



**Nguyen Bich Ngoc\***

National Economics University, Vietnam

## **THE TRANSITION PROCESS OF VIETNAM'S TRADE POLICY FROM CLOSED ECONOMY TO "SERVICIFICATION" ECONOMY**

### **Abstract**

As one typical transition economy, Vietnam has sharply progressed from a centrally-planned system to a market economy due to the economic reform. Together with the socio-economic development strategy, trade policy has been fully consistent with the transformation. While the effects of trade policy have received much concern in the academia, the paper finds out deeply the change on strategies of trade policy in transition economies in the attempt to catching up the advanced countries. The finding is to draw on the whole picture of Vietnamese trade policy over the period (from 1986 to 2016) and to analyse the remarkable changes leading to successes and failures on these policies.

**Keywords:** Transition process, Trade policy, Vietnam

### **Introduction**

While most literatures mention the effects of trade policy on economic, the paper finds out deeply the change on strategies of trade policy in transition

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\* Address e-mail: [bichngoctqt.neu@gmail.com](mailto:bichngoctqt.neu@gmail.com).

economies in the attempt to catching up the advanced countries. With the variety of socio-economic context, the orientation of trade policy would lead to the fail or success for these countries.

The paper aims is identification the orientations of Vietnamese trade policy during three generations up to 30 years (from 1986 to 2018). These periods have witnessed the transformation from “a centrally planned system” in which implemented in Second Five-year Plan (1976–1980) and Third Five-Year Plan (1981–1985) to “a decentralized system” in which launched a political and renovation policy (*Doi moi*) in 1986. Indeed, 1986 was considered as the landmark of Vietnam’s economic development. To draw the whole picture of the evolution in Vietnamese trade policy, the paper uses descriptive statistics and legal documents in Vietnam from 1986 toward 2030. Based on evidences and statistics, Vietnam has experienced successfully in transforming economy due to utilize the comparative advantages for exporting-oriented industry, to strengthen international cooperation in the region and global, and to allocate effectively endogenous and exogenous factors.

## 1. Review of the literature

It is no doubt that trade policy plays the central role of economic growth in most countries. “Policies toward foreign trade are among the more important factors promoting economic growth and convergence in developing countries” (IMF, 1997, p. 84). The “outer – oriented” trade strategies led to the superior growth performance of countries (Krueger, 1998, p. 1513). The empirical studies show that the transformation from closed to open economies are mostly acted by trade liberalization. In the research of (Reynolds, 1985), he concluded that the open international economy was crucial for the rapid economic growth based on the evidences of forty-one developing countries outside Europe and North America.

However, the question is that whether the theory is suitable to apply into transition economies or not. Transition economies has seen with some features such as experiences from central-planning economy, the existence of state-owned enterprises which dominate in some fields, the strongly government interventions in the market. Based on researching on some typical transition economies, evidences have been proved again the efficiency of outward policy. Chinese policy in the eleventh of 5-year Plan (2010–2015) had oriented to export-oriented model and step by step to

modify the trade balance between export and import, as well as focus on attracting FDI for promoting technological and information innovations (Toan, 2012, p. 3–12). In details, Chinese foreign policy stands on the three basements including: firstly, not important who the partners are, but whom makes profits would be the China's trade partners; secondly, the economic development must implement by internal restructuring then external trading; thirdly, utilizing unexploited resources from the cooperation with the third world countries (Loan, 2015, p. 69–85). Especially, China has been successful to accelerate privatization of SOEs by the way to set clear priorities in their privatization attempt and place the corporation in a wider context of macroeconomic reform. But, China also meets some challenges due to the dominance of Mercantilism, which leads to trade imbalance and the negative effects on domestic consumption. Until now, China becomes the second largest economy in the world due to the steely determined awareness of internal restructuring system as well as maximizing benefits from international cooperation.

Another example is Russia - the leading country in the communism. Russia has merited the remarkable growth during the period of 2000–2008 (the growth rate of 7% per year). After the Soviet period and the hyperinflation in 1998, the macro economy of Russia had sharply recovered due to the favorable trend in earnings from oil and gas exports, economic reform during Putin's administration. Based on Trade Policy Review of Russia Federation (WTO, 2016), the main reasons of the success stem from liberalization of trade and investment, especially the strong comparative advantage of exporting fuel to recover the economy. However, The Russia Federation has focused on surpluses in both trade and current accounts of its balance of payments on the oil and gas export revenues. Nevertheless, government also set the key priority to diversify economy away from the dependence of mineral and energy resources with the aim of sustainable development in the future. In other aspects, while government has declined the number of State-owned enterprises (SOEs), some of largest SOEs occupy a dominant position in key sectors (banking, transport and energy). In terms of international integration, Russia joined the EAEU (Eurasian Economic Union) so that trade policy formulation is implemented through both national institutions and legislation and EAEU bodies and laws. In this regard, Russia also face challenges from governance issues, the relative complexity of its economic environment, the fluctuation and exhaust of oil prices, together with political issues with countries.

## 2. Materials and methods

Based on theoretical and practical evidences, the usual orientation for transition economies focus on two problems: economic reform (or internal structural changes) and trade liberalization. More details: 1) increasing in industrialization; 2) decreasing in the agriculture; 3) changing trade patterns; 4) increasing application of human capital and knowledge to production; 5) undertaking institutional change (Cypher, 2008, p. 21–23). Successful development almost remarked by a maturation in the trade pattern, in which limit a range of primary exports or labor-intensive industries in place to the diversity of export products toward high value-added manufactured goods and services. Each stage of the development process is relative to the orientation of trade policy for socio-economic goals. In details, some basic models of trade policy are relatively demonstrated as: *1 – The import – substitution policy; 2 – The export – oriented industrial policy with trade protectionism selectively; 3 – The export – promoting policy with trade liberalization; 4 – Services trade policy* (The process transfers from merchandise export diversification to “servicification”, in which primary sector become increasingly reliant on services for production and trade).

According to literature review, the paper sums up the progress of trade policy in Vietnam since the reform of 1986 and emphasizes on the remarkable changes to result in the successes, as well as the existing failures.

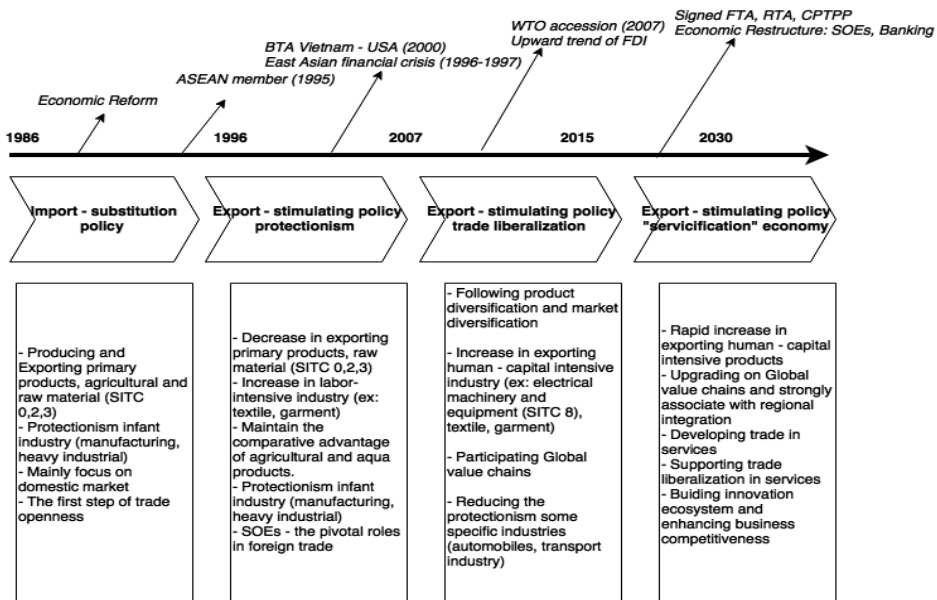
The paper includes 4 main parts: First part reviews the literatures on the case study for economic reforms in typical transition economies. The second part shows the overview of the transition process of Vietnam’s trade policy based on the practical study and Vietnamese regulations. The third part analyses the most remarkable changes in Vietnam’s trade policies. The last part discusses about the successful and unsuccessful and the reasons behind these results.

## 3. Results

According to the strategy of export and import in Vietnam though 10-year periods, the strategy of trade policy has changed consistently with the world economy (see Figure 1). Vietnam has also utilized mostly the internal and external factors to orient trade patterns. Based on the observation, Vietnam has experienced

from 4 models of trade policies, which are appropriate with the theoretical process of trade policy suggested by economists as well as the globalization trends. These policies include import substitution from 1986 to 1996, export-stimulating with protectionism some specific industries from 1996 to 2007, export-promoting with trade liberalization from 2007 to 2015, exporting-led policy with priority in services toward to 2030. Over the period, Vietnam has witnessed the shift in comparative advantage from low value-added exports (mainly primary products, agricultural products) to labour-capital intensive products. Besides, Vietnam has also located in global value chain and gradually upgraded in the chain.

Figure 1. Vietnam Trade policy flow during the periods



Source: summarized by authors analysis based on Vietnamese legal documents and Vietnamese reports (Decision 46/2001/QD-TTg; Decision 2471/2011/QD-TTg, <http://chinhphu.vn> (28.03.2018)).

To obtain the outcome of trade policy, government has implemented multiple policy instruments. Based on the flow of trade policy, the most remarkable changes as trade policy instruments during the periods are indicated as below.

### **3.1. The initial reform of privatization**

Over two decades, the most remarkable changes of Vietnam trade policy are the initial reform occurred in 1986, with the most important characteristics of private ownership. According to Decree 217/1987, some reforms aimed at improving SOE's governance and steering them more towards market activities, practical steps towards equitization in the early 1990s (Wacker, 2017, p. 283–301). Then, the government had actions to equitization several medium sized SOEs (evidences 5 SOEs were equitized). Until now, Vietnam has emphasized the importance of private sector in the whole economy in the socio-economic development strategy and has approved a Comprehensive Reform Perspective to accelerate equitization SOEs.

In terms of trade, government has released the permission for private enterprises joining in the international trade activities and has launched the trade promotion activities to support for SMEs. The declining role of the state-owned enterprises in some primary industries (typically in the agriculture) has been the outcome of equalization and restructuring program for a decade. According to the regulation on the restructuring in the agriculture during the period from 2013 to 2020 (Decision 899, 2013), government encourage private enterprises and foreign invested businesses to invest and trade in the sector. Meanwhile, government create a fair playing field for both domestic and foreign investors. However, SOEs have dominated in some selective industry for protectionism with at least 80% (especially in transportation and some fields with the intent of national defense and security).

### **3.2. Pursuing price and trade liberalization**

In the period, Vietnam had transformed from closed economy to open market and welcome the wave of globalization. Policy instruments implemented as: removing quantitative restrictions as export and import quota, removing subsidies for exporter from government budget, devaluating official exchange rate (WTO, 2013). At the end of 1988, some industries were liberalized prices close to the market value and the few remaining prices were controlled for state customers such as cement, steel, electricity. Meanwhile, external trade and FDI regulation had progressed to open up and boost the economic growth. In details, the decision of the establishment of export-processing zone was in force, combined with releasing restrictions on foreign direct investment to promote some export-oriented projects.

The most specific characteristics of Vietnam's transition is to use external commitments to force domestic reform. The two-noticeable cooperation had remarked the positive engagement of Vietnam with the world economy including Bilateral Trade Agreement Vietnam – United States in 2001 and the WTO accession in 2007. These milestones have led to the new page in the foreign trade activities for Vietnam and have welcomed to the world market. During two decades, Vietnam's trade policy continues to pursue the diversification of market and products. Indeed, Vietnam has negotiated and signed successfully many trade agreements (including bilateral and multilateral trade agreements). Together with the engagement, Vietnam has fully implemented the commitments in removing and reducing tariff and other trade barriers to facilitate foreign enterprises as well as highly market access. The engagements also have functions to boost the domestic reforms during the transition period

### **3.3. "Localization" campaign in the development of supporting industry**

The development of supporting industries improves the level of localization for manufacturing. Importantly, the strategy aims to decrease the dependence of imported input for exporting – oriented industry, especially in the textile that the main exporting industry of Vietnam over many periods. To increase in local content in some key sectors, Vietnam has raised "localization" campaign with some activities including: encouraging consumer to consume domestically-produced goods (Vietnamese people use Vietnamese products). Additionally, ten SOEs in the primary industries (such as: coal, iron, steel, cast iron, fertilizers, plastic, cars, motorbikes) signed the voluntary cooperation for use each other's output in 2012. The cooperation agreement gave the list of goods produced domestically for recommendation enterprise's decision to make transactions. In fact, the activity encouraged the domestic consumption and discriminate against foreign products in long- term.

### **3.4. Changing the model of developing export in-scale to in-depth is based on exploiting efficiently the static and dynamic comparative advantage**

During the period, Vietnam has utilized the available endowments (cheap labor with low skills, natural resources) to export the low value-added goods. However, it difficultly maintains the high growth of exporting and the bad effect on environment, as well as the instability macroeconomic. In order to sustainable development, Vietnam has attracted external resources including FDI, technology to enhance the national competitive capacity and integrate into the global value chain. FDI has considered as the determinant to associate with global value chain.

On the other hand, Vietnam combined the static comparative advantage and the dynamic comparative advantage with the aim of sustainable development, higher productivity and high stages in the global value chain. The dynamic comparative advantages are institutional restructure, high-level technology, high-quality labour, modern infrastructure. Since the WTO accession, Vietnam has reached the goal to restructure institutional system and conformity with international regulation.

### **3.5. Trade liberalization in services cautiously and toward to knowledge economy**

The strategy of trade liberalization in services is the orientation of Vietnam in the attempt to shift to the new phase “servicification”. In 1991, Vietnam established a two-tier banking system with the State Bank relinquishing its commercial banking functions. It clearly demonstrates in Master Plan for development of Services Sector to 2020 with the aim to promote the role of the sector in the economy. To obtain the goals, government liberalize 11 services sectors out of 12 services categories and 105 subsectors out of 155 subsector categories. However, government maintain the limit foreign ownership of services companies in domestic market (ex: maximum 49 or 65% in some telecommunication services). Generally, Vietnam has processed the amendment, supplement or promulgation domestic laws and regulations related to services to consistent with WTO commitments. Furthermore, Vietnam has also positively negotiated services sectors in regional trade agreements such as ASEAN + 6 and has gone beyond the RTA commitments in business services, healthcare, tourism, transport services. On the path to knowledge-based economy,



government has more concerns about innovation, creativity. The National Program on supporting to innovation, creativity and start-up ecosystem has been launched since 2016. The system is expected to nourish the competitive capacity of Vietnamese enterprises and become the innovation hub to create new knowledge.

#### 4. Discussion

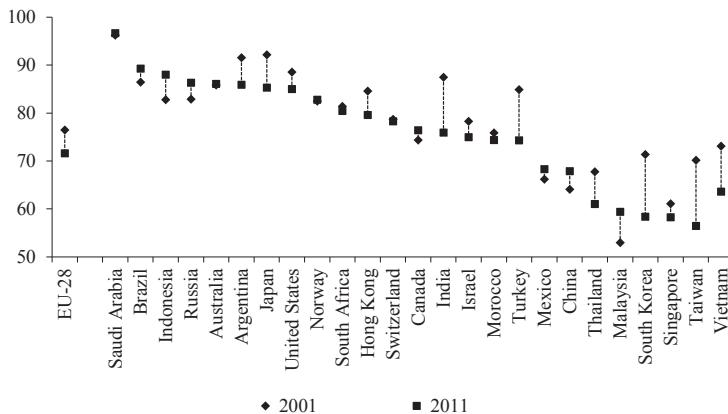
The outcomes of transition process have showed clearly in both two sides (achievements and drawbacks) as discussed below.

##### 4.1. The achievements

##### 4.1.1. Strongly participation in global value chains

In fact, the domestic value-added share of gross export in Vietnam has declined, as well as most countries (2001–2011) (see Figure 2). The Vietnam statistic has proved the decrease by 10% in the dependence of raw material and mineral productions (except for the case of Saudi Arabia, Brazil, Indonesia, Russia). Otherwise, Vietnam has presented the strongly link in global value chains, although the government's efforts in rising the local content have not yet been successful

Figure 2. Domestic value-added share of gross export (from 2000 to 2011)



Source: author's calculation based on Dataset: Trade in Value Added (TiVA): December 2016, extracted on 16 March 2018 15:16 UTC(GMT) from <http://stats.oecd.org>.

or significant. Probably, the statistics reflect the scope and dependence into global value chains. Vietnam still stands at the end of the production chain whereas activities such as assembly have a relatively low added value.

#### 4.1.2. Increasing in the intensity of technology in exporting and importing products

Technological developments can explain the changes on trade patterns. According to Statistics of technological classification in merchandise export (Table 1), the rate among technological intensity level has significantly changed. At the beginning of the period, Vietnam mainly attracted low technology and primary products to serve for exporting labor and low-technology intensive products (with 0.54% of primary products and 0.28% of low technology in merchandise export). However, importing low technology was uncontrolled for a long time to result in some problems relating to environment. In fact, Vietnam is situated on the last chain of the product cycle so that most of outdated technology or machines made from other developed countries (especially China due to the low price) has spread all over. Government is aware of the “technological rubbish” issue so that they have emphasized on the new strategy orienting to importing advanced technology with the aim of enhancing the quality of exports. Consequently, the sharp growth of high technology level in exports (from 0.06 to 0.36% over 16 years) describe the success of government’s efforts aiming to the knowledge economy.

Table 1. Vietnam’s exports classified by technology-intensity level

Technological Classification in merchandise exports	2000		2016	
	total exports (%)	trade value (mln USD)	total exports (%)	trade value (mln USD)
High technology	6	807	36	60,977
Low technology	28	3,562	34	56,952
Medium technology	5	624	9	15,081
Primary products	54	6,969	14	24,233
Resource-based products	7	888	6	10,512

Source: author’s collected based on WITS database 2016, <http://wits.worldbank.org/WITS> (15.03.2018).

### 4.1.3. The upward trend in trading services and the pivotal role of services in the structural economy

In the process of industrialization and modernization, Vietnam has successfully implemented structural changes. In 2016, services contribute the largest proportion at 45% to GDP, following to 36% of industry and 18% of agriculture. The growth rate of services in 2016 (comparing with 2006) has stood at 120% in export and 221% in import (based on the World Bank data, 2016). Among commercial services, tourism has made up the largest exporting share at above 50% in total due to the geography advantage of Vietnam. In terms of import, the share of transport has doubled between 2006 and 2015 to become the largest services in importing. It reflects the prerequisite to meet the rapid growth in foreign trade (Figure 3).

Figure 3. Structure of services trade



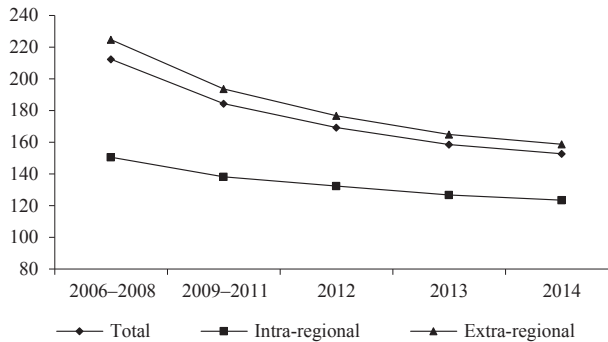
Source: author's calculation based on WTO database 2015, <http://stat.wto.org> (30.03.2018).

### 4.1.4. Improving trade facilitation based on trade-related infrastructure and strengthening the competitiveness

According to ESCAP Trade cost database (Figure 4), It is important to note that trade cost of Vietnam has the downward trends over the period (2006–2014), especially intra-regional. Vietnam's lowest trade cost partners include Malaysia across ASEAN countries and Korea across developed economies. It is interesting that some economies which has the common boundaries with Vietnam (such as China, Cambodia, Laos, Thailand) has the higher trade cost with the comparison to others (United States, Korea, Japan). This figure has also corresponded with the

growth of services, in which transportation, logistics and other business services have driven the force of trade facilitation. According to World Bank's Doing Business, Vietnam has improved markedly from 91<sup>st</sup> in 2015 to 68<sup>th</sup> in 2017 in terms of business environment and competitiveness, stemming from the improvement in infrastructure, regulatory quality.

Figure 4: Trade cost (ad-valorem, %)



Source: ESCAP Worldbank database, [http://databank.worldbank.org/data/reports.aspx?source=escap-world-bank-international-trade-costs#\\_](http://databank.worldbank.org/data/reports.aspx?source=escap-world-bank-international-trade-costs#_)

## 5. Discussion

Although Vietnam trade policy embrace export-oriented model and market-based reform to accelerate trade performance, the government has been neglected the function of strengthening market-supporting institutions. For example, Vietnam set priorities for developing automobile industry with the ambitious targets (for all types of vehicles with local-content up to 60%, meeting 80% of domestic demand in 2010). However, the target had been reached due to the low competitiveness of the industry under the strict competition with foreign enterprises because the industry lacks the supporting mechanism (from input to output on manufacturing chain). In addition, the growth rate of supporting industry has not been respective with the development orientation. Industrialization process lack of comprehensive development strategy and cluster-industrial strategy in which horizontal-development industrialization promote the higher value-added industry.

The fast trade liberalization brings benefits for foreign – owned enterprises, while domestic enterprises do not take the advantages. Vietnam’s government focus on broad-based privatization of the SOEs, while more important things to do is to create a healthy environment for all types of firms to grow their competitiveness. As the results, some financial difficulties of these SOE groups exposed since 2010, 17 SOEs had suffer loss of profit over 1000 billion VND in 2016 (such as: Vietnam shipbuilding Industry corporation (Vinashin), Vietnam cement comporation (Vicem). On the other hand, the acceleration of trade performance has been contributed by most of FDI sectors relating to international activities with the rapid average growth annually (Based on the statistics of Table 2), while the domestic enterprises have not shown the significant improvement in terms of competitiveness and the role in international trade activities

Table 2. Export and import by economic sectors

	2006–2010		2011–2015	
	value (USD)	average growth (%)	value (USD)	average growth (%)
<b>Export</b>	<b>280.4</b>	<b>17.4</b>	<b>655.8</b>	<b>17.5</b>
Domestic enterprises	125.5	18.9	224.8	7.6
FDI enterprises	154.8	16.1	431.0	23.9
<b>Import</b>	<b>343.2</b>	<b>18.2</b>	<b>666.1</b>	<b>14.3</b>
Domestic enterprises	214.0	15.7	301.4	7.4
FDI enterprises	129.1	22.1	364.7	21.3

Source: Vietnam GSO, Report of export and import over 10 years (2005–2015).

## Conclusions

The overview of some case study (China, Russia and Vietnam) indicates that these two pivotal factors lead to the successful economic transition process include internal reform in key areas and the high level of trade openness. Especially, in the case of Vietnam, the fast trade liberalization plays a vital role in transition periods. In details, the increase in trade liberalization has described on 4 stages of trade policy from import-substitution to export-oriented with some protectionism, then export- oriented with enlarging liberalization, lastly toward servicification policy with sharply liberalization in services. Together with these periods of policy,

the swift among resources has seen clearly, in which has increased in the level of capital and technology- intensity, mainly from the flow of FDI. Undoubtedly, trade liberalization policy has had a huge positive impact on Vietnam's economy and the acceleration of trade liberalization in services has motivated toward the modernize economy.

Thanks to trade reform, some challenges have still existed until now. In contrast with other transition economies, Vietnam has boosted the internal structural reforms by external commitments with global and regional cooperation (the clear evidences over the periods from 2011 to 2016). In fact, the fast-changing trade reform has forced by FDI sectors, while the domestic sectors have not transformed unremarkably. The issues bring about the long-term dependence on external resources, then hardly obtain the sustainable development goals. Furthermore, Vietnam's trade policy lack of the comprehensive trade promotion policy such as strengthening supporting industry, creating the cluster-industrial zones, enhancing the competitiveness of business environment, or trade promotion activity.

In conclusion, Vietnam has experienced from the economic transition's success due to the fast-paced trade liberalization in which the main core value of trade policy over the periods. However, the results also depend on not only the right path of strategy but also the efficiency of policy implementation.

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## **EWOLUCJA POLITYKI HANDLOWEJ WIETNAMU OD GOSPODARKI ZAMKNIĘTEJ DO GOSPODARKI ZORIENTOWANEJ NA USŁUGI**

### **Streszczenie**

Gospodarka Wietnamu, jako typowa gospodarka podlegająca procesowi transformacji, w szybkim tempie przechodzi ewolucję od centralnie planowanej do rynkowej. Jest to efekt przeprowadzanych reform społeczno-gospodarczych. Polityka handlowa, stanowiąc element strategii rozwojowej, jest istotną częścią wspomnianego procesu transformacji

ustrojowej. Podczas gdy efekty praktyki handlowej są przedmiotem wielu prac naukowych, w artykule poświęcono wiele uwagi zmianom – transformacjom strategii polityki handlowej w gospodarkach, aby doganiać kraje rozwinięte gospodarczo. Badaniami objęto wszystkie aspekty polityki handlowej Wietnamu w okresie 1986–2016, ukazując jej znaczące osiągnięcia, jak i niepowodzenia.

**Słowa kluczowe:** proces transformacji, polityka handlowa, Wietnam

**Kody JEL:** F43, F61, F63