

Vietnam



TRADE TAXES REGIONAL INTEGRATION AND GROWTH

Michael Daly, IMF

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Part I: BACKGROUND



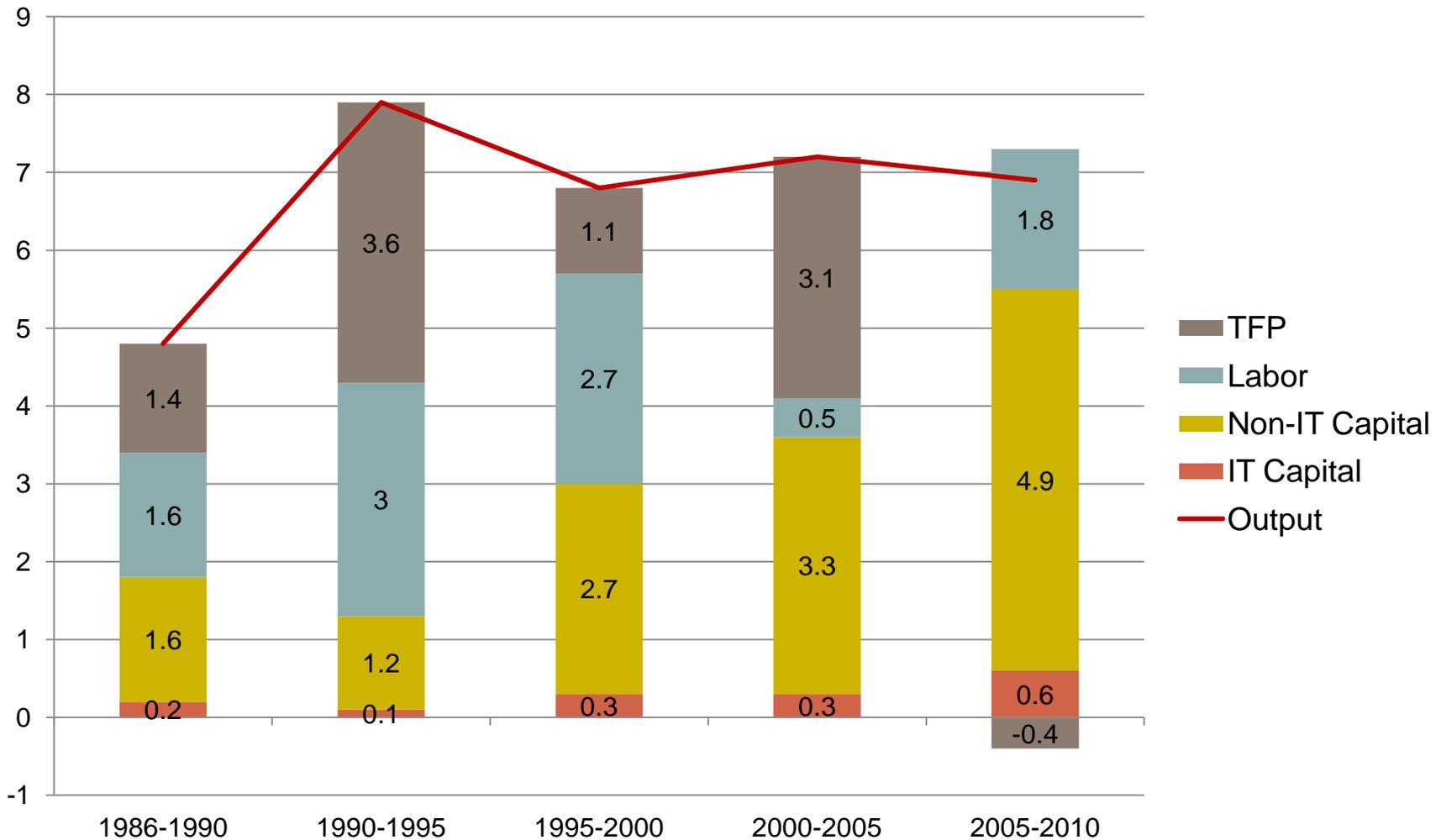
1. Trade and Growth



- **Open trade regimes** most conducive to growth
- Recent development successes due to strong **export growth**
- **Liberalization of trade** (taxes) integral part of economic reforms
- As obstacles to growth mainly home-grown, need **unilateral** reforms
- **Multilateral** liberalization adds impetus to & underpins reform
- But accession to the WTO presents an **opportunity**, not a guarantee, -- it will not remove all domestic obstacles to growth
- Recent proliferation of **PTAs**, whose benefits are not obvious

Vietnam's Growth Accounting Decomposition, 1970-2010

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2. Main Economic Problem



- **Slowdown in TFP growth**
- **Main sources of TFP growth:**
 - (human capital)
 - re-allocation of resources according to comparative advantage
 - scale economies (SE)
 - technological progress.

3. Role of Tax Policy in Reversing TFP Slowdown



- Unclear whether taxation contributed to TFP slowdown;
- But tax policy can hamper efficient re-allocation of resources and other sources of TFP growth;
- Trade taxes impair competition and thus TFP growth.

4. Is the WTO a World Tax Organization?



- **Border & internal taxes now subject to WTO rules reflecting principles of:**
 - Non-discrimination (MFN and National Treatment);
 - Predictability (i.e., “bindings”); and
 - Transparency (notifications & TPRM).
- **Disputes resolved at the WTO**



5. Main GATT Rules for Tariffs



- Art. I (*General Most-Favoured-Nation Treatment*)
- Art. II (*Schedules of Concessions*), tariff “bindings”
- Art. III (*NT on Internal Taxation & Regulation*)
- Art. X (*Publication & Administration of Trade Regulations*)
- Art. XVIII (*Government Assistance to Economic Development*), e.g., “infant industries
- Art. XXIV (*Customs Unions & Free Trade Regulations*)

6. Trade Tax Revenues



Since Vietnam's accession to the WTO in 2007

- tariffs' share of tax revenues down from 8.2% to 5.5%,
- export taxes' share up from 1.8% to 2.5%.
- So trade taxes are still important sources of revenue (and instruments of industrial policy).

Part II: IMPORT TARIFFS



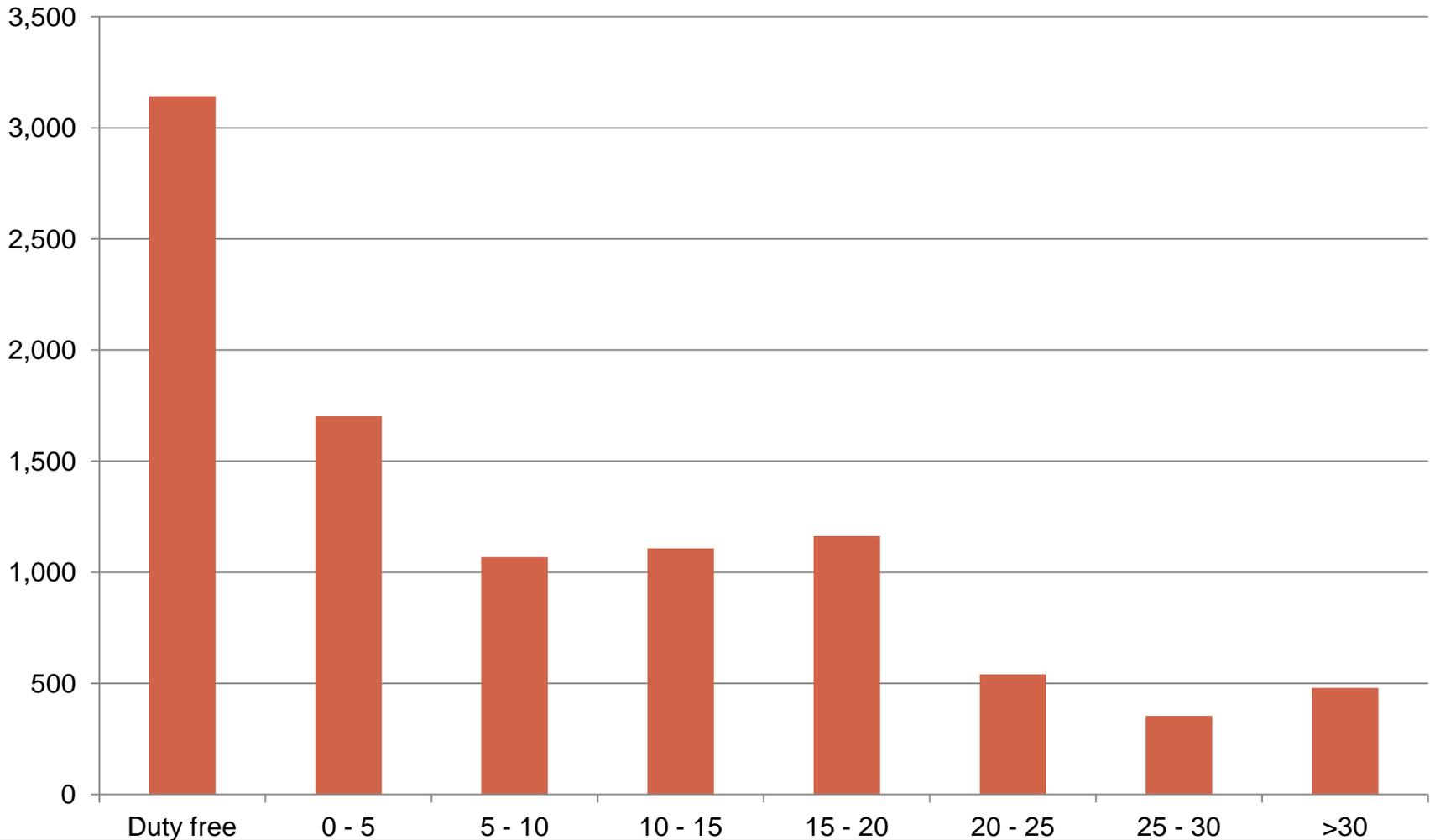
7. Structure of Vietnam's MFN Tariff



Table 7

- Simple average *bound* MFN tariff (11.5%)
- High *applied* MFN tariff protection (10.4%)
(*Effective* rate of protection may be 20%)
- Wide dispersion in *applied* MFN tariff rates (12.5)
- One-quarter of *applied* MFN rates >15%
- “Tariff peaks” concealed by opaque *specific* rates
(which are also more distorting and regressive)
- One-third of tariff lines are duty-free (0%).

Number of Lines by Applied MFN Tariff Rate



8. International Tariff Comparisons



Table 8

- VN's average *bound* MFN tariff (11.5%) < most ASEAN Countries
- *Applied* MFN tariff protection (10.4%) < most ASEAN Countries
- *Applied* MFN tariff dispersion (12.5) > most ASEAN Countries
- “Tariff peaks” (25.6%) > all ASEAN Countries
- *Specific* rates (virtually 0%) < most ASEAN Countries
- Duty-free tariff lines (32.9%) < Brunei, Malaysia & Singapore.

9. Preferential Trade Agreements



- Proliferation of PTAs (>200), especially in Asia (56)
- ASEAN, ASEAN+3
- Bilateral PTAs (Australia, NZ, India)
- Trans-Pacific Partnership?
- Contrary to WTO principle of non-discrimination
- Consistency with Art. XXIV.8 (“substantially all trade”)

10. Cautionary Tale about PTAs



- Discriminatory -- contrary to MFN principle
- Trade determined by preferences rather than TFP
- Trade diversion > trade creation?
- Impedes multilateral trade liberalization (DDA)?
- Adds to complexity of trading system
- Places large traders at an advantage

11. Rationale for Tariffs



- (a) Source of tax revenue**
- (b) “Optimal” tariff (Terms of Trade effects) = $1/\epsilon_{SX}$
(can provoke retaliation – rationale for WTO)**
- (c) Policy instrument (“infant” industry), SE.
Frequent changes in tariff rates**

12. Evaluation of Tariffs



- (a) Is a source of tax revenues (5.5%)
(if tariff rates not prohibitive)
- (b) But domestic markets too small to influence ToT
(In any event, need to know ϵ_{sx})
- (c) Doubly distorting instrument of industrial policy
Relatively ineffective policy instrument
(Need to identify industries where potential SE)
Taxes exports (unless duty drawbacks)

13. Policy Implications



- More uniform tariff -- 3 bands: 0%, 8%-10%, 15%, reflect stages of processing (not “picking winners”)
- Convert *specific* to *ad valorem* rates
- Replace tariffs with excises, VAT, etc.
- Alternative policy instruments more effective.

Part III: EXPORT TAXES



14. Main GATT Rules for Export Taxes



- Art. I (*General MFN Treatment*)
- N.B. No bindings
- Art. X (*Publication & Administration of Trade Regulations*)

15. Scope & Structure of Export Taxes



- Subject to bindings in protocol of accession
- Levied mainly on natural resources (& leather)
- Rates of up to 40% (on iron ore)
- Subject to frequent changes
- Scope doubled from 43 to 94 products since 2007
- Used more than other ASEAN countries

16. Rationale for Export Taxes



- (a) **Source of tax revenue**
- (b) “Optimal” export tax (ToT effects) $= 1/\epsilon_{dx}$
- (c) **Industrial policy (downstream processing)**
- (d) **Tax on economic rents**
- (e) Conservation of natural resources
- (f) Ensure security of supply
- (g) [Pre-empt trade defence measures]

17. Evaluation of Export Taxes



- (a) Is a useful source of revenue (2.5%)**
- (b) Possible ToT for some exports
(But need to know ϵ_{dx})
Can provoke retaliation**
- (c) Relatively ineffective instrument of industrial policy**
- (d) Inefficient tax on economic rent**

17. Evaluation of Export Taxes (cont'd)



- (e) Inefficient instrument to conserve natural resources
- (f) Inefficient instrument to ensure security of supply
- (g) [Efficient means of pre-empting trade defence measures]

18. Policy Implications



- If (b) or (g), export tax optimal
- Otherwise, replace export taxes with internal taxes
- If (d) or (e), replace with natural resource rent tax or “green” tax
- If (c), alternative policy instruments more effective

Part IV: CONCLUSIONS



19. Tariff Policy



- Substantial source of tax revenue
- Little, if any, rationale for “optimal” tariff
- Usually inefficient instrument of industrial policy (“Picking winners” seldom successful)
- More uniform tariff is desirable in short-term
- Pre-announce phase-out & replace with excises, VAT

20. Export Taxes



- Main rationale appear to be (a), (c) and (d)
- Even if not intended to assist downstream processing, this is the consequence
- Export taxes usually inefficient instruments of industrial policy
- Phase out and replace with internal taxes

21. Additional Observations



- Some internal tax measures *de facto* border taxes (e.g., exports not zero-rated under VAT)
- Need to improve coherence in tax policy (e.g., absence of zero-rating deters exports of services & CIT incentives for investments)
- Need more transparency of tax policy

22. Transparency in Tax Policy



- Tax policy in Vietnam is made largely in the dark
- Lack of key data (especially tax revenues forgone)
- Absence of key indicators (nominal tariffs, ERPs, ERAs, METRs)
- Little, if any, rigorous evaluation of tax measures (or PTAs)
- Need “sunset” provisions for all tax measures

23. Essence of Transparency



- **Transparency entails four key elements:**
 - (i) Description of policies and measures (WHAT?)
 - (ii) Rationale or objectives (WHY?)
 - (iii) Costs – taxes forgone or expenditure (HOW MUCH?)
 - (iv) Economic evaluation - EFFECTIVENESS in achieving objectives (cost-benefit analysis)
- **Policy implications** (more cost-effective alternatives?)



THANK YOU!