THE WORLD BANK
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# TAKING STOCK

## An Update on Vietnam's Recent Economic Developments

**Special Focus:**
Facilitating Trade by Streamlining and Improving the Transparency of Non-Tariff Measures

THE WORLD BANK

December 2018

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# ACKNOWLEDGEMENTS

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**OFFICIAL INTERBANK EXCHANGE RATE: US$ = VND 22, 743**
Government Fiscal Year: January 1 – December 31

# ABBREVIATIONS

| | |
|---|---|
| **ASEAN** | Association of Southeast Asian Nations |
| **ASEAN-4** | Indonesia, Malaysia, the Philippines, and Thailand |
| **ATIGA** | Goods Agreement |
| **AVE** | Ad Valorem Equivalent |
| **CIT** | Corporate Income Tax |
| **CPI** | Consumer Price Index |
| **CPTPP** | Comprehensive and Progressive Agreement for Trans-Pacific Partnership |
| **EAP** | East Asia and Pacific |
| **EMDEs** | Emerging Markets and Developing Economies |
| **EU** | European Union |
| **EVFTA** | EU-Vietnam Free Trade Agreement |
| **FDI** | Foreign Direct Investment |
| **FTA** | Free Trade Agreement |
| **GDP** | Gross Domestic Product |
| **GSO** | General Statistics Office |
| **HS** | Harmonized System |
| **IMF** | International Monetary Fund |
| **MARD** | Ministry of Agriculture and Rural Development |
| **MAST** | Multi-Agency Support Team |
| **MOF** | Ministry of Finance |
| **MOH** | Ministry of Health |
| **MOIT** | Ministry of Industry and Trade |
| **MOLISA** | Ministry of Labor, Invalids and Social Affairs |
| **MPI** | Ministry of Planning and Investment |
| **NTM** | Non-tariff measure |
| **PIT** | Personal Income Tax |
| **PMI** | Purchasing Managers' Index |
| **RCEP** | Regional Comprehensive Economic Partnership |
| **SBV** | State Bank of Vietnam |
| **SOEs** | State-owned enterprises |
| **SPS** | Sanitary and Phytosanitary Measures |
| **TBTs** | Technical Barriers to Trade |
| **VAMC** | Vietnam Asset Management Company |
| **VAT** | Value-added Tax |
| **VTIP** | Vietnam Trade Information Portal |
| **WTO** | World Trade Organization |
| **YTD** | Year to Date |
| **y/y** | Year-over-year |

# OVERVIEW

## Recent economic developments

**The external environment has become less sanguine and more uncertain.** Global real GDP growth is forecast to moderate from a projected 3 percent in 2018 to 2.9 percent in 2019 and 2.8 percent in 2020, as economic slack dissipates, central banks unwind policy accommodation, and global trade and investment growth weaken with deepening trade war tensions among major economies. Following a recent peak of 6.6 percent in 2017, GDP growth in emerging East Asia and the Pacific is forecast to ease from a projected 6.3 percent in 2018 to 6.0 percent in both 2019 and 2020, largely tied to a falloff in exports amid rising trade tensions and a structural slowdown in China.

**Despite weakening external conditions, growth in Vietnam has proven resilient, supported by strong domestic demand and a dynamic export-oriented manufacturing sector.** Real GDP growth in Vietnam posted a robust 7 percent (y/y) through Q3-2018. The industrial and construction sectors grew 8.9 percent, driven by a vibrant 12.9 percent growth in manufacturing, which, along with agriculture at 3.7 percent, was supported by high, albeit easing, external demand. The services sector grew by 6.9 percent, supported by buoyant private consumption and tourism. Domestic demand has remained strong, reflecting healthy private consumption and investment, supported by rising wages, accommodative monetary policy and strong FDI inflows.

**While the external balances remained in surplus, heightened global financial volatility spilled over into domestic markets in 2H-2018.** The current account surplus is projected to stay at 2.2 percent of GDP in 2018, as in 2017. Although trade flows moderated, the slowdown in import growth outstripped the moderation in exports. Pressures on the dong had been building since June 2018, due to rising global trade tensions, weakening currencies across Asia, and a rise in capital outflows. The State Bank of Vietnam (SBV) responded with a combination of FX interventions, domestic liquidity tightening and letting dong depreciate gradually, which is down by about 2.7 percent against the U.S. dollar in nominal terms (YTD). However, the real effective exchange rate continued to appreciate by about 2.5 percent (YTD), and could erode Vietnam's export competitiveness. While Vietnam's limited exposure to volatile capital flows has contained immediate spillovers of global volatility, it experienced some disruption, with an equity market correction of 10 percent in October.

**Monetary policy remains accommodative, but credit conditions have tightened in 2H-2018, amidst a slight pickup in inflation.** Due largely to administered price hikes, the CPI inched up in 2018 through October to a still moderate 3.6 percent (y/y). The SBV lowered the banking sector's credit growth target and set credit growth limits for commercial banks, and interbank rates have risen and are now in line with the discount rate. As a result, credit growth eased to an average of 15 percent (y/y) for the year through October, compared to 18.6 percent over the same period in 2017. The credit-to-GDP ratio remains elevated, however, at 136 percent as of Q3-2018.

**The reduction of the budget deficit helped contain public debt accumulation.** With preliminary data through Q3-2018, the budget deficit is projected at about 4 percent of GDP in 2018, down from 4.3 percent in 2017. Continued fiscal restraint and restrictions on public guarantees have also ensured compliance with the statutory debt limit of 65 percent of GDP.

**Strong economic activity has supported continued real wage gains and job growth.** Real wages grew by 3.2 percent during the first half of 2018 (y/y). Officially reported unemployment was unchanged at 2.2 percent through Q3-2018, as in 2017, and underemployment declined slightly to 1.5 percent over the same period from 1.6 percent in 2017.

**Despite progress in improving the business climate, Vietnam's ranking in the Ease of Doing Business 2019 slipped to 69th out of 190 economies, down from 68th last year.** This reflects the need to keep pace with reform progress in other countries to maintain competitiveness. Nevertheless, Vietnam saw absolute gains in several areas, including for Starting a Business.

## Medium-term outlook, risks, and policy implications

**Vietnam's outlook remains robust, despite growing external headwinds.** Vietnam's economy is expected to grow at nearly 6.8 percent in 2018, before decelerating incrementally to 6.6 percent and 6.5 percent in 2019 and 2020, respectively, largely reflecting weaker external demand. Inflation is expected to remain muted, at about the SBV's target of 4 percent, given anticipated monetary policy tightening over the medium term. The current account is expected to remain in surplus, but to decline slightly with slowing exports. Over the medium term, continued fiscal restraint is expected to maintain the deficit at close to 4 percent as a share of GDP, in line with the government's target.

**Risks to the outlook have intensified and are titled to the downside.** Domestically, a slowdown in the restructuring of the state-owned enterprise and banking sectors could undermine growth prospects and create public sector liabilities. Vietnam also remains susceptible to external volatility, given its high trade openness and limited fiscal and monetary policy buffers. Escalating global trade tensions could affect Vietnam's export-oriented prospects, and a falloff in external demand could lead to weaker external positions and lower GDP growth. Tightening global liquidity could reduce capital inflows and put downward pressure on the dong and asset prices.

**Table 0.1: Vietnam: Selected economic indicators**

| | 2015 | 2016 | 2017e | 2018f | 2019f | 2020f |
|---|---|---|---|---|---|---|
| GDP growth (%) | 6.7 | 6.2 | 6.8 | 6.8 | 6.6 | 6.5 |
| Consumer price index (annual average, %) | 0.6 | 2.7 | 3.5 | 4.0 | 4.0 | 4.0 |
| Current account balance (% of GDP) | 0.1 | 2.9 | 2.2 | 2.2 | 2.1 | 1.9 |
| Fiscal balance (% of GDP)[1] | -5.5 | -4.8 | -4.3 | -4.0 | -4.0 | -4.0 |
| Public and PG debt (% GDP, MOF) | 61.8 | 63.7 | 61.4 | 61.5 | 61.5 | 61.4 |

*Sources:* GSO, MOF, SBV, and World Bank.

**Pursuing greater macroeconomic resilience and enhanced competitiveness would support long-term growth prospects.** As an open economy, Vietnam needs to maintain a responsive monetary policy, exchange rate flexibility, fiscal consolidation, and moderate credit expansion to strengthen the macro-policy framework and enhance resilience. Advancing structural reforms, including for state-owned enterprises and the banking sector, along with improving efficiency in public sector investment, would boost productivity and potential output. Policies that strengthen trade facilitation would enhance Vietnam's export competitiveness, especially in the context of the recently ratified Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and the EU-Vietnam Free Trade Agreement (EVFTA) (see the Special Focus).

1 Based on the definition from the Government Financial Statistics, IMF

## Special Focus: Facilitating Trade by Streamlining and Improving the Transparency of Non-Tariff Measures

**Non-tariff measures (NTMs) are defined as policy measures that could have an economic effect on international trade in goods, that is, changing quantities traded, prices, or both.** This includes technical regulations and standards, as well as sanitary and phytosanitary standards. While principally designed to achieve specific regulatory objectives, such as food safety or consumer protection, they can be used as substitutes to tariffs in protecting domestic producers and consumers. When NTMs are poorly designed and implemented, they often increase the cost of doing business, reduce transparency, and limit national competitiveness.

**In Vietnam, while tariffs have been decreasing along with the process of international economic integration, the number of NTMs has increased rapidly.** Vietnam's average preferential tariffs have fallen from 13.11 percent in 2003 to 6.33 percent in 2015. In contrast, the number of NTMs has increased rapidly from 15 measures in 2004 to 330 measures in 2015[2]. Moreover, the NTMs are often not uniformly and consistently defined or classified according to international standards, and their policy objectives are often unclear and overlapping. The existence of multiple databases on NTMs, with regulatory information compiled from different sources, can lead to inconsistent information and a lack of coordination among agencies in the publication and updating of information, resulting in poor transparency and increased costs of business operations.

**Despite efforts in recent years to make improvements, including the establishment the Vietnam Trade Information Portal, the NTM system in Vietnam remains complicated, opaque, and costly**. This is reflected in the following aspects: (a) the level of incidence of NTMs in Vietnam is higher than that of most Association of Southeast Asian Nation (ASEAN) countries; (b) the current NTM system is very complex, containing a large number of legislative documents on compliance, procedures for implementation, and forms to be filed; (c) there are overlapping legal documents for each import and export item issued by different agencies; and, (d) there are complex implementation procedures, and limited coordination among relevant agencies.

**A set of reforms for simplifying NTMs and improving transparency include:** (a) issuing guidance and definitions of NTMs in accordance with international practice, clearly establishing NTM policy objectives in relation to the market they are aimed at addressing; (b) formal introduction and application of the UNCTAD-MAST (Multi-Agency Support Team) classification system; and, (c) issuing regulations on the use of the Vietnam Trade Information Portal (VTIP) as the official source of information on NTMs in accordance with the World Trade Organization Agreement on Trade Facilitation, and establishing an interagency mechanism to coordinate efforts with focal points from specialized inspection bodies to regularly update the VTIP.

2 According to the ASEAN-ERIA-UNCTAD database.


# PART I

## RECENT ECONOMIC DEVELOPMENTS

## EXTERNAL ECONOMIC ENVIRONMENT

**1. The global economic environment has become less favorable.** Global growth is moderating, as the recovery in trade and manufacturing activity loses steam (figures I.1 and I.2). Global real GDP growth is projected to moderate from 3 percent in 2018 to 2.9 percent in 2019, as economic slack dissipates, major central banks continue to remove policy accommodation, and global trade and investment growth weaken further with deepening trade war tensions between the United States and China. Growth in advanced economies is projected to ease slightly from 2.2 percent in 2018 to 1.9 percent in 2019, and decelerate toward potential, reaching 1.6 percent in 2020, as capacity constraints become binding and monetary policy normalization continues. External conditions, which started to deteriorate in 2018, are expected to become even less supportive for emerging markets and developing economies (EMDEs). This reflects moderating advanced-economy growth, softening global trade and investment, tightening financing conditions, and rising trade tensions. EMDE growth, which moderated to an estimated 4.2 percent in 2018 from 4.3 percent in 2017, as several countries suffered financial pressures, is expected to increase only slightly to 4.3 percent in 2019 and 4.6 percent in 2020, as the recovery in commodity exporters levels off.

**Figure I.1: Global real GDP growth** (%)

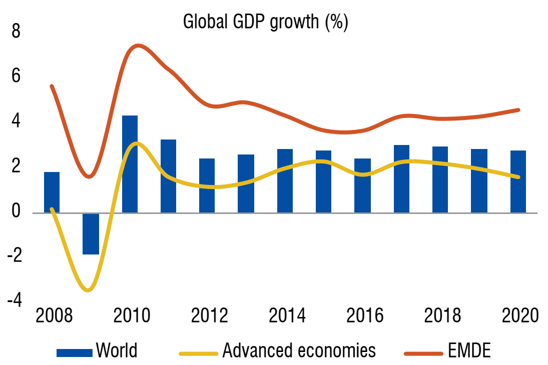
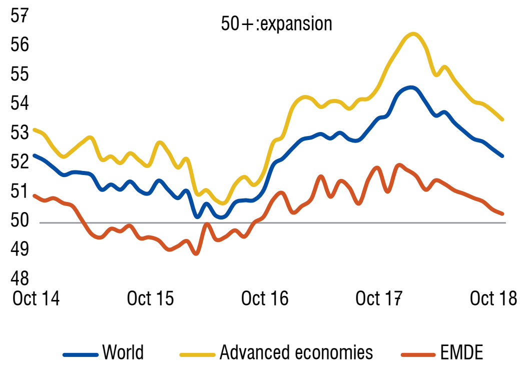
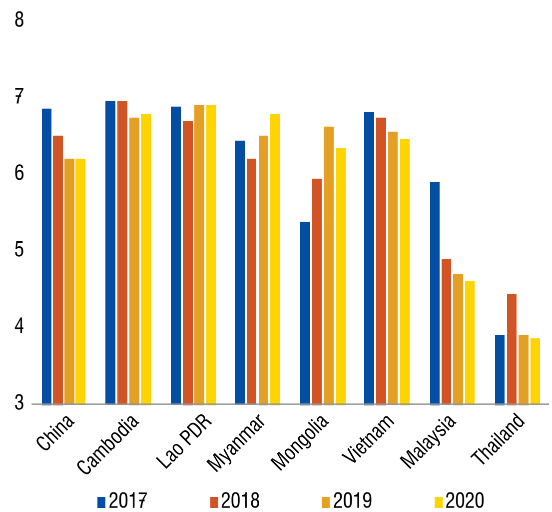



**Figure I.2: Manufacturing Purchasing Managers' Index (PMI)**




*Source:* World Bank.

**Figure I.3: East Asia Pacific GDP Growth** (%)




*Source:* World Bank.

**2. Despite emerging headwinds, growth in developing East Asia and Pacific (EAP) remains resilient.** Real GDP growth in the EAP region is expected to gradually moderate from 6.3 percent in 2018 to 6 percent in 2019 and 2020 (figure I.3). The slowdown in regional growth reflects the structural slowdown and weaker exports amid rising trade tensions between China and the United States, and a projected deceleration in China's growth through 2020. Growth in China is projected to slow from 6.5 percent in 2018 to 6.2 percent on average in 2019-20, and domestic and external rebalancing are expected to continue. Authorities in China have shifted to more accomodative monetary and fiscal policies in response to a more challenging external environment, including escalating trade tensions. Activity in the rest of the region, excluding China, is expected to remain steady, around its potential rate in 2019 and 2020, but downside risks to the outlook have increased. This reflects increasingly adverse demographic patterns, a projected slowing pace of capital accumulation, and the need to rein in excessive credit growth. Tightening global financing conditions, higher borrowing costs, moderating capital flows, and lingering policy uncertainty could also hamper investment growth in the coming years, further constraining potential growth.

**3. Risks to the global and regional outlook are tilted to the downside and have intensified.** The probability of escalating trade restrictions continues to increase, which could have broad-based consequences and reverberate through global value chains. This could be compounded by elevated policy uncertainty and geopolitical risks, which could negatively impact confidence and investment both in the affected countries and globally. In addition, a faster-than-expected tightening of global financing conditions could further reduce capital inflows, heighten financial market volatility, and place pressure on regional exchange rates and asset prices. Rising borrowing costs could substantially increase the burden of debt servicing, which has been contained in recent years by low global interest rates and risk premiums. Domestic vulnerabilities—elevated domestic debt and large external financing needs in some countries—would amplify the impact of external shocks and dampen growth, especially where policy buffers are limited.

## RECENT ECONOMIC DEVELOPMENTS IN VIETNAM

### *Strong growth supported by favorable domestic conditions and strong external demand*

**4. Despite a more challenging global environment, Vietnam's economy is showing resilience, supported by robust domestic demand and export-oriented manufacturing.** Preliminary data indicate that Vietnam's GDP growth for the first three quarters of 2018 came in at a robust 7 percent (y/y) (figure I.4). GDP is estimated to have expanded by 6.9 percent (y/y) in the third quarter, a slight moderation from the 7.5 percent in Q1-2018, but somewhat of a rebound from 6.5 percent in Q2-2018 (figure I.5). The agriculture, forestry, and fishery sectors saw strong growth of 3.7 percent. The industrial and construction sectors were up 8.9 percent, driven by vibrant growth of 12.9 percent in manufacturing. The services sector posted 6.9 percent growth, supported by buoyant private consumption and tourism (figure I.5 and box I.1).

**Figure I.4: Quarterly GDP growth**
*(y/y, %)*

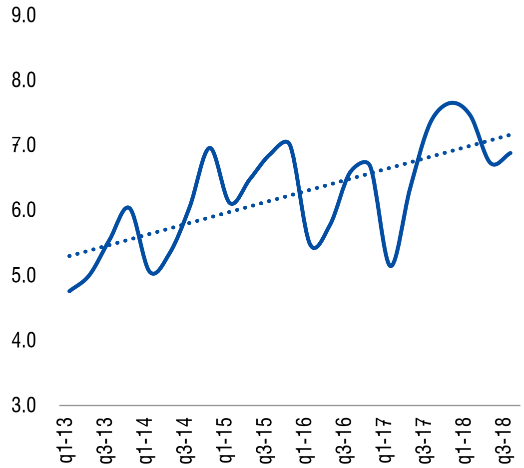
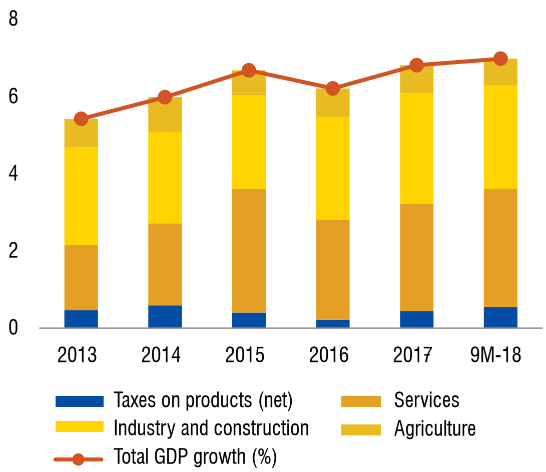



**Figure I.5: Contribution to GDP growth**
*(supply side, percent)*




*Source:* GSO

**5. On the demand side, domestic demand remains resilient, underpinned by buoyant investment and consumption growth.** Final consumption and capital formation are expected to contribute 5.3 and 2.4 percentage points, respectively, to the overall GDP growth of 2018. In the first nine months of 2018, investment grew by 10.9 percent (y/y) in nominal terms, bringing total investment outlays to about 34 percent of GDP through the third quarter, up from 33.3 percent in 2017.[3] Investment from the foreign-invested sector rose 8.4 percent (y/y) over the same period, and accounted for nearly a quarter of total investment outlays in Vietnam (figure I.6). In addition, public investment strengthened in the third quarter of the year, contributing about 33.6 percent to total investment outlays. Despite this increase, the share of public investment has posted a steady decline in recent years, from 12.4 percent of GDP in 2016 to 11.9 percent in 2017 and a projected 11.4 percent of GDP in 2018, as the government has clamped down on investment spending to support fiscal consolidation.[4] The recent decline of public investment has been more than offset by strong private domestic investment and consistent foreign direct investment (FDI) inflows, which have led to rising total investment as a share of GDP over recent years (figure I.7).

**Figure I.6: Total investment**

*(% of GDP)*

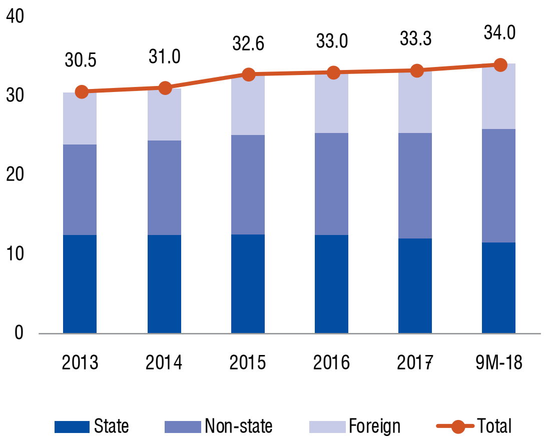
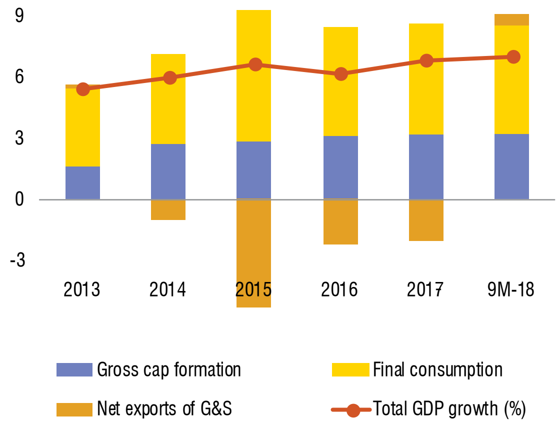



**Figure I.7: Contribution to GDP growth**

*(demand side, percent)*




*Source:* GSO.

**Box I.1: Unlocking Vietnam's service sector**

While the export-oriented manufacturing sector has been a key driver of Vietnam's impressive growth in recent years, the service sector has also been growing rapidly. Robust industrial growth led to increased demand for support services, such as transportation and logistics, and banking and finance, while the liberalization of services also created opportunities for a rapid expansion in trade, retailing, and telecommunications. Economic prosperity has helped to boost residential and commercial real estate and tourism. As a result, the average annual growth rate for the service sector was 6.8 percent from 2010 to 2017, which is slower than the industry and construction sector, but above the average GDP growth rate of 6.1 percent.

Due to its large size, the service sector made a sizeable contribution to GDP growth: the service sector contributed 2.6 percentage points compared to 2.5 percentage points of the industrial sector, during the same period. As a consequence of outperforming growth of other sectors, the share of the service sector increased to 41 percent of GDP in 2017 from

3 Based on Vietnam's current regulations, gross capital formation differs from total investment outlays by excluding investments related to project site clearance, land compensation, reallocation and resettlement, and other safeguard costs.

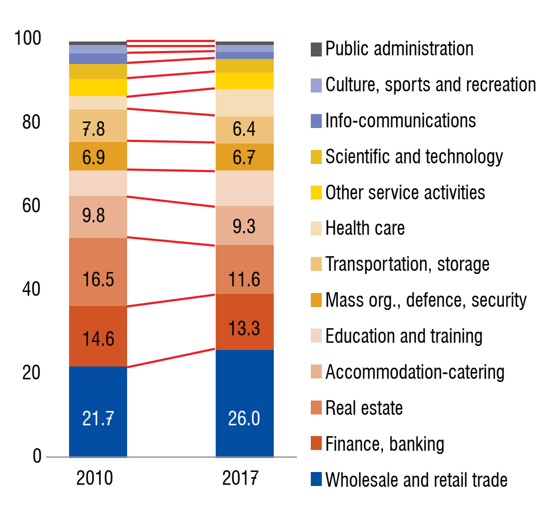
4 Public investment includes investment from the state budget, banking loans, and equity of state-owned enterprises.

37 percent in 2010. The number of registered enterprises in the trade and services sector grew by an average annual rate of 15.3 percent from 2010 to 2016, and this sector constituted 70 percent of total registered enterprises at the end of 2016 compared with 66 percent in 2010, albeit most of these enterprises are micro and small enterprises in relatively low-value-added sectors, such as retail and hospitality.

Services are currently a major source of employment in Vietnam, with retail trade, transport, tourism, and public administration generating the vast majority of new jobs. Currently, around a third of the total workforce is employed in the service sector. Despite impressive progress to date, the share of employment in the sector relative to the economy remains modest compared with other countries in the region; for example, in Thailand, the Philippines, and Singapore, the sector accounts for 56 percent, 60 percent, and 70 percent of total employment, respectively.

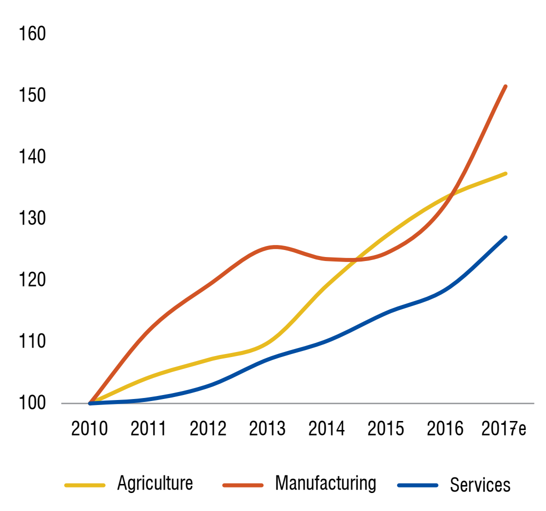
To become a more important engine for overall economic growth in Vietnam, labor productivity in the sector needs to improve. Currently, the growth of labor productivity of the service sector is still lagging productivity growth in both the manufacturing and agriculture sectors. The most important obstacle to developing an efficient service sector relates to the slow compositional change toward commercial-based and higher value-added subsectors. Other important impediments include underdeveloped physical infrastructure, scarcity of skilled human resources, and various kind of restrictions on trade services.

**Figure I.8: Composition of the service sector**
*(% of total)*




*Source*: GSO.

**Figure I.9: Labor productivity index**
*(2010 = 100)*




*Sources:* GSO and World Bank estimates.

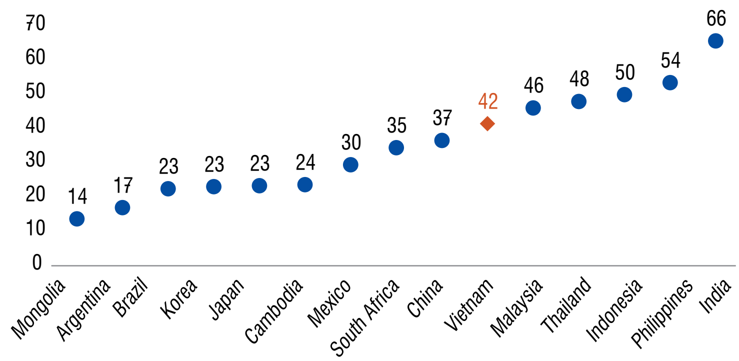
The government can help lay the foundation for a vibrant services sector through both policy reform and investments in physical infrastructure and human capital. The services classified as supporting inputs for facilitating growth in other economic sectors, such as transportation and logistics, tourism, education and training, telecoms, business services, and finance, etc., should be prioritized.

To unlock the full potential of the service sector, Vietnam needs to promote the sector's development through comprehensive, market-oriented reforms, such as:

- Improving regulations on market entry and exit and promoting fair competition;
- Reforming the regulatory and supervisory systems to clarify the position of the state in the service sector;

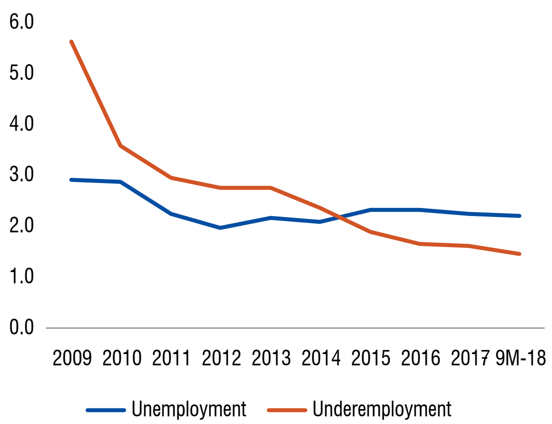
- Developing the service area, ensuring international and regional integration through structural restructuring, business innovation, information technology application, and professional training; and,
- Mobilizing resources from all economic sectors – public and private in the development of the service sector.

**Figure I.10: Services Trade Restrictions Index, 2017**




*Source:* World Bank.

**Figure I.11: Unemployment rate**
*(% of labor force)*




*Source:* MOLISA and GSO.

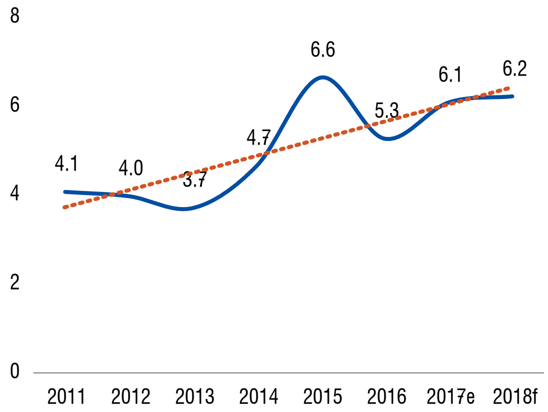
**6. Strong growth outturns over recent years have supported steady job creation and rising labor income.** The official unemployment rate in Vietnam is very low, at around 2 percent (figure I.11).[5] Correspondingly, the labor force participation rate is relatively high above was 76.6 percent as of Q2-2018 for the population aged 15 and above. A laborer's monthly average income during 2010–17 rose by 10.5 percent per year in nominal terms (around 4 percent in real terms). In particular, the income for state employees increased 8.9 percent per year in nominal terms over the same period, while the incomes of laborers at private and foreign-invested firms grew by 11.6 percent and 11.4 percent per year, respectively. In 2017, Vietnamese employees earned a monthly average income of VND 8.3 million, up 10.1 percent, year-on-year (approximately 6.6 percent in real terms), supported by productivity gains (figure I.12).

**7. However, the quality of the labor force remains a challenge.** Albeit an improvement from 14.5 percent in 2009, as of Q2-2018, only 21.9 percent of the labor force had received vocational training or other forms of higher education (table I.1). The largest gains in recent years have been in the number of people receiving degrees from universities (up 4.1 percentage points as a share of the total over the same period), and from technical

5 As the official unemployment rate only measures officially reported unemployment in the formal sector, it does not fully capture the extent of unemployment in either the informal sector or in the agriculture-based rural areas. It also does not factor in the extent of "underemployment" in the economy.

schools (up 2.6 percentage points). However, surveys show that worker skills and availability remain more serious concerns for employers than labor market regulations and taxes. Many employers identify hiring new workers as a particularly serious challenge, due to inadequate skills, especially among those applying for technical, professional, and managerial occupations.

**Figure I.12: Labor productivity change** *(%)*




*Sources:* MOLISA and GSO.

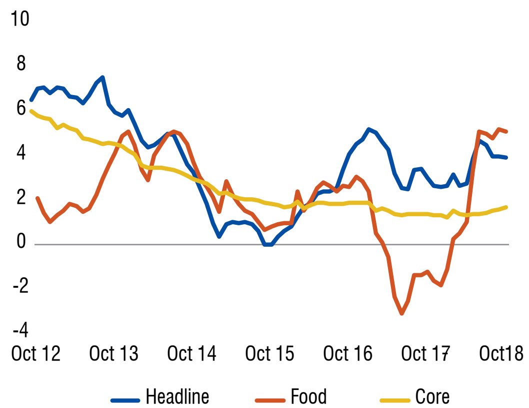
**Table I.1: Professional/skills of the labor force** *(% of total)*

| | 2009 | 2017 | Q2-18 |
|---|---|---|---|
| No professional or technical skills | 85.5 | 79.0 | 78.2 |
| Vocational training | 4.8 | 5.3 | 3.5 |
| Technical school | 2.7 | 3.7 | 5.3 |
| Junior college | 1.5 | 2.7 | 3.5 |
| University and higher | 5.5 | 9.3 | 9.6 |

*Sources:* MOLISA and GSO.

## *Headline consumer price index moderated and core inflation remained stable*

**Figure I.13: Consumer Price Index** *(%, y/y)*




*Source:* GSO.

8. **While below the State Bank of Vietnam's (SBV's) annual target of 4 percent, inflationary pressures trend downward in the last quarter.** The reflecting administered price hikes mainly in healthcare and education, year-on-year average headline CPI rate rose to a still moderate 3.6 percent in the first 10 months of 2018 (figure I.13). Poor weather and an associated supply shock to agricultural output exerted pressure on food prices, which rose 5.1 percent (y/y) in October 2018. Retail fuel price fluctuations also contributed to higher headline CPI. In contrast, core inflation (excluding food, fuel, and administrative-managed prices) remained stable at 1.4 percent (y/y) in the first 10 months of 2018.

9. **While the monetary policy stance remains broadly accommodative, the SBV introduced some tightening of credit growth in the third quarter of 2018.** The SBV slightly lowered the credit growth target for the banking sector to 17 percent in 2018 from 18 percent in 2017 (figure I.14). The SBV also set credit growth limits for each commercial bank, depending on its health at the beginning of the year, to regulate overall credit growth and to support the target. In addition, the SBV reaffirmed its decision to strictly control lending to high-risk sectors (real estate, securities, and private consumption). Liquidity in the banking sector also tightened markedly, due to slower deposit growth pushing up short-term interbank interest rates (figure I.15). Amidst tighter financing conditions, credit growth moderated to about 15 percent (y/y) in October.

**Figure I.14: Monetary aggregate**
*(y/y change in %)*

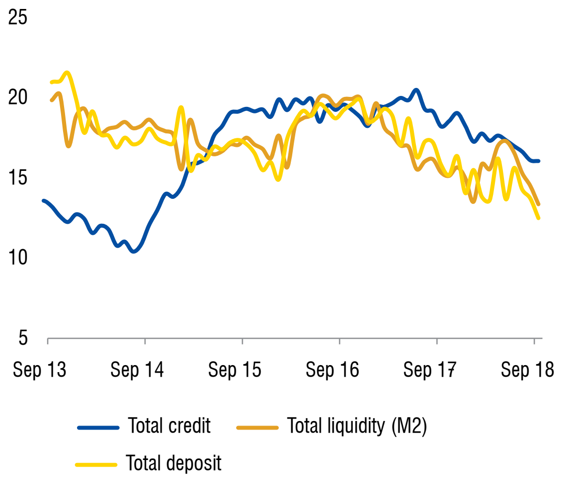
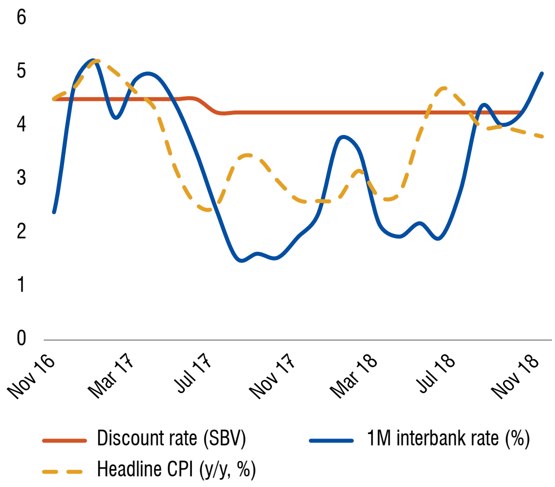


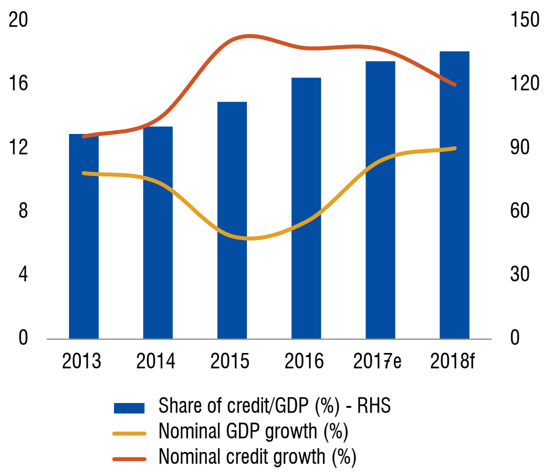

**Figure I.15: Policy and interbank rate**
*(monthly average, %)*




*Sources:* GSO and SBV.

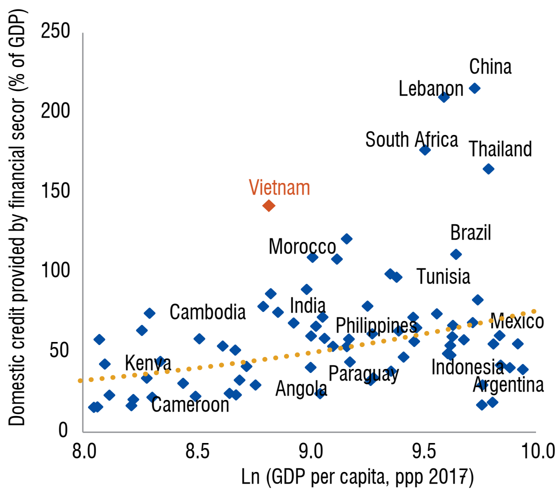
10. **Nevertheless, the stock of banking sector credit remains high in Vietnam.** The rapid expansion of credit in recent years—at more than twice the growth rate of nominal GDP—has elevated the credit-to-GDP ratio to 136 percent as of Q3-2018, higher than most countries at Vietnam's income level (figures I.16 and I.17). High levels of indebtedness, compounded by extended periods of rapid credit growth, could amplify risks to financial stability. These concerns are reinforced by relatively thin capital buffers and an overhang of past nonperforming loans in some banks.

**Figure I.16: Credit intensity**
*(% of GDP)*




*Source:* World Bank.

**Figure I.17: Credit provided by financial sector**
*(% of GDP)*




*Source:* World Bank.
*Note:* Credit provided by financial sector includes banks' lending and loans from other financial institutions, such as financial companies and insurance firms.

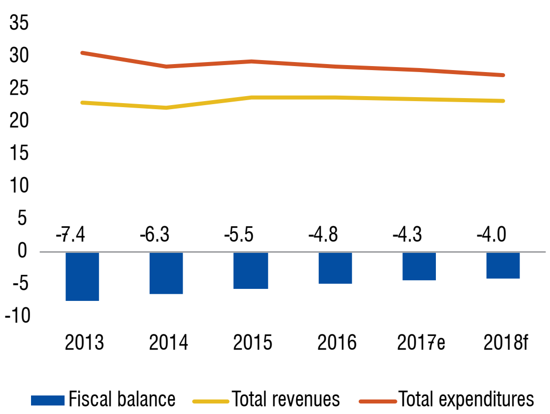
**11. The resolution of nonperforming loans (NPLs) has continued, particularly with recent progress in those managed by the Vietnam Asset Management Company (VAMC).** The share of NPLs in the banking system fell to a relatively low 2.1 percent in June 2018, from 2.5 percent at the beginning of 2017, as banks stepped up NPL resolution through debt collection and the sale of collateral with the application of Resolution 42. Using a broader measure of all NPLs on bank balance sheets to include those warehoused with the VAMC, combined with bank loans deemed at high risk of becoming NPLs in the near term, the government estimates NPLs at about 6.5 percent of all outstanding loans in mid-2018, down from 10 percent in December 2016.

## *Fiscal consolidation in progress*

**12. The reduction of the budget deficit helped contain public debt accumulation in the last two years.** With preliminary data through the third quarter, the 2018 budget deficit is projected at about 4 percent of GDP (figure I.18). Continued fiscal restraint and proceeds collected from SOE equitization helped contain public debt accumulation and ensured compliance with 65 percent of the GDP statutory debt limit (figure I.19). This follows a period during which Vietnam's total public debt had increased by nearly 13 percentage points of GDP from 50.8 percent in 2012 to an estimated 63.7 percent in 2016, approaching Vietnam's statutory limit of 65 percent of GDP.[6] However, lower fiscal deficits since 2017, as well as restrictions on public guarantees in 2017 and 2018, have helped Vietnam contain further increases in public debt and to stabilize the public debt-to-GDP ratio at about 61.5 percent since 2017.

**Figure I.18: Fiscal balance**

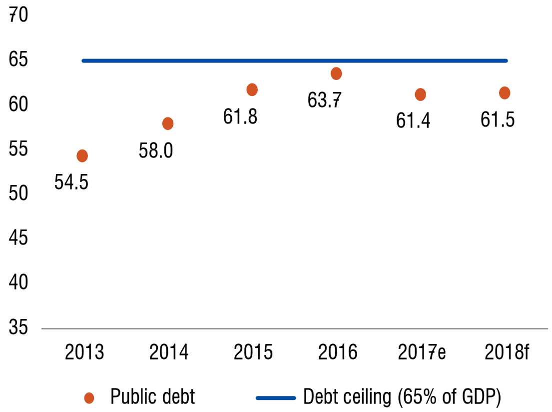
*(% of GDP)*




*Sources:* MOF, IMF, and World Bank.

**Figure I.19: Public debt**

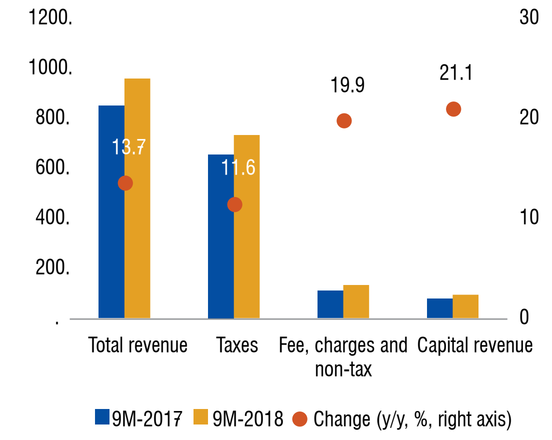
*(% of GDP)*




*Source:* MOF.

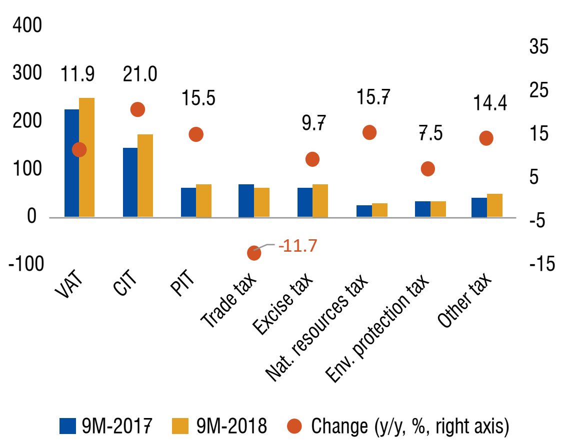
6 Public debt data from the Ministry of Finance of Vietnam.

**Figure I.20: State budget revenue**




*Source:* MOF.

**Figure I.21: Tax collection**




*Source:* MOF.

13. **Revenue performance improved in the first nine months of 2018.** Total nominal revenue growth in the first nine months of 2018 is estimated at 13.7 percent (y/y), reaching 73 percent of the annual plan (figure I.20). Among the strongest gains, the sub-category of oil revenues rose 42.5 percent (y/y), thanks to higher oil prices, slightly increasing the share of oil in total revenue from 4 percent in 9M-2017 to 5 percent in 9M-2018. Nominal tax collection also improved, expanding 11.6 percent, while capital revenue and non-tax sources rose by 21.1 and 19.9 percent, respectively, due to strong proceeds collected from equitization of state-owned enterprises.

14. **Buoyant tax collection, boosted by strong economic growth, helped stabilize revenue mobilization.** Nominal tax collection increased by about 11.6 percent in the first nine month of 2018, compared with the same period last year. Among key taxes, the value-added tax (VAT) and corporate income tax (CIT), which together contribute nearly half of total tax revenues, increased by 15.5 percent (figure I.21). This was largely driven by strong private consumption and overall economic activity. Natural resource revenues also accelerated thanks to a higher oil price. In contrast, trade tax collection fell sharply by 11.7 percent, mainly due to import tariff cuts associated with Vietnam's implementation of commitments under various FTAs and a slowdown in imports.

15. **Public expenditure growth moderated, while growth in public investment recovered in 2018.** During the first nine months, total expenditures increased in nominal terms by 9.8 percent, with recurrent and investment spending increasing by 7 percent and 25 percent, respectively (figure I.22). Despite an improvement in the last two quarters through Q3-2018, public investment just reached about half of the annual target, and the share of investment spending in total expenditure remained subdued, having declined to 21 percent of total spending in the first nine months of 2018, compared with an average of 25 percent during 2013–17. Recurrent expenditures, including administration, wages and salaries, social security, pensions, and other public services remained elevated at 71 percent of total spending (figure I.23).

**Figure I.22: Budget expenditure**
*(billion dong)*

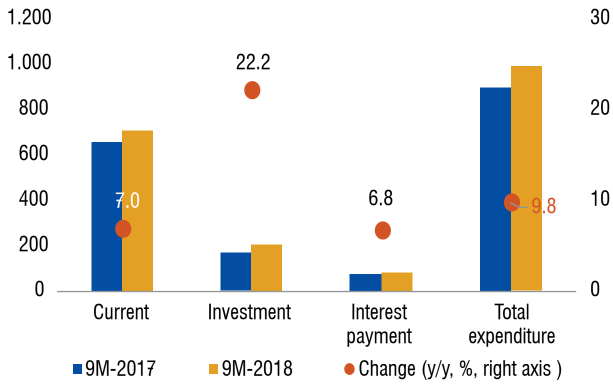
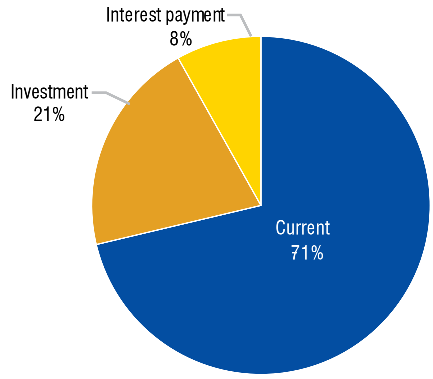
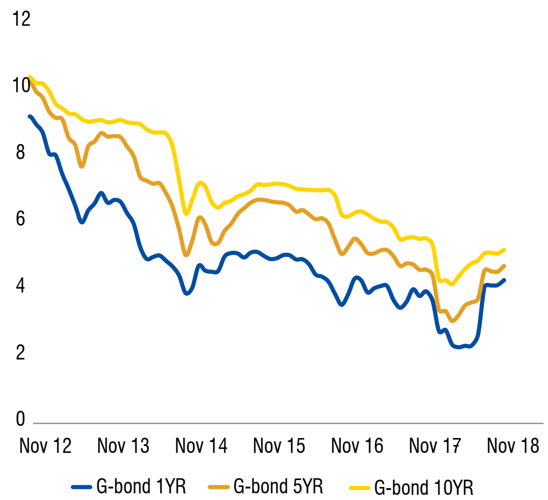



**Figure I.23: Composition of expenditures**
*(% of total)*




*Source:* MOF.

**Figure I.24: Government bond yield**
*(monthly average, %)*




*Source:* MOF.

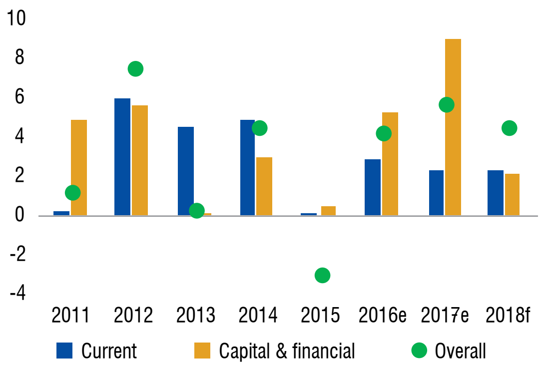
**16. Despite the recent pickup in government bond yields, they remain relatively low, and domestic borrowing continues to be the main source for financing the fiscal deficit.** Tighter liquidity conditions in the banking sector led to a sharp increase in government bond yields, especially at the short end of the yield curve (figure I.24). Nevertheless, the government continued to rely on the domestic market to meet its financing needs. As of Q3-2018, domestic borrowing has accounted for three-quarters of the financing needs of the government. The recent upturn in government bond yields notwithstanding, the government has taken advantage of increasingly favorable financing conditions over the past five years in the domestic market to enhance its debt portfolio. According to government reports, the average maturity of domestic government bonds increased from only 3.2 years in 2011 to about 6.7 years in the first nine months of 2018. Over the same period, the average borrowing interest rate fell from 12 percent to 4.5 percent, which has helped contain the increase in the interest burden despite the shift away from concessional financing.

**17. Looking ahead, the Government of Vietnam has reinforced its commitment to continue fiscal consolidation.** The government is seeking to strengthen fiscal discipline by improving tax administration and broadening the tax base. Efforts are also underway to rein in growth of recurrent spending, and to further tighten controls over new public investment projects. However, fiscal consolidation measures should be calibrated to safeguard resources for key development objectives to sustain potential growth in the longer term.

## *Strengthening external position, despite uncertain global trade developments*

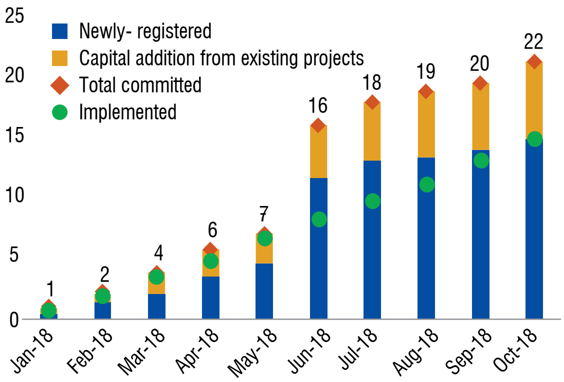
**18. Vietnam's external position strengthened, underpinned by a current account surplus and robust FDI inflows.** Vietnam's merchandise trade balance recorded a widening surplus of nearly US$7.2 billion in the first 10 months of 2018, with a slowdown in import growth more than offsetting a deceleration in exports. The capital account surplus also remains sizable due to sustained FDI inflows (figure I.25). As of October 20, a sum of about US$22 billion of FDI (newly committed and capital expansion from existing projects). In addition, foreign investors also invested US$6.3 billion in equity and capital in Vietnamese firms. During the same time, FDI disbursement amounted to US$15 billion—a 6.3 percent increase (figure I.26). The improved balance of payments allowed the SBV to shore up foreign reserves to the equivalent of about 3.1 months of import cover by the end of Q2-2018 from 2.8 months in December 2017. However, despite external surpluses, some exchange rate pressures emerged in the second half of the year, triggered by the volatile currency markets across Asia and a rise in internal flight to 'safe-haven' assets (to US-dollars and gold).

**Figure I.25: Balance of payments**
*(% of GDP)*




*Sources:* SBV, IMF, and World Bank.

**Figure I.26: FDI to Vietnam in 2018**
*(US$ billion, accumulated)*

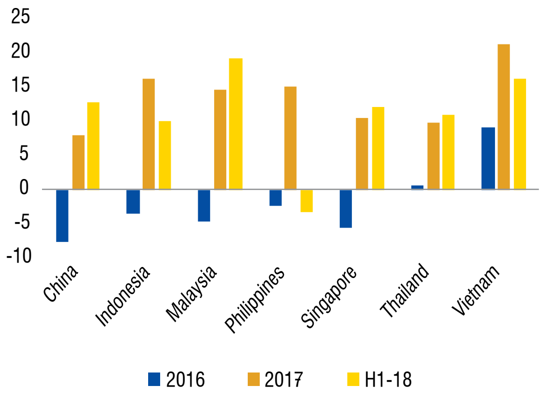



*Source:* MPI.

**19. Export growth remained strong during the first ten months of 2018, despite uncertain global trade developments.** Vietnam's total exports are estimated to have expanded by 15.2 percent (y/y) in the first ten months of 2018, mainly reflecting favorable conditions in Vietnam's major export markets. While this is a slowdown from the 21.9 percent growth over the same period of 2017, Vietnam's export growth continues to outperform many peer countries in the region. This has contributed to the rise in Vietnam's share of total ASEAN-6 merchandise exports by nearly 2.5 percentage points, from 14.2 percent in 2015 to 16.7 percent in June 2018 (figure I.28).[7]

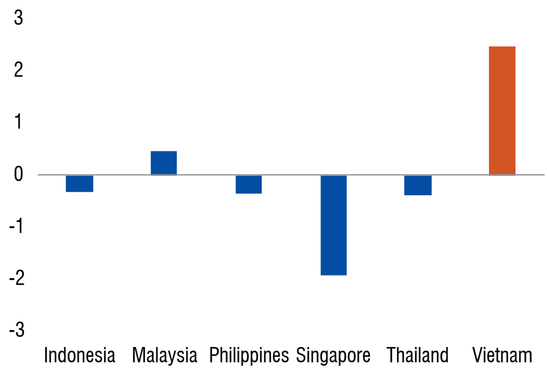
7 The ASEAN-6 countries are Indonesia, Malaysia, Philippines, Singapore, Thailand and Vietnam.

Figure I.27: Merchandise exports in EAP
*(current US$, growth in %)*




*Source:* World Bank.

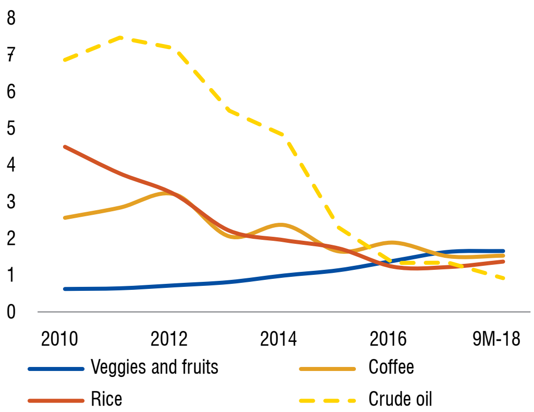
Figure I.28: Export share in ASEAN-6
*(percentage point change, 2015 to June 2018)*




*Source:* World Bank.

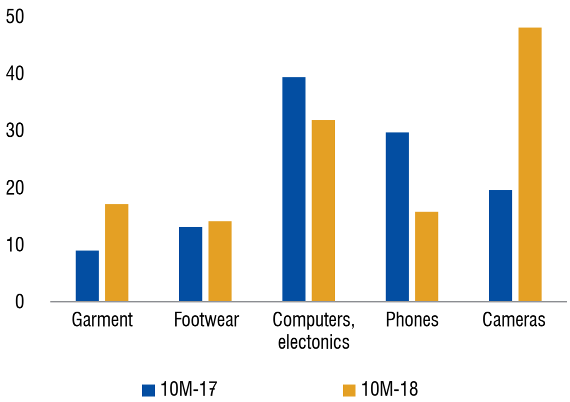
**20. While growth of total merchandise exports eased somewhat in 2018 compared with 2017, growth remained strong across most export categories.** Agricultural commodities posted strong gains, with rice exports up by 16.3 percent in value terms and 3.5 percent in volume terms in the first 10 months of 2018 (figure I.29). Exports of vegetable and fruit increased by 14 percent to nearly US$3.3 billion over the same period, bypassing export earnings of Vietnam's traditional commodities, such as crude oil (US$1.8 billion), rice (US$2.6 billion), and coffee (US$3 billion). Concurrently, key labor-intensive manufacturing exports, such as garments, footwear, phones, cameras, and computers continued to grow at a healthy pace, thanks to favorable conditions in Vietnam's key trading partners (figure I.30)[8]. Notwithstanding, a decline in Vietnam's oil production has compressed its oil exports, which contracted by 45 percent in volume terms and 23 percent in value terms in the first ten months of 2018, continuing a secular decline evident since 2012.

Figure I.29: Export value of key commodities
*(% of total merchandise exports)*




*Source:* Vietnam Customs Office.

Figure I.30: Exports of key manufactured goods
*(growth in %)*

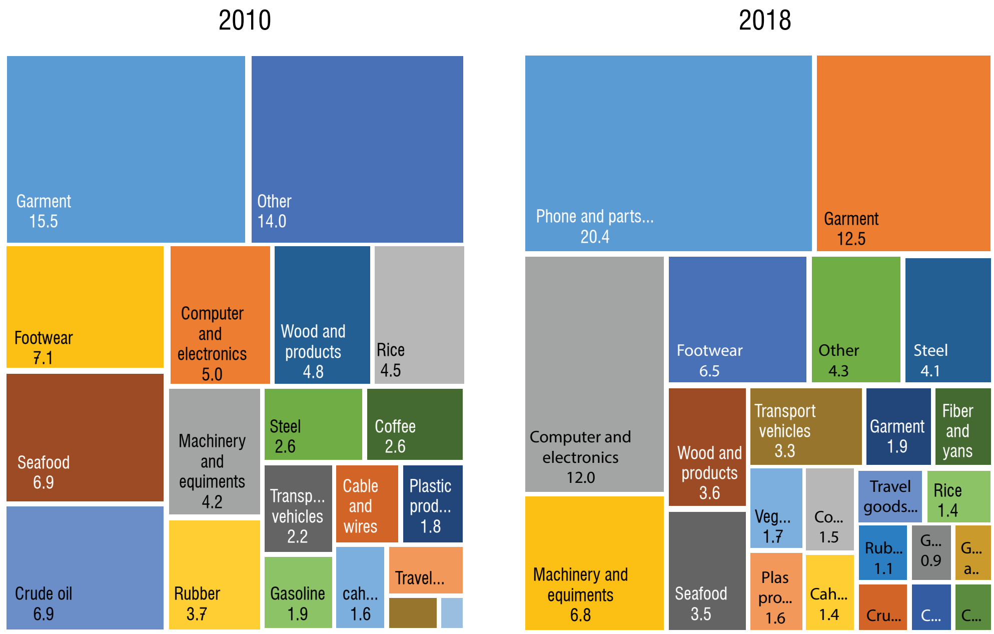



8 Export-turnover-growth for phones and phone parts has reached an average of about 40 percent in 2012-17. However, the growth rate has moderated in 2018 because of stalled demand.

21. **Vietnam's exports are becoming more sophisticated.** Vietnam's strong export performance is underpinned by impressive diversification of its export basket in the last eight years (figure I.31). Manufacturing exports now account for around 85 percent of total exports, up from 65 percent in 2010, driven by dynamic growth in the export-oriented foreign sector. Higher-value manufacturing exports, such as phones, computers, camera, and electronics and related components have increased from a 5 percent share in 2010 to an estimated 35 percent in 2018. By the same token, the share of primary commodities has steadily fallen, with oil exports down from nearly 7 percent of total exports in 2010 to around 1.3 percent in October 2018. However, Vietnam suffers from underdeveloped supply chains, heavy reliance on imports of raw materials, and lack of supporting industries, which need to be addressed in order to enhance value added and sustain export competitiveness as wages inevitably rise.

**Figure I.31: Vietnam export composition**

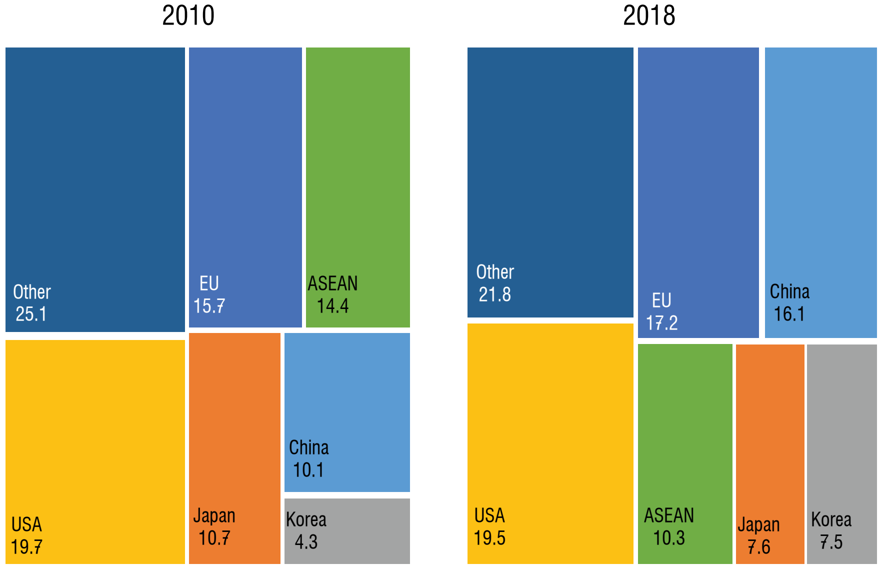
*(% of total)*




*Source:* Vietnam Customs Office.

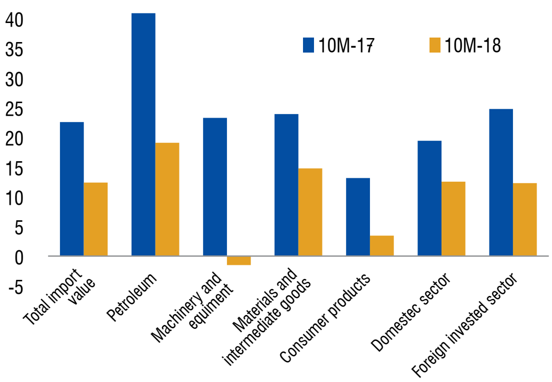
22. **Vietnam has also successfully maintained diversified market destinations for its exports.** Among its trading partners, the United States remains Vietnam's largest, accounting for 19.5 percent of Vietnam's total exports. This is followed by the European Union (EU), the Association of Southeast Asian Nations (ASEAN), China, Japan, and the Republic of Korea. Trade between Vietnam and the United States has remained largely unaffected by recent trade policies. Vietnam's exports to the United States rose 14 percent from January through October in 2018 compared with the same period last year, while Vietnam's imports from the United States surged 40.4 percent, led by agricultural products, such as soybean, wheat, cotton, animal feed, as well as computers, machinery, and equipment, etc., and comprised 5.5 percent of Vietnam's total import turnover. Having diversified export markets has helped Vietnam to sustain export gains and to mitigate economic risks from external economic fluctuations. Vietnam has already signed numerous free trade agreements, with two more major trade pacts on track to come into effect in the near future, the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) and the EU-Vietnam Free Trade Agreement (EVFTA). These new agreements will give Vietnam the opportunity to increase its market access for its exports and new sources of foreign investment.

**Figure I.32: Vietnam exports by destination**
*(% of total)*




*Source:* Vietnam Customs Office.

**Figure I.33: Vietnam merchandise imports**
*(growth in %)*




*Source:* Vietnam Customs Office.

**23. Import growth moderated significantly in the first 10 months of 2018.** In value terms, imports expanded by about 12.4 percent during the first 10 months of the year, compared with 22.6 percent during the same period last year (figure I.33). This deceleration is mostly related to declining imports of machinery and equipment, and to slowing demand for material and intermediate goods for export processing. After surging in the last three years, imports of machinery and equipment by foreign- invested firms declined by 7 percent in the first nine months of 2018, reflecting volatility in the investment cycle. However, imports of machinery and equipment by domestic firms increased by 1.2 percent, reflecting the completion phase of major public and domestic investment projects. Imports of fuel declined by 5.5 percent in volume which was compensated by a rise in domestic production to meet domestic demand. Imports of completed automobile decreased 30 percent in value terms, largely reflecting a cut in tariffs from ASEAN countries.

**24. The United States and China are among the most important markets for Vietnam's exports and imports.** While the U.S. market is the largest market for Vietnam's exports, China is the largest source of Vietnam's imports. As of October 2018, the United States and China together account for 36 percent of Vietnam's export earnings, and nearly a third of Vietnam's import bill. Vietnam has a substantial trade surplus with the United States, which reached nearly US$29 billion during the first 10 months of 2018, but has a correspondingly large deficit with China equivalent to almost US$20 billion (figures I.34 and I.35). Vietnam's key exports to the U.S. market are mainly consumer goods, such as garments, footwear, phones, furniture, and seafood (figure I.36). By contrast, Vietnam is part of China's supply chain and exports either raw materials or intermediate inputs for China's production. China is also an important market for Vietnam's agricultural exports, such as vegetables and fruits, rice, seafood, and cassava (figure I.37). Key imports from China are also linked to global supply chains, and include machinery and equipment, fabrics for garments and accessories for footwear, phones and computer parts, and consumer goods.

**Figure I.34: Vietnam-U.S. trade**
*(US$ billion)*

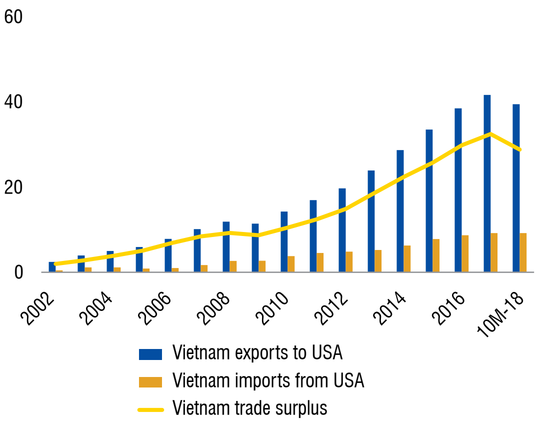



**Figure I.35: Vietnam-China trade**
*(US$ billion)*


**Figure I.36: Vietnam's key exports to the United States**
*(% of total)*

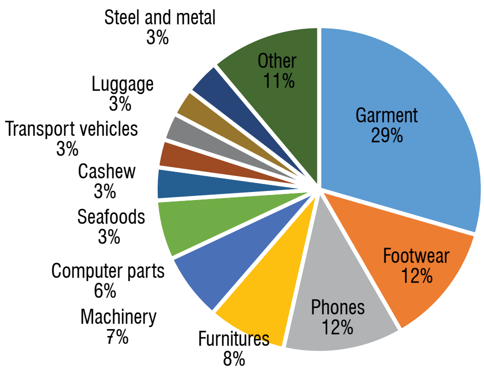
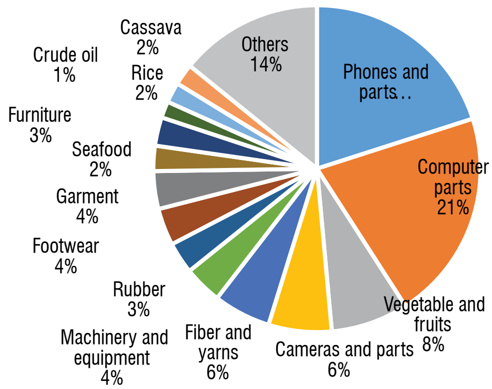



**Figure I.37: Vietnam's key exports to China**
*(% of total)*



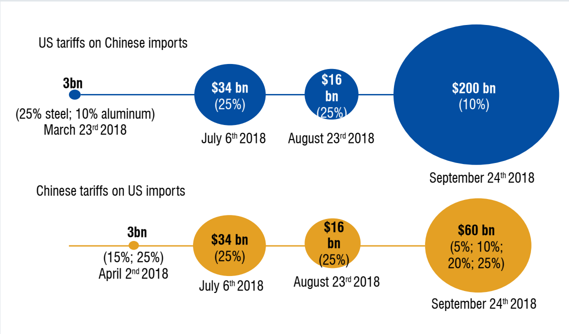

*Source:* Vietnam Customs Office.

**25. Escalating trade tensions could bring both opportunities and challenges for Vietnam.** On the one hand, Vietnam could serve as an alternative supplier of several commodities to the U.S. market for China. Among the ASEAN countries, Vietnam is also considered as a new host country for investors to move their stakes from China. On the other hand, if the demand for Chinese products falls, Vietnam's exports to China would be hit, because Vietnam is a part of China's supply chain. Furthermore, Chinese goods might flood Vietnam, which would hurt local manufacturing (box I.2).

## Box I.2: The U.S.-China trade tension

After months of threats, the United States has unleashed a trade offensive against major trading partners, especially China and other economies with which its bilateral trade is in deficit. This offensive has taken the forms of trade protection through increased import tariffs, as shown in figure I.38, and renegotiations of, or exit from, existing or negotiated trade agreements. The U.S. protection inevitably led to retaliation by several trading partners. While negotiations between the United States and major trading partners are underway, uncertainty remains high and there are risks of further escalation of the dispute.

### Figure I.38: The U.S.-China trade tension timeline




*Source:* World Bank.

Escalating protectionism could impact the world economy and Vietnam in various ways. Rising tariffs and associated increases in the cost of inputs and final products are expected to dampen global trade flows and global GDP. These direct effects of current tariffs are expected to be relatively small, given their limited scope. However, ensuing uncertainty related to the global trade and investment environment could lead to broader impacts, including capital outflows from emerging markets, deeper disruptions of global supply chains, and dampened prospects of foreign direct investment. As one of the most open economies in the World, Vietnam is not insulated from these impacts. While Vietnam has not been the target of direct trade measures by the United States (except for the aluminum and steel tariffs), and may in the short run benefit from trade diversion from both China and the United States, it is exposed to a potential escalation of trade disputes through indirect effects, including dampened external demand and cross-border investment flows.

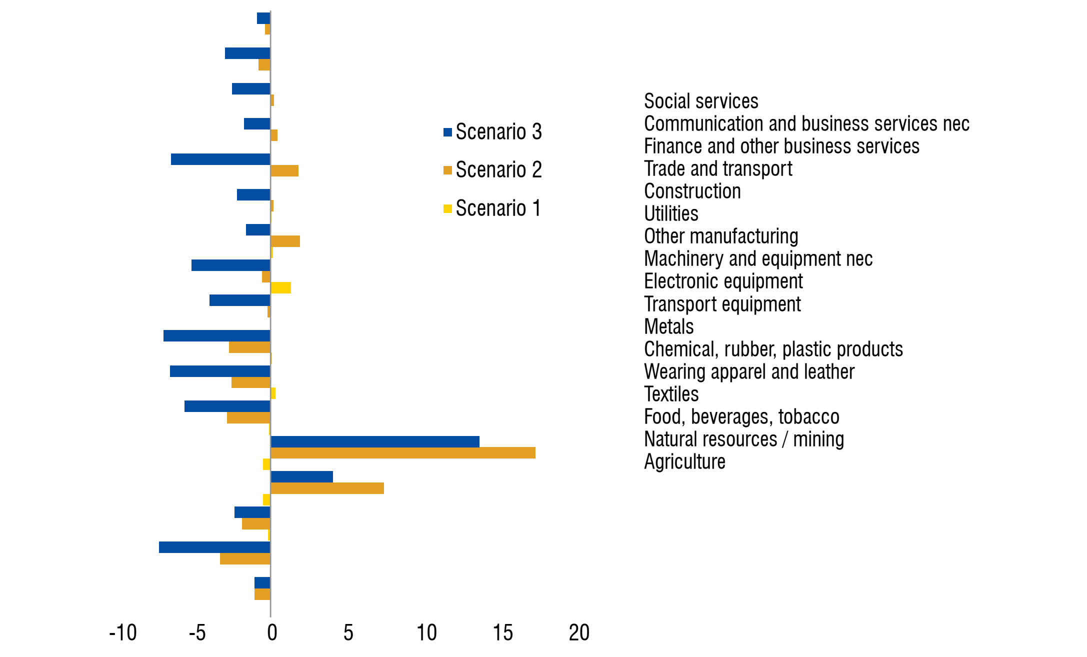
Vietnam, for which both the United States and China are major trading partners, is expected to incur nontrivial but manageable impacts. China is the largest import source, while the United States is the largest and most important market for Vietnam's exports. On the one hand, trade diversion could lead to Vietnamese exports replacing some Chinese exports to the United States, now subject to higher import tariffs, as well as some U.S. exports to China being affected by China's retaliatory tariffs. On the other hand, Vietnam is likely to be negatively impacted by a slowdown in global growth and trade and loss of investor confidence. Impact simulations suggest that the adverse impacts through uncertainty and investments would most likely outweigh benefits from trade diversion, resulting in a GDP decline of up to 0.6 percent. In addition, there is a risk that Vietnam could also face trade disputes, given its structural trade surplus with the United States.

On the other hand, Vietnam may be negatively impacted by dampened global demand and lower investor confidence. Heightened trade tensions may weigh on the global recovery and dampen global demand. In value-added terms, China and the United States alone account for final demand equal to 8 percent and 4 percent of Vietnam's GDP, respectively, so any major slowdown in these economies would spill over to Vietnam. In addition, uncertainty about the U.S. policy stance and risk of escalation of protectionist measures (both in product and regional scope) could induce investors to delay offshore investments or even induce them to restore production to the United States (which is one of the stated objectives of the current U.S. trade policy). While Vietnam is not directly subject to protectionist measures, the general uncertainty could spill over and weigh on investment flows, especially if disputes persist over the medium term.

Producers in Vietnam could also face increasing competition in the domestic market, as Chinese goods seek alternative destinations. The competitive shock is likely to fall most heavily on those countries that already source a relatively large share of their imports from China, and that have an export structure similar to China (Indonesia, Malaysia, the Philippines, Thailand, and Vietnam) (Bastos 2018). Greater competition pressures from China in domestic markets may impose adjustment costs within countries, particularly to the extent that greater import competition displaces workers in some industries. These competitive pressures could be magnified to the extent that the Chinese yuan depreciates vis-à-vis other EAP currencies. Nevertheless, there are important benefits to the domestic economy from increased competition and include lower prices and greater product varieties for consumers and producers, and efficiency gains due to further specialization in different varieties or stages of production.

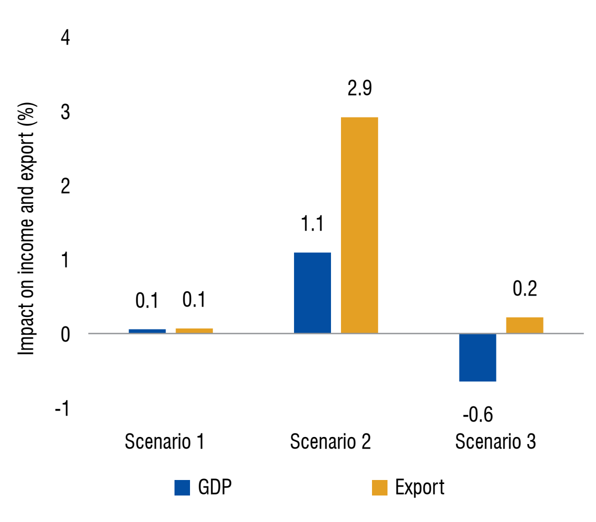
On balance, impact simulations suggest that adverse impacts through uncertainty and the investment channel could outweigh benefits from trade diversion. Figure I.39 illustrates the potential impacts of the trade war on Vietnam's income and exports, using the same computable general equilibrium (CGE) model and scenarios as presented above. Due to trade diversion effects, Vietnam would benefit in terms of higher exports and income growth under both Scenarios 1 and 2. Under Scenario 1 (25 percent tariff on current product list), the impacts are relatively marginal, reflecting the limited scope of the current measures. If this tariff was expanded to all bilateral trade between the United States and China (Scenario 2), impacts on overall GDP and exports would be significant, with Vietnam replacing a substantial part of the trade flows between China and the United States. Scenario 3 shows adverse impacts resulting from dampened investor confidence that could outweigh potential trade diversion gains.

**Figure I.39: Impact on Vietnam's output by sector**




Source: Freund C., Maliszewska M., Ruta, M., 2018.

**Figure I.40: Impact on Vietnam's income and exports**




*Source:* Freund C., Maliszewska M., Ruta, M., 2018.

At the sectoral level, impacts depend on the scope of protectionist measures, as shown in figure I.40. The main beneficiaries are sectors that are subject to U.S.-Chinese import tariffs. In Scenario 1, most benefits are concentrated in electronics, which are subject to U.S. import tariffs, and where Vietnam already has strong export competitiveness. Under Scenarios 2 and 3 (which assume a 25 percent tariff on all bilateral trade), trade diversion benefits would be concentrated in the textile/garments sector due to preferential market access for final products to the United States, while many other sectors would be negatively affected due to reduced demand for intermediary and final products. Under Scenario 3, adverse impacts are compounded by the drag on global investment activity, with capital and intermediate goods suffering the most, including natural resources, chemicals, rubber and plastics, metals, transport equipment, machinery and equipment, and construction.

While bilateral trade flows between Vietnam and the United States have not been the target of specific tariffs, there are risks concerning safeguard measures applied by the United States to Vietnam's exports to contain the U.S. trade deficit with Vietnam. Vietnam is among the list of 16 countries that are under investigation by the U.S. Department of Commerce, because of its bilateral trade surplus with the United States. As such, Vietnam has already become the subject of several safeguard measures applied by the United States. During January 2017 to March 2018, the United States initiated 104 trade protection investigations concerning anti-dumping, countervailing, tax avoidance, and safeguard measures—a 100 percent year-on-year increase in investigations. To date, the United States has implemented 428 anti-dumping and countervailing measures. In 2017 alone, for the first time after 25 years, the U.S. Department of Commerce initiated an anti-dumping and countervailing/anti-subsidy investigation without receiving any legal filing from firms representing the concerned domestic industries. One example is the recent introduction of measures imposed on cold rolled steel and flat rolled steel from Vietnam. It is likely that the U.S. administration will monitor the possible diversion of production or trade from China to neighboring countries (such as Vietnam) to circumvent anti-dumping tax and countervailing duties. To mitigate such risks, Vietnam will need to put in place an effective monitoring mechanism and relevant measures to avoid such impacts.

**Policy implications**

The current uncertainties regarding the global and investment environment suggest the need to reinforce several policy directions. Many of these policy measures would be beneficial to Vietnam regardless of whether the trade war continues or escalates.

*First, strengthening macroeconomic resilience.* The uncertainty regarding the global trade environment exacerbates general global risks. As an open and globally integrated economy, Vietnam needs to have a macroeconomic policy framework that is resilient and capable of withstanding shocks, including those emanating from global trade disruptions. Maintaining responsive monetary policy and exchange rate flexibility are particularly important as immediate buffers to manage external trade and financial volatility.

*Second, enhancing competitiveness.* Policies that strengthen trade facilitation will be vital to boost exports and enhance Vietnam's export competitiveness, given that Vietnam is not the only country targeting the U.S. and China markets. A detailed report (Pham et al. 2013) identified key ingredients for successful trade facilitation such as a sound policy and institutional framework, strengthened infrastructure and transport services, simplified regulatory procedures, and major efforts to capture greater value added from supply chains. In addition, targeted trade finance, technical support, market intelligence, and other export services are needed to boost Vietnam's exports. FDI promotion should aim to facilitate investor entry and their retention, including through simplified entry requirements for investors, transparent processes, guarantees against expropriation, and prevention of profit repatriation. At the same time, further efforts are needed to boost the participation of domestic private sector enterprises in global and regional value chains.

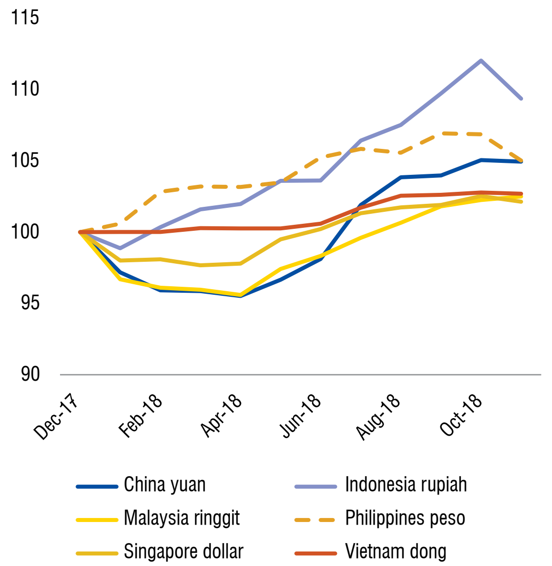
*Third, preemptively addressing potential distortions to trade.* Some of the U.S. policy measures are rooted in concerns about non-tariff distortions that are seen as tilting the global trade playing field against U.S. companies. These include concerns about the protection of intellectual property rights, market access in service sectors, public procurement practices, and various non-tariff barriers as well as subsidies, especially to state-owned enterprises. As part of recent trade agreements, including the CPTPP and EVFTA, Vietnam has already committed to addressing many of these potential distortions. Swift and consistent implementation of these commitments would not only enhance Vietnam's overall competitiveness but also address potential concerns by the United States and other trading partners and reduce the risk of safeguards (including anti-dumping, countervailing/anti-subsidy, and tax probes), and other measures being imposed on Vietnam. Establishing an effective mechanism of traceability on origins of goods and disclosing transparently to trading partners would also be crucial to reducing the risks of becoming the focus of safeguard measures.

*Fourth, fostering regional integration.* Uncertainty concerning the U.S. trade policy stance reinforces the importance of pursuing regional integration. The trade war has ironically given impetus to this integration. The conditions needed to finally complete implementation of the ASEAN Economic Community may finally be met, while China's push to launch the Regional Comprehensive Economic Partnership (RCEP) will likely be accelerated. With respect to the RCEP, China is likely to promote its negotiation, for which Vietnam should carefully review and adopt a strategy for early agreement, as China's reliance on RCEP countries is likely to increase. Beyond these agreements, the CPTPP should also be ratified and implemented. Vietnam should also focus on implementation of the Vietnam-EU Free Trade Agreement, the largest free-trade agreement in terms of economic and domestic reform impacts.

**26. Heightened global financial volatility spilled over into domestic markets in the second half of 2018.** Responding to high volatility in international currency markets, the SBV allows dong to depreciate graduallly. Vietnam continues to operate a crawling peg system, with the exchange rate as the main nominal policy anchor. Pressure on the currency had been building since early June 2018, tied to rising global trade tensions and weakening currencies across Asia. These pressures have been exacerbated by the depreciation of the Chinese yuan in mid-June. Reluctant to raise interest rates, the SBV responded by letting dong depreciate gradually with some intervention in the foreign exchange market. Year to date, the dong has depreciated by about 2.7 percent against the U.S. dollar in nominal terms (figure I.41). However, due to the limited nominal depreciation of the dong (relative to the depreciation of the currencies of key trade partners) the real effective exchange rate of the dong has continued to appreciate, and has risen by about 2.5 percent since the beginning of 2018, and may over time erode Vietnam's export competitiveness (figure I.42).

**Figure I.41: Nominal exchange rate**

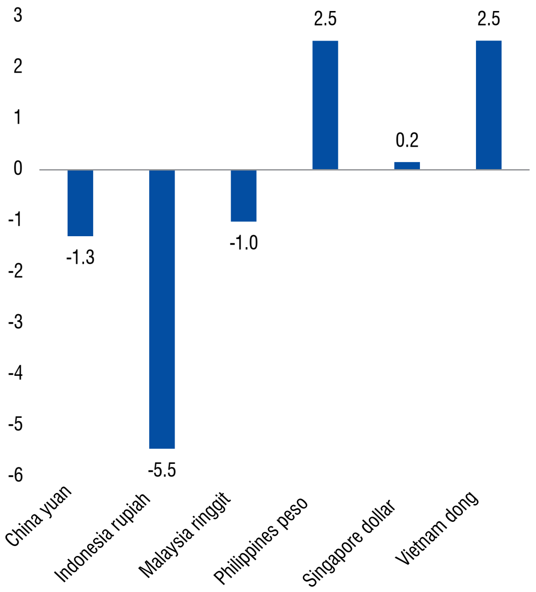
*(Dec 2017 = 100)*




*Source:* World Bank.

**Figure I.42: Real effective exchange rate**

*(year-to-date change in %)*




*Source:* World Bank.

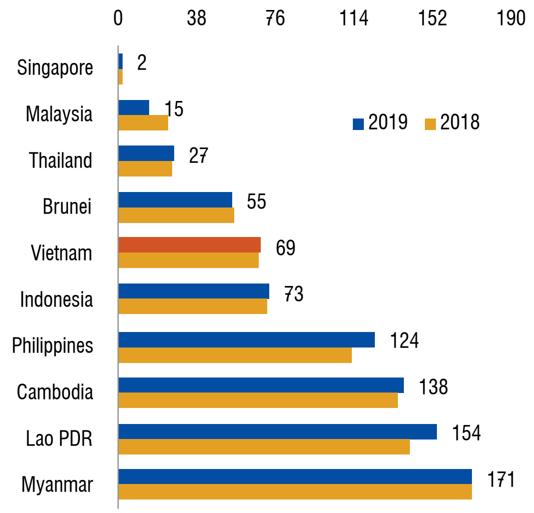
## *Stepped-up efforts are needed to enhance Vietnam's business environment*

**27. Despite progress in improving the business environment, Vietnam's ranking in Ease of Doing Business 2019 slipped to 69th out of 190 economies, down from 68th in last year's report** (figure I.43). This reflects the need to keep pace with reform progress in other countries to maintain competitiveness. Following the adoption of a series of Resolution 19 since 2014, several aspects of the business environment have been improved to facilitate private sector investment, economic growth, and job creation. While Vietnam's ranking relative to other economies dropped slightly, it continued to see absolute improvements in several areas, including ratings for the categories of Starting a Business, Access to Electricity, and Enforcing Contracts (figure I.44). The Doing Business Report 2019 highlights specific reforms in the following areas for Vietnam:

- *Starting a business:* Vietnam made starting a business easier by publishing the notice of incorporation online and by reducing the cost of business registration.

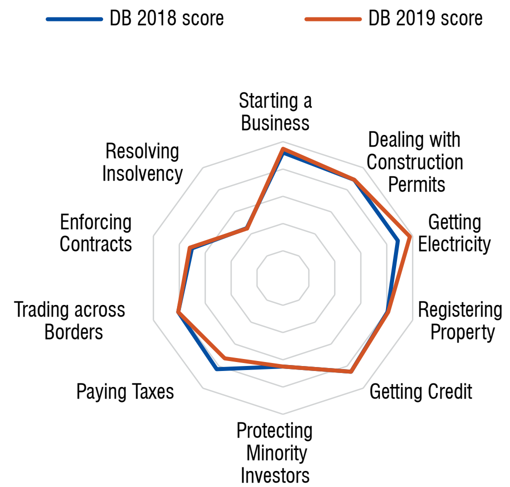
- *Paying taxes:* Vietnam made paying taxes easier by no longer requiring hard copy submission of the value-added tax return and allowing joint payment of the business license tax and value-added tax. Vietnam also made paying taxes less costly by reducing the employer's contribution to the labor fund from 1 percent to 0.5 percent.
- *Enforcing contracts:* Vietnam made enforcing contracts easier by making judgments rendered at all levels in commercial cases available to the public online.

**Figure I.43: Ease of Doing Business rank**



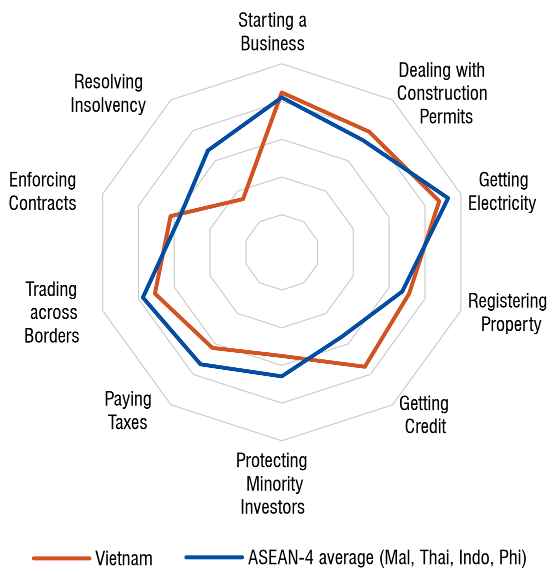

*Source:* Doing Business 2019.

**Figure I.44: Vietnam – Change in score**




*Source:* Doing Business 2019.

**Figure I.45: Vietnam compared to the ASEAN-4**




*Source:* Doing Business 2019.

28. **Some dimensions of the business environment in Vietnam still lag in performance relative to other countries.** Vietnam is rated among the top five performers in ASEAN, but it continues to score below Singapore (2nd), Malaysia (15th), Thailand (27th), and Brunei (55th). Benchmark scores where Vietnam continues to be below the ASEAN-4 (Indonesia, Malaysia, the Philippines and Thailand) include Resolving Insolvency, Paying Taxes, and Trading Across Borders (figure I.45). Continuing reforms to improve regulatory quality and cut red tape remains an important priority. In addition to improving regulations on paper, it is crucial to ensure consistent, efficient, and fair enforcement. The government on November 9, 2018, issued Resolution 139/NQ-CP to set a target of cutting or simplifying at least half of business conditions and requirements in the areas of investment, land, construction, tax payment, and social insurance, for Vietnam to reach an Ease of Doing Business score equal to the average score of the ASEAN-4 countries by 2020.

## MEDIUM-TERM ECONOMIC OUTLOOK, RISKS, AND POLICY IMPLICATIONS

**29. Vietnam's economy is expected to grow at close to 6.8 percent in 2018, before decelerating slightly in 2019 and 2020 to 6.6 percent and 6.5 percent, respectively.** Growth continues to be underpinned by robust domestic demand, reflecting strong private consumption and investment growth. Inflation is expected to increase slightly during the last quarter of the year, tied to fuel price increases, adverse impacts of unfavorable weather on food prices, and year-end seasonal factors, with annual inflation ending the year at around 4 percent. The current account is expected to remain in surplus, largely due to an improved trade balance. In the longer term, the current account surplus is projected to have moderated, with slowing exports and rising income transfers associated with the repatriation of profits by FDI enterprises. The fiscal deficit is projected to narrow gradually to about 4 percent of GDP in 2018, which would further reduce the public debt-to-GDP ratio. Over the medium term, the fiscal account is expected to hold steady at 4 percent as a share of GDP, in line with government commitments (table I.2).

**Table I.2: Vietnam key short-term indicators**

| | 2015 | 2016 | 2017e | 2018f | 2019f | 2020f |
|---|---|---|---|---|---|---|
| GDP growth (%) | 6.7 | 6.2 | 6.8 | 6.8 | 6.6 | 6.5 |
| Consumer price index (annual average, %) | 0.6 | 2.7 | 3.5 | 4.0 | 4.0 | 4.0 |
| Current account balance (% of GDP) | 0.1 | 2.9 | 2.2 | 2.2 | 2.1 | 1.9 |
| Fiscal balance (% of GDP) | -5.5 | -4.8 | -4.3 | -4.0 | -4.0 | -4.0 |
| Public and PG debt (% GDP, MOF) | 61.8 | 63.7 | 61.4 | 61.5 | 61.5 | 61.4 |

*Sources:* GSO, MOF, SBV, and World Bank.

**30. This medium-term outlook is subject to a number of risks.** Despite improved short-term prospects, there are significant downside risks. Domestically, a slowdown in the restructuring of the state-owned enterprise (SOE) and banking sectors could adversely impact the macro-financial situation, undermine growth prospects, and create large public sector liabilities. A sudden tightening of liquidity could cause a credit crunch and higher interest rates that could distort bank and corporate balance sheets. Further fiscal consolidation through the continued contraction of public investment could undermine long-term development objectives. Vietnam's economy also remains susceptible to further volatile developments in the global economy, given its high trade openness and relatively limited fiscal and monetary policy buffers. External risks include escalating trade protectionism, heightened global and regional geopolitical uncertainty, and continued tightening of global financing conditions that could lead to disorderly financial market movements.

**31. Pursuing greater macroeconomic resilience and enhanced competitiveness would support long-term growth prospects.** Policy makers should take advantage of the still favorable growth dynamics to advance structural reforms, including for the SOE sector and the banking sector, along with improving efficiency in public sector investment, which would boost productivity and potential output and support strengthened service delivery. As an open economy, Vietnam needs to maintain a responsive monetary policy, exchange rate flexibility, fiscal consolidation, and moderate credit expansion to strengthen the macroeconomic-policy framework and enhance resilience. Continued implementation of policies to improve efficiency in public debt management would generate cost savings, which would support the country's transition toward its growing reliance on market-based financing, and could become increasingly important in the context of rising global interest rates. Policies that strengthen trade facilitation would enhance Vietnam's export competitiveness, which, along with stepping-up the pace of reforms to support the business enabling environment, would further bolster investment activity, including from foreign investors.

# PART II

## FACILITATING TRADE BY STREAMLINING AND IMPROVING THE TRANSPARENCY OF NON-TARIFF MEASURES

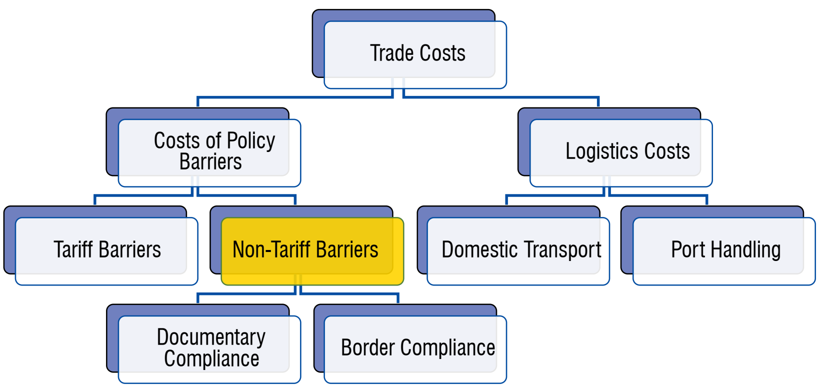
## BACKGROUND

*While tariffs have been decreasing along with the process of international economic integration, the number of non-tariff measures (NTMs) has increased rapidly in Vietnam. NTMs are defined as policy measures often used to substitute tariffs that can potentially have an economic effect on international trade in goods, changing quantities traded, and/or prices. Although principally designed to achieve specific regulatory objectives, such as food safety or consumer protection, they can be used to substitute tariffs in protecting domestic producers and consumers. When NTMs are not well designed and implemented, they often increase the cost of doing business, reduce transparency, and erode national competitiveness. This note provides an overall assessment and recommendations for simplifying and improving transparency of NTMs in Vietnam to support its competitiveness.*

**1. Lowering trade costs is critical to boosting exports, improving competitiveness, and enhancing integration in global value chains.** In the last two-and-a-half decades, under the effects of multilateral and bilateral free trade agreements (FTAs) signed and implemented by Vietnam, tariffs on international trade have been reduced. This has contributed to significantly reducing trade costs, and has substantially boosted international trade, making Vietnam one of the most open economies in the world. However, with lower tariffs, the room for continued tariff reduction is narrowing, so in the future, further reductions in trade costs can only be achieved by reducing costs of non-tariff measures and logistics costs. The structure of trade costs as shown in figure II.1 has been analyzed in the special topic note on "Reform Priorities for Reducing Costs and Enhancing Competitiveness in Vietnam," issued as part of the June 2018 Taking Stock report.

**2. In practice, NTMs are often used as government policy instruments, in place of tariffs, aimed at protecting domestic production.** However, they are World Trade Organization (WTO)-compliant when they are designed to address market failures and respond to appropriate needs for domestic producer and consumer protection, for example, to ensure that products placed on the market are safe. Figure II.1 shows that the costs associated with NTMs are part of the cost of policy barriers in the overall structure of trade costs.

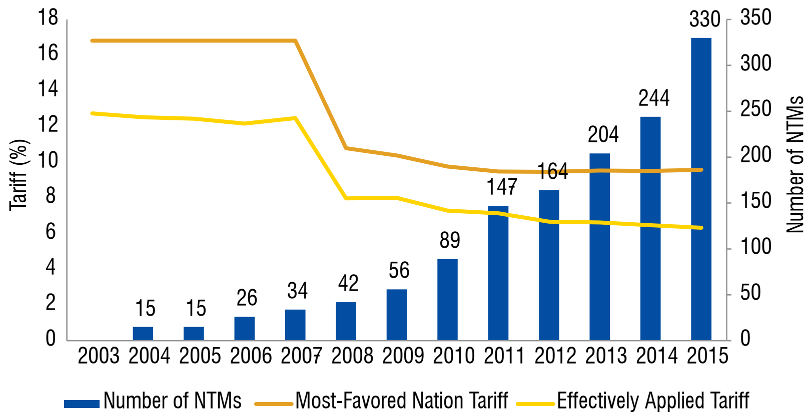
**Figure II.1: Trade costs structure**




*Source:* Taking Stock, Trade Information Portal, World Bank, June 2018.

**3. Global trends and practices in Vietnam show that, while tariffs are rapidly declining, the number of NTMs is increasing.** Figure II.2 shows that, under the effect of Vietnam's implementation of a number of regional FTAs, average tariffs, both in terms of most-favored nation tariffs and preferential tariffs (effectively applied tariffs), applicable to all commodities have been declining. Vietnam's average preferential tariffs have fallen from 13.11 percent in 2003 to 6.33 percent in 2015. Meanwhile, the number of NTMs has increased rapidly from 15 measures in 2004 to 330 in 2015, according to the ASEAN-ERIA-UNCTAD database[9].

**Figure II.2: Trend of tariff and non-tariff measures in Vietnam, 2003–15**



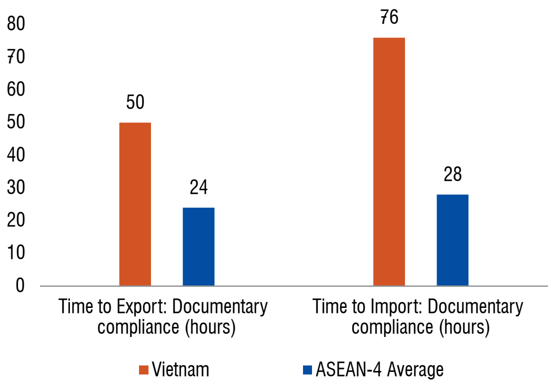

*Sources:* WITS and ASEAN-ERIA-UNCTAD database.

**4. This trend indicates the substitution of tariffs with non-tariff measures.** The proliferation of NTMs could, for example, imply their use as an alternate instrument of protection when tariffs are being reduced in accordance with multilateral and bilateral trade agreements (Deardorff and Stern 1997). It may also reflect stronger demand for higher-quality and safer products as a result of income growth (Bernard et al. 2011). Whatever the underlying cause for the proliferation of NTMs, addressing the issue of the rising number of NTMs is becoming increasingly important for Vietnam's trade.

**5. NTMs, if poorly designed and implemented, can restrict trade, distort prices, and erode national competitiveness.** While NTMs might have a legitimate purpose, such as protecting people, animals, plants, or the environment, these measures may end up being redundant or fail to resolve perceived market failures or intended policy goals. In that case, NTMs increase trade costs, including the cost of compliance with technical regulations and bureaucratic procedures for permits and licenses, and limit the competitiveness of the business and the country. In turn, rationalizing NTMs can help boost trade and income growth. Hoekman and Nicita (2008), for example, estimated that cutting the ad valorem equivalent (AVE) of NTMs in half, from around 10 percent to around 5 percent, would boost global trade by 2 to 3 percent, that is, between US$320 billion and US$480 billion.

9 See http://asean.i-tip.org/.

**Figure II.3: Compliance with NTMs – Vietnam compared to the ASEAN-4**




*Source:* Doing Business, World Bank (2018).

**6. Vietnam's high trade costs result mainly from the high cost of compliance with non-tariff measures.** Figure II.3 shows that documentary compliance time for NTMs for imports in Vietnam (76 hours) was two-and-a-half times higher than the average for the subset of four countries of the Association of East Asian Nations (ASEAN-4) of Malaysia, Singapore, Thailand, and the Philippines (28 hours). Similarly, the time for documentary compliance for NTMs for exports in Vietnam (50 hours) was more than twice the ASEAN-4 average (24 hours).

## CONCEPT, DATABASES, AND CLASSIFICATION OF NON-TARIFF MEASURES

*In Vietnam, NTMs are often neither uniformly or consistently defined, nor classified according to international standards, and their policy objectives are often unclear and overlapping. This can hamper transparency and lead to poor compliance with Vietnam's commitments under the World Trade Organization (WTO), the ASEAN, and other FTAs. The existence of multiple databases on NTMs, with regulatory information compiled from different sources, can lead to inconsistent information and/or lack of coordination among agencies in the publication and updating of information, causing poor transparency and increasing the costs of business operations. This report recommends: (a) issuing guidance and definition of NTMs in accordance with international practice, clearly establishing their policy objectives in relation to the market failures they aim to address; (b) formal introduction and application of the UNCTAD-MAST classification system; (c) issuing regulations on the use of the Vietnam Trade Information Portal as the official source of information on NTMs in accordance with the Trade Facilitation Agreement of the WTO; and, establishing an interagency mechanism to coordinate efforts with focal points from specialized inspection bodies to regularly update the Vietnam Trade Information Portal.*

**7. NTMs are defined clearly in multilateral and bilateral trade agreements to facilitate trade among signatories.** For example, the agreements on sanitary and phytosanitary standards (SPS), technical barriers to trade (TBT), and import licensing procedures regulate NTMs among WTO members. The ASEAN Trade in Goods Agreement (ATIGA) also regulates the NTMs and specific obligations among ASEAN member countries. Most regional FTAs, especially the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and the EU-Vietnam Free Trade Agreement (EVFTA), have a chapter on simplification of NTMs. In contrast, NTMs are not fully defined and recognized according to their nature and in international practice in government regulations and policies in Vietnam, where they are known as specialized control measures (henceforth NTMs).

**8. An accurate definition of NTMs should be introduced in Vietnam to avoid overlapping and duplication in the implementation of policy objectives, and to ensure full compliance with international trade obligations.** According to the United Nations Conference on Trade and Development (UNCTAD) website[10], "NTMs are policy measures other than ordinary customs tariffs that can potentially have an economic effect on international trade in goods. They are increasingly shaping trade, influencing who trades what and how much. For exporters, importers and policymakers, NTMs represent a major challenge. Though many NTMs aim primarily at protecting public health or the environment, they also substantially affect trade through information, compliance and procedural costs."

10 See https://unctad.org/en/Pages/DITC/Trade-Analysis/Non-Tariff-Measures.aspx.

NTMs in line with international practice include state management regulations applicable to import and export activities, including sanitary and phytosanitary standards, technical barriers to trade, pre-shipment inspection and other procedures, price control measures, rules of origin, intellectual property, and export-related measures.

**9. Vietnam does not have an NTM classification on international standards and should consider applying the Multi-Agency Support Team (MAST)[11] classification of NTMs, in line with the decision made at the 2014 ASEAN Economic Ministers Meeting.** The MAST system provides clear definitions of each NTM category. Table II.1 shows the MAST's NTM classification for Vietnam. For exports, NTMs are classified as export-related measures. For imports, NTMs are broken down into two categories; technical measures, and nontechnical measures. The technical measures applicable to imported goods are divided into: (a) Sanitary and Phytosanitary Standards (SPS), (b) Technical Barriers to Trade (TBT); and, (c) Pre-shipment and other formalities. Nontechnical measures applicable to imported goods include: (a) contingent trade-protective measures, (b) non-automatic licensing, quotas, prohibitions, and quantity control measures; (c) price control measures; (d) finance measures; (e) measures affecting competition; (f) trade-related investment measures; (g) distribution restrictions; (h) restrictions on post-sales services; (i) subsidies; (j) government procurement restrictions; (k) intellectual property; and, (l) rules of origin. Types of measures are abbreviated and arranged alphabetically. As more and more countries apply MAST, it will be possible for Vietnam to conduct comparative analyses, with positive effects on shaping trade policy.

**Table II.1: Vietnam's NTM classification**

<table>
<tr><th colspan="3">NTMs by type</th><th>Code</th><th>Number of NTMs</th><th>Share in Total (%)</th></tr>
<tr><td rowspan="15">IMPORT</td><td rowspan="3">Technical Measures</td><td>Sanitary and Phytosanitary Standards</td><td>A</td><td rowspan="3">263</td><td rowspan="3">66</td></tr>
<tr><td>Technical to Trade</td><td>B</td></tr>
<tr><td>Pre-Shipment Inspections and other Formalities</td><td>C</td></tr>
<tr><td rowspan="12">Non-technical measures</td><td>Contingent Trade-Protective Measures</td><td>D</td><td rowspan="12">73</td><td rowspan="12">18</td></tr>
<tr><td>Non-Automatic Licensing, Quotas, Prohibitions and Quantity Control Measures other than for SPS or TBT Reasons</td><td>E</td></tr>
<tr><td>Price Control Measures,</td><td>F</td></tr>
<tr><td>Finance Measures</td><td>G</td></tr>
<tr><td>Measures Affecting Competition</td><td>H</td></tr>
<tr><td>Trade-Related Investment Measures</td><td>I</td></tr>
<tr><td>Distribution Restrictions</td><td>J</td></tr>
<tr><td>Restrictions on Post-Sales Services</td><td>K</td></tr>
<tr><td>Subsidies (Excluding Export Subsidies)</td><td>L</td></tr>
<tr><td>Government Procurement Restrictions</td><td>M</td></tr>
<tr><td>Intellectual Property</td><td>N</td></tr>
<tr><td>Rules of Origin</td><td>O</td></tr>
<tr><td colspan="2">EXPORT</td><td>Export-Related Measures</td><td>P</td><td>66</td><td>16</td></tr>
<tr><td colspan="4">TOTAL</td><td>402</td><td>100</td></tr>
</table>

*Source:* MAST's classification of NTMs by UNCTAD, figures are based on VTIP database, 2018.

11 UNCTAD established the Multi-Agency Support Team in 2006 to work on the taxonomy of NTMs to provide a clear and concise definition of NTMs, develop a classification system of NTMs to facilitate data collection processes and analysis, and devise ways to efficiently collect information on NTMs.

**10. In addition to accurately defining NTMs, a comprehensive and accurate database, presented in a clear and transparent manner, is paramount to facilitate trade. Such a database would** not only to facilitate importers and exporters obtaining trade information and complying with regulations, but also to enable researchers to analyze various impacts of these measures, and thereby support effective planning and implementation of NTMs. To this end, the WTO's Trade Facilitation Agreement requires participating countries to build a single, centralized trade portal, based on regularly updated data. In Vietnam, there are several NTM databases managed by line ministries. However, NTM information is not systematic nor adequate in both quantity and content. According to Vietnam's international commitments under the WTO and ATIGA, full and complete NTM information should be available, including classified by Harmonized System (HS) codes, tariff rates, and accompanying procedures.

**11. To begin to address this, in 2017 Vietnam established the Vietnam Trade Information Portal (VTIP), providing a complete database of NTMs.**[12] The VTIP aggregates information from three important data sources, including Customs administration data, the above-mentioned UNCTAD and ERIA database,[13] and non-tariff data from other ministries. The VTIP database, therefore, is a powerful tool that can help not only exporters and importers access accurate trade information, but also policy makers to plan and implement effective NTM policies. The VTIP is administered by the General Department of Vietnam Customs with technical support from the World Bank and went into operation in July 2017 to comply with the WTO's Trade Facilitation Agreement.

**12. The VTIP has a rich database of over 2,000 pages of logically structured documents in both English and Vietnamese and has a number of advantages over other NTM databases in Vietnam.** It is easy for users to find streamlined and complete instructions about export, import, and transit procedures in Vietnam on the VTIP, including a list of goods with HS codes (up to eight digits), import tariffs, non-tariff measures, procedures, and relevant forms. Data on the VTIP are accurate and up to date. As of July 2018, the VTIP covers 1,056 legislative documents, 402 NTMs, 398 administrative procedures, and 397 forms. Both the UNCTAD and VTIP databases list the name of the NTMs associated with the HS code and the relevant legal document. The VTIP also provides a description of administrative procedures and advice on how to comply with the measures, as well as a flow chart of processes and applied forms of the procedures, thereby helping users in preparation. Currently, VTIP is the only NTM database in Vietnam that fully satisfies the requirements under Article 12 of ATIGA and Article 1 of the WTO's FTA. Vietnam should further promote the maintenance and use of this database (see box II.1 for more detail), given these advantages and as other NTM databases in Vietnam are not as comprehensive or user friendly.

12 See https://www.vietnamtradeportal.gov.vn

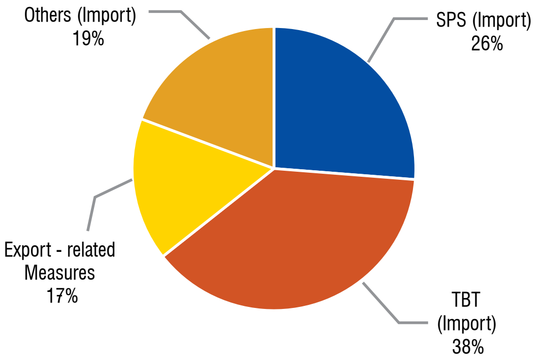
13 The UNCTAD and ERIA database includes NTM data for the 10 ASEAN countries of Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam (see http://asean.i-tip.org/). Based on this UNCTAD database, in 2015, Vietnam had 300 NTMs, including 248 technical measures (SPS and TBTs), equal to 75 percent of total measures, 25 nontechnical measures (8 percent of total measures), and 57 export-related measures (17 percent of total measures). (The most recent data in the website are for 2015).

**Box II.1: Key Features of the Vietnam Trade Information Portal (VTIP)**

- The VTIP is a one-stop point for information relating to import, export, and transit in Vietnam. Hosted by the General Department of Vietnam Customs, the portal provides an accessible, logical, helpful window for traders to access important regulatory and procedural information needed to export, import, and transit.
- The portal is an important step for the government toward improving the predictability and transparency of the country's trade laws and processes. The initiative is also in line with the government's commitment to the WTO requirements to comply with Article 1 of the Trade Facilitation Agreement.
- Using the top menu items, visitors can easily find useful information about the portal and its content, along with a comprehensive and well-organized guide to export, import, and transit processes and procedures in Vietnam.
- The sidebar also features useful links to border trade, TBT/SPS enquiry points, top market access, e-customs, free trade agreements, relevant publications, announcements, and upcoming events in Vietnam.
- Information provided inside the portal includes:
    - *Laws and regulations:* information on trade, including laws and regulations, measures, standards, procedures, process maps, guidance notes, fees, forms, licenses, and permits
    - *Customs Tariff:* Information on Customs Tariff (organized by HS Code) as well as duty, fees, taxes, levies, and applicable penalties in case of breach
    - *NTMs*: Information on NTMs comprising licensing and permit requirements, technical conformity standards, certification requirements, and generally any form of authorization, inspection, verification, or other forms of control concerning export, import, and transit
    - *Trade agreement:* Information relating to international, regional, and bilateral trade agreements to which Vietnam is a party, including the applicable rules, regulations, and requirements and the opportunities for Vietnam on a product-by-product basis
    - *Procedures:* Information on procedures required when applying for licenses, permits, border clearance, or other regulatory obligations relating to export, import, or transit of goods and means of transport
    - *Forms:* Forms (application forms, licenses, permits) relating to procedures
    - *Links:* Links to ministries, departments, agencies, other authorities, regulatory bodies, commercial banks, private institutions, trade associations involved in trade, and other relevant institutions.

*Source:* Vietnam Trade Information Portal (VTIP); https://www.vietnamtradeportal.gov.vn

**Figure II.4: Structure of NTMs in Vietnam**




*Source:* VTIP 2018.

13. **Figure II.4 shows the structure of NTMs in Vietnam (as of August 2018).** Of the 402 NTMs, the measures applied to imports account for the majority of NTMs (336 measures, accounting for 84 percent of NTMs), compared with 66 export-related measures (accounting for 16 percent of NTMs). Of the import measures, Vietnam has 263 technical measures and 73 nontechnical measures. Among technical measures for imports, SPS (26 percent of the NTMs) and TBT (38 percent) are the most common measures.

14. **This report suggests reform measures to be taken in order to clearly define and classify NTMs in accordance with international practice.** Guidance for and definition of NTMs and their clear policy objectives should be reviewed carefully, and only issued to address market failures. Vietnam should consider the formal introduction and application of the above-mentioned UNCTAD-MAST classification system. As the VTIP has already been established and is being operated by the General Department of Vietnam Customs, regulations should be issued on the use of this portal as the official source of information in accordance with the WTO Agreement on Trade Facilitation, and on the establishment of an interagency mechanism to coordinate efforts with focal points from specialized inspection bodies to regularly update the VTIP.

## OVERALL ASSESSMENT OF NTMs IN VIETNAM

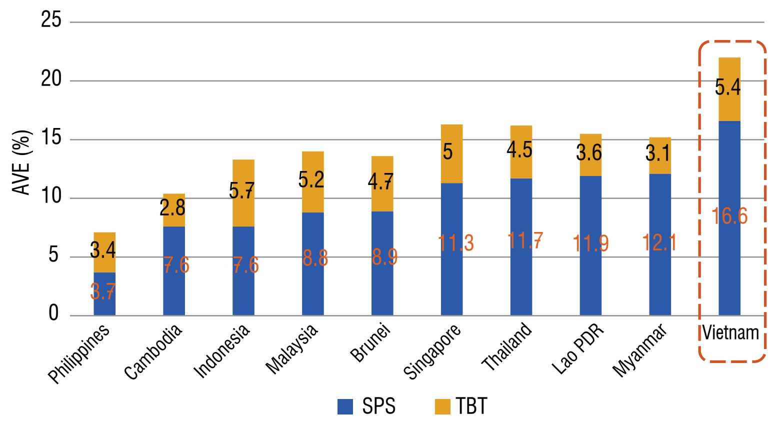
*Despite efforts in recent years to make improvements, including the establishment the VTIP, the NTM system in Vietnam remains complicated, opaque, and costly. This is reflected in the following aspects: (a) the level of incidence of NTMs in Vietnam is higher than that of most ASEAN countries; (b) the current NTM system is very complex, containing a large number of legislative documents guiding the compliance with measures, procedures for implementation, and forms to be filed; (c) there are overlapping legal documents for each import and export item issued by different agencies; and, (d) there are complex implementation procedures and a lack of coordination among relevant agencies.*

### *High cost incidence of non-tariff measures*

15. **The cost incidence of NTMs in Vietnam is significantly higher than that of most other ASEAN countries.** The impact of an NTM can be estimated in the same way as the effect of a tariff measure, and its value can be calculated using the ad valorem equivalent (AVE), (Kee and Nicita 2006; Dean et al. 2009; Rickard and Lei 2011; Grübler, Ghodsi, and Stehrer 2016). Cadot and Ing (2018) have adopted a new AVE methodology for ASEAN countries, with the result showing that the average AVE of technical barriers to trade (TBT) of ASEAN countries is 4.34 percent, and the average AVE of sanitary and phytosanitary measures (SPS)[14] is 8.34 percent. This compares with 5.4 percent and 16.6 percent for Vietnam's TBT and SPS measures, respectively. Higher AVE values than most ASEAN countries imply that there is room for Vietnam to reduce the ad valorem equivalents of NTMs to boost its competitiveness (Figure II.5).

14 The AVE for the SPS is calculated as the simple average of the AVEs for agricultural and food products, including animal products, vegetable products, fats and oils, and food and beverages. AVE for TBT are calculated as the simple average of AVE for chemicals, plastics and rubber, leather, footwear, textiles and apparel, cement, metals and metal products, machinery, and transport equipment.

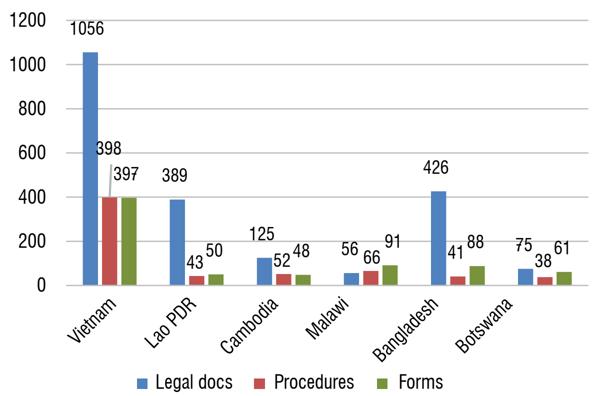
**Figure II.5: AVE for SPS and TBT measures: Vietnam compared to the ASEAN**




*Sources:* Author's calculation based on data by Ing and Cadot (2018).

## *Complicated regulatory framework for NTMs*

**Figure II.6: NTMs: Vietnam compared to selected countries**




*Source:* Trade Information Portal, World Bank, 2018.

**16. The current system of NTMs in Vietnam is very complex.** Figure II.6 compares Vietnam's system with several countries using data from trade portals established with World Bank support in other countries. The number of legal documents stipulating NTMs (1,056 documents),[15] the number of procedures to be followed (398 procedures), and the number of forms (397 forms), are much higher than in comparator countries. This is one of the main reasons for high trade costs and the difficult conditions for trade facilitation, with significant impacts on the business environment in Vietnam.

15 The Trade Information Portal's statistical method is to count all documents related to a specific NTM, including laws, decrees, circulars, and decisions (if any). For example, the measure of food safety inspection for imported products is regulated by the following documents: Law 55/2010/QH12 on food safety, Decree 15/2018/ND-CP detailing some articles of the Law on Food Safety, Circular 52/2015/TT-BYT, related to food safety inspection of imported products of the Ministry of Health, Circular 28/2013/TT-BCT on Food Safety Inspection for Imported Products of the Ministry of Industry and Trade, Circular 20/2012/TT-BYT and Circular 22/2012/TT-BYT (corresponding to Products for children up to 12 months of age or from 6 to 36 months of age) regulations on conformity announcement.

**Table II.2: Issued NTM regulations, 2004–17**

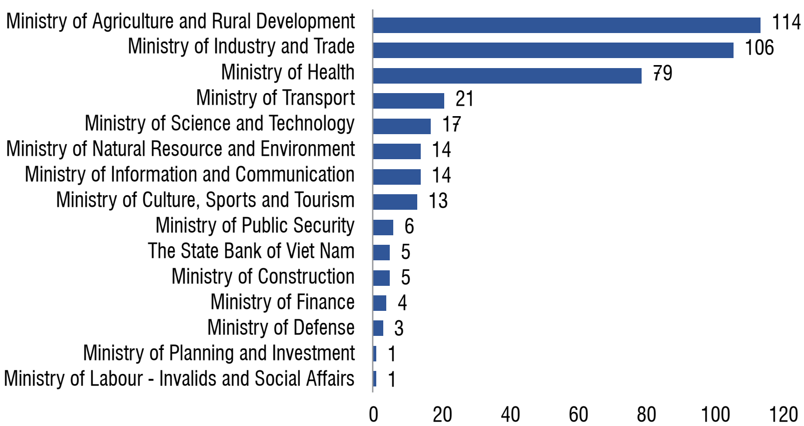
| Year | Laws and Ordinances | Decrees and PM Decisions | Circulars and Ministry Decisions | Total |
|---|---|---|---|---|
| 2004 | 2 | | 2 | 4 |
| 2005 | | | 1 | 1 |
| 2006 | | 5 | 5 | 7 |
| 2007 | 1 | 1 | 1 | 3 |
| 2008 | | 2 | 3 | 5 |
| 2009 | | 1 | 6 | 7 |
| 2010 | 1 | 3 | 14 | 18 |
| 2011 | | 1 | 12 | 13 |
| 2012 | | 6 | 14 | 20 |
| 2013 | 2 | 6 | 13 | 21 |
| 2014 | | 8 | 26 | 34 |
| 2015 | 1 | 1 | 25 | 27 |
| 2016 | | 7 | 16 | 23 |
| 2017 | | 7 | 5 | 12 |
| Total | 7 | 45 | 143 | 195 |

*Source:* VTIP 2018.

**17. The number of regulatory documents that provide guidelines for compliance with NTMs,** including Laws and Ordinances of the National Assembly/Standing Committee of the National Assembly, Decrees and Decisions of the Prime Minister, Circulars and ministerial Decisions as presented in table II.2, increased during 2004–17. The increase is higher after 2010. This trend may reflect the process of the intention to strengthen legal institutions, adjusting laws and regulations to accommodate Vietnam's commitments under several FTAs signed during this period. However, the number of documents, issued by different agencies, leads to overlaps and lack of transparency, which increases the compliance cost for export and import activities by businesses.

**18. Figure II.7 on the classification of NTMs by issuing agency shows that 15 ministries are responsible for 402 NTMs or specialized control measures in Vietnam.** Although there are many agencies involved, three ministries are responsible for the largest number of NTMs, including the Ministry of Agriculture and Rural Development (MARD), the Ministry of Industry and Trade (MOIT), and the Ministry of Health (MOH). These three ministries manage 74 percent of the current 402 NTMs. This is in line with international practice where, in other countries, similar state management agencies are also responsible for more NTMs than other agencies. This also points to the importance of these ministries in keeping NTMs simple and transparent for trade facilitation.

**Figure II.7: Number of NTMs by issuing agency**




*Source:* VTIP 2018.

**19. A more detailed classification of NTMs by type of measure and by issuing agency is provided in table II.3.** This shows the number of NTMs divided by three most important types of measures including sanitary and phytosanitary measures, technical barriers to trade, and export-related measures. It is also divided into 13 related regulatory bodies.

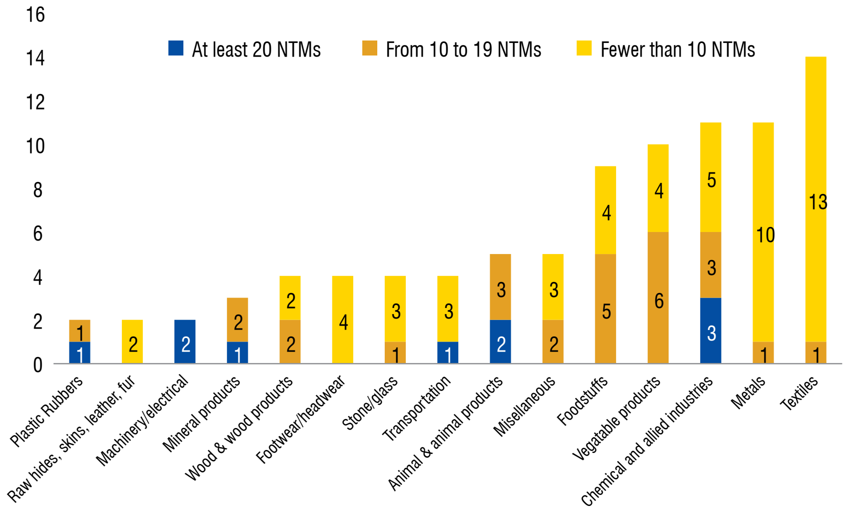
**Table II.3: NTMs by type of measure and issuing agency**

| Item | Issuing agency | SPS | TBT | Export-Related |
|---|---|---|---|---|
| 1 | Ministry of Health | 35 | 35 | 6 |
| 2 | Ministry of Agriculture and Rural Development | 42 | 21 | 23 |
| 3 | Ministry of Industry and Trade | 24 | 21 | 26 |
| 4 | Ministry of Transport | 2 | 14 | |
| 5 | Ministry of Construction | | 8 | 2 |
| 6 | Ministry of Finance | 1 | 3 | |
| 7 | Ministry of Information and Communication | 1 | 2 | 2 |
| 8 | Ministry of Science and Technology | 3 | 15 | |
| 9 | Ministry of Culture, Sports and Tourism | | | 4 |
| 11 | Ministry of Public Security | | 5 | |
| 12 | Ministry of Natural Resource and Environment | 7 | 5 | 2 |
| 13 | Ministry of Labor, Invalids and Social Affairs | | 1 | |
| 15 | State Bank of Vietnam | | | 1 |

*Source:* VTIP 2018.

**20. All HS-2 product groups are subject to at least one NTM, and most product groups are subject to at least two NTMs.** Figure II.8 shows the classification of NTMs by product group that have to comply with less than 10 NTMs, 10 to 19 NTMs, and more than 20 NTMs.

**Figure II.8: Classification NTMs by product group**




*Source:* VTIP 2018.

**21. Product groups are not only affected by many NTMs, but are also subject to measures by many agencies at the same time.** This has a lot to do with the cost of import-export activities. Table II.4 summarizes product groups that are subject to regulatory compliance at the same time.

**Table II.4: Product group affected by more than one issuing agency**

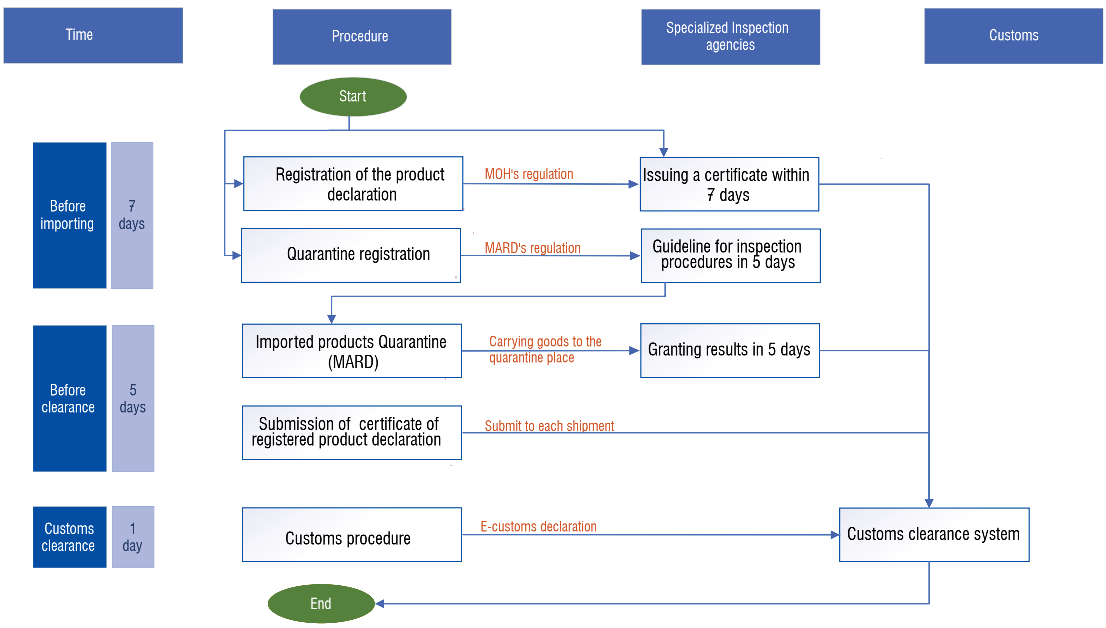
| HS codes | Product group | Affected by 1 agency | Affected by 2 agencies | Affected by at least 3 agencies |
|---|---|---|---|---|
| 01–05 | Animals & animal products | | 2 | 3 |
| 06–15 | Vegetable products | | 3 | 7 |
| 16–24 | Foodstuffs | | 2 | 7 |
| 25–27 | Mineral products | | | 3 |
| 28–38 | Chemicals & allied industries | 1 | 5 | 5 |
| 39–40 | Plastics/rubbers | | | 2 |
| 41–43 | Raw hides, skins, leather, & furs | 1 | 1 | |
| 44–49 | Wood & wood products | 2 | | 2 |
| 50–63 | Textiles | 10 | 4 | |
| 64–67 | Footwear/headgear | 3 | | 1 |
| 68–71 | Stone/glass | 1 | 1 | 2 |
| 72–83 | Metals | 7 | 3 | 1 |
| 84–85 | Machinery/electrical | | | 2 |
| 86–89 | Transportation | | 2 | 2 |
| 90–97 | Miscellaneous | 2 | | 4 |

*Source:* VTIP 2018.

### *Overlapping procedures and lack of interagency coordination*

**22. Procedures for adhering to state management measures on specialized control are very complex, showing that multiple legal documents issued by multiple agencies overlap, increasing import and export complexity.** Figure II.9 shows the procedures for importing milk, in which the preclearance process requires enterprises to complete overlapping procedures by the three ministries of Agriculture and Rural Development, Health, and Commerce, concerning imported product quarantine and food safety inspection. Box II.2 details the regulations that indicate the overlap of multiple documents managed by multiple agencies for importing milk (HS 0401).

**Figure II.9: Procedures for importation of milk**




*Source:* VTIP 2018.

**Box II.2: Legislation guiding importation of milk (HS 0401)**

Milk is regulated by four legislative documents on specialized control (or NTMs) in Vietnam, including:

- Circular 25/2016/TT-BNNPTNT, providing for the quarantine of terrestrial animals and animal products of the Ministry of Agriculture and Rural Development;
- Circular 52/2015/TT-BYT, related to food safety control of imported products of the Ministry of Health;
- Circular 28/2013/TT-BCT, related to food safety inspection of imported products of the Ministry of Industry and Trade; and,
- Decree 15/2018/ND-CP regulating the implementation of some articles of the Law on Food Safety, and regulations on procedures for registration of product announcements.

Of the four documents related to specialized control, three documents regulating food safety inspection are set by two different ministries. In addition, the importation of milk must comply with other provisions in the following legal documents:

- Regulation on product labeling as stipulated in Decree 100/2014/ND-CP; and,
- National technical standards for nutritional products of Circular 20/2012/TT-BYT or Circular 22/2012/TT-BYT (corresponding to products for children up to 12 months of age or 6 to 36 months).

Food safety inspection for imported dairy products has been simplified by Decree 15/2018/ND-CP. However, milk is still both quarantined according to regulations of the MARD, and at the same time, subject to food hygiene and safety inspection by the MOH and MOIT. Therefore, imported milk is still managed by three ministries. The shortcomings of Decree 15/2018/ND-CP, reflecting the overlap and lack of coordination among related agencies, will not be resolved without further detailed guidance.

*Source:* VTIP 2018.

## STREAMLINING AND IMPROVING THE TRANSPARENCY OF NTMs

*This report recommends a set of reforms for simplifying NTMs and improving transparency, including: (a) establishing a standard procedure for reviewing and applying cost-benefit analysis, eliminating unnecessary measures and regulations; (b) redesigning procedures to ensure their effectiveness and simplified compliance; (c) the application of risk management; and, (d) interagency coordination.*

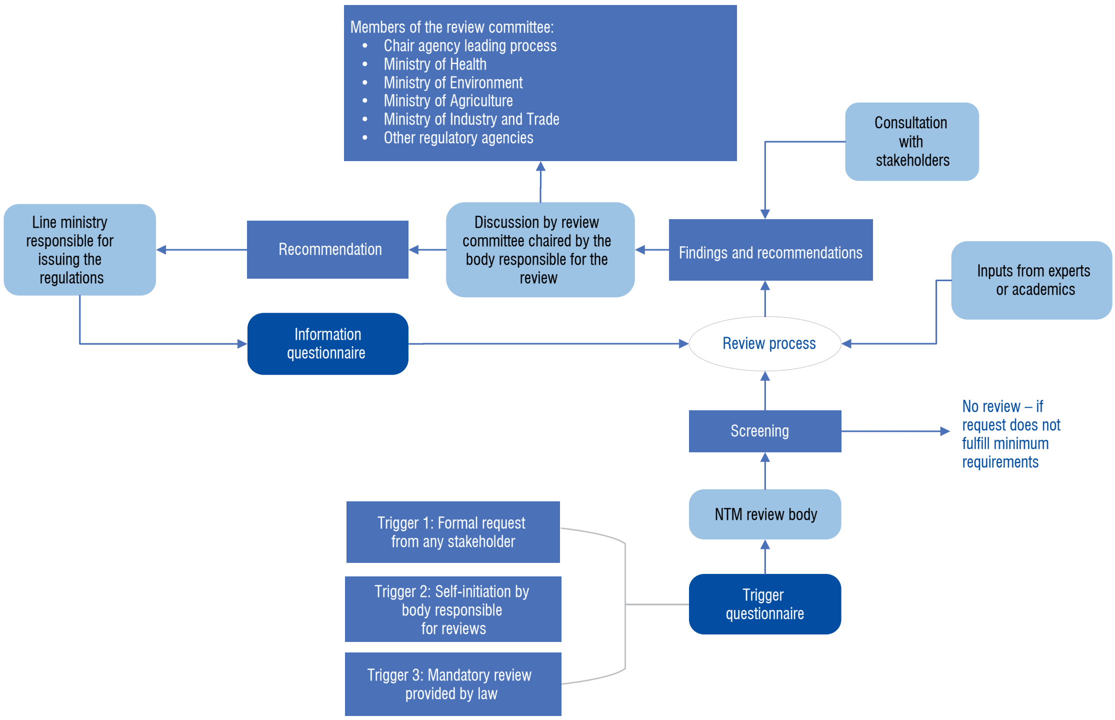
### *Process and institutional setup for NTM review*

**23. Vietnam is at a crucial stage in modernizing the regulatory system for trade facilitation.** Strong political will at the top level of the Government has translated into sustained efforts by all agencies to review the regulations and reduce their number, simplify their requirements, and remove any unnecessary step for traders. This effort is critical to support the ongoing automation of border clearance procedures. International good practice shows, in fact, that automation can produce significant results only when it follows a deep effort of simplifying and streamlining NTMs and their enforcement. Despite the appreciable attempt to reduce and simplify regulatory requirements, current results are not as significant as they need to be. The government should address this shortcoming by adopting practices and methodologies that have been successfully used in other countries, such as developing a clear policy framework and a systemic approach to managing NTMs, including for their definition/identification, classification, publication, review, and streamlining.

**24. International practice on NTMs shows that the introduction of new NTMs should occur only when there is a clear justification.** A new NTM needs to be issued only when it addresses a clearly analyzed market failure. According World Bank (2016, P.41), a "market failure is a situation whose outcome is suboptimal from a collective point of view, that is, where the pursuit of individual interests does not lead to the common good. For a market failure to justify government intervention, a case must be made that market forces left to themselves will not lead to a solution." In a trade context, market failures can involve cases where consumers are insufficiently informed and may harm themselves or others by purchasing defective imported products, cases where the import or export of certain products creates a hazard for biodiversity or the environment. A government regulatory intervention is justified when the market cannot address a given problem by itself, or when it cannot do it in a reasonable amount of time.

**25. Following international experience, Vietnam should consider establishing processes and institutional mechanisms for NTM review.** Although Vietnam has guidelines on the promulgation of legal normative documents,[16] it is unclear under the current system how to assess the impact of NTMs. In addition, the capacity of line ministries is limited, and the feedback from private enterprises on draft documents remains limited. Figure II.10 introduces a review process and institutional mechanism to rationalize NTMs in the World Bank publication "Streamlining NTMs: A Toolkit for Policy Makers" (World Bank 2016).

**Figure II.10: Sample process and institutional setup for NTM Review**




*Source:* "Streamlining NTMs: A Toolkit for Policy Makers," World Bank (2016).

**26. The NTM review process recommended in "Streamlining NTMs: A Toolkit for Policy Makers" includes the following principles and steps:**

1. The primary responsibility for regulation lies with the issuing regulatory agency/ministry. The aim of the review process is to support their work.
2. The review process aims at improving trade regulations by determining whether they are fulfilling their stated objectives with the least possible restriction of trade.
3. The review process should be led by a body, ministry, or committee (or inter-ministerial or interagency committee) with a clear mandate, accountability, and strong political support.
4. The review favors a gradual approach to regulatory reform that is sustainable over time and aims to establish a review process that can grow over time. Gradualism means that the review process could initially focus on specific institutions (for example, standard-setting bodies) or regulations (for example, prohibitions, licensing, or other prima facie trade barriers), and later on move to wider issues. The final

16 Decree 34 of 2016 provides detailed instructions to the relevant agencies on the implementation of the Law 80/2015 on the promulgation of legal documents, defined based on "cost-benefit analysis for one matter or several matters related to production, business, consumption, the investment and business environment, competitiveness of enterprises etc." (Article 6). Article 7 foresees that both quantitative and qualitative methods can be employed.

goal is that countries adopt wide regulatory reforms to implement ex-ante best regulatory practices, including regulatory impact assessments.

5. The initiation of the review process should be substantiated to avoid using resources on irrelevant requests. To achieve this, the proposal provides for minimum requirements to initiate and conduct the review.
6. The review process should proceed as an ex-post regulatory impact assessment insofar as it must provide an analysis of the costs and benefits of the measure in place to allow for an informed decision by the authorities responsible for the review, as well as the agency/ministry responsible for issuing the regulations as to whether a measure should be maintained, changed, or eliminated according to the review findings.

**27. Even if their objective is legitimate, existing NTMs could restrict trade more than necessary due to the lack of capacity and/or vested interests of direct NTM management agencies, and therefore need to be scrutinized and streamlined by an objective body to effectively contain unnecessary deficiencies.** State management agencies have issued a large number of NTMs and regulatory documents expressing the desirability of achieving policy objectives such as protection of human health, animal and plant life, environmental protection, and sector development. However, these state management agencies may not fully consider the national interests of trade and investment and competitiveness enhancement, and likewise the current self-review process might not be efficient. Therefore, it is a good practice that mandatory review should be given to or closely supervised by one independent and objective body to ensure the harmonization of the policy support objectives with the common goal of facilitating trade, promoting a business and investment environment, and competitiveness. Box II.3 presents the Indonesian experience in reforming the method of reviewing NTMs.

**Box II.3: Institutional setup to streamline new NTMs in Indonesia**

Streamlining NTMs in Indonesia received a new impetus in September 2011 from the Ministry of Trade, which launched a pilot program establishing a review process for NTMs issued by this ministry, currently responsible for 61 percent of all NTMs issued.

The main thrust of the program is to remove the NTM review process from the unit that implements NTMs, and to equip a new unit with adequate capacity to conduct regulatory impact assessments. The decree establishes a Non-Tariff Policy Team within the Ministry of Trade whose tasks are to: (a) coordinate with relevant agencies for input into the formulation and establishment of NTMs; (b) formulate and submit recommendations to the Minister of Trade on NTM policies; (c) monitor and evaluate the implementation of NTM policies; (d) introduce NTM policies to stakeholders; and, (e) participate in international trade negotiations in the framework of bilateral, regional, and multilateral cooperation with implications for Indonesia's NTM policies.

The ministry also introduced a standard operating procedure for reviewing NTMs to conduct objective and independent assessments within a specified time. The team will analyze the eligibility of a proposed NTM, analyze potential impacts of a proposed NTM using appropriate analytical tools, verify the proposed NTM's consistency with other national policies and with the WTO rules or other international agreements, and hold public consultations through meetings with stakeholders or field surveys. The Non-Tariff Policy Team should reach a conclusion regarding the NTM within a maximum of 60 working days.

*Source:* "Streamlining NTMs: A Toolkit for Policy Makers," World Bank (2016).

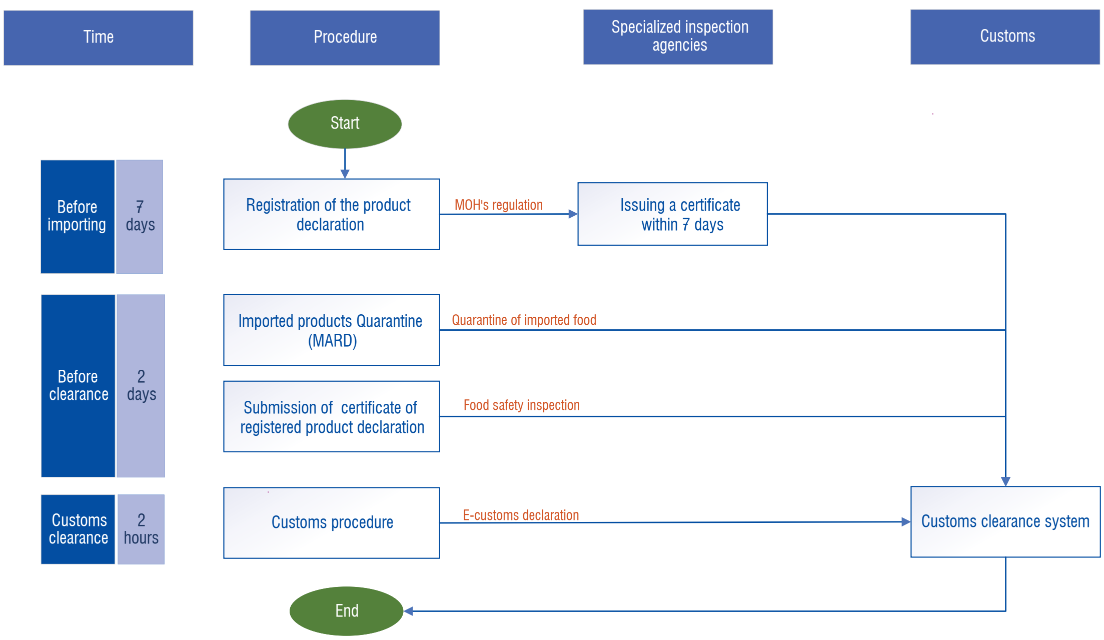
## *Simplifying procedures*

**28. The complexity of the procedures enforcing the compliance process should be simplified and the procedures synchronized between Customs and other bodies designing and implementing NTMs.** Bureaucratic simplification is a prerequisite for effective automation of business processes through the national single window.

Business process reengineering is an important modernization process for Customs administrations and NTM management authorities in many countries. International practice in customs modernization and NTM regulatory bodies could be considered including the Revised Kyoto Convention, WTO's Trade Facilitation Agreement, proposed Customs procedures by the World Customs Organization, and chapters on NTMs of free trade agreements. In many cases, simplified and modern business processes are incorporated into national one-stop systems for developed countries.

**29. Figure II.11 provides an example of the simplification of the process of importing milk as mentioned in paragraph 22 and figure II.9,** whereby the three steps of the preclearance sector-inspection-process should be integrated, including the step on quarantine of import by MARD, and the steps on food safety inspection by MOH and MOIT. In addition, a database of products that have been approved for product registration should be developed and shared among the enterprise, registration agency, and Customs to facilitate a smooth customs clearance process. It is also necessary to develop and update the database of enterprises applying the reduced inspection method for food safety control measures prescribed by the MOH. A simplified process would help reduce compliance time by businesses. The government should appoint a body responsible for accredited certification conformity to represent the three entities. This is just one example of simplifying procedures that requires considerable effort and interagency collaboration.

**Figure II.11: Simplified procedures for importation of milk**




*Source:* VTIP 2018.

## *Applying risk management in NTM agencies*

**30. Risk management and post-clearance inspections are increasingly applied at the Customs administrations and NTM management authorities in many countries.** The main objective of applying risk management and post-clearance audit is to achieve a balance between reducing risks that international trade can expose a country to and trade facilitation. In Vietnam, as in many other countries, Customs administration has made some progress in applying risk management methods and technologies, while other non-tariff measure regulators are still facing a modernization gap in comparison with Customs. Cross-sectoral cooperation is paramount, especially in the sharing of already existing Customs risk-based data. Box II.4 presents international experience on the application of risk management in non-tariff measure management agencies.

**Box II.4: NTMs and risk management in border agencies**

The practice of most governments is to assign aspects of regulatory responsibility at the border to a number of different agencies. Each of these agencies has its own specific mandate from government, and taken together they cover issues as diverse as health, product safety, biosecurity, immigration controls, revenue collection, and transport security. Nevertheless, the fundamental nature of the challenge that each agency confronts is the same, that is, to facilitate the legitimate movement of people and goods, while at the same time maintaining the integrity of the border by ensuring compliance with relevant legal requirements.

Proper border management is critical to the cost-effectiveness of international trade transactions and the smooth flow of legitimate goods and people from the perspective of both the public and private sector. And while some agencies may have particularly good procedures in place, the achievement of effective and efficient border management is ultimately a whole-of-government task, requiring the involvement of all government agencies with responsibilities at the border. This also highlights the need to regulate borders in a way that reduces the impact of interventionist strategies as much as possible. In other words, while maintaining cross-border control is nonnegotiable, the way in which it is achieved should also provide appropriate levels of facilitation.

Risk management can help SPS and TBT administrations handle this tradeoff by focusing attention and resources on the riskiest transactions. This is particularly crucial as SPS and TBT administrations are often impotent to efficiently enforce and control declaration and shipment compliance. Often lacking modern technologies, they also suffer from a lack of coordination with more modern Customs administrations. As SPS agencies are much smaller and far less modernized than Customs agencies, notably regarding information technology infrastructure, capacity building should be expected from Customs to SPS agencies, especially given that much of the data that are required to implement risk-based analysis for technical measures are already part of Customs' management system.

Finally, it is difficult and counterproductive for the administration to control and check every transaction. With limited resources, opportunity costs of inspecting both low-risk and high-risk importers are high: while wasting time and spending mostly on compliant importers, resources dedicated to high-risk importers are reduced. A risk-based approach contributes to reverting this situation toward a win-win situation. It defines the actions (such as sample tests, full inspection) to associate to each transaction depending on its risk profile, which itself results from the assessment of the declaration's risk of infraction. The latter relies on historical data of the transaction's characteristics, in other words, on whether the elements of the declarations have previously been associated to fraudulent declarations. By providing appropriate prioritization of actions through the targeting of the riskiest transactions, risk-based processes enable more efficient resource allocation.

Border agencies should integrate the concept of risk in their search for compliance with regulations. Risk has two elements: the likelihood of something happening, and the consequences if it does in fact happen. The combination of these factors provides an understanding of the overall level of risk, which then allows the administration to compare and prioritize the variety of risks that have been identified. Then the aim is to determine the relative significance of each risk to make informed decisions.

*Source:* "Streamlining NTMs: A Toolkit for Policy Makers," World Bank (2016).

### *Interagency coordination*

**31. In Vietnam, the National Committee on Trade Facilitation and National Single Window was established to guide the formulation and oversee the implementation of trade facilitation policies and the delivery of international commitments under the WTO's Trade Facilitation Agreement.** To support the fulfillment of its mission, a well-functioning and empowered Secretariat with specialized technical knowledge should be formed to implement the Committee's directions. The Secretariat should be assigned relevant responsibilities to coordinate NTM-related policies among ministries. To do this well, among other tasks, the Secretariat should be responsible for: a) reviewing NTM policies based on the standards and methods applied in other countries; and, b) introducing reforms of the NTM regime and principles for cost-and-benefit-based impact assessments, quality control of new NTMs, and review and rationalization of existing NTMs. The Committee and the Secretariat should also take charge in establishing a coordinated mechanism among relevant agencies in regularly updating the VTIP and monitor implementation of this coordination mechanism.

**32. In conclusion, we would like to highlight five key policy recommendations addressed in this note for the Government of Vietnam to consider.**

1. Vietnam should make every effort to establish a least-cost and transparent system of NTMs with uniform and consistent definition and classification in accordance with international standards and clear policy objectives. The key principle is that measures can be issued only in the presence of a market failure. Actions to be taken include adoption of the UNCTAD-MAST classification system; clear guidance for the use of VTIP as the official source of NTM information and data; and establishment of interagency coordination efforts, with focal points from specialized inspection bodies to regularly oversee the VTIP.
2. Despite the concerted efforts to reduce and simplify specialized control regulatory requirements, current results are not as effective as they should be. Vietnam should embark on a deeper reform program by learning from international experience and best practice to establish a standard procedure for reviewing and applying cost-benefit analysis to be conducted by objective and capable bodies to eliminate deficiencies due to the lack of capacity and vested interests of direct NTM management units.
3. International experience shows that a prerequisite for effective automation of business processes through a national single window is to re-engineer complicated procedures enforcing the compliance process toward and simplification and synchronization between Customs and other bodies designing and implementing NTMs.
4. NTM agencies should apply risk management and post-clearance inspection to achieve a balance between reducing risks that Vietnam could be exposed to by international trade and facilitating trade and competitiveness. Data required to implement risk-based analysis for SPS and TBT measures are already part of Customs' management system, and therefore should be shared for risk management systems in other NTM agencies.
5. Above all, a conducive interagency coordination mechanism is vital for this multidisciplinary reform program to be successful. The establishment of the National Committee on Trade Facilitation and National Single Window is a critical first step. The next step should be to ensure that a well-functioning Secretariat with specialized technical knowledge is in place to support the Committee in carrying out its directions for and overseeing implementation of the NTM reform program, and ultimately to support improvements in Vietnam's competitiveness.

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