterprises, speed up the “equitation” of State-owned enterprises to enhance activity efficiency, and strengthen the private sector - an important player in the market economy.

Another significant issue in macroeconomic reforms and closely related to the AFTA implementation process is tax reform. Learning from experiences of other developing countries, Vietnam has undertaken tax reforms via reducing taxes on production and raising taxes on consumption and income. These policies are reasonable, given an economy in transition like Vietnam. In addition, they help to facilitate the process of moving to a new tax system. New forms of taxes like VAT and corporate income tax have also been initiated. As to the corporate income tax, apart from common tax rates imposed on domestic enterprises that are not subject to the foreign investment law, preferential tax rates have been provided in order to encourage domestic investment and to narrow the gap between domestic investment and foreign investment.

Also noteworthy are the policies of foreign currency control. Since the current foreign reserve position of Vietnam is still low and Vietnam's economy quite vulnerable to external shocks like other ASEAN member states, the government of Vietnam is increasingly strict in controlling foreign exchange, in order to apply its policy of managed floating. The impact of this strict policy on economic development remains controversial. Many witnesses, however, argue that this policy will produce better results if associated with bank reforms. At present, foreign currency revenues from all social-economic organisations have to be deposited at financial institutions that are authorised for trading foreign currency and can only be withdrawn when certain conditions are satisfied. This measure is still essential today, considering the current difficult situation; it may, however, hinder attracting foreign investment in Vietnam.

# 3. Impact of AFTA on Vietnam's economy

## 3.1 Impact on trade activities

Under the CEPT Agreement, ASEAN member states give each other preferential tariff rates of 0-5%. This helps Vietnamese products to access a regional market that incorporates many substantial advantages: a population of more than 500 million, convenient transportation systems and relatively moderate requirements on product quality. Moreover, the reduction in import tariffs or duties lowers investment costs, thereby enhancing the competitiveness of Vietnamese products in the regional market.

Nevertheless, influences of free trade often are two-sided. On the one hand, free trade helps to create large markets and encourage production and exports. On the other hand, if the domestic economy as a whole is not strong and competitive enough, many economic sectors may forfeit even in the home market. Put simply, the home market will shrink and lots of enterprises that are rather weak and uncompetitive will be in danger of bankruptcy.

Besides, throughout the realisation of CEPT, changes in trade structure will also arise and originate trade losses. The reason is that the regional trade liberalisation allows intra-regional trade at lower prices due to lower tariff rates. Meanwhile, the same products produced by a non-ASEAN country at lower or equal production costs may become more expensive. This blocks inflows of goods from non-ASEAN countries into Vietnam, thereby inducing a loss in taxation revenue (import duties) and raising import prices instead of lowering these.

According to many economic researchers, compliance to CEPT will enhance Vietnam’s ASEAN import and export value with lower increases in exports than in imports. As to Vietnam’s extra-ASEAN trade, exports will expand at the same time that imports will contract due to the changing trade structure. Generally speaking, overall increases in export value stem mainly from increases in the quantity of exports.

The Vietnam-ASEAN trading relations have considerably improved. ASEAN member countries have become increasingly important business partners of Vietnam. The average growth rate of Vietnam-ASEAN trade is at 20-25% per year. In total Vietnam's export turnover to ASEAN, exports to Singapore contributes some 60-70%. Singapore is a typical market for re-exports. It is therefore too soon to conclude that ASEAN is the dominant market for the Vietnamese products. Shares of major products exported to ASEAN are 16%, 18% and 6.6% for crude oil, rice and sea food respectively; garments are exported to Singapore for re-exportation.

**Table 1: Vietnam - ASEAN trading relations (million USD)**

| Two-way external trade turnover | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 |
|---|---|---|---|---|---|---|---|---|---|---|
| Indonesia | 70 | 198 | 215 | 220 | 250 | 246 | 200 | 249 | 573,7 | 706,2 |
| Malaysia | 51 | 87 | 134 | 135 | 260 | 295 | 450 | 363 | 364,2 | 565,9 |
| Philippines | 61 | 11 | 67 | 65 | 74 | 67 | 305 | 247 | 468,8 | 439,4 |
| Singapore | 692 | 1,149 | 1,400 | 1,440 | 1,672 | 2,104 | 4,549 | 3,232 | 2,704,9 | 2,705,4 |
| Thailand | 115 | 141 | 160 | 160 | 220 | 551 | 640 | 793 | 968,9 | 869,0 |
| ASEAN-Vietnam trade | 989 | 1,586 | 1,976 | 2,030 | 2,476 | 3,263 | 6,144 | 4,884 | 5,080,5 | 5,285,9 |
| world-Vietnam trade | 3,093 | 4,073 | 5,133 | 6,100 | 8,600 | 13,604 | 18,398 | 20,170 | 20,859 | 23,159 |
| Ratio of ASEAN/ world trade (%) | 32.0 | 38.9 | 38.5 | 33.3 | 28.8 | 23.9 | 33.4 | 24.2 | 24.4 | 22.8 |

Source: Ministry of Trade and General Department of Statistics, 97-99

According to some forecasts, the ASEAN market represents about 13% of Vietnam exports in 2000. This figure is expected to be 11% and 10% in 2001 and 2002, respectively. Major products are rice, peanut core, cashew, seafood, manufactured goods and household goods. In the last few years, Vietnam's trade deficits with ASEAN have remained at a quite high level. In 1998 this deficit amounted to US$ 1.34 billion, representing 60% of Vietnam's total trade deficit and more than 50% of total exports to ASEAN. Therefore, accelerating exports to ASEAN and establishing a trade balance are considered as a one of most critical issues of Vietnam for years to come.

In spite of many challenges ahead, Vietnam has been undertaking two key policies, in attempting to achieve a trade balance with ASEAN. On the one hand, it endeavours to deepen its export volume, especially of manufactured and semi-manufactured goods, and to concentrate on directly commercialised goods instead of goods for re-export, in order to strengthen export efficiency. On the other hand, Vietnam effectively sets out requirements on exports to ASEAN in exchange for imports from ASEAN. Most of the imported goods from ASEAN are now motorbike parts and fertilisers. For example, Vietnam would ask exporting countries to import Vietnamese goods, such as rice, peanut core, and cashew, etc. Importantly, these two policies should be accompanied by a further continuing enhancement in product quality so that Vietnamese products can be firmly traded in the entire ASEAN market and the severe competition of imported goods from ASEAN does not impede domestic sectors.

General speaking, AFTA does not have direct impact on import-export relations of Vietnam. Equivalently, AFTA will not create any extremely quick momentum or fundamental changes for Vietnam's trade unless there are improvements in the structure of domestic production. However, together with movements in economy and society, domestic demand for consumer goods will change. Over the past few years of "Doi moi", these changes have been seen considerably large both in terms of structure and quantity. At present, products from China, though low in quality, are still holding a strong position in the domestic market due to very low prices, and thus possibly affordable for most consumers. As the overall purchasing power increases, consumers' choice will become wider. Therefore, benefiting from AFTA' s preferences, ASEAN goods will probably occupy a large part of Vietnam's market and thus put a strong pressure on goods from China, especially smuggled goods.

### 3.2 Impact on attracting foreign investment

Up to December 1999, Vietnam has accomplished considerable achievements in attracting foreign direct investment (FDI). According to statistics from the Ministry of Planning and Investment, Vietnam has witnessed more than 2500 FDI projects with a total initially registered capital and added capital of approximately US$ 40 billion. The amount of investment capital realised is US$ 16 billion, representing almost 40% of total registered capital. More than 1000 projects have been started with total revenues achieved of over US$ 11 billion.

According to many researchers, the structure of FDI in Vietnam is more and more in harmony with the new requirements of the transformation of the economic structure. By 1990, investment capital in tourism was higher than in industry and forestry-agriculture. However, during the past decade, foreign investors have been more engaged in industry sectors, thereby raising the share of foreign capital invested in industry in 1999 up to 51.03% (compared to 37.04% in tourism and 11.93% in forestry-agriculture and fishery). Several industrial sectors are performing with 100% foreign invested capital. Examples are crude oil extraction and production, and vehicle manufacture. In other sectors like steel industry, television manufacturing and detergent production, the share of FDI in total investment is showing an increasing trend.

Asian FDI inflows increased over the years (table 2). Particularly, ASEAN members obtained about US$ 13,998 million of FDI in 1998. In 1999, this figure went down by 34.3% to approximately US$ 9.2 billion. FDI in most countries in the region was seen to be lower than that in 1998: Malaysia down by 27%, Singapore 25% and Vietnam 18.4%. In the case of Indonesia, about US$ 356 million of FDI came out of the country. Thailand has been relatively quick in economy recovery; consequently FDI registered in Thailand in 1998 was of US$ 7,449 million, double of that in 1997. This overall reduction in FDI in ASEAN is mainly caused by the Asian crisis, instability of politics in Indonesia, the low reform of financial systems and the devaluation of currencies of countries in the region, the appreciation of the Japanese yen and the increases in interest rates by the American Federal Reserve since the beginning of 1999. In addition, FDI to Vietnam from ASEAN has strongly improved, of which Singapore and Malaysia were two of the ten biggest investors in Vietnam at the end of 1999.

**Table 2: FDI flow in Asian countries (US$ million)**

| | 1988-93 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 |
|---|---|---|---|---|---|---|---|
| China | 8,852 | 33,787 | 35,849 | 40,180 | 44,236 | 43,751 | 40,400 |
| Thailand | 1,899 | 1,343 | 2,000 | 2,045 | 3,732 | 7,449 | 6,078 |
| Philippines | 770 | 1,591 | 1,459 | 10,520 | 1,249 | 1,752 | 737 |
| Vietnam | 319 | 1,936 | 2,349 | 1,455 | 2,745 | 1,972 | 1,609 |
| ASEAN-8* | 7,768 | 11,814 | 16,486 | 20,602 | 19,557 | 13,998 | 9,200 |
| NIEs | 9,787 | 18,744 | 16,335 | 23,616 | 24,789 | 25,706 | 43,354 |
| Asia | 27,113 | 65,954 | 71,654 | 87,952 | 93,518 | 87,158 | 96,148 |
| | (57.8%)** | (62.9%) | (64.0%) | (60.6%) | (52.3%) | (48.6%) | (46.3%) |

**ASEAN-8: ASEAN excluding Singapore and Brunei*
*** % FDI of Asian countries to the whole Developing Countries*
*Source: World Investment report, 2000 – Saigon Times No.15, 2001 (5/4/2001)*

In general, investment projects in ASEAN are small in scale and basically do not differ from those in developed countries in terms of investment structure. Most of the projects relate to amounts of US$ 1 million to US$ 5 million, with low technology and high intensity in labour and resources. Among ASEAN, Singapore has a few high-tech projects. Apart from limitations, FDI of ASEAN in Vietnam has in an important way contributed to social-economic developments in Vietnam over the past few years. FDI of ASEAN has helped Vietnam to generate US$ 369 million of export revenue and provide jobs to more than 34,400 people.

Nevertheless, as far as attracting FDI from non-ASEAN countries is concerned, other member states are in a better position than Vietnam, for reasons related to Vietnam's investment environment which is less attractive compared to that of other ASEAN members. Research on more than 1000 large corporations by American International Investment Consultancy Inc. A.T. Kearney shows that among 25 countries and territories that have the most favourable investment environment in the world, there are four ASEAN states. Thailand ranks 15$^{th}$, Singapore 21$^{st}$, Malaysia 24$^{th}$ and the Philippines 25$^{th}$ in this list. Clearly, a strong competition in attracting foreign investment between ASEAN members is considered as a large obstacle for the development of Vietnam's economy in the coming years.

## 3.3 Impact on government revenues

The impact of AFTA on Vietnam’s government budget revenues are significantly important. Like in other developing countries, revenues from import-export activities account for a substantial amount of the total government budget. This percentage amounts to 30% for Vietnam, 16% for Thailand and 31% for Indonesia, but only 2% for e.g., Canada. Thus, there seems to exist a rational element in the discussions that commitments to AFTA might have adverse impact on the government revenues.

In fact, a reduction of tariffs has a two-sided impact on revenues from import-export activities. On the one hand, with respect to the same volume of imports, a reduction of tariffs will lower the taxation income. On the other hand, a reduction of tariffs yields lower prices, leading to higher demand and a higher volume of imports. Statistics for other ASEAN member countries reveal that the trade volume of the products included in CEPT has been strongly increasing. Therefore, since the time that the CEPT commitments were made, intra-ASEAN trade has grown at the yearly average rate of 26%.

Furthermore, in the light of the CEPT as discussed above, ASEAN member states have to reduce tariffs on products traded within the region down to 0-5%. In the case of Vietnam, more than half of the items in the current import tax system already meet this required CEPT tariff rate, so that Vietnam in effect only has to bring tariffs down on the remaining half of the items. To put it briefly, AFTA’s possible negative impact on government tax revenues is negligible.

Statistics also show that, among the products imported from ASEAN, these from Singapore account for 60-70% of Vietnam’s total trade with the whole region. However, most of these products do not originally come from Singapore, and therefore are not subject to the CEPT. With the application of the Value Added Tax (VAT), Vietnam believes revenues from this new form of tax will to some extent compensate for the drop in total tax revenues when AFTA commitments are implemented. Estimates by the Ministry of Finance show that when Vietnam fully completes its AFTA obligations in 2006, the decline in tax revenues will be approximately US$ 80-90 million, representing a decrease of 2%.

### 3.4 Impact on the production structure

The implementation of the AFTA commitments will lead to market expansion and trade liberalisation which will substantially contribute to a boost of intra-ASEAN flows of capital, labour and technology. This will help Vietnam as well as other member states to speed up the transformation of the structure of production. Vietnam is now actively seeking and determining its comparative economic advantages. Tropical agriculture and an abundant source of labour with various skills are eminent examples of Vietnam's advantages. Under AFTA the more developed ASEAN countries will benefit when sectors that require a large amount of labour and low technology are reduced and the activities transferred to developing ASEAN members. The more developed member states will be able to faster develop high-tech sectors, thereby strengthening their industrialisation levels. In the meantime, the less developed and developing members will also enjoy opportunities to make use of their cheap labour resources, apply appropriate technologies and learn from experiences of the developed members how to accelerate the industrialisation process, shorten social-economic disparities and keep up economic development in line with the others.

Work by Seiji Naya, Pearl Imada and Manuel Montes indicates that ASEAN members will experience changes in the production structure. Yet these changes are small:

- In Indonesia, production will achieve the highest growth in sectors using a lot of labour and natural resources, such as textiles, garments, wooden products, paper and paper-related products.
- In Malaysia, production will expand in sectors using a lot of labour like the garments and wood industry. The manufacturing industry with high capital content will also strongly expand. Sectors that will shrink most are these producing food, paper and paper-related products, ceramic and glass-related products, and non-metallic products.
- In the Philippines, production will increase in sectors with a high capital content, including non-metallic manufactured products and electrical engines. Industrial chemicals and wooden products will be slightly down. Among ASEAN, the Philippines is less affected by AFTA since its trade co-operation with other countries in the region is fairly moderate.
- In Thailand, the food sector will strongly go up. Electrical engines, leather products, metallic and non-metallic products will also increase but at a lower rate. Wood processing, non-electrical engines and industrial chemicals will contract.
- In Singapore, production will be boosted in sectors with a high capital and technology content. In the mean time decreases will be experienced in sectors using large amounts of labour.
- In Vietnam, production will expand in sectors with a heavy labour and natural resources content, such as textiles, garments, handicrafts, agroproducts processing, and increase slightly in high capital and technology intensive sectors such as metallic and non-metallic products, food and beverages, electronic products and chemicals.

Generally speaking, although overall changes in production are not notable, the structure of production will adjust. The higher the level of industrialisation, the higher the capability of integration.

## 4. Challenges during the implementation of AFTA in Vietnam

At present, development levels of ASEAN member states vary greatly. The economies of the five original ASEAN members are some 10-30 years in advance, compared to Vietnam's economy. These countries have relatively developed processing industries, exporting to many countries in the region and in the world. More importantly, in these countries infrastructure and conditions for exploiting natural resources are quite favourable; the domestic markets are sufficiently strong for an independent development of domestic production; the management competence and the market-based economy have advanced together with a young and well-educated workforce and efficient bodies of economic management. Disparities between ASEAN members are illustrated in table 3.

Vietnam's next challenge is that its export structure is very similar to that of other members, while the latter have a higher development level and are using higher technologies. Moreover, Vietnam has not held any key sectors or potential products; product competitiveness has been rather weak. Hence, as tariffs are removed and trade is fully liberalised, Vietnam will certainly undergo numerous disadvantages. This also implies a pitfall of bankruptcy of corporations, the products of which are poorly competitive. On that account, it is clear that the impartiality of trade and business opportunities of the ASEAN members does not truly imply real fairness, as the initial conditions of the ASEAN members differ considerably.

**Table 3: Main indicators related to GDP of ASEAN**

| Country | Population (mil. per.) | Total GDP (bil. USD) | Percentage GDP of ASEAN(%) | GDP/cap. (USD) by normal calculation (*) | GDP/cap. compared to Vietnam | GDP/cap. (USD) by ppp (**) | GDP/cap. compared to Vietnam |
|---|---|---|---|---|---|---|---|
| 1. Brunei | 0.3 | 5.3 | 0.73 | 17,667 | 56.5 | 18,414 | 17.7 |
| 2. Campodia | 10.3 | 2.9 | 0.40 | 282 | 0.9 | 500 | 0.5 |
| 3. Indonesia | 200.0 | 222.5 | 30.51 | 1,113 | 3.6 | 3,270 | 3.1 |
| 4. Laos | 4.8 | 2.1 | 0.29 | 438 | 1.4 | 1,458 | 1.4 |
| 5. Malaysia | 21.1 | 99.2 | 13.60 | 4,701 | 15.1 | 8,360 | 8.0 |
| 6. Myanmar | 47.5 | 12.1 | 1.66 | 255 | 0.8 | 650 | 0.6 |
| 7. Philippines | 71.9 | 83.8 | 11.49 | 1,166 | 3.7 | 2,590 | 2.5 |
| 8. Singapore | 3.7 | 94.1 | 12.90 | 25,432 | 81.5 | 19,350 | 18.6 |
| 9. Thailand | 61.0 | 186.4 | 25.60 | 3,056 | 9.8 | 6,350 | 6.1 |
| 10. Vietnam | 75.4 | 23.5 | 3.22 | 312 | 1 | 1,040 | 1 |
| | 495.4 | 731.5 | 100.00 | | | | |

Source: South-East Asian Research Magazine, March 1999

*(*) Total GDP/total population in current prices*
*(**) ppp: Purchasing Power Parity*

At present, most Vietnamese enterprises are still inactive in approaching markets and seeking customers. Products have a quite low value added, and therefore are unable to meet new requirements imposed by the market. Besides, obsolete machinery and equipment and low technology are other examples of obstacles to integration. Apart from enterprises subsidised by the government, only one-third of the remaining industrial enterprises is relatively well-equipped. The overall rate of industrial equipment improvement is fairy low at 10-11%. These impediments adversely affect the enhancement of the product quality and the reduction of production costs. For that reason, many domestic products are more expensive than the same products imported at an import tariff rate of 20-40%. Moreover, compared to other countries in the region Vietnam's investment efficiency is at a low level, represented by the high ICOR[1]. Vietnam's ICOR has increased from 2.8 in 1995 to 5.4 in 1999, and 5.6 in 2000 (estimated) - the highest one in the region. In other words, to have a growth rate in GDP of 1%, a larger amount of capital is needed, implying capital utilisation efficiency tends to slow down.

**Table 4: ICOR comparison of ASEAN countries, 1991-1998**

| | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 |
|---|---|---|---|---|---|---|---|---|
| Vietnam | 2.50 | 2.10 | 3.10 | 2.90 | 2.80 | 3.00 | 3.80 | 5.40 |
| Singapore | 5.73 | 5.52 | 3.39 | 3.59 | 3.72 | 4.80 | 4.53 | 4.93 |
| Indonesia | 3.42 | 4.65 | 4.64 | 3.93 | 3.79 | 1.09 | 6.27 | -2.28 |
| Malaysia | 3.72 | 4.91 | 4.47 | 4.11 | 4.30 | 5.06 | 5.39 | -6.77 |
| Philippines | - | - | 9.90 | 5.36 | 5.00 | 3.72 | 4.44 | -47.60 |
| Thailand | 3.66 | 5.36 | 4.86 | 4.48 | 4.58 | 7.56 | -104.25 | -4.38 |

Source: Calculated from data of Asian Development Outlook 1999, ADB
Vietnam Economic Times 1999-2000 & Vietnam Economic Review 8/2000

Another difficulty should be mentioned. Integrating into the regional economy, where all protective barriers are to be eliminated, Vietnam has to confront dramatic changes in its economic system. The recent Asian monetary and financial crisis has created large shocks in the region. In less developed countries, macroeconomic policies are inadequately flexible and not in accordance with international standards, corruption and bureaucracy are pervasive, and bank and financial systems are underdeveloped. These economies which certainly include Vietnam, are thus very vulnerable to external changes.

Regarding human resources, the technical and management staff in Vietnam has not been well-prepared in terms of language and professional skills and working methods. An ASEAN member cannot effectively participate in and benefit from the association unless it has a strong and efficient staff of executives and entrepreneurs in all fields, proficient in languages and profession, active and creative. Based on the annual "Human development report" by UNDP, indicators for human resource development of ASEAN countries in 1997 can be found in table 5.

**Table 5: Comparison of for human resource development of ASEAN countries**

| Country | GDP/cap. ranking in the world (1) | Average life expectation (year) (2) | Illiteracy rate (%) (3) | HDI index (ranking in the world) (4) | Comparison between GDP & HDI (1)-(4) |
|---|---|---|---|---|---|
| 1. Brunei | 19 | 75 | 12 | 36 | -17 |
| 2. Indonesia | 115 | 64 | 16 | 102 | +13 |
| 3. Laos | 136 | 52 | 43 | 138 | -2 |
| 4. Malaysia | 44 | 71 | 17 | 53 | -9 |
| 5. Myanmar | 168 | 59 | 17 | 133 | +35 |
| 6. Philippines | 103 | 66 | 5 | 95 | -8 |
| 7. Singapore | 13 | 76 | 9 | 34 | -21 |
| 8. Thailand | 49 | 69 | 6 | 52 | -3 |
| 9. Vietnam | 148 | 68 | 6 | 121 | +27 |

Source: South-East Asian Research Magazine, Mar. 1999

[1] ICOR is calculated as a ratio between the rate of investment capital per GDP and GDP. ICOR reflects the percentage of investment capital required if the growth rate of 1% in GDP is to be achieved.

## 5. Some methods to improve Vietnam's integration capability

In order to accomplish a successful integration, Vietnam has not only to formulate and implement appropriate external policies but also to reform internal institutions in harmony with international standards and establish institutions that are capable of taking an active part in the regional and international affiliation. Vietnam should comply with the rules of the game that the ASEAN countries have been evolving and experiencing. Vietnam should learn from them in terms of investment in the industrialisation of the economy and in the strengthening of its export capacity.

First of all, Vietnam has to carry out economic institutional reforms covering commerce, investment, banking, finance and administrative procedures, etc following its market orientation. Since “Doi moi” was launched, Vietnam's institutions have improved, bureaucratic mechanisms have been to a large extent eliminated, the market orientation has been in large part determined. Several tough challenges, however, still remain to be solved. As discussed above, Vietnam is to gradually reduce import tariffs, remove quantitative restrictions and non-tariff barriers under the CEPT. Furthermore, Vietnam should deepen domestic production in a way that is appropriate with the new situation and does not create any negative social shocks. Vietnam has also to revise its investment policies in both domestic sectors and foreign trade, for creating an efficient and flexible environment for investment. The last monetary and financial crisis in the region helped to uncover shortcomings of Vietnam's investment environment as well as its monetary, banking and financial systems. Most apparent shortcomings are as follows: the exchange rate controlling mechanism is rigid, the determination of interest rates is not market-based, policies of allocating investment capital are inefficient, banking credit regulations are complicated, the commercial banking system is poor both in terms of technology and working experience. As a result of that, a fundamental institutional reform is a must in order to overcome the shortcomings mentioned above. In recent years, the government has issued many modifications of commercial and banking regulations, abolished the import licensing for hundreds of product items, allowed all sectors to import and export, eliminated the policy of rigidly setting exchange rates by the Central Bank and replaced this by the multi-bank flexible exchange rate system. These reforms are most significant but not yet sufficient. Continuing and next steps need to be effectively undertaken in line with new requirements.

Secondly, Vietnam has to implement reforms in human resource training. Though Vietnam's human resources are currently plentiful, they are exposed to many weaknesses. The percentage of the people which obtained a basic education is quite high. Professional training is, however, relatively poor and unsatisfactory compared to the requirements of the international market. Vietnam's education and training has so far only addressed domestic needs, thus is not adapted to its integration requirements. For that reason, Vietnam's human resources are inefficient with regards to its ASEAN affiliation, and reforms of education, training, utilisation and maintenance of human resources are indeed pressing issues.

In addition, Vietnam needs to construct and improve business organisations that are well qualified for the ASEAN affiliation. The Government should encourage all economic sectors to participate in foreign trade activities and to establish corporations that are capable of making direct investments in foreign countries. Furthermore, joining AFTA requires Vietnamese enterprises to improve and enhance efficiency of their business activities and to properly implement technological innovations and appropriate working methods. Strong enterprises should both focus on existing manufactured industrial products and actively examine new products. Currently, it is necessary to establish and increase the production capability for manufactured industrial products through exports. In the long-term, however, the main focus should be on manufactured products. Notably, the diversification of the exports is significantly vital for Vietnamese enterprises on the purpose of sustainability and development when joining in AFTA.

Besides, Vietnam ought to build up and upgrade infrastructure systems so as to facilitate and broaden regional and international cooperation. Specifically, the construction of large harbours and of regional and international airports, and the connection with Asian road systems are important. Telecommunication systems are to be modernised. Free economic zones for exports need to be established. If necessary infrastructures mentioned above are lacking, Vietnam hardly takes an active and efficient part in the integration process.

## 6. Conclusion

The analysis above has made it clear that the impact of AFTA on Vietnam's economy is substantial. As Vietnam completes its AFTA commitments in 2006, intra-ASEAN traded goods will flood the domestic market and hamper the development of domestic sectors unless Vietnam's economy is sufficiently strong. At present, competitiveness of the Vietnamese enterprises has not yet been well established. Up to the middle of 1999, only some 100 enterprises in the country have been granted an ISO 9000 certificate, 70% of which are State-owned enterprises. Most Vietnamese corporations largely depend on foreign business partners in fields such as exhibition activities, product design, technology, marketing activities and product distribution.

Although the challenges ahead are enormous; the integration process will accelerate the industrialisation and modernisation process in Vietnam and the long-term benefits of integration are unquestionable. To overcome the challenges, Vietnam should implement simultaneously and efficiently a wide range of policies. A tighter and more effective collaboration between state organisations and private corporations should be established so as to provide the latter with better information on technology, products, markets and international standards.

Moreover, supportive policies for raising the product quality, and for seeking new markets and new business partners should be implemented. Investment policies should be reformed so that products and sectors with a high comparative advantage are prioritised, increasing investment in potential and export-promoted products.Vietnam should encourage production of goods for exports and consumer goods for domestic consumption, in order to decrease imports of necessities. It is important that reforms are deepened and strengthened continuously. Liberalisation and the "open door" policies should be further implemented so as to boost the competitiveness of Vietnam's products and Vietnam's economy.

Finally, the success of the implementation of the above-indicated measures and policies critically depends on Vietnam improving its legal and administrative system, reforming adequately the banking and financial sector, giving priority to upgrading the social-economic infrastructure, accelerating the equitization of State-owned enterprises and promoting the private sector.

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