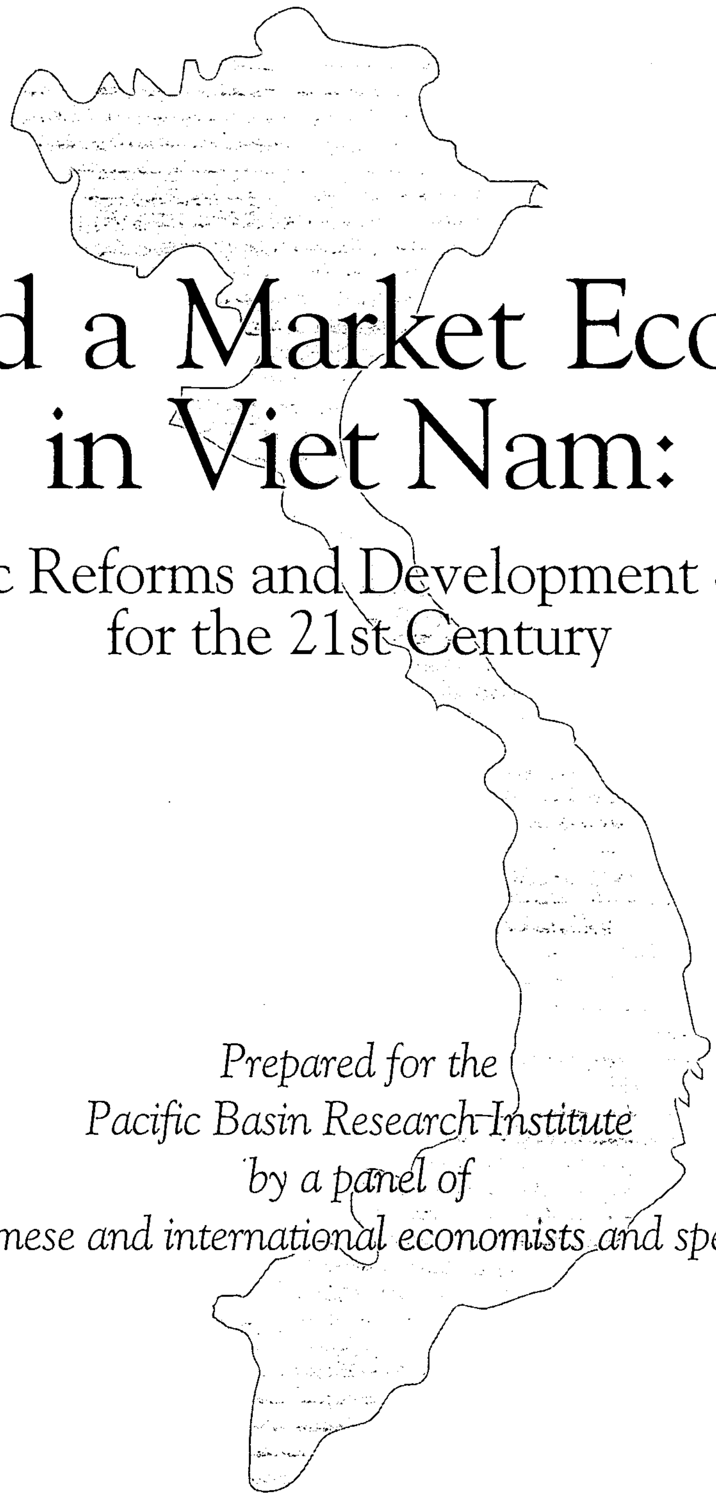

Toward a Market Economy in Viet Nam:

Economic Reforms and Development Strategies for the 21st Century

Prepared for the
Pacific Basin Research Institute
by a panel of
Vietnamese and international economists and specialists

December 1993

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On Statistics

The extreme volatility of the Vietnamese economy over the past decade has meant that statistics are more than usually difficult to interpret. In general, the situation has improved somewhat, compared to earlier years, especially after Viet Nam received technical assistance from international agencies for changing its own self-serving and outdated methods of collecting and reporting statistics into an internationally acceptable national accounts system. But discrepancies among various governmental agencies are still frequent.

The authors of this report have used all possible sources, including official publications in Viet Nam and multinational lending agencies. In the end, it has been necessary sometimes to make a synthesis of these sources. We can only ask our readers to bear this in mind and consider these figures only as estimates in a rapidly changing situation.

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Pacific Basin Research Institute

At the dawn of this century, U.S. Secretary of State John M. Hay predicted that "the Pacific will become the ocean of the future." Today, Hay's forecast has been realized. Asia—specifically, East Asia—is currently the fastest-growing economic region in the world. One by one, strikingly efficient and competitive East Asian nations are entering the global economy with great success.

Viet Nam is located in the heart of this dynamic region. Forced to speed up liberalization of its command economy after the collapse of communism and the disintegration of the Soviet Union, the country has adopted a number of free market-oriented reforms that have attracted the interest of American businesses, news media and policy-makers.

Viet Nam's economic reform measures have brought some limited success, but much remains to be done before Viet Nam can make a successful transition to a free economy and a stable civil society and join the ranks of the advanced economies in the region.

The purpose of this report (and the soon-to-be-published book-length study on which this report is based) is to analyze Viet Nam's economic situation and reform program, and to help define the basis of a broad-based and realistic program of economic and political reform that can advance the cause of economic development and democracy in Viet Nam.

In preparing this report, the Pacific Basin Research Institute has obtained the collaboration of a core group of Vietnamese scholars and professionals of various backgrounds working together with other economists from the United States, Canada, Japan, the Republic of China, Australia and Europe. We thank them all for their help. We also thank our many friends and critics whose comments have contributed greatly to our report. Finally, we wish to express our gratitude to the William H. Donner Foundation for its support and the free hand given to the members of our group. Without the support of the Foundation, this project could not have been undertaken.

Bui Diem
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December 1993

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Toward a Market Economy In Viet Nam:

Economic Reforms and Development Strategies for the 21st Century

ecutive mmary

Viet Nam is strategically located at the center of Southeast Asia, one of the most dynamic regions in the world economy. With abundant natural and human resources and a population expected to reach 100 million early in the next century, Viet Nam has the potential to become an influential partner in the economic development of the area.

The failures of Communist economic and political philosophies and the collapse of the Soviet Union forced Viet Nam to accelerate changes to its foreign and domestic policies. While refusing to relax political control, the Vietnamese Communist Party has adopted a number of economic reforms intended to transform Viet Nam's command economy into a market economy.

This report reviews Viet Nam's past and present , analyses reform performance and identifies the changes that are needed if Viet Nam is to participate meaningfully in the world economy. These changes are not only economic in nature; Viet Nam's economic reforms depend upon the supporting environment of an open and stable civil society, one attractive to investors and international assistance agencies, one in which a private sector—the life of a market economy—can flourish.

Finally, this report has also been written to clarify what further steps are needed to create an appropriate environment for all Vietnamese, living both in Viet Nam and abroad, to play a positive role in the development of a dynamic, prosperous and free Viet Nam.

Caution Is Required

In spite of rosy predictions of an economic "take-off" in Viet Nam, it should be remembered that:

- It is one of the world's poorest countries, with an annual *per capita* income below US$200.
- Ravaged by decades of intermittent war, it has suffered constant economic turmoil since 1975.
- It is entering the world economy at a time when that economy is becoming less favorable to export-oriented economic strategies.
- It has no normal legal framework and is still without an independent and impartial judiciary necessary for the effective rule of law.

History of Economic Turmoil

Viet Nam's regional factionalism was reinforced by prolonged civil war between the 16th and 18th centuries. In the 19th century, it became a French colony; its independence was not restored until after World War II. The country became a battleground for the two geopolitical ideologies of the postwar period. The war ended in 1975 with a Communist victory that brought the whole country under Communist rule.

Strict Marxist-Leninist management of the economy resulted in economic catastrophe in the late 1970s. Famine threatened many areas of the country; the population experienced a precipitous fall in living standards. Government persecution drove many skilled professionals abroad; military intervention in Cambodia isolated Viet Nam diplomatically.

The Vietnamese Communist Party relented in 1979, adopting reforms that allowed private production and trading of goods. Incentive measures intended to spur production in agricultural and industrial sectors were partly implemented; however, the heavily fettered economy was quickly beset by spiraling inflation. In 1982, a backlash by conservative elements of the party led to a return to Communist orthodoxy.

By 1986, the economic crisis reached the breaking point, and Vietnamese authorities were again forced to embrace reform. The government issued its "Economic Renovation" *(Doi Moi)* program, still in effect. This program sought to deregulate many elements of Viet Nam's controlled economy, allowing currency and some commodity prices to float freely and giving more autonomy to state-operated enterprises. Despite some notable improvements, the economy remains unstable and the country's infrastructure weak.

Problems and Recommended Solutions

The origins of Viet Nam's problems are complex, rooted in economic backwardness, socialist central planning, inadequate institutions and regional imbalances. The regime sees the necessity of change, yet resists it for fear of losing political control. Following are highlights of reform measures that need to be undertaken to transform Viet Nam's command economy into a market economy.

Macroeconomic Stabilization

Problems that require immediate attention include a serious budget deficit, a non-productive, highly subsidized and poorly managed state sector, continuing inflationary pressures due to deficit financing, the public sector's lack of financial discipline, high unemployment, low domestic savings and investment, a persistent current account deficit and a large foreign debt.

Macroeconomic stabilization should aim at reducing and rationalizing current spending, instituting adequate budgetary scrutiny and control, improving the structure and administration of the tax system, and eliminating the persistent deficits of state-owned enterprises. Moreover, it should focus on proper monetary and credit management, restructuring of state-owned enterprises, savings and investment mobilization, export promotion, and private sector development to boost employment.

Developing an Institutional Framework

Viet Nam does not yet have a democratic framework, nor an independent and impartial judiciary capable of insuring the rule of law and securing the trust of the populace, as well as that of foreign and domestic investors. Property rights—including land-ownership rights—

still need to be clearly defined and legally protected. Laws to support the functioning of the market system (e.g. commercial and bankruptcy law) are yet to be enacted. As it stands, regulations change frequently and the interpretation of the law is subject to political influence.

Property rights must be institutionalized and protected. Most importantly, a trustworthy and efficient legal system, sensitive to commercial needs and staffed by competent and ethical professionals, must be established.

Building a Modern Banking System

The banking system in Vietnam is dominated by state-owned banks which loan largely to the public sector and enjoy preferential treatment by the State Bank. Private investors' access to capital is limited, and state-owned enterprises still benefit from subsidized interest lending by state-owned banks.

The strengthening of the banking system—the backbone of a market economy—requires radical reforms aimed at increasing the autonomy of the State Bank in formulating and implementing monetary policy; ensuring the establishment of a strong commercial banking network; upgrading the supervision of commercial banks; implementing property, accounting, collateral and bankruptcy regulations; and revising the bank taxation policy to foster efficient private banks.

Upgrading the Physical and Social Infrastructure

Viet Nam's physical and social infrastructure is in extremely poor condition. Deteriorating transportation and obsolete communications, combined with inadequate education and health care systems, pose serious obstacles to human resource development, job creation and resource allocation.

Viet Nam needs to establish a serious rehabilitation and development program for its physical infrastructure (roads, bridges, ports, telecommunications, etc.). The priority should be on repair and upgrading of existing facilities. Whenever multilateral aid and credit are made available for this purpose, plans should be realistic so as to avoid the kind of mega-projects often encountered in underdeveloped countries.

External Resources Mobilization

Viet Nam requires a large infusion of capital. To this end, and to establish its credibility with donors and investors, Viet Nam needs to work resolutely toward the creation of a market economy.

Serious efforts should be made to create a healthy political and economic environment to encourage the contribution of the large Vietnamese community abroad, which could assist particularly in training and technology transfer.

Overall Development Strategy

The above elements must be integrated into a comprehensive development strategy designed to address both the short and long-term needs of the country. This development strategy includes the following components:

1. *Regional Integration.* Viet Nam's membership in the Association of South East Asian Nations (ASEAN) is a requirement not only for transferring capital and trading among its members, but also for long-term negotiations between ASEAN and Viet Nam's powerful trading partners in East Asia.

2. *North-South Integration.* While it is important not to slow the pace of development of well-positioned regions, Viet Nam must pay special attention to its weaker regions (the North and the highlands in the North and South) to encourage balanced development and avoid regional conflicts.

3. *Export Promotion.* To promote exports successfully, the government must allow the private sector to take the initiative, while limiting its own efforts to maintaining adequate physical and legal infrastructures. Viet Nam's export efforts should accommodate the global conditions of increased competition and interdependence.

4. *Agricultural Sector Development.* Effective and successful development of the agricultural sector would raise living standards for the bulk of the population, while providing additional internal markets. It would also slow the push toward rapid urbanization and provide the basis for extended family and community to serve as a social safety net, at a time when Vietnam cannot afford even a modest Western-style social welfare program.

5. *Population Control.* A comprehensive effort should be undertaken to reduce the current explosive growth rate of the population. The most successful way to limit population growth rates has been to raise living standards and levels of education of the population, especially in rural areas.

Requirements for Success

Political stability is important, but stability must be based on representational democracy and the rule of law for sustainable economic development. Despite limited reform, the Communist Party of Viet Nam keeps a tight hold of power, rejecting multi-party democracy and free elections. Without a normal democratic framework, Viet Nam will not be able to achieve popular consensus or a fully integrated society. Political liberalization is necessary to achieve such a consensus, to enlist popular support for painful economic reforms and to mobilize the untapped potential of all Vietnamese outside as well as inside the country.

Without this broad and decisive approach, Viet Nam may fall easily into the illusion of being able to achieve the transition to a market economy without taking into account all economic and political dimensions. Economic reforms which are comprehensive, simultaneous and complementary stand a better chance of success.

Ultimately, economic progress cannot and will not be sustained without a free and open society.

Economic Reforms to Establish a Market Economy in Viet Nam

Prepared for the Pacific Basin Research Institute by a panel of Vietnamese and American economists and specialists

Foreword

The collapse of the Soviet bloc and the failures of Communist economic and political regimens are forcing the government of Viet Nam—still nominally Marxist-Leninist—to change its internal and external policies. These adjustments are of deep concern not only to the people of Viet Nam. Events in Viet Nam—with a population expected to reach 100 million soon after the turn of the century—will also greatly effect economic and political development in Southeast Asia, one of the most dynamic regions of the world economy.

Around the world there exists a reservoir of goodwill for the Vietnamese people. Some countries are now ready to extend both bilateral credits and technical assistance. Viet Nam can eventually also count on aid from the multinational lending agencies affiliated with the United Nations. More importantly, the international business community is anxious to reach Vietnamese markets and to tap the country's vast—and talented, if unskilled—labor force. In fact, the international community could and would fuel the rapid expansion of the Vietnamese economy if basic, minimal guarantees for normal transaction of business were assured.

The broad objective of this report has been to suggest a strategy for economic development which would best meet the particular needs of Viet Nam, while generally maximizing its access to foreign capital and technology. It is a strategy that, for its success, necessitates a hard choice of reforms to liberalize the country. The Pacific Basin Research Institute has obtained the cooperation of a broad-based group of Vietnamese professionals living abroad, and international experts who have had experience in Viet Nam or are familiar with the problems related to the transformation of a command economy into a market economy in former socialist countries.

In the waning years of this century, the world has become more interdependent. Events in one small region can cause a chain reaction affecting other regions, leading to greater prosperity or greater instability. The Asia and Pacific area is one of those regions, with a high rate of economic growth which should continue well into the next century. This represents a great promise and a great challenge for Viet Nam. If the country is successful in its transformation to a market economy, it will become a constructive player in the region, and the Vietnamese people will rightfully enjoy the fruits of their labor. But if Viet Nam fails to grasp the new global and domestic realities, poverty and instability will continue, and continue to affect the entire region.

The primary purpose of this report is to provide an up-to-date review of Viet Nam's economy, identify key problem areas and recommend what remains to be done to sustain and accelerate its transformation into a free market economy. While mainly economic in nature, the report also takes into account non-quantitative elements of the development process. The professionals who prepared it share the same basic premises for building a genuine market economy:

- property rights must be fully recognized and respected
- an adequate legal framework should be created to establish the rule of law and to warrant equal rights of all before the law
- as economic agents, the people should be able to respond freely to economic stimuli, and thus, market forces should not be unduly hindered
- the principle of delegation of power should be established and enforced by democratic rule in politics

The report consists of two parts: The first part (which is the present paper) is a summary of findings and a set of guidelines for reform; the second part, to be published next year in book form, is a compendium of working papers on various areas of the Vietnamese economy.

The worldwide sympathy for the long-suffering people of Viet Nam and the potentially rich commercial opportunities which await investors and trading partners should not obscure the fact that, so far, the regime has taken relatively modest steps toward reform. Most of the work remains to be done.

Introduction

This report will address the question of how Viet Nam—one of the world's remaining Communist societies—can achieve a successful transition to a market economy. Events in Viet Nam are moving rapidly. Independent of publicized political issues—the U.S. government's decision on the embargo, normalization of relations between Washington and Ha Noi, developments inside the Vietnamese Communist Party (VCP)—there are fundamental issues that must be addressed. This report does so, and proffers recommendations for Viet Nam, for its new (or potential) trading partners and for international organizations. This report has been conducted by a group of Vietnamese and international economists and specialists who have an intimate knowledge of Viet Nam, and who care deeply about the future of the Vietnamese people. For that reason, the authors feel a special obligation to the international community to present a realistic appraisal of the situation. Because there increasingly have been optimistic predictions of a Vietnamese economic miracle, this analysis may appear somewhat severe. But it should be remembered that, at present, Viet Nam is one of the poorest countries in the world, with an annual *per capita* income below US$200 [Table 1:Viet Nam Profile]. And although it has abundant natural resources and a pragmatic and hard-working population, the country has suffered constant economic turmoil since 1975.

Table 1: Viet Nam Profile

Area (sq. km.):		332,000
Land under cultivation (ha. per capita) (1988 est.):		0.13
Population in millions (1993 est.):		70.4
Rural percent (1990 estimate):		79.6
Urban percent:		20.4
Density (persons/sq. km., 1993):		212
Population annual growth rate:		2.2
Crude birth rate (per 1,000):		31
Crude death rate (per 1,000):		8
Life expectancy at birth, in years (1992):	Female:	69
	Male:	64
Infant mortality (per 1,000):		49
Literacy rate (percent):		88
GNP per capita in US$ (1991):		146

Official Demographic Projection

	Population (Millions)	Labor Force (Millions)
1993	70.4	35.0
1994	71.8	36.0
1995	73.2	37.2
1996	74.6	38.3
1997	75.9	39.5
1998	77.3	40.7
1999	78.6	42.0
2000	80.0	43.4

Although it lies in the region with the most intense economic activity in the world, Viet Nam is entering the world economy only in the 1990s. The global environment is not likely to be as favorable in the 1990s as it has been to export-oriented economies. The success of its neighbors' development in the 1970s and 1980s may not necessarily be the pattern that Viet Nam can follow. Each of the Four Little Dragons—South Korea, Taiwan, Hong Kong, and Singapore—has its own peculiarities which led to success. Nor is Viet Nam China. The China model, with its myriad political and economic problems, also faces an unknown future.

Accordingly, extreme caution is required for any strategy for Viet Nam based on an assumption of the country's rapid transformation to a world-class economy [Table 2: Basic Economic Indicators]. The barriers to development must not be underestimated; in Viet Nam, the failings of Marxism have badly compounded the traditional problems of a colonial economy.

The history of the Vietnamese economy since World War II has been tragic. Almost three decades of intermittent war ended in 1975 with the military victory of the Communist forces. As a result, a strict Marxist-Leninist order was imposed on the entire country, mandating collectivization of agriculture, a high priority for heavy industry, eradication of the private sector and rigid central planning.

Already ravaged by war, the economy could not withstand the Communist experiment. After the crisis reached alarming proportions in 1979—including regional famine—the Vietnamese leadership came under pressure to initiate a reform program making central planning less rigid, especially in the agricultural sector. The improvement that resulted was, however, judged politically incorrect by conservative elements in the VCP. The reform program was quietly halted in 1982. Reformers were removed from key positions, and the economy returned to confusion and crisis.

Responding to a worsening economic situation, and having drawn lessons from the inadequate off-and-on reforms of the previous years, the Vietnamese authorities initiated another reform program in late 1986. This "economic renovation" *(Doi Moi)* program became more comprehensive after 1989 through a series of *ad hoc* measures. In fact, the VCP leaders had few options: The collapse of communism in Europe meant the loss of the major source of economic assistance and markets for Vietnamese exports. With the disintegration of the Soviet Union, Viet Nam lost its major political ally and financial backer.

Table 2: Basic Economic Indicators

	1987	1988	1989	1990	1991	1992	1993 (Estimated)
Population (millions)	52.5	63.7	64.8	66.2	67.7	69.9	70.4
Real GDP Growth*	4.0	5.1	8.0	5.1	4.0	8.1	6.7
by Sector*							
- Agriculture	-.6	4.0	16.6	1.5	2.2	6.3	3.0
- Industry	9.8	2.4	-2.7	2.9	4.3	12.0	10.0
- Services	5.5	8.9	17.7	10.4	7.9	9.3	8.0
by Demand*							
- Total consumption	4.7	4.8	5.0	6.2	0.6	4.8	6.7
-Capital formation	-12.8	-5.1	-8.1	27.1	9.8	13.2	10.1
Sectoral contribution to GDP (percent)							
- Agr. & Forestry	40.7	40.1	41.1	40.6	41.0	38.0	
- Ind. Min. Const.	30.5	31.2	28.0	27.4	23.0	22.4	
- Services	28.8	28.7	30.9	32.0	36.0	39.6	
Balance of payments [1]							
Exports ($ millions)	854	1038	1946	2404	2087	2475	2829
Annual change (%)	8.3	21.6	87.4	23.5	-13.2	18.6	15.0
Imports ($ millions)	2455	2757	2566	2752	2338	2506	2975
Annual change (%)	13.9	12.3	-6.9	7.3	-15.1	7.2	25.0
Trade balance	-1601	-1718	-620	-348	-251	-31	140
External debt ($ bn)	10.7	13.0	14.0	14.6	15.3	16.4	17.0
Debt-service ratio (%)	-	-	58.0	60.0	60.0	51.0	50.0
Budget (in percent of GDP)							
Budget revenue	15.4	13.1	16.0	16.1	14.8	18.6	
- State enterprises	11.5	8.4	7.5	7.5	8.8	10.8	
- Non-state sector	2.7	3.4	4.5	4.4	4.0	4.9	
Current expenditure[2]	15.9	16.1	16.4	16.1	12.5	14.7	
Capital expenditure	4.9	5.1	8.5	5.6	3.1	5.6	
Overall fiscal deficit	-5.5	-8.3	-9.1	-6.4	-1.3	-3.1	1.5
Domestic financing	3.8	5.5	7.0	3.1	0.2	0.4	
- of which State Bank	3.6	3.4	8.1	3.1	0.6	-	
Money supply (M2)*	324	445	170	60	54	10	20
Domestic credit*	341	446	159	46	48		
Inflation*	417	411	176	129	67	17	15

*Year to year percentage changes.
[1] Converted at an exchange rate of 2.4 transferable rubles per US$ since 1989
[2] Excludes interest payments.

The new reform program, buoyed by the dynamism of the Vietnamese people, has produced some positive economic results. According to the most recent estimates for 1992, the country achieved an annual GDP growth rate of approximately 8%, a substantial reduction in the chronic trade deficit[1] and, after reaching three digits in 1987 and 1988, annual inflation fell below 20%.

But Viet Nam risks stagnation if there is not more systematic and comprehensive reform. Its efforts thus far have been handicapped by the pattern common to other former Communist regimes where the leadership has too often tried to preserve the power of a privileged elite. This presents a dilemma for Ha Noi's leadership, for it is difficult to envisage reform and prosperity in Viet Nam as long as the present power structure is preserved. If the leadership fails to grasp this reality, the country will continue to fall further and further behind the rest of the region.

The economic facts as they emerge from this report require Viet Nam authorities to address these basic issues:

- macroeconomic stabilization
- legal and institutional reform
- private property rights
- state enterprise reform
- physical infrastructure
- social safety net
- North-South integration
- technical training and technology transfer
- mobilization of external resources
- long-term development strategy

Obviously, this is a formidable list. These issues cannot be attacked simultaneously. This report indicates that there must be immediate objectives, intermediate goals, and a long-term strategy. The immediate objective must be to strengthen stabilization measures and build macroeconomic institutions that will support these measures. This will not be possible without a radical reform of Viet Nam's legal system and institutional framework, including establishing and ensuring full private property rights, implementing state enterprise reform, reorganizing the government and rebuilding a physical infrastructure consistent with Viet Nam's development needs.

Intermediate goals should include the development of Viet Nam's human and natural resources. This includes education and training, health care, a social safety net and population control. Finally, Viet Nam is a country with large regional imbalances. It must find an effective way to address growing North-South disparities. This problem has such economic and political implications that without a solution there will be little hope for stability and no possibility of integration into the global economy.

While recognizing the limitations of an agriculture-based strategy, Viet Nam must, by the end of the next decade, have a modernized rural sector in place that can be the basis for a stable society and can maximize comparative advantage for the rapid growth of industry. That industry will in turn provide the basis for export-led economic expansion and determine Viet Nam's role in the increasingly integrated East Asian economy. The Asia-Pacific region's dynamism presents a great challenge for Viet Nam; only if Viet Nam is successful in its transformation to a market economy will it become a constructive regional player.

The success of this strategy is not only important to Viet Nam, but to the whole international community, and to the United States in particular. Although the future of Viet Nam is in the hands of the Vietnamese, any American policy seeking to help maintain peace and progress in East Asia will have to cope with 100 million Vietnamese early in the next century. A successful U.S. policy regarding Viet Nam will be an integral part of any policy that deals with China, Japan, and the ASEAN powers. That policy should be grounded in the goal of encouraging Viet Nam—either through government-to-government relations, multinational lending agencies or the private sector—to move toward a free and open society without which a market economy cannot ultimately succeed.

Background

Located at the extreme eastern edge of Southeast Asia, Viet Nam, with a tropical monsoon climate and a total surface of 330 square kilometers (half the size of Texas), is a long, narrow country, as the map on this page shows. Viet Nam has a population of approximately 71 million growing at the rate of 2.2% annually (40% under 14 years of age). Its elongated shape—a littoral never more than 75 miles wide in central Viet Nam, with mountains jutting into the sea—makes communication difficult, and has historically led to regional factionalism. The population is concentrated in the Red River and the Mekong River deltas [Table 3: Demographic Indicators].

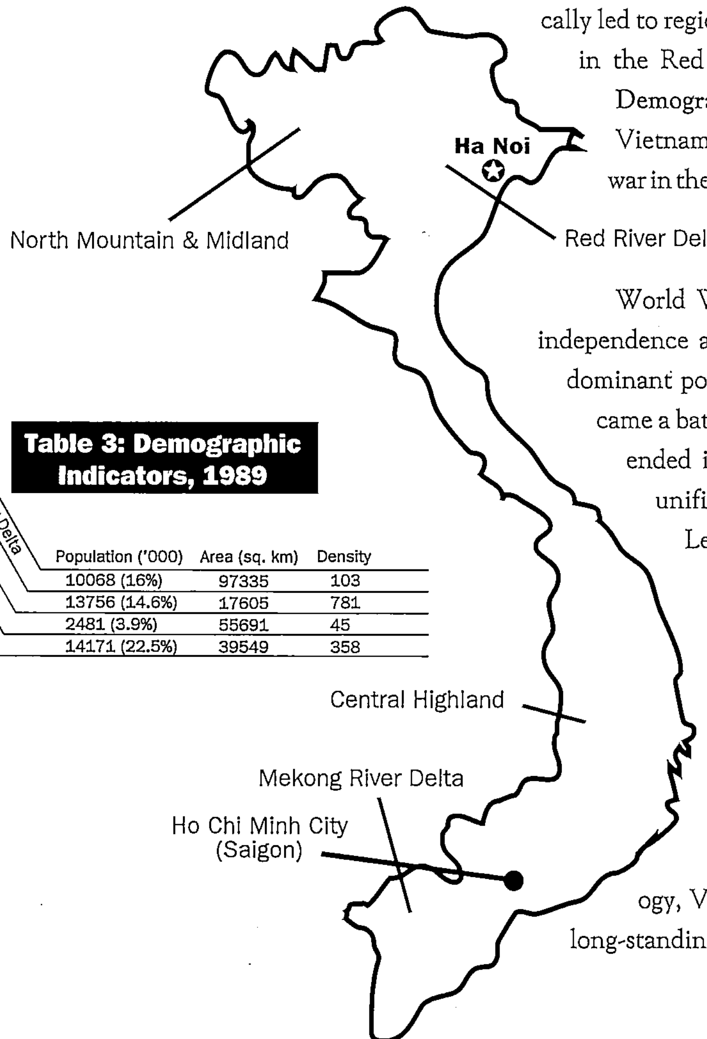


Table 3: Demographic Indicators, 1989

	Population ('000)	Area (sq. km)	Density
North Mountain & Midland	10068 (16%)	97335	103
Red River Delta	13756 (14.6%)	17605	781
Central Highland	2481 (3.9%)	55691	45
Mekong River Delta	14171 (22.5%)	39549	358

Vietnamese regionalism was reinforced by 150 years of civil war in the 17th and 18th centuries. The 19th century saw Viet Nam become a French colony and protectorate, remaining so for more than 80 years. The end of World War II marked the reinstatement of Vietnamese independence and the beginning of a struggle between the two dominant political ideologies of the Cold War. Viet Nam became a battleground between these two camps. This struggle ended in 1975 with a Communist military victory that unified the country under the banner of Marxist-Leninism. Despite this victory, large numbers of Vietnamese continued to oppose Marxism and its workings. More than 2 million Vietnamese have fled Communist rule since 1975.

Thus both geography and history have combined to saddle Viet Nam with the burdens of poor communications and factional strife. But with the rapid diffusion of contemporary technology and the collapse of Marxist ideology, Viet Nam has the potential to overcome these two long-standing obstacles to unity and national prosperity.

Recent History of Economic Reforms

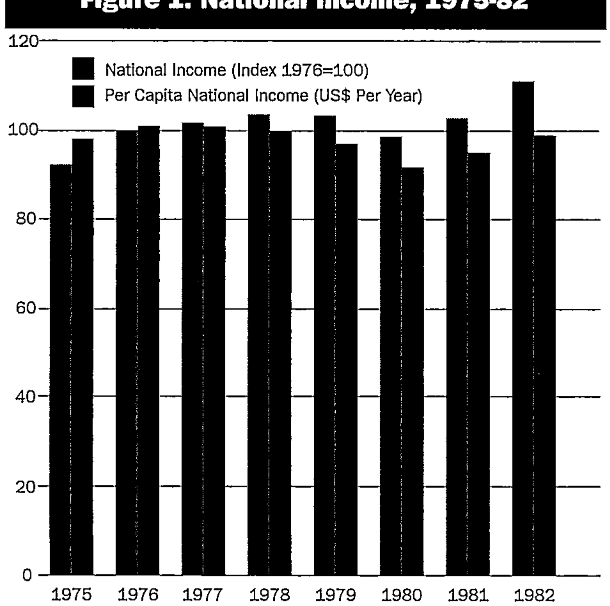
Since 1975, united Viet Nam has been dominated by the Marxist-Leninist policy of "socialism building" that had appeared in parts of the North as early as 1946. When the economy bankrupted in the mid-1980s, an "economic renovation" program was initiated within the framework of socialism.

1. "Socialism Building"

After 1976, the government extended the socialist model to the whole economy of Viet Nam. Agriculture was collectivized, and all manufacturing industries as well as many services, were nationalized. The economy soon ran into trouble. The second Five Year Plan (FYP) from 1976 to 1980 was a complete failure, with economic growth reaching only 0.4% per year, as confirmed by the political report at the Sixth Congress of the Vietnamese Communist Party in 1986 [**Figure 1: National Income 1975-1982**].

The population (especially that of the former South Viet Nam) experienced a catastrophic fall in living standards. Worse, harsh treatment of the vanquished supporters of the Republic of Viet Nam led to the long detention and/or mass exodus of many people with the skills and knowledge needed to help the country recover from the devastation of war. Compounding the postwar hardships, Viet Nam's intervention in Cambodia resulted in diplomatic and economic isolation of the country, further straining its resources.

Figure 1: National Income, 1975-82



With famine seriously threatening many areas, the Vietnamese leadership was forced to retreat from the Communist model: In the South, production incentives were introduced in the state sector, and the drive to collectivize farmers was halted. In the aftermath of the Sixth Plenum of the Party Central Committee in August 1979, modest measures of gradual reform were promulgated. For example, nationalized, collectivized and private units of production were encouraged to produce and trade those goods that were not under state management. In the agricultural sector, incentives were instituted to maximize efficient use of agricultural lands. A contract system was introduced: after fulfilling state quotas, farmers and cooperatives were permitted to dispose of their remaining surplus, and agricultural cooperatives and enterprises could trade among themselves. While this system was being implemented in agriculture, the authorities simultaneously began encouraging industry and other sectors of the economy to expand incentive-pay systems based on piecework rates or other measures of worker performance.

These developments were followed by decisions made at the Fifth Party Congress to re-orient sectoral policies toward agriculture, consumption goods and exports (the three priority programs), bringing some relief from the immediate crisis [**Figure 2: Growth Index 1975-1982**].

Productivity incentives also resulted in higher prices on the free market, in turn requiring that wages and salaries for workers and government officials be raised. The annual inflation rate reached 34.9% in 1981 and 82.6% in 1982. Grain and food prices almost doubled, increasing by 96% in 1982 [**Figure 3: Price Increases in Ho Chi Minh City (Saigon), 1978-1982**].

This spiraling inflation quickly wiped out the effect of wage increases in the public sector and produced a continuing drop in the standard of living of civilian and military cadre whose support was critical to the regime. As a result of the disaffection among these crucial constituencies, the reform suffered a backlash from VCP hard-liners. Draconian economic measures were reintroduced in late 1982, returning to a more orthodox Marxist-Leninist model lasting until June 1985. In that year, a resolution of the Eighth Plenum of the Central Committee on "price, wages and currency" reintroduced production incentives and price liberalization measures.

As a result of the 1979-1982 reform, the initial phases of the third FYP (1981-1985) brought encouraging growth rates of 6% per year between 1981-1984. However, by late 1986, the yearly growth rate had fallen to 1.3%, and the change in method of wage and salary payments (and their across-the-board increases) provoked significant monetary expansion. Price increases and currency devaluation intensified the inflation pressure: from September 1985 to September 1986, price increases reached 700%. Thus the results of the third FYP were even worse than the second. In response to this worsening of the economic situation, the Sixth Party Congress, in mid-December of 1986, inaugurated the "Economic Renovation" program which began the current cycle of reforms.

Figure 2: Growth Index 1975-82

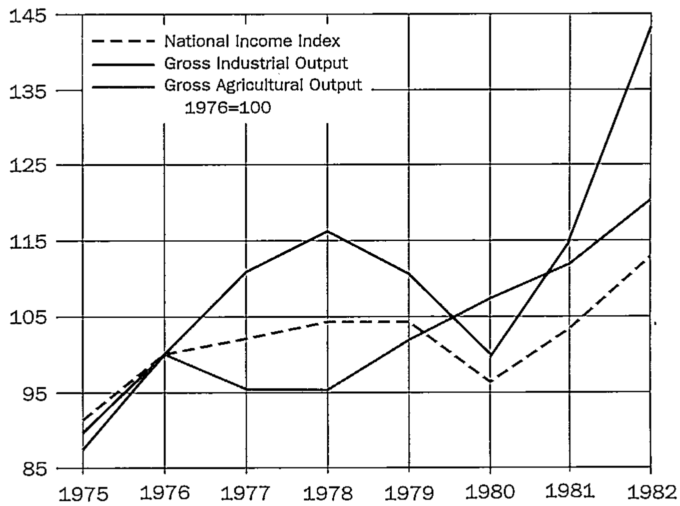
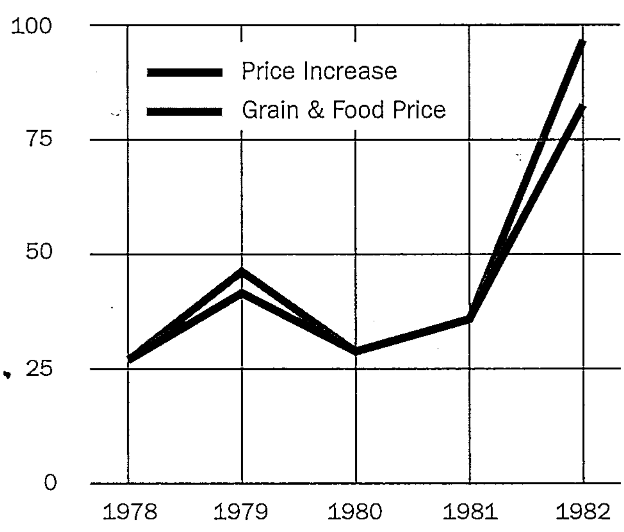


Fig. 3: Price Increases in Ho Chi Minh City (Saigon), 1978-82



2. "Economic Renovation"

As compared with the economic liberalization of 1979-1982 (which was the authorities' reaction to the pressure of market realities) Viet Nam's "Economic Renovation" program was a top-down reform, initiated by the leadership after learning from previous reform experiences. This time, in addition to readjustments, the authorities also launched a macroeconomic stabilization program to avoid the negative side effects of previous reforms.

The first act of "renovation" was publicly to condemn the bureaucratic centralist system based on state subsidies. Market mechanisms were lauded, and stronger measures decreed to motivate production. In 1987 and 1988, all checkpoints were removed to allow the free flow of merchandise. Several resolutions of the Central Committee and the Council of

Ministers were promulgated in order to:

- free price controls on most of the basic commodities
- expand management autonomy of the state owned enterprises (SOEs)
- admit the existence of non-socialist economic components
- free the agricultural sector, allowing farmers to rent land on a long-term basis and abolish state-planned production
- experiment with banking and enterprise reform
- deregulate exchange control and readjust the exchange rate
- promote foreign trade

After some stabilization, inflation pressures started to build again, with the inflation rate reaching 30% a month. The economy again suffered severe problems, including supply bottlenecks and budgetary and external deficits. At the end of 1988, additional reform measures were announced. The most important included:

- new laws and regulations on foreign trade and investment
- successive currency devaluations
- price liberalization and abrogation of the cooperatives and subsidy systems, particularly in the agricultural sector
- management autonomy and financial accountability for state-owned enterprises
- establishment of two commercial banks created from two State Bank's departments of credit
- public acknowledgment given to the development of the private sector

Price and exchange reforms were more comprehensive than those undertaken in China or Eastern Europe. But banking, private-sector, legal and regulatory reforms were fragmented and often ambiguous.

The collapse of communism in Central and Eastern Europe and the Soviet Union in 1989-1990 deprived the Vietnamese regime not only of ideological support, but also of major markets and its major source of economic assistance, pushing the country to the brink of disaster. This new crisis forced the authorities to expand the reform program after March 1989, reorienting the economy toward ASEAN and the West.

Viet Nam overcame the immediate crisis. During 1992, with the help of increasing oil exports and unusually good weather (which brought a bumper rice crop), Viet Nam achieved an improvement in foreign trade, rapid growth (close to 8% of GDP), with inflation coming under relative control (17% per year). These accomplishments in the midst of difficult circumstances were no small achievement.

Yet while limited reform has been undertaken, the Vietnamese economy remains weak and fragile. As can be seen from the basic data (see Tables 1 and 2) real per capita GNP has undergone a period of rapid growth, but remains at a low level by international standards. Inflation is under better control, but at 17% per year remains high. Rice production is up dramatically, and since 1991 Viet Nam has become the third largest rice exporter in the world[2]—yet malnutrition persists in some provinces. Finally, the loss of substantial quantities of East Bloc and Soviet aid have cost the economy a great deal in terms of agricultural inputs and other imports.

3. Evaluation of the Reform

Essentially, the authorities instituted economic reforms in three broad areas:

1. *Price decontrol and foreign exchange.* In 1989, most prices were allowed to adjust to their market levels; however, prices of many essential goods (such as sugar, kerosene, soap, fish sauce and pork) remain controlled. Many price subsidies were abolished, but others remain (such as those for electricity, water, housing, medicine and paper). The Dong was allowed to float freely.

2. *Banking, state-owned enterprises and collective sector.* The agricultural collectivization program was largely abandoned in most areas, and farming was privatized. Financial restructuring was announced in July 1987. But three years elapsed before laws regulating the central bank and other banking and financial companies were promulgated. Unfortunately, implementation of these laws through regulation lags. In late 1987 and early 1988, new reform measures were introduced to increase the autonomy of state-owned enterprises (SOE's) and, indirectly, much of the central planning apparatus was dismantled.

3. *Legal and regulatory.* During the past few years, the authorities have passed a number of foreign investment laws, real property laws and banking, commercial and labor legislation. The intent of these statutes is to attract foreign capital and improve production management. However, there is no coherent legal system; these laws are therefore fragmentary, often inconsistent and usually ineffectual. Furthermore, regulations to implement them have yet to be put in place, undermining any possible effectiveness of these statutes. Finally, there is no consistent enforcement of the laws mandating equal treatment in economic activities. The dual authority of Party and government is responsible for these inconsistencies and much else that is wrong in Vietnam. In the area of land ownership, all land remains the property of the state, but farmers can lease land (up to 20 years for annual crops and up to 50 years for perennial crops) and may transfer the leases to their children. The state also recognizes the rights of individuals and companies to own their own homes, plants and equipment—but not the land on which they are built. The right to dispose of land has not been recognized, and the procedures through which land can be hypothecated are still ambiguous.

The reform process has had some temporary successes. However, except in the case of the investment law, little has been accomplished in the way of legal and institutional reform. Moreover, it is clear that the Vietnamese authorities continue to avoid taking any action that will diminish the privileges of Communist Party members. Whenever a conflict between politics and economics arises, it is always the economic arguments that are sacrificed. Despite the abolition of the collectivization program, the authorities did not completely dismantle the collective networks—especially in the North—using them instead as a "land management and renting" structure to extract funds from farmers to finance the Party apparatus. The authorities were also reluctant to restructure and privatize SOEs, many of which are known to be part of the financial arm of the Party.

Of the three main areas touched upon by the reform program (prices and exchange rates, banking and state enterprises, legal and institutional reforms) only in the first area have reforms been seriously carried forward.

Basic Issues and Recommendations

Despite a measure of success resulting from the reform, Viet Nam still faces a host of serious, interrelated problems that are potentially destabilizing and, if not addressed in time, may wipe out the gains achieved so far. Each of these problems has complex origins in the compounded effects of economic backwardness, central planning and transitional imbalances; the consequences are critical and extend far beyond the economic sphere. The following is a checklist for Viet Nam as it tackles its substantial (but not insurmountable) problems on the road to a more open and productive economy.

1. Macroeconomic Instability and Structural Weaknesses

While macroeconomic problems are legion, several are herein identified as critical. These problems, clearly related to each other, include a serious budget deficit; the absence of adequate budgetary scrutiny or fiscal administration; a non-productive, highly subsidized and poorly managed state sector; continuing inflationary pressures resulting from deficit financing; high unemployment and underemployment; low domestic savings and investment; a persistent foreign accounts deficit; and a large foreign debt.

Table 4: A Summary of the Vietnamese Budget, 1987-1991

(In percent of GDP)	1987	1988	1989	1990	1991
Revenue	12.2	11.3	11.9	13.1	9.3
Tax Revenue	2.2	2.9	3.4	3.6	3.2
Transfer from State Enterprises	9.2	7.2	5.6	5.3	3.4
Other Revenue	0	1.2	3	4.3	2.7
Current Expenditures (excluding interest)	12.7	13.9	12.2	13.2	8.8
Wages and Salary	1	1.7	4	3.7	1.8
Subsidies	4.9	5.3	0	0	0
Others	6.8	7	8.2	9.4	7
of which: Operation & Maintenance	1.8	0.5	0.8	0.6	0.4
Capital Expenditures	3.9	4.4	6.4	4.5	1.6
Deficit (-)	-4.4	-7.1	-6.8	-6.5	-2.7
Financing	4.4	7.1	6.8	6.5	7
Foreign Loans & Grants (Net)	1.4	2.4	1.5	4	–
Domestic Loans (Net)	3	4.7	2	2.5	2.7
State Bank (Net)	2.9	2.9	6	2.5	0.5
Government Securities (Net)	0.1	0.1	0	0	2.3
Arrears	0	1.7	-0.8	0	2.3

Macroeconomic stabilization should focus, therefore, on the following:

- the government's budget
- monetary and credit management
- state enterprise reform
- savings and investment mobilization
- export promotion to close the external balance gap
- movement toward fuller employment

(a) Budget Deficit, Inflation and Public Finance

In comparison with other countries, Viet Nam's government expenditures appear to be modest and are in fact declining in real terms. However, Viet Nam continued to suffer a budget deficit close to 6.5% of GDP in 1990, 3% in 1991 and an estimated 4% in 1992. This deficit has been caused by low-tax and non-tax revenues, and by declining contributions by state enterprises to the budget [Table 4: Summary of the Vietnamese Budget, 1987-1991].

As a percentage of GDP, total expenditures grew from 16.6% in 1987 to 18.3% in 1988 and 18.6% in 1989 (compared to total revenues of 11.9% in 1989), generating a budget deficit close to 6.7% in 1989. Facing this situation, the government took several measures to restrain public expenditures, lowering them to 17.7% in 1990 and 12.1% in 1991.

Total revenues as a percentage of GDP declined from 12.2% in 1987 to 11.3% in 1988 before increasing to 11.9% in 1989 and 13.1% in 1990. Contributions from state enterprises to the budget diminished from 9.2% in 1987 to 7.2% in 1989 and to 3% in 1991. These declines in government enterprise revenues were in part offset by increases in tax collections from the non-state sector (resulting from 1991 tax law revisions) and revenues from a surge in oil production (0% in 1989 to 2.5% in 1990).

While there has been a recent improvement in revenue collection, the public finance system in Viet Nam remains weak in its ability to generate revenues, a fact that enlarges the deficit, tends to push the authorities toward inflationary finance, and inhibits the ability of the government to conduct normal business. Non-tax transfers to the budget from a few centrally owned state enterprises historically have been the most important source of state revenues, yet these sources recently have declined as state enterprise profits have fallen, with higher costs of inputs attributable to the decline in East Bloc and former Soviet aid.

While the tax system of Viet Nam is nominally unitary, the government has serious intragovernmental problems resulting, in part, from the absence of a system of tax or revenue sharing. With *ad hoc* arrangements, local authorities have no incentive to collect revenues or transfer them to the central government. Furthermore, authorities have numerous incentives to use taxes, fees and charges that are not covered by tax-sharing rules to avoid sending revenues to the central government. This bottom-up transfer leaves the central government vulnerable to the kind of fiscal starvation that contributed to the dissolution of the Soviet Union and now threatens the viability of the Russian Federation. Only the three major cities of Viet Nam have a budgeted contribution to central government revenues.

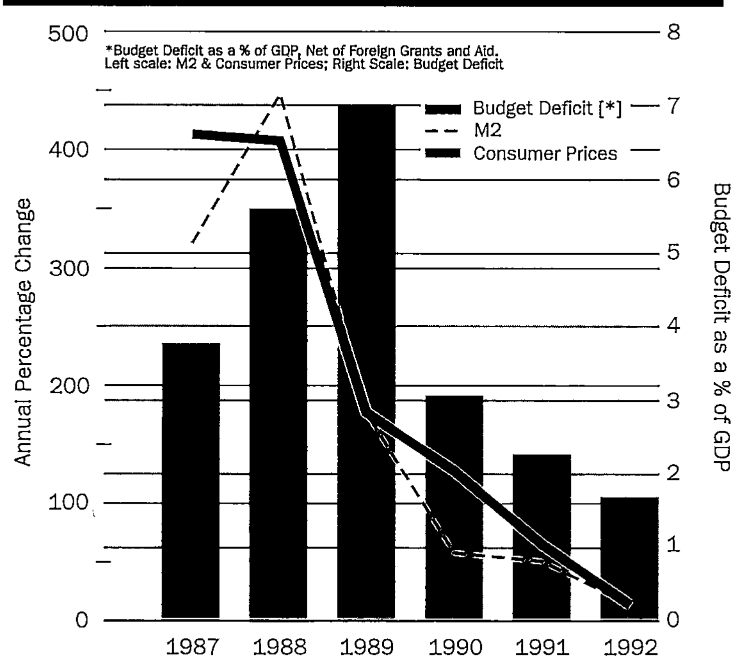
In order to stave off larger deficits, the government in 1991 cut back expenditures, especially in public investment (from 6.4% of GDP in 1989 to 1.6% in 1991), precisely at a time when demand for it (maintenance of the physical infrastructure, public utilities, importation of fertilizers, etc.) was particularly pressing. The authorities also reduced expenditures through a staff retrenchment program, demobilization of troops and reduction of direct subsidies to state enterprises. However, one year later, current expenditures had already substantially increased. Furthermore, in comparative terms, defense spending remained high. It is unofficially estimated at between 4.5% and 5% of GDP—more than a third of government expenditures.

In the past, budget deficits and capital expenditures were principally financed by assistance from the Soviet Union and Soviet bloc countries. This assistance has vanished. Declining grants and aid were only enough to finance about 18.5% of the deficit in 1991, compared to 33% in 1988. There is virtually no room for the government to finance its budget deficit in a non-inflationary way. Thus a principal cause of base inflation continues to be the persistent budget deficit.

The authorities in Viet Nam take great pride in the fact that the inflation has finally been controlled (close to 17.5% in 1992, 67% in 1991 and 130% in 1990, versus 417% in 1987). However, Viet Nam is still vulnerable to continuing inflationary pressures because of its chronically weak production capacity in the face of growing demand. Persistent and substantial demand pressures underlie a constant threat of renewed rapid price increases.

Further enhancing the likelihood of renewed inflation is the lack of adequate monetary policy and institutions. Following the reorganization of the banking system ("Law Regulating The State Bank of Viet Nam" and "Law on Banks, Credit Cooperatives and Financial Institutions," Oct 1, 1990), the State Bank of Viet Nam, theoretically, was to be concerned primarily with preserving the stability and value of the Dong. Controlling inflation would depend, to a great extent, on its capacity to limit lending to the government or to state-owned enterprises through state-owned commercial banks. However, the State Bank has clearly failed in its mission, continuing to act primarily as the credit financing arm for the Ministry of Finance. Monetary authority is not yet distinct from budgetary authority, and the confusing economic management system results in contradictory policies of the State Planning Commission, the Ministry of Finance and the State Bank, aggravated by the lax management of local authorities. ("Money and Credit Management" and "The Banking System," see below)

Figure 4: The Budget Deficit & Inflation, 1987-92



A final, underlying source of inflation is the subsidization of state enterprises through excessive credit. In 1990, outstanding loans to these state-owned economic units accounted for 4 trillion Dong out of a total of 4.5 trillion Dong in loans outstanding. Since state-owned enterprises contributed only about 20% of GDP in 1991—but absorbed almost 90% of total credit—they are also contributing to inflation.

Government lending to state enterprises at less than the market rate of interest amounts to substantial government subsidies for those enterprises. In 1991, credit subsidies amounted to 1.2 trillion Dong, about a third of government revenues received from these enterprises. Furthermore, their economic performance is so poor that many of the loans to state enterprises will never be repaid.

More recently, serious attempts have been undertaken to limit credit to government entities. But the amount of credit in the economy remained high, especially due to government advances to state enterprises, enlarging the budget deficit and adding to inflationary pressures on the economy.

Inflationary pressures, therefore, arise from several related causes including the budget deficit, inadequacies in the tax system and monetary institutions and subsidies to inefficient state enterprises [Figure 4: The Budget Deficit and Inflation, 1987-1992]. To eliminate inflationary pressures, efforts should be directed toward improving the cost-effectiveness of government operations, increasing the efficiency of the revenue system and creating responsible monetary institutions which would control credit to state enterprises.

Since spending on physical and social infrastructure has been low, it is difficult to envision further cuts in non-military expenditures. However, military expenditures could and should be reduced. There also exist many areas for improvement in expenditure planning and management. In regard to planning, there is a need to develop a revolving medium-term public investment program, well integrated into the annual budget. Investment policy and projects must be subject to public as well as intragovernmental scrutiny and debate. Government agencies at the national and provincial levels should adopt public investment policies aimed at projects yielding the highest social returns. In expenditure control, reporting practices and the public accounting system need to be improved. Conventional techniques to meet these objectives are well known, but Viet Nam lacks the skilled personnel to apply them. Until domestic human capital is developed in these areas, the Vietnamese should take full advantage of those skills to be found in the Vietnamese overseas communities.

Better management of the debt—particularly its domestic component—will require substantial improvement in coordination among the agencies involved, information gathering and development of technical and administrative skills. The government has already discontinued central bank financing of budgetary deficits. While this achievement is significant, the government must now pursue a policy of marketing its debt instruments in a competitive capital market. As this new market develops, Viet Nam will need to create new debt instruments and might well look to the experience of other reforming economies.

With a view to increasing budgetary revenue, the government should give priority to mobilizing fiscal resources. As a general policy, tax reform should be implemented to enhance the efficiency and equity of the system, broaden the tax base, raise the level of compliance and improve tax administration. Ultimately, a successful Vietnamese tax system will depend on the taxpayer's confidence in the government's administration of the collection and allocation of revenues.

Since general taxes may remain difficult to collect while the administrative apparatus is being improved, other sources of revenue must be pursued. These should include dividends from state enterprises, public tariffs and user fees, natural resource royalties, charges for environmental degradation, etc.

The intragovernmental jurisdiction of tax authorities (at the central and regional level) should be clarified. As a rule, revenues should be collected by the authority which is most efficient. Following this rule, high-income countries generally collect taxes and earmark them for transfer to local government as determined by law. This is probably not the case in Viet Nam, and is unlikely to be any time soon. Viet Nam should undertake to determine the most efficient government entity to collect tax revenues. However, tax revenues should be earmarked for the most part by the central government.

Third, the subsidization of state enterprises through excessive granting of credit must be rigorously controlled (see "State Enterprises" below).

(b) Low Savings and Investment

Although Vietnamese data on savings and investment are confusing, one can see that low national savings and investment is the structural cause for the country's poor growth record. While other Asian developing countries have average savings rates of 24% of GDP, the savings rate in Viet Nam was less than 6% until 1985 and negative in more recent years due to the frequent phenomenon of negative real interest rates [Table 5: Savings & Investment, 1985-1989]. Public savings have been generally negative, around -10% of the GDP before 1990, -2.1% in 1992 and likely -9% in 1993 due to a large fiscal deficit predicted for that year.

Table 5: Savings and Investment, 1985-1989

(In percent of GDP)

	'85	'86	'87	'88	'89
Investment	12.9	8.6	8	8.5	10
State Budget	8.4	4.1	3.5	3.9	6.3
Pub. Enterprises	2.5	2.5	2.5	2.1	0.5
Other Domestic	2	2	2	2	2
Foreign	0	0	0	0.5	1.2
Curr. Acct. Deficit	7.3	10.3	9.1	10.5	4.9
National Saving	5.6	-1.7	-1.1	-2	5.1

For years, Viet Nam's investment rate has been extremely low. At 10% of the GDP, it was equivalent to about half of the average of other Asian developing countries. Despite this scarcity of capital, Viet Nam has invested a major part of its resources in inefficient, centrally managed enterprises (59% in 1986 and 75% in 1989). Most of this investment is in heavy industries utilizing obsolete technologies. Infrastructure has been neglected; plants and equipment have not been maintained. This has resulted in low productivity. Until 1989, private investment was almost non-existent due to the government's prohibition of the private sector. There has been in recent years a reverse trend, but reliable data on the increased investment in the private sector are not readily available.

Preliminary estimates of savings and investment in 1992 indicate some progress (respectively 15% and 17% of GDP). But uncertainties about future government actions and economic reform handicap private investment. Consequently, most private investment is concentrated in short-term projects such as trade, services, and small and light manufacturing. With time, private investment may grow both in scope and in duration—but only if government policies remain favorable to the development of the private sector, and if financial intermediaries can play their critical role of bringing investors and savers together. To date, the absence of efficient financial intermediation has forced most investment to come directly from household savings.

As noted, the measured savings rate in Viet Nam is very low. The actual domestic savings rate in Viet Nam is unknown because most savings have been hedged in gold or U.S. dollars and thus fail to show up in the data. The reasons for this defensive behavior are legion but principally relate to inept government interest rate polices, a lack of diversified financial instruments, the absence of laws defining creditor rights, inadequate banking services (especially in rural areas), and insufficient regulation and oversight of financial institutions.

Following the monetary reform of 1989, which temporarily raised the deposit rate above the inflation rate, financial institutions attracted substantially more household savings. But most of the deposits were short-term, not exceeding three months. The collapse of many urban credit cooperatives in 1991 and 1992 (widely reported both in the local and international press) and increasing uncertainty about the viability of financial institutions pose serious obstacles to mobilizing household savings, traditionally the bulk of Vietnamese savings.

To mobilize domestic savings, a wide range of reforms needs to be designed and implemented to address the above-mentioned deficiencies. These reforms would take care to encourage both public and private savings. Public savings could be fostered through prudent management of current government expenditures, by strengthening the financial discipline of those state enterprises remaining in state hands, and by enhanced revenue mobilization. To increase private savings, depositors should be motivated by positive real interest rates to maintain deposit accounts with banks. A rural network of bank branches should be developed to better mobilize rural savings. The Vietnamese might look to the long history of successful cooperative finance in Scandinavia or that of community development credit unions in the U.S. for assistance in developing such a indigenous, community-based network. Priority should be given to the monitoring and regulation of financial institutions, diversification of financial instruments, and reinforcement of the legal framework to defend creditors' rights. First steps might include the formulation of regulations on collateral, check issuance and credit risk evaluation systems.

Public investment policies should follow strict cost-benefit evaluation criteria. Policies should be geared toward encouraging private investment, both domestic and foreign. Arrangements should be made with international and regional financial institutions for access to credit on reasonable conditions for the private sector, both in terms of domestic and foreign exchange requirements and working capital and equity requirements. Viet Nam should place particular emphasis on possibilities for investment from private sector promotion institutions such as the International Finance Corporation and the various investment guarantee organizations such as OPIC, Hermes, the U.S. Export-Import Bank, etc.

Private foreign investment should be facilitated by establishing a legal framework to support the implementation of the Foreign Investment Law. The greatest impediment to foreign investment now is the continuing conflict among various government jurisdictions and local Party authorities. This problem can be eliminated only through a transparent decision-making process and a system equally accessible to potential investors, foreign and domestic. There is a long history of organizational and administrative measures to achieve these results, particularly in Western Europe in the post-World War II period, from which Viet Nam can borrow. To encourage local and foreign investors, consideration should be given to providing relevant information concerning laws and regulations relating to domestic and export markets. Accurate information regarding technological specifications and on natural resource availability should also be provided.

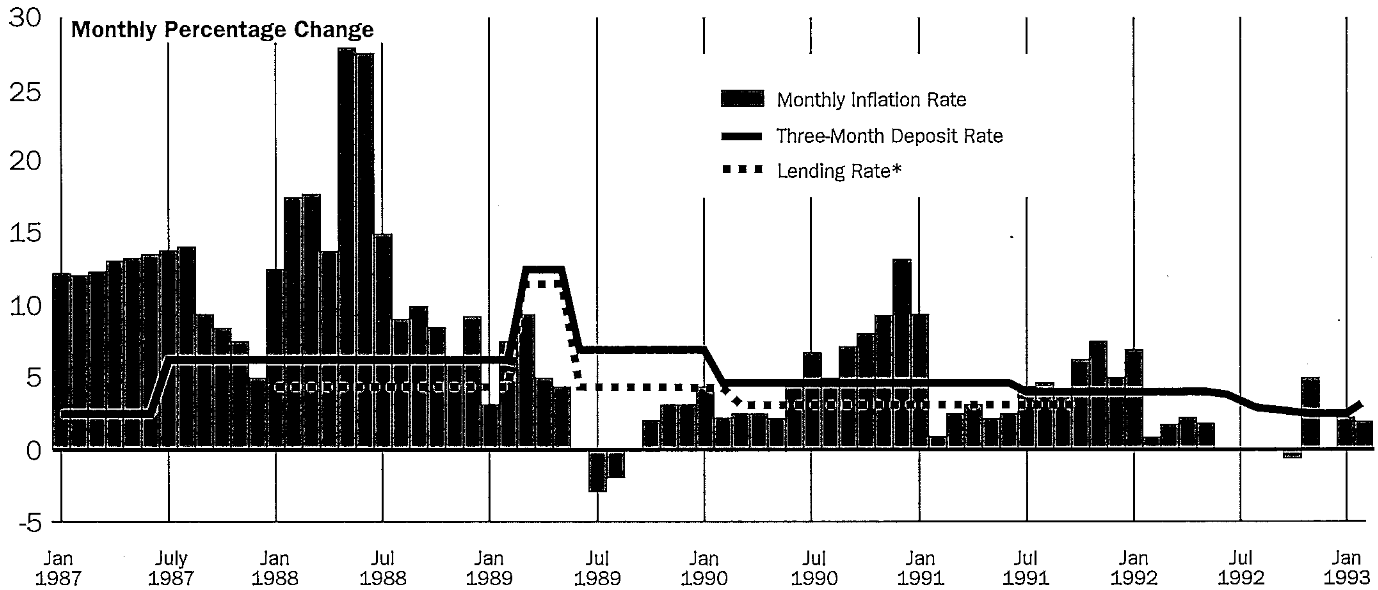
(c) Money and Credit Management

The archaic banking system in Viet Nam, in dire need of overhaul, suffers from its initial concept as a monolithic banking system, from poor performance and from a lack of competitiveness, particularly in relation to other Asian banks. Reforms initiated in 1988 aimed at creating a two-tiered system (a central bank and a commercial banking system) failed to deal with the fundamental problem of the central bank and its relationship to the central government and to commercial banks. Additional reforms did set up a multi-tiered system, but its actual implementation has been held up for years. The major issues now are to define the independence of the central bank in formulating monetary and credit policy, establish the legal business and banking framework, improve the payments system and prudently supervise commercial banks and the relationship between banks and SOEs.

Interest rates should reflect market forces. Deposit interest rates should be positive in real terms, and the remaining structure of interest rates should follow accordingly [Figure 5: Monthly Inflation and Interest Rates, 1987-1992]. The operational autonomy of the central bank should be assured and monetary authority should be clearly delineated from budgetary authority through the independence of the central bank.

Greater use should be made of monetary policy as the market economy develops. Appropriate policy tools such as reasonable reserve requirements, rediscounting, and

Figure 5: Monthly Inflation and Interest Rates, 1987-1992



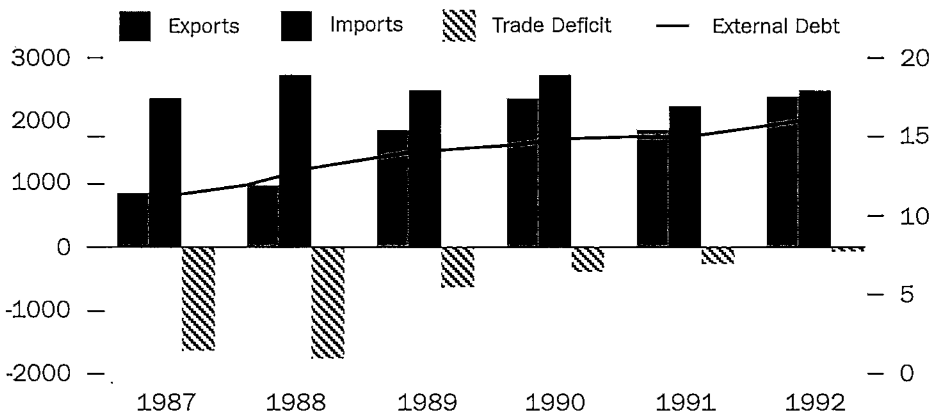
**Lending rate: Interest rate charged on working capital financing to trade and service sectors. Whenever available, the high range of the interest rate is recorded.*

open market operations should be introduced. Further improvements in the banking system include the development of a contemporary interbank system, the development and installation of appropriate bank accounting systems, and the provision for annual independent audits.

The expansion of domestic credit, particularly credit to the government and state enterprises, should be monitored to insure that large increases in such credit are averted, and that private sector credit needs are properly met. To attain this goal, annual financing programs should be prepared and maintained, with regular monitoring. Such programs should be consistent with real economic growth targets and inflationary and external current account constraints. Rather than relying on discretion, sensible rules for credit expansion should be established and followed.

The central bank's role as supervisor of the commercial banks can only be implemented through the establishment and enforcement of banking regulations. These regulations should provide for prudential supervision, an inter-bank payments system, status of credit cooperatives, etc.

Figure 6: External Balance, 1987-1992



Left Scale: Exports, Imports, Trade Deficit (in millions of US dollars)

Right Scale: External Debt (in billions of US dollars)

(d) External Deficit and Foreign Debt

Although in 1992 Viet Nam managed to considerably reduce its trade deficit, no relief is yet in sight from the pressure on the balance of payments. Viet Nam's current-account deficit in 1993 is estimated at over 5% of GDP [Figure 6: External Balance, 1987-1992].

As assistance from the Soviet bloc has dried up, Viet Nam has little prospect of a rapid turnaround in its balance of payments until other sources of external finance become available. Given the modest contribution from actual foreign investment (only US$120 million in 1990, $200 million in 1991, and $600 million in 1992), the external debt will remain a major constraint on the economy.

The run-up of Viet Nam's external debt occurred at an alarming rate after 1984, increasing more than 100% in six years. As of the end of 1992, Viet Nam's total external debt amounted to US$4.6 billion in convertible currencies and over R10 billion to the non-convertible area (mostly to the former Soviet Union's Russian Federation). Much of the hard currency debt will be soon rescheduled, and the value of the ruble debt must be settled by negotiations, given the rapid decline of the ruble exchange rate[3]. Nevertheless, debt service will remain a serious burden for Viet Nam [Table 6: Balance of Trade and Payments].

In recent years, Viet Nam has made a determined effort to repay some of the outstanding official debt; however, payments have been partial or late. More importantly, its record of short-term debt payment is also poor. Of the total amount of US$612 million owed by Viet Nam in short-term convertible currency debt, more than a third, US$212 million, is in arrears. Debt owed to international organizations is only US$284.4 million, of which US$109 million owed to the IMF in 1991 accrued to $140 million by 1993. A pool of Western creditors has now financed Viet Nam's repayment of this debt, making possible a new IMF credit. However, even with the lifting of the U.S. embargo, prospects for Viet Nam to get more external credit financing will not be as rosy as is generally supposed.

This external debt servicing is a heavy drain on the country's scarce resources. The government should seek to obtain rescheduling and debt-reduction agreements with its creditors and international lending institutions to see that commercial debt remains manageable. A final concern is the complex but weak control over foreign exchange by

Table 6: Balance of Trade and Payments, 1988-1992

Year	1988	1989	1990	1991	1992 (Est.)
Merchandise Trade Balance					
Exports	465	980	1290	1980	2250
Imports	600	985	1445	1755	1900
Trade Balance	-135	-5	-155	135	350
Services					
Export of Services	140	115	160	205	240
Interest Receipts	10	30	35	35	40
Import of Services	-115	-220	-360	-375	-345
Interest Payments	-220	-250	-270	-290	-230
Private Transfers (Net)	7	10	10	20	25
Official Transfers (Net)	13	0	110	110	120
Balance of Services, etc.	-165	-315	-315	-295	-150
Current Account Balance	-300	-320	-470	-160	200
Equity Investment (Net)	60	100	120	200	250
Net Credit from:					
IMF	10	-14	-7	-10	0
IBRD	0	0	0	0	0
ADB	0	-10	8	-2	-2
Official Bilateral	111	-152	207	10	20
Commercial Banks	15	15	367	-60	-20
Other Private Credits	117	28	31	100	120
Residual Lending	0	-18	-166	-146	-318
Errors and Omissions	12	448	-112	76	0
Change in Reserves: (- = increase)	-16	-77	22	-8	-250

the central government. Foreign exchange control is beyond the competence of an overburdened bureaucracy, and only liberalization can achieve stability and reduce corruption. The ultimate aim must be to scrap foreign exchange controls.

In the long term, only a resolute policy to promote exports will induce Viet Nam to impose the necessary discipline in production and management. While recognizing the long-term merit of a development strategy based on industry and industrial-based exports—and although there are good prospects for light industry exports based on local materials and the availability of low cost labor—Viet Nam now has a comparative advantage in agricultural and marine export products. For this reason, the modernization of the rural sector and the development of exports based on agribusiness could be a pragmatic solution for the medium term. Viet Nam was and continues to be an agricultural country. During the late 1970s and the early 1980s, economic development focused on the industrial sector at the expense of agriculture. These policies have been reversed during the past few years and, as result of these reforms, rice production has increased steadily to a total of almost 20 million metric tons in 1991, making Viet Nam the world's third largest exporter of rice, with over 1 million tons a year. This is already a base which should serve as a starting point for a modernization and development program. But Viet Nam has other reasons for making agriculture a priority. In fact, in many respects, rapid development of the agricultural sector can help increase food consumption (still at a low level, in spite of the increasing volume of rice exports), reduce the pressure from a high unemployment rate, and improve the potential for export of food, fuel, agricultural and agriculture-based products. The export surplus generated from the agricultural and rural sectors could serve as a starting point for the industrial development program to be implemented at the turn of the next century.

As part of an immediate effort to develop agriculture and improve the balance of trade, the government should assist the private sector in the promotion of agricultural exports through dissemination of information on international price and trading practices through packaging, marketing, and organization of trade fairs. Beyond these kinds of export promotion measures, experience has shown that export promotion is most successful when the government allows the private sector to take the initiative while focusing its efforts on improving the physical and legal infrastructure of the country.

The opportunities for exports to quota-free markets and the possibility of securing export quotas in other major markets should be pursued. Vietnamese exporters must learn to respond to the particular requirements of potential importers. These may range from specific niche markets to unique product specifications—or even to human rights concerns. Policy should build on the fact that Viet Nam, before communism, had a tradition of integration in the world economy and development of entrepreneurial skills which now must be reinvented.

If the country is not to depend on any single market, it is also necessary to diversify its production. Specifically, this diversification should be market-driven, with the state providing only the necessary infrastructure. Following the principle of equal treatment in market competition, imports should be liberalized without favoring those with import-export foreign exchange allocations for state-owned enterprises.

Tourism should be more carefully considered as a source of foreign exchange. An integrated tourism plan could be worked out and pursued, focusing on the physical and cultural attractions that the country can offer and profiting from the experience—good and bad—of neighboring ASEAN countries, particularly Thailand, Hong Kong and The Philippines.

Experience with Soviet project aid to modernize large-scale industry indicates that the country's absorptive capacity in capital-intensive manufacturing is low, and such projects generally are to be avoided. There is also a pressing need for coordinating foreign aid to avoid possible overlap or conflict between donors, and to optimize aid impact. An effective mechanism should be developed at both the central and local levels to coordinate all available bilateral and multilateral foreign aid. The government should employ strict cost-benefit criteria in negotiating and allocating foreign aid.

Table 7: Size of the Public Enterprise Sector, Selected Countries

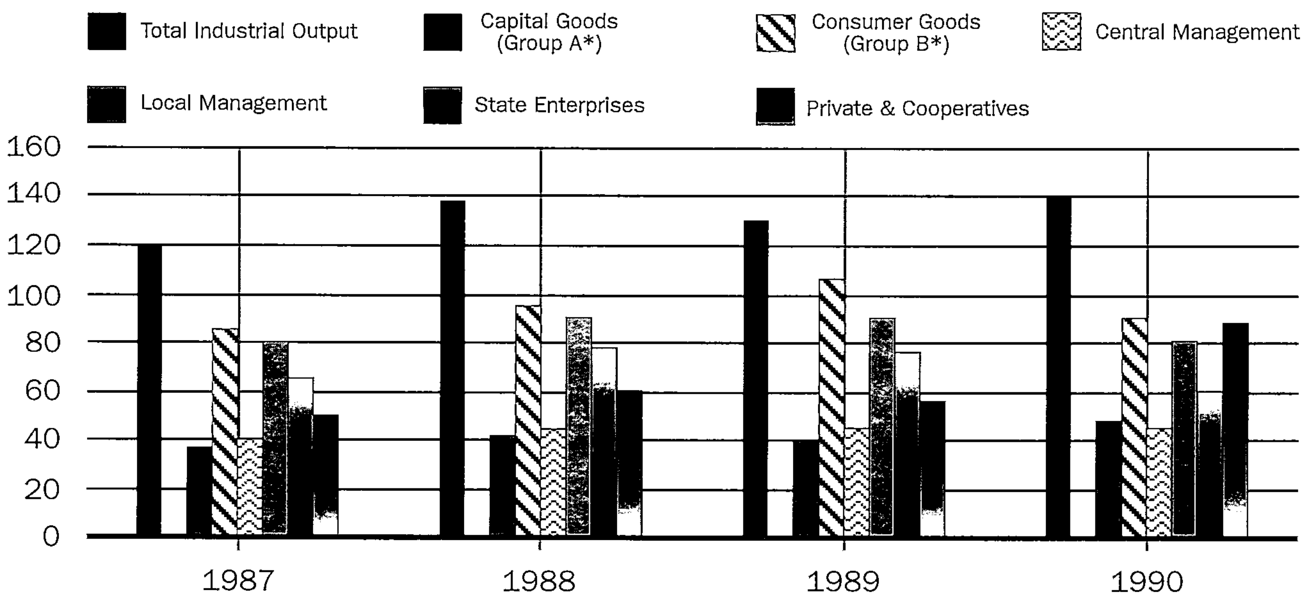
	Share of GDP (%)	Share of Labor Force (%)	Number of Enterprises
Viet Nam (1989)	**23.7**	**7.7**	**12084**
Industrial sector	10.5	2.8	3566
China (industrial sector)	57	45.6	104000
Hungary (1984)	65.2	70	-
Poland (1985)	81.7	71.5	9000
[Industrial sector]	40	23	5850
Soviet Union (1990)	80-90	-	55000
East Germany (1982)	96.5	94.2	-
Czechoslovakia (1986)	97	-	-
Laos	15	2	-
Malaysia (1987)	23.9	-	867

(e) State-Owned Enterprises

According to a 1990 survey, there were about 12,000 registered state enterprises operating (not counting those not registered but still operating with state-owned assets), ranging from large industrial concerns to small retail stores. Managing total assets estimated at $12 billion and employing some 2.3. million workers (7.7% of the labor force), the SOEs in Viet Nam have a relatively small impact on the national economy; therefore, the subsequent damage of their potential collapse may be less devastating than in former socialist countries. Their contribution to the GDP dropped from 33% before the reform to just above 23%, modest compared to Hungary (65%), Poland (71%), the former Soviet Union (80-90%) and Czechoslovakia (97%). [Table 7: Size of the Public Enterprise Sector, Selected Countries] Thirty-eight percent of these registered enterprises have suffered severe financial losses. These losing concerns employ almost 800,000 workers and manage 210.7 billion Dong in assets.

The state enterprises owned by central ministries (about 1,695 in 1990, among them close to 700 in the industrial sector) are the largest and are efficient by Vietnamese standards. According to the authorities, only 29.6% are losing money. The majority of medium and small enterprises belong to provincial and local administrations and the Party's apparatus (about 10,389). These smaller enterprises are much less efficient. Nevertheless, more of these enterprises are being created in the commercial and service sectors. About 40% of these enterprises are currently losing money, and 30% barely break even. Most profitable state enterprises enjoy preferential interest rates and extensive credit privileges: 96% of non-agricultural credit has gone to state enterprises. [Figure 7: Gross Industrial Output, 1987-1990]

Figure 7: Gross Industrial Output, 1987-1990



Total includes: Capital plus Consumer Goods, or Central plus Local Management or State plus Private Enterprise
*Group A: industrial units producing means of production. Group B: industrial units producing consumption goods.
(All figures are in billions of 1982 Dong.)

Problems facing the state enterprises are manifold:

- They are generally overcapitalized due to preferential availability of credit and other advantages. This results in a lack of financial discipline which can take the form of outright misuse of scarce resources. Vietnamese state enterprises have been provided substantially more investment than they can effectively absorb.

- They are generally grossly overstaffed, a legacy of the ambition to insure employment for everyone, particularly Party cadre.

- With the exception of a few enterprises geared toward exports, most state enterprises are still using obsolete technologies and equipment, which produce at very high cost. The products produced are often difficult to market because of their low quality.

- Most state enterprises are suffering from both the incompetence and corruption of managers. These chronic problems are compounded by the lack of delineation of responsibilities between state enterprise managers and the central and local governments and Party authorities.

Since late 1991, the government has made a genuine effort to reduce subsidies and to reform state enterprises by granting more autonomy to their management and requiring some financial discipline. So far, these efforts have brought little success. Since they face strong resistance from Party cadre managing these enterprises, the reforms could only be superficial.

Although state enterprise reform is considered a strategic priority, it would be difficult for Viet Nam to divest all state enterprises in the near future, even if the government chose to do so. As a matter of policy, it is nevertheless necessary to state clearly the objectives of the divestiture program as well as the steps envisioned for its implementation. These include assuring that state enterprises are not a burden to the government, organizing them on a corporate basis and restructuring them for eventual divestiture.

On one hand, those local state enterprises that cannot survive on their own must be disposed of rapidly. Those which are performing and which do not fall into a strategic classification will have to be reorganized in the medium term and sold to the private sector by local administrations. Current management and employees and the local population should be given preference in acquiring the assets. Appropriate techniques for establishing fair market values are important to prevent any individual or group from gaining an unfair advantage in the acquisition of state-owned assets. Appropriate techniques and machinery for the disposition of unnecessary and uneconomic enterprises should be established.

On the other hand, those centrally-owned state enterprises that are retained must be closely monitored by a central governmental agency and must learn to operate efficiently and economically. They could be strengthened by a system of incentives (using standard incentive mechanisms such as managerial compensation based on profits, production bonuses for workers, and so on). The overall guiding principle should be that state-owned enterprises must be able to survive using their own resources. Serious consideration should also be given to the portfolio of bad loans that have been advanced over the years to state enterprises. No new state-owned enterprises should be established, nor should the authorities allow local Party members to establish more companies with the ultimate purpose of misappropriating public assets as "equities" to generate quick profits for themselves (the "privatization" process of public assets transferred from state business to Party members).

f) High Unemployment and Underemployment

No official figures on current unemployment are available, but most unofficial sources estimate unemployed workers to number between 6 and 7 million, or about 20% of the total labor force in 1990. There is no doubt that the low level of investment is a long-term cause of high unemployment. The problem of unemployment is compounded by the phenomenon of under-employment in a backward agrarian society, estimated at around 45% in some rural areas in the North. (There are no nation-wide estimates.) Furthermore, the ongoing reduction in size of the civil service, partial demobilization of the armed forces, as well as the decrease in the number of locally managed state enterprises, have all contributed to increased unemployment and under-employment.

The expansion of the private sector has partly compensated for the state sector employment losses [**Table 8: Higher Job-Creation in the Non-State Sectors, 1988 and 1990**]. But this has not happened on a sufficient scale to prevent a substantial increase in unemployment. Furthermore, given the annual population growth rate of 2.2% or more and the age structure of the population, it is estimated that each year in this decade more than one million new workers will enter the job market.

Table 8: Higher Job Creation in the Non-State Sectors, 1988 and 1990

(in thousands of people)

	Total	Goods Producing Sector	Service Sector
State Sector:			
1988	4051	2710	1341
1990	3544	2288	1257
Non-State Sector:			
1988	24425	23786	639
1990	26152	25483	669
State Share of Total:			
1990	11.9%	8.2%	65.3%
Change in State Employment, 1988-1990:	-507	-422	-84
Change in Non- State Employment, 1988-1990:	+1726	+1697	+29

The unemployment problem constitutes a painful short-term constraint that should be taken into account when conducting economic reform in areas such as closing down uneconomic state-owned plants and factories. High unemployment, however, makes the reforms specified in this report all the more pressing. Without these economic reforms and others leading to a stronger private sector, job-creation prospects for Viet Nam will remain gloomy for a long time. On the other hand, unemployment and under-employment offer an opportunity to Viet Nam for rapid expansion. Given the industriousness of the Vietnamese people and the incentives that would be provided by a market economy, this labor reserve could provide international companies the opportunity to participate profitably and efficiently in investment in Viet Nam.

2. Lack of Supporting Infrastructure

From a strictly economic viewpoint, Viet Nam's economy may already have some of the characteristics of a market economy. But its transformation is fragmentary because of the inadequacy (or absence) of some basic elements of a market economy. These include Viet Nam's inadequate, poorly functioning legal system, deficient economic institutions and mismanagement, corruption and a decaying physical infrastructure.

(a) Inadequate Legal System

During the transitional period, the legal system deserves special attention. The country does not yet have an independent, impartial judiciary capable of insuring the rule of law and securing the trust of the people. All members of the judiciary are Party members, and the People's Committees charged with overseeing and implementing laws and regulations are tightly controlled by the Party. The new and revised Vietnamese Constitution kept intact Article 4 which states that the Party "is the only force leading the state and society and the main factor determining all successes of the Vietnamese Revolution."

In spite of Viet Nam's efforts to move toward a market economy, the authorities still refuse to recognize private property, specifically ownership of land. The private sector cannot develop without the state's full recognition and protection of private property rights.

Despite some improvement in administrative procedures and revision of the legal framework brought about by the enactment in 1990 and 1991 of the Company Law and other laws defining private property rights, the refinement of the tax code and the revision of the regulations governing employment, Viet Nam still lacks adequate commercial and labor codes and banking and bankruptcy laws.

Another major flaw that could distort the results of even the best-intentioned reforms is the lack of a competent and efficient public administration. The few professionals who are more or less knowledgeable are not always judged trustworthy by the Party, while loyal but incompetent Party members are given positions of responsibility. Most of them are unfamiliar with the functioning of a market economy, and therefore are not prepared for the implementation of reforms. Inadequate salaries, a lack of transparency in government procedures and uncertainty about the future have driven many into corruption. Corruption and the resulting inconsistencies in the application of laws and regulations continue to be major deterrents to investment. By all accounts, corruption throughout the country now exceeds its worst wartime levels.

A principal requisite for growth in Viet Nam is a legal system that is fair (providing equal treatment under the law), understood, and which recognizes the right to private property in all its traditional forms. The improvement of the legal system necessitates setting up new administrative mechanisms and procedures, necessary legislative as well as judicial mechanisms (especially in the settlement of commercial disputes) and most importantly, the training of persons responsible for implementation. The creation of a sound legal infrastructure, including a clear system of property rights, must receive high priority. The development process has been hobbled by the lack of warranty of property rights, undermining incentives to accumulate and maintain productive assets in the private sector.

(b) The Banking System

The banking system—the backbone of a working market economy—is in a transitional period in Viet Nam, but after three years of reform remains antiquated, underdeveloped and inefficient. As a result, domestic financial markets are practically inoperative. The reform program aims at establishing the framework for a two-tier system with the separation of central banking from commercial banking, the increased independence and diversified ownership of financial institutions, and the presence of private and foreign banks operating in a competitive environment. Beginning the reform in 1988, two commercial banks were created out of two credit departments of the State Bank of Viet Nam (SBVN). Two laws governing the state bank and other financial institutions were later promulgated in 1990; the decrees on the status and regulations of foreign banks were introduced in May and June 1991; other regulations on short-, medium- and long-term credits were also instituted by the SBVN in 1991. One positive aspect of the reform is the new role conceded to shareholding and foreign banks, creating a more competitive environment for the banking system.

However, the current system is highly concentrated, with the domestic banking sector overshadowed by state-owned banks. The system includes the SBVN, two SBVN-owned commercial banks (the Industrial and Commercial Bank of Viet Nam, or "Incombank," and the Agricultural Bank of Viet Nam), two state-owned specialized banks (the Bank of Foreign Trade, or "Vietcombank," and the Bank of Investment and Development of Viet Nam), 22 locally-owned banks (shareholding banks), an unknown number of urban and rural credit cooperatives, eight foreign bank branch offices, three joint-venture banks and 14 representative offices of foreign banks, including Citicorp and Bank of America.

Despite the reform, the financial sector remains unable to perform its required functions of resource mobilization and allocation. There are several reasons for this. First, in the formulation of monetary and credit policies, the SBVN remains tied to the government and the Party. The network of local branches of the state bank is closely connected with local Party apparatus. It remains, therefore, a source of subsidized credit.

Second, the state-owned banks lack the required management skills and organizational structure to perform their functions. Finally, successful financial intermediation requires the development of adequate supervision and regulation of banking practices, the upgrading of the payments system and a modern bank taxation policy. In the tangle of credit and monetary relationships, the largest borrower is currently the public sector, including the government and SOEs, and the largest lender, the government-controlled central bank; over 90% of the banking system's credit goes to the SOEs, and around 80% of the banking system's net credit to state businesses comes from the central bank. This heavy borrowing by the public sector has resulted in rapid increases of the money supply and is thus a source of price instability. For this reason, separation of the functions of SBVN—as a body of the government, an engine of money supply, a lender, a controller of credit mechanisms, etc.—is crucial to the economic reform.

The central bank should be entrusted with conducting monetary and credit policy, but should not be an equity investor in commercial banks. Policies related to interest rates and monetary control should be established as first priorities. Although the latest policy anticipated the impact of high inflation by raising real interest rates, the inflation component in the interest rate did not reflect actual price fluctuations. After a period of negative real interest rates, the economy today is hurt by high real interest rates. The access to capital is thus still limited for most investors.

A related issue is the lack of competition in the banking sector. The current banking law does not specifically prohibit excessive concentration of economic power in a single institution or state-owned bank; neither does it clearly attempt to increase competition in the banking sector, nor to promote equal treatment of public and private customers. Without freedom of entry and equal treatment, the private sector will be harmed by the bias of the SBVN, which likely will undermine competition and favor the state-owned banks' provincial network.

In conclusion, the strengthening of the banking institutions requires radical reforms aimed at: increasing the role and capability of the central bank in credit and monetary policy; restructuring SOEs; restructuring state commercial banks (to appraise their impact on banks' portfolios); implementing regulations related to the issues of property, accounting banking, payments systems, collateral and bankruptcy; upgrading the supervision and regulatory capacity of the state bank; and finally, revising the bank taxation policy to support the financial intermediation function of the banking sector.

(c) Decaying Physical Infrastructure

Viet Nam suffers from inadequate and increasingly deteriorating transportation and communications systems. Most highways, railways and waterways were built many decades ago and were partly destroyed during the war. Although some of them have been rebuilt since, the vast majority have been poorly maintained and are in extremely bad condition. Even more modern facilities built in the South have severely deteriorated.

It is obvious that Viet Nam currently lacks the means to finance necessary infrastructure investment. By making serious market-oriented reforms, many of which have already been discussed, Viet Nam could accomplish two objectives: first, and most important, it will make the economy more efficient and hence a more capable negotiating partner in contracting for the infrastructure it needs. Second, serious reforms will help Viet Nam convince the West and the developed Asian nations that its development strategy is realistic, and that it can be trusted to use foreign aid and credit responsibly.

Telecommunications, which remain a state monopoly, are antiquated and inadequate. Ha Noi's telephone system is basically the one left behind by the French in 1954, and Ho Chi Minh City still uses the one inherited in 1975. However, facilities and systems for external use have improved slightly in recent years since they provide quick and relatively safe paybacks in foreign currency. The government has a plan to increase the coverage of the telephone network by a factor of ten.

Improvement of the telecommunications system should have highest priority. Specifically, the government needs to set investment priorities to insure that telecommunications among distribution nodes and between distribution nodes and international telecommunication links are improved.

Viet Nam's transportation system is in a serious state of disrepair due to the country's shortage of foreign exchange. Its railroad rolling stock, trucks, busses, barges and port handling facilities have declined both in quantity and quality. Most of the waterways, especially those in the North, are heavily silted. Haiphong, the North's main port and Viet Nam's third city, now suffers particularly. In the South, the situation looks somewhat better. This did not come about as a result of a master plan to upgrade the country's physical infrastructure, but rather as a by-product of the tendency of local jurisdictions to take advantage of foreign trade opportunities.

Road improvement will be of crucial importance to facilitate the free flow of commodities and the economic and social integration of remote regions. All construction should conform to internationally recognized standards. Such construction should include plans for adequate maintenance and repair. It is urgent that responsibility for infrastructure improvement and maintenance be clearly defined among the central government, the provinces and the districts.

While the energy sector is crucial to economic recovery and development (currently accounting for a third of the country's export earnings), the mechanism to operate a market for energy is not in place, six years after the dismantling of central planning. Coordination between central ministries needs to be improved in order to define an energy policy that prevents resources from being wasted in surplus infrastructure. At the institutional level, improved managerial capability of large state-owned companies is also required to better adapt the energy sector's response to market mechanisms.

The identification, design and evaluation of public investment projects must be subject to intersectoral and intrasectoral scrutiny, in order to insure optimal utilization of scarce foreign exchange resources. Large capital projects must be examined and selected on the basis of cost-benefit analysis. The overall objective is the judicious support of an emerging market-oriented economy through the provision of the necessary infrastructure funding not available from the private sector.

3. Non-Economic Issues

The economic situation is also afflicted by non-economic factors, most obviously a monopoly of political power, the widening imbalance between North and South, and the weakening of the social fabric due to the poor quality of education, health, nutrition and sanitation services. The situation is further complicated by the fact that political power, previously centralized in a small group in the Politburo, is now diffused among many groups with different allegiances and agendas.

(a) The Politico-Economic Environment

In addition to the overarching issues of banking and legal systems, Viet Nam lacks other sound economic institutions to support the proper functioning of the market system. As in all other Communist countries, the lines between government and Party are not clearly defined. In such a situation it is extremely difficult—if not impossible—to monitor and coordinate the implementation of the reform program without the involvement of the Party apparatus. Actually, despite the official effort to reduce the Party's influence on the management of governmental agencies, all levels of government still have to rely constantly on the Party to exercise their authority.

In the political arena, the basic problem remains the determination of the conservative elements of the VCP to maintain the claim that the Communist Party alone is qualified to rule the country. There is no public admission by the leadership that it was precisely because of the Party's policies that the country's economy (and morale) was in shambles during most of the 1980s.

This claim of political monopoly is undermined by the collapse of communism in Europe and the Soviet Union and contributes to a continuing atmosphere of uncertainty. That is perhaps the most important non-economic factor of the current development equation. Such an environment is inhospitable to investment, especially long-term investment, and encourages capital flight and corruption.

(b) Imbalances Between North and South

The division of Viet Nam into North and South was rooted in the civil war between the Nguyen and the Trinh princes from the 17th to the 19th century, and was further aggravated by the French colonial regime, which divided Viet Nam into three parts with different administrative systems. Moreover, the division of the country in 1954 into two parts, each following a different political and economic system, added to the disparities between North and South that remain almost 20 years after the reunification of the country [Table 9: Regional Disparities, 1989].

The North-South divergence is the most critical of disparities and is reflected in every aspect of the Vietnamese economy. The population in the South had an annual per capita income in 1989 estimated at D683,000, twice the income of the population in the North, estimated at D345,000. Even in the Ha Noi-Haiphong area, where the population has an income equivalent to the national average (around D500,000 in 1989), it is nevertheless only 40% of the average per capita income of the population in the Ho Chi Minh City area. The North Central Coast, traditionally the poorest area in the country, has the lowest income level, about half of the national average and only 17% of that in the Ho Chi Minh City metropolitan area. In the Red River Delta agricultural area of the North, where population density is the highest, the per capita income is only 77.5% of the national average, and only two-thirds of the average per capita income of the Mekong Delta population in the South.

Notwithstanding three decades of heavy emphasis on industrial development in the North, even government statistics indicate that a larger share of total industrial output today comes from the South (53% of heavy industry and 65% of light industry against 47% of heavy industry and 33% of light industry from the North). Ho Chi Minh City is by far the most important industrial producer, accounting for 41% of total light industry output. Even state enterprises are more efficient in the South, accounting for about 65% of the total financial contribution of all state enterprises to the government budget.

In the South, output per worker averages 3.6 times that of the North in heavy industry, and 2.5 times in light industry. Thus the North accounts for 76% of total employment in heavy industry and 56% in light industry, in spite of the aforementioned differential in industrial output. mining, food processing, tourism and financial services, is also concentrated in the South, further accentuating the economic disparities between the two regions.

Table 9: Regional Disparities, 1989

	Population ('000)	GDP per capita (D'000)	Population per physician	Pupils per teacher	Per capita budget revenue (D'000)	Per capita budget expenditures (D'000)	Expenditure to Revenue ratio
Viet Nam	**63335**	**507**	**3929**	**26.7**	**44.1**	**31.3**	**0.71**
Northern Regions	31331	345	3155	24.8	30.1	29.2	1.2
Ha Noi-Haiphong	4504	518	2111	26.9	86.2	46.5	0.54
North Central Coast	7685	226	4581	24.8	19	27.1	1.7
Northern Mountains	10068	315	3124	22.1	23.1	30.3	1.31
Red River Delta	9074	393	3129	26.6	22	21.5	0.98
Southern Regions	32004	683	4969	27.9	37	34.2	0.75
Ho Chi Minh City & Environs	7797	1278	2882	29.5	128.4	44.2	0.34
Central Highlands	2490	243	6053	24	23.9	38.1	1.59
South Central Coast	7545	371	4545	27.2	32.2	26.5	0.82
Mekong Delta	14172	599	8513	30.8	41.6	32.2	0.78

In the North, economic incentives should be used to attract investment in infrastructure, transportation and communication. Viet Nam should explore incentive programs used in North America and Western Europe to attempt to assist underdeveloped regions. Training efforts should be intensified, especially in the North. Meanwhile, regional balance requires better implementation of the transmigration programs from North to South and to the Highlands.

C. Health, Education and Social Issues

In spite of Viet Nam's tradition of concern with social investment and mass education, the country today is plagued with serious deficiencies in social care, education and environmental protection.

The population of Viet Nam suffers from worse malnutrition—underweight (45%) and stunted (56%) children—than any other country in South Asia except Bangladesh. Recent improvements in food production were not accompanied by diversification of procurement or transportation and storage. As a result of these deficiencies and the rapid rate of population increase, people in many regions still suffer from chronic malnutrition.

Viet Nam has not invested in potable water systems or sewage treatment; only one-half of the urban population and one-third of rural households have access to potable water. With the decay of the pre-Communist water treatment system in the South, there are now no modern sewage treatment facilities in the entire country. The health care system is inadequate nationwide and non-existent in remote regions. Medical and surgical equipment are antiquated and in many cases barely functional. The quality of life and health of the population have been materially lowered by crowding, pollution, stress and occupational hazards. Although considered as better-equipped than Ha Noi, Ho Chi Minh City has one of the lowest living space allotments per capita in the world (3.1 persons per room).

Viet Nam also has a poor educational system—even by the standards of less developed countries—with inadequate curricula, unmotivated and poorly paid teachers (among the lowest-paid in Asia), high drop-out rates, crumbling school buildings and obsolete teaching equipment. As the economic situation deteriorated during the last decade, neglect spread into every aspect of the educational system.

As a result of this deplorable situation, the country's young population is underfed, much labor remains unskilled, urbanization is uncontrolled, juvenile crime is widespread, and the rural population lives under unsanitary and socially retarded conditions.

Although industrial development is very limited, Viet Nam has already encountered a series of environmental problems: numerous oil spills; siltation of the newly established hydroelectric project in Hoa Binh; coal mining and coal transportation techniques which contribute to land and water degradation; oil and water contamination due to defoliants; deforestation (forest cover is only 23% today, compared to 50% in pre-war years); particulate pollution in the coal-fired Ninh Binh power station; inadequate waste treatment facilities in the industrial projects in the South; the list, sadly, is long. Since 1991, to its credit, Viet Nam has been responsive to these issues and has benefited from international organizations' assistance in the adoption of a national plan for environmental development; however, the country needs better coordination between central ministries in dealing with industrial and environmental development strategies and a better understanding of environmental technology.

In the final analysis, even the most spectacular production gains are of little relevance until and unless the benefits are accessible to the people. Part of this poverty alleviation must come through the provision of more and better social services.

While many of these social problems have other root causes, their severity is magnified by population pressures [Table 10: Population Growth, 1960-1991]. Therefore, an immediate objective for social policy is a better family planning program. The authors of this report believe, however, that only through an effective economic development program—one that lifts actual living standards and changes life-styles—can the problem of population be ultimately, successfully addressed.

The desired objective over the long term is balanced growth between urban and rural areas and the modernization of rural communities (which implies the adequate delivery of services in the fields of family planning, education, health, nutrition, and housing).

Table 10: Population Growth, 1960-1991

Year	Population ('000)	Growth Rate
1960	30172	3.93
1970	41063	3.24
1979	52742	2.16
1989	64412	2.1
1990	66233	2.83
1991	67678	2.18

Public investment in health care, nutrition and education may not bring about quick or spectacular payback, but it is crucial to the long-term health of the economy and, more importantly, to that of the society as a whole. In seeking to expand and improve the quality of health and education at all levels, the government should target poor regions, allow a greater role for the private sector in tertiary and vocational education, and utilize decentralized management in public health programs.

The recent increase in food production has not been accompanied by better systems of food procurement, transportation and distribution. As a consequence, short-term measures—even supplementary food programs—are needed to avert faltering growth among young children in several rural areas. In the medium term, income growth can be expected to eradicate malnutrition and improve health.

It is also important that Viet Nam avoid the problems that have plagued other societies in transition when certain segments of the population have been left behind. In no small part, Viet Nam can depend upon its extended-family institution to provide assistance for many individuals who require transitional support. While the establishment of certain social programs will be necessary, such programs should be only in response to a demonstrated need, and should be designed to avoid the mistakes that have been made by virtually all of the Western democracies.

With respect to the implementation of the poverty alleviation program, social services should be undertaken primarily by local authorities and, whenever possible, through voluntary action. As an alternative to a public poverty alleviation program (which has well-known shortcomings), a "Social Investment Fund" could be established in response to local needs and implemented by non-governmental organizations and local authorities. If the government succeeds in overcoming the current barriers to cooperation with the Vietnamese overseas community, the contribution of Vietnamese ethnic expatriates in this area could be substantial.

Transfer of technology, education and training can best be achieved by the private sector through investment and trade. However, there is also room for a vastly expanded program of technical assistance on the state-to-state level. Vietnamese professionals can profit from a program of international exchanges, both in the private and public sectors. To reduce their resistance to reform, it is important to retrain and equip cadre with the appropriate skills for a market economy. The potential contribution of Vietnamese expatriates in this respect is obvious and critical. Their cooperation requires the government to make a serious effort to provide a healthy political and economic environment. Only that will induce them to contribute effectively both their talent and capital to the cause of economic development and pluralism in Viet Nam.

In conclusion, in assessing the current situation, we have identified these areas of concern:

- Budget deficit, inflation and public finance
- Deficient investment and savings
- An archaic banking system
- A trade deficit and large foreign debt
- Dysfunctional state enterprises
- High unemployment and underemployment
- Inadequate legal system and deficient institutions
- Decaying physical infrastructure

- Regional inequities
- Public health, education and social issues

Besides sharing the major macroeconomic problems of most developing countries, Viet Nam suffers from specific ills resulting from decades of communism. These issues are neither new nor newly discovered. In fact, the Vietnamese authorities, on many past occasions, have identified and tried to address some of them. For the most part, the solutions were undermined by the rigidity of the system, as well as by its own cadre at different levels; results were mixed. For this reason, a more comprehensive approach is needed.

Imperatives for Viet Nam's Economic Development

Lagging behind other Asian countries in modernization and economic development, Viet Nam has no choice but to adopt a decisive outward-looking strategy [Table 11: Viet Nam and its Asian Neighbors, Per Capita GDP]. Obviously, for such a strategy to succeed in a poor country like Viet Nam (trying to catch up with other countries already on the road to development), the requirements are multiple.

In the preceding paragraphs, we have made a series of assessments and suggestions aiming at transforming remnants of the command economy in Viet Nam. Our recommendations are based on the necessity of meeting the basic requirements of the situation in Viet Nam. They are 1) stabilizing the macroeconomic situation through addressing the issues of budget deficit, low investment and savings, financial and banking reform, external deficit, legal and institutional reforms, 2) developing the human and natural resources, the social integration and the physical infrastructure, in order to 3) build up a sound base for future development.

Finally, Viet Nam should pursue a policy of integration into the South East Asian sector of the global economy through membership in the ASEAN, and should make serious efforts to promote exports—manufactured goods, natural resources, and agricultural products. For this strategy to work, the country has to improve its trade and exchange policies and to modernize and develop its agricultural sector as a part and the first essential step of an export-led development program.

It bears repeating that, by its geographic location in South East Asia, Viet Nam is at the center of the most dynamic region of the world economy. The most evident need for Viet Nam, in both political and economic terms, is to have good trade relations with its neighbors. With the exception of Cambodia, Laos and China, its neighbors belong to ASEAN, a group of new countries which emerged as a regional organization representing the interests of the six countries (Thailand, Malaysia, Singapore, Indonesia, Philippines, Brunei) that form a circle around Viet Nam. Still loosely structured and with some disagreement about immediate goals, the ASEAN organization has been successful in helping to bring about a peaceful end to the war in Cambodia and was particularly active in promoting regional cooperation and trade relations between the countries in South East Asia and Asia and the rest of the world. ASEAN also has a decisive role representing and helping the smaller South East Asian economies in dealing with their major donor and neighbor, Japan, and with China, which poses problems for the region as a whole and for individual countries in South East Asia, particularly Viet Nam. In such an environ-

Table 11: Viet Nam and its Asian Neighbors: Comparison of Per Capita GDP

GDP per Capita, in US$

		1988	1989	1990
1	**Viet Nam (1*)**	**186**	**196**	**202**
	Viet Nam (2*)	**-**	**95.3**	**98**
2	Bangladesh (3*)	174.6	185.3	192.1
3	Myanmar (3*)	299.3	408.9	449.5
4	China (4*)	330	360	-
5	Pakistan (3*)	335.9	344.8	354.6
6	India (3*)	356.3	336.1	-
7	Srilanka	414.6	409.7	456.3
8	Indonesia	479.8	524.5	-
9	Philippines	666.9	739.5	765.6
10	West Samoa	731.6	671.7	-
11	Vanuatu	959.6	911.9	-
12	Papua Guinea	1017.9	967.4	888.7
13	Thailand	1092.4	1256.6	1444.6
14	Fiji	1495.5	1672.6	1900.2
15	South Korea	4167.2	5025.3	5603.5
16	Taiwan	6199.7	7347.6	7726.7
17	Singapore	9319.5	10719	15241
18	Hong Kong	9790	10919	12087

(1*) Converted GDP per capita from Vietnamese Dong to US$ based upon the FOB export price of the most representative export products and export potentials.
(2*) Converted GDP per capita from Dong to US$ based upon the yearly average of the official exchange rate. Method applied by other countries.
(3*) Fiscal year.
(4*) GNP per capita.

ment, Viet Nam cannot afford to avoid seeking integration into this sector of the global economy—an integration that is even more necessary if Viet Nam is to pursue an export-led growth policy. For that purpose, it will need not only transfers of capital and technology, but also intra-regional trading arrangements.

Just as the ASEAN nations have found their relationship with the U.S. critical—both for economic and political reasons—Vietnamese leadership must continue to pursue an effort to normalize and expand relations with the U.S. As we have indicated, our report does not bear out the long-standing official line from Ha Noi and other interested parties in the U.S. that the American trade embargo has been the quintessential impediment to the development of the economy of Viet Nam. But it is clear that trading relations with the U.S. would contribute to its integration into the world economy just as it has for the other Southeast nations as well as Japan, South Korea, Taiwan and, more recently, China. American markets and transfer of American technology are essential for a rapidly developing Viet Nam.

Pragmatism requires, then, that Vietnamese leadership accept the obvious political constraints that will be placed on any U.S. leadership in its dealings with Ha Noi. President Clinton has already made it abundantly clear that he believes expansion of trade and investment opportunities must go forward hand-in-hand with the promotion of an American agenda for human rights and democracy. At the United Nations on September 28, 1993, he said: "In a new era of peril and opportunity, our overriding purpose must be to expand and strengthen the world's community of market-based democracies ... They make more reliable partners in trade, in diplomacy, and in the stewardship of our global environment." That will be certainly the case with Viet Nam, where there will be strong domestic pressure on any administration to relate any U.S. aid and trade package for Viet Nam to guarantees for political liberalization.

In closing this list of guidelines for reforms and suggestions for priorities, it is worth mentioning that, while specifics may vary from one country to another, general requirements for successful economic reform always include at least the following:

- *Commitment to reform.* Successful economic reform always requires painful adjustments. Therefore, it must be backed up by a strong commitment by the political leadership to proceed with the entire reform package. Though flexibility is important, frequent policy reversals are detrimental to the credibility of the reforming authorities.
- *Comprehensive reforms.* Since partial efforts at reform are ineffective, there is no substitute for simultaneous and complementary reform measures.

Conclusion

This report has sought to give a realistic assessment of current economic conditions in Viet Nam, to suggest a series of policies designed to correct short-term macroeconomic imbalances, and to present guidelines for using administrative reform to create a structure that will support Viet Nam's transition to a market economy.

If Viet Nam is to fulfill its potential for providing a healthy and prosperous life for its people, these reforms must be drastic and must be part of a consistent long-term strategy aimed at rapid economic growth. Moreover, the authors of this report insist that such a long-term strategy can succeed only if it, in turn, is part of a program for a fully-integrated Vietnamese society built on a broad social consensus. Only popular broad consensus will support successfully that regime that undertakes what at times will be painful measures.

To build such a consensus, Vietnamese leadership must take into account today's prevailing social and economic disparities: between the disadvantaged majority and the privileged minority represented by the Party's elite, between rich and poor, North and South, victors and vanquished, urban and rural, modern and traditional. With so much of its history dominated by conflict, Viet Nam is extremely vulnerable to social and regional disruptions that can lead to widespread violence—even at a foreseeable future date when economic development is at last proceeding apace. The recent history of several former Communist countries demonstrates how critical it is for stability to recognize and address these volatile disparities.

It is therefore essential that Viet Nam follow its own carefully considered path toward development. Other nations' experiences may be valuable to study more for what should *not* be done than for what should be done. In a country with such vast regional differences and such a long history of conflict, it is essential that efforts be made to distribute the gains of economic growth. By using indirect incentives (taxes, infrastructure investment, etc.) the central government can attract private sector initiative and investment nationwide, without neglecting backward areas. Through policies that encourage a level playing field for foreign and domestic investors alike, the government can assure Viet Nam's more rapid integration into the world economy, with all that this means in the transfer of capital and technology.

There must be a balance between private and public investment. Better health care, nutrition, and education may not bring immediate economic results, but they are essential objectives for society as a whole. In the struggle to reduce poverty, the government must emphasize raising the level of agricultural productivity as the most practical social welfare safety net in an underdeveloped economy, and as the shortest route to an improved standard of living for the largest number of people.

Last, but not least, it would be a tremendous waste (that may be very costly to a developing Viet Nam) for the government to fail to employ the skills of the two million Vietnamese living abroad. Their potential for assisting an economic development program is incalculable: they have lived—and, for the most part have shown enormous adaptability—in a variety of foreign cultures. They have learned to take advantage of free markets and the opportunities offered by the social infrastructure of more developed economies, including educational opportunities. They have witnessed and participated in economic prosperity, complex societies governed by law, and the arts. Many are successful entrepreneurs, scientists, managers, technicians and international public servants, possessing precisely the skills needed by Viet Nam in building a pluralistic, free market society.

However, their role remains problematic. Despite their expertise and willingness to participate in the development of Viet Nam, the majority agrees that economic development must be accompanied by a more appropriate political environment if they are to participate meaningfully. A transparent, representational government and a free society are the *sine qua non* of such an environment.

The demands of the overseas community are, in the end, only concomitants of what the authors of this report consider the basis of a successful development program in Viet Nam. Fundamental to such a program must be stability. That, in turn, can only be achieved through a firm resolve to proceed with drastic reform on the basis of a political consensus. That political consensus, in turn, requires that the Vietnamese people have a sense of confidence in a future that they themselves—not a small elite—will determine.

Notes

[1] *The Deputy Prime Minister initially estimated a trade surplus of $150 million. Subsequently, the Ministry of Commerce estimated a surplus of $50 million. However, in April, estimate revisions to the trade data published in the Statistical Yearbook showed a deficit of $31 million.*

[2] *Internal rice distribution has not improved, which explains why hunger remains a problem in the Center and certain Northern provinces, despite large rice exports. Before World War II, Viet Nam was traditionally the world's second-largest rice exporter.*

[3] *For figures prior to 1990-91, the Vietnamese authorities assumed an equivalence between dollars and rubles.*

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