TARIFF EFFECTS ON VIETNAM'S CAKE MARKET

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In recent years, the Vietnam Government has applied policies on trade protection to encourage domestic producers. It has also used a lot of assistance tools such as: export-import tax, export subsidy, quantitatively restricted import, determination of minimum prices of exports and imports and other regulations on foreign trade. The reason is that Vietnam's economy has faced many limitations of managerial level, infrastructures, investment capital, etc. So far, Vietnamese enterprises have accumulated much experience in administration, business and production and it is time for the Government to open the door wider with a view to global economic integration. This process has forced local manufacturers to shoulder heavy duties and firmly enhance product quality with competitive prices compared to foreign commodities. It also provides a fair playground for local and foreign enterprises.

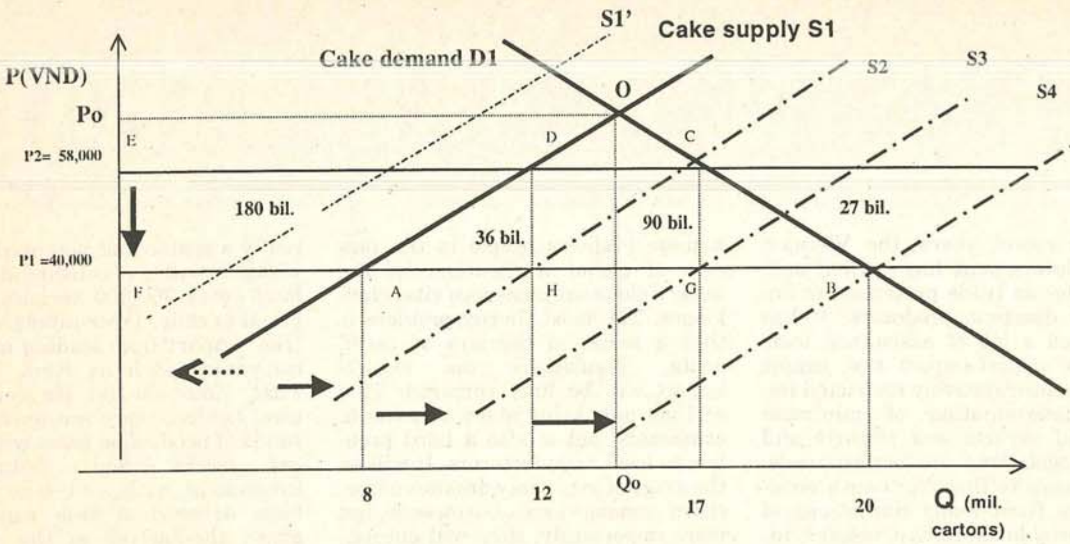
It is only a half-year for Vietnam to implement the tariff reduction program in accordance to CEPT in the ASEAN Free Trade Area (AFTA). A new opportunity is open to Vietnamese business people in the process of global integration, at the same time poses numerous vital challenges. The most thorny problem is that a series of barriers of tariff, quota, regulations on export-import...will be fully removed. This will not only bring many benefits to consumers, but is also a hard problem to local manufacturers. It will be the stage of extremely drastic competition among local businesses but more importantly, they will encounter an overwhelming volume of imported goods when the country's protectionism is abolished in the time to come.

The Vietnam's cake market is also facing great challenges in the process of global economic integration. In the meanwhile, it is a very attractive market to local and foreign enterprises.

According to recent statistics of food companies, the Vietnam's per capita demand for cake is 140 g annually. So with a population of more than 72 million, the country needs 10,080,000 kg of various cakes, equivalent to 20 million cartons (each carton contains 0.5 kg for convenience in calculation). This is really a stable and potential market which attracts a considerable labor force - over 300,000 workers, as compared to other labor-intensive industries. Apart from leading industrial companies such as Kinh Đô, Đức Phát, Kotobuki-Hải Hà Joint Venture, Lubico, there are tens of thousands of production units with different scale and technological investment with a view to meeting huge demand of this market. To adapt themselves to the dynamic market mechanism, in the past years some enterprises have boldly invested in setting up modern technological lines with the aim to produce various kinds of high quality cakes at the request of customers. They have also been able to export their products to traditional markets including Russia, Mongolia, Japan...In the meantime, local manufacturers have investigated consumers' taste and promote their business in such large markets as the U.S., Australia, India and some Middle East countries.

With its trade protectionism to support local manufacturers, the Government has regulated the import of this product by imposing an import tax rate of 45%, using the

Figure 1: Vietnam's cake supply and demand



minimum price level for tax assessment and other administrative regulations, for example, certificates of origin, quality, specification, category...(without quantitative restrictions).

By instruments of statistics, and macroeconomics, we will sequentially analyze tariff effects on the Vietnam's cake market before and after removal of tariff.

Suppose the quality of homemade cakes and foreign counterparts is the same due to local businesses' technological innovation and the price of a 500 - gram carton of cake is VND40,000 on average (not including import tax).

We see the market demand (FB) will be 20 million cartons per year if the price (P1) is VND40,000 per carton, while the local production (FA) reaches 8 million cartons only. Therefore, an import volume (equal to AB) of 12 million carton is needed.

I. Imposition of 45- percent tax rate

Then P2 = VND40,000 + (VND40,000 x 45%) = VND58,000 per carton. Due to higher price, local manufacturers want to increase their output and technological investment, and improve management...with the aim to meet the market demand for 12 million cartons at price of VND58,000 per carton. Therefore, the rest will be offset by an import volume of 5 million cartons (CD)

As such, the tariff has affected and boosted local production from 8 to 12 million cartons and contributed to import reduction (from 12 to 5 million cartons). The figure illustrates these fact and figures as follows:

Tariff effects:

1. On consumers: They will not only enjoy no more benefits but also suffer losses as follows:

- The number of cake is less as compared to that before import tax imposition (falling from 20 to 17 million cartons per year).
- The price is higher from VND40,000 to VND58,000 per carton or up VND18,000 per carton (EF). The consumption totals 17 million cartons per year (EC). The consumers' loss caused by tariff is equal to the area of CEFG: S(CEFG) = VND18,000 x 17 million = VND306 billion, a part of this amount will be paid to the Government and the rest comes to local manufacturers' pockets.

2. On the Government: With a tax rate of VND18,000 per carton (EF), the import volume of cake is 5 million cartons (CD), the Government will collect an amount of import tax worth VND18,000 x 5 million = VND216 billion (equivalent to the area of CDHG).

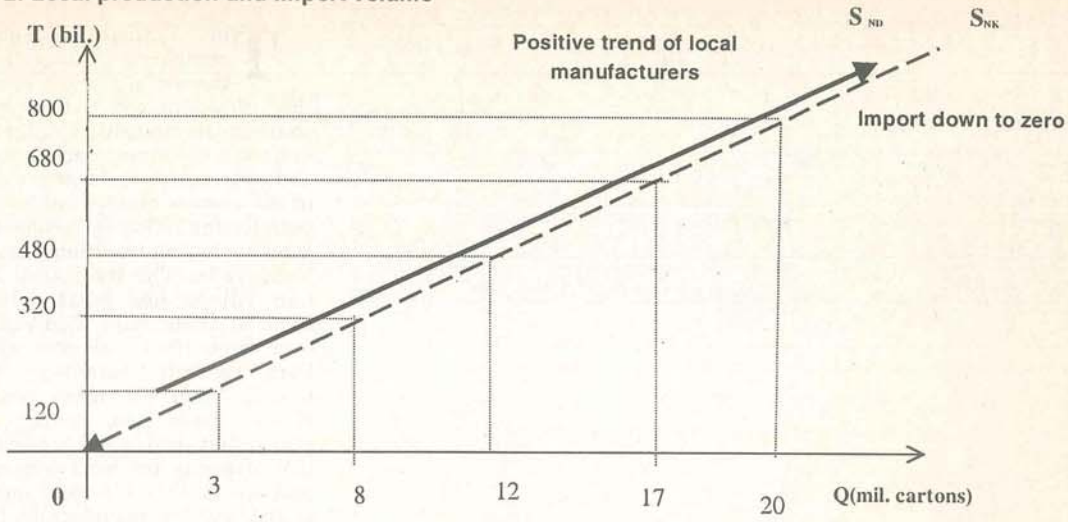
3. On local manufacturers: The price of each carton faces an increase of VND18,000 per carton and the production reaches 12 million cartons (ED) then. Domestic enterprises enjoy a rise of VND216 billion in their sales (S(DEFH) = VND18,000 x 12 million = VND216 billion). However, although their sales climb by VND216 billion, their actual gains do not reach this figure because they have covered growing marginal costs due to growing output. This compensation for marginal costs is equivalent to the area of Triangle AHD (= VND36 billion). The remainder is the area of Quadrangle DEFA (S(DEFA) = VND180 billion) which is the actually increased gain of local manufacturers.

4. On the whole society:

- When the price soars from VND40,000 to VND58,000 per carton, consumers' benefits will experience a fall equivalent to the area of Quadrangle ECBF, while the Government only collects an import duty of VND90 billion only (equal to S(CDHG). As such, a part of consumers' loss is not redistributed to other people (equivalent to the area of Triangle CBG: S(CBG) = S(CDHB) – S(CDHG) = VND27 billion). In the other words, the society wastes a part of benefit provided by tariff.
- When the price soars from VND40,000 to VND58,000 per carton, enterprises will receive an amount of VND216 billion (equivalent to the area of Quadrangle EDHF) while their actual gains increase only VND180 billion (equivalent to the area of Quadrangle EDAF). As such, a part of consumers' benefit loses but does not promote the enterprises' gains and the loss is equivalent to the area of Triangle DAH: S(DAH) = S(EDHF) – S(EDAF) = VND36 billion, that is, the common benefit is lost due to tariff.

In short, the tariff takes away two amounts from the social aggregate benefit equivalent to the area of Triangle DAH plus the area of Triangle CBG: S(DAH) + S(CBG) = 36 billion + 27 billion = VND63 billion. This is a loss of consumers which is not redistributed to other sectors in the economy. It is also an unproductive cost of the economy. According

Figure 2: Local production and import volume



Local production		Import	
Output Q (mil. cartons)	Value (VND bil.)	Volume Q (mil. cartons)	Value (VND bil.)
8	320	12	480
12	480	8	320
17	680	3	120
20	800	0	0

to the above calculation, the annual unproductive cost of the cake import volume subject to a tax rate of 45% totals VND63 billion.

II. In case of 0 – percent import tax

Then: P1 = P2 = VND40,000 per carton, the demand for consumption (FB) is 20 million cartons per year while the local supply (FA) is 8 million cartons only. So the import demand (AB) totals 12 million cartons (1.5 times the local supply).

Suppose the cake demand line is fixed, if the local manufacturers want to hold the whole market shares (no imports), the ideal supply line will move to point B (S4), meeting 100 % of the total demand or 20 million cartons. The domestic businesses will gain VND800 billion; consumers will not lose the two vain amounts totally worth VND63 billion and they can save VND18,000 per carton.

- If the supply line moves steadily to H (S2), then the local production will reach FH = 12 million cartons and the sales total VND480 billion and the amount of imported cake will be HB = 8 million cartons worth VND320 billion.
- If the supply line moves to G (S3), the local production will reach FG = 17 million cartons, the sales reach VND680 billion, the amount of imported cake is GB = 3 million cartons worth VND120 billion.
- If the supply line moves to B (S4), the local production will meet 100% of the total demand or reach FB = 20 million cartons and the sales are worth VND800 billion and there is no demand for imports.

However, we only consider positive efforts of local producers, that is, if they continuously improve quality, category and design, apply technological advances and well manage their business, they will dominate the whole market and defeat their foreign rivals on the home ground. Furthermore, they will find it easy to win foreign consumers' confidence when they want to expand markets abroad.

In addition, we should not ignore negative activities of local producers; that is, they do not implement effective measures to drive back foreign commodities which are flooding local markets once the tariff barriers are removed. The danger is a real fact because domestic consumers are waiting for Vietnam to implement its commitments to AFTA and abolish tariff so that they can purchase foreign goods having higher quality, lower prices and nicer packages. Then, the supply line will go to the left (S'1) and FA will be gradually shortened to zero. The loss is terrible. The whole market will be dominated by foreign manufacturers with 20 million cartons of imported cake worth VND800 billion.

The change in local cake production and import volume is indicated in the following table and figure:

The above mentioned is one of problems that local businesses have to encounter when the process of integration is shortened. Cake is a kind of typical goods impacted by changes in tariff. Moreover, the abolish of quantitative restrictions (quota) also have direct effects on strategic commodities in the process of global integration including rice, rubber, auto, steel...(these effects will be analyze in another article).

The analysis of tariff effects on the Vietnam's cake market may be useful to local producers not only in the cake industry but also in other industries. It displays a typical model to measure the competition between local and foreign goods which are influenced by changes in tariff and quota. Therefore, manufacturers should have appropriate measures to survive and develop just on the home ground.

The above description is also a warning to recent import of foreign goods such as Thai rice, Indian sugar, Chinese watermelon, foreign salt, and so on. If the Government has no proper policies and strategies and local enterprises do not take effective measures to improve their products right now, someday Vietnamese traditional goods including food, fruit, and even handicraft may be replaced with foreign goods!■