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PRELIMINARY ASSESSMENT OF THE SOCIALIST REPUBLIC OF VIETNAM'S REQUEST FOR GRADUATION TO MARKET ECONOMY STATUS IN TRADE DEFENCE INVESTIGATIONS

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1. EXECUTIVE SUMMARY

Over the last few years Vietnam has achieved an extended period of impressive economic performance. Its current economic structure is an increasingly modern and market-based system and is becoming more and more integrated into the world economy.

The question of Market Economy Status (MES) is not a question of judgement on the general functioning of the Vietnamese economy but an assessment of whether, in a number of specific technical areas, Vietnam has a sufficiently market based system to ensure that prices and costs in Vietnam can be used in trade defence investigations as the benchmark for fair export prices.

The conclusion of this report shows that Vietnam, all in all, has achieved significant progress in its overall transition towards an effectively functioning market economy. However, Vietnam continues to face considerable challenges. Market Economy Status is assessed on the basis of five criteria. Vietnam has clearly fulfilled one of these criteria, Criterion 1, which relates to the degree of government influence over the allocation of resources and decisions of enterprises, whether directly or indirectly. Vietnam has also made substantial progress on criteria 2 (absence of State-induced distortions in the operation of enterprises). And Vietnam has made considerable progress on the remaining three criteria.

For Criterion 2 progress has been extensive. The reform of State Owned Enterprises (SOEs) has been impressive though a number of difficulties remain. However, the political commitments made to remove military owned SOEs from commercial activities still have to be fully honoured. There are also serious concerns about some moves to extend the role of SOEs to areas outside their core business though recent Government decisions show a willingness to restrict these noncore activities. The quickest route to achieving swift progress here would be for Vietnam to draw up plans for the equitization of those SOEs which are still fully government owned.

Significant progress has been achieved with respect to Criteria 3 with all the necessary laws now in place. The major issue here is the effective implementation of the Law on Accounting and the Law on Auditing. The correct application of these laws is a key element with regard to trade defence investigations as these require accurate and market based accounting systems. Further progress would also require concrete measures to increase the number of certified accountants and auditors as that number remains small in relation to the number of enterprises in Vietnam.

Relative good progress has been achieved with regard to Criterion 4 which relates to a coherent, effective set of laws which ensure the respect of property rights, competition laws and the operation of a properly functioning bankruptcy regime. The necessary laws are now in place but now effective implementation of these laws need to be demonstrated. So far there is little evidence on record that this is the case. On IPR Vietnam has made some strenuous efforts to show progress but it is clear that this is still an area which requires more attention. The same applies with regard to the implementation of the bankruptcy law, as the number of cases pursued remains unrealistic low in relation to the number of registered companies in Vietnam. It is also important that Vietnam enhances its juridical system to address these problems.

While the competition laws cover a number of important elements, enforcement is still in the infant stage.

The existence of a genuine financial sector which in general operates independently from State influence is the important characteristic which needs to be shown for fulfilment of Criterion 5. There are indications that the Vietnamese Government is accelerating the reform of the banking sector. However, a number of problems can be identified with the most being that the role of the State Bank of Vietnam (SBV) needs to be better defined. The dual role of SBV as both shareholder and supervisor needs to be clarified. The indications that State Owned Commercial Banks (SOCBs) obtain better treatment than private financial institutions also underline the need for change.

In summary, this report acknowledges the considerable progress that has been made by Vietnam following the European Commission's last assessment of October 2006. This report has aimed to be as clear as possible about the actions which remain to be taken for Vietnam to achieve market economy status for trade defence investigations. The Commission remains strongly committed to working with Vietnam to achieve that.

There is the question of identifying the quickest route to Vietnam obtaining MES. To this end the European Commission is ready to meet Vietnamese representatives as soon as possible after the completion of this report so that both sides could agree on the steps which need to be taken for Vietnam to make the swiftest progress towards the MES goal.

2. INTRODUCTION

During the last 30 years Vietnam has undergone an extraordinary transformation from an isolated, poor and collectivized agriculture-based economy into a booming nation with a dynamic and diversified private sector coexisting with a large public sector, fully integrated into the world economy. It has achieved an extraordinary reduction in poverty and is becoming a significant player in world trade. In the mid-eighties Vietnam approved a broad process of economic reform that introduced market reforms and set the groundwork for Vietnam's much improved investment climate. Since 2001, Vietnamese authorities have reaffirmed their commitment to economic liberalization and international integration. They have moved to implement the structural reforms needed to modernize the economy and to produce more competitive, export-driven industries. The economy grew 8.5% in 2007, making it the third consecutive year where they had achieved 8% growth, although it fell back to 6.3% in 2008 in line with the global economic downturn. Based on some uniform and bold stimulus actions, the economic downturn could be reversed to a certain extend in 2009. Macroeconomic trends showed positive signs with economic growth of 4.5% for the first 9 months of 2009.

In January 2007, Vietnam joined the WTO. WTO membership has provided Vietnam with a platform for its economic reform process. In 2008 a trade volume of 11.956 billion EUR (11.5 billion EUR in 2007) made the EU Vietnam's second most important trading partner, after China. Vietnamese exports into the EU exceed imports by more than twice. The EU's trade balance with Vietnam reached 10.508 billion EUR for the first 11 months in 2009 (10.818 billion EUR for the same period in 2008).

Since October 2000, Vietnamese companies have had the possibility to request market economy treatment on an individual basis in the context of EU anti-dumping investigations. This amendment to the basic EU anti-dumping Regulation was made in order to reflect the changed economic conditions in a number of countries including Vietnam, taking account of the ongoing process of equitization[1] of State Owned Enterprises and the emergence of companies for which market economy conditions prevail.

In June 2004, Vietnam lodged an official request for Market Economy Status (MES). In October 2006, the Commission issued its preliminary assessment of Vietnam's request to be granted countrywide Market Economy Status (MES) for the purpose of trade defence investigations. The present document presents the current state of play with respect to Vietnam's request and in that respect constitutes a revision of the previous preliminary assessments issued by the European Commission.

2.1. Methodology of the assessment

The five following cumulative criteria must be fulfilled for any country in transition (a category to which Vietnam belongs) to be granted countrywide MES for the purpose of trade defence investigations:

1. Degree of government influence over the allocation of resources and decisions of enterprises, whether directly or indirectly (e.g. public bodies), for example through the use of State-fixed prices, or discrimination in the tax, trade or currency regimes.

2. Absence of State-induced distortions in the operation of enterprises linked to privatisation (i.e. "carry over" from the old system). Absence of use of non-market trading or compensation systems (such as barter trade).

3. Existence and implementation of a transparent and non-discriminatory company law which ensures adequate corporate governance (application of international accounting standards, protection of shareholders, public availability of accurate company information).

4. Existence and implementation of a coherent, effective and transparent set of laws which ensure the respect of property rights and the operation of a functioning bankruptcy regime.

5. Existence of a genuine financial sector which operates independently from the State and which in law and practice is subject to sufficient guarantee provisions and adequate supervision.

These criteria have been communicated to the Vietnamese authorities and acknowledged by them, and they form the framework for the present and future assessments.

In order to establish whether Vietnam on a countrywide basis complies with these criteria, the information provided by the Vietnamese authorities was carefully analysed. Current information which could be obtained from authoritative external sources was also used. The complete list of these documents is attached in the annex.

2.2. Background

As already mentioned above, Vietnam's official documented MES request was lodged in June 2004. MES is a technical status that requires that prices and costs in Vietnam would be used

[1] Equitization is the conversion of a state-owned company into a joint-stock or limited liability company, with the majority (if not all of the stocks/ shares) retained by the state.

in trade defence investigations. Currently, Vietnam (and a number of other countries) is considered by the EU as economies in transition which means that under the relevant provisions of the EU's anti-dumping law (Council Regulation 384/96) prices and costs in Vietnam cannot normally be used in these investigations. This is because they may not be a credible measure of the true costs of production as the state intervention may have distorted them or made them unreliable. Instead, and in accordance with WTO rules, analogue data from other economies, that have been accorded MES, is used.

Vietnam's 2004 request was carefully analysed by the Commission services. As a result, a number of specific areas were identified in which further information was needed in order to assess the request. A first assessment was drafted in this respect and forwarded to the Vietnamese authorities in October 2004. This document requested 21 specific items of information, including the texts of the most relevant legislative acts.

Vietnam provided most of the requested information in June 2005, at the occasion of a meeting on MES hosted in Hanoi by Vietnam’s Trade Ministry and with the participation of the Commission’s Trade Defence services. The remaining information was provided in the course of September 2005 and March 2006.

A brief summary of the information provided by the Vietnamese authorities in June 2004 was included in the October 2005 assessment and is not repeated here.

In October 2006, the Commission issued its preliminary assessment (‘the October 2006 assessment’) of Vietnam's request for graduation to MES. The October 2006 assessment presented all of the progress made during the period 2004 – 2006 and listed detailed shortcomings that were still pending in all 5 criteria. Information and conclusions presented in the October 2006 assessment are not repeated here. The results of the October 2006 assessment were discussed with Member States and sent to the Vietnamese authorities.

An MES Working Group was established to facilitate the exchange of information between the Vietnamese authorities and the services of the Commission. The first meeting of the EU-Vietnam MES working group was held in Hanoi in March 2007. During this meeting, Vietnam submitted comments and supplementary information of the October 2006 assessment.

Upon the request made by the Commission, Vietnam submitted new information on MES in August 2007. This information was discussed in Hanoi during a meeting between representatives of Vietnam's Ministry of Industry and Trade and EU experts that took place in October 2007. Vietnam submitted further detailed information on MES both during the October 2007 meeting as well as in November 2007.

In the meantime, several meetings and contacts with Vietnamese Government representatives took place at which Vietnam's MES request was discussed.

The present assessment is structured according to the five criteria set out under point 1.1 above. Each section features (i) a concise overview of the additional information received from the Vietnamese authorities following the October 2006 assessment, (ii) relevant information obtained from external sources following the October 2006 assessment, and (iii) a conclusion specific to the criterion examined.

3. ASSESSMENT

3.1. Criterion 1

Degree of government influence over the allocation of resources and decisions of enterprises, whether directly or indirectly (e.g. public bodies), for example through the use of State-fixed prices, or discrimination in the tax, trade or currency regimes.

To meet this criterion, a state must demonstrate that it does not exercise undue influence over the allocation of economic resources in the economy or decisions of companies. This could take the form of price fixing, obligations to produce for export, restrictions imposed on exports of raw materials or subsidies for industrial inputs. These elements are all relevant to trade defence investigations because they directly impact on the costs of producing goods in that economy, often unfairly for competitors.

3.1.1. Additional information presented by the Vietnamese authorities

The additional information requested concerning this criterion has been provided, including the texts of the new Decrees and Circulars providing detailed guidelines on the implementation of the law on investments and the provisions of the corporate income tax.

The Vietnamese authorities state that all sectors of the economy are established, organized and operated under the Law on Enterprise and corporate income tax applied to foreign-invested enterprises and domestic-invested enterprises is at the same rate. At the end of 2007, Vietnam amended its list of state monopolies to include 13 socio-economic sectors mostly outside the industrial sector.

Vietnam still retains discretion in determining prices on land, natural resources, some medicines, public transportation, postal services, and telecommunications. There is decreasing price interference by the state with regards to air fares, oil and natural monopolies such as water and electricity. For gasoline prices, free market forces prevail although subject to an ex-post facto registration. For water and electricity, transition to full market determination in prices has begun – full market determination will be applicable as of 2010. To ensure sustainability, the World Bank is lending some support to the Government of Vietnam to liberalise its pricing policy in electricity. However, there is no price discrimination policy applied between foreign or domestic users including for electricity prices which are calculated solely on the basis of volume of consumption. In this regard, Vietnam has underlined that the practise of controlling electricity prices is still applied in a number of industrialised countries.

The Common Investment Law, which entered into force on July 2006, has removed all export requirements previously laid down in the business licences. Investors are no longer subject to compulsory conditions relating to the consumption of domestically sourced materials, the realization and development of their production and business programmes, the recruitment of personnel or on use of technology.

The latest tax reforms include the introduction of a new Personal Income Tax, and revision of the Corporate Income Tax, VAT, excise taxes, and tariffs on petroleum products. The Decree on Corporate Income Tax that entered into force on February 2007 repealed any link between income tax rates and export performance. The same type of rates, either full or reduced depending on investment preferences, is applied to all enterprises (either domestic or foreign). To ensure fiscal sustainability, the authorities are considering introducing a new budget law in

2010, which is expected to cover a broad range of issues, including plans to develop a medium-term fiscal framework and, as well as some form of performance-based budgeting. The intention is also to decentralize some of the fiscal decision-making and the shortcoming in the availability of accurate data.

As of WTO accession, Vietnam committed itself not to use any new subsidy programme prohibited under the WTO agreements, including direct or indirect subsidies intended to encourage exports or substitute imports with domestic products. The only derogation to this principle applies to investment incentives granted to investment projects prior to accession, but these will be scrapped in 2011, at the latest.

Vietnam's State-Owned enterprises are established and operated under three forms i.e. (i) State-Owned companies, (ii) Shareholding companies and (iii) Limited Liability companies. The latter two are already operating under the provisions of the Common Law on Enterprise. The former type will until 2010 continue to be operated under the provisions of the Law of State –Owned Enterprises, and thereafter will fall also under the Common Law on Enterprises.

3.1.2. Information from other sources

State interference in pricing

Accession to the WTO has entailed a wide range of commitments on the part of Vietnam. Concerning pricing and price controls Vietnam will comply with WTO agreements and notify the WTO of actions it takes to control prices. On export restrictions Vietnam will maintain export controls on some sensitive products, such as rice, certain wood products, and minerals (to prevent illegal exploitation). These controls are in conformity with WTO agreements. According to IMF's current Country Report for Vietnam, administered prices are estimated to account for less than 10% of the Consumer Price Index basket. Between 1992 and 2002, a large number of commodities were subject to price control by the authorities. In the meantime, prices of several important commodities have largely been liberalized. However, services in sensitive areas such as electricity, water, petroleum products, bus fares, postal services and telecom charges continue to be set by the government. With respect to setting prices for air fares, electricity and water, the transition to full market determination has begun. As regards fuel prices the IMF and World Bank have confirmed that domestic prices for gasoline and kerosene have been largely aligned with international oil prices. This is due to the fact that the Government has followed a determined policy to remove subsidies to domestic distributors.

With regard to the electricity sector, the Asia Development Bank has in its Country Strategy and Program for 2007-2010 recognized that since the enactment of the Electricity Law in 2005, Vietnam has demonstrated its strong commitment to create a transparent electricity market. This has amongst other involved taking measures such as the establishment of the Electricity Regulatory Authority and the commencing of the equitization process of power plants and power distribution units owed by the state.

The state-owned sector in the Vietnamese economy and the development of the private sector

According to the IMF's 2007 Country Report for Vietnam, the contribution of the public sector to GDP is approximately 37%. The contribution of the non-state sector to industrial production has increased at constant prices between 2002 and 2006 at around 150% while that of the state sector to total industrial production has in the same period decreased from 40,3% to 31,6% of the GDP. At the same time, the non-state sector has proven to be the main vehicle for job creation with its share accounting in 2006 for almost 91% of total employment in Vietnam.

The impressive rise in the share of the domestic private sector as well as the foreign invested sector in the Vietnamese economy has been acknowledged and praised by both the IMF and the Asian Development Bank in their most recent reports. At the end of 2007 there were an estimated 250,000 enterprises and 3 million family-run businesses in Vietnam. Of these, nearly 70% are involved in the trade and services sector, with the remaining 30% involved in manufacturing/industry. In 2007, the private sector contributed about 45% to GDP and accounted for about 90% of the national employment. GDP growth is thus increasingly driven by the private sector, with 59,000 new enterprises registering in 2007 alone, an increase of 26 % over the previous year. Foreign Direct Investment commitments almost doubled to €14.6 billion.

The level playing field

The substantial improvement in creating a level playing field for State, domestic private and foreign firms in Vietnam has been acknowledged by all international institutions. The Vietnam Development Report 2009, issued under the auspices of the World Bank with contributions from all Donor countries, Agencies and International Organizations, recognizes that the new Unified Enterprise Law, adopted in 2005, effectively establishes one common legal framework for all types of firms.

The Report also welcomes the adoption of the Common Investment Law which has laid the ground for levelling the playing field between domestic and foreign firms in the area of investments. Taken together, all these legal developments have made a pivotal contribution to Vietnam's accession to WTO.

The World Bank has also recognized in its 2007 Country Partnership Strategy Report that the new enterprise and investment laws have contributed to creating a level playing field. In particular, it has highlighted the fact that corporate income tax rates have been streamlined. Finally, the Asian Development Bank, in its 2007 Country Strategy and Program, acknowledged that the new enterprise and investment laws have further reduced administrative barriers to business development and expansion and has allowed foreign and domestic private enterprises alike to invest in practically all areas (except those specifically prohibited by law).

A further positive step towards achieving the goals is the reformed personal income tax system which came into effect in January 2009. The new income tax structure will broaden the tax base by making benefits taxable in addition to salaries, and will apply the same tax rates to Vietnamese and foreign workers. The IMF has welcomed the recent tax reforms. The IMF also welcomed the initiative to revise the state budget law. Bringing the definition of the budget balance closer to international standards, including elimination of off-budget transactions, would facilitate fiscal policy decision-making and help inform the public about fiscal policy stance and direction.

Export requirements for Business Licences

According to the World Bank 2007 Country Partnership Strategy Report, all quantitative restrictions imposing limits on the economic activities of companies have been removed. Furthermore, both the World Bank and the IMF have acknowledged Vietnam's compliance with its WTO obligations to remove export subsidies and export oriented tax incentives.

3.1.3. Conclusion

- Conclusive progress has been registered for this particular criterion. The private sector has shown outstanding performance and development. There is a clear plan leading to the convergence of the few remaining administered prices with market prices. The legal provisions permitting discriminations between private and public sector enterprises have been removed. Also, state interference in the decision-making process of companies - both in the form of restrictions and conditions limiting the scope of their activities - has been completely eliminated.

The Commission considers that the information received from external sources confirms that Vietnam has made decisive progress in removing State interference in the Vietnamese economy and creating an economic environment that does not distort market prices. There are no indications provided by these external sources that state interference in pricing or discrimination between private and public sector enterprises exist. This situation should be permanent as Vietnam has to comply with its commitments agreed by its accession to the WTO. On the basis of the elements outlined above, the Commission concludes that Vietnam has successfully completed the endeavour of fulfilling the conditions with respect to criterion 1.

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3.2. Criterion 2

Absence of State-induced distortions in the operation of enterprises linked to privatisation (i.e. “carry over” from the old system). Absence of use of non-market trading or compensation systems (such as barter trade)

This criterion is considered fulfilled if a state is able to demonstrate that no state-induced distortions in the daily operation of enterprises linked to privatisation exist. Preferential government treatment for individual enterprises must be avoided.

3.2.1. Additional information presented by the Vietnamese authorities

The additional information requested concerning this criterion has been provided.

Reform of the State Owned Enterprises

The Vietnamese authorities have implemented a plan to reform State-Owned enterprises (SOE) by restructuring and/or by ownership transfer. The reform of SOEs also forms part of the commitments made by Vietnam upon accession to the WTO. According to the information provided by the authorities there was as of September 2007 a total of 1.854 enterprises in which the State owns 100% of capital, accounting for about 40% of GDP and 30% of credit in the economy. In 2007, a further 158 State Owned Enterprises were reformed of which 101 have been equitized. The Vietnamese authorities are currently implementing a roadmap, based on a Decision by the Prime Minister in December 2006, to equitize a further 71 SOEs in the period 2007-2010.

According to the National Steering Committee for Enterprise Reform and Development, a total of 98 SOEs changed ownership in the year 2008, realising nearly 20 per cent of the government's yearly plan. So far this year Vietnam has sold shares in 13 SOE. Up to date, a total of 3854 SOEs have completed equitization. The beginning of the equitization of some of the largest SOEs also began in 2008, including SOEs from various sectors (beverage, transport and construction) as well as from the bank sector (Bank for Industry and Trade – Vientinbank). According to announcements by the Government, Vietnam will approve a plan to change all 100 per cent SOEs into joint stock and limited liability firms as from 1 July 2010. Vietnam plan to sell shares in nearly 950 SOEs during 2010. However, the information available on the overall situation of equitization of SOEs is sketchy and more information is necessary.

The authorities have submitted that the process to equitize SOEs, notably with respect to the mechanism, sequence and procedures applied has been improved and is now more transparent and closer to the market. In this respect, the Government has issued a Decree on June 2007 on the conversion of 100% State-Owned enterprises into shareholding companies. The Decree requests a compulsory evaluation of SOEs by independent evaluators for companies whose total asset value is more than 30 billion Vietnamese dongs or in which the value of State owned capital is more than 10 billion Vietnamese dongs.

At recent meetings with the IMF, Vietnam authorities reiterated their commitment to SOE reform, recognizing that it would help sustain Vietnam's rapid economic development. The authorities explained that the slower-than-expected equitization process was due to unfavourable market conditions but that they intended to press ahead with their plans to equitize the remaining non-strategic SOEs.

Furthermore, the situation concerning the military-owned-enterprises remains unclear. According to information submitted by the Vietnamese Authorities, there were 144 military owned enterprises doing business in 2006, with total revenues representing around 3,4% of GDP. The gradual withdrawal of the military from profit-making businesses (in exchange for an increase in the defence budget) is part of the officially announced Government policy (Vietnam Communist Party Central Committee of January 2007). However, the authorities have not been able to provide any kind of roadmap for the equitization of these enterprises which remain the most visible vestige of the old non market economy system. Enterprises owned by the military are still engaged in a broad range of economic activities (ranging from coffee production, coal mining, garment manufacture, tourism, banking, insurance, stock broking, and telecommunications to health services).

The land market

In line with the provisions of the 2003 Law on Land, the Vietnamese authorities have issued a series of Decrees and Circulars laying down revised implementing provisions on the managements of the land market. Vietnam has submitted that its applied methods on land price evaluation are close to market prices and ensure the balance of interests amongst the State, land users and investors. Vietnam has also introduced new methods in the calculation of land value as capital contribution of the State in equitized SOEs and taken measures for the establishment and operation of a functioning real estate market.

Due to a regulation of the State Bank of Vietnam Joint Stock Commercial Banks are not allowed to engage directly in real estate business.

Barter Trade

The non-market trading system has been completely eliminated. The only barter arrangement remaining in force is the debt repayment scheme with Russia on account of loans granted by the former Soviet Union. According to information submitted by Vietnam in 2007, approximately 65% of Vietnam's debt has already been repaid.

3.2.2. Information from other sources

Reform of SOE and their "equitization" process

Figures produced by WB on the equitization of SOEs in Vietnam do not correlate with those given by the Vietnamese authorities. According to the WB, in 2007, 116 SOEs were equitized – or 21% of the original 600 SOE target. With an estimated contribution of 35% to GDP, SOEs represent one-third of the economic power of the country. In aggregate, at the end of 2007, approximately 3,000 enterprises remained fully or partially state-owned, with 3,800 SOEs equitized.

SOEs still constitute a substantial part of Vietnam's economy. While the state sector still receives important benefits in terms of access to credit, land and favourable policies, its contribution to the economy in terms of added value, job creation and exports remains low. At the same time, the private sector, which generates the bulk of jobs, consists largely of small, undercapitalized firms that find it difficult to grow into medium and large companies because they find it so difficult to access land and finance. The pace of SOE reform and measures introduced has been commented on by many international institutions. SOE reform has slowed significantly, and the economic slowdown appears to have weakened its momentum.

The World Bank has also in its 2007 Vietnam Development Report and recent update of June 2009 raised specific problems with respect to the SOEs that have to be resolved as well as pointing out the challenges ahead. The slow pace of the SOEs equitization process has also been noted in the World Bank's 2007 Country Partnership Strategy Report with the overall process so far being considered as only partially satisfactory.

In its 2007 Country Report (and recent update in April 2009), the IMF has reported insufficient improvement in SOE governance and has requested that SOE reform be fast tracked to enable SOEs to meet the challenges of global competition and decrease their reliance on the State budget. In recent statements IMF repeated this position and emphasised the importance of the broader structural reform agenda for Vietnam, especially in the area of SOE (and banking sector) where the reform momentum has slowed over the past year. Assessing the financial position of the SOE sector remains difficult in the absence of information on their performance, but it is expected that the financial position of some of the larger SOEs has come under increased strain in 2008. The IMF has recommended that Vietnam authorities should step up the monitoring of SOEs and identify and restructure those representing significant fiscal risks. They should also press ahead with the equitization process (including SOCBs) as market conditions improve, which would help strengthen the performance and governance of SOEs, especially if the participation of foreign strategic investors is broadened. IMF calls for faster SOE reform in order to enhance competitiveness and efficiency.

IMF, WB, EIU, ADB, Harvard studies and others recently highlighted a major upcoming concern on the activities of SOEs. Despite the plans of the Vietnam's authorities to step up equitization of state-owned commercial banks and SOEs, new SOE-dominated financial-industrial groups could pose challenges for bank regulation and supervision. The involvement of large SOEs in the financial sector, outside their core business, in areas such as real estate constitutes a concern (e.g. SOE company Electricity of Vietnam has invested in mobile phone networks and banking). Currently, the involvement of state-owned enterprises in the banking sector is not high, but as at the start of 2008, there were reportedly 15 new applications for banking licenses by major SOEs, and the government has been under pressure to grant at least some of these. Indeed, 3 have already been granted in 2008. The IMF (which is now preparing its next Country report) stressed that related-party lending within new SOE groups involved in a mix of industrial and financial operations should be prohibited.

IMF sees also a need to improve data quality and communication of SOEs. In their views a significant gap remains in the data available on SOE (and on fiscal and banking operations). Transparency and accountability have become even more important as state firms diversify from their core business to seek profits in unrelated ventures.

Likewise, the Asian Development Bank in its Country Strategy and Program for 2007-2010 has called for improvements in the regulatory environment for SOEs restructuring, as well as increased transparency and corporate governance in SOEs. The Asian Development Bank has noted that the number of equitized enterprises remains below the official target while most of the enterprises equitized so far have been small with an average of fewer than 250 employees and with capital valuation of less than 5 billion Vietnamese dongs. The banks estimation was that only about 10% of state capital has been transferred to the private sector.

In addition, some of the legislation introduced recently for the purpose of valuating SOEs remains problematic. The conversion methods applied are still not based on market economy principles but on State imposed methodologies. At the same time, SOEs are allowed to transfer capital contributions, assets and investments to State owned corporations and write off their debts before being converted into equitized enterprises.

To anticipate rising levels of uncontrolled foreign borrowing undertaken with an explicit or implicit government guarantee, the National Assembly is considering a law which would make the Ministry of Finance solely responsible for managing the debts of government agencies and SOEs (according to the Economist Intelligence Unit). The significance of the draft law goes beyond debt management: central authorities would then have the right to decide which SOEs could take on foreign debt and also how much they could borrow. Centralising decision-making at this level could be considered as a step backwards in terms of the government's moves to implement market-oriented reforms for the purpose of restructuring state-owned companies.

The land market

The situation in the land market remains problematic. The World Bank notes in the 2007 Vietnam Development Report that the process of land-use planning and conversion, land acquisition and resettlement, land valuation, compensation and taxation all remain inconsistent and cumbersome. The same report criticizes the methods used for the valuation of land use rights for SOEs that are being equitized and questions whether these companies can actually dispose of the land on which they are located. It also refers to rigidities and inefficiencies in the land administrative framework that affect access to land and impose constraints on the evolution of the land market. The 2007 Country Partnership Strategy

Report, also issued by the World Bank, calls for the establishment of the framework for an efficient land market as currently there is an incomplete land policy framework.

Since that time there have been no significant developments. The new legal provisions introduced by the Vietnamese authorities do not alter the main features of the land market. Land prices are still established on the basis of State imposed administrative methods. Although the new Common Investment Law has removed any link between rent prices and export requirements in the business licenses of companies, the regulatory framework imposed to the market by the State authorities is strongly inspired from non-market economy rules proving that the land market is still subject to distortions carried over from the former non-market economy system.

The real-estate market in the major Vietnamese cities has been growing quickly. Real estate projects continue to figure prominently in Foreign Direct Investments (FDI) in Vietnam. In 2008, the real estate related portion of FDI made up approximately 18% of total FDI commitments. However, land market does not operate under proper market conditions. The real estate and construction sector has both Vietnamese companies as well as international operators. The current Land Law was enacted in 2004. Land Use Rights (LURs) are the closest equivalent to a title document in Vietnam. Under the Land Law, a foreign investor may not own LURs. There are two ways in which a foreign investor may acquire LURs over a piece of land to develop its projects: a) by way of land lease from the State or b) by way of contribution by its local partner as its share of equity in a joint venture of business cooperation contract.

Restricted rules also exist for foreign organisations and individuals wanting to purchase apartments (recently new defined in National Assembly Resolution No 19 from January 2009). This resolution is valid for five years.

3.2.3. Conclusion

The Commission considers that the information received from other sources identify the following problematic areas for the fulfilment of this criterion:

- There is a strong need for further restructuring of the SOEs and for completion and strengthening of the equitization programme. The number of sectors concerned should be expanded and the process should include large companies rather than only small SMEs. At the moment political commitments exist to remove military-owned-enterprises from profit making activities. These need, however, to be accompanied by specific equitization programmes applicable to military-owned-enterprises. Moreover, the methodologies applied in evaluating SOEs should be market inspired and oriented and it should be ensured that no hidden subsidies or financial bailouts are allowed for SOEs that are in the process to be equitized. Vietnam's plan to sell more than 900 SOEs within short the next 2 years seems to be overambitious compared to the number sold in previous years.

New activities of some of the Vietnamese SOEs which are outside their core business are raising serious concerns among international institutions like the IMF and WB (and others). There does however appear to be a move to scale back involvement in these activities with a decision the Government in February 2009 to restrict state enterprise investments in noncore business (especially in financial companies). This is a move in the right direction.

The land market is still not functioning according to open market principles. Methods applied in establishing market prices should be market driven and the authorities should refrain from excessively regulating the market but focus on removing the distortions carried over from the former non market economy system. Land must be valuated at its market prices in all government and corporate transactions, including transactions between SOEs and between government agencies to reduce profiteering and land-based speculation.

Clarifications from Vietnam on all the above-mentioned issues should be provided for in the next report. There is a general view that SOE reform and accelerated privatisation are crucial issues that require Government attention. Preferential treatment for SOEs must be eliminated. It is important to maintain reform in all these areas to achieve further progress with regards to this criterion.

3.3. Criterion 3

Existence and implementation of a transparent and non-discriminatory company law which ensures adequate corporate governance (application of international accounting standards, protection of shareholders, public availability of accurate company information)

In order to meet this criterion it is necessary for a state to demonstrate that within its economy companies are subject to a transparent and rigorous system of company law. This includes being subject to international accounting standards and international standards for shareholder protection and transparency. Transparent and reliable company records are absolutely central to trade defence investigations, as they are the chief means of determining a company's cost.

3.3.1. Additional information presented by the Vietnamese authorities

The additional information requested concerning this criterion has been provided.

The authorities have provided several documents regarding the implementation of the Law on Accounting of June 2003, including a time table for the implementation of the Decree issued in 2007 on control quality of auditing and accounting service, the report for 2007 on the activities of independent auditing enterprise issued by the Ministry of Finance as well as an updated list of accounting standards issued by Vietnam.

All domestic companies, listed and unlisted, are required to use Vietnamese Accounting Standards (VASs), which have been developed by the Ministry of Finance. Generally, the VASs are based on International Accounting Standards (IASs) though some modifications were made to reflect local accounting regulations. None of the recent International Accounting Standard Board's amendments to IASs or new IFRSs have been adopted.

According to the latest update from the authorities, 26 Vietnamese Accounting Standards (VAS) have to date been issued by the Ministry of Finance (up from 16 in 2006). The Vietnamese authorities have clarified that 10 more standards, in particular relating to financial instruments, are expected to be issued in the period 2009 - 2012. However, the issuance of new accounting standards and updates of existing ones seem to have discontinued since 2006.

The Vietnamese are pursuing their efforts to train more certified accountants and auditors to meet existing demand. With the support of the World Bank, Vietnam Association of Certified Public Accountants (VACPA) is gradually introducing audit standards.

In terms of auditing companies, there were a total of 156 independent auditing companies (including SOEs) operating in Vietnam at the beginning of 2009. They are employing a total of 1500 certified auditors and 300 of them hold an international auditor's certificate. According to the 2004 Decree on Independent Auditing, state owned auditing companies or stock companies established before 2004 must within a three year deadline be transformed into a Limited Liability company, a partnership or a private enterprise, a deadline that many companies have found hard to meet. It appears that enterprises that have not met this deadline will not be granted the necessary auditor's certificate to operate but no concrete information on the future operations of these firms is at the moment available.

Furthermore, the Vietnamese authorities have openly acknowledged that despite the significant efforts made to ensure that the existing independent auditing enterprises train and prepare their auditors, the resulting quality has not matched actual demand nor has it been in line with current legal requirements on auditing and accounting. In its report for 2007 on the activities of independent auditing, the Ministry of Finance has highlighted a series of problems relating to the operation of the auditing companies. To name but a few: auditors signing off on company without having personally carried out the audit, auditors who are not registered at the Ministry of Finance signing off auditors' reports, serious errors in the auditing reports (auditor opinion does not include enough comments, report signed off before the conclusion date of the auditor contract, Financial Statements (FS) attached with the auditor reports are incorrect, items in FS audited without benchmarking data…).

The authorities have explained that in general, companies use either in-house accountants or make use of external ones on a needs basis. The authorities have explained that it is not mandatory for most companies under the current legal framework to have their accounts audited (except for foreign owned enterprises, companies listed in the stock market, financial organizations and SOEs included in the State Audit of Vietnam). For this reason, many companies do not operate with proper accounting systems and with accounting systems that are based on the principles of the International Accounting Standards (IAS).

As regards the public sector, an important development under the 2006 Law on State Audit has been the transformation of the State Audit of Vietnam (SAV) from a Government Agency into an independent institution reporting to the National Assembly. The SAV's responsibilities are to audit expenses under the state budget including SOEs. Based on information provided by the Ministry of Finance, the SAV needs to extend its verification scope and to improve the quality of audits. Up to the last quarter 2008, the SAV had not accomplished its aims. Only a limited number of the consolidated State budgets financial statements of ministries, industries, localities, State-owned projects, programmes and economic organizations had been audited. Currently, the number of entities and units which are audited are few compared to the total number that needs to be audited by SAV. Only an annual average of 40-50% of the consolidated State budget financial statements of localities are audited, with only about 30-40% of districts being audited each time. The Ministry of Finance considers that this is a difficulty that cannot be immediately overcome because it is time-consuming for the SAV to build the necessary capacity and facilities. However, there is a clear intention on the part of the Vietnamese Government to improve that situation as key tasks are being defined to strengthen and develop the SAV.

As regards auditing of SOEs, the authorities have provided the Auditing Plan for 2007 which lists SOEs included in the SAV’s annual audit programme including those under the Ministry of Defence. According to the authorities, all of the SOEs have had their financial statements audited by independent auditors and have implemented accounting systems in conformity with the Law on Accounting. The authorities acknowledged however that there were problems with the implementation of accounting standards for establishing consolidated accounting books.

3.3.2. *Information from other sources*

Despite acknowledging the progress realised in the area of corporate governance over the last year, both the World Bank and the Asian Development Bank have expressed serious concern over the state of the accounting/auditing practices applied in Vietnam, with respect to corporate reporting as well as public financial management. The World Bank has stated the inconsistent reporting and compliance with accounting standards reduce the credibility of business and investment opportunities.

In terms of public finances, the World Bank has in its 2007 Country Partnership Strategy Report highlighted the lack of public accounting standards, the incompleteness of the existing accounting regime and the use of accounting practices not aligned with international standards. It has also stressed the need for the utilization throughout Government of an integrated chart of accounts to ensure coherent financial reporting. With respect to SOEs, the Asian Development bank reports in its Country Strategy and Program for 2007-2010 that accounting and reporting standards remain inadequate, thereby contributing to obscuring the true picture of the sector's overall financial situation. It estimates that around 55% of all SOEs still do not conduct audits. IMF has equally underlined the need for improved financial reporting.

As regards SAV, the World Bank in its Vietnam Development Report 2007 stresses that although the new law is a step in the right direction, significant progress remains to be made on the implementation of provisions of the law relating to the state auditors themselves (qualifications, selection, dismissal, tasks …) and on the procedures to conduct the state audit. In this regard, the World Bank has in its 2007 Country Partnership Strategy Report stressed the need to make government accounts and financial reports audited by the SAV and the financial statements and audit reports available to the public in a timely manner.

In addition to problems inherent to the functioning of the SAV, its overall auditing capacity remains weak making it difficult for it to effectively manage the increased scope of its task including the compulsory audit of all SOEs.

At the end of 2008, the World Economic Forum ranked Vietnam nearly at the end of a list of countries (50 out of 52) in terms of both strength of auditing and accounting standards and investor protection.

Accounting problems in Vietnam are not limited to the industrial sector. Accounting standards in the financial sector are generally regarded as rudimentary and poor. Some improvements have been made but Vietnam still falls well short of international standards.

Experiences of recent or ongoing AD investigations have also underlined that Vietnamese companies often do not apply the appropriate accounting rules on the ground.

3.3.3. *Conclusion*

The Commission considers that while significant progress has been achieved with respect to the implementation of the Law on Accounting and the Law on Auditing, several significant problems remain. Despite efforts to speed up the process to train and certify additional accountants and auditors, the numbers trained so far are insufficient for an economy the size of Vietnam.

Another serious problem is that IASs are not consistently applied by domestic companies in their accounting systems. This evidently creates problems when these companies become involved in Trade Defence proceedings, since the information contained in their accounts cannot be considered as a reliable source of data with respect to the production, cost and sales elements need when calculating normal value and export price.

Further progress would require concrete measures to increase the number of certified accountants and auditors. The introduction and application of IAS would have to be accelerated both at the level of corporate reporting and public financial management. This would have to be accompanied by the implementation of IAS based accounting rules which are properly monitored by the relevant authorities.

3.4. Criterion 4

Existence and implementation of a coherent, effective and transparent set of laws which ensure the respect of property rights and the operation of a functioning bankruptcy regime

To meet this criterion a state must demonstrate that within its economy an effective legal regime operates with respect to property rights, bankruptcy, and the protection of intellectual property. Ambiguity over private ownership is important in trade defence investigations, because they can effect access to credit by private companies, and non-payment of royalties for the use of intellectual property can obviously constitute an unfair cost distortion.

3.4.1. Additional information presented by the Vietnamese authorities

The relevant legislation is in place (Bankruptcy Law of 2004 and recent subsequent implementing Decrees (e.g. Nov 2008 – Regulation on Bankruptcy of Financial Enterprises Established and Operation in Vietnam). The authorities have provided the requested statistical information on the number of bankruptcies registered in Vietnam. According to the latest information, there was in 2006 a total of 53 companies that filed for bankruptcy with 16 declared bankrupt and 37 cases unresolved. In 2007, the figure rose to 100 bankruptcy cases (including the 37 unresolved 2006 cases) with 99 declared bankrupt and 1 case unresolved. According to recent calculations by the Ministry of Planning and Investment nearly 18 % of Vietnamese business went bankrupt in 2008.

The statistics on the total number of companies actually registered in Vietnam is not available. Vietnam did provide figures pertaining to Small and Medium Sized Enterprises (SMEs) where a higher number of bankruptcies have been noted. In the period 1990-2006, a total 254.800 SMEs have registered for business (includes re-registration). Out of these, 1.832 SMEs have stopped operating and 471 have filed for bankruptcy. In 2006 alone, 46.600 new SMEs have been established.

As regards intellectual property rights, the relevant legislation and implementing regulations appears to be in place (the Law on Intellectual Properties came into effect on 1 July 2006) In terms of enforcement, the authorities have explained that they have during 2007 organised several training sessions on IP rights both for Government officials and the business community. The authorities have also carried out a number of seizures of counterfeit goods.

The National Office of Intellectual Property also says that, by June 2008, 426 cases of IPR violations have been resolved.

According to the Ministry of Science and Technology, Vietnam is lagging behind other regional countries in the number of internationally registered inventions and trademarks. During 2008, Vietnamese authorities received and processed 32,000 applications for the registration of trademarks and more than 2,000 applications for the patenting on new inventions. However, the country has just 2,000 internationally registered inventions and trademarks. The Ministry openly announced that the implementation of IPR in the country faces numerous obstacles, including lack of proper legal documentation, weak financial mechanisms as well as a lack of human resources for verification. This is in a context where Vietnam has a very large market for fake products.

3.4.2. Information from other sources

Judicial system

Several international organisations have underlined the general weakness of Vietnam's legal framework. In its Country Partnership Strategy Report for 2007 and updated version, the World Bank characterizes the progress realised so far towards developing a legal system for a modern economy as only partially satisfactory. In its 2007 Vietnam Development Report, the World Bank further notes that despite the introduction of administrative courts more than a decade ago, these have largely been inefficient in making judicial review and correcting administrative action. According to the World Bank, barely 1.000 cases are processed every year compared to 100.000 complaints submitted.

Both the World Bank and the Asian Development Bank have also pointed to problems of acute understaffing and lack of funding for the judiciary system, including for commercial courts. The capacity of the judiciary to interpret the law and ensure its enforcement is further being hindered by the absence of publication of court decisions. Finally, the Asian Development Bank in its Country Strategy and Program for 2007-2010 has noted that the quality of legal drafting remains weak and that there are frequent delays in issuing enabling legislation.

Bankruptcy

According to the World Bank, the current situation with respect to bankruptcy is unsatisfactory. Despite the introduction in 2004 of a new Bankruptcy Law, the number of solved bankruptcy cases (99 in 2007) remains far too low compared to the number of registered companies in Vietnam and the size of the economy.

The low number of bankruptcies is not only due to a shortage of specialised judges, but also that the current legal framework does not permit creditors to foreclose on any collateral without the consent of the debtor leading to very low recovery rates and very few cases actually being brought to court. This situation is also confirmed by the World Bank's "Doing Business 2009" report for Vietnam which states that a case of bankruptcy takes more than 5 years (comparable figures: Region – 2.7; OECD – 1.7) to conclude and costs (% of estate) up to 15% (Region - 23.2.; OECD – 8.4) of the property value concerned with a recovery rate (cents on the dollar) of only 18% (Region – 28.4; OECD 68.6). As a result, very few enterprises terminate their business via official regulations and procedures.

In its 2007 Vietnam Development Report, the World Bank stresses that this is also a problem for SOEs as the current legal framework does not promote the restructuring of the SOEs and State Owned Commercial Banks (SOCBs).This has led to a very low rate of bankruptcies recorded for SOEs: only 26 of the 3.004 enterprises equitized between 2001 and 2006 have gone bankrupt.

With regard to the banking sector though bankruptcy laws exists it has never been applied as no bankruptcy has ever occurred (WB).

Intellectual property rights

Despite significant improvements regarding the legal framework for protecting intellectual property rights, the problem remains one of implementation and enforcement. Pirated and counterfeited merchandise still appears to be widely available in the Vietnamese retail sector and enforcement measures are lengthy and burdensome.

On the legislative front, it is worth noting that Vietnam in the course of 2008 implemented its WTO commitment to criminalise instances of "large commercial scale" piracy and counterfeiting. In June 2009, the National Assembly of Vietnam also approved a new version of the Criminal Code which seems to be a step forward in the direction of deterrent sanctions against IPR violations. In addition, at the end of 2008, an effective regulatory framework for the protection of data exclusivity for pharmaceutical companies appeared to be under development and, according to Vietnam's authorities, is expected to be in place as of October 2009.

As regards enforcement, the number of enforcement actions has increased.

Despite these improvements, a lack of effective enforcement of the domestic IPR regulations and a lack of trained IPR officials and excessive length of proceedings are still identified as the main weaknesses of the system in the IPR Enforcement Survey conducted by the European Commission in 2009. Moreover, civil procedures, provisional measures, criminal procedures and customs procedures still seem to be deficient.

Vietnam has made clear and visible progress in the IPR area. In order to remedy the persisting deficiencies of the IPR system, Vietnam needs to continue its pursuit of the effective implementation of IPR legislation with specific initiatives and actions taken to this end.

Competition regime/laws

The Law on Competition was enacted and came into effect in July 2005. Two State authorities have been established for the law implementation – the Vietnam Competition Administration Department (VCAD), with investigative powers, belonging to the Ministry of Industry and Trade of Vietnam and .the Vietnam Competition Council (VCC) with adjudicative powers.

The Law applies to all business and professional and trade associations in Vietnam; FDI enterprises registered in Vietnam and state administrative bodies. The law replaces other enacted laws regarding restrictive business practices and unfair trade practices. It prohibits: agreements that substantially restrict competition, abuse of dominant and monopoly position, concentration of economic power that restrict competition and anti-competitive behaviour or decisions by officials or State administrative agencies, taking advantage of their authority. However, the Law appears to exempts enterprises operating in a state monopoly sector or enterprises engaged in production or supply of public utility products or services from the application of the 2005 Law on Competition. Although the Law on Competition does not exclude these sectors from its application there is specific sector legislation in - banking, telecommunications, electricity and, pharmaceuticals, which also contains rules on competition. .

A major challenge will be to educate sectoral regulators and all government agencies to consider the impact of their policies on the economy as a whole rather than on individual sectors. Therefore coordination between the VCAD and sectoral regulators is essential. Moreover, it is essential to increase awareness of Competition Law among all stakeholders, by undertaking public education on competition matters in order to make sure the public understands the purpose of Competition Law and supports its implementation. In addition, Government Agencies should consider the competitive effects when drafting their policies as well as when reviewing existing policies in order to take into account the possible effects on market structures. While the competition laws covers a number of important elements, enforcement is still in the infant stage. The Competition Authority has since its establishment, dealt with very few competition cases.

3.4.3. Conclusion

The Commission considers that the information received from other sources confirms that there are still important weaknesses to correct with respect to this criterion. The legal framework for the judiciary still needs to be significantly strengthened notably at the level of the court system and administrative reviews. Nevertheless, significant progress including in the area of IPR, has been made though enforcement remains a major concern.

On bankruptcy, despite the introduction of a new Bankruptcy law in 2004 and recent Regulation Degrees, the number of cases pursued remains unrealistically low, which is not an indication of a fully functioning market economy. The calculated rate (according to the Vietnamese Ministry) of 18% is quite low compared to other economies such as Taiwan and South Korea. In other countries, procedures for enterprise liquidations are quite simple, but in Vietnam, the process is very complicated. Therefore, in Vietnam the number of bankruptcies is low. In the first five month of 2009, Vietnam registered 34,800 new businesses but only of with 2,400 going bankrupt.

There are major challenges with regard to the implementation of Vietnam's competition law. The main weakness is that enterprises operating as state monopolies or in the utilities sector are exempted from the application of competition laws and the criteria for merger control.

3.5. Criterion 5

Existence of a genuine financial sector which operates independently from the State and which in law and practice is subject to sufficient guarantee provisions and adequate supervision

To meet this criterion a state must demonstrate that its financial sector operates free from state control and is governed by commercial standards in terms of cost of credit. These elements are central to trade defence investigations, because access to credit at special rates constitutes an obvious and unfair competitive distortion in favour of a company.

3.5.1. Additional information presented by the Vietnamese authorities

The reform of the financial sector is laid down in a comprehensive roadmap adopted pursuant to a decision by the Prime Minister in 2006. This roadmap mandates the adoption in 2010 of new Laws for the State Bank of Vietnam (SBV) and Credit Institutions, the transformation of the SBV into a modern central bank with responsibility for supervising and monetary policy. It should also clearly separate the role of SBV with regard to the management of SOCBs and its more normal banking supervision functions. By Decree of August 2008 the Government prescribed the functions, tasks, powers and organizational structure of the SBV. This Decree still leaves the SBV with some responsibilities which still leave it involved in the management functions of the SOCBs. As to the SOCBs themselves, the equitization process should be more intensively pursued and their commercial orientation should be strengthened.

In terms of liberalising the financial sector, the authorities have submitted that since 1 April 2007 foreign owned banks can (as a result of Vietnam's WTO accession) operate 100 % foreign owned subsidiaries in Vietnam. In addition, foreign credit institutions are entitled to purchase equitized SOCB stock at the same level as the Vietnamese commercial banks. The authorities have underlined that the ratio of implantation of foreign owned banks in Vietnam has been significant.

According to data of the State Bank of Vietnam (July 2009) , there were 86 commercial banks operating in Vietnam, 6 SOCBs, 5 joint venture banks, 38 joint stock commercial banks and 33 branches of foreign banks. In addition there were 998 smaller banks (People's Credit Funds), 17 Finance Companies and 13 Financial Leasing Companies.

The Vietnamese authorities state that interest rates for loans from the SOCBs are determined exclusively by market mechanisms, with no discrimination as regards rates applied to private or state-owned enterprises. The SBV now only supervises and intervene in the credit market by determining the base rate and the compulsory rates for deposits in VND and USD. The preferential loans (subsidized loans and export credits) previously provided by the SOCBs for certain types of domestic operators have been abolished and have been transferred to the Vietnam Development Bank (VDB) and the Bank for Social Policies.

The authorities have not been able to provide any new concrete information on the progress in non- performing loans (NPL) and the methodologies used to evaluate loan applications. On the Debt Asset Trading Corporation (DATC) which is the state owned enterprise assigned to assume bank liabilities to free up loan capital, the authorities have not been able to explain the methods followed by DATC to solve non-performing loans or to give the number of cases that it is dealing with. The authorities indicated that they would provide a copy of the last published Balance Sheet of the DATC's.

3.5.2. Information from other sources

Banking sector

According to the Asian Development Bank, the State still largely controls the banking sector: the 6 SOCBs account for around 70% of domestic bank credits. The non bank sector (including leasing insurance, private equity fund, micro finance institutions, credit guarantees and the securities market) is still underdeveloped and plays a limited role in economic development. The IMF states in its Country Report 2007 that pursuant to a decree adopted in June 2007, the authorities have raised the maximum share of foreign individual strategic investors in each bank from 10% to 15% (and 20% with the Prime Minister's permission). In addition, since June 2007, several foreign banks have applied for the establishment of wholly owned subsidiaries in Vietnam. The establishment of wholly owned subsidiaries in Vietnam has been undertaken in line with Vietnam's WTO commitment in 2008. Up to date, five foreign banks have been licensed to operate as wholly owned subsidiaries in the country.

Despite this partial market opening, the Asian Development Bank in its Country Strategy and Program for 2007-2010, points at the existence of numerous market distortions which still inhibit adequate supply of financing for private sector companies including prioritized lending to SOEs, restrictions on competition from foreign banks, high collateral requirements, limited project appraisal and business review capacity and lack of transparent financial information.

The reform of the banking sector

While acknowledging the impressive economic development of Vietnam of the past decade, the current situation with regard to the regulatory framework in the financial sector has attracted criticism from the World Bank in its 2007 Country Partnership Strategy Report. The general appraisal is that the pace of the reform process must be quickened, notably at the level of the reform of the SOCBs and SBV. The IMF encouraged Vietnam to expedite plans to grant SBV adequate autonomy and authority to carry out monetary policy aimed at price stability and effective bank supervision. According to a study of the Harvard University (on request of Vietnamese Government) Vietnamese banks are not yet managed in accordance with international standards and there is a strong need to implement the restructuring of the SBV. Recent large investments of SOEs in banks and financial companies have created and increased the risk for the real economy and diverted urgently needed capital to non-core business areas.

A key milestone according to the World Bank will be the implementation of the revised Law on the SBV and the revised Law on Credit Institutions to the National Assembly. There are indications that the Vietnam Government is accelerating the approval of these two laws though so far no drafts of the laws have been made public. The success of Vietnam's financial reform process will crucially depend on the ability of the government to transform the SBV into a modern central bank responsible for bank supervision and monetary policy. This will require a restructuring of the SBVs central and provincial organization, which in turn will help undermine the cosy relationship existing at present at provincial level between borrowers, lenders, and supervisors. The IMF has emphasized the importance of the acceleration of structural reforms, especially for SOEs and the banking sector where the reform momentum has slowed over the past year.

Joint Stock Banks (JSBs) are a relatively recent innovation in Vietnam. However, their dynamic and innovative business and management mindset, is putting competitive pressure on the SOCBs and foreign banks. There are some signs that Vietnamese authorities intend to further improve the situation for the JSBs with slight increases in foreign participation allowed since 2007. Total shares owned by international investors in these JSBs must not exceed 30%. However, these shares are not easily obtained and investors are restricted in share transfers for a number of years after such an investment.

The IMF also raises concerns as a result of the current global financial and economic problems. Following several years of strong performance, Vietnam's economy is facing a number a challenges. External challenges are compounded by domestic challenges stemming from a large current account deficit, as well as weaknesses in the banking and corporate sector. IMF experts noted that strains in the banking system had increased in 2008, and that these continued further in 2009, as economy activity slows. Banks have high loan-to-deposit ratios (Vietnam 2007: 95%; average ratio in Asia of approx. 80%) and rely heavily on short-term interbank funding, and their profit margins were squeezed by the higher funding costs and caps on lending rates. The IMF continues to encourage the SBV to further strengthen its capacity to undertake risk-based inspections of banks, with a particular focus on ensuring that banks are properly assessing and reporting credit risks on their loans, including those extended under the interest subsidy schemes (part of economic stimulus package).

The IMF also emphasized the need to improve data quality as significant gaps remain in the data available on fiscal, state-owned enterprises, and banking operations. Significant shortcomings in financial transparency and banking supervision complicate the analysis of banking vulnerabilities in Vietnam. Moreover, only a few of the SOCB publish detailed financial statements.

Government finance statistics and monetary statistics are, according to the recent IMF staff report, weak and improvement is recommended. Government data reflect the consolidated operations of the state budget, which cover all four levels of government (central, provincial, districts, and commune). However, they exclude data on off-budget investment expenditure, quasi-fiscal activities of SOEs, and extra budgetary funds, among which is – for MES assessment - an important Enterprise Restructuring Fund, for which data is not compiled on a regular basis. As a result, government financing data, in particular domestic bank financing, cannot be reconciled as reported in the fiscal and monetary accounts.

According to WB, SOCBs are still the main source of funding for SOEs, many of which are inefficient and uncompetitive by international standards. Already heavily exposed to these enterprises, the SOCBs often have no alternative but to continue their support. They are also prone to government intervention, appear overstaffed, and seem to be administrated rather than managed.

As regards the credit institutions, the World Bank welcomes the current efforts to speed up the process of equitizing SOCBs and strengthening their corporate governance, a process that the authorities estimate will be completed by 2010. However, for the process to be successful, the Wold Bank has stressed it will require bringing onboard strategic investors. In this respect, it is positive that 3 of the SOCBs (incl. Vietcombank) have hired major international banks to assist them in the process of appraising assets and selecting strategic investors. These steps should in the long run help SOCBs to become autonomous, profit making institutions.

Another step in the right direction according to the World Bank has been the separation of preferential and policy based credit activities from the SOCBs through the creation of the VDB and the Social Policy Bank. The VDB predecessor was the Development Assistance Fund which provided subsidized loans (at around 70% of the market rate) to domestic companies, mainly SOEs. The lending of the VDB has now been made compatible with WTO rules and is authorized to support a specific sector of economic activities regardless of company ownership.

The World Bank also highlights as a positive development that the credit ratio to the private sector has in 2007 increased to 67% (from 58% in 2001) and that provided to SOEs substantially fallen. However, the share of the non-performing loans in the banking sector remains high (estimated at 8-10%) as a fraction of total credit and indications of an increase in the share of NPLs are already there (estimation: 13%) can be expected to increase further on in the context of the declines in stock and real estate prices, hikes in interest rates, and general slowdown in economic activity. According to the East Asia Forum, Vietnam has still not enforced international standards for the measuring of non-performing loans with the result that they may be understated. The limited profit incentives in the SOCBs and their unchecked lending to SOEs have led to poor quality of their lending portfolios with resulting accumulation of contingent liabilities. It further appears from assessments based on IAS audits that the overall quality of SOCBs' portfolios is not improving. This is compounded by the fact that only limited progress has been noted in resolving debts under the DATC framework and in limiting the provision of preferential credits from the SOCBs.

The next necessary step in the reform will be the transfer of responsibility for exercising the government's ownership rights over SOCBs from the SBV to the State Investment Capital Corporation thereby removing the conflict of interest that has constrained the SBVs bank supervision so far.

According to IMF's view it is also important to move ahead with the issuance of implementing regulations for Vietnam's Anti-Money Laundering Decree.

Exchange rate conversions

The analysis of certain concrete AD-cases showed that often the economic transactions between other currencies and the Vietnamese currency are not always carried out at actual market exchange rates ruling at the transaction date.

In Vietnam, there exists a dual system of exchange rate conversions. They are: (i) the official system where the State Bank of Vietnam, the central bank, fixes an interbank rate and commercial banks are allowed to apply 5% flexibility (+/-) around this rate. In fact, due to this artificial determination of exchange rate, banks in recent months do not have enough USD/ foreign currencies to sell to companies or individuals that need the foreign currencies; (ii) rates applied in the grey market where USD – the most common foreign currency in Vietnam – is usually sold at a price often 3-5% higher than the rate of commercial banks.

3.5.3. Conclusion

The overall size, sophistication, and number of enterprises in Vietnam are increasing – as is their need for greater access to finance. The World Bank Investment Climate Survey indicates access to finance to be a more significant constraint to enterprises in Vietnam than those in other countries. SMEs in Vietnam in particular face difficulties as they will not able to easily access financial services and secure financing, due mainly to a strong risk-adverse bias on the part of banks with respect to SME lending and the absence of specialized financial institutions to provide loans to SMEs. SOEs and large companies benefit from this imbalance.

The Commission considers that state control over the financial sector still remains strong though this more recently may be because of the economic crisis. Financial institutions work under principles derived from the former non market economy system and there is conclusive evidence that allocation of capital to enterprises is not always governed by normal economic principles. These practises undermine competition between economic operators as the financial situation of companies is not based on prevailing market economy conditions. This also means that in the cases of anti-dumping proceedings, company specific data is not based on the real situation of companies but on distorted debt structures and non real costs.

The role of SBV as an independent force to effectively supervise the financial system needs to be further strengthened. The central bank should focus strictly on a supervising role and take the necessary steps to eliminate its position as a player in the commercial banking sector. Furthermore, it is of a paramount importance that DATC when solving non-performing loans of state-owned enterprises is guided/governed by rules and activities which are transparent, clear, non-discriminatory and based on free market economy principles. As regards SOCBs, these should modernize their activities, use IAS in their activities, continue their equitisation process and eliminate state intervention in their business decisions.

The Commission would appreciate receiving (i) concrete information on the performance of DATC, (ii) an updated time-table on the introduction of the still missing rules relating to the supervisory authority of the SBV, and (iii) data relating to the NPL ratio and capital adequacy ratio of the banks.

4. GENERAL CONCLUSION

Vietnam is making important progress in its overall transition towards an effectively functioning market economy. The analysis carried out so far of the five MES criteria on which this assessment is based confirms this conclusion.

As regards criterion 1, the Commission considers that Vietnam fulfils the necessary conditions. The restrictions hitherto imposed on companies' business decisions have been removed. In terms of a level playing field for firms operating in Vietnam, it has been confirmed that the same rules apply for all type of companies whether private or public, foreign or domestic. Price setting practices are *de facto* confined only to public utilities and domestic and foreign users are charged the same rates. Finally, the progress achieved over recent years in the development of the Vietnamese private sector has made this sector the most dynamic and GDP generating sector of the economy.

As regards criterion 2, considerable progress has been made. Barter trade has been eliminated and the land market is now largely market based and most SOEs are now privatised. However, some difficulties remain. Vietnam needs to accelerate its efforts with regard to the restructuring and privatisation of remaining SOEs especially military enterprises. There are also concerns about proposals to increase the activities of SOEs to areas outside their core-business. This could be problematic with regard to the progress achieved so far. There is also a clear need to improve the transparency and accountability of SOEs. In this context, it would be helpful for Vietnam to identify its plans for the equitization of remaining SOEs. Vietnam also needs to free the land market from the remaining few though significant state distortions.

As regards criterion 3, substantial progress has been made with the necessary legislation now in place. Therefore the important question now is to ensure that these laws are implemented effectively. The functioning of the State Audit of Vietnam (SAV) needs to be improved as its overall auditing capacity remains weak. SAV has not yet accomplished its declared aims and a clear signal should be given to the strengthening of the work of SAV. More consistency in reporting and compliance with accounting standards would increase the reliance with regards to the credibility of business and investment opportunities. The number of experienced and certified accountants and auditors remains small in relation to the number of enterprises. There is a clear need to train more accountants and auditors.

Vietnam has also demonstrated that it has made progress with regard to criterion 4. Regarding bankruptcy laws it is their effective implementation which needs to be shown. One other problem which is very apparent here is the lack of transparency with regard to the number of companies affected by bankruptcy. Vietnam also has problems of acute understaffing and lack of funding for the judiciary in this area.

Despite the clear effort and progress made by Vietnam on IPR, this area requires more attention. This could be achieved by more determined efforts with regard to a more proactive attention to the implementation of the relevant laws.

The existence of competition laws in general is considered as progress. However, the exemption of major business sectors from its implementation and insufficient awareness of Competition law among all stakeholders needs to be addressed before further progress can be achieved.

For criterion 5, there are indications that the Vietnamese Government is accelerating the reform of the banking sector. However, there are still elements which negatively influence progress. Further information is needed on progress with respect to non-performing loans and the methodology which is used to evaluate loan applications. A significant number of market distortions still inhibit adequate supply of financing for the private sector. On the legislative front Vietnam has announced but not yet introduced the necessary changes with respect to the regulatory framework. To achieve further progress improvement of data quality and availability is needed. The role of State Owned Commercial banks (SOCBs) needs to be clarified with regards to its policy of uncontrolled lending to State Owned Companies (SOEs).

The Financial Sector in Vietnam is characterized by a number of deficiences. Within the banking sector, SOCBs obtain better treatment than private financial institutions. SBV's dual role of ownership of SOCBs and having responsibility for the supervisory functions of these same SOCBs remains a significant problem. The absence of risk-based lending is a serious issue as it is a distortion which can significantly affect the reliability of prices and costs which are so important in trade defence investigations.

All in all significant progress has been identified. The information analysed shows that Vietnam now fulfils one out of the five MES criteria with encouraging progress made on criterion 2. There is more to be done for the remaining three criteria but progress is evident. Nevertheless substantial problems remain for these three criteria though none that could not be addressed by Vietnam if the determination exists to aim for full market economy status.

In the meantime, of course, Vietnamese companies can continue to avail themselves of the possibility for companies to apply for individual market economy treatment in the context of each anti-dumping investigation.

With regard to the way ahead it is clear from the above that Vietnam could make swift progress if a number of key steps were followed. Overall the biggest issues refer to the effective implementation of laws that are already in place. In that context, it is obvious that for Vietnam to move ahead on market economy status much remains in their own hands. For example, it is for Vietnam to ensure a quicker training of auditors and accountants to ensure that the accounts of companies are in good order and are reliable enough for use in trade defence investigations. Much the same applies to bankruptcy laws.

The European Commission is ready to meet with Vietnamese representatives as soon as possible after the completion of this report to identify the steps which would bring the fastest results in terms of Vietnam's goal of achieving MES. The aim would be to create a roadmap setting in more detail concrete steps which need to be taken to reduce outstanding shortcomings in the context of granting MES.

5. ANNEX – SOURCES OF INFORMATION (AS AVAILABLE UPON AUGUST 2009)

I) DOCUMENTS PRESENTED BY VIETNAM

- Submission 7 November 2007 (60 pages of supporting documentation)
- Letter 31 October 2007 (22 pages submission and 640 pages of supporting documentation)
- Letter 27 August 2007 (39 pages of supporting submission)
- Letter of 8 March 2007 (27 pages of supporting submission)
- The State Bank of Vietnam – website (last access July 2009)

II) OTHER SOURCES

b) World Bank

- World Bank (with Asian Development Bank and bilateral donors): Vietnam Development Report 2009
- World Bank and International Finance Corporation (IFC): Doing Business 2009
- World Bank, International Development Agency (IDA), Multilateral Investment Guarantee Corporation (MIGA) – Vietnam Country Partnership Strategy 2007/IDA at work: August 2008
- Tacking Stock, June 2008
- Tacking Stock, June 2009
- IFC – International Finance Cooperation (World Bank Group) –Financial Sector Diagnostic 2008

c) International Monetary Fund (IMF)

- Vietnam: IMF country report – 2006
- Vietnam: IMF country report - 2007
- Vietnam: 2008 Article IV Consultation – Staff Report, March 2009

- Vietnam: 2008 Article IV Consultation – IMF Country Report, April 2009
- Vietnam: Statement at the conclusion of the 2008 Article IV consultation Mission to Vietnam

d) Asian Development Bank

- Asian Development Outlook 2008, 2009 – Viet Nam
- Country Strategy and Program - Vietnam 2007-2010 (mid term review expected to be completed in 2009)
- Country operations Business Plan 2009 - 2011

e) World Trade Organization (WTO)

- Documents related to Vietnam's WTO accession negotiations

f) Other

- Office of the United states Trade Representative – 2008 Special 301 Report
- International Intellectual Property Alliance – 2008 Special 301 report Vietnam (IIPA 2009 Special 301 report on copyright protection and enforcement)
- World Economic Forum, Financial Development Report 2008
- Report US Harvard University (forwarded by EC Delegation)
- Economist Intelligence Unit, December 2008; March 2009
- UNCTAD – Investment Policy Review Vietnam 2008
- US Central Intelligence Agency – The world fact book 2009 Economy
- East Asia Forum – Vietnam's banks under scrutiny, 2008
- EU Commercial Counsellors Report on Vietnam, May 2009
- Asia Focus – Federal Reserve Bank of San Francisco
- Vietnam Business Forum, June 2009
- Vietnam Association of Certified Accountants May 2009

III) EC ANTI-DUMPING MEASURES IN FORCE AGAINST VIETNAM INVOLVING MARKET ECONOMY TREATMENT DETERMINATIONS

- <u>Stainless steel fasteners</u> – new investigation initiated on 24.08.2004, definitive measures imposed on 19.11.2005
- <u>Bicycles</u> - new investigation initiated on 29.04.2004, definitive measures imposed on 14.07.2005

- Footwear (with uppers of leather) – new investigation initiated on 07.07.2005, definitive measures imposed on 06.10.2006