THE ECONOMIC DEVELOPMENT POLICY IN THE TRANSITION TOWARD A MARKET-ORIENTED ECONOMY IN THE SOCIALIST REPUBLIC OF VIET NAM

PHASE 1
FINAL REPORT
OPINIONS OF THE FIVE-YEAR PLAN FOR SOCIAL AND ECONOMIC DEVELOPMENT 1996-2000 IN VIET NAM

VOL.3 FISCAL AND MONETARY POLICY

AUGUST 1996

Ministry of Planning and Investment
THE SOCIALIST REPUBLIC OF VIET NAM

Japan International Cooperation Agency
JAPAN

Overall Contents

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Preface to the Final Report, Phase 1

This study was proposed after consultation with Viet Nam's Prime Minister Vo Van Kiet and Vietnamese officials when a high level Mission of the Japanese government on Economic and Technical Cooperation visited Viet Nam in October 1994. A formal agreement was reached during Party Secretary-General Do Muoi's official visit to Japan in April 1995 to carry out the study as part of Japan's official development aid (ODA) to Viet Nam. It was agreed that the Study would be implemented under the Social Development Studies Program of the Japan International Cooperation Agency (JICA) and a Scope of Work Agreement defining the details of the Study was officially signed in August 1995 between Vice Minister Mr. Vo Hong Phuc of Viet Nam's Ministry of Planning and Investment and Councilor Mr. Norio Hattori of Japan's Ministry of Foreign Affairs Economic Cooperation Bureau.

The project was agreed to be conducted as a joint study between Japan and Viet Nam and the research groups for that study was organized on both sides with the participation of first rate scholars and experts. Professor Shigeru Ishikawa headed up the Japanese Research Group, Dr. Nguyen Quang Thai the Vietnamese project team. Under the Agreement, the project is to be pursued in two phases. During the first phase, the over-arching goal is to study the Five-year Plan for Social and Economic Development in Viet Nam (covering the years 1996 to 2000). This phase was planned to end in June 1996 with the submission of a Project Report to the leadership of Viet Nam via the Ministry of Planning and Investment. The research of the first phase includes, in addition to the study for the general commentary on the draft Five-year Plan, four specific studies relating to the following four selected topics respectively which are to be conducted at the four separate Sub-Research Groups as "in-depth" studies of the draft Five-year Plan.

(1) Macro economic growth and the its relationship with inflation and stability;
(2) Capital mobilization in the fiscal and monetary domains;
(3) Industrial development and industrialization policies; and
(4) Policies on agriculture and rural development.

During the course of the research, both sides agreed to add the three topics below, though the research on them has not yet been organized:

(5) Development gaps among domestic regions;
(6) Unemployment and underemployment problems; and
(7) Relieving starvation and mitigating poverty.

This research project has attracted the attention and interest of Viet Nam's leaders. Party Secretary-General Do Muoi and other senior officials have received reports on on-going research findings from the scholars involved in the project. Scholars on both sides have revised their reports in light of the leading opinions provided by Party Secretary-General Do Muoi in September 1995 and March 1996, and at his request they have prepared an Executive Summary Report (March 1996) earlier than the Final Report so that their opinions may be incorporated in the document "Orientations and Tasks of the 1996-2000 Five-year Plan for Socio-Economic development in Viet Nam."

The Executive Summary Report was written solely, and the Final Report was written mainly, by the Japanese Research Group but it reflects the findings of joint research conducted by both sides of Japan and Viet Nam. This joint research was deepened through five seminars of various sizes, two in Hanoi (the Start-Up Seminar in August 1995 and the Seminar to hear opinions on the Draft of the Final Report in March 1996) and three in Tokyo in October and November 1995 and January 1996.

The method this research project desired at its planning stage to follow was a "joint study" of the Vietnamese and Japanese Research Groups by way of identification of research topics and determination of research methods and data on the basis of joint discussion, proceeding of the joint study with frequent contacts, meetings and field surveys, and writing (as much as possible jointly) of the research findings and derived policy options. We are pleased that this desire was achieved at least preliminarily, especially toward the end of the first phase.

The Final Report consists of five parts, and is printed correspondingly in five volumes. Part One is on general commentary on the draft Five-year Plan*, and the following Parts on in-depth studies of specific issues of the draft Five-year Plan conducted by the four Sub-Research Groups. In each of these Parts (or Volumes), that summary of the research results either for general commentary or at each Sub-Research Group which was written for the Executive Summary Report, is reproduced (with some revisions) and, together with the comments on it by the Chief Sub-Research Group of the Vietnamese side, constitute the Introductory Chapters. They are followed by papers and notes, each written by either Japanese or Vietnamese member, and joint field-survey reports.

The research tasks (or topics and sub-topics) selected for the five Parts are summarized as follows.

First, the research tasks of the General Comment Part (Volume 1) are the interpretation and evaluation of the contents and outcomes of the Doi Moi policy, the leading strategy principles which was initiated in 1986 and is still effective and governing the new Five-year Plan (draft), and the analyses, from a more operational view-point, of the policy-systems contemplated in the new Five-year Plan (draft). The latter questions, firstly, from the aspect of economic system reform, what is the structure of blue-prints of marketization designed for the Vietnamese economy is, and, secondly, from the aspect of productive force restructuring, what type of the economic "development model" for industrialization or its variant available in development economics is suitable as a guideline for the Viet Nam economy taking into consideration the initial conditions of her economy. The answers to these questions should be useful as clues for exploring the policy options for Viet Nam.

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* In this Final Report, the term "Draft Five-year Plan" refers to either one of the following documents which were sent to the Japanese Academic Group directly from the Ministry of Planning and Investment. Specific reference of either of these is made in our report only when it is necessary.

(1) *1996-2000 nen gokanen no keizai shakai kaihatsu keikaku no shuyou naiyo no shoki soan* (This is the Japanese translation version of the original in Viet Nam language which was sent to the Japanese Academic Group at the end of June 1995 so that opinions on it may be presented at the Start-Up Seminar in August 1995. In English, this is *Initial Draft of the Five Year Socio-Economic Development Plan in 1996-2000:* Main Contents. Later in August 1995, the document, Some Issues on Industrialization and Socio-Economic Development in Viet Nam from Now Upto the Year 2000 was sent to the Japanese Academic Group. This appears to be a version with minor revisions of the "Initial Draft.")

(2) Socio-Economic Development and Investment Requirements for the Five Years 1996-2000, Government Report of the Consultative Group Meeting, Paris, 30 November to 1 December 1995, Hanoi, October 1995. (This was transmitted to the Japanese Academic Group on October 3, 1995 so that opinions on it may be presented at the Seminar in Tokyo in January 1996.)

In our earlier general comment on the "Initial Draft" of the Five-year Plan, four items of policy options were suggested, which in fact were made the research topics of the four Sub-Research Groups at its start. It is possible to locate these four policy options within the overall framework we have just shown for the analysis on the policy-systems of the Five-year Plan (draft).

The study task of the Part for Macroeconomy Sub-Research Group (Volume 2) is to attempt a simulation analysis of the issue in a hypothetical situation where the Viet Nam government wants to attain the degree of a high rate of growth of GDP which is enabled only by a considerably high rate of domestic investment, considering the fact that the present level of domestic saving ratio is still very low, not significantly higher than zero, and both the debt service payment obliged by the large accumulated external debts and the minimally required government social service expenditures amount large, how strong would be the pressure for domestic inflation and external balance of payment deficit. The statistical indicators used for simulation are taken from the figures in the Five-year Plan draft.

To this Part is added a study on the environmental issues: how important it is for such a country as Viet Nam where industrialization is at its initial stage to take measures to minimize the "environmental degradation" and "industrial contamination" as early as possible.

The research tasks of the Part for the Fiscal and Monetary Policy Sub-Research Group (Volume 3) are firstly, a systemic analysis to clarify the transformation of fiscal and monetary mechanism of the Vietnamese economy accordingly as the economy changes its resource allocation formula from the one in the planned economy of basing itself on the centralized material planning and, with it, material allocation to the one in the transitory economy where the government intervenes partly by material allocation and partly through the fiscal and monetary policy instruments that are conventional in the market economy. The research tasks are, in addition to it, to investigate the *modus-operandi* of the present fiscal and monetary system, from the point of view of the effectiveness of the domestic saving mobilization and to explore the measures to improve them. As priority items, the issue of how to adjust the fiscal relationship between the central and provincial governments so that the total government revenue could be raised and the regional income disparity be reduced and the issue of how to raise and enhance the financial system which may facilitate the preservation of the long-term and medium-term investment funds for industry, in particular, to the private sector are taken up.

From the point of view of foreign saving mobilization, studies are made with respect to the sources from FDI, ODA and others and the issues involved in these source.

The research tasks of the Part for Industrial Policy (Volume 4) are firstly to make surveys not only on the existing production and export-import statistics of industry, but also on the not-yet well covered or organized statistical information and data on industry on the by firm or by establishment, by ownership, by size or by regional bases, and thereby to clarify the present situation and its characteristics as well as the issues to be

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(3) *Directions, Planning Tasks of Socio-Economic Development for 5-Year 1996-2000, Report of the Central Executive Committee of the Party, Section VII to be Submitted to the Eighth Congress of the Party*, Viet Nam Communist Party Central Executive Committee, Hanoi, November 14, 1995. (This was sent to the Japanese Academic Group in March 1996 so that opinions on it may be presented at the Final Seminar in Hanoi.)

(4) *Political Report of the Central Committee (VIIth Tenure) to the VIIIth National Congress of the Communist Party of Viet Nam* (This was published in Viet Nam dated April 10, 1996. Comments for this was in time only for including them in Postscript to the Executive Summary Report.). The finally adopted version of this document at the Party National Congress is the following. Communist Party of Viet Nam VIIIth National Congress, *Orientations and Tasks of the 1996-2000 Five-year Plan for Socio-Economic Development, Report of the Central Committee, the VIIth Tenure, to the VIIIth National Congress*, Hanoi, 28th June-1st July, 1996. It was sent to the Japanese Academic Group on July 12, 1995.

solved of the Vietnamese industry. Exploration should be made on that basis, and taking into consideration the experiences of East Asian economies as a predecessors of Vietnamese industrialization, with respect to the order of industry-by-industry development in terms of the dynamic shift of comparative advantage position. The use of FDI and the way of participation in the regional integration schemes of AFTA and APEC are also to be explored. Lessons must be learned also from the experiences in the East Asian countries with regard to the matter of establishing the oil refining, petro-chemical, iron and steel, cement and chemical industries, which are capital lumpy and intensive, yet the government was anxious to build earlier, capturing the advantage in rich resource endowment.

Finally, the research tasks of the Agriculture and Rural Development Sub-Research Group (Volume 5) are to identify the policy instruments for further increase in agricultural production for the sake of promoting economic development, on the basis of the analyses on the changes in the institutions and organizations of agricultural production as well as in the production incentives during the 1980s and in the first half of the 1990s. Among these research tasks, especially important are the clarification of the roles of the factors like the potentiality of increasing the area under rice planning, the production incentive effect of institutional changes and price increases, research and development and irrigation investments. Investigations are also to be made on the way to improve agricultural finance and farmers' organizations in the way consistent with the market-oriented economic reform.

In pursuance from the Final Report, the joint research of the second phase will start on the basis of a new agreement between the two parties.

In addition to submitting this Final Report to the leadership of Viet Nam, we have sent it to you in hopes of soliciting your opinions for more effective start of the second phase joint study.

July 1996, Hanoi and Tokyo

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1
Summary of the Studies on Fiscal and Monetary Policy

I. Role of fiscal and monetary policies in economic development

Enormous investments and development funds are required for economic industrialization and modernization being promoted by the Vietnamese government. The Fiscal and Monetary Sub Research Group conducted a study on measures for mobilizing investments and development funds (mainly savings mobilization). The results of the study are summarized in Section II and Section III as the flows of public and private investments and funds. Section I briefly shows that the capital accumulation mechanism is shifting from physical planning to fiscal and monetary means along with the change to a market oriented economy as the framework of the current state analysis.

1. Investment and saving ratios in Viet Nam

The domestic savings ratio of Viet Nam increased slightly from 10.1% in 1991 to 17% in 1994. However, Viet Nam still has a low domestic savings ratio in comparison with neighboring countries where the domestic savings ratio exceeds 30%. The low ratio derives from the fact that the savings surplus in the whole economy is limited because of the low income level. Another factor contributing to the low savings ratio is that Viet Nam is changing to a market oriented economy. Under the planned economy, no bank system was available for common people. Common people were not expected to contribute to domestic savings. The people have not acquired the habit of bank savings even now that a bank system has at least been formally established. Common people's access to banks is extremely low because of the service and credit problem. Worries over inflation are exerting a major influence on this trend. Gold and cash still have a larger share of the people's saving assets.

The income difference between the north and the south is another restrictive factor for investments and savings in the Vietnamese economy. Rapid economic growth inevitably brings about an income difference among regions. In Viet Nam, the differing initial conditions between the north and the south have widened the income difference. A policy giving high priority to correcting the income difference is often in conflict with the efficiency oriented mechanism of a market economy. The absence of self-help efforts deprives local governments of incentives for mobilizing savings.

2. Fiscal and monetary system under the planned economy

The state-owned enterprise (SOE) sector forms the nucleus of a planned-economy system. In accordance with the heavy industry promotion policy under the planned economy in Viet Nam, capital was accumulated by physical planning in which SOEs played a major role. The role of the fiscal system was to secure a flow of funds without disturbing the physical planning. National savings required for equipment investments were concentrated in governmental savings, mainly transfers of operating surplus of SOEs. The savings collected by this method were distributed to SOEs for their equipment investments through governmental budgets. There arose a problem of soft budget restriction. As long as SOEs operate according to governmental commands and plans, the government must provide assistance for their deficits.

The Bank for Investment and Development in Viet Nam (BIDV) played the role of a fund conduit for actual distribution of investment funds. The State Bank of Viet Nam (SBV), the central bank, which also functioned then as the only commercial bank, supplied operating funds. Both of these banks moved funds according to governmental commands without playing the role of a financial intermediator. Also, it should be noted that local governments in Viet Nam exerted major influence on bank's fund supply operations. Administrative divisions were the basis for setting up branch offices. Branch offices were placed subjected to a dual command structure, the main office and local governments. The latter exerted greater influence. This minimized the possibility of autonomy in the flow of bank funds.

3. Fiscal and monetary system under the transition to a market-oriented economy

The market oriented economy mechanism was officially introduced after the adoption of the Doi Moi policy in 1986. Let's summarize the changes from the viewpoint of the flow of investment funds. As a result of the financial system reform that started in 1988, the mono-bank system was changed to the two-tier banking system. The financial source of SOEs was changed from fiscal funds to bank loans. The Agricultural Bank and the Bank for Industry and Commerce were established by separating the commercial banking function from the SBV. Negative interest rates provided as subsidies were changed to positive interest rates. Market oriented restrictions were thus imposed on bank loans. Direct financing to SOEs by the SBV and fiscal deficit financing were discontinued because they caused inflation. As a result of the tax system reform in 1990, the source of fiscal revenues was changed from transfer of operating surplus of SOEs to taxes. Thus, Viet Nam roughly completed the formal introduction of the market economy system by 1992 - 1993.

After the introduction of the market economy mechanism, capital formation for industrialization has been implemented in two sectors, public investments and private investments (including profit-making business investments by SOEs). It is predicted that funds for public investments will be secured relatively smoothly in the future. The tax revenues, which are the source of public investments, are increasing steadily. The target of the 5-year plan, 20 - 21% of GDP, has almost been accomplished. Since Japan resumed ODA in the form of yen loan in 1992, the funds will keep increasing in the immediate future. The budget fund distribution function that was previously assigned to the BIDV was transferred to the General Department of Investment and Development that was newly established under the Ministry of Finance. Direct control by the MOF strengthens the control of budget funds. Profitability must be assured for obtaining loans which are provided on an assumption of repayment. The issue is how the government responsible for executing policies can ensure profitability.

On the other hand, it cannot be said that the private investment system is functioning properly. Bank loans to the private sector are increasing, but short-term loans account for most of them and the lending rates are high. The problem is that the private sector has few medium- and long-term fund sources. Bank deposits are increasing, but they are enticed by high interest rates. Most deposits are short-term. Only speculative business can be profitable at such high interest rates. Although the industrial sector has fund needs for expanding business, high interest rates are suppressing their needs. Banks are unable to play the role of monetary intermediator because they have few borrowers. Meanwhile, the habit of holding bank deposits has not been disseminated widely among common people in spite of high interest rates. As a result, Viet Nam has no fund circulation system that connects the household economy sector, the enterprise sector, and the government sector.

Two-tier Banking Index (TBI)

TBI is an index comparing a deposit bank's amount of credit accommodation with a central bank's amount of credit accommodation. It is defined as $X/Y - 1$. "X" is the total amount of credits by the bank sector including the central bank to the economic world excluding the bank sector. "Y" is the total amount of domestic credits by the central bank. The value of TBI is high in an economic system where deposit banks are performing an independent monetary intermediation function (20 in Japan and 18 in the U.S. in 1989). The value of TBI is zero in a mono-bank system because the national bank is the only issuing bank and the only commercial bank.

4. Changes in fund flow

When the market economy mechanism was introduced, budget subsidies to SOEs and direct financing by the SBV were discontinued almost completely. SOEs had to obtain deposit-based loans from a commercial bank. As a result of the tax reform, transfers of operating surplus to the budget was replaced by taxes based on sales and profits. Thus, the budget restrictions for SOEs became hard. In fact, SOEs' share in the GDP is increasing, but bank loans to them show a decreasing trend. Also, the net transfer to the budget is increasing rapidly. It is suspected that SOEs are under severe fund restrictions. On the other hand, the fact that commercial banks have problems of bad loans proves that the market mechanism is not functioning properly in the bank system.

Looking at the progress of the monetary intermediation function in Viet Nam on the basis of the Two-tier Banking Index, it is evident that the TBI (Refer to the above box.) was 0.6 immediately after the introduction of the two-tier banking system (in 1989), and rose to 1.1 in 1994. Although it shows an improving trend, the figure is extremely low and the rate of increase is slow. This indicates that it will take considerable time before the commercial bank can manifest a real intermediation function. The ratio of domestic credit balance to GDP was lowest (0.15) in 1992 and shows an improving trend (0.21 in 1994). However, progress has been slow. This proves the difficulty of promoting monetary system reform without reforming the real sector economy.

II. Public Investment and its funds flow

1. Mobilization of fiscal funds

(1) Fiscal issues

According to the Five-year Plan (1996 - 2000), the level of public investments must be increased to 10% of GDP for accomplishing the target economic growth. The level of tax revenues must be raised to 20 - 21% of GDP for obtaining the funds required for the public investments. To increase public investments required for accomplishing planned economic growth and for mobilizing the funds needed Viet Nam has three issues in the fiscal field, ① securing investment and development funds in the state budget, ② tax reform for raising incentives for reinvestment, and ③ efficiency improvement of fiscal expenditures.

(2) Securing fiscal funds for investment and development

To secure sufficient public investments, fiscal funds needed for investments must be mobilized by constructing a tax system that can maintain the current tax revenue level (ratio to GDP: 20 - 21%). At the same time, Viet Nam must adjust the current tax system that depends highly on taxation on imports and exports to change smoothly to an open economy (namely, that of AFTA). By means of the tax reform phase II starting in 1995, Viet Nam must accomplish two tasks, mobilization of fiscal funds and establishment of an efficient tax system.

The tax reform planned for 1996 - 2000 has the following four directions: ① reviewing the current tax items for securing stable tax revenues, ② constructing a equitable tax system, ③ harmonizing with the ASEAN tax system and the international tax system, and ④ improving the tax collection system. It is planned to adjust and change many tax items in accordance with the basic policy of changing to a unified and simple tax system.

The nucleus of the tax reform are the changes from turnover tax, profit tax, and high personal income tax to VAT, corporate tax, and income tax, respectively. Generally, the taxable base is to be enlarged and tax rates are to be lowered. VAT is anticipated to be the main component of future tax revenues, so it is desirable to introduce it quickly. However, since a business accounting system, daily bookkeeping, and invoice exchanges are prerequisites for introducing VAT, difficulties are anticipated for its complete introduction. Since it is doubtful whether majority of small and micro businesses such as retailers will acquire the business practice easily, the current turnover tax will have to be continued for small and micro business for the time being. Meanwhile, the issue of lowering import and export tariffs involves the following problems that require cautiousness: ① problem of protecting infant domestic industry from international competition and ② introduction of tax items (such as special consumption tax) that can substitute import and export duties which are currently the greatest source of tax revenues.

The policy of abolishing the current income tax for high income people and expanding the tax base to all income groups will be effective for redistributing the national incomes and for increasing tax revenues in future. Since direct taxes such as income tax have high income flexibility, economic growth tends to be directly reflected to tax revenues when the ratio of direct taxes (the ratio of direct taxes to the total tax revenues) is high. The feasibility of strengthening the income tax in Viet Nam in this stage involves some doubts, but actions to increase income tax revenues proved successful in some developing countries.

The Social Insurance Fund is a promising source of medium- and long-term funds that can be used for public investments. The insurance premiums that are the source of the Social Insurance Fund consist of ①employers' burden (15% of the total amount of wages), ② employees' burden (5% of wages), ③governmental subsidies, and ④ other. Governmental subsidies are indispensable for paying annuities for the immediate future due to the shortage of insurance premium income. In view of the large percentage of the young population and the potential of future economic growth, the fund will play an important role for the economic development in Viet Nam when it will have surplus funds and use them as medium- and long-term funds under a strict management policy.

(3) Tax reform for raising incentives for reinvestment

The targeted tax revenues (ratio to GDP) of the Five-year Plan was already accomplished in 1994. Therefore, it is important to direct efforts to more qualitative tax reform in the future. First, the current tax system that has deprived the industrial sector of motivation for reinvestment must be reformed to promote investment. Since tax revenues will be increased in the long-term by encouraging expansion and reproduction in the industrial sector, this reform is important. The current tax system is characterized by excessive dependence on some tax items. Four tax items consisting of turnover tax, profit tax, import/export duty, and Special consumption tax account for 76% of the tax revenues (as of 1995). Comparing Viet Nam with the other ASEAN countries in the effective tax rates imposed on enterprises, Viet Nam has the highest tax rates, due mainly to the turnover tax. This indicates that an excessive burden is imposed on enterprises. In other words, the current tax system collects a large amount from those which have large funds and are easy to impose taxes on such as SOEs, foreign investment, and imported goods. This may be reasonable from the viewpoint of securing tax revenues, but lowers enterprises' will to reinvest profits. This is undesirable from a long-term viewpoint because it hinders sound industrial development. The tax system must be changed to a system that promotes enterprise activities under open economy and is suitable for international trading.

A centralized tax collection system compared with a de-centralized one is generally a cost-saving, streamlined, and efficient method for collecting funds and redistributing them. For such a tax system to function well, local tax officers must have high morale. In reality, the centralized tax collection system that the Vietnamese government is trying to establish is often not functioning efficiently. The central government accuses local governments of tax income hiding, while local governments are protesting to the central government that they cannot pay the necessary expenses because local disbursements are controlled by the center. The basic problem lies in that local revenues and disbursements are not linked; disbursements are controlled by the central government, but the tax collection system depends on local governments' revenues.

At present, the Vietnamese government is promoting centralized fiscal management, attaching importance to income distribution among regions. This deprives both wealthy regions and poor regions of a will to increase tax revenues. They are missing tax revenues that could have been obtained under a better system. To get away from the situation that is undesirable for both the central government and local governments, it is necessary to construct a fiscal system that links an increase in local revenues to local disbursements. For this purpose, it is important to provide local governments with an incentive to increase revenues by clarifying the revenue allocation rules between the central government and local governments.

(4) Efficient disbursement of fiscal expenditures

For increasing public investments, it is necessary not only to increase fiscal revenue sources, but also to raise the efficiency of fiscal expenditures. This requires the following: ① Distribute more funds to investment and development by avoiding waste in current expenditures, ② limit public investments to projects of high public nature, and ③ construct an appropriate audit system for efficient fiscal operation.

One of the most serious problems related to budgets is the underdeveloped state of its operation and management system. The fiscal authorities have not tracked the state of budget execution because Viet Nam has no well-established accounting system or a budget law. It is said that an enormous amount of fiscal disbursements has been wasted. To strictly control budget execution, the government is planning to establish a system in which state organizations such as the central bank audit financial statements and accounting procedures of budget executing organizations.

For operating public investments efficiently, it is desirable to decrease the fiscal burden by separating commercially feasible projects from the budget. For this purpose, public investments that are funded by the budget should be classified clearly into capital investments and loans. It is desirable to discontinue financing profitable public investments from the budget. At the same time, it is advised to distribute investment and development funds exclusively to projects of high public nature. One of the ideas for commercially feasible projects is to establish an organization that operates independently from the government and to assign the financing function to it. For example, a public organization such as a national development bank can be established to finance projects preferentially for industries and enterprises having strategic importance for the country in both the public and private sectors. For such an organization to function efficiently, autonomous management without receiving subsidies and a high-level credit examination ability must be established.

2. Use of foreign savings for public investment

Viet Nam has an extremely large demand for public investments for economic development represented by infrastructure investments. The country must continue to mobilize foreign savings for procuring required funds.

Under the current domestic and international economic circumstances, only a limited increase can be expected for grants. Commercial loans are not realistic in view of the high cost. Therefore, ODA loans will continue to be the major fund procurement means.

(1) Thorough external debt management

Since ODA for the Viet Nam has expanded relatively steadily, ODA loans tend to be regarded as a convenient fund procurement method. However, ODA loans accompany repayment risks unlike grants and FDI that do not require repayment. Therefore, ODA loans and other foreign debts must be managed cautiously based on an accurate public investment plan and tax revenue outlook.

At present, the Vietnamese government has set a guideline of allocating 10% of the state budget and 15% of the exports to the repayment of external debts. However, critical assumptions for the guideline, such as estimated amounts and their way of calculation of oil reserves, oil production, and the investments required for attaining the production have not been presented. Some governmental officials show a desire to further increase external borrowings based on an optimistic estimate of oil and natural gas income,without an objective and quantitative future plan.

(2) Matching the sources to the uses of ODA funds

ODA funds vary in interest rates, repayment conditions, and risks according to the different systems and objectives of donors. Since financing conditions do not strictly reflect the profitability of individual projects, projects must be selected prudently to avoid a discrepancy between cost and benefit. Otherwise, possibilities of being unable to make repayments increase. It is important to set guidelines (matching between funds and usages) for allocating funds to appropriate investments based on their interest rates and other conditions.

The Vietnamese government is considering the issue of foreign bonds on a commercial basis (such as Euro-bonds) because ODA funds are not growing. It is true that such foreign bonds can be issued even at present. However foreign bonds carry high interest rates at present with unrepaid liabilities. It is advised to issue foreign bonds after lowering the fund procurement cost by completing the negotiation with London Club Countries.

III. Private investment and its fund flow

1. Mobilization of private savings

The issue in the financial field is to foster financial institutions capable of sufficiently providing investment and development funds necessary for the achievement of the Five-year plan. Financial institutions must create a smooth circulation of funds for the areas in need.

(1) Insufficient function of the current financial system

The reform of the Vietnamese financial system has rapidly progressed since 1988. However, it is difficult to say the financial system fully meets the demand of the market. First, looking at commercial banks as financial intermediaries. Their short-term deposit rates tend to be set higher than middle- and long-term ones, making it hard to collect savings of the latter type, while commercial banks are mainly engaged in short-term financing for fear of economic and political risks. Furthermore, they do not make safficient financial investigations. They make little use of an analyzing method to forecast future proceeds based on financial data. Most of them seem to center on financing based on collateral.

Next, the general public is analyzed as fund suppliers. Most of them do not trust financial institutions partly because many credit unions went bankrupt in 1990. Difficulty in withdrawing deposits is considered to be another reason for their distrust in banks. In fact, they fear very much that sources of bank savings may be traced, leading to money capture. Instead they are said to save hoarded cash or gold, and a survey on Viet Nam's living standards shows they resort to saving in the form of gold, cash or dollars. According to an issue of the "Economist", Viet Nam's general public save gold corresponding to 10 billion dollars (about 140 dollars per capita), which is a considerably large amount of money compared with a $274 per capita GDP. These days more money has been put on fixed deposits due to higher rates, but gold seems to be more attractive as medium- to long-term saving measures. They still remember the days when they suffered from hyper inflation, and do not believe that inflation rates will be stabilized for long. Therefore, it is necessary to make efforts to shift gold or cash saved by the general public to bank saving.

Finally, regarding enterprises as fund users, private enterprises, many of which run self-funded businesses, are less favored than SOEs in acquisition of assets, collateral and access to funds. Though promising, enterprises exporting labor-intensive products are not in a position to be financed by banks due to their insufficient mortgage.

(2) Establishment of fund flow from the household sector to the industrial sector

Inflation-free growth is an important issue for Viet Nam to achieve its Five-year plan. What is important is how to expand the national financing system and to realize fund provision to satisfy fund demand. That necessitates the improvement of the financial system and the recovery of the people's trust in banks through their own efforts to improve their service. Obviously stabilizing Viet Nam's economy is the most important thing for realizing strong economic growth and a sound financial system.

For Vietnamese companies to raise external funds, the general practice is bank borrowing mostly in the short term. Companies are nearly unable to issue stock to raise funds in the capital market. Furthermore, there is no securities market providing purchases and sales of such debentures and stocks. In this way, the establishment of middle- and long-term funds is an important issue for Vietnamese enterprise. They are an urgently required extension of the function of indirect financing through banks. Also desirable is the development of a capital market, the establishment of a stock exchange and the raising of medium- to long-term funds.

1) Strengthening of commercial banks

Improved bank service is a basic factor to recover bank credibility. For example, when customers apply to open savings accounts, it should not take a long time before they are approved and formally issued. When depositors ask to withdraw their savings, they must be available immediately. Information about customers should be kept absolutely confidential. Moreover, banks are expected to give their customers a saving incentive by offering new financial means such as an inflation indexed deposit and a long-term deposit with large prize money. It is also desirable for banks to improve their credit creation function, and to make banks more accessible for customer utilization. One suggestion is to introduce and discount commercial bills allowing customers to convert them into cash easily.

In line with the above reform, it is important for the government to encourage the people to deposit their money and push a savings campaign forward under a slogan of Vietnamese growth and progress. In promoting national deposits, the government must guarantee that it will not trace the sources of national deposits for, say, two years nor confiscate their money, but remunerate those who have large deposits. At the same time the government should study the feasibility of introducing a tax incentive which could induce the people to make deposits. With this is mind, it is not desirable to impose a tax on interest rates.

2) Mobilization of medium- and long-term funds through security markets

At present an urgent task is to expand the function of indirect financing by raising bank deposits to achieve the Five-year plan, but in light of industrialized Viet Nam toward 2000 and thereafter it will be very significant to develop a stock market allowing investors to furnish funds for those in need. First, to furnish funds by issuing medium- and long-term bonds it is necessary to develop a distribution market that enables investors to convert securities into cash before a due date.

3) Institutionalizing the informal sector

The existence of informal financing has been pointed out in Viet Nam. Its concrete scale and actual status is not clear, but it is said that there are two types of informal financing: private-sector financing and individual-sector mutual aid funds known as Ho or Hui. They feature short-term loans, high interest rates, easy procedures, and high risks. A future issue will be to introduce these funds into an institutionalized financing system. What can be considered as a new scheme of institutionalized finance is to build a union composed of only merchants, and to establish a centrally organized body (banks) to operate with surplus funds collected unilaterally from the union.

The union's major role would be mutual aid by union members. When member merchants are in need of operational funds, the union makes a loan to members who have the minimum required deposit balance. The union's surplus funds go to a centrally organized body, run by experts in investment and finance. Furthermore the union collects deposits from its members on a face-to-face method, that is, the union's staff visit each member each month to collect small amounts of money. Another idea is a new type of installment devised to benefit depositors in the long run. Participants deposit small amounts of money periodically over the course of, for example, five-years in an educational loan for children that is available at a low interest rate at a maturity date. The new device can be realized on the premise that the existing informal financing should be matured enough to have a corresponding organization and that entry into the credit union should be designed to greatly benefit its members.

4) Mobilization of postal savings utilizing the post office network

It is desirable to study the introduction of a new network of savings mobilization as a tool to furnish medium- and long-term funds. Many Asian countries have introduced postal savings. They successfully collect small amounts of funds from the general public, thanks to the postal system's state-run feature and the convenience of its nationwide network that cannot be covered by banks. It is also said that success necessitates that a reliable person in a local area is appointed as the post master. Deposits collected through the postal office network are utilized for investment or financing in the centrally organized body, helping to furnish medium- and long-term funds. It must be studied whether or not a postal savings system, or one utilizing another established system can be developed in Viet Nam.

2. Supply of medium- and long-term funds to industries

For successful economic development in an economic transition period, it is indispensable to foster internationally competitive industries, particularly manufacturing industries that require the supply of medium- and long-term funds. Long-term funds are necessary to build plants and purchase machinery. There is also a great demand for long-term operating funds in labor-intensive industries with effective export promotion and employment. Foreign enterprises investing in Viet Nam have demand for domestic funds to hedge exchange rate risks.

However, Viet Nam today has no financial system organized to supply such medium- and long-term investment funds to industries, and particularly not to developing private enterprises. This poses a bottleneck to industrial development. Below is an overview of the structure of a financial system that provides a smooth supply of medium- and long-term funds to industries.

(1) Stabilization of the macroeconomy

Viewing Viet Nam's actual financial status, interest rates are inversely set lower for the long-term and higher for short-term loans, and there still remains strong concern about inflation, consequently most financing terms are set for as short as three to six months. So precious funds tend not be supplied to the export-oriented manufacturing sector that needs medium- and long-term funds, but are supplied to the domestic service sector from which investment is recoverable in a short period, or to short-term financial investment such as the purchase of government bonds or is deposited in banks with high interest rates.

Such a lack of medium- and long-term financing is mainly due to the unstable macroeconomic circumstances where there is significant risk in lending and obtaining general credit. A vicious circle of high interest rates caused by inflation risks and bank default risks increase the risk of unrefundable loans, which financing to the short term, and to close acquaintances. This conspicuous lack of credit creation is reflected in the spot cash payment policy (lack of a draft payment system), still prevailing in Viet Nam's industries.

(2) Securing domestic medium - and long-term fund sources

Currently in Viet Nam most medium- long-term funds come from ODA, FDI and the budget. Compared with the scale of demand there is scarce supply of medium- and long-term funds in the form of fixed-term deposits and stocks purchased by domestic enterprises and people. The issuance of securities is said to be a success, but government bonds, whose redemption period is one year at the longest, are not effective as medium- and long-term fund sources, and newly introduced project bonds featuring a maximum three-year redemption period are mainly purchased by SOEs without getting much fund mobilization from general public.

Under review is the establishment of a stock market as a decisive factor for the mobilization of domestic savings, but the private enterprise sector remains underdeveloped and the reform of state-owned enterprises is still under way. The preparation and disclosure system, including enterprise accounting information, is not developed yet, and it will take a long time before effective conditions required by the direct finance monetary market are ready for enterprises.

As mentioned above, allocating part of the social insurance funds or casualty insurance companies' funds to medium- and long-term financing may be a solution. A considerable amount of medium- and long-term funds will be secured by having the social insurance fund invest in long-term bonds such as enterprise bonds and bank bonds.

It is important to increase medium- and long-term savings by the public through the introduction of a postal deposit as mentioned above, and measures should also be examined for converting short-term deposits into medium- and long-term fund sources. For example, major banks engaged in medium- and long-term financing sell medium- and long-term bonds to stock companies. These companies are capable of collecting deposits and utilizing them as sources for medium- and long-term financing. In Japan this "Wariko" system, is the adopted fund raising system of the Industrial Bank of Japan.

(3) Establishment of a medium - and long-term fund supply system

It is as important as to secure fund sources to establish a financial system capable of stabilized supply of relatively risky medium- and long-term financing to certain industries to be fostered.

Today in Viet Nam, government agencies (the General Department for Investment and Development, the Ministry of Finance, and the National Investment Assistance Fund) and the BIDV supply medium- and long-term funds mainly to state-run enterprises. As medium- and long-term funds are preferentially allocated to SOEs, particularly to basic industries, they are hardly accessible for private companies, particularly small and medium enterprises (SMEs) or non-basic and unimportant SOEs. Many private companies depend on private high-interest financing for their equipment funds. Furthermore, the overall financial industry is not capable of reviewing a project for effective medium- and long-term financing due to a lack of accurate financial data of concerning enterprises and to the banks' underdeveloped audit system.

It should be noted then that agencies supplying medium- and long-term funds should make a credit judgment independent of a policy judgment and have professional credit analysis ability. Direct financing from government to enterprises is not desirable when credit judgment and policy priority are inconsistent. The latter is given priority and this leads to a great danger of accumulated bad debts.

A possible alternative is to change BIDV to an institution specialized in medium- and long-term financing with government reserves for medium- and long-term funds, and appropriate review ability gained through its long experience in medium- and long-term financing credit analysis. In this case BIDV may supply medium- and long-term financing directly to leading national and private enterprises, and indirectly to private SMEs through private joint stock banks that receive wholesale banking of medium- and long-term funds. At the same time it is desirable for BIDV to prevent bad debts by establishing management autonomy and cultivating credit analysis ability through improved study and training (a change from collateral-oriented to project-analysis-oriented financing).

For immediate effect, a possible measure is to further promote utilization of leases such as those for machinery and equipment. State-owned banks have already established leasing joint ventures, and it is desirable to support this trend and expand its scope into other sectors such as SMEs.

3. Mobilization of foreign savings for private investment

Private investment from overseas generally develops in the following order: FDI (foreign direct investment), financial investment by bond purchase and bank loans, and eventually through financial investment by institutional investors. Viet Nam, on the way to a market economy, has now entered the first stage, and finds FDI a major channel for mobilization of foreign savings.

(1) Promotion and utilization of FDI in the a long-term

FDI is very significant in mobilizing foreign savings without accumulating external debts and in increasing productivity of domestic industries through technology transfer. On the other hand, FDI is cost-conscious and volatile in itself. Therefore, it is essential to promote infrastructure development from the medium-to-long term viewpoint. It is also imperative to make efforts to promote FDI by immediately improving the acceptance system and removing impediments to disbursements.

A particular concern is that the gap between FDI commitment and actual expenditure has been increasing recently. Foreign enterprises which have announced investment in Viet Nam seem to be deterred by some obstacles or difficulties in implementing FDI.

Financially important is to secure funding for FDI projects. Primarily essential is the improvement of the domestic system for supplying long-term funds to FDI projects in order to reduce exchange risks and promote investment. In this respect further promotion of the establishment of joint venture banks and support for fund raising in Viet Nam should be considered. Fund raising from overseas should also be promoted, and to that end it is desirable to promote closer relations with other Asian monetary markets including Hong Kong and Singapore through business cooperation between financial institutions.

(2) Side effects of FDI = Exchange rate management under the pressure of the overvalued Dong

The contract-based total amount of FDI to Viet Nam has now reached the same level as GDP, and it is feared that the in-flow of foreign currencies that comes with it will create upward pressure on the Dong, impede export competitiveness, and increase trade deficits.

On the other hand, it is feared that a further depreciation of Dong will affect external debts problems, and that an increase in export prices will increase trade deficits and cause inflation. As seen in Mexico, a slump in the national currency could cause a vicious circle of increasing trade deficits with rising import prices, sharply dropping foreign currency reserves, and further falls of exchange rates, threatening major economic confusion. Therefore, it is desirable, for the present, to stick to the following foreign exchange rate policy for safety and stabilization.

1) Real effective exchange rates

Currently the nominal exchange rate of the Dong to the dollar is stable, but the real rate of the Dong has been continuously appreciating due to different inflation rates in Viet Nam and the USA. This threatens to hinder Viet Nam's competitive power in exports.

However, the dollar tends to depreciate against Asian currencies in general. The 'real effective exchange rate,' to be computed by taking the weighted average of the currency rates of all of Viet Nam's trade partners, may not be appreciating so much as the real exchange rates with the US dollar. The problem is not as severe as it initially seems and consequently it is desirable to use real effective exchange rates for more effective foreign exchange rate policy.

2) Acceptance of Dong appreciation to a certain extent

Today's trend of re-evaluating real effective exchange rates has resulted from persisting inflation. This is the cost of past inflation, and in this respect Dong appreciation should be accepted to some extent.

Re-evaluation on a moderate level of real effective exchange rates could promote the reform of the domestic economic structure, particularly the rationalization of exports, and this would lead to reinforced international competitive power. This also promotes conversion of the domestic dollar into the Dong. The merits of a Dong hike need to be noted, too.

3) Dollar purchase operations

It is a proper measure for the central bank to conduct dollar purchase operations to cope with the appreciation of the Dong. However, this will cause an excessive flow of the Dong in Viet Nam, so sterilization is required to absorb it. This sterilization is achieved by selling government bonds, central bank bonds, and debentures concurrently. In this respect the recent issuance of central bank bonds and study into the establishment of a government bond market may be evaluated.

On the other hand, there is a great possibility that such bond selling operations would cause a drop in bond prices or high interest rates. Under the present circumstances the central bank carries out dollar purchasing operations exclusively for state-owned foreign exchange banks and this poses a problem of uneven supply sources of domestic funds. It is accordingly necessary to study the use of other measures along with dollar purchasing operations.

2

Comment on the "Report on Economic Development Policy in the Transition toward a Market-oriented Economy in Viet Nam" (phase I)

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Monetary-financial policy

Fiscal and monetary policy had been reformed togher with the process of economic mechanism innovation, shifting from the centrally-plannd and command economy to a market-oriented economy. It play very important role in the process of economic stabilization and anti-inflation. The section on monetary-financial policies has presented rather completely monetary-financial issues related to Development policies in Viet Nam today in the Report on Opinions on the draft New Five-year Plan for Social and Economic Development in Viet Nam an in Executive Summary Report on Economic Development Policy in the Transition toward a Market-oriented Economy.

Contents of sections in the Report, in general, have reflected monetary-financial status of Viet Nam at present. Structure of the report is relatively completed. In genaral, we agree with the opinions and results of research presented in the Report.

The issues in point 2.2 are presented rather accurate, except that section on private saving mobilization, it was stated that people hold gold and dollars because they do not trust banks, which was correct only three or four years ago. At present, the situation has been changed, people have actively deposited into banks. However, private saving mobilization requires that the system of banks must be further renovated not only in technology, technique but also in service manner and style.

We agree with conclusion that the income difference between the north and the south is another restrictive factor for investments and savings in the Vietnamese economy. Moreover, we agree that rapid economic growth inevitably brings about an income difference among regions. However, we should make priority policy to develop economy in the north more rapidly in order to increase income of the people in the north. Of course, it does not mean that we forget to develop or develop lesser economy in the south.

The survey on fiscal and monetary system under the planned economy is correct. In fact, in the Planned economy, the banks moved funds according to governmental commands without playing the role of a financial intermediator.

It is a fact that in present, the private sector has meet many difficulties to have loans from the banks, even there are only short-term loans with high interest for the private sector (although the loans are increased). Moreover, the private sector hardly has medium-and long-term funds sources. We agree that the industrial sector has very high demand for fund for expandig business, but high interest rates are suppressing their needs. Therefore, our policy is that interest rate will be reduced when there are available market approriate conditions. Private savings mobilization is written comprehensively in the Report. A savings mobilization system through post-office network should be established in Viet Nam. Although Vietnamese people have not been accustomed to deposit through postal savings system at present, but these ideas should be examined to apply and disseminate proper knowledge among people.

The opinions that a centralized tax collection system compared with a decentralized one is generally a cost-saving, streamlined, and efficient method for collecting funds and redistributing them...and the centralized tax collection that the Vietnamese government is trying to establish is often not functioning efficiently, are correct.

We agree with suggestion that the tax system must be changed to a system that promotes enterprise activities under open economy and is suitable for international trading.

It is a fact that Viet Nam has no well-established accounting system or a budget law. Therefore, It causes an underdeveloped state of budger's operation and management system and a wasted enormous amount of fiscal disbursemnts.

In fact, the burden of state budget will be reduced if some public investment projects are commercially undertaken. Therefore, Viet Nam should commercialize some public projects such as some schools, hospitals and places for tourism.

At present, foreign debt management in Viet Nam is still decentralized and lack of common policy and measures to effectively manage this source of fund, therefore foreign debt management should be centralized. The fact that Viet Nam is still lack of experience in foreign debt negotiation as said in the report is true. Viet Nam should centrally manage foreign debt as well as implement active measures and policies in foreign debt borrowing and repayment in each period of time.

Exchange rate policy should be examined in complex with other policies. Exchange rate policy alone cannot solve all the issues, but it is necessary to put it in complex of policies such as policy against inflation, policy on savings, policy on export policy for inducing FDI...

In fact, financial system in Viet Nam has not been developed yet, and it is very important to push up formation and development of financial system at present stage, particularly, tax system should be reformed in order to be step by step in accordance with international practice when Viet Nam joins ASEAN. In which replacing turnover tax with VAT, profit tax with company income tax reforming individual income tax import and export taxes...are very necessary in the next 1-2 years. Experiences in ASEAN countries on establishing tax system and requirements on reforming tax system of Viet Nam in accordance with AFTA are very useful.

Vietnamese bank system does not have to pay turnover tax but now the tax system to the banks should be improved in the future, but Viet Nam has own characteristic features, this issue needs to be examined further.

In conclusion, fiscal mobilization policy, policies on taxation, budget revenue and expenditure are rather deeply analyzed in the Report.

Conclusions on necessity of medium to long-term funds and recommend to undertake an investment needs survey of business sector are desirable. Furthermore, suggestion that Viet Nam should invest in export-oriented business sector is accurate.

Of course, the report would have been more comprehensive if there had been analysis on relationship of monetary-financial policies to economic growth and inflation. The report had been completed very well.

In second phase (Phase II), in our view, A compulsory and incentive savings system should be researched because they are very helpful for Viet Nam economy. Moreover, It may be necessary to carry on research work and examine experiences in other countries such as Japan, South Korea, China, Singapore...

Capital market, securities market are being vital important issue in Viet Nam. It is quite necessary to promote researching and establishing a securities market in Viet Nam.

All the issues related to monetary-financial policies should be continued to research and to improve more deeply, especially the issues related to foreign debt management, deposits and saving of households and of banking system, exchange rate promoting to export. Moreover, we should organize some surveys and investigations on saving of households in three parts of countries (north, midle and south) in order to estimate capital resource in the people, survey on financial and accounting issue in enterprises (state-owned and private enterprises) and local budget according to the new budget law and research relations between money supply, economic growth, inflation and investment.

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General Comments on the Vietnamese Drafts on Financial and Fiscal Policies for the Five-year Plan 1996-2000 : Some Lessons from East Asia[1)]

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I. Introduction

Development of any national economy involves both social costs and benefits, as perceived in rapidly industrialising economies of East Asia during the last three decades. We can draw some significant lessons from their rich experiences for the Socialist Republic of Viet Nam.

1. Some common features of the East Asian development

There has been a rapid pace of industrialisation and industrial and technological deepening throughout the period up to mid-1990s, shifting at the relatively early phase of industrialisation from import-substitution policies to export-oriented policies and focussing on labour-intensive sectors in the first ten to fifteen years, while simultaneously exploring into the possibilities for initiating and expanding some capital- and technology-intensive industries, as shown in changing proportions of these sectors as percent of GDP, employment and exports.

There has also been a rapid development of the modern service sector particularly since mid-1970s, though differing among East Asian countries in the exact time depending on the initial conditions of development, as shown in the rise of modern service sector as percent of GDP, employment and exports.

In pursuing the rapid industrialisation and economic modernisation programmes, all the East Asian countries except the Democratic People's Republic of Korea and for a long time Myanmar have taken an open-door policy, welcoming foreign direct investment with a view to mobilising necessary financial resources, foreign exchange, advanced technology and management know-how and enhancing their access to foreign markets. The open-door policy has also compelled East Asian countries to liberalise both internal and external economic relations by utilising market competition at home and abroad, which has made the

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1) Based on my reading of the Socio-Economic Development and Investment Requirements for the Five Years 1996-2000: Government Report to the Consultative Group Meeting in Paris from 30 November to 1st December 1995, Dr. Lai Quang Thuc's paper entitled Financial and Monetary Policies and Measures in the 1996-2000 Socio-Economic Plan that appeared in the VIET NAM ECONOMIC REVIEW, 28 June, 1995, Dr. Tran Van Ta's oral presentation on Budgeting and Taxation Reforms for the Years 1996-2000 at the Japan-Viet Nam Joint Study workshop in Tokyo on 29-30 January 1996 and Dr. Ho Quang Minh's paper entitled Economic Development. Development Cooperation and Environment Development of Viet Nam, presented at the Tokai University Symposium on IN PURSUIT OF COMMON VALUES IN ASIA. held in Tokyo on 15-16 February, 1996. I have also benefited a great deal from, among others, a draft prepared for JICA on this joint study programme, entitled The Economic Development Policy in the Transition Toward a Market-Oriented Economy in the Socialist Republic of Viet Nam: Fiscal and Monetary Policies, 15 February, 1996 and a draft prepared on 30 January, 1996 by Dr. Borje Ljunggre, Swedish Ambassador to Viet Nam, entitled Doi Moi in the Year of the 8th Party Congress: Emerging Contradictions in the Reform Process?.

East Asian industrialisation really competitive on the world market. It was fortunate for these East Asian countries that their industrialisation programmes also coincided with the on-going liberalisation of the international trading regime under the Kennedy, the Tokyo and the Uruguay Rounds of multilateral trade negotiations.

In the rapid process of industrialisation and economic modernisation of these East Asian countries, however, the positive role of government has always been recognised as vital, not only in laying the foundations of economic and social infrastructures but also in providing a competitive market framework under which private sector could operate efficiently and accelerating the development and expansion of export-oriented industries through appropriate macroeconomic policies, fiscal and financial policy interventions. This development approach adopted by most of the East Asian countries (the only exception was Hong Kong) has been termed as developmental market-economy against the liberal market-economy.

Consequently, most of the East Asian countries have achieved a rapid integration with the rest of the world economy through expanding international trade and direct investment by multinational corporations (MNCs), as shown in the rising share of their trade as percent of world trade in nearly all manufactured goods.

As a result of the rapid industrialisation and economic modernisation, however, such new critical issues have emerged in East Asian countries, as discussed later, as a result of a rapid pace of urbanisation including the emergence of several megapolis with all its attendant problems, environmental degradation and rising social crimes, to name a few.

2. Different patterns of East Asian development during the postwar period

While there have been common features in the economic development of East Asian countries, there have also been differences in the stage of economic development among them, though their degree differing among them.

Dynamic economies of Hong Kong, the Republic of Korea, Singapore and Taiwan, having gotten on the bandwagon of rapid economic growth and world trade expansion during the period 1960s-70s and forging ahead in the 1980s and 1990s, have now become ready, when and where appropriate, to join OECD countries as trading, investment and aid partners. Hong Kong, however, is scheduled to cease as a self-governing British Crown Colony and rejoin the People's Republic of China in 1997.

Countries of the Association of South East Asian Nations (ASEAN) minus Singapore, having tried during the last three decades to catch up with the dynamic economies of East Asia, will be ready to join OECD, though at different timing, either before or in the second decade of the 21st century.

Cambodia, the People's Republic of China, the People's Democratic Republic of Lao, Mongolia, Myanmar and the Socialist Republic of Viet Nam, having awaken to changing realities at home and abroad, are now making massive efforts for transition from centrally planned to open market-oriented economy, though following different models of transition.

The Democratic People's Republic of Korea, having missed a rapid growth boat of neighbouring East Asian economies, is now pondering on the extent and depth of necessary economic and political reforms.

Rising domestic constraints and disequilibria in nearly all East Asian economies, are now calling on governments to constantly restructure their economies and carry out those reforms in favour of the poor and a greater degree of economic and political democracy.

3. Some major factors responsible for the rapid industrialization and the successful economic and social development in East Asia

Among the most important and critical factors has been the political stability for a sustained period of time. None of the high-performing East Asian countries would have been successful in economic development and restructuring, had it not been for the sustained period of political stability. In this connection, the long-drawn war in Cambodia, Laos and Viet Nam had really affected their economies adversely, slowing down the pace of their economic development and industrialization.

A firm political commitment to development, particularly to high-growth with equity, under monetary and fiscal discipline has been extremely significant for all East Asian countries. When lacking of this, they have suffered at times from not only slowdown in economic growth but also a period of economic confusion and chaos. The open-door policy of these countries, however, has compelled them to revert to the high-growth path.

In the long run, nothing has been far more important than steady increases in human capital and physical infrastructure investment, which alone made it possible for these countries to encourage both domestic and foreign investors to invest in their development process. In this connection, the provision of basic education for all, making their people literate and easier to adjust to the changing internal and external economic conditions, and the reorientation of their educational system in favour of a greater emphasis on science and technology and skill development have been vital. In terms of the physical infrastructures, the most critical have been the efficient network of energy supply, transportation including harbours and airports and telecommunications.

High rates of domestic savings and entrepreneurial spirit have been found equally important, if not more as the rapid pace of investment in human capital and physical infrastructures. In fact, East Asian countries would have found it impossible to achieve such high rates of industrialization and economic development unless these had been available in their respective countries. In this connection, the presence of ethnic Chinese business community with its emphasis on competition and innovation has helped the success of East Asian industrialisation and manufactured export expansion.

Efficient and clean bureaucracy, though varying to some extent among different countries of East Asia, has also been a cornerstone not only for making appropriate macroeconomic policies but, more importantly, for implementing those policies effectively. The rapid industrialisation and economic modernisation programmes have required these countries not only to have the technical knowledge and professional expertise but also apply them with a good sense of judgment, accountability and fairness.

Fortunately most of the East Asian countries have had a long tradition of effective government and private sector partnership in policy making and implementation process. There has been a sense of mutual trust in each other, making an effective use of their respective comparative advantages whether in mobilising domestic resources to accelerate economic development or developing certain strategic industries crucial to their technological improvement or export expansion.

As said earlier, it is to be noted that there had been a relatively favourable international economic regimes and environments including trade, investment, technology transfer and aid, particularly during the period 1960-80 which definitely helped East Asian countries to promote export-oriented industrialisation programmes and thus accelerate their economic development. Beginning in 1980 the high-interest policies of Reagan Administration began to emerge to fight against the rampant inflationary pressures around the world, including the second energy crisis of 1979-80, and plunged the world economy into a somewhat long period of economic slowdown and stagnation in some cases, triggering a series of protectionist waves in the United States and elsewhere.

4. High growth policies and measures in East Asia [2]

1) Measures encouraging basic education for all and science and technology education in particular
2) Fiscal, financial and administrative measures mobilizing household and public savings, though differing among countries
3) Fiscal and financial measures accelerating private investment, both domestic and foreign, in productive capacity and technology

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2) See PART II.

4) Fiscal and financial measures oriented toward export promotion and selective technology imports
5) Fiscal and financial measures assisting the growth of sunrise industries
6) Measures promptly adjusting the value of respective national currencies to international market
7) Fiscal, financial and administrative measures in favour of greater equity in income and assets

5. Social cost of development in East Asia
   1) Environmental deterioration including a steady rise of air, water and soil pollution, and poor urban amenities
   2) Relatively widening income and wealth differentials both in the urban area and between the rural and urban areas and still inadequate housing for the poor, though the bottom has gone up
   3) Poor social security benefits and poor urban amenities relative to increases in personal and corporate incomes and continuing environmental degradation
   4) Some form of social coercion to foster the national unity and commitment to high growth and rapid industrialization

6. Major issues facing East Asian economies in 1990s and 21st Century
   1) Growing bottlenecks in physical infrastructures, mainly caused by rapid industrialization, population pressures and urbanization
   2) Increasing scarcity of skilled, technical, professional and managerial manpower
   3) Adverse environmental impact including air, water and soil pollution and other health hazards, deforestation, noise and so on
   4) More intense pressures for greater social equity and sustainable development
   5) Growing pressures for the liberalization of trade and investment regimes
   6) Constant search for growth triangles/quadrangles and enhancement of subregional economic cooperation
   7) A growing interest in forming some sort of East Asian or Western Pacific economic grouping to prevent the European Union and the North American Free Trade Area from becoming more inward-looking

7. Lessons of the East Asian development for Viet Nam[3]
   1) Need for maintaining political stability for a sustained period
   2) Need for strengthening political commitment to development and sustainable human development policies
   3) Need for maintaining monetary and fiscal discipline and improving macroeconomic policy stability, consistency and flexibility
   4) Need for enhancing the quantity and quality of human capital and physical infrastructures investment
   5) Need for increasing domestic saving and improving entrepreneurial spirit
   6) Need for reinforcing good governance at all levels of government
   7) Need for improving the institutional mechanism and working of government and private sector partnership
   8) Need for constant upgrading of technology, productivity and international competitiveness under dynamic comparative advantages
   9) Need for sustained and greater efforts in narrowing income and asset disparities

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3) See PART III.

10) Need for urgent and accelerated reduction in defense spending and other economically and socially unproductive public expenditures
11) Need for urgent improvement in social amenities and environment
12) Need for protecting civil rights, workers' rights and improving working conditions for all
13) Need for ensuring basic human needs for all, particularly for women and children
14) Need for promoting subregional and regional cooperation for peace, security and economic and social development

8. The role of Japan in reorienting international development cooperation for Viet Nam in the 1990s and beyond in favour of both sustained growth through trade and investment expansion and greater equity, sustainable environment and human development
   1) Need for assisting self-reliant development of Viet Nam by way of sustaining and improving the international trading regime in favour of freer access to product markets and technology of all countries, particularly industrial countries
   2) Need for improving the international investment regime in favour of freer access to rapidly expanding international capital market, further deregulation in investment restrictions and installing a multilateral accord on investment guarantee and dispute settlement applicable to all signatory countries
   3) Need for improving the international aid regimes in favour of assisting Viet Nam to improve their organic and positive linkages with trade and investment, including expansion of their exports and improve their national development capacity to deal with rising domestic and international pressures, constraints and disequilibrium
   4) Need for increasing bilateral and multilateral development cooperation for Viet Nam and reorienting their development cooperation to facilitate the realisation of all the lessons of development as mentioned in the above section 7
   5) Need for improving the quality of bilateral and multilateral development cooperation for Viet Nam by way of enhancing aid efficiency and effectiveness in terms of meeting expected impact
   6) Need for enhancing the efforts of the international community to assist Viet Nam to effectively transform from centrally planned to market economies as soon as possible, with minimum adverse impact on the population and in particular women, children and the poor
   7) Need for reinforcing the efforts of the international community to assist Viet Nam in dealing with global issues such as population, refugees, environment, narcotics and AIDS, if any
   8) Need for assisting Viet Nam to improve aid coordination among bilateral and multilateral donors to maximise the individual and overall cost-effectiveness of international development cooperation projects and programmes
   9) Need for vastly improving policy and operational coordination among the United Nations development organizations, specialised agencies and humanitarian assistance organizations operating in Viet Nam and between them on the one hand and the Bretton Woods institutions and regional development banks on the other and eventually reshaping the functional and organizational division of labour between the two, including reorganization and integration of duplicating functions and organizational setup
   10) Need for encouraging newly industrializing and other more advanced developing economies to enhance their development cooperation to Viet Nam both quantitatively and qualitatively.

II. Postwar experiences in domestic resource mobilization in East Asian countries [4]

1. Introduction

Macroeconomic performance, as measured by overall budget deficits, current account imbalances and consumer price inflation, has been improving over the last two decades in most East Asian countries, with only a few exceptions such as China, Laos and Mongolia.

The gap between gross domestic savings and investment has been found highly variable among East Asian countries, and with few exceptions the proportion of domestic resources set aside for investment has been rising impressively over the last two decades. These trends represent a remarkable change as the domestic savings as percent of GDP were either negative or marginal in the range of 1-8 percent in 1960.

Transition economies of Lao Peoples' Democratic Republic and Viet Nam have experienced a very large negative resource gap during their transition. Even with a considerable amount of inward private remittances, national savings financed only a quarter to a third of GDI in the late 1980s. The relative low rates of domestic savings in these economies point to the urgent need for a supportive policy framework for enhanced domestic and external resource mobilization in the coming years.

2. Financial resource mobilization through fiscal measures

Though varying among East Asian countries, the bulk of domestic investment has come from domestic savings in whose mobilization the government has consistently played a crucial role through fiscal management on both revenue and expenditure sides.

Also, the government regulation and promotion of financial intermediation have exerted a powerful influence on the level and efficiency of private sector financial mobilization and allocation.

On the average, there has been an increased transfer of financial resources toward the government sector, with the fiscal revenue as percent of GDP rising to nearly 30 % in Singapore. In some countries the rising share of resources obtained by government has not been accompanied by a commensurate rise in domestic savings rates, thus leading to a crowding-out phenomenon and probably lesser efficiency in domestic resource utilization.

Far from being a source of government non-tax income, many of the public sector enterprises have generated sizable net demands on the government budget to cover persistent operating losses. And they have also often been provided with a privileged access to domestic capital markets and not infrequently external borrowings at concessional terms involving an implicit subsidy.

A growing concern for greater operational efficiency and financial discipline has led in many East Asian countries to adopt greater operating autonomy, precise specifications of objectives and performance criteria, rationalization of pricing policies and the enhancement of financial transparency and accountability. Also, privatization of public enterprises and administrative deregulation have been resorted as another instrument.

Privatization of public enterprises has been rather slow particularly in transition economies of East Asia, since: a) entrepreneurial and risk-taking capabilities, managerial expertise and venture capital resources have been in short supply, b) alternative employment opportunities necessary for the unskilled

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4) This is a revised version of my paper entitled the same, presented at the Japan-Vietnam Workshop held at JICA headquarters in Tokyo on 28-29 January, 1996. This is largely based on a survey and reports that appeared in the ESCAP, Economic and Social Survey of Asia and the Pacific 1992, Asian Development Bank (ADB), Asian Development Outlook 1992 and ADB, Domestic Resource Mobilisation through Financial Development, 1991.3)

workers displaced through privatization have been found rather scarce, particularly on comparable terms and c) there has been the lack of skilled personnel to evaluate marketable assets of public enterprises along with the thinness of domestic capital markets.

While privatization should through enhanced competition theoretically bring about greater efficiency in resource use, competition cannot be regarded as a natural consequence of privatisation and deregulation which, if left entirely to market forces, might: a) impose heavy adjustment costs, b) reduce investments in essential infrastructure projects and c) take an inadequate account of dynamic comparative advantage.

In addition, privatization and deregulation, if not accompanied by complementary regulatory framework, might result in private monopoly, the lowering of public health and safety and deterioration in environment.

In many East Asian countries government savings have been enhanced through careful control of spending and securing higher payments from recipients of public sector services. A wide range of user fees and charges and their increases have been installed though selectively and on a differentiated basis to rationalize demand for public services, raise delivery efficiency and improve equity targetting in government provision of infrastructure facilities and services. Also, private sector has been increasingly involved through BOT (Build, Operate and Transfer) and BOO (Build, Own and Operate) measures in the complementary provision and management of both economic and social infrastructures.

There has also been a growing interest in increasing efficiency in the mobilization of public savings through improvements of the existing taxation system by means of tax base widening and deepening. Better designs of fiscal instruments and other innovations such as value-added taxation have also been introduced in many East Asian countries since the late 1970s in accordance with available administrative capabilities. Value-added taxation is considered to help reduce the cascading effects, distortions in resource allocation and production costs associated with a plurality of levy points and a multitude of indirect taxes which it would replace. Furthermore, attempts have been made by tax authorities to ensure greater compliance and lesser avoidance.

3. Financial intermediation and liberalization

While private savings have represented a larger share of the domestic savings in nearly all East Asian countries, the proportion of such resources held in tangible assets, e.g., real estate, precious metals and ornaments, and in highly liquid forms such as currency and demand deposits has been decreasing sharply with the spread of banking and other capital market institutions as well as the increasing variety of financial instruments and papers in recent years. Particularly the stock and bond markets have increasingly become an important means for the mobilization of private savings not only in advanced developing countries but also in other developing countries.

In the past the financial sector in many East Asian countries had been dominated by a small number of commercial banks which, by and large, were geared mainly to the finance of commerce and short-term transactions. Their inability and reluctance to fund medium- and long-term industrial and agricultural development projects was one of the major reasons for bank nationalisation during the 1960s and the early 1970s. There was also in one country after another the establishment of state-owned banks and development finance institutions for more specialized purposes.

There has been an increasing spread of branch banking particularly in rural areas, which is considered to have contributed a great deal to raising the domestic savings rate. As a result, there has been an upward trend of M1 and M2 as percent of GDP in most East Asian countries.

There were in the 1960s and the early 1970s a number of constraints on the mobilization of domestic savings in many countries of the region. Prevailing management approaches and practices were not suitable to local requirements, apart from the need for more innovative savings facilities and lending techniques. There were also inadequate linkages between banking institutions and nonformal credit societies to meet small financing needs in both urban and rural areas. Loans were often extended in favour of large established enterprises, resulting in financial market segmentation and dualism, forcing small private enterprises relying on non-institutional sources of credit.

Government policies of maintaining interest rates below the levels consistent with underlying market forces, which now has ceased to exist in most East Asian countries, also resulted in the 1960s and the early 1970s in the high frequency of credit rationing, directed allocation of investible funds to high-priority sectors set forth by the government and the entrenchment of informal or curb markets for the unorganised private sector.

Such policies had been terminated first in advanced developing countries of East Asia and some ASEAN countries so that attractive interest rates on bank deposits helped to mobilize domestic savings indispensable to export-oriented industrialization programmes. Singapore saw a sharp rise in the domestic savings from nearly 10% of GDP in the mid-1960s to some 42% in the mid-1980s. Taiwan also saw a fourfold rise in private sector savings from 4.5% of GDP in 1952-53 to 18.5 percent in the early 1960s. Its domestic savings reached as high as 32% of GDP in the 1970s and 33% in the 1980s. ROK saw a shooting up of bank deposits from 4% of GDP in 1965 to nearly 21% during the 1970s.

The average ratios of domestic credit extended to the private sector in total bank lending clustered in the early days around 40-50%, but have risen to 85-90% in advanced developing countries and around 70-75% in other East Asian countries except transition economies. This has been in the main due to the dominance of private sector businesses, fiscal concessions such as the exemption of interest payments from corporate income taxation to offset the burden of high interest rates on loans. Such implicit subsidies have, however, contributed to high gearing ratios in ROK, though declining in recent years as capital markets saw a remarkable development, allowing firms to rely on equity and bond issue.

There is an increasing evidence of a strong correlation between positive real interest rates on the one hand and domestic savings mobilisation, credit availability, factor productivity and hence output growth on the other.

III. On the financial and fiscal reforms conductive to macroeconomic stanbilization, non-inflationary growth and economic restructuring in Viet Nam [5]

1. Introduction

In making a critical analysis of the financial and fiscal reforms in Viet Nam and some tentative policy recommendations in June and November 1995 and in January 1996 at Japan-Viet Nam Workshops for creating favourable domestic economic environments for enhanced international development cooperation, an emphasis was made that there were a few critical tasks to be urgently dealt with by the Government of the Socialist Republic of Viet Nam and that these economic environments could not be installed unless there were A POLITICAL LEADERSHIP AT THE HIGHEST LEVEL COMMITTED TO DEVELOPMENT AND POLITICAL AND SOCIAL STABILITY in the country, which itself could be a result of sustained economic growth with equity and human development.

Since then further studies had been made on the most recent reforms and developments in the financial and fiscal sector by the academic groups and consultant groups both in Japan and Viet Nam in consultation with our Vietnamese counterparts and their associates, and the outcome of these studies was presented at the March Workshop in Hanoi this year. These studies reconfirmed that the general direction and thrusts of the tentative policy recommendations made at the earlier workshops were correct and sound and revealed that the following remarks could be appropriately introduced at the Japan-Viet Nam Workshop in March

5) This is a revised version of my paper entitled the same, presented at Japan-Viet Nam Workshop held at JICA headquarters in Tokyo in November, 1995.

1996. The financial and fiscal group in Japan firmly believes that these findings, though never final, would be quite useful to the possible successful conclusion of the Phase I of the Joint Viet Nam-Japan Research Project on Macroeconomic Policy Reforms to be made by end March this year.

As chair of the financial and fiscal group I am pleased to see in this final report for Phase I that the entire range of the financial and fiscal issues that the Japanese and Vietnamese collaborators had agreed upon to deal with, i.e., domestic and external resources mobilization and the institutional mechanism to facilitate them including debt management and foreign exchange rate policies have now been covered by the members of the financial and fiscal group: Professor Watanabe on the banking and financial reforms, Professor Tajika on fiscal reforms, Mr. Kinoshita on external resource mobilization and debt management including foreign exchange rate policy, Mr. Mori on the mobilization of medium- and long-term financial resources and Professor Okada on foreign direct investment.

2. Further economic reforms needed for macroeconomic stabilization, non-inflationary growth and economic restructuring

Three economic environments pointed out at these earlier workshops as requiring the GOV's urgent actions and measures were: general environments for macroeconomic stabilization and growth, some specific measures and arrangements conducive to increased mobilization of official development finance (ODF) including official development assistance (ODA) and its effective utilization, and those climates and conditions favourable to trade and direct investment expansion at home and from abroad.

(1) General environments for macroeconomic stabilization and non-inflationary growth

a) the GOV must be able successfully to meet all the development needs and requirements as perceived by the people and the Party,

b) the GOV must constantly adjust their macro- and micro-economic policy measures in response to changing domestic and international economic and political scenes,

c) the government must proceed with further deregulation in economic activities and trade and investment liberalization measures and, if at all, accelerate them not only to enhance efficiency in resource utilization at home but equally importantly to compete more effectively with the neighbouring countries in expanding exports and attracting foreign direct investment (FDI). On the other hand, the GOV must tighten social regulations and enforcement thereof, to reduce corruption, urban crimes and environmental degradation, and

d) the government bureaucracy must constantly be streamlined at the national, provincial and local levels with a view to enhancing their administrative efficiency and policy effectiveness and reducing corruption.

(2) Specific environments for ODF including ODA and other official flows (OOF) and external debt management

a) the Cabinet and the ministries, government agencies and entities and SOEs must constantly be sensitised to the changing priorities and programmes on the part of bilateral and multilateral donors as expressed in terms of volume, types, terms and conditions and conditionalities of all kinds, in order for Viet Nam to be able to obtain ODF and in particular ODA from the international community, as professed in the draft of the Five-Year Plan 1996-2000,[6] for nearly half of their domestic investment requirements during the Plan period,

b) the GOV must ceaselessly improve aid effectiveness by way of both better understanding the modalities and procedures pertaining to international development cooperation by different donors and enhancing aid project/programme identification, formulation, implementation, monitoring and evaluation capacity and strengthening the aid coordination mechanism within government and various ministries and the annual consultation machinery for external aid,

c) the GOV must constantly improve their external aid and debt management capability by strengthening the professional competence of those MPI (Ministry of Planning anfd Investment), central bank and MOF (Ministry of Finance) officials concerned and streamlining their bureaucratic control over external aid and debt negotiation, disbursement and repayment schedules and responsibilities, and

d) the GOV could collaborate with other aid recipients at multilateral fora in persuading the international donor community on the need for expanding both ODA and OOF and improving aid effectiveness including a greater use of national and international non-governmental organizations (NGOs).

(3) Domestic environments for trade and investment at home and from abroad

1) For creating the appropriate monetary and financial environments,

a) the GOV must unequivocally maintain tight money policy, under an otherwise imminent presence of high inflationary pressures, consistent with their own national goal of higher rates of economic growth,

b) the central bank's capacity to formulate and effectively implement monetary policies and effectively supervise commercial banking operation must be constantly built up to enhance people's confidence in commercial banks and their sound banking practices,

c) the GOV must replace their preferential low-interest loans currently given to many SOEs and POEs by better supervised selective credit policies in favour of those strategic industries and sectors requiring rapid development and productivity improvement,

d) a national development bank could be installed for an effective implementation of selective credit policy tailored to the rapid development of international competitive industries and enterprises both in the state and private sectors,

e) the installation of rural savings banks and postal savings system, though difficult under the current circumstances, could also be a critical option for mobilizing a large amount of domestic savings now either sleeping under the carpet in individual households or being used in informal credit market and for using their savings to finance central and local government investment projects and programmes,

f) the social security fund or central provident fund (CPF) should be installed to mobilize domestic savings from all workers, whether employed or self-employed, with a view to providing all its members with social security benefits and residential and/or real asset investment loans, with the possibility of employers' and workers' premium contributions to the CPF varying with increasing income on both sides,

g) efforts for enacting an all-embracing commercial banking law must be accelerated with a view to encouraging the strengthening of the functioning of private banking institutions with an extensive branch banking network, catering to the need in local communities as well as at the centre for meeting both safe deposit and efficient lending requirements including facilities for discounting trade bills and other commercial papers,

h) the GOV could consider introducing at a later appropriate time the commercial bank deposit insurance scheme as found in developed countries to ensure safety up to a certain amount of demand, savings and other deposits by domestic and foreign savers,

i) the development of the capital market institutions is urgently required for government and corporate bonds and corporate shares including the smooth functioning of stock exchanges in Hanoi and Ho Chi Minh City and their secondary markets with a view to mobilizing and channeling the existing large amount of domestic savings and foreign savings held by Vietnamese overseas in response to rising and diversified market demand for credit and equity

6) "Some issues on Industrialization and Socio-Economic Development in Viet Nam from upto the year 2000" State Planning Committee, August 1995.

capital, and

j) more liberal fiscal incentives must be immediately installed for mobilizing small savers whether through commercial banks, postal savings banks, securities houses and workmen's inhouse saving schemes and channeling their savings for meeting the rising market demand for large-scale credit by both public and private enterprises.

2) For creating the favourable fiscal environments,

a) the installation of the development-oriented fiscal policies tailored to different stages of national economic and social development is an urgent task of the GOV, taking into account all the market-oriented economic variables, e.g., prices, industrial production, unemployment, budgetary balance and trade and current account balances,

b) nothing is more important at this juncture of Viet Nam's national development than to formulate and implement those tax policies with a view to maximising tax revenues and ensuring equity among different segments of the tax-paying population, whether individuals and corporations, having a due consideration to the balance between direct and indirect taxes and between income, asset and consumption taxes, e.g. introduction of land lease holding tax and land lease transaction tax,

c) a thought ought to be given to ensuring an appropriate distribution of taxing authority between the central, provincial and local governments in terms of the sources and types of taxes to be collected, with a view to minimising the dependence of provincial and local governments on the centre for tax revenues, paying a due attention to the need for some type of national revenue sharing plan to redress the problem of regional disparities requiring progressive narrowing for ensuring national unity. In this connection, care must be made in taxation policies for not dampening the growth of the rapidly growing areas of the country which will have a favourable spillover effect on the growth of the country as a whole,

d) strengthening the tax collection and administration machinery all over the country is an urgent task to be dealt with by the GOV to maximize tax collection and minimize tax evasion, loopholes and corruption, with an immediate abolishment of the current practice of "penalising" foreign investors, whether corporations or individuals, by imposing all kinds of additional "nonofficial" tax burdens,

e) a need is recognised by all for constantly upgrading the skills, technical and professional competence of the tax officials,

f) a need is equally recognised for immediate formulation and implementation of public expenditure (recurrent and investment) policies to minimize waste, facilitate market-oriented economic and administrative reforms and maximize contribution to economic growth and restructuring and the development of strategic industries. In so doing, care must be made not to allow monopolistic practices by SOEs when grouping together those SOEs engaged in the production and distribution of similar products and services,

g) the GOV must strengthen the budget office authority and capability to argue rationally with, and convince, the ministries, government agencies and entities demanding an ever increasing budgetary allocation on the need for both formulating development-oriented budgetary expenditure programmes and implementing them effectively,

h) constant pressures of budgetary deficits must be minimized by way of increasing tax revenues, but more importantly reducing both indiscriminatory budgetary subsidies to SOEs and POEs and wasteful public expenditures on arms and entertainment, and

i) it is an urgent task for the GOV to establish an independent general accounting or auditing office at the national, provincial and local levels and strengthen the technical and professional competence of the accounting and auditing officials to supervise and improve the budgetary and administrative performance of the ministries, agencies, entities, SOEs and POEs.

3) For creating the favourable specific environments for foreign direct investment (FDI),

a) any legal, administrative and policy impediments to FDI must be examined carefully for swift reduction, if impossible to eliminate immediately,

b) the GOV must facilitate the entry and successful operation of FDI by providing all the economic and social infrastructures considered essential to them,

c) all FDI must be given a national treatment for all their business transactions including procurement of land lease, finance, plant construction, machinery and equipment, parts and components, industrial raw materials, domestic distribution and overseas exports and staffing, as in other ASEAN countries and, for that matter, in all countries favouring FDI,

d) the GOV must speedify their accession to all the international agreements and conventions concerning FDI, including those as agreed by the World Trade Organisation (WTO) and abide by them in dealing with FDI applications and operation within Viet Nam,

e) the GOV could initiate at the earliest convenience their bilateral agreements on investment guarantee and nonappropriation of FDI with the governments of those countries sourced with potentially large FDI,

f) through joint ventures with local firms and investors, the GOV could encourage all FDIs to facilitate their technology transfer to Viet Nam whether in general management, production, marketing and other specific functional management areas,

g) the GOV should install financial, tax and administrative incentives for all FDIs coming into the strategic industries and regions as desired by the GOV and additional incentives for those FDIs contributing in particular to the Vietnamese export expansion, competitive import substitution and R & D for improving the Vietnamese scientific and technological capabilities. In this connection, one window or one stop approval system as in Singapore and elsewhere can facilitate the entry and successful operation of FDI,

h) the GOV must tighten their control over social crimes and corruption and smuggling so that FDI could come into Viet Nam and operate their business safely and with minimum irritations, and

i) in view of all the above benefits, encouragement and expectations by the government and people of Viet Nam, the GOV must encourage all FDIs to act as good corporate citizens by displaying the best business practices in all matters internal and external to corporations and the best social practices in their community and government relations.

4
Marketization and Utilization of Domestic Resources in Viet Nam: Fiscal and Monetary Policy Recommendations for the New Five-year Plan

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I. How to read marketization signals

Studies by the World Bank, IMF, and the Overseas Economic Cooperation Fund (a Japanese development aid institution), as well as our "Japan–Viet Nam Joint Research Project" reveal much about the process of marketization in Viet Nam and the roles played by fiscal and monetary policy. One of the most important facts to have been learned is that the country enacted several bold policies in the initial stages of marketization.

When Viet Nam eliminated price controls for agricultural products and many other commodities, it triggered the serious inflation of the late eighties and nineties, and the policies enacted at that time of greatly reducing the amount of fiscal debt underwritten by the central bank and embarking on a large-scale reorganization and consolidation of loss-producing state enterprises produced many of the "pains of marketization" but avoided forcing the public to make deep sacrifices. Though it had a compelling reason for doing so—the cut off of funds from the Soviet Union and other socialist countries—we should nonetheless praise Viet Nam for taking on the battle to rectify prices that had become horribly distorted under the socialist system.

As inflation subsided and the United States, in 1993, lifted its ban on trade with the country, government aid and private-sector direct investments began pouring into Viet Nam as if they had only been waiting for the proper chance. It appeared to all as if this money would help spur marketization, but several ironic surprises were in store for the economists who follow the economic reforms of this country.

The first was the fact that the reorganized state enterprises had become stronger and actually increased their share of GDP. Then on the fiscal side was the fact that the tax reforms of the nineties included increases in the share of the revenues and expenditures of local governments controlled by the central government. Signals from the monetary side have been mixed as well. In 1988, the early stages of the transition to a market economy, Viet Nam separated off four state banks from its mono-banks, where money was merely a means of exchange, calling the four new institutions "commercial banks." Unfortunately there have been no major reforms since. Indeed, with the rise of "soft budgets" at state enterprises, the financial position of the "commercial banks" has worsened.

Having survived the cut-off of funding from overseas and triple digit inflation at home, Viet Nam is trying to take its own path to the market economy. The question is whether this path is just a detour that will eventually lead to a real market economy, or whether its destination has the state at the center with strong state enterprises close to the core and the economic activities of the private sector playing a more peripheral role. Like the jumbled roads in Ho Chi Minh City, it is an opaque process of trial and error and probably closer to the truth to say that no one really knows what path Viet Nam will take.

But even if that explanation suffices for economic reform, one must still wonder why this country continues to send zigzagging signals on the direction of marketization. The purpose of this paper is to shed light on that mystery. There are several keys to its solution: the fact that Viet Nam is a transitional economy seeking to develop into a market economy, and (not unrelated to this) the facts that its capital and labor markets are underdeveloped and that there have been sharp inter-regional gaps ever since the conclusion of the Viet Nam War in 1975. These three characteristics often lead to conflicting demands along the road to marketization, which is why Viet Nam is forced to send mixed signals, as we shall see in discussions of state enterprise reform, regional allocations of public investments, financial reform, and allocations of tax revenue between the central and local governments.

The Five-year plan that began in 1996 says little concrete about fiscal and monetary policy, and because of this several grave issues (discussed below) have shot to center stage without sufficient preparation. The fact that it is forced to grapple with these problems all at once and without being able to indicate means for their individual resolution says much about how deep the problems that Viet Nam faces are. This paper would like to make two proposals from the fiscal perspective on tapping domestic resources.

First, it examines the Budget Law, preparations for which began in 1991 and which will be the most important piece of legislation the legislature has to deal with in 1996. This paper will show that over-obsession on the part of the government with reallocation of resources between central and local entities has impoverished both of them. It goes on to argue that future policies should aim at ensuring resources for central and local governments, defining allocation rules, and having the center concentrate its energies on the supply of both physical and human public goods (roads, school education, health and sanitation, etc.) while local governments concentrate their energies on achieving greater prosperity.

The second recommendation concerns a point that has almost never been addressed in previous reports: the use of funds paid into installment pension plans as a means of better tapping domestic resources. Singapore and Chile are the two most important recent examples of countries that have used pension funds to encourage capital accumulation. In Chile's experience, the pension funds have become the largest domestic source of investments and have made major contributions to the privatization of state enterprises. Viet Nam is only now beginning to put in place a social security system, which is why such future-oriented discussions need to be taking place.

Part II of this report examines in more detail the three defining aspects of Vietnamese economic reform discussed above and the difficult choices that reformers will be facing as a result. Part III points out problems in fiscal and monetary policy as contained in the new Five-year plan and shows that the difficulties involved are a reflection of the difficulties in economic reform discussed in Part II. It then goes on to make two specific recommendations from the fiscal perspective, as outlined above.

II. Why economic reform is difficult in Viet Nam

1. Three defining characteristics

One of the reasons why the process of transition from a socialist to a market economy is not easy is that the functions of the market atrophy under socialism. As touched on in the discussion of Vietnamese financial reform, under socialism money was merely a means of exchange. Production in socialist systems involves allocations of physical quantities and under such conditions the financial mediation functions of capital markets do not take root; money is just a means of exchanging objects. That is why the important roles that capital markets play, the roles of mediating between the lenders and borrowers of funds and providing decentralized and efficient allocation of funds, do not develop.

The same holds true of the labor market. Under socialism, most workers were assigned much in the same way as other physical quantities. Neither workers nor producers were able to turn to the markets to mediate their search for better opportunities. Leaving aside cases in which the government assigns individual work places, most workers, once hired, tie their destinies to that of their employer, sitting back and enjoying the many non-wage benefits that state enterprises provided. No matter how low benefit levels might be, everyone else is probably also in the same boat so there is no incentive to work harder in order to achieve greater prosperity.

In the process of transition to a market economy, Viet Nam, like other socialist countries, was forced to start off with capital and labor markets that had spent long years atrophying. Furthermore, it had sharp gaps in income between regions. Compared to the north (Hanoi, Hai Phong) and the center (Da Nang, Hue), the south (Ho Chi Minh, Dong Nai, Vung Tau, Can Tho) is far more prosperous, enjoying a greater endowment of industry, agriculture, and commerce, and also of mineral resources.

According to World Bank documents dealing with the problems of poverty in Viet Nam,[1] per capita incomes in the poorest regions of the north and center are only about one-third what they are in the south. Compounding this is the fact that the history of socialism in the south dates back only to 1975 and political unrest since that time has prevented full-fledged socialist industrialization from taking place. The capital and labor markets might not be all that mature, but neither were they artificially atrophied under socialism. When rice prices were liberalized under "opening" policies, production surged forward and rice has now become a major export product. This seems to show that the markets are still able to function.

Viet Nam must thus move forward with marketization carrying not only the problem of atrophied markets that all socialist countries have in common, but its own unique regional problems. These three constraints of being a transitional economy, having atrophied markets, and having sharp regional gaps mean that Viet Nam has difficult policy choices to make in economic reform.

2. The conflicting signals of economic reform

The implications of these three constraints for economic reform are necessarily conflicting in many cases, which is why Vietnamese economic reform ends up sending confusing signals to Viet Nam watchers—those who are most interested in the country's future.

The reform of state enterprises provides the first case study in this confusion. If the transition to a market economy is the goal, then what the government ought to do is disclose the finances of state enterprises that have depended solely on the state and lacked the initiative to improve productivity. It should then liquidate those that deserve liquidation and take over those debts that deserve to be wiped away. Having thus made the enterprises transparent, it can begin to improve their profitability, and with these preparations in place, it can begin privatization. But with atrophied markets in general and non-existent capital markets in particular, privatization not only does not go forward, there is a good possibility that corporate assets will not be appropriately valued. Added to this is the potential need to take policies to activate the state enterprises of particular regions, which is the easiest way to maintain balance between the south and other areas.

These conflicting policy demands have resulted in the government ostensibly advocating the privatization of state enterprises, while at the same time forming groups among state enterprises in certain industries and giving priority in investment allocations to state enterprises from specific regions. Obviously, it is difficult to perceive the ultimate destination towards which Vietnamese economic reform is working when the signals are this contradictory.

Another problem intimately related to state enterprise reform is that of regional allocations of public investments. If the preference is for a market economy, then allocations should be weighted toward regions with the highest profitability or the greatest growth potential. Since Viet Nam lacks adequate electrical

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1) World Bank, 1995, *Viet Nam: Poverty Assessment and Strategy*, Tables 7,8, and 9.

transmission facilities, it should build new power plants next to sites with heaviest demand; for roads and other infrastructure items, it ought to begin with those place where externalities can best be taken advantage of. But one need not point out the electric power lines that traverse the country from north to south or the reliance on BOTs to build roads and bridges in the south to see that in regional allocations of public-investment funds Viet Nam's top priority is not marketization.

As a third case of mixed signals in economic reform, consider reforms to the financial system. We have already noted that lending risks are increasing because reforms (including forgiveness of bad debts) have failed to make headway at state enterprises. It is often pointed out that Viet Nam lacks adequate domestically-funded savings and investment, but it is close to impossible to tap funds when the financial sector is unable to provide what should be its most important function, that of mediation, or being able to objectively assess future risks. Banking reform has not gone forward, so domestic banks continue to be smothered by the state commercial banks, but even the state commercial banks are leery of lending to state enterprises, so they invest their "surplus" funds in real estate instead.

With not even the state commercial banks able to fully read where the government intends to go with corporate reform, they have been slow to reform themselves and done little to improve either their banking services or their ability to evaluate project proposals. Part of the reason for this slowness of domestic banks to reform may be that Vietnamese banks are small and unable to compete with foreign banks, but it is unlikely that the gap between foreign banks and domestic Vietnamese banks will be growing rapidly smaller in the near future. It is therefore not just a matter of waiting for bank reform to eventually take place. Rather, it is difficult to know just what, exactly, one should read into the background to reform.

The fourth problem in trying to read signals about marketization from Vietnamese economic reform is in the area of allocations of tax revenues between central and local governments. Viet Nam has fifty-three provincial-level governments, including provinces proper and large cities like Hanoi, Hai Phong, and Ho Chi Minh. Provincial fiscal statistics for 1994 show a total of fourteen provinces to be paying taxes to the central government, three in the north (Hanoi, Hai Phong, and Quan Ninh) and eleven in the south (Ho Chi Minh City, Baria-Vung Tau, Long An, Tien Gian, Vinh Long, An Giang, Kien Ging, Can Tho, Minh Hai, Dong Nai, and Song Be). Thirty-nine provinces, including all of those in the center, were unable to raise enough to cover their expenditures even from "provincial fixed revenue" (the main source of tax income at the provisional level) and their share of the "turnover tax" (split with the central government) and had to receive subsidies from the central government.

Were marketization its highest priority, then Viet Nam, as a transitional economy, should allocate more resources to areas of highest economic growth in order to prop up the economy as a whole. But as was the case with regional allocations of public investments, marketization is not the primary goal of economic reform; income redistribution is given more weight.

In this section we have examined the mixed signals sent by Viet Nam economic reform in terms of four specific areas: state enterprise reform, regional allocations of public investments, financial reform, and allocations of tax revenue between government levels. There are some equations that do not have an answer when certain constraints are imposed. Perhaps Vietnamese economic reform is searching for solutions for problems that have no answers.

III. Two recommendations for the new Five-year Plan, primarily on fiscal policy

1. Attitude toward fiscal and monetary policy

The new Five-year Plan says little concerning fiscal and monetary policy, but that is not so much a reflection of the relative size and importance of the issues involved as it is of the fact that muddy prior policies have made it impossible to even define the issues involved. In other words, neither solutions nor answers are in sight.

As far as our studies show, the new Five-year plan mentions fiscal and monetary policy only once. Here is what it says:

> "The state budget is still under pressure, the tax system is not appropriate, the delegation of authority for state budget allocations is not clearly defined, and there are still leakages in the management of public assets and finances. Domestic saving and investment ratios are still too low. There are still many issues to be resolved in order to liberalise and make more effective use of resources from the different domestic economic sectors. Money and capital markets are still in an embryonic stage. A securities market has not been established. The seeds of high inflation has [sic] not been completely dissipated. The management of exchange rates and foreign exchange are [sic] not flexible enough."

Nowhere in this picture can one see the heroism that liberalized prices, cut subsidies, and fought back triple-digit inflation. It is merely a declaration that the problems are too large and intractable to deal with, an abandonment even of the effort to search for the root causes. Regardless of the stage of development of the capital market, it is self-evident that it will be impossible to float new loans to state enterprises already burdened by bad debts. Merely writing, "Domestic saving and investment ratios are still too low" without showing an awareness of these sorts of reasons why does not an economic plan make. There is mention of the seeds of inflation still remaining and foreign exchange controls being too rigid, but in general, the writing fails to show an aggressive attitude of "let's get these problems solved."

The reason for inadequate coverage of fiscal and monetary policy in the new Five-year plan in spite of the fact that these areas hold the key to Viet Nam's marketization is probably that the people drafting the plan were just as unable to read a consistent message from prior policies as anyone else. It is with this in mind that this paper offers the following two recommendations.

2. Recommendation 1: Strict rules for inter-governmental fiscal adjustments

My first recommendation concerns fiscal adjustments between central and local governments as described in the Budget Law, preparations for which began in 1991 and which was being considered by the legislature as of this writing in March 1996. We have already seen how deeply important inter-governmental fiscal adjustments are to Viet Nam's economic development. It is against that back drop that, in the course of deliberations on the bill, the March 14, 1996 Viet Nam News reports Prime Minister Vo Van Kiet as following up on comments about the fact that only fourteen out of fifty-three provincial-level governments were paying taxes to the center by saying, "Greater autonomy at a provincial level would only be the first renovating step." As far as concrete methods for delegating authority to local governments, he observed, "The government requests to assign specific contribution of revenue for each province and city for a fixed period ranging from three to five years, instead of two years."

Finally an attempt is being made to solve the problems by delegating authority to the provinces and allowing them to find their own solutions. What should be underscored in the following comments are the problems in the way in which provincial revenues and expenditures have previously been assessed and tax payments to or subsidies from the center decided. In the final paragraphs of Part II we noted that most of Viet Nam's tax revenue came from eleven southern provinces. The biggest source of fiscal funding is Ho Chi Minh City, which is only allowed two trillion Dong in spending against almost ten trillion Dong in tax revenues, the rest being absorbed by the center. On the opposite side of the coin are several province that receive subsidies almost equivalent to their tax revenues.

What needs to be emphasized is that in a lopsided fiscal structure such as this one in which there is no relation between tax revenues and expenditures, neither affluent provinces nor poor provinces have much incentive to collect more tax revenues and make their territories more prosperous. Certainly affluent provinces have no incentive to collect more taxes. If they do, they may get use of the funds the first year, but then the next year they will be forecast to provide even higher tax revenues to the center. And, interestingly enough, as long as there is no clear link between expenditures and revenues, it will be to the advantage of subsidized regions to continue to rely on the center rather than making efforts on their own to increase tax revenues.

The result of centralized fiscal management is to rob rich areas, poor areas, and the central government itself of tax revenues that otherwise could have been tapped. All lose. To escape from this trap of disincentives requires that there be a linkage between expenditures and revenues, that systems be put in place in which provinces that are able to secure more tax revenue are also able to spend more. In this respect, the Budget Law now before the legislature is an important first step towards reform, but there are still problems that remain.

For instance, the law will allow provinces free use of their increase for three to five years, but does nothing to alleviate concerns that it will be taken away from them thereafter. All it really does is delay for three to five years the argument over whether the money should remain with the province or be given to the center. As the end of the period in which they are allowed free use of revenues approaches, a sharp drop off can be expected in provinces' efforts to secure them.

Therefore, this paper's recommendation on inter-governmental fiscal adjustments is that the rules on allocation of resources between central and local governments be made clearer than is at present being discussed and that there be a "contract" between governments designed to bring out self-help efforts at the provincial level. In doing this, the central government may continue to have a policy goal of redistributing income between regions, but should try wherever possible not to impede the efforts of provincial-level governments while expanding the size of the economy as a whole.

3. Recommendation 2: Use pension funds to tap domestic resources

The second recommendation of this paper on use of domestic resources is to link Viet Nam's future growth and youthful labor force to the accumulation of capital. Viet Nam created a new "Viet Nam Social Insurance Agency" in 1995. The agency is overseen by the Ministry of Labor, Wounded Warriors and Social Affairs, but has an independent budget accounted for separately from previous pension and social insurance systems, which were administered with government budget. As of 1996, participating employers contributed 5% of wages, the employee 15% as premiums. The Viet Nam Social Insurance Agency is currently only for government employees, though it appears to be accepting premium payments from employees in other sectors.[2]

There is no information on the participants or beneficiaries of the Viet Nam Social Insurance Agency, but if mandatory collection of 20% of wages as insurance premiums expands to non-government employees, it obviously could grow into a very large-scale program, and this is even more the case because Viet Nam can look forward to wage increases as its economy grows and is blessed with a young labor force to begin with.

We therefore strongly recommend expanding the number of participants in the pension plan, using the installment method to control premiums, and strictly controlling how funds are invested. Unfortunately, no information has been disclosed about the operations of the Viet Nam Social Insurance Agency other than that it has an independent budget. It is unknown whether it employs installment methods or assessment methods, how much of a balance of assets it has or how that money is invested. If it is currently using an assessment method and the monies paid in are going right back out to cover fiscal deficits, it means the loss of an extremely important opportunity to tap domestic funds.

At the beginning of this paper we noted Singapore and Chile as examples of countries that had effectively used funds accumulating in pension plans managed under the installment method. Chile has been particularly successful, having privatized its pension system and in the process created the country's largest institutional investor, an organization that has contributed much to the privatization of other state

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2) Ministry of Planning and Investment, Viet Nam, 1996, *Japan-Viet Nam Joint Research*, MPI materials, "VI Regime of Social Insurance in Viet Nam."

enterprises. The fact that private-sector investment experts are given charge over how funds are used means that investment decisions are rigorous, which has in turn contributed greatly to improving the managerial discipline of domestic state enterprises. Viet Nam should not just leave the management and investment of pension funds up to a single government institution, it should look for a system in which investment is more rigorous and contributes to the development of capital markets rather than just state enterprises.

IV. Concluding remarks

This paper has examined three defining characteristics under which economic reform in Viet Nam must proceed: the ultimate goal of marketization, market functions that have atrophied under socialism, and the unique north-south economic gaps. It being extremely difficult to discover a path to economic reform that satisfies all three constraints, the solid, market-oriented reform signals that were seen from the late eighties to about 1991 have become muddled in the course of subsequent reforms, as seen in state enterprise reform and other specific examples.

From there the paper recommended that, from the perspective of fiscal policy, clearer rules were needed for inter-governmental fiscal adjustments than were being considered in the current deliberations on the Budget Law. It further recommended that the establishment of an installment-type pension system with rigorous fund management would be an important method for effectively linking assumed future economic growth and an abundant supply of young labor to the accumulation of capital.

Tax system reform is another important item on the fiscal policy agenda. The reason that this paper has not commented on it is not because it is a low priority issue, but because we agree with the plan for introducing a value added tax as the core tax replacing the turnover tax, even if a bit of trial and error will be unavoidable in the process.

Other issues in tax reform include taxation of high personal incomes, and stronger taxation of foreign companies making direct investments in the country. We have our doubts about how desirable it is to strengthen taxation of personal incomes at a time when Viet Nam is trying to tap domestic funding, and about how much value there will be in strengthening taxation of the investment profits of foreigners as the economy opens to the outside in preparation for ASEAN Free Trade Area (AFTA) membership, but these are issues that all countries must arrive at realistic solutions to through a process of trial and error. Thus for "Vietnamese Tax Reform Part Two" (the first part having come in 1990), we must voice our support for the core strengthening of the value added tax but will need to carefully monitor future developments regarding the other aspects.

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5
The Transformation of the Banking Sector in Viet Nam

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The transformation of the banking sector is crucial in building a new capital formation mechanism, together with the reform of the fiscal mechanism. The purpose of this paper is to find the main characteristics of the transformation process of the banking sector in Viet Nam since the introduction of the two-tier banking system in 1988. The banking sector serves as a mechanism of both settlement and financial intermediation in a national economy. This paper focuses on its latter function as a financial intermediary and measures its development process by two types of quantitative indexes.

One is the ratio of domestic credits extended by the banking sector to GDP, an index of financial intermediation which measures the importance of the flow of funds channeled through the banking sector to meet the demand for funds from various sectors of the economy. We compute the ratio for the entire economy, the government, nonfinancial public enterprises and the private sector respectively.[1]

The other index, called two-tier banking index (TBI), is defined by X/Y - 1, where X is the total domestic credits to nonfinancial economic units extended by the banking sector as a whole; and Y is the total domestic credits including the credits to commercial banks extended by the central bank (State Bank of Viet Nam, SBV). It measures the depth of the two-tier banking system. Its value is equal to zero under the complete monobank system: the monobank finances its credits entirely by issuing currency or equivalently the central bank refinances 100% of the credits extended by commercial banks. In the economy with active commercial banks, TBI takes on a much higher value than zero: for example, its values are 20.0 for Japan and 18.2 for USA at the end of 1989.

The analysis covers the period from 1989 to 1994.

I. Indexes of financial intermediation

The figures from Figure 1 to Figure 3 show the characteristics of the development process of the financial intermediation function of the banking sector in Viet Nam.

(1) Figure 1 shows the behavior of the ratio of total domestic credits to GDP for the economy as a whole. It shows that the amount of credits (relative to GDP) channeled through the banking sector continued to deteriorate in Viet Nam until 1992 (when the real interest rate turned positive and the interest rate spread became positive for the first time since 1989). That is, we observe financial disintermediation before 1992, rather than the development of intermediation function.

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1) The ratio for the entire economy is approximately the same as the M2/GDP ratio.

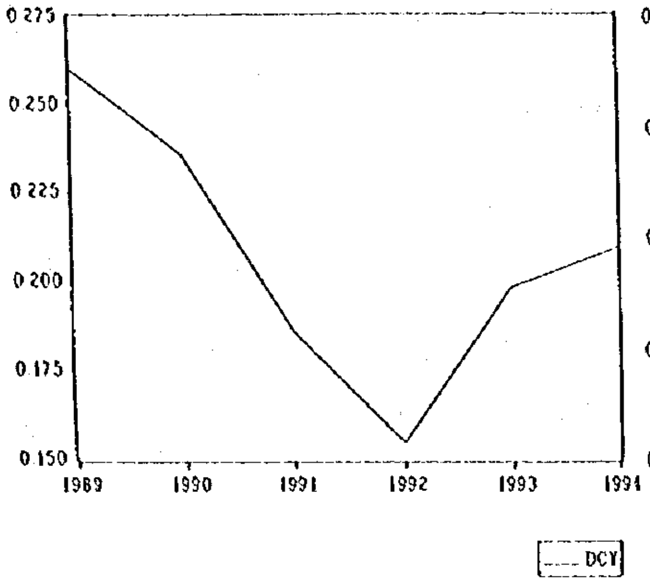

Figure 1 Total domestic credits / GDP ratio

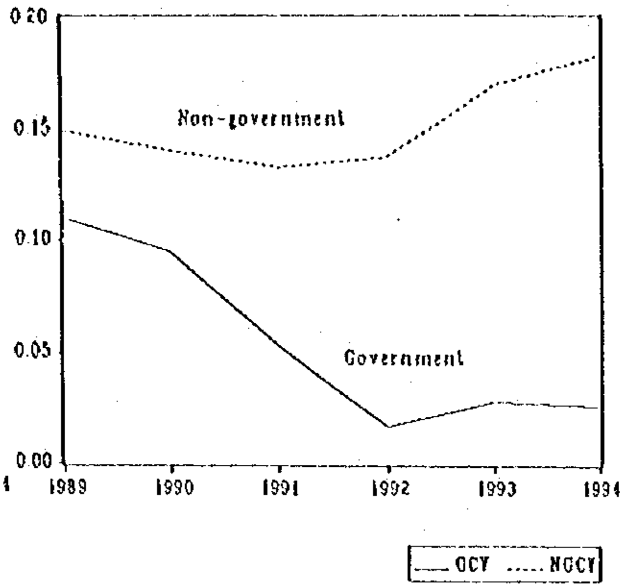

Figure 2 The allocation of credits between government and the non-government sector

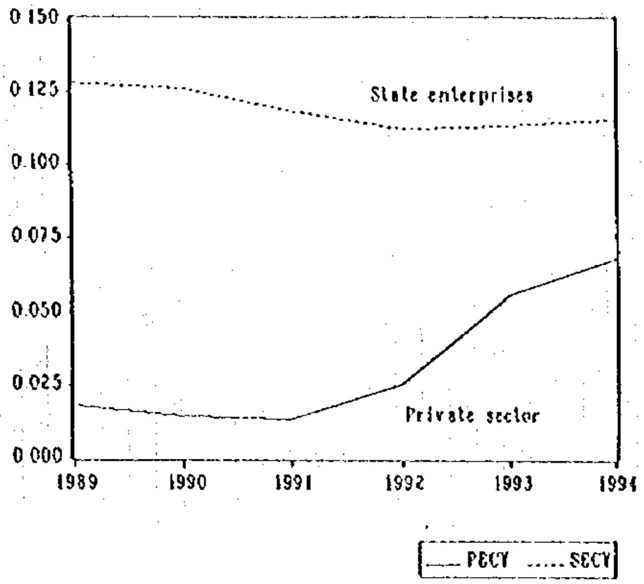

Figure 3 The allocation of credits between state-enterprises and the private sector

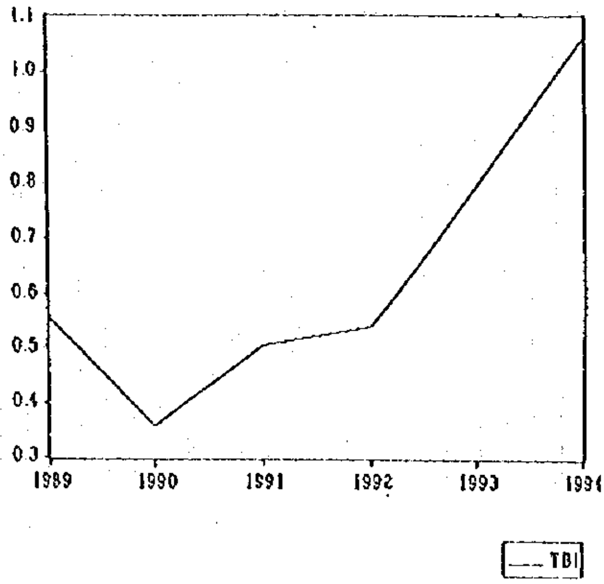

Figure 4 Two-tier banking Index

(2) Figure 2 shows, however, that the financial disintermediation before 1992 occurred mostly in the credits extended to the Government. That is, the financial disintermediation to the non-government sector (primarily the enterprise sector including state as well as private enterprises) was much smaller than that to the government sector. After 1993, the degree of intermediation began to pick up for the non-government sector quickly, while that for the government sector stabilized at a low level.[2] It is clear that the government has been restraining its financial needs severely.

(3) Figure 3 shows that the rapid increase in the intermediation ratio is attributable to the fact that more credits were allocated to the private sector, although its level is still lower than that of state enterprises.

These observations indicate that the financial intermediation function of the banking sector began to develop slowly but steadily for the economy as a whole after 1992, and that the development came almost entirely from its larger role as a mechanism to channel funds to the private sector. The rapid development of financial intermediation toward the private sector may be partly attributable to the financial discipline observed by the government since 1991. However, the level of financial intermediation itself, .21 in 1994, is still very low, compared to the level of matured market economies. For example, its values are 1.37 in Japan, 1.43 in Germany and .76 in the US.

II. Two-tier banking index

Figure 4 shows the development process of the two-tier banking system in Viet Nam in terms of TBI. After 1990 it has been increasing steadily.

III. Concluding remarks

The observations obtained in Sections I and II indicate that the government has created a policy environment which is amenable to the development of the banking sector around 1992 and that the intermediation function of the banking sector has been being strengthened slowly but steadily, particularly toward the private sector of the economy.

2) This is rather exceptional. For example, in Poland or Hungary, the government began to absorb an increasingly higher fraction of of credits.

6
Medium - to Long - term Funds in Viet Nam

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I. Demand for medium - to long - term funds

Demand for investment and development funds is quite large in Viet Nam, and mobilization of such funds is the critical issue for the Vietnamese Government. The volume of investment necessary for 1996-2000 is estimated at US$ 41-42 billion in the next Five-year Plan. Public investment, FDI and private investment are $15.6 billion, $14 billion and $12.4 billion respectively in the plan. The government is also preparing the Public Investment Program (PIP), which covers all projects expected to be funded by the state budget, for 1996-2000. The PIP lists investment projects amounting to US$ 17 billion. The figure is almost equivalent with the public investment in the Five-year Plan (see Table 1,2)

Investment projects can be classified by investor (executioner) and by economic nature of investment as in Table 3. It is essential for the government to differentiate investment projects into public sector type, private sector type and mixed (public and private) sector type in order to fund each project properly. Social and economic necessity governs public sector type and profitability governs private sector type. The description by the government on state owned enterprises (SOEs) investment is sometimes ambiguous in terms of economic nature and accordingly the guiding policy is also ambiguous. Attention must be given to the confusion of public investment with SOE investment and the probability of crowding out the private sector investment by SOEs.

According to a macroeconomic projection of the government, private sector business investment as well as commercially viable investments of SOEs seem to have considerable size of US$ 12.8 billion (see Table 2). Through our interview with business entities, we also noticed the funds needed to make commercially viable investments in SOEs as well as in small and medium private enterprises (SMEs). We recommend that the government undertake an investment needs survey of the business sector by questionnaire to grasp the magnitude and contents of commercially viable investment projects.

Aside from investment projects, medium- to long- term funds are also needed for SOE bad debt settlement as well as for long- term working capital. It is imperative to manage bad debt properly and save scarce funds so as not to jeopardize new investment opportunities. Working capital needs for medium- to long- term are also important in Viet Nam. An emerging export sector is labor- intensive industries such as textile and food processing. These industries need more working capital for labor and material cost rather than investment capital.

In general, long- term investment in Viet Nam is still regarded as risky by the business sector. Their concern is uncertainty about inflation, the foreign exchange rate, economic growth, policy changes and so on. Thus the private sector, including foreign investors, tends to invest in projects with short- term returns such as hotels, restaurants and real estate. In addition, the current bank lending rates are considerably high for the industrial sector, which needs long- term investment by long-term business perspective. As a rather new phenomenon, the high interest rates entice funds from the private sector into bank deposits rather than into business investment (see Table 4). Although the industrial sector has fund needs for expanding business, high interest rates are suppressing their needs.

Autonomous management of SOEs has made progress in terms of pricing, materials purchasing and personnel management. Investment decision making, however, is still under government control as described in Government Decree 177. Viewpoints of government and business entities on investment projects are and should be different. Policy priority tends to not go along with profitability. The current investment decision making system may suppress SOE investment opportunities.

II. Medium- to long - term fund raising

Availability of medium- to long- term funds is very limited in Viet Nam. In addition in Viet Nam they are generally shorter than the international standard (medium- term is 1- 3 years and long term is 3- 5 years). Foreign funds such as ODA and FDI have become important sources of medium- to long- term funds and are expected to play a major role for 1996-2000 (see Table 1, 2). A large gap, however, has already grown between commitment amount and disbursement amount.

Domestic funds for the medium to long term needs mostly come from the state budget, which is also heavily constrained. Fiscal savings, defined as fiscal revenue minus current expenditure, has been positive and covering a part of capital expenditure since 1992 (see Table 5). However, the savings is as small as US$ 0.7 billion in 1994 and most of the capital expenditures are financed by fiscal borrowings. The main sources of fiscal deficit finance are ODA and government bonds, which have to be repaid. A major portion of the government bonds are short term, Treasury bills and Treasury bonds of one year maturity. As a new endeavor the government has issued a project bond with one, two and three year maturities to specifically finance the North-South electric line project, to which mostly SOEs subscribed.

Contradicting official data up to 1994, both the banking sector and the business sector stated that bank deposits were increasing (To date we have not been provided even 1995 data). As an example, a joint- stock bank we visited proves how deposits are growing (see Table 6). The Government endeavors with high interest rates finally succeeded in enticing domestic savings to the banks. Most of the deposits, however, are short- term. The majority of term deposits are for 6 months. With the perceived uncertainty, depositors do not want to deposit in the long term. Nor do banks want to receive deposits with such high interest rate as having no borrowing demands. A major portion of deposits is still from SOEs.

Other than deposits, state owned commercial banks (SOCBs) issue bank bonds with one year maturities. The Bank for Investment and Development of Viet Nam (BIDV) issues one-, three- and five-year bonds. SOCBs also borrow from foreign banks. Some SOEs issued corporate bonds in 1995. The composition of SOCB liabilities varies from institution to institution, reflecting the differences in business, which in turn provide the possibility of gaining from other institutions' experience (see Table 7).

Private companies do not have easy access to bank loans. Funds available for private companies are mostly short- term (See Table 8, 9). For investment funds, private companies have to rely on their internal funds and informal finance as well as short- term revolving funds. Informal finance from acquaintances sometimes provides better terms than banks. The financial situation confronting the private sector, however, generally hinders or postpones the investment opportunity. Furthermore the current tax system featuring high effective tax rates for business sector, does not promote internal savings and reinvestment.

The Social Insurance Fund is a possible source of medium- to long- term funds. The Social insurance system, which was supported by the state budget, was reformed in 1995. The fund is now responsible for the pension payments to those who retired after January 1995. For the pension system as a whole, however, governmental subsidies are indispensable for paying pensions for the immediate future. In view of the large percentage of the young population and the potential of future economic growth, the fund will have surplus funds play an important role as medium- and long-term funds. The premiums of casualty insurance companies are another possible source. Though the term of casualty insurance is one year, growing premium payments would enable long- term investment. As the economy grows, people would need life insurance, which is a more suitable source of medium- to long- term funds.

Another possibility is to issue medium- to long- term bonds to savings banks.

III. Financial intermediaries and medium- to long- term funds

The BIDV and the General Department for Investment and Development (GDID) of the MOF are major suppliers of medium- to long- term funds in Viet Nam. GDID provides funds from the state budget to the government's public investment projects and to specifically authorized projects of SOEs. BIDV formerly functioned as the provider of funds from the state budget, which GDID has taken over since January. 1995. BIDV is now the main provider of medium- to long- term funds on a commercial basis.

The National Investment Assistance Fund (NIAF) was established under the administration of GDID in December 1995. Though the responsibility of the NIAF is not completely clear yet, it will provide low or no interest loans to SOEs with specific investment projects. We have not yet seen clear demarcation of funds flow among these organizations.

It is not efficient for a government section to provide loans to business entities. Policy priority and credit judgment are different and sometimes contradictory. If credit judgment cannot override policy judgment, repayment of loans will be dubious. Projects with the highest policy priority should be financed by the budget, not by loans.

The share of medium- to long- term credit is increasing, but the loans are mostly to SOEs (see Table 8).It is the State Bank of Viet Nam (SBV)'s policy to increase private sector credit by SOCBs, but mostly in the short term. Private sector banks are more hesitant to provide medium- to long- term funds under uncertain economic conditions. The main flow of medium- to long- term funds is from SOCBs to SOEs. Conversion of short- term deposits to medium- to long- term loans is minimal. According to the SBV, only about 10% of deposits are long- term and 15% of short- term deposits are converted to medium- to long- term loans.

The reverse interest rate structure, where the long- term rate is lower than the short- term rate, has been a major deterrent for banks to lend long term. Vietnamese government has come a long way to equalize the short- term and long- term lending rates. Investment funds were given to SOEs by the government before the reform. A sense of borrower's responsibility was and still is scarce at SOEs. This leads to confusion on the part of SOEs regarding the difference between assets, equity capital and debt. Credit analysis practice seems to vary from institution to institution, and is inadequate at most financial institutions. Financial data is inadequate in all sectors, especially in the private sector where tax is routinely evaded. The financial system does not function properly without appropriate financial data. It is not plausible that every financial institution is capable of credit analysis, especially of long- term investment projects. It is true even in light of experience in banking sectors of some advanced countries where most banks are incapable of sufficient project appraisal. This capability, however, is critical not only for sound banking but for Viet Nam's negotiation with foreign investors and lenders.

Collateral lending is the general practice, which has limitations and may lead to the situation where the banks' checks, if any, on the creditworthiness of their clients are insufficient. Leasing has become active and applied in various types of business. SOCBs established joint venture leasing companies as well as wholly owned subsidiaries. Leasing is promising in terms of not facing the collateral problem. In ASEAN countries, leasing has supplemented the inadequate supply of medium- to long term- funds, especially in the manufacturing sector.

A possible alternative to efficiently utilize scarce medium- to long- term funds is to reorganize BIDV as a specialized institution for medium- to long- term loans. BIDV is financially viable with large capital and reserves and seems to have staff with credit analysis expertise. And for small and medium enterprises, joint- stock banks can be a good partner. Small banks are usually well versed with the business of their clients. After checking the credit analysis capability, BIDV makes wholesale loans of medium- to long-term funds to certain joint- stock banks.

East and South-East Asian countries invariably established policy based finance institutions to utilize scarce medium- to long- term funds focusing on priority sectors. Commercial banks neglected to finance medium- and long-term funds needed for industrial development. The areas in which they are involved and their performances are varied partly due to the different levels of government intervention in the economy. Howevwer autonomous decision making on loans is a crucial factor in not incurring accumulated bad debt. Government should play the role in the policy formulation and should leave the loan decision on individual projects to financial institutions.

Foreign banks including joint venture banks now regard only well performing SOEs as possible clients. The private sector has not matured yet and the exercising of collateral rights on SOE assets is difficult in practice. Thus many foreign banks focus their business in wholesale on SOCBs. Foreign banks can be vital for bringing external funds into Viet Nam, but they are currently in low profile due to restrictions and a high tax rate.

Table 1 Investment figures of the Five-year Plan (1) (in billions of 1995 US$)

	1991-1995		1996-2000	
Investment	18.0	100.0	41-42.0	100.0
(State)	(7.7)	(43.0)	(15.6)	(37.1)
(FDI)	(4.9)	(27.0)	(14.0)	(33.3)
(Private)	(5.4)	(30.0)	(12.4)	(29.5)
Fund Sources	18.0	100.0	41-42.0	100.0
(ODA)	*(2.0)	(11.1)	(8.0)	(19.0)
(FDI)	(4.5)	(24.7)	(14.0)	(33.3)
(Domestic)	*(11.5)	(63.9)	(21.0)	(50.0)
#Eurobond	-	-	1.0	-
#ICOR	2.0-2.5	-	3.0-3.3	-
#Inv/GDP	**19.1	-	30.0	-

(Government Report to CG)

* based on rough disbursement figures

** calculated for 1991-94 using IMF data

Table 2 Investment figures of the Five-year Plan (2)

(in billions of 1995 US$)

Investment		Sources of Funds	
Public Investment	15.6	Budget	8.1
		ODA	7.5
(Government)	(8.7)	-	
(SOEs)	(6.9)	-	
SOE Commercial	5.9	Domestic	5.9
Private	19.9	FDI	13.0
		Domestic	6.9
Total	41.4	Total	41.4

(Government PIP report)

Table 3 Classification of medium to long term fund needs

Investment entities	Nature of investment	Sources
Government	Public	State budget ODA
SOEs	Public	State budget ODA
	Mixed	State budget + ODA
	Commercial	Short term revolving Retained earnings
Private	Commercial	Short term revolving Retained earnings Informal
Bad debts of SOEs	-	State budget
Long term Working Capital	-	Short term revolving

Table 4 Selected monthly interest rates (%)

	Long term lending	Short term lending	Spread	6 month deposit rate	Inflation rate**
Oct. 93	1.2(14.4)*	2.1(15.2)	0.9 (10.8)	1.7(20.4)	5.2
Aug. 94	1.7(20.4)	2.1(15.2)	0.4 (4.8)	1.7(20.4)	14.4
Dec. 95	1.7(20.4)	1.75(21.0)	0.05(0.6)	1.7(20.4)	12.7

(SBV) *in parenthesis annual rate calculated at simple interest

**inflation rates are for calendar years 1993, 94 and 95

Table 5 Macro and state budget data

(in billions of current VND)

	1986		1987		1988		1989		1990		1991		1992		1993		1994		1995	
GDP-const.					25,385		28,093		29,526		31,286		33,991		36,735		39,982			
GDP current. *	599	100.0	2870	100.0	14,428	100.0	28,093	100.0	41,955	100.0	76,707	100.0	110,535	100.0	136,571	100.0	170,258	100.0	217,000	100.0
Consumption									35,507	84.6	64,052	83.5	88,910	80.4	116,168	85.1	141,456	83.1		
Capital Formation									6,350	15.1	11,588	15.1	18,806	17.0	26,542	19.4	37,572	22.1		
Government									2,126	5.1	2,135	2.8	6,450	5.8	9,600	7.0	11,300	6.6		
Private									4,224	10.1	9,453	12.3	12,356	11.2	16,942	12.4	26,272	15.4		
Trade Balance									98	0.2	1,067	1.4	2,819	2.6	-6,139	-4.5	-8,770	-5.2		
Export											22,915	29.9	35,767	32.4	38,538	28.2	53,606	31.5		
Import											21,851	28.5	32,957	29.8	44,677	32.7	62,377	36.6		
Cap Frm + Tr Bal									6,448	15.4	12,655	16.5	21,625	19.6	20,403	14.9	28,802	16.9		
State Budget																				
Revenue	84	14.0	379	13.2	1,740	12.1	3,899	13.9	6,153	14.7	10,353	13.5	21,023	19.0	30,500	22.3	42,125	24.7	52,770	24.3
Total Expenditure	121	20.2	515	17.9	2,840	19.7	6,781	24.1	9,522	22.7	13,196	17.2	25,120	22.7	38,975	28.5	46,212	27.1	55,970	25.8
Current Exp.	83	13.9	395	13.8	2,167	15.0	5,155	18.3	7,398	17.6	11,061	14.4	18,670	16.9	29,375	21.5	34,497	20.3	40,120	18.5
Current Balance	1	0.2	-16	-0.6	-427	-3.0	-1,256	-4.5	-1,245	-3.0	-708	-0.9	2,353	2.1	1,125	0.8	7,628	4.5	12,650	5.8
Capital Exp.	38	6.3	120	4.2	673	4.7	1,626	5.8	2,124	5.1	2,135	2.8	6,450	5.8	9,600	7.0	11,715	6.9	14,860	6.8
Overall Balance	-37	-6.2	-136	-4.7	-1,100	-7.6	-2,882	-10.3	-3,369	-8.0	-2,843	-3.7	-4,097	-3.7	-8,475	-6.2	-4,087	-2.4	-3,200	-1.5
Interest Arrears	1	0.2	2	0.1	26	0.2	769	2.7	932	2.2	1,683	2.2	2,218	2.0	1,965	1.4	1,142	0.7		0.0
Financing	35	5.8	134	4.7	1,074	7.4	2,113	7.5	2,437	5.8	1,160	1.5	1,879	1.7	6,510	4.8	2,945	1.7	3,200	1.5
Banking	23	3.8	89	3.1	450	3.1	1,931	6.9	832	2.0	144	0.2	-2,208	-2.0	2,044	1.5	633	0.4		0.0
.2+	0	0.0	3	0.1	17	0.1	-231	-0.8	341	0.8	249	0.3	1,414	1.3	2,541	1.9	1,690	1.0	2,000	0.9
Foreign	14	2.3	43	1.5	370	2.6	413	1.5	1,264	3.0	767	1.0	2,673	2.4	1,925	1.4	622	0.4	1,200	0.6

Source : IMF 1995 b
WB 1995 c

91-94 inv/gdp
94508
494071
19.1

Table 6 Bank deposits

(in billions of VND)

	1991	1992	1993	1994
Total Deposit	13881	16564	18071	22622
Dong Deposit	5527	8351	10665	14429
Total/GDP	18.1	15.0	13.2	13.3
Dong/GDP	7.2	7.6	7.8	8.5

(SBV)

	12/93	12/94	9/95	12/95
Total Deposit	1.6	20.3	115.7	226.4

(Annual report of a Joint Stock Bank in Hanoi)

Table 7 Composition of liabilities of SOCBs as of Dec. 1994

(billions of VND)

	Agri Bk	%	BIDV	%	Incom Bk	%	Vietcom	%
Deposit	3029	25.3	1230	14.2	5453	51.2	11921	71.3
Bond	3644		151	1.7	2217	20.8	167	1.0
Bank brrwng		30.4	1160	13.4	260	2.4	412	2.5
State bank	2533	21.1	913	10.5	641	6.0	58	0.3
Capital	1961	16.3	3415	39.4	477	4.5	526	3.1
Others	831	6.9	1793	20.7	1607	15.1	3643	21.8
Total	11998	100	8662	100	10655	100	16727	100

(Annual reports) *Preliminary unconfirmed classification included

Table 8 Shares of long-term credit

(%)

	1991	1992	1993	Sep.1994	*private
Agri Bk	4.7	5.3	16.5	21.8	35.3
BIDV	74.1	76.7	82.5	74.3	0.7
Incom Bk	4.1	6.6	12.4	13.0	21.1
Vietcom Bk	10.1	12.0	19.5	25.2	2.6
Others	2.4	2.1	6.0	8.5	10.4
Total	15.5	16.8	24.7	27.9	10.7

(WB) * private share of total long-term credit

Table 9 Private sector shares in credit outstanding

(%)

	1991	1992	1993	1994
Agri Bk	11.8	36.3	64.0	66.6
BIDV	0.3	0.7	2.0	3.1
Incom Bk	3.4	9.7	26.1	28.2
Vietcom Bk	0.0	0.1	1.9	3.0
Others	4.6	20.0	26.6	29.9
Total	4.8	14.0	27.1	28.0

(WB) *Figures for 1994 are as of Sep. 1994 except Total

7

Foreign Capital Mobilization
-- Centering on FDI and Foreign Debt Management --

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I. Foreign capital mobilization or foreign saving in general

Vietnamese government seems to be planning to grow its economy at an annual growth rate of 9-10% during the next five years. Investment made by both domestic investors and foreign investors must increase accordingly (investment rate should be 27-30% of GDP annually, in case ICOR be 3).

Through the Doi Moi success, its domestic saving[1] vis-a-vis GDP have increased from– 0.1% in 1989 to about 18% in 1994 and 21% in 1995. It was a marvelous achievement. Further efforts to raise its rate is strongly required, however. No doubt, to realize high domestic saving ratio is a key factor whether Vietnam can attain its ambitious growth plan without occurring serious debt problems. In the next five years, however, it is quite likely that the domestic saving will be far in short from the total necessary investment amount, say, around 30% of GDP or more. So, the actual growth rate shall be largely determined by how much foreign savings could be raised, and how efficiently those savings will be utilized.

Foreign savings (FS) or necessary external financing comprise foreign official loans, grants and private financing as well as other private capital inflows, namely:

FS = Official Development Finance (ODF) + Private Financing (PF)
ODF = ODA[2] (official development assistance) + OOF[3] (other official flows)
PF = FDI (Foreign Direct Investment) + PEI
(Portfolio Equity Investment) + other private flows

For Viet Nam, how to procure sizable ODF and FDI is vitally important due to its limited capacity for repayment and to help constructing socio-economic infrastructure projects mainly by concessional funds and to increase productive capacity with technology transfer through FDI. Other financing is supplemental and should be minimal for the some years to come.

Under the next Five-year Plan draft as of November 14 1995 released by Viet Nam Communist Party's Central Executive Committee, I-S balance projection in 1996-2000 is as follows (See Table 1) :

Under the above assumption, annual averaged disbursement for ODA will be approximately $1.4 billion. However, according to a statement by the World Bank at Viet Nam Consultative Group Meeting on Nov. 30 -

1) However, scrutiny of these high figures may be necessary due to statistical problems. It may include deposits of foreign subsidiaries in Viet Nam. And, too acute a judgment that Viet Nam can reduce foreign saving considerably in coming years in case Vietnam succeeds to induce enough foreign capital may lead to a mistake.
2) ODA: concessional loans and grants, e.g. IDA, OECF, JICA, ADF
3) OOF: World Bank, ADB, EXIMBANK, etc.

Table 1 I-S balance prospects for the next Five-year Plan (1996-2000) of Viet Nam

Total Investment $41~42 billion*

(Public investment 1/3, Domestic private investment 1/3, FDI 1/3)

… each abt. $13~14 billion

=Total Savings $41~42 billion

(Domestic saving 40%, foreign savings ** 50% or $ 20~22 billion respectively)

* This total investment figure is illustrated when the average exchange rate in 1995 is used. In accordance with the exchange rate of 11,500 Dong per/US$, total investment will be $58 to $60 billion during the same period. See Dr. Lai Quang Thuc's paper presented at March 2-3, 1996 Hanoi Seminar (No. 3-1, P.2).

** assuming that 1/3 of the total requirement be mobilized by ODF or mostly ODA, and the rest 2/3 by FDI, annual averaged target amount for ODA and FDI will be about $1.4 and $2.6 billion respectively.

Table 2 Foreign trade and FDI

(Million US $)

	1990	1991	1992	1993	1994
Export	1731	2042	2475	2850	3610
Import	1772	2015	2535	3505	4008
FDI(Approval)	596	1288	1938	2777	4071
FDI(Realized)	200	260	535	1001	1500
FDI(BOP basis)	120	220	260	300	435

Dec. 1, 1995, disbursements of ODA are projected to rise to $663 million in 1996. It is not easy to project how much disbursement of ODA will come up from 1997 on. It may rise quickly due to many pipeline projects. It is sure, however, that utmost efforts should be made to upgrade efficiency on ODA implementation, while educating people.

II. Foreign direct investment

According to the above Box, an annual averaged requirement on disbursement on FDI will be $2.6 billion. The targeted amount looks challenging. However, the past performance of incoming FDI is not that bad (Table 2), showing that FDI disbursements were $1.0 billion in 1993 and $1.5 billion in 1994. Looking at this trend, the targeted amount does not look far from reality. Actually, however, there are lots of problems on Viet Nam's investment climates, its FDI licensing process and the implementation.

So, I would conclude that the target could be attained under the following conditions :

1) if quicker and more transparent decision-making process for providing licenses to foreign investors be established.

2) if foreign investors for oil and gas continue to develop oil and gas at a high pace.

3) if various land problems including prices, lease-hold and mortgage of land-use rights be appropriately solved by legalization.

In China, for instance, land-use rights could be mortgaged to overseas enterprises in case land-use right was purchased, and a borrower can only provide itsproperty to an overseas lender as security for repayment on time.

4) if infrastructure-making be implemented continuously and rationally including construction and expansion of harbours, roads, railroads, power houses and electricity transmissions, tell-communications and industrial estates.

5) if intellectual property rights be legalized and well observed.

6) Smuggling to nurture domestic demand-led investment be virtually abolished.

7) if other investment climates be improved (fair treatment to foreign investors is a must).

It is good that Vietnamese authorities have made discussions with foreign investors (including potential ones), economic federations[6], researchers and various embassies from time to time and began to understand problems. Improvements are evident. However, further efforts are required particularly to alleviate bureaucratic process and avoid strong voices of vested interests.

Foreign investors can hardly get long-term local financing in Viet Nam. Even short-time borrowing rate is prohibitingly high, which makes the cost management extremely difficult. So they cannot be free from foreign exchange risk. This ails particularly small enterprises. Some devices should be developed to reduce such inconvenience.

III. Foreign debt management

In the above-mentioned Consultative Group Meeting the World Bank stated that, first, foreign borrowing may seem like an easy option for financing development, but all too many countries have come to grief with that strategy; second, a careful managed public investment program must be at the heart of the plan, adding that "The danger that we see as Vietnam develops its five-year plan is that the Government will try to do too many things and rely on risky financing for some of item." It concludes that the Vietnamese Government should be very cautious in tapping private commercial borrowing in order to obtain appropriate lending terms and to ensure its ability to service the debt in the future.

Viet Nam currently owes $4.2 billion of public and publicly guaranteed debt in convertible currencies and additional debt in non-convertible currencies amounting to about 10.5 billion transferable rubles.

Vietnamese government has shown its guideline to make annual repayment be within 10% of the budget and within 15% of the export by 2015. However, no clear assumptions are given to ensure this guideline and it looks too many uncertainties exist[5]. For instance, there seems not so definite figures of oil reserves and concrete development plans of oil and gas by which to estimate accurately how much foreign reserves can be gained by oil export in coming years.

Hence, what we can say currently is that Vietnamese government should maintain strong will to keep Debt Service Ratio Debt Service / GDP ratio as well as short-term borrowing out of total borrowing at a reasonable level by updating all related figures and information from time to time.

Vietnamese Government could learn the lessons of the "lost decade" of the 1980s for Latin American countries due to the debt overhang[6]. The failure originated from that the following facts:

1) the increase of prices of primary goods in the 1970s and subsequent international inflation gave the governments of Latin America wrong judgments that they could take advantage of "borrowers advantage", in other words, they believed that inflation would virtually write off their obligation toward future.

2) Commercial banks (lenders) also made wrong judgments that "(sovereign) country" would be never broke even if the situation where the debt be rescheduled may happen. Having so believed, they continued to lend in the form of syndicated loans almost limitlessly as far as the borrowers were governments or their agencies.

3) Their interest rates were on a floating rate basis. Hence, when the U.S. FED tightened its belt at the end of the 1970s, the interest rate soared to an incredibly high level.

Another points which should be noted is that Latin American countries put more emphasis on rather inefficient, large scale import substitution industries with high tariff, which made a great contrast with Asian

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4) Take one instance. KEIDANREN offered a request letter to Vietnamese Government dated Feb. 10, 1995. Responses were made by Vietnamese government. However, KEIDANREN still requests improvements of licensing standards, administrative capacity making, measures against smoggling, etc. There are other problems like intellectual property rights and land prices. Land prices for foreign firms are said too costly compared with those in neiboring countries. (See attached Ms. Okada's paper.)

5) Minute check of each assumptions and parameters is a must and simulations under different scenarios should also be made regularly. To increase FDI is encouraged also from this objective.

6) See for instance the following paper: Toshihiko Kinoshita, "Developments in the international debt strategy and Japan's response", EXIM REVIEW, Research Institute for International Investment and Development, The Export-Import Bank of Japan, Vol. 10, No.2, 1991, pp. 62-80.

countries which have encouraged exportable industries mainly by private firms including joint ventures. Averaged annual growth rates of exports of Latin America in the 1970s and in the first half of the 1980s were 19.0% and 0.1% respectively. By contrast, those of East and South-east Asia were 26.3% and 4.4% respectively. Thus the long-term debt outstanding of Latin America in 1980 and 85 were 140% and 268%. Those of Asia were 62% and 102% respectively. So, following cautions will be well paid.

1) In making future debt payment schedule, prepare for the worst possible situation, by picking up minimum exportable amount (not wishful figures) and use the highest possible payment amount.

2) Try to make the debt (outstanding) schedule of the private sector in addition to that of the public sector. Central Bank has to use its foreign reserves even when the former remits foreign currency for repayment. It will be extremely difficult to do so under the current foreign exchange system. Therefore, some workable monitoring system might be quickly built-up.

3) Risk-management of foreign exchange rate fluctuations should be built-in.

4) The government should be prudent in foreign borrowing and should reduce foreign borrowing if dispensable. The annual limit of borrowing is the "limit" or "ceiling" and not a borrowing target.

5) Cautions should be also given to prepare for the necessary payment related to FDI or PEI, such as remittance of dividends to foreign shareholders, royalty payment and repayment to parent companies overseas.

6) Ordinary debt management indicators such as debt outstanding / GDP ratio and Debt Service Ratio are carefully observed. No less important are cash flow management. Also prepare for the emergency. For that object, close contacts with international financial institutions and other central banks are indispensable all the time.

[NOTE] Viet Nam could get good lessons on foreign borrowing from other South-east Asian countries, successful stories as well as failures. How the Philippines, Indonesia,Thailand, etc. have dealt with external debt and what were the lessons will be introduced in the phase II of this study.

Appendix

Obstracles to the Foreign Direct Investment to Viet Nam

I. Requirements by the Japanese federation of economic organizations

The Japanese Federation of Economic Organizations (KEIDANREN) submitted a document titled "Requirements by KEIDANREN to the Vietnamese Government for Further Development of Economic Relationship between Viet Nam and Japan" dated February 10, 1995. The contents can be divided into the following categories:

1) issues on deficiency of laws and institutions
2) issues on distortion of economy
3) issues on inefficiency derived from bureaucracy
4) others

1. Issues on deficiency of laws and institutions

(1) Exporting processing zones and industrial zones

KEIDANREN additionally required on October 1995 to issue detailed regulations on the Investment Act issued on January 1, 1995. To this requirement, Mr. Vo Hong Phuc, vice director of SPC, answered at Keidanren,Tokyo in January 1996 that Vietnamese Government has already issued the Decision 192CP on December 28, 1994 and ordered related ministries to draw detailed regulations.

As for Export Processing Zones (EPZs), Viet Nam has licenced six EPZs. One, developed by The Very Good Company Ltd., formally failed and its licence was withdrawn[7]. All but one of the other five are facing substantial difficulties, though common problems tend to exist in developing countries which operate EPZs[8]. It is mainly caused by insufficient incentives, especially tax incentives [9], lack of sufficient infrastructure and unappropriate location[10].

In order to attract more investment into Viet Nam's special zones, the SCCI issued on 24 October 1995 circular No. 2374/UB/KCX on the conversion of EPZs to Industrial Zones (IZs). Under this Circular, both EPZs infrastructure development business and those companies established in EPZs can transform themselves into companies developing or operating in IZs. In an IZ, companies can sell goods and services directly on the domestic market in addition to exporting them[11]. Thus, companies engaging in EPZs and EPZ infrastructure development business will be able to get broader range of clients. Furthermore, if more infrastructure development business enter in EPZs, and if their businesses become profitable enough, EPZs could be better equipped and widened.

EPZ enterprises which will change status should note that their tax position will naturally change. Profits tax on production enterprises in EPZs is levied at the rate of 10 percent. In an IZ, the tax rate will be 18 percent, but will be reduced to 12 percent if the enterprise exports over 80 percent of its products. With respect to enterprises in the area of services sector, profit tax which has been levied in an EPZ at 12 percent will be levied in an IZ at 18 percent[12].

In Decisions No. 758/TTg and No. 751/TTg, the Prime Minister recently established Management Committees for EPZs'and IZ's situated in the Hanoi and Song Be provinces, respectively[13]. Since exceptionally successful EPZ is located in Ho Chi Minh City, this Decision seems to intend to diversify FDI geographcally outside of Ho Chi Minh City.

(2) Land

1) Clarification of criteria for land evaluation

KEIDANREN has requested clarification of evaluation criteria of prices of the land thereby reduce rent for the land. Responding this request, the Vietnamese Government issued Decision 1417/TC-TCDN dated on 31 December 1994 which prescribed:

1) Reducing land rent
2) Clarification for concrete criteria for pricing land rent
3) Special treatments for investment to remote areas

Decision 1417 specifies the land rent to be paid by foreign investors in Viet Nam. It specifies different rates and coefficients applicable to various types of land using the following formula:

Land Rent = rental rate * location coefficient * infrastructure coefficient * industry coefficient[14]

On 6 September 1995, Ho Chi Minh City's People's Committee issued Guidelines No.2510/UB/KT implementing Decision 1417 with respect to land in the Ho Chi Minh City province[15].

The Guidelines first modify and clarify which areas of the Ho Chi Minh City province belong to which rental category. It can be highly evaluated that the Guidelines also clarify the rates for certain areas not mentioned in decision 1417 but surrounding Ho Chi Minh City[16]. It is desirable that the Guideline should expand the area of which it clarify the rates.

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7) Freshfields, *Indochina Note*, November 1995, p. 2.
8) *Ibid.*; Mr. Nguyen Gia Hao, Chamber of Commerce and Industry in Viet Nam, personal interview, March, 1996.
9) Richard Irwin, Price Waterhouse Viet Nam Limited, personal interview, March, 1996.
10) Mr. Nguyen Gia Hao, Chamber of Commerce and Industry in Viet Nam, personal interview, March, 1996.
11) Freshfields, *op. cit.*, p. 2.
12) *Ibid.*
13) Freshfields, *Indochina Note*, January 1996, p. 1.
14) Freshfields, *Indochina Note*, December 1995, p. 5.
15) *Ibid.*

2) Land clearance

KEIDANREN has requested to set up a guideline on land clearance. As for this issue, the Vietnamese Government guides potencial partners of joint ventures to discuss compensation for clearance of land before concluding joint venture contract. In spite of this guidance, KEIDANREN still complains that there are still troubles. For example, a land has not been cleared for more than six months after a member company of KEIDANREN got licence of FDI.

On 15 June 1995 Hanoi People's Committee issued Introduction No. 21/CT/UB on compensation for clearance of land for foreign investment projects[17].

3) Disclosure of land information

After various amendment and setting of rules on land, KEIDANREN still requests further disclosure on land information. In addition, KEIDANREN desires simplification of the process of obtaining land use right.

4) Foreign organizations and individuals renting land

KEIDANREN also requires clarification of land lease procesure.The General Department of Land Administration has provided details on land lease procedures with Circular No. 1124/TT/DC issued on 8 September 1995. The procedure is as follows:

First, an application to lease land must be submitted to the relevant local Land Administration Department, then forward to the relevant local People's Committee which will deliver its opinion on the proposed land lease. This phase is to take approximately two months[18].

The next step is to occur only once an investment licence has been obtained. Depending on the classification of projects, applications will be examined by the General Department of Land Administration or the relevant local People's Committee, which then issue a decision to lease land and a land use right certificate. This procedure is to take approximately one month[19].

5) Poperty registration

KEIDANREN complains that there is no registry book in Viet Nam.

Notice No. 2314/CT/NgV of the Ho Chi Minh City Taxation Department, issued on 6 July 1995, prescribes the registration of transfers of property[20].

Thus, the Vietnamese Government issued a series of rules, which are appreciable. However, there is still a problem to be solved. According to member companies of KEIDANREN, Vietnamese side often provides land without infrastructure. Land without infrastructure cannot be used as "land" for business use. It is true that land rent is somewhat decreasing due to increase of land supply, however, it still costs much to convert land without infrastructure to be usable for business use. For this reason, land rent is regarded to be still very expensive compared with those in neighbour nations. It is desirable for Vietnamese side to get proper understanding of "land" for business use.

(3) Foreign currency purchase

1) Clarification of criteria for currency purchace and remittance

In general, under the foreign investment laws and regulations in Viet Nam, foreign investors must balance their foreign currency requirement with their income in local currency. Under the present system, member companies of KEIDANREN requested on October 1995, ① clarification of foreign currency exchange and remittance system, ② guarantee of stable foreign currency exchange, and ③ creation of

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16) *Ibid.*
17) Freshfields, *Indochina Note*, October 1995, pp. 5-6.
18) *Ibid.*, p. 5.
19) *Ibid.*
20) Freshfields, *Indochina Note*, August 1995, p. 3.

financial market for fund raising.

The exception to the general rule for foreign currency balance exists in favour of businesses which manufacture import substitutes listed by the SPC, or which construct infrastructure projects. This exception is prescribed by the official document of the central bank No. 152/CV/NH7 issued on 5 April 1995. This document is in the form of recommendation to the Government[21].

On 9 September 1995, the new list of import substitutes was issued which has been substantially expanded and includes 30 goods. Enterprises producing one or more of the 30 products listed may purchase foreign currency with Vietnamese Dong. The maximum amount of foreign exchange that will be sold to a foreign-invested enterprise upon such conversion privilege is the amount that would have been required to import the goods sold by the foreign-invested enterprise for Dong[22].

2) The Establishment of the Financial Market

<Securities and capital market>

The Prime Minister issued Decision No. 361/TTg which decides establishing a preparatory board for the establishment of the stock exchange[23].

<Issuance of international bonds>

On 18 May 1995 the State Bank of Viet Nam issued Decision No. 139/QD/NH1 concerning the issuance of international bonds by state-owned commercial banks[24].

<Banking>

In November 1995, the Government announced that foreign credit institutions wishing to get representative office licences should apply to the State Bank of Viet Nam, not to the Ministry of Trade. Circular No. 01/NH5/TT defines the credit institutions. It specifies that such entities include commercial banks, investment banks, financial companies and other organizations operating in the area of finance and banking. Securities companies do not clearly fall within the definition of Circular 01[25].

<Foreign exchange counters>

Many foreign exchange counters which have authority to change foreign currency into Vietnamese Dong have been engaging in illegal foreign exchange transactions. To put a halt to such practices, the State Bank of Viet Nam's Department of Foreign Exchange announced that as from 30 June 1995, all private foreign exchange counters are to cease their operation. Only those exchange counters belonging to State-owned enterprises are allowed to continue their operations.

<Insurance companies>

On 18 August 1995, Decision No. 927/TC/QD/TCNH, issued by the Ministry of Finance on August 18, 1995, indicated that it would permit insurance companies to set out their own terms, conditions and rates. Although foreign insurance companies are not permitted to do business in Viet Nam, the Decision may help to encourage them to insist on their getting business licence[26].

<Credit leasing>

Until 27 May 1995, when the State Bank of Viet Nam issued Decision No.149/QD/NH5, issued by the State Bank of Viet Nam on May 27, 1995, promulgated regulations on credit leasing. The new law is limited to Vietnamese Banks and credit institutions. A hundred percent foreign equipment lessors and credit institutions will have to await the issuance of the Decree to enter this field of activity[27].

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21) Freshfields, *Indochina Note*, October 1995, p. 3.
22) *Ibid.*
23) Freshfields, *Indochina Note*, August 1995, p. 2.
24) Freshfields, *Indochina Note*, July 1995, p. 4.
25) *Ibid.*, p. 5.
26) Freshfields, *Indochina Note*, August 1995, pp. 6-7.
27) Freshfields, *Indochina Note*, July 1995, p. 5.

(4) Infrastructure

KEIDANREN requested the stable supply of electricity and sufficient infrastructure especially for foreigners' living, that is, office buildings, hospitals, houses, hotels which have international communication network, and schools for Japanese children. On these requests, Mr. Vo Hong Phuc replied that hospitals for foreigners, office buildings, and international schools have been already established in Hanoi, Ho Chi Minh City, and areas where a lot of foreigners reside and that a school for Japanese children is to be set up in April 1996.

KEIDANREN is still asking for lower rent of housing and sufficient supply of hotels and office buildings for residents from Japan.

1) National Road No. 1

Under Official Correspondence No. 700/TC-TCT issued by the Ministry of Finance on 5 May 1995, organizations, including foreign invested business, carrying out construction or renovation work on National Road No. 1 are qualified to an exemption from turnover tax and a reduction in income tax[28]. This prescription is expected to encourage the entrance of firms to the National Road No. 1 Project.

2) Plan for industrial and infrastructure development

On 10 July 1995 the Government issued Announcement No. 91/TB setting out the Prime Minister's views on industrial and infrastructure development. According to the Government, Viet Nam should focus on agriculture, forestry, fishery, industry, energy, power, the production of construction materials, products for export, products using cheap labour, metallurgy, seafood processing in cooperation with Iceland, and ship building with Finland[29]. The announcement also states that future industrial zones are to be situated outside Hanoi and urban areas generally. In Central Viet Nam, development is to be concentrated in the Dung Quat, Van Tuong and Van Thanh areas, and alongside the main roads[30]. The announcement may have an effect of decentralizing FDI[31]. Too much concentration of FDI in Ho Chi Minh City and Hanoi tends to expand unequality of in-come.

(5) Joint venture

KEIDANREN requires the following matters:

1) abolition of the requirement of unanimous vote to decide important matters

Though equity share exceeds fifty percent, important issues are often not resolved in absence of unanimous vote.

2) abolition of limitations to choose partners

3) disclosure of information on partners

creation of accounting system which meets the requirement of the market economy unification of the format of financial statements promotion of disclosure for the exact feasibility studies

4) disclosrue of information on domestic banks

5) permission for setting more than two bank accounts

it is necessary to have more than two bank accounts when sales area expands

6) introduction of direct

employment system employing through FOSCO costs very high

As for unanimous vote, Mr. Phuc responded that it is important for both parties of joint ventures to have equal position and mutual reliance. According to him, it is unfair that a party who possesses more than fifty percent of the share can solely decide important issues.

As for disclosure requirement, it is difficult for domestic firms and banks to provide financial

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28) Freshfields, *Indochina Note*, August 1995, p. 4.

29) *Ibid.*, p. 5.

30) *Ibid.*

31) As for geographical distribution of FDI, see anonymous report, *Foreign Direct Investment by Province in Vietnam as of Dec. 31, 1995*, Hanoi, 1996.

statements which satisfy market economy demands, for the accrual principle has just been slightly introduced into the accounting rules for domestic enterprises. The journal system for double bookkeeping has just been created. The accounting principles for foreign invested companies are subject to internationally accepted accounting practices, however potencial joint venture firms are still domestic firms. Mr. Phuc stated that each firm must prepare financial statements and get them audited, which are offered for public inspection.It is neccessary that Vietnamese potencial partners improve accounting ability and, in keeping pace with the improvement, the standard setting body improve the accounting principles themselves.

2. Issues on distortion of economy

1) Smuggling

KEIDANREN required to strengthen the Government's control over smuggling. Mr. Phuc deeply agreed with this opinion, but no additional measures were announced yet.

<Smmugled goods arrived by sea>

As Viet Nam has over 2,000 kilometers of coastline, most smuggled goods come in by sea. At the end of October 1995, the Government issued Instruction No. 701/TTg. This Instruction lists the fight against smuggling as one of its priorities for 1996. It has assigned specific responsibilities to various authorities, including the Ministries of Defence, Interior, Trade, and Justice, The General Department of Customs and local People's Committees[32].

<Smuggled goods arrived by land>

The Government is also attempting to control smuggling of motorbikes overland through Viet Nam's western border. Official Correspondence No. 6720/KTTH issued on 22 November 1995 requires owners of illegally imported motorbikes to register them before 31 December 1995. Those not registered before this date are to be confiscated[33]. Thus the Government tries to control smuggling by land by strengthening registration system.

2) Payment of bad debts and the return of requisitioned assets

This is an very important problem, though Vietnamese Government seems to lack proper understanding. KEIDANREN has required to solve issues on bad debts to foreign private sectors and requisitioned assets, of which the latter were not referred to by Mr. Phuc.

Mr. Phuc replied that, for Viet Nam, the bad debts issue is quite a hard problem to solve. Bad debts to Japanese private sector are as follows on October 1996:

Bad debts to Japanese banks:

The total principal amount: $310.6 million

Bad debts including interest and penalty: $650 million

Results of the negotiations at London Club are unknown.

Bad debts to Japanese enterprises : $279.6 million

Rescheduling is under negotiation as for large block debts.

Small amount debts to small and medium sized enterprises are being paid according to the schedule mutually agreed.

Viet Nam has also been introducing measures to assist with the repayment of outstanding foreign debts (principally owed to its former COMECON trading partners) through the provision of Vietnamese goods and services. In July 1995 the Government enacted Decree No. 40/CP on Repayment Foreign Debts with Goods and Services paid for in Foreign Currency[34].

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32) Freshfields, *Indochina Note*, January 1996, pp. 1-2.

33) *Ibid.*, p. 2.

34) Price Waterhouse, *Viet Nam: A Guide for the Foreign Investor*, Price Waterhouse, Hong kong, 1996, p. 79.

Circular No. 87TC/TCDN issued on 23 November 1995 provides guidance on various matters such as the selection of Vietnamese companies to fill export orders for such debt-offset deals, and for the setting of prices that will be applicable[35].

3. Issues on inefficiency derived from bureaucracy

KEIDANREN required the following matters to the Vietnamese Government on October 1995 concerning the licencing process of proposed FDI.

① Further clarification of criteria on screening and licencing FDI
② Quick notice to foreigners in English when laws and tax codes are amended
③ Consideration for Vietnamese comparative advantage to neighbour nations when laws and rules are amended
④ Consistent attitude to licencing FDI projects (attitude often differs according to staffs' position)
⑤ Obtaining consistency between former laws and amended laws (licenced projects are sometimes rejected based on amended laws)
⑥ Improvement of Ability for Licencing Practice

Concerning this requirement, Mr. Vo Hong Phuc, Vice Director of SPC, stated that the Government issued Decision 191CP on December 28, 1994 which prescribed ① reduction of institutions which are enrolled in screening proposed projects, ② shortening the screening period, and ③ clarification of each role of the central government and local governments. Furthermore, personnel, especially executive members, in charge of screening and licencing proposed projects are being trained to improve efficiency.

As for licencing proposed FDI projects, the Goverment has issued the following rules.

(1) Criteria for amendment of licenced FDI project

On 4 May 1995 SCCI issued Circular No. 910/UB/QL on the amendment of investment licences (Circular 910), since many investment licences have had to be amended, often because the investor discovered that further capital was needed. Circular 910 describes the modification procedure in detail, listing the documents that must be submitted to the SCCI[36].

(2) Preparation and implementation of FDI project

On 8 April 1995 Hanoi's People's Committee issued Decision No. 727/QD/UB on FDI projects in Hanoi (Decision 727), implementing Decree No. 191. Decision 727 specifies various application documents which the Hanoi People's Committee wishes to examine in addition to those submitted to the SCCI, including the land allocation agreement, the planning certificate, if property is contributed as capital, and a valuation of the property[37].

KEIDANREN highly evaluates the adoption of one-stop shop and expects the improvement of efficiency in screening and licencing procedure. KEIDANREN suggests that MPI should delegate a part of screening and licencing jobs to foreign accounting firms until MPI staff are trained enough to respond to efficient screening and licencing demand by foreign enterprises.

4. Others

(1) Automobile and motorbike assembly

It is desirable for the Vietnamese Government to bring about domestic parts industries and, at the same time, introduce foreign core organizations, that is, assembling entities. Sometimes both requirement conflict each other.

Circular 215 states that proposals for automobile and motorbike assembly projects must include a plan

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35) *Ibid.*, p. 80.
36) Freshfields, *Indochina Note*, July 1995, p. 1.
37) *Ibid.*

for local production of parts and accessories. However, limiting imports of parts by the Ministry by various measures including tariffs and quota raises manufacturing cost in Viet Nam[38].

The SCCI recently requested that the current quotas on the import of spare parts and components for car assembly joint ventures be lifted, and replaced by appropriate taxation of imports[39].

In response to the SCCI request, on 16 September 1995, the Government Office has issued Official Correspondence No. 5168/KTTH addressed to several Ministries and recommended that, for hi-tech spare parts and components which are not produced in Viet Nam, import quotas should be cancelled. The Ministries of Finance should study how to adjust import duties so as to encourage the manufacture of hi-tech spare parts and components in Viet Nam[40].

KEISDANREN additionally requires the following matters:

① preventing corruption
② penalty against those who are illegal
③ deligation of decision making right
④ roaring cost concious officials
⑤ permission for importing second hand machinary
⑥ tariffs system for parts
since tariffs are set individually for parts and kits, it costs much to import individual part more than to import by kit
⑦ deregulation of the limitation to loan amount (currently the amount of 30% of assets is permitted)
⑧ clarification of laws and regulations for labour union
⑨ reduction and abolishment of export sales tax
⑩ keeping peace and order
⑪ a bulk application of licence and loyalty
⑫ deregulation of conditionalities for loyalty

II. Requirements by US - and European-based multinational enterprises to which KEIDANREN does not refer

1. Intellectual right

There has been legislation protecting most forms of intellectual right property in Viet Nam, including the Ordinance on Trademarks in Viet Nam of December 1982. However, infringements are widespread. It seems partly due to a lack of knowledge of the law and partly due to a lack of knowledge of the concept of intellectual property[41].

The Ordinance on Trademarks in Viet Nam of December. 1982 was widely amended in March 1990. Under this ordinance, a trademark may be registered with the National Office of Industrial Property (NOIP) in Hanoi, which is governed by the Ministry of Science, Technology and Environment[42].

It is worth to note that, since March 1993, Viet Nam has adopted a "first to file" rule. This rule means that the first company or individual to register a trademark with the NOIP is prima facie the owner of the property, while most other countries adopt a "first to use" basis[43].

In the Civil Code which is to be in effect in this July, explicit definition of individual property rights including the ownership rights for individuals and juridical persons to patents, utility solutions, industrial designs, trademarks, the right to use an appellation of origin and other objects that may stipulated by

38) Freshfields, *Indochina Note*, September 1995, p. 1.
39) *Ibid.*
40) Freshfields, *Indochina Note*, Nonember 1995, p. 3.
41) Price Waterhouse, *op. cit.*, p. 79.
42) *Ibid.*
43) *Ibid.*, p. 80.

implementing legislation[44].

The Code prescribes that if an entity wishes to obtain a licence to use the property and no agreement can be reached between the owner and that entity, or if the State needs the property for national defence, security, health care or other urgent demands of society, the owner is forced to sell the industrial property[45]. US- and UK-based multinationals wish to clarify what kind of cases are assumed under this provision.

2. Dispute resolution

As for dispute resolution, the foreign business could opt for Vietnam courts or arbitration before the Vietnam International Arbitration Centre, or the Economic Arbitration Centre. However, foreign enterprises felt to be treated impartially. Alternatively they could specify a non-Vietnamese court or arbitration, which seemed more impartial[46].

With the exception of a few Eastern European countries, no treaties existed for the enforcement of any judgement or award received[47].

It can be highly evaluated that, on 28 July 1995, Viet Nam's President issued decision No. 453/QD/CTN authorising Viet Nam to join the New York Convention of 1958 on the recognition and implementation of foreign arbitral awards[48].

Following to this action, the Ordinance on the recognition and enforcement of foreign arbitral awards was signed by the Standing Committee of the National assembly on September 1995. Under the Ordinance, a defendant can object to recognition and enforcement for such reasons as the law of Viet Nam does not permit resolution of the dispute by arbitration, or recognition and enforcement is inconsistent with Vietnamese public policy[49]. There may be still a room in this prescription that foreign entities feel unfair at dispute resolutions.

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44) Freshfields, *Indochina Note*, January 1996, p. 3.
45) *Ibid.*, p. 4.
46) Freshfields, *Indochina Note*, September 1995, p. 4.
47) *Ibid.*
48) Freshfields, *Indochina Note*, October 1995, p. 7.
49) *Ibid.*