PROCEEDINGS OF THE INTERNATIONAL WORKSHOP ON VIETNAMESE ECONOMIC DEVELOPMENT

March 22 - 23, 1998
Tokyo, Japan

May 1998

Japan International Cooperation Agency (JICA)

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Part I

Short Notes for Presentations

The International Workshop on Vietnamese Economic Development
Introductory Remarks

Shigeru Ishikawa

1. Welcome all the participants coming from the World Bank, IMF, UNDP, ADB, both sides of the VJS Team and also from various Japanese organizations.

2. As an organizer of this Workshop, a few remarks are in order about the fact that the idea of holding this Workshop was initially proposed during our meeting with the representative of the World Bank in Hanoi early last year, but actual holding has been delayed until today. It was thought useful at that time that in this workshop each side would present its main methodologies for, and the results of, the analyses on the economic and financial issues of the Vietnamese economy and main policy suggestions derived from these studies. In the discussions that would follow, we thought it fortunate if each side could identify in other side's study those complementary areas and aspects which were not emphasized in its own studies. (As all the groups agreed on the desirable goal of Vietnamese economic reform which are marketization and liberalization of the economy and trade, focusing the discussion too much on the differences in policy suggestions among them would not be productive and even not useful.)

Meanwhile, IMF in Hanoi agreed on the desirability of holding such workshop. MPI also joined this agreement, and promised to send the delegation.

<u>Assigned task of the Vietnamese-Japanese Study Project</u>

3. Now the task assigned to me here is to present a summary of what we, the Japanese side of the VJS Team did in this project in terms of the methodologies and the results of the studies and policy suggestions. With regard to the history of the VJS project, I surmise all participants are aware of it. Preface to the Executive Summary Report (Phase 2) described it, in

any case. With regard to the organizational aspect, I mention herewith two points only:

(1) The project started in August 1995 with the assigned task of presenting our opinions on the draft Five-Year Plan of Viet Nam (1996-2000) in the project's first year (Phase 1). It proceeded in the succeeding years (Phase 2) with the new task of watching the implementation of the plan and making advises on any new economic issue the Vietnamese economy would face. Phase 2 ended formally in February this year. The VJS Team continues informally to exist and sometimes organize *ad hoc* study projects on specific topic (e.g. an East Asian financial turmoil project currently in progress).

(2) The studies for meeting these assigned tasks are conducted as a principle jointly by the VJS Team. This Team consists of the research groups on both sides. On the Japanese side, some twenty academics constitute the group, each belonging to one of the four sub-groups on (I) agriculture and rural development, (ii) foreign trade and industrial policies, (iii) public finance, money and banking, and (iv) SOE reforms. On the Viet Nam side, there are counterpart members and groups. Members are from the MPI staff. We have had continuous exchange of views with the Viet Nam side on the individual, sub-group and all-member workshop bases.

Research stance and our development experiences

4. Turning to the contents of the studies, I wish to refer to the basic stance of our studies on Vietnamese economic development and its policies. In the JICA's report: *Country Study for Japan's ODA to Vie Nam* (March 1995), which is the *de fact* predecessor of this VJS project, it was described explicitly.

(1) Viet Nam is not only a "transitory economy" with the task of transforming the planned socialist system into the market economy system, but also a "developing economy" with the task of transforming the underdeveloped market economy system into the fuller developed one. In this sense, Viet Nam is similar to China

and differs from the Eastern European countries.

(2) Official goal of Vie Nam's economic reform is announced as "market economy under the state control, which is similar to China's goal of "market economy under socialism." In our study, we do not concern about the word "state control" or "socialism" considering that its addition is made with political consideration, no significance in economic analysis.

(3) As a policy prescription for realizing the tasks of economic development, the specific measures for raising and fostering market economy-type organizations, institutions, technologies, productive facilities and even ideologies should be worked out. Issuance of orders eliminating socialist systems and introducing market economy rules would not by themselves automatically create the workable system of the market economy. Economic development also requires productive force development starting from a significant productivity increase in agriculture, if the country is in the early industrialization stage. And this also would not be brought about simply with the market force.

5. If in this stance there is something special and unique, that is due to the priority of the empirical studies on the developing economies which our development experiences on both prewar and post-war Japan and contemporary East Asian countries induce us to place. These experiences are indicated below, and, in sum, characterized as those of the "late-comer" countries or "late late-comer" countries which accomplished "take off" after WW1 or WW2. Their experiences should be different from those of the countries in Europe and America which completed industrialization before WW1, in that the market economy framework was underdeveloped and the capital accumulation for industrialization lagging.

6. (Short note) In terms of the relevance to the contemporary developing countries probably most popular Japanese experience is the government industrial policy of a "picking the winners" style and with the use of "directed credit." This was the experience of the immediate post WW2 period and in the 1960's, where economic recovery from the war damage and the technology catching up were the major challenge. Equally important but not publicized is the government measures to facilitate the affiliation with the international economic organizations (including promotion of the status in it) in the way that

was not harmful to its own industrial progress, *e.g.* in the affiliation to GATT and in the promotion to the article 8 country status in the IMF. About these experience there are a large number of references. (In connection with this project, Ishikawa's paper presented at Tokyo Workshop, March 22 1997 may be referred.) Next, for the large number of the earlier stage developing countries, the experiences of the prewar Japan are more useful. Two points may be mentioned: One, growth of productivity in agriculture, supported by both technology innovation and rural community solidarity played a fundamental role in enabling industrialization. Second, the pattern of product and technology choice in the modern manufacturing sector was quite often characterized by preference for the products of a lower quality but with cheaper costs and prices than the standard importables or for simply native consumer goods. Shielded by such strategies (not by the protective tariff), Japanese manufacturing acquired a time span in which technology and capital accumulation was made possible.

As for the application of the lessons of these experiences to the contemporary economic development and the combination of these and East Asian experiences, references are made for my three works: (I) *Economic Development in Asian Perspective*, Kinokuniya Co., 1960, (ii) *Labor Absorption in Asian Agriculture*, An Issues Paper, ILO-ARTEP, June 1978, and (iii) "Appropriate Technologies: Some Aspects of Japanese Experience," in Austin Robinson (ed.) *Appropriate Technologies for Third World Development*, Macmillan, 1979.

On the other hand, the above stance requires us to study the economic issues of individual developing countries inductively and using the experiences or intensive survey methods mostly on the microscopic basis. This is somewhat different from the research method which is often used in the "early comer" countries, and which tends to rely upon the application of the theories developed there and taken for granted the matured market economy.

Comment on the early draft FYP

7. Upon reflection, this stance and our characteristic approach seems well reflected on our opinions on the early draft Five Year Plan (1996-2000) which were shown to us in the summer of 1995. They are on four points:

(1) Domestic savings ratio shown in the Plan is only a little above the 10% line during 1990-1993. When the fixed capital depreciation ratio is deducted, the net ratio was probably close to zero. To raise this ratio substantially should be the first priority goal of the FYP, outweighing anything else. This is especially so, as there is a huge amount of external debt.

(2) In the light of this, the planned rate of growth of GDP is deemed too ambitious. The desire to achieve high growth should be refrained for the time being.

(3) The starting point of long-term development is the "breakthrough" in agricultural productivity and the resulting considerable increase in per capita farm income. The road to rural industrialization is thereby opened. Even in Southern Viet Nam which was a major rice producing region for exports in prewar years, population pressure is so large that the above is the only way for agricultural progress.

(4) Industrialization might rely at least for the time being on the recognition of small-and-medium-sized enterprises with intermediate or native technologies, rather than on the large-scale enterprises with state of the art technologies and equipment.

8. The empirical studies of various economic issues of FYP formulation were done, together with the policy suggestions, mainly in the four sub-groups. In Phase 2, the sub-group studies continued similarly. These are, however, to be taken up for summary and discussions in the sessions that follow.

<u>Issues of trade liberalization</u>

9. However, this introduction should deal with the issue of trade liberalization, which has arisen by Viet Nam's participation in ASEAN Free Trade Area (AFTA) in December 1995, but which was made a central concern of the government only from the early 1997. Since the request to us to take up the study on the AFTA rules and the effects of Viet Nam's

adherence to it upon the Vietnamese foreign trade and industry came after the period when the Phase 2 research stet-up had been established and well under way, the study was conducted on the *ad hoc* basis by the overall research leader. Similarly, when the currency and financial crises of Thailand arose in April 1997 and spread in a number of other countries in East Asia, the Viet nam government required us to do a study with the particular reference to its possible impact upon Vietnamese economy. We have accepted the request and organized an *ad hoc* study team to deal with it.

10. With regard to the financial turmoil issue, we shall have a chance to discuss it by devoting a special session. Regarding the financial crises issue, the results of our study were incorporated in ESR, using large space of Part 1. Main points are as follows:

(1) The basic principle of the AFTA agreement is to achieve nearly complete trade liberalization among the member countries by the early 21st century (2003; for Viet Nam 2006). Tariff reduction in principle started from the first year of AFTA. As for those products which are temporarily exempted from tariffs, they are incorporated into the tariff reduction scheme between 1999 and 2003 in five equal installments. Viet Nam's import trade was protected mainly by the state monopoly trade and other NTBs, while the tariff rates, dispersing between 0 and 60% (on average 17%), were determined with the aim of increasing tariff revenue. There were no motives of "infant industry protection." In the list of tariff reduction which the government of Viet Nam presented to AFTA secretariat at the end of 1995, the average tariff rate of total 857 product lines in 1996 was indicated as 0.88%. This rate remained unchanged by 2003. This was a reflection of the above tariff policy. In other words, for Viet Nam where industrialization was yet in a very early stage, no industry had yet emerged as one to be protected. Therefore, the issue the AFTA participation is offering to Viet Nam is whether or how the AFTA participation will affect the attempt of Viet Nam to start up her industrialization.

(2) Priorly to considering this problem, there are a few points to be clarified. As one of them, we have to predict how the present

proportions of total import trade which were occupied by the AFTA countries and industrial countries, respectively, as import sources (presently the proportion of the AFTA countries being 26%) will change. Investigation of this question requires knowledge of the present state of comparative production costs of imports from the AFTA countries against imports from industrial countries; and the direction of their possible changes by the early 21st century. Moreover, we have to know various conditions of Vietnamese trade with non-AFTA countries in the forthcoming years. This will be determined significantly by the results of negotiation with WTO relating to Viet Nam's application for affiliation to it. Probably, even with regard to the trade with non-AFTA countries, the trend toward trade liberalization would be strengthened as compared to the present.

(3) Assuming that the constraints from AFTA will prevail over all the foreign trade of Viet Nam, we have to remember that the effects of AFTA participation upon Vietnamese trade are double-edged, both favorable and unfavorable. Favorable effects will come from the possibilities in which trade liberalization would bring competition and disciplines to domestic industry and thereby select inefficient industries and enterprises. Unfavorable effects will be the abandoning of the policy option to take "infant industry protection" for the starting up of Vietnamese industrialization, the protection which many late-comer industrial countries, like Malaysia and Thailand, enjoyed until recently. By the year 2006, however, Viet Nam possesses a short time period to exercise this option.

(4) Policy implications: Firstly, the government may make a comprehensive survey on the present and prospective industries and classify them into three categories: (a) those industries which possess international competitiveness even at present, (b) those industries which could acquire it if infant industry protection is provided before 2006, and (c) those industries which could not become self-sustainable by 2006 even with such protection. Available resources for industrialization should be allocated concentrating to the industries (a) and (b). Utmost efforts should be paid for conducting these surveys. Secondly, there may be an

option to initiate international negotiation in pursuit of the postponement of the target year 2006. However, in order for the negotiation to become effective, Viet Nam should draw up convincing scenarios of raising the self-sustainable industries until the postponed target year.

Challenge of internationalization

11. In the past two and a half years, Viet Nam was able to design her medium- and long-term development plan on the basis of the accomplishment of economic restoration from the war-time destruction and dislocation. But soon after the passing through of the new Five-Year Plan (1996-2000) at the Eighth Party Congress, Viet Nam had to face a set of new challenges of opening up the so far closed national economy toward the world economy. The first set came as an international obligation for trade liberalization in the form committed in AFTA. The successive sets for trade liberalization would emerge in connection with the APEC and WTO to which Viet Nam has already applied for affiliation. The next step may come in the form of the external pressure for capital-account liberalization, sooner or later.

One has to remember that it is for the first time in recent economic history that the country which has not yet completed even the starting phase of industrialization nor the financial sector modernization in the elementary sense, are encountering exogenous pressures for trade and even capital liberalization.

Moreover, for Viet Nam these challenges have emerged amidst the period in which, due to the current financial turmoil in East Asia, the structure of international competitiveness in trade and investment among the neighboring countries has been changing dramatically and the future prospects are by no means certain.

These are very important long-term issues which this workshop may be able to take up very timely

Future cooperation among the participating organizations

12. Final remarks on the desirability to continue this kind of international cooperation about the Viet Nam study.

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NEW ECONOMIC POLICIES AND ISSUES RAISED FOR FURTHER STUDY:

NEW MEASURES SEARCHED UNDER THE CONDITIONS OF CURRENCY CRISIS IN EAST ASIA

Ph.D. Nguyen Quang Thai
Research Team Leader

1. Paralleled with its known achievements, Vietnam is also facing new challenges. Further pursuing its renovation under the conditions of harmonization into the world economy, Vietnam has to be consistent with its selected path and promote more strongly its renewal.

Based on studying policies formulated by internal and external consultants, the leadership of Vietnam has come up with new economic policies which are reflected in the Resolution of the 4th Conference of Central Party Executing Committee (the 8th Congress).

2. The most highlighting features of this Resolutions are:
To be consistent with renovation path, bring into full play internal resources, use efficiently internationally assisted resources, improve the competitiveness of the economy under the new conditions, maintain and improve macro economic stability in a bid to successfully the planned development objectives. Some key advocacy in macro economic area are as follows:

a. Adjustment of economic and investment structure in order to improve efficiency and competitiveness of the economy: the adjustment must be done in both sectoral and regional master plan and investment structure for better efficiency.

b. Adjustment of agricultural and rural development structure; poverty alleviation.

c. Adjustment of financial and banking relations for maintaining macro economic stability.

d. State owned enterprise reform.

Based on this Resolution, the Government has taken a series of new measures and policies in order to translate the Resolution into practice, and has strongly reformed its steering activities for organizing the implementation of the Resolution.

Some new advocacy and policies can be summarized as follows:

a. Concerning investment structural adjustment, the Government has provided guidance for reviewing master plans and implementation progress of investment projects at all levels. At the central level, efforts are made for speeding up implementation progress of some large scale investment projects - especially loan funded projects - in order to ensure their completion on schedule. At the same time, some other large investment projects like North-South highway project are adjusted, halted, delayed or rescheduled. In addition, favorable conditions are created for complete investment in small and medium projects, transferring advanced technology which can be applied quickly to production thus contributing to improvement of competitiveness of Vietnam's goods and services in domestic and international markets.
The government also issued new decrees on foreign investment, reorganization of ODA management system for higher efficiency and has been submitting the law (amended) on encouraging domestic investment to National Assembly for consideration with an aim of creating new investment opportunities for all domestic and foreign economic sectors.

b. In the area of agriculture and rural development, the Government has taken measures on mechanism, policy and investment for facilitating more comprehensive and efficient agricultural development in a close relation with rural credit programs, poverty alleviation, afforestation... The Government also took new measures on procurement and import and export, thus facilitating agricultural products sold at reasonable price.

c. In the area of budget revenues and expenditures, the Government has prepared for the expedition of new laws in a more equitable manner and has also taken various measures for encouraging export (tax reduction, permitting domestic and foreign private sectors to take part in export) and reducing import (especially through commercial credit system)...

d. In the area of state owned enterprise reform, the Government has been applying measures for improving SOE's performance efficiency by equitizing a part of SOEs, thus enabling economic activities more efficient and consistent with international commitments.

Under the common difficult conditions, the new Government of Vietnam has been very active in instructing concerned agencies and localities to have measures taken in a good manner for further economic development with efficiency and sustainability, creating a springboard for more rapid development in the coming years. In 1997, the economy recorded a growth rate of about 9% (the non-cross-check figure is 8.8%), of which growth rate in agriculture, industry and service is 4.7%, 13.7% and 8.7% respectively, which shows the economy still continues growing relatively well despite certain difficulties.

Although in 1998, there are still more difficulties, especially under the impacts of the regional currency crisis, Vietnam's economy still has potential for fairy good growth rate.

Some implications by the financial crisis in the region to Vietnam and current measures taken can be summarized as follows:

a. With regards to import and export:

- export value declined by 5%, equivalent to over US$400 of which export value of rice decreased by US$100, although the volume of rubber, coffee, crude oil...export is greater (US$40/ton)
- Although imports price has been declined after exchange rate was adjusted, difficulties have been arisen.

In order to overcome these difficulties, the Government has taken urgent measures for encouraging export and fighting against commercial frauds and smuggling.

b. Financial situation and exchange rate have had impacts on the overall balance of the economy.

- Pressure for adjusting exchange rate closer to purchasing power and foreign exchange rate supply and demand has resulted in two times adjustment of transaction and official exchange rate range to 10% and 6% respectively. To date, the exchange rate is VND 13,000 against

USD 1, closely following conditions in the market.

- Budget revenues meet with difficulties with a decline in import and export earnings. Exchange the adjustment in some other countries, like South Korea, has also resulted in a decline in revenues from ODA. The Government has taken some measures on expenditure reduction in order to ensure budget deficit of more or less 4% of GDP.

c. Some difficulties arisen in investment.

- Investment from state budget: due to a decline in domestic revenues, the Government has to control more strictly capital allocation for focusing on important projects with possibility of quick investment returns.
- ODA investment is promoted for better fulfilling commitments.
- FDI investment has been threatened to a decline, and therefore it has been encouraged by new and more flexible policies.

d. Reform of SOEs will be proceeded in a quicker manner because number of loss making enterprises have been increasing due to widespread difficulties including exchange rate adjustment which results in difficulties in debt service and an increase in input price leading to difficulties in selling products.

The Government and National Assembly have also further promoted administrative reform with the promulgation of regulations on state servants and anti corruption...

We hope to have your constructive comments.

STRUCTURAL CHALLENGES FACING VIETNAM[1]

Andrew Steer
Director, World Bank in Vietnam

This note briefly summarizes recent developments and current challenges, and suggests broad areas to reform. It is based upon the findings of an economic team, comprising economists for the World Bank offices in Hanoi and Washington.

I. Recent Macroeconomic and Structural Developments

While data on economic performance suggest that inflation has remained low in recent months, and that agricultural and industrial production has been quite robust, there are significant external and internal risk factors that could lead to a significant slowdown in economic growth and disrupt Vietnam's hard-won gains on macroeconomic stability. The main factors threatening Vietnam's growth performance and macroeconomic stability are:

- *Impact of the financial crisis in Southeast Asia.* While Vietnam to-date has remained somewhat insulated from the initial impact of the crisis, the slowdown in economic growth in the region and the improved competitiveness of neighboring economies is likely to put pressures on the Vietnamese economy.

  ⇒ *Both export prices and export demand are likely to weaken.* Preliminary estimates suggest that the decline in the prices of Vietnam's major export commodities during 1997 would have had a significant impact on export revenues. (Some indication of the impact of price changes can be gained by valuing Vietnam's 1997 export volumes by 1996 prices, which yields a total revenue some $250 million below the actual 1997 figures.) While prices of some primary commodities have revived somewhat recently, prices are likely to remain weak. Recent gains in the price of rice, for instance, will likely be more than offset by declines in crude oil prices. Prices of imported textiles and garments from Asia into Europe, Japan and the United States have also declined in recent months. Import demand in Asia economies is also declining as their adjustment programs are beginning to impact on their growth rates.

  ⇒ *Foreign direct investment inflows into Vietnam are also likely to slow.* While implementation of FDI projects was higher in 1997 than 1996, FDI approvals were lower. With the exception of a major tourism project recently approved in Dalat, FDI approvals were also very limited in January and February 1998. And in the first two months of 1998, FDI implementation was only US$ 1.5 billion on an annualized basis--a sharp drop from US$2.1 billion in 1997.

[1] *This informal paper was prepared for the International Workshop on Vietnam Economic Development, Tokyo, 22-23 March 1998.*

⇒ *Declines in international competitiveness are likely to erode performance of export and import substituting activities.* While the real effective exchange rates (REER) for some of Vietnam's main regional competitors have fallen considerably, Vietnam's REER has appreciated. As at the beginning of 1998 The REERs for Indonesia, Malaysia Thailand and the Philippines had depreciated by 40%, 22%, 26% and 18% respectively compared with the average for the past five years, while Vietnam's REER appreciated by around 10%. In addition to this movement in REER, transactions in the foreign exchange interbank market have been extremely thin. Importers have suffered from a lack of availability of foreign exchange. The recently introduced foreign exchange surrender requirement (Decree 37) is likely to exacerbate the already stressed foreign exchange market, and as a result, the environment for foreign investment. Vietnam, whose success will rely on high growth of exports and inflows of foreign investment, needs a competitive exchange rate and a properly functioning foreign exchange market.

- **The performance of the SOE sector.** The lack of efficiency and competitiveness in the SOEs is beginning to act as a drag on economic growth and threaten financial stability. From the limited data received for 1996, it appears that the financial performance of the SOE sector has been marginal at best. Anecdotal evidence suggests that it has seriously deteriorated in 1997:

⇒ The profitability and ratio of return on assets were both extremely low, in spite of tax privileges for import substitution industries, tariff protection and access to subsidized credit. For the SOE sector in aggregate, the ratio of profits (before taxes) to sales was below 4 percent in 1996, and the ratio of profit (before taxes) to assets was below 9 percent.

⇒ Industrial production in 100 per cent state owned enterprises is growing much more slowly than in joint ventures, despite enjoying considerable privileges and preferential access to resources. SOE industrial production grew at around 6 percent in the year ending January 1998, compared to more than 10 percent for the industrial sector as a whole, and 23 percent for the joint ventures.

⇒ The SOE sector is responsible for most of the large accumulation of overdue loans in the commercial banking system and is the main threat to the system's solvency.

⇒ In summary, the significant resources going into SOEs--they account for roughly half of total credit in the economy--are not generating sufficient returns in terms of growth in employment, productivity, and income or in terms of poverty reduction.

- **The performance of the banking system.** The financial position of the banking system is very fragile.

  ⇒ Overdues have risen, and banks have high indirect exposure to foreign currency and liquidity risk. One third of all loans are denominated in foreign currency and over half of the loans in the joint stock banks are in foreign currency.

  ⇒ At present rapid deposit growth is masking the liquidity problems of the banking system.

  ⇒ These factors make the banking system extremely vulnerable to a slowing economy, a depreciation of the dong, or substantial deposit withdrawals.

II. Basic Objectives and Broad Thrust of The Government's Policy

Given these risk factors, the Government has clearly recognized the urgent need to deepen economic reforms, and take appropriate action to address the growing problems in the banking and SOE sectors and to introduce more competition into the economy.

The World bank believes that the broad policy thrust of the government is sound, and is willing to support its implementation with a Second Structural Adjustment Credit. The primary thrust of SAC II would be to support three key elements of the new Governments' six-point reform program, as outlined in the resolution of the recent Fourth Plenum of the Central Committee of the Communist Party of Vietnam.

The three elements of reform to be supported under SAC II are :

1. Raising economic efficiency and competitiveness through private sector development and trade liberalization.
2. Accelerating the reform of state enterprises
3. Strengthening and rationalizing the banking system

The action program on these elements measures supported under SAC II would assist Vietnam in moving from an inward-oriented, state enterprise-dominated industrialization strategy towards one that focuses on international competitiveness and economic efficiency by achieving a more neutral incentive regime and allowing increased room for private investment and entrepreneurship.

III. Implementation of the Government's Program

Private sector development and trade reform

Trade policy:

The government has recently announced important steps to further improve the international trade regime, including:

- removing quantitative restrictions on imports of consumer goods which will now be regulated by tariffs; and
- allowing private sector participation in the import of fertilizer and the export of rice.

Officials have also foreshadowed replacing the system of licensing enterprises to engage in international trade with a simple registration process open to all legally established enterprises. This action is a critical part of the reform agenda and this needs to be implemented as soon as possible.

We also note that:

- The maximum tariff rate is now 60 per cent, and the maximum rate is expected to be reduced to 50 per cent in the new Import/Export tax law.
- The government plans to unify treatment of imported and locally produced goods under the special sales tax.
- The government plans to simplify and rationalize the tariff structure by reducing the number of tariff rates significantly.
- A start has been made on implementation of the GATT valuation code by reducing the number of items for which the minimum price list will be used.

These are all very important steps, but care must be taken that additional distortions do not creep into the system. In particular, we are concerned that that the proposed maximum tariff will not apply to all goods, and that will be an exception list. We are also concerned that the process of managing consumer goods imports by tariffs may involve a significant increase in the average and dispersion of tariff rates, and provide high levels of protection for local production of these goods.

In addition, despite the changes in the treatment of consumer goods, quantitative restrictions remain on a number of major industrial products. The coverage of these restrictions increased considerably during 1997. These restrictions have destabilized markets for key products, provided high protection for local producers, mainly SOEs and reduce the competitiveness of industries using the products. These restrictions need to be removed under Vietnam's obligations under AFTA and as a prerequisite for joining the WTO. We note that Decision 11/1998/QD-TTg indicates an intention to control imports to ensure that the trade deficit does not exceed 20 per cent of the value of exports. We would advise that Government not plan to impose additional administrative restrictions -- either directly or through controls on access to foreign exchange -- to meet this target or to limit consumer good imports.

Business licensing and registration:

The current procedures for formation and registration of new enterprises are widely recognized to be cumbersome and non-transparent, and open to considerable discretion which can be used to limit competition in particular sectors of the economy.

The Prime Minister has called for streamlining of the business registration process to facilitate the growth of new enterprises, particularly private sector enterprises, and for actions to remove barriers that private enterprises face in getting access to credit and land. We are studying the recently issued Decree No 7/1998/ND-CP, but remain unsure as to the steps and timetable for addressing some of the key actions. These are:

- the centralization of the business registration process (adoption of the "one-stop shop" concept). In particular, the logic for requiring a firm to obtain an establishment license, a business registration and an investment license is unclear. In addition, the rationale for a private enterprise to prepare and present to the Government a business plan prior to obtaining an establishment license is unclear;
- the creation of registries for non-moveable and moveable property for use as collateral, and
- changes in the regulations surrounding transfer of land and the use of land as collateral.

State-owned Enterprise Reform

The recent performance of the SOE sector highlights three important problems:

- the vulnerability of the SOE sector to small downward price pressures and increases in the cost of inputs;
- the high opportunity cost to the economy of the scarce resources currently being allocated by the banking system and the budget to the SOE sector; and
- the risk being posed to the viability of the banking system and to macro-economic stability.

The Government has recognized these problems and announced a program to improve the performance of the enterprises in the sector, including through: (i) an accelerated equitization program; and (ii) reforms of the enterprises that, for the time being, will remain state-owned.

Equitization

Discussions held with officials of the Ministry of Finance, Office of Government and the General Department for Management of State Capital and Assets in Enterprises indicate that the Government is committed to a significant acceleration and deepening of its divestiture program. The following are particularly noteworthy:

- the announcement of a program of 150 equitizations in 1998, 300 to 400 in 1999 and a total of 1,000 by year 2000; and,
- the development of a wide consensus that the existing procedures of equitization need to be greatly simplified to reach the equitization program's targets.

As outlined in the recent resolution of the 4th Party Plenum, the Government plans to use alternative methods of divestiture for small, and possibly medium-scale, state-owned enterprises. We agree that equitization is not appropriate for these enterprises. International experience suggests that simpler methods (such as the sale through auctions and tender and/or the transfer for free or for a minimum price to the workforce) are the best way to deal with the large number of small state enterprises and the only approach to achieve the Government's divestiture targets. There is ample evidence from the Vietnamese experience, as well as from other transition countries, that the rapid transfer of very small firms to private owners generally results in significant improvements in efficiency, profitability and employment. We would advise the Government to introduce these methods in the proposed revision of the legislation on divestiture.

The Ministry of Finance has requested World Bank assistance in the development of an appropriate legal framework and in the design of the detailed procedures and mechanisms along the lines suggested at the recent Equitization Seminar. The Bank is currently mobilizing experts with relevant international experience to work on these issues within the timeframe proposed by the Steering Committee on Equitization and the General Department for Management of State Capital and Assets in Enterprises and will firm up a concrete proposal for assistance in the next few days.

The Government is aware that, because the equitization program would remain limited to relatively small enterprises, it will not quickly result in a dramatic change in the overall performance of the state-owned enterprise sector and recognizes the need to significantly improve the performance of the remaining state-owned enterprises. Timely collection and analysis of information on the evolution of the performance of the largest SOEs is essential for decision-makers in Government to identify enterprises at risk and develop strategies to deal with the medium and large non-performing SOEs as a matter of priority.

Weaknesses in State enterprise monitoring capacity

We share the views of the Minister of Finance that the information base on the state-owned enterprise sector must be significantly improved. Currently, information flows to policymakers does not allow them to identify those state enterprises whose financial performance could pose a risk to the banking sector and the economy, or to take timely action to remedy problems. Better understanding of the characteristics and financial situation of the state-owned enterprise sector will be essential for the Government's reform program.

Need for Improved Efficiency and Accountability of State Enterprises

There is overwhelming evidence from developing and transition economies alike that state-owned enterprises do not sustainably improve their efficiency and financial performance - a priority objective of the Government of Vietnam - if they do not face hard budget constraints. In this regard, we concerned by some recent decisions/instructions/circulars that send the wrong message about the strengthening of financial discipline in the state-owned enterprise and banking sector.

The Government has announced its intention to cut strongly to address this problem. This will require decisive measures to stop the drain on budgetary resources through subsidized loans, tax incentives, budgetary injection, and on banking resources - which is reaching serious proportions - caused by non-performing state-owned enterprises. Care will also needed to ensure that the Public Investment Program not include large investments in sectors which will require protection and special budgetary and credit treatment.

Strengthening and rationalizing the banking system

The increasing vulnerabilities of the banking sector require urgent action. They also highlight deficiencies in four important areas:

- existing accounting framework and auditing procedures do not adequately reflect changes in the financial capacity of bank borrowers and they allow financial institutions to mask existing problems. This poor disclosure precludes the Government and the banks themselves from obtaining accurate information on the true financial condition of the banks;

- the Central Bank has inadequate legal and operational resolution mechanisms for intervening in troubled banks, and for closing and liquidating insolvent banks;

- the existing lax entry requirements regarding the level and quality of capital and quality of management have led to the entry of very weak and insufficiently capitalized banks; moreover, the regulatory framework does not adequately guard against shareholders using banks to do connected and insider lending; and

- financial institutions have inadequate risk assessment, monitoring and management capacity.

Recent Government Actions

The Government has announced its intention to firmly address these problems. We would agree that actions to date have been insufficient to address the problem and in some instances, they have served to mask existing problems. Some recent prominent examples are:

- Instruction # 9 on the extension of the maturity of loans at risk;
- Instruction # 417 on the elimination of collateral requirements for loans to SOEs;
- Circular # 3 on the write-off, rescheduling of non-performing loans to SOEs and transfer of budgetary resources into the SOCBs;
- the recent transfer of budgetary resources totaling VND 500 billion to Agricultural Bank for the write-off of non-performing loans; and,
- attempts to deal with problems in the joint stock banks have included mergers which did not create stronger banks but rather weaker ones.

On the positive side, the People's Committee in HCM City and SBV have set up a task force to assess the vulnerability of and propose restructuring solutions for 19 joint stock banks. This process needs to be strengthened and expanded towards the development and implementation of a comprehensive solution to the growing problems of the joint stock banks.

Strengthening the Institutional Framework

There is a need to implement international accounting standards and prudential regulations to ensure that financial statements present a true and accurate picture of banks' financial condition. Current accounting standards hide the extent of problems that banks are experiencing in their loan portfolios and allow insolvent institutions to continue to report profits. Banks are not required to take pre-tax provisions for loan losses and despite growing overdue, profits continue to be reported. Adoption and implementation of international accounting standards would allow for greater transparency in banks' financial statements. This would, in turn, enable banks and government officials to assess the true extent of emerging and existing weaknesses and enable them to take more rapid, proactive measures to address and resolve the issues.

A comprehensive prudential framework is necessary to assure orderly and disciplined entry and exit into the banking sector as well as to assure that the appropriate incentive structure exists for prudent behavior on the part of bankers. Sufficiently high minimum capital for entry needs to be set forth and consistently applied. Insider and related party transactions as well as loan concentration limitations need to be clearly set forth. Appropriate enforcement mechanisms need to be put in place to assure adherence.

International experience suggests that the risk of a systemic banking crisis can be minimized if the government adheres to the following three principles: (i) take early and prompt action; (ii) take a comprehensive approach; and (iii) do not extend an extensive government guarantee as it raises moral hazard. Thus, to stem a potential systemic banking crisis, the government should take pro-active approach and develop a strategy to manage financial system distress through defining a transparent and consistent resolution mechanism to rehabilitate viable institutions and to close insolvent ones.

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The Role of the State in Sustainable Development: *Lessons for Viet Nam from the East Asian Miracle and the Crisis*

by

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Please allow me to first thank JICA, and Professor Ishikawa and his team, for inviting UNDP to participate in this workshop. This workshop is not only timely but also urgently needed so that Viet Nam's major development supporters and advisors can together take stock, share ideas, and better advise and support Viet Nam to successfully meet the many development challenges ahead.

Viet Nam's development strategy in recent years has been increasingly influenced by the East Asian experience. This is of course fully understandable and justified in light of the impressive record of exceptionally high rates of growth and development in a significant number of the East Asian economies over the past forty years. At the same time, the heavy role played by the state in directing development in some of these countries may seem appealing to many officials in a country, which is in cautious (and perhaps at times reluctant) transition from central-planning to a more market-based economy.

Similarly, media coverage in recent months on the role of *market failure* in contributing to the ongoing regional crisis may seem to justify temptations for re-regulation, as well as reduced liberalization and reduced openness to the global economy. Understandably, officials opposed to change in general, or those interested in preserving the status quo and the existing distribution of benefits, might find such temptations difficult to resist.

Therefore, a clear understanding of the role played by the state in the successes and failures of these countries, and the related lessons, both positive and negative, is particularly important to guiding Viet Nam's sustainable development. While there are many such lessons that might be presented here, my paper attempts to focus only on the most important lessons learned for Viet Nam at this juncture in the country's development process. Finally, in order to be useful to Vietnamese policy makers, my paper focuses particularly on related implications for the role of the state in successful and sustainable development. In so doing, my paper will briefly touch upon many of the main subjects in each of the sessions of this workshop.

My presentation is organized as follows:

First, I would like to briefly review some of the positive lessons from the Asian development experience. I think it is important to remember that despite the ongoing crisis, there have been many development achievements in East Asia, and many of these achievements remain very much in tact; (We should avoid *"throwing the baby out with the bath water"*.)

Second, I would like to briefly review some of the negative lessons we have learned from the ongoing crisis, including the respective roles of *government failure* and *market failure*; Here I would also like to highlight some formerly ambiguous lessons in the Asian Miracle that now appear much clearer in light of the crisis;

Third, I shall argue that the current crisis is really much more a result of government failure rather than market failure. The current crisis certainly has elements of market failure, and there is no question that all countries need a minimum level of prudential government banking supervision and regulation. Nevertheless, much of what may appear at first glance to have been market failure was on closer examination created by government failure. Therefore, while there is a case for more effective regulation in certain areas, such as financial markets, many other lessons from the ongoing crisis imply a need for far less government in directing resource allocation and investments.[1] I shall also briefly touch upon the relationship between the openness of an economy and the likelihood of such crisis.

Finally, I shall highlight some of the more important lessons and policy implications for Viet Nam today from the broader East Asian experience as well as from the more recent crisis.

General Comments on Lessons Learned

Within individual country experiences there have been periods of success, providing positive lessons, as well as periods of failure, providing negative lessons. The current crisis has helped clear up some former ambiguities in the East Asian Miracle experience, and enables a clearer distinction between the positive and negative lessons from the various country experiences.

Before outlining some of the positive lessons, I would wish to remind that, despite the ongoing financial crisis, there have been many impressive development achievements in East Asia which remain largely in-tact and which will be further built upon following a period of restructuring. Real incomes per capita have grown tremendously and poverty has been reduced substantially over the past forty years, particularly in Japan, South Korea, Taiwan, Singapore and Hong Kong, but also in Malaysia and to a lesser degree in Thailand. With the possible exception of Indonesia, where financial, structural, social and political challenges appear greatest, most of these countries are likely to sustain most of their past achievements and further build upon these following a period of sufficient restructuring. Yes, there will undoubtedly be some temporary losses in real incomes over the

[1] Of course the state in all countries must carefully plan and direct public sector investments in basic infrastructure, basic social services, environmental management and other areas where the *invisible hand* of the market tends to *fail* because the rate of return on such *public goods and services* cannot be easily captured by private investors, or where over exploitation results because private investors are able to avoid the full costs.

coming two or three years in number of these countries, but there is scope to absorb these in most countries concerned.[2] In short, while most countries will undoubtedly continue for a while to be adversely affected by the downturn in the region and/or internal imbalances, only a few of these countries are facing severe crisis, and most will probably eventually emerge even stronger than before following appropriate restructuring.

Some Positive Lessons

Some of the most important of these positive lessons from both the broader East Asian experience as well as the recent crisis include the following:

1. **The importance of relying mainly on domestic savings for development, and the state's role in creating an environment that encourages high savings rates;** This is an old lesson which deserves renewed prominence in light of the ongoing crisis.[3] Notably, the countries least affected by the crisis are the ones that have avoided excessive reliance on net foreign savings, particularly in the form of debt, especially Japan, Taiwan, Hong Kong, Singapore and to a lesser degree, Malaysia. On the other hand Thailand and particularly Indonesia have been carrying heavy foreign debt levels relative to GNP and Exports. The Philippines, despite restructuring and progress in recent years, is still carrying significant debts from the Marcos years. In the case of South Korea, total debt is significant but more manageable as a share of GNP and exports. The debt problem in South Korea has as much to do

[2] Converting income per capita figures expressed in US dollars at the substantially devalued exchange rates obviously exaggerates the decline in real incomes during 1997-98.

[3] In principle, the source of financing, domestic or foreign, should not matter as long as the overall incentive system, relative prices and investment environment are rational. However, in our less than perfect world, foreign financiers have proven to be less demanding on transparency, information availability and accountability until crisis strikes (which is too late!). This is particularly the case in less developed countries where foreigners often provide financing on the basis of state guarantees, explicit or implicit understandings, and "relationships", and have proven to be more willing to compromise on pure commercial criteria. Many of these same conditions also seem to apply to ODA loans and willingness to compromise on information availability and rational policy (again, until crisis strikes!).

with its term and liquidity structure as it has to do with the quality of related investments financed by the debt; Notably, Taiwan, which followed a policy of *pay as you go* to higher levels of development based on sizeable trade surpluses and domestic savings, accumulated nearly $100 billion of foreign exchange reserves, and is now in the enviable position to capitalize on the many bargain opportunities in the region.

2. **Export-led development based on comparative advantage,** which was often in the form of labour intensive manufactures, was **the basis for success in most of the "miracle" countries,** particularly those with small domestic markets as measured by income per capita, purchasing power or population size; (The scope for *protected import substitution* is considered in the next section.) Developing countries with small domestic markets have found it much easier to sell higher value added products to richer export markets in order to earn their way to higher levels of development. **Therefore, a considerable degree of openness to international trade** and finance is **essential** for the rapid development of low income countries.

3 **Heavy investment in Human Resource Development,** particularly **education and training,** has been the foundation in most of the more successful East Asian economies for graduating to increasingly higher levels of development. Moreover, such broad-based human resource development better enables broad-based participation in the fruits of development, sustainable poverty reduction and sustainable social stability. (Inadequate initial investments in education and vocational training in Indonesia and Thailand appear to underlie some of these countries current difficulties.)

4. **State leadership in promoting the development of the private sector and private sector-led growth is essential to successful development and sustainable poverty reduction;** This lesson is extremely important (but it is too often taken for granted). In all successful developed and developing countries,

both inside and outside the region, the private sector has been the main engine of sustainable growth and development.[4] Notably, no country has successfully developed with an SOE-led development strategy, although many countries have tried and failed (eg. former Soviet Union, former Eastern European countries, North Korea, and others. In the case of China, the country is hardly to be yet considered a success story given its continued very low income per capita and widespread poverty, and even there the SOE sector is being rationalized precisely to better ensure financial sustainability.);

5. Especially for low income countries, **an industrial sector based on small and medium-sized enterprises** better enables flexibility, adaptability, risk diversification, sustainability and stability. This has been most clearly demonstrated by the dramatic success of Taiwan over the past 35 years; Low income countries can least afford and manage the high costs and risks attached to developing industrial sectors narrowly based on large specialized capital intensive industries;

6. **Maintaining a competitive exchange rate is essential** to promote exports, discourage excessive reliance on imports, as well as to ensure rational financial planning and discourage excessive foreign borrowing of under-valued foreign currencies (which later become difficult to repay at more realistic exchange rates).

7. **All of the other well-known lessons including sound and stable macroeconomic policies** (low budget deficits, rational growth of money and credit, low inflation, etc.)

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[4] This has been the case in Japan, Taiwan, Hong Kong, Singapore, South Korea, Malaysia, Thailand, and Indonesia. Notably, while the state played a significant role in directing development in Japan, production was by the private sector. Similarly, the infamous Chaebol in South Korea were not state-owned, but rather privately owned. Most remarkable was the transformation in Taiwan in promoting private sector production from only 47% of real value added in the industrial sector in 1955 to 95% today, which in turn contributed to growth in real incomes of around 9% per annum on average over most of the past 40 years, rapidly expanding employment, as well as dramatic and sustained poverty reduction.

Some Negative Lessons

Please allow me to now turn to some of the more negative lessons from the East Asian experience, particularly from the ongoing financial crisis.

Since the outbreak of the crisis in July 1997, the media has paid considerable attention to the role of *market failure* in contributing to the current regional crisis. One of the conclusions of my paper is that, while market failure had a role to play in the crisis, it was in fact Government failure that set up the market failure in most of the crisis countries.

In addition, the ongoing regional crisis has helped to clarify a number of formerly ambiguous lessons related to the role of the state in the East Asian Miracle, particularly state directed industrialization and state directed lending.

Moreover, it is also worth noting that many of the negative lessons learned from the ongoing regional crisis, are in fact old lessons being re-learned from past regional debt crises, particularly in Latin America.[5] (*Those who ignore history, are destined to repeat it.*)

Again, the following focuses only on those lessons that are most relevant at this current juncture of Viet Nam's development:

1. **High economic growth rates, even in the presence of relatively healthy macroeconomic policy indicators, do not necessarily imply sustainable development;** As the ongoing crisis has clearly demonstrated, **an array of other types of policies** which impact on the **overall incentive framework** and the quality resource allocations and investments, or affect the **ability of markets to function efficiently**, have an equally critical role to play in sustainable development. In the years

[5] However, in contrast to the East Asian crisis countries, the underlying causes of the last regional debt crisis in Latin America involved much less rational macroeconomic policies (including huge budget deficits, rampant growth in money and net domestic credit, triple digit plus inflation, rigid exchange rates, and unsustainable current account deficits financed largely by foreign commercial debt.)

before the crisis broke, most of the East Asian countries concerned were enjoying relatively high rates of economic growth and reasonable macroeconomic indicators (low budget deficits or even surpluses in some cases, low inflation rates, reasonable growth in the money supply). In some cases current account deficits had become significant in recent years, although this latter factor, by itself, was not cause for great concern, since most countries pass through periods of deficit and surplus on their way to higher development. However, the role played by the state in directing or heavily influencing the allocation of financing, as well as in depriving markets of needed information on which to base rational decisions, resulted in a large number of unsustainable investments financed by debt, both domestic and foreign.

2. **State-directed lending for industrialization eventually has heavy inefficiency costs contributing to the build up of financial and structural imbalances, financial instability and crisis;** This has particularly proven to be the case in South Korea, through loans to the Chaebol from state-owned investment banks, as well as in Indonesia, through state-directed lending to the ruling family's interests; State directed lending appears to have been least damaging, and in some cases even helpful, when it was broadly directed in a *neutral* manner towards developing and promoting exports (eg. South Korea during the 1960s and early 1970s).

3. **Similarly, state influenced lending, either through explicit or implicit guarantees on loans to the corporate sector, also eventually has heavy costs which contribute to financial and structural imbalances.** Again, South Korea and Indonesia are cases in point. In some cases, the guarantees were not written into contracts, but rather were unwritten tacit understandings (or misunderstandings!). For example, recall that Peregrine's bankruptcy was a result of a $250 million loan to an Indonesian taxi company, based purely on the relationship between this company and President Suharto's daughter. (Why in the world would a taxi company ever need $250 million?!?) State influence in the case of Thailand was somewhat different, but again an example of government failure. The Thai government's long-held policy of fixing the exchange rate despite a burgeoning external current account deficit in recent years

encouraged a build-up of speculative short-term borrowing which became unmanageable once the exchange rate was unavoidably devalued.

4. **Government failure in either withholding essential and reliable information from the market or in failure to enforce legal requirements related to transparency, accountability and financial reporting** of corporate finance **set up the market failure and** ongoing financial **crisis**; One of the single most important ingredients to well-functioning and efficient markets is easy access to reliable information on which rational decisions can be based. Lack of reliable information increases the risk of over-investment in some areas and under-investment in others, and can contribute to dangerous speculation and investor "herd mentality". Again, little was known about the real financial health of the corporate and banking sectors in Indonesia, South Korea, and Thailand due to the lack of published audits on which private domestic and foreign investors (including depositors and foreign lenders) could make informed and rational decisions.

5. **Corruption,** which was facilitated by the general lack of transparency, combined with state directed or state influenced investment in the private sector, contributed to the development of high cost and financially unsustainable investments; (While difficult to quantify due to the lack of information, this appears to have been particularly the case in Indonesia, the Philippines (under Marcos), Thailand and South Korea.)

6. Lack of **a minimum of state prudential supervision of the banking sector,** which is needed in all countries, both developed and less developed, contributed to *market failure* in the banking sectors in a number of these countries. This is one area where more effective government regulation and supervision appears justified to minimize the risk of *market failure,* since unregulated banking by nature is prone to high risks of *moral hazard* and market failure. This lesson was particularly highlighted in the case of Thailand. In the case of South Korea, the liberalization of cross-border capital flows in recent years appears to have resulted in *state*-owned investment banks taking advantage of the greater freedom to dramatically increase short-term borrowing in order to on-lend to Chaebol, all of which left the country

highly vulnerable to both liquidity and solvency problems once the regional contagion and herd mentality began to turn adversely.

7. Adequate **information on foreign debts** needs to be collected and monitored in order to enable **adequate debt management** and avoid balance of payments financial crisis; (This is a very old lesson that seems to be re-learned with increasing frequency in this century.) Not only must the total amount of foreign debt be monitored, but also its terms structure, as well as any contingent obligations in the form of state guarantees. South Korea would have fared much better in the current crisis if the country had borrowed at lengthier terms (which would have been quite feasible in the years prior to the outbreak of the crisis), enabling greater time for a more orderly restructuring of the corporate sector without outside pressures, and reducing the likelihood that some liquidity problems may well deteriorate into solvency problems because of lack of working capital availability from more cautious and demanding financial markets.

8. **Protectionist trade policies aimed at** developing **import substitution** industries tended to quickly lead to balance of payments problems and **lack of financial sustainability**, particularly where the domestic markets were small (again as measured in terms of income per capita and purchasing power).[6] Almost all countries in East Asia have at one time or another attempted protected import substitution, including South Korea, Taiwan, Singapore and others. However, the smaller the domestic market's purchasing power, the more quickly balance of payments financial difficulties, or even crisis, was experienced. Only Japan appears to have been able to absorb the related inefficiencies and enjoy some of the possible positive externalities that might come from protected import substitution due to its greater domestic purchasing power even as far back as 1955.[7] In any case, the developed countries were more sympathetic to

[6] A clear distinction needs to be made between *efficient import substitution*, which should be encouraged and which eventually comes about naturally for many products and countries where the incentive framework and investment environment is rational; and *protected imported substitution*, which often results in inefficiency due to insufficient competition with more efficient foreign producers.

[7] Even as early as 1940, Japan already had an impressive industrial complex and network of international trading companies and offices abroad. Measured in today's values, Japan's average income per capita in

protectionist policies of less developed countries during the 1950s-70s, partly due to the *Cold War* agenda. Today, richer countries are much more demanding on trade liberalization as a basis for admitting exports from less developed countries, and hence the scope for protected import substitution is very limited.

9. **An inequitable distribution of the benefits and costs of development can eventually compromise social stability.** This is a very old lesson. If the general population tends to receive a disproportionately small share of the growing benefits of development in good times, but is expected to bare a disproportionately large share of the adjustment costs in bad times, preserving social stability becomes more tenuous.

In sum, the negative lessons and underlying causes of the ongoing regional financial crisis relate mainly to *government failure* and imply a need for much less government in directing investments and resource allocations, and a much greater role for Government in creating an enabling environment that strongly encourages domestic savings, and the conditions for markets to function effectively and efficiently. In some cases, there is a need for more effective government supervision and regulation of domestic financial sectors.

Policy Implications for Viet Nam

Viet Nam is in the very fortunate position to benefit from all of these lessons in order to avert crisis and instability, while achieving prosperity and sustainable poverty reduction.

In fact, well before the ongoing regional crisis began to emerge in July 1997, the United Nations released in 1996 a study entitled *Catching Up*, which attempted to alert Viet Nam that it was heading towards its own

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1955 was already in the order of $4000 per capita per annum, reflecting significant domestic purchasing power, as well as a considerably higher level of development and official technocracy than most South East Asian economies today. For example, Viet Nam's income per capita today is in the order of $320 per annum, or at best, an estimated $1,100 on a purchasing power parity basis.

major financial crisis within five years for many of the same reasons that a number of countries in East Asia are now suffering crisis.[8] In particular, the analysis in *Catching Up* concluded that while many of the traditional macroeconomic indicators looked very impressive in Viet Nam (eg. gnp growth, inflation, the budget deficit, etc.), a deeper analysis strongly concluded that the existing framework of incentives and direct government interventions influencing the allocation of investments and other resources in Viet Nam was financially unsustainable. There was clearly a need for a more rational balance between the pace of financing and the pace of reform.

Fortunately, Viet Nam is now able to benefit from the lessons learned in the region (which in fact validated the analysis and policy recommendations in *Catching Up*) and to adjust its policies so as to avert such a crisis.[9]

The most important lessons that Viet Nam can capitalize on include the following:

1. There is an **urgent need for much greater transparency and reliable information,** particularly on **Viet Nam's banking and corporate sectors,** in order to lower the risk of serious government failure and market failure. Viet Nam's economy is one of the most information-starved in the world.[10] Broad-based urgent action is needed in undertaking reliable and independent audits of SOEs and banks so that that the state has reliable information on which to base its reform decisions and development strategy, and so that domestic and foreign investors can make informed decisions and serious market failure is avoided. Without reliable information on the real financial health of SOE

[8] *Catching Up: Capacity Development for Poverty Elimination*, UNDP and UNICEF, October 1996.

[9] For example, prior to the crisis, attempting to convince certain policy makers in Viet Nam about the dangers of state-directed investments in the corporate sector was more difficult in light of the apparent success of the Chaebol in South Korea.

[10] As a reflection of this fact, Viet Nam is one of the few countries in the world that does not provide basic economic statistics for publication in the IMF's monthly *International Financial Statistics (IFS)*. In contrast, more than 160 other countries, many of which are far less developed than Viet Nam, regularly publish basic economic statistics in the *IFS*. For more on the *Information crisis* in Viet Nam, see *Catching Up*, pp. 32-34.

sector and on the related quality of banking sector loans, there is a serious risk of over-investment in financially-unviable ventures, eventual financial crisis and instability. In general, reliable information is urgently needed in many other areas critical to rational decision making by both the state and the private sectors in Viet Nam.[11] In short, while Viet Nam is not yet in financial crisis, it is in the midst of an *information crisis* which needs to be urgently redressed to avert financial crisis.

2. As a next step in the SOE reform process, **state directed new lending to state-owned enterprises in commercial sectors needs to be sharply curtailed and carefully rationed**, based on reliable audits, and only to such SOEs where genuine profitability and viability are proven; Based on lessons learned in the region and elsewhere, urgent action is needed here to avoid the growing risk of *government failure* through excessive lending and investment in Viet Nam's SOE corporate sector. There is clearly a high risk that the related debts may eventually reach unmanageable and dangerous proportions, eventually setting back the country's development process below its already generally impoverished level. As recommended below, all such SOEs in commercial sectors should eventually be privatized while they are still profitable or before they become more of a burden on the country.

3. Similarly, **state-guaranteed lending needs to be minimized and carefully monitored.** A recent banking decree enabling SOEs to borrow from banks on the basis of state guarantees (from ministries, people's committees, etc.) and without need to pledge collateral should be rescinded in light of the lessons from the current regional crisis (as well as past regional debt crises). Similarly, in order to avoid any *misunderstandings with the market* about the degree of state protection of private investments, foreign funded or otherwise, the Vietnamese State should openly declare a clear policy on sovereign guarantees. Otherwise, there is a danger of excessive debt related foreign investments with SOE

[11] In the case of Viet Nam, even the State does not appear to have reliable or useful financial information on SOEs and banks because of past incomplete and highly questionable accounting practices which evolved under the former central planning model regarding issues of depreciation of "free" capital provided by the State, reporting of interest on a payments rather than on an accrual basis, etc.

joint ventures based on misunderstandings about the state's willingness or ability to back such investments in a financial crunch.

4. Moving towards a **more competitive *dong* exchange rate** will be unavoidable and inevitable in order to promote exports, discourage a flood of cheap imports, encourage rational financial planning of any new foreign borrowing, and avoid a general drying up of foreign currency. The question is how much to depreciate and at what pace in light of the financial volatility and instability in the region, and the desire to avoid importing financial instability. Fortunately Viet Nam's very low inflation rate provides plenty of scope for absorbing a significant depreciation of the *dong*, while maintaining low inflation through tight monetary and credit growth. Moreover, since Viet Nam's currency is not yet freely convertible (which has heavy inefficiency costs in itself), managing this particular adjustment should be relatively easy. The *dong* already appeared significantly overvalued before the regional crisis erupted in July 1997.[12] With the substantial depreciation of many competitor country currencies in the region, Viet Nam will increasingly experience great difficulty in competing in export markets as well as with imports (smuggled or otherwise) in the domestic market. True, a devaluation will increase the *dong* cost of servicing existing foreign debt obligations, but it will also fortuitously improve exports, restrain imports, increase foreign investor confidence, encourage more rational valuation of new foreign borrowing, and generally increase foreign exchange availability and liquidity for servicing existing foreign debt.

5. Clearly Viet Nam's low **domestic savings rate** of 16% of GNP (albeit more than double the rate of 1990) **will need to increase substantially** to over 30% (as was the case in other successful East Asian countries during their early stages of development) to avoid excessive reliance on foreign savings, particularly foreign debt. Achieving this higher savings rate will require an improvement in the overall enabling environment and incentive framework, and as was the case in most other successful East Asian countries at early stages of development, an export-led development strategy needed to achieve higher levels of income.

[12] See *Catching Up*, pp. 27-28.

6. In light of lessons learned in the region, an export-led **development strategy** based on labour-intensive manufactured exports would still **appear by far the best strategy for Viet Nam** in light of the very low purchasing power of the domestic market (reflected by an average income per capita of only $320 per annum), the country's comparative advantages in the region, and the much more demanding international trading environment in recent years (which rules out significant scope for protectionism if access to export markets is to be maintained and developed.)[13] Therefore, a much more aggressive shift towards export-led development and away from protected import substitution, in both policy and concrete action, would appear prudent (and urgent!) in order to further lower the high financial risks attached to protected import substitution in costly capital intensive industries; Moreover, **increased openness to international trade** and finance will be essential to ensuring producer access to cheap raw materials and intermediate products as well as for maintaining and developing access to export markets.

7. **Ensuring Stability with Openness:** Judging from all of these experiences and lessons learned, financial and socio-economic stability is best preserved by: **sound economic and financial management,** including regular **orderly adjustments of financial variables** in line with evolving conditions; **diversification** of development in general, but particularly with respect to exports; **minimal reliance on short-term debt** (and potentially short-term portfolio investment) to minimize the risk of liquidity problems or speculative capital flows resulting from exogenous factors; and an **equitable sharing of both the benefits and costs** during the development process, including during periods of financial and adjustments; No country can completely avoid some degree

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[13] Viet Nam's greatest comparative advantage is its *potentially* low cost, literate and relatively disciplined labour force. Acutally realizing this *potential* comparative/competitive advantage would require greatly simplifying a range of regulations impeding investors (eg. land regulations, foreign exchange regulations, business licence approvals, trading quotas and licences, etc. etc.) all of which add to the cost of doing business in Viet Nam, as well as more realistic employment taxes and fees. For example, a Vietnamese worker earning take home pay of $1,000 actually costs an employer in the order of $5,000 due to employment related taxes and fees paid to the State (and this does not include the cost of the employer's investment in local staff training). All of this would appear to more than wipe out Viet Nam's most important competitive advantage, and discourage labour intensive industry and related job creation.

of financial volatility in an ever-changing world, although the risk of crisis can be minimized by capitalizing on past lessons learned. Most successful developing countries, both inside and outside the region, have enjoyed long-periods of stability with openness and rapidly growing prosperity, despite occasional short periods of correction and adjustment to redress imbalances. Even a relatively closed economy, as was the case of Viet Nam in the mid-1980s, can experience financial and economic crisis. (*North Korea is the most closed economy in the world, but experiencing one of the most protracted economic and financial crisis.*) A frequent source of instability is state avoidance of small orderly adjustments of financial variables (eg. the exchange rate, interest rates, prices, etc.) in the short-term, resulting in the build-up of large imbalances and unavoidable substantial adjustments over the medium- to longer-term, risking serious instability and crisis. Past state impediments to smooth financial market adjustments (eg. Thailand's long-held fixed exchange rate despite a significant and widening current account deficit in recent years) underlies much of the current financial instability in East Asia. This was also the case of many other countries in Latin America, Africa, Eastern Europe and the former Soviet Union during the latter half of the 1970's and early 1980s.

8. Much more **pro-active state promotion of the non-state sector** will be essential to Viet Nam's successful development in light of lessons learned both inside and outside the region. As previously emphasized, no country in the world has successfully developed with an SOE-led development strategy, although many countries have tried and failed (eg. former Soviet Union, former Eastern European countries, North Korea, and others.) In this regard, the Party leadership and policy makers will need to be convinced of the wisdom of not just tolerating, but proactively promoting, the private sector.[14]

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[14] In the run up to the National Party Congress in June 1996, the desire was expresed in the Party's Draft Political Report that the State would account for 60% of GNP by the year 2020, up from around 40% in 1996. While this quantitative objective was conspicuously absent in the Party's final Political Report, many observers felt that it remained the unwritten desire of many senior officials in the Party. Moreover, the country's official Public Investment Program (PIP) document covering the five years from 1996-2000, implies that up to 80% of total planned investment spending will be state-related, including around half of the planned $7.5 billion of ODA for the five years which was earmarked for the development of SOEs via state credits. See *Catching Up*, pp. 19-23.

9. Concrete reform of state owned enterprises (SOEs) will be essential to developing an export-led development strategy, financial sector reform, development of the non-state sector, and even rural development and sustainable poverty reduction.[15] Serious reform would involve equitizing many more than the planned 150-200 SOEs currently being registered, which represent only a few percent of the existing 6,000 SOEs. In addition, as recommended earlier, a genuine hardening of the state budget constraint on SOEs is needed. While it is true that the Government has ceased direct state budget subsidies to SOEs, the same is not true of state directed credits to SOEs. As we have learned earlier this year, yesterday's credits have become today's subsidies as they are written off as non-repayable by SOEs. Similarly, today's credits will become tomorrow's subsidies. Therefore, a genuine hard budget constraint would also include state directed credits.

10. Greater transparency and accountability to the people by the State, and **an equitable distribution of both the benefits and costs of development**, will be important to minimizing the risks of social instability in times of economic downturn. This can be achieved through more balanced geographical development (particularly through a further shift in the public investment program to basic infrastructure in rural areas), and increased investments in human resource development (especially education and vocational training), and more efficient and targeted poverty reduction support.

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[15] For example, developing an export-oriented growth strategy, essential to the financial sustainability of Viet Nam's economic growth, implies trade liberalization, including import liberalization. However, without prior reform of SOEs, such import liberalization would likely result in an import boom, a significant widening of the trade deficit and an unsustainable accumulation of foreign debt and financial crisis. Similarly, banking and financial sector reform are also dependent on SOE reform, since the quality of bank portfolios in Viet Nam remain heavily determined by the quality of SOE investments, because, as you know, SOEs remain heavily dependent on state-directed banking credits. As we learned in recent years, well before the break out of the recent regional financial crisis, the quality of SOE investments has become increasingly doubtful. Furthermore, the development of the non-state sector, essential to the successful development of any country, is being "crowded out" by SOE's preferred access to land, credit, business licenses, quotas, and other monopoly privileges. Even rural development and poverty reduction is being held back by the low prices received by rice farmers, which in turn results from rice export quotas being allocated largely to monopoly state trading companies.

Summary and Conclusion

There have been many impressive development achievements in East Asia over the past 40 years that remain largely in-tact in most of the countries concerned despite the ongoing financial crisis. Incomes have grown dramatically and poverty has been substantially reduced. These achievements have been built on sound macro-economic and financial policies; high savings rates; state-leadership in pro-actively promoting private sector development; export-led development in most cases; heavy investments in human resource development, and others. Moreover, these achievements will be further built upon following a period of sufficient restructuring.

A careful examination of factors leading up to the current regional crisis indicates that the main source of today's regional difficulties was poor Governance (including *government failure)*, which contributed either directly to the build-up of structural and financial imbalances in a number of the crisis countries concerned; or indirectly, by impeding the ability of markets to function effectively and efficiently. Attempts by the state (or state-owned bodies) to direct and/or influence lending and investments for industrialization in a non-neutral manner have failed. Government withholding of essential information needed for markets to function efficiently and/or failure to enforce legal requirements for transparency and reliable financial reporting set up *market failure* in a number of cases. This general lack of transparency also facilitated corruption and the development of a large number of high-cost and financially unsustainable investments in both the state and corporate sectors. In some cases, lack of minimum government supervision and regulation of the banking sector contributed to the imbalances. In at least one case (Thailand), government attempts to fix the exchange rate despite a persistent and sizeable current account deficit, contributed to the buildup of serious financial imbalances. Similarly, government or state-owned bodies contributed to an unmanageable build-up of short-term debt in some of the countries. Government failure to carefully monitor and manage the overall external debt situation in a number of the countries concerned, also greatly contributed to the balance of payments crises.

Fortunately Viet Nam is in a position to capitalize on both the positive and negative lessons learned in the region over the past forty years. In light of the current stage of the country's development and the international trading environment, an export-led development strategy still appears to be by far the best option for sustaining successful development. (Viet Nam's generally poor domestic market implies that protected import substitution would be financially unviable.) In order to be sustainable, pro-active state promotion of the private sector as the main engine of export-led growth will be essential in light of lessons learned in the region and elsewhere. This will require concrete reform of state-owned enterprises in order to free up resources for the non-state sector and increase general efficiency. In the regard, the State in Viet Nam has an important role in improving the enabling environment for markets to function much more effectively and efficiently, and in minimizing the risks of both government failure and market failure. Much greater transparency and useful and reliable information will be needed so that markets can function efficiently, and resources are allocated more realistically. In sum, less government in directing the allocation of resources and more government in improving the enabling environment for the non-state sector and the Vietnamese people would appear to offer the most potential for Viet Nam's successful development and sustainable poverty reduction.

Table 3 Preliminary estimates of effective rates of protection for Viet Nam Estimates base on tariff rates only

		Estimates based on 1995 I-O table				Estimates based on 1989 I-O table			
	Industry	Tariff on output	Tariff on inputs	Materials to output ratio	ERP	Tariff on output	Tariff on inputs	Materials to output ratio	ERP
1	Agriculture	9.7	4.1	0.46	14.4	9.7	7.0	0.35	11.1
2	Forestry	0.0	3.1	0.22	-0.9	0.0	5.8	0.23	-1.7
3	Fishing	15.0	10.4	0.47	19.2	15.0	13.3	0.64	18.1
4	Mining	2.5	5.5	0.36	0.9	2.5	6.2	0.51	-1.3
5	Fuels	1.5	4.6	0.55	-2.3	1.5	5.2	0.64	-5.3
6	Vegetable and fruit canning	31.6	13.4	0.57	55.5	31.6	10.1	0.85	157.4
7	Tea and coffee processing	41.8	13.1	0.53	74.8	41.8	11.6	0.79	158.6
8	Sugar	22.0	14.9	0.82	54.1	22.0	13.3	0.76	48.9
9	Tobacco, alcohol and beverages	54.4	14.3	0.84	260.5	54.4	14.0	0.75	176.6
10	Other food stuffs	18.3	16.1	0.75	25.3	18.3	14.5	0.77	31.4
11	Textiles, carpets and rugs	21.6	13.2	0.77	49.0	21.6	16.1	0.69	33.8
12	Leather, footwear and bleaching	31.4	16.1	0.47	44.9	31.4	18.8	0.68	58.1
13	Wood processing and products	16.4	7.2	0.53	26.9	16.4	10.9	0.59	24.5
14	Paper and products	16.4	5.2	0.74	48.8	16.4	8.1	0.79	47.7
15	Petroleum and natural gas	10.2	na	na	na	10.2	na	na	na
16	Fertilisers and pesticides	0.0	3.9	0.65	-7.3	0.0	3.8	0.71	-9.4
17	Chemical products	2.3	4.8	0.74	-4.9	2.3	5.5	0.77	-8.1
18	Pharmaceuticals	1.9	2.7	0.67	0.3	1.9	7.0	0.65	-7.7
19	Soaps and detergents	41.4	7.2	1.00	49142.6	41.4	8.1	1.02	undefined
20	Rubber and rubber products	23.7	6.4	0.75	76.7	23.7	12.6	0.74	55.0
21	Plastic and plastic products	17.1	9.5	0.73	38.1	17.1	14.1	0.74	25.7
22	Other chemical products	7.1	5.3	0.72	12.0	7.1	6.7	0.68	8.1
23	Ceramics, glass and porcelain	24.5	5.4	0.61	54.3	24.5	7.7	0.70	63.8
24	Cement	7.1	5.9	0.69	9.7	7.1	7.9	0.61	5.9
25	Other non-metallic minerals	12.0	5.5	0.77	33.6	12.0	7.3	0.65	20.8
26	Manufacture of ferrous metals	6.5	3.7	0.74	14.7	6.5	5.5	0.75	9.6
27	Manufacture of non ferrous metals	1.1	3.3	0.62	-2.4	1.1	2.8	0.68	-2.1
28	Equipment and machinery	9.1	6.7	0.48	11.4	9.1	7.6	0.62	11.6
29	Electrical and electronic products	13.2	6.4	0.62	24.5	13.2	9.4	0.57	18.2
30	Other metallic products	13.7	7.0	0.46	19.5	13.7	7.2	0.59	22.9
31	Other industry	13.9	9.6	0.38	16.4	13.9	11.8	0.44	15.5
	Average	13.5[a]	7.8	0.54	20.1	12.6[a]	8.4	0.48	16.5

na Not applicable (there is no domestic production). [a] This is a production weighted average of the rates by input-output industry

Table 4 Long-Term TFP Growth Rates by Sector

	TFP growth rate		
	Korea	Japan	Taiwan, China
Sector	1966-85	1960-79	1966-86
Food	7.30	- 1.76	2.0a
Beverages	7.90	0.0	—
Tobacco	13.40	—	—
Apparel	—	1.98	10.5
Textiles	10.70	0.47	7.6
Leather	12.60	1.03	—
Shoes	—	1.03	—
Wood	9.40	2.81	0.3b
Furniture	12.10	1.74	—
Paper	8.20	1.44	2.3c
Printing	10.70	- 0.18	—
Chemicals	13.10	3.36	3.3
Petroleum	- 0.30	- 3.55d	0.0b
Rubber	11.40	1.02	6.3b
Nonmetallic minerals	2.80	—	2.4
Basic metals	—	—	7.2
Iron and steel	3.70	1.34	—
Metal products	7.60	3.41	4.4
Nonelectrical machinery	8.00	2.30	6.7e
Electrical machinery	10.70	5.37	—
Electrical equipment	—	—	7.1
Transport equipment	11.20	4.32	2.7
Precision instruments	—	—	11.0
Plastic products	—	0.92f	0.0
Other manufacturing	7.50	- 1.76	—
Average	8.8	1.2	4.6

Not available.
a. Food and beverages
b. Rubber, petroleum, and wood products
c. Paper and paper products
d. petroleum ref. and coal
e. All machinery
f. Plastic
Source World Bank (1993), The East Asian Miracle. Economic Growth and Public Policy, p. 304.

Table 5 Change of revealed comparative advantage in Viet Nam

	1991			1992			1993			1994		
1	042	Rice	89.9	042	Rice	126.7	042	Rice	99.8	042	Rice	74.4
2	899	Miscellaneuos manufactured articles, N.E.S.	32.4	223	Other seeds for "soft" fixed oil	33.2	036	Crustacean, molluscs and aquatic inverearates fresh, frozen	23.4	232	Natural rubber	26.0
3	264	Jute and other textile fibres	31.1	075	Spices	25.2	232	Natural rubber	22.6	071	Coffee and substitutes	24.1
4	075	Spices	27.9	687	Tin	24.2	075	Spices	19.5	036	Crustacean, molluscs and aquatic inverearates fresh, frozen	23.3
5	036	Crustacean, molluscs and aquatic inverearates fresh, frozen	25.8	036	Crustacean, molluscs and aquatic inverearates fresh, frozen	22.9	899	Miscellaneuos manufactured articles, N.E.S.	19.3	264	Jute and other textile fibres	23.1
6	687	Tin	23.5	232	Natural rubber	21.7	037	Fishs prepared , preserved N.E.S.	18.3	075	Spices	22.9
7	232	Natural rubber	19.7	899	Miscellaneuos manufactured articles, N.E.S.	21.4	071	Coffee and substitutes	16.3	899	Miscellaneuos manufactured articles, N.E.S.	20.7
8	037	Fishs prepared , preserved N.E.S.	16.5	071	Coffee and substitutes	16.8	074	Tea and mate	14.6	261	Silk	15.2
9	071	Coffee and substitutes	14.4	037	Fishes prepared , preserved N.E.S.	14.5	687	Tin	14.4	687	Tin	13.4
10	223	Other seeds for "soft" fixed oil	13.1	245	Fuel wood and wood charcoal	11.9	264	Jute and other textile fibres	14.0	074	Tea and mate	13.3
11	261	Silk	12.3	025	Eggs, birds's, fresh, dried or otherwise preserved	11.2	261	Silk	12.7	025	Eggs, birds's, fresh, dried or otherwise preserved	9.1
12	222	Seeds for "soft" fixed oil	9.0	074	Tea and mate	10.6	223	Other seeds for "soft" fixed oil	12.2	223	Other seeds for "soft" fixed oil	8.5
13	025	Eggs, birds's, fresh, dried or otherwise preserved	8.5	333	Crude petroleum	6.9	025	Eggs, birds's, fresh, dried or otherwise preserved	11.0	612	Manufactures of leather or of compound leather	6.8
14	074	Tea and mate	5.8	679	Iron ,steel castings, unworked	6.2	222	Seeds for "soft"fixed oil	7.9	265	Vegetable textile fibres (exc. cotton and jute)	6.8
15	282	Iron and steel scrap	5.3	222	Seeds for "soft" fixed oil	5.4	333	Crude petroleum	6.7	222	Seeds for "soft"fixed oil	6.5
16	333	Crude petroleum	5.1	291	Crude animal materials, N.E.S.	5.3	635	Wood manufactures N.E.S.	6.4	245	Fuel wood and wood charcoal	5.5
17	679	Iron ,steel castings, unworked	5.0	322	Coal, lignite and peat	5.0	291	Crude animal materials, N.E.S.	5.3	333	Crude petroleum	5.5
18	247	Wood in the rough or roughly squared	4.9	264	Jute and other textile fibres	4.6	245	Fuel wood and wood charcoal	5.2	291	Crude animal materials, N.E.S.	5.4
19	655	Knitted or crocheted fabrics	4.4	612	Manufactures of leather or of compound leather	4.2	612	Manufactures of leather or of compound leather	4.4	635	Wood manufactures N.E.S.	5.3
20	211	Hides and skins, raw	3.9	261	Silk	4.2	322	Coal, lignite and peat	4.0	037	Fishes prepared , preserved N.E.S.	5.1
21	322	Coal, lignite and peat	3.8	247	Wood in the rough or roughly squared	4.0	679	Iron, steel castings, unworked	3.8	696	Curlery	4.6
22	266	Synthetic fibres for spinning	3.8	054	Vegetables fresh, simply preserved	2.8	658	Made-up textile articles....	2.8	322	Coal, lignite and peat	4.5
23	612	Manufactures of leather or of compound leather	3.8	057	Fruits, nuts, fresh, frozen	2.7	847	Clothing accessories	2.6	841	Ready-made cloths all kinds	3.7
24	658	Made-up textile articles....	3.1	841	Ready-made cloths all kinds	2.5	851	Footwears and parts thereof	2.5	035	Fish, dried, salted or smoked	3.3
25	054	Vegetables fresh, simply preserved	2.9	655	Knitted or crocheted fabrics	2.4	841	Ready-made cloths all kinds	2.5	851	Footwears and parts thereof	3.2

Table 6 Foreign direct investment to the major developing member countries of the ADB (US$ Million and %)

		1982	1985	1988	1990	1991	1992	1993	1994
Viet Nam	Value				120.0	213.0	260.0	300.0	1048.0
	Share, %				(1.3)	(1.4)	(1.5)	(0.8)	(2.4)
Indonesia	Value	225.0	310.0	576.0	1093.0	1482.0	1770.0	2004.0	2109.0
	Share, %	(6.0)	(8.2)	(7.9)	(11.9)	(9.7)	(10.4)	(5.6)	(4.9)
Singapore	Value	1298.0	809.0	3537.0	3541.0	3885.0	1034.0	3232.0	3411.0
	Share, %	(34.6)	(21.5)	(48.8)	(38.5)	(25.3)	(6.1)	(9.1)	(8.0)
Thailand	Value	189.0	162.0	1081.0	2304.0	1847.0	1969.0	1505.0	147.0
	Share, %	(5.0)	(4.3)	(14.9)	(25.1)	(12.0)	(11.6)	(4.2)	(0.3)
Malaysia	Value	1397.0	695.0	719.0	2332.0	3998.0	5183.0	5006.0	4348.0
	Share, %	(37.2)	(18.4)	(9.9)	(25.4)	(26.1)	(30.4)	(14.0)	(10.1)
Philippines	Value	16.0	12.0	936.0	530.0	544.0	228.0	763.0	1861.0
	Share, %	(0.4)	(0.3)	(12.9)	(5.8)	(3.5)	(1.3)	(2.1)	(4.3)
China, P. R. of	Value	386.0	1030.0	2344.0	2657.0	3453.0	7156.0	23115.0	31787.0
	Share, %	(10.3)	(27.3)	(32.3)	(28.9)	(22.5)	(42.0)	(64.8)	(74.1)
Others	Value	243.4	751.7	-1945.2	-3388.3	-86.7	-557.6	-276.7	-1834.9
	Share, %	(6.5)	(20.0)	(-26.7)	(-36.9)	(-0.5)	(-3.3)	(-0.6)	(-4.1)
Total DMCs	Value	3754.4	3769.7	7247.8	9188.7	15335.3	17042.4	35648.3	42876.1
	Share, %	(100.0)	(100.0)	(100.0)	(100.0)	(100.0)	(100.0)	(100.0)	(100.0)

Source The Asian Development Bank . Key Indicators of Developing Asian and Pacific Countries 1966 (Vol. XXVII).

Note 2 - 1

Participation in AFTA/APEC/WTO and Industrial Policy In Vietnam

= An Overview =

Paper presented at WB,IMF and Vietnamese-Japanese Joint Study Team Workshop held on March 22-23, 1998 at Tokyo

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Introduction

Vietnam has started massive industrialization in these ten years of economic reform and renovation under the Doi Moi. It should be pointed out, however, that even the minimum basis of industry complex remain unestablished. When taking into consideration the current level of deficit in current account, it is almost mandatory to emphasize the importance of the export-oriented industrialization in Vietnam. It can be forecast , however, that more import than export may be induced because of the limited basis of indutry complex. Therefore, it should be emphasized that the primary phase ofimport substitution is also an essential part of industrialization strategy for Vietnam.This is the reason why import substitution = cum = export-oriented industrialization is advocated as a strategy for indutrialization in this paper.

(1) The Initial Conditions for The Export-Oriented Industrialization

1) The Industrial Structure

Table(1) shows that import ratio is very high among the manufacturing subsectors; construction materials, steel, chemical industry including fertilizer, rubber, and plastic , electric and electronics, and textiles , in particular.

Reflecting such high import ratio, import inducement coefficients are more than one among many manufacturing sub-sectors;

steel, electric and electronic industry, and pharmaceutical industry in particular. Furthermore, import inducement coefficients are more than 0.8 among the chemical, construction materials, textile industries.

Table(1). Vietnam. Import Ratio, Import Inducement Coefficient.

	Import Ratio (M/X+M)	Import Inducement Coefficient	Export Ratio
Electricity&Gas	0.0	0.246256	0.00
Water Supply	0.0	0.157554	0.00
Mining	0.001370	0.164369	0.4513
Construction Materials	0.511645	0.867312	0.0505
Steel	0.872278	1.391505	0.0044
Chemicals	0.607913	0.937204	0.0401
Pharmaceuticals	0.651136	1.165780	0.0068
Food Processing	0.251447	0.499252	0.3295
Leather&Foot Wear	0.190556	0.434825	0.3710
Textiles	0.447500	0.870200	0.5363
Electric & Elecronic	0.728442	1.250256	0.0031
Other Manufacturing	0.399519	0.680020	0.0291
Crop Cultivation	0.063213	0.244863	0.2345
Animal Husbandry	0.013365	0.127625	0.0425
Forestry	0.355338	0.424242	0.2689
Fishery	0.162506	0.384634	0.4626
Construction	0.00	0.607471	0.00
Transportation	0.167475	0.547475	0.0643
Postal & Telecom.	0.008257	0.110727	0.0293
Wholesale & Retail	0.045832	0.164418	0.2032
Finance & Insurance	0.00	0.078182	0.00
Public Administration	0.00	0.171309	0.00
Hotel & Restaurant	0.086107	0.237556	0.3662
Culture,Education, Sanitation	0.039945	0.230183	0.0082
Others	0.068888	0.151471	0.0160
Total	0.196626		0.1554

Source: Vietnam Input-Output table 1989-1995.

2) Deficit in Trade Balance

Table(2) shows the current trends in trade balance as a ratio to GDP.

Table(2). Trade Balance as Ratio to GDP

1991	2.9%
1992	0.4
1993	- 7.3
1994	-11.4
1995	-13.4
1996	-16.6

3) The Level and Sructure of Protection

Table(3) shows the effective rates of protection in 1989 and 1995. We can find rather the moderate level of protection, with no significant negative protection rate against several sub-sectos except exceptionally high protection rate for several subsectors. It can be said that Vietnam has started the initial phase of industrialization under the relatively more freer trade regime than the neighboring ASEAN countries started. By joining with AFTA, APEC and WTO, Vietnam will face with much more severe international competition.

(2) Alternative Strategies : Export-Led and Import Substitution

Contrary to the forerunners of East Asia, Vietnam has not yet attained even the minimum level of industry complex and technological capabilities even thogh there exists rather well-educated people. In that sense, there seems to be reason for Vietnam's considering to foster the minimum base of industry complex and technology capability as well, while export promotion is undoubtedly necessary for economic development in the process of trade and investment liberalization. This suggests it will be necessary for Vietnam to proceed not only export promotion, but also import substitution with careful pclicy implementation, simultaneously. Table(4) shows the patterns of total factor productivity growth in Korea, Taiwan and Japan in the early stage of industrial development. Here it is observable that not only labor-intensive manufacturing sub-sectors but also capital-intensive sub-sectors which were heavily protected in the period, present high growth rate of total factor productivity.

(3) Promotion of Exports

1) Promotion of Traditional Exports

Table(5) shows traditional export products with comparative advantage. It must be emphasized that import inducement coefficients of these products are guessed to be rather low. The medium-and-small scale industry is expected to play an important role in promoting exports of these products.

2) Promotion of New Manufacturing Products for Exports

The electrical and electronics products, textile products, and parts of automobile industry are examined later as possible new products. At the latter stage of development in the electrical and electronics industry, metal mold industry will be induced to gain a foothold as a possible supporting industry. Promoting new export products, however, should be very carefully pursued by paying attention to the existing and future international division of labour under AFTA, which is expected to establish by foreign direct investment.

(4) Prospects for Import Substitution

By taking account of the necessity to establish the minimum base of industry complex, five industries; cement, urea fertilizer, petrochemical, iron and steel, and oil refinery, are carefully examined.

Each industry above are divided into three stages: down stream, middle stream, and upper stream. Each stage is carefully examined in selecting the specific stage of industry with respect to the amount of backward linkage demand for each stage of industry to realize economies of scale, the multinational enterprise's interest to invest in each stage and incentives given to foreign direct investment, and the required amount of investment. Our examinations indicate that protective measures are required at the early stage of development to successfully implement import substitution. However it should be remarked that schedule of protective measures for these industries will be constrained by that stipulated under AFTA.

(5) Foreign Direct Investment and National Competition

Many developing countries, including the ASEAN countries, are becoming more and more outward-oriented --- more open to trade and investment. While the global bandwagon toward the integrated world economy has gathered momentum since the 1980s, another began rolling in the opposite direction. There has been a flowering of attempts to put issues of ' national competitiveness ' centrally on domestic policy agendas not only in these developing countries but also in developed countries. There has been serious calculations of the possible sources of national advantage to attract foreign direct investment. The East Asian countries, , particularly the ASEAN countries, have designed the solidarity pact among political, business and union interests to increase the attractiveness of a unified individual country as fresh place for both domestic and foreign investment.

Even formation of AFTA can be understood to be a ' competitive collaboration ' among the ASEAN countries to attract foreign direct investment into the region. Such a region of countries with diversified comparative advantage under free trade system would stimulate the multinational enterprises to operate the international division of labor in the region as a part of their worldwide networks. It can be pointed out that concerns about shifting foreign direct investment away to China is another motivation for formulation of AFTA (Table(6)).

For Vietnam, however, only affiliating to AFTA is not a sufficient strategy to attract foreign direct investment and to foster the base of industry.

While participation in AFTA will be possibly a good opportunity for being integrated into the globalization process, Vietnam will face with the competition in ' location advantage of investment ' among AFTA countries. It will depend upon the domestic conditions for trade and investment, ' national competitiveness ', which is quite closedly related to the extent that Vietnam will be able to realize and enjoy gains from AFTA.

(6) Affiliation to AFTA and WTO

As has already pointe d out, there exists enough incetive for Vietnam to participate in the international division of labor within the framework of AFTA which is expected to be intensified and spread by the multinational enterprises. Vietnam's affiliation to WTO should be considered in parallel with her participation in AFTA in timing, however here ,in order to directly expand exports of mainly traditional exports to the vast markets of developed countries through MNF treatment and GSP schemes.

Industrial Policy Options for the Development of Export Industries in Viet Nam

Seiichi Masuyama

In the executive summary, we dealt with four export-oriented industries: electric and electronics, metal mold manufacturing, garment and textile, and ship repair. Because of the time constraint, my presentation today will be limited to two industries: electric and electronics and garment and textile. As the regional environment surrounding Viet Nam has changed drastically since the time of writing, I would like to structure my presentation in two parts. First, I would like to review the content of our summary report, and second, I would like to discuss the implications of the Asian currency crisis for a possible change in our views on the development of export industries in Viet Nam.

1. Electric and Electronics Industry

We believe that Viet Nam has a reasonable chance to develop an internationally competitive electrical and electronics industry in the long run, because of its favorable endowment of quality labor relative to other ASEAN countries and because of the size of its latent market and its location in the ASEAN region where the electric and electronics industry is growing rapidly.

However, as Viet Nam is a late-comer by a wide margin to the very internationalized industry and its domestic market is still small due to low income levels, it will be able to develop the industry only by attracting FDI in the export-oriented sector. In the long run, a more broadly based electric and electronics industry should be established with the development of domestically owned firms and research and development functions. Apart from the export-orientation, major issues for the development of the electric and electronics industry in Viet Nam are as follows:

① Maximizing utilization of the capital and technology of MNCs
② Securing international competitiveness by developing supporting industries
③ Promoting technology transfer and development
④ Planning and implementing a consistent industrial development policy

First, Viet Nam should make maximum use of FDI to develop the electric and electronics industry. The changing investment behavior of MNCs offers a great opportunity for Viet Nam to develop its electric and electronics industry from a very backward state. MNCs in the industry, which have invested in ASEAN countries to develop strategic export facilities, are now in the midst of relocating production facilities in the area to cope with the formation of economic blocks such as the EU and NAFTA, the expansion of emerging markets with increasing internal production, such as China and Eastern Europe, and the rapid growth of ASEAN markets and the formation of AFTA. Facing worsening labor shortage and rising wages in Singapore, Malaysia and Thailand, where they have built major production centers, MNCs are being forced to relocate labor-intensive operations to low-income countries in the region such as Viet Nam, Indonesia, and the Philippines and to upgrade their operations at existing facilities to the production of more technology-intensive products.

Moreover, the purpose of strategic export facilities is now changing to include sales to local markets, as the global export capacity in the electronic and electronics industry has outgrown demand and the potential of the local market has become an important criterion for investment. Viet Nam may need to pursue a two-pronged strategy of import substitution and export promotion. Therefore, excessive requirements for export volume and local content will be counterproductive to attract FDI in the industry.

In order to attract FDI, Viet Nam should improve its investment environment significantly and offer better incentives for investment. Viet Nam's investment environment is often said to have such problems as inadequate infrastructure, long delays to obtain necessary permits for investment and operation, high income taxes, difficulty in obtaining visas, inadequate housing, and inequality in the pricing of public utilities, such as electricity, for foreign residents. Moreover, Viet Nam's lack of intra- and inter-ministry coordination of policy measures relating to FDI is an even more serious problem than these specific problems. In order to offer attractive incentives to potential investors, such policy measures as a variety of incentives including the exemption or reduction of income taxes and import duties, the improvement of infrastructure of industrial parks, including the supply of electricity and water, telecommunication and transportation and the one-stop handling of permit applications, overseas remittance, royalty payments, local content requirements, customs duties, equity ownership restrictions, environmental restrictions and export requirements, need to be carefully coordinated.

Third, in order to develop an internationally competitive electric and electronics industry with long-term viability, the development of efficient parts industries will be crucial. Since Viet Nam's local suppliers are limited and there are virtually no internationally competitive machining firms, which form the foundation for the electric and electronics industry, Viet Nam should invite foreign direct investment in order to develop supporting industries. Since they are mostly medium- and small-sized firms that lack capabilities in negotiating joint ventures with state-owned enterprises, special support by the Vietnamese government is required.

There is a need to promote technology transfer. Although export activities by foreign enterprises based in export processing zones will generate foreign currency and employment in the short run, the transfer of technology will be limited largely to simple assembly technologies. Therefore, it is necessary to take policy measures to facilitate technology transfer to domestic firms through technology cooperation agreements or joint ventures involving domestic firms, particularly in supporting industries. In order to operate effectively in such relationships, domestic firms should be reformed to make their business practices conform to international standards. Although one means of technology transfer is human resource development programs supported by ODA, technology transfer through business experiences including involvement with foreign enterprises is most effective.

There should be schemes to support the spinning-off of capable managers, engineers, and skilled workers from state and foreign enterprises. Policy support will also be necessary for the export activities of local manufactures, which are expected to grow from around the year 2000. Policy measures in this area are similar to those for promoting SMEs.

And finally, there is a need for government to implement consistent industrial development policies. Government's role is vital for the effective utilization of FDI as we discussed before. Government should not become directly involved in industrial affairs and the government's role should be to develop an overall master plan for the electric and electronics industry in Viet Nam, to lay the general legal framework, and to prepare adequate infrastructure. Moreover, Viet Nam should tailor its policies to be compatible with the rules of AFTA, APEC, and WTO. It should avoid protectionist policies as much as possible.

Taking such factors into account, it is our idea that Viet Nam should develop its electric and electronics industry by pursuing a phased development strategy, shifting from an export-oriented and FDI dependent one to a more broadly based development strategy centered as supporting industries develop and technology transfer occurs

2. Garment and Textile Industry

Viet Nam's garment and textile industry is biased toward the garment sector. This is because Viet Nam has a comparative advantage in the very labor-intensive garment sector with her industrious and competent but still low-wage workers. Due to the participation of foreign enterprises and the private sector and to trade liberalization, Viet Nam's garment export increased very rapidly in the 1990s by successfully shifting markets from traditional CMEA countries to western markets including the EU and Japan. Export to the potentially huge American market is insignificant because Viet Nam lacks most-favored-nation (MFN) status. Moreover, foreign direct investment in this sector particularly through subcontracting arrangements provided necessary design, raw materials supply and overseas marketing capabilities.

However, Viet Nam is not yet competitive in the up-stream fiber and mid-stream fabric sectors, which are more capital intensive. Viet Nam does not hold comparative advantage in these sectors and state owned enterprises dominating these sectors lack managerial, technological, marketing, and financial capabilities necessary to be internationally competitive.

Although Viet Nam's bias toward the garment sector is very much in line with the development pattern of the garment and textile industry throughout East Asia, the lack of industrial inter-linkages poses a problem for the establishment of a full-fledged garment and textile industry in Viet Nam to compete with countries such as Thailand and Indonesia. Compared with competing neighboring countries, Viet Nam's supply of fabrics has limited variety. Local production of polyester mixed fabric, synthetic fiber, and manmade knit fabric is desirable to enhance industrial inter-linkages in Viet Nam's garment and textile industry.

We think that the garment sector should be the basis on which Viet Nam's textile sector will develop by enhancing backward integration. In addition to encouraging subcontracting activities, it is necessary to take measures to develop the transportation infrastructure and to speed up customs clearance, to support overseas marketing, to establish and support design sectors, to liberalize and modernize the domestic distribution system, and to liberalize the private sector. Design information centers should be established to disseminate the information about overseas markets to the small and medium sized enterprises in Viet Nam.

As Viet Nam is starting from a very weak competitive position in the up-stream and mid-stream sectors of the garment and textile industry, increasing inter-linkages in the industry is generally believed to be achievable only by active utilization of FDI. A similar situation to what we described for the electric and electronics industry at the regional level exists in the garment and textile industry. Rising wage levels in the more advanced ASEAN countries such as Malaysia and Thailand mean that comparative advantage in labor-intensive sectors of the garment and textile industry in East Asia has shifted to latecomer countries such as Viet Nam. Following investments in the garment sector, the relatively labor-intensive fabric production and dyeing processes are likely to move from countries such as Thailand to countries such as Viet Nam. On the other hand, capital-intensive production of fiber is likely to concentrate in existing production bases in Taiwan and Korea in East Asia and in Indonesia and Thailand in ASEAN under the liberalized trade regime. Liberalization under the AFTA/CEPT will accelerate the process of concentration in ASEAN.

The single most important phenomenon in the East Asian textile scene at the start of the next century is the emergence of China as the major producer and consumer of garment and textile products. The potential of an East Asian garment and textile producer country will be determined by how it positions itself as an exporter to the Chinese market.

Thus, the priorities of Viet Nam's garment and textile industry are to strengthen linkages with other ASEAN countries in the medium term and to position itself to supply the Chinese market in the long term. It may be advisable, at least in the initial stage before local supply of synthetic fibers and fabrics becomes available, to encourage the Japanese MNCs to enhance their intra-ASEAN industrial linkages between garment production in Viet Nam and fiber production in Thailand and Indonesia, in order to complement the lack of local supplies.

As state enterprises in the mid-stream and up-stream sectors lack international competitiveness, they should be consolidated into a limited number of promising enterprises, which should be modernized. Their obsolete machinery should be replaced, but more importantly, their marketing and management have to be strengthened with the help of foreign enterprises.

Human resource development along with enhancing integration from the up-stream to the down-stream sector is the key to upgrading Viet Nam's garment and textile industry. It is necessary to increase training in state institutions and opportunities should be pursued to utilize foreign aid for this purpose. However, the really meaningful training and technology transfer will have to come on the job from MNCs. Profit-oriented MNCs are obviously reluctant to provide training and technology transfer unless they receive sufficient economic incentives.

3. Modification of Our Analysis in Response to the Asian Currency Crisis

Below are our initial, tentative thoughts, without any formal review, on how the Asian currency crisis might modify our recommendations.

The drastic devaluation of the currencies of the Southeast Asian countries has dramatically strengthened their export competitiveness in labor-intensive industries against such countries as China and Viet Nam and it has substantially improved the availability of human resources. Therefore, the incentive to shift labor-intensive production from countries such as Malaysia and Thailand to countries such as Viet Nam has substantially weakened. This means that investment by MNCs in Viet Nam's labor-intensive export sectors, such as garment and fabric production and electrical and electronics industry assembly plants, is much lower than had been expected before the currency crisis. Since Viet Nam's competitiveness against other ASEAN countries has substantially eroded, the increased risk of devaluation of the *dong* will make foreign investors extremely cautious about investing in Viet Nam.

On the other hand, the domestic consumer markets of the Southeast Asian countries have shrunk dramatically, as have the AFTA consumer markets. The incentives for domestic and AFTA consumer market-oriented investment have weakened accordingly, while import competition from AFTA member states may be stronger because of over-supply.

We expect that Southeast countries will resume their growth sooner or later because of their increased competitiveness and hence the conditions on which we based our study will re-emerge. This means that our analysis is still valid for the long run, but our recommendation for an export-oriented FDI-based development strategy for the two industries needs to be postponed by three to five years. In the meantime, Viet Nam may need to undertake development of its export industries without major contributions from FDI. Apart from a possible adjustment of the exchange rate, the export potential of SMEs needs to be utilized fully. Since the competition to attract FDI has become much keener, Viet Nam must earnestly carry out improvements in regulation and infrastructure in order to capture precious FDI opportunities as well as to prepare for the next wave of FDI when the pre-crisis conditions return.

Specific points concerning the electrical and electronics industry are as follows:

a. Japanese investment in the consumer electronics sector will shift substantially in favor of existing bases such as Malaysia and Thailand but Japanese investment in the information equipment sector will not affected very much. This is because investment in this sector is more recent, and Japanese corporations will explore investments in new areas such as Viet Nam with the expectation of the resumption of labor shortages in countries where they have existing bases.
b. Compared with the garment and textile industry, investment in the electric and electronics industry is carried out with more long-term outlook irrespective of short-term competitive position. The interest in investing in Viet Nam will still be maintained.

With regard to the garment and textile industry, the specific features of the impact of the Asian currency crisis are as follows:

a. Since the garment and textile industry in Southeast Asia is highly export oriented, the effect of the currency crisis was very favorable, greatly strengthening the industry's export competitiveness. Japanese corporations have increased their share over local firms which are plagued with severe financing problems. Therefore, the Japanese corporations' interest in expanding existing production bases has increased strongly with a corresponding decline in interest in new areas such as Viet Nam. Even cash-rich Taiwanese enterprises, which are expected to have increased interest in investing in the region because of their weakened competitive position, will be attracted to the bargains in the countries with drastically devalued currencies.
b. It will take much longer for Viet Nam to upgrade its textile industry by inviting FDI. Viet Nam needs to improve its infrastructure with a long-term perspective. On the other hand, if a country such as Indonesia experiences severe social turmoil, Viet Nam's relative position will improve.

Policy Alternatives and Their Implications for Capital Intensive and Infant Industries

Koichiro Fukui

The importance of export-oriented industries has been emphasized in analyzing the economic development of ASEAN counties. On the other hand, capital intensive and infant industries have also played an important role in industrialization historically in some countries. In the executive summary we have examined six capital intensive and infant industries, in which Vietnamese government has strong interest. They include automobile & parts, iron & steel, petroleum refining, petrochemical, urea fertilizer, and cement. We believe our analysis remains valid despite the recent economic uncertainty in East Asia caused by financial and currency turmoil. Here, we present several extracts from our executive summary and add one new important issue of the automobile industry in Viet Nam.

1. Automobile industry, because of its vast value-added, substantial job-creating effect, high backward linkage effect of demand, and considerable technological spill-over effect, has attracted the special attention of policy makers. In ASEAN, too, the governments of Thailand, Indonesia, Malaysia, and the Philippines have been working in earnest to nurture automobile industries of their own.

   If Viet Nam begins to work in earnest to nurture automobile & parts industry now, the following three basic approaches (not exclusive each other) can be considered. The first approach would be to promote expansion of the market for the domestic product. Expansion of the market for a domestic product usually leads to the reduction of manufacturing costs and a further growth in demand. The second possible approach is promoting local production in order to retain the added value generated in the industry within the country and also structuring a network of parts manufacturers. However, this would need to be a long-range program because it is normally impractical to greatly increase the ratio of local production when the domestic market is still small. The third approach is to aim to participate in the international specialization within the ASEAN area in line with the MNC (Multi-National Corporation) strategy. Since export of completed vehicle is difficult for the time being, Viet Nam should work to foster export items in the parts sector by utilizing foreign direct investment.

(One new important issue)

Vietnamese government recently proposed to the automobile industry to impose special consumption tax (SCT), not only to imported vehicles, but also to domestic vehicles. One theoretical background of this proposal seems to the equal treatment to both imported and domestic vehicles. We have also pointed out that SCT only for imported vehicles would create problems in participating WTO, and that the protection tariff to domestic vehicles should be simply restored to some 200% (effective tariff with current SCT), which had been in practice in Viet Nam until a few years ago. This high import tariff could be fully justifiable from the examples of neighboring countries. If this new policy would be implemented, domestic vehicles would become much more costly, which is completely a different environment for all existing auto-manufacturers in Viet Nam. This policy also works in opposite direction to our three possible approaches.

2. Iron & steel, petroleum refining, petrochemical, and urea fertilizer require huge amount of investment with long pay-back period and small difference of production cost per unit could divide the winner and the loser. They are international commodities and the price of products fluctuates according to the global economic situation, and supply & demand. For these reasons, the timing of investment, the trend of international supply & demand, and the feasibility of each project must be carefully examined, even though the country with sizable population like Viet Nam will eventually need all these industries domestically.

One common aspect of these industries is that natural resources necessary for these industries exist in Viet Nam and there may exist a natural tendency to take advantage of this fact by adding more values to these materials. However, like in iron & steel industry, the experiences in Japan and Korea have proven that the existence of raw materials does not add any competitive edge. Raw materials can be sold as they are, although too much attention to them could bring another danger of so-called 'Dutch disease'.

3. The experience in NIEs and ASEAN countries shows that the cement business is lucrative in the early stages of industrialization. In the case of Viet Nam the demand for cement has been rising sharply and joint venture companies with FDI will increase cement producing capacity in line with the demand growth in the coming years. On the other hand, VNCC must modernize its old facilities to enhance competitiveness. One possible alternative is to separate it from the governments' organization as a profit-pursuing entity having the right to operate the cement distribution and retail business. As is eloquently shown from the experience of Thailand and Indonesia, the cement industry is a suitable industry to nurture the domestic industrialists.

Development Policy on SMEs and Supporting Industries in Vietnam

Prof. Masahiko Ebashi
Meiji Gakuin University

We have made a research on the private sector in Vietnam, especially on its small and medium enterprises(SMEs) which are engaged in manufacturing. Recognizing the fact that SMEs have an important role to play in modernizing Vietnamese manufacturing and strengthening its international competitiveness, we have made a recommendation on the development policy on SMEs and supporting industries for Vietnam.

1. Stagnation of Private Sector Development in Vietnam

Since the start of Doi Moi, the private sector of Vietnam has made a significant contribution to vitalize its economy. Especially, the private sector defended its economy from the crisis when the state sector was seriously damaged by the sudden abolition of state subsidies and virtual termination of economic aid from the former Soviet Union during 1989-1991.

However, the private sector in Vietnam is still weak and the pace of its development has been relatively slow. Though the number of formally registered enterprises in private sector which include all type of enterprises of private ownership and cooperatives has been increasing by about 6,000 in every year, the size of the enterprises is generally small and vulnerable in its management base.

Table 3-3 shows a result of a census of all types of establishments in Vietnam as of July 1995. The census finds that there were 23,708 enterprises in Vietnam on July 1, 1995, broken down as follows: 5,873 state enterprises (24.8%), 17,433 non-state enterprises (including cooperatives; 72.3%), and 692 foreign-capital enterprises (2.9%). The breakdown by industry reveals that about 40% were in commerce and repairs, followed by 36% in manufacturing.

Though the number of enterprises in private sector shared about 72% of the total, its share of total sales was only about 16% and its share of total employment was about 21%.

(Comparison with China)

Table 2-4 traces changes in the share of industrial production (by value) in China and Vietnam accounted for by the state enterprise sector, the non-state enterprise sector, and the foreign-capital enterprise sector. Note that the state enterprise sector's (excluding joint ventures with foreign capital) share of industrial production in Vietnam declined from 60.5% in 1990 to 50.8% in 1995. This was the result of sharp expansions in the production of foreign-capital enterprises, which saw their share of total industrial production rise from 11.0% to 25.1% over the same period. On the other hand, the share of industrial production by non-state enterprises in Vietnam has been declining year by year, going from 32.4% in 1990 to 24.2% in 1995.

In China, the state enterprise sector's share of industrial production declined much more quickly than it has in Vietnam. Over a ten-year period, the state enterprise sector shed about 31 percentage points, going from 64.9% of total industrial production in 1985 to only 34.0% in 1995. Production growth for the Chinese collectives sector, non-state enterprise sector, and foreign-capital enterprise sector was in all cases higher than for the state enterprise sector. During the 1990-1995 period, industrial production by non-state enterprises in China grew by an average of 55.7% per year (nominal rate), while foreign-capital enterprises posted average growth rates of 70.8%. Compared to Vietnam, the non-state enterprise sector in China (including township and village enterprises) has been stronger in its development. The collectives sector and the non-state enterprise sector combined accounted for about 50% of Chinese industrial production in 1995. The non-state sector has, therefore, been troublingly slow to develop in Vietnam, at least in comparison to China.

The background reason of slow development of private industrial sector in Vietnam could be explained by the following factors;

1) relatively short history of economic reform toward market economy
2) severe business environment for private sector enterprises
3) lack of government support on finance, technology and market information etc.
4) the virtual collapse of industrial cooperatives which could not respond to the new business environment such as the economic shift to a market economy, large scale of inflow of Chinese goods and the collapse of COMECON

On the other hand, the successful development of Chinese industrial cooperatives could partly be explained by the following factors;

1) existence of long experience for industrial management by communes
2) existence of managers and leaders who can manage cooperatives and have enough entrepreneur spirits
3) existence of the opportunity for small enterprises to survive locally resulting from the inability of large state enterprises to dominate markets because of the difficulties of transportation and distribution of their products

2. Current Situation of SMEs in Manufacturing

On July 1, 1995, there were 8,577 enterprises in Vietnam that were engaged in manufacturing. Of this number, 2,122 (24.7%) were state enterprises (excluding joint ventures with foreign capital), 6,073 (70.8%) non-state enterprises (collectives, private enterprises, joint stock companies, limited companies), and 382 (4.5%) foreign-capital enterprises. The absolute number of enterprises in manufacturing of Vietnam is so small when compared with other ASEAN countries(see Table 3-9). Besides, when the small rice mills and brick makers are excluded, Vietnam's total number of manufacturing enterprises is estimated only around 4,300- 4,500.

The average number of workers for state enterprises was 324, followed by 193 for foreign-capital enterprises, and 39 for non-state enterprises. State enterprises account for 58.5% of total capital, foreign-capital enterprises 30.7%, and non-state enterprises 10.7%. Average total capital per enterprise was about 41.0 billion dong for foreign-capital enterprises, 14 billion dong for state enterprises, and 900 million dong for non-state enterprises. Non-state enterprises average only 1/16 the capital of state enterprises. However, the difference between state and non-state enterprises shrinks to just 2:1 when total capital per worker is considered. State enterprises carry far more workers per unit capital than do non-state and foreign-capital enterprises.

Labor productivity, as measured by sales per worker, is highest at the foreign-capital enterprises, a reflection of their high capitalization. They are followed by state enterprises and non-state enterprises in that order. However, non-state enterprises have the highest capital productivity, with a capital turn-over rate of 1.84, compared to 1.63 for state enterprises and 0.45 for foreign-capital enterprises. (See Table 3- 17 (4))

(Profile of SME)

There is no clear definition of what constitutes a "small and medium enterprise" (SME) in Vietnam. If we follow the definition: " less than 10.0 billion dong of total capital or not more than 500 employee in the case of SME in manufacturing" which is used by Dr. Ngyuyen Hai Huu, MOLISA and an expert on SME, 96.7% of Vietnamese manufacturing enterprises are SMEs. As seen in Table 3-2, some 96.7% of the country's enterprises have no more than 500 employees, and 91.3% have less than 10 billion dong in total capital.

When SMEs are broken down by number of employees, about 71% of all SMEs have no more than 50 employees. About 32% of the total are micro-enterprises with 1-10 employees; 39% have 11-50 employees.

In addition to enterprises proper, Vietnam also has about 530,000 household enterprises engaged in manufacturing, which provide a total of 1.23

million jobs. This household enterprises produced 21% of Vietnam's total industrial production (77% of private sector industrial production) in 1994.

Household enterprises tend to be found in industries like foodstuffs, food processing, and beverages, apparel, lumber and woodworking, non-metal products, metal products, and furniture. They employ, on average, 2.3 people, but there are 161 household enterprises with 51 or more employees, including some with more than 500. These enterprises do not register for several reasons, among them the complexity of the permit process and taxation. We consider it important that the government include these household enterprises, with their latent capacity, among the enterprises eligible for SME programs, providing them with encouragement to formally organize and assistance in future growth.

3. The business environment for SMEs in Vietnam

Vietnam is in the transition from a centrally-planned to a market economy, and its business environment is therefore, on the whole, at a disadvantage to those of other ASEAN countries. Among the major problems facing enterprises in Vietnam are a plethora of restrictions and regulations, government meddling, an inefficient financial system, a complex and heavy tax system, and a backwards business support system. These are problems that Vietnam's state enterprises also face to one degree or another, but the business environment is far more severe for non-state enterprises, and particularly for SMEs and household enterprises. Among the specific problems confronting SMEs and household enterprises are:

1) the administrative procedures for enterprise establishment permits, enterprise registration, land acquisition, and building permits; 2) bank lending; 3) procurement of capital goods and raw materials; 4) obtaining export licenses; 5) transportation; 6) customs clearance procedures; 7) obtaining technology and market information; 8) obtaining management expertise; and 9) taxation.

Figure 1 illustrates the problems in the Vietnamese business environment in terms of the degree of seriousness for different groups of enterprises: state enterprises, large non-state enterprises, small and medium non-state enterprises, rural enterprises, household enterprises, and general non-state enterprises in the north and in the south. The degree of seriousness reflects the author's perceptions formed from interviews in Vietnam with enterprises, government officials, and researchers. They may not always be accurate, but they do capture general trends.

It should be clear from this that non-state enterprises face more problems than do state enterprises, and that the business environment is much more severe for SMEs and household enterprises. The main restrictions and regulations that are in place raise transaction costs to a point that makes it difficult for enterprises to develop. SMEs in particular do not enjoy the breadth of options that larger enterprises do in bringing down their transaction costs, which makes the problems more serious for them.

4. Increased Role of SMEs in Vietnam Under the New Economic Environment in East Asia

(New economic environment for Vietnam)

- stagnation of FDI inflow
- devalued currencies of East Asian countries and its economic turmoil
- stagnation of domestic saving
- stagnation of production by major SOEs
- slow down of domestic private investment

(Possible result of new economic environment for Vietnam)

- decreased level of both domestic and foreign savings and slower export growth → lower investment ratio→lower economic growth

(New direction of development strategy for Vietnam)

- export promotion which include currency adjustment
- drastic measures for attraction of FDI
- measures to raise productivity of capital and labor which include SOE reform, development of private sector SMEs(including rural industries) and the diversification of agriculture.

5. Recommendations for Vietnam

(Principles of SME Development)

1) Improve business environment for SMEs:
Correct the difference between SOEs and SMEs in terms of their business environment in order to help stabilize SME business operations and to enhance their potentialities.
2) Implement multi-staged SME development policies based on the phases of economic development of Vietnam and the ASEAN countries.
3) Prepare a comprehensive development policy for SMEs which properly links with other economic policies.

(Recommended SME Development Policies by Different Stages)

SME development measures in Vietnam could be developed on the basis of the following three core areas.
1)Building up foundations for SMEs' business activities as soon as possible. The foundations are to be laid through the establishment of an SME Basic Law. This includes the SME development policy, the organization of a financial assistance system, and the formation of SMEs' commercial and industrial

associations which will be the major recipients of SME assistance service.
2)Foster supporting industries in coordination with developed foreign countries and foreign companies operated in Vietnam by utilizing local SMEs associations and industrial organizations.
3)Promoting exports by utilizing SMEs' associations and industrial organizations.

In these three pillars, there are many important points. Regarding the establishment of SME Basic Law, we pointed out the concrete idea in this report. Regarding the organization of financial assistance system, we indicated the detail scheme in this report, too. The original source of funds for the SME financial assistance system may partly be raised by foreign official financial assistance.

Figure: Stages to promote SMEs

	I (1997~2005)	II (2005~2010)	III (2010~2015)
Building up foundations for SMEs Deregulation and liberalization of business environment	· Establish an SMEs Basic Law · SMEs Credit Supplementation system · Establish for Financial Institutions for SMEs · Formation of SME Industrial Associations · Promote investment of SME using by leasing companies	· Provide information and foster experts through SME Industrial Associations · Promote Venture Capitals System	· Promote modernization of SME facilities and equipment
Fostering supporting. industries	· Establish Technical Training Centers and foster trainers · Promote establishment of metal and machinery industries	· Spread technologies by establishing Regional Technology Development Centers · Supporting Industry Development Program	· Promote Database System for supporting industries · Promote modernization of supporting industries' facilities and equipment
Promote export activities of SMEs	· Promote Export Credit System · Improve export permission system	· Establish Export Promotion Center and provide market and technology information · Spread technologies by establishing Regional Technology Development Centers	· Enact financial laws to promote facility modernization of exporting industries · Further promotion of world network for Export Promotion Center

Source: Complied by NRI

(Lessons from Taiwan)

Vietnamese economic situation has some similarity with Taiwan. The government of Taiwan nationalized the Japanese enterprises just after the war and newly created SOEs controlled its domestic market. In 1952, the state sector share of the total manufacturing production was 56.2% and the share of private sector was 43.8%. In 1963, this share changed to 40.6% and 59.4% accordingly.

Taiwanese private sector SMEs were obliged to find their market abroad because the SOEs were so dominant in the domestic market, especially in the market of basic industries. Thanks to the development of SMEs mainly for export manufacturing, the number of manufacturing enterprises in Taiwan increased from 27,709 in 1966 to 69,517 in 1976, then, 113,639 in 1986. And the exports by SMEs shared two thirds of Taiwan's total exports in average of 1981-1985.

Successful development of exports by Taiwan SMEs could partly be explained by the following reasons;

1) taking advantage of its comparative advantage in labor intensive products
2) efforts to produce diversified export items with small quantity in which the economy of scale is not such an important factor for competitiveness
3) active participation into the international arrangement with foreign companies such as the utilization of foreign trade companies, OEM (original equipment manufacturing) arrangements and international sub-contracting
1) being involved in the severe competition both in domestic and foreign market

Besides, the government of Taiwan supported this move with reform on foreign exchange rate and investment incentives which encouraged investment, saving and export by means of tax deduction and simplification of procedure for factory land acquisition.

As we have discussed in our final report, there are many other area for Vietnam to support SMEs in order to expand its exports, to generate more employment and to build supporting industries.

However, Vietnamese leaders still seems to be reluctant to develop big private enterprises because of ideological or political reasons. This seems to be the core of the problem of weak private sector in Vietnam.

Figure 1. Matrix of Vietnam's Business Environment

	SOE	Private Sector					
		Big Firms	SME	Household	Rural Industry	North	South
Business registration	◎	○	△	△	△	△	○
Access to the land	◎	△	×	×	×	×	△
Access to the bank loan	◎	△	×	×	×	×	△
To use land use right as collateral for loan	◎	△	×	×	×	×	×
To use land use right as investment capital	◎	×	×	×	×	×	×
Joint venture with FDI	◎	×	×	×	×	×	×
Direct Export	◎	△	×	×	×	×	×
Access to the overseas market information	○	△	×	×	×	×	×
Access to the information on technology	△	△	×	×	×	×	×
Access to the information on laws & regulations	○	○	○	○	○	○	○
Tax system and regulation (actual)	△	△	△	△	△	△	△
Access to the management information	△	△	×	×	×	×	×
Hiring skilled staffs & workers	△	△	×	×	×	×	×
Training opportunity for staffs & workers	○	○	×	×	×	×	×
Customs procedure	○	×	×	×	×	×	×
Access to raw materials	○	△	△	△	△	△	△

◎ very easy, ○ rather easy, △ rather difficult, × very difficult
Source: Made from author's interview to the Vietnamese private firms and researchers.

Figure 2. Share of Private Investment to the Total Capital Investment

Source: CIEM, Vietnam's Economy 1996, Feb. 1996

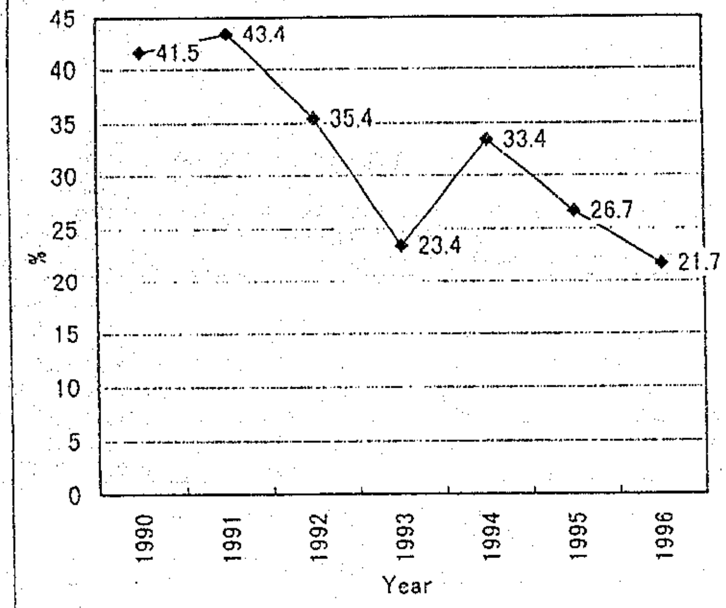

Table 2-4. Gross Industrial Production by Economic Sectors in Vietnam and China

	China (100 Million RMB, Current Price)										Vietnam (Billion VND, 1994 Price)							
	Total	%	State	%	Collectives	%	Private	%	Foreign/ Stock Co.	%	Total	%	State	%	Non-State	%	Foreign	%
1980	5,154	100	3,918	78.0	1,213	23.5	1	0.0	24	0.5								
1985	9,716	100	6,302	64.9	3,117	32.1	180	1.9	117	1.2								
1990	23,925	100	13,064	54.6	8,523	35.6	1,290	5.4	1,048	4.4		100		58.6		32.4		11.0
1994	76,609	100	26,201	34.2	31,434	41.0	8,853	11.6	10,121	13.2	75,189	100	45,453	60.5	21,063	28.0	8,671	11.5
1995	91,895	100	31,220	34.0	33,623	36.6	11,821	12.9	15,231	16.6	99,621	100	51,708	51.9	24,434	24.5	23,479	23.6
1996(est)											113,700	100	57,740	50.8	27,460	24.2	28,500	25.1
Ave. Growth Rate%(90/95)	30.9		19.0		31.6		55.7		70.8									

* Vietnam: 1. Non-State includes Collectives, all types of Private Enterprises and Households.
2. Percentage figure of 1990 is based on the 1989 price.
3. The figure of foreign sector in 1990 is estimated from the value of fuel industry.

Source: China Statistical Yearbook 1995, 1996
Vietnam: Statistical Yearbook 1996 and Data of DSI-MPI

Table 3-2. Number of All Enterprises in Manufacturing Industry by Scale of Employee and Total Capital

	No. Of	Enterprises	By No. Of Employee(Persons, %)						By Total Capiatal (Million Dong, %)		
	(July1,95)	%	1-10	11-50	51-100	101-200	201-500	501<	< 5000	5000-<10000	10000≦
Manufacturing Total	8,577	100.0	31.6	38.8	10.9	8.3	7.0	3.3	86.0	5.3	8.7
Food, foodstuffs, drinks	3,200	37.3	51.9	32.9	5.2	4.4	3.8	1.8	92.7	2.6	4.7
Tobacco	28	0.3	4.9	29.3	17.1	22.0	12.2	14.6	28.6	25.0	46.4
Textile	417	4.9	20.5	29.3	15.9	13.2	11.7	9.5	72.4	7.2	20.4
Garment, tanning, dyeing animal's skin, leather	384	4.5	14.7	19.0	14.6	18.5	21.2	12.0	77.9	9.1	13.0
Leather goods	137	1.6	14.6	15.6	8.5	11.3	19.3	30.7	56.9	14.6	28.5
Wooden, bamboo, rice stubble products	656	7.6	24.0	45.7	15.5	7.8	5.6	1.5	90.2	4.9	4.9
Paper products	198	2.3	17.7	48.0	17.3	8.1	5.5	3.4	83.8	6.1	10.1
Publishing, printing, copying	203	2.4	28.7	39.4	18.1	11.5	2.0	0.3	87.2	3.9	8.9
Coke, mineral oil products, nuclear fuel	3	0.0	13.3	33.3	33.3	6.7	6.7	6.6	0.0	0.0	100.0
Chemicals, chemical products	290	3.4	25.8	38.6	13.6	10.6	9.3	2.1	66.2	10.7	23.1
Rubber, plastic products	226	2.6	32.8	45.4	10.7	5.8	4.0	1.2	79.6	9.8	10.6
Non-metal products	1,162	13.5	11.7	58.5	12.3	9.1	7.1	1.4	91.9	3.6	4.5
Metal	131	1.5	30.3	40.6	7.9	7.9	7.9	5.4	79.4	5.3	15.3
Metal Products(excl. machinery & equipment)	380	4.4	34.4	43.1	11.5	6.0	3.7	1.3	89.2	5.8	5.0
Machinery & equipment	247	2.9	17.6	33.3	13.8	15.4	13.8	6.0	72.1	20.9	17.0
Office machine, computer, calculator	6	0.1	60.0	10.0	20.0	10.0	0.0	0.0	66.7	33.3	0.0
Electric machines & equipment	88	1.0	21.8	37.4	17.7	8.2	12.2	2.7	67.0	12.5	20.5
Radio, TV and communication equipment	76	0.9	17.9	33.0	20.8	14.2	12.3	1.9	51.3	10.5	38.2
Medical instrument, optics & clocks	25	0.3	17.1	37.1	20.0	11.4	8.6	5.7	64.0	16.0	20.0
Motor bikes, trailer	87	1.0	26.3	35.0	14.6	13.1	8.8	2.1	74.7	10.4	14.9
Other means of transport	185	2.2	13.4	41.6	19.1	11.1	11.1	3.7	76.2	8.7	15.1
Bed, wardrobe, tables, chairs and others	441	5.1	29.8	47.2	10.0	8.7	3.1	1.3	89.1	6.1	4.8
Re-processing	7	0.1	44.4	44.4	11.1	0.0	0.0	0.0	85.7	0.0	14.3

Note: 1. Total Number of Enterprises as of July 1, 1995 which include SOEs, all kind of Private Enterprises and Foreign Enterprises.
2. Percentage share of the number of enterprises by scale of the employee is based on the figure of the data which include branches of above mentioned enterprises as of July 1, 1995.
3. Percentage share of the number of enterprises by scale of total capital is based on the figure of Dec.31,1994..
Source: Ket Qua, Kinh Te Hanh Chinh Su Nghiep, Nam 1995, Nha Xuat Ban Thong Ke, Hanoi, 10-1996

Table 3-3. Number of Business Establishments by Sectors and by Industries(As of July 1, 1995)

	Total Establishments	Mining	Manufacturing	Electricity/ Gas/Water	Construction	Trade/ Repair	Hotel/ Restaurant	Transport/ Communication	Finance	Science/ Technology	Property/ Consulting	Culture/ Sports	Medicare/ Health	Education /Training	Public Service	No of Employee	Branch Employee	Total Employee
Enterprise Total	23,708	298	8,577	117	2,355	9,468	1,094	870	206	17	521	8	8	98	71	1,345,403	689,452	2,034,855
Domestic Enterprises	23,018	289	8,195	113	2,323	9,438	991	832	193	16	456	7	6	90	67	1,263,439	673,584	1,937,023
SOEs	5,873	160	2,122	100	948	1,511	294	304	36	7	266	1	2	85	37	886,985	619,626	1,506,611
Central	1,940	69	774	11	350	409	70	112	14	5	95	0	0	8	14	469,694	388,063	857,757
Local	3,933	91	1,348	89	589	1,102	224	192	22	2	171	1	2	77	23	417,291	231,563	648,854
Private	17,143	129	6,073	13	1,375	7,927	697	528	157	9	190	6	4	5	30	376,454	53,658	430,112
Cooperative	1,867	74	1,067	1	81	282	13	235	96	2	10	1	2	0	3	87,771	6,195	93,966
Private Enterprise	10,916	26	3,822	11	709	5,639	494	130	13	1	50	3	0	2	16	127,819	5,034	132,853
Stock Company	118	0	32	0	6	19	2	6	48	0	4	1	0	0	0	13,072	7,133	20,205
Company Limited	4,242	29	1,152	1	570	1,987	188	157	0	6	126	1	2	3	11	147,792	35,296	183,088
Foreign Enterprises	692	9	382	4	32	30	103	38	13	1	65	1	2	6	4	81,964	15,868	97,832
100% Foreign	150	1	124	2	1	3	2	0	7	1	5	0	0	1	3	32,966	4,143	37,109
Joint with SOEs	433	7	203	2	22	22	83	27	6	0	50	1	2	7	1	40,953	8,844	49,797
Joint with COOP	6	0	1	0	2	1	0	0	0	0	2	0	0	0	0	105	47	152
Joint with Private	59	0	39	0	4	2	9	3	0	0	2	0	0	0	0	5,652	1,185	6,837
Joint with Mixed	32	1	12	0	3	2	7	2	0	0	5	0	0	0	0	1,367	1,443	2,810
Cooperation	12	0	3	0	0	0	2	6	0	0	1	0	0	0	0	921	206	1,127
Households	1,879,402	34,072	531,229	487	12,298	793,467	273,430	139,993	365	123	19,029	1,082	10,322	16,810	46,686	3,241,129		3,241,129
of which Registered	941,635	14,897	110,617	126	268	354,026	83,947	45,717	40	8	9,983	169	4,934	5,113	11,767	1,247,915		1,247,915
Paid Tax	802,943	20,713	143,001	158	243	441,255	112,508	48,450	25	5	10,802	117	3,998	9,256	15,352	1,512,507		1,512,507
Total Establishments	1,903,110	34,370	539,806	604	14,653	802,935	274,524	140,863	571	140	19,550	1,090	10,330	16,906	46,757	4,586,532		5,275,984

Note: Number of Establishments exclude branches of enterprises.
Source: Ket Qua, Kinh Te Hanh Chinh Su Nghiep, Nam 1995, Nha Xuat Ban Thong Ke, Hanoi, 10-1996

Table 3-9. Definition and the Role of SMEs in Manufacturing Industry of Asian Countries

	Total Enterprises (,000)	No. of SMEs (,000)	SME Share %	SME Employment (,000)	SME Share %	SME Production Share (%)	Year	Note	Definition of SMEs in Manufacturing
Japan	856.6	852.3	99.5	10,396	73.8	51.8	1991		≦300 Employee or ≦¥100 Million(≒US$ 9 Million) in Legal Capital
Singapore	3.5	2.7	77.8	55	35.2	NA	1991		Local Equity 30%< and <S$ 12 Million(≒US$ 8.5 Million) Fixed Assets
Korea	297.7	296.2	99.5	2,782	65.3	45.6	1992		≦300 Employee
Taiwan	159.2	156.0	98.0	1,734	78.7	* 39.4	1992	*Sales	≦NT$40 Million in Paid Capital and ≦NT$120 Million(≒US$ 4.5 Million)Total Asset
Malaysia	28.3	26.2	92.6	760	40.2	* 19.6	1994	*Value Added	SMI: ≦MR2.5Million(≒US$ 1 million) in Shareholders' Fund
Thailand	* 64.1	63.2	98.6	1,281	73.8	NA	1991	*Excluding Rice Mill	SMI: <200 Employee and < 100 Million Baht(≒US$ 4 Million) in Invested Capital
Philippines	78.6	77.8	98.9	545	50.0	* 26.3	1988	*Sales	<200 Employee and ≦ 40 Million Peso(≒US$ 1.5 Million) Total Assets excl. Land
Vietnam	8.6	8.3	96.7	*607	60.8	NA	1995	*Include workers in branches	≦ 500 Employee or < 10 Billion Dong(≒US$ 0.86 Million) Total Assets

Note: Malaysia and Thailand use the term of SMI(Small and Medium Industries) which means the SMEs operating in industry.
Source: "The APEC Survey on Small and Medium Enterprises 1994", APEC Committee on Trade and Investment, Ministry of Economic Affairs, Chinese Taipei and Table 3-2.

Table 3-17(4) Management Indicators of Enterprises in Manufacturing Industry by Industries and by Economic Sectors

	Sales in 1994 (Billion VND)	%	%	SOE	%	Private	%	FDI	%	Sales per employee (Million VND)	SOE	Private	FDI	Capital Turnover Ratio	SOE	Private	FDI
Manufacturing Total	66,475	100.0	100	49,156	73.9	10,162	15.3	7,157	10.8	66.5	71.5	42.7	97.2	1.29	1.63	1.84	0.45
Food, foodstuffs, drinks	19,589	29.5	100	12,581	64.2	4,272	21.8	2,736	14.0	108.2	97.7	98.7	240.7	1.64	2.40	2.87	0.54
Tobacco	3,620	5.4	100	3,543	97.9	62	1.7	15	0.4	330.2	343.3	108.8	205.5	3.42	3.48	3.10	0.75
Textile	5,055	7.6	100	3,553	70.3	947	18.7	555	11.0	40.6	38.1	40.7	68.7	0.89	0.80	3.52	0.59
Garment, tanning, dyeing animal's skin, leather	3,358	5.1	100	2,307	68.7	664	19.8	387	11.5	24.7	28.0	15.6	35.1	1.31	2.12	0.66	0.84
Leather goods	1,985	3.0	100	1,033	52.0	321	16.2	631	31.8	24.1	26.1	13.3	33.7	0.70	1.43	1.08	0.34
Wooden, bamboo, rice stubble products	2,091	3.1	100	873	41.8	1,001	47.9	217	10.4	37.1	34.4	37.4	51.1	0.93	0.81	2.25	0.58
Paper products	1,663	2.5	100	1,273	76.5	194	11.7	196	11.8	88.4	80.0	31.2	90.2	1.11	1.09	1.53	0.95
Publishing, printing, copying	1,770	2.7	100	1,737	98.1	18	1.0	15	0.8	106.2	110.0	25.4	89.8	1.20	1.21	2.00	0.48
Coke, mineral oil products, nuclear fuel	1,635	2.5	100	1,459	89.2	0	0.0	176	10.8	865.2	871.6	0.0	-	9.58	30.40	0.00	1.43
Chemicals, chemical products	6,343	9.5	100	5,687	89.7	369	5.8	287	4.5	148.6	155.4	84.6	167.3	2.08	2.38	1.91	0.81
Rubber, plastic products	1,461	2.2	100	883	60.4	506	34.6	72	4.9	84.5	78.3	98.7	80.5	1.59	1.80	2.50	0.32
Non-metal products	6,442	9.7	100	5,901	91.6	466	7.2	75	1.2	57.8	68.2	20.0	48.5	0.97	1.10	1.55	0.08
Metal	2,361	3.6	100	1,648	69.8	90	3.8	623	26.4	142.4	123.4	52.2	415.3	1.32	1.80	1.00	0.79
Metal Products(excl. machinery & equipment)	887	1.3	100	545	61.4	236	26.6	106	12.0	35.1	31.7	32.3	132.7	1.17	1.33	1.71	0.50
Machinery & equipment	1,600	2.4	100	1,384	86.5	166	10.4	50	3.1	38.2	34.6	50.1	59.8	1.15	1.26	1.69	0.26
Office machine, computer, calculator	78	0.1	100	64	82.1	1	1.3	13	16.7	243.0	428.7	16.7	117.1	3.39	4.92	-	1.30
Electric machines & equipment	1,023	1.5	100	816	79.8	56	5.5	151	14.8	73.0	70.0	35.6	195.8	1.19	1.82	0.63	0.57
Radio, TV and communication equipment	2,153	3.2	100	1,880	87.3	116	5.4	157	7.3	216.1	273.1	87.8	89.3	0.91	2.04	1.15	0.12
Medical instrument, optics & clocks	134	0.2	100	101	75.4	7	5.2	26	19.4	35.7	40.2	10.1	46.8	0.71	1.91	0.54	0.21
Motor bikes, trailers	568	0.9	100	294	51.8	24	4.2	250	44.0	48.6	32.2	21.7	174.3	0.67	1.03	0.92	0.47
Other means of transport	1,549	2.3	100	1,224	79.0	79	5.1	246	15.9	45.3	40.3	27.5	266.8	0.70	1.41	1.65	0.19
Bed, wardrobe, tables, chairs and others	1,101	1.7	100	362	32.9	566	51.4	173	15.7	35.9	39.9	33.8	36.1	1.21	1.99	1.28	0.60
Re-processing	10	0.0	100	7	70.0	3	30.0	0	0.0	60.6	82.4	37.5	-	0.71	0.58	1.50	0.00

Source: Ket Qua, Kinh Te Hanh Chinh Su Nghiep, Nam 1995, Nha Xuat Ban Thong Ke, Hanoi, 10-1996

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VIETNAM PROGRAM

BRIEF COMMENTS ON VIETNAM'S TRADE AND INDUSTRIAL POLICIES (SESSION THREE)*

10 MARCH 1998

Structural Differences between Japan and Vietnam...

How should Vietnam industrialize, and what part should foreign markets and capital play in that process? One general approach is to follow, as much as possible, the general strategy which Japan followed in the decades leading up to the 1970's oil shocks. This involves government selection of promising "heavy" industries and various kinds of support to promote them – usually some mix of protection, soft loans, and tax breaks. This allows individual firms to expand more quickly with more debt than they would under pure "open market" conditions. In the case of Japan, most of the actual investment and production was carried out by competitive private firms, which were broadly coordinated by MITI. The period of maximum coordination in 1950-73, was marked by capital controls and a relatively "closed" economy, so far as imports were concerned. These aspects, while not entirely gone, were progressively relaxed as Japan met international commitments under the GATT and other treaties. Savings rates were high and trade surpluses were typical.

In Vietnam, most industrial production is by monopolistic state enterprises or their joint ventures with foreign firms. The comparative size of the two economies is very different. Vietnam is 3% to 4% of Japan's GDP in 1960 (in today's dollars and prices). The openness of the economies is also different. Vietnam's trade ratio, the exports and imports over GDP, is about 80% if smuggling is included. Japan in 1960 had a trade ratio of one-sixth. The rates of savings are also far apart, with Japan's rate double that of Vietnam. Though harder to measure, the ability of the respective bureaucracies to resist political pressures is also likely to be distinctly different. The international environment is also different. Japan was not viewed as a serious competitive threat until after 1970, and was able to license many technologies very cheaply. Vietnam is competing with many other Asian,

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and some other, nations but is expected to participate in market opening moves which others have also agreed to. Licensing is no longer so cheap or easy.

...And Recent Economic Troubles...

Since 1995, Vietnam has been running and seems likely to run current account deficits on the order of 10% to 15% of GDP, if it is assumed that overseas gifts cancel net smuggling. This rate of debt accumulation is probably too high to sustain, especially given the more difficult environment for attracting capital in all of Asia. There are also signs that the transition of existing heavy industries to competitive status will take much longer than the few years typical of Japan. This creates a potential contradiction in the drive to push these industries as fast and as far as envisioned in the 1996 Public Investment Program. Another likely difficulty comes from the anticipated integration of Vietnam in the ASEAN free trade area (AFTA). If inefficient heavy industry absorbs most of the investment resources and takes years to become competitive, it is not clear that integration with ASEAN is feasible except over the very long term. This is because the high cost of inputs from inefficient import substituting industries would make it hard for Vietnam to compete in export markets, and tend to drive away the export-oriented foreign investments that it needs to create jobs and generate foreign exchange. The purely domestic market for industrial goods in Vietnam is small and glutted. It is not clear how much more growth can come from restricting industrial growth to that market, even without the additional competition from ASEAN's more advanced economies. Their recent devaluations, debt restructuring, and excess capacity will make them fierce competitors in all markets.

...Make Import Substitution Within ASEAN, Rather Than Vietnam, A Possible Choice.

The "ASEAN Five" had a mid-1990's GDP of over $500 billion, about twenty times that of Vietnam's 1996 GDP. Their population was over four times Vietnam's. It may be wiser for Vietnam to industrialize within AFTA if it is feasible, rather than rely on its own small, glutted, and not easily protected markets. This argument gains force from the likely reliance on foreign investment for much of the industrial growth. Unlike Japan, technology (not now so easily licensed) and capital and marketing/management will be needed from abroad. How many companies will wish to commit major talent and funds to a small, poor country in an unstable region with a currency that cannot easily be converted when profits need to be repatriated? If they do not, will domestic savings and foreign aid be sufficient to propel growth forward rapidly over several years? It seems likely that as the ASEAN economies recover and confidence again is built up, Vietnam's best hope for rapid industrial growth (in addition to labor-intensive manufactured exports to the EU, Japan, and America) is import substitution within ASEAN.

In any trade grouping, there is a question of whether or not trade creation (which adds to national wealth) is larger than trade diversion. With trade diversion, a nation ends up buying from a neighbor within the trade grouping because of lowered intra-group tariffs, even though a lower cost before-tariff supplier outside the group exists and was being used. Since tariffs go to the nation, they are only a financial and not a true economic cost. Trade diversion destroys wealth. For Vietnam, the potentially trade expanding part of this integration may be larger than the trade diversion, though that needs to be checked. (The role of smuggling makes analysis difficult. The more smuggling, the more irrelevant any changes in trade restrictions are likely to be.) Vietnam's labor is productive for its cost and highly educated, and could easily link up with foreign capital and technology. The fact that Vietnam is starting late means less than it might in other cases. (Vietnam in AFTA is not equivalent to Bolivia in LAFTA, the former Latin American customs union. Bolivia was a late starter but could not industrialize, so dropped out of that customs union.) My simple suggestion is that JICA or some joint ASEAN group should look at import substitution in a "normal" ASEAN market, abstracting from the immediate crisis. If Thailand and Malaysia get over their financial crises (as seems likely), a "normal" economy might come as early as later 1999. The case of Indonesia is harder because it is more political and involves the treatment of the Indonesians of Chinese descent, but if Indonesia were unable to settle down, it would be more important than ever for the rest of ASEAN to cooperate. The calculus of import substitution would be changed, with a smaller effective market but also less low-wage competition. On balance, ASEAN without a functioning Indonesia is still favorable compared to Vietnam going it alone.

But a Study Is Needed to Highlight the Opportunities and Dangers.

This study should survey actual and potential investors and major firms, not just be a desk study. Given the overwhelming strength of Chinese and even South Korean industry, it may well be that ASEAN's best hope is to cooperate on area-wide import substitution. This is, however, likely to be especially true for Vietnam. Without the beneficial competition and market potential of its neighbors, it is unlikely to be able to mobilize adequate foreign private capital or technology to industrialize successfully.

It is true that over $30 billion of FDI has been licensed, but only $8.3 billion (through 1996) was in industry, and only a fraction of that has been realized and is likely to be realized. From 1988 to 1996, only $2.4 billion was invested in all FDI/ JV industry, including the 30% share of the Vietnamese partner, which is mostly land, was 28% of the licensed amount. (Even these amounts may be inflated for various reasons having to do with JV reporting.) Many of the as yet unrealized investments are likely to be delayed or cancelled in the less promising economic environment.

With rising debt, scarcer capital, small and glutted markets, and modest prospects for FDI led heavy industrial growth, it is likely that area wide rather than nation wide import substitution is Vietnam's best strategy. Of course, it should also pursue manufactured export growth. If the government follows recent plans and uses ODA for heavy industry, it is likely to short-change the critically necessary rural infrastructure. This would hurt demand from rural areas, poverty alleviation, exports, and equity across the various regions of Vietnam. On balance, it does not appear to be a close call. If import substitution is going to be a major industrial growth strategy, it is better followed with ASEAN than nationally. If import substitution within ASEAN is viewed as too risky or difficult to arrange, then a different approach altogether may be needed.

If Not Import Substitution Within ASEAN, A Different Strategy Would Be Preferable.

There are not many models for rapid, long-term economic growth without some form of import substitution. However, several Asian economies have managed to engage in only limited amounts of forced or subsidized IS, while emphasizing profitable manufactured exports. The types of import substitution that quickly become competitive will occur in any case, or with only moderate protection. Those products requiring high levels of protection not only conflict with commitments made under AFTA, but also tend to fail to bring down their production costs to competitive levels very quickly. During the early phases of growth until about 1970, Malaysia had relatively little heavy industry, for example. It should be possible, if IS within ASEAN proves too difficult, to combine profitable IS with relatively modest protection with manufactured exports, further processing of raw materials, and some high-technology exports. If foreign private investors who export find Vietnam a choice destination, this overall process could proceed quickly, with a lot of technology and skill transfer within a few years.

There should be no illusions about the difficulty in switching from a state led, foreign financed national IS strategy to one more feasible. Decisions regarding infrastructure, the exchange rate, the financial system, and the trade and regulatory system will all need to be revisited. However, with even China moving decisively away from state led industrialization, although still toying with the idea of *chaebol*-like national champion firms, it seems likely that Vietnam will eventually have to give a no greater role than China to state led industrialization. Current policies will probably not attract adequate FDI, so the alternative to some revised strategy is almost certainly failure. Neither domestic savings nor firm level efficiency is high enough to be regionally competitive. The major question is what industrial strategy is promising in reality but also acceptable to the leadership in Vietnam.

APPENDIX:

1. Foreign Exchange: Daily Trading Value at Interbank Market Activity Stalls

First half, 1996: $8 million

First half, 1997: $3 million

First 5 weeks, 1998: $0.2 million

Source: p. 60, Far Eastern Economic Review, February 26, 1998

2. Recent regulations of the State Bank allow companies to keep only "needed" amounts of foreign exchange in their own bank accounts. The "surplus" foreign exchange is converted into dong and is available only when a "requirement" is demonstrated. Only one foreign currency account per firm is allowed. These regulations are meant to reduce speculation against the dong. (From Decision No. 37-QD-TTg, Decision on A Number of Measures on Foreign Exchange Control in the Current Circumstance, issued 14 February 1998; and Official Letter on Implementation of Article 5 of Decision 37-1998-QD-TTg, dated 23 February 1998.)

3. Approved foreign investment in 1998 as of February 19, 1998 was $926.5, million, a 54% decline in value compared to the same period in 1997. However, over $700 million of this was in a single tourist resort project, which is of doubtful profitability in the near future due to over-capacity and reduced regional tourism caused by the economic crisis. If this single project is removed, the remaining amount of licensed investment is about 90% less than the same period in 1997.

These trends in foreign exchange and investment suggest that the economic troubles in Asia are reducing the amount of serious investor interest in Vietnam, and creating a situation in which foreign exchange is less available than previously. This will make investing in capital and foreign exchange intensive heavy industry more difficult to sustain. It also makes the effective reliance of Vietnam on FDI for its industrial development less certain of success. Trade data do not yet allow confident analysis of the impact of devaluation in neighboring countries on the ability of Vietnamese firms to compete, though the trade gap is running at about $200 million a month. This is a large amount, still roughly equal to 10% of GDP.

ENHANCING EFFICIENCY AND COMPEITTIVENESS OF VIETNAM'S INDUSTRIAL SECTOR

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1. Over the last years, industrial growth rate of Vietnam reached over 13% per annum, however, there is a big challenge for further development of the industrial sector is how to enhance its efficiency and competitiveness to cope with the situation in the region and the world. This is the very weakness of Vietnam's industrial sector in the process of integrating into the economy of the region as well as the world.

The financial crisis with its complicated developments also have certain affects on export situation of Vietnam making the country to face with more and severe competition which vary by specific commodity items.

Therefore, enhancement of efficiency and competitiveness of the economy is regarded as the first priority task in the annual action programme of the present Government of Vietnam.

2. For long-term and suitable development, readjustment of industrial structure is needed to basically overcome potential danger of a crisis. Renovation of industrial structure should be based on the principles aiming at enhancing production and business efficiency as well as competitiveness of the industrial sector which is still very weak now.

The extremely important task of the economy in the years to come is to create a profound development step in the industrial structure shifting with a dynamic production and investment structure capable of bringing into full play comparative advantages of the country, enhancing productivity, quality, efficiency of the sector to be competitive both in the domestic and international markets. The directions of industrial structure shifting are as follows:

+ The textile and garment industry should be pushed stronger to export orientation aiming to create more employment and earn foreign currencies making contributions to balance of payment. Creating favourable environment for foreign investment promotion should be implemented in a close combination with encouraging all economic sectors to participate in production and export activities.

+ Processing industry, especially agricultural- forestry-fishery products processing in areas where there are large-scale sources of raw material should be accelerated for export. Strong development of this industry will have effect on rural and agricultural industrialization based on exploitation of labour and land potentialities of the agricultural sector. This helps to create the movement of lobour from agriculture to industry through which a new labour distribution is to be formed, and at the same time, positive effects on renovation and enhanced efficiency of agricultural production would be created aiming to provide markets for industrial products and ensure inputs for industrial sector. This industry is suitable to development of small and medium enterprises which the Government has policy to promote.

+ Forming foundation to foster and develop important industries that Vietnam has dynamic comparative advantages (such as human resources) with a view to turn these industries into competitive ones in the future, beyond the year 2000. In long-term industrialization and modernization strategy of the country, electronics, mechanical-engineering and information technology are seen as important industries (which also could be referred to as leading industries) because of the following reasons:

- These industries capable of creating technology capacity as well as industrial linkages which have spill-over effects on technology level improvement of other industrial and economic sectors.
- Vietnam has comparative advantages in well-educated and dynamic human resources; and a prospective domestic market which for the time being still limited but with a good potential beyond the year 2000 when the national income will increase, a big demand will be resulted in.
- They constitute important components of an industrial sector serving for a country with over 100 million population beyond the year 2000.

It is necessary to encourage foreign investors to invest in these industries, especially in supporting industries producing parts and components with a view to create conditions for taking part in the international labour assignment.

It is important to accelerate development of selected natural resources-based industries such as oil-refinery, petrochemical, metallurgy and so on. These industries are mainly to ensure supply of material inputs to other industries so they are mainly import-substituted ones. However, these industries are very capital-intensive, requiring big investment and high technology level, they should be carefully selected taking into account well-estimated domestic needs and appropriate steps and timing. Establishing joint-ventures with foreign investors is possibly a good way to make use of foreign investment capital and technology. In the forthcoming years, priority should be given to projects which have advantages in oil and gas resources such as blast-furnace steel-making project with capacity of 5 million tons/year should be delayed as the demand is not so big for such a big capacity, and at the same time, the project requires a too large amount of investment.

3. Adjusting nominal exchange rate in a more flexible manner to avoid both trends of rigidity anchoring the exchange rate or over-adjustment aiming to promote export while not to cause big changes for import of industrial production inputs.

In parallel with exchange rate measure, it is necessary to implement other measures to encourage export activities. The existing export promotion policies should be checked and supplemented with export promotion urgent policy measures thus to enhancing competitiveness of Vietnam's industrial goods.

In line with export promotion, import should be strictly controlled within the acceptable limits according to principles and commitments made with AFTA. Constraining import of inessential consumer goods that could be met by domestically produced goods. Giving priority to import of material and inputs for export processing.

In the long run, export-pushed policy should be kept firmly to reduce trade deficit. Allowing all economic sectors, state-owned and non-state enterprises to participate in import-export activities, streamlining custom procedures, introducing the mechanism of quota bidding and so on.

To establish free-trade zones, where special regulations are provided in a more open and easy manner for acceleration of industrial and trade development. Approval on establishment of Mong Cai Border-Gate Free-Trade Zone is an important initiation for the development of this model.

4. Creating attractive environment for promotion of foreign investment. Attracting foreign direct investment plays an very important role in the cause of industrialization and modernization of the country. Foreign investment promotion activities in Vietnam are faced with both favourable opportunities and severe challenges, the latter are mainly because of the weakness of Vietnam's investment environment itself on one hand, and increasingly fierce competition in this field, on the other.

In January 1998, Decision No. 10/1998/ND-CP on some measures to encourage and guarantee foreign direct investment (FDI) activities in Vietnam was promulgated by the Government.

This Decision is aimed at improving the investment environment of the country, committing to guarantee interests of foreign investors doing business in Vietnam and directing investments to priority projects, areas and territorial regions of the country.

To ensure stability and consistency of Vietnam's foreign investment policy, the Decision affirms: In case, new regulations of the Government have negative effects on interests of enterprises with foreign investments then the new changes are not applied to those enterprises which have given investment license before the effective date of the Decision, while they have right to enjoy new, more preferential provisions stipulated by the Decision.

Administrative management at sectoral and local levels, especially, after license administrative procedures also have to be recognized and consolidated.

5. Further accelerating implementation of guideline on State-owned Enterprises (SOEs) Reform. This is a big guideline policy covering a number of policy contents, implementation of which is very complicated. What's important to emphasize here is SOE Reform with concrete measures such as equitization, ownership diversification, leasing practice, management contract and so on will be the means of great importance in strengthening investment environment, thus contributing to enhancing the market competitiveness.

A Short Note on SOE Reform – Mainly Summarizing Chapter 4, ESR

Shigeru Ishikawa

1. Characteristics of this study

In pursuit of the assigned task of this study on the Vietnamese SOE reform, we took two sets of special approach and methodologies:

(1) Approaches;
- a) A gap approach
- b) An approach to market economy promotion

(2) Methodologies
- a) A comparative Viet Nam-China Study method
  -- This is mainly for overcoming the severe shortage of statistical and other information on the SOE topic on the Vietnamese side.
- b) Integration of two contemporary survey results on the Vietnamese SOEs
  - (i) A joint OECF-CIEM(MPI) project on the questionnaire study of some 200 sample SOEs
  - (ii) A joint JICA-CIEM(MPI) project on the in-depth study of 13 selected SOEs

There may be some differences in these approaches to the studies on SOE reform from those taken by the World Bank and IMF.

(1) The approach to institutional aspect of the reform: the approach within the given framework of SOE *vs.* the approach in wider perspectives including the possibilities of divestiture and privatization
(2) Probable differences in the weighting of the significance of the actual facts of the market economy underdevelopment and the remaining customary elements in the economy
(3) The emphasis of the research method either on the macroeconomic and legal-institutional aspects or on the microeconomic aspects

Despite these differences, however, these two approaches, and hence the study results, are complementary.

2. <u>The framework of the study</u>

(1) For the purpose of deriving policy options for the SOE reform, the overall performances of the SOE activities are analyzed in terms of
   a) statistical indicators showing productivity and financial performances, and
   b) institutional stability of the SOE system and maturity of the conditions for advancing the stage of SOE development.

(2) The above SOE performances should be explained largely by (i) specific determinants of the SOE performances and (ii) mechanism in which these determinants work together to yield the overall performances.

(3) In Table 1 of the background paper, this framework is shown in terms of the research items of the whole study. In the attached Table 1, the framework is summarized in three columns. The items surrounded by broken lines are those directly relating to the institutional aspect and what we are seriously concerned about.

3. <u>A Stage-making for SOE development</u>

(1) A standard model of SOE development stages in Viet Nam (commonly to China)
   i) Patrimonial stage
   ii) The stage of factory under complete planning
   iii) The stage of enhanced autonomy
   iv) The corporatization stage
   v) The privatization stage

(2) The present stage in Viet Nam is on (iii). In 1991-1994, a "re-registration of SOEs movement" resulted in a divestiture of a large number of SOEs under local government jurisdiction. But they were mostly small-sized. Presently only seven SOEs were corporatized (as of early 1998). In China, as of the end of 1995, about 2400 enterprises were incorporated in the form of joint-stock company, ltd. and about 17,500 enterprises in the form of limited company.

4. <u>Results of the study on the present conditions</u>

<u>A. Performances</u>

(1) Productivity and finance: As compared to China, the performance were less serious. (In China, while the performances in TFP were fairly good, those in the profit and loss account serious.)

(2) Institutional dimension: Institutional stability of SOEs in the autonomy

enhancing stage is generally weak due to excessive "insider control", although the degree of autonomy achieved in Viet Nam appears much larger than in China. (See Table 2) The conditions for shifting to the next stage of corporatization are poor.

B. Determining factors of the performance

(1) Initial conditions of the economy – A low, net domestic saving ratio; a very early industrialization stage; a low level of financial development (such as expressed by the low % of M2/GDP and the low ratio of the bank credit extended to SOEs); the labor surplus conditions seem less serious in Viet Nam, as drastic employment reductions were made two times in 1989-90 (total number reduced amounted to 518 thousand persons 25% of those employed in the state sector) and in 1991-94.

Product and factor market environments -- In general poorly developed. In the financial domain, a gold and dollar economy plays a significant role. State commercial banks' role of financial intermediary is weak. Hence a large stock of bad credit.

(2) Factors relating to the SOE development stages

a) The length of stage (ii) in Viet Nam was very short (1975-1985) as compared to China (1949-1978). This brought about a few effects on the later development of economic systems and industrial structure in Viet Nam.

b) Progress of stage (iii), which in fact was in the early 1980s, was not necessarily deliberately designed. A series of economic and financial crises which started at the end of 1980s (the end of Russian aid, collapse of the COMMECON trade and involvement into Cambodian Civil War) forced the government to abandon any systematic attempt of promoting and fostering the state enterprises expect for a small number of large ones. Laissez faire policy was the result. This compares to China's policy to develop the state enterprises under the deliberate government control.

c) Residuals from the past stages

Due to the incomplete fulfillment of the tasks for each SOE development stage in the past, these residuals remain even at the present stage, though with lesser force than in China. A few pieces of available evidence:

i) Absolute controls of the SOE by the state – as reflected in the fact of "forced donation" being practiced.

ii) Soft budget constraints

iii) The power of managers outweighs the state as supervisors

iv) Lack of adherence of contracts and property right

d) Government policies

Esp. matter of corporatization and privatization

e) Management and technological reform, which plays decisive roles independently from the exogenous, determining factors in the above. (Tomatsu & Co. will make a presentation about this item.)

C. Mechanism combining these factors together

(1) Information about the *modus operandi* of these combination is seriously lacking.

(2) Some of the revealed ones are as follows:

i) Many SOEs considered the Cabinet Decision about SOE autonomy enhancing (1989) as providing them with in unconditional autonomy in production and asset disposition, hence refusing to accept government supervision and intervention.

ii) SOEs did not fulfill obligations to repay bank loans.

iii) SOEs were not seriously concerned about the obligation to maintain and increase the value of capital assets invested by the state.

On the basis of the unofficial information on the SOE reform proposal, we consider that the *modus operandi* of the various determinants working together in China were in operation in Viet Nam, though to the lesser extent.

D. Overall obsarvations

(1) was due to the fact that recurrent reshuffles of bad SOEs and periodical Short-term indicators of the SOE performances exhibited fairly good results. But this elimination of work spots (redundant workers) brought about a temporarily good outlook. Since this was not accompanied by the structural improvement, the condition tended to deteriorate again. (Such as the ratio of loss-mating SOEs to total SOEs decreased from 35% in 1990 to 8% in 1993; but it started to increase from that year steadily to 20% in 1996. In 1997 it is estimated 30%)

(2) SOEs' autonomous decision-making power may appear much stronger than that in China. However, this is due to results of the government measures to throw out, and abandon the deliberate protection and raising of, most SOEs in the years of economic and fiscal crises toward the end of the 1980s. In China, the government measures to protect and raise SOEs persisted.

(3) Therefore, for most SOEs in Viet Nam there is not yet organizational and operational capability accumulated to raise its legal-institutional status to modern corporations. In addition, production facilities and technologies are poor. Product and factor market environments are also very weakly developed. Hence, the conditions for shifting the present SOE stage upward are not yet prepared.

5. Policy suggestions

(1) In light of the above observation of the present conditions of SOEs, but taking into consideration the current debate with the international agencies, it seems pragmatic for Viet Nam to consider the adoption of the GAP approach in dealing with to SOE reform. In order to make the negotiation successful, the Vietnamese government might formulate detailed scenarios of SOE reform which specify target dates and target numbers of transformation, so that she may convince others of the necessity to take a gradual approach.

(2) In any case, the classified approach to SOE reform is advisable. First, between SOEs of the commercial nature and SOEs of public goods nature; second, between SOEs in the industries with potentially competitive power in foreign trade and SOEs in the industries without such power.

(3) Against those SOEs which are classified as those to be retained, it is desirable for the Vietnamese government to take a deliberate policy of raising the capability in the organizational, business managerial, technological, productivity raising, and man-power training aspects, as well as legal-institutional reforms. Measures should also be taken to promote the market economy environments of the SOEs. In particular, the banking sector reform should come as the first priority matter.

(4) International donors might devise innovative measures to promote the Vietnamese government to redirect her SOE reform in the above ways. One of such innovative measures is suggested in the World Bank loaned project of technical innovation of Shenyang Machine Tool Plant Co. Ltd., combined with its institutional and organizational reform. It started in 1995 with the agreement of providing loans of US$ 121 million.

We have not dealt with the aspects of General Corporations and of private sector enterprises, as our study project did not cover them.

Table 1. Causality Map of the SOE Performances

A. Determinants of the performances	B. Mechanism	C. Performances
Initial conditions -Resource endowments -Domestic savings ratio -Industrialization stage	Integration of determinants through: -Production functions -Incentive mechanism -Ownership and management relations	Aspects of production forces -Productivity -Finance
Market environments -Labor markets -Fiscal system and Financial markets -Product markets	Institutional stability and shift in the stages	Aspects of institutions -Stability and shift capability
SOE development and factors relating to the SOE stages -Institutions of present SOEs -Residual elements of the past SOE development stages -Gap with the required elements of the imposed SOE stage		
Government economic policies Organizational, technological reforms done inside SOEs		

1. Space surrounded by broken lines indicates the area where the analysis in the stage-wise SOE development matters.

Table 2. Percentage of Surveyed SOEs which has not yet acquired managerial autonomy

Viet Nam 1996		China 1995	
Product mix, output	9.5%	Production and sales	13.7%
Input purchase, sales	28.0%	Price determination	21.9%
Employment	11.0%	Hiring	37.6%
		Dismissal	48.5%
Exports and imports	10.5%	Exports	74.4%
		Imports	78.4%
Profit disposition	34.5%		
Investment	21.5%	Investment less than 2 years of maturity	73.4%
		Investment more than 2 years of maturity	76.1%
		Asset purchase	68.3%
Asset disposition	40.0%	Asset disposition	75.6%

Sources: OECF-CIEM project and OECF-CASS (Chinese Academy of Social Sciences) project, both arranged by Yoshio Wada.

Result of OECF-CIEM Study

Yoshio Wada

Overseas Economic Cooperation Fund of Japan

1. Framework of the Analysis

Table 1 Incentive Structure, Property Rights Structure

	Incentive Structure	Ownership(Property Rights) Structure
Internal (Micro)	Managerial autonomy, Performance Contract, Labor Incentive etc.	Corporate Governance structure, such as the role of management board, appointment of Executive Directors, etc.
External (Macro)	Competitive Environment (product markets, factor markets), Financial discipline(hard budget constraint)	Legal Structure(Company Law, Commercial Law, Accounting Principle) and their applications (asset evaluation etc.)

2. Character of Sample SOEs

Table 2

Structure of the surveyed SOEs as classified by industry and geographic areas
(*Unit: # of Enterprise*)

Industry	Hanoi	Hai Phong	HCMC	Dong Nai	Quang Nam - Da Nang	Total	%
Food processing	8	5	12	2	9	36	18
Garment and Textile	9	5	18	3	12	47	23.5
Electronics and electric equipment	9	1	9	2	1	22	11
Building materials	7	5	8	4	7	31	15.5
Chemical	10	7	9	3	6	35	17.5
Machinery manufacturing	10	5	8	1	5	29	14.5
Total	53	28	64	15	40	200	100

Table 3

Origin of Vietnam's SOEs (Unit: No. of SOEs, %)

	North	Central	South	Total
Established by the state	71(87.7)	31(77.5)	40(50.6)	142(71.0)
Nationalized(Foreign)	3(3.7)	0(0.0)	7(8.9)	10(5.0)
Nationalized(Private)	5(6.2)	6(15.0)	30(38.0)	41(20.5)
Nationalized(Collective)	2(2.5)	2(5.0)	1(1.3)	5(2.5)
Others	0(0.0)	1(2.5)	1(1.3)	2(1.0)
Total	81(100)	40(100)	79(100)	200(100)

Source: Based on the survey results

Table 4: Structure of enterprises as classified by year of incorporation

Criteria	In all three regions		Northern Region		Central Region		Southern Region	
	# of SOE	%	# of SOE	%	# of SOE	%	# of SOE	%
Before 1975	64	32.00%	51	62.96%	1	2.50%	12	15.19%
From 1975 to before 1988	104	52.00%	18	22.22%	32	80.00%	54	68.35%
From 1988 to before 1992	22	11.00%	9	11.11%	5	12.50%	8	10.13%
From 1992 to now	10	5.00%	3	3.70%	2	5.00%	5	6.33%
Total	200	100.00%	81	100.00%	40	100.00%	79	100.00%

3. Productivity and Financial Performance

Table 5: Labor Productivity and Capital-Labor Ratio of SOEs

(Unit : 100Million Dong /Worker)

	# of Samples	Real Labor Productivity			Real Capital/Labor Ratio		
		1991	1993	1995	1991	1993	1995
All SOEs	154	13.2	19.4	20.6	10.2	10.9	14.6
North	73	8.9	12.7	15.7	6.8	9.2	15.3
Central	37	12.7	18.4	24.1	8.5	8.2	8.9
South	44	26.7	36.5	24.5	22.0	17.1	16.0
Central Government	68	14.0	22.8	25.7	12.3	12.9	16.8
Local Government	86	12.0	14.7	13.1	7.3	8.0	11.5
With Foreign Collaboration	46	14.8	16.5	21.7	10.7	8.6	17.6
Without	108	12.7	20.5	20.2	10.0	11.7	13.3
Established by Gov.	116	12.8	21.4	21.0	10.4	11.0	14.6
Nationalized	38	14.7	9.3	19.6	9.3	10.0	14.8
Food Processing	27	13.1	14.2	16.6	10.6	10.1	7.7
Garment & Textiles	37	9.0	12.1	17.0	7.9	8.0	16.1
Electric, Electronics	15	36.4	37.2	8.8	26.2	20.2	8.7
Construction materials	24	11.7	25.8	55.1	11.0	11.6	25.5
Chemicals	29	13.9	28.2	12.1	10.1	12.6	18.1
Machinery manufacturing	22	8.4	7.4	26.3	5.2	7.8	14.3

注 : Labor Productivity=Value added/Worker (Million Dong/Worker)

Capital-Labor Ratio=Value of Fixed Assets/Worker (Million Dong/Worker)

Values of 1993, 1995 are converted to real terms by GDP deflator(Industry)

Figure: Financial Performance by Region

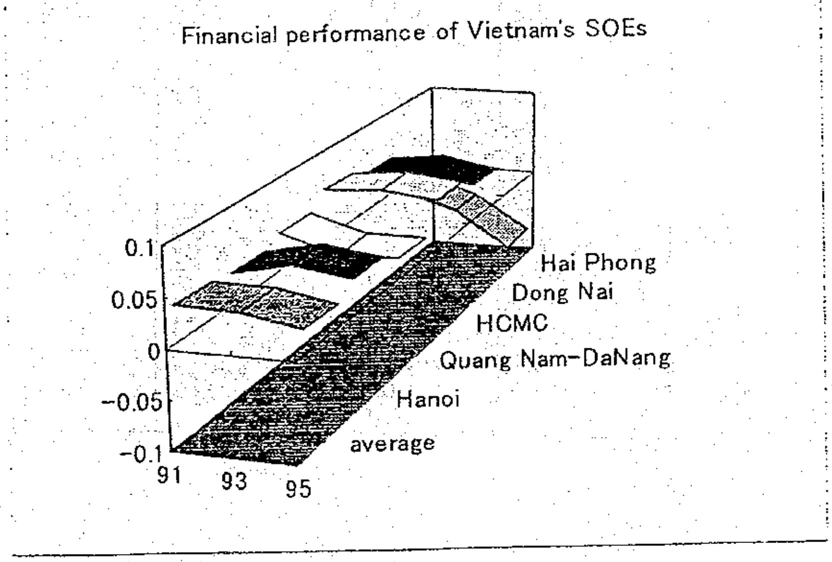

Table 6: Cost Structure of SOEs (Unit : % of total cost)

	Material cost	Labor cost	Social Security	Depreciation cost	Others
All					
1991	70.6	5.4	0.6	5.5	17.8
1993	69.5	7.4	0.9	4.3	18.0
1995	61.7	9.0	0.6	4.7	24.0
By region					
North					
1991	68.4	7.3	1.3	4.8	18.2
1993	70.2	9.1	1.4	4.6	14.8
1995	68.0	10.7	1.0	5.4	15.0
Central					
1991	71.3	4.7	0.4	5.9	17.8
1993	69.4	6.8	0.7	4.3	18.9
1995	58.2	8.4	0.5	4.5	28.4
South					
1991	70.2	8.4	1.2	3.4	16.8
1993	68.2	7.5	1.1	3.4	19.8
1995	69.5	8.5	0.9	3.4	17.6
By industry					
Food Processing					
1991	84.6	2.5	0.2	3.1	9.5
1993	75.2	3.1	0.4	4.2	17.2
1995	43.9	4.0	0.4	4.8	46.8
Garment & Textile					
1991	48.5	9.7	0.9	6.3	34.6
1993	45.3	16.2	1.7	5.0	31.8
1995	58.2	18.6	1.3	7.0	15.0
Electronics					
1991	74.8	7.1	0.8	4.6	12.7
1993	81.6	5.8	0.8	2.0	9.8
1995	81.9	7.7	0.3	2.2	7.9
Construction					
Material	64.4	3.4	0.6	14.2	16.8
1991	73.9	5.0	0.6	6.5	14.0
1993	68.6	7.1	0.5	6.1	17.8
1995					
Chemical	79.8	4.3	0.6	2.2	13.1
1991	75.4	6.9	1.0	3.5	13.2
1993	68.6	7.9	0.5	3.0	13.7
1995					
Machinery	64.0	11.3	1.7	4.1	18.9
1991	58.5	13.7	1.8	3.5	22.4
1993	56.0	14.2	1.0	2.9	26.0
1995					

Table 7 : Average Wage of SOEs Unit : Thousand Dong

	1991	1993	1995
All	192.7	432.3	712.9
North	107.9	289.3	595.7
Central	121.4	204.9	393.7
South	334.0	647.6	862.9
Central Government	228.2	490.0	832.3
Local Govenment	115.9	319.1	500.0
Food Processing	194.4	375.7	686.8
Textile & garment	191.9	353.2	571.8
Electronics	227.3	595.3	1,103.2
Construction Material	193.3	413.5	914.5
Chemical	195.6	510.5	856.4
Machinery	124.1	382.8	679.1

4. Incentives of SOEs

Table 8: Major Competitors of the Surveyed SOEs

	None	Private Small	Large	SOEs	coops.	foreign	JV	Smaggling	Imports
All	3.5	36.5	36.0	69.0	8.0	24.5	30.5	64.0	30.0
North	6.2	44.4	37.0	75.3	11.1	13.6	25.9	32.1	32.1
Central	2.5	40.0	35.0	62.5	12.5	17.5	20.0	27.5	7.5
South	1.3	26.6	35.4	65.8	2.5	39.2	40.5	39.2	39.2
Central Government	4.0	33.3	28.3	75.8	5.1	24.2	34.3	44.4	38.4
Local Govenment	3.0	39.6	43.6	62.4	10.9	24.8	26.7	23.8	21.8
Food Processing	5.6	47.2	41.7	66.7	0.0	22.2	30.6	8.3	13.9
Textile & garment	6.4	29.8	36.2	67.2	6.4	40.4	25.5	34.0	29.8
Electronics	0.0	27.3	27.3	63.6	9.1	27.3	59.1	45.5	59.1
Construction material	0.0	45.2	29.0	77.4	12.9	19.4	35.5	38.7	16.1
Chemical	0.0	42.9	45.7	82.9	11.4	22.9	17.1	42.9	40.0
Machinery	6.9	24.1	31.0	75.9	10.3	6.9	27.6	41.4	31.0

Table 9 : Financial Source of SOE Investment (1995) **(Unit : %, Million Dong)**

	Fiscal funds	Bank borrowing	Own funds	Average Investment
All	19.8	51.8	28.3	3,252
North	18.4	62.4	19.2	2,465
Central	1.5	87.4	11.1	1,979
South	24.5	38.6	36.9	4,704
Central Government	22.1	44.6	33.3	4,416
Local Government	15.1	66.7	18.2	2,112
established by state	21.4	53.0	25.5	3,086
nationalized	16.6	49.4	34.1	3,658
Food processing	26.9	26.7	46.4	4,011
Garment & Textile	12.9	76.0	11.1	3,231
Electronics	22.2	55.8	22.0	2,298
Construction material	11.9	56.3	31.8	3,796
Chemical	15.4	60.7	23.9	2,955
Machinery	35.7	31.2	33.0	2,845

Table 10: Structure of Debt of SOEs(1996) (Unit : %)

	Bank borrowing	Interenterprise debt	Deferred tax	Deferred wage
All	48.4	34.9	9.6	7.1
North	56. 5	31.1	7.9	4.5
Central	60.0	26.4	5.3	8. 3
South	33.5	43.6	13.8	9.2
Central Government	44.9	40.5	6.8	7.9
Local Government	51.5	29.9	12.1	6.4
established by state	50.1	34. 2	9.7	6.0
nationalized	44.0	36.9	9.4	9.9

Table 11: Timing of acquiring managerial autonomy(answers from managers) (Unit:%)

	75-79	80-85	86-90	91-94	95,96	Not yet
Production	5.5	8.0	55.5	19.0	2.5	9.5
Import/Export	7.0	8.5	44.5	26.5	3.0	10.5
Employment	7.0	8.0	44.5	26.5	3.0	11.0
Input/sales	3.0	6.5	38.0	22.5	2.0	28.0
Distribution of profits	5.0	6.0	31.5	20.0	3.0	34.5
Investment	2.0	2.5	34.5	33.5	6.0	21.5
Asset disposition	2.0	2.0	26.0	27.0	3.0	40.0

Source: Based on the survey results

Table 12: Frequency of contact between SOEs and Governments

(# of SOEs)

	All regions		North		Central		South	
	# of SOE	ratio	# of SOEs	ratio	# of SOEs	ratio	# of SOEs	ratio
No contact	0	0.0%	0	0.0%	0	0.0%	0	0.0%
very limited	4	2.0%	2	2.5%	1	2.5%	1	1.3%
Case to case	137	68.5%	59	72.8%	26	65.0%	52	65.8%
every week	14	7.0%	5	6.2%	2	5.0%	7	8.9%
every month	45	22.5%	15	18.5%	11	27.5%	19	24.1%
total	200	100.0%	81	100.0%	40	100.0%	79	100.0%

Table 13:

Forms of cooperation between Vietnam's SOEs and foreign companies (Unit: No. of SOEs, %)

	North	Central	South	Total
Cooperation with foreign partners				
No	60(74.1)	33(82.5)	38(48.1)	131(65.5)
Yes	21(25.9)	7(17.5)	41(51.9)	69(34.5)
Total	81	40	79	200
Form of cooperation				
Joint venture	8(50.7)	4(57.1)	23(56.1)	35(50.7)
Subcontract	1(4.8)	1(14.3)	0(0)	2(2.9)
Processing cont.	12(54.1)	2(28.6)	18(43.9)	18(43.9)
Total	21	7	41	69

Source: Based on the survey results.

5. Corporate Governance

- **SOE Law(1995)**
- **General Corporations**
- **Equitization**
- **Company Law?**

Study of Current Conditions in Production Management and Finance at State Owned Enterprises in Viet Nam

Tohmatsu & Co.

1. Purpose and course of the study

This study emphasises analysis of some Vietnamese enterprises on an ad hoc basis and includes statistical data provided by an Interim Report on a SOE Questionnaire Survey conducted by CIEM & OECF. Implications from macro data i.e., percentage of loss making enterprises, is important but not precise enough to draw any concrete policy. To argue on economic reform policy, it is particularly important to know the actual facts on performance of the enterprise and to analyse how these factors affect them and in what way.

After reviewing collected questionnaires from 17 State Owned Enterprises (SOE) the study team interviewed directors, vice-directors (and) or the chief accountants of 11 SOE's and 3 General Corporations (GC). The team also analysed the status of performance from financial data obtained during the survey period (Table 1). Although this was insufficient to analyse and provide consulting on all aspects of SOE's the team attempted to understand both the actual status and individual characteristics of each SOE.

2. Performance and factors leading to this

Although there is much variation in the figures shown in Table 1 & 2, the team observed, on an average, a remarkable improvement of performance in sales growth (12%) and profit (11%) over the last several years (1990 - 1995).

The main factors for this good performance are as follows :

- While subsidies from the government (hard budget) were abolished on a rather wide scale, weak and unprofitable SOE's were either closed or merged in accordance with the 1986 SOE reform policy. As a result, only the relatively stronger and more healthy SOE's remained.
- Management autonomy on internal control was given to the directors of SOE's to a considerable extent (It may be interpreted that the SOE's threw out restrictions

imposed by the controlled economy rather than the government intentionally giving autonomy) paving the road for their capabilities to directly influence performance of SOE's. (Most directors interviewed seemed to possess good business ability and sense)

- Although there still remains a big surplus of unskilled labour, this number has comparatively reduced due to the effort of the enterprises, i.e., an increase in production capacity and developing of new business, while maintaining social insurance costs of the enterprise at a low level (in comparison to SOE's in China).

However, the debt ratio which reflects the well being of the enterprise was high in several SOE's with competitiveness being rather weak from a long term point of view. The following reasons were sited :

- While capital expenditure demands remained very strong, most SOE's suffered as a result of difficulty in making timely investments due to a lack of funds and appraisal know-how by financial institutions.
- Internal reservation is also difficult due to high interest rates (average monthly short term rate is 1.2%) even in cases where the enterprise could obtain loan funds.
- Lack of experience in operating businesses under the market economy also posed as a factor. Preparation of management plans, integrating sales, purchase production and financing were not adequate and in particular marketing strategies were very poor.
- A lack of skilled labour seemed evident in most SOE's, especially in marketing, high operational technology and product development; administration staff are also limited. A very small number of businesses provide the required education and are involved in training co-operation programs with colleges.
- Employee incentives based on piecework payment or job contracts for the leasing of production or sales tools was popular. This system seemed productive for product enlargement on a short term basis, however, systems and policies relating to a qualitative level up in the improvement of quality, product development, marketing promotion and the like seemed insufficient.

3. Issues and recommendations

Based on the results of the survey with due consideration, there still lie several issues and problems which require improvement by the persons concerned. The following are comments on high priority issues which should be realised and implemented as soon as possible regardless of any macro economic policies set up.

3-1 *Internal (managerial) issues and recommendations*

- Innovating the consciousness of the management and employees of enterprises in order to grow out from a production (factory) oriented to a market (corporation) oriented system.
- Establishment of core business functions such as marketing, research and development, business planning within the enterprises organisation.
- Long and middle range management plans should be prepared using the 'plan', 'do', 'see' management cycle.
- Vertical organisational activities, such as the establishment of management boards consisting of the top level directors from key departments, quality control (QC) circles, project teams for product development and the like should be implemented.
- Human resource development for production engineering, product development and marketing are essential.
- Capital investment plans should be prepared in a timely manner with financial control, including accounts receivable and accounts payable always being maintained.
- A corporate accounting system should be instituted and efforts should be made to implement it using suitable information technology/equipment.

3-2. *External (Environmental) issues and recommendations*

Besides fiscal and financial policies, industrial and legal reformation, government officials should consider and introduce the following policies in order to achieve SOE reform :

- Monitoring and evaluation of SOE's as the owner
  - promoting the implementation of new accounting standards and auditing system by independent accounting firms
  - preparation of evaluation standards for SOE reform and oversee its implementation
  - preparation of guidelines for evaluating, assigning and dismissal of directors

and incorporate related incentive programs including the management contracting method

- assist in developing a management model for SOE reform

- Implementing policies in order to develop and accumulate management techniques and know how:

  - by acquiring management skills and production techniques through promoting Joint Ventures with foreign companies,

  - establishment of a management and technical institute (as in the Japan Productivity Centre) by CIEM, colleges, GC's etc.

- Measures to counter the surplus number of labourers and policies to raise the skill level of workers:

  - strengthening facilities for vocational training and placement guidance

  - promotion of a flexible labour market

- The role of General Corporations and Precautions to be taken: Precise evaluation of GC's is difficult as this system was only introduced recently. However,

  - GC's should play the role of co-ordination so as to enable the SOE's to operate on a more free and flexible base sharing resources (labour, money, equipment etc.) and information among them.

  - Attention is necessary however, to ensure that the autonomy of the SOE's does not become restricted nor the enlargement of privileges of the GC's or setting of monopoly prices.

4. <u>Equitisation and Joint Ventures with Foreign Direct Investment (FDI)</u>

Additional surveys were conducted by the study team on equitised. to be equitised firms and a few Joint Ventures. The following is a summary of these surveys.

4-1 *Equitisation*

- The number of equitised SOE's as of June 1997, was about 10 and there has scarcely been any increase since then. The reasons for the delay seem to as follows:

  (a) resistance from concerned persons against uncertainty

  (b) difficulty in evaluating the enterprise to determine share pricing

  (c) Incomplete legal procedures with respect to equitisation

  In order to promote equitisation, concrete countermeasures for the above reasons as well as the following issues should be considered :

  (a) Equal treatment of all economic sectors and abolition of privileges for SOE's

  (b) Setting up a stock market

  (c) Implementation of an external audit and disclosure system

4-2 *Joint Ventures with FDI*

- In order to strengthen competitiveness between SOE's in a positive manner, it is important to utilise both finance and management know-how. However, the probability of foreign firms investing in SOE's is still low due to several restrictions imposed. The following are policy proposals that should be considered :

  (a) Settle on a strategy plan to strengthen SOE's utilising JV's

  (b) Release and/or reduce restrictions in order to promote incentives for foreign firms

  (c) Improvement of the law on foreign investment and other legal issues

  (d) Promoting competitive circumstances between domestic SOE's and FDI firms as well as among FDI firms.

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BRIEF COMMENTS ON STATE ENTERPRISE RESTRUCTURING IN VIETNAM (SESSION FIVE)*

The basic idea in Vietnam is that state-owned enterprises (SOE) and their joint ventures with foreign investors should have a leading role in industrialization. This means a major role, since state enterprises have been growing at least as fast as private firms in recent years, while joint ventures have been growing twice as fast. Together, the state enterprises and the joint ventures account for about three-quarters of industrial output, up over 10% from just five years ago. This is in sharp contrast to China where the share of pure state enterprises in total gross industrial output has been falling for 20 years from about 80% in 1978 to 28% in 1996.

The view taken of state enterprises, or any enterprises, in this paper is not ideological. There is no *a priori* assumption that state is better than private or private better than state. The problem is to devise an industrial structure that can compete in domestic and world markets, make profits at prices similar to those in unprotected markets, and generally repay their loans and hire more workers at reasonable wages. A short period of protection is one way to get started, but not a prolonged period of "infancy".

There is not, in general, good financial data available on the performance of state firms. It is reasonable to assume that they are performing as well or as poorly as in China, unless reliable information shows otherwise. (China has had extensive experience in managing state enterprises, including incentive contracts.) In China, the state enterprises in industry, as a group, lost money in 1996. Since the industrial state enterprises in Vietnam account for about 90% of all capital, a low or negative rate of return means that unless loans or foreign investment supply funds, there will not be much to invest.

It is argued in my previous paper that there is a sharp falling off in foreign investor interest in Vietnam. As Lee Kuan Yew observed, "Foreign investors come to make money,

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* A paper prepared for the Workshop on Vietnamese Economic Development, sponsored by JICA and held March 22nd and 23rd, 1998 in Tokyo, Japan

not to help reconstruct Vietnam." There has been a lot of trouble making profits and with changing rules, forced conversion of foreign currency accounts in banks, and a difficult situation with overall demand, it seems likely that additional foreign investment will be very difficult to attract under the current rules. Foreign commercial banks will not make many loans for projects that have little ability to export, or cost as much in foreign exchange for imported inputs and debt as the imports they displace. In short, the strategy of relying on state enterprises or their joint ventures cannot be adequately financed, unless aid (ODA) is used. It is assumed that the domestic banking system will not be able to mobilize much long-term capital in the near future due to a lack of confidence in the value of the *dong*, and the tendency of banks to keep foreign exchange even when a saver wants to withdraw his own money.

Where does this leave the 6000 state enterprises, of which 2777 are industrial state firms? If they cannot earn money, cannot attract foreign investors, and cannot borrow much they cannot grow much. Either they must improve their operations so as to generate more funds from internal expansion, or find ways to attract commercial credit. Alternatively, they may tap ODA funds. However, this would put the state enterprises in direct competition with roads, irrigation, water supply, sewers, and other social investment that is normally the primary destination of ODA. The proposed Son La hydroelectric project, with an estimated cost of $3.5 billion not including interest, would itself use several years worth of ODA at current or likely disbursement rates.

There seem to be a variety of views about the present state and future of the SOE. The Resolution of the Fourth Plenum of the Communist Party of Vietnam separates public service enterprises from business enterprises. For the latter, "it is necessary to set up plans to introduce the share-holding system to these enterprises to improve their operations. We must revise and supplement regulations and strengthen management organizations to introduce the share-holding system to state enterprises at all levels. The sale of shares to foreigners should be done on a trial basis….We will transform state enterprises into limited companies or joint stock companies." This suggests a group of enterprises with some strong and weak points that can be improved. On the other hand, General Tran Do said in a recent wide ranging letter to the Communist Party, "Everyone knows the kind of losses the state-owned enterprises generate; the size of the government subsidy for them every year; and how horrible a source of corruption and waste they have become." This view suggests more deep-seated and systemic problems that need more than incremental measures.

Many of the smaller state enterprises will equitize, and perhaps this will help them. Changing the ownership alone without other changes may not make a major difference, but aligning the interests of management with owners is unlikely to do damage. However, if the ownership is split among the Ministry of Finance, other state enterprises, the top management, and a little for workers, it is not clear if operations will be much different. It depends on the shares of ownership and the vigor and skill which the various owners show in supervising management. If a "main bank" system were developed, as in Japan, the banks could grow into a supervisory role over time. However, if the accounting remains murky, owner supervision lax, and the banks simply interested in collateral, it is not likely that equitization will, by itself, create major changes in management behavior.

It may be that many of the smallest state enterprises can be given to the workers and managers if they assume liability for the loans, pension benefits, and agree to certain employment targets. This would obliterate the supervision problem, and many firms may not be worth much more than their liabilities.

It is likely that the larger state enterprises will need real restructuring. This means some analysis, a business plan, and real supervision. They may be equitized, but in this case it will have to be meaningful. A small number of large firms, no more than a few hundred, might be supervised by the Ministry of Finance and other shareholders. In some of these firms, ODA should be used as part of a package to improve their operations. If some part of the work force needs to be retired, ODA should be used to compensate the retiring workers. These firms may also benefit from protection, but as the Resolution of the Fourth Plenum said, "The state will continue to follow a reasonable protection policy to help domestic production, but protection will be selective, conditional, and temporary."

However, the future success of the economy and of industrialization will ultimately not depend on reforming the state enterprises or on equitizing them. It will require the growth of the private sector on an equal basis, with a revitalized banking system. There is no example of a successful nation that has used a state owned and managed sector as its main pillar. This development should be the real goal of a contract between the donor community and the Vietnamese leadership – not the obliteration of all state enterprises, but a policy environment in which efficient private and public firms can flourish. The recapitalization of the banking system with ODA is as important, no more important, than the restructuring of most of the state enterprises. (Helping the workers displaced is very important, and must be done with the financial restructuring.) If the banking system begins to operate in a normal way, it will make the capital allocation decisions. It will demand decent financial accounts. It will monitor management performance. It will force corrupt or incompetent management to leave or change its ways. This is why the question of industrial and financial restructuring must be jointly analyzed and determined. Without the right incentives and supervision, no amount of money will be well used. Without money, even smart and honest management will have trouble turning a firm around.

The fact is that Vietnam is attempting to industrialize in a fundamentally more difficult environment than any other Asian economy has faced in some time. It needs to find a method of ownership and control for its state firms, and to promote the development of private firms, if it is to begin "catching up" to some of its neighbors. Ironically, the very things that act as drawbacks – weak financial and industrial sectors – also may help it overcome its problems more easily. The ratio of bank credit to GDP is only about 20%, compared to about 100% or more for China, Thailand, or Malaysia. Its share of state enterprise to total employment is only 5%. This makes the problems in these sectors, however severe, soluble with ODA. Vietnam can use its low income and development as an advantage to reform its major banks and firms, avoiding the mistakes that many of the other Asian nations made.

A serious negotiation is needed about what is needed, what is acceptable, and what is expected. If the major donors and the Vietnamese leadership can agree on a plan of action, then additional aid can be released when specific milestones are reached. It makes no sense to be "generous" in the sense of lending for badly run companies or overpriced factories that cannot compete or for poorly chosen projects. Vietnam does not need to accumulate debt for these purposes, and would be better off if it did not. On the other hand, the donors should be interested in warmly supporting real reform. ASEAN could use a strong Vietnam, and the region would be better off if it began to grow in a solid and sustainable way.

This is a time of fundamental reassessment in both Asia and Vietnam. Lessons will be drawn from the crisis for some years to come. However, the basic lesson of the past year and more is clear: borrowing can be a curse if it is done carelessly or poorly, just as it can be a blessing if it is used well. The challenge for Vietnam is to find an acceptable policy mix which will direct the money it does borrow into productive uses and profitable firms. It needs to identify the steps it wants to take to achieve this, and then persuade the donors that these are serious steps that will in fact be taken. The donors need to agree to the package and then support it as the milestones previously agreed to are reached. The United States is not a major donor, but should begin to play a more constructive role. If it does not, at least, provide MFN to Vietnam, it will be hard to make the overall package work, since manufactured exports will need to be part of any overall restructuring. If all the pieces fall into place, the rate of progress in Vietnam could be very rapid.

Economic Reform and Fiscal Management of Viet Nam

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March 1998

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1. Review of fiscal management of Viet Nam

Quote from our Executive Summary:
"4.1 Reforming fiscal management"

2. Major characteristics of public finance of Viet Nam

2.1 Improving revenue-raising capacity of the government
2.2 Structural problem: too much dependence on the SOE's for raising revenues

3. Central-local fiscal relations

3.1 Strengthened fiscal centralization
3.2 Allocation of capital among provinces
3.3 Evaluation of the Budget Law: is the law a major step toward decentralization?

4. Prospect of public finance in Viet Nam

4.1 Successful introduction and implementation of the Value-Added Tax is a key for stable budget.
4.2 Reforming the current Pay-As-You-Go social security system into a funded one will contribute to increasing savings and to developing financial markets.
4.3 Strengthening fiscal incentives of local governments will be conductive to better allocation of resources and, therefore, faster growth.
4.4 Public expenditure, especially capital expenditure and basic social expenditure, needs fundamental review.

Attached tables and figures:
1. "4.1 Reforming fiscal management"
2. Table 6 Budget Operations
2. Table 7 Structure of Revenue
3. Table 8 Tax to GDP Ratios
4. Table 9 Central and Local Fiscal Relations
5. Table 13 GDP Ratios of Expenditures, Revenue and Investment by Province
6. Table 14 Regression Results

Attachment

4.1 Reforming fiscal management

Viet Nam embarked on a major tax reform in 1991 and introduced the laws on such essential taxes as the export-import tax, the turnover tax and the profit tax. Though not in the form of laws, various other tax ordinances and the government decrees were introduced in this first-stage reform process to frame tax administration into the more transparent form.

These series of efforts that have been put toward modernizing tax system and strengthening tax collection have led to the increase in tax revenue. In fact, the progress has been significant enough to push the revenue to the GDP ratio up above twenty percent. Together with banning financing the fiscal deficits by means of money issuance by the State Bank, the efforts paid on the fiscal management contributed to stabilizing the economy in Viet Nam.

Good achievements on the macro economic front, however, have left some structural problems in fiscal policies. In a sense, one may say that the fiscal issues of Viet Nam are getting to be more intrinsic; that is, the tax reform calls for more structural changes than mere frame-constructions. So far the bulk of Vietnamese taxes have been coming from the SOE's in either profit or turnover taxes, or export-import taxes or non-tax revenues from the oil. The versatile market economy that Viet Nam has been intending to stride into will find this excessive dependence on a handful of taxes inefficient for mobilizing resources in the country.

In this regard the second-phase tax reform has been over due, and the recent efforts toward this direction is a welcome sign. The Value-Added Tax (the VAT, hereafter) and the Business Income Tax (the BIT, hereafter) are the focal issues of this process. The reform in the individual income tax would also be necessary, but raising personal income tax along with the introduction of the VAT would be in both administrative and tax-burden perspectives too much at a time.

Our diagnosis of the coming tax reform has been prepared in a separate paper entitled "A Note on Major Issues of the 1997 Tax Reform in Viet Nam: the Value-Added Tax and the Business Income Tax" (prepared under the request by Dr. Lai Quang Thuc at the MPI). Our messages in the note are the following.

In the VAT, signals should be sent more clearly about the basic nature of the tax; that is, the VAT is the tax on consumption, therefore intermediate costs including capital investment must be fully deducted, and the zero rate must be fully applied to exports. When implementing the VAT, these issues are as important in Viet Nam as elsewhere, however they are especially so to Viet Nam.

The reason of this stems from the tax environment in Viet Nam in which taxes have been collected by local governments, and some of the provinces have been endowed with the entire collection and have been allowed to use the tax proceeds for themselves. Under this circumstance there can be a case where the VAT collected at an intermediary stage may be retained and used by the place the tax is collected. That means that the sources of tax rebates (i.e., the input taxes) are taken away at preceding stages and that they are gone when they are supposed to be paid out to succeeding stage producers.

This problem would be most important for export rebates. Since the zero rate is applied to their products, exporters can recoup all the taxes paid to their inputs at preceding stages. These rebates can be very big, since the exports are the final stage of production and the VAT paid up to their production would be well piled up. And yet, one of the most important features of the VAT is that unlike the turnover tax it is the tax on domestic consumption. The export rebates are, therefore, the thing that must be strictly guaranteed by the government to every exporter, no matter the producer is Vietnamese or foreigners.

The profit tax is replaced by the Business Income Tax and a uniform tax rate will be applied to every firm. In view of the present highly distortionary profit tax structure, setting the tax rate at a uniform level is a major step forward to the transition to market economy. However, because of the very wide range of the profit-tax rates, it is understandable that those enterprises that have been granted the lowest tax rate are hurt, and therefore, very reluctant to the reform. Thus, gradual transition to the uniform profit-tax regime would be unavoidable for successful implementation of the BIT.

Surprising features of the proposed law is that the supplementary tax on excess profits is still in place. This seems to be only rationalized under the constraint that the high income made possible by the "excess" profits cannot be properly taxed. However, it is also the fact that the costs of this tax are very high, since the profits, if left to producers, could have been put into investment. This would apply both to the SOEs and private enterprises that have suffered from the limited access to financial markets.

As for the tax treatment of the FDI we have emphasized the importance of receiving more FDI and suggested the risk of pushing it to other countries if Viet Nam starts raising the tax on it. Our suggestion seems to have been well taken by the legislators, and at the final draft of the BIT the rate of profit tax to the FDI has been set at the rate that has been specified under the Foreign Investment Law. This seems to us an inevitable choice for Viet Nam; moreover, more simplification like the elimination of foreign remittance tax would be the next step that deserves serious attention.

Finally, and not the least important at all, there are a couple of fiscal areas that need more reform and examination for achieving better resource allocation and higher economic growth. They are the fiscal relations between the center and the localities, especially provinces, and the mobilizing saving through the funded pension system.

The Budget Law enacted in 1996 is the first legal arrangement that has outlined the scope of revenue and expenditure of the four levels of government: the center, provinces, districts and communes. The year-by-year budget negotiation at the Ministry of Finance in Hanoi has consumed enormous time and efforts of both central and local key people in financial affairs. The new Budget Law has settled the dust of the long hours that have been put to the budget bargaining by temporarily stabilizing the fiscal arrangement from three to five years. Given the previous situation this looks like a progress, however it would go without saying that more commitment on the part of the government is needed to make the fiscal arrangement between the center and localities transparent. Thus, the Budget Law should most properly not be viewed as some achievement, but a call for the beginning of setting up rules among various levels of governments.

The importance of the funded pension system cannot be emphasized enough in Viet Nam that has been suffering the sever shortage of savings. Presently the Vietnamese social security system is the Pay-As-You-Go type transfer system from the young to the old. One of the most important resources in Viet Nam is the young people; and the funded pension will help increase saving and mobilizing it by shifting part of income mandatorily from the young to capital investment. The financial market that has been so much belated in coming into being will also be very much stimulated by the development of the funded social security system. The experiences of Singapore's Central Provident Funds are just one example of this sort of pension systems. More recent pension reform in Chile and Mexico might apply better to Viet Nam. In any event, the focus of discussion should be not to spend away the pension contributions by buying the state bonds for financing the budget deficits, and to connect this important scarce resource to more productive ventures.

Summary : Reexamination of financial policies in view of the observation in Savings and Investment Survey of Households - 1997

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This paper presents some of the findings of the Savings and Investment Survey of Households implemented from April to May in 1997 (SISH97) and examines their implication for the issues of financial policies in Vietnam. The SISH97 is distinct from all other surveys conducted in Vietnam in its focus on savings and investment behavior of the household sector. It is much more explicit in the institutional environment in which savings and investment decisions are made by individual households.

The sample size of the SISH97 is 1788 households which are chosen randomly from the entire nation to satisfy two different objectives: (1) to find the changes of household behavior between 1993 and 1997 by including the same panel households surveyed in the 1993 Vietnam Living Standard Survey (VLSS) and (2) to obtain the estimates of the behavior of households which best reflect the current conditions for the 7 regions and the whole nation. 771 households out of 1788 households are chosen from the VLSS households and the remaining 1017 households are chosen from the sample households of the Multipurpose Survey Households Survey.

Following observations are derived from the Survey data.

(1) From the long-term point view, the most significant evidence seems to be the rapid progress of monetization of the economy. The fraction of households with positive stock of currency (dong) doubled from 44.9% in 1993 to 89.6% in 1997. Furthermore the average amount of currency held by households increased almost 10 folds from VND307,000 to VND2,958,000 between VLSS93 and SISH97 after adjusting for inflation. These figures imply that the government earned seignorage revenue as much as 4% of GDP each year from 1993 to 1997. However, the fact that almost 90% of the households now have positive dong stock indicates that the rapid monetization

process driven by a higher demand for real currency balance is now close to completion and the monetary deepening will take place through different channels, such as banks or other financial institutions. One important policy implication of this observation is that the room to finance government budget by seignorage revenue is now much more limited than it was four years ago. In this sense, the economy is more prone to inflation if the central bank prints more money to finance government budget deficits.

(2) In spite of the extensive and intensive monetization (dongization), the fraction of households with positive stock of gold remains almost the same for the nation as a whole, a couple of points higher than 30%. However a substantial change has taken place in the composition of households with positive stock of gold. In Urban Area the fraction of households with positive stock of gold has declined from 63.0% to 28.7% while it has increased from 20.7% to 32.4% in Rural Areas.

It is curious to know why such asymmetric changes have occurred in Urban and Rural Areas. One possible reason is the difference between the two areas in the accessibility to deposit facilities. Wealthy households in Urban Area are found to have bank deposits substantially higher than those in Rural Area.

While the average amount of gold held by household has increased from VND784,300 to VND1,853,400 over the four years and this increase is equivalent to the imports of gold worth $375million each year, the importance of gold in the portfolio of money and financial assets has declined from 62.9% to 29.6% because of the increase in the fraction of the dong currency among the monetary assets from 14.4% to 41.4%. The position of the US dollar in the portfolio of household assets is negligible.

What do such observations imply for gold policy? Given that monetization (dongization) is close to completion, demand for quasi-money (that is, savings instruments easily convertible to currency) will grow faster than demand for currency with income growth. While it is clear that gold import is not an efficient mechanism to meet such demand for safe savings instruments from the viewpoint of the economy as a whole, the prohibition of gold imports may simply end up with higher smuggling. The real gold policy must be sought in the policy of creating attractive savings instruments easily accessible by households.

(3) The fraction of households with deposits in banks and other financial institutions remained almost the same, 5.1% in VLSS93 and 4.9% in SISH97 respectively among the households panel. Given the significant nationwide progress in monetization (dongization) and the substantial dishoarding of gold in Urban area, it is puzzling to find such a result.

It is found, however, that deposit facilities of banks are available or useful only to those households which are rich enough to deposit a large amount of money in banks. In effect, there is a minimum deposit size that is binding in the portfolio decision of a household.

The policy implication of this observation for financial deepening is rather straightforward. We need to eliminate the minimum size constraint of deposits. The banking policy must be designed in such a way that banks benefit from attracting small depositors and that households benefit from depositing even a small amount of money in banks. Obviously the regulation on the interest spread has been deterring the necessary contradicts with such requirement.

For the household sector as a whole, the supply of funds collected through deposits is VND11.7 trillion and the fund offered to the households sector through banks is VND10.6 trillion. In net, about VND1.1trillion is channeled to the non-household sector through banks and other financial institutions. Since GDP is VND258.6trillion in 1996, VND11.7 trillion is about 4.5% of 1996 GDP and VND1.1 trillion is 0.4%.

(4) The average saving rate of individual household is either 28.6% or 17.1%, depending on how we treat the purchase of durable consumption goods. These values themselves do not seem to be very low. But households invest most of these savings into accumulating real assets, mostly to purchase or repair houses and land. As a consequence, accumulation of monetary assets which are used as vehicles to transfer resources from the household sector to the business and government sectors becomes extremely small, only 0.6% of current income. At present the financial surplus of the household sector as a whole is only of a negligible size.

One interesting fact about the savings rate is that its value is lower for households in higher Quintiles in Current Expenditure when we include the purchase of durable goods as a part of consumption: it takes on 25 to 27% for Quintile 1 and 2, but only 13.5% for households in Quintile 5. This implies that households in higher Current Expenditure Quintiles spend a larger proportion of their income to purchase durable consumption goods in comparison with households in lower Quintiles.

(5) When a household has a financial surplus, it splits the surplus mostly to increases its cash (76.0%) and gold (10.8%) and partly to reduce its debts (9.9%). When it has deficits, it finances the deficits mostly by reducing its cash (78.9%) or gold (5.7%) and increasing its debts to relatives or friends (4.8%) or banks and other financial institutions (2.8%) or sellers (2.8%). Again the contact of households with formal financial institutions is mostly limited to small amount of borrowings.

Vietnam seems to have entered the stage of development where establishing effective financial intermediaries are crucial for further development. Monetary deepening with currency seems to be coming to an end. Monetary deepening with gold imports worsens the trade imbalance, which could destabilize the development process itself. The demand for higher real money balances must be met with deposit facilities of financial intermediaries. It is important to eliminate the de facto minimum deposit constraint in the use of deposit facilities. For this purpose a proper incentive structure must be in place which enhances the development of the banking sector.

The Asian Financial Crisis:
The Impact and The Lessons for Vietnam

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A. Introduction

1. The crisis in Asia has occurred after several decades of outstanding economic performance. During the thirty years preceding the crisis, per capita income levels had increased tenfold in Korea, fivefold in Thailand, and fourfold in Malaysia. Moreover, per capita income levels in Hong Kong and Singapore now exceed those in some industrialised countries. Until the current crisis, Asia attracted almost half of capital inflows to developing countries -- nearly $100 billion in 1996. In the last decade, the share of developing and emerging market economies of Asia in world exports has nearly doubled to almost one fifth of the total. This record growth and strong trade performance is unprecedented, a remarkable historical achievement. So what went wrong?

B. Origins of the Crisis

2. The key domestic factor that led to the present difficulties appear to have been: first, the failure to dampen the overheating pressures that had become increasingly evident in Thailand and many other countries in the region and were manifested in large external deficits and property and stock market bubbles; second: the maintenance of pegged exchange rate regimes for too long, which encouraged external borrowing and led to excessive exposure to foreign exchange risk in both the financial and corporate sector; and third, lax prudential rules and financial oversight, which led to a sharp deterioration in the quality of the banks' loan portfolios. As the crisis unfolded, political uncertainties and doubts about the authorities' commitment and ability to implement the necessary adjustment and reforms exacerbated pressures on currencies and stock markets. Reluctance to tighten monetary conditions and to close insolvent financial institutions has clearly added to the turbulence in the financial markets. Although the problems in these countries were mostly homegrown, developments in advanced economies and global financial markets contributed significantly to the buildup of financial imbalances that eventually led to the crisis.

3. In many respects, Thailand, Indonesia, and Korea -- the countries most affected by the crisis -- do face similar problems. They have all suffered a loss of confidence, and their currencies are deeply depreciated. Moreover, in each country, weak financial systems, excessive unhedged foreign borrowing by the domestic private sector, and a lack of transparency about the ties between government, business, and banks have both contributed to the crisis and complicated efforts to diffuse it.

4. But the situation in these countries also differ in important ways. One notable difference is that Thailand was running an exceptionally large (8 percent of GDP) current account deficit, while Korea's was on a downward path, and Indonesia's was already at a

more manageable level (3.25 percent of GDP). These countries also called on the IMF at different stages of their crisis. Thailand called on the IMF when the central bank had nearly run out of usable reserves. Korea came still closer to a catastrophe, a situation which has imported following the election of Kim Dae-jung, the forceful implementation of the IMF-supported program even before he takes office, and the start of discussions with commercial banks on the roll-over of Korea's short-term debt.

5. Indonesia, on the other hand, requested IMF assistance at an earlier stage, and at the start -- in early November -- the reform program seemed to be working well. But questions about the implementation of the program and the President's health, as well as contagion from Korea, all took their toll.

C. Developments in Asian financial markets

6. Against the U.S. dollar, the currencies of Korea, Thailand, Malaysia, the Phillippines and Indonesia have depreciated (on a cumulative basis since the start of the crisis) by 35-70 percent, and the currencies of Japan, Singapore and Taiwan Province of China with about 15-20 percent (Chart A1). In real effective terms, the Vietnam dong has therefore appreciated substantially during 1997, notwithstanding the effects of the widening of the trading band in mid-October 1997, and the 5.6 percent devaluation in mid-February, 1998.

7. In addition, there have been sharp declines in stock market indices in all the affected countries with attendant losses in private wealth (the cumulative declines were around 40 percent in Indonesia, Korea, Malaysia, and Thailand; around 35 percent in Singapore and the Philippines; and 20-25 percent in Japan and Taiwan).

8. The combination of these factors: a sudden loss of confidence, decline or reversal of capital flows, and tightening of financial policies, have all resulted in sharply lower expectations for growth in the South-East Asian region. In the World Economic Outlook (WEO) published in May, 1997, average GDP growth for 1998 in the region was projected at 6.6 percent -- in successive downward revisions this has been lowered to 3.5 percent. (The projections referred to in this table are from November 1997 and are therefore somewhat outdated; further downward revisions are likely).

D. The Vulnerability of Vietnam in 1998

9. Inasmuch as there are important differences between the countries most affected by the crisis, it is not difficult to identify key differences between Vietnam and the rest of the region. Two important differences are, first, that Vietnam's financial markets are less

integrated with international markets, and second, that the structure of its capital inflows--largely foreign direct investment and concessional ODA--is also somewhat different.

10. Nevertheless, there are also some important similarities between Vietnam and the crisis-ridden economies in the region. First, the external current account deficit, estimated at about 9 percent of GDP in 1997, is by far the largest of the major ASEAN economies; such large deficits, which appear readily financeable in good times, can become a critical source of vulnerability if confidence wanes. Second, the exchange rate has appreciated in real effective terms and there are evident and growing pressures in the foreign exchange markets. Third, there are clear signs of stress in Vietnam's banking system have been growing over the past year. Fourth, there are signs that many enterprises have experienced a weakening financial performance, and have significant borrowing in dollar terms. These similarities indicate that Vietnam is vulnerable to some of the difficulties encountered elsewhere in the region, and the two primary channels where Vietnam will feel these difficulties will be exports and foreign investment.

11. Export growth, which averaged more than 30 percent annually between 1992 and 1996, slowed to about 20 percent in 1997 and will likely decline significantly further in 1998. There are two reasons to expect such a decline; the real appreciation of the dong vis-a-vis regional currencies, which implies a loss of competitiveness <u>both</u> in regional and in third-country markets, and the downward revision of regional growth rates, which implies less demand growth for Vietnamese exports.

12. The magnitude of Vietnam's vulnerability on the export side follows from Table A2 and A3. About 66-68 percent of Vietnam's export have been destined to the region in 1996 and 1997. In particular, about 26 percent of Vietnam's exports were "non-traditional" and highly price-sensitive commodities such as textiles, marine products, vegetables, and cashewnuts.[1] These commodities are predominantly destined for this region (textiles 57 percent, marine products 81 percent, vegetables 79 percent, and cashewnuts 71 percent) and would be among the first to be affected. In addition to this, however, there will also be an impact on "traditional" commodities such as rice, coffee, and crude oil, which make up 31 percent of total exports. Although these commodities are priced in US dollar in world markets, Vietnam -- together with Thailand and Indonesia -- are among the world's largest exporters of rice and coffee, which could result in some downward pressure on prices. Moreover, crude oil prices have declined sharply in world markets during the second half of 1997, partly as a result of expected lower energy demand in the Asian region in 1998, and partly as a result of increased production quotas in OPEC.

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[1] This refers to 1997. It should also be kept in mind that almost 70 percent of "other goods", many which are also likely to be quite price sensitive, go to the region.

13. Vietnam is; however, also vulnerable with regard to disbursement of FDI and thus balance of payments financing. In part, this follows from the decline in commitments in 1997, which, other things equal, would result in a decline in disbursements in 1998. In addition to this comes the effects of the crisis. About 62 percent of undisbursed FDI commitments are from the region; given the deep financial problems facing enterprises from this region, one would expect a tendency toward postponing projects for some time (Table A4). Contributing to this is the fact that more than 50 percent of undisbursed commitments are essentially in property development (hotel and tourism, buildings, New Cities, and construction) (Table A5). These are markets that are already showing clear signs of saturation -- independently of the crisis -- thus adding to a pressure for project postponement.

E. Some Important Policy Lessons

14. To maintain macroeconomic stability and sustained high growth, I see five critical lessons as critical for Vietnam. These lessons can be expressed as the need for:

- an early and comprehensive policy response;
- more, rather than less, integration into the world economy;
- greater flexibility in exchange rate management
- decisive action to correct banking sector weaknesses
- more transparency and a clearer regulatory framework

An early and comprehensive policy response is needed

15. A first lesson is simply that a gradualist and piecemeal approach to structural reform and macroeconomic management is no longer appropriate -- an early and comprehensive policy response is needed.

16. The fast pace of developments in Thailand, Indonesia, and Korea last year, but also the Mexican crisis in 1994 and other crises before that all underscore one simple point: early policy actions to address emerging financial sector weaknesses and external imbalances are likely to be much less costly, in terms of their impact on employment, incomes and growth, than if the problems are allowed to fester. Delaying a necessary policy adjustment not only deepens a crisis but also creates a confidence problem so that the adjustment--when it is eventually implemented--may need to be even greater to stem the crisis. To take one example, foreign investment inflows will be more difficult to maintain if policies only begin to adjust once a crisis hits, so that the reduction in the

external current account deficit will have to be larger than if policies responded in a more timely manner.

17. Moreover, the policy response has to be comprehensive, with a number of mutually supportive elements, in order to maintain confidence. In the case of Vietnam, this implies -- in addition to continuing prudent fiscal and monetary policies -- structural reforms in a number of areas, most notably:

- reform of state-owned enterprise, with rapid progress on equitization of small and medium-sized firms, and restructuring or closure of significant loss-makers;
- trade liberalization, with removal of non-tariff barriers to trade and significant simplification of the tariff schedule;
- financial sector reform; and
- greater exchange rate flexibility.

The latter two will be discussed in more detail below.

More integration is necessary

18. A second lesson is not to slow down Vietnam's integration into the world economy. In a very narrow sense, it is true that existing foreign exchange restrictions, the absence of a stock market, and the limited integration of Vietnam into regional financial markets have helped protecting the country from the immediate effects of the current financial crisis. Nevertheless, Vietnam cannot insulate itself from regional developments -- without an adequate policy response there will be a contagion effect, as argued in paragraphs 11-12 above.

19. One should keep in mind that the cornerstones of the success-stories of the ASEAN countries over the recent decades as well as the impressive growth of the Vietnamese economy in recent years are precisely market-oriented reforms, participation in international trade, and access to foreign capital. Continued reform in this direction would assist in developing more flexible tools of macroeconomic management that can be used to shield Vietnam from external shocks and turbulence while at the same time ensuring that Vietnam can continue to reap the benefits of an open and integrated economy and thus promote the development of the country. This point has been put quite succinctly by Mr. Gabriel Singson, Governor of the Central Bank of the Philippines: "Volatile capital flows will continue to be a challenge. But the answers are not in a return to control, but in managing the flows better." Indeed, the challenge in responding to potential volatility of capital flows lies in improving policy framework, not by imposing more administrative

controls, which limit enormous potential benefits of inflows and are likely to be of limited effectiveness, and possibly counterproductive.

Greater flexibility in exchange rate management

20. An unavoidable lesson for Vietnam is that greater flexibility in exchange rate management is necessary. I will offer three reasons why this is so:

- A (trade-weighted) measure of the real effective exchange rate of the dong has appreciated significantly as illustrated in paragraph 6.
- The persistence of the dong at the top of the interbank trading band, both before and after exchange rates measures in 1997 and in February of this year (Chart 1).
- The low, and declining, volume of trading in the interbank market, and the apparent emergence of a large inter-enterprise market for foreign exchange (Chart 2).

21. There is no doubt that judgements on when to shift in the direction of greater flexibility involve difficult decisions. In Vietnam, one such judgement obviously pertains to the exposure of the enterprise sector to large liabilities in foreign currencies. Clearly, a significant depreciation of the dong would increase the debt-servicing burden for many enterprises, especially those in import-substituting activities, and exacerbate an already difficult situation. This difficulty is, however, an argument in favor of early action rather than the opposite: the financial situation of the enterprise sector is not going to get better just by itself, and a comprehensive policy package of the type suggested earlier would go a long way toward limiting any depreciation of the dong under a more flexible exchange rate arrangement.

22. For many of the countries affected by the crisis, an earlier shift to a more flexible exchange rate regime could have helped to prompt the needed policy adjustments in a more timely manner, as well as conveying a better perception of exchange rate risks to investors and domestic borrowers. Certainly, the efforts by the Thai authorities to maintain for too long the exchange rate peg for the baht without sufficiently supportive domestic policies greatly contributed to the ultimate cost of the crisis.

Bank soundness

23. The experience of many other countries--in South East Asia and elsewhere--has shown that a financially weak and inadequately supervised banking system can be very costly both in terms of lower economic growth, (by lowering confidence, widening interest

rate spreads, and undermining the efficiency of investment) and the direct burden on public funds. For example, there have been at least a dozen cases in the developing world where estimated losses or resolution costs have exceeded 10 percent of GDP, including the recent cases of Venezuela, Bulgaria, Mexico, and Hungary.[2] The magazine "The Economist" recently published figures that suggest that overdues, or non-performing loans, in Thailand, Indonesia, Korea, Malaysia, and the Phillippines average about 15 percent of total loans, and that the cost of resolving this problem would amount to about 13 percent of GDP. And I am sure that for those of you that are familiar with the details of Vietnam, non-performing loans in the order of 15 percent of total outstanding credit must be a painfully familiar figure.

24. Therefore, a comprehensive strategy is needed to deal with problems at an early stage and should include the following key elements:

25. Early closure of insolvent institutions. The first priority should be to identify and close promptly institutions that cannot be kept open without major central bank support. In Vietnam, a significant number of joint stock banks are probably insolvent and need to be suspended quickly.

26. Restructure other weak banks, subject to strict conditions. Some of the state banks have substantial nonperforming loans and will require major restructuring. Progress in reforming the broader state-owned enterprise (SOE) sector will obviously be critical to these efforts.

27. Limits on explicit or implicit guarantees. As banking crises develop, a "flight to quality" often develops as creditors attempt to reduce their exposure to weaker institutions. It is important that the authorities, including the state banks, avoid granting ad hoc guarantees to these institutions, since such actions will greatly increase the exposure of the public sector in the event of a widespread crisis.

28. Strengthened supervision and prudential regulations. Vietnam's systems are inadequate for the effective monitoring of banks so as to detect, and correct, emerging problems at an early stage.

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[2] See, for example, **Banking Crises in Emerging Economies: Origins and Policy Options**, by Morris Goldstein and Philip Turner, Bank for International Settlements, October 1996.

Transparency

29. The final lesson I would like to emphasize concerns the availability and transparency of information that markets need to assess economic policies and financial sector developments. As events in Thailand again illustrate, when complete and timely data are not available, the risk is magnified that initial problems will develop into full-blown crises. This is true in all areas of data disclosure, but especially in exchange markets. Information is the lubricant of efficient market decisions, both in government and in the business community. I should point out, however, that in Vietnam the issue of transparency goes well beyond data disclosure; it also applies to licencing and approval procedures, and consistent and fair enforcement of rules and regulations that treat all market participants on the same footing.

F. Concluding Remarks

30. It is now apparent that the events of recent months in Asian financial markets may well have a severe adverse impact on the economy of Vietnam in 1998 and beyond. This reflects the contagion effects beyond the ASEAN countries, most importantly to Korea, and the delays by the Vietnamese authorities in introducing greater exchange rate flexibility, tightening fiscal and monetary policies, and implementing structural reforms in the banking sector, state-owned enterprises and the international trade system.

31. These developments have created the risk for Vietnam of a loss of macroeconomic stability and a balance of payments crisis, in the absence of prompt and decisive policy actions. The expansionary financial policies that are now in place are likely to cause higher inflation. The continued shortage of foreign exchange will result in severe import compression. These trends could lead to increased pressures for administrative controls that would contribute to misallocation of resources, lower economic growth and greater smuggling and corruption. For all of these reasons, there would be potential for social unrest.

Chart A1. Exchange Rate and Stock Market Indices, Sep 1997-Jan 1998
Cumulative percent change relative to pre-crisis peak

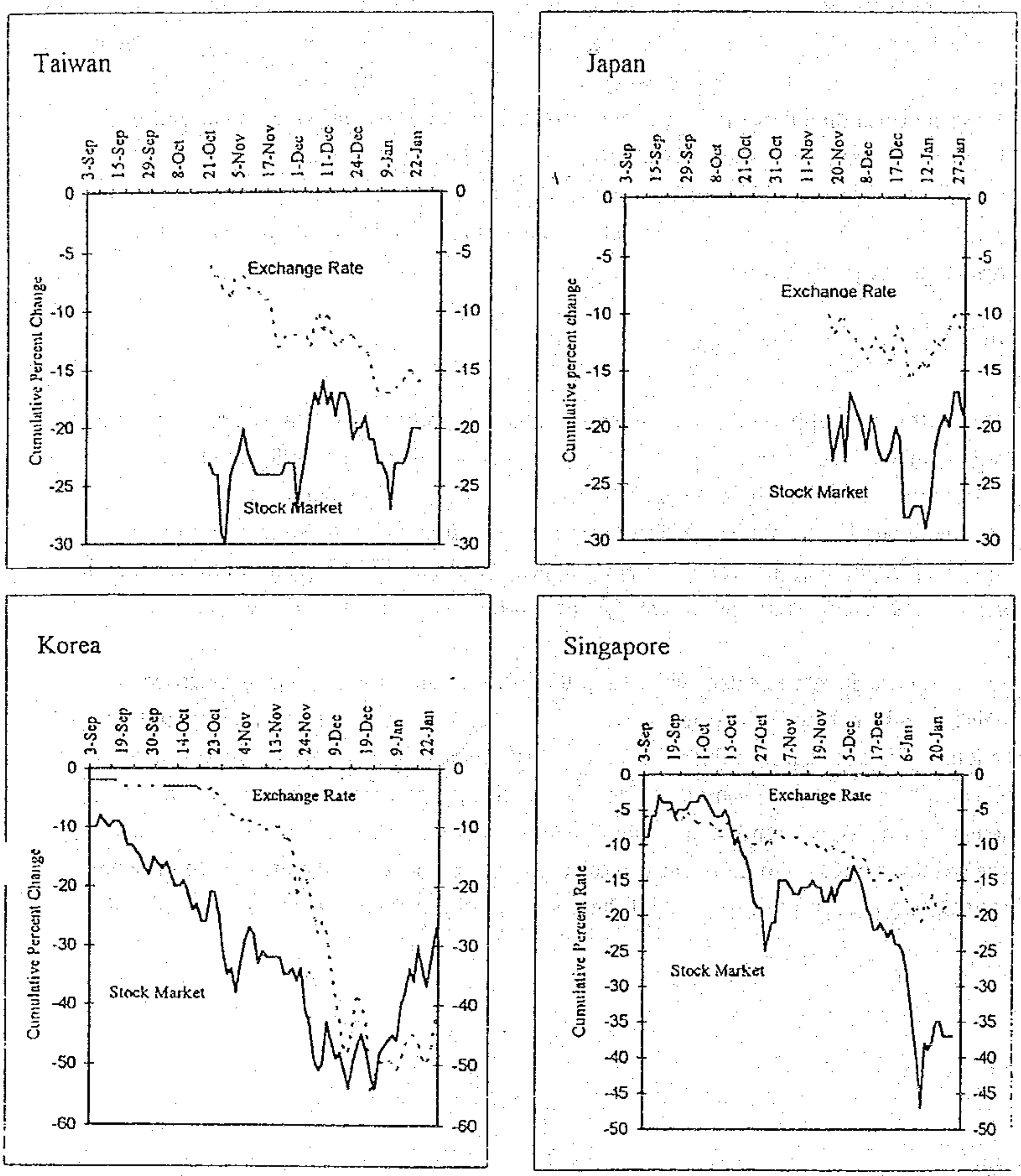


Chart A1. Exchange Rate and Stock Market Indices, Sep 1997-Jan 1998
Cumulative percent change relative to pre-crisis peak, (concluded)

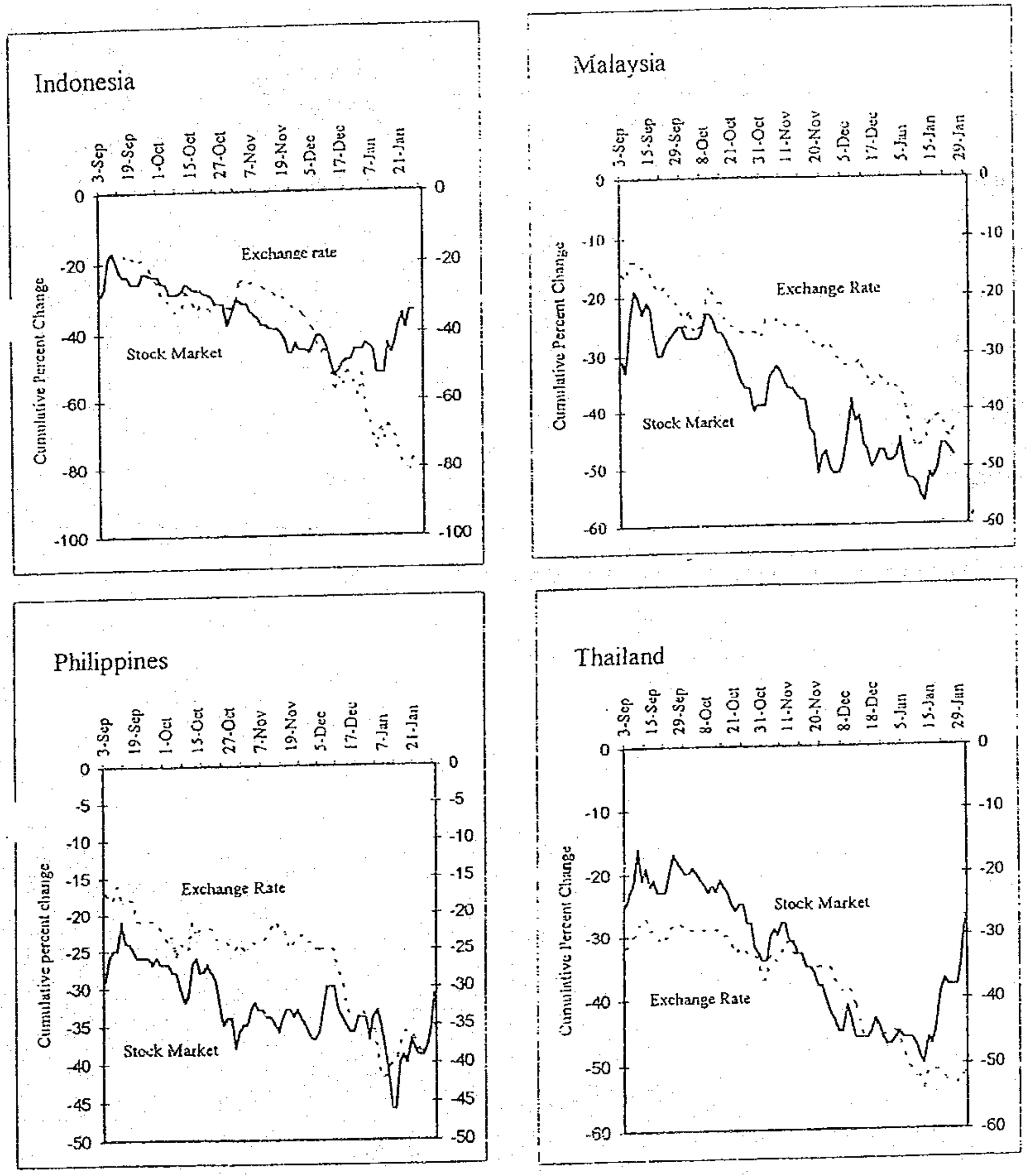


Table A1. Selected Asian Countries: Revisions to GDP Growth Forecasts.
(In percent)

WEO Forecast for 1998

	May-97 Published	Oct-97 Published	November -97, IMF staff projection	Cumulative Revision
Thailand	7.0	3.5	0.0	-7.0
Indonesia	7.4	6.2	2.0	-5.4
Malaysia	7.9	6.5	2.5	-5.4
Korea	6.3	6.0	2.5	-3.8
Philippines	6.4	5.0	3.8	-2.6
China	...	9.0	7.5	-1.5
Taiwan POC	6.3	6.4	4.8	-1.5
Singapore	6.1	5.5	4.7	-1.4
Hongkong SAR	5.0	5.0	4.1	-0.9
Unweighted average	6.6	5.9	3.5	-3.1

Source: World Economic Outlook and staff estimates.

Table A2: Export as percent of Total Export by Country

Destination	Rice	Rubber	Coffee	Crude Oil	Coal	Textile	Marine	Vegetable	Cashewnut	Tea	Other	Total
Export of 1996												
Japan	0.4	5.2	4.9	11.8	37.6	21.6	49.1	8.5	8.3	1.7	5.4	12.9
Korea	5.1	3.6	0.4	16.1	2.9	2.9	2.1	4.8	0.0	-	9.2	7.6
Rest of Asia	35.6	23.7	36.5	70.8	8.0	15.2	31.4	64.4	24.6	10.7	48.2	42.3
Other countries	58.9	67.6	58.2	1.4	51.5	60.3	17.5	22.3	67.2	87.5	37.2	37.2
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Export of the first 10 months of 1997												
Japan	0.2	3.8	7.0	23.5	48.3	27.1	47.8	12.3	0.6	-	15.7	19.2
Korea	3.0	1.3	0.7	-	0.0	6.3	2.5	2.5	0.2	-	7.3	4.4
Rest of Asia	28.7	24.4	31.2	64.3	9.1	23.4	26.3	26.9	5.4	-	38.2	36.1
Other countries	68.1	70.4	61.1	12.2	42.5	43.2	23.4	58.4	93.8	100.0	38.9	40.2
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Table A3: Export as percent of Total Export by Commodity

Destination	Rice	Rubber	Coffee	Crude Oil	Coal	Textile	Marine	Vegetable	Cashewnut	Tea	Other	Total
Export of 1996												
Japan	0.4	0.9	1.7	16.7	4.5	26.2	33.7	0.6	0.5	0.1	14.6	100.0
Korea	7.8	1.0	0.2	38.8	0.6	6.1	2.4	0.6	0.0	-	42.4	100.0
Rest of Asia	9.8	1.2	4.0	30.7	0.3	5.6	6.6	1.4	0.5	0.1	39.8	100.0
Other countries	18.4	4.0	7.2	0.7	2.2	25.4	4.2	0.6	1.5	0.9	34.9	100.0
Total	11.6	2.2	4.6	18.3	1.6	15.7	8.9	0.9	0.9	0.4	34.9	100.0
Export of the first 10 months of 1997												
Japan	0.1	0.4	1.8	18.8	3.2	20.7	22.7	0.5	0.0	-	31.8	100.0
Korea	7.2	0.6	0.8	-	0.0	21.0	5.2	0.5	0.1	-	64.7	100.0
Rest of Asia	8.3	1.4	4.4	27.4	0.3	9.5	6.6	0.6	0.2	-	41.2	100.0
Other countries	17.7	3.5	7.7	4.7	1.3	15.8	5.3	1.2	3.7	-	37.8	100.0
Total	10.5	2.0	5.0	15.4	1.3	14.7	9.1	0.9	1.6	0.5	39.0	100.0

Table A-4. Cumulative Commitments and Disbursement of Foreign Direct Investment by Investor, 1988-97

Investor	Total Commitments	Total Disbursements	Undisbursed Commitments	Disbursement Rate (%)
		(in million US$)		
Japan	3,066	1,224	1,842	40
Korea	3,123	1,227	1,896	39
Rest of Asia (*)	14,882	5,895	8,987	40
Other	10,233	3,019	7,213	30
TOTAL	31,304	11,365	19,939	36
		(percentage share)		
Japan	9.8	10.8	9.2	
Korea	10.0	10.8	9.5	
Rest of Asia	47.5	51.9	45.1	
Other	32.7	26.6	36.2	

Note (*)- including Singapore, Taiwan, Malaysia, Hong Kong, Thailand, Indonesia, and the Philippines

Table A5. Cumulative Disbursements of Foreign Direct Investment in Vietnam by Sector, 1988-97

Sector	Total Commitments	Total Disbursements	Undisbursed Commitments	Disbursement rate (%)
		(in million US$)		
Heavy Industry	5,311	1,874	3,437	35
Petroleum and Gas	1,316	2,018	-702	153
Infrastructure of IP and EPZ	830	314	516	38
Light Industry	2,995	1,247	1,748	42
Food Industry	1,966	779	1,187	40
Agriculture and Forestry	1,458	690	768	47
Hotel and Tourism	3,058	1,459	1,599	48
Services	181	52	129	29
Building of Apartments and Officetel	4,337	879	3,458	20
New Cities	3,344	0	3,344	0
ransport and Telecommunication/Post	2,710	598	2,112	22
onstruction	2,946	799	2,147	27
Culture-Health Care-Education	413	69	344	17
Fisheries	135	47	88	35
Banking and Finance	304	542	-238	179
			0	
TOTAL	31,304	11,365	19,938	36
		(percentage share)		
Heavy Industry	17.0	16.5	17.2	
Petroleum and Gas	4.2	17.8	-3.5	
Infrastructure of IP and EPZ	2.7	2.8	2.6	
Light Industry	9.6	11.0	8.8	
Food Industry	6.3	6.9	6.0	
Agriculture and Forestry	4.7	6.1	3.9	
Hotel and Tourism	9.8	12.8	8.0	
Services	0.6	0.5	0.6	
Building of Apartments and Officetel	13.9	7.7	17.3	
New Cities	10.7	0.0	16.8	
nsport and Telecommunication/Post	8.7	5.3	10.6	
Construction	9.4	7.0	10.8	
Culture-Health Care-Education	1.3	0.6	1.7	
Fisheries	0.4	0.4	0.4	
Banking and Finance	1.0	4.8	-1.2	

Chart 3. Exchange Rate Developments, 1996-98

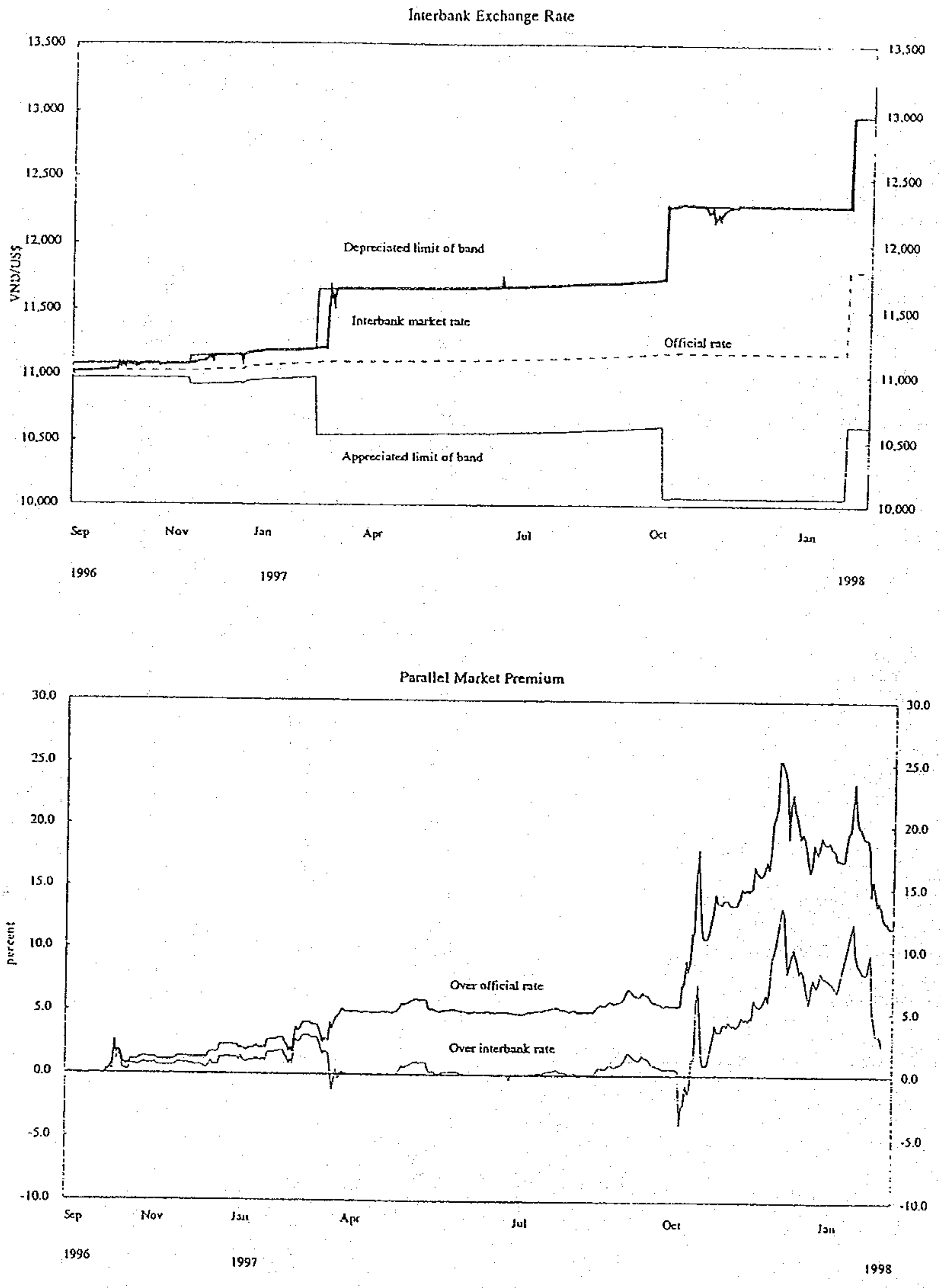
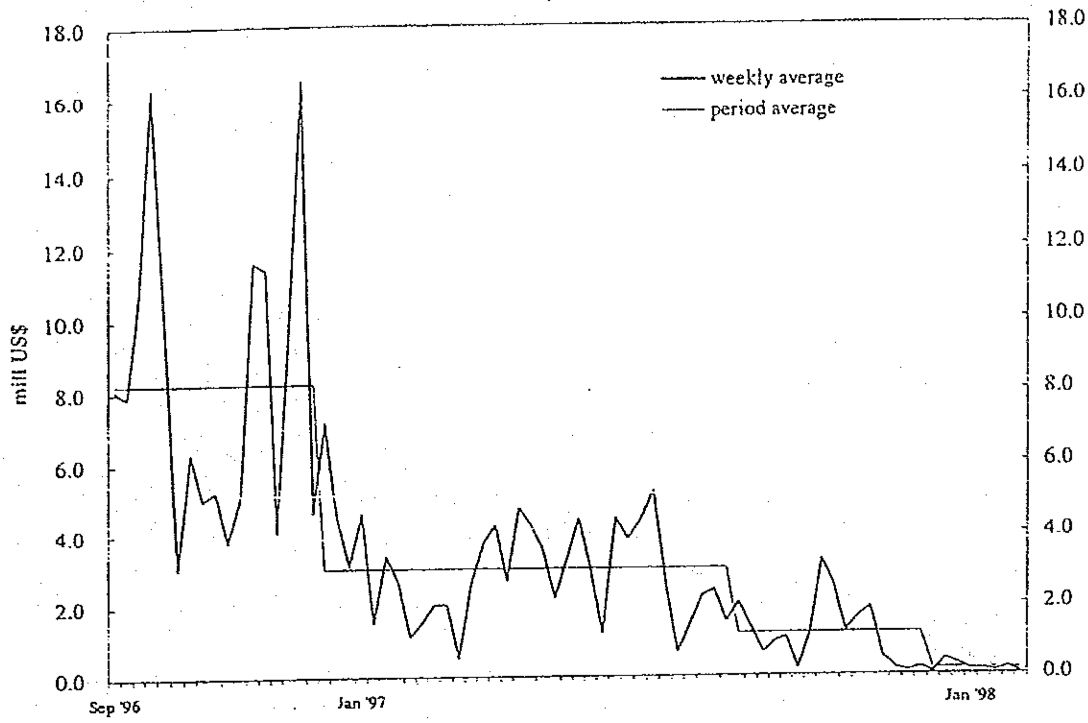
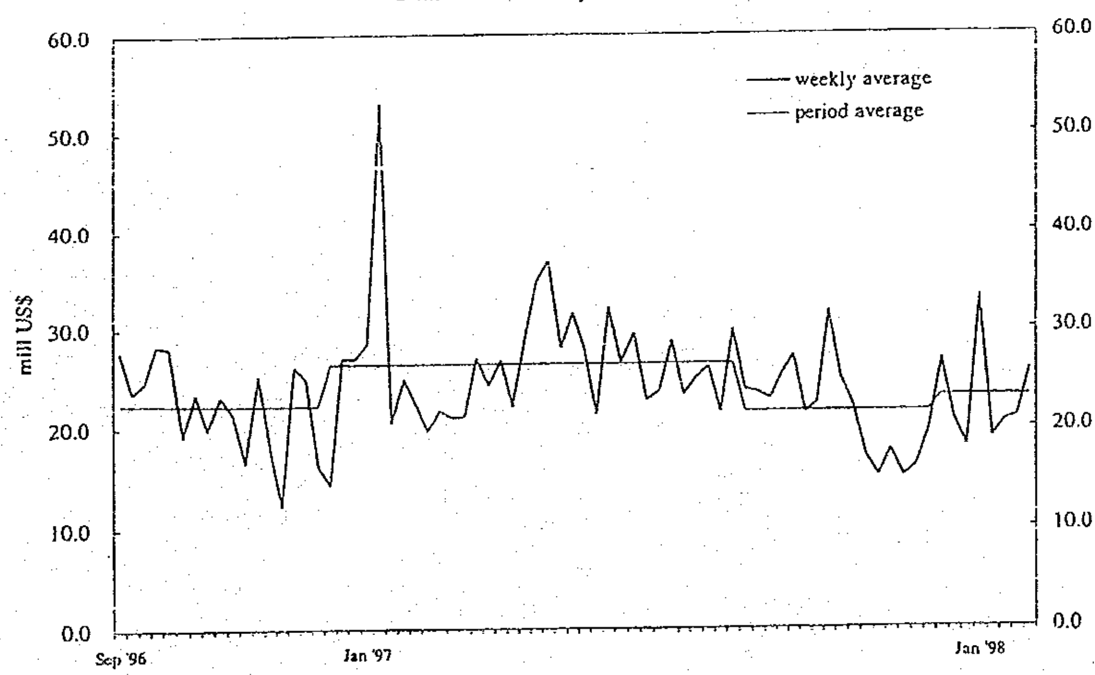


Chart 4. Foreign Transactions Volume 1996-98

Interbank Daily Transactions Volume



Bank-customers Daily Transactions Volume



Note 6 − 1

SUMMARY OF FINDINGS AND SUGGESTIONS OF THE REPORT: AGRICULTURE AND RURAL DEVELOPMENT

Yonosuke Hara
Seiji Shindo

1. Agriculture of Viet Nam has shown an impressive growth performance since the start of the Doi Moi policy. The reform of managing agricultural production and marketing by giving a freedom of decision-making to farmers and merchants has contributed to the growth. Yet farmers are facing under-developed market institutions and suffering from the "market failures" caused by imperfect markets especially of products and credits. They also face the small-sized markets mainly resulted from the shortage of physical infrastructure such as roads and communications. Underdevelopment of market institutions is the major reason of the poverty in rural Viet Nam.

2. Apart from the aspects related to transition to a marketed oriented economy, development of the Vietnamese agriculture represents a case of agricultural and rural development in a country densely populated with limited land resources. Provision of economic incentives to farmers through the implementation of the Doi Moi policy is thus considered to be not enough, if indispensable, to achieve a sustainable development of agriculture. The studies of agriculture and rural development intend to analyze changes taken place in related areas and topics to the agricultural and rural development mainly since the late 80's and to derive policy options and possible actions towards its further development.

3. Diversification of agriculture is one of the means or even the sole ones to earn increased cash income from agriculture in most parts of the country where farmers are in subsistence conditions while non-agricultural employment opportunities are limited. It also represents a response to the growing and changing demand for agricultural products in domestic and overseas markets.

4. Exploitation of overseas market of agricultural and rural products, a
long with that of domestic market, is crucial for promoting agricultural
diversification. It also ensures for producers to receive a proper share
of benefits. Marketing strategies of several agricultural products having
a potential of future expansion in overseas markets are analyzed. It i
s suggested that efforts of the government in this area are focused on
the provision of assistance in increasing the access of farmers to marke
ts, including provision of market-related information, and improvement
of market related physical infrastructure such as roads, storage and ot
her facilities. On the other hand, in view of smallness of individual far
ms, such activities as promotion of products and negotiations with the
purchasing companies, processors, and traders are effectively carried ou
t by farmers' groups.

5. Agricultural cooperatives being established under the new Cooperativ
e Law could play a role in this respect. It is proposed that upon the i
nitiatives of and needs for concerned cooperatives, "cooperative unions o
r federations" would be established in selective areas, each including se
veral unit cooperatives and covering one administrative district. These
cooperative unions would assume the functions of coordinating producti
on and marketing of products in the area. The government encourages
and facilitates farmers and unit cooperatives to organize and participat
e in unions in drawing the guidelines and guaranteeing loans. Provisio
n of market information, particularly of the overseas market would be
handled by establishing an "agricultural information center". Under the
current circumstances, this may take a form of semi-governmental org
anization such as an export promotion agency.

6. In a similar context to take the advantage of scale economy with th
e participation of small farmers, a greater involvement of agricultural c
ooperatives into the rural finance system provides an option in strengt
hening the system. Rural financing system in Viet Nam was restructur
ed at the beginning of the 90's and its performance so far can be rega
rded as a success while the reform has been instituted under many co
nstraints. Yet this option is worth to be considered in search for the fu
ture pattern of development responding to an increasing demand for cr

edit along with savings mobilization. This would also mitigate the nega tive effects caused by the dominant position that the Viet Nam Bank f or Agriculture and Rural Development occupies in the current system.

7. The creation of rural non-farm employment opportunities is another crucial element to improve rural economy and alleviate rural poverty. Nearly 70% of the total labor force engage in agriculture, and the sect or has absorbed more than 70% of the annual increment of labor force in past few years, while no significant rural to urban migration as ob served in many other East Asian countries appear to take place. At pr esent a variety of rural traditional industries apart from some SOEs a nd labor-intensive small-scale manufacturing enterprises serve as sourc es of non-farm employment in rural areas. Findings based on the obser vations of several cases suggest that to create and promote rural non-f arm employment, physical infrastructure development, provisions of cre dit, and strengthening marketing activities are most important. Due to specific regional nature of rural employment, they should be incorpora ted into the socio-economic development programs of respective areas.

8. In congnizance that development of rural infrastructure is a key for improving rural economy as well as market functioning, one of the stu dies analyzes the situation and indicates policy options for developing r ural infrastructure including irrigation, drainage, flood control, rural ro ads and electrification, centering in the Red River Delta region. It is r evealed that as the state money plays the major role in rural infrastru cture investment, a continuing and increasing allocation of the state bu dget is needed for maintaining the production increase at the recent pa ce. Specifically an integrated approach encompassing main and tertiary irrigation/drainage facilities, together with consolidation of scattered fa rmland plots and construction of on-farm roads is recommended. For th e purpose of market strengthening and employment generation, rural r oads specifically at community level and building local and urban mark et facilities are considered important.

9. Since the poverty in Viet Nam is largely a rural phenomenon, pover ty issues are effectively tackled in the context of rural development. Th

us poverty can be reduced in the process of rural development starting from increased rural income in agriculture and through an expansion of employment opportunities in urban and rural areas which then brin gs out increased income for the urban sector and the economy as a wh ole. Experience in East Asia countries presents that both economic gro wth and income equity have been attained led by labor intensive and small-scale industries. As a labor abundant country, Viet Nam may be able to follow this process.

Rural Finance in Viet Nam

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I. Introduction

When Prof. Ishikawa had a meeting with The General Secretary Do Muoi in June 1997, Do Muoi referred to the result of our research on agricultural ad rural development.

"Agricultural Bank could not meet the demand from farmers. The amount of unpaid loans of farmers is just 4-5 percent, much better than the repayment performance of State Owned Enterprises".

II. Major Players in Rural Financial Markets in Viet Nam

1. Formal lenders
   (1) The Viet Nam Bank for Agriculture (VBA)
      82% in formal loans for rural sector
   (2) The Viet Nam Bank for the Poor (VBP)
      11%
   (3) People's Credit Funds (PCFs)
      7%
   (4) Others
      NA
2. Informal lenders

III. The Development of Rural Finance in Viet Nam

1. The expansion of credit and the level of outreach
2. Mobilization of savings
3. Loan Recovery Performance
   VBA's Annual Report 1994: overdue ratio of production units 2.1%
   VBA's Annual Report 1995: ratio of bad debt 3.4%
   Ratio of frozen debts (SBV has guaranteed to repay the principal) to total outstanding loans: 1993 7.1%, 1994 8.7%, 1995 7.3%
4. Efficiency of financial intermediation
   In 1995:
   Interest earned as % of average amount of outstanding loans: 18.9%
   Interest paid as % of average amount of outstanding loans: 13.1%
   Operating costs as % of average amount of outstanding loans: 4.9%
5. From our field surveys
   1) contribution to agricultural diversification
   2) contribution to alleviate the burden of debts
   3) contribution to income generation

The development of rural finance in Viet Nam can be evaluated as a "Success".

IV. Major Problems

1. Smallness of loan size
2. Limited investment opportunity
3. Shortage of medium/long term loans
4. Insufficiency of efforts of deposits collection
5. Observation from field studies -
   (1) Regional diversity
   (2) Insufficiency of saving mobilization
   (3) Distributional bias of credit allocation

6. Cooperative finance in rural Viet Nam

   Is it possible to construct cooperative finance in Rural Viet Nam?

V. Factors for the Development of Rural Finance in Viet Nam

1. Strong demand for loans in Vietnamese rural villages
2. Finance supported by local administrative organizations and indigenous groups
3. Successful macroeconomic policy
4. International environment

VI. Future possibility of Agricultural Cooperative in Viet Nam

1. Tradition of mutual help and autonomy in rural Viet Nam
2. Existence of economy of cooperation
3. Negative effects of VBA's monopolistic position on the performance of rural finance

Major Constraints

1. Debts problems of previous agricultural cooperatives
2. Negative image of previous agricultural cooperatives
3. Existence of PCFs as cooperative type financial institution

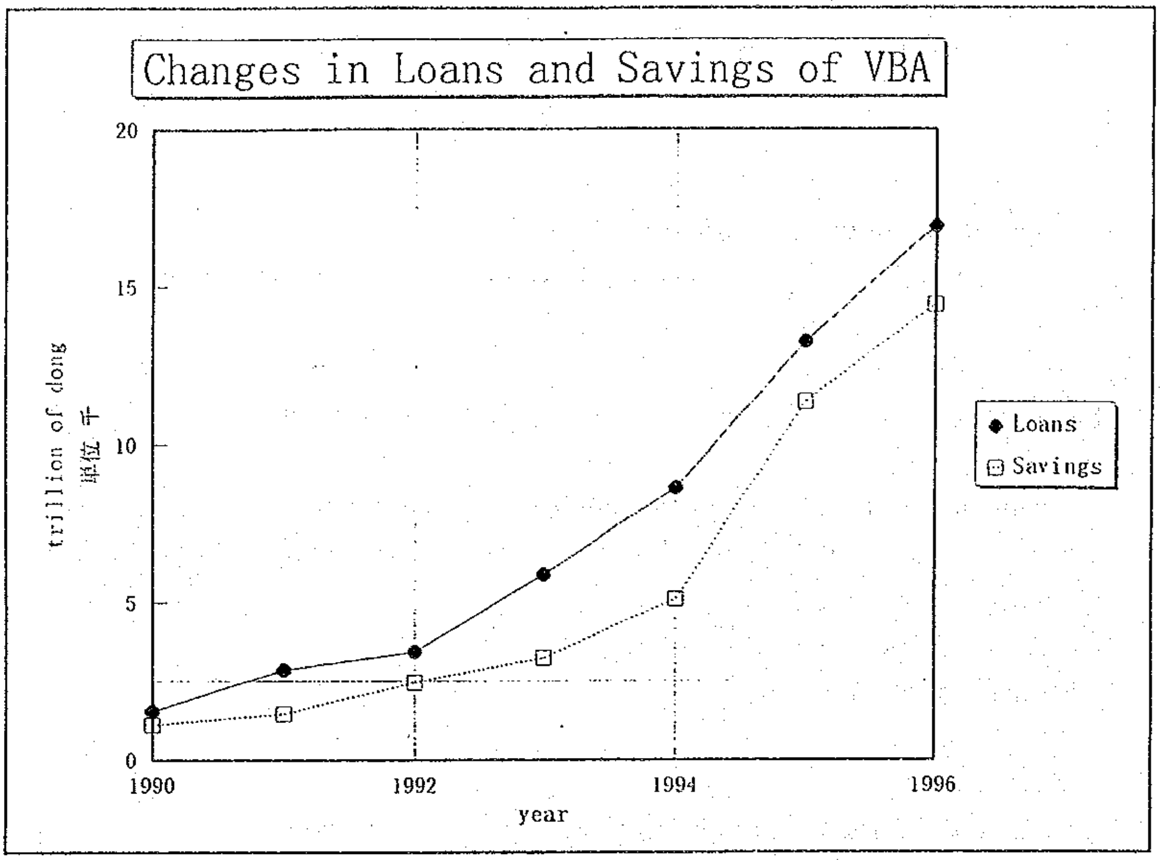
Changes in Loans and Savings of VBA
20
15
10
5
0
trillion of dong
单位 千
1990
1992
1994
1996
year
Loans
Savings

Table 1 Main Features of the Surveyed Communes

Province	Commune	Population	Number of Household	Of which Farm Household	Agricultural Area(ha)	Average Ag. Area per Farm(ha)	Remarks
Ninh Binh (Red River Delta)	Ninh Phong	6,349	1,500	1,500	390	0.26	269 households engaged in carpentry. 5km from Provincial Town
	Ninh Thang	3,600	920	920	293	0.32	Low Land, 15km from Prov. Town
Quang Ngai (Central Coast)	Ngia Son	820	152	152	51	0.34	Hill and Remote Area
	Son Tinh	11,000	2,600	2,100	390	0.19	Center of Son Tinh District
An Giang (Mekong Delta)	Vinh Binh	7,500	1,384	1,050	3,600	3.4	Remote Commune
	An Chau	18,190	3,500	1,000	600	0.6	9km from Prov. Town, Center of Chau Thanh District

Table 8 Accumulated Borrowed Amount per Surveyed Household by Financing Institution

(mil. dong, %)

Province	Commune	Formal Finance						Informal Finance					Total
		VBA	PCF	VBP	RSB	Treasury	Formal: Total	Relative	Friend	Money Lender	ROSCAs	Informal: Total	
Ninh Binh (Red River Delta)	Ninh Phong	44.5	6.0	1.7	9.0	–	61.2	1.5	6.0	–	–	7.5	68.7
		(64.8)	(8.7)	(2.5)	(13.1)	(–)	(89.1)	(2.2)	(8.7)	(–)	(–)	(10.9)	(100.0)
	Ninh Thang	20.5	–	3.5	–	–	24.0	6.0	2.5	5.2	–	13.7	37.7
		(54.4)	(–)	(9.3)	(–)	(–)	(63.7)	(15.9)	(6.6)	(13.8)	(–)	(36.3)	(100.0)
Quang Ngai (Central Coast)	Ngia Son	–	–	40.7	–	–	40.7	–	–	–	–	–	40.7
		(–)	(–)	(100.0)	(–)	(–)	(100.0)	(–)	(–)	(–)	(–)	(–)	(100.0)
	Son Tinh	11.5	–	18.0	–	–	29.5	15.2	–	–	–	15.2	44.7
		(25.7)	(–)	(40.3)	(–)	(–)	(66.0)	(34.0)	(–)	(–)	(–)	(34.0)	(100.0)
An Giang (Mekong Delta)	Vinh Binh	420.0	–	10.3	26.0	–	456.3	43.0	79.1	47.5	–	169.6	625.9
		(67.1)	(–)	(1.6)	(4.2)	(–)	(72.9)	(6.9)	(12.6)	(7.6)	(–)	(27.1)	(100.0)
	An Chau	156.8	–	5.8	7.5	8.5	178.6	–	–	–	2.0	2.0	180.6
		(86.8)	(–)	(3.2)	(4.2)	(4.7)	(98.9)	(–)	(–)	(–)	(1.1)	(1.1)	(100.0)
Total		653.3	6.0	80.0	42.5	8.5	790.3	65.7	87.6	52.7	2.0	208.0	998.3
		(65.4)	(0.6)	(8.0)	(4.3)	(0.9)	(79.2)	(6.6)	(8.8)	(5.3)	(0.2)	(20.8)	(100.0)

Table 9 Number of Borrowed Households and Average Lending Amount per Surveyed Household by Financing Institution

(No. of households, million dong)

Province	Commune	Formal Finance						Informal Finance					Total no. borrowed HHLs 3/
		VBA	PCF	VBP	RSB	Treasury	Formal Total	Relative	Friend	Money Lender	ROSCAs	Informal Total	
Ninh Binh (Red River Delta)	Ninh Phong	8	3	3	1	–	12	3	1	–	–	4	13
		(5.6)	(2.0)	(0.6)	(9.0)	(–)	(5.1)	(0.5)	(6.0)	(–)	(–)	(1.9)	(5.3)
	Ninh Thang	15	–	5	–	–	18	2	2	1	–	5	22
		(1.4)	(–)	(0.7)	(–)	(–)	(1.3)	(3.0)	(1.3)	(5.2)	(–)	(5.0)	(1.7)
Quang Ngai (Central Coast)	Ngia Son	–	–	27	–	–	27	–	–	–	–	–	27
		(–)	(–)	(1.5)	(–)	(–)	(1.5)	(–)	(–)	(–)	(–)	(–)	(1.5)
	Son Tinh	2	–	12	–	–	14	6	–	–	–	6	18
		(5.8)	(–)	(1.5)	(–)	(–)	(2.1)	(2.5)	(–)	(–)	(–)	(2.5)	(2.5)
An Giang (Mekong Delta)	Vinh Binh	38	–	6	4	–	41	5	2	8	–	14	44
		(11.1)	(–)	(1.7)	(6.5)	(–)	(11.1)	(8.6)	(40.0)	(5.9)	(–)	(12.1)	(14.2)
	An Chau	27	–	3	1	3	32	–	–	–	1	1	33
		(5.8)	(–)	(1.9)	(7.5)	(2.8)	(5.6)	(–)	(–)	(–)	(2.0)	(2.0)	(5.5)
Total		90	3	56	6	3	144	16	5	9	1	30	157
		(7.3)	(2.0)	(1.4)	(7.1)	(2.8)	(5.5)	(4.1)	(2.9)	(5.9)	(2.0)	(6.9)	(6.4)

Note 1/. Figures in parentheses are the average borrowed amount per borrower.
2/. Average lending amount = Total lending amount / Number of borrowed households
3/ Total number of households borrowing from respective lenders in each commune may not add up with "total number of borrwing households" since one household may borrow from more tha one sources.

Table 10 Number of Households by Borrowing Purposes and by Financing institution.

(household, (%))

Lending institut.	Total no. of borrowed HHLs 1/	Agriculture: Cultivation	Agriculture: Livestock	Agriculture: Fishery	Agriculture: Other Ag. Production	Agriculture Total	Non-agricultural Productive: Home Industry	Non-agricultural Productive: Trade	Non-agricultural Productive: Other Non-ag. Production	Non-agriculture Total	Consumption Purpose: Consumption	Consumption Purpose: House Construction	Comsumption Total	Others	Total no. HHLs 1/,2/
VBA	90	42 (41.2)	38 (37.2)	3 (2.9)	- (-)	83 (81.4)	3 (2.9)	3 (2.9)	1 (1.0)	7 (6.9)	- (-)	11 (10.7)	11 (10.7)	1 (1.0)	102 (100.0)
PCF	3	-	1	-	1	2	1	-	-	1	-	-	-	-	3
VBP	56	4 (7.4)	48 (88.9)	- (-)	1 (1.9)	53 (98.1)	1 (1.9)	- (-)	- (-)	1 (1.9)	- (-)	- (-)	- (-)	- (-)	54 (100.0)
RSB	6	2	2	1	-	5	-	-	-	-	-	-	-	-	5
Treasury	4	-	3	1	-	4	-	-	-	-	-	-	-	-	4
Formal Finance Total	159	48 (28.6)	92 (54.8)	5 (3.0)	2 (1.2)	147 (87.5)	5 (3.0)	3 (1.8)	1 (0.6)	9 (5.4)	- (-)	11 (6.5)	11 (6.5)	1 (0.6)	168 (100.0)
Relative	16	5	2	3	-	10	1	-	-	1	2	3	5	-	16
Friend	6	1	2	1	-	4	-	1	-	1	1	-	1	-	6
Money Lender	9	4	2	2	-	8	-	1	-	1	2	-	2	-	11
ROSCAs	2	-	1	-	-	1	-	-	-	-	-	-	-	1	2
Informal Finance Total	33	10 (26.6)	7 (20.0)	6 (17.1)	- (-)	23 (65.7)	1 (2.9)	2 (5.7)	- (-)	3 (8.6)	5 (14.3)	3 (8.6)	8 (22.9)	1 (2.9)	35 (100.0)
Total	157	58 (28.6)	99 (48.8)	11 (5.4)	2 (1.0)	170 (83.7)	6 (3.0)	5 (2.5)	1 (0.5)	12 (5.9)	5 (2.5)	14 (6.9)	19 (9.4)	2 (1.0)	203 (100.0)

Note 1/. Total numbers of borrowed households from respective institutions may not add up with the total number of households by borrowing purpose since one household may use one loan for more than one purposes.
2/. Total number of households by lending purposes. The figures may be smaller than the number of borrowed households, since those not specified the purposes are excluded.

Table 8 Households of Responsible Positions (HRP) and Their Relationship with Institutional Loans

(number of household)

	Ninh Binh (north)		Quang Ngai (central)		An Giang (south)	
Total number surveyed	100		100		100	
	HRP 9	Non-HRP 91	HRP 12	Non-HRP 88	HRP 30	Non-HRP 70
Number of household with VBA loan	23		2		65	
	HRP 5	Non-HRP 18	HRP 2	Non-HRP 0	HRP 25	Non-HRP 40
Number of household with VBP loan	8		39		9	
	HRP 1	Non-HRP 7	HRP 8	Non-HRP 31	HRP 3	Non-HRP 6

Notes:

1) Data from survey questionnaires of Rural Finance Team

2) HRPs(households of responsible position) are those household of which member is working at institutions related to the administration, like provincial, district, village, and community offices, or is the leader of mass organization at village level.