6. THE 1987–'94 VIETNAMESE CORPORATE INCOME TAX REFORM

6.1 INTRODUCTION

Between 1987 and 1993 Vietnam introduced drastic corporate and individual tax reforms. The reforms were needed to raise desperately needed revenue for a communist country facing bankruptcy. This chapter analyses the tax reform in the context of the opening of Vietnam’s economy as it aimed to reform its communist system into a socialist market economy. As with the Indonesian case study, the Vietnamese case study focuses on income tax for companies; no specific attention is given to reforms in the turnover tax, the introduction of a value-added tax and reforms of the special sales tax. The chapter aims to provide an insight into who and what influenced the tax reform. What were the limitations faced by policymakers? And what was the role of various influential actors, including foreign advisers?

State enterprises were for many years the main contributors to Vietnam’s government revenue. After the introduction of a market-oriented system in the late 1980s, the revenue from state enterprises dropped significantly. In addition, until 1989, foreign grants, mainly from the former Soviet Union, constituted 20% of total government revenue (SIPU 1993). The Vietnamese Government faced declining revenues while at the same time its budget was rapidly expanding. In order to deal with the revenue shortfall, the government introduced a range of new taxes in the late 1980s and 1990s. Between 1990 and 1995 Vietnam carried out the first major phase of reforming its tax system.

I wish to emphasise that for this study far less information was available than for the Indonesian case study. As mentioned in chapter 1, this is a problem faced by many conducting research in Vietnam. As pointed out by Vietnam expert Melanie Beresford (1997, p.188), “… the closed character of the state system and the concern of the Communist Party leaders from the earliest times to present a unified front to the rest of the world makes it very hard to obtain a clear picture of Vietnamese policy-making. Therefore we often guess how political positions are arrived at and how leaders gain the necessary support for them.” The Vietnamese case study consists of two parts. The first part focuses on the Foreign Investment Law (1987), dealing with the taxation regime for foreign investors. The second part focuses on income tax of domestic corporate entities. Particularly for the first part, limited information was available about internal decision-making. Because the second part involved advice from the Swedish aid agency and the Swedish tax administration, I was able, under Swedish disclosure laws, to obtain more information regarding the processes leading to the New Profit Law of 1990.

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109 As mentioned in 1.3, it is important to emphasize that since the tax reform processes between 1987 and 1993 in Vietnam, much has changed in Vietnamese tax laws. The principal purpose of the study is to develop a model for understanding such tax reform processes.

110 See footnote 44.

111 One hour interview with Dr Lloyd Kenward, former IMF representative in Indonesia and economic adviser to both Vietnamese and Indonesian government departments, 27 November 2005. As he pointed out: “Generally Vietnamese public servants take meticulous notes of meetings, developments and processes. However, it is extremely difficult to have access to such information. The Vietnamese will see no reason to share that with foreign researchers, unless there is a clear benefit to them. So you often will not have access to such materials.”
The chapter starts with an introduction to Vietnam, followed by an examination of its government structures and law-making processes during the time of this case study. Next an historical overview is given of Vietnamese taxation and the background of the 1987–90 tax reform is examined. These aspects combined provide the background against which the actual decision-making of the tax reform took place, which is subsequently discussed. The chapter concludes with an update on tax law developments after 1990, followed by some conclusions.

6.2 VIETNAM: COUNTRY BACKGROUND

The name Vietnam is useful, but not entirely appropriate, for describing the history of what we currently call Vietnam. During the period 1000 BC to 1000 AD, Nam Viet covered roughly the northern part of Vietnam (see map). The southern part, the Champa, did not stretch as far south as Vietnam does today. Under the Le dynasty, 1414–1700, Nam Viet expanded further south and the southern part, Champa, declined.

The traditional centre for the Vietnamese was and is the Red River delta in the north of Vietnam. The area is suitable for wet rice cultivation and people, attracted by the fertile land, moved to this area. As the population and the demand for agricultural land increased, there was a need for expansion. There were no possibilities to move further north due to the Chinese presence. Because of their dependency on low-lying delta land for their rice-based culture, the only move the Vietnamese could make was to the south. Around the 13th century the Vietnamese had started to move down the coast of central Vietnam (de Vylder and Fforde 1988, p.21). The move southwards took many centuries, and it was only in the beginning of the 19th century that the Vietnamese reached the northern part of the Mekong delta in the south of today's Vietnam.

The system of local collectives, including the rural communes, which predates the socialist system by many generations, is important not only historically, but also as a means to understand contemporary Vietnam. The system gave protection and a basic social framework, which was not only economic but also social and even spiritual, for those living in rural areas. Communal assets were common in the local systems. The communes were taxed as a collective, which gave the local members of the community some leverage against state officials, often viewed as corrupt and brutal, who came to collect taxes (de Vylder and Fforde 1988, p.21).

This does not imply that the state did not have a certain authority. Vietnam was under Chinese rule circa 200–930 BC. One heritage from over 700 years of Chinese domination is a deeply rooted system of powerful, centralised bureaucracy. Belief in this system is still present among many Vietnamese, in addition to a tradition of strong local communities.

After independence from Chinese rule, a number of dynasties ruled Vietnam, until French colonial rule began in 1859. French rule was met with great hostility and various groups in Vietnamese society tried to raise anti-colonial movements. It was ultimately the communist movement, the Viet Minh, that was successful.
In the early 1940s, the French Government became unable to control large areas of Vietnam and the Vietnamese resistance began to gain ground, especially in rural areas. In 1954, the French were defeated at the battle of Dien Bien Phu. After French surrender, the Geneva Accords were signed providing for a temporary division (300 days) of Vietnam into a northern and a southern part and the scheduling of nationwide elections in 1956. After the signing of the accords the south was governed by an anti-communist leader, Ngo Dinh Diem. Diem feared a victory for the Communist Party and therefore did not implement the election arrangements of the Geneva Accords. Instead he held a referendum and declared himself president, a move supported by many Western countries (Steinberg 1987, p.361).

The North Vietnamese government, under the control of the Communist Party, undertook development programs, which involved setting up a huge bureaucratic system to allocate resources into key sectors for national construction (de Vylder and Fforde 1988, p.26). In the late 1950s, the government adopted the official policy of collectivisation of agriculture (supported by China) (Beresford 1997, p.181). Peasants were reorganised into agricultural co-operatives, which were seen as an appropriate substitute for the traditional collectives. The co-operatives had a broad range of tasks including providing welfare, social reorganisation and sometimes financial assistance to their members. A radical land reform programme saw 1.5 million peasants each receiving half a hectare of land. The government also started a major crackdown on ‘land lords’, many of whom were denounced to security committees. In the first year of independence, 10,000–15,000 people were executed and 50,000–100,000 were imprisoned.

During this period, the North depended heavily on foreign aid. From 1963 to 1975 foreign grants and loans formed more than 60% of the non-military budget.

The government had not given up its claim to South Vietnam. In 1976, after a ten-year war, in which the US supported the South Vietnamese government, the two countries were formally reunited. After 1976, the south of Vietnam was Suddenly transformed to fit the North Vietnamese model. Farms were collectivised, leading to a drop in farm production. Private companies were nationalised, small business people were forced to abandon their businesses, and the middle class was subject to harassment of all kinds, including re-education camps and exclusion of their children from education (Marr 1994). In 1978, anti-capitalist campaigns were launched targeting private businesses and many Vietnamese (mainly ethnic Chinese) fled the country.

In the late 1970s, as Vietnam emerged from 30 years of national division and war, most of its economic policy-makers had very limited experience and what they had was often based on a neo-Stalinist command economy. The Communist Party was eager to translate its victory in the war against the South and the US into national and institutional unity. It brushed aside regional differences and looming problems with implementing socialist policies through weak institutions in a less than enthusiastic southern Vietnam.
Between 1979 and 1986 the communist system started to show signs of decay (Marr 1994, p.5). The communist leaders became increasingly nervous, seeing their power declining as they lost control over developments. The Vietnamese currency, the Dong, significantly declined in value (in 1985 at a rate of 16–18% per month) which further undermined public confidence (Marr 1994, p.5). The farm co-operatives in the north were dysfunctional, farmers in the south evaded the rigid co-operative structures, and the informal economy blossomed, thus undermining the government’s planned economy.

Vietnam’s foreign policies had turned out to be quite painful, especially its role in Cambodia.112 There were ongoing tensions with China and the break-up of the Soviet Union in the early 1990s made it doubtful whether continued support from this source could be counted on.113 It was against this background that the government decided to introduce market-oriented economics and as part of that reform to introduce a range of taxes.

But as pointed out by Riedel (1999, p.8), “Vietnamese policy-makers were pushed by these international developments, but even more importantly they were pushed by the actions of individual communities and factories which spontaneously experimented on their own with (…) market-oriented solutions to the manifest failures of the planning system.” In other words, the pressure for change came from the bottom of the Vietnamese system before the leaders at the top understood their necessity.

6.3 GOVERNMENT STRUCTURES AND LAW-MAKING PROCESSES 1984–’91

Vietnam is divided into 53 provinces and further subdivided into close to 500 districts and 17 towns. The districts are subdivided into approximately 1,000 communes. At each level of government there is a legislative authority and an executive body elected by the legislative. At the central level is the Legislature, the National Assembly, and the Government headed by the Prime Minister (Pott 2002, p.117-118).

The Communist Party is the dominant force in the political system of Vietnam. But the Constitution requires all organisations of the party to operate within the framework of the Constitution and the laws. The party is clearly present at all levels of administration to ensure that leadership is not threatened and that there is consistency with central policies (Bergling, Haggqvist et al. 1998, p.82).

How the Vietnamese political system works in practice and how pressures from interest groups translate into policy changes remains hard to determine. As mentioned earlier, Beresford (1997, p.188) points out that the closed character of the state system makes it very hard to obtain a clear picture of Vietnamese policy-making. Or as journalist Beaulieu puts it (1993), “Information exchange is not a Vietnamese strength, at least not as far government goes.” She is supported by researcher Nguyen Thanh Ha, who claims that, “… the legacy of wartime secrecy,

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112 In 1991, the Paris Peace Accords were signed that included the withdrawal of the Vietnamese Army from Cambodia.
113 The late 1980s–early 1990s saw the democratisation of Eastern Europe and the break-up of the Soviet Union.
based on the military principle of limiting the flow of information to those with a proven need to know is still very apparent and also makes discussion and scientific debates more difficult” (Nguyen Thanh Ha 1992).

Is the Vietnamese Government strongly authoritarian or does it rule thanks to a broad consensus from its citizens? As outlined by Kerkvliet (1996, p.65), four distinct representations of society–state relations can be found in Vietnam. The first representation sees the governing and rule-making bodies of the state as almost self-contained; social forces simply have no impact. The second approach sees the state and the Communist Party, in particular, allowing social forces to participate but only via institutions and organisations established by the state. The state uses these organisations to foster its own agenda. The third approach holds that the power of the state is far less unqualified than the first two assume; it describes the Vietnamese state as trying not very successfully to impose its policies on society. The fourth representation sees the state considering social pressures and demands, especially if they derive from peasants and/or workers, two groups the Communist Party claims to serve. Although only limited work has been done to test these different representations, Kerkvliet convincingly argues that the fourth approach is closest to reality (Kerkvliet 1996).

The central government needs to take local and provincial governments into consideration. Much of Vietnam’s politics can be seen as a lively dialogue between the centre and localities (Haughton 1994, pp 1-33). Although the centre has far-reaching powers of resource allocation, directing foreign aid and investment, it does attempt to reach general consensus regarding its longer-term policies. Most local governments use the strategy of selective implementation and application of government policies in case of disagreement. Although government policy has changed, many of the socialist features of the 1960s and 1970s remain. Ministries are divided into many different compartments with a strong vertical organisational structure that provides linkages between Hanoi and provincial and even district levels. Horizontal communication between ministries or even within each ministry is often problematic.

Prior to the 1975 unification, the party’s central committee was dominated by senior officials who served in the central party apparatus in the central government or in high positions in the army (Thayer 1996, p.47). After reunification, the committee changed to include provincial party leaders and other secondary-level officials. As Thayer (1996, p.59) shows, the reunification of 1975 had a great impact on both North and South Vietnam. Some argue that during this period the seeds of economic reform were planted in the North and that the South never accepted the socialist policies from the North.

The law-making process was, at least in form, very much a top-down affair, especially until the early 1990s. Legislative support for government policies was guaranteed since the communist party dominated the National Assembly (NA), the highest representative body. The NA is elected for a period of five years. Strict conditions apply to most candidates for the NA, including membership of the Vietnamese Communist Party. In 1992 the Constitution was revised to strengthen

114 A minority of non-party members is allowed in the NA.
the role of the NA in the legislative process. The NA now meets twice a year (each session lasts up to five weeks). The Standing Committee is the permanent body of the NA serving as legislature between the sessions of the NA. Laws have the highest status and need to be approved by the NA. Ordinances can be approved by the Standing Committee of the NA. The government has authority to enact decrees.

There are seven committees of the NA (Bergling, Haggqvist et al. 1998). The committees are: Law (largest and most important); Economy and Budget; Social Affairs; Culture and Education of Youth, Youngsters and Children; Science, Technology and Environment; Defence and Security; and External Relations.

Laws are generally created by drafting committees set up under the responsible ministry or agency. When the NA adopts a plan for a new law or to revise existing laws, it delegates the carrying out of the plan to the Standing Committee. The plan also designates the agency that will draft the law and stipulates a timeframe for this work (Bergling, Haggqvist et al. 1998, p.29). The ministerial committee collects material and feedback from agencies and organisations and may also arrange seminars for experts and researchers during the drafting process (Bergling, Haggqvist et al. 1998, p.29). When the drafting is completed the law is sent to the government, which decides whether to submit it to the Standing Committee of the NA. The Standing Committee then designates one or more committees of the NA to examine the draft. For tax laws, this is the Economics and Budget and the Law committees. The views of these committees, the government, and possibly other organisations are taken into account by the Standing Committee before it adopts a proposal (in the case of an ordinance) or submits it to the NA (in the case of a law). The NA approves the law by majority vote. The president publishes the laws and ordinances.

Tax policies are determined at the central level (Bird, Litvack et al. 1995, p.22). The Ministry of Finance (MoF) and particularly its General Department of Taxation (GDT) are the key policy-makers in the area of taxation. Within the MoF, the vice-minister, together with the Director of International Co-operation (within the MoF) play an important role. In the GDT, the Director General, the Deputy Director General, and the head of the Foreign Investment Enterprise Taxation and International Co-operation and the Taxation Policy Division, are key players.

6.4 HISTORICAL OVERVIEW OF VIETNAMESE TAX

From the 1st to the 6th century AD Vietnam was occupied by China. This era involved intensive exploitation in the form of taxation (Hodgkin 1981, p 22). The main burden of taxation during this period fell on the peasantry and craftsmen. Although the arrangements by which tax collectors could keep part of the collected revenue as a form of salary may have contributed to a motivated team of collectors, tax evasion was nevertheless widespread.

This period was followed by the Vietnamese Tang dynasty (618–906 AD) which was marked by a strong, unifying, administrative framework. The dynasty increased their
control in Vietnam. They introduced new taxes such as a graduated property tax. The mountain regions, regarded as barbarous, came under a separate tax regime. These minority peoples suffered especially from the weight of taxation.115

At the start of the 10th century the Tang Dynasty was crumbling and in 906 it collapsed. For several decades the rich Vietnamese Khuc Thua Du family held power. During this period (906–30 AD) taxes were reduced significantly. This independence lasted for 70 years until, with the establishment of the Ly dynasty in 1009, the Chinese ruled again.

The Ly dynasty (1010–1225) was a period in which the rulers paid much attention to improving and strengthening the administrative system. Professional administrators were in charge. These mandarins had rights of taxation that could be inherited by their oldest sons for a small fee. The mandarin bureaucracy only dealt with village-based Councils of Notables. Villages acted like corporate entities or organised interest groups in their dealings with central–local relationships. Village leaders interacted with families and clans, but not individuals (Gillespie 2001).

In order to finance the administration, many new taxes were centrally introduced in 1013, including taxes on rice fields, mulberry orchards, foodstuffs brought to market, salt imports, rhinoceros’ horns, elephants’ tusks, oils and perfumes, and forest products (Hodgkin 1981, p 35). The Ly dynasty set up a national register of the male population. While the main reason was to create a national army (in addition to the existing private armies), the information was also used as a basis for tax assessment.

The 13th century saw the establishment of the Tran dynasty that lasted from 1225 until 1400 AD. Under this regime, taxes increased and it became possible to pay taxes in cash. At the district level, officials were appointed to collect the taxes in the different villages. Normally one official would be in charge of two-to-four villages. In the 14th century the Tran dynasty weakened, in part because of the burden of taxation. Prior to 1378, only land-owners paid taxes, but in 1378 this was extended even to landless people. These increases were introduced to finance the Champa wars in which Vietnam was involved. The measure caused much resentment among the poor, who were scarcely able to feed themselves, let alone pay taxes. The system of taxation was reformed in 1396, the government responding to threats of unrest over the tax burden. Taxation was made progressive and the area of rice fields possessed became the basis of assessment for taxation. Landless peasants, widows and orphans were exempt.

In 1428 the Le dynasty was established. Le Loi, a Vietnamese from Thanh Hoa province, was the first ruler of this dynasty. The Le rulers were active in expanding southwards. In order to fund this expansion they reformed the tax system. Expenditures increased not only for the army but also for the bureaucracy, palaces, pagodas and court ceremonials. The tax burden increased, taxes became more complicated and were strongly regressive. Those belonging to the privileged class

115 Not only did they suffer from a heavy tax burden, they also had to face a system of exchange, whereby three kilograms of salt, which they had to import, was equal to one buffalo (Hodgkin 1981, p.27).
(mandarins) were exempt from land tax, a tax most peasants had to pay. This was in sharp contradiction with the government’s own code (the Le Code),\textsuperscript{118} which stated:

In the assessment and levy of taxes and corvees, those who violate established rules (this means taxes and corvees shall be imposed first on the rich and the strong and then on the poor and the weak; first on households with many men, and then on households with few men) or considerations of equity (this means fair apportionment between the poor and the rich, the strong and the weak; fair decision on who must serve first and who must serve later, who shall perform the light tasks and who shall perform the heavy tasks), shall be demoted or dismissed\textsuperscript{117} (Nguyen 1997, p.187).

Phan Huy Chu, a 19th century historian, described the tax situation in the first part of the 17th century as follows:

Because of the lacquer tax, lacquer trees had to be cut down. Because of the silk tax weaving looms were destroyed. Taxes on wood forced woodcutters to put away their axes (Hodgkin 1981, p 79).

Tax evasion was widespread although the Le Code included severe punishment for corrupt officials and tax evaders.\textsuperscript{118}

When the Chinese invaded Vietnam in 1788, the Vietnamese resistance was lead by Quang Trung. In 1789, Quang defeated the Chinese. He managed to mobilise the mass of the peasantry, but faced a country in desperate need of food. Quang used taxes as a threat to increase land cultivation. Communes were given a year in which to bring fallow land into cultivation, under threat of having to pay twice as much tax in the year after. At the same time taxes on local products were reduced or abolished.

When the Nguyen dynasty was established in 1802, the population registers became the basis for the taxation system. Detailed information was held in these registers on every peasant and the land he owned. This information was useful in assessing liability for land tax. Another important tax was the so-called ‘body tax’ or poll tax, mainly paid by peasants aged between 20 and 55, since many privileged groups were exempt (Hodgkin 1981, p. 109). Other taxes levied included taxes on the products of mines and forests, on crafts, saltworks, cinnamon, fisheries, incense, honey and mats.

The second part of the 19th century was marked by encroaching colonialism. This period also saw an increase in the tax burden. The reasons for the increase included the very costly administrative structure the French colonisers introduced, the need to finance the formation of six companies of ‘native troops’ in 1862, and the French desire to demonstrate that the new colony was self-supporting (Hodgkin 1981, p 154). The existing land tax almost doubled to around 20% of an average peasant’s income. The


\textsuperscript{117} Article 325, Chapter on Household and Marriage, The Le Code.

\textsuperscript{118} For example, article 541 in the Chapter on Deceit and Forgery of the Code states: “Whoever is alleged to be dead to evade the head tax and corvee shall be condemned to penal servitude as a soldier assigned to elephant stables. He shall be required to pay the tax and the charge for the missed corvee as well as the punitive damage to that amount.”
burden of the land tax could force poor peasants to increase their debts, resulting in being forced to sell their land to rich landlords in order to pay their taxes. The poll tax, introduced under Nguyen, increased substantially. Europeans and those working for the French were exempt from this tax. Another group that was exempt were Buddhist monks. This exemption was used by unemployed people in the 1930s to evade the poll tax, disguising themselves as monks by dyeing their clothes and shaving their heads (Woodside 1976, p.197).

The French also continued with the so-called corvee, compulsory work for the government without payment. The corvee was in theory 5–20 days a year and could involve working on infrastructure projects such as railway- and road-building projects and later for rubber plantations. Corvee work could be far from home, the working conditions were poor and unhealthy, and often took much more than five days. However, many managed to escape the corvee (Woodside 1976).

The French introduced other new taxes, including taxes on rice wine, opium, tobacco and gambling. Excise taxes on the government monopolies of alcohol, opium and salt accounted for 70% of the government’s operating revenue. The alcohol tax was especially unpopular among the peasants (Gran 1975; Hodgkin 1981, p 180): first they paid a land tax to cultivate the land, than they paid a tax on rice, followed by a tax on alcohol (rice wine), a product of the rice. The salt monopoly was another harsh levy, as salt formed an important ingredient in the usual diet of rice and fish (dried and salted). With high salt taxes, salt became beyond the reach of many households.

The French Government’s approach towards taxation was based on taxation of the individual instead of a more communal unit of taxation (as under mandarin bureaucracy). Previously, if a village collected more taxes than budgeted the surplus was used as a buffer for unexpected costs or needs. This system was abolished under the French, leaving villages sometimes with severe financial problems (Gran 1975, p 336).

In comparison with the period prior to French colonisation, tax revenue increased ten times: 2 million francs in 1867 to 19 million francs in 1879 (Hodgkin 1981, p.154). Tax evasion was very common even though tax collectors could be extremely harsh in order to collect the required taxes. French assiduousness, especially in collecting salt and alcohol taxes, created a surge in tax evasion among the peasants and increased smuggling and the production of ‘moonshine’. The French, aware of the problem of tax evasion, introduced a system of identification in 1902 to improve the collection of direct taxes. Each taxpayer had to carry a card that was used as identification and tax receipt. The card led to another source of tax evasion as a French official document in 1915 described:

> The personal tax cards ... leave open the gates to a multitude of abuses whose repression is quite difficult and in many cases impossible. These cards are, in effect, impersonal, and the number of adult Vietnamese who lack one is very considerable. The tax loss is appreciable. Many of the cards are fantasies.

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119 The body tax was raised from 0.5 piastre to 2.5 piastras around 1900 (Hodgkin (1981). Vietnam: The Revolutionary Path. London, Macmillan Press.)
They are bought in any village, at any price, under any name. Despite the orders given to notables not to sell the cards, this commerce is still very prosperous (Gran 1975, p 354).

Before 1900 many villagers managed to escape most taxation. But the card had some success, and the government increased the number of taxpayers in the period 1900–20.

Those who were the main victims of the tax system were those most easily traced in the administration system, such as the Chinese minority, merchants, and many small business people. These were mainly found in urban areas, where what local wealth there was had concentrated. They were regularly burdened with new taxes and duties during the period 1864–1920. The villagers ‘only’ had to pay some of these taxes, mainly those on salt and alcohol.

The tax regime undoubtedly contributed to popular resistance to the colonial rulers. ‘It is only because the taxes are too high and we are not able to pay them that we must voice our opinion together,’ said the poet Nguyen Thuong Hien in 1908 (Hodgkin 1981, p 181). In that year a great anti-tax revolt from March to May took place. Under the slogan ‘Don’t pay taxes to the French’, the protesters challenged the tax system as well as the corvee or forced labour system. The government’s answer to the protests was violent and there was considerable bloodshed.

In the period 1918–40 the number of tax collectors rose, corruption flourished and added to the formal costs of taxation. Penalties on tax evaders were increased. The French and their local administrators were brutal in their pursuit of those not paying their taxes (in 1934, 20% of Vietnamese households did not fulfil their tax requirements) and police and soldiers frequently ransacked houses to arrest tax evaders (Gran 1975). Another aspect that provoked anger among many taxpayers was the fact that tax was not always collected in the villages where they lived. Sometimes the peasants had to come to a district office, half a day’s travel away. Once there, they might have to wait up to three days before a tax collector was able to meet them and collect usually more than the official taxes.

In 1938, villagers from the mountainous areas marched to Cao Bang, protesting against the heavy tax and corvee duties and demanding better living standards. The government came to the conclusion that most tax officials were not capable of doing their work and that they had let potential revenue escape then. Governor General Robin of Indochina addressed the problem in 1934: “The perpetrator of frauds would disappear if his gain was not greater than the risks he ran,” (Gran 1975, p.428).

In the early 1940s, the French lost control over large areas of Vietnam as the Vietnamese resistance began to gain ground, especially in rural areas. The so-called Red Villages issued several rules, including the abolition of all colonial taxes, poll tax, salt tax etc. These rules were formalised in 1945 when the Communist Party of Vietnam issued guidelines on how to rebuild and develop Vietnam.\textsuperscript{120} Included in the

\textsuperscript{120} On 2 September 1945, Ho Chi Minh read Vietnam's declaration of independence in Ba Dinh Square (Hanoi).
proposals were guidelines in regard to taxation. The French taxes and corvee were to be abolished and replaced by a mildly progressive income tax.

After the independence, the Vietnamese communist party introduced a farm tax, based on agricultural output. Over time other taxes were imposed on the private sector. One example of taxation under the communist government was the tax on business transactions levied between 1975 and 1978, the so-called ‘unreasonable profits’ tax. An income tax applied to private shopkeepers, a commodity tax for certain goods (mainly non-essentials), a slaughter tax and customs duty. Collecting taxes was in the hands of village committees.

However, as noted above, most state revenue came from state-owned enterprises (SOEs), which contributed to the state coffers by way of remitting profits as well as paying taxes. The government paid only limited attention to possible other taxes and did not develop these until the early 1990s.

6.5 BACKGROUND OF THE 1986–90 TAX REFORM

The decline of revenue from SOEs and the ending of Soviet funds, combined with an ever-expanding budget, put the Vietnamese Government in a difficult position. Prior to 1988, over 70% of tax revenue was collected from only a few SOEs (Jenkins and Terkper 1992, p.6). As mentioned below, the Vietnamese Government had been pressured into experimenting with economic liberalisation before government revenue dried up. Once that happened, it added to the push for a further move into a market economy. Forced by the urgent need for other sources of government revenue\(^{121}\) and the need for private investment, the Vietnamese Government introduced major tax reforms.

In 6.3 I discussed the system of political representation and the role of government which is an important part of the model (see Chapter 4) used for the two case studies.

Continuing the model, I will now discuss the rise of reformers in the communist party and their economic and fiscal policies. This provides an analysis of the causes for reform and the context of the reform itself. I also pay attention to the culture of public institutions following earlier discussions about sociological institutionalism, including a detailed discussion of the Vietnamese tax administration. In addition, this part addresses the use by the Vietnamese government of foreign advisers. Further following the model, I will discuss the role of interest groups (see also interest group theories in Chapter 4).

**Reformist rise in the communist party**

The political key to change was in the hands of Truong Chinh, a senior Party official who had been the designer of the land reforms in the North in the 1950s and the driving force behind the integration of the South into the communist system. As a former general secretary of the party he was well respected. And it was Chinh who started to listen seriously to the complaints and frustrations of local officials in 1984.

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\(^{121}\) The steady flow of Soviet advanced army supplies stopped too, and budget constraints forced cuts in the defence budgets. Some army units did not have the funds to provide food and clothing to their personnel. This caused the military to become more involved in business activities.
(Riedel and Turley 1999, p.18). There were complaints by individual communities and factories which requested market-oriented solutions as answers to the failures of the planning system. In other words, the pressure for change came from the bottom of the Vietnamese system before the leaders at the top understood their necessity. Many believe that Chinh was the key in organising the frustrations and complaints into an articulate movement (Riedel and Turley 1999, p.18).

Chinh had an ally in Party Secretary Nguyen Van Linh, who favoured economic reform. In 1985, Linh was promoted to the political bureau and Chinh became Secretary General of the Party. Jointly they were able to deal with conservative members opposing economic change. But both were products of the Party system and they would not suddenly condemn past Party policies. Moreover, the Party consisted of a highly consensual top leadership which ruled out any radical plans (Riedel and Turley 1999, p.41).

At the Sixth Party Congress in December 1986, the Party introduced the strategy of doi moi (renewal). The fresh approach was received with enthusiasm by Congress participants. However, the new ideas did not include a more democratic multi-party system. People were invited to express their grievances, but not by establishing their own interest groups; rather, by using the existing institutions (Marr 1994, pp.5-6). Reformers like Chinh were allowed to make changes, but only in the margin (Riedel and Turley 1999, p.20).

Doi moi was not as radical as often portrayed and the discussions at the Sixth Congress are a clear illustration of the mind-set of many members at the time. There was elaborate discussion about whether private enterprises should be permitted to hire up to 10 or 30 workers and if the capitalist economy should be allowed back into northern Vietnam (Riedel and Turley 1999, p.19). Beresford compellingly argues that the doi moi reform was a good illustration of the fact that Vietnamese political leaders behaved very much like their pragmatic counterparts in other countries rather than as zealous communists. They skilfully built coalitions of interest to support certain policies (Beresford 1997, p.188). They carefully considered the dominant interest groups, including those within the party system with ties to SOEs, and farmers’ groups. During this period members of key party organisations who seemed to represent old-style, conservative, dogmatic communist views, were replaced with representatives who favoured more liberalisation (Beresford 1997, p.188).

**The Vietnamese General Tax Department**

In 6.3 I discussed the Vietnamese state structures in general. An important part of state structures in the model is the tax administration itself, which is discussed here. As shown in the organisational chart below, in Vietnam the tax policy division is part of the overall tax administration. In some countries this division is based in Treasury or other parts of the government. In 1990, the tax department employed more than 34,000 people, not including the 20,000 part-time employees who collected taxes at the village level (see the organisational chart below). The majority of these full time employees came from the army. A majority of GTD employees had no training in tax matters. However, at central level, a large majority of employees (approximately 220 in 1992–93)
had a university education (Gandhi, Nellor et al. 1993, p.87). In 1990, 1.4% of all Vietnamese above 15 years old had received tertiary education, compared to 0.2 % of Indonesians in the same age group in 1990 (Barro and Lee 2000). Many in the tax administration had received tertiary education both in Vietnam and abroad (mainly in other communist countries).\textsuperscript{122} The high level of in-house expertise at the central level of the Vietnamese department of taxation is an important factor. As shown in the Indonesian case study. Minister Wardhana was in a difficult position, he wanted drastic tax reform, but did not have qualified in-house staff in his Ministry of Finance to develop these reforms. His Vietnamese counterparts at central level were better educated which lessened the need to look for foreign expertise.

\textsuperscript{122} Based on my experiences and interactions with members of GDT.
**Foreign advisers**

Another part of the model under State Structures part of the model is the use of foreign advisers. When making changes in its overall communist approach in the mid-1980s, Vietnam was very careful in inviting foreign advisers to assist. It adopted the policy that advice from abroad needed to come from a wide and diverse selection of countries. For this reason, it was quite common that advice was sought from four or five countries, regardless of the topic.

The IMF had regularly sent staff to Vietnam beginning in 1975, and IMF missions made several visits during the first half of 1989 to discuss Vietnam’s arrears. The government’s interlocutor with the IMF, Nguyen Xuan Oanh, had worked for the IMF in the early 1960s. The problem was that the IMF had no real leverage over policy because the US Government prevented lending to Vietnam. This also kept the Asian Development Bank and World Bank from becoming more active in Vietnam (Riedel and Turley 1999, p.22). As Riedel and Hurley point out, none of these organisations could put pressure on Vietnam to adopt IMF-approved policies. The external push had to come from other directions, mainly the loss of support from the socialist countries.

Vietnamese policy-makers were well aware of the IMF strategies when they drafted their Foreign Investment Law in 1986–87 and when they were in the early stages of drafting their profit tax in 1988 and 1989. But they identified more closely with their Chinese neighbours and other Asian countries when considering their longer-term future than with Anglo-American models as promoted by the IMF (Riedel and Turley 1999, p.43). Moreover, the advice given by the multilateral aid agencies was already embraced by policy-makers themselves. They knew that the recommendations made by these agencies were the gateway to international capital and investment. They cleverly used the successful examples of their neighbouring Asian ‘tigers’ in a bid to sell their Foreign Investment Law and other reform policies domestically (Riedel and Turley 1999, p.45).

It is important to note that most of the World Bank, Asian Development Bank, UN Development Programme, IMF and various other bilateral aid projects such as

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123 The Asian Development Bank initiated a project in the audit area in Vietnam. The main reason for this initiative was the increasing pressure from member countries to improve the transparency of the financial system. The bank was already in the process of issuing more grants and loans to Vietnam and wanted to ensure some accountability for the funds given.

124 Early in 1990 the MoF and the Vietnamese Central Bank signed an agreement with the UN Development Programme. The IMF was selected as the executive agent. After 1993, the IMF appointed one long-term advisor who worked together with short-term consultants in the area of tax policy and tax administration. The UN also funded the tax administration modernisation project.

125 The IMF has had a representative in Vietnam since the early 1990s. It has published a stream of reports advising the Vietnamese Government how to develop its tax system. In 1994, an IMF mission visited Vietnam to report on tax and customs administration reforms. The mission members met with Vice-Minister of Finance Nguyen Sinh Hung and Vice-Minister of Finance Pham Van Trong. The mission had detailed discussions with Tran Xuan Thang, head of the General Department of Taxation, and his deputies Nguyen Thanh, Deputy Head of the Customs Department and Do Huu Ngap, Director of General Affairs. The report states: “Since 1989, progress has been made in setting up a basic tax system in Vietnam that is suited for a market economy” (Corfmat, F., J.-P. Bodin, et al. (1994). Vietnam: Strategies and Priorities for Tax and Customs Administration Reforms. Washington, International Monetary Fund, Fiscal Affairs Department. This is a clear example of the different views held by IMF representatives versus Vietnamese Government officials who did not want a market economy but a socialist-market economy instead. The IMF, too, emphasised the need for simplicity of the tax system and for a self-assessment system (Corfmat, F., J.-P. Bodin, et al. (1994). Vietnam: Strategies and Priorities for Tax and Customs Administration Reforms. Washington, International Monetary Fund, Fiscal Affairs Department.)
Germany's 1994 assistance to the budget department and French assistance to MoF staff did not commence until 1993.  

**Interest Groups**

What the press could write and how people organised their daily lives were increasingly less circumscribed after 1986. But the Party still played a very central role in Vietnam. There was little tolerance of any criticism of the one-party system, and religious and political dissenters were dealt with harshly. The new party Secretary General, Nguyen Van Linh, interpreted *doi moi* as a tool for economic reform rather than for more democratic processes. This made it very difficult or even impossible for society groups to act independently from the Party.

I now turn to the actual economic reforms including the introduction of the Foreign Investment Law and the Profit Tax that the government introduced as its political response to the fiscal pressures it was under.

### 6.6 The Reforms 1986–90

The following discussion of the income tax reform has two distinct parts: one dealing with the Foreign Investment Law of 1987 and the other with domestic income tax law and the new Profits Tax of 1990. First I discuss the broader economic response developed by the Vietnamese Government.

**Broader economic response**

The government took a range of measures to improve its fiscal position. In 1987, it introduced the Foreign Investment Law and an Import–Export Tax Law. In 1988, the system of licensing and quotas was largely replaced by import and export duties and foreign investment regulations were introduced.

With the introduction of the Foreign Investment Law, Vietnam slowly started to attract foreign investment. Most of this came from the East Asian ‘tigers’, all of whom found Vietnam’s low labour costs attractive since their competitive edge was being eroded by rising costs. Thus Vietnam opened up to foreign investment at an opportune time, when rising land/labour costs in other parts of Asia, and burgeoning capital surpluses among the ‘tigers’, meant that Taiwan, Hong Kong, Korea, Singapore and some of the ASEAN countries as well, were looking to invest abroad, especially in labour-intensive, export-oriented manufacturing. Vietnam, with its large, cheap, labour force, proved an inviting destination for their investment dollars.

Reforms undertaken after 1986 included almost total price liberalisation, bringing the official exchange rate into line with market rates, and giving managers of enterprises...
much greater autonomy to make commercially-based decisions. Since 1989, Vietnam has been a major rice exporter. The state and collective sectors, while still dominant, were reduced, and private enterprise was officially encouraged. Economic policies removed the traditional socialist emphasis on heavy industry and gave priority to food production, consumer goods and exports. Vietnam rapidly diversified its trade, which up until 1990 was 70% with the COMECON (socialist bloc) countries, and its major trading partners started to include East Asian countries such as Singapore and Japan, which together accounted for half of Vietnam's trade by 1995 (Spencer and Heij 1995).

In 1989, Vietnam witnessed the collapse of Eastern Europe and the unravelling of its political ruling elites. These developments put further pressure on Vietnamese policymakers to improve private sector activities and increase revenue sources.

In 1989, the government abolished the two-price system (official price versus market price), meaning all prices were now market prices. It cancelled most subsidies to government employees, the printing of money was reduced and a positive interest rate was now allowed. This resulted in much lower inflation in 1990 and increased output by farmers (Marr 1994, p.6).

Table 3. Government Revenue Sources 1988–91 (% of total revenue)

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<tr>
<td>State-owned enterprises</td>
<td>63.8</td>
<td>47.0</td>
<td>40.0</td>
<td>36.2</td>
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<tr>
<td>Non-state sector</td>
<td></td>
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<tr>
<td>Agricultural tax</td>
<td>18.4</td>
<td>18.9</td>
<td>15.7</td>
<td>21.3</td>
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<tr>
<td>Non-agricultural tax</td>
<td>10.6</td>
<td>11.0</td>
<td>10.8</td>
<td>12.8</td>
</tr>
<tr>
<td>External trade</td>
<td>7.5</td>
<td>9.3</td>
<td>11.9</td>
<td>13.4</td>
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<tr>
<td>Other revenue</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Fines/lotteries/fees</td>
<td>10.3</td>
<td>24.8</td>
<td>32.4</td>
<td>29.1</td>
</tr>
<tr>
<td>Crude oil</td>
<td>18.4</td>
<td>19.9</td>
<td>22.0</td>
<td></td>
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<tr>
<td>Foreign remissions</td>
<td>19.9</td>
<td>22.0</td>
<td>22.0</td>
<td>0.7</td>
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</table>

Source: (World Bank 1992, p.57)

As Table 3 shows, revenue from SOEs dropped to about 47% in 1989 and 40% in 1990. In 1990, the government did enjoy some relief thanks to revenue from oil exploration. The oil revenue filled the gap left by declining ability to take profits and to tax SOEs129 (Haughton 1994, p.5). Between 1989 and 1991, the government introduced drastic measures to curb public expenditures: it abolished subsidies to SOEs, cut state investment programmes, slowed wage increases for public servants and demobilised half a million soldiers (Riedel and Turley 1999, p.23). Many SOEs folded, though these were mostly smaller ones; the large ones survived.

Most people benefited from the government’s measures as inflation sharply decreased. In 1989, over 70% of the Vietnamese workforce were farmers and only 15% worked in...

129 These revenue streams filled in the gap long after 1990.
the civil service. The liberalisation of agriculture prices and the abolition of the collectives (land tenures were distributed to individual households) resulted in increased income for most farmers. The fast growing private sector was able to absorb many former SOE employees (Riedel and Turley 1999).

The reforms in the early 1990s aimed to move the economy from a centrally planned one to a more market-oriented model. On the economic front, the government tried to reduce the amount of red tape, but the sheer size and power of the bureaucracy needed to maintain the kind of controls that the government also wanted, made this a difficult task.

On the fiscal revenue side, a few SOEs generated most of the revenue in the 1980s. These SOEs were mostly owned by various ministries at central, provincial or local level (two-thirds of all SOEs were under province/city or district jurisdiction) (Marr 1994, p.7).

Aside from these few revenue-generating enterprises, the government acknowledged that a significant number of these SOEs were not profitable, but it was understandably reluctant to allow massive, rapid restructuring, with its inevitable shedding of labour, in the context of an unemployment rate of 20% and no social security network. But revenue from these weak SOEs continued to decline and the government was forced to look for alternative revenue sources.

Agriculture supplied an important part of tax revenue via a separate tax, the agricultural tax (see Table 3). The tax depended on the specific category of land (how it was classified). The rate was fixed in tonnes of paddy rice per hectare and taxpayers had the choice to pay their taxes in cash or in kind. Revenue from this tax was in no proportion to the overall share of agriculture in the economy, the agricultural sector paying far less tax than other economic sectors. The tax was adjusted downwards for crop failures but not adjusted upwards for higher yields. A pattern of expectations among farmers had grown so that it would have been difficult for the government to increase agricultural tax revenue without upsetting a majority of the population.

Reforming the legal framework
Vietnam reformed many sectors after 1989. The first wave of commercial laws, comprising the Law on Foreign Investment 1987, Land Law 1988 and Ordinance on Economic Contracts 1989, were mainly based on Chinese market reforms. Only in

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130 This can lead to contradictions, best summed up in a phrase from the April 1992 Constitution: "... a multi-sector commodity economy operating in a market-oriented mechanism under the administration of the state and in accordance with socialist orientation."

131 At the same time, domestic investors were unwilling to take risks buying the stocks of these enterprises. There were few investors, especially as there was no previous culture of risk-taking investment. There had been some success in selling bonds issued by some SOEs (in the cement industry), but the selling of such debt instruments is of course far from privatisation (Spencer, C. and G. Heij (1995). A Guide to Doing Business in Vietnam, Perth, Western Australia, Asia Research Centre, Murdoch University.

132 As discussed in chapter two, the definition of tax is deceptive when examining the revenue flows from state-owned enterprises. SOEs received many benefits from the Vietnamese Government and their real contribution to the state coffers is lower than stated below.

133 For example, in 1992 the agricultural tax was 10% of total revenue even though the agricultural sector represented 40% of the economy in that year (Jenkins, G. P. and S. E. Terker (1992). Vietnam's Tax Reforms: Policies in Transition Economies. Cambridge, Massachusetts, Harvard International Tax Program, Harvard University.
areas where China lacked appropriate experience were laws imported from Western countries, for example, the Law on Companies 1990 was based on French law (Gillespie 2001).

As the economic reforms progressed, the state needed a legal framework that devolved economic decision-making power to market players. This, in turn, required massive importation of Western commercial law (often funded by foreign aid agencies). Especially after the 1992 Constitution recognised private commercial ownership, commercial legal frameworks covering companies, taxation, securities, insurance, anti-monopoly and many other areas were introduced (Gillespie 2001).

The existing tax regime prior to 1987 was marked by a complex structure (a myriad of rates and schedules) and a narrow base that mostly relied on transfers from SOEs (Zee 1993, p.281). Moreover, SOEs were able in practice to negotiate their tax burden. Prior to 1990, most taxes were collected at the provincial and district levels, resulting in illegal tax incentives given by local authorities to SOEs (Zee 1993, p.281). In regard to the tax reforms, Table 4 outlines the tax laws introduced in the period 1989–93.

<table>
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<th>Table 4. Tax Reforms</th>
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<td><strong>ENACTED</strong></td>
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<td>Foreign Investment Law</td>
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<td>Profit Tax Law</td>
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<td>Natural Resources Tax (Ordinance)</td>
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By 1989, the Vietnamese Government had arrived at several key objectives (Zee p. 281):
1. Replacement of the existing tax regime, which was largely based on decrees and regulations
2. Uniform tax treatment of SOEs and private sector companies
3. Greater revenue mobilisation through base broadening and including the growing private and trade sectors
The Foreign Investment Law 1987

The Foreign Investment Law (FIL), passed in 1987, set out priority areas for foreign investment. The law outlined the different steps required for foreign investors to set up activities in Vietnam. This included permitted forms of investment, the maximum percentage of foreign participation and the licences required to operate in Vietnam. The law also outlined the tax rates applicable.

The creation of the FIL involved a range of institutions, think tanks, the GDT and senior bureaucrats in the MoF. It was these highly educated and well informed officials who developed the new tax policies. However, the basic ideas and features of the FIL were not of their making. They came from Vietnam’s neighbour, China. The Vietnamese FIL had strong similarities with the Chinese foreign investment laws. In the mid-to-late 1980s the Vietnamese Government looked abroad for examples of successfully attracting much-needed foreign capital. It should come as no surprise that developments in China were used as an example. At the time Vietnam did not receive much ‘Western foreign advice’ and, given the common communist features in both China and Vietnam, Vietnam naturally found the experiences of its northern neighbour particularly relevant. Both countries had large pools of unused or underused resources, particularly labour in the countryside. This rural labour force could be used for industrialisation. This is not to say that the reforms in Vietnam and China were quite the same. At the start of its reform in the late 1980s, Vietnam was much poorer and less industrialised than China. Vietnam’s communist history was shorter than China’s and Vietnam therefore faced less political resistance when introducing the reform than China did. At the same time, China had the advantage of support from Western countries and Japan while Vietnam was subject to an embargo by those very same countries. China had a reasonably smooth ride with increased trade and foreign investment while Vietnam suffered from the loss of support from Eastern Europe. It is fair to conclude that balance of payment difficulties, accelerating inflation and revenue loss played a far greater role in Vietnam than in China (Riedel and Turley 1999, p.12).

In order to understand China’s FIL, we need to go back to 1978. In that year China commenced its economic reform, opening its economy to the outside world and reforming its economy to attract foreign capital and technology. China’s increase in foreign direct investment was closely related to its rise in exports. In 1978, foreign trade only accounted for 9.8% of GDP; in 1990 this was 35.2% of GDP (Liew 2000, p.146). Many foreign investors relocated their labour-intensive factories to China (from Hong Kong and Taiwan) to take advantage of cheap labour. The Chinese Government encouraged this with the setting up of so-called special economic zones, where an attractive investment regime applied, including reduced tax rates.

Part of China’s economic reform was the introduction of the Joint Venture Law of 1979, which covered Chinese–foreign joint venture enterprises. In 1986, the Wholly Foreign-Owned Enterprises Law was introduced and in 1988 the Law on Chinese–

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134 On 29 November 2005, the National Assembly of Vietnam passed the Law on Investment No. 59/2005/QH11 which took effect on July 1, 2006. This new law abolished the FIL and created a uniform legal framework for, and levels the playing field between, domestic and foreign
Foreign Co-operative Enterprises. The three laws together formed China’s legal framework for foreign investments and clearly reflected the government’s objectives to attract foreign capital, import advanced technology and management techniques, promote international trade and co-operation and maintain the policy of opening China to the outside world (Li 1993, p.269).

China’s existing tax system was inadequate given these reforms (Li 1993, p.272). There were too few types of taxes being levied and the tax rates were very high resulting in a heavy tax burden. The government did not levy corporate income tax on the profits of SOEs, but it did charge a corporate income tax for collectively-owned enterprises, with high tax rates. As in Vietnam, taxes were not normally enacted by the National People’s Congress, but were often promulgated by temporary stipulation of the State Council, authorised to do so by the Congress (Li 1993, p.272). These stipulations did not have the authority of a tax law. The Chinese Government decided to establish a separate tax system that supported foreign investments. A joint venture income tax and a foreign enterprise income tax were introduced by formal legislation.\textsuperscript{135} Compared to their domestic counterparts, foreign investors enjoyed lower tax rates (for example, 30% versus up to 55% for domestic taxpayers) and were eligible for tax incentives depending on the activity of the company. The tax incentives included tax exemptions for up to two years and reduced rates of 15% for the third year; these periods could be extended depending on the activities performed. Foreign investors active in the special economic zones also enjoyed tax rates of 15%. The overall tax burden was significantly lighter for foreign enterprises than for domestic enterprises. According to Li (1993, p.270), the combined tax burden of enterprises with foreign investment was about one-third of that borne by domestic enterprises.\textsuperscript{136}

Many believe the Chinese dual system was a compromise to ensure swift approval by the National People’s Congress (Li 1993, p.272). The special tax system for foreign investment was in line with international standards and conventions, a prerequisite for companies operating in an international environment, where attracting foreign capital and exporting to international markets are crucial. China’s approach of creating a separate tax system for enterprises with foreign investment was quite unique. Most other countries have a unified tax system combined with possible tax incentives, or Special Economic Zones, to attract foreign investment and technology, but these incentives do not detract from the generally unified nature of their tax system (Li 1993, p.271).

The developments in China were closely followed by the Vietnamese Government. Vietnam adopted China’s unique approach with the introduction of its FIL (Beresford 1997, p.190). There were many similarities between China and Vietnam that led the government to choose this model. The common factors were:

\textsuperscript{135} This was in contrast with the domestic tax law regimes which continued to be issued in the form of temporary stipulations.

\textsuperscript{136} Based on statistics for Shanghai Industrial Enterprise 1987—90.
1. Vietnam, too, needed a tax system to accompany foreign investment; the existing
tax laws were inadequate to cater for foreign investors. There were too few types
of taxes being levied and tax rates were very high resulting in a very heavy tax
burden. The FIL introduced a joint venture income tax and a foreign enterprise
income tax.

2. As was the case in China, the Vietnamese FIL can be seen as a compromise to
ensure swift approval by the NA without giving up on socialist ideals, with
domestic private initiatives kept out of the new tax regime. The FIL ensured that
the tax parts were in line with international standards, essential for companies
operating in an international environment where attracting foreign capital and
exporting to international markets are crucial.

3. Like their Chinese counterparts, the Vietnamese Government considered the tax
burden an important factor influencing investment decisions and therefore
believed it was important the rates were internationally competitive. Having the
separate tax system meant that it was possible to have the rates low without
affecting the large tax revenue stream received from domestic enterprises (mainly
collective-owned enterprises) due to high domestic corporate tax rates.

The FIL set priority areas for foreign investment, including the possibility of 100%
foreign ownership (although most foreign investors preferred to form joint ventures
with mainly Vietnamese SOEs). The law outlined the different requirements for
foreign investors to set up activities in Vietnam. These included obtaining licences,
the forms of investments allowed and the level of foreign participation. The
government clearly outlined the areas in which foreign investment was desired,
including (Heyde and Chew 1992, p.273):

- major economic programmes involving export-oriented production or import
  substitution;
- high technology industries using skilled labour or raising the production capacity
  of Vietnamese enterprises;
- labour-intensive industries using raw materials and natural resources
  originating from Vietnam;
- infrastructure development; and
- foreign exchange-earning services such as tourism, ship repair, airport and
  seaport services.

In contrast with the Chinese example, the FIL itself also outlined the corporate taxes
payable by foreign investors. The rates varied between 10% and 25%. The actual
rate was negotiated for each project with the State Committee for Co-operation and
Investment (SCCI), which was responsible for obtaining approval for the agreed
rate from the MoF. The lower rates of 10% or 15% were available for companies with
large capital investments (1992 amendments). Generally companies investing in

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137 The rates could even be lower in the Special Economic Zones (SEZ) that Vietnam established. SEZs are
not further discussed here.

138 This committee was established in 1987.

139 Since amendments were made to the Foreign Investment Law in late 1992, profits tax has ranged between
10% and 25%. Investors are also eligible for tax 'holidays' (ranging from one-to-four years after the first
year of profit-making) and reductions on profits tax (ranging from two-to-four years after the expiry of the
tax holiday). The most favourable terms are available to manufacturing companies operating in Export
Processing Zones. Similar terms are available to companies developing infrastructure in ‘difficult’ areas, to
reforestation projects and to projects designated as strategic.
heavy industries were subject to lower rates than services companies (Haughton 1994, p.15). This was a key characteristic of the planned economy that favoured heavy industries. However, it was criticised by foreign economists like Haughton who argued that, “it remains doubtful if digging up more minerals (heavy industries) is more worthwhile than providing a better system of credit for farmers (services) or producing shoes for export (light industries),” (Haughton 1994, p.15).

Any profits that were reinvested were exempt from tax under the FIL. This exemption was not available to their domestic counterparts under their Profit Tax, as will be discussed later. Taxable income included all revenues from the sale of products or provision of services, as well as other income resulting from any activity during a tax year (Heyde and Chew 1992, p275.). Revenues were calculated differently for foreign joint venture partners as compared to their Vietnamese joint venture partners. Tax deductible expenses included most standard business expenditures. In addition there was a catch-all category of other expenditures. However, these expenditures could not exceed 5% of the total of all other deductible expenditures. FIL investors were allowed to use a foreign accounting system, subject to approval by the Ministry of Finance. In some cases such approval would only be granted if certain modifications in the accounting system were made (Heyde and Chew 1992, p.275). The result was that foreign investors in similar situations would end up with quite different tax liabilities.

1989 Major tax reforms and the start of Swedish assistance

The Swedish aid agency, SIDA, played, and still plays, a role in tax reforms in Vietnam. The relationship between SIDA and Vietnam has its roots in the 1960s and 1970s. Sweden, under consecutive social-democratic governments, was one of the few Western countries that continued providing aid to Vietnam during the years of war. In 1969, it was the first Western country to open an embassy in Hanoi. This resulted in SIDA having significant political support in government circles in Hanoi. Moreover, the Vietnamese Government viewed the social-democracy model, as applied for many decades in Sweden, as a useful example for Vietnam.

Co-operation between Sweden and Vietnam in the area of tax started in 1989 (thus after the enactment of the FIL). In that year, the National Tax Board (NTB) of Sweden visited Vietnam, which was followed by a Vietnamese visit to Sweden. The Vietnamese delegates were from the MoF and the GDT. The timing of the two visits coincided with the drafting of the new Profit Tax Law by the GDT and other MoF staff (it was enacted in June 1990). The team was interested in Sweden’s corporate tax system and the specific tax incentive policies it had continued for several decades. In the 1980s Sweden had overhauled its tax system and reduced corporate tax rates from 56% to 30%. It retained certain tax incentives, which was possible because Sweden’s tax revenue did not heavily depend on corporate tax revenue, its main source of revenue deriving from indirect taxes. As the Vietnamese delegates later explained, the structure of the tax rates selected in the reforms of the profit tax of 1990 were influenced by knowledge gained from the visit to Sweden in 1989 (SIPU 1993, p.8).
It should be noted that most of the tax collaboration between Sweden and Vietnam took part in the period after the initial corporate income tax reform of 1990 and the role of Swedish advice is of limited relevance to our case study of the 1990 profit tax. The Swedes had only limited input during this period. Nevertheless important, having said that, I briefly discuss the key elements of the cooperation as background information.

In 1991, the Swedish–Vietnamese tax project started under guidance of the Leadership Board of the GDT with the Deputy Director General as the authorised representative. On the Swedish side, the international consulting office of the Swedish NTB was responsible for co-ordinating the project (Swedish International Development Cooperation Agency 1997).

The project’s estimated cost was SEK 9 million,\textsuperscript{140} financed by SIDA and the MoF (General Department of Taxation 1993). Significant funds were allocated for interpreters so non-English-speaking participants in the project would not be excluded.

The objective of the co-operation was to assist the Vietnamese Government with (SIPU 1993, p.5):

- creating a coherent legislative framework for taxation in Vietnam,
- developing and strengthening the basic structures of the tax administration, including the elaboration of the internal organisation of the tax department on central, regional and district levels.
- preparing at least one handbook for operational routines,
- implementing pilot projects in one or two districts to test the computerisation of the administration,
- developing a comprehensive training system for staff and laying the basis for a decision on the future institutional arrangements for staff training.

According to the evaluation report of the project (SIPU 1993, p.6), the project was based on the exchange of information and on the transfer of ‘know how’ in the field of tax policy and tax administrative issues. Expertise and experiences of the NTB were made available to their Vietnamese counterparts through mutually agreed activities. The Vietnamese were responsible for the application of new ideas and knowledge which was gained during the co-operation.\textsuperscript{141} The NTB’s major task was to facilitate increased knowledge and competence on tax policy and tax administration. A large part of the project focused on study visits by Vietnamese delegations to Sweden and other countries, visits by Swedish experts, and on seminars and workshops in connection with study visits in Vietnam. At no point did Swedish advisers write advisory reports as the HIID advisers did in Indonesia. Making a wide range of information sources available was the core of the Swedish assistance. It was then up

\textsuperscript{140} In 1992 a further SEK 2 million SEK was allocated to the project to fund equipment for a local area network at the GDT. Approximately SEK 900,000 was allocated for tax policy assistance.

\textsuperscript{141} I am fully aware that claims of local ownership statements are easily echoed in donor agency reports and not always substantiated. In this case, the SIDA reports do substantiate this approach, the Vietnamese counterparts were truly driving the reforms and applications of ideas.
to the Vietnamese team to translate that into policy advice. There was a highly skilled and educated pool of Vietnamese tax officials who were able to provide high calibre reports and analysis. This Swedish approach of ‘changing within’ is also in sharp contrast with that of other agencies. The IMF, for example, produced several reports based on short-term visits\textsuperscript{142} advising Vietnam what it should or should not do and describing how inadequate the system was (Gandhi, Nellor et al. 1993; Corfmat, Bodin et al. 1994). These reports generally ignored the political realities of policy-making. The agreement between the Swedish NTB and the Vietnamese GDT facilitated various visits by Vietnamese delegations to study the Swedish tax system. The GDT team conducted 12 study visits to Sweden (including 64 delegates) to research tax policies and tax administrative matters. Eight other visits were made by a total of 40 delegates to the Philippines, Singapore, Indonesia, Thailand, China, Malaysia, South Korea and Hungary (see Table 5. below for an overview of these visits). After each visit the Vietnamese delegation drafted a report with findings that was subsequently circulated within the MoF and distributed to the members of the NA.

This was only a part of the overall tax project. Many other visits were conducted regarding tax organisation, operational handbooks, computerisation, training (total of five visits abroad to Sweden and Singapore). The Swedish NTB had 10 missions to Vietnam with a total of 20 experts advising on the different areas outlined in the agreement. Under the project, 25 scholarships were given to Vietnamese tax administrators. Six officials went to Singapore for tax training and nine went for computer training. Ten officials went for English language training to Thailand and Sweden. The Vietnamese tax administration has limited experience with computerisation for surveillance and control of tax assessments and tax avoidance. The use of modern technology, including the development of tax information systems, is of great importance to enable the tax administration to fulfil its tasks adequately. Positive steps were made by the Vietnamese Government with the introduction of computers in the Tax Department in 1993 under a Swedish pilot project.

\textbf{Table 5. Visits to Sweden and other countries during 1991-1992}

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</thead>
<tbody>
<tr>
<td>1</td>
<td>Study visit to Sweden to discuss tax policy and tax administrative matters. Four Vietnamese experts went on the trip together with one interpreter, 1991.</td>
</tr>
<tr>
<td>3</td>
<td>Visit to Sweden to study operational routines for collection of each specific type of taxes. Four experts, one interpreter, 1992.</td>
</tr>
<tr>
<td>4</td>
<td>A Vietnamese delegation visited Indonesia to study tax policy and administration. Four experts, one interpreter, 1992.</td>
</tr>
<tr>
<td>5</td>
<td>A Vietnamese delegation visited Hungary to study tax polices and tax administrative matters (emphasis on VAT and agricultural tax). Four</td>
</tr>
</tbody>
</table>

\textsuperscript{142} Often visits of two weeks or less form the basis of expert advice. For example, in the case of Gandhi’s IMF report, the team spent 14 days in the country.
The SIDA project conducted several activities, including a seminar on VAT and excises in Vietnam, attended by two Swedish tax experts. There was also a Vietnamese visit to Sweden studying Swedish tax policy after the 1991 reform (VAT and capital income tax). The delegation contained four experts from the MoF and GDT (and one interpreter). In addition, another delegation of four experts from the MoF and GDT (and one interpreter) visited China in 1992 to study China’s overall tax system.

The new profits tax of 1990

Earlier on in this chapter we saw that Vietnamese tax policies are decided at the central level (Bird, Litvack et al. 1995, p.22). Generally, the MoF together with the GDT are the key policy-makers in the area of tax. Within the MoF, the vice-minister, together with the Director of International Co-operation (in charge of donor projects and coordination) play an important role. In the GDT, the Director General, the deputy Director General, and the head of Foreign Investment Enterprise Taxation and International Co-operation (in charge of tax) and of the Taxation Policy Division are key players. The domestic tax reforms were guided by the Vice-Ministers of Finance Pham Van Trong and Phan van Dinh, as well as Nguyen Duc Duy, Deputy Director General of the GDT followed by Mr Truong Chi Trung (the then Deputy Director General) for the second phase of reform 1994–97. Nguyen Ba Toan, Director of International Co-operation at the MoF. Minister of Finance Ho Te had no direct involvement in the tax reform. In effect, tax policy was shaped at the highest level of the GDT and the MoF. There was only limited input from the wider community. Regarding tax policy matters, staff of the Fiscal Policy Department of the MoF and the tax policy division of the GDT played a major role. According to Tuan-Hiep Dang, who worked at the GDT during this period, most decisions regarding the content of the legislation were made by the GDT. As he explained, the senior members of the GDT usually made the first draft for a new law or a revised tax law. Most of the decisions to make certain changes in the tax laws or to design new laws were made by the GDT. In a few minor cases, issues were initiated by

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143 The discussion below excludes the turn over tax.

144 Followed by Mr Truong Chi Trung (the then Deputy Director General) for the second phase of reform 1994—97.

145 This meant that the tax laws could be seen as more progressive because generally leaders in the government sector tended to express modernist views, while representatives of the party, work, mass association, and political organisations in the military and security sectors had defended traditionalist ones (Riedel, J. and W. S. Turley (1999). The Politics and Economics of Transition to an Open Market Economy in Vietnam. Washington, Organisation for Economic Co-operation and Development.).

146 Two hour Interview on 16 June 2000 with Tuan-Hiep Dang.
request or suggestions made by the Party, but these mainly related to concerns by
the Party regarding agricultural land tax and personal income tax.

Dang pointed out that after the draft for the Profit Tax Law was tabled at the NA, no
substantial changes were made: “The members of the National Assembly often
lacked the sufficient knowledge or information to really influence the debate. They
would only comment on a particular detail if that had their attention, but they did not
have the overview to give any structural comments.”147 In contrast, for example, to
the import-export duties’ legislation which relied heavily on Ministry of Trade data and
co-operation, the Profit Tax Law did not depend on other ministries.

It is hard to obtain much reliable information on what influenced Vietnamese policy-
makers in designing the profits tax. China had enacted a similar tax in 1984 and
some of its features can be found in the Vietnamese version of 1990 (Hussain and
Zhuang 1998, p.58). As with foreign investments, the profit tax favoured investments
in heavy industry over services, reflecting features of the planned priced economy
(see for more details (Thi Nguyet Le 2006. p.150). Comparing the profits tax,
applicable to domestic companies and the FIL, applicable to foreign investors
incorporated under the FIL, results in the following overview (Haughton 1994, p.14):

<table>
<thead>
<tr>
<th>Locally owned and joint venture companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sectors</td>
</tr>
<tr>
<td>Heavy Industry</td>
</tr>
<tr>
<td>Light Industry</td>
</tr>
<tr>
<td>Services</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Foreign companies*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Categories</td>
</tr>
<tr>
<td>Standard</td>
</tr>
<tr>
<td>Preferential**</td>
</tr>
<tr>
<td>Exceptional***</td>
</tr>
</tbody>
</table>

Notes:
*Foreign companies had to have at least 30% foreign participation.
**To qualify, special conditions had to be met regarding the number of employees,
advanced technology, minimum export levels and large invested capital. The 15% rate applied to investment in infrastructure, heavy industry and natural resources,
built-operate-transfer projects or in remote areas.
***Applied to investment in mountainous areas only.

For domestic companies, profits in excess of VND 6 million148 (just above 500 US
dollar) were subject to a 20% surtax. If earnings were re-invested, the tax on this part
of income could be reduced by 50%. However, this was significantly less generous
than the tax regime for foreign investors.

The profit tax was enacted into law in October 1990 for the private sector and
became applicable to SOEs in January 1991 (Jenkins and Terkper 1992, p.26). In

147 Two hour interview on 16 June 2000 with Tuan-Hiep Dang.
148 Between 1990 and 1995 the exchange rate for 1 US dollar was approximately 11,000 Dong.
contrast to China, where the non-SOEs and SOEs had separate tax regimes, the Vietnamese opted for the same tax regimes for both types of enterprises (Hussain and Zhuang 1998, p.60).

The profit tax explicitly excluded the agricultural sector of Vietnam and therefore only covered a small part of all the economic activities of this rural society. Agricultural producers had a separate tax — the agricultural tax — and were not subject to the profits tax. Problems emerged as the law did not define taxable income and deductible expenses in detail. The tax base was turnover-less-expenses, with no proper clarification of expenses (Jenkins and Terkper 1992, p.27). The fact that these deductions were not defined meant that there was no discussion or opposition to the tax as in Indonesia. Most business taxpayers and tax officials agreed on acceptable tax deductions by negotiation.149

In addition to a profit tax, companies faced a so-called turnover tax (which was replaced by a value-added tax in 1999), one of the most complicated taxes in Vietnam. Many felt the rates were too heavy and that the final profit levels were not taken into consideration. The tax was levied as a percentage of total turnover (which was often estimated) and varied from 0.5% to 30% (11 different rates) depending on the perceived profitability of the sector and whether a particular item was imported or domestically produced. Businesses involved in the production of goods for export could be exempted. The tax caused unrest on various occasions with taxpayers accusing tax officials of imposing turnover tax randomly and increasing the rates regularly (Phuong 1996, p.5).

Moreover, in addition to the above taxes, SOEs had to pay cash depreciation and user charges (Jenkins and Terkper 1992, p.27), despite the profit tax being presented as the sole unifying tax for all domestic companies, including SOEs. These rates were significantly higher than for their foreign counterparts, clearly illustrating the government’s different approach to domestic corporate taxpayers.

Amendments to the 1990 Profits Tax
The Profits Tax Law was amended on 6 July 1993 to reduce the tax rates as a measure to encourage domestic business initiatives (Dick 1993, p.9; Dao Tri Uc 1996, p.12). All three corporate tax brackets were reduced by 5% to 25%, 35% and 45%. The lowest rate applied to energy, mining, forestry and fishing; the medium rate to light industry, food processing and other production; the top rate was applicable to trade, restaurants and the service sector.

The amendments also introduced the carry-forward of losses for three years and extended the credit of up to 50% of tax liability for reinvestment, to promote reinvestment of capital. In addition, new enterprises were not liable for profit tax for two years and then paid only 50% of the standard rate for the following two years. In mountainous regions, this reduction lasted for four years, signalling that the government was attempting to promote investment in the poorest parts of the country.

149 Interview on 16 June 2000 with Tuan-Hiep Dang.
6.7 REACTIONS TO THE TAX REFORM

Before discussing the reactions to the profit tax and FIL reform it is important to emphasise that the informal levies charged by a range of authorities did not change. As pointed out by Thayer (1996, p.56), abuse of power by party and state officials was (and is) a very serious problem in Vietnam. The once squeaky-clean image established during foreign occupation was long gone and many Vietnamese experienced the abuse of power. Vietnamese party officials acknowledged the seriousness of the problem, that many Vietnamese experienced a serious financial burden due to illegal fees rather than formal taxes. Local authorities levied a wide range of taxes and fees and sought ‘donations’, many of them with no basis in law. The GDT even issued warnings to taxpayers that there seemed to be a persistence of ‘unofficial’ fees deliberately being imposed by government branches and regional and local authorities (Vietnam News, 18 April 1993). So any changes in formal tax levels would only have a limited impact on the overall financial burden of taxpayers.

Views of Vietnamese tax policy-makers

The FIL was clearly a victory for particular groups of senior policy-makers. Or as described by Riedel (Riedel and Turley 1999, p.40), “… of course Vietnam has formal interest organisations of the state corporate variety, but it is the interests embodied in government agencies and branches of the party that are primarily able to exert pressure on top leaders and policy.”

According to Hiep Dang,150 the GDT had independence in developing its tax laws and was generally positive about both the tax parts of the FIL as well as the profit tax. But as we have seen earlier, since senior GDT officials represented Party views there would have been little disagreement in any event.

Reactions from the public

The FIL and profit tax only applied to enterprises and since 70% of the Vietnamese workforce were farmers, the local impact of the new FIL and Profits Tax Law was limited.151

Many of those who were affected by the new laws were not inclined to pay tax at all (Haughton 1994, p.14). For centuries the Vietnamese tried in many ways to hide their wealth from their foreign oppressors. The effects of historical experience in the field of taxation are summarised in the comments of the rector of Hanoi’s Finance and Accounting College: “In the past, paying taxes meant supporting the invaders. Now we must teach people that by paying taxes they are helping themselves, helping their communities to provide better services. We need education and public debate” (Beaulieu 1993, p.4). In the early 1990s the Vietnamese Government started an educational program in secondary schools to increase tax awareness, explaining

150 Interview on 16 June 2000 with Tuan-Hiep Dang.
151 Many had greatly benefited from the liberalisation of agricultural prices and decollectivisation and had seen their household income increase. For those without work after the collapse of SOEs, the private sector was blossoming and many managed to obtain work in this sector (around one-third of SOE employees found work in the private sector) (Riedel, J. and W. S. Turley (1999). The Politics and Economics of Transition to an Open Market Economy in Vietnam. Washington, Organisation for Economic Co-operation and Development.
what taxes are and why it is a citizen’s duty to pay tax (Beaulieu 1993, p.15). The program was based on similar Swedish educational projects.

**Foreign corporate taxpayers**

The Vietnamese Government sought to encourage foreigners to invest in Vietnam. Foreign investors' initial reaction to the FIL seems to have been very positive, but once established and doing business successfully, many experienced high, sometimes illegal, taxes, harassment by tax officials, and the problems of hidden fees (Spencer and Heij 1995). Some foreign investors estimated that corruption added 5% to 10% to operating costs (Spencer and Heij 1995). For example, if a foreign company wanted to obtain a fax line, the telecommunication company would charge a fee of approximately US$300 just for giving permission, without providing any matching services (Haughton 1994, p.17).

Moreover, the idea of the FIL being a 'one stop shop' that would deal with all issues faced by foreign investors turned out to be far from reality.

An example of the difficulties foreign investors faced was a case in the Hai Phong port. The Hai Phong tax department complained that foreign companies did not pay their taxes as projected tax revenue was much higher than actual revenue. Four of the 21 foreign projects had not registered at all with the tax department. Other complaints included not registering a company’s accounting system with the MoF, not submitting annual accounting reports or not using the forms issued by the tax department (Vietnam Investment Review 1994, p.10). However, the department admitted that foreign companies faced many difficulties when they tried to fulfil their tax duties. These difficulties, according to the department, related to the lack of professional knowledge and the lack of foreign language skills of the tax collectors. The complicated laws formed another problem for foreign investors. Even with the best intentions, foreign investors may not have complied with the law because of a lack of understanding of the Vietnamese tax system.

**Corporate taxpayers/private companies: domestic**

Given the history of Vietnam, private businesses kept a very low profile during the 1980s and into the 1990s and had very limited power to influence tax policies. Although an emerging group, private small businesses were not powerful enough to exert effective pressure for change, even at the margins. At the same time, there are indications that a large number of Vietnamese private businesses understated their actual income (Riedel and Turley 1999, p.25). Many did feel, though, that the Profit Tax Law was harsh in comparison with the FIL. Whilst foreign investors paid a maximum of 25% income tax, and often much less, local business paid up to 45% (Beaulieu 1993, p.9).

Many business owners perceived that government officials’ harassment prevented them from being successful. Domestic investors may, indeed, have been encouraged by the Vietnamese Government to start a business. These other (financial) requirements had often a much more serious impact on private businesses than the formal tax obligations.
For example, in 1988 Hanoi’s first private domestic construction company was established (Far Eastern Economic Review 1992). The company, Thai Thanh Construction Enterprise, completed 23 construction projects in the following two years, including schools, shops and student dormitories. In December 1990, the People’s Committee of Hanoi requested that for future bids for construction projects by private companies, these companies would have to make a deposit equal to the total value of the project. Unable to fulfil this requirement the company appealed against the People’s Committee’s decision, without success. The company was shut down (Far Eastern Economic Review 1992).

**State-owned enterprises**

In the 1980s, all large companies were SOEs (Riedel and Turley 1999, p.33), dominated by the Communist Party. Many SOE managers and directors were party members and many Communist Party committees had commercial interests in the SOEs. SOEs had serious political influence and their managers often considered private businesses as a necessary evil or unwelcome competition (Riedel and Turley 1999, p.34). Even though some of the privileges of SOEs were formally abolished, SOEs continued receiving privileged treatment.\(^{152}\) They were therefore not much concerned about the introduction of the new tax laws. Often SOEs benefited from special concessions from the government, they continued to be able to access cheap credit from state banks, and they successfully monopolised their markets with government support. At the same time, SOEs were the main perpetrators of tax fraud, according to investigations by the GDT (Vietnam Investment Review 1993, p.1).

In summary, when the broad definition of tax is applied to this case study, it becomes clear that for many affected by the new tax laws, important parts of their tax bill remained the same. Informal taxes did not change and formed a large part of their overall tax burden. Moreover, only a selected group was affected by the new laws; the majority of rural Vietnamese were not affected. Those affected were not always in a position to express their views. In the 1980s and early 1990s private company owners were still experiencing hostility from government officials as well as large parts of the public (many educated under communist rule). SOEs were affected but knew that there was always room to use their power and influence to reduce the overall financial burden on their companies.

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\(^{152}\) It is worth mentioning that the issue of SOEs receiving favourable treatment is not unique to socialist countries, as some suggest. Market economies such as Malaysia, Thailand and Indonesia face similar problems with their SOEs.
of its neighbours, particularly China. Many believed that the government was clinging too closely to a Marxist approach and was not embracing true reform (Riedel and Turley 1999, p.9). This resulted in limited economic growth and therefore limited growth in tax revenue from the profits tax and the FIL. This trend continued until 2005/6. Foreign investment seems to have picked up since 2006.\textsuperscript{153}

The first phase of tax reform in Vietnam had increased tax revenue significantly.\textsuperscript{154} As outlined in Table 6 below, the move away from the dependence on revenue from SOEs was remarkable. During the period 1990-1994, the average growth of GDP was around 7.5%.

However, attempts to increase the private sector’s tax share has had some success. In 1999, a new corporate tax law was introduced with a standard 32% rate applicable to businesses involved in manufacturing, trading and services. Foreign-investment companies, along with SOEs and domestic private companies and small businesses, were taxed at this rate, although there were many exceptions applied (in the form of additional remittance income tax and supplementary income tax) for both foreign and domestic corporations (see \textit{(Thi Nguyet Le 2006)}. This new law was issued in response to complaints by domestic groups that there was no level playing field as between foreign and domestic investors. In 2004, a revised corporate tax law established a unified rate of 28% with no exceptions \textit{(Thi Nguyet Le 2006, p.158)}. This was taken a step further in 2005. On 29 November of that year the NA passed the Law on Investment No. 59/2005/QH11, which took effect on 1 July, 2006. This new law abolished the FIL and created a uniform legal framework for, and ‘leveled the playing field’ between, domestic and foreign investment (Nguyen 2006).

\textsuperscript{153} Interview with lawyer Andrew Hilton, foreign investment adviser in Vietnam, 14 October 2006.
\textsuperscript{154} While Vietnam has made considerable effort to improve its statistical service, its capacity to collect and analyse statistical information is still rudimentary. It is difficult to obtain accurate figures. Nevertheless, some indication is given by the statistics supplied in the Tables below.
Table 6. Breakdown of Government Revenue

<table>
<thead>
<tr>
<th>Year</th>
<th>Domestic Government Revenue</th>
<th>Fees, lottery earnings etc.</th>
<th>Non-tax rev., incl. depreciation</th>
<th>Tax Revenue</th>
<th>Oil-related revenue</th>
<th>Non-oil tax revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>1987</td>
<td>14.3%</td>
<td>1.1%</td>
<td>0.6%</td>
<td>12.8%</td>
<td>1.2%</td>
<td>12.8%</td>
</tr>
<tr>
<td>1988</td>
<td>13.1%</td>
<td>1.3%</td>
<td>0.6%</td>
<td>11.1%</td>
<td>2.2%</td>
<td>11.1%</td>
</tr>
<tr>
<td>1989</td>
<td>16.0%</td>
<td>2.3%</td>
<td>0.9%</td>
<td>12.9%</td>
<td>2.4%</td>
<td>11.7%</td>
</tr>
<tr>
<td>1990</td>
<td>16.1%</td>
<td>2.2%</td>
<td>1.3%</td>
<td>12.6%</td>
<td>2.4%</td>
<td>10.4%</td>
</tr>
<tr>
<td>1991</td>
<td>14.8%</td>
<td>1.5%</td>
<td>0.9%</td>
<td>12.0%</td>
<td>3.8%</td>
<td>9.5%</td>
</tr>
<tr>
<td>1992</td>
<td>18.6%</td>
<td>2.4%</td>
<td>2.0%</td>
<td>13.7%</td>
<td>4.1%</td>
<td>9.9%</td>
</tr>
<tr>
<td>1993</td>
<td>22.9%</td>
<td>2.9%</td>
<td>1.5%</td>
<td>18.5%</td>
<td>3.9%</td>
<td>14.4%</td>
</tr>
<tr>
<td>1994(P*)</td>
<td>25.1%</td>
<td>2.1%</td>
<td>1.3%</td>
<td>21.7%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Of Which:
- Agricultural Tax
- Personal Income Tax
- Land and Housing Tax
- Import and Export Duties
- Taxes on JVs & private enterprises
- Taxes on SOEs
- Memo items:
  - Turnover tax revenue (all)
  - Profit tax revenue (all)
  - Special consumption tax (all)
  - Trade taxes/imports

Source: Tran (1992): Ministry of Finance; Statistical Yearbook 1992; World Bank (1992) Table 1

(*)= projections only. The data in this Table is incomplete, no further information has been available.

Table 7. and 8. show that the reform process made progress in shifting the tax revenue base from agriculture and SOEs to private sector and taxes on trade.

Table 7. Vietnam: Share of Major Sectors as Percentage of Total Government Revenue

<table>
<thead>
<tr>
<th>Year</th>
<th>Taxes on Trade</th>
<th>Agriculture Tax</th>
<th>Non-agriculture Private Sector</th>
<th>State-owned Enterprises</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td>11</td>
<td>7</td>
<td>9</td>
<td>72</td>
<td>1</td>
</tr>
<tr>
<td>1996</td>
<td>25</td>
<td>3</td>
<td>15</td>
<td>54</td>
<td>3</td>
</tr>
</tbody>
</table>

Source: (Bell 1997)

Table 8. Vietnam: Share of Major Taxes as Percentage of Total Tax Revenue

<table>
<thead>
<tr>
<th>Year</th>
<th>Petroleum Tax</th>
<th>Trade Taxes</th>
<th>Turnover Tax</th>
<th>Profit Tax</th>
<th>Excises</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td>21</td>
<td>11</td>
<td>20</td>
<td>13</td>
<td>8</td>
<td>27</td>
</tr>
<tr>
<td>1996</td>
<td>12</td>
<td>25</td>
<td>17</td>
<td>16</td>
<td>5</td>
<td>25</td>
</tr>
</tbody>
</table>

Source: (Bell 1997)
As outlined in Table 9., the overall tax-to-GDP ratio rose from about 14.7% in 1990 to over 23.6% in 1996 (Nguyen 1997, p.5). In 1990, non-SOEs contributed 4% of GDP to total government revenue. In 1996, non-SOEs contributed 10.7% of GDP to the total government revenue. Over the same period the revenue received from SOEs had remained steady at around 9%.

**Table 9.** Government Revenue 1990–97 Percentage of GDP

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total revenue and grants</td>
<td>14.7</td>
<td>23.9</td>
<td>23.6</td>
<td>22.2</td>
</tr>
<tr>
<td>Tax revenue, excluding SOEs</td>
<td>4.0</td>
<td>10.5</td>
<td>10.7</td>
<td>11.4</td>
</tr>
<tr>
<td>Tax revenue and transfers from SOEs</td>
<td>8.6</td>
<td>9.8</td>
<td>9.7</td>
<td>8.4</td>
</tr>
</tbody>
</table>

Source: (Nguyen 1997, p.5)

In 1995, tax revenue increased, but still fell short of national targets. In 1996, the GDT complained that tax revenue did not meet targets and it pointed out a range of reasons why tax compliance and tax revenue were low in Vietnam. These included:

- the complexity of many tax laws and a confusing tariff system;
- taxation laws that left large gaps for tax evasion;
- ‘unofficial’ fees deliberately being imposed by government branches and regional and local authorities;\(^{155}\)
- poor collection management;
- the extent of change in tax laws and policy making it difficult for the tax administration to issue detailed instructions for implementation; and
- the occasional reluctance by the provinces to pass on to Hanoi tax revenue collected locally\(^{156}\) (Vietnam Investment Review 29 Jan–4 Feb 1996, p.12).

In addition, in the 1990s problems remained with the privileged treatment of SOEs, even those that were loss-making entities (and most of them were). Although there was a trend to move away from SOE revenue, SOEs still contributed a significant part of government revenue. Problems occurred since it was virtually impossible to treat SOEs and private companies on an exactly equal footing. Even if the tax rules were equally applicable to both sectors, some special privileges for SOEs remained. Thus when SOEs substituted their equity for interest-deductible debt financing (under cheap credit arrangements with state banks), this deduction may have significantly decreased their taxable income.\(^{157}\)

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\(^{155}\) This resulted in increased protests by taxpayers at the local level. In September 1997, the severe unrest in Thai Binh province was caused by corrupt local officials levying illegal taxes.

\(^{156}\) The central government had to face the occasional lack of political will at lower government levels to hand over taxes collected on behalf of the central government. For example, many southern provinces were net contributors to the national budget while the northern provinces were net receivers. Ho Chi Minh City complained that it could keep only a very small portion of the taxes it collected. This led to several conflicts, with the central government accusing some provinces of hiding tax revenue (Vietnam Investment Review (1994). Vietnam Investment Review(5-11 September): 10. Under a new law, effective from 1997, clear guidelines were given regarding the rights and obligations between all administrative levels, from central government to local levels (Vietnam Investment Review (1996). Vietnam Investment Review(25-31 March).The receipts from turnover tax, income tax, natural resource taxes and land revenue were shared between the central and provincial governments. The provincial governments received revenues from housing tax, licence tax, registration tax and various fees and charges. Various other charges and taxes including the taxes on land were shared between the provincial and commune levels of government.

\(^{157}\) Private companies could not deduct their interest costs above a certain ratio of debt vs. equity (most cases 3 to 1). If the company had debt over this ratio, no interest costs could be deducted.
6.9 CONCLUSION

The failures of the socialist planned economy resulted in the decision to open up the economy for foreign investment, to allow more private initiative and to reform the tax system to increase government revenue. The cracks in the planned economy commenced before the collapse of SOEs and the drying up of Russian aid funds in the late 1980s. In the early-to-mid-1980s, the communist leaders had already become increasingly nervous, seeing their power decline as they lost control over key parts of the planned economy. As mentioned earlier in this chapter, policymakers were forced to act by the actions of individual communities and factories, which requested market-oriented solutions as answers to the failures of the planning system. In other words, the pressure for change came from the bottom of the Vietnamese system, but still within the state apparatus, before the leaders at the top understood the need for change.

These developments led to the 1986 *doi moi* policies, which resulted in the introduction of a foreign investment law to attract foreign investment. The FIL included a section on the taxation of foreign investors in Vietnam. The government was well aware that the domestic income tax system needed reform as well and commenced this in the late 1980s, before the ending of Soviet funds. It was the urge to do so due to the need for other sources of government revenue and the need for private investment.

Key reformers had sufficient influence within the Communist Party to push reform. But even the reformists were products of the party system and had limited room to manoeuvre. They were allowed to make changes, but only in the margins. The *doi moi* reforms set the broad policy frameworks for tax reform to take place. The design of the tax laws themselves involved senior personnel of the GDT. These staff members were trained in Party thinking and ideology and would not have proposed any reform contradicting the Party line. The domestic profit tax reflected this ideology of the government towards private sector initiatives, resulting in relatively high tax rates.

Sociological institutionalism explains some key features of the Vietnamese bureaucracy. Many bureaucrats from the MoF and GDT appear to have played a role within the reform, and aside from the few identifiable actors who initiated the reform in the mid-1980s, it is impossible to identify or suggest that one or two people were the key players. Often well educated and articulate, these bureaucrats reflected a culture of a well informed and skilled bureaucracy. They also represented a culture of non-disclosure of information; any frank discussion based on exchange of information is done behind closed doors and not shared with anyone outside their particular government department.

Interest groups that were not part of the formal party system or the bureaucracy were not in a position to express their concerns or promote their interests. The private sector was too weak and too vulnerable to expect much influence on the proposed reforms. Even though many probably felt that the reforms were inequitable since they
favoured foreign investment over domestic investment with much higher tax rates applicable to domestic investors. As the reforms did not affect the key constituency (the majority of people living in rural areas) of the regime, the government was not too concerned. The press was in no position to create public debate with no press freedom available.

An inclusive definition of tax is crucial to understanding the reforms. Foreign investors, particularly the many newcomers to Vietnam, soon realised that the FIL only provided a part of the tax picture that they encountered in Vietnam. The many additional levies and taxes made the FIL less important in the overall tax burden for these investors. SOEs enjoyed many privileges that could be described as subsidies or tax incentives and these did not suddenly change with the introduction of the new profit tax. Moreover, their connection to the party apparatus, particularly the lower levels, meant that they could expect to continue negotiating their tax burden with their local tax officials.

Vietnam’s history explains its hostility towards foreign involvement in its domestic affairs. There was a major foreign influence on the reform, though, and it came from China. The Chinese FIL, in particular, had a major influence on the Vietnamese FIL, although there were no identifiable Chinese advisers involved. The domestic Chinese profit tax also provided some guidance for the Vietnamese equivalent. This means that international factors, as outlined in organisational theory, played a role. Vietnam closely watched its neighbour China during its tax reform; this was partially due to the comfortable example China could provide its socialist colleagues in Hanoi. But it was also related to the competition China would offer in attracting foreign investment. The FIL was internationally competitive and in that sense international factors may have played some role. However, the domestic profit tax does not seem to have been influenced by factors of international competitiveness, but rather by the Swedish income tax system combined with the hostile and cautious views of senior policy-makers regarding private sector development. These views were clearly the reflection of the culture within their institution, a legacy of communism with a cautious step into the market economy.

The political response was a change in the level of taxation, changes in the tax system, and to some extent a change in the tax burden with foreign investors paying less tax than their domestic counterparts. Overall taxes as part of GDP increased and the burden shifted away from SOEs to foreign and domestic private enterprises. However, in the light of the discussion on an inclusive definition of tax, a part of the tax reform must be considered largely symbolic as the reality of unofficial taxes continued for taxpayers.