

# **Economy of Vietnam**

**By**

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## **Introduction**

Vietnam has been a country ruled by colonists, divided or at war for most of the twentieth century. Unification of the country in 1976 was followed by invasion of Cambodia in 1978, and a subsequent brief but violent war with China. This troubled history had profound consequences for economic development in general, and attempts to impose central planning in particular. Central planning was imposed upon Northern Vietnam in the 1950s, and upon Southern Vietnam after 1976, but less extensively. The experience with central planning was therefore brief and incomplete.

Vietnam's economic transition, typically identified as "starting" in 1986, was a relatively painless affair of structural adjustment and stabilisation – at least for the first decade. The state sector was never large in Vietnam, where 80 percent of the population lived in rural areas, mostly growing rice. Further, by 1986 the planned part of the economy was thoroughly undermined. The collapse of the CMEA trading relationship forced restructuring in the modest state-owned enterprise sector, which shed almost one-quarter of its workforce during 1988-1992. Institutional reforms also, however, created a boom in the urban household services economy that soaked up the unemployed. The shift in markets was relatively easy without the burden of a large military-industrial complex, and Vietnam's exports to CMEA found new Western buyers with ease.

The 1990s have seen a transformation of the economy of Vietnam. Structural changes occurred during 1987-1991, but changes in institutions ("rules of the game") have lagged and the legacy of administrative control remains. Further, important services, such as accounting, banking, and the legal system remain highly rudimentary. In some regards, therefore, "transition" is a generational process.

## **Before reunification**

In 1954, Vietnam was divided in two at the 17th parallel. In the North, under the rule of the Vietnamese Worker's Party (now the Vietnamese Communist Party), a Stalinist central planning model was adopted. This model was implemented much as it had been in China. It began with a drive to collectivise agricultural production. The purging of "landlords" in the late 1950s crushed opposition to collectivisation and extended Party economic control to the village level. Some commentators claim that cultural differences

enabled collectivisation to be imposed in the North, but not subsequently in the South after 1976 (Tri 1990:15, Fforde and De Vylder 1996:124). It seems more likely that more than ten years of bitter fighting had eroded the will for further bloodshed. The absence of a campaign of collectivisation through force in the South after reunification, similar to that which had taken place in the North, was a major factor in the failure to collectivise Mekong agriculture. The inefficiency of collectivisation had also become evident. Paddy yield per hectare in the North had fallen from 2,290kg in 1959 to 1,840kg in 1960. This accounted for most of the decline in total paddy production from 5.19 million tonnes in 1959 to 4.18 million tonnes in 1960. Average annual paddy production during 1960-69 remained low (4.21 millions tonnes). Collectivisation had placed the entire Northern economy under pressure. In the Post-reunification period, fatigue and pragmatism prevailed.

Northern agricultural production fluctuated during the war years, but paddy output was only above the 1959 level in 1974. The weaknesses of the centrally planned model were disguised by the war, and by annual inflows of about US\$1 billion of economic aid (Tri 1990:39), mainly from the former USSR, but also from other East European countries and China. Official statistics showed a three-fold increase in the value of industrial production from 1960 to 1975, but this was at uncompetitive, inflated prices compared to international prices and was not reflected in per capita product output data.

Until 1976, the Southern economy was dominated by the inflow of American military and civilian funding. Aid funds provided infrastructure. Industrial development was pursued through import substitution. Farmers benefited by selling their agricultural surplus. The non-traded goods sector, particularly services, grew rapidly as consumer demand increased. The effects of war, import substitution and the growth of services, led to rapid urbanisation. The market economy was vigorous, but living beyond its means. When the Americans left, the consumer demand that had propped up the economy collapsed.

## **Reunification**

After reunification in 1976, Vietnam was a poor country trying to recover from a prolonged period of war. As a result of the war, 52 percent of the population of 49 million were women. Only 21 percent of the population lived in urban areas. The North could barely feed its 25 million because two decades of war and central planning had resulted in stagnant agricultural production. Between 1958 and 1975 the Northern population had grown by 64 percent, while the production of staples only increased by 11 percent. There was little industrial and almost no infrastructure and service development. Markets were clandestine and hence ill developed. Although market transactions persisted to a considerable degree in the South, reunification led to an immediate fall in living standards.

The national economic strategy for recovery was to integrate the two economies by imposing Northern central planning upon the South. A five-year Plan to “achieve basic

socialist transition in the South” was initiated in 1976 (Tri 1990:58). All financial activity was brought under the control of the State Bank, and a drive to collectivize the villages of the Mekong Delta began. The aim was also to merge the predominantly light industry, import substituting and privately owned enterprises in the South with the Northern centrally-planned “heavy” industries.

The 1976-80 Plan failed because of the inherent inefficiencies of planning, and because of the unwillingness to take measures that would collectivise and extract an economic surplus from Southern agriculture. Resistance to collectivization in the South saw Vietnam’s output of staples fall by 9 percent, and the paddy yield per hectare fall 18 percent, from 1976 to 1978. Farmers refused to harvest crops, slaughtered livestock, and abandoned land. They refused to sell crops at low official prices. It was estimated that over one million tonnes of rice were fed to pigs each year (Tri 1990:80). By the end of the decade, the Mekong delta remained largely uncollectivised. Most of the production collectives and cooperatives that did exist had limited functions.

The planned industrial growth from enhanced North-South “economic complementarity” also failed to materialise. Weak infrastructure, together with barriers to internal trade (tolls and travel permits), increased transport and transaction costs. Output data tells a sad story: in 1980, total production of coal, cement, steel, fertilizer, cloth, and paper were all below 1976 levels (Tri 1990:96). State enterprises were reportedly operating at only 30-50 percent of their productive capacity (Tri 1990:95).

Plan failure was already apparent in early 1978, but the military demands of the invasion of Cambodia, and the subsequent drop in foreign aid and war with China, precipitated a crisis. The central planning system, already greatly compromised by unplanned production and market activities, albeit illegal, broke down. Cuts in aid, particularly Chinese aid, reduced supplies of cheap inputs for state enterprises. Vietnam was still trying to maintain an army of over one million persons until the late 1980s, but state procurement of staples fell in 1978 and 1979 (Fforde and De Vylder 1996:129). Unplanned economic activity proliferated. State enterprises had to work outside the plan to provide minimal living wages for workers, and workers found additional jobs to supplement those incomes. Central state management weakened when cheap inputs vanished. The central authorities did not have an economic surplus to feed the state sector, which itself did not produce a surplus.

Liberalisation after 1978 was a spontaneous “bottom up” process which placed great pressure on authorities to sanction economic realities and permit further compromises to central planning. The first official steps towards liberalisation were taken at the Party’s Sixth Plenum in September, 1979. The Plenum sought to stimulate agricultural production. Procurement quotas for paddy, and the agricultural tax, were fixed for five years, and state procurement prices increased. Above-quota production could be sold on the free market. Markets were officially sanctioned, so that extensive legal market activity began to co-exist with central planning (unlike in most other centrally planned economies).

During the five-year Plan years, instead of imposing an already diluted Northern development model on the South, Southern practices were extended throughout Vietnam. The economy which emerged in the 1980s was as much a product of “southernising” the North, as it was of “northernising” the South (Beresford 1989). Strict central planning no longer dominated resource allocations. After 1979, it is more appropriate to refer to Vietnam as a command economy than as a centrally-planned economy.

### **Forlorn hope: defending the plan, 1980-1985**

After the economic crisis of 1978-79, the state periodically tried to re-establish the dominance of central planning, but was too weak to do so. The inherent inefficiencies of planning mean that economic resources were underutilised, and hence even modest liberalisation could generate strong supply responses. Periods of growth after liberalisation episodes were seen by the authorities as opportunities to reimpose central control, which only precipitated further crises.

The liberalisation initiated in 1979 continued into the early 1980s. In 1981, an “end-product system” replaced work points in agricultural cooperatives. Cooperatives were set production quotas above which production could continue to be sold on markets or at “negotiated” state prices that were close to market prices and included some bartering, such as provision of cheap fertilizer to farmers [Tri 1990:132]. Central planning controls over state enterprises were also officially loosened. In January 1981, Decision 25-CP introduced a “Three-Plan System” which legalised the already extensive market activities of state enterprises.

The early 1980s saw a confusing policy of pragmatic liberalisation and attempts to recentralise economic authority. Recentralisation imposed further layers of distortions on an already grossly distorted economy. Without a domestic economic surplus, the state could expand only through aid or by reducing real incomes paid to workers. Both strategies were pursued. In response, state enterprises expanded “unplanned” activities to supplement official salaries, and workers increasingly found additional work. Fforde and De Vylder (1996:118) present data showing an increase in state worker “other incomes” after 1979, which peaked at almost 60 percent of total income in 1986 and declined slowly thereafter.

In 1976, 45 percent of total budgetary revenue came from external sources. This share fell as relations with China and industrial countries worsened, but rose again to 41 percent in 1980 after the former USSR increased its support. The trade deficit with the CMEA countries increased from 380 million rubles in 1980, to 721 million rubles in 1985 (when Vietnam’s CMEA exports only covered about one-third of imports). Soviet aid also underwrote forty large construction projects, and supported over 200 state enterprises during 1981-85. In 1985, it was reported that Soviet projects accounted for 35 percent of electricity generation, 95 percent of coal production, and 51 percent of cement output (Tri 1990:155). Foreign assistance was never large relative to the whole economy, but because it was entirely directed to the state sector, its role in maintaining this sector

afloat was vital. Without foreign assistance, the state could not have maintained its position during the 1980s.

By 1985 the state sector was again under strain. Agricultural production had stagnated, real incomes had fallen, and “unplanned” economic activity continued to grow. The recentralising policies followed after 1982 were again undermining the economy. Increases in the money supply induced inflation in the free markets which state prices had to follow. This resulted in a so-called “leading effect” of the parallel or open market that made the transition process in Vietnam differ from that in former USSR or other former socialist countries in Eastern Europe. Nguyen Khac Vien, writing in 1982, remarked that “we now have two parallel markets. One is organized and state directed, with stable prices. The other is the free market which operates according to supply and demand. Things would be easier if our state were strong enough to control the whole market, but it isn't; our state is not rich enough” (p.379).

In September 1985, in a vain attempt to solve the problem of high free market prices, the authorities increased state prices and introduced a currency reform. The price rises were accompanied by increases in loans to state enterprises and in wages. The monetary reform introduced a new dong that was to replace the previous dong on a one-to-ten basis with limits per person (as also happened in 1978). As personal savings had been predominantly in gold and US dollars, the main impact of this reform fell upon state enterprises whose cash holdings were wiped out. Without commodity convertibility, the bank deposits of state enterprises had little influence on the price level directly, but a budget blowout and spiraling inflation were inevitable. In 1984 budget revenues had covered 81 percent of expenses; in 1985 they only covered 55 percent of expenses. In 1986 the general price index rose by 487 percent.

The Vietnamese planners were unable to ignore the markets. The state maintained constant prices until the breakdown of planning in 1978-79. In the late 1970s, market inflation was running at about 30 percent annually, eroding the real value of state procurement prices. Official price increases above the prevailing market inflation rate were consequently required in 1981-82 to increase the real state price being paid for agricultural produce. Thereafter state prices followed free market trends closely. In 1979 state procurement of staples in the Mekong Delta had totaled 380,000 tonnes, after the price reforms, procurement rose to 1.9 million tonnes in 1984 (Fforde and De Vylder 1996:106).

The failure to maintain strong central planning made it possible to undertake “price shock therapy” in 1989. Repressed inflation associated with a monetary overhang had been eliminated by free market exchanges (commodity convertibility) and annual inflation of over 300 percent per year during the preceding three years. Free market prices had come to dominate economic activity, with the notable exception of key industrial sector inputs, where low prices were maintained through the subsidised trading and aid relationship with CMEA countries. What was left for reform was the “residual element of central planning” (Fforde 1991:12). In other words, prices already mattered when the Vietnamese authorities began removing the shell of the old planning system.

The 'reforms' of 1985 were the last attempt to maintain the fiction of central planning. The failure of the 1985 policies strengthened the hand of reformers who advocated a more market-oriented economy. The pro-market forces included a rising commercial interest group within the state sector (Fforde and De Vylder 1996:143), and Southern liberals within the Communist Party. The death of Party General Secretary Le Duan, in July 1986, created the opportunity for fundamental change within the existing political structure. The Sixth Party Congress of December 1986 was an ideological watershed which initiated the transition to a market economy in Vietnam.

## **The Transition to Markets**

### ***1986-1988: Commitment to cautious reform***

While the Sixth Party Congress in December 1986 is usually regarded as an ideological watershed in the political economy of Vietnam, in fact it introduced a period of policy confusion. Liberalisation continued to be selective and planning remained protected.

When inter-provincial trade barriers were abolished in 1987, rice prices declined. Central Committee policy decrees issued during 1987-88 loosened control over foreign investment, land, foreign trade, banking, state industrial management, the private and household sectors, and agriculture. Reforms accelerated in 1988, when the cooperative method of agricultural production was abandoned in favour of household production, and small private enterprises were officially encouraged. But the fundamental contradictions of maintaining a two-price system remained. The budget deficit grew to 7.1 percent of GDP in 1988, and the trade deficit grew as the state tried to compensate for rapidly falling aid. Most of the deficit was financed by State Bank borrowings. Inflation remained high at an annual rate of about 300 percent. In early 1989, residual planning still in place had to be abandoned.

### ***1989: Macroeconomic stabilisation***

In March 1989, the Vietnamese government introduced several stabilisation measures. Although direct subsidies and price controls on electricity, coal, and some other products remained, most were removed. Government expenditures for the first half of the year were tightened, falling from 14.1 percent of GDP in 1988 to 12.3 percent in 1989. Bank interest rates were raised to high positive levels. They were accompanied by credit ceilings on lending to state enterprises. The foreign exchange rate was brought close to the black market equilibrium rate. Gold trading was liberalised. Liberalised trade regulations were facilitating a rapid increase in rice exports. The effect was impressive. Inflation, which rose monthly by 13.6 percent in 1988, still rose by 9.2 percent in February 1989, but then progressively fell, with prices falling from May to July of that year. State Bank financing of the budget deficit in the second half of 1989 brought monthly inflation down to around 2.5 percent, and this level was maintained into mid-

1990.

The 1989 reforms addressed the money flow problem, rather than any perceived money stock problem (the “monetary overhang”), which had been the focus of the 1978 and 1985 monetary reforms. Money [M1] rose from 9.2 percent to 15.2 percent of GDP. Budget and credit policies had been tightened as indicated, and strong monetary growth was absorbed by a once-off monetisation of the economy and sterilisation of increased household deposits in the banking system (Dollar 1993). Sterilisation was achieved as credit ceilings restricted lending to state enterprises, and the underdeveloped legal and banking systems meant that non-state lending options were limited.

After years of near hyper-inflation, the “monetisation” of the economy and of household saving portfolios in early 1989 saw a revival of confidence in the domestic currency. In a once-off change in saving behaviour, households shifted into monetary assets (Dollar 1993). The real purchasing power of gold and US dollars fell by about 25 percent over three months to May 1989, as households shifted into dong and bank deposits. During ten months from March 1989, household deposits in the commercial banks increased from 0.8 percent of GDP at end-1988 to 3.8 percent at end-1989 (Lipworth and Spittaller 1993).

Universal poverty and the distortions of the period up to 1986 explain the high supply responses to later reforms, particularly to the ending of active discrimination against private enterprise. But they also explain why there is a strong lingering distrust of the banking system. Non-dong forms of saving are still preferred. In 1993, a national survey reported that only 6 percent of the Vietnamese population used banks (Economist Intelligence Unit 1993).

The once-off monetisation of the economy in 1989 helped to limit the inflationary impact of sweeping price reforms and monetary expansion. An estimated 8 percent GDP growth in 1989 resulted from supply responses in agricultural and services to changes introduced in 1988, which more than compensated for the 2.8 percent decline in industrial production.

### ***Macroeconomic stability after 1989***

The fiscal expansion of late 1989 continued into 1990. Inflation returned and real interest rates became negative again in August 1990. Despite increases in budget revenues, notably from petroleum exports in 1990, inflation was 68 percent. The fundamental causes, money financed budget deficits and state enterprise subsidies, continued. The government reacted by reducing current and capital expenditures so that the budget deficit fell from 6 percent of GDP in 1990 to 2.5 percent of GDP in 1991.

At a Central Committee meeting of the Party in December 1991, macroeconomic stability and control of inflation were declared the priority policy objectives to 1995. An anti-inflationary drive followed. It was characterized by large-scale selling of dollar and gold reserves to draw dong from circulation. This, and the lagged response to tighter fiscal

policies in 1991, reduced the annual inflation rate to 18 percent for 1992. Indirect subsidies to state enterprises were also lowered significantly in 1992. The momentum was maintained so that inflation fell to 5 percent in 1993, although it rose again to 14 percent in 1994. Relative stability of the exchange rate, and in gold buying and selling, have also been maintained since 1991. The interest rate (the monthly rate for three month deposits) was lowered progressively by the State Bank from 2 percent to 1.4 percent.

Control of inflation continued to improve. Diversified financing of the deficit, including experimental bond floats, reduced the growth of money supply. The growth of M2 was estimated at 28 percent for 1994, compared with 19 percent in 1993 and 34 percent in 1992. With non-inflationary financing of the budget deficit from 1992 to 1994 (Le Dang Doanh 1994), the annual inflation rate did not return to pre-1992 levels. In 1993 current budget revenues increased 13 percent, in part because prices were increased for petroleum, postal services and electricity, although these areas are still lightly taxed by international standards. Steady increases in revenue from external trade taxes since 1991 helped.

Macroeconomic stability in the mid-1990s more threatened by trade and exchange rate policies than by fiscal management. In 1995, the trade deficit grew to 11.5 percent of GDP. This rose to about 19 percent of GDP in 1996, with imports exceeding exports by US\$3.2 billion. These deficits are only partly covered by aid and foreign investment inflows. A regulated contraction of imports was the policy response that achieved reduced the trade deficit in the late 1990s at the cost of lowering imports.

## **Vietnam in the 1990s**

The economic performance of Vietnam in the 1990s would be classified as a “miracle” if such achievements were not so common in the latter half of the twentieth century. GDP growth rates ranged between 8.1 percent to 9.5 percent during 1992-97, led by industry and services, but with average agriculture sector growth still an impressive 4.8 percent per annum. Vietnam was exceptional pre-Asian crisis even compared to the “miracle” economies of Asia. From a low base, economic growth and exports were booming, feeding each other in a virtuous circle of development.

The period since 1986, however, has not been without its problems. Many of these, such as rural-urban income inequality and migration, are more typical of a fast-growing developing economy than a transitional one, as such. There seems little point in trying to distinguish “transitional” from other causes of changes, but we should bear in mind that Vietnam in 2000 is both a fast-growing developing country and an “economy in transition”. It is also still a very poor country, where concerns about food production and ownership of agricultural land remain central.

## **Growth and development post-Asian Crisis**

The Asian Financial Crisis, which sent the region reeling in late 1997, had relatively little immediate impact on those countries without open capital accounts and foreign currency rationing. Vietnam, like Myanmar, has therefore been able to maintain reasonable rates of growth in recent years. The longer-term picture is more sanguine. Foreign direct investment in Vietnam has slowed dramatically. Despite the recent strong growth in trade volumes, it will probably be several more years before Vietnam returns to “catch up” rates of GDP growth in excess of 6 percent.

Thus, despite the Asian financial crisis and apparent hesitation in Vietnam to embrace further structural change, the economy continues to grow quite rapidly. Major economic indicators show a general recovery since 1998, and more recent forecasts put GDP growth for 2000 at 5 to 6 percent and export growth at over 20 percent (partly due to rising world prices for some agricultural products and crude oil). Sustained high rates of development will, however, require a return of foreign investment, an increased rate of gross savings as a percent of GDP, and development of a private corporate sector in Vietnam.

## **Agriculture**

### ***Overview of agricultural reform process***

Employing 72 percent of the Vietnamese labour force, and producing 26 percent of its GDP in 1998 (down from 34 percent in 1992), the agricultural sector remains the backbone of the productive economy in Vietnam. The performance of the agricultural sector has therefore largely determined the direction of political and policy reforms since 1976. Agriculture's share in GDP typically declines with development, although agricultural output rises in absolute terms. But this was not the case in Vietnam under central planning. In the late 1980s, the agricultural share of GDP rose as a result of official price increases rather than output gains, and despite falling productivity indicators. It was not until the 1990s that a clear trend of rising aggregate output, rising productivity and a falling share of GDP became evident.

The foundation for a quick supply response to the sharp rise in official prices in early 1989 lay in the removal of internal trade barriers in 1987 and the return to household production in 1988. In 1993 the National Assembly approved a new Land Law. Annual crop farmers were given 20-year renewable tenure rights to their land up to a maximum of three hectares. The new code allowed citizens to transfer, exchange, lease and inherit rights to use farmland. They could also use land as collateral for farm loans. With more secure property rights, the Agriculture Bank played some role as a lending agency in rural areas. Total paddy output grew annually by 3 to 6 percent during 1993-1997, and by 5.9 percent in 1998 to 31.85 million tonnes. Rice exports increased again in 1999 to 4.5 million tons.

Wholesale trading of rice remains highly regulated. Farm-gate prices are held below world prices, and the rationing of export quotas, in particular, has provided a lucrative

rent-seeking opportunity. The UN (1996) estimated that the rice “quota system has an effect equivalent to a tax received by trading monopolies on 30 percent of the value of the paddy crop” (p.40). In recent years, however, rice exporting has been liberalised and become more competitive, much to the gain of farmers, despite ongoing provincial cartels.

### ***Food***

The rise in gross food output has been a feature of Vietnam’s success story. Total food production increased by 50 percent during 1988-1997 (and 30 percent on a per capita basis). Livestock numbers and industrial crop production increased even faster (GSO 1999, p.42). This extraordinary performance has enabled Vietnam to become a major rice exporter, and has caused a steady decline in the incidence of poverty.

Liberalisation of markets and a strengthening of property rights have generated strong supply responses in the agriculture sector during transition. Long-term investments in annual and perennial crops by households have had a dramatic impact on living standards. The benefits, as may be expected however, have not been evenly spread. More farmers are losing their land. Those who were growing only enough to survive have been bypassed by the reforms. The bottom strata of the poor remain very poor, and the task of lifting these households out of poverty is more complex than it was for those who were capable of producing a surplus for markets.

### ***Land***

Land scarcity appears to be increasing in most regions of the country. An average farm family of five cultivates around one-half hectare of land, with farmers in the Mekong and Central Highlands averaging one hectare. The People’s committees have less scope to reallocate land or to find unused land for newly formed families. Families with three or more children (often the poorer families) can no longer expect to receive more land on this account. There are reports of land consolidation (purchase of user rights) by larger commercial farmers (especially in the South), or by developers converting land to industrial, residential or recreational use (UNDP, 1998). A new class of landless families is thus being created, who work for wages on other people’s land, who may find off-farm activities, or who join the increasing flow of people seeking work in urban areas.

In 1996, at least 2 million rural residents were officially estimated to have migrated to cities looking for work (equal to 7 percent of the nation’s working age population). An estimated 23,000 arrived in Hanoi seeking casual work in 1996, compared to an estimated 9,000 in 1992. Ho Chi Minh City reported a rural influx of 700,000 persons in 1996: Six out of seven of whom did not have permanent registration permits, and data do not show how many were seasonal (circular mobility) rather than looking to change permanent residence (UNDP, 1998).

### *Forestry and cash cropping*

According to estimates by the United Nations Development Programme, the area of forest declined from 44 percent of total land area in 1943 to 23 percent in 1995. The 1979 land use survey of the country put the total area of forest at 13.4m. ha. By 1994 it was estimated that Vietnam's forested area had fallen to 9.4m. ha. In 1997 Vietnam had 19.6m. ha of forestry land, accounting for two-thirds of the total natural land area. The forest area was only 10.1m. ha, of which 8.78m. ha was natural and 1.37m. ha was planting area. Waste land and barren hill areas totalled 10m. ha in the same year. Deforestation remains a major problem, with around 200,000 ha being lost every year in the mid-1990s. In 1998 there was 17,408 ha of "fired forest" and 20,475ha of "destroyed forest" (GSO 2000). If this rate is sustained, the country will be without forests before the middle of the next century.

Since the Vietnam war, when an estimated 5 percent of the country's forests were destroyed and a further 50 percent damaged, forests have continued to be lost through a combination of uncontrolled logging, population pressure and "slash and burn" agriculture. Deforestation also threatens to have a detrimental effect on agriculture in the delta provinces, where forests are important for flood control. Furthermore, most household energy is derived from fuel wood. Given the seriousness of the problem, the Government has repeatedly taken measures to curb the rate of deforestation, including, since 1992, a ban on the export of logs and low value-added timber products. A number of areas have also been designated national parks. As the rate of deforestation indicates, enforcement has proved to be difficult. Accordingly, Vietnam has enlisted the services of the FAO to undertake several forest farming projects, with the aim of increasing the planting rate. In the 1991-2000 period it was expected that a total of 18 forest projects, worth US\$272.7m., would be undertaken to plant 785,000 ha of forest. Vietnam planted 210,000 ha of forest in 1997, and 199,400 ha in 1998.

The expansion of cash crop production has been an important element of Vietnam's economic reforms. Since 1993 Vietnam has been a leading exporter of groundnuts and cashew nuts, with cashew nuts providing US\$125 million in export earnings in 1997. Other successful cash crops include rubber, coffee and tea. Between 1990 and 1995 rubber output more than doubled, and increased to 225,700 tons in 1998, and the Government remained keen further to increase production. In 1991 Vietnam became Asia's second largest producer of robusta coffee, and exports rose to 382,000 tons in 1998. In 1999 coffee was Vietnam's second biggest agricultural export after rice (US\$1,025 million), with coffee exports of US\$592m. in 1998. Falling world prices for rubber have meant that, despite a steady increase in export volume from 122,000 tonnes in 1996 to 212,000 tonnes in 1999, revenues from rubber have fallen to US\$125 million (US\$163 million in 1996).

## **Poverty and social services**

### ***Poverty alleviation***

From near famine conditions in 1988, and one-quarter of Vietnamese people in food poverty in 1992/93, the numbers of Vietnamese in poverty have fallen sharply. Nevertheless, in 1997/98, almost half the rural population was still in general poverty unable to meet “basic needs”.

Alleviating poverty requires access to markets and facilities, and education. The three must go together. In Vietnam, 37 percent of rural households lacked access to electricity in 1995, and only 38 percent had safe drinking water. The Central Highlands and the Mekong Delta suffer the most from weak facilities. There are few all-weather roads penetrating rural areas. Integrated efforts are required to link rural people to markets (roads, bridges), to improve access to facilities and resources (land rights), and to strengthen personal capacities and information flows (education).

Rapid economic growth in Vietnam has not been accompanied by a markedly worsening income distribution, at least as measured by the Gini coefficients (GSO 2000). According to Vietnam Living Standards Survey (VLSS) data, greater inequality in urban areas, particularly in northern Vietnam, resulted in a marginal national increase. Vietnamese survey data show erratic and marginal changes in income distribution throughout Vietnam during 1994-1997, with an apparent reversal of the inequality trend in 1997. Therefore, both the absolute level of inequality and the trend do not seem to be matters for concern, and by international standards Vietnam remains a relatively equitable society.

### ***Health and education***

One underlying cause of Vietnam’s success was relatively strong systems of primary health care and basic education prior to the reform period. Achievements in areas such as literacy and life expectancy were therefore both a cause and a consequence of Vietnam’s rapid development during the 1990s. By 1998 Vietnam’s literacy rate was above that of China and Indonesia, despite both countries have much higher GDP per capita.

During transition, the collapse of subsidies and in-kind payments from the planning system was not immediately replaced by monetary equivalents, which were constantly eroded by high inflation until about 1992. Teachers left schools, and increasing opportunity costs saw student dropout rates rise. Health services declined, particularly in rural areas. Recovery since 1992 has been evident but incomplete. Education services have improved markedly. There are still teacher shortages, but dropout rates have fallen, and government funding of the sector has risen. Government funding of health services has been less generous. *De facto* privatisation of education and health services has allowed services to increase in line with rising household incomes. Those in poverty,

however, may still access health and education services worse than in 1985.

Informal and formal social security systems have also come under pressure to adapt to a more market-based economy. Increased factor mobility, of land use and workers, has undermined traditional systems of welfare support. Extended family ties have been important through this transitional phase, as welfare systems become monetised and community organisations develop. The formal social security system has seen less change. The 1995 Labour Code was essentially an attempt to expand the existing system to cover the non-state sector. It did not address the fundamental design and delivery problems that make it financially unsustainable and an obstacle to labour mobility. Health insurance remains in crisis.

Both the health and education sectors were in decline until about 1992-93, when increased government spending, development assistance, and selective policy liberalisation reversed the trend. The number of grade school teachers had been declining since 1988-89, but so did the numbers of students. The number of grade school students fell by 8 percent to 11.7 million during 1987-1990. Numbers of both students and teachers picked up again in the 1990s (the number of secondary school students did not rise until 1992-93). The teacher:student ratio had therefore been somewhat steady at 1:27, but has subsequently risen to 1:31 in 1987-88. The number of kindergarten teachers had stagnated until recent years, when liberalisation (private kindergartens) prompted a boom in teacher numbers and schools.

Health data shows a less clear picture of slump and recovery. Although the numbers of doctors have increased each year, the numbers of nurses has fallen sharply. The number of hospital beds shows an increase since 1994 (after falling steadily from 224,000 beds in 1987), but this and other aggregate data disguise other trends. For example, although the number of hospital beds was 198,000 in both 1992 and 1997, the number of these in rural areas had fallen from 69,600 to 63,800. The slump in health services, particularly in rural areas, may be continuing, but this is not reflected as a priority concern in the central government budget.

Central budget education expenditures rose steadily as a percentage of GDP from one percent in 1991 to about 2.4 percent in 1997. Health sector expenditure trends have been less consistent: rising from 0.8 percent of GDP in 1991 to 1.3 percent in 1994, but subsequently dropping to about one percent of GDP (World Bank 1998b, p.97). These education and health sector shares are still low by international standards. The increases have not compensated for substantial falls in local government funding during transition. Further, expenditures are inequitably targeted in favour of urban areas.

## **Employment**

The early years of economic transition, from 1986 to 1991, saw substantial structural change in Vietnam's labour force. Total State sector employment fell by about 250,000 persons each year during 1989-1991. About 500,000 soldiers were demobilized. Returning worker migrants have added to the supply. The demographic profile aggravated the situation by increasing the number of persons of working age by 3.7 percent per year (39 percent of the Vietnamese population was under 15 years of age in 1990). During this "first phase", the booming household sector absorbed the growing supply of workers. Unemployment and underemployment, while severe, was never at socially dangerous levels. Unemployment was estimated at between 1.9 to 6 million persons.

In the "second phase", beginning around 1992-93, change in the structure of employment was less dramatic. The threat of large-scale unemployment and under-employment remains a serious problem for Vietnam: both in terms of political stability and efficient resource use. The sustained growth of the private household sector has soaked up some of this labour force growth, but the ability of the economy to generate jobs with higher value-added is crucial.

### ***Employment: the first phase***

The 1989-91 shedding of workers was mostly due to the collapse of CMEA trade (a market-based shock), and because of a tightening of state enterprise budget constraints during the 1989 stabilisation period (restructuring). At about the same time, however, removal of internal trade barriers and official Decrees supporting the development of the private sector created incentives and opportunities for Vietnam's household businesses. This process a coordinated reform allowed state enterprise employment to fall from 8.7 percent of total employment in 1989 to 6.2 percent in 1991, but without a huge rise in unemployment as the private sector created jobs for 4,369,000 workers.

The capacity for the private sector to absorb more employment is, however, very limited without further institutional change. Value-added and profit margins in private household activities are very low. Household economic activities are also very competitive, so the scope for once-off household-based employment generation through institutional reforms is limited. The only open avenue is up: the promotion of private small-and-medium enterprises – or what may be better described as the private corporate sector.

### ***Employment: the second phase***

Vietnam remains an economy with much of its GDP coming from agriculture with most of its labour force employed in agriculture. The state sector employs only nine percent of Vietnam's 39 million workers, but that percentage varies considerably across economic

sectors. About one-quarter of industry sector workers have been employed by the state throughout 1993-99. In commercial service areas, however, the share of state employment has halved from 26 percent in 1991 to 13 percent in 1997. It has also fallen, but less quickly, in other sectors.

Despite the slowly falling share of total employment, the number of persons in the state sector has risen during 1991-97. The workforce increased by 6 million persons during 1991-97, of whom the state sector absorbed 155,000 (3 percent), and the non-state sector the remaining 5,865,000 – mostly in agriculture (2 million), but also in industry (898,000), trade (1.38 million), and across most other sectors.

In terms of employment, therefore, the state sector has been stagnating. This is despite priority still being given to state sector development, and a reported rising state sector share of GDP in recent years. The state sector and its enterprises, even with protection and access to state funds, foreign investment, land, and bank credit has failed to produce jobs.

Vietnam faces an imperative to create jobs. To remove biases towards capital-intensive development, reform and privatise state enterprises, and strengthen competition and markets. A set of policy reforms, for example, that enable the private corporate sector to develop and to openly compete with state enterprises would precipitate a bout of employment-creating restructuring. So would policies that enable state enterprises and state Corporations to compete more against each other. Such a package would have the potential to increase overall employment, even if unemployment-creating state enterprise restructuring was actively pursued.

## **Financial sector**

In contrast to the negligible role that the financial sector played in centrally planned economies, financial intermediation is key to the functioning of markets. Financial sector reform is thus a litmus test of the transition to markets. The Vietnamese financial sector remains dominated by a few large banks. The banking sector constitutes only 2 percent of GDP, reflecting its undeveloped nature.

### ***Interest rate policy***

Prior to 1989, government policy kept interest rates strongly negative with obligatory enterprise and household deposits. In early 1989, rates were set at levels which were strongly positive in real terms, and an announcement was made that explicit account of inflation would determine future changes (World Bank 1992:82).

The correlation between interest rates and inflation during 1989 was very weak, however, and it was not until after 1991 that interest rate movements became discernibly related to inflation trends. Even so, a three-month term deposit, rolling over, would have accrued a

real interest return of 132 percent over the 2.5 years between July 1992 and December 1994. In 2000, interest rates remain controlled and hence consequent problems of miscalculation, rationing, resource wastage, corruption and patronage are ongoing.

### ***Government banks***

A step toward financial sector reform was taken in 1988 when the Agriculture Bank of Vietnam (VBA) and the Industrial and Commercial Bank of Vietnam (ICBV) were created as commercial banks out of departments of the State Bank. They dominate commercial deposits and lending. Two existing small specialised banks, the Bank for Foreign Trade for Vietnam (BFTV) and the Bank for Investment and Development of Vietnam (BIDV), made up the formal financial sector.

Establishing the two-tier banking system in 1988 had little effect until monetisation in 1989, when the World Bank considered that deposit growth caused “a transformation of the degree of penetration of the banking system in the economy” (World Bank 1991a:76). Deposits had grown to 3.8 percent of GDP, but by international standards this was still low. The Asian Development Bank (1991:10) seemed closer to the truth in seeing the financial sector as “a major constraint to economic growth”.

The proportion of non-state enterprise lending began to increase after 1991. The non-state sector share of net domestic credit rose from 10 percent in December 1990 to 38 percent in March 1995. Increased bank autonomy and experience supported the trend for non-state lending, as did “harder” budget constraints on state enterprises, and the improved institutional environment which was reducing the risks associated with non-state enterprise lending.

The Agricultural Bank adapted to changing circumstances quite promptly. Within six months of the authorization of lending to farm households in July 1991 (Directive 202/HDBT), the Bank had lent 405 billion dong (about US\$36 million) to 558,680 households (about US\$65 per household). By 1995, the VBA had reportedly lent to seven million households, with an average of about US\$110 per household (UN, 1996:100). The monthly lending rate was uniformly 1.25 percent, which was below market rates, thus requiring government subsidisation and rationing mechanisms.

The State Bank of Vietnam has to continue to subsidise state commercial banks because of the interest rate regime and because of the asset portfolio with which the banks were established. The two large state commercial banks were probably insolvent when they were formed in 1988. These banks would require liquidation of bad debts and a substantial recapitalisation to operate commercially. The World Bank estimated the recapitalisation needs of the commercial banks at 6 percent of GDP in 1991 (p.14). A Debt Resolution Committee has since identified the extent of existing bad debts, and facilitated the payment of some outstanding debts, in some cases through liquidation proceedings. The government has also authorised writing-off some bank debts.

The legal and property rights framework has only been strengthened very gradually. The

devolution of economic and legal autonomy from the Party and the State to rights for individuals has not been easy to accept. The task of developing a commercial rights-based legal system was formidable, both technically and politically, and has a long way to go.

Several commercial laws have been passed since 1986. A Land Law in 1987 established private use of allotted land in agriculture. A series of Ordinances on economic contracts in 1989, on Economic Arbitration in 1990, and on Civil Contracts in 1991 began to codify contractual procedures (Gillespie 1992:5). A Law on Private Enterprises, and a Law on Companies, were introduced in 1990. Changes to the Constitution in 1992 allowed individuals to exercise property rights over income producing assets and personal property. A bankruptcy law was introduced in 1993, as was a new land law that clarified property rights and allowed mortgages on land. "Codification", and clarity of rights on paper, has been an important first step to developing an effective legal and property rights framework, but the effective, transparent and fair enforcement of these new laws is not in place. The legacy of the Party-dominated legal system is that "courts have yet to develop a high level of commercial expertise or a robust form of independence" (Gillespie, 1992:9).

### ***Regulatory framework***

Efficient financial intermediation is severely constrained by the lack of appropriate monitoring capacity at the State Bank. In 1991 Scheuer, an International Monetary Fund consultant, noted that the Economic Planning Department of the SBV had few staff, one archaic computer, and consequently "no consolidated report for the banking system was produced" (1991:4). He also discovered that "no department or office at the SBV is responsible for the collection and processing of reports of joint-venture banks" (p.5), and that the SBV did not even have complete lists of joint stock and housing banks in Vietnam. Comprehensive supervision of all financial sector organisations now lies with the SBV, although direct cease-and-desist powers are lacking. Implementation of the SBV's limited authority remains constrained by skill shortages and poor administrative procedures. Its supervisory capacity is also dependent on the perceived credibility of its role as an autonomous agent of monetary policy. At present this role is compromised by the necessity to act as a "frequent lender" to the state commercial banks which cannot make profits from financial intermediation.

## **Trade**

### ***Trade performance***

Buoyant trade growth has been a remarkable feature of Vietnam's transition. The value of total trade increased steadily from 1988, with only a slight leveling-out in 1990 when CMEA-area trade collapsed. Using the IMF/World Bank exchange rates, the total volume CMEA trade was not large prior to 1987 and fell subsequently. The CMEA relationship

only permitted Vietnam to run a large trade deficit for a short period to 1988. After 1988, trade with the convertible area was always larger. The collapse of CMEA in 1990-91 was therefore not a significant shock to the economy as a whole. The impact was mainly in the loss of subsidies to state industrial enterprises.

Vietnam's total trade as a percentage of GDP has risen from 32 percent to 88 percent in eight years to 1999. Exports have grown erratically, and even declined as a percentage of GDP in 1993, while import growth has been steady and, in some recent years, excessive. Exports to Japan, and imports from Hong Kong, grew steadily. The switch to hard currency exporting was achieved largely because Vietnam's main exports were primary products that found a ready world market. Labour-intensive manufactures and assembly operation exports ("light industry") have increased in the 1990s due to investments by Asian economies utilising Vietnam as a low wage export base.

The dramatic return of Vietnam as a net exporter of rice in 1989, and the steady growth in petroleum exports meant that the collapse of CMEA trade in 1990 appeared only as a pause in a strong upward trend. Petroleum exports increased almost four-fold between 1989 and 1992, and were an important contribution to both exports and economic growth. The strong export performance, together with rising capital inflows, facilitated a rapid rise in imports of machinery and spare parts.

The slump in exports and FDI post-Asian crisis spurred Vietnamese authorities to remove restrictions on exports, including abolishing the need for private companies to obtain export licences. These institutional reforms explain part of the strong export performance during 1999-2000 (although about half of recent growth in receipts is due to higher oil prices). The eventual signing of the most favoured nation (MFN) treaty with the US in 2000 has been hailed as an important milestone in the political and economic reform process in Vietnam. No immediate economic impact is expected, and in fact it is likely that the trade deficit will widen again if oil prices fall and the exchange rate remains relatively fixed at 14,200 dong/dollar.

### ***Trade policies***

Vietnam's trade and investment policies can be characterised as "export-led protectionism", whereby import substitution is encouraged with trade protection, and export industries promoted by providing subsidies to countervail the high relative costs of intermediary products. This should not be interpreted as simply some "South Korean model", but rather central planning monopoly-based protectionism paired with a crude interpretation of export-led development.

The legacy of central planning is, most importantly, a strong belief self-sufficiency through import substitution. Another important aspect is the lingering belief in the role of government to manage and frequently "fine tune" the whole economy, and a consequent disregard for the costs of price distortions and uncertainty created by this approach in a market economy.

A new tariff code was introduced in 1993. It had over 20 different rates ranging from zero to 200 percent, making it too complex to be effectively administered. The new rates were generally higher than those set in 1991, but for many goods they were still in “an acceptable range” according to the World Bank (1995:61). The average (unweighted) rate was 12 percent. Almost 80 percent of tariff lines were set at 20 percent or lower. In 1994 the requirement for import permits for all but 15 products (refined petroleum, fertilizer, cement, and some consumer items) were eliminated. An import duty exemption scheme was improved in 1994 so that a firm need not pay duties on imports used to produce exports (World Bank 1994:58). Membership of the ASEAN Free Trade Area (AFTA) in 1996 began a process of imposing international standards of free trade on Vietnam. This process will take many years to be effective, particularly given the allowances made for poor developing countries like Vietnam.

Customs duties now make up about 25 percent of government revenues. This, however, is only one of the objectives assigned to this policy instrument. Consequently, the tariff schedule is complex and constantly changing. The number of tariff rates fell from 36 in 1995 to 31 in 1996, then jumped back to 35 in 1997, but was subsequently beaten down to 26 rates, ranging from 0 to 60 percent, in 1998. The schedule in February 1998 identified 3,163 separate items (CIE 1998, p.39), and within one item there may be many relevant minimum import prices applied.

Despite the ASEAN agreement to remove all surcharges by 1996, Vietnam maintains surcharges (export taxes) on a small number of important products. During the past three years, customs surcharges have been applied for various periods of time to imported petroleum, some types of steel and iron, and fertiliser. Exports of coffee, unprocessed cashew nuts, and rubber have also had surcharges applied in recent years, purportedly as part of a price stabilisation fund process (GoV 1998, p.118).

The surcharge rates have been changed with an alarming frequency. Since mid-1994, the rates on petroleum products have been changed fourteen times (GoV 1998, p.115). Rates on petroleum products differed between north and south Vietnam until 1996. Rates of between 2-10 percent are applied to eight different types of iron and steel products.

In 1998 foreign exchange management controls became a more prominent economic policy tool in Vietnam. The controls are being used to meet macroeconomic and specific trade and industry policy objectives. The increased emphasis on financial controls preceded the removal of import licensing, and was most probably a response to the Asian financial crisis and dwindling capital inflows. That is, an emerging “shortage of dollars” promoted a strengthening of foreign exchange controls which, as usual, were then also used to pursue other development strategy objectives. The main foreign exchange rationing instruments are Letter of Credit deposit requirements; priority access lists; and surrender requirements.

Vietnamese trade policy reforms during the past few years may be interpreted as generally protectionist, although in some instances they were merely codifying existing

policies. The salient feature has really been one of contradictory liberalisation: both protectionist and liberalising measures were being introduced every year. Publishing the CEPT tariff reduction schedule and abolishing import licences in 1998 point one way, while foreign exchange controls, and the creeping increase in the use of quotas, bans and surcharges point the other.

It is hard, therefore, to say that Vietnam is firmly on the path to fulfilling its AFTA and APEC trade liberalisation commitments. If anything, trade policies have become more restrictive during 1996-2000. Most non-tariff barriers have become stronger, with only licensing and rice exporting notably weaker.

Vietnam's trade regime in 2000 remains restrictive by international standards. The Vietnamese policy framework is still very much a legacy of central planning. The planning vision of development and role of the state stifle the pace of liberalisation. Entrenched interest groups, particularly state enterprises and corporations, slow the liberalisation process even further. Such a cauldron of conflicting ideologies, interests and economic perspectives cannot be expected to produce a "liberal" trading regime in the short term.

## **Foreign investment**

Promotion of foreign investment was an early and relatively straightforward step in Vietnam's reform process (Gates 1995(2): 396). Vietnam enacted its first foreign investment law in December 1987. It was amended in June 1990 and again in December 1992. Although the law attempted to be reassuring about the rights of foreign investors and although it provided the usual 'give-away' incentives in the form of tax holidays and other privileges, it was ineffective until a realistic exchange rate was established in 1989. Even then, the weak legal framework, the continuing American trade and investment embargo, and the lengthy process of approving foreign investment projects prevented a significant rise in commitments until the mid-1990s. As in China, foreign investment began informally by Asian developing countries investing in labour-intensive export production outside the approval and statistical structure.

"Total capital" FDI commitments to Vietnam exceeded US\$34 billion in 1998. This measure reported by Vietnamese authorities includes the Vietnamese partner's contribution, typically land, to joint-venture projects. About three-quarters of projects with foreign investment are joint ventures, with the Vietnamese contribution averaging 25 to 30 percent of the official value. After deflating total capital by 22 percent (30 percent of three-quarters), the 262 projects licensed totaled an intent of investing US\$3.7 billion in 1994. This is equal to about 19 percent of Vietnam's 1994 GDP.

FDI commitments peaked at US\$8.5 billion in 1996, and have fallen steadily ever since. In 1999, commitments totalled US\$1.3 billion, and were only US\$252 million during the first five months of 2000.

Disbursements have typically lagged promises. In 1993, the net inflow of foreign investment totaled only US\$300 million, and net inflows for the 1991-1993 period were less than one-sixth of those for Thailand and Indonesia (World Bank 1995). 1996-97 saw annual disbursements of about US\$2.3 billion, but this average has fallen to US\$700 million during 1998-2000.

Serious obstacles remain in provisions that give minority partners, often state enterprises or government entities, veto power in a joint venture. Several agencies have to approve foreign investment projects. Although the Office of Government processes all large projects directly, the approval process remains lengthy, arbitrary and tedious by regional standards. Laws governing the implementation of contractual agreements are still lacking. In this situation, the lack of an adequate dispute resolution mechanism is a serious problem. Local authorities have considerable power and their approval is as necessary as that of central agencies. Even then, disputes over problems such as site clearance for hotels have caused delays lasting years. Property rights remain unclear. These weaknesses add to the evident risks of investing in a country that continues to subscribe to "market socialism". In June 2000, the Law on Foreign Investments was amended. The changes covered land issues and transfer rights, but were not as broad or as encouraging as they could have been.

An initial focus on petroleum and gas projects is now being replaced by manufacturing and infrastructure projects. Investments in hotels and tourism remained strong throughout the 1990s. Over two-thirds of investments have been from developing Asian countries. Taiwan is the largest investor, followed by Hong Kong and the Republic of Korea. Japanese commitments involved 110 projects with total capital promises of \$1.7 billion by July 1995. This was 10 percent of total commitments, which was less than that from Western Europe (14 percent), but greater than that from America (6 percent).

## **Mining**

Interest in mineral resources was one of the factors that drew the French to Tongking in the late 1880s. Their exploitation was an important feature of the colonial economy, and was further developed by the Japanese during their brief control of the region during 1940-45. The Vietnamese themselves continued this development from the 1950s with the assistance of Soviet geologists. There are commercially viable reserves of coal, iron ore, bauxite, chromite, copper, tin, titanium, zinc, gold, apatite and gemstones, although many of these are underexploited. Coal reserves are located in the north-eastern province of Quang Ninh and in Bac Thai province in the Thai Nguyen Basin. Proven reserves of coal are estimated to be approximately 3,500m. tons, although the actual figure for reserves of all types of coal (bituminous coal, anthracite, lignite and peat) may be as high as 30,000m. tons. Iron ore deposits of around 500m. tons have been located in a mine at Thac Khe. Proven bauxite reserves are estimated to be 4m. tons, mainly in the southern province of Lam Dong. Deposits of zinc and lead have been located in the North, although their extent is as yet unclear. Slate is being mined and exported from Son La.

The most important mining activity arises from the coal deposits. Output expanded considerably in the early 1970s, but stagnated for some years after 1977, following the widespread withdrawal of Chinese labourers after the deterioration of Sino-Vietnamese relations. Production peaked at 6.9m. tons in 1988, but averaged only 4.4m. tons per year in 1989-91. Since then production has recovered, with annual coal output averaging 6.8m. tons between 1993 and 1996, rising to 10.7m. tons in 1998. The Vietnam Coal Corporation, Vinacoal (which assumed sole responsibility for production and distribution in 1994), the target of increasing Vietnam's annual coal production to 12m. tons by 2000, but difficulties in the markets make it unlikely. In 1999, mines under Vinacoal were being closed. Labour conditions in these mines are appalling.

Exports of coal declined for three years in succession from 1977 to only 600,000 tons in 1980, and in 1987 the level of exports was estimated at only 233,000 tons. By 1990, however, coal exports of 788,500 tons had exceeded the 1980 figure. Further rapid increases were subsequently achieved, and in 1996 coal exports were 3.6m. tons for US\$115m., before a decline to 3.2 m. tons, (US\$94.5m). in 1998. Since the 1980s the Government has sought to promote foreign investment in the mining sector. However, this has remained at a relatively low level despite the 1996 mining law.

## **Petroleum**

In June 1986 Vietnam finally became an oil-producing nation when petroleum began to flow from the Bach-Ho oilfield, which was developed jointly with the USSR by Vietsovpetro. By mid-1987 the field, which is located 160km east of Ho Chi Minh City in the South China Sea, was producing some 5,000 barrels per day (b/d), and, in the absence of a domestic refinery, Vietnam was exporting petroleum to Japan. In 1996 production of crude petroleum was approximately 8.8m. tons. In 1994 two new fields (Dai Hung and Rong) came on stream. However, only a fraction of the petroleum produced was refined locally, at a small plant in Ho Chi Minh City built with French assistance. Wrlld price rises saw the value of Vietnam's oil exports rise from US\$1.2 billion in 1998 to US\$2.1 billion in 1999.

The project to build a new refinery at Dung Quat in the central province of Quang Ngai, with a capacity of 130,000 b/d, is well advanced. This was originally due to be operational by 2000, with a second refinery of similar capacity scheduled for construction several years later. However, Dung Quat has been surrounded by controversy. The intial group of foreign investors withdrew after the location in Central Vietnam was announced. Another group later pulled out claiming that the project was not economically viable, thus prompting the Government finally to proceed alone. In early 1998 the Russian foreign economic association, Zarubezhneft, agreed to help finance the proposed US\$1,300m. refinery, enabling an advancement of the project. In October, however, it was reported that construction of the refinery had been postponed indefinitely owing to a dispute between the US contractor and the other companies involved.

In the mid-1990s Vietnam's production level of crude petroleum was roughly equivalent to that of a minor producer such as Romania, but still be well below that of Malaysia and Indonesia (Vietnam's oil reserves are now estimated to be about one-third of Indonesia's). During 1995-98 oil production increased 22 percent annually to 12.5m. tons in 1998. In some respects, the industry has yet to fulfil initial expectations. Between 1988 and 1999 the Government allocated 35 production-sharing contracts to foreign oil companies, with a total of about US\$3,100m. invested. However, in terms of commercially viable finds, the results have been disappointing. In 1995 less than 25 percent of the country's 16 blocks had been allocated, and it was believed that some of the most promising areas had yet to be explored. Nearly all the major international oil companies are represented in Vietnam, including those from America, since the lifting in early 1994 of the US trade embargo.

Vietnam is also seeking to exploit its natural gas reserves, with proven reserves of 300bn cubic metres, and prospective reserves of 1,700bn cubic metres. Since production at the offshore gas field of Tien Hai peaked in 1987, Vietnam produced only associated gas from Bach Ho (nearly all of which was burnt off). However, in 1995 a gas pipeline from Bach Ho to Ba Ria (near the oil centre of Vung Tau) was completed, thereby allowing the utilization of gas for power generation, and gas production increased 154 percent during 1995-98. A three-phase masterplan for the industry has been drawn up, with 14,00m. cu m of gas expected to be produced in the final phase (2005-2010).

## **Industry**

Only a limited range of industrial activity was allowed to develop during the colonial period to avoid competition with French imports. Apart from mining, the only significant industries in Indo-China before 1940 were those of cement at Hai Phong and textiles at Nam Dinh and Hanoi. After 1954 the Vietnamese set out to develop both existing and new industries. In the South there was some development of light industry in the late 1950s and early 1970s, mainly related to the production or assembly consumer goods, and a cement works was established at Ha Tien near the Cambodian border.

"Socialist construction" entailed the creation of a heavy industrial base for the new economy. However, US bombing soon destroyed development of industry before 1965. After 1968 a gradual decline in the emphasis on heavy industry was perceived. One of the major emphases in the second National Plan was towards light and consumer goods industries in an effort to relieve the shortages of basic commodities, which were leading to disillusion among the long-suffering population. In practice, however, these policies made little headway until the advent of economic reforms in the 1980s. Although emphasis continues to be placed on heavy industry, the expansion of light industry, which began in the early 1980s, was furthered in the 1990s. Between 1993 and 1996, industrial growth averaged a robust 13.6 percent per year, slowing to 12.1 percent in 1998. Some of the large-scale state-owned industries performed well during the early 1990s (although many did not), following the input of foreign capital and technology in the form of joint-venture agreements. According to official figures, state industry and the non-state sector

grew at roughly the same pace. Light industrial growth was also strong. In 1998, industry (including mining, manufacturing, construction and power) constituted 32.7 percent of GDP and employed 16 percent of the working population.

Four areas of manufacturing showed particular promise in the 1990s: textiles, footwear and garments; agro-processing; electrical industries; and automobile and motor cycle assembly. In 1999 textiles and garments represented a significant source of export earning US\$1,747 million, after a stagnant year in 1998. Footwear exports reached US\$1,350 million in 1999. In April 2000, the government negotiated a 27 percent increase in the size of its EU quota, which combined with access to the US market should see further strong growth in the sector. Vietnam remains price competitive in garments, but less so after the devaluations of regional competitors since 1997.

In the early 1990s electronics and automobile production were still at an early stage of development. Both are import-substitution industries protected by tariffs and non-tariff barriers, and both have now saturated the domestic market demand. In 1993, foreign companies assembling electronics goods in Vietnam included Daewoo, Hitachi and Philips. Since 1995 the sector has expanded considerably with output of assembled T.Vs almost trebled in the period 1995-1998, reaching 364,000 pieces in 1998. The 30-40 percent growth rates in the electronics industry of the early 1990s have now settled down to closer to 10 percent annually.

By 1997, fourteen foreign joint ventures in the automobile industry had been licensed with total investment US\$940 m., with total assembly capacity at 144,660 cars a year and 45 different models. Of the 14 joint ventures, seven companies (Mekong Corporation, Vina Star Motor Corporation, Viet Nam Motor Corporation, Mercedes-Benz Vietnam, Ford Vietnam, Toyota Vietnam, Isuzu Vietnam, SuZuki Coporation and the Daihatsu Motor Co of Japan) were in production. Only 6,882 cars were assembled in 1999 (6,404 in 1998), which is less than 10 percent of projected domestic demand for the period 2000-2005. In 1998, 212,000 motocyles were assembled in Vietnam, meeting 20 percent of domestic market potential, which is estimated at 1m. a year in 1997-2005.

The cement and steel sectors continue to receive special priority. Annual growth of cement demand was 22 percent during 1991-1996, while production grew 15 percent in 1999. Cement production increased from 2.5m. tons in 1990 to 5.8m. tons in 1995, and 9.3m. in 1998. Crude steel production was 408,000 tons in 1996 and 853,000 tons in 1998. Import of cement increased almost three-fold during 1994-96, while imports of steel in the same period more than doubled. In 1998, however, the Government, owing to declining demand and rising domestic production banned steel imports.

Another emerging industrial sector is plastics, with output reaching 200,000 tons in 1994. Given the rapidly expanding requirements of the packaging industry, it is planned to increase plastics production eight-fold by 2000. A joint venture to produce PVC (with accompanying import protection) is, however, causing an increase in local costs and forcing the industry into import-substitution niches.

## **Power Generation**

By 1975 the total power generation of both zones of the country was only 3,000m.kWh. Production in 1980 was put at approximately 3,720m.kWh. Although the situation has improved since the mid-1980s, power shortages, particularly in the South, have been a feature of recent years. With energy demand rising at a rate of about 20 percent per year, electricity output has failed to keep pace. Electricity demand is forecast to reach 25,000m - 27,000m. kWh in the year 2000. Power generation in the South increased by an estimated 16.5 percent in 1993: the extra output was largely due to the newly-inaugurated gas turbine generators at the Ba Ria - Vung Tau power plant as well as by increased output at the Da Nhim and Tri An hydroelectric power stations. Further important developments were the construction of a new generator at the hydroelectric power station at Hoa Binh, the completion of the 1,500km North-South power line in May 1994 and two hydroelectric power stations in the Middle and the South, YALY and Thacmo. Total electricity output rose from 19,253m. kWh in 1997 to 21,847m. kWh in 1998. By 2002, generated capacity of forecast to be 33,000m.kWh. Nevertheless, an overhaul of the distribution system and the establishment of a regulatory framework to attract foreign investment remain badly needed. Some 19 percent of the electricity generated by power stations was lost in transmission in 1997.

The government is trying to bring electricity to 80 percent of rural households by 2005 (63 percent in 1995). During 1998-99, the government also announced its intention to move away from hydroelectric power to rely more on gas and coal.

## **Transport and communications**

A key factor constraining development is the inadequacy of infrastructure. The French endowed Vietnam with a railway system whose main arteries were lines between Hanoi and Ho Chi Minh City (then Saigon) and between Haiphong and Yunnan. After 1954 the Chinese helped to build a third major route between Hanoi and Guangxi via Lang Son. The system was badly damaged during the war, in both North and South Viet Nam, and its reconstruction was a priority task after 1975. The lines to the People's Republic of China, however, were closed towards the end of 1978 and further stretches were damaged as a result of the war with China during February-March 1979. Better Sino-Vietnamese relations, however, led to the reopening in February 1996 of the cross-border rail link. Other lines are in extreme need of modernization. Express trains in 1999 take 32 hours to travel the 1,730km between Hanoi and Ho Chi Minh City. Some 25 percent of Vietnam's estimated 400 engines remain coal-powered. In 1995 the Government estimated that investment of more than US \$3,670m. was needed for the modernization and expansion of the railway system.

Road transport became increasingly important in the 1960s, although roads and bridges suffered heavy damage during the war. In the South the USA built a new highway between Ho Chi Minh City and Bien Hoa, as well as a large number of lesser roads.

However, the road transport sector is still judged to be a "weak link" in the economy. A large percentage of the US \$13,040 million pledged by foreign aid donors during 1993-98 is targeted at upgrading the road network, and improvements are seen in the upgraded North-South nationwide road No 1, and the newly built Hanoi-Haiphong highway. Most road bridges in Viet Nam have a maximum weight capacity of just 10 tons, and of the country's 105,500 km of highways only 25 percent are paved. A six-lane highway linking Hanoi with Noi Bai airport was opened in 1994, but the new airport terminal is well behind schedule.

The principal port facilities before 1975 were at Haiphong, Da Nang and Ho Chi Minh City. By 1978 moves were being made to build a new port at Cua Lo, as well as to modernize Haiphong to increase its capacity to 2.7m. tons per year. Upgrading work was still taking place in 1996 and until this work is completed, the latter will continue to suffer badly from congestion. In the southern-central provinces, it was decided to modernize the ports of Quy Nhon and Nha Trang, to enable them to cope with timber exports. In the Mekong delta there are plans to develop a new container facility at Ho Chi Minh City and to upgrade several of the river ports to take ocean-going vessels. Haiphong and Can Tho ports require dredging to reduce chronic siltation, and new container terminals are also planned at Haiphong and Tan Thuan. Vung Tau port is due for extensive upgrading. While large amounts of foreign financial aid and investment have been pledged, their disbursement and implementation have been delayed by problems associated with bureaucracy and the low level of domestic capital mobilization. Aid disbursements reportedly totalled US\$5.3 billion during 1993-98, which was 39 percent of commitments.

As a result of rapid economic and political developments in recent years, by 1997 more than 17 foreign airlines served Viet Nam. In the early 1990s a major programme of airport development was under way, with Noi Bai (Hanoi), Tan Son Nhat (Ho Chi Minh City) and Da Nang airports all targeted. By 2010 Tan Son Nhat is scheduled to be able to accommodate 10m. passengers and 1m. tons of freight per year. The number of passengers carried by Vietnamese airlines increased from 500,000 in 1990 to more than 2.7m. in 1996 and the volume of freight increased from 4,000 in 1990 to 50,100 in 1997. Viet Nam Airlines had one of the most modern fleets in the world in 1998, with 22 aircraft less than one year old.

With the onset of reform, Vietnam's telecommunications network also received attention. In 1991 there were only two telephones per 1,000 people; by 1997 there were 1.3 per 100. The Government's target is to raise the telephone penetration rate to four to five lines per 100 people by the year 2000. An estimated US \$2,700m. of investment will be required if this target is to be achieved.

## **Vietnam into the 21<sup>st</sup> century**

Vietnam's transition is undoubtedly one of success. Incomes have risen, poverty fallen, and farmers have gained. That success, however, is largely due to the failure to implement central planning in depth after 1976. Further, the fact that Vietnam is a poor developing country, with largely unprocessed agricultural exports, and a labour force willing and able to work at wages slightly above subsistence, makes it very different from most transitional economies.

Structural transformation of Vietnam's "residual element" of central planning was therefore achieved during the first decade of transition without dramatic J-curve effects, with the exception of industrial production for a couple of years. It seems, however, that social services and support systems also experienced a slump and gradual recovery.

Vietnam's reform process, some argue, has slowed in recent years (World Bank, 1998; UNDP 1998). Others point out that transition is a long process and that progress over the past decade has been impressive (Mallon and Irwin, 1997). It is all, of course, relative. Structural reform in Vietnam during 1988 to about 1992 was impressive: macro-economic stabilisation, state enterprise reform (which shed 22 percent of its workforce during 1989-91), a re-orientation of international trade, and a boom in private rural and urban household economic activity due largely to fundamental institutional reforms. Reforms of the past five or so years invariably look pale in comparison.

The future prospects, however, remain bright, so long as incomes continue to rise and jobs are created. The specter of a steady rise in the numbers of unemployed remains. Rural-urban migration is increasing. This "employment imperative" is not being addressed through policies promoting capital-intensive import substitutes, or by ongoing protection of the state enterprise sector. Development of a private corporate sector is painfully slow, yet it is the prerequisite for sustained long-term development, and hence on the ability to generate increasing levels of income transfers to achieve welfare goals.