

Follow-up Study for the Economic  
Development Policy in the Transition toward  
a Market-oriented Economy in Viet Nam

VOL. 1 General Commentary / Industry and Trade

December 1999

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J1157519(8)

Ministry of Planning and Investment  
The Socialist Republic of Viet Nam

Japan International  
Cooperation Agency

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## Foreword

This study entitled "Follow-up Study for the Economic Development Policy in the Transition toward a Market-oriented Economy in Viet Nam" was conducted within the framework of the technical cooperation program of the Government of Japan.

The study was carried out as joint research by professional experts specializing in economic policy from both Japan and Viet Nam. The research groups were organized for this purpose were led by Prof. Shigeru Ishikawa, Professor Emeritus of Hitotsubashi University, for the Japanese side, and by Dr. Nguyen Quang Thai, Vice President, Development Strategy Institute, Ministry of Planning and Investment, for the Vietnamese side were set up in each country.

The research groups held discussions with the Vietnamese government organizations concerned, and conducted jointly field surveys. This report was prepared jointly by the Japanese and Vietnamese research groups on the basis of mutual trust and understanding.

I hope that the useful suggestions presented in this report will contribute to the formulation of policies for economic transition and sustainable development of Viet Nam, and it would be my great pleasure if the report would be used practically by concerned organizations, officials and experts.

I wish to express my sincere appreciation to Professor Ishikawa, Dr. Thai and each research members for their serious efforts in finalizing this study, and to the officials concerned for their valuable opinions.

December 1999

Kimio Fujita  
President  
Japan International Cooperation Agency





## Preface

This report introduces the results of the Follow-up Project of the "Study on Economic Development Policy in the Transition Toward a Market-oriented Economy in Viet Nam" which has been conducted under a "Japanese-Vietnamese Joint Research" program between September, 1998 and September, 1999. The main survey was carried out on the basis of formal agreements between the Japanese and Vietnamese governments between August, 1995 and March 1998. The survey was separated into two phases (Phase 1 and Phase 2) and conducted for the purpose of giving advice on the formulation of a new Vietnamese Five-Year Economic and Social Development Plan (1996-2000) and related matters. At the end of Phase 2, while there were in many circles demands for the successive implementation of Phase 3, it was considered desirable, prior to it, to conduct a comprehensive evaluation of new internal/external situations of Viet Nam that had started to emerge as early as in mid-Phase 2. This process resulted in the birth of this follow-up project. This project was implemented by the Japan International Cooperation Agency (JICA) through its technical assistance program, and in particular its expert assignment scheme.

Among many such new internal/external situations, two must be cited. First, Vietnamese Government came to realize that its commitments to AFTA as a member nation to reduce custom duties on producers goods imported from the AFTA area to 5% or less by 2006 and further to eliminate completely the existing non-tariff barriers placed severe constraints on the paths to industrialization of the country. Secondly, the currency/financial crisis, as well as resulting economic slump in general, which originated in Thailand in July, 1997 and expanded over many East Asian countries has had an impact on the Vietnamese economy in a variety of ways, including decreases in exports and foreign investments and a serious increase in unemployment. These have served as an important factor to Viet Nam's recent serious economic recession. This also raised new questions regarding how Viet Nam's future external economic integration should proceed, particularly from the aspect of external current/capital accounts, and in which speed the corresponding domestic economic system reform should be carried out..

The follow-up project has taken up three topics (1) agriculture / rural development, (2) monetary and financial matters, and (3) industry/foreign trade and conducted small-scale studies on each topic. The framework of the study envisaged consists of: Part 1, a comprehensive assessment of the current economic situation in Viet Nam and a listing of the issues currently facing the Vietnamese economy; Part 2, a small-scale ad hoc survey of certain selected issues from among the above issues; and Part 3, an agenda for further studies. This final report consists of three chapters corresponding to the above three topics, and one additional chapter for General Commentary. Each chapter is arranged according to the above framework.

For the comprehensive assessment of the current economic situation, naturally, Japanese members mostly depended upon the findings of Vietnamese members, resulting in a much larger input by Vietnamese members in the final report.

Before submitting the final report, a Hanoi Workshop was held on July 20 and 21, 1999 for discussions on the results of joint research. At the workshop, the Japanese government, given the results of the follow-up work, officially announced its preparedness to assist Phase-3 Joint Vietnamese-Japanese Research with its principal aim now shifted to the advice to the Vietnamese Government on the formulation of a new Five-Year Plan (2001–2005) and related matters.

For the implementation of this Follow-up project, we were able to obtain the valuable cooperation/assistance from many circles as was the case during Phases 1 and 2. We would express our profound gratitude for this.

The Japanese joint research group is particularly impressed with the strong concern of and support for this project extended by the new Secretary General Le Kha Phieu, and other Vietnamese government leaders.

The Vietnamese joint research group gives special thanks to JICA and its Vietnam office for the assistance for the research implementation.

In addition to submitting this final report to Vietnamese government leaders, we have also sent it to you. We solicit your opinions in advance of the implementation of the Phase-3 Joint Vietnamese-Japanese Research Project, which is expected to be started soon.

December, 1999, Hanoi/Tokyo



Nguyen Quang Thai

Vietnamese Cochair of the JVJR Group  
Doctor of Economics



Shigeru Ishikawa

Japanese Cochair of the JVJR Group  
Doctor of Economics

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# Executive Summary

## Introduction

1. This report's purpose is to announce the results of the Follow-up Project of the Study on Economic Development Policy in the Transition toward a Market-oriented Economy in Viet Nam that was conducted from September 1998 to September 1999; the project followed the Joint Vietnamese-Japanese Research (JVJR) method, which was also used in the main Study. This main Study itself was done during the period of August 1995 - March 1998 with the aim of making studies and offering advice on the formulation of a new Vietnamese Five-year Economic and Social Development Plan (1996-2000) and related matters, under agreements between the Vietnamese and Japanese governments. It was carried out by separating itself into Phases 1 and 2. The two governments decided in July 1999 to implement Phase 3 of this Study. However prior to this decision, the Follow-up project started with the aim of performing a general assessment of new internal and external developments which had already emerged in Viet Nam, and thereby preparing carefully the possible Phase 3 Study.
2. There are a number of factors to consider regarding these new internal and external situations. But it must first be mentioned as a background that the current 5-year plan had made a successful start in 1996 for both long-term economic development and market economy-oriented system reform. In fact, the preparation of this 5-year plan itself was made possible only after the Vietnamese economy finally recovered from the effects of war damages and economic crises (hyper-inflation, foreign currency reserve losses, and huge financial deficits), which occurred between the end of the 1980s and the beginning of the 1990s. The economic crises took place mainly due to the collapse of the former Soviet Union and its bloc that ended its support to Viet Nam's public finance and international balance of payments during the period. A swift changeover from the old Soviet Bloc to the US dollar Bloc in the by-area-of-destination structure in the foreign trade and international balance of payment was successfully carried out. The agricultural sector overcame its crisis by introducing higher-yielding varieties of rice. Also, the relation ship with major donors, including Japan and the IMF / World Bank was normalized around 1993. The "Joint Vietnamese-Japanese Research" program was started under such circumstances for the purpose of giving advice for drafting and operating the country's 5-year plan. The Vietnamese economy started to show encouraging growth in terms of its GDP, exports, FDI inflow, and other indicators between 1992 and 1996.

The first of the new situations was observed as an abrupt downturn in all of these indicators,

starting from the middle of 1997. This downturn exerted an impact not only on public finance and banking as well as the international balance of payments, but also on state-owned and private enterprises. This was directly caused by the currency / financial crisis and, general economic slump that originated in Thailand in July 1997 and later expanded to other East Asian countries. This crisis raised new problems, namely, how should the Vietnamese external economy be integrated eternally in the future from the aspects of both current and capital accounts of the international balance of payments. (The East Asian crisis and its impacts on the Vietnamese economy had been already preliminarily reviewed in Phase 2.)

Secondly, Viet Nam promised, under the rules of AFTA (which it joined in 1995), to implement a reduction in custom duties on imports from the AFTA areas / to 5% or less by 2006 as well as a total elimination of non-tariff barriers. The Vietnamese government has, however, realized that agreement placed a great burden on its progress toward industrialization.

3. The Follow-up project, based on the same "Joint Vietnamese-Japanese Research" method as used in the preceding two phases, conducted research that was narrowed down into three fields (agriculture / rural development, fiscal / monetary matters, and industry / foreign trade), was staffed with much fewer people, and had a more limited scope in its survey than those of Phases 1 and 2. The framework of the research envisaged commonly for the three fields consists of: (Part 1) a comprehensive assessment of current economic situations in Viet Nam to list up the issues currently facing its economy, (Part 2) an ad hoc survey of a few issues from among the above list, and (Part 3) an agenda for future research. During Phases 1 and 2, we were asked by the Vietnamese government to present our views and opinions on the problems that were not foreseeable at the time of research planning were include in the part entitled "General Commentary" in the Phases 1 and 2 Final Reports. This time, such ad hoc studies were not conducted, but at the initiative of the co-chairmen of both sides, papers were prepared relating to overall comments on the measures taken by the Vietnamese government to cope with the new situations and to deal with longer term economic reform. This was presented in the Part: General Commentary: In the following, summaries of the studies on the above research fields as well as for General Commentary are presented each prepared by the co-leaders of respective research groups.

## General Commentary

1. The Vietnamese co-chairman's paper, starting with a broad description of the

economically critical situation now existing in Viet Nam, stresses that the Vietnamese economy is in the process of a transition from a regime of direct planning mainly for the state sector to a regime of a market economy premised on indirect planning for the economy as a whole or the government's macro-economic management. The Vietnamese economy is changing over from the supply side-emphasized type that was suitable at its less-developed stage with excess demand to the demand side-emphasized type that carefully watches price signals both at home and abroad. It has already abolished all the mandatory output indicators, except for five product items: electric power, oil, gas, rice and exports. Other points for comprehensive evaluation include the following:

- (1) The problem of regional / global economic integration has been more and more critical to Viet Nam while, on the other hand, the serious difficulties due to the Asian region's economic crisis are intensifying. This requires a dramatic "breakthrough" toward the success of long-term economic development as well as economic system reform.
- (2) For agricultural / rural development, dependence on the growth of net farm production alone is not sufficient at present, but diversification and industrialization are indispensable. On the other hand, rural labor is still poorly utilized, implying a large potential. There is room for the "richness-first theory" in parallel with the eradication of poverty.
- (3) In industrial policy-making, efficiency and competitiveness during the international integration process must be considered. It is, therefore, unavoidable to protect infant industries, but in resorting to tariff protection it is necessary to clarify beforehand the schedule for abolishing protective tariffs in stages after the goal is achieved.
- (4) Implementation of costly projects such as the Thai Nguyen Steel and Cast Iron Company and the Ha Bac Fertilizer and Chemical Company should be decided with careful consideration.
- (5) Long-term unconditional relief of state enterprises that are running deficits only causes an excessive burden to government budget and finance and, therefore, is useless.

2. The Japanese co-chairman's paper was specially prepared, in consideration of the situation recently faced by the Vietnamese government, where the matters to be negotiated with international organizations, including the IMF / World Bank and individual donor countries are increasing and becoming more complicated. The paper argues that progress in the economic system reform toward a market economy in a country in transition could be assessed by the degree in which the economic policy-making authorities' preparation of the scenario (or economic development strategy) for the said country's transition to the market economy has taken good shape. The paper further compares the basis of this argument on the Chinese and

Vietnamese experiences. The scenario denotes a program of transition which fairly concretely describes three items; (i) the goal of transition to a market economy, (ii) the process to reach the goal, and (iii) a timetable of achieving (i) and (ii).

The reasons why this scenario is decisively important for developing countries experiencing economic transition such as China and Viet Nam are as follows: (i) As for a transition to a market economy, the IMF / World Bank model available serves as a ready-made model that is useful in understanding the state of the economy and its structure when it reaches the goal, but it does not specifically let us know the state of the goal of the specific country nor does it the process to reach it. (ii) In countries like China and Viet Nam, where the market economy has been only poorly developed, it is necessary for the government as well as those concerned to attempt a trial-and-error-type search for the best method to nurture and enhance such an underdeveloped market economy. It will be difficult to identify the passage to reach the goal, without such efforts. (iii) The scenario of transition to a market economy found for each country is public goods and has strong external effects. It serves as a guidepost for government departments/agencies as well as the private sectors in their policy decision-making and, for foreign donor countries, as a factor by which to have a confidence on its future path of systemic development and hence to facilitate negotiations for assistance from a longer-term perspective.

The progress of transition to a market economy in terms of scenario-making is lagging behind much more in Viet Nam than in China. The message this research delivers is as follows:

- (1) It is desirable that the Vietnamese government will take every opportunity to announce that the goal of its economic system reform is a complete transition to the market economy, and that the steps toward that goal form an irreversible single passage in the long term that will be followed steadily until the goal is established as a whole as well as in each individual field. It seems that this kind of announcement is of extreme importance, particularly during hard economic time such as having been seen in recent years, so that necessary emergency relief measures for the economy in general or for individual fields are not mistaken as a retreat from the already committed road toward the market economy.
- (2) For the international organizations and individual donor countries now rendering economic assistance to Viet Nam, it is advisable that they be aware that the task of transition from the economic planning system of the former socialist economy to a market-oriented economic system is an extremely difficult one, both in understanding an exogenous model for marketization and in designing the steps toward transition. (It took China 15 years from its decision to part with the planned system to its preparation of a scenario of transition to a market economy.) It is also necessary for them to be sympathetic of the serious hardship Viet Nam is facing as this process begins. All in all,

they might refrain from being too impatient and making inflexible demands; instead, they might extend technical assistance (TA) or other services that will facilitate the transition.

The above message is a common one to those given in the following chapters, particularly for fiscal and monetary matters and industries and foreign trade.

## **Industry and Trade**

Viet Nam is in the process of rapid global economic integration. During the 1990s, Vietnam has moved vigorously and decisively from the status of international isolation to open and active external economic relations. Important diplomatic relations have been restored, trade and investment links have been activated, and ODA inflows began to contribute significantly to infrastructure-building and social development. These new changes resulting from external integration have now become the primary driving force of the Vietnamese economy that achieved very high growth until very recently. The Government is determined to continue with the policy of bold international integration despite the regional economic difficulties in 1997-98.

In the area of international trade, the Government is now committed to the obligations of AFTA and APEC and currently negotiating to enter WTO. An open trade regime provides a strong impetus to systemic reforms and domestic enterprise restructuring, which is highly desirable. But free trade also poses potentially serious challenges for a country like Viet Nam with underdeveloped markets, industries and governing structure. To maximize the benefits of free trade and minimize its potential costs, the country needs to be well prepared to cope with possible difficulties along the way. The workshop discussed existing problems and future tasks as Viet Nam inserts itself in the highly competitive global market.

The Vietnamese side, consisting mainly of officials directly involved in AFTA, APEC, and WTO trade negotiations, contributed papers identifying past achievements and remaining policy inconsistencies. The first paper from the Vietnamese side reviewed key issues in overall industrial development, including the quality of business environment, shortage of SMEs and rural enterprises, and the need to re-focus industrial strategy under free trade commitments. The second paper provided a detailed list of WTO-inconsistent policies currently practiced in Viet Nam. These included import bans and quotas, lack of procedural transparency, (partial) state monopoly in foreign trade, export subsidies, and incompatible technical standards.

The third paper characterized the formulation process of Viet Nam's trade policies from the operational viewpoint. It noted the lack of clear trade and industrial policies behind committed tariff rates, and frequent uses of quantitative restrictions.

The fourth paper discussed the official master plan for the textile and garment industries in terms of industrial structure, capacity, equipment and technology—and necessary policies to support it. The fifth paper reviewed the past improvements and current status of Viet Nam's trade statistics with special attention to methodological consistency and international comparability.

From the Japanese side, the first paper numerically assessed free trade impacts (import penetration, trade diversion, etc.) by combining GSO's trade data with the proposed tariff reduction. The cement industry is further analyzed as an illustration. This industry, now protected with import bans, must overcome a cost gap of over 50 percent to be internationally competitive. The second paper reviewed recent trade and FDI policies in the neighboring ASEAN countries. During the Asian crisis, movement towards open trade and investment accelerated, with less room for active industrial promotion. The automobile industry was studied as an example. The third paper reported the status of Viet Nam's SME sector, with its lack of linkage and supporting industries. The fourth paper introduced the experience of General Corporations in China, from which tentative lessons were drawn for Viet Nam.

Throughout the session, the need to establish industrial policies consistent with AFTA, APEC and WTO (whether for promotion or downsizing) was well recognized by all participants. Despite this general consensus, at present, the Government does not have concrete and feasible action plans for individual industries to meet free trade challenges. Instead of further arguing the general merits of free trade versus industrial promotion, participants felt that actually drafting such action plans—even for a limited number of industries—is essential in the next stage of research.

Another related issue was consistency between short-term stopgap measures to cope with crisis and recession (such as import bans and quotas, now frequently used) and the long-term commitments to free trade. Temporary safeguards are permitted even under WTO, but they must take the form of surcharges rather than quantitative restrictions. Moreover, the timing and conditions for removing short-term barriers must be specified.

For successful negotiations with WTO, IMF, World Bank, etc., Viet Nam should commit to a clear long-term timetable for trade liberalization while requesting temporary protection of a small number of industries, backed by workable restructuring plans and firm deadlines. Without such

careful preparations and strong ownership in trade policy formulation, bold commitments to open up may lead to inadvertent foreign dominance, high unemployment, social outcry—and even reversion to tight trade controls.

## **Financial and Monetary Matters**

### **1. Background of the Follow-up project**

1. Viet Nam has started the historical process of integrating its economy with the regional and world economy more than a decade ago. And it has been quite successful. It has boldly implemented an innumerable number of changes necessary to integrate its economy with the world economy, including the transformation of its economy from a centrally planned economy to a market based economy. The crucial component of the transformation was the separation of the Government, SOEs and the commercial departments of the mono-bank. The Government stopped financing the investment of SOEs for commercial purposes. Commercial banks separated from the mono-bank assumed the function to mobilize funds from the public in general and to allocate the mobilized funds to SOEs and other business firms for their investment.
2. But the reform effort of Vietnam to continue the transformation process is now facing a serious challenge because of a change in its external environment. The Asian economies were hit by unexpectedly harsh financial and economic crises and were striving for their recoveries. In comparison with the hard hit ASEAN economies, Viet Nam was weathering the storm with minimum damages to its growth paths. This was partly attributable to the various ad hoc policy measures taken by the Government in response to the crisis. They helped Viet Nam stay close to its long-term growth path planned before the Asian crisis.
3. Nevertheless, one could not avoid asking the question whether the growth path supported by the ad hoc policy measures taken in response to the crisis would be sustainable. What would be the long term effects of the ad hoc measures on the economy? The question was important because the ad hoc measures often seemed to contradict with the key characteristics of the long term financial reform to realize effective and sound financial sector: In order to answer the question concerning the sustainability of the growth path, it is necessary to clarify the financial states of banks and enterprises as accurately as possible. How are they affected by the Asian crisis? How are they affected by the ad hoc measures? How are the ad hoc measures related with the long-term structural policy measures implemented during the same period? These are the

questions that formed the background of the Follow-up Project for the financial sector reform.

## **2. Major results of the Final Report of the Follow-up Project**

6. The financial states of a large number of banks and enterprises are found to be quite precarious. But this is more or less expected. What is surprising is the sheer number of ad hoc policy measures that have been implemented since the mid 1997 in order to mitigate the financial difficulties of SOEs. They all have the effects of weakening the incentives of SOEs to keep stringent financial disciplines, postponing the solution of their financial problems to the future, and as a consequence increasing the vulnerability of state owned commercial banks (SOCBs) to credit risks. While it is not possible to evaluate the credit risks in the balance sheets of the SOCBs accurately, the financial positions of some of them might have become negative already if credit and market risks were fully taken into account. They are becoming more vulnerable to external shocks.
7. Furthermore, little progress has been made in creating institutional environment that help the private business sector develop. Ad hoc measures to assist the flow of funds to SOEs have had no effect on credit crunch to private firms. Legal environment is not well developed yet that enables banks to control the adverse selection problem among private borrowers. Consequently, many private firms have little or no access to bank credits.
8. The financial states of joint stock banks are extremely unstable. A number of joint stock banks are deeply insolvent and their balance sheets are even closer to that of a pyramidal scheme. The policy environment is not conducive for the development of joint stock banks. The regulation on interest rates might have been a primary reason for the instability of joint stock banks.
9. But the picture of the financial sector is not overwhelmingly bleak. The long-term institutional reform of the financial sector continued during the same period. The Law on State Bank and the Law on Credit Institutions were enacted on 26/12/1997 and made effective on 01/10/1998.

The Government and the SBV issued various prudential regulations under the Laws and provided the guidelines how to classify their assets and to set aside loan loss reserves and when to write off bad loans. They aimed at strengthening the capability of credit institutions to manage their credit risks. Income taxes on banks were revised also to help them creating more



adequate loan loss provisions. A criterion based on the CAMEL rating was established to evaluate the risks of joint stock banks and to identify the problem banks among them. The new accounting system made effective since 1996 were fully implemented in 1998. The restructuring process of joint stock banks started in HCMC in 1998 and is being in progress. The Government took some steps to increase the capital base of the SOCBs. A basic legal framework was established that provides a financial infrastructure for issuing and trading securities, such as stocks and bonds. A new mechanism was established to enhance the equilization process of SOEs. The restriction on the spread between loan and deposit interest rates was abolished. A new legal framework was established to provide a coherent and comprehensive framework for regulating foreign exchange transactions in view of achieving convertibility of dong for current account transactions in the future.

10. It is clear that these long term reform measures are creating the foundation of a market based economy in which the functions of the Government, SOEs and banks are sharply separated and in which banks perform the function of financial intermediation on the basis of their own evaluation of credit risks. But the ad hoc measures are sending the message to SOEs and banks that stringent financial disciplines should not be applied to the relationships between them. And the latter message often seems to be stronger than the message implied by the long-term measures. This has created confusion among banks and enterprises and made it more difficult to predict the dynamics of the financial states of banks and enterprises. This is because the dynamics of financial states depend not only on the long term reform measures implemented in the past or at present, but also on the expected structural policy measures to be taken in the future. But, being confused, many firms and banks do not have clear expectation about the institutional environment to which they have to adapt their behavior in the long run.

### 3. Policy implications

11. In order to minimize the negative incentive effects of ad hoc measures, further efforts are needed to clarify the final goal of the financial sector reform and to implement the long run structural policy measures consistently to achieve that goal.
12. Stronger efforts should be made both to find prudential regulations that can be easily monitored and effectively enforced in Viet Nam and to improve the organizational capability of the SBV, banks and enterprises to implement the regulations.

13. It is important to assess the magnitude of the credit risks and market risks being accumulated in the banking sector accurately and to take remedial actions to reduce its risks and make it more robust to external shocks.

#### **4. The agenda for further studies**

14. Firstly, it is important to evaluate the combined effects of ad hoc measures and long run reform policies on the incentives of bankers, managers and workers of SOEs, and their regulators. How are the moral hazard problems caused by the ad hoc measures being controlled? The answer to this question will depend on how effectively the long run reform policies are enforced in the economy.

15. Secondly, it is equally important to examine when and how to implement the long run reform policies. The problem is inherently difficult because every country is different and the difference matters in its solution. The unique historical conditions of Viet Nam are that it is in the transition process to a modern market economy from both a centrally planned economy and a peasant economy at an early stage of economic development. For the development of the financial sector, it is equally important to note that Viet Nam experienced hyper inflation in the middle 1980s and that the credit unions collapsed nationwide at the end of 1980s. But still the experience of other economies should be helpful in analyzing the problems to the extent that common factors exist.

This is especially true because many Asian economies have been implementing radical financial reforms after the latest financial crises, aiming at establishing financial systems robust to external shocks in the open economy.

16. Thirdly, it is important to examine the nature of the safety net that is being used to protect depositors of banks. The information is extremely limited on how the costs of insolvent banks were allocated among their owners, depositors, other creditors and so on. Nevertheless the nature of the safety net is extremely important for determining the efficiency and stability of the banking sector.

## **Agricultural and Rural Development**

### **Background of the Follow-up Project**

1. The joint research project of Phase 1 and Phase 2 focusing on important issues of agriculture and rural sector in Viet Nam gave rise to many useful results. One point to be born in mind is that the Phase 1 and Phase 2 studies were conducted separately for the topics selected, hence the interrelations among the topics were not much studied. This Follow-up study started with a view to understanding the agricultural and rural development comprehensively while giving deeper considerations to the interrelations among the aspects.
2. However, since such comprehensive studies, if conducted evenly for all agricultural products, may cause us to lose the heart of the matter, it was decided to focus only on the rice economy that is the main agricultural production in Vietnam. In short, the Follow-up study of our team is to analyze "the reproduction process of rice economy" assuming that rice economy represents agricultural and rural economy of Viet Nam.
3. Based on the above-mentioned principles, the list of research topics was determined after having discussion between Japanese and Vietnamese side. Then, among the research topics of the list, the following four issues were selected as especially important research subtopics for this project. These are: present stage of rice economy, structure of rice economy including bipolarization of farm households in the Mekong Delta Areas, post-harvest problems and distribution of rice, and supporting institutions for agriculture and rural sector.
4. To the final report, six Vietnamese experts contributed. In addition, the chief of the Vietnamese side wrote separately the comprehensive report named "Agricultural and rural development in the 1990s." From the Japanese side, three researchers submitted their reports. One of them is the survey report on rice economy of the Mekong Delta Areas. Survey reports conducted by the Japanese side with the cooperation of the Can Toh University, on the distribution system of rice and the rural financial system in the Mekong Delta Areas were also attached to the final report.

### **Major results of the Final Report**

5. Viet Nam is a rice country. In 1987, the share of Vietnamese agriculture in GDP was 27 percent, much higher than surrounding ASEAN countries. Among many products in the Vietnamese agriculture rice farming is producing the half. The share of rice production in national income is one-seventh, and the rice sector earns more than 10 percent of total export. Besides, around two-third of the country's food energy is supplied by rice. In the diet of Vietnamese people, rice

occupies an important position.

6. However, the conditions for rice production in Viet Nam are not favorable. Paddy field is about 60 percent of arable land, but the arable land is only 21 percent of whole land area. Arable land is absolutely limited compared with the huge number of rural population, which is counted as around 80 percent of the total population. Arable land per one agricultural worker is extremely small. In terms of average farmland for one agricultural household, it is about 0.8 ha. Besides, the share of irrigated land is only about 30 percent. Scattered landholding is another problem for efficient farming. Also it should be noted that Viet Nam is characterized by agro-ecological diversity among regions. Rice farming is not available in some regions.
7. Even under such unfavorable conditions, rice production grew significantly in Viet Nam since the Doi Moi reform policies. The average annual growth rate of paddy production during the period from 1988 to 1998 was as high as 5.2 percent. This growth rate was much higher than growth rates of agriculture of ASEAN countries in the 1990s. Such a high growth rate of paddy production cannot be found in the hundred years history of Japanese agriculture. The growth of rice production in Viet Nam after the Doi Moi was remarkable.
8. With respect to factors for the growth of rice production, several important points should be referred. First and foremost factor is the reform (Doi Moi) in 1986, which liberalized the economic incentives of farmers. Farm households were recognized as independent economic units, so they could use all their ability and capacity to enrich their family. In addition, owing to the right investments especially in irrigation, bases for the development have been arranged. Changes in rice prices compared with input prices were also favorable. Advanced technologies, such as HYVs (High Yielding Varieties) were available to Vietnamese rice farming. Credit supply from Agricultural Bank also contributed to the development of Vietnamese agriculture. Introduction of competition in rice distribution system enhanced the efficiency of the system.
9. The growth of rice production has favorable effects on farm economy. First, per capita food supply increased remarkably. The amount of food supply (rice equivalent) per capita increased 24 percent from 1990 to 1998. Hunger problems that used to be serious in Vietnam in the 1970s and 1980s were mostly eliminated. Second, the income of rice growing farmers was improved, although their income level was still generally low, and much differed depending on their land size. Third, export volume of rice increased significantly, which ranked Vietnam as the second largest exporter of rice in the world. In addition, it is worth noting that the quality of export rice has been improved gradually although still there are many problems to be solved.

## **Problems and future directions of agriculture and rural sector in Viet Nam**

10. Although many important achievements were attained, Vietnamese agriculture and rural sector have still many problems and weaknesses. First, there is a problem whether Vietnamese rice economy will be able to grow at such a high rate as in the previous decade. Judging from historical reviews for agricultural production in various countries, it is unlikely that this high growth will continue for the coming decade. No further expansion of farmland is expected. Allowance for further improvement in productivity is small. There is a criticism from environmental viewpoint against the overuse of agricultural chemicals. Vietnamese agriculture will be forced to change from the existing policy that is simply seeking the goal of larger production than ever.
11. Second, improvement in farmers' income through the expansion of rice production is harshly restricted. The biggest constraint for this is the limited land size of paddy farmers. Probably, improvement in agricultural productivity and farmers' income can be possible only by solving the problem of excessive labor force in rural Viet Nam. The problem of abundant rural labor force is already appearing through the phenomenon of the increase in the number of landless and land lacking households in the Mekong Delta Areas. This problem should be solved by creating employment opportunities in rural areas. However, the dense population of the poor in the rural areas cannot be reduced in a day. The Government must continue to cope with this problem by implementing social policies.
12. Third, infrastructure and supporting institutions for rice economy are still weak. Infrastructure such as irrigation, drainage, rural roads and so on, is still poor. Post-harvest losses are high because facilities and technologies are backward. Rural finance is not sufficiently developed to meet the credit needs of farmers and rural enterprises. Agricultural cooperatives are being transformed from old types to new ones, but the speed for the transformation is slow. Especially the problem of farmers organizations should be discussed further.
13. One of new directions is to improve the quality of agricultural products. Rice for export has been already significantly improved, though its quality is still lower than foreign rice. It is also important to seek more value added by improving agricultural related activities, such as distribution, storage and processing of agricultural products.
14. Another is to change the rice based monoculture. Diversified agriculture is required. To detail

the way for diversification, it is necessary to accurately know the demand in both the domestic and overseas markets. Change in dieting pattern comes suddenly. In order to prepare for the change, it is important to collect food consumption data by conducting several surveys.

## General Commentary





# General Assessment of Certain Economic Issues in the Current Renovation

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## I. General Assessments

Analyzing Viet Nam's social-economic situation, it is necessary to make clear the distinguished characteristics of Viet Nam from other countries. Viet Nam is being on the transition to market-oriented economy, with the Government's macro-intervention, the planning system has dramatically changed. The changing mainly is in three aspects:

- Transition from the centrally planning to a market-oriented economy, that is transition from supply-side approach, suited to the hard lowly developed and demand surplus period, to the demand-side approach, with paying more attention to the domestic and international market signals. The current commodity's stagnating reflects the complicatedness of the transition.
- Transition from direct planning, mainly for the state sector to indirect planning for the economy as a whole. It means transition from direct imposing targets on thousands economic units to creating development environment for them. At the moment only targets of five products are still being directly imposed. They are the products that the Government should take under its control from macro level: electricity, oil and gas, rice export, etc.
- Transition from a close, mainly in international transaction with the former Soviet Union economy, to an open to all countries, that above of all to the East-Asian, the area occupied of about 70% of the country's trade and investment. International integration became a first important factor that may have influence on efficiency and quality of economic growth.

But the transition is still being continued, to match the rapid, efficient and sustainable development requirement, to be adequate to integration demand as well as the changing in the politic and economic relation of the world and the region. Though Viet Nam has experienced certain progresses in the last period, but to make the renovation get appropriate assistance to overcome the crisis's impacts and get into the recovery process, to create a stronger engine for the long-term social economic development, obviously there is a need of a more dramatic and synchronous breaking force.

## II. Some Key Issues in Recent Economic Development

After some years of rapid development with average GDP growth of 8.2% during period 1991-1995, recently GDP growth has become slowly. In the last two years, under the Asian crisis impact, GDP growth rate as follows:

1995	9.5%
1996	9.3%
1997	8.2%
1998	5.8%

In the first half of this year, the country's economic situation continued to be in difficult path, GDP only grew at 4.3% in contraction of more than 6% in the same period of last year. Although agriculture still maintained rather high growth rate, export of agricultural products speeded up, but the economy has shown obvious weakness, that really in deep concern:

1. Though with rather high growth rate, agriculture still has to face up some difficulties in slow consumption of its products both in domestic and international market. Price index of agricultural products is not stable and has the tendency of not to keep up with the general price index. This may have not good impacts on agricultural production.
2. After many years grew with rapid rate of more 12%, Industrial Growth now has become more slowly: 13.6% in the first half of the year 1997, 12.6% in the first half of the year 1998 and only 10.3% in the first half of this year (1999). Industrial production of some large industrial centers has faced up many difficulties. HCM City's industry grew at 4.1% (meanwhile the same time in last year it grew of 10.8%), Hanoi's industry grew at 6.8% (in the same time in last year it grew of 10.2%). The growth rate of the SOEs fell down seriously, and was only 3.6%, that much lower than the average industrial growth rate and its growth rate of the same period in the last year (more than 10%). Many important state owned general companies have their selling income fallen, for example, the Coal General Company's selling fell by 21%; Steel General Company's selling fell by 9.5%; Brewery and Alcohol General Company's selling fell by 5.6%. This reflects the low effectiveness and competitiveness. The private sector, (household scale) also has growth rate to come down, but still reached the rate of 6.6%, that mainly match the on-place demand. The Foreign Direct Investment sector continued to grow rapidly, with more than 22%. In the last two years 290 enterprises more have completed the construction period, made total number of FDI enterprises that have completed the construction period up to 850 industrial enterprises in the year 1998 and contribute to the industrial product value of 35.2% of total in the first half of this year. The product stagnation has become serious because of weak competitiveness and a partly because of smuggled imports. The

FDI sector's export also is not relevant to its production increase (22% vs 8.9%).

3. Service sector grew slowly. In the first half of this year service sector grew with only 2.8%, lower than the growth rate of the same period in last year (5.8%). The major component of that is trade sector, which occupied of 35% of total value of service sector, but only grew at 2.1% in the first half of this year, in contrast of 6.2% of the same period of last year. Total retail sale increased only by 1.5%, meanwhile total external trade flow decreased by 3.4% in comparison with the same period of last year. Some of FDI enterprises also reduced their production volume because of market shrinkage. In recent months commodity and service price continuously reduced, that not only reflects the reducing of purchasing power but also deflation, if not applied any necessary measure in time.
4. Social investment continuously reduced in the last two years and value added of construction sector in general did not increase. This not only impact to current growth, but also may impact to production in the coming years. Meanwhile the economies in the region are showing signals of recovery, the weakness of investment and construction sector in Viet Nam may be a bad effect to the economy's efficiency and competitiveness.
5. Financial and monetary sector has been dramatic changing with some new policy. State budget still is in rather big deficit.
6. Social aspect is being with many critical issues, especially the increasing of poverty, unemployment and underemployment under the pressure of low economic growth.

All the above stated issues show that, it is necessary to concentrate on the economy's gradual recovery from the crisis's impacts in the next time period and assuring a sustainable growth in the long-term, toward the 21<sup>st</sup> Century.

### **III. Agricultural and Rural Development and Some Points of View on the Regional Focal Development**

At present, agriculture is a major productive sector, using 2/3 of the social labor force. Rural area is the place of habitation of 79% population. That is why government of Viet Nam has put agriculture onto the development focus, bases on industrial compliment and rural modernization.

Emergед issues in the development policy of agricultural and rural development:

- The recent rapid and fairly comprehensive development of agriculture, forestry and fishery play an important factor of the country's economic sustainability, including food security. However, practical experiences show that where purely agricultural based development

there more likely to get in to a lot of difficulties. Therefore, in the future, diversifying agricultural production and rural economy, gradually conducting agricultural and rural industrialization is the essential way to improve the population living standard. At the moment, labor effectiveness and production efficiency in farming activities is low, meantime available and feasible important reserves are not fully explored. For example, rate of working time of laborers in the rural area in 1998 was 71% and in 1997 was of 73%<sup>1</sup>. This may be rationalized not only by shortage of capital, lack of appropriate technology, narrow market for farm products, but also by regulations and policies (e.g. land use policy, labor hire policy), the absence from the beginning of the integration between industry and agriculture (including rural industry development). A higher rate of working time of laborers (more than 77% in Taynguyen, where industrial crops are accelerated and about 80% in Hanoi and Ho Chi Minh City suburbs, where farming is diversified with husbandry development, that occupies 35-40% of working time) illustrates a big development potential of agricultural and rural industry. Diversification of economic development in the rural areas; diversification of occupation with new appropriate cooperation and integration forms, both internal the rural areas and between rural and urban areas; widening production size and enhancing product quality; improving marketing policy for farm and farm based products are extremely essential factors for development.

- Concerning the sustainable development policy, the government is now focusing on poverty elimination with focal investment onto 1715 poorest communes<sup>2</sup>. To make it more easier to solve the poverty elimination, one should distinguish (at least) 3 categories: poor countries, poor regions and poor households. In parallel with duty of reducing absolute poverty among the poor households that still make of 17% of total population by using a number of measures (providing credits, skill enhance training, developing of S&M enterprises...) is also a responsibility to facilitate the richer household in more freely but legally doing business. The recently approved "Law on enterprises" by the National Assembly has demonstrated the efforts in reforming to this direction. No any way to enhance the living standard's of the whole population as well as of the poor households other than accelerating the country's economic growth in general.
- It is quite clear to see the increasing gap between the regions in development. While the potential focal economic regions grew with 10-15% in average annually, the remote and in trouble areas grew just only at very moderate speed: 5-7% or even lower. Another

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<sup>1</sup>- "Status of Labor-employment in Viet Nam" 1997, 1998 Statistical Publishing House 1998, 1999

<sup>2</sup>- "1715 Poorest Communes" or 1715 Communes are being in especially serious trouble and/or in the mountainous and remote areas: The Government of Viet Nam has approved the Decision 135/1998/QĐ-TTg, July 31, 1998 on "The Social-Economic Development Program for the areas of especially serious trouble and/or areas in the mountainous and remote areas". To fulfill this Decision, 1715 communes have been selected. The List of these 1715 Communes has been submitted to the CG Meeting in Paris December 1998.

considerable issue is the free migration from the north mountainous area to Taynguyen. Unless an appropriate solution is introduced to speed up the too poor areas and enhancing the living standard in these areas, it might easily to appear unexpected negative social issues. While average per capita income in Ho Chi Minh City is more than US\$ 1,000 and in Hanoi about US\$ 700, average per capita income in the provinces like Hagiang, Backan is under US\$ 100 only. Therefore, accelerating the poor regions' development is an objective demand and poverty elimination is a critical issue. But resolving of this issue should be in a long period, even very long time period, since the economy has a dual development duty: enhancing population income of such a poor country like Viet Nam and narrowing the regional development gap. It may be a solution that in the next period of time to facilitate the poor areas to gradually develop by providing them assistance from the government and using local labor force. At the same time it needs to introduce appropriate promotion policies to get more dramatic and synthesized resources for rapid, efficient and sustainable development in the focal regions. So, poverty elimination is in the focus of the rural development, but for the focal regions the main task is to make essential policy and to mobilize all available and potential-feasible resources for development investment. These focal region may grow with rapid speed, or even extremely rapid speed in order to create a new economic potential and a new engine for the economy as a whole. It is especially critical important when the economy is being in the stagnated situation like it is now. It might be acceptable that the development gap between the regions keeps increasing in some period of time, but it is unacceptable to let poverty (absolute poverty and food shortage) last all the time in some regions.

#### IV. Suitable Industrialization Policy in the Current Period

For a longtime future, industrialization, modernization is of necessity to pushing up the country, to prevent being further in backward. But industrialization is not so simple when the mankind is entering the threshold of the 21 century with extremely rapid progresses in science and technology and the complicated changes in the international and regional market. There are some issues that need to be emphasized:

- Prudential and correct selection of the industrial development priority with more attentions are placed on efficiency and competitiveness under the integration, conditions. Strictly to perform the AFTA, WTO and Viet Nam-US trade agreement commitment schedule. To keep following the export promotion policy and consider it a strategy solution, since a economy may only be succeeded in the domestic market when it may be succeeded in the international market. Tariff barriers (as well as taxation of non-tariff barriers) are necessary for infant industry protection, but it is necessary to draw a very clear schedule for gradually taking them out in order to enhance the economy's effectiveness and competitiveness that may help the economy firmly stand on the international integration.

- Estimations of the social-economic efficiency in determining the development pace for the capital intensive industries at the same time with rapid opening labor intensive industries and the industries that may have domestic, regional and international market should be done with extreme prudential. It needs a prudential consideration when decide to rehabilitate inefficient and costly projects such as the Thainguynen Steel Company, Habac Fertilizer Company as well as to decide too early starting such a capital intensive project like the Second Oil Refinery Factory.
- Special assistance to the S&M size enterprises' development, and encouraging rapid establishment of the "Centers for S&M size enterprises promotion" should be in focus so that the S&M size enterprises may receive efficient assistance in all necessary aspects: policy and regulations, capital and technology, skill training, market seeking and inter-network integration of all kind: large, medium and small size enterprises.
- Industrial policy should be united from the beginning with the trade policy, including the market policy under the integration requirement. Technology policy should be emphasized to enhance the national, industrial and enterprises' competitiveness.

## V. Financial Sector Reform and Capital Creating for Development Investment

Viet Nam is an economy with fairly moderate economic potential, occupying 5% of total GDP of ASEAN10, and per capita GDP is only a half of that of China. Moreover, domestic saving is low in comparison with all other countries in the region, -is only 20% of GDP, that made of 50% of that of China and 40% of Singapore. This reinforced Viet Nam to accelerate the capital mobilizing process, both from domestic and from abroad resources to match development targets. One of the most general solutions is continuing to accelerate the renovation, conducting the reform process with more clear methodology and schedule, improving credibility from both, domestic and foreign investors. During the renovation process it is necessary to pay special attention to the financial sector reform, that may have strong impacts on the macro-economics stabilization, increasing resources for development investment, creating favorable environment for doing business and conducting production and enhancing efficiency and competitiveness of the economy. The reforming process of the financial sector needs not to bring along with a dangerous "shock" to the economy<sup>3</sup>, especially when other economies in the region are already on the recovery road and when Viet Nam's economy seems to be in downward at least 1 or 2 or even 3 years unless the government introduces certain appropriate decisions with outstanding executive. Dealing with the bad debt of the enterprises, especially the bad debt of the SOEs is perhaps a critical

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<sup>3</sup>- It is very important to carry the reform prudentially, not to make change any thing so quickly so that the economy, especially the enterprises may easily get into troubles.

point at the moment. Thereafter, auditing the major SOEs has a significant importance for commanding the actual business and production efficiency and consequently for escaping from the trap of useless and unconditional rescuing the longtime loss-making SOEs, that resulted in a extremely heavy burden for the national finance and government budget.

## VI. Economic Policy Completion for the Next Period

Continuing renovation is the official policy of the Government of Viet Nam, which is clearly noted in the New Government Action Program<sup>4</sup>, as well as in the annual plan, including Plan 1999. To make it clear to facilitate the negotiation process on the assistant conditions, normally Viet Nam points of view are similar to the donors' points of view, but not necessarily in term of pace and schedule during the negotiation process on package assistance with IMF, WB and Japanese government.

- Holding macroeconomics stabilization and enhancing economy's efficiency and competitiveness during the integration process. Deeper investigation should be in need to determine the directions of enhancing efficiency and competitiveness for each major product and industry. The significance of the government expenditure and monetary stabilization policies in holding macroeconomics stabilization should be aware. To respond to the downward of the foreign capital inflow, especially FDI, it is necessary to put the macroeconomics balances, especially the sensitive indicators like government revenue and expenditure, trade balance, current account deficit under strict control.
- Consolidating the financial sector, considering it a determined link in holding macroeconomics stabilization and enhancing the enterprises' efficiency. The two law: Law on Banking and Law on Credit Organizations should be concretized so that their implementation may provide the transparency for the whole financial and banking system at macro level as well as at the enterprises' level.
- Conducting the SOEs (which contribute 2/3 of domestic, beside FDI production) reform, including enterprise classification, considering this a first important solution. In parallel with SOEs equitization accelerating (that is especially necessary when 50% of SOEs is S&M size enterprises), it is in need to conduct initial auditing the 100 major enterprises. This may result in providing necessary information for determining the steps of reform and equitization (may be the enterprises with capital size above VND 10 billion and revenue more than VND 80 billion).
- Investing in the social and economic infrastructure, especially transportation irrigation,

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<sup>4</sup> - "New Government Action Program": The Action Program invented by the newly elected Government at the 10<sup>th</sup> Viet Nam National Assembly Congress, held in July 1997. This Action Program has addressed by PM Phan Van Khai at the First Meeting of the National Assembly held in September 1997.

schools, hospitals, clean water supply, and preparing the development prerequisites are unceasing and urgent concerns for a long-term development impetus for both public and private sectors.

- Accelerating agricultural and rural development, environmental protection, considering this the first important solution, which provides sustainable development and poverty elimination, included the 1715 poorest communes assistant program.
- Investing in human resource development and resolving the social issues with two important chains (at the moment) - poverty elimination and job creating, skill training for the youth.
- Conducting administration reform and encouraging openness and public participation in the renovation process. Creating the credibility for domestic as well as foreign enterprises.

## **VII. The IX Party Congress Preparation**

Viet Nam has been active in carrying out research in different aspects toward the IX party congress planned to be held in the first half of the year 2001. To this end, many works to be done now contain significance in economic policy aspects not only for the near future, but also in the long-term (up to the year 2010) policy framework.

At the moments, all industries and all local authorizations actively participate in drafting the research assignment topics so that in the year 2000 the draft of the Social and Economic Development Strategy for the period 2001-2010 and the draft of the five-year plan 2001-2005 may be published for public comment.

In the scope of the joint Japan-Viet Nam policy assistance project, it may be suggested to select some first priority issues among the 14 research sub-topics that are now being carried out by the Viet Nameese assigned experts to be implemented in the four study teams.



Table 1A. Gross Domestic Product - Growth rate

	1991	1992	1993	1994	1995	1996	1997	1998	1999E
GDP	6.0	8.6	8.1	8.8	9.5	9.3	8.2	5.8	4.5
Agriculture	2.2	6.9	3.3	3.4	4.8	4.4	4.3	3.5	2.8
Industry & Construction	7.7	12.8	12.6	13.4	13.6	14.5	12.6	10.0	8.0
Service	7.4	7.6	8.6	9.6	9.8	8.8	7.1	4.5	3.0

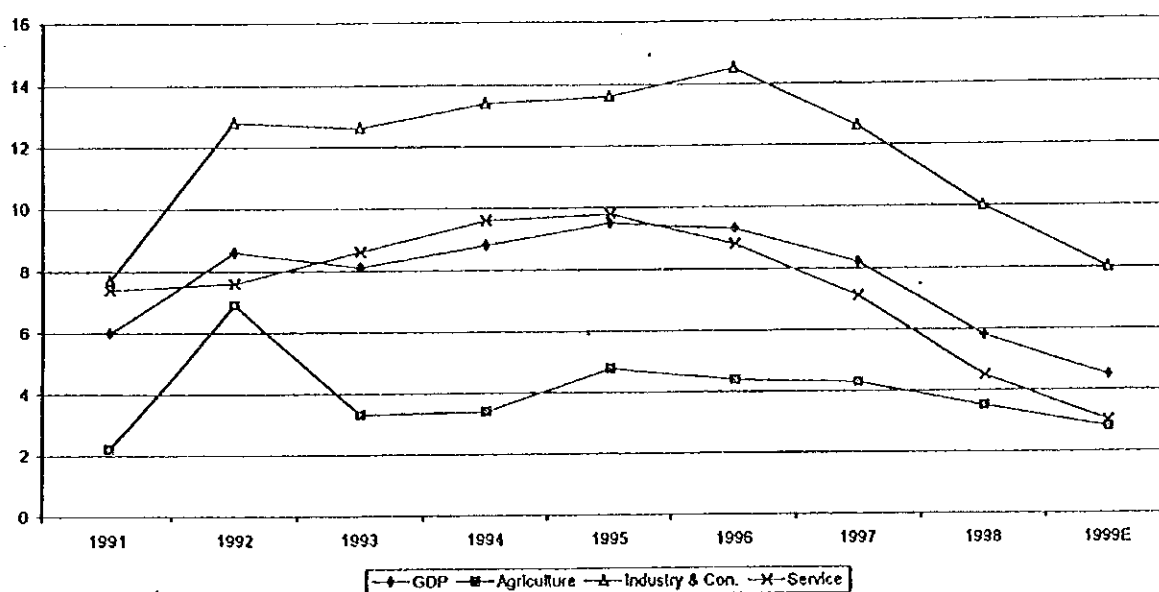
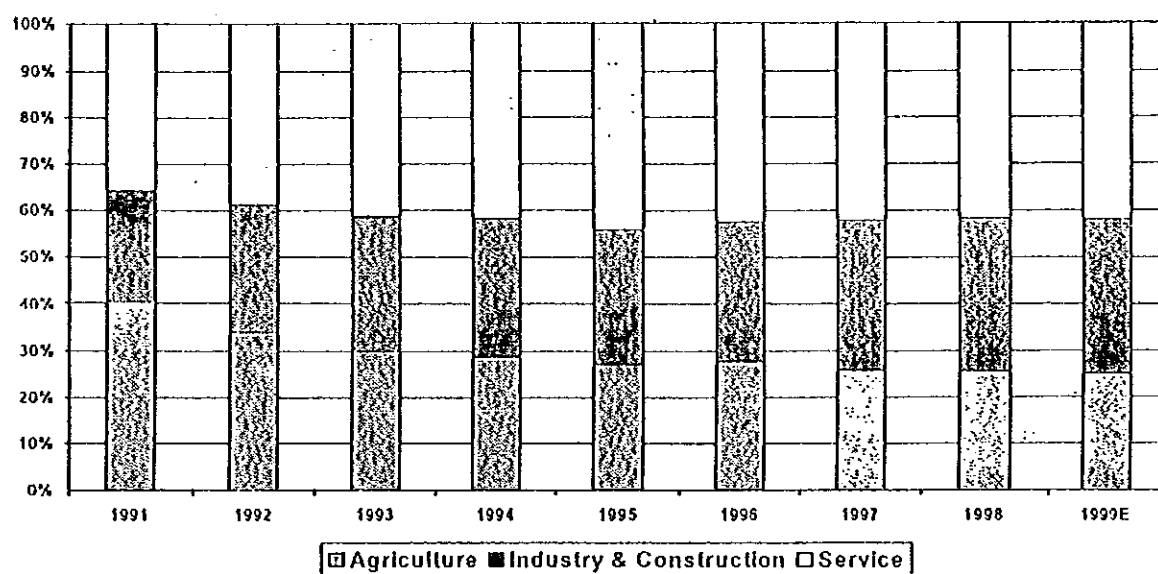


Table 1B. Gross Domestic Product - Structure

	1991	1992	1993	1994	1995	1996	1997	1998	1999E
GDP	100.00	100.00	100.00	100.00	100.	100.00	100.00	100.00	100.00
Agriculture	40.49	33.94	29.87	28.69	27.18	27.26	25.77	25.75	25.10
Industry & Construction	23.79	37.26	28.90	29.60	28.76	29.73	32.08	32.59	33.00
Service	35.72	38.80	41.23	41.71	44.06	42.51	42.15	41.66	41.90



**Table 2. Balance of Gross Domestic Product at current price (Bill. VND)**

	1991	1992	1993	1994	1995	1996	1997	1998	1999E
<b>A.SOURCE</b>	80632	11501	148867	195400	249710	301876	339150	388253	434000
1. Gross Domestic Product	76707	110535	136571	178534	228891	272037	313624	361468	406000
2. Balance of Trade	3925	4516	12296	16866	20819	29839	25526	26785	28000
-Percent of GDP	5.12	4.09	9.00	9.45	9.10	10.97	8.14	7.41	6.90
<b>B. USES</b>	80465	114812	150739	193520	24369	301771	339338	388890	443000
1. Final Consumption	68959	95314	116719	148037	187233	225231	250584	285130	321700
-Percent of GDP	89.90	86.23	85.46	82.92	81.80	82.79	79.90	78.88	79.24
2. Gross capital formation	11506	19498	34020	45483	62131	76540	88754	103760	121300
-Percent of GDP	15.00	17.64	24.91	25.48	27.14	28.14	28.30	28.71	29.88
3. Error	167	239	-1872	1880	346	105	-188	-637	-9000
<b>TOTAL SAVING</b>	11506	19498	34020	45483	62131	76540	88754	103760	121300
1. National Saving	7748	15221	19852	30497	41658	46806	63040	76338	84300
-Percent of GDP	10.10	13.77	14.54	17.08	18.20	17.21	20.10	21.12	20.76
2. Foreign-saving	3758	4277	14168	14986	20473	29734	25714	27422	37000
-Percent of GDP	4.90	3.87	10.37	8.39	8.94	10.93	8.20	7.59	9.11

**Table 3. Gross Domestic Product per capita at current price (Thous. VND)**

	1991	1992	1993	1994	1995	1996	1997	1998	1999E
GDP per capita	1132	1596	1923	2462	3059	3610	4088	4631	5114
Final consumption	1017	1373	1643	2042	2531	3989	3266	3653	4052
Food per capita(kg)	324.6	348.7	359.0	361.3	372.8	387.7	399.1	407.9	403.1
Electricity(Kwh/per)	137	141	152	172	198	225	249	279	307
Export per capita(USD)	31	37	42	56	74	96	120	120	126



# Economic System Reform and the Significance of Its Scenario-Making

## — Review by Comparing Experiences of Viet Nam and China —

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### I. Introduction

This report is intended to review the present stage of the market economy-oriented economic system reform now under way in Viet Nam and its problems, relying on the comparative studies on the Chinese and Vietnamese experiences. The research is premised on that it is of decisive importance for the success of developing country-type transitional economies like China and Viet Nam to prepare a scenario of economic system reform.

The scenario mentioned here means a broad schedule of reform defining (i) the goal of the system to be achieved for the economy as a whole as well as for specified policy fields, (ii) the processes to reach it, and (iii) the time schedule of reform which expressly states the target dates of reaching them. The description of the state of the economic system to be realized as the goal should comprise that of (a) the institutional characteristics of resource allocation, property ownership and economic units, and (b) the effective mechanism of dynamic development that would be established on these institutions. The description of the processes toward that goal should comprise that of the transitional measures to be taken along the path connecting the planned economic system to the market economic system. Scientific accuracy can not be expected relating to any predictory factors contained in each of the three components and, therefore, the scenario may be nothing more than an expectation as to the matters like this. In this sense, it may well be called a vision rather than a scenario. The scenario must, however, be written clearly enough not only to be able to serve as a guidepost for those concerned in the reform but also to enhance the "transparency" about the entire reform intention.

Next, this scenario never becomes effective if it only tries to transplant any exogenous model of economic reform for marketization such as that advocated by IMF/the World Bank<sup>1)</sup>, which is now internationally playing a leading role to promote the market economy-oriented economic system reform. The most important reason is because, as we have argued<sup>2)</sup> the latent framework of market economy (or the mechanism of social division of

1) Shigeru Ishikawa, "Structural Adjustment - the Review of the World Bank-Method", in *Asia Keizai* (Asian Economy) 35.9, Nov., 1994. (in Japanese)

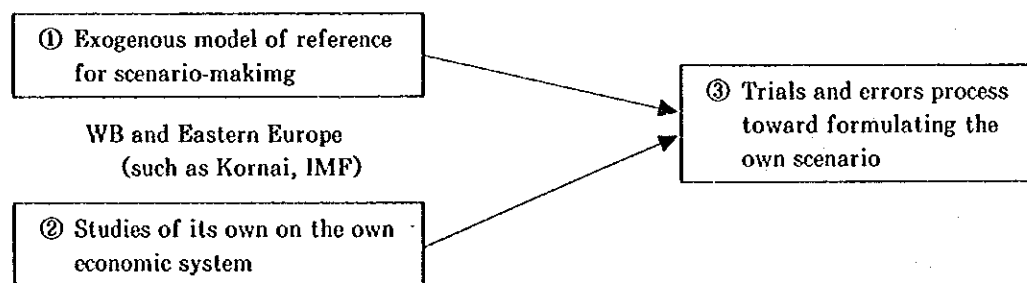
2) Shigeru Ishikawa, "An Approach of Promoting the Development of the Market Economy - Theoretical Positioning and Application" in *Kaihatsu Enjo Kenkyu* (Developmental Assistance Studies) 14-1, 1997. (in Japanese)

labor in production) and its component is still in the process of formation, particularly in developing country-type socialist countries like China and Viet Nam. Therefore, the reform will never be successful without accompanying the steps for nurturing and fostering these still immature market economy system. (Such a conception does not exist in the model of IMF/the World Bank.<sup>3)</sup>) In addition, there remain operations of residual elements of institutions and organizations that were effective in their planned economy period or even before that. There are differences among them of initial conditions, including the level and structure of production. Other constraints also arise out of the issue of political reform, value systems of the people belonging to various social strata, and their changes.

These imply first that in order to start the reform for marketization of the economy which is an entirely new undertaking for the two countries, an exogenous model of reference for scenario-making of transition is useful, but that the reform would not be successful unless at the same time the extensive and intensive studies on the own economic system would be conducted by themselves to acquire the accurate perception of it. Moreover, the exogenous model of reference and the studies of its own on the own economic system must be synthesized to derive its own scenario for marketization. This is a process which involves complicated "trials and errors" requiring a long period of gestation, even the result thus obtained would be at first merely an elementary one, requiring further improvements in successive steps to formulate an increasingly sophisticated scenario. But, even if an elementary one, the formulation and publication of the first step scenario is an important land-mark for the progress of the marketization.

The three steps for scenario-making thus would be shown in *Fig.1*.

*Fig. 1. Conceptual steps for Scenario-making*



3) For a detailed explanation of this point, Shigeru Ishikawa, "From Development Economics to Development Cooperation Policy", Ishikawa, ed. in *Theoretical study on Development Cooperation Policy*, Institute of Developing Economies, 1996. (in Japanese)

Finally, the significance of the scenario-making for the developing cum transitional economy like Viet Nam and China could be grasped by the fact that the formation and announcement of the scenario play the role of "public goods" with strong external effects both domestically and externally. Namely, for the line-ministries of the central government and various local governments as well as the private sectors, only through thus revealed scenario it becomes possible to be informed of the government policy intention and make it a guidepost by relying on which they are able to decide their own policy measures. Externally, scenario-making and publication would accelerate the smooth negotiation about the economic cooperation and other economic relations with the donor countries and international aid organizations.

In particular, under the circumstances such as today, where the externally-originated economic crisis has been forcing the country to adopt emergency measures to interrupt application of many of the already decided liberalization and marketization measures, publication of the scenario, even if it were not full-fledged one, would be useful to avoid misinterpretation of the government willingness sooner or later to return to the original course.

In the following, Section 2 compares the extent of progress of the marketization of the economy between the two countries, first in the national level by means of studying the important policy decisions on economic system reform and second in the sectoral level. Section 3 asks when and in what motives the formal decisions of abandoning the centralized planning system were made in the two countries, and examines some of the initial conditions which influenced that decision. Section 4 studies the "trials and errors" process which China and Viet Nam proceeded in a fairly long period between the decision of discontinuing the centralized planning and the present. The relationship with the World Bank and IMF is also inquired. Section 5 concludes the discussion in terms of the analytical tasks and policy implications. As China has gone a few steps ahead in scenario-making, the empirical cases for study in this paper as well as research data are much more in China than in Viet Nam. Therefore in the following, more references are made as for China.

## II. The Present Stage of the Economic System Reform

### (1) Assessment from the scenario-making

In *Tables 1, 2 and 3*, a set of important party and government decisions on economic system reform for Viet Nam are presented, including the Doi Moi strategy of the 1986 party Congress which started the Vietnamese system reform, and the most recent decision at the 1996 Eighth Party Congress as well as the ensuing government announcements. Our present concern is in the latter two. *Tables 2 and 3*.

As for China, *Table 4* shows the decisions of three Important meetings of the Party Central Committee together, first the decision at the 11-3 C.C. in 1978 Plenum which started China's

system reform, second the decision at the 12-3 C.C. Plenum in 1984, extending the priority area of the reform from the rural to the urban economy, and third the decision at the 14-3 C.C. in 1993 Plenum. Our present concern is in the last one.

Assessment To make comments first on China's decision, the 1993 decision, entitled the "Decision to establish the system of socialist market economy", is considered to be a full-fledged (although yet elementary) scenario for a market economic oriented reform which has appeared for the first time in China, and as such is benefiting government officials engaged in economic administration and nearly all the stakeholders in making own their own decision-making. It made clear the government objectives which focussed in the long run realization of both at market-type efficiency and equity. In the area of reform of economic management system, a central concern was placed on the establishment of the macroeconomic control mechanism. Very importantly, it describes specifically the measures to nurture and foster the yet underdeveloped markets and market economy system.

The year 2010 was set as the target for achieving the aims of individual items of reform, and the year 2050 as the target for basically realizing the goal of "modernization", which would make China one of the most advised industrialized countries.

It should be noted, however, that subsequently to the 1993 14-3 CC Plenum, a number of difficult economic problems in the real economy have arisen, awaiting the news systemic reform hence a revision of the first scenario to emerge. But there is no development toward that direction so far.

As for Viet Nam the policy decision of the 8<sup>th</sup> Party Congress made clear the goal of market economy creation, with the phrasing of "multi-sectoral economy operating along the market mechanism under state control and in the direction of socialism" (underline is by myself). The target for the year 2020 was set for becoming a "industrialized country." The decision covers the transitionally policy measures to be taken in the process toward reaching the goal. But the description of the measures is, as shown in *Table 1*, rather broad and not specific enough.

Two policy statements shown in *Table 3* (1) and (2), seem useful, as it may reflect the development of systemic reform after the 8<sup>th</sup> Party Congress. In fact, the contents of the proposed reform become much more specific. The remaining issues were on the aspects of financial sector reform (especially of central bank function of monetary policy and the state commercial banks financial intermediary function), state enterprise reform, industrial policy (particularly with regard to fostering of export industries which should be enlarged and become competitive under the new environments of greater trade liberalization), and institutional reform of rural economy, all of which had to be much more specified so that a clear vision would be provided as to the transitory policies during the processes toward reaching the goal.



*Table 3* also suggests, particularly in connection with its special column (3), that considerable part of the required items of system reform have been made a subject of the policy dialogues between the Vietnamese government and the WB and that the former gradually accepted the latter's policy.

Among the reasons of these differences is seemingly the difference in the initial conditions of two countries at the start of the reform period which will be discussed in section II. Complicated international economic environments facing the present Viet Nam economy and the resulting difficulty to make reliable prediction of the future prospects for the external economic relations must also play a significant role, in addition. New Viet Nam government which starts in August 1997, appears to be paying great effort for the scenario-making within the framework of mid- and long-term economic projections besides the formulation of the next FYP(2001-05).

Use of term socialism in the decisions In all the decisions shown in *Table 1* through 4, use was made of the term socialism or the term in a different name but with the same meaning, either singly or in conjunction with the term market economy, for defining the goal of the economic system reform. The implication of this use of "socialism" seems to have changed over time. In the present usage, socialism implies simply the preservation of the state ownership over the strategic economic units.<sup>4)</sup> Moreover, those aspects and sectors where the market economy system has been rooted, are already wide enough to make it difficult to revoke it.

## (2) Differences in progress of sectoral systemic reforms

Three sectors are to be chosen for assessment. Generally, China seems at a more advanced stage in the progress of reform, and its economic growth effect more distinct.

In order to assess the extent of market economy development in sectoral terms, one has to question the relationship between the solution of the production tasks in the real economy and the progress of scenario-making in the systemic dimension. As we shall note shortly in Section 3, the economic system reform started in both Viet Nam and China with the primary motives to solve serious production tasks encountered. In this connection, I wish to propose a concept of the "first generation problem" of production tasks and correspondingly, a concept of the "first generation scenario" which could be formulated only after the solution of the "first generation problem" could become foreseen.

(i) Fiscal and Monetary Policy In the two countries alike, "the first generation problem" was to accomplish a change in the pattern of flow of capital accumulation funds from

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4) The interpretation of "socialism" in this context by the World Bank is the same as mine. Pater Harrold et al, eds., *Macroeconomic Management in China - Proceeding of a Conference in Dalian*, June 1993, World Bank, 1993, p.145.

the public finance-centered flow to the bank-centered one as shown in *Fig. 1*. The results were more or less successful but China's success is more marked: esp. easily in progress of the Central Bank's monetary policy and the expansion of deposit absorption and credit extension of the State commercial bank.

(ii) SOE's equitization and corporatization

Both Viet Nam and China aim at these as far as the large and medium sized SOEs are concerned. In terms of the number of equalized SOEs, China is more advanced. However, this perhaps belongs to the second-generation problem. In the first-generation stage of SOE reform, the increase in production and management decision-making was the objective and Viet Nam was more in progress. One of the reason might be due to the difference in the initial condition as discussed shortly. Moreover, there might be a difference in seriousness in the operation of various nonmarket, economic factors which combine to constrain the activities of SOEs as shown in *Fig. 2*. The secured generation problem has emerged, which is how to devise a suffocative mechanism of macroeconomic management to be capable of tiding over the structurally determined depression emerged in the late 1990s.

(iii) Performances of agriculture and rural industrialization.

In the two countries alike, the first generation problem seems a "breakthrough" in agricultural productivity and the resulting spread of nonagricultural production especially rural industry. China is much more advanced than Viet Nam. Mechanisms of this progress are drawn in *Fig. 3* on the basis of China's experience. One of the factors behind the difference between the two countries is probably relating to the difference in active use of the practices of customary rural communities (in particular those which played an important role in the organization of territorially-based cooperative and "two-tier management" policy the latter been practiced since mid-1980s). This is a complementary factor to the system of self cultivating farms. Now in China, the second-generation problem is emerging, in which the stage of "food problem" was over and the stage of a "farm problem" in the Schultz's sense has come: maintaining stability of prices and supplies in response to harvest fluctuations is becoming the task.

### III. The Period of Time when the Economic System Reform Started and its Motive

(1) Specification of the starting period

There is a wide agreement to specify the starting period of China's economic system reform as December 1978, when 11-3 CC Plenum made the policy discussion summarized in *Table 4 (1)*. For Viet Nam also it is common to specify the starting period as December 1986, when the sixth Party Congress decided the Doi Moi strategy shown in *Table 1*. The problem is that these two decisions were often considered as the decisions of starting the

market economy-oriented reform in both countries respectively. Strictly speaking, this is not true. The fact is that the economic system reform which transformed itself into a more focused market economy oriented reform began several years later and only gradually.

Thus, the first question to be asked is what about this first stage economic system reform and in which motives it started in both countries.

## (2) The motive observed in the decisions

In China's 11-3 CC Plenum Decision, there was no single word used for denoting the market-economy or its predecessor concept, the "commodity economy". As indicated in *Table 4*, the motive for the reform was simply a government desire to restart the "construction of socialist modernization" disrupted during the period of cultural revolution, thus recovering the great loss in output incurred during the "lost decade". The content of the "socialist modernization" was, when this aim was presented to the People's Representative Conference first in 1964 and again in 1975, "to realize thoroughly modernization of agriculture, industry, national defense and science and technology with three five year plans," and thereby "to have China's national economy deploy at the front line of the world".

Now, this 1978 decision required the "excessively centralized planning system" in the past to be discontinued and replaced by a new system of economic management in which "decision-making powers were boldly decentralized to local governments and state owned enterprises with appropriate material incentives (*Fangquan rangli*)". Formal and informal policy documents published almost at the same time revealed the frequent acts in the past that important economic policy decisions were made not in accordance with the economic laws (in particular, the Law of Value) but following the political leader's will, and that there were at the basic level of economic administration very undemocratic activities by the cadres. The desire of reform which those documents exhibited may be considered to be part of the motive of the 1978 decision.

As for Viet Nam, the proposed contents the *Doi Moi* strategy of 1986, were much more comprehensive and specific than that of China's 1978 decision.

The motive of the strategy was, as shown in *Table 1*, to achieve socialist transformation and construction. But the strategy also stressed the importance of introducing the Commodity Economy. The reason was described, in effect, as follows: "Viet Nam is now in the early transitional stage toward socialist construction. As the aim of our transitional stay is not to shift from capitalism to socialism, but to shift from small-scale production directly to socialism, it is of a long-term process with difficulty. Vietnamese economy should try first to overcome "natural economy" and shift to "commodity economy" and for that purpose it is allowed to apply the law of value and the law of demand and supply. With regard to the economic management it criticized the existing mechanism as "outmoded" and it was to be "renovated":

- (i) The domain of direct planning was to be reduced and the domain of indirect planning

to be expanded as a step toward providing orientation to the national economy.

(ii) The scope of autonomy of the national economy.

(iii) In the areas of public finance, banking pricing and wages, the state budget be balanced, currency issue be restrained, real wages be stabilized, prices be adjusted through demand and supply relationship and not by imposing officially set prices.

### (3) Background

The most important findings from the above survey are firstly that the economic system reform in the two countries started without clear vision of the market economy creation as the goal, and secondly that the goal was envisaged rather as strengthening the existing socialist regime. These may be explained in terms of the background economic conditions:

(i) Around the time of starting the economic system reform, the two countries had encountered more or less critical economic conditions. In China, the accumulated loss incurred during the Cultural Revolution period (1966-76) was claimed to be in a huge amount. In the same year 1978 when the "11-3 CC Plenum was held, a new Great Leap Forward movement based on a large-scale plant imports was taken place and due, ironically, to the "erroneous politician's will" resulted in a big failure. To rectify the difficult condition thus caused by these two factors, a large-scale campaign for "adjustment" started in 1979. The "Fangquan Rangli" policy in the field of systemic reform could be regarded as part of that "adjustment". Yet, as China's fundamentals in national savings, investment, GDP and balance of payments were in good performances (*Fig.4 and 5*), the economic difficulties at this time appear not as serious as those encountered in Viet Nam.

The kind of economic difficulty which Viet Nam encountered was best exhibited in *Fig.5* (panel A). It indicates that after the national unification until 1986, all domestic investment (I') and even part of domestic consumption (C') were financed by M-X, which in turn was financed largely by the economic aid from the Soviet Union, Eastern European countries and China. But the amount of aid gradually decreased and finally came to nil around 1990. The amount of gross national saving was in the same period supposed to be nil or negative, as seen in *Fig.1*. Furthermore, food grain production just recovered from the protracted condition of bad crop, causing frequent crises.

Given such real economy difficulties in combination with the "outmoded economic management mechanism", the outcome would have been inescapable that the economy would on the one hand be retarded to the direction of "natural economy", and on the other would face seriously high inflation (as much as 50% on average during 1976-1984) in the domain of the state sector where most of the money economy remained but suffered from the large government budget deficit. The proposal of the new economic management mechanism was made in order to avoid such tendency. However, the reforms of price, public finance and currency reform which were introduced in June,

1985 (immediately before the Doi Moi reform) with the same purpose resulted in a big failure: the rate of inflation soared more than 5 times in a year.

- (ii) A reason why the term socialism was used with a crucially important role assigned was probably due to the fact that both Viet Nam and China had not access to the Western models of market economy-oriented reform, or even when they had, it was beyond their capability to comprehend these models immediately. Another reason was that the only policy instruments they could use at that period for overall economic management was those traditionally practiced in the planned economies with the use of the administrative means. Even though the new policy for the systemic reform accompanied the measures for economic liberalization in various aspects, that certainly would not mean that the overall control by the central government of the entire national economy will be abandoned. There is one more reason which relates to the value system of the people in various strata. It had to take sometimes for it to change accommodation to the new institution that may emerge.

To comment on a socialist practice of overall economic management, the core of it was the Soviet Economy-type centralized and material planning method, which was based on the compilation and use of the "Material Balance Table" for all individual items of main producers' goods in the economy and which in turn became the basis of the five-year plans of the national economic development. In China and Viet Nam this method was practiced, though not to a full extent, until at least early 1980s in case of China.

*China:* as shown in *Table 7*, "Commodities under Unified Distribution" by the State Planning Commission numbered 370 items in the period when the method material balancing was used most extensively. But the coverage of the Material Balance Table was incomplete in both coverage of commodity items and their qualities, which is clear when comparison is made with case of the Soviet Union. (During the period of Cultural Revolution they were not compiled at all.) This suggests that in China, the domain of the economy which was covered by the full-fledged planning system was narrow and even not tightly planned, and in fact there was in the country a vast domain where the economic activities were simply under the constraints put by usual (price and circulation) regulations. Yet, the planning of the core sector was considered crucially important.

In the case of the Soviet Union, the number of "Funded commodities" by GOSPLAN was around 2000 items. The rigorousness of compilation was high. Coverage of the main producers' goods by the Tables was complete.

*Viet Nam:* It appears that the method of the Material Balance Tables are in practice to some extent after the second Five Year Plan (1981-85). But there is no precise information.

- (iii) There are distinct differences between the contents of initial policy decision for the systemic reform in Viet Nam and China, in that the Vietnamese policy relied on the concept of a "commodity market" and the Chinese policy did not and that the Vietnamese policy covered individual policy areas in fair detail. These are largely explained by the difference in the time period in which the two policy decisions were made. It is recalled that the economic system reform in COMECON countries and China entered a new phase after the mid-1980s, in which the policy view that officially allowed the introduction of the "commodity markets" (for the first time accepted as an official policy in Hungary in 1968) became widespread, although the market economy, hence admission of the "factor of production market" was delayed. (Formally at least, the latter introduced widely in Eastern Europe in 1989 when many Communist Party dominated governments were disintegrated. In Russia, it was realized only in 1992.)

These mean that the Doi Moi strategy was formulated and published in the atmosphere of 1980's, together with the concept of "Commodity Economy". Viet Nam might have benefited from the opportunities to refer to the system reform models of the countries in Eastern Europe and China where the "Commodity Economy" concept was introduced. In contrast, China's policy of 1978 was made prior to the 1980s. In China, the concept of the commodity markets was first introduced thereafter in the 1984 decision of 12-3 CC Plenum.

#### IV. "Trials and Errors" toward Own Scenario

This section inquires what have been taken place in between the start of the economic system reform and its most recent stage in both countries. In connection with *Fig.1* (conceptual steps for scenario-making), this is mainly to investigate its panel ③: Trials and errors toward formulating the own scenario, synthesizing panels ① and ②. The investigation will be made in two steps; first, in terms of the policy decisions which exhibit an evolution of the idea of the nationwide, economic system reform and second, in terms of the sectoral quest for better systems. Only one sector among the three which were taken up in section II, namely the fiscal and financial sector, is chosen for a detailed study.

In connection with panel ① of *Fig.1*, some studies on the World Bank and IMF activities would be made in relation to the two countries.

##### (1) Evolution of the policy decisions

###### (i) The case of China

The study on this evolution should be based on investigation of secular important policy decisions on economic system reform which were made in between the 1978 decision at the 11-3 C.C. Plenum and the 1993 decision at the 14-3 C.C. Plenum. Of these, the 1984

decision at the 12-3 C.C. Plenum is summarized in *Table 4*, together with the former two. In addition, the 7<sup>th</sup> Five-Year National Economic and Social Development Plan approved at the 6-4 National People's Representative Conference in 1986 and the decision at the 13<sup>th</sup> Party Congress in 1987 are here taken up.

"Commodity economy" and "Market economy" First, the 1984 decision specified as the goal of the systemic reform the establishment of the "commodity economy under the planned management". This represented one step further in evolution from the "socialist modernization" of the 11-3 C.C. Plenum decision. The goal of "Commodity economy" for the first time appeared in the Soviet Bloc in a system reform of Hungary in 1968 (called New Economic Mechanism) attempted within the framework of the planned economy. The Russian reform Perestroika under the Gorbachev regime was based theoretically upon this concept. This was also the goal of the 1986 Vietnamese reform called Doi Moi.

The admittance of "Commodity Economy" was equivalent to admitting the existence of the market in the social its economy, although strictly limited to the product market. Factors of production, in particular, labor and funds were not commodities. Their markets were hence not admitted. The admittance of the markets for the factors of production was made for Hungary in 1989 and for Russia in 1991 (the Reform under Yeltsin). Only in this occasion, the term "market economy" was legalized.

The 1986 plan and the 1987 decision both took further evolution steps: the slogan of "the state coordinates the markets and the markets induce the enterprise" represented a new goal that was made much closer to the "market economy", and a new economic management system was proposed on the basis of indirect control and macroeconomic management.

Thus, in terms of the successive policy decision, the evolution from the stage of "Socialist modernization" and Fangquan Rangli to the stage of "market economy" appears continuous. But two events that occurred in between became the milestones separating the two stages sharply.

Debate on "Goal Models" As one of them, there was an academic debate on the models of goal for the system reform which took place in 1985 and after. The debate was partly inspired by the publication of the proceedings of an International Symposium on Macroeconomic Management sponsored by the World Bank Mission in China<sup>5)</sup>, in particular by an article in it written by J. Kornai.

A summary of the debate was provided by a well-known Chinese economist Wu Qinglian and others.<sup>6)</sup> There was a group of scholars, who argued that the socialist economy was to be based on the management by "mandatory planning"; so the market coordination

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5) *ibid.*

6) Wu Qinglian, Zhou Xiaochuan et. al, *Total Designs of Chinese Economic Reform*, China Review Co., 1998. (in Chinese)

should be subjected to the planning coordination. Other group argued that the fundamental defects of the traditional socialist economy were on "excessive centralization", so the correct goal should be to overcome it by means of Fangquan Rangli.

Against these arguments, Wu Qinglian considered that Fangquan Rangli was, in principle of the resource allocation and hence in corresponding motive force, in conflict with the planning regime.

Therefore, Fangquan Rangli was not capable of displaying its potential effect. On the other hand, socialist economy was, first of all, the commodity economy; hence the movement of the economy should be mainly on the basis of the market mechanism. The state economic management should aim at securing the normal operation of the market mechanism and its intervention be limited to those areas of "market failures". Only with this goal of the reform pursued and the well coordinated sectoral reforms in various policy areas deployed the successful results would be acquired.

Wu and others complained that although the above 1986 plan and the 1987 decision endorsed these last lines, they were in fact not implemented.

Limit of the effect of Fangquan Rangli Another event setting the milestone was the occurrence in fourth quarter of 1984 of the overheating of the economy as a result of the continuous implementation of Fangquan Rangli policy. It was due to the inflation of the excess-demand type which took place for the first time in the People's Republic period. Due to the powerful anti-inflationary measures with hard landing effects, it turned to an improvement in the second half of 1985. But the trade balance turned to the deficit accordingly and the recovery to the condition of trade surplus required three years. In 1989, a similar type inflation emerged, and in this case even a panic conditions occurred in the consumer markets, side by side with the unusual price rises.

In the planned economy period, while the large-scale economic fluctuations due to the noneconomic factors (such as the Great Leap Forward and Cultural Revolution) took place, there was no fluctuations at all caused by the macroeconomic factors. China's economy in the six years after entering into the reform period and until 1984 enjoyed very smooth development, most probably due to the fact that it was able to be exempt from such a large-scale fluctuation due to the noneconomic factors, in addition to the effect of the policy of Fangquan Rangli in the reform period.

The emergence of this economic overheating of a new type compelled the Chinese government gradually to recognize that the overheating was not capable of being overcome by any means of traditional planned economy management; it was only effectively dealt with by the market economy-type measures for macroeconomic management. "Trials and Errors" in this area of macroeconomic management are shown as follows:

According to an IMF study,<sup>7)</sup> China experienced in the reform period four macroeconomic

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7) IMF, *People's Republic of China, Selected Issues*, June 16, 1997, Annex II, Macroeconomic Cycles in China.



cycles (1978-81, 81-86, 86-90, 90-). The downward phase of the first three cycles was effected all by the administrative means of cutting the aggregate demand, entailing the severe hard landing. Only in the last cycle, the downward phase from 1994 was brought about with use of such monetary policy instruments as reserve ratios, interest rates and market operations of treasury bills. Soft landing was achieved. But at present, a new issue has arisen that the growth rate cannot rebound to go up after reaching the bottom. However, this is a second-generation problem.

On the use of the term socialism Side by side with these changes in the economic mechanism, which has come to depend so crucially on the use of macroeconomic management and other market-economy type instruments, the direction toward marketization seems to become irreversible. Therefore, the term "socialism" used in the policy decision is becoming more and more a simple adjective attached the term "marketization". The changes in the value system of the people and the political tendency toward democratization are additional factors of this irreversibility.

#### (ii) The case of Viet Nam

There are only a few materials available for assessing the evolution of the economic system reform in terms of the important policy decisions of the party. Only significant observation is that there are only a few significant changes in the stipulated contents of the reform between the 1986 decisions and the 1996 decision. The observation does not change when the 1997 decision made at the 7<sup>th</sup> Party Congress is taken into consideration. One clear change was that the words, "realization of industrialization and modernization" were added to the goal of the reform in the productivity aspect. In the systemic aspect, the realization of "Commodity economy" was the goal already set in the 1986 decision. It was changed to the "realization of the market mechanism under state control" at the 1996 decision. The setting of the goal "Commodity economy" was made in the period in which many transition governments, including China, already allowed to incorporate it in their goal. The introduction of the market mechanism was made already in 1989 at 6-6 C.C. Plenum, but most probably at the advice of IMF and the World Bank.

The reason why no drastic changes in the reform contents were observed in these decisions seems to be that the Doi Moi policy of reform was already at that time fairly advanced, incorporating many contents of the reform in other transition countries. As these advanced contents were too far apart from the reality of the Vietnamese economy, the realization was not very easy. On the other hand, the Vietnamese economy was until the mid-1990s amidst of crises conditions, hence there was not sufficient time to care for the systemic reform.

#### (2) Trials and errors in the public finance and banking sector

In section II (2) we assessed in the selected three sectors ( public finance / banking, state

owned enterprises and agriculture/rural economy) the extent of progress in market economy development in terms of the progress in scenario-making. The sectoral scenario-making was based on the institutional change which was achieved while the solution of the "first generation problem" for each sector was sought after by the "trials and errors" approach. In the case of the public finance/banking sector, for instance, the resulting institutional change was a change in the mechanism of flow of investment funds in the economy from the public finance-centered to the state owned banks-centered one.

In that section, however, we have noted only the final outcome of these institutional changes, but not discussed the process to reach it. In this section we have to deal with the process, which are grasped both ex post and ex ante. Ex post, they are described in a consistent chain of causality among objective factors. Ex ante, they are largely the process of the government and other decision makers "trials and errors" without blueprint, although there are likely the cases in which exogenous model of reference (Fig.1) plays some role. In the following we confine the study solely on the public finance/banking sector, as example. Its ex post and ex ante parts are treated separately.

(i) Ex post study

The achieved change in the investment funds flow mechanism is described by separating its components as follows.

- ① In China, the ratio of the value added (or income produced) of the state owned enterprises (SOEs) which is distributed to the enterprises and the state as profits and taxes (or the relative capital's share of the income produced) was diminished (*Fig 2*).

This change was in line with the new idea of "small government" and "commercialized capital investment", and was effected though the measures for "turning profit surrender to taxation" (Ligaishui) and for "turning budget grant to bank loan" (Bogaidai). The change also reflected the fact that the SOEs now became independent units from the control by public finance. And the resulting economic performances were successful (*Tables 6 and 7*). Partly as its side effect, however, the ratio of budget revenue the GDP declined (*Fig.6*). In Viet Nam, both Ligaishui and Bogaidai were introduced. After that, the ratio of government revenue to GDP increased. The reason behind the difference should yet be studied.

- ② In China the relative labor's share of the SOEs' income produced, accordingly, increased (*Tables 6 and 7*). Side by side, the same share in total GDP and the total of household income to GDP increased (*Fig.5*).

The labor's share consists of "standard wages" and bonuses, social insurance and fringe welfare expenditures. In the planned economy period, the labor's share was kept in a low level and so the household income over GDP ratio. As for Viet Nam, the statistical data for studying this topic are lacking.

- ③ In China, the increase in the household income over GDP ratio accompanied the increase in the household savings over household income ratio and in the household savings over total domestic savings ratio (*Fig.9*). As for Viet Nam, *Fig.5* indicates that domestic and national savings ratios improved considerably after 1989, but the current level was not yet sufficiently high to be capable of sustaining national construction by itself.
- ④ In China, the increase in the household savings played a major role in increasing the bank deposits and through the Bank's financial intermediation, the bank credits to the enterprises. Thus, the  $M_2 / \text{GDP}$  ratio (and the combined demand and time deposits / GDP ratio) exhibited a significant increase from 24.8% (18.8%) in 1978 to 101.2% (55.5%) in 1992 and the bank loan to enterprises and individuals over GDP ratio from 61.3% in 1984 to 91.2% in 1993. These performances of "financial deepening" were the results of the financial sector reform to abolish a mono bank system of the socialist tradition by separating its functions into two : the Central Bank and the Specialized Banks (later turned to the State Commercial Banks) (Ercenghua).

In Viet Nam, while Ercenghua was accomplished, the financial deepening was lagging behind: in 1992 the  $M_2 / \text{GDP}$  ratio was 24.5%, and the deposits/GDP ratio 7.6%. In the both countries, the ratio of non-performing loan to total loan is very high.

(ii) Ex ante study

This aspect of the study is limited to China due to inavailability of data. But even for China the study suffered from insufficiency of data. Below, description is made as to what were taken place in the trials and errors process for seeking better institutions and policies to resolve the production and management task at each time period. But the description is confined to the items for which the data are available.

① Beginning of Bogaidai; from public finance to banking.

At the beginning period of the economic reform, due to the recovery factors, production and consumption expanded in general and hence the economy enjoyed a favorable turn. However, the most authoritative economist at that time in China, Xue Muqiao warned, in his article published in People's Daily, Sept. 2, 1980, that the state budget for the year 1977 was suffering from a huge deficit, as much as 16% of the revenue. Due to the rising amount of household and SOEs' savings, even this much budget did not result in a significant increase in money issue. But there were many factors which forced the rising trends of budget deficit in the undisciplined increase in basic investments. He supported the change in the existing system of financing fixed capital investment by state budget for that by bank loans.

② Need of the central bank: Ercenghua

The result of alteration of investment funds flow from the budget-centered to the

bank-centered was, however, not success. In 1983, Professor Liu<sup>8)</sup>, Vice President of the People's Bank warned that the management and use of the people's savings mobilized in the state commercial banks through their loans were uncoordinated and undisciplined; when the economic conditions were favorable, part of the "comrades" ordered large-scale construction at will, causing the disruption of the economic balances. He urged that the People's Bank becomes the macroeconomic coordinator relating to money issue and credit creation, using the economic and administrative means.

③ Financial intermediary of the state commercial banks

It should be extremely difficult for the banks which had long played simply the role of a cashier in the planned economy to be transformed immediately into the banks which play the financial intermediary role in the market economy. There are many cases in which trials and errors were committed by the state commercial banks in the earlier days and compiled by themselves.<sup>9)</sup> The fact that they are even now plagued by a huge amount of bad assets suggests that such trials and errors are still being taken place.

④ Increase in the relative labor's share in the SOEs value added

This was brought about, not by the government deliberate policy measures, but as a result of spontaneous focus which caused the increases in wages and wage funds (payrolls) of the SOE's sector in the year after 1978. In the earlier transition period, the wage increase was taken place mostly by the increase in the bonus component, while the standard wages component remained constant. In the government expectation, the latter preformed the function of wages for livelihood, while the former the function of incentive wages. In fact, however, the bonus component increased continuously, and the highest level bonus acquired by the most efficient SOE in the locality was soon emulated by other SOEs through what was at that time called "Panbi effect". Government exhibited patience against this trend, commenting it as the repayment of the past debts to the working class accumulated in the planning period.

A major wage reform of 1984 aimed at legalization of this trend, but linked the further increase in withered wage payrolls or the bonuses to the individual SOEs' achievement of certain performance indicators (such as increase in the profit and tax payment to asset ratio) which are contracted beforehand between the SOEs and government. However, the result was not successful. It was reported that the contracts were manipulated by the SOE side in a way that was favorable to the employees. (This was a typical case in which the theory of principal-agent relations predicted. In this Chinese

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8) *Zhongguo Jinrong* (Chinese Finance), 1983, NO.11.

9) Chen Bainian, *China's Financial Reform and Monetary Policy* (in Chinese), Jingji Guanli Co., 1992 and Shi Chunguei ed., *Example and Evaluation of Non performing Loans of Bank* (in Chinese), Zhongguo Finance Publication Co., 1996.

case the interests of the managers and workers seem identical.)

### (3) Role of the World Bank and IMF

Among the exogenous models of reference for the system reform which exerted effects so far (or in resolving the first generation problem), the role of the actual reforms conducted in Eastern Europe was subtle in the case of China, but fairly distinct for Viet Nam as was indicated above. In Viet Nam, even the Chinese reform was likely to be used as reference in addition. As for the exogenous models presented by the World Bank and IMF, one has to remember that there are differences in the relationship of the two countries with these two international organizations: the point is that these models are, for China, simply a model whose importance as the reference model China could decide herself, whereas for Viet Nam, the models are in a sense obligatory to her as Viet Nam has been since 1994 a recipient of the Structural Adjustment Lending of both World Bank (SAL) and IMF (ESAF), and the models were incorporated in the conditionalities set as the policy reform conditions for receiving the lending. (China has never been the recipient, as her fundamentals were unlike Viet Nam's, very sound).

The impact of this difference was distinct and after 1998 becoming more so as the economic situation in Viet Nam deteriorated under the influence of the East Asian slump. Namely, the SAL and ESAF started their first round in 1994. In 1996 the loan and credit fully disbursed and the negotiation for the second round started in the same year. However, the negotiation has not yet reached agreement even now. It appears that the most difficult issues lie in the policy measures to reform state commercial banks, SOEs and non-tariff barriers, the issues which we specified in this paper as "second-generation problems". More than three years of unsettled negotiations are likely to have brought about some tensions at least sometimes.

In contrast, the relations with China appear continuously friendly. In the earlier period starting from 1980, when People's Republic of China renewed her membership position, the World Bank stance was "educative". This was reflected in the second economic report which the World Bank conducted on China in 1985.<sup>10)</sup> The stance was, while supporting generally the Chinese strategy (including its Socialist orientation), to suggest and elaborate the way of resolving the immediate economic difficulties of China with the use of market-oriented means. Specifically, for instance, the report appraised as the exploration of a "socialist financial market" with no historical precedence, what I have termed earlier a new mechanism of flow of investment funds with the center placed on the state banking system. Such friendly relationship appears to continue, although the style of contacts between them were somewhat normalized after the Tian an men Incident.

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10) World Bank, *China: Long-Term Development Issues and Options*, The Johns Hopkins Univ. Press, 1985.

## V. Tentative Conclusions

The analytical task of this paper was to explore the mechanism with which the developing economy type transition economies, Viet Nam and China, were transformed into the market economy. This mechanism is essentially an evolution process to grope for a system of market economy to be reached through trials and errors. The evolution process was to be accomplished with a larger framework of "Globalization" (or of the integration of the domestic economy with the international economy) in the 1990s. (This aspect, however, has not been discussed in the paper.) The following are what have been made clear in the paper.

- 1 Three characteristics are distinct in the Vietnamese and Chinese economies: (1) the framework of the market economy only developed more or less incompletely even before the period of planned economy, (2) in the planned economy period, the centralized, material planning system was introduced. But the domain of the economy where this system was transplanted in a full-fledged sense is only a part, and the rest of the economy was only partially regulated. (3) The demand for marketization has arisen as a joint pressure from the endogenous and globalization requirements.
- 2 The process of transition in the two countries is one in which the market economy system is being nurtured and enhanced in parallel with the gradual disappearance of the planned economy system, including the regulatory framework.
- 3 The most difficult, but significant phase in this process is one of "trials and errors", groping for more effective alternative policies and institutions, while the individual units endeavor to solve their production and management tasks or the government endeavors to solve the tasks of growth and stabilization. This trials and errors phase is similar to K. Arrow's "Learning by Doing" in the investment goods industry; the effective policies and institutions thus acquired belong to the uncodifiable technical knowledge by R. Nelson.<sup>11)</sup> As the economies under question are those without matured market economy, a mechanism of "induced institutional innovation"<sup>12)</sup> is hard to work, hence the result of "trials and errors" would not be predictable.
- 4 In this trials and errors process, the exogenous models of reference for marketization tend to provide a useful guidance for resolving the tasks. The significance of exogenous models in the development of social and economic systems is ascertained by a study on "cultural diffusion" in cultural anthropology. An author of this discipline even argued that in any country's culture, more than 80% of its components may consist of those

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11) Richard Nelson, "Production Sets, Technological Knowledge and R&D; Fragile and Overworked Constructs and Analysis of Productivity Growth" in *American Economic Review* 70-2, May 1980.

12) Yujiro Hayami, *Development Economics*, Oxford Univ. Press, 1990, P.19.

transplanted from other country's culture.<sup>13)</sup> Among those reference models, the one to which the present developing countries can most easily access would be what the World Bank and IMF normally offer as conditionalities attached to the SAL and ESAF.

It should be stressed that the reference value of the World Bank and IMF models lies in that it indicates the state of overall structure and its components of the economic system when the goal of marketization would be achieved. But they do not indicate the state of the process or path the economy should pass through before the goal is reached. This comes from the fact that the World Bank and IMF models are premised on the market economy, which is highly developed. There is another limitation of the usefulness of these models. This is due to the fact that for those people and agencies in the transition countries who get accustomed to the institutional environments completely different from the market economy system, it is sometimes very difficult to comprehend the market economy itself.

- 5 One cannot deny *a priori* the likelihood that the course of economic system reform which is determined through the trials and errors process would be off the track toward the direction of the marketization shown in the World Bank and IMF model. But that likelihood would be prevented from happening if the same transition country would count this course as disadvantageous and even risky under the prevailing trends of Globalization.
- 6 In the transition period, new tasks of production and management will emerge one another from the real economy as the previous tasks are resolved. The set of policy measures to resolve them, or what I called an "economic development scenario", should accordingly be renewed. It is very advisable that when the "first generation problem" is resolved after passing through the trials and errors process and on that basis the "first generation scenario" formulated, publication of that scenario would become a powerful instrument to nurture and enhance the immature framework of the market economy, even if the scenario itself is yet incomplete and revisable. It is the public goods with wide external effects.

Next, in terms of the task for development policy, the findings of this paper may be summarized:

- (1) There are two steps required for completing the transition process: one to eliminate the planned economy system and two to nurture and strengthen the market economy system. Of these two, more difficult is to proceed with the second step and it requires time to complete it. In China it took 15 years to resolve the "first generation problem" and on the basis of it to derive the "first generation scenario". In Viet Nam, mainly due

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13) Yehudi A. Cohen, "Culture as Adaptation", in Cohen ed., *Man in Adaptation: The Cultural Present*, Second Edition, Chicago, Adline.

to the economic difficulties encountered under the impacts of the East Asian financial crises, even the “first generation problem” seems yet to be resolved satisfactorily.

In China, the “second-generation problems” already emerged. They are, in particular, the tasks for improving financial intermediation by the banking system, introduction of effective corporate governance in the SOE sector, and resolution of structural depression which appeared recently to affect the normal pattern of macroeconomic cycles. The “second generation scenario” is expected to be thought about on the basis of the solution of these tasks.

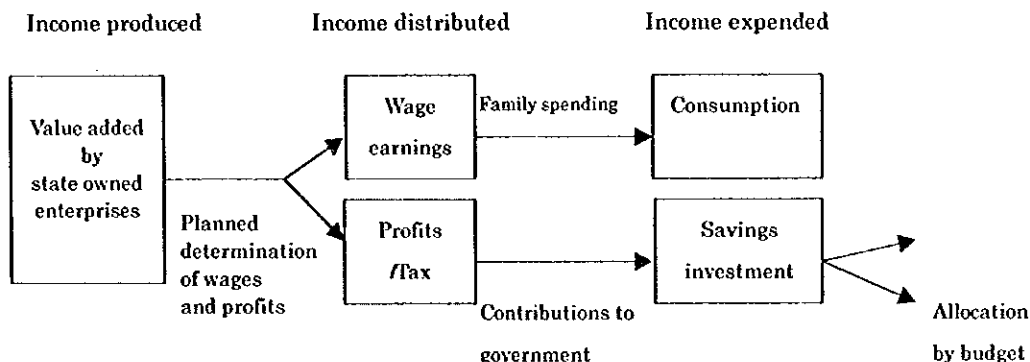
- (2) In order for the exogenous models for reference to be really useful, it is necessary that (i) the contents of the reference models, in particular the meaning of the marketization for the own country be comprehended by the government and the people. (ii) Studies be conducted on the applicability of the models to the countries concerned (*Fig.1* panel ②) and, on that basis, certain adjustments be made on the models. (iii) the thus adjusted models be made acceptable to the people of different strata.
- (3) The formation of human capital, in particular that increased by the promotion of higher education, be required in connection with (i) of the previous paragraph.
- (4) When the exogenous model is implemented under the external pressure and imposition, at least some of these necessary steps may possibly be bypassed. A result is that the implementation of the model is likely to become one of the more or less Big-ban type. In such a case, unless the bypassed steps are later filled with, real solution will not be obtainable.
- (5) The role of scenario-making and its official publication as public goods is continuously important under the circumstances where the government role is decisively large, but is evolving such as in the transition process. In some cases, the scenario can play a role of public goods, even if only the component relating to the goal is published. The external effect ranges over both domestic and foreign aspects.  
Today, the external effect in the foreign aspect seems very important, particularly for Viet Nam.



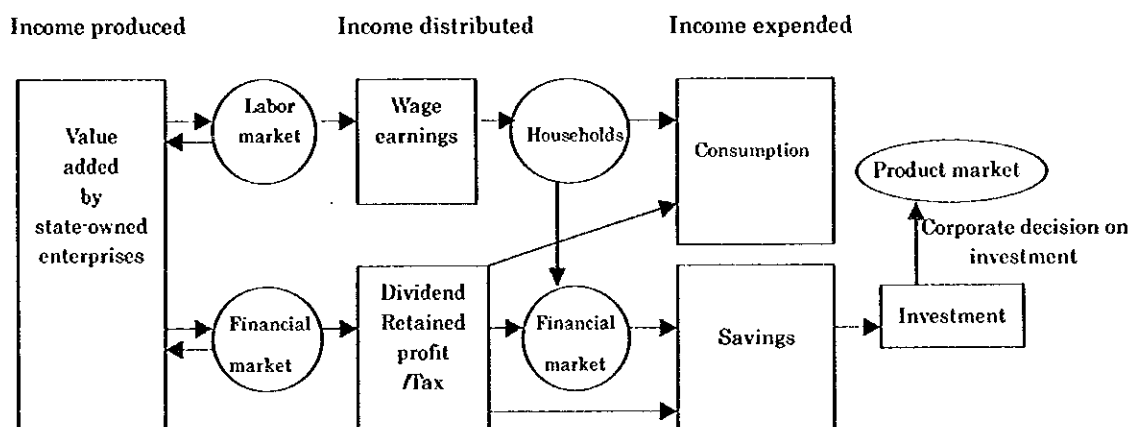
Fig. 2

# China: Changes in the Pattern of the Flow of Funds for Capital Accumulation From Planned Economy to Market Economy Period

## (1) Centralized planning economy



## (2) Decentralized market economy

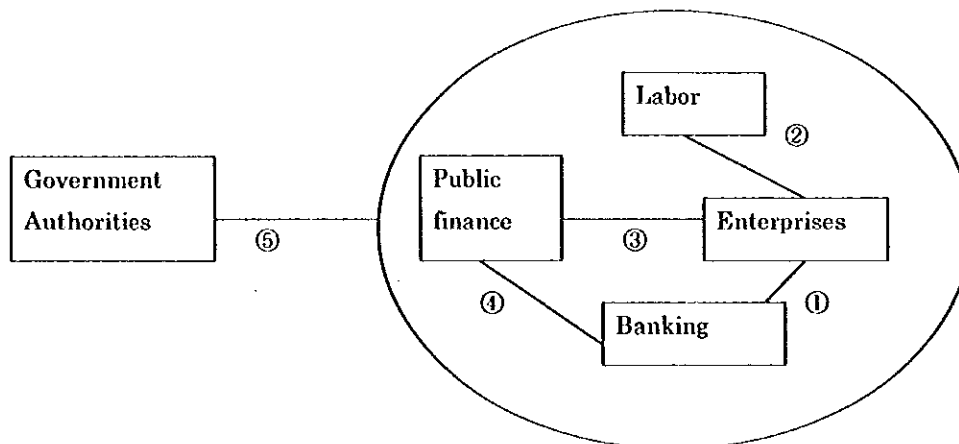


Note: This flow chart omits the "product market", to avoid complexity. The reason is that this chart relates to the income flow but does not take into consideration the material flow. Important segments in the omitted material flow include (1) acquisition of producer's and capital goods, (2) production, and (3) sale of products, which are conducted in parallel with the formation of income produced. In planned economy, these are all carried out by production or distribution enterprises under the government's mandatory planning. Under the market economy system, these enterprises carry them out by themselves in accordance with their own decision.

Source: Shigeru Ishikawa, "Economic Reform in Three Indo-Chinese Countries", in International Financial Information Center, *The Present Status of and Outlooks for the Vietnamese / Laotian / Cambodian Politics and Economy*, Chapter 1, Aug., 1992. (in Japanese)

Fig. 2

**Non-market type interdependence among principal economic entities  
in the Chinese economy**

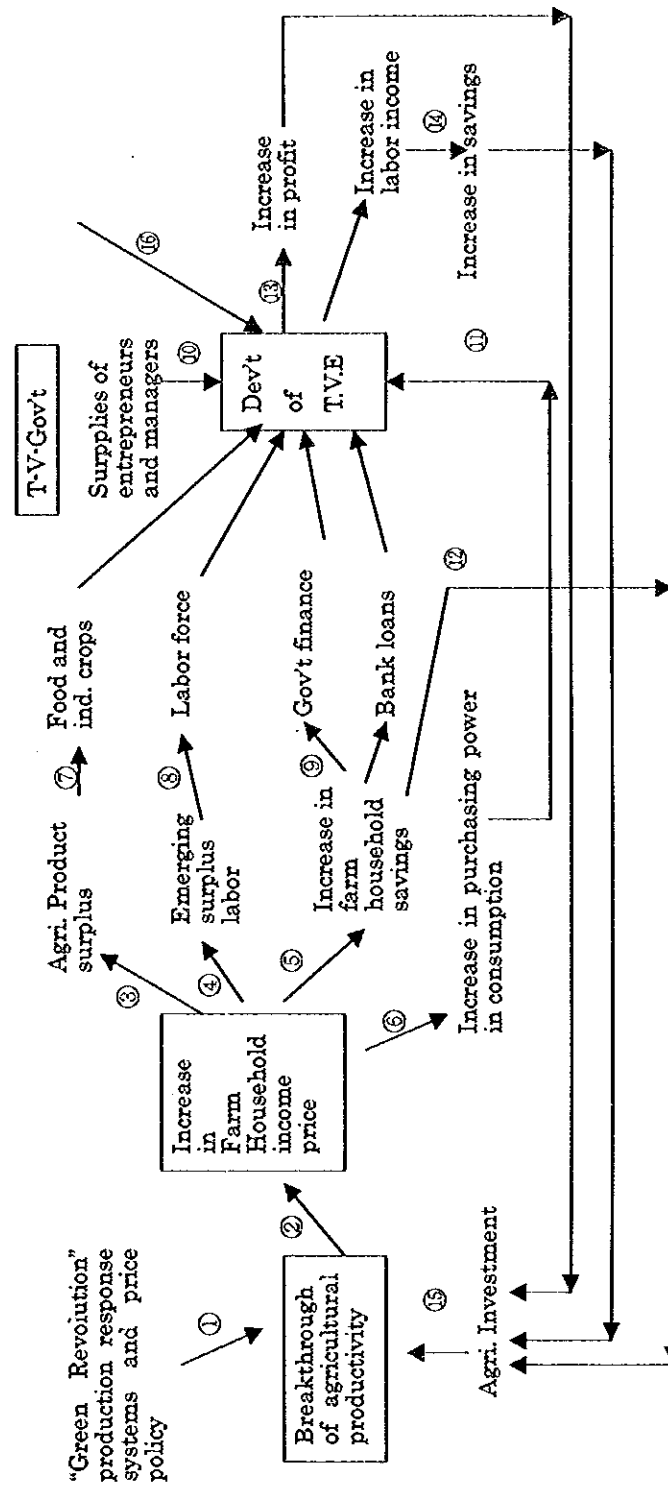


**Remarks:**

1. Among the economic entities within the large circle, there are both economic and noneconomic relations of interdependence. The economic interdependence can be captured in terms of the flow of funds. If the economy is of a well-developed market economy, such flow of funds could bring about equilibrium interrelationships among these entities.
2. However, in China's economy where the market economy is yet underdeveloped and a number of customary elements as well as planned economy practices remain in operation, noneconomic interdependence tends to work significantly distorting the possible equilibrium state of the flows of funds among the entities.
3. Some aspects of such non-market type interdependence are indicated in the figure by arrows: ① indicates possibility of large accumulation of "bad debt" to the banks by enterprises, due to the prevalence of "Soft budget constraints". ② indicates the relations where enterprises bear the burden of social security benefiting labor, and hence families. ③ indicates the frequent cases where the government compulsorily collect whatever the surpluses enterprises earned. ④ the larger portion of total bank loans is policy loans with the non-repayment or default ratio very high. ⑤ indicate that behind the interrelations ①~④, there is a relation of "absolute rule" by the government over the enterprises and banks, the line ministries and the local level governments often consider the persistence of these interrelations as their interests.

Fig. 3

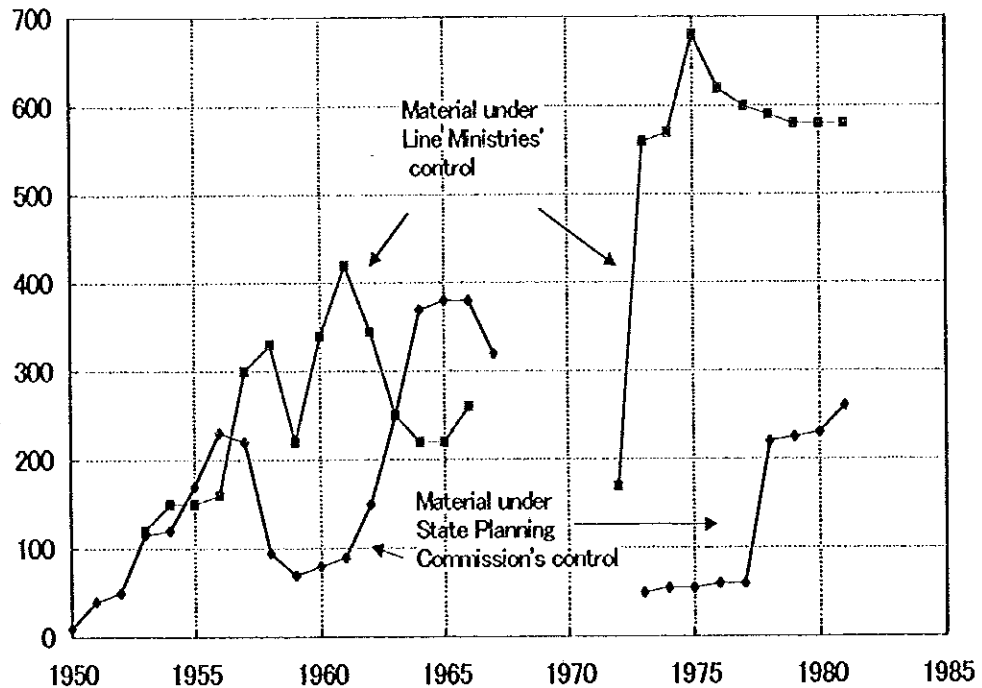
China: "Breakthrough" of agricultural productivity and industrialization:  
A causality map of the case of Southern Jiangsu Province



Source: Viet Nam Ministry of Planning and Investment and Japan International Cooperation Agency, *The Economic Development Policy in the Transition Toward a Market-Oriented Economy in the Socialist Republic of Viet Nam, Phase I Final Report*, August 1998, Vol.1 General Comments, P38.

Fig.4

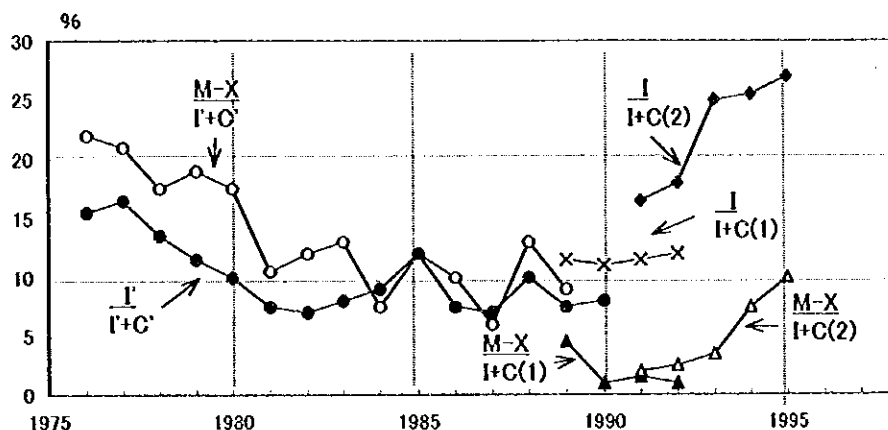
Items of "Goods under Unified (or State Planning Commission's) Control" and  
"Line Ministry-Controlled Goods" in Number: 1950-1981



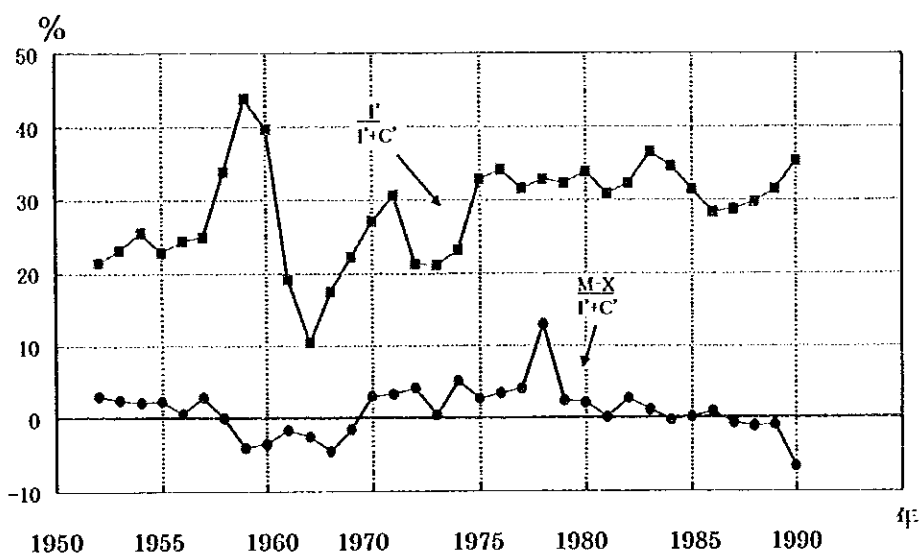
Sources : "Chinese Enterprise Management Encyclopedia", Enterprise Management Publishing Co., 1984. "China's Economic Management of the Present", 3rd Ed., (in Chinese), Chinese Economic Science Publishing Co., 1985, P. 291.

Fig. 5 Changes in the domestic investment and its relationship with the foreign savings:  
Viet Nam and China

A. Viet Nam: 1976-1995



B. China : 1952-1985



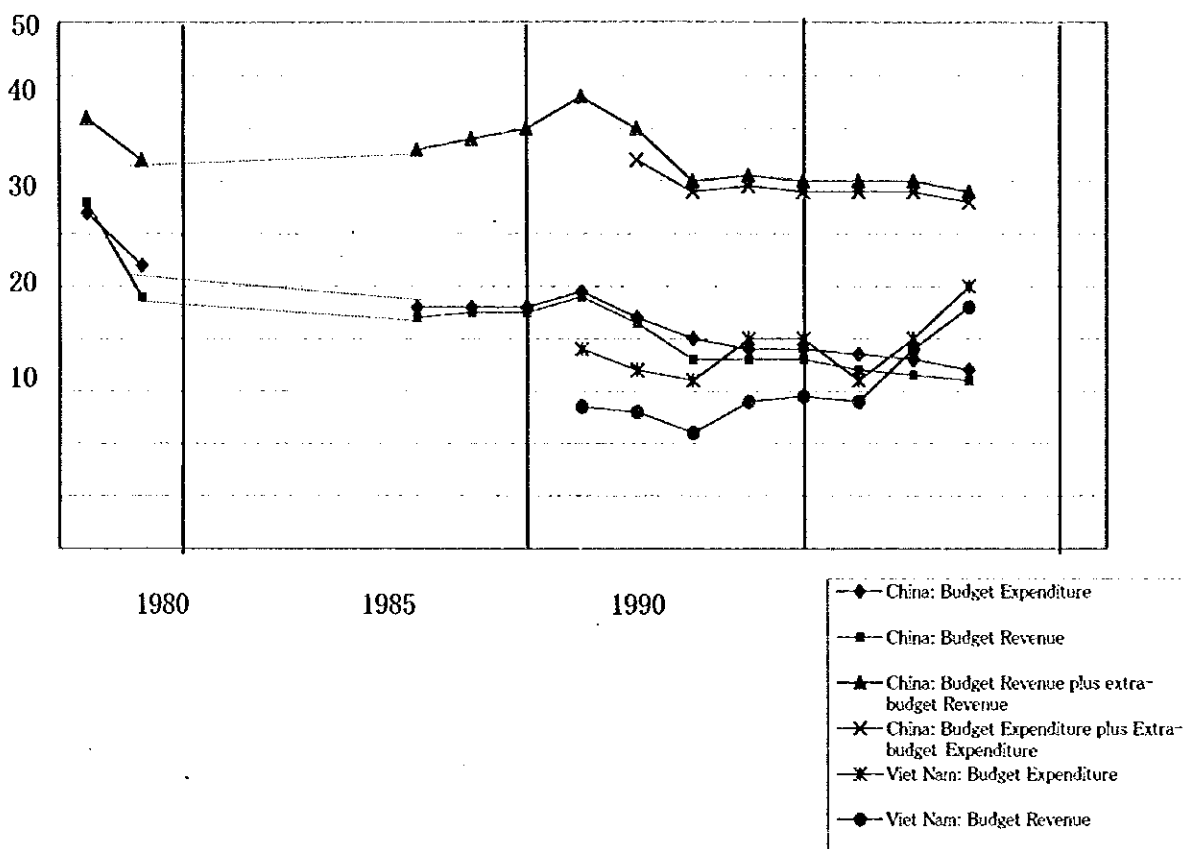
Sources : A :For1976-90, General Statistical Office, *Economy and Finance of Viet Nam 1986-1990, Hanoi*,  
For 1989-95, IMF, Viet Nam, Recent Economic Developments, 1994 and 96.

B: State Statistical Bureau, *Chinese Statistical Yearbook*, various years.

Remarks :  $(I+C)$  stands for the concept of "Available National Income in the Socialist Country's concept.  $(I+C)$  stands for Gross Domestic Expenditure, or Aggregate Demand.  $(M-X)$  is the balance of import and export trade, assumed to be measured in the same scope in the Social Country method and the SNA. This is called in the title as foreign savings. As  $Y=C+I-(M-X)$ , the distance between line  $I/I+C$  and line  $M-X/I+C$  is equivalent to  $S/I+C$ . When  $M-X/I+C$  is located above  $I/I+C$  as the case in Viet Nam during 1976-85, the distance indicates that Viet Nam was relying on foreign savings not only for total investment but also for part of consumption.

Fig.6

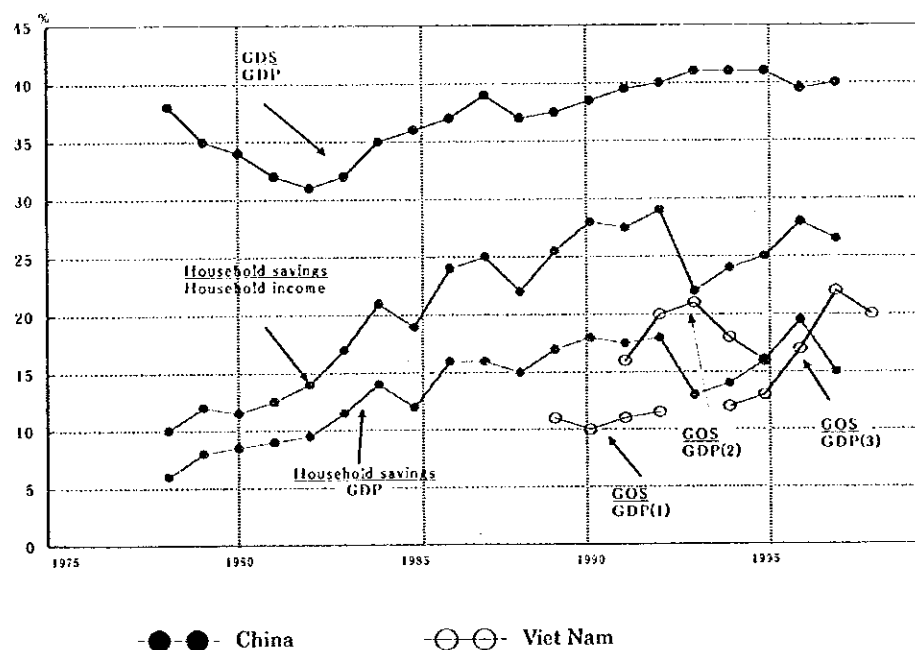
**Viet Nam and China : Overtime changes in the State Budget Revenue and Expenditure in % to GDP**



Source) : China: State Statistical Bureau, *Zhongguo Tongji Nianjian* 1994  
(Chinese Statistical Yearbook 1994)

IMF's Materials : World Bank, *Viet Nam, Public Sector Management and Private Sector Incentives : An Economic Report*, 1994.

Fig 7 : Behaviors of domestic and household savings' ratios : China and Viet Nam



Source : Research Group, Research Department, Chinese People's Bank, "Influences of Chinese People's Savings and Household Savings," *Jingji Yanjiu*, 1955 No.5, and IMF sources for Viet Nam.

Table 1

**Central Committee's Political Report to 8th Party Congress :  
Viet Nam (June, 1996)  
-Reference to Economic System Reform Vision-**

1. Goal of reform
    - a. "Industrialization/modernization"<sup>1</sup> is basically to be realized by the year 2020. (To be made an industrialized country where modern material/technical foundations are established, a rational economic structure is available, and advanced production relations are installed.)
    - b. From now to 2000, continual development efforts are to be directed toward the multi-sectional economy operating along the market mechanism under state control and in the direction of socialism.<sup>2</sup>
  2. Multi-sectional economic development and state enterprises
    - a. Development of multi-sectional economy including the admitted private and state capitalist sectors (the latter sector consists of joint ventures Viet Nam between state capital and domestic/foreign capital).
    - b. State-operated enterprises are 100%-state owned but may be reinforced with non-state owned capital by equitization. But the state is not permitted to loose majority control or allow privatization.
  3. Macro-economic management
    - a. The "subsidies-based bureaucratic, and centralized management mechanism" is to be abolished and replaced by a planning system to give a guidepost to the economic units engaged in market-based activities. State planning must define macro-level targets and decide and guarantee major economic balances.
    - b. The government will carry out direct investments in many fields for developmental orientation.
    - c. Well-prepared systems of many economic laws/regulations are to be developed.
  4. Market creation  
Markets for commodity and service, financing, money, securities, and real estate are to be established, allowing market forces to function harmoniously.
  5. Renewal for finance / banking and price policy<sup>3</sup>.
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(Notes)

1. The goal of "industrialization/modernization" was newly set at a Party Representative Conference in Jan. 1994.
2. At the 6-6 Plenum of Central Committee (Mar. 1989) which further specified the economic policy of the Doi Moi Policy, the goal of this system reform was specified as the "mixed commodity economy operating along the state-controlled market system".
3. At the same Plenum of Central Committee, a central role of this "mixed commodity economy" was placed on switching "administrative pricing system" to the "market-based pricing system."



Table 2 :

## Vietnamese Government's Economic Reform Measures of 1997 and World Bank's CAS

(1) Government Report to the CG Meeting, Tokyo, Dec.1997.(1)	(2) Prime minister's address in National Assembly, Nov.1997(as summarized by WB)	WB, Country Assistance Strategy (1999-2002)
<p>1. Improve the efficiency and competitiveness of the economy as well as individual firms. In the international economic environments where trends for integration and competitiveness are strengthened, this is the most important task. (1) Restructure the industry sector including encouragement of FDI (2) Investment for infrastructure development (3) Create competitive environment (4) Export promotion</p> <p>2. Develop agriculture and rural industrialization (1) Program for promoting commercialization of agricultural products and rural-urban transactions (2) Contribution of resources from state, ODA and rural people for infrastructure construction. (3) Improve the distribution mechanism: develop linkages between State trading units, small traders and farmers. (4) Autonomy of household-based rural economy.</p> <p>3. Promote State enterprise reform and private enterprise.</p> <p>4. Financial, monetary and pricing policies. (1) New policy measures for strict thrift by state, enterprises and people. (2) Develop a system of commercial banks and credit organizations to enable all individuals and firms getting access: flexible interest and exchange rate. (3) External debt management (4) Learn the lessons from the Southeast Asian Crises</p> <p>5. Cultural development, social justice and environmental protection, education and training; employment generation; health care; new civilized life style</p> <p>6. Administrative reform</p>	<p>1. Improving Macroeconomic Stability and Competitiveness</p> <p>2. Strengthening the Financial Sector</p> <p>3. Reforming State Owned Enterprises</p> <p>4. Raise Productivity Through Infrastructure</p> <p>5. Accelerate Rural Development and Increase Environmental Protection</p> <p>6. Invest in People and Promote Social Equity</p> <p>7. Improve Public Administration, Transparency and Participation</p>	<p>1. Improve Macroeconomic Stability and Competitiveness (1) Improve Macroeconomic Stability (2) Enhance Efficiency and Competitiveness of Economy and promote labor-intensive Industrialization</p> <p>2. Strengthen the Financial Sector (1) Strengthen the Financial Sector so that it can play a better role at mobilizing savings and channeling funds efficiently</p> <p>3. Reform State Owned Enterprises (1) Reform the state owned enterprise sector to promote more efficient use of resources</p> <p>4. Raise Productivity Through Infrastructure (1) Transport Infrastructure (2) Energy Sector (3) Urban Development, Industrial Growth, and Environmental Management</p> <p>5. Accelerate Rural Development and Increase Environmental Protection</p> <p>6. Invest People and Promote Social Equity (1) Maintain Viet Nam's competitiveness, and improve the welfare of its people, by investing in a well-educated, healthy workforce (2) Promote Social Equity and Eradicate Hunger and Hard-core Poverty (3) Mitigate the Social Costs of Adjustment</p> <p>7. Improve Public Administration, Transparency and Participation</p>

Note 1. As far as the title of six items of this report is concerned, they are very similar to those of the items of major policies to step up the country's renovation process in a resolution adopted at Viet Nam CC's 8.4 Plenum, Dec.22-29,1997.

**Table 3. Central Comment's Report to 6<sup>th</sup> Party Congress:  
Viet Nam (Dec.1986)**

**1. Basic tasks**

- (i) Since the national unification in 1975, the party led the people of all nation in a new advance toward socialist construction and national defense.

Socialist transformation has achieved a farther progress and the majority of the peasants in the South entered the road of collective production.

- (ii) However, in the past decade, in the reverse side of this achievement, many mistakes were committed. In the field of production investment and other matters of reshuffling the economic structure, we were too hasty to acquire the success without taking into consideration our capability. With regard to the socialist transformation also, there were such impatient attempts as immediately nationalizing the private capitalist sector, with the aim of eliminating the nonsocialist sector soon. The renovation of economic management mechanism achieved progress after 1979 and good results. Yet, the mechanism of bureaucratic centralization of the state subsidy type has not yet basically been eliminated. The mistakes in the price, wages and currency were serious.

- (iii) Beneath all these mistakes, there is a subjective and hasty formation of the guiding principles, with insufficient recognition of the fact that the transition to the socialist society is a long-range historical process. There is also reliance on the outmoded economic management mechanism, coming from the mentality of not willing to recognize the objective law of Commodity production. Renovation of the way of thinking such as these is necessary.

**2. Reform of economic and social policy**

- (i) Reshuffling of production structure and large-scale adjustment of investment structure.

The new Five-year Plan should achieve three biggest targets for getting rid of the economic crisis: Food grains, consumer goods and exports. Commodity economy should be developed, internal and external exchanges be expanded and autarchic ("natural economy") tendencies be overcome.

- (ii) Establishment of socialist production relation.

It is a multi sectoral economy consisting of peti-commodity production, private capitalism and state capitalism.

- (iii) Renovation of the economic management mechanism.

The old mechanism of the bureaucratic centralization and state subsidies pattern should be swept away. Mandatory planning on the basis of administrative means be discontinued.

A new mechanism be built to suits to the objective law and the economic development level. It requires the correct use of commodity and money relations and a unified planning. The state and collective enterprises should have autonomy in production, management and finance. Price formation policy be based on the Law of Value. Wages policy should address the urgent matter of maintaining the real wages of the wage-earners.

Table 4

## China : Vision/Scenario of Changeover to Market Economy and Its Evolution : 1984 ~ 1993

(1) Social market economy decision in Nov., 1993 (14-3 C.C. Plenum)	(2) Economic system reform decision in Oct., 1984 (12-3 C.C. Plenum)	(3) Commune of the 11-3 C.C. Plenum December 1978
<p>The socialist economic system is a system allowing a variety of economic subsystems with the basis placed on the publicly-owned economic system to develop together, where the market plays a basic role of resources allocation based on the state macro-economic coordination.</p> <ol style="list-style-type: none"> <li>1. State owned enterprise management mechanism to be reforms/modern enterprise system to be established.</li> <li>2. Nurturing and enhancing market system               <ul style="list-style-type: none"> <li>Price reform</li> <li>Commodity distribution system</li> <li>Financial market (capital/money)</li> <li>Labor force market</li> <li>Real estate market</li> <li>Information market</li> </ul> </li> <li>3. Macro-economic management               <ul style="list-style-type: none"> <li>Public finance system</li> <li>Financial system</li> <li>Foreign exchange control system</li> <li>Investment system</li> <li>Planning system</li> <li>Township and Village Enterprises</li> </ul> </li> <li>4. Personal income distribution/social security system</li> <li>5. Rural economic system reform               <ul style="list-style-type: none"> <li>"Two-tier" management system</li> <li>Service activities</li> <li>Township/village enterprise</li> </ul> </li> <li>6. External economic system               <ul style="list-style-type: none"> <li>Coastal opening zone</li> <li>External trade system</li> <li>Foreign investment</li> </ul> </li> <li>7. Science and technology system/educational system</li> <li>8. Legal system</li> </ol>	<p>With the principle of combining the basic principles of Marxism with Chinese realities as well as of properly responding to the experiences of present world-over countries including advanced capitalist ones in mind, the basic duty of this reform is to build an active and characteristically Chinese socialist economic system, encouraging the development of social production power.</p> <p>11-3 C.C. Plenum played a historic role such as in getting under control disorders, presenting the reform tasks, and promotion of rural reform, while 12-3 C.C. Plenum should fulfill its responsibility such as for drawing overall reform blueprints, accelerating reform paces, and carrying out reform of the economic system as a whole with emphasis on urban area.</p> <ol style="list-style-type: none"> <li>1. Enterprise vitality to be enhanced               <ul style="list-style-type: none"> <li>The relation between state and an enterprise (to become juridical corporation having certain rights/responsibilities as a socialist commodity producer and business owner independently managed at his or her own responsibility for profits/losses under state plan/control) as well as an enterprise and workers to be corrected.</li> </ul> </li> <li>2. The socialistic planned system relates to a planned commodity economy on the basis of the integration between commodity economy and planned one.               <ul style="list-style-type: none"> <li>The commodity economy is yet underdeveloped, requiring commodity production/exchange to be expanded. But in China, labor force is not a commodity and state-owned firms, resources, etc. are also not commodities. Any plan must be approximate and flexible. Mandatory plans are to be downsized and other areas should be either subjected to guidance oriented or entirely left up to the market mechanism.</li> </ul> </li> <li>3. Non rational pricing system to be corrected               <ul style="list-style-type: none"> <li>Financial system to be reformed so that it can help adjust macro-economy.</li> <li>Price control system to be reformed.</li> <li>Tax system to be improved.</li> </ul> </li> <li>4. Governmental economic control organization               <ul style="list-style-type: none"> <li>Strategies/plans/policies for uplevelling economy and society to be developed. Resources development and regional/sectorial development plans to be established, major projects, especially, of energy/transportation/materials industry, to be properly located, economic laws/regulations to be better-installed, etc.</li> </ul> </li> <li>5. Multilateral economic sub-systems to be developed for wider internal/external economic and technology exchange.</li> </ol>	<p>Priority of all party activities should be shifted after 1979 to the construction of socialist modernization.</p> <p>Mao Zedong instructed, after basic completion of "socialist transformation, to shift the center of the party activities to economic and technology reform. While a huge amount of work was done in this line with important results, the work was interrupted and destroyed by Lin Biao and the Gang of the Four. At present the mass campaign for revealing the criminal acts of Lin Biao and the Gang of the Four gained basic victory. The conditions to restart the construction of socialist modernization has thus been established.</p> <ol style="list-style-type: none"> <li>(i) The goal of socialist modernization is to realize the initiatives of the 3 year and 8 year plans and 23 year vision, and to complete the Four modernization in Agriculture, Industry, National Defense and Science and Technology. For modernization, a big advance is required and those production relations and upper structure which do not accommodate to this goal should be altered.</li> <li>(ii) Serious defects of China's economic management regime are excessive centralization of decision making power. Boldly decentralize the powers to local governments and enterprises, which, in turn, should have more autonomy.</li> <li>(iii) Agricultural production should be recovered soon from the destruction incurred in the part few years. The ownership right and autonomy held by the People's Communes, Production Brigades and Production Teams be protected by Laws. As regards the government purchase of food grains, official quotas should not be broken and the unified purchase price of grains should be increased by 20% and that of grains sold to the state beyond the quota be rewarded by the price 50% higher than otherwise.</li> </ol>

Table 5

**Long-Term Changes in Per-Capita National Income:  
A comparison of Viet Nam, China and other Asian Countries**

	Per-Capita Income (\$) in Early 1950s (EACAFE)	Per-Capita GNP (\$) in 1992
Viet Nam	117(1954)	150
The Philippines	73(1954)	770
Thailand	108(1952)	1,840
Indonesia	88(1952)	670
Japan	193(1954)	28,190
China	79(1957)	470

Sources: JICA ed., *Country Study for Japan's Official Development Assistance to the Socialist Republic of Viet Nam*, March 1995. China's numbers are added, taken from Ishikawa's paper published in J.N. Bhagwati, *Economics and World Order*, Macmillan, 1972, and World Bank, *World Development Report 1994*, as in other figures for 1992.

Notes: In the original table in JICA ed.(1995) the following note is attached. "Price indices for U.S. producer and consumer goods climbed approximately fourfold in the period from 1950 to 1990. Based on comparable adjustments for inflation, Viet Nam's per-capita GDP in 1992 measured only one-third its level in 1954."

For China, the figures shown in the table indicate roughly 6 times increase in per capita incomes. My estimate of China's national income suggests 4% annual growth rate of per capita income during 1952-80. My paper in *The China Quarterly*, June 1983

Table 6

**China: Share of State-Operated Enterprise Income Allocated to State,  
Enterprise, and Workers<sup>1</sup>**

	1978		1984		1989	
	100 million yuan	(%)	100 million yuan	(%)	100 million yuan	(%)
Net enterprise income	906.4	100	1354.2	100	2591.6	100
Share of income to state	703.1	77.6	860.5	63.5	1308.9	50.5
Tax included in the above	265.8	29.3	410.9	30.3	970.5	37.4
Profit-contributions	437.3	48.2	406.4	30.0	259.3	10.0
Other Charges <sup>2</sup>			43.2	3.2	79.1	3.1
Share of income to enterprise <sup>4</sup>	22.1	2.4	116.3	8.6	377.4	14.6
Profit reserve included in the above	7.8	0.9	64.0	4.7	198.1	7.6
"Repayment of loans before tax" <sup>3</sup>	14.3	1.6	52.3	3.9	179.3	6.9
Share of allocation to workers	181.2	20.0	386.4	28.5	905.3	34.9
Wages included in the above	155.0	17.1	299.6	22.1	670.0	25.9
Insurance/welfare	26.2	2.9	86.7	6.4	235.3	9.1

(Materials) Ho Ping, Nie Ming-Juan, "State-Operated Enterprise Income Distribution State and Measures Study", in *Jingji Yanjiu* ("Economic Studies"), 1992 (in Chinese), No. 3

- (Notes) 1. Statistical values here correspond to final distribution income according to *Table 7* concept.
2. To be collected from retained enterprise profit after tax. Contribution to a "fund for priority construction of energy and transport project" and a "budget regulation fund."
3. A kind of tax concession.
4. The breakdown of this item shows how final distribution income has been allocated among various uses but not distribution results of accrued income. Particularly, "repayment of loans before tax" is not a concept in terms of national income account but in terms of asset-liability account.

Table 7

## China: GNP Distribution to Government/Enterprise/Household

- % -

	1979		1984		1988	
	Primary distribution	Final distribution	Primary distribution	Final distribution	Primary distribution	Final distribution
GNP (100 million yuan)	4,364		7,953		16,382	
Government	12.2	23.5	11.9	15.5	11.4	11.7
Enterprise <sup>1</sup>	37.1	12.1	31.2	11.4	27.3	10.8
Household	50.8	64.4	56.9	73.1	61.3	77.5
Contents of the above <sup>2</sup>						
Rural residents	33.8	n.a.	39.0	n.a.	29.8	n.a.
City residents	13.8	n.a.	11.8	n.a.	12.1	n.a.
Others	3.8	n.a.	6.2	n.a.	19.3	n.a.

(Materials) Guo Shunging, Han Wenxin, "*Distribution and Expenditure of China's GNP*", the People's University of China Press, 1991(in Chinese), pp. 75, 77, 79, 98, 99.

- (Notes)
1. The figures in this line were derived as the difference between GNP and the government and household distribution income.
  2. This section is tentatively estimated. The rural residents' income is obtained by multiplying national sample-surveyed value of per farmer cash income with the size of farming population. The figures not covered by the above two items are given as "others".