

Reform of the Distribution and Commerce Sector in Vietnam: Process and Problems*

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1. Introduction
2. Commerce and Distribution Services before Doi Moi
3. Structural Reforms and Distribution Services
4. Private Sector Development and Distribution Sector
5. Economic Integration, FDI and Distribution Services
6. Concluding Remarks

1. Introduction

The introduction of “*Doi Moi*”, the comprehensive reform program of Vietnam, in 1986 has resulted in remarkable success. Inflation declined dramatically, from 160 per cent per annum in 1988 to less than 10 per cent in 1997, and the economy has been growing steady and rapidly since *Doi Moi* took place. Strong economic performance goes hand in hand with significant reduction of poverty. As the size of the economy roughly doubled between 1993 and 2002, the fraction of the population living in poverty declined by half, from 58 per cent to 29 per cent. Vietnam’s achievements in terms of poverty reduction are one of the greatest success stories in economic development.

Besides changes in production and supply side, reforms in commerce and distribution have made considerable contribution to the outstanding reduction of poverty incidence during the reform years. In general, there are three key channels through which reforms in commerce and distribution sector can affect poverty. First, better distribution has contributed to improvement of access to inputs and markets for outputs, and hence led to reduced transaction costs and increased profitability of business. With prices serving increasingly as the market signals, the allocation of resources has become more and more market-based with increased efficiency and this enhances further economic growth. Second, the majority of newly established household and private business has been engaged in retail trade and distribution and these labor-intensive business entities have been a major of income- and employment-generating source for unskilled labor in Vietnam in the reforming years. Third, improved distribution system has

* Paper prepared for Korea Institute for National Unification’ Workshop “Economic and Social Reform of Vietnam and Its Lessons for North Korea”, July 14-17, Seoul, Korea.

certainly been an important factor contributing not only to improved redistribution of increased income as a result of rapid economic growth but also to the improved provision of newly created opportunities to the poor in Vietnam. With better distribution mechanism and improved mobility of factors and resources, the poor has been able to obtain a reasonable share of the overall benefits generated by sustained rapid economic growth and this is an important underlying cause of the pro-poor growth pattern of Vietnam in the last two decades.

This paper reviews the process of the reforms in the commerce and distribution sector in the context of the comprehensive economic renovation taken place in Vietnam since the mid-1980s. The next section provides a brief overview of the commerce and distribution sector before Doi Moi. Section 3 and 4 discuss the structural reforms and reforms aiming at private sector development either in the commerce and distribution sector or closely related to this sector. Section 5 analyses main reforms in the context of trade liberalization and economic integration directly affected the commerce and distribution sector. Section 6 concludes the paper and highlighting main success as well as identifying key challenges and issues facing this sector.

2. Commerce and Distribution Services before Doi Moi

In the past, Vietnam followed the centrally planned economy model in which almost all production and distribution decisions were made centrally. As achieving social equality is one of the most important objectives of building socialist economy, great emphasis was put on the establishment of a state distribution system. The central goals of setting up a state distribution system are to ensure price stability and fair distribution of goods and services, especially making sure that every household has access to most basic or “essential” goods.

To achieve these goals, a state-run distribution system had been established with three main components: (1) the system of trading state-owned enterprises (SOEs) and trading cooperatives, (2) the rationing scheme, and (3) the pricing scheme.

The system of SOEs in commerce and distribution services was rapidly developed in the post-Dien Bien Phu period. In 1958 the Department of Commerce was established to take charge of the management of the distribution and commerce sector. In each province, a provincial department of commerce was established under the management of Department of Commerce. In 1960, the Department was split up into two departments for domestic and foreign trade separately.

The business was run by a system of state-owned enterprises (SOEs). At central level, there were state-owned general whole sale corporations that undertook the whole sale activities in North Vietnam. At provincial levels, there were provincial state-owned enterprises responsible for both wholesale and retailing services. The government had also set up a widespread network of trading SOEs in districts from the mid 1960s.

The scope of trading SOEs had grown very rapidly. In 1955, there were only 511 enterprises with 11,700 staff. By 1974, there were 6124 enterprises and 124,200 employees. The share of state sector in total retailing turnover also increased gradually in the post-unification period.

Table 1: Contribution of state and private sectors in total retailing turnover (%), 1976-1987

| Year | Total retailing service | State Sector | | | Private |
|------|-------------------------|--------------|------|--------------|---------|
| | | Total | SOEs | Cooperatives | |
| 1976 | 100 | 44.6 | 36.6 | 7.9 | 53.9 |
| 1980 | 100 | 39.1 | 29.9 | 9.2 | 59.9 |
| 1985 | 100 | 53.6 | 40.7 | 12.9 | 46.4 |
| 1987 | 100 | 56.8 | 41 | 12.6 | 43.2 |

Source: GSO, 1996.

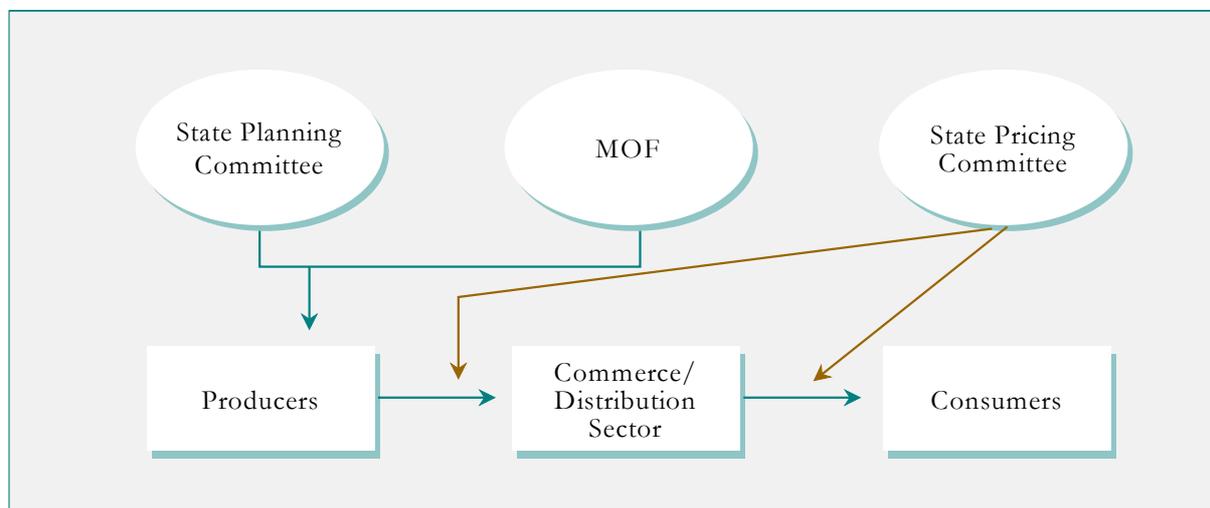
Distributing cooperatives represented another important type of business entities operating in the commerce and distribution sector. Characterized by communal ownership, the cooperatives have been seen as an important stepping stone in the building of socialism. The distributing cooperatives were operational in the rural areas to serve the peasants.

Another key component of the former distribution system in Vietnam is the rationing scheme which was applicable to the essential goods such as rice, foodstuff and kerosene. In principle, every individual in urban areas was entitled to some fixed amount of each type of the essential goods, depending on various factors such as age and the sector he or she is working for. Since the quantity of industrial production output or international trade was determined by the government via State Planning Committee, and grain output was far below the demand, rationing was introduced to ensure relatively fair distribution.

State-set pricing mechanism is also an important component of the former distribution system. Before 1986, the state set prices of goods and services several items were subsidized with low prices. In the past, the trading SOEs could buy goods and services from several sources: other production SOEs, cooperatives or agricultural cooperatives. There were different price setting mechanisms for each type of suppliers. The production SOEs were obliged to supply to the trading SOEs the production output as allocated by the government and the price included the production costs, fixed proportion profit rate and taxes. The production cooperatives carried out subcontracting work, receiving raw material and deliver the final output as specified in the contract. Agricultural cooperatives had to sell to trading SOEs or cooperatives food and some other main agricultural products at norms and prices as determined by the government. In the 1970s, the government introduced the two-way exchange scheme, in which the farmers can exchange a proportion of their output for investment goods or industrial consumer goods.

In addition to the above mentioned three important components of the past distribution system, there were also important policies that had decisive impact on the distribution of goods and services before the mid-1980s. Among the most important ones were the restricted domestic and international trade policies. Especially after the liberation of South Vietnam in 1975, several regulatory measures were imposed to limit inter-provincial trade and address smuggling. Engaging in international trade was also one of the privileges of large trading SOEs and private enterprises were not allowed to transact internationally.

Figure 1: Working of the Commerce and Distribution Sector before Doi Moi



Even in the period of rapid expansion of the SOEs and cooperatives in the distribution and commerce sector, there existed *a parallel system of private small agents* participating in the distribution. Unlike the former socialist countries in Eastern Europe and the former Soviet Union, the distribution state sector was not in a dominant position as in the industrial production. The participation of private sector mostly in form of small traders or household business in retailing system has been a salient feature of the economy and consequently, a parallel distribution system was in place. Table 1 shows that when Doi Moi took place, the share of the private sector in the total retail turnover was still very high, indicating that the sector remained of crucial importance after many years of developing a state-run distribution system.

The existence and operation of the individual and household traders in the distribution system was closely linked with the structure of the economy. Until the end of 1980s, agriculture remained the largest economic sector of the economy producing about 40 per cent of GDP and employing more than 70 per cent of the labor force. Besides their own gardens, each rural household were allocated a small piece of agricultural land for their own use. Farmers also raise small stock of livestock at home and while a large proportion of the home grown vegetables and livestock were consumed at home, some of them were exchanged at local market places.

3. Structural Reforms and Distribution Services

The comprehensive economic reform formally introduced in the mid-1980s has led to fundamental changes in both production and distribution system in Vietnam. In fact, the reform process was initiated earlier with partial, unofficial relaxation of constraints on private activity and gradual moves towards production and trade outside of official channels (De Vylder and Fforde, 1988).

Some important reform measures were introduced in the beginning of 1980s that resulted in initial

changes in the nature of the relationship between production and distribution in Vietnam. Limited autonomy was given to SOEs in efforts to gradually abandon the system of “full allocation and full delivery” where the state provides all inputs and recovers all profits. The number of mandatory targets was reduced and the SOEs can now operate outside the plan after the mandatory targets have been met. As an incentive to SOEs, they now could retain up to 85 per cent of the profits from activities outside plan for their own purposes. Attempts were also made to move official prices closer to market rates and decentralize trade to local enterprises.

The reform actually took place in the mid 1980s with comprehensive strategy and reform measures adopted with the conclusion of the Sixth Party Congress. The move away from central planning towards indicative planning and market-based economy was clearly stated and this represented a critical turning point in policy direction.

In relation to the distribution system, remarkable changes were implemented in the second half of the 1980s. In early 1987, many check point that had been established to limit domestic trade were substantially reduced. Consequently, the distribution of agricultural goods improved considerably and private markets for these goods also developed rapidly.

Substantial price reforms were introduced in 1987 with the official prices of most non-essential consumer goods being raised to close to market rates. At the same time, the scope of rationing was considerably reduced. In 1989, most direct production subsidies and price control were removed, basically marking an end to the two-price system. Prices now serve as market signals instead of being set by the state. The use of market prices in economic contracts and in retail activity has made a significant contribution to changing the way the distribution system works in Vietnam.

In international trade, significant liberalization measures took place in the end of 1980s and beginning of 1990s. The system of quotas was replaced by tariffs and state monopoly in foreign trade was relaxed with increased access to foreign trade rights and licenses. Producers have been allowed to sell their exports to any licensed foreign trade company since 1989. In 1991, private companies were allowed to engage directly in international trade. Quotas were removed on all but ten exports and 14 imports and tariffs were introduced in the beginning of 1990s. The number of foreign trade permits increased rapidly over a relatively short period of time, from about 30 in 1988 to 300 in 1991 and private firms held about 15 per cent of foreign trade permits by mid-1993 (World Bank 1993:77).

In the early 1990s, a private trading system grew up alongside the state trading system, often acting in cooperation with the state trading companies to utilize the expertise of the state trading companies. Other causes of increased state-private cooperation during this period include privileges of trading SOEs in areas like access to quotas or subsidized credits. There were still considerable entry barriers to international trade in the 1990s. For example, the Ministry of Trade issued import and export licenses permitting enterprises to engage in foreign trade. Obtaining such licenses could be time consuming with cumbersome procedures with several requirements included minimum capital requirements, past foreign trade experience, and qualifications of enterprise personnel.

Perhaps one of the most important reforms in Vietnam in general and in distribution in particular is the reform of state-owned enterprises. For this significant economic sector, a gradual reform approach has been adopted. The overall goal of the on-going SOE reform is to develop a multi-sector economy where the state sector assumes the leading role of the economy and comprises of effectively functioning SOEs. The SOE reform began with the gradual reduction of state intervention in the production and

business decisions of state-owned enterprises. SOE managers have been granted with increased autonomy and freedom and SOEs can now engage in economic contracts mostly at their own willingness rather than being mandated to transact with pre-determined partners at fixed prices. Increased management autonomy obviously provides better incentives for state enterprises and is an important step towards the separation of regulatory independence from operation. Two important legal documents: the Law on Bankruptcy and the Law on State Enterprises were promulgated in 1993 and 1995 respectively with substantial progress being made in clarifying responsibilities and accountability of SOEs and establishing SOEs as limited liabilities entities. These laws aim at the facilitation of improved governance and the closure of non-viable SOEs.

With state investment and operation of SOEs now prioritized in strategic industries and areas, SOEs in commerce and distribution services have been also rearranged and reformed. The strategic objectives of the state distribution services have been limited to the establishment of sufficient reserves and buffer stock of essential goods to mitigate the sudden shocks of demand and supply and therefore contribute to the stabilization of prices. The coverage of the state distribution services has also been reduced to distribution of essential goods that the other economic sectors have not been capable of supplying these goods. Since the beginning of 1990s, the state distribution sector mainly engage in whole sale, especially of strategic goods such as petroleum and fertilizer, and the share of this sector in retailing services has steadily decreased over time. The rapidly growing private sector has increasingly dominated the retailing services with small and micro private enterprises and household business prove to be much more efficient in a dynamic environment than the less flexible central and local SOEs.

Table 2: Contribution of state and private sectors in total retailing turnover (% , 1991-95)

| Year | Total retailing service | State Sector | | | Private |
|------|-------------------------|--------------|------|--------------|---------|
| | | Total | SOEs | Cooperatives | |
| 1991 | 100 | 28.9 | 26.9 | 2 | 71.1 |
| 1992 | 100 | 12.7 | 11 | 1.7 | 74.7 |
| 1993 | 100 | 22.7 | 21.8 | 0.9 | 77.3 |
| 1995 | 100 | 22.5 | 21.7 | 0.8 | 77.5 |

Source: GSO, 1996

To further separate state ownership from state regulatory and public services functions, the administrative grouping of enterprises under umbrella organizations was adopted and the government issued Decisions 90 and Decision 91 in 1994 requiring state corporations and state enterprise unions to re-register either as State Corporations 90 or State Corporations 91¹. The main objectives of these two Decisions are to consolidate enterprises for improved supervision and to facilitate the abolition of line ministry and local authority control over state enterprises. Arguments favoring the establishments of state corporations focused on the economies of scale and the improved administration over a reduced number

¹ State Corporations 90 were required to have at least five members and total legal capital of VND 100 billion, and their establishment can be approved by ministers or provincial people’s committees. State Corporations 91 were required to have at least 7 members with minimum of total legal capital of VND 1000 billion, approved by Prime Minister.

of enterprises.

It has been argued that the establishment of large state corporations may lead to increased monopoly power. Especially where domestic market is concentrated or trade barriers remain significant, there is potential for corporations to coordinate the operations of their member enterprises to exploit possible monopoly position. In the distribution and commerce sector, the wholesale services for some essential goods were concentrated in one state corporation as in the case of Vietnam Petroleum Corporation and Cement Corporation of Vietnam. With limited competition induced by regulations, some corporations have continued to use monopoly pricing (Van Arkadie and Mallon, 2003).

Another effort to increase the effectiveness of SOEs in Vietnam is the move to harden SOE budget constraints. The possibility to get direct support from the state budget had disappeared already in the early 1990s, but the larger SOE still had privileged access to credits from state banks to cover their losses. Although data are fragmentary, it is clear that the financial system is still struggling with the overhang of non-performing loans from this period.

Since the beginning of 1990s, the reform of SOEs in Vietnam has moved to the next stage with measures aiming at the diversification of state ownership. This equitization process started with a pilot program in 1992. The program called for transformation of a limited number of viable or potentially viable small scale non-strategic SOEs into joint-stock companies. The adopted approach to equitization was selling off enterprises shares to employees on preferential terms and to other investors including domestic public and private investors. Foreign investors have also been allowed to buy shares of equitized SOEs but on a limited basis. In May 1996, the Government issued Decree 28-CP extending the scope of equitization to all non-strategic small and medium sized SOEs. Decree 28-CP was amended in March 1997 and replaced by Decree 44 in 1998. The equitization process has however been very slow. By the end of 1997, only 17 small and medium sized SOEs had been equitized (Van Arkadie and Mallon, 2003). Main reasons behind the slow equitization include the lack of transparent guidelines on the valuation of assets of the equitized SOEs, weak corporate governance and very limited liquidity of the shares due to the lack of an official stock market². The pace of the equitization, albeit still slow relative to the target, has been proceeding much faster after 1998. Between 1998 and the end of 2000, there have been more than 450 equitizations (VDR 2001:33).

The Government also set up a special Social Safety Net Fund for redundant SOE workers, run by the Ministry of Finance (MOF). Workers who are either separated from their jobs or volunteer to leave them are offered two months of basic salary per year of service, plus a training allowance equivalent to six months of salary, plus six months of salary to support their job seeking process, plus a lump-sum of 5 million VND. The design of this compensation package was aimed at minimizing the expected welfare loss of separated workers. The Social Safety Net Fund has been in operation since mid-2002. It has assisted 8,000 separated workers from 230 SOEs, paying an average compensation package of 28.8 million VND.

² The first stock exchange centre of the country was established only in July, 2000 and only large equitized SOEs can be listed. At present, there are 29 firms listed in the centre.

4. Private Sector Development and Distribution Sector

Another significant move parallel to the reform of SOEs is the strategy to facilitate the development of a multi-sector economy where the private sector receives greater attention and increasingly equal treatment. The view towards the private sector has changed fundamentally with Doi Moi and private sector has been officially considered as an important sector of the economy with the passage of the Law of Companies and the Law of Private Enterprises both in December 1990. The 1992 Constitution recognizes private property rights in a state managed market-oriented multi-sector economy and therefore was a milestone in laying the foundations for a private sector to compete with the state sector (Government of Vietnam:18-19).

Table 3: Average Annual Growth Rates by Service Sub-Sector: 1986-2003

| Service Sub-Sector | Average Annual Growth Rate | | | |
|--|----------------------------|---------|---------|---------|
| | 1986-90 | 1990-95 | 1995-00 | 2000-03 |
| Science & technology | 9.6 | 7.5 | 5.5 | 9.2 |
| Education and training | 9.5 | 11.2 | 5.6 | 7.2 |
| Finance and credit | 6.2 | 16.4 | 7.5 | 7.1 |
| Health care and social services | 11.1 | 5.8 | 5.0 | 7.1 |
| Commerce; equipment repair | 4.2 | 7.4 | 5.9 | 7.0 |
| Individual and community services | 5.5 | 10.1 | 8.0 | 5.6 |
| Mass and association activities | 4.9 | 10.3 | 12.5 | 5.5 |
| Cultural and sports activities | 13.5 | 9.3 | 7.8 | 5.0 |
| State management, security & defence, compulsory social protection | 7.8 | 7.2 | 2.6 | 4.8 |
| Business services; real estate | 6.7 | 9.6 | 4.7 | 4.1 |
| Hotels and restaurants | 6.2 | 9.8 | 5.6 | 4.0 |
| Transportation, warehousing, communications | 3.4 | 7.2 | 6.5 | 3.8 |
| Total GDP | 4.4 | 8.2 | 7.0 | 7.1 |

Source: GSO, *Statistical Yearbook* (various years).

A strongly response to the more enabling business environment and official recognition of private property rights is the sharp jump in household investment in agriculture and retail trade in early years of the reform and resulting in significant increase in output. Household business has been very important in rural and informal urban economic activity and provided employment for most of the population. This type of business has flourished especially in the early years of reform. The number of households increased from 0.84 million in 1990 to 2.2 million in 1996. (Van Arkadie and Mallon 2003: 159).

However, the degree of informality of private sector business remains quite high despite the fact that it has gradually decreased with the promulgation of the New Enterprise Law in 1999. Estimation using data obtained from surveys conducted by GSO in 1989, 1992, 1994 and 1996 show that the GDP of the informal sector is more than half the size of the formal sector's GDP (GSO 2001)³. The share

³ In GSO's definition, informal activities include not only household and unregistered business but also

of the formally registered private sector remained relatively unchanged and of about 7 per cent of GDP throughout the 1990s, indicating that a significant proportion of activity of the rapidly growing private sector was very likely not reported.

It should be noted that the private service sector has been benefiting most from the policies facilitating private sector development. The share of private sector in the services sector has steadily increased and private sectors now accounts for more than half of service GDP. They dominate retail trade activities with their share increasing from 41 per cent in 1986 to nearly 76 per cent 1996 (Van Arkadie and Mallon 2003: 159). The role of SOEs in retail trade was reduced further after the New Enterprise Law was issued, from 30% in 1990 by nearly half to 17.2% in 2002.

Recent developments in Vietnam have indicated that the private sector has increasingly become the default alternative for further development, and the policies towards private enterprise have undergone significant reform. Official documents have upgraded the private enterprise sector to one of the cornerstones of the economy, and efforts have been made to reduce some of the privileges of SOEs, to create a level playing field for private firms.⁴

Table 4: Percent of Vietnam’s GDP by economic activity: 1995-2003 [constant price]

| Economic Activity | Percent of GDP | | | Average Annual Growth | |
|------------------------------------|----------------|-------------|-------------|-----------------------|------------|
| | 1995 | 2000 | 2003 | 1995-00 | 2000-03 |
| Agriculture, fishing, forestry | 26.2 | 23.3 | 21.0 | 4.4 | 3.5 |
| Mining | 5.3 | 6.7 | 6.1 | 12.2 | 3.6 |
| Manufacturing | 15.5 | 18.8 | 21.2 | 11.2 | 11.5 |
| Utilities | 1.7 | 2.3 | 2.7 | 13.4 | 12.1 |
| Construction | 7.5 | 7.5 | 8.5 | 7.2 | 11.3 |
| Commerce | 17.2 | 16.3 | 16.3 | 5.9 | 7.0 |
| Hotels & restaurants | 3.4 | 3.2 | 3.2 | 5.6 | 6.7 |
| Transport, storage, communications | 4.0 | 3.9 | 3.8 | 6.4 | 6.4 |
| Financial services | 2.0 | 2.1 | 2.1 | 7.5 | 7.1 |
| Science & technology | 0.6 | 0.6 | 0.6 | 5.7 | 9.2 |
| Business services; real estate | 5.0 | 4.5 | 4.1 | 4.7 | 4.1 |
| Public administration | 3.6 | 2.9 | 2.7 | 2.6 | 4.8 |
| Education & training | 3.6 | 3.3 | 3.4 | 5.6 | 7.2 |
| Health & social services | 1.5 | 1.4 | 1.4 | 5.6 | 7.1 |
| Recreational, cultural | 0.6 | 0.6 | 0.6 | 7.8 | 5.1 |
| Community, personal services | 2.3 | 2.4 | 2.3 | 8.0 | 5.2 |
| Total GDP | 100.0 | 100.0 | 100.0 | 7.0 | 7.1 |
| Services - Vietnam’s Categories | 43.8 | 41.3 | 40.5 | 5.7 | 6.4 |

Source: Calculated by the author from GSO, *Statistical Yearbook 2003*, Table 27.

not-reporting income, smuggling, NGO activities etc.

⁴ See for instance the discussions in Government of Vietnam (2002).

The new Enterprise Law, came into force in 2000, has considerably simplified the company registration process and enhanced the growth of private enterprise. On average, it takes only 17 days and less than USD 40 to have a new business registered that is in sharp contrast with 99 days and USD 660 in the past (VCCI, 2002). The considerable reduction of barriers to entry has offered a big push to the expansion of private enterprises. By the end of September 2003, more than 75,000 new private companies had been registered under the new law, most of them small and medium sized firms. By contrast, the total number of private firms registered during the preceding 10-year period (1990-1999) had not exceeded 45,000. Reports in Vietnamese press indicate that the private sector's share of total investments increased from 20 percent in 2000 to 27 percent in 2003 (to exceed that of the SOE sector), and that private firms created 1.6-2 million new jobs during this period (Saigon Times Weekly, Nov 8, 2003). In fact, it was estimated that only about 70 per cent of the newly registered firms and actually newly established and the rest had been operating informally before they decided to register. Again, this is another indicator of the extent of informality of private sector in Vietnam before the New Enterprise Law coming into effect.

5. Economic Integration, FDI and Distribution Services

Open door policy has been one of the main pillars of the economic reform in Vietnam and also viewed as one of the most important engines of Vietnam's outstanding achievements. At the onset of Doi Moi, the Law on FDI was promulgated in 1987 marking the first important milestone towards the official recognition of the foreign invested sector as one important sector in the multi-sector economy. The Foreign Investment Law has been amended four times to better promote and ensure investors' rights. Forty one (41) investment protection agreements and thirty eight (38) double taxation avoidance agreements were concluded with various countries and territories. The Government allowed foreign investors to make direct investment in Viet Nam in all forms, including the 100%-foreign-owned companies, in all sectors not prohibited by the Government. With regard to the sectors where there are constraints (such as communications, crude oil exploitation, telecommunications), investors are entitled to make joint investment with local partners. The Government, on the other hand, only exerts prohibitions of foreign investment in sectors that are deemed harmful and threatening to (i) the national culture, (ii) the national security, (iii) public social benefits, and (iv) the environment.

Trade liberalisation and integration with the world economy has perhaps been the policy area with most advanced structural reforms. In the yearly years of the reform, the government had introduced several measures to remove trade barriers. The non-tariff barriers system was replaced by a tariff system in the end of 1980s and restrictions on foreign exchange controls have gradually been loosened. The monopoly of SOEs in foreign trade has been steadily reduced and private enterprises can engage directly in export and import. In the last few years, the government of Vietnam has clearly demonstrated its firm commitments in further integrate the economy into world economy (participating AFTA, signing BTA, supporting AEC, and negotiation efforts exerted to become a member of WTO in 2005). By the end of 2010, it is expected that the average tariff rate under the Effective Preferential Tariff Scheme will be about 9.3%, and all commitments under AFTA will be completed. Accession to the WTO will be essential for fostering competition in all sector, especially the service sector which is at present dominated by a

few state-owned corporations.

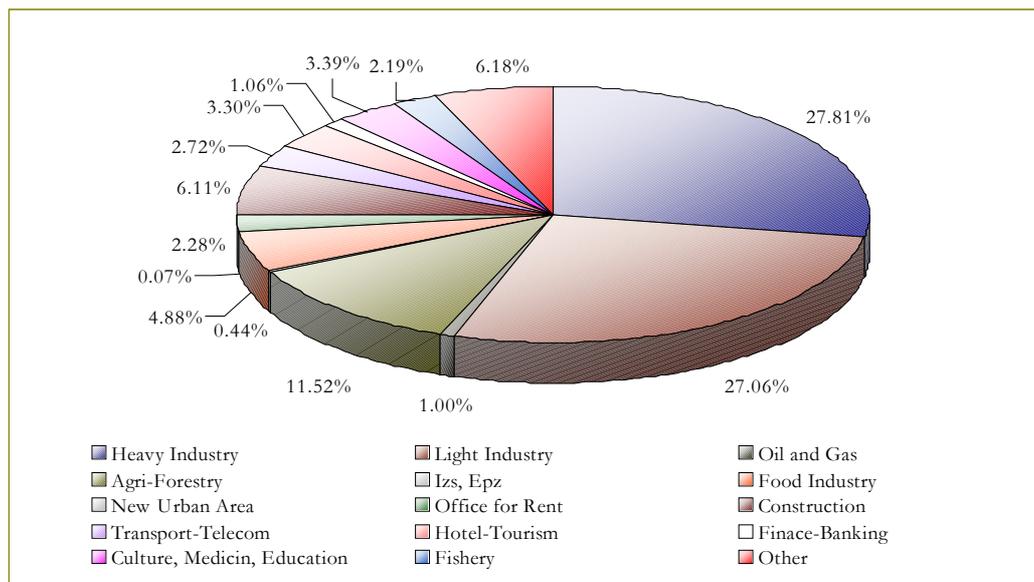
Table 5: The Integration with the World Economy

| | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 |
|------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Trade (percent of GDP) | | | | | | | | | |
| Exports | 24.9 | 26.3 | 29.4 | 34.3 | 34.5 | 40.2 | 46.5 | 46.2 | 47.5 |
| Imports | 35.8 | 39.3 | 45.2 | 43.3 | 42.4 | 40.9 | 50.2 | 49.9 | 56.1 |
| Total trade | 60.7 | 65.6 | 74.6 | 77.6 | 76.8 | 81.2 | 96.6 | 96.1 | 103.6 |
| FDI (US\$ million) | | | | | | | | | |
| Approvals | 3,766 | 6,531 | 8,497 | 4,649 | 3,897 | 1,568 | 2,012 | 2,536 | 1,558 |
| Inflows | 1,636 | 2,260 | 1,963 | 2,074 | 800 | 700 | 800 | 900 | 1,100 |
| GDP Growth | 8.8 | 9.5 | 9.3 | 8.2 | 5.8 | 4.8 | 6.8 | 6.9 | 7.0 |

Note: FDI estimates are based on reported foreign equity inflows plus foreign borrowing by joint ventures.
 Source: Vietnam Development Report 2004, and GSO.

Radical changes in international trade and investment regimes have resulted in remarkable success and Vietnam has been able to achieve double-digit export growth from 1990. Vietnam is also one of the success stories in attracting foreign investment. The contribution of FDI to the overall GDP has gradually increased in recent years, with FDI is picking up considerably since 2004 after a set-back in the years following the Asian financial crisis.

Figure 2: Composition of FDI 1998-2003



Source: MPI Website

However, barriers to foreign investors do differ across sectors and FDI in Vietnam tends to concentrate in some particular industries, especially the highly protected heavy industries. Despite recent liberalization, Vietnam's regulations continue to place significant restrictions on foreign participation in the services sector in general and, in the importing and distribution sectors in particular. In this context, "foreign" refers to companies or organizations with foreign capital. To a large extent, import and distribution activities are reserved for Vietnamese entities, and offshore manufacturers must work through Vietnamese firms to establish distribution or retailing operations inside Vietnam. However, foreign-capital companies licensed to manufacture in Vietnam may be permitted to distribute their products domestically. Investment licenses now may also allow foreign-invested companies to import raw materials for manufacturing their products locally, as well as finished products before production start-up for the purpose of test marketing and developing the business over a limited period of time.

According to the U.S. - Vietnam BTA currently in force, U.S. firms are permitted to form joint ventures with Vietnamese partners in distribution services three years after the date of entry into force of the Agreement (i.e. on December 10, 2004) subject to some limitations on trading and distribution rights. One hundred percent U.S. invested capital firms may be established seven years after the date of entry into force of the Agreement subject to the same limitations, which shall be abolished over phase-out periods.

There is a general misconception that market-seeking FDI in domestic sectors such as retail yields little development impact. The opposite is true. FDI in retail has been a key driver of productivity growth in Brazil, Poland, and Thailand, resulting in lower prices and higher consumption. Large-scale foreign retailers are also forcing wholesalers and food processors to improve. And they are now becoming important sources of exports: Tesco in Thailand and Wal-Mart in Brazil are increasingly turning to local products to feed their global supply chains. Retail also happens to be a pillar of the tourism industry. The misconceptions about FDI are made worse by political economy factors: while attracting efficiency-seeking FDI does not affect incumbents, attracting market-seeking FDI usually does. In the future more and more FDI will be market seeking investment in service sectors as well as investment in tourism and offshore services.

Foreign investors have shown more interest in commerce and distribution services in recent years. A significant development in wholesaling is the launch in 2001 of a wholesale cash-and-carry operation to serve small retailers by Germany's Metro AG group. Metro Cash and Carry operates a members-only service restricted to businesses and offers a variety of both food and non-food items. Over the next three to five years, the company plans to build seven large stores spread throughout Vietnam. Currently, they have two large stores in Ho Chi Minh City and a new store opening in Hanoi on July 31, 2003.

Another fast developing area in distribution services is shopping center development. The Saigon Superbowl and Diamond Plaza in Ho Chi Minh City, the nation's first large-scale entertainment and retail centers, only opened in 1996 and 2000. French hypermart developer CORA has opened a complex anchored by its flagship mega-store in Dong Nai Province which is mobbed on weekends by shoppers from Ho Chi Minh City and the surrounding provinces. It has opened subsequent hypermarts in Binh Chanh and Cholon Districts of HCMC and announced plans for several more stores (including outlets as far afield as Hanoi and Can Tho) over the next few years. Other recent developments include a very large retailing center (21,797 sq. m) in the mixed-use Thuan Kieu Plaza in Cho Lon, HCMC's "Chinatown", as well as SAVICO-Kinh Do Plaza, a pastel "strip mall" type development in the heart of District 1.

Although Ho Chi Minh City leads this sector, similar developments are taking place in Hanoi. One major project is a \$30 million joint venture between CORA and Thang Long General Import-Export and Travel Company to develop a hypermart on eleven hectares of land only ten kilometers from the center of Hanoi. The project is presently in the phase of land compensation and site clearance.

Showrooms and service centers for specialized products such as electronics, appliances, automobiles, and industrial goods are also increasing. General Electric (GE) Company's Appliance Division and Lighting Division have launched chains of retail outlets in the past year, and industrial equipment manufacturer Parker-Hanafin and air conditioner giant Carrier have opened similar outlets in HCMC. All of this is changing the way the wealthier and more cosmopolitan segment of urban Vietnamese shops. But apart from these pioneering projects, retail outlets still consist mainly of family-run market stalls or small street-front shops.

6. Concluding Remarks

The reforms in commerce and distribution sector in Vietnam in the last 20 years have made significant contribution to the overall outstanding performance in economic growth and poverty reduction. The move towards a market economy in which prices are determined by market forces is critical in improving the efficiency of resources allocation, creating right incentives for economic actors to participate more

Table 6: Share and Growth of Employment by Economic Activity: 1990-2002

| Economic Activity | Percent of Employment | | | Average Annual Growth | |
|------------------------------------|-----------------------|-------|-------|-----------------------|---------|
| | 1995 | 2000 | 2002 | 1995-00 | 2000-02 |
| Agriculture, fishing, forestry | 70.1 | 68.2 | 66.1 | 1.3 | 1.0 |
| Industry* | 11.2 | 12.1 | 12.9 | 3.4 | 6.1 |
| Commerce | 5.8 | 7.4 | 8.0 | 7.0 | 7.0 |
| Hotels & restaurants | 1.6 | 1.8 | 2.0 | 5.4 | 5.5 |
| Transport, storage, communications | 2.3 | 2.5 | 2.9 | 4.1 | 10.4 |
| Financial services | 0.2 | 0.2 | 0.2 | -0.4 | 18.5 |
| Science & technology | 0.2 | 0.1 | 0.1 | -1.9 | -0.9 |
| Business services; real estate | 1.9 | 0.3 | 0.33 | -29.1 | 6.6 |
| Public administration | 2.5 | 2.5 | 2.5 | 2.2 | 1.8 |
| Education & training | 2.5 | 2.6 | 2.7 | 2.2 | 5.7 |
| Health & social services | 0.7 | 0.7 | 0.7 | 1.4 | 1.2 |
| Recreational, cultural | 0.2 | 0.2 | 0.2 | 2.9 | 2.8 |
| Community, personal services | 1.1 | 1.3 | 1.4 | 6.0 | 6.1 |
| Total Employment | 100.0 | 100.0 | 100.0 | 1.8 | 2.7 |
| Services - Vietnam's Categories | 18.7 | 19.6 | 21.0 | 2.8 | 6.2 |

* Includes mining, manufacturing, utilities, and construction.
 Source: GSO, calculated from various issues of the *Statistical Yearbook*.

actively and effectively in the production and distribution chains.

While the extent the improvements in the commerce and distribution sector contributed to the productivity growth, expansion of production as well as growth of the other services sectors remains to be studied, direct contribution of the commerce and distribution sector to GDP growth and especially employment growth has been very significant. Growth data of various sectors as provided in Table 4 show that over the period 1995-2003, GDP of commerce services grew faster than the average GDP of the services sector, and in the period 2000-2003, commerce service sector is one of the fastest growing sector of the economy. But perhaps more important is the role of this sector in generating employment. Over the period 1995-2002, commerce and distribution services sector experienced the highest rate of employment growth, almost three times of the national average. Commerce and distribution sector is now the third-largest employer behind agriculture and industry and the latest includes some other services sub-sectors such as construction and utilities. The commerce sector has also the highest growth elasticity of employment with one percentage point increase in GDP results in more than one percentage point increase in employment.

Table 7: Employment and production increase 1996-2001. Index 2001=100

| Sector | Employment increase | GDP Increase | Employment elasticity |
|----------------------------|---------------------|--------------|-----------------------|
| Agriculture | 104.9 | 121.3 | 0.23 |
| Manufacturing | 121.1 | 167.1 | 0.31 |
| Construction | 130.2 | 137.2 | 0.81 |
| Trade | 140.2 | 129.4 | 1.08 |
| Hotels & Restaurants | 130.4 | 127.3 | 1.02 |
| Transport | 129.4 | 136.8 | 0.80 |
| Public Administration | 109.5 | 112.2 | 0.90 |
| Education | 116.1 | 128.8 | 0.56 |
| Health and Social Services | 106.7 | 128.9 | 0.23 |
| Total | 111.6 | 133.8 | 0.34 |

Source: GSO, various issues.

With labor being the most important asset of the poor, creating employment is arguably one of the most important measures to reduce poverty. Available data from the Living Standard Surveys conducted by GSO show that people with farm jobs are much more likely to be poor. In 2002, 82.5 per cent of the poorest quintile were self-employed in agriculture. Richer quintiles have much higher proportion of people with non-farm jobs. About three in four people in the richest quintile are employed or self-employed in the non-farm sector (VDR 2004). The commerce and distribution sector is very labor intensive and generated 8 per cent of the total employment in 2002, therefore was an important factor behind the impressive poverty reduction in Vietnam in the last 20 years.

The success of the commerce and distribution growth can be attributed to two main factors. First,

reforms aiming at facilitating the development of private sector are of crucial importance for the proliferation of the private firms in the distribution service sector. Small traders and household business had always been an important player in the retailing services even before Doi Moi took place. The entrepreneurship existing in the pre-Doi Moi period has been strongly encouraged to develop by the reduction of barriers to market entry and the gradual development of market institutions. In addition, important legal framework has been developed that set up the foundations for the operation of the private sector and boosting business confidence and investment by allowing individuals to exercise property rights over income producing assets and personal property.

The second important factor leading to the successful development of the commerce and distribution services sector is that the government has adopted a right approach emphasizing gradualism and appropriate sequencing. The comprehensive reform process has taken place in a context of stable macroeconomic environment. Political stability has been crucial in maintaining high level of private business confidence. The reform in the commerce sector has occurred gradually with initial reform measures were undertaken in domestic trade in which internal barriers to trade were removed in early years of reform. Autonomy of SOE managers has also increased step by step, and a gradual reduction of SOE monopoly in retailing services was accompanied by the facilitation of private sector development.

Table 8: Percent of Enterprises in Each Size Category, by Economic Activity: December 31, 2002

| Economic Activity | Number of Employees | | | | | Total |
|--------------------------------------|---------------------|--------------|--------------|--------------|--------------|--------------|
| | < 5 | 5-9 | 10-49 | 50-199 | 200+ | |
| Commerce | 74.5 | 48.4 | 27.3 | 13.0 | 8.6 | 39.4 |
| Manufacturing | 7.2 | 15.8 | 27.3 | 41.2 | 51.6 | 23.5 |
| Construction | 3.7 | 7.1 | 17.8 | 20.3 | 20.4 | 12.5 |
| Agriculture, forestry, fishing | 1.3 | 5.5 | 7.7 | 5.6 | 4.8 | 5.4 |
| Transport/storage/communications | 2.4 | 4.3 | 6.6 | 7.5 | 5.6 | 5.2 |
| Business services; real estate | 5.1 | 6.6 | 4.8 | 4.4 | 2.1 | 5.1 |
| Hotels/restaurants | 4.3 | 6.5 | 4.2 | 2.8 | 1.5 | 4.5 |
| Financial services | 0.2 | 4.0 | 1.0 | 0.6 | 0.6 | 1.7 |
| Mining & quarrying | 0.3 | 0.7 | 1.9 | 2.8 | 2.6 | 1.4 |
| Other services | 0.2 | 0.3 | 0.4 | 0.6 | 1.0 | 0.4 |
| Recreation/culture/sports | 0.3 | 0.2 | 0.3 | 0.5 | 0.4 | 0.3 |
| Utilities | 0.3 | 0.2 | 0.2 | 0.5 | 0.7 | 0.3 |
| Education & training | 0.2 | 0.3 | 0.2 | 0.1 | 0.0 | 0.2 |
| Health & social services | 0.1 | 0.1 | 0.2 | 0.1 | 0.1 | 0.1 |
| Science & technology | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Services - Vietnam categories | 87.2 | 70.8 | 45.1 | 29.6 | 19.9 | 56.9 |

Source: GSO, *Statistical Yearbook 2003*, calculated from Table 237.

Despite important achievements mentioned above, there are some critical issues facing the commerce and distribution sector in Vietnam. The future development of the distribution services sector depends crucially on how Vietnam is going to address these issues to improve the sector's competitiveness and ready to stand out the increased foreign competition resulting from regional and international integration.

One widely acknowledged issue is the fragmentation of the commerce and distribution services. The sector has been made up of millions of household businesses and hundreds thousand small trading companies. As of December 2002, three in four micro firms with less than 5 employees and nearly 50 per cent of enterprises employed 5 to 9 workers are trading enterprises.

With underdeveloped infrastructure, small scale of trading firms together with simple services technology implies that the distribution system is a fragmented patchwork of state-owned import-export companies, private and state-owned wholesalers, independent Vietnamese agents and distributors, retail outlets, and street stalls with no or very limited link among them. For many products, nationwide distribution requires the establishment of separate networks in the North, the South, and the Central Region. Lack of physical infrastructure links among the major regions together with cultural and economic differences across the nation make it difficult to achieve "one-stop" distribution in many sectors.

Another issue is weak law enforcement. Weak law enforcement implies insecure property rights and an immediate consequence is a higher level of risk of doing business and transaction costs. Firms are forced to adopt a number of risk mitigation strategies to limit their exposure in case the other firms breach the contract. They may use short-term contracts with the promise of renewal upon successful completion or delayed payments to ensure future deliveries. It would take much more time to develop trust in partners. Besides wasting time and resources, firms will opt for short-term and small-scale activities and this clearly hinders the growth of private enterprises. In addition, small firms that account for the vast majority in Vietnam businesses have no effective way to protect themselves from breach of contract by the other party.

Weak business environment represents a further major issue for the development of private sector in general and the distribution sector in particular. The weakness in the business environment of Vietnam compared to other countries has been documented in a study of the World Bank. The report *Doing Business in 2005: Removing Obstacles to Growth*, cosponsored by the World Bank and International Finance

Table 9: Indicators for Starting Business in East Asia

| | Number of Procedures | Time (days) | Cost (% of income per capita) |
|----------------|----------------------|-------------|----------------------------------|
| Malaysia | 9 | 30 | 25.1 |
| Indonesia | 12 | 151 | 130.7 |
| Thailand | 8 | 33 | 6.7 |
| Singapore | 7 | 8 | 1.2 |
| Korea | 12 | 22 | 17.7 |
| Vietnam | 11 | 56 | 28.6 |
| Philippines | 11 | 50 | 19.5 |
| China | 12 | 41 | 14.5 |

Source: WB, Doing Business 2005.

Corporation, finds that investment climate reforms, while often simple, can help create job opportunities for women and young people, encourage businesses to move into the formal economy, and promote economic growth. Vietnam's business environment ranks in the bottom quartile of the World Bank list of 145 countries despite recent rigorous reforms of its business laws. Borrowers and lenders in Hong Kong (China) and Singapore enjoy all ten main types of legal rights that expand access to credit, while those in China and Vietnam have fewer than half as many legal rights.

An important implication of weak law enforcement and business environment is the high level of informality. When contracts are not very enforceable and therefore the level of property protection is not high, relationship-based business is more popular and the degree of uncertainty is also not conducive for long-term investment. It partly explains why business remains small-scale and employment in Vietnam has been dominated by self-employment. Recent survey by MOLISA shows that in 2003 about 2 in three people in working age are self-employed or have household business. The share of self-employment has even increased by nearly 4 percentage points from 1999 showing that small-scale informal activities remain one of the most important sources of employment for Vietnam in the years to come.

Other implications of weak law enforcement and low quality of business environment include the increasing scale and scope of corruption. This can impose another much worrying sign and reduces incentives to invest, lower quality of public infrastructure and services and hence result in lower rate of growth and poverty reduction. Smuggling is another consequence of weak law enforcement combined with high level of protection for some industries and this has resulted in the creation of an informal distributing channel for smuggled goods.

Appendix: Main milestones of Reform in Vietnam in the first few years of Doi Moi

| | <i>Changes in trade and exchange system</i> | Other reforms |
|------|---|--|
| 1986 | | - VI Party Congress declares beginning of Doi Moi |
| 1987 | - <i>Law on Foreign Investment</i> — introduction of ‘open door’ policy | - Land law established private use of allocated land in agriculture - Creation of a central treasury to execute the budget |
| 1988 | - Foreign exchange control decree liberalises retention of foreign exchange, opening of foreign currency accounts, use of transfers to pay for imports and repay foreign loans - Devaluation of trade and invisible payments exchange rates - Restrictions on establishment of foreign trading organisations relaxed and central government monopoly of foreign trade terminated - <i>Law on Import and Export Duties</i> introduces the customs tariff | - Creation of two tier banking system - Cooperative method of agriculture production abandoned in favour of households - Farming households given long term rights to use land for agricultural production - Encouragement of private enterprises becomes official policy - <i>Land Law</i> creates nontransferable, exclusive land use rights for agriculture |
| 1989 | - Quotas removed on all but ten export and 14 import commodities (subsequently reduced to seven export and 12 import commodities) - Requirement that SOEs fulfill CMEA export targets before exporting to convertible currency area removed - Number of export commodities subject to export duties reduced from 30 to 12 and most rates reduced - Producers of exportables allowed to sell to any appropriately licensed foreign trade company - Number of import commodities subject to duties reduced from 124 to 80, range of rates expanded from 5–50 per cent to 5–120 per cent - Foreign exchange rate system unified | - Nearly all forms of direct subsidisation of production and price control removed — end of ‘two price’ system - Domestic trading in gold legalised - <i>Ordinance on Economic Contracts</i> establishes rights for legal entities to enter into contracts - Bank interest rates made positive in real terms |
| 1990 | - Special sales tax introduced - Turnover tax and profit tax introduced - <i>Law on Foreign Investment</i> revised | - <i>Law for State Bank of Vietnam and National Law on Banks, Cooperative Credit Institutions and Financial Institutions</i> enacted, prohibiting SBV from commercial banking and empowering it as central bank - <i>Law on Private Enterprises</i> establishes legal basis for establishment of sole proprietorships - <i>Law on Companies</i> establishes legal basis for, limited liability and shareholder business entities |
| 1991 | - Foreign exchange trading floors opened at SBV - Regulation on setting up export processing zones (EPZs) promulgated - Export duty on rice reduced from 10 per cent to 1 per cent - Imported inputs used to produce exports exempted from duty - Private companies allowed to directly engage in international trade | - Agriculture Bank of Vietnam allowed to lend to households |
| 1992 | - Harmonised system of tariff nomenclature introduction - Foreign investment law amended to reduce discrimination in favour of joint ventures against 100 per cent foreign owned enterprises, and to introduce build operate transfer (BOT) concept for infrastructure projects - Trade agreement signed with European Union (EU) establishes quota on exports of textiles and clothing to EU and grants tariff preference on selected imports from EU | - New constitution allows individuals to exercise property rights over income producing assets and personal property - Pilot equitisation program for SOEs introduced |

Source: Excerpted from CIE 1998:5.

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