The Current Economic Challenge to Vietnam

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Vietnam, the thirteenth largest country in the world in terms of population, is referred to as a "transitional economy" a phrase which is also meant to apply to parts of the former Soviet empire and the People's Republic of China and which implies, of course, that these countries are involved in major structural and institutional shifts away from long experiments with centrally controlled socialism. For Vietnam the beginning of the transition is often dated with the Sixth Party conference in December 1986 which voiced public criticisms of the country's central planners, their state enterprises and the alarming rate of price inflation (Vo 1990:243).

As in the Soviet Union the long experiments with central economic control, the rejection of competitive markets as allocational guides, and the restrictions on most trade and investment from the West had left Vietnam with an economic system that was functioning poorly (Marr 1988; Tran 1994). The problems were aggravated by drought and the costs of the country's cruelly prolonged wars.

This is the poorest of the countries categorized as transitional. The people of Vietnam are estimated to be about half as wealthy, on average, as the Chinese (EIU 1997). Estimates of purchasing power parity suggest that the Vietnamese economy would have to grow about 7% per year in excess of population growth for more than 20 years to make its people on average as wealthy as the people of Thailand are at present (with the Thais currently about one-fourth as wealthy as the Japanese) (World Bank 1996).

But poverty has many dimensions and Vietnam scores much closer to

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Thailand in terms of literacy, infant mortality and access to health services and is credited with a more equitable distribution of income than exists in Thailand (UNDP 1996). This paper analyzes Vietnam's economic path since 1986, compares its current economic situation with its neighbors, and reflects on the government's stated aim of advancing a new vision of international socialism into the 21st century (Tran 1994:78).

Fast growing neighbors as a model.

The comparison of the Vietnamese economy to its neighbors is especially interesting because some economies in that neighborhood have grown in recent years with unprecedented speed and their histories remind us that much is possible. On the other hand recent slowdowns in regional growth rates provide lessons regarding threats to sustained growth in an integrated world economy and suggest uncertainties regarding the economic wisdom of some government policies and institutional developments. But while there is disagreement about the causes of the present downturns in East Asian economies and over the appropriateness of remedies to be provided, there are important areas of consensus with regard to some of the factors which have contributed to the recent economic growth in that region (Wade 1990; World Bank 1993). Four contributing factors are regularly identified.

1. The first is a *strong reliance on competitive markets* with openness of entry for new economic enterprises and flexible prices. This reliance is seen to have contributed in a major way to efficiency and rising productivity. Not that all prices have been competitively determined, but that "market forces" have often been the instruments which have provided incentives for hard work and creativity and the impetus for the movement of goods and people toward uses which have increasingly satisfied peoples' needs. The government's role in establishing infrastructure and the sequencing of industrial structure have been (by and large) determined by responses to market pressures and not dictated by ideological prescript.

(The efficacy of such a course of action is what Western economic theorists have maintained ever since Adam Smith but the rapid conversion of so many national policy makers is remarkable given the enthusiasm and religious zeal with which alternatives to competitive markets were sought and tried out during the first eight decades of this century. Today the government of Vietnam like that of China declares its acceptance of market dogmas while repeating (at least in a formal way) some of the familiar negative accusations against capitalism in respect, for example, to distributional equity and life quality (Tran 1994:78). Thus the issue is kept alive as to whether the precipitous conquest of socialist tenets by the advocates of capitalism in the past two decades may have oversold capitalism in terms of, for example, equity or the preservation of the planet's physical resources for posterity. But the rapid economic development and impressive maintenance of distributional equity in South Korea, Taiwan, Hong Kong and Singapore--as well as in Japan--give powerful encouragement to an increasing reliance on market forces as does the zeal with which governments from Warsaw to Beijing to Hanoi are joining the chorus of advocates of competitive markets.)

2. The second generalization regarding East Asia's rapid economic growth--almost as widely accepted--is that a prosperous economy needs to be *an open economy* willing to buy from and sell to the rest of the world at prices determined in competitive global markets. Again the schoolbook premises about comparative advantage and free trade have been reinforced as the most rapid growth in low-income areas has taken place where trade restrictions have been least intrusive. The East Asian high performers have gradually but persistently opened their markets and the rapid increase in their exports to the rest of the world is seen as a major contributor to their success.

A corollary to this is openness to foreign investment, the inflow of capital from overseas motivated by the search for commercial profits. Foreign ownership of a country's capital raises--and has always raised--fears regarding the possibilities of "dependence," abuse by foreigners and exploitation, witness the recent statements of Malaysia's Prime Minister. But there seems little doubt that the increasing openness to foreign capital inflows has contributed to the unprecedented economic successes of the region. This seems to be a conclusion that is widely accepted so that the principle function of the foreign embassies of low-income countries is now to advertise for prospective investors. And the governments which these embassies represent are aggressive in their zeal to bend their tax laws with heavy sacrifices aimed at the attraction of foreign capital.

Maybe fears of foreign exploitation were exaggerated in the first place--or perhaps the world has changed during the 20th century so that the improvements in transportation and communication have opened international commerce to the kind of effective competition that Adam Smith dreamed of when he spoke of the guidance of an "invisible hand." Today the attributions of harm to foreign investors lie more in problems associated with the extreme liquidity of international capital flows threatening the stability of growth rather than in the legitimacy of ownership rights in other people's "means of production."

3. The third factor contributing to the growth of the East Asian economic miracle workers as popularly perceived has been *stability of their governments*. Not that all stable governments have guided their countries to economic success, witness North Korea or Burma. But the absence of a strong and efficient governmental apparatus has ordinarily insured economic weakness. Robert Wade's distinction between "hard" and "soft" states seems useful in this regard. Hard states, he says, are those whose governments have the capacity to resist public demands and can actively shape their economies. Soft states, by contrast, must register the changing demands of social groups and must respond to them. Wade argues that the relative hardness of states of East Asia has contributed to their finding and following successful paths to rapid growth. The strength of the governments in those states he saw as a consequence of their historic situation (specifically their having to respond to serious internal social dislocations while under foreign military threat) and because they possessed a tradition of bureaucratic integrity:a well-trained corps of civil servants, skillful leaders, and circumstances in which the bureaucrats were fairly independent of "existing bases of social control." (Wade 1990:337-8).

Wade's generalizations seem helpful. While the governments of the successful economies of East Asia have varied in their enthusiasm for controlling, protecting, and shepherding economic activity, they have been quick on their feet and both willing and politically able to change course when appropriate and able to abandon experiments that did not fulfill expectations. The relative independence of government bureaucrats from pre-existent sources of social and political power and thus their ability to pursue goals without continuous sidetracking in acknowledgment of "democratic" pressures or falling victim to bias or corruption seem crucial elements in explaining the economic successes as these have been interpreted.

4. Fourthly, and finally, their *systems of universal education* have provided a major contributing factor to these national economic success stories. Starting with universal primary education and then expanding into secondary and vocational facilities the achievements have been impressive so that even the wealthiest countries of the world look with envy and seek to learn the lessons inherent in their programs. The educational achievements operate in harmony with the advantages noted above preparing people to respond efficiently to market opportunities, dispersing widely the inflow of new ideas, and providing the personnel for a competent governmental bureaucracy. Moreover, the equality of educational opportunity contributes to political stability.

Factors other than these four were, of course, also relevant to the extraordinary performances in East Asia. For example, with regard to the issue of distributional equity it was important that these countries were pressured to redistribute wealth especially land as they emerged from the milieu of the Second World War. Facilitating their growth were military alliances and support from the US and the fact that they emerged at a moment in history when world trade was about to begin an unprecedented expansion.

While the recent histories of Indonesia, Malaysia, and Thailand are often said to provide additional, parallel evidence in support for the four generalizations about fast growth, the slow economic growth of the Philippines is cited to show the negative consequences that flow from violations of those principles. The Philippines is located at the heart of this economically hyperactive part of the world and boasts a rate of literacy among the highest in Asia. But it has been remarkably unsuccessful in its efforts to generate economic growth. The cause is attributed to "inward-looking" governmental policies which provided too much protection too long to an inefficient but immensely wealthy elite. The governmental bureaucracy has been judged "overbearing and expensive" rather than efficient and flexible (*The Economist*, 11 May, 1996). Concentrations of wealth have persisted as has widespread poverty for the vast majority and one of the highest birth rates in East Asia. When, in the last two years of the Ramos presidency, the country shifted towards greater openness and expanded international competition, the economy seemed ready to grow again. But as the distribution of wealth among Filipinos remains grossly unequal and the rate of population growth unsustainably high, the obstacles to continued success are formidable.

Vietnam

There would seem to be plenty of lessons to be learned from these histories regarding policies and institutions conducive to economic growth in the modern world. And Vietnam's challenge in the charting of its new course might be seen as choosing the good and rejecting the bad from a set of historical precedents without equal in their currency and applicability. But strong differences are obvious. Vietnam contains as many people as the combined populations of South Korea, Taiwan, Singapore and Hong Kong and its density of land occupation is comparable to a province of eastern China. With population growth of a million per year and with 70% of its workers in agriculture, it shares some of the characteristics of countries in southern Asia and sub-Saharan Africa where obstacles to development have proven most intractable (Fforde 1987).

What is the record thus far? In 1987 Vietnam began its formal departure from Soviet-style central planning and centralized economic controls (Dodsworth 1996; Gates 1995). Prices and wages were gradually freed to respond to market pressures. The collectivization of farms which had been pushed to near 100% in the North and had been extended into the South after 1975 was systematically reduced after 1987. Farmland was "returned to the tillers" and the movement toward state ownership of industrial enterprises was reversed (Hiebert 1993).

The economy responded with remarkable energy. Between 1987 and 1992 agricultural output increased nearly 40%. Foreign trade expanded rapidly with Vietnam becoming a net exporter of rice, and total exports (by 1996) grew to 36% of its GDP. Already by 1993 Vietnam had the highest ratio of net foreign investment to GDP of any country in the world and that GDP was growing at a sustained rate of more than 8% per year (EIU 1997).

If this growth rate could be sustained Vietnam would be on its way to emulating those of its East Asian neighbors which have grown fastest. What are its chances? The search for an answer brings into focus some of the major themes of Western economic theory, the policies of organizations like the IMF, and the struggle to identify (ideologically and practically) the direction which Vietnam chooses to adopt for itself. In this investigation three areas of governmental accomplishment are clearly relevant:the government's capacity to maintain relative price stability so that its domestic markets can accomplish their allocational and incentive functions, the establishment of a credible rate of exchange for Vietnam's currency in furtherance of international commerce and investment, and the government's ability to resolve the problems of its state-owned enterprises.

The fight against inflation. Governments are tempted to pursue inflationary policies as a way for them to acquire wealth without the necessity of collecting taxes. There are three reasons usually given as to why they should resist the temptation. First, it is obvious from history that there is a rate of price increase which is so high that it impedes the normal functions of the country's commercial and political institutions, therefore, the argument goes, any inflation should be avoided because of the fear that it might get worse and wreck the economy. A second argument reminds that inflation at any rate redistributes wealth and will for this reason be opposed at least by those from whom the wealth is taken. A third objection to inflation--the most relevant to Vietnam's current situation--is that (with a fixed exchange rate) rising domestic prices encourage imports and discourage production for export. This leads to deficits in the international balance of payments which, in turn, interferes with a country's smooth incorporation of things and ideas from abroad.

Inflation in Vietnam was clocked at 394% in 1988--a rate to be reckoned with under any circumstances (Dodsworth, 1996:20) and this was at a time when the country's problems were intensified by the collapse of Soviet commercial ties and aid flows. Nevertheless by 1993 the rate of inflation in Vietnam had been reduced to an innocuous 5%. The result was achieved by a severe tightening of the country's money supply and by rigorous modifications in fiscal policy including expansion of tax revenues and reductions in government spending. While these are the kinds of policies that are frequently recommended by outsiders (including the IMF and the World Bank), they are also the kinds of policies that incite popular opposition. Wealth is shifted from previously protected groups, higher interest rates reduce investment and increase unemployment, and jobs are lost at enterprises dependent on government transfers (Hiebert, 1993:133). In its speedy reduction of the rate of inflation Vietnam's government evidenced both determination in its policy direction and its political prowess. Many governments could not have done it.

Exchange rate policy. The government of Vietnam also pursued tough-minded policies with respect to the country's foreign exchange rate. Before the 1987 reforms Vietnamese trade was primarily limited to its CMEA partners and included mostly commodity flows decided on in inter-governmental agreements shielded from most world markets and from market forces in general. The exchange rate was rigidly controlled as part of these agreements--and was seriously overvalued--and imports were discouraged by quotas and licenses. (Dodsworth, 1996:chs. 6-7)

Beginning in the late 1980s Vietnam's trade was gradually opened to the world and Vietnamese oil, rice, garments and other light manufactured goods and coffee moved increasingly into world markets. Individual buyers and sellers within Vietnam began establishing commercial contacts with foreigners and from 1990 to 1994 both exports and imports expanded by more than 20%

per year. Import restrictions were reduced although they remain significant and are criticized as methods of providing favoritism to those with state affiliation (Pham, 1995:34; *The Economist* 8 July 1995; EIU, 1997:11). This increased openness to foreign commerce was accompanied by a gradual reduction in the value of the Vietnamese dong and by a set of accommodating monetary and fiscal policies. The exchange rate was devalued in September 1988 (900 per U.S. dollar) but the "parallel" exchange rate (4000 per U.S. dollar) continued to reflect substantial overvaluation. The public was given increased rights to hold and use foreign currencies and in August 1991 the government permitted the purchase and sale of foreign currencies on "trading floors" in Ho Chi Minh City and Hanoi under conditions which were meaningfully competitive and largely uncontrolled. The official reference rate is now adjusted daily and has been pressured to lower levels in 1997 and 1998 in response to devaluations by some of Vietnam's major trade competitors (EIU, 1998:27). As suggested above the devaluations of the dong were accompanied by fiscal and monetary polices which were sufficiently restrictive to prevent the reemergence of inflationary pressures which would have offset them. (Dodsworth, 1996:38)

The kind of exchange rate adjustment which the Vietnamese government engineered has been undertaken in many countries during recent decades. In many cases and certainly in most transitional economies such programs have generated heavy popular criticism. Currency devaluation hurts various individuals quite directly. A controlled and overvalued foreign exchange regime is profitable to individuals and firms who are privileged to acquire the foreign exchange and to spend at the artificially attractive rate. They will resist its removal. The public too is likely to see a falling exchange rate primarily as a reduction in its capacity to buy cheap imports, and popular opposition to devaluations seem universal despite the fact that an overvalued rate fosters trade deficits and encourages inefficient productive methods. Vietnam's capacity to engineer a rapid devaluation despite these inherent obstacles demonstrates again both bureaucratic power and determination .

The phase-out of state enterprises. The government of Vietnam evidenced a similar combination of capabilities in the early stages of its program to reduce its commitment to its state-owned enterprises. The contraction and phasing-out of "SOEs" has posed difficult problems wherever it has been undertaken and especially in countries of the former Soviet Union and China. Although the SOEs are often inefficient in a strict commercial sense, they provide jobs and thus social security for both employees and bureaucrats. This makes them hard to abandon. Their phase-out or privatization is made especially intractable by difficulties in redefining and assigning property rights. The SOEs are public property--owned in some sense by the entire community. Often they came into existence without market prices having been transferred for their creation. Their value to society is determined by benefits to the community which are not limited to physical productivity or commercial profitability. But prospective buyers, looking for monetary profit, will not be willing to compensate previous owners (the community) for the "social" (non-financial) contributions of the SOEs since those functions do not contribute to their monetary profits and will no longer be performed. As long as they face only a "soft" budget constraint the SOEs can cover their losses with loans from state banks financed with new money and subject only to minimal requirements for repayment. But how are they to be sold to commercially motivated buyers as part of the transition to a competitive economy without sacrificing part of their value to the community and how are the proceeds from the sale--whatever they are--to be distributed fairly? The issue has been complex everywhere and a fertile field for administrative failure, corruption and injustice.

The early record of the Vietnamese government in this regard was impressive. Perhaps in terms of the specific goals sought the most impressive of any "transitional" state. Economic losses from the SOEs were brought under control as the government allowed increasing market pressures to be brought to bear on unprofitable state enterprises. Net transfers from the public budget to SOEs persisted until 1988 but by 1989 the SOEs were making net contributions to the budget and these contributions were to grow in subsequent years (as a percent of GDP) (Dodsworth, 1996:47). Although the value of output of the

SOEs expanded, employment in public enterprises declined with job losses in the state sector as high as 12% per year from 1989 to 1991 and continuing though at a reduced rate thereafter.. Under such pressures productivity per person rose rapidly reinforced by an inflow of foreign investment with (it should be noted) almost all foreign joint ventures in Vietnam taking place with state-owned partners. (*The Economist*, December 12, 1995:34)

The pain of these job losses was tempered by the relatively small fraction of the country's economy attributable to the SOE sector and by the overall economy's rapid growth which made it possible for many individuals released from their jobs in the state-controlled sector to find employment elsewhere. The government was credited with having pursued a course in the shifting of assets from the public domain which avoided the most serious of the equity problems referred to above. An IMF survey in 1996 contained the following statement "In some countries a 'lack of ownership' or accountability emerged during the transition, leading to widespread asset stripping and to nonsustainable bonus payments and other abuses. In Vietnam few such doubts about ownership have arisen . . . and substantial efforts have been made in fighting corruption." (Dodsworth, 1996:15)

Such early evaluations may have been overly optimistic. Perhaps the first of the SOEs to be reorganized were the likeliest to succeed. Perhaps the indulgent attitude of banks willing to lend money to prospective buyers will tighten under pressure from the IMF, ASEAN, and more severe international competition. The inflow of foreign investment funds which has accommodated restructuring is likely to diminish. And if Vietnam's growth rate slows as her neighbors experience severe recession, pressures from her unemployed may be harder to assuage. Reflecting tightening conditions the General Statistical Office reported a fall in SOE profitability from 1995 to 1996 (EIU, 1998:17) and there are signs that both internal and external factors may cause this trend to continue.

Conclusion

Vietnam's recent history provides a record of important accomplishment.

The achievement of price stability, the expansion of foreign commerce and avoidance of overvaluation of the currency, and the rapid transfer of control of major economic assets give evidence of the kind of a strength and determination in the country's governmental apparatus which suggest encouraging similarities to successful neighbors. It is equally apparent, however, that critical challenges remain.

Population Growth. The country's population growth rate (2.1% from 1990-94) was 17% higher than India's, 75% higher than China's, and more than double Thailand's. In an agricultural economy like Vietnam, the increase in the size of rural families puts pressure on arable land, reduces the productivity of traditional agriculturalists and offsets the gains of technological advance. This pressure from rising population is an ancient problem for southeast Asia which is now much aggravated because of improved health and diet and sustained high fertility rates (Fforde, 1987:75).

Viewed from another angle the rapid population growth offsets efforts to improve educational facilities and raises the dependency ratio. Evidence suggests that the quality and comprehensiveness of the country's educational facilities have declined since the initiation of the 1987 reforms. Vietnam's ethnic minorities have long been educationally disadvantaged with illiteracy among the highland Bana people estimated at 80% as recently as 1989 (Heibert 1993:60). And in rural areas generally an adverse effect of the demise of the collective farms is that children who were previously free to attend school when land was collectivized are now much more likely to be seen as economic assets on private farms and thus kept out of school (Brazier, 1992:36). In urban areas private schools are reemerging after having been shut down by the communist authorities but cannot accommodate the heavy demand for their services (Heibert, 1993:66). Overall the average expenditure per student in 1991-2 was only about US$ 6 (Bird, 1995:28).

Distributional Equity. Any reduction in the availability of education will increase the gap between rich and poor--a gap already widened as the rapid shift to private ownership and competitive markets removes economic safety nets and enables successful individuals to become unprecedentedly rich. The experience of other transitional economies also suggests that the transfer of ownership of public enterprises will aggravate inequities unless the process is specifically designed in a way which focuses on the distributional character of emergent property rights and is accomplished with competence and honesty. Available statistics suggest that by 1993 Vietnamese income was already distributed less equitably than Indonesia's, India's or Sri Lanka's (World Bank, 1996).

The achievement of distributional equity (however that goal is formulated) will, like the maintenance of macro-economic stability, depend largely on what the government does or does not do. Opportunities for the misuse of power are great because so much power has been concentrated. Dangers are maximized as the agencies of societal control are reshaped, juridical institutions are in a state of flux, and ideological goals remain ambiguous.

New Legal Foundations. The historical roots of Vietnam's legal system are extraordinarily diverse. They include ancient traditions now largely anachronistic, experiments in colonial policy making and jurisprudence ill-suited to a contemporary independent state, and ideological principles now being reexamined. Consider, for example, the role of the state as protector of property rights. A system is needed which can respond to three formidable challenges:1. Fluctuating prices and the opening of new markets require property rights which protect commercial incentives-- including the incentives of foreign investors whose savings are needed to help Vietnam rebuild and expand. 2. New rules regarding the acquisition and retention of assets must recognize and respond to the enormous accumulation of injustices which have arisen from eight decades of colonial rule, four decades of warfare and from the imposition of poorly conceived efforts to centrally control and centrally plan. 3. Finally, the terms under which property is owned must reflect and define Vietnam's "economic system," giving evidence of the country's commitment to distributional fairness, and providing substance to its definition of "socialism."

For some countries of Asia new concepts of property law were forced on the post-war governments by revolution or by the pressure of outsiders. For Vietnam the pressures for such changes come largely through the market place. Thus far Vietnam's strong state has done little to clarify the legal premises regarding property ownership so as to shape an effective institutional response to these challenges. A comparison with the transition of "ownership" rights in SOEs in the People's Republic of China gives cause for optimism. China seems to be achieving a workable blend of managerial efficiency and allocational fairness for those of its industrial activities being "privatized" (or somehow transferred from central control). China's economic growth rate remains high. And perhaps the people of China find themselves increasingly comfortable with the distributional consequences of this institutional evolution at least by comparison with alternatives of recent memory. Economic growth in China has been sustained as the "soft budget" constraint on SOEs is gradually hardened against a background of decentralizing political power and the changing role of the Communist Party. The passage of time may clearly change our evaluation of this remarkably unique transformation. But that is always the case. And in China much has been done for many in the past decade. China's accomplishments invite hope that Vietnam might be similarly innovative and discover a path of institutional reform which will somehow sustain and raise the prospects for a long-suffering people.

Supporting her increased reliance on competitive markets Vietnam needs not only new concepts of property rights but also laws and institutions which sustain contract rights, regulate and tax foreign investment and profit repatriation and provide bankruptcy procedures (Pham, 1995).

Capital Markets. Finally, a major influence on the pace of Vietnam's economic growth and the sustainability of that growth will be the institutional integrity and efficiency of the country's capital markets. Once again the most persuasive evidence for this generalization comes from East Asia where the deficiencies of banks and other financial institutions and related government offices are identified as major causes of the downturn which has gripped the region. Vietnam's capital markets evolved from ad hoc efforts to meet the needs of its state controlled ventures and are at present largely inchoate (Fforde and Vylder 1996:263-8, 307). Now the government is called on to evolve new capital markets which can screen potential entrepreneurs with honesty and efficiency while they respond to the savings preferences of the Vietnamese people and the willingness of foreigners to invest in their country.

The degree to which Vietnam succeeds in meeting these challenges will determine whether its emerging markets will become a source of efficiency and equity for the people or whether they will be used to channel the gains from new ventures into the hands of individuals who are fortunate enough to be in a position to profit from the remnants of the old institutions as they are dismantled. The newly industrializing countries of the region have demonstrated that change may be rapid enough and profound enough to generate both impressive productivity and substantial equity. Vietnam is the testing ground for an even more challenging transformation.

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