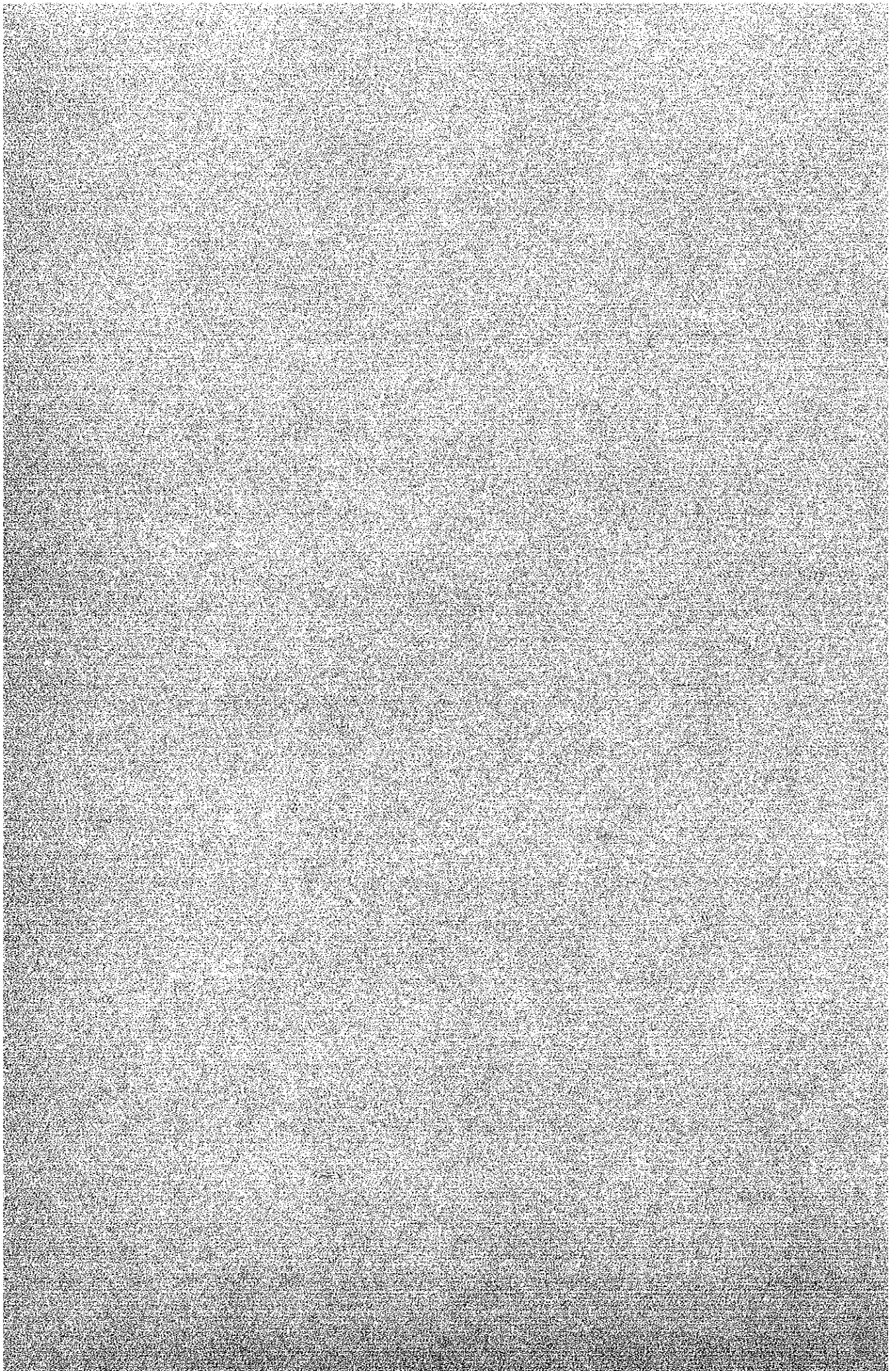


Part II

Record of Discussion



Session 1: Introductory Session

Chair: Prof. Hara

Mr. Ikeda: Good morning ladies and gentlemen. My name is Ikeda. I am in charge of Social Development Study Department of JICA. On behalf of the secretariat of this workshop, I would like to express thanks to all of you here, and also especially to those who came all the way from Vietnam and the United States.

The study was conducted jointly by Vietnamese and Japanese research group from August 1995 to December last year under the JICA's technical assistance scheme. I would like to express our sincere respect to all the efforts extended by the members of the joint research group headed by Dr. Nguyen Quang Thai and Prof. Shigeru Ishikawa. Today, we invited head of resident mission and also resident representative from the World Bank, IMF, UNDP, Asian Development Bank, Harvard Institute for international Development, and members of the joint study group, and Ministry of Finance, and Ministry of Foreign Affairs. We hope this two day workshop will be very constructive and fruitful for the smooth and further development of the Vietnamese economy. Now, I would like to ask Prof. Hara to chair the workshop. Prof. Hara.

Prof. Hara: Good morning. My name is Hara, and I belong to the Institute of Oriental Culture at the University of Tokyo. Frankly, I arrived from Singapore this morning, just three hours ago, and I still feel a little bit sleepy. Anyhow I will try my best. The session one for this morning is entitled "introductory remarks." We may have seven presentations, this morning's session will be a good starting point of the two days workshop. My duty is to manage the time, and we should finish this morning session by noon. Therefore, I would like to ask the cooperation of all participants, to make the presentations or questions rather clear and brief. I think most important part will be the general discussion. Therefore, in order to maximize the time for the general discussion, I would like to ask all speakers to confine your time. So, I will assign some minutes to each speaker.

First, I would like to ask Prof. Ishikawa to make the introductory remarks. I think Prof. Ishikawa's speech should be the basis of this two day workshop. Therefore, I would like to give Prof. Ishikawa around twenty minutes for his presentation. Please, Prof. Ishikawa.

Prof. Ishikawa: Thank you very much, Mr. Chairman. First, I would like to welcome all the participants coming from the World Bank, IMF, UNDP, ADB, and both sides of the Vietnamese-Japanese Study Team, and also from various Japanese organizations. I am saying this on behalf of the Japanese side members of the VJS Team.

Now, 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 we all 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 difference in policy suggestions among them would not be productive and even not useful. Meanwhile, IMF in Hanoi agreed on the desirability of holding such a workshop. MPI also joined this agreement and promised to send the delegation.

This is the reason why I tentatively used the title of my introductory remarks as the World Bank, IMF, and Vietnamese-Japanese Study Team Workshop. This is the title which is not yet agreed upon or not yet discussed among the World Bank, IMF, and Vietnamese-Japanese Study Team. But anyway, these brief remarks will make you understand why this title was used.

Now, the task assigned to me here is to present a summary of what we, the Japanese side of VJS Team, did in this project in terms of the methodologies and results of the studies and policy suggestions. With regard to the history of the Vietnamese-Japanese Study Project, I surmise all participants are well aware of it. The 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.

One, the project started in August 1995 with the assigned task of presenting our opinions on the draft Five-Year Plan of Vietnam, 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 issues the Vietnamese economy would face. Phase 2 ended formally in February this year. The Vietnamese-Japanese Study Team continues informally to exist and sometimes organizes ad hoc study projects on a specific topic, for instance, an East Asian financial turmoil project currently in progress, and for which we assigned special one session tomorrow.

Two, the studies for meeting these assigned tasks are conducted as a principle jointly by the Vietnamese-Japanese Study Team. This team consists of 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 the following topics: 1) agriculture and rural development, 2) foreign trade and industrial policies, 3) public finance, money and banking, and 4) SOE reforms. On the Vietnamese side, there are counterpart members and groups. Members are from the MPI staff. We have had continuous exchange of views with the Vietnamese side on the individual, sub-group, and all-member workshop basis.

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.

1) Vietnam is not only 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, Vietnam is similar to China and differs from Eastern European countries.

2) The official goal of Vietnam'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 don't concern very much about the word "state control" or "socialism" considering that the addition of this adjective 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.

If in this stance, there is something special or 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 in paragraph 6 printed in shorter words, and in sum, characterized as those of the late-comer countries or late, late-comer countries which accomplished take off after World War I or World War II. Their experiences should be different from those of the countries in Europe and America which completed industrialization before World War I, in that the market economy framework was underdeveloped and the capital accumulation for industrialization lagging.

Now, I think that with regard to what we consider as Japanese experiences in economic development, I think some essential points are described here in paragraph six, but probably we will have a chance to talk about this later on. Well, I think Prof. Dapice will mention this issue, in that connection, we may have the chance to talk this again, the relevance of the Japanese experience in considering Vietnamese economic issues and considering their policy options vis-à-vis the Vietnamese economic development.

Now, coming to the last part of paragraph six, 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, existence of the matured market economy.

Upon reflection, this stance and our characteristic approach seems well reflected in our opinion on the early draft Five Year Plan, 1996 to 2000, which was shown to us in the summer of 1995. They are on four points.

1) Domestic savings ratio shown in the draft plan is only a little above the 10% line during 1990 to 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 Five Year Plan, outweighing anything else. This is especially so, as there is a huge amount of external debt accumulated.

2) In 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 South Vietnam, 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 the state-of-the-art technologies equipment.

The empirical studies of various economic issues of Five Year Plan formulation were done together with the policy suggestions, mainly in the four sub-groups. In Phase 2, the sub-group studies continued similarly. They are, however, to be taken up for discussion in sessions that follow this.

However, this introduction should deal with issue of trade liberalization which has arisen by Vietnamese participation in the ASEAN Free Trade Area 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 Vietnam's adherence to it upon the Vietnamese foreign trade and industry came after the period when the Phase 2 research setup had been established and well under way, the study was conducted on an ad hoc basis by myself. Similarly, when the currency and financial crises of Thailand arose in July 1997 and spread in a number of other countries in East Asia, the Vietnam government required us to do a study with the particular reference to its possible impact upon the Vietnamese economy. We have accepted the request and organized an ad hoc study team to deal with it.

With regard to the financial turmoil issue, we shall have a chance to discuss it by devoting a special session. Regarding the financial crisis issues, the results of our studies are incorporated in Executive Summary Report. Regarding the trade liberalization issue, the results of our study were incorporated in Executive Summary Report, using large space of Part 1. The main points are as follows:

1) The basic principle of the AFTA agreement is to achieve nearly complete trade liberalization among member countries by the early 21st century. 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. Vietnam's import trade was protected mainly by the state monopoly trade and other NTBs, that were determined with the aim of increasing tariff revenue.

There were no motives for infant industry protection. In the list of tariff reduction which the government of Vietnam 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 Vietnam where industrialization was yet in a very early stage, no industry had yet emerged in the government mind as one to be protected.

Therefore, the issue the AFTA participation is offering to Vietnam is whether or how the AFTA participation will affect Vietnam when the government will decide to start up her industrialization.

2) Prior to considering this problem, there are a few points to be made clear. As one of them, we have to predict how the present proportion of total import trade which came from the AFTA countries, ASEAN NICs and industrial countries, especially, will change. Investigation of this question requires knowledge of the present state of comparative production costs of imports from among these regions, and the direction of their possible changes in the early 21st century. Moreover, we have to know various changing conditions of Vietnamese trade with non-AFTA countries in the forthcoming years. This will be determined also significantly by the results of Vietnamese negotiations with WTO relating to application for affiliation to it. Probably, even with regard to trade with non-AFTA countries, the trend toward trade liberalization would be strengthened as compared to the present.

3) Assuming that the present constraints from AFTA will prevail over all foreign trade of Vietnam, 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 discipline 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 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, Vietnam possesses a short time period to exercise this option.

Now, policy implications. Firstly, the government may make a comprehensive survey on present and prospective industries and classify them into three categories: a) those industries which possess international competitiveness already at present, b) those industries which could acquire it if infant industry protection is provided appropriately

before 2006, and c) those industries which couldn't become self-sustainable by 2006 even when such protection is applied. 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 negotiations in pursuit of the postponement of the target year 2006. However, in order for the negotiations to become effective, Vietnam should draw up convincing scenarios of building up the self-sustainable industries until the postponed target year.

Now, I should stop here. In the last paragraph I emphasize the fact that Vietnam is now facing the challenge of internationalization of their economic policies. And this task is very severe task for Vietnam, and it's probably the task of this conference to consider how Vietnam can be assisted by international donor community to cope with these difficulties. Thank you very much.

Prof. Hara: Thank you very much, Prof. Ishikawa. I believe that all the participants could realize Prof. Ishikawa's basic ideas regarding the development. I should say Prof. Ishikawa's ideas are rather common amongst the Japanese academicians, especially those who related to the development economics. Therefore, we, especially Japanese team consider that Vietnam is not only a transitional economy but also a developing economy, as Prof. Ishikawa clearly stated. Therefore the development of market economy itself is a problem. This is our basic idea.

Then, next, may I ask Prof. Thai to give your speech? Unfortunately, due to the time limitation, I can give you only ten minutes.

Dr. Thai: Thank you, Mr. Chairman. Dear friends, first of all, on behalf of the Vietnamese delegation, I would like to thank you very much for your invitation to ask us to come here, and to attend the donors' discussion, donor meeting discussion, from the World Bank, IMF, ADB, and the international communities. I would like to say that from 1995, the Vietnamese government requested JICA to send a mission to Vietnam, for the investigation to make some suggestions to Vietnamese leadership, as a preparation for the Eighth Congress of the Party. From 1995 up to now, three years already, Japanese experts regularly come to Vietnam, and every time when they come Vietnam, they make a report directly to the leadership of Vietnam. These suggestions and analyses are very useful for the leadership to improve the drafts of the recommendation of the National Congressional Party and some of the Central Committee meetings. Now, we can make discussion here, I think this is an open discussion. In this case we can present to you our ideas and you can discuss it. If we can find common ideas, it would be very nice. We can reconfirm it, and find out some new measures to develop our country. If we can find out some different approaches or different ideas, it would be very nice, too. In this way, we can make some adjustments and can reconfirm our ideas. When we come back home after this Tokyo workshop, we can continue the cooperation with your side, to improve our study jointly with JICA, as well as with the donor communities to improve our policy. Why? Because

now we have to face many difficulties in transition period and the impact of the Asian currency crisis comes directly to Vietnam. Every day, we hear about the matter.

Now, I would like to briefly present and introduce some of the ideas from my paper. As you know, the Central Committee meeting was held, in November last year. This meeting was very important because its focus was on economic aspects. The main idea from the meeting was that we have to mobilize more and more domestic resources and efficiently use the international support from external resources, in order to increase the competitiveness of Vietnam, including export policies of Vietnam in the near future. This meeting focused on four points.

First, the adjustment of economic and investment policy in Vietnam. For this matter, we have to make some adjustments in our master plan, by the sector and by region in our country. And we have to focus on most important projects, therefore we have to make adjustments, delay, and the cancellation as well, of some big projects, [for example] a highway from North to South of Vietnam. We are very concerned with how we have to stop this project. Instead, we can focus on some smaller projects with more efficiency. Concerning the external resources, we have to use important disbursements from World Bank, ADB, and Japanese supports more efficiently. We have to mobilize more domestic resources, as well. With regard to this, we discuss about the new law on the domestic investment promotion, in the next section of National Assembly.

Second, concerning the agricultural and rural development, and poverty alleviation, we are very concerned with this matter, because 80% of the population now live in rural areas. We are especially concerned about the rural credit and issues similar to that. They are very important, however, there is not enough time for the discussion. Prof. Hara knows very well about the matter.

Concerning the adjustment of finance and banking system, last year the National Assembly just approved a new law on the banking system. And we made some measures for the exchange rate last month, on 14th of February this year, the decree on the exchange rate adjustment and the foreign currency management was made. This is a very important decision. We are very concerned with the measures for the export promotion, as well. For instance, for now, foreign companies can export. Foreign companies, not producers, however can export if they can find out the market. Many measures.

Concerning the SOE-reform, we continue to reform our country as the commitment in donor meeting, held in Tokyo last year. This year, we will equitize about 150 enterprises, next year 400, and after that 1000. Of course this is dangerous for us, very difficult. We have to prepare and prepare more details about what is the best way to do it with efficiency. At the same time, we have to mobilize domestic resources, and make the new good environment for private sector so they can develop the areas. In this matter, we make many measures on the trading and on the investment activities of the people, so they can make businesses for themselves and reconfirm more. For this to work, the administrative reform is very important. The legal framework which is very clear and

easier to understand for both foreigners and for Vietnamese people, is important for the implementation.

In Vietnam, under the new environment and in East Asian crisis, there are many impacts for Vietnam in the export/import, and in SOE activities. This year, perhaps half SOE working not very efficient, because input increasing and output difficulties. And the Vietnamese export now have to find out some new measures and regulations. In this matter, the international export and communities can work together with us. As one banker reported in Vietnamese translation -- this report is very important for us -- not only the joint study between JICA and Vietnam, but it also said deepening reform. This is the main idea from the Central Committee meeting last year, "continue reform". And from last year, we have new assembly, new Central Committee, new ..., and new General Secretary of our party. However, I can reconfirm to you that our policy has not changed, we will keep improving and continuing the reform of our country. We are very happy if international community can help us to improve the policy and some concrete measures for the continued development of our country in the difficulties evident now. Thank you for your attention.

Prof. Hara: Thank you very much, Dr. Thai. I was very happy because Vietnam's government still continues sincerely the so-called *Doi Moi* reform. O.K., then from now on I would like to invite the speakers from the various institutions. Firstly, may I ask Mr. Steer from the World Bank.

Mr. Steer: Thank you very much, Mr. Chairman. I won't use my fifteen minutes because so many wise things have already been said by Dr. Thai and Prof. Ishikawa that I don't need to say them.

Let me say to start with though that this is a great pleasure to be here. This conference is at a very, very appropriate time. The authorities in Vietnam are struggling with some of these very issues that this important report struggles with, and as Dr. Thai says, this is a time, this is a year when decisions are being made. It's not that the government as you say is going to dramatically change direction, but you are deepening reform. So this conference is actually at a very opportune time. I commend Prof. Ishikawa and the Japanese team, and even, more I commend the Vietnamese team for jointly working on this piece of work. This document and these papers have some very, very important ideas in them, and there is plenty for us to discuss for the next couple of days. So I support our chairman, who says we should discuss rather than give speeches. Let me also commend JICA for supporting and financing this piece of work. It's a very good initiative.

Last time that some of us on this side were in Tokyo was last December when we had the consultative group meeting. At that meeting, the donors strongly endorsed the new government's agenda. You mentioned the four points -- those were the main four points -- but there are two additional points that we discussed there on the six-point agenda, and the donors wholeheartedly pledged themselves to help implement this agenda. The agenda that Prime Minister Phan Van Khai had laid out was first, competitiveness, second, financial sector reform, third, state enterprise reform, fourth, rural development,

fifth, social equity, and sixth, public administration reform. And the donors went all the way to the extent that even with the crisis situation, the donors increased their pledges. In Japanese yen terms, they increased their pledges to Vietnam for the next year by 18%. In dollar terms that was 2.4 billion dollars; a lot of support for the government. The challenge now is to implement those reforms, and that's very tough indeed.

Let me tell you the kinds of things that I would like to get out of this meeting in the next couple of days. Basically, let me suggest the issues that we're struggling with, as we are working with the government. Let me tell you some stories that I hope to get insights on.

First story. Three weeks ago, we convened a group of twenty-five small and medium business people in Vietnam. These are people, these are private Vietnamese entrepreneurs. They run enterprises that have between five and two hundred employees. We spent half a day with them. They are some of the most entrepreneurial people in the world. They are longing to be unleashed to generate employment. They say, if we had credit, especially credit that's more than one year long, we could really make a difference. If we had access to simplified regulations, if we knew more about export potential markets, if we had better access to land and transactions associated with land, if we could knowingly get people out of technical colleges and high schools that were well educated, we could transform this country. That was their message. And I hope that as we talk in the next couple of days, we get some insights into how we can help those people.

Second story. I was called up about a month ago -- so was Mr. Verbiest -- by the chairman of the People's Committee of Haiphong. Haiphong is one of the most dynamic cities in Vietnam, as you know, and he said, we would like to become the first special economic zone in Vietnam. Can you come and talk to us? So Mr. Verbiest and I went down and we spent a day talking about a special economic zone. And the People's Committee says we really would like to become this special zone the way that China did it, but we don't really know what that entails. Can you help us? Can you make us into a real growth hub? The government of Vietnam has chosen three growth triangles -- in the South, Ho Chi Minh City, Vung Tau; in the center, Da Nang; in the north, Hanoi, Haiphong, Halong. Can you help us? That's the second question that I would like some insights to -- what would it entail in other words to become a special economic zone, what are the down sides, what are the up sides.

Third question. Three days ago, I was in Ha Tinh Province. Ha Tinh Province is a poor province. It's about eight hours south of Hanoi. It's half way between Hanoi and Da Nang. And basically it's a rice producing area, doesn't produce much else. This year, rats are taking a lot of the harvest of rice. I met with thirteen farmers. They said for five months of the year, there's only employment for us for three hours a day. Is there any way you can help generate employment? We can't get any credit beyond four or five months, one season's credit. Anyway you can help us? We met of course with the head of the People's Committee there, and he said, how do we as a poor central province, how do we get growth going? Are we dependent on rice? What options are there for us in diversification? And then he said, I am a little troubled by the fact that the government has picked three growth poles and we are not one of them. What do we do as the

government is promoting growth in Haiphong in a special economic zone? What happens to us? How do I get my people to be employed and to grow? So I hope we are going to get some insights into that kind of question, too.

Another story. Two weeks ago, we had an economic team visit Vietnam with the purpose of putting together and supporting a structural adjustment credit for Vietnam. And the question that I have for all of you is, what are the kinds of conditions that we should be supporting in that adjustment operation? Clearly the government has said, we want to reform our financial sector, because it's not working right. The government is very keen to do that right. What are the kinds of reforms in the financial sector that are going to be required in the next one year, two years? And I think, incidentally, the Japanese academics have a lot to contribute, because you have many of the same problems in your country right now as Vietnam has in its country right now, somewhat at a different scale, so I think there could be some real insights as to what we might do to help the Vietnamese financial sector, what to really do on state enterprise reform. The government has said that it will equitize 1,000 companies by the year 2000. That's out of 6,000 state owned enterprises. But what are the kinds of measures that one will want to put in place for the remaining 5,000 state enterprises to make sure that they don't continue sucking out the savings from the economy, and indeed from the international flows thus denying those farmers in Ha Tinh getting the credit that they need, or those small entrepreneurs that we met two weeks ago?

A third element of our structure adjustment credit would be trade policy reform. And there the question is of course what are the kinds of measures that over the next one year, the next two years, the next three years, would be appropriate for Vietnam? As we look at trade policy reform in the last three months, we are very impressed with what the government has been doing, much more so for example than in the financial sector. I've handed out a paper here entitled, Structural Challenges Facing Vietnam. I am not going to present it, certainly not planning to discuss it at this introductory session. But here we lay out some of the concerns we have. Let me say incidentally, I am assuming we are all having a frank discussion here, and I respond very much to Dr. Thai's references to that. So we are having a serious discussion and I am hoping that the papers we hand out are understood not to be cited or anything like that, so we can be frank together.

So those are some of the stories, if you like, that we are struggling with now with the authorities, with people like Dr. Thai and some of the other distinguished Vietnamese team. And I am hoping we get some insights in the next two days.

Let me say that right now we are also putting together our next five year assistance strategy for Vietnam. We have some very tough questions that we need to answer. And we are meeting virtually every day at the moment with the authorities trying to figure out how we could be more helpful to prevent growth declining.

Seems to me there is a principle that ought to run through the discussion for the next couple of days, and that is given that resources are going to be more scarce in the coming months and years, how do we make every dollar, every yen, and especially every dong

earn its living in the economy? How do we make sure that an investment generates employment, reduces poverty, and promotes the right kind of productivity change? One thing we know for sure that as resources are now scarcer, we need to see better productivity with those dollars. What we know for sure that if the 1.3 million jobs that need to be created every year in Vietnam, if they are to be created, we all need to do a much better job at making the dollars and yen and the dong earn employment generation. And it seems to me that as we are discussing the appropriate industrialization strategy for this country, for Vietnam, we need to ask not just would it be a good idea, are there benefits from investing in steel or automobiles or this type of industry, but rather is that the best use of resources for this country? And one of the questions that I will be genuinely seeking answers to, and I will ask questions, and I am sure lots of us will, will be what are the costs of doing this, and what do we have to do less of if we are going to do this? My suspicion is that in Ha Tinh Province today, what we ought to be doing is having a greatly accelerated public investment program, small scale, in rural roads giving priority to employment generation in the hungry season. That's my guess. My guess is the best use of some of our funds right now, would be the say to Dr. Thai and Mr. Ly and some the others is, let's take some funds, let's put it in the hands of provincial authorities who are charged with, in a very participatory way, working with their people as they are very, very good at doing, and allocating investment funds for rural roads, for primary schools, for flood protection, and so on. But that's going to cost some money, and if we do that, we can't do some of the other things. So it seems to me in economic terms, we need to take a little bit more of a general equilibrium approach to some of the questions of industrialization than we tend to do when we look at them paper by paper, sector by sector.

So I have taken more than my ten minutes and I apologize very much. Let me say again, what a pleasure it is to be here, and I look very much indeed forward to interacting with you all. Thank you.

Prof. Hara: O.K., thank you very much. Quickly, I would like to ask Mr. Eric from IMF. And how many minutes do you need?

Mr. Offerdal: Five.

Prof. Hara: O.K., good!

Mr. Offerdal: That's quite enough, because I will indeed echo many of the things that have already been said, so I can afford to be very brief, and as Andrew said, many wise things have already been said, so I am not at all envying the people who come after me to their task.

Let me just make a few quick points. First of all, thank you very much for the invitation. I think this workshop is really one of the many indications that Vietnam is indeed a country that is enjoying tremendous goodwill interest in the international community, and indeed is a country with an almost unlimited number of friends in the world.

I am coming to Vietnam and to this workshop with the perspective of being a relative new comer to Vietnam. I am certainly a new comer in terms of experience with the country compared to most of the people in the Study Team and also indeed most of my colleagues here at the table. So in a sense, I am coming with a perspective of experience not in Vietnam, but in other countries, and in particular, other transition economies. One of the things that really has struck me after my few short months in the country is that Vietnam in many respects is quite similar to other transition economies. It's facing very much the similar challenges and difficulties. Indeed, Dr. Thai just mentioned, the fact that creating a market system is difficult. Indeed it is and it's been difficult everywhere where it's been tried. Nonetheless, Vietnam is also a country that has enjoyed tremendous success over the past, in the recent past, over the past few years, and it is also a country that has an enormous potential for further success, further development and growth, and a country that has clear and undisputable comparative advantages.

However, and I think in a sense that's one of the underlying themes of both the recent World Bank reports and some of the documents that the IMF has put out, it hasn't quite become public yet, but I can tell you that, in a sense, the underlying theme is that although the objectives of the reform process, of the *Doi Moi*, clearly remain the same, there is no question that the implementation, the speed of implementation has slowed down over the past few years. The peak of the reform process in terms of strong, bold reform was really in the early 1990s. Since then, there has been a perceptible slow down. And at the same time, there has been a weakening of the Vietnamese economy. I don't want to sort of put a causality to those two things, but those are, I think, fairly straight-forward observations.

And this presents Vietnam with a very difficult set of challenges, both short-term and long-term. I think in the short-term, it's fairly obvious. It's simply the Asian crisis, and how to meet the difficulties, or the more adverse external environments that that presents. But I think, there are important long-term challenges that also need to be discussed, and in a sense, that is very much the theme, I think, of the Study Group's report. These challenges are obviously to maintain a high growth rate, and in a sense catch up with the other countries in the region. Perhaps most importantly, and I very much agree with Mr. Steer, on creating employment across the country, and create a more, regionally more balanced growth than what we have seen over the past few years. And in a sense, the challenge is to make it economically feasible and interesting to create labor intensive enterprises, labor intensive activities outside Ho Chi Minh City and Hanoi. And this is in a sense our perspective on rural development and poverty alleviation.

And I think a third challenge is really to increase domestic resource mobilization, increase domestic savings, and thus reduce the current account deficit over the medium to long-term, and at the same time, secure an efficient investment allocation. And in a sense, both of these things -- increasing domestic savings and securing efficient investment -- really comes down to having a solid and efficient financial system in Vietnam.

Let me just round off by in a sense echoing the points that Mr. Steer made about ... two things that I would really look to seek answers to, in a sense, to get a better understanding

of, and therefore create, if you like, a better platform for myself to be helpful to the Vietnamese authorities to participate and contribute to the policy discussions that they have, and in a sense through that, provide lessons and experiences from other countries. Those two areas are really along the lines of what he mentioned in terms of costs. The first cost issue is really this opportunity cost that Mr. Steer spoke quite eloquently about, which is essentially the long-term issue of the costs, the loss of growth and development that will result from inefficient allocation of credit, of investment, and employment. Whatever the reasons for such inefficient allocation might be, whether it is the trade system or whether it is a poorly functioning financial system, or whether it is the mechanisms in the government budget. But there are costs that Vietnam cannot afford in long-term growth from inefficient resource allocation, and I think we need to think very carefully about those. Vietnam is a country that unfortunately and for very understandable reasons has already lost quite a bit of time in its economic development, and you really cannot afford to lose any more time.

The other issue of cost is one of costs of delay in the reform efforts. This in some sense is a more short-term issue. The Vietnamese economy right now is starting from a relatively difficult position, and the longer key reform efforts are delayed, the more difficult and the more costly to the economy they will be. And it is again enough to point to recent experiences elsewhere in the world. Just look at the very recent experience in Thailand and Korea. But those are just two examples. We can point to the experience of Mexico in 1994. The annals of the IMF are quite literally filled with countries that have delayed, for a number of reasons, delayed significant structural reforms and lost considerable time in its economic development as a result.

To come back to the point that I made initially, there is no question that many of the reforms that are under discussion, under the structural adjustment credit from the World Bank, and under the ESAF with the IMF, these reforms are difficult. There is no question about that. We as much as, although from a different perspective, but we as much as the Vietnamese authorities acknowledge that. But at the same time, one of the things that really has impressed me in my few short months in Vietnam is the efficiency, the competence, the hard working efforts of the civil service and of the population, the labor force at large. Vietnam is without question one of the most dynamic, hard working countries I have ever seen. With all due respect, I think you are underestimating your own capabilities. I do think if any country in the world can pull off this reform effort, it's Vietnam. Thank you.

Prof. Hara: Thank you very much. Then may I ask UNDP, Mr. Watz? How many minutes do you need?

Mr. Watz: I am not going to, of course, read the paper that we produced. I will walk through with you if you permit me.

I am also new, in fact. I started to be one of the more ancient in Vietnam. But I think the whole international team is quite new, be it IMF, ADB, World Bank and UNDP. So in a

way we all have a fresh look to things, and since our system has very little institutional memory, it's easy to have a fresh look.

Allow me to thank Prof. Ishikawa to have invited us in this team, and also JICA to have facilitated our coming here.

The focus of our thinking here is to see the role of the state in sustainable human development and what are the impact, the lessons for Vietnam. These days every time you open a newspaper, you have literally a course on economics in Asia. So we have tried to recapitulate what were the lessons from our own perspective. It does not mean we agree with everything we have listed or that we think they are the good questions. But we think at least they are the questions we should be discussing during this meeting with the level of the participants.

First point. Vietnam's development strategy in recent years has been obviously increasingly influenced by the East Asian experience in particular. The heavy role played by the state in directing development in some of these countries may seem appealing to a country which is cautious -- I've added something which I will not say now -- in a cautious transition from central planning to a more market-based economy. I would like to briefly review with you what are the positive lessons first, what are the negative lessons that the country can read and absorb from the East Asian crisis or the Asian crisis, and what are the lessons that can be learned for Vietnam in particular.

Let me just say that first we all know that despite the ongoing financial crisis, everybody has to admit that there were many impressive development achievements in East Asia, which remain largely intact and valid, and which will be further built upon following a period of restructuring. And I think already still reading these newspapers and articles, encouraging signs are coming even sooner than people would have thought a few months ago.

What are the positive lessons? Let's say very quickly, seven. I will list seven: 1) The importance of relying mainly on domestic savings for development, and the state's role in creating an environment that encourages this high saving rates. 2) Export-led development based on comparative advantage, which was often in the form of labor intensive manufactures was obviously the basis for success in most of the "miracle " countries. 3) Heavy investment in human resource development, particularly in education and training have been the foundation of most of these successes. For each of these there are points, you have illustrations both negative and positive applying to Asian countries. 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. 5) Especially for low income countries, an industrial sector based on small and medium-sized enterprises better enables flexibility, risk diversification, adaptability, sustainability, and stability. 6) It seems to us that maintaining a competitive exchange rate is essential. And we can see that everyday about this competition among exchange rates in Asia. 7) All the other well-known lessons can be included here, including sound and stable macroeconomic policies which are known to you.

Now, we could list very quickly some negative lessons from the same experience in the same area of the world. 1) High economic growth rates, even in the presence of relatively healthy macroeconomic policy indicators do not necessarily imply sustainable development. An array of other types of policies have an equally critical role in sustainable development. And here again, we list a number of examples. 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. These can be subject of quite a long discussion, I feel. 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. 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. 5) The famous -- I see we are here in a closed meeting, so I don't hesitate to, as a journalist, to list it -- corruption. 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. 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. 8) Protectionist trade policies aimed at developing import substitution industries tended to quickly lead to balance of payments problems and lack of financial sustainability. 9) And finally, an inequitable distribution of the benefits and costs of development can eventually compromise social stability. And we all know that this is now one of the major concerns of the government of Vietnam.

So what are the policy implications of the above for Vietnam? I am sure you could already list most of these policy implication. 1) There is a need, and that was clear if I can say so in the last consultative group meeting in Tokyo led by the World Bank, there is an urgent need for much greater transparency and reliable information on Vietnam's banking and corporate sectors. 2) As a next step in the SOE reform process which was mentioned by all speakers so far, state directed new lending to state-owned enterprises in commercial sectors needs to be sharply curtailed and carefully rationed for the reasons already mentioned. 3) Similarly, state-guaranteed lending needs to be minimized and carefully monitored again. 4) There is obviously a need to continue to move towards a competitive dong exchange rate. I don't need to elaborate on this. That can be discussed later also. 5) Clearly Vietnam's low domestic savings rate of approximately 16% of the GNP will need to increase substantially to approximately 30%. 6) In light of the lessons described above, an export-led development strategy based on labor-intensive manufactured exports would still appear to be by far the best strategy for Vietnam. 8) Very important point -- all these points are of course are very much interlinked and related -- much more pro-active state promotion of what we call the non-state sector would be essential to Vietnam's successful development. 9) Again, concrete reform of the state-owned enterprises. 10) Greater transparency and accountability to the people by the State, and an equitable distribution of both the benefits and costs of development.

As a conclusion, because Mr. Chairman I guess my time is I have not told stories like Mr. Steer, but I have made too many points. We are very optimistic, I think, as the United Nations and as a group of donors about the future of Vietnam. I will not repeat what Mr. Offerdal just said, but really, Vietnam is at a crossroads now, and maybe it's good that the financial crisis in Asia happened now in a way to help Vietnam to take some tough decisions, big changes, a la Vietnamese that is following their own perspective and decision, but there's certainly no time to lose. In a certain manner, Vietnam is now in a position to capitalize on both the positive and negative lessons learned in the region over not only the past forty years but I would insist more on the past eighteen months maybe or less.

In conclusion, our view is like for most countries in the world, that it might be more difficult for Vietnam because of its recent history, is less government in directing the allocation of resources, and more government in improving the enabling environment for the non-state sector. Thank you very much.

Prof. Hara: Thank you very much. Anyhow, the very nice summary of the positive and negative lessons of East Asia is very useful for discussing the appropriate development strategy in Vietnam. Then Mr. Jean-Pierre Verbiest, please. I will give you at most ten minutes.

Mr. Verbiest: I will try less than ten minutes, because a lot of things have been said before. First of all let me thank JICA and the Study Group, and Prof. Ishikawa in particular for organizing this seminar. I was very impressed by the quality of the documentation and papers. There's a lot of material. I think next time we should have a one week meeting, because two days will be too short. There's a lot of things to discuss.

I would like just go sort of over a few points which I think we need to discuss here and try to find some answers or try to share experiences. And I just want to do it running down on the development parts, which we see for Vietnam.

I think the first thing, which actually Prof. Ishikawa mentioned in his introductory remarks although I didn't read it, was that growth in productivity in agriculture supported by technology innovation, rural community solidarity played a fundamental role enabling industrialization. I think that's very important. That's a theme which has come through a few papers, particularly in your paper. Obviously, Vietnam, contrary to East Asian countries, has an enormous potential in agriculture. I think that is the first area of development which should be emphasized in Vietnam, not only for economic reasons, but also for social reasons. We talked about employment, employment or income. It is not normal that the more farmers work, the poorer they become. That's not what development is about. So I think we will need to look into that and what needs to be done. Andrew told the anecdote of Ha Tinh Province. But I think what we see is that research in agricultural diversification is very important. I lived most of the 1980s in Thailand, and for instance when we started producing chickens for export to Japan, it was very difficult. It took two or three years before we got the quality, because the Japanese market is very difficult. It took two to three years to find out the right way of producing, and then it became a major

export of Thailand. I mean, the whole area produced only chickens. But then there was a role played by agriculture research and market research also what the Japanese market wanted.

I think also there is still a lot to be done in Vietnam on liberalizing trading in agricultural commodities. That will relate to my second point in a sense that there are still a lot of state trading companies getting monopoly rents out of trade in agriculture. We tried, the bank, ADB, tried to work on liberalizing the rice trade, the domestic and foreign rice trade, and I think, we were relatively successful there.

Finally, in rural development in agriculture, a major problem of course in Vietnam is a lack of infrastructure, which Andrew also mentioned, and that's where probably ODA can play a big role in helping to build rural infrastructure and bringing people in villages and so on to the market. We did some studies in other countries. The impact on poverty is enormous, because immediately when you have rural infrastructure, if you make a survey a few years later, you will see the impact on the incomes of people.

So I think agricultural development is one area. And I think we need to work on what should be done. There are a number of papers, and there are number of discussions.

The second area which I think we should discuss is the development of small and medium-scale enterprises. This has been mentioned before. I think that's an area where, frankly speaking, Vietnam has failed very much so far. We could look at the experience of Japan, the earlier experience of Japan, before the Second World War, very much in the beginning, and the experience of China which has been very successful in developing small and medium-scale enterprises. And that goes from agro-industries, I mentioned before, there is tremendous possibility in Vietnam, to closer to the industrial area, which I will talk about later which is for instance component producers for cars or whatever, and we heard before, and I think we all know that there are people there, in the streets and in the villages, who have tremendous possibilities and tremendous skills. If only you look at the handicraft industry in Vietnam, we can see how skilled people are. But somehow, very little has happened so far. It's clear to me that the government needs to really play a pro-active role in stimulating small and medium-scale manufacturing. It should not be a sin to do this, to create such industries. It should be very much encouraged, because they are the people who are going to produce employment, and they are the people who are going to lead eventually to higher degrees of industrialization.

A question to ask is, how do we support them? There are a number of things which are relatively straightforward; like the new company law will help the access to credits. But the access to credit is not the only point. I mean the environment, the legal environment, is still very much lacking. The access to resources, I think Andrew mentioned a few like land and so on, and that is one of the reasons why we have to deal with the state-owned enterprise sector, because the state-owned enterprises, the system is too biased towards the state-owned enterprise sector. So if you don't touch state-owned enterprises, like their favored access to land or export licenses, and so on, you will not be able to stimulate small and medium-scale enterprises. So you have to do it together, to touch the privileges of

state-owned enterprises, otherwise private entrepreneurs will not be able to grow. Developing SMEs is also, I think, a part of the strategy of raising and relying much more on domestic investment, so raising also domestic savings and create a real Vietnamese industry, not one which is either state-owned or foreign direct investment.

The third area I want to talk about and which has been discussed through the papers is that of industrial development, so what goes beyond SMEs or industrialization. It's synonymous to capital intensive industries, it's also synonymous to infant industries, and what do we do there.

First of all, I would like to say that maybe we should think, and I think one of the papers discusses that, that the area, the separation between SMEs and industrialization is not so clear. You could, for instance if you look at the case of Thailand in automobiles is very interesting, because they never really tried to develop a domestic industry, to have their own car industry like Malaysia, like many of the other countries, Korea, Japan earlier. They started with component producers, who were not necessarily big people, I mean quite small. And then they became so competitive that now everybody wants to invest in Thailand; I mean General Motors, Japanese producers first, because they have all the component manufacturers there. But we are not talking about huge car plants or developing your own car plants. So the definitions we have to look at goes to the question of size of the market when you have world trade increasing so rapidly.

Obviously in Vietnam, because of the shortage of capital and because of the stage of development it is in, it is too early to really go into major heavy industry, capital intensive industry. Any mistake, I think, is very costly. We know that from other countries. It will be very costly. Already I think there are signs that some of the foreign direct investment has gone into the wrong areas. Maybe if it had gone in the right areas, I think the growth rates would have been much higher than we see now.

Now, the question is, I think we need to discuss it here, how do we support the development towards sort of a higher ranking industrialization? There are two practices. One is, which is the strategy mainly followed in East Asia, trying to pick up the winners. The other one is just to wait and see what the market is going to do. I think we need to discuss this, because picking the winners in today's world becomes increasingly difficult when you have a completely open trading system where increasingly capital markets are globalized and technology change is so fast. I mean, trying to manage your dynamic comparative advantage is very difficult.

The other area in this relation we need to talk about, I think Dr. Thai mentioned, is the area of administration, government, of managing your dynamic comparative advantage. So does the government have the technical capability and the administrative capability of doing it? I think the experiences of failures are way longer than the ones of successes. I am not sure. Maybe a few we can find.

Most of us, we would support creating more conducive environment for possibility of investment at different levels in the country, for instance, foreign direct investment can

decide, well, Vietnam becomes the country where it is interesting to produce wheels for cars or whatever. So this would be our general attitude.

Now, if there is some support given, we should be very clear on the transparency of it and to have it time bound, so that we are sure we are not running into really bad experiences and waste of resources many countries are facing. I think I will leave my remarks to that. Thank you.

Prof. Hara: Thank you very much. I think that many points which you raised will be discussed in the following sessions in detail. Finally, may I ask David Dapice from Harvard. I will give you at most 10 minutes.

Dr. Dapice: Five is fine. Maybe we can have real discussion. I would like to start by thanking Prof. Ishikawa and Dr. Thai and their study groups for a significant and useful study. I think that JICA is to be congratulated for bringing these different groups together to talk, and I hope we can talk about the issues that have been raised. A lot has been said. Let me lay out a few points which to some extent pull together and to some extent complicate what has been said already.

There is obviously I think in Vietnam a potential for sustainable rapid equitable growth, but present conditions will not achieve it. I think we agree on that. It's necessary to identify sources of funds, who's going to get them and how they'll be used, and if certain sectors or products are going to be favored. If some sectors are favored, others will be taxed. You know, doing one thing means doing the opposite in another area, and that's important.

We need to think not just about the role of government, but about the role of competition. Not just in Vietnam, but I think in much of Asia and elsewhere, many people identify competition with chaos, with disorder, with wastefulness. As we discuss, will competition be eliminated, will it be encouraged, will it be constrained, there is both government failure and market failure, and we have to realize that any good policy deals with both, not just with one.

The decision making structure in Vietnam, as in most nations, is complicated. Government ministries differ, state enterprises have their own interests, localities lobby for special treatment, and none of this is unique to Vietnam. It's true in other places, as well, but because of the weak private sector, the problems of politics mean that there are problems in economics, which is true to a greater extent in Vietnam than in many other countries where the private sector is able to operate more or less on its own with its own center of gravity.

As a result, hard decisions, political decisions need to be made and have been made in the past in Vietnam. But they are hard to make without a sense of crisis. There is a sense of crisis building, but the lack of transparency which has been referred to, plus the defused nature of the decision making makes it very difficult to reach a consensus internally. I

think if we can increase the transparency and the information, and the clarity of the analysis, maybe that agreement will be easier.

There are obviously fundamental and important, short and long term, regional and global trends that need to be understood and incorporated in our discussion. Many have been referred to at some depth; the rise of China, the potential and the risks of ASEAN, the need to attract global FDI, the faster pace of product change and so on, all of these make, old style, if I can put it that way, detailed government planning more difficult. Obviously, flexibility, efficiency, speed, tend to favor private, small and medium enterprises which is one reason why a greater role for them is almost certainly appropriate.

I guess the bottom line for this conference as I see it is that economic progress and development is a political as well as a technical question. Aid works to create wealth rather than debts when it strengthens the indigenous groups that want and are supporting a viable growth strategy. Aid can help ease the costs of adjustment and make a viable growth strategy more acceptable. The danger of aid is that it will slow, kill or even reverse progress for reform rather than accelerating it if it's used simply to reinforce inefficient tendencies rather than accelerate ones that create wealth. All successful countries end up financing most of their investment. ODA, FDI ends up over time being a small part of total investment over time. So we have to create the conditions and the institutions and the firms that create the savings, that do the investment, and obviously SOE reform, financial reform all fits in here. I think creating those conditions is as important as creating a specific road or factory. We need to look at the institutional change as much as the specific sectoral requirements.

Prof. Ishikawa ended by saying, I think the key question for this conference, which is what can ODA do to help Vietnam. I think that is the fundamental question, and I hope this conference accelerates a meeting of the minds between the ODA community and the Vietnamese leadership about what needs to be done and what are common goals, and if they can be agreed to, can significant disbursements be based on progress towards those common goals. And I think if that structure can be set up and accelerated then this conference will be successful. Thank you very much.

Prof. Hara: Thank you very much, Mr. Dapice. According to my watch, only seven or eight minutes remain. I believe that the topics or issues raised by all the presenters are rather clear. What we should discuss this afternoon and tomorrow, I think is now made very clear by these various presentations. The various points raised in the presentations will be discussed in the following sessions. I would like to ask Dr. Thai or some other Vietnam participants to give us some ideas after hearing the presentations made by the foreign institutions. Firstly, I would like to give some time to Dr. Thai to say something after hearing these speeches.

Dr. Thai: Thank you, Mr. Chairman. I think the presentations were very clear in ideas for supporting Vietnam, and have mentioned about some of the key issues. Of course, when we come back to Vietnam, we have to submit a report to the leadership about everyone of your ideas. However, I think we have common languages, because we have

to continue the reform, and we can develop our country because Vietnam has some advantages, the comparative advantages. First of all, while the growth rate in other Southeast Asian countries are zero or minus, how Vietnam can continue eight percent, six percent, or five percent higher growth than other Southeast Asian countries? How can we continuously develop our country? Agricultural sector can continue its development. In the industry, FDI projects have somehow slowed down. However, recently the projects continue to develop, twenty percent per year up to now. FDI is very important. For the private sector or the non-government sectors, we have to push them for the mobilization of domestic resources, for the development of our country in the near future. On this matter, as in the UNDP's presentation, the role of the state as government is very important, not directly allocating the funds from ODA, as Mr. Dapice raised in the question. Of course we have to make analysis, on how can we use the ODA and the external resources to keep the good environment and infrastructure, on the role of the people, on legal framework, on preconditions for developing our country, and on administration and retraining of the officials, because the legal framework have whole implementing officials and therefore it is very important. Vietnamese people, as well as foreigners are very concerned about the legal framework in Vietnam. However, sometimes the legal framework is very nice, its writing is very nice, but implementing, implementation is more important. Not just saying, but working and doing, now. We have to retrain our officials and make the administration reform in Vietnam stronger, in the near future. In this area, the World Bank, ADB and UNDP is supporting us very much in the training costs, and job training, and of course, JICA Study Team in Vietnam jointly has a training for jobs.

When Prof. Ishikawa works with me together, he teaches me. Not only the methodology, but sometimes make investigation together. We fly from Hanoi to Hue and to Ho Chi Minh City together, and he explains us with his experiences from other Asian and Southeast Asian countries. In this way, we can learn a lot from your side. And I think your opinion is very nice for this workshop. We have to make very detailed analysis by sectors and by some specific topics, very clearly. However, a letter from the World Bank, which is from Mr. Andrew Steer to Prof. Ishikawa this morning, about rural areas is very important. When there's some difficulties, environmental, in this case, we have to manage good condition for the people in rural areas, because now the gap of the living standards between rural and urban areas is getting wider and wider. We are very interested in the case that if you could invest into rural areas as Prof. Ishikawa had suggested three years ago. Sometimes, some people don't like opinions from Prof. Ishikawa. Three years ago, when you talk about industrialization in our country, they said why Prof. Ishikawa talks about rural areas. However, he explained us that Vietnam will mainly continue to be an agricultural country. Eighty percent of the country is rural area, and there's abundant labor force, therefore it is very difficult to find a job, or the working place. For this situation, he said to us that we have to be very concerned about the rural areas and its unstable environment. Economic growth is very nice. Growth in our country is very important, but social and environmental, and many other issues, as well. However, we are in changing process and now there's the currency crisis in East Asia. There are many difficulties. However, I believe about the future of Vietnam, we have many potential. If we have right policy, in which we have to find out the short-term and

the long-term policies jointly, some emergency measures to protect the economy from the impacts of Asian currency crisis, and a long-term policy to continuously develop our country by investing into human resources, are very important for Vietnam's future. I would like to emphasize again, that the *Doi Moi* policy, revolution, reform will continue, and we believe this is the only way for Vietnam to go. To realize this, the international support to us is very important. Thank you.

Prof. Hara: Dr. Thai, thank you very much. As a chairman, I would like to ask one question to Dr. Thai or other Vietnamese participants, because Mr. Eric has expressed, if my memory is correct, his very important observation that the speed of reform in Vietnam has recently declined. I think this observation is very important. Dr. Thai said that Vietnamese government still continue the renovation or reform policies. But on the other hand, some outside observers, see that the speed of reform declined. At least, I would like to know the Vietnamese side views regarding to Eric's observation.

Mr. Ham: (translated comments) As Mr. Thai said, the only thing we want to continue is the reform, renovation path. And we want to create a favorable environment for the foreign investment. Recently, the government realized that we have to know how should we do with the policy, which the government just promulgated. If you have read the newspapers recently, you can recognize that the Prime Minister recently has been visiting many small and medium enterprises, and meeting with them and listening to their opinions. The Prime Minister also said that we have to smoothly and efficiently implement the government's policy to make foreign investors believe the government of Vietnam. And the government also criticized the authorization or the organization which obstruct the activity of the foreign investment. Could you please review the decision number 10 and the decision number 7 that the Vietnamese government just promulgated recently. They are about the domestic investment and foreign investment. Thank you.

Prof. Hara: Eric?

Mr. Offerdal: I just wanted to add one quick comment to what you just -- you actually made my point at the very end -- which is simply that the emphasis in the public pronouncements and also in the recent documents that have come out from the government on foreign investment is good. But ultimately, far more important than that is actually domestic investment and creating the right enabling environment for domestic investment and domestic entrepreneurs. This is, I think, really the point you made in your initial anecdote. That's really where the most fundamental basis for future growth is going to lie.

Prof. Hara: Unfortunately, I myself become a little bit hungry. I would like to close this morning session. As I already told you that many issues raised in this morning session, can be fully discussed in the afternoon and tomorrow's sessions. Thank you very much for your kind cooperation.

Session 2: Trade & Industrial Policy

Chairman: Mr. Steer

Mr. Steer: Well, I would like to welcome you back to the second session, which is a very, very important one, clearly. We have a wonderful group of papers. I have this much as background for this session. Some of the issues that will be discussed are extraordinarily important for Vietnam right now.

We have six speakers. We've agreed that it's very important that we have plenty of time for discussion, and so the speakers have kindly agreed to be brief. We recognize that some of them have a lot to say, so I am not going to actually cut you off unless you really overdo it. But we have asked you if you can to limit your interventions to seven minutes. I think we should assume that everybody has read all the papers. I think we all have on our side. So my recommendation would be that the speakers would focus on what their recommendations are and why, as opposed to giving background to the sector, because I think we've all prepared quite well for this seminar, and I think most of the people in this room have lots of questions that they would like to ask, and it would be a pity having taken so much trouble all to come here not to have the opportunity to have a discussion. So I would propose that we try and be as precise as possible about the recommendations and the reasons, empirical and otherwise, why those recommendations are valid, and that will give us then something to focus on in the discussion.

Prof. Imaoka is going to give the overview, and we're very grateful to you, sir. Thank you very much.

Prof. Imaoka: Thank you very much, Mr. Chairman. Just referring to the Note 2-1, this one, which has been just distributed on your desk. Referring to this paper, I added one important information in this paper. So just I would like to concentrate on discussing this data first.

In Vietnam in these ten years of economic reform and renovation under the Doi Moi, Vietnam has started massive industrialization. But according to our knowledge, Vietnam has not yet established even the minimum level of the industry complex. So to show that evidence, I would like to refer to the Section 1 in my paper in page 1. Next page, you can find Table 1. Here we calculated import ratio and the import inducement coefficient and export ratio. Here, if you look at this Table, you can find among the so many industrial sub-sectors, the import inducement coefficient is more than 1.0. That means when we increase the output, then the import might be induced more than the output, through the industrialization. And even the promising labor intensive manufacturing sectors, you can find very high import inducement coefficient. So this is the one very important point.

And would you refer to page 3. Because there is such a structure of industry complexity in Vietnam, in Table 2, you can find that since 1994, a very rapid increase in deficit in

trade balance as a ratio to GDP. So this trend is quite closely related to the structure of industry complex in Vietnam.

And thirdly, level and structure of protection, here, from the back, five pages, here you can find the effective rate of protection for Vietnam for 1995 and 1989. Here, if you look at this table, compared with other neighboring ASEAN countries, when they started industrialization, level of protection was very modest, except very few industrial sectors. So Vietnam must start the early stage of industrialization under the freer trade regime. So, in that sense, lessons from other countries, from other experiences would not be so useful to discuss the industrialization in Vietnam. So in our study, we emphasized very much the role of foreign direct investment to promote, to give an initiative, and to give an incentive to foreign investors to promote investment further and to mobilize domestic resources.

I would like to talk about the export promotion strategy in Vietnam. Regarding -- would you refer to page 4 -- here, I have discussed the promotion of exports. But regarding the promotion of new manufacturing products for export, here, this part, might be discussed by Mr. Masuyama much more intensively. So I would like to refer very briefly to the promotion of traditional exports. Here, in back pages, you can find Table 5. Here you can find traditional export products with a comparative advantage. Regarding these products, I would like to emphasize import inducement coefficient of these products are guessed to be rather low. And to promote these traditional exports, I would like to emphasize the role of medium and small scale industry is very important. The role of medium and small scale enterprises in general has been discussed in this morning session. So, that's all. Thank you very much.

Mr. Steer: Thank you very much, indeed, Prof. Imaoka. That was extremely interesting. We actually wanted you to keep on talking, which is a sign of a very good speaker. Thank you very much, and I liked very much the fact that you pointed us to your paper, because I am sure that will raise lots of questions later.

I would like to ask Prof. Masuyama to speak now on industrial policy options for the development of export industries in Vietnam.

Mr. Masuyama: I am not a professor, just Mr. Masuyama. Thank you, Mr. Chairman. I am very pleased to talk about the industrial policy options for the development of export industries in Vietnam. I would like to make this presentation in two parts. First, I would like to review the content of our summary report by focusing on the electric and electronics industry and the garment and textile industry. And second, I would like to discuss the implications of the Asian currency crisis for possible change in our views on the development of export industries in Vietnam.

First, about electric and electronics industry. As Vietnam is a late comer by a wide margin to the very internationalized industry, and its domestic market is small due to low income levels, we believe that it will be able to develop the industry only by attracting foreign direct investment in the export-oriented sector. Major issues for development of

the electric and electronics industry in Vietnam are as follows. First, Vietnam should make maximum use of foreign direct investment to develop the electrical and electronics industry by taking advantage of the changing investment behavior of multinational corporations. Multinational corporations in the industry are now in the midst of relocating production facilities in the area to cope with the worsening labor shortages and rising wage levels in Singapore, Malaysia and Thailand, the traditional strategic export center. Multinational corporations are being forced to relocate labor intensive corporations to low income countries in the region such as Vietnam, Indonesia, and the Philippines. In order to attract foreign direct investment, Vietnam should improve its investment environment significantly, and offer better incentives for investment. Moreover, particular attention should be paid to carefully coordinate a variety of policy measures pertaining to foreign direct investment in order to have a coherent and transparent structure. I think, this coherence policy is the one strong point that the Japanese corporations emphasize about the investment environment in Vietnam.

Second, it is crucial to develop efficient parts industries by inviting foreign direct investment in this sector. Since potential investors in this sector are mostly medium and small sized firms that lack capabilities in negotiating with a state owned enterprise, special support by Vietnam's government is required.

Third, there is a need to promote technology transfer by taking policy measures to facilitate technology transfer to domestic firms. I have elaborated on some points in the report.

And finally, there is a need for government to implement consistent industrial development policies by developing an overall master plan for the electric and electronics industry to lay the general legal framework and to prepare adequate infra-structure rather than intervening in industrial affairs.

Second, I would like to talk about the garment and textile industry. Vietnam has been increasing garment exports as the participation of foreign enterprises in the form of subcontracting arrangements, and the private sector, and trade liberalization have realized Vietnam's comparative advantage in this very labor intensive sector. However, Vietnam hasn't developed the competitive fabrics and fiber sectors because of the lack of comparative advantage, and because of the inefficiency of state enterprises in this sector.

We view this lack of industrial inter-linkages poses a problem for the competitiveness of the garment and textile industry in comparison with countries such as Thailand and Indonesia. We think that the full development of the garment sector is the top priority because it can be the basis on which Vietnam's fabric and fiber sectors would develop by enhancing backward integration. Increasing backward integration to the fabric and fiber sectors is generally believed to be achieved only by active utilization of foreign direct investment, particularly starting from the more labor intensive fabric sector. A similar situation of what we described in the behavior of multinational corporations in the electric and electronic industry exists in this industry also, and Vietnam should take advantage of

it. And because of the AFTA sector trade liberalization, capital intensive, it is very difficult to have feasibility in capital intensive fiber sector in this industry.

Thus, the priorities of Vietnam's garment and textile industry are to strengthen linkages with other ASEAN countries in the medium term, and position itself to supply the increasingly huge Chinese market in the long term. It may be advisable, at least in the initial stages before local supply of synthetic fibers and fabrics become available, to encourage multinational corporations with strong quality orientation to enhance their industrial linkages between garment production in Vietnam and fiber production in Thailand and Indonesia.

Finally, I would like to talk about this possible modification of our recommendations due to this recent Asian currency crisis. We haven't done any formal studies. This is our tentative views.

The drastic devaluation of the currencies of the Southeast Asian countries has dramatically strengthened the export competitiveness in labor intensive industries against such countries as China, Vietnam, and it has substantially improved the availability of human resources. Therefore, the incentive to shift labor intensive production from such countries as Malaysia, and Thailand to countries such as Vietnam has substantially weakened. This means that investment by multinational corporations in Vietnam's labor intensive export sectors such as garment and fabric production and electronics assembly is much lower than had been expected before the currency crisis. So Vietnam's competitive position has been substantially eroded.

Moreover, the domestic consumer markets of the Southeast Asian countries have shrunk dramatically as have the AFTA consumer markets. The incentives for market-oriented investment in ASEAN have weakened accordingly. Thus, it will be difficult to pursue a two pronged strategy of export promotion and import substitution, which we suggested in the electric and electronics industry. However, we expect that Southeast Asian 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 recommendations for an export-oriented, foreign direct investment-based development strategy for the two industries needs to be postponed by say, three to five years.

In the meantime, Vietnam may need to undertake development of its export industries without major contributions from foreign direct investment. Apart from the possible adjustment of exchange rates, the export potential of small and medium sized enterprises need to be mobilized fully. Since the competition to attract foreign direct investment has become much keener, Vietnam must earnestly carry out improvements in regulation and infrastructure in order to capture precious foreign direct investment opportunities as well as to prepare for the next wave of foreign direct investment.

Thank you very much for your attention.

Mr. Steer: Thank you very much indeed, Mr. Masuyama. Prof. Fukui is going to speak next. Thank you very much.

Prof. Fukui: Thank you, Mr. Chairman. In the morning session, many of you have expressed concern about what Vietnam should do about heavy and chemical industries. Actually, I got some impression that you are thinking we're protectionist by nature and selling experiences of our glorious past in the 50s and 60s. Actually, when we began this project, the draft of the Five Year Plan in Vietnam had been already prepared with an emphasis on heavy and chemical industries. Then, to make a recommendation convincing, we had to do very intensive work. For these heavy and chemical industries, because of the time limit, I just prepared very brief paragraphs of my paper (Note 2-3), that is second page. If you see number 2, iron and steel, petroleum refining, petrochemicals, and urea fertilizers -- these industries require a huge amount of investment, and the pay back period is very long, and the small difference of production cost per unit could divide the winner and the loser, and the international price fluctuates according to the global economic situation and supply and demand. For these reasons, the timing of investment, the trend of international supply and demand, or the feasibility of each project must be carefully examined, even though the country with a sizable population like Vietnam will eventually need all these industries domestically. These are the findings which we concluded.

And why they made emphasis on these industries, one reason is that natural resources, indigenous resources, exist inside Vietnam, like iron or coal or crude oil. So there is a natural tendency that Vietnam wants to take advantage of this fact and tries to add more values to these materials. But if you see experiences in other countries, like iron and steel in Japan and Korea, the existence of these raw materials does not add any competitive edge and the raw materials can be sold as they are. These are about heavy and chemical industries.

From now, I would like to talk about automobile industry which was added to this project in the second year. This is a very, very special industry which almost all governments with a sizable population treated it as a special industry from the beginning. They treated it in a special way even in the United States in the 80s. Of course, Japan did it in those glorious 50s and 60s.

This is a case in ASEAN countries. It is very irritating to your eyes, but what I would like to point out is in ASEAN countries, Thailand, Malaysia, Indonesia, Philippines, they treated this industry as a special one and tried to make it grow from the very initial stage. Thailand began it in the 60s and most advanced in ASEAN countries. But still their protection is something like 60% to 70%. In Malaysia and in Indonesia, their protection is something like 200%. But they did it. Vietnam, should the country begin to nurture this industry right now, is a big question by looking at these things. But if they want to nurture this industry now, there are several things that they must do. If you see my paper's first page, if they want to nurture the industry now, there are three basic approaches that we thought it universal.

The first approach is to promote expansion of the market for the domestic product. Expansion of the market for domestic product usually leads to the reduction of manufacturing costs and a further growth in demand.

This is a case of one typical passenger car made in ASEAN countries. Do you see this reduction of cost? This is 40,000 in volume, the price is about ten thousand dollars, in case of Thailand. When the numbers are increased, cost is reduced this way.

The second possible approach is promoting local production in order to retain the added value generated in the industry within Vietnam, and also structuring a network of parts manufacturers. But this localization needs to be a long range program, because it is normally impractical to greatly increase the ratio of local production when the domestic market is small.

The third approach is to aim to participate in the international specialization within the ASEAN area in line with the multinational strategy.

Each country protected the completed vehicle in one country, but MNCs are moving in a different direction, that is, an ASEAN-wide, reorganization of parts manufacturing.

This is the case of Toyota. Toyota is trying to concentrate diesel engines and floor panels in Thailand, transmissions in Philippines, steering links or shock absorbers in Malaysia, gasoline engines in Indonesia. With this concentration, the economy of scale works and it's easier for them to produce cars more economically.

Now, this is the case of parts manufacturer, Denso. Denso is trying to concentrate the production of starter motors and alternators in Thailand, air conditioners in Malaysia, combination meters in Philippines, compressor spark plugs in Indonesia.

There are many other parts which will be localized in ASEAN basis, and Vietnam should be incorporated into this scheme. It is the time. They are already going in this direction. So thinking of that, in that sense, Vietnam cannot wait to have automobile industry in the future. On the other hand, this is going on while each country is protecting a completed car market. AFTA is regionalism, but this is always a confrontation between national ego and regionalism.

After these three basic approaches, I would like to add one new issue, which Vietnamese government is proposing, which is explained in my paper on the second page. Recently, Vietnamese government or general tax office is proposing to their automobile industry to impose a special consumption tax, not only to imported vehicles but also to domestic vehicles. This seems to be that imported vehicles and domestic vehicles must be treated in equal way, which is right. So from the beginning, we were advising that this should be a simple tariff instead of this strange combination of tariff and special tax. If you want to make a completed car market in Vietnam, 200% protection is not high. That's exactly what they are doing in Indonesia and Malaysia. It's much simpler. In the days of WTO, equal treatment is necessary. If you want to make it, the right direction is to raise the tariff

in the way you had three years ago, because thirteen automakers have established the companies in Vietnam already. If you suddenly change the rule like this, that creates very, very negative impact on foreign investments.

In this project, our group used this kind of table -- these smiling faces and angry faces in each country -- Thailand, Malaysia, Indonesia, Philippines, Vietnam, land prices, power rates, water rates, minimum wages, workers, engineers, middle managers. In Vietnam, investors think it's a very, very difficult country already. If you change the rule like this, suddenly increasing tax by 100%, the result would be very, very negative. And also this would go against the three basic approaches that we found. What I am presenting you is if you want to have completed car market in Vietnam, I mean domestically, then these are the things that you must follow in a consistent way.

We have other arguments about AFTA and WTO in our paper, but at this point I would like to stop my presentation.

Mr. Steer: Thank you very much indeed, Mr. Fukui. I very much appreciate the clarity with which you made those statements. I used to have a boss in the World Bank that used to instruct us all not to write generalities. He said, you've got to write something with which a reasonable person could disagree, and you've passed that test. And we will have some good discussion, I am sure of the ... that was Larry Summers for those of you that know him.

Could we move on now to Prof. Ebashi, who is going to speak about small scale enterprises and supporting industries in Vietnam. Thank you.

Prof. Ebashi: Thank you, Mr. Chairman. I am very happy to introduce our study on development policy on SME and supporting industries in Vietnam.

In this morning's session, this issue on SME was spotlighted, and I am also happy with this. Could you kindly look at the background paper 2-4, which was distributed this afternoon?

Although this is not the background paper, this is Note 2-4. I would like the paper, page number 7 should be replaced with the new one, which will be distributed now from the secretariat. That's for page number 7, the part of lessons from Taiwan, because with original one a few sentence was cut at the end.

Although the private sector in Vietnam has made a significant contribution to vitalize the economy since the start of Doi Moi, it is still weak and the pace of development has been slow. Could you look at the Table number 2-4, which explains about the industrial production by sectors in China and Vietnam? This table traces changes in the share of industrial production in China and Vietnam accounted for by state enterprise sector, the non-state enterprise sector, and the foreign capital enterprises sector. Compared to China, the non-state enterprise sector in Vietnam has been comparatively slow in its development. The background reason of slow development in 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 the market economy, the large scale 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 of pro-industrial management by communes since 1958, 2) existence of managers and leaders who can manage cooperatives and have enough entrepreneurial 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.

Then, I would like to explain about the current situation of SME in manufacturing in Vietnam. On July 1995, there were 8,577 enterprises in Vietnam that were engaged in manufacturing. The absolute number of enterprises in manufacturing of Vietnam is so small when compared with other ASEAN countries.

Could you look at the Table 3-9? You can see the number of enterprises in manufacturing in other countries, and also the number of SMEs, and the role of SMEs is explained in this small table. Also the definition of SME is varied by country, but this is mentioned there.

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. These household enterprises produced 21% of Vietnamese total industrial production, 77% of private sector industrial production in 1994. These household enterprises do not register. Some are big household enterprises with more than 500 employees. They 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.

Next, I would like to explain about the business environment for SMEs in Vietnam. Vietnam's business environment for SMEs on the whole is 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 backwards business support system.

Could you look at Figure 1? This was made by myself based on my perception after interviewing the people concerned. This Figure illustrates the problems in the Vietnamese business environment in terms of degree of seriousness for different groups of enterprises. It should look 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.

Then, I would like to touch upon about the increased role of SMEs in Vietnam under the new economic environment in East Asia. Devalued currencies of East Asian countries and its economic turmoil will affect, has already affected, Vietnamese exports. At the same time, the stagnation of FDI inflow into Vietnam, and the low level of domestic savings will bring Vietnam a lower economic growth. The stronger measures for export promotion, which include currency adjustment for attraction of FDI with liberalization of trade and investment, and for raising productivity of capital and labor, which include SOE reform and development of private sector SMEs, will be the new direction of development strategy for Vietnam. This means that the necessity to develop private sector SMEs becomes higher for Vietnam under this new situation.

And lastly, I would like to touch upon the recommendation for Vietnam, and also some lessons from Taiwan. In the Executive Summary, we explained a lot, and also in the final report more in detail about the concrete recommendations. Since it's already exceeded my allocated time ...

We set the following three principles of SME development in Vietnam. The first, to improve the business environment for SMEs. That means reduce or abolish the differences between private sector enterprises and state enterprises. The second, to implement the multi-staged SME development policies based on the phases of economic development in Vietnam. The third, to prepare a comprehensive developing policy for SMEs, which properly links with other economic policies. As for our recommended SME development policy by different stages, please refer to the figure on page 6.

Lastly, I would like to mention about the lessons from Taiwan. Vietnamese economic situation has some similarities with Taiwan. The government of Taiwan nationalized the Japanese enterprises just after the war, and newly created SOEs dominated its domestic market. In 1952, the state sector share of the total manufacturing production was 56.2%. 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. So thanks to the development of SMEs mainly for export manufacturing, the number of manufacturing enterprises in Taiwan increased from 27,000 in 1966 to 113,000 in 1986. And the export by SMEs shared two thirds of Taiwan's total exports in average of 1981-85.

Successful development of export by Taiwan SMEs could partly be explained by the following reasons: 1) taking advantage of its comparative advantage in labor intensive goods, 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 trading corporations, OEM, the original equipment manufacturing arrangement, and international sub-contracting, 4) being involved in the severe competition both in domestic and foreign market. Besides, the government of Taiwan supported this move with reforms on foreign exchange rates and investment incentives,

which encouraged investment, savings, and exports by means of tax deduction and simplification of procedures for factory land acquisition.

It seems that there are many lessons which Vietnam can learn from Taiwan, especially in the area to develop its SMEs in export manufacturing. However, Vietnam's leaders still seem to be reluctant to develop big private enterprises or capitalists, because of ideological or political reasons. At the same time -- maybe Dr. Thai has a different opinion on this -- at the same time the attitude of the government and bank officials responsible for issuing permits and loans have still not completely reconciled to the market economics. This seems to be the core of the problem of weak private sector in Vietnam. Thank you, Mr. Chairman.

Mr. Steer: Thank you very much indeed, Prof. Ebashi. Let's turn now to Prof. David Dapice.

Prof. Dapice: Thank you very much. It's much harder writing real papers than commenting sagely on them and I will not take much time commenting. I have enjoyed the presentations and found a lot of meat in them up to this point, and I hope we can discuss it.

Trying to put together what has been said, what is consistent and necessary for industrialization in Vietnam? A lot more firms. We just need more -- certainly more private, especially small and medium, I think -- and a better performing state industrial sector, probably equitized, although perhaps not necessarily. And much much better public/private cooperation. I think these are the elements that would push industrialization forward.

Now, I've suggested in the very brief paper I wrote that developing sort of economies of scale industries or heavy industries within ASEAN makes more sense for Vietnam than trying to go it alone nationally, because Vietnam's current market size is small, per capita income levels are low, and smuggling is enough of an issue that if you rely on very high protection it's apt to be defeated by spontaneous measures.

There are problems with ASEAN. I think even the political structure of ASEAN could be in trouble if Indonesia has severe problems. I simply mention this, it's not anything we can do anything about. But if you are going to commit public investment funds based on an ASEAN or AFTA structure, then that becomes a public risk not just an FDI risk. If Denso does a parts factory in Vietnam, that's Denso's investment. If Vietnam does it, then it's a public debt that Vietnam has to worry about. That's different. I think even if ASEAN holds up, the stability of the rules within AFTA are not clear. I think many countries within AFTA will try to evade one way or another or create special tariff categories or bans, and if they do that, again, then the assumptions of a larger market would not be fulfilled, and that is a risk. It's a business risk.

To attract FDI, and even to attract domestic investment -- and I underline this -- that domestic investors have alternatives. They can buy gold, they can hold dollars, they can

buy real estate. They can do things that are not terribly productive for your country rather than industrialize, and really, the task is not just to attract foreigners to industrialize, it's to attract ordinary Vietnamese to decide that it's a safer and more profitable and better thing to invest in industry, because now you don't have as much industry as many other countries as was shown very clearly.

I wish sometimes that for larger investments, there were a "Ministry of Timing," ... There has been a tremendous over-investment in steel, in autos, in petrochemicals in the region, and to go ahead in a rigid fashion with exactly those investments when they can be imported below cost makes no sense. So maybe after you make your general decisions about what industries you want to do, the "Ministry of Timing" can decide that that's O.K. in 2006, but not now. So I guess, my advice here is to take advantage of the gluts, take advantage of other people's mistakes, hit them where they ain't, not where they are, and use that as an advantage rather than as a drawback.

The importance of smuggling in both the short-run and the long-run, I think, needs more study. It is a fact of life in Vietnam. It's extremely difficult to get a handle on. I believe that if there were more studies, you might find you already have a low rate of effective protection -- effective meaning the actual prices, not the tariffs or the other protection.

I would also say that the discussion until now understandably has been focused on goods, but increasingly services will be important. Already you are exporting software services in a significant amount. In a recent high technology tour that we took a Vietnamese delegation around to Silicon Valley, one of the speakers who was a Vietnamese American from the Silicon Valley area said, we have a 110 people in my firm which writes software and 100 are working in Saigon, and they do it all over the Internet, and this is growing and could grow much, much faster with appropriate education. And software design, other things like this, I think could become an important export, and is probably a comparative advantage.

The only other point I would like to make right now is to second the various people who have said that there are both macro and micro steps that you need to become more attractive to both outsiders and your own people. The macro steps include the things like the exchange rate, I think, the banking system, and then simple things like electricity supply or the cost of phone services. I mean all of these things ultimately make a difference. And then the micro things are more like regulation and taxes and so on.

Finally, if you do go ahead and use state enterprises as a primary means of industrialization -- and I might say that a part of my paper talking about Japan was really aimed at a Vietnamese audience who was thinking in those terms rather than at the writers of the report -- if you are going to use state enterprises, it seems to me that that in itself creates biases towards the type of products, the scale, and so on. So you can't just decide that, alright, we are going to have a state sector and then we are going to decide what we are going to produce. The two are related. And if you have small and medium firms growing in importance, they will produce lighter industry things, intermediate technology

things, more agro-processing things. So the institutional choices and the product choices are linked, and I think it's important to understand that, too. Thank you very much.

Mr. Steer: Thank you very much, David. Now we turn to Mr. Pham Quang Ham to give his comments.

Mr. Ham: [Translated comments] Thank you Mr. Chairman. I would like to say briefly about the competitiveness and efficiency of the Vietnamese industrial structure. I want to emphasize that it's already weak, and after the currency crisis in Asian countries, it's become weaker. Therefore, now we are facing the severe competition situation, of course, according to the case and according to the good products. Therefore, the new Vietnamese government decided to enhance Vietnamese efficiency and competitiveness to cope with the situation in the region and the world economy.

The weakness of Vietnamese industry, as you know, is that we don't have good products and good quality, and we don't have good market. Therefore, I want to emphasize two points and would like to receive advice from the international experts. The first one is we don't have good industrial linkage, so we want to create the industrial linkage. And the second, we don't have good management strategy and Vietnamese businessmen are not so active. So please help us to solve these problems.

Secondly, in order to enhance the competitiveness and the efficiency of Vietnamese industry, we need to readjust the industrial structure. Here, I would like to divide it into three points. The first point is, in my opinion, I want to foster the processing industry, the labor intensive industry to enhance the exports promotion. The second is the industry of mechanical engineering. And the third is the heavy industry, and the industry of producing raw materials, or related to raw materials, some-thing like that. For the Vietnamese government, we have the policy that we want to enhance and continue to focus on these above industries I just mentioned to you. Besides, the government has to prepare the competitiveness of these kinds of industries also. As an expert of industrial sector, I realize that the mechanical and engineering industries are very important. Regarding the heavy industry, I think the Vietnamese government should be very cautious and careful in selecting the priority of heavy industry. And thanks to JICA Ishikawa project, you have contributed many good ideas to the Vietnamese government, especially the economic policies recently.

Talking about the small and medium industry, we realize the importance of small and medium industry very much. However, if we deal with policy, I think we have two kinds of policy. The first policy is the policy to promote the small and medium industry, and second is the private sector. I think, in general, people will overlap and misunderstanding between the small and medium industry and the private sector industry are just the same. But for the Vietnamese people, we understand them in different way. I agree to Mr. Ebashi with all the ideas you just gave us. I already took Mr. Ebashi to many villages that have existing small and medium industries. However, in my opinion, I don't think if we promote all of these kinds of small and medium industries in those villages, it is good for the Vietnamese industry itself. And we don't have enough market either. Therefore, I

agree and I think we should promote the small and medium industry in network and in interlinkage of the heavy and the important industries, and for the time being, we have already begun these kinds of activities.

Therefore, attracting the foreign investment to the assembly industry is just the same purpose of these kinds of things I just mentioned. Even inside Vietnam, we have so many opinions. But I think we can promote it, and during the process of promotion, we can select which one is good and which one is bad. I mean, we gave so many permission to those kinds of small and medium industries ... excuse me, I mean, we already gave so many permission, so many licenses for the assembly industry. For example, for the automobile industry we already gave fourteen permissions. However, fourteen may be very much, but I think in the process of implementation we can select good one and bad one.

In my paper, I already mentioned about the export promotion and other things. So you can read it, and I think my co-workers will have opinions about that. However, I have to emphasize that we try to improve and we try to renovate all the things we have done in order to create good investment environment and to attract FDI. For example, now the government get the license for free-trade zone already. We also realize that the situation of other countries in 1970s was totally different to Vietnam's situation right now. So we realize that how should we do, and how should we make a free trade zone to have efficiency and to attract FDI or things like that. Here, I want to inform you that the Mong Cai in Quang Ninh Province, the government of Vietnam already decided giving them the permission for being ... like a free-trade zone. And I think that in order to promote the competitiveness of Vietnamese industry, the Vietnamese businessmen must become strong themselves.

Regarding SOE reform, I think, many of you here already mentioned. I think tomorrow we will have more questions and we can discuss this. Thank you very much.

Mr. Steer: Thank you very much, Mr. Ham. The next session after coffee will be state enterprise reform, so we could pick up those issues then.

I would like to thank all the speakers for being very brief and to the point, and that backed up with excellent papers really has equipped us for a good discussion. Given that the speakers went quite quickly over a lot of fairly technical material, I propose that we begin with simply questions. So anybody should feel free now to raise questions to the speakers. If there is anything that they said that wasn't clear or any empirical or other form of evidence, and then having taken those questions, we will then move on to discussion and comments. So does anybody have any questions? Mr. Watez.

Mr. Watez: I don't know if I understood well, but I was struck by something the last speaker, Mr. Ham, said about -- maybe its an excessive modesty -- when he said that he is aware that Vietnam has bad products and bad systems, or something like that, he said. I think in Vietnam, there is a lot of opportunities on the contrary, even for not very

sophisticated products, but for example, the handicraft in Vietnam is first class quality. My question? I am surprised by these statements.

Mr. Steer: O.K., a question, Mr. Ham. What did you mean?

Mr. Ham: For the handicraft goods, I didn't mention that it's bad.

Mr. Watz: My question is, Mr. Ham made a general statement ...

Mr. Steer: Shall we come back to this?

Dr. Thai: I would like to add to what Mr. Ham mentioned. In Vietnam now, we would like to develop industry in general, and the leadership says about the industrialization of our country right now, not tomorrow, way under 2000. However, we can find out some weakness in industrial system. The linkage between the heavy industry and the small and medium enterprises, and SOEs and private sector, are not in existence. And the competitiveness of goods and services in Vietnam is not very high. And now the crisis in East Asia, it is very difficult to export these goods. However, when we developed some FDI projects in Vietnam, in 1986, the gross output from FDI projects in industry were about one fourth, 25%. And last year, that became more, 30%, because FDI projects can increase 20% a year from last year. This is very high pace. And for the local industries, only 10% or 11%. In this case, why we cannot develop. It is because of the market. They cannot export, because the quality is not very high. When we talk about the industrial villages, like Dr. Ham said, they can export a little, however, they cannot continue its expansion. These activities, we have to link between the small and medium enterprises as supporting industry, and this linkage is the network in the industry. This is very difficult task. When we try to develop heavy industry, as refinery, and steel industry, they are very costly. We cannot get it. So, what way is good for developing the industry in Vietnam? If bigger, not enough money, if smaller, not enough quality. So we have to have linkage and develop ... Some people say, this depends on SOE, O.K. However, for the private sector, private sector enterprises are very small. They cannot export. And now when devaluation of the Vietnamese dong occur, the import cost of raw material will increase at least 5%. In this case, they cannot get benefit from their activities. Some problems in Vietnam now. Of course, after several years for the adjustment, we can, step by step, improve. However now, we face many difficulties.

Mr. Steer: Thank you. Let me ask a technical question if I may to Prof. Imaoka. You talked about effective protection rates, and they were based upon tariff rates, and of course, it's very low -- effective protection based on tariffs. I am wondering if your team did calculations of effective protection taking into account non-tariff barriers?

Prof. Imaoka: Well, yes, of course, this effective rate of protection was estimated and compiled by the Minister of Investment, his ministry, and it is very difficult to estimate the effective rate of protection by taking account of non-tariff barrier because it's almost impossible to get a domestic price and international price. Otherwise, we cannot

estimate. So I hope in the future, Vietnamese government would estimate the effective rate of protection by taking account of such an actual price difference between the international price and domestic price. Yes, I know very well about your question and what you mean.

Mr. Steer: All right. I mean I would agree. I did not know what the answer was going to be, but I certainly think it's dangerous obviously, presenting very low protection rates.

Prof. Imaoka: Yes, particularly, the state sector is involved in trade, so here we can also find implicit protective measures. And this must also be taken into account. So in that sense, I completely agree with your opinion. When we take into account such a non-tariff barrier, this protection rate might be much higher.

Mr. Steer: Thank you. Questions? Everything else is totally clear? Mr. Verbiest.

Mr. Verbiest: I have a small question. Nobody mentioned China in the whole of this region. The papers talk about production capacity going to Indonesia, Malaysia, Philippines, whatever, but I am very surprised nobody mentioned China. I think China is a very big player. So I was wondering if ... I don't know if anybody has any comments on China.

Dr. Thai: I think that's true. And it's very dangerous for us. However, in international workshop we don't like to raise this question. In fact, when one analyzes the Thailand's situation, not in Vietnam. Thailand's electronics export have come down. Why? Malaysia. Why? Because capacity in FDI project in electronics industry in China. The devaluation of Chinese currency four years ago, already from five to eight Chinese currency to a dollar. This is dangerous for Vietnamese side. However, last year we found out our mistake. In this case we have to make some adjustment. However, what way for adjustment? We have to take slow way, step by step.

Mr. Steer: Thank you. Other comments on China? Any other questions or clarification? David.

Prof. Dapice: Could I just ask -- I'm not sure who on the Japanese side -- to talk a little bit about the Japanese experience in improving the quality and technology of small and medium scale industries. I think actually that is something that is directly transferable. It is a way to upgrade many of the Vietnamese small and medium industries without necessarily linking them directly to a larger state enterprise or industry. I think, just small and medium enterprises themselves, if I understand correctly in the case of Japan, were in fact improved, and I think just summarizing that experience would be helpful.

Mr. Steer: Comments on that?

Prof. Ebashi: Just after the war, our government encouraged at first to organize the industrial association. This association was considered as the core to translate technology, at the same time to borrow money to the member SMEs. So, the encouragement of the organization of industrial association. The second, our government really stressed the importance on the financing facilities for the SMEs. As for the transferring the technologies to SMEs, our government also encouraged to put up the common facilities which the small enterprises cannot buy for themselves, the expensive machines and technologies for themselves. And then the government put up the common facilities, which the member SME can use the machines and equipment through the channel of organization of industrial association. I think there are many other factors, but this seems to be the core. And also in our final report, we mentioned about the necessity to putting up the regional technology development center. This is also one of the experience of our case in Japan. Thank you.

Mr. Steer: Yes indeed, both of you. Prof. Ishikawa, first, and then Prof. Imaoka.

Prof. Ishikawa: I would like to make some supplementary points on Prof. Ebashi's remarks. Probably three things might be mentioned. One, in the pre-World War I period, in Japan, there were only very small scale industries and large scale industries; no middle sized industries. And the development of the middle sized industry started only after World War I, because of the spread of electricity use all over Japan, and also the increase in the production capacity of small sized motors, electric motors and oil motors. And through the use of electricity and these small sized power machines, the middle sized factories spread all over Japan. The situation now in Vietnam might be something like the situation in Japan prior to World War I. That's the first thing I would like to mention.

And the development of middle sized industry in Japan after World War II is mainly due to the fact that the industrial linkages developed between the large scale manufacturing, processing industry, assembly-type, and the parts and component industry. So I think this might be useful for thinking about the lessons. Thank you.

Mr. Steer: Thank you very much. Prof. Imaoka.

Prof. Imaoka: Yes. I would like to briefly refer to the institutional factor to make the medium and the small scale enterprises more efficient in Japan, that's the sub-contracting system. Still now, between the big company and the medium or small scale enterprises, more than 85% of medium and small scale enterprises are under the sub-contracting system, and particularly, to promote the export from these sectors, *sogo shosha*, that's general trading company, played a very important role to give market information to medium and small scale enterprises, and sometimes they have given finance and technological information, and they guaranteed buying the certain amount of the output from these small scale enterprises. So this system has made these medium and small scale enterprises specialized in very specific areas of production. And from here they could earn the economies of scale.

When I was a student, medium and small scale enterprises were very much criticized by Japanese economists, but now the role of medium and small scale enterprises has been re-appreciated in the sense that because of such a quite efficient relationship between the medium and small scale enterprises and big companies. Thank you.

Mr. Steer: Thank you very much. Now, let's open the floor to comments, views, as well as questions. Eric Offerdal first and then ... oh, you've still got a question? Yes, please.

Mr. Watanabe: I have one question about trade policy. Last year if I remember right, in terms of dollar, the import of Vietnam remained the same as the previous year while the income elasticity of imports is more than one, close to two, how Vietnam managed to contain the imports at the same level from the previous years. I worry if there are some measures taken by the Vietnamese government which is creating various distortions in the business practices. It's very important how exactly Vietnam is coping with this problem of imports and how it manages to contain imports right now. Otherwise, it could be a long lasting bad effect in the long run.

Mr. Steer: Excellent question, which gets back to tariffs and non-tariffs. Who would like to give an answer to Mr. Watanabe's question? Mr. Offerdal would.

Mr. Offerdal: Well, I have a couple of points sort of, but they are only partial responses, but I think to some extent when you are looking at that, you have to ... what you are referring to is registered imports. But there was last year a considerable increase in unregistered, smuggled, imports. That's one aspect of it. Another aspect of it is that there may well have been a significant drawdown of inventories of various raw materials and inputs that basically offset the stable imports. Thirdly, of course, GDP growth may not actually have been quite as high as we think. I think the final story on GDP growth is still to be told. But each of those, in a sense, are a component, and I really don't have an idea or any clue how important each of those three elements might be in the full answer to this question. Could I throw in ...

Mr. Steer: I think the fourth reason is that the government really wanted to narrow its current account deficit, and so put all kinds of administrative barriers to prevent imports last year. And then, they, I think about September or October time, they lifted them again. So, I think that was the fourth reason. And of course, it wouldn't get captured up in any protection indicators at all unless you were able to take non-tariff barriers into account. So I think they just by fiat said no imports of certain things because they worry about balance of payments. I think that's a fourth reason.

Mr. Offerdal: Well actually I think I can probably give you a fifth reason as well, which is simply the lack of access to foreign exchange to imports, which I think was quite significant as well, especially in the second half of the year.

Mr. Steer: You were going to make another point?

Mr. Offerdal: Yes. I wanted to essentially throw in a completely different point, which is simply that, in a sense, draw the discussion if I may a little bit back to first principles, and the idea that you, Andrew, mentioned at the beginning namely of this issue of opportunity costs, because when I was reading through the various notes and papers, it seemed to me that in rapid succession we see calls for support, promotion, protection, incentives for electronics, garments, agro-processing, heavy industry, small and medium size enterprises, FDI, import substitution, export orientation, private sector, state owned enterprises, and I have no particular view on protection or support, either one of them. But one thing is clear, and that is that Vietnam cannot support all of these things simultaneously. And in a sense, I don't mind all these calls for support or protection per se, but what I am missing in the discussion is basically the answer to why. And it doesn't seem like we've focused very ... At the outset, perhaps the basis for this ought to be somewhat more of a focus on market failures or externalities, that would in a sense, be the justification for some of these things. And clearly, you could say for example that with attracting FDI, there is a significant positive externality, that means that Vietnam should do things to attract FDI simply because of the technology transfer and the management skills, and all these things that tend to come with FDI.

It is not at all clear to me that the externality in developing an auto industry, to take one example, justifies the kind of protection that would be necessary to make it a viable industry in Vietnam. And this really comes down to this idea of, if you provide incentives for one activity or one source of finance, or something else, you basically lose the opportunity to support something else. There is something lacking in this discussion that basically has to do with why it is necessary to support all of these, in principle, good things.

Mr. Steer: Thank you very much. Prof. Ishikawa?

Prof. Ishikawa: Thank you. There is one question related to the written notes of Prof. Dapice. You said in this short note that -- let me see, on page 3 -- you presented a very interesting terminology of import substitution within ASEAN. You said that it seems likely that as the Asian economies recover and confidence again is built up, Vietnam's best hope for rapid industrial growth is import substitution within ASEAN. I would like to ask your elaboration of what you consider by this import substitution, taking into consideration, for instance, that now the proportion of total import trade of Vietnam, which is occupied by AFTA area, next to NICs area and probably, the third one, industrial countries. Probably the proportion might be one fourth, more than one half, and probably one fourth. And the relative competitiveness between these three sectors might be very different at present. And this will change toward forthcoming years as the introduction of the AFTA rules prevail. So I would like to ask you especially in connection with this somewhat detailed consideration of trade structure facing Vietnam, some elaboration of import substitution within Asia might be very useful.

Mr. Steer: David?

Prof. Dapice: I think that I was looking at again how Vietnam can attract FDI for a range of industries which are efficient. I started with the assumption that a very small market that really is very nearly out of foreign exchange now, and has for that reason a bad reputation among investors as a place where you can get money out of easily, will have a lot of trouble attracting the range and quality of foreign direct investment that Vietnam would want to attract to achieve efficient industrialization, that is industrialization which is not dead end, which does not take care of existing rather small imports substitution demand, but then stop, because it can't lower costs rapidly enough to go anywhere else. That's the basic thought behind my next step of reasoning which was that current Vietnamese policy as I understand it has already signed on to lowering its own national tariffs and having a common external tariff with AFTA. So that will be as I understand it the environment in which any foreign investment or domestic investment will have to take place. If that is so, then the fact that Vietnam does have skilled labor, it does have, I think an ability to combine foreign capital and technology with its labor very quickly, and it does have a market roughly twenty times larger in AFTA than in its own small market, makes it more logical to think of production within AFTA than simply within Vietnam.

I think the suggestion, or the slide that showed that Denso pattern of specialization within ASEAN is a good example of how corporations are thinking this way, and I think if you are going to rely to a large extent on FDI for much of your higher level industrialization, then you will have to adopt a rational strategy which takes account of their own corporate planning.

So I think again, the secret here is not to believe my analysis or anyone's analysis, the secret is to engage in ongoing discussions with investors who want to develop efficient industries in a reasonably short period of time and do not require so much protection that it really is several decades before an efficient, integrated auto assembly auto industry is developed. I think several decades is simply too long, whereas I think auto parts or motorbikes or metal moldings or many other things which you've mentioned in your study are much more likely to become feasible and attract foreign investment within a relatively short period of time. That was the idea behind my suggestion.

Mr. Steer: Could we follow up on Mr. Offerdal's question? Let me just supplement it. He said, you can't support all of these at the same time. Now there are some things that would help them all, this sort of so-called win-win options, I mean, streamlining regulations, making the financial system work, and so on, giving access to export credit and import licenses. Those are good for everything. I mean, presumably those are very important. But there are other things. The main things are the preferential treatments which I guess means you either take public money and you allocate it to a sector, or you provide some kind of protection which by protecting one industry will cost to the economy or hurt somebody else. So, maybe Mr. Fukui would be the best equipped, along with Mr. Masuyama might want to say something on that. Specifically, when you looked at the steel industry, the auto-mobile industry, what are the costs of giving the kind of support that you seem to be recommending?

Mr. Fukui: In iron and steel, petroleum refining or petro-chemicals, or urea fertilizer, if you see our brief comments here, we are not recommending special treatment for these industries, which is clear. My problem in this project is only automobile industry. This is one industry that almost all governments treat it in a special way. Is it really worth? It takes thirty, forty, fifty years to make this fully competitive. Thailand has been already promoting it for thirty years and still they are far behind Japanese standard, or American standard. But they created AFTA anyway. And we did not go into detail on that issue that you raised. It's not fully explainable. On the other hand, a company like Denso is doing this kind of things at this timing in AFTA framework. That means, maybe it's a good timing for Vietnam to be involved in this car business. It can't be only parts. You must have some completed cars at this moment. Then, if you begin the business right now, what would be the consistent policies to do it? That's our focus in this project. So our approach is pretty different from other heavy and chemical industries in the case of automobiles. I know that does not answer to your question, but this is one industry and the approach that we took in this automobile industry, because it is the right timing for them to ... seems like a good timing to begin their business, because MNCs are behaving in this way. It's a timing.

There is one other trend in this currency crisis. Even these companies which already have a basis in ASEAN countries are having problems, because still about 50% of the child parts are imported from Japan. And those child parts are becoming expensive, because of this devaluation of local currencies. Natural attitude is again they are going to localize more, which is good news for these countries but bad news for Vietnam, because there aren't any basis. That's one reason why we are recommending this kind of policies. If they decide to begin the business now, what would be the consistent way.

For other heavy and chemical industries, our suggestion is very clear. In this atmosphere of AFTA and WTO, they must be very careful, and a certain set of policies which were available in the past is not available now.

Mr. Steer: Do you have cost estimates in the automobile industry of what is it costing Vietnam today in terms of its fourteen assembly plants, and second, if they followed the route that I think you are proposing, how much would it cost in economic terms, not just financial, but economic to the economy, given they need 200% protection?

Mr. Fukui: Well, there are fourteen companies right now, but they are just beginning to make investments. The amount is still very small. There are a few companies which made investments, something like 4 billion yen. That's a maximum. Others are very small. So it just has begun. It's not that much.

Mr. Steer: What would be the trajectory? I mean, do you have ... I mean I don't want to push you on this if you don't have your numbers, I mean ... you understand the question, though?

Mr. Fukui: Yes.

Mr. Steer: It seems to me that you are taking a very partial equilibrium point of view. You are saying, here is a sector, sort of it's a nice time to get into it. You then ought to be able to answer the economic costs, it seems to me. And then someone among the team, of all of us here, then needs to put it into a general equilibrium, for instance, what are we therefore giving up? Do we as a team, are we recommending ... ? You had a statement in your presentation that said, Vietnam can't wait to get into the automobile industry, and I am wondering if that's an economic statement, or whether it's a political statement, because I think you did a vote. We are all frank here. We may as well all be, I mean, I think you'd say they couldn't wait. Now, you haven't done a homework though to say that. But I would suspect that most economists looking at the economy would say, absolutely, they can wait, they shouldn't get into the automobile industry.

Mr. Fukui: Well, this is not a question for Vietnam also. How about your opinion about AFTA itself, including Thailand?

Prof. Imaoka: Excuse me, as one of the members of this study group, I would like to add something to his reply to your question. Of course, we have taken into account of the opportunity cost in the sense that for an example, to pick up the one in heavy industry, we separated this industrial process into three parts, downstream and middlestream and upstream, and we measured opportunity cost in terms of capital labor ratio. And we recommended to establish, for example, even though we recommend to implement the oil refinery industry in Vietnam, we recommended to start from the labor intensive process of that industry. So in that sense, we have taken into account of the opportunity cost in terms of capital intensity. This is one point.

And second point is their recommendation is based on a very intensive survey on the incentive on foreign direct investors. That means they have inquired to the Japanese investors and other investors, not all over the world, but mainly to the Japanese investors. So, when they have an incentive to invest into Vietnam, that means implicitly, they are trying to measure the rate of return, implicit rate of return, behind the economic calculus of the investors in Japan. So in that sense, of course, we didn't apply any formal cost/benefit analysis to make this kind of recommendation, but still implicitly we have done some kind of informal cost/benefit analysis of all these projects. Thank you.

Mr. Steer: Thank you. Prof. Ohno?

Prof. Ohno: Just a follow up on this opportunity cost and general equilibrium. Anybody who has done a economic projection would know that of course this opportunity cost idea is very nice in textbooks, but when you do this, I don't think it's any better than partial equilibrium analysis. And I think it's just a fantastic imagination to say that if you do the homework in general equilibrium, CG model or something, then you can get much better results than what Mr. Fukui did.

Mr. Steer: Excuse me, I am not recommending any modeling. I am sorry, I was just using the term.

Prof. Ohno: It doesn't have to be a model. It could be opportunity cost, it could be turning either way, since there's so much uncertainty about the exchange rate, whether there will be another financial shock, whether there will be a domestic inflation, whether there will be a demand shift, whether Vietnam has the technical capacity to absorb the next level of technology and so forth. So you can turn the same argument against yourself, and against us. It's a little bit too abstract to me to say that, of course, you have to take into account the opportunity cost, but unless you present yourself, the reasonable cost of opportunity cost, which I don't think is very easy, I don't think this argument will be productive.

Mr. Steer: O.K., Mr. Offerdal, and then Mr. Dapice.

Mr. Offerdal: Maybe I am fantastically dunce. But I still, even though it's beginning to be a few years since I left school, I still believe that these first principles do have some validity to them. I am not really necessarily seeking any exact numerical calculation of costs and benefits. My lack of understanding is far more fundamental and basically it goes to what exactly is the positive externality to Vietnam of an auto assembly manufacturing or an auto industry? That basically, as you pointed out, may well take thirty, forty years before it becomes economically productive or profitable. There may well be something that I just don't understand. That's my basic problem. It's sort of the same thing as with FDI. Yes, there are clear, positive externalities to it, but at least, there you can relatively easily make the argument what those externalities really consist of. But in the auto industry, it completely escapes me.

Mr. Steer: Prof. Dapice?

Prof. Dapice: I want to come down firmly in between the two groups. Let's talk about refineries, O.K.? You can sign long-term refining contracts now for less than a dollar a barrel in the region. If you spend 1.2 billion dollars for a 40 million barrel-a-year refinery, the most you can earn is about three percent on your investment. You are bound to have at least nine or ten percent more on most other investments that are, you know, in light and medium industries, I would say at least, because the interest rates are much higher and I think they earn a lot more. So you are essentially sacrificing over 100 million dollars a year, and it's a reasonable question; is it worth 100 million dollars a year for the foreseeable future to have an oil refinery? And again, you can change your mind in five years. It's not like you are making a thirty year decision, you are making a three or five year decision. This is why I talk about the "Ministry of Timing." You really need to think, do we want to give up that much lost output somewhere else, probably in rural industry by building a refinery? It seems to me that kind of partial equilibrium is legitimate, and 100 million dollars is a lot of money in rural industry. That creates a lot of jobs. You are probably talking about a few thousand dollars a job. So this is not a trivial question.

We could go on with other lists of things which have been discussed. I think that kind of mental exercise, which I believe is what Eric is suggesting, is useful. I think it would reduce social tensions and help the overall confidence of both domestic and foreign investors to have a shift in that direction. So I think it's a reasonable question. I think that you are right, that getting too fancy is not helpful, but being a little fancy, or at least making that comparison it seems to me is helpful. So maybe we actually agree.

Prof. Ohno: I think we are not really disagreeing. I think Mr. Fukui did exactly that kind of calculation to reject the oil refinery for Vietnam. He has the opportunity cost and cost and benefit analysis at the back of his head. He didn't just use the term, and that's exactly what is necessary. We don't have to really bring up the technical terms and use models. I guess, it's the question whether you use the term or not. I think it's exactly that's what we are doing. This is a very imperfect world. And we can use an Excel or a Lotus spreadsheet to do a nice projections, but if you change a few numbers, you can change the opposite conclusions. So, in a world like this, how much number crunching do we want to do, how much back of the head sort of imagination we should use? I think that's the question. And I think Mr. Fukui's approach is just one valid approach.

Mr. Steer: Sounds like we've reached agreement. Let me tell you what I mean by general equilibrium. I mean that when we meet those businessmen, small businessmen, in Vietnam and they can't get long-term credit because there's not enough savings in the economy to give them long-term credit because that savings is going to finance an oil refinery, that's general equilibrium. We need to think that through. We are making a concrete choice to support an oil refinery, whatever, that is a state owned enterprise. We have to understand as a result of that, we are making a choice not to make that credit available to those small entrepreneurs. Or when I'm down in Ha Tinh Province, and there is no budget revenue this year to finance adequate counterpart funds for a rural roads project, that's general equilibrium. That's what I mean. I don't want a CG model. I want those kinds of analyses to be done, and I am just asking if it were done and I guess the question really is very simple -- how much does it cost in investment to generate a job in automobile or refinery?

Prof. Ishikawa: May I ask?

Mr. Steer: Yes.

Prof. Ishikawa: I think that when we received the request from the Vietnamese government to take up the issue of automobile industry set up, as Mr. Fukui mentioned, we faced a very delicate and very difficult position to take. My question is how the World Bank and IMF take the policy stance vis-à-vis the issue of this kind of very delicate question -- the question of Vietnamese government's desire to set up automobile industries just like the other neighboring countries movement toward establishing these very sensitive industries? I wonder what is your position, policy position?

Mr. Steer: Well, I was telling Dr. Thai today that Vietnam owns the World Bank, and they don't own JICA or this team. The World Bank is a cooperative, so they own us. One of the privileges you get from the World Bank if you own them as an owner is you get unbiased advice, you hope. So what we would do is we would give the very most confidential advice. Most of our advice wouldn't see the public light of day, but if we are asked for advice on these subjects, we would say what we think. As I read the Fourth Plenum, and I read the statements of Mr. Phan Van Kai, and I read officials such as Dr. Thai, I hear poverty is a driving force, employment is a driving force, rural development is a driving force, and I want to honor those desires. So I want to say, look, our analysis suggests that if you want to absorb 1.3 million people a year, and you've got maximum 1 billion dollars a year coming in of ODA at the moment, you've got maybe 2 billion dollars, if you are really lucky, of foreign direct investment coming in, and you've got a savings rate of 17% of GDP which ought to be raised to 24%, that's so much money you've got to invest, and you've got a banking system that is trying to intermediate that money, you know, there is just arithmetic that can be done. And it seems to me there's some very innovative thinking going on, for example, in MPI at the moment on exactly those lines.

I am sorry. I am supposed to be a chairperson. Eric?

Mr. Offerdal: The answer from our side is essentially the same, that, of course, Vietnam as all other countries, Vietnam is a sovereign nation. If they really want to build up an industry, whether it's the auto industry or something else, that's their obvious right as a sovereign nation. But the fact of the matter, as Mr. Steer just said, is that in our view such a policy is just not consistent with the government's own objectives of employment creation, of poverty alleviation, and so forth. Therefore, we would advise against it. It's basically as simple as that.

Prof. Ishikawa: Confidential?

Mr. Offerdal: Yes, I mean this is presumably a confidential forum.

Mr. Steer: I think that is important. I am assuming that we are all ...

Prof. Ishikawa: Thank you.

Mr. Steer: But of course, as you rightly say, Prof. Ishikawa, a country clearly will and probably should do things not based on economic analysis, but based on political analysis, and a country has a perfect right to do those, and will have the full support of the World Bank should it choose. But, I mean our job is to clarify what is economically sensible, and then it's not for us to decide what is politically sensible.

Now Prof. Ishikawa kindly agreed to let us go on a little bit longer and that's why we have, because it's such an important issue. He pointed out that there is actually a gap of an hour and a half between the time we finish at 5:00 and the cocktail reception at 6:30, so that's

why we went on for an extra twenty minutes. Would anybody like to raise any final issues in this section? Oh, Mr. Verbiest.

Mr. Verbiest: I think we discussed quite a lot throughout this session apart from the automobile industry ... Well, even in automobile industry, we discussed quite a lot the role and the importance of SMEs. I think it comes out quite clearly throughout the papers. Now, I sort of feel somewhat concerned about what Dr. Ham and Dr. Thai said at the end of the talk, that this had to be developed within a certain plan and with the necessary linkages, and so on. That concerns me very much, because I think the history of SMEs, I think partly in Japan also, but also in China, is by definition they develop on their own. It's not to say that you can't put in the framework for their creation, like for instance, you could have export promotion centers or export information centers like they did in Taiwan. I am not sure about Japan and China. You could get them access to credit easier than others. You could try to favor their trading because they are small enterprises so it would be more difficult, for instance, to access export markets. But basically, I think you just need to put the minimum framework in place and then the rest, you let them go. They choose what to produce. So I am sort of a bit concerned. The experience of the other countries is that small and medium scale enterprises were developed within the private sector, so they were purely risk taking ventures. So I am not sure if we ... I mean, even taking into account, say if you look at component manufacturer, supposing Vietnam wants to promote a car industry, then as a private producer sitting in one province, I can say, well, this is an interesting venture, I am going to start producing car seats. The experience of Thailand for instance was like that. Thailand produces all the car seats for BMW in the whole world practically. And it was just a very small enterprise. It started making very lousy seats in the beginning. BMW didn't buy them, and improved them progressively, and now, it's sort of more than even a medium scale enterprise. So, I am a bit concerned on the approach from the government side. I am not sure if you want to have an answer to this, but ...

Mr. Steer: Yes, indeed.

Prof. Ebashi: We proposed the multi-staged development policies on SMEs. However, I have an impression that even our first stage proposal is demanding too much to the Vietnamese government, as Dr. Offerdal mentioned, that maybe Vietnam cannot support at the same time. That's my impression.

But if the Vietnamese government has not much resources to support SMEs in various fields at the same time, nor without international cooperation on this area, at least I would like the Vietnamese government to tackle the problems to solve these difficulties which the private sectors are now facing. For example, I interviewed many SME managers, owners and managers. One of their comments was very impressive, because he said we are doing a very risky business, because if I were the manager of SOE, even bankruptcy, we may not be charged, jailed. But since I am the owner of a private company, once borrowed money from the bank, and then bankrupted, then I must go to jail. With this very risky business framework, they are challenging, doing a business now. So correcting this kind of incredible legal system ... I mentioned also the necessity to organize the

industrial associations. That's very important for the exchange of technologies and market information. However, the Vietnamese government, until recently, was very reluctant to allow the private sector to organize this kind of industrial associations and so on. So even without the special funding or special financing scheme, or special deduction of taxes, incentives, at least, the government can do to rectify the business environment for the private sectors.

Mr. Steer: Thank you very much, Prof. Ebashi. That was an extremely helpful clarification. Go for the win-win options first before getting into the guided kind of approach. Incidentally, I thought your matrix that you invented was brilliant, very, very clever. I hope everybody looked at that -- Table 1 in your paper. I would like to thank the presenters for really excellent presentations, excellent papers and for really stimulating a very good discussion.

Prof. Ishikawa just asked me make an announcement which is that tomorrow's order is going to be a little different from what was proposed. We are very keen to bring the rural development up, so we will begin tomorrow with rural development and agriculture that Prof. David Dapice will chair. Then the second half of the morning, apparently, we do public finance and banking, and then, a couple of the participants have to leave at lunch time, so we were going to give them the opportunity just to say a word before they leave. And then, in the afternoon, we would do financial turmoil and the closing, the final sort of analysis and description. Is that right?

Prof. Ishikawa: Yes, public finance and also financial turmoil.

Mr. Steer: Oh, public finance is in the afternoon, too?

Prof. Ishikawa: Yes.

Mr. Steer: All right. So I would like to thank you all. Anything you would like to say before we close the session? No? O.K. It is now time for tea, and we come back and discuss state enterprises afterwards. Thank you. Applause to the presenters!

Session 3: SOE Reform
Chairman: Mr. Offerdal

Mr. Offerdal: Shall we start? Let me welcome you to the final session for today on SOE reform. We have two hours at most to address this critically important issue for Vietnam. As in the previous session, I'd really like to encourage the five speakers we have on the list to, in a sense, focus their presentations on findings and conclusions and recommendations.

For my own part, when I think about SOE reform, I think about the 6,000 state owned enterprises that are currently in operation in Vietnam. They basically fall into two categories. One group will be equitized and the rest will in some form or another, remain under state ownership. I am going to, in my own mind to be looking for answers to issues that basically revolve around the role of government in that latter group in terms of how many enterprises are going to remain under state owned enterprises, and why, and how will the government of Vietnam deal with the more difficult state owned enterprises, those that are making significant financial losses today. How are they going to be restructured, and in particular, perhaps, how are they going to be restructured in a socially responsible and acceptable manner? I know that is a key issue that the government is currently expending considerable resources thinking of, and I hope we can get the discussion revolving around those issues as well.

The first speaker is Prof. Ishikawa.

Prof. Ishikawa: Thank you. I think the SOE reform is a matter about which the information insufficiency is very, very serious. as in other areas of our study. So, our emphasis of the Japanese Vietnamese Study Team was to put priority on making fact finding investigations prior to making any kind of policy suggestions. So SOE reform as I have mentioned under number two (of Note 3-1), methodologies, a comparative Vietnam-China Study Method, and integration of two contemporary survey results on Vietnamese SOEs are looked at.

As for the first one, the comparative Vietnam-China Study Method was taken mainly for the purpose of overcoming the severe shortage of statistical and other information on SOE topics on the Vietnamese side. As we all know, the two countries are following the similar type of economic systems, and also the development stages and systemic development stages also are, relatively speaking, similar. So we can use our narration, Chinese SOEs, more conveniently and usefully for making up this insufficiency of the information about Vietnamese SOE.

Next one, two contemporary survey results on Vietnamese SOEs: 1) a joint OECF-CIEM project on the questionnaire study of some 200 sample SOEs. Some of the essential points are being presented by Mr. Yoshio Wada of OECF after my presentation. This also constituted OECF's comparative study of Vietnamese and Chinese SOE development, 2)

a joint JICA-CIEM project on the in-depth study of thirteen selected SOEs. But this was conducted mainly by Tohmatsu and Company, a well known management consultant in Japan. Mr. Hagi, a partner of this Tohmatsu and Company will present the results of the in-depth study from the management consultant point of view.

I mentioned the approach in two respects. One is a gap approach, the other is an approach to market economy promotion. This, I actually described in the early part of my background paper, which was presented in Executive Summary report, so I would like to postpone this description later on if it is required, as it's necessary to take some time to make description about this part.

So let me start with page 2 (of Note 3-1), the framework of the study. For the purpose of deriving policy options for the SOE reform, the overall performances of the SOE activities are analyzed in terms of: 1) statistical indicators showing productivity and financial performances, 2) institutional stability of the SOE system at the present stage and maturity of the conditions for advancing the present stage of SOE development to the next one -- next one, in fact means the corporatization stage. Number 2, 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 Note 3-1, this framework is shown in terms of the research items of the whole study. In attached Table 1, you must see on page 7, the framework is summarized in three columns. Column A, determinants of performances, and various items in this column is assembled to the column B mechanism, and worked at for deriving column C's performances. And the items surrounded by broken lines are those directly relating to the institutional aspect and in fact, what we are seriously concerned about. Probably, this might be the characteristic aspect of our study following the approach to market economy promotion, in particular, reference to the SOE development.

Now, stage making for SOE development is considered as necessary for making studies of the SOE development in terms of the market economy development approach. A standard model of SOE development stages in Vietnam, which is common to the analysis for Chinese SOE specifies the succession of 1) patrimonial stage, 2) the stage of factory under complete planning, 3) stage of enhanced autonomy, 4) the corporatization stage, 5) the privatization stage. The present stage in Vietnam is at number 3, the stage of enhanced autonomy. In 1991 to 1994, registration of SOE 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 2,400 enterprises were incorporated in the form of joint stock company, limited, and about 17,500 enterprises in the form of limited company.

The results of the study on the present conditions.

A. Performances.

1) Productivity and finance. As compared to China, the performance was less serious. In China, while performances in total factor productivity were fairly good, those in profit and loss account serious. So, why productivity aspect is good, but financial aspect is so serious.? This is a question we had to face in studying China's case. But in Vietnam, this difference is not so certain.

2) Institutional dimensions. Institutional stability of SOEs in the autonomous enhancing stage, which is the present stage, is generally weak due to the excessive insider control, although the degree of autonomy achieved in Vietnam appears much larger than in China. About this, see Table 2 on page 8. So you can see from this, in terms of the degree of management autonomy awarded from the line ministries, Vietnam's performance is much better. China -- this performance is very, very bad. Why so? This is also a question.

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 low percentage of M2/GDP and the low ratio of bank credit extended to SOEs, the labor surplus condition seems less serious in Vietnam as drastic employment reductions were made two times in 1989 to 1990, and in 1991 to 1994. Product and factor market environment -- 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 very weak. Hence, a large stock of bad debt, especially to the SOEs.

2) Factors relating to the SOE development stages.

A) The length of Stage 2 in Vietnam was very short as compared to China. This brought about a few effects on the later development of economic systems and the industrial structure in Vietnam. In Vietnam, the length of Stage 2 was only ten years, but in China, thirty years or so. That affected very much on the later development of the system development.

B) Progress of Stage 3, which in fact was in the early 1980s was not necessarily deliberately designed. This is a point about which somewhat different observation might be existed. A series of economic and financial crisis which started at the end of the 1980s forced the government to abandon any systematic attempt of promoting and fostering state enterprises excepting 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 deliberate government plans.

C) Residuals from the past stages.

Due to the incomplete fulfillment of 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 are: i) absolute control of the SOEs by the state as reflected in the fact of forced donation being practiced, ii) soft budget constraints -- this is well known, iii) the power of managers outweighs the state as supervisors. This is more remarkable in Vietnam. iv) lack of adherence to contracts and property rights. This is the same in China and in Vietnam.

D) Government policies, especially in matters of corporatization and privatization. These items to be answered in the following items.

E) Management and technological reform which plays decisive roles independently from the exogenous determining factors in the above. Tohmatsu and Company will make a presentation about this item in sufficient details.

Next, mechanism combining these factors together. In terms of the causality map, Column C is now referred to. Information about the *modus operandi* of these combination is seriously lacking. But some of the revealed ones are as follows: i) Many SOEs considered that the cabinet decision about SOE autonomy enhancing were providing them with unconditional autonomy in production and asset disposition, hence, refusing to accept government supervision and intervention, ii) SOEs didn't fulfill obligations to repay bank loans, iii) SOE managers were not seriously concerned about the obligation to maintain and increase 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 Vietnam as well, although to a lesser extent than in China.

Overall observations. Short-term indicators of the SOE performances exhibited fairly good results, but this was due to the fact that recurrent reshuffles of bad SOEs and periodical elimination of weak spots, for instance, redundant workers, brought about a temporary good outlook. Since this was not accompanied by the structural improvement, the conditions tended to deteriorate again, such as the ratio of loss-making SOEs to total SOEs decreased from 35% in 1990 to 8% in 1993, but it started to increase again from that year steadily to 20% in 1996, and in 1997, it is estimated to be 30%.

SOE's autonomous decision making power may appear much stronger than that in China. However, this is due to the result of government measures to throw out and abandon the deliberate protection and raising of most SOEs in the years of economic and fiscal crisis towards the end of the 1980s. In China, the government measures to protect and raise SOEs persisted.

Therefore, for most SOEs in Vietnam, 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 marketing environments are also very weakly developed. Hence, the conditions for shifting the present SOEs stage upward are not yet prepared.

Policy suggestions.

1) In light of the above observations of the present conditions of SOEs, but taking into consideration the current debate with international agencies, it seems pragmatic for Vietnam to consider the adoption of the GAP approach in dealing with the SOE reform. In order to make the negotiations successful, the Vietnamese government might formulate detailed scenarios of SOE reform, which specify target dates and target phases 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 good nature; second, between SOEs in the industries with potentially competitive power in foreign trade and SOEs in 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 capability in the organizational, business management, technological, productivity raising and manpower training aspects as well as legal/institutional reforms. Measures should also be taken to promote the market economy environment of SOEs. In particular, the banking sector reform should come as the first priority in nature.

4) International donors might devise innovative measures to promote the Vietnamese government to redirect her SOE reform in the above ways. One such innovative measure is suggested in the World Bank's loan project of technical innovation of Shenyang Machinery Tool Plant Company, Ltd., in China in Shenyang, combined with its institutional and organizational reform. It started in 1995 with the agreement providing loans of 121 million dollars (U.S.)

We haven't dealt with the aspects of general corporations and private sector enterprises as our study project didn't cover them, but covered by some other groups. Thank you very much.

Mr. Offerdal: Thank you for what I think is an extremely innovative way of looking at the situation in Vietnam, where as we all know, the information about the situation of state owned enterprises isn't really as good as one would wish. Could I just ask a technical question before we proceed?

Prof. Ishikawa: I think two other person's presentations will be complementary.

Mr. Offerdal: O.K., but this is just a mere detail.

Prof. Ishikawa: O.K.

Mr. Offerdal: Some of the statements in your paper presumably, for example about the labor surplus condition on page 3, and also on abandoning the deliberate protection

and raising of SOEs, those observations that are made, I take it, through 1995, roughly that's the time frame, or do they include ... are these observations based on developments also in 1997?

Prof. Ishikawa: 1997? No.

Mr. Offerdal: O.K. The next paper is by Mr. Yoshio Wada.

Mr. Wada: Thank you very much, Mr. Chairman. Actually, I am from Overseas Economic Cooperation Fund of Japan, and I am not in the team of JICA study. Our study is independently done by OECF and CIEM, Central Institute of Economic Management, in Vietnam. What we did was really ultramicro approach, or panel study approach to Vietnamese state owned enterprises. This is a comparative study. We have another part of study in China. That is, 800 state owned enterprises were surveyed in China, and 200 enterprises were surveyed in Vietnam. Two hundred is around ten percent of industrial enterprises in Vietnam. but eight hundred in China is just less than one percent of their state owned enterprises. I just want to go through the framework of our analysis.

We classified incentive structure and property rights structure. This is really an issue of management, like what kind of incentive managers have, or workers have. This is a kind of governance mechanism inside of the firm. We classified the incentive structure and ownership structure, and internal structure and the external structure. For the internal incentives, the manager autonomy or performance contract or labor incentive, that kind of issues are dealt with in the internal incentive structure. For external incentives, it's very competitive environment like product market competition, or factor market, like capital markets or labor markets competition. And also financial discipline -- that is like hardening budget constraint. For the property rights structure, there is a micro and macro aspect. For micro aspect, it's by company to company, the role of management board is different. Appointment of executive directors or more broadly, power in the firm is really different from firm to firm. For macro aspect, the legal structure is not different by firm to firm, by individual firm, and their applications like what kind of evaluation measures are taken to their asset evaluation, this kind of structure is really common to all the firms.

What we surveyed in Vietnam is in Table 2 (of Note 3-2) -- two hundred enterprises, from Hanoi, Haiphong, Ho Chi Minh City, Dong Nai, Quang Nam-Da Nang -- and from six industries; food processing, garments and textiles, electronics and electric equipment, building materials, chemical, and machinery manufacturing. But in this chemical, it's not chemical industry you suppose. It's like soap making companies in chemical industry. So it's really primitive industries there, so it's really different from what you see in the modern industrialized countries.

On the second page -- this is really basics for the Vietnamese state owned enterprises. From 200 enterprises, there are some kind of distinction between enterprises from the origin of Vietnamese, how they formulated. And in the northern part of Vietnam like Haiphong or Hanoi, around 87% of state owned enterprises were established by the state. But in the southern area, like Ho Chi Minh City, around 40% are nationalized private

firms, and 50% is established by the state after 1975. Table 4 shows the structure of enterprises as classified by years in corporation when, how they are established. And most of state owned enterprises were established from 1975 to before 1988, of course, at the time of the planning. But there are some enterprises established before 1975, especially in northern region and there are state enterprises incorporated after 1988, after the beginning of state owned enterprises in Vietnam.

This is the productivity part. Actually, we tried to make a TFP analysis for Vietnamese state owned enterprises, but especially price data is really limited, so we gave up. We just did labor productivity, just simple calculation of labor productivity, and real capital and labor ratio -- that's a factor intensity. The labor productivity for all state owned enterprises improved from 1991 to 1995. At the same time, capital intensity is increasing. That means of course labor productivity is improving, but it's really due to some aggressive investment for state owned sector. This figure shows financial performance of state owned enterprises. Actually the timing of the financial performance, the data we got was 1991, 1993, and 1995. From 1991 to 1993, the financial performance was improving, but after 1993 to 1995, a slight decline was observed.

We have a very, very simple cost structure for our survey of SOEs. We separated five cost items, from material cost, labor cost, social security, depreciation cost, and others. From 1991 to 1995, we observed that the labor cost was really increasing. This is really due to -- this is Table 7 -- the increase of wages, not an increase of employees. Actually, we have a similar study for China. In that case, in the cost structure, we identified -- this part is really increasing in China. This is Vietnam's data, but in Chinese state owned enterprises, the expenditures, which categorized in "others" were really increasing. Actually, I have another paper to write down that incidence, and what we saw was somebody is eating Chinese state owned enterprises. That means some portion of their cost was taken by somebody. That's what we saw in the Chinese case. But in Vietnamese case, it's not like that. Labor cost is really increasing, and for others, this is increasing, but we couldn't get details for that cost.

For the incentives part. How severe the competition of Vietnamese state owned enterprises? Actually this smuggling is for this and imports is 64%. Most of Vietnamese state owned enterprises identify their competitors as other state owned enterprises. Around 70% of state owned enterprises answered that their major competitors are state owned enterprises. But 64% of state owned enterprises feel that imports are really competitor, and 30% of surveyed state owned enterprises answered that smuggling is really competitive to their products. So it's not like the private company or other cooperatives are competitors for state owned enterprises. The reality is that state owned enterprise itself and smuggling or imports are competitors for state owned enterprises in Vietnam. This gives some kind of incentives for managers. That means the managers receive the competitive pressure, but that is not based on the market. It's really the state owned enterprises and imports that are their major competitors.

The financial source of state owned investment is on Table 9. This table shows what kind of financial discipline was given to managers of state owned enterprises. Actually, most

of financial source is from bank borrowing. Around 51.8% was from bank borrowing, and around 20% is from fiscal funds. Vietnamese government made a clear statement that they cut all the subsidies to the state owned enterprises, but there are some companies, which receive the fiscal funds from the government. All funds are around 30%. So they accumulated their own funds, but most of the financial source for their investment is from the bank borrowing. If the bank is really severe enough to get the repayment from the state owned enterprises, that gives really hard budget constraint to state owned enterprises. But it's not really the case in Vietnam. So that is kind of an understanding.

This is the structure of debt of state enterprises. Actually, the bank borrowing constitutes around 50% of their debt, and around 35% is inter-enterprise debt, and deferred tax payments are around 10%, and deferred wage payments are around 7%. So that constitutes their debt structure. And Table 11 shows, as Prof. Ishikawa explained in his note, the timing of acquiring managerial autonomy is in Table 11. You can see that most of state owned enterprises get their autonomy during 1986 to 1990 at the start of their reforms. Actually, Vietnam started reforms of state owned enterprises in 1987. That was Decision 217, and they started in late 1987. And as soon as the reform started, most of the state owned enterprises feel that they get managerial autonomy, or free to choose. But it was not really the case in China. Even after twenty years of reforms, most of state owned enterprises didn't feel that they get autonomy.

So what's the difference? My impression is that Vietnamese case is spontaneous privatization. So at the time of the beginning of reform, government released all the rights, all the decision making rights in the state owned enterprises, and they cut the subsidies. As soon as they get the reform started, they are really privatized -- not privatized -- but they spontaneously see their assets as their discretion. That was reflected in this timing of managerial autonomy.

The last one -- frequency of contact between state owned enterprises and government. Of course, there are no companies which answers that they don't have any contact with the government, but very few companies answered that their contact with their owners are very limited. In the case to case, most of the state owned enterprises responded that their frequency of contact with the government is case to case, not periodical. That means there are no formal mechanisms for monitoring state owned enterprises in Vietnam. After that kind of spontaneous privatization, what happened in Vietnam was most of managers want to solve the problem by getting a cooperation with outside forces, that means foreign companies. Surprisingly, more than 30% of state owned enterprises have some formal relationship with foreign partners, out of 200 state owned enterprises. The major form of cooperation is processing contract, that is, just get materials and hire labor for processing that materials, and just export it. That is the major form of cooperation in Vietnamese state owned enterprises. Actually, I visited more than twenty state owned enterprises, but their forms of cooperation is really primitive stage -- just get labor from that area, and get material from the Japanese trading companies, and just process it, and just export it. That's the major form of cooperation.

Five. For the corporate governance part, we do not have any data for corporate governance. But we can guess the status of reforms from the state owned enterprise law or general corporations and status of equitization, and everybody thinks that this is really primitive stage of corporate governance. What we saw in Vietnam was really insufficient incentives given to companies or company managers, and also really insufficient corporate governance.

What will happen in this situation is kind of really dangerous. In China, this kind of situation is identified as an institutional vacuum. The same thing is actually occurring in Vietnam. There is an institutional vacuum. The problem with an institutional vacuum is that if there is an institutional vacuum, somebody who has different, inconsistent motives with the market economy come to that state owned enterprises, and he can get money, or he can use that as a political device, and he uses that state owned enterprise as a, how do I say, not market economy-type firms.

So, that is the result of OECF's study. Actually, I have written a really thick Japanese paper. It will be translated in two months. So, I hope everybody will see that. Thank you very much.

Mr. Offerdal: Thank you very much for an absolutely fascinating paper. I think, just looking at the data you have put together here teaches us a lot about the state owned enterprises in Vietnam. I was also quite fascinated to hear some of your concluding comments on the institutional vacuum.

The remaining speakers will have considerably less time available to them, unfortunately, since we have now taken about one out of the two hours. So if I may suggest ten minutes per person for the remaining three speakers. First, Mr. Hagi.

Mr. Hagi: My name is Koki Hagi, management consultant of Tohmatsu and Company. Please look at the papers, note 3-3. Our study emphasizes 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 and OECF. Implications from macro data, suggest that the percentage of loss making enterprises like this is very important, but not precise enough to draw any concrete policy. Therefore, we interviewed the directors, vice-directors, and/or the chief accountants of eleven SOEs and three General Corporations. The team also analyzed the status of performance from financial data obtained during the survey period. Although this was insufficient to analyze and provide consulting on all aspects of SOEs, the team attempted to understand both the actual status and individual characteristics of each SOE. I don't have much time, therefore, please read column 2, performance and factors relating to page 2, and column 3, issues and recommendations. This includes external environmental issues and recommendations, No. 3. And also this includes internal managerial issues and recommendations from page 2 to page 3. And page 4, as additional survey, we conducted some study of equitization and joint ventures with FDI. This time, I prepared my summary paper again to explain the results of our study.

I would like to explain this study using three symbolic words. What is important for SOE reform in Vietnam? The first is "corporation," the second is "customer satisfaction," the third is "sharing."

A corporation is the status of a judicial person, not as a part of the government, nor an individual person, having capital and assets and the responsibility for the debt within the capital at the disposal of the corporation. This word doesn't mean in a strict sense of the meaning. You can replace the corporation to the word of enterprise. A corporation is body independent of government and individual. Therefore, the government may not intervene in their operations and at the same time, individual persons don't have the right to deal with any materials of firm imposing his own personal intention. All concerned persons must comprehend the concept of the corporation as a judicial person.

The second concept is customer satisfaction. This is often used in many countries where firms must focus on providing better goods and better services. However, in the case of Vietnamese SOEs, the basic philosophy of production still being the most important factor should be changed to the customer being the most important, or in other words, market-defined production must be emphasized. Not only employees in charge of sales and marketing department, but all employees should realize that they must make an effort to produce merchandise and provide service that satisfy customers.

The third concept is sharing. This implies that corporation regardless of whether SOE or private firm, consists of several stakeholders where many people are concerned, and must share profit, property and information in accordance with the situation. Especially when share means stock of the firm, the person or government has a right in accordance with a percentage of all shares of the firm. It is neither less nor more than that.

If current SOEs are part of the government, production-oriented or the government distribute profit they should move to this situation. Modern SOEs are judicial persons, market-oriented, and the profit should be distributed in accordance to individual share. Based on these concepts, several issues must be improved with respect to SOE reform. However, this time I will recommend two issues that are essentially important regardless of what macro-economic or social policies are adopted.

One is the practical implementations of a new accounting system, and another is the introduction of an external and internal audit system. If the financial statement of the firm is unclear or unreliable, not only will the director be unable to make management decisions, but also no one can invest capital, nor lend money, and no government official can adopt suitable policies. Since 1996, new accounting standards were due to be implemented in all SOEs. However, the study team couldn't review the results, because they were not open. Nevertheless, it will take some time before the new accounting system take root in all SOEs. In order to advance the time needed to fix it, action should be taken by the MOF (ministry of Finance)'s initiative. These activities are necessary.

Another issue is preparation of case models when re-structuring SOEs. In order to restructure SOEs, several basic functions should be organized within the enterprise.

Preparation of selected case models and the implementation of them seems practically effective. CIEM and other related government agencies or institutions should take the initiative to create such models and popularize them. This would include several actions: 1) Establish core business functions like marketing, accounting, or development of new goods, new merchandise, 2) To design long term business plans based on the management cycle system, so called "plan-do-see." Also organizational reformation is important, especially to strengthen the management board or quality control circle as a horizontal group. Further human resource development is very important. Individual strategy is different depending on the characteristics of the firms and circumstances, but in Vietnam, this kind of basic function is very important. Thank you very much.

Mr. Offerdal: Thank you. This is becoming more and more interesting to me. Two more speakers, and then we will go to the general discussion. First, Mr. Steer.

Mr. Steer: Thank you. Just five minutes. I thought these papers were fascinating. I am not going to comment on them. I did though think they were genuinely very, very interesting.

I think the government's broad policy on state enterprises is reasonably clear. It's laid out by the Fourth Plenum. The government has stated that by the middle of this year or the fall at least they will have categorized all state owned enterprises, they will equitize a substantial number of them, and the others will be made more accountable. The Prime Minister has emphasized at great length and with very strong language that the declining performance of them over the last year is something that can't be tolerated. So we have here a government or authorities that are very clear about the need to reform them, and that's very impressive indeed.

In my note (Note 1-3) that I handed out this morning, it has some data on the recent deterioration, although I must admit this data looks very interesting as well. The current intention is to equitize a thousand by the year 2000. That would be roughly one per day between now and then. Mr. Tu and his colleagues in the Ministry of Finance are going to be very busy between now and then. A couple of weeks ago, we brought some practitioners from other countries around the world and equitizing or privatizing one per day is by no means impossible. The Czech Republic did four per day. The Russians did eight per day for a couple of years. So, it can be done, but one has to be pretty well organized in order to do it. So far, eighteen have been done in the last five years. So it will have to be accelerated. Now, the good news about those eighteen is that they've now been analyzed in depth. Employment in every single one of those eighteen has increased. They are all doing extremely well compared to how they were doing before. Money is flowing into them. So that's the good news. Generally around the world, it's very, very clear that when you equitize or privatize small companies, employment rises and money comes in. That's true in virtually every country you look at. It's probable, therefore, that one could equitize these one thousand companies out of the 6000 with basically no loss of employment for the most part, and increased employment, increased financing, increased investment. So that's very good news.

But there do need to be procedural changes to make that happen. There is a decree called Decree no. 28, which will need to be re-drafted. The government is planning to do that, and we and others are providing technical assistance. I think there is no shortage of financial money available from donors to help in that process. The government wants the best international lawyers, the best specialists. There's no difficulty whatsoever in bringing them in to do this. The government simply has to request them and I think they are doing that now. So, I think, if there is a political will to do that, there's no question that it can be done. And organizations like the IFC, which is the private sector wing of the World Bank have now started to work with some of the people's committees of the cities, which of course own an awful lot of these state enterprises -- Hanoi, Haiphong, Ho Chi Minh in particular -- in order to sort of help them through that process. And organizations like IFC will not only advise, but they'll also actually do the transaction, mobilize money, and so on. So, I think that's good news.

I think equitization of the larger companies is really not that likely in the next year or two. It would be nice if some of them were pushed by the government to do that, but I don't sense there is any great appetite. I think what some of the larger ones are going to be doing is selling off some of their components. Now, quite a lot of them already are selling off their new expansions. For example, BOTs are being done in power, even in water supply in Ho Chi Minh City now. The question will be whether organizations like say EVN, the electricity board, will actually equitize some of its provincial generating and distribution bodies. They are thinking of doing that, apparently, and that would be very exciting. Similarly, for example, maybe Vietnam Railways or someone could think about that. Whether it will happen in the large industrial sectors, I don't have insights.

Now, in terms of those remaining state enterprises, data are extremely weak, obviously. The first priority is to, as the Minister of Finance himself says quite often, is to get on top of the data to make sure that balance sheets are understood, and the economic costs of subsidies are known. It's very commonly said in Vietnam that there are no subsidies, and by that is meant budgetary subsidies. Incidentally, I mean it's not surprising there were budgetary money going to the state enterprises. That's for investment, I think for the most part. I think that happens all the time and that's appropriate. Nothing wrong with the government providing money to the electricity generating board to invest in electricity generation. But there aren't recurrent subsidies through the budget for the most part now. And that's very good.

There are, however, very substantial subsidies that are sort of hidden in the financial structure. I mean, that's O.K. It's just important to clarify them. For example, the financial system is channeling half of all its resources to the state enterprise sector, and then it's rolling over loans, it's writing off loans, and so on, and I think that's a dangerous form of subsidy, because it's hidden. So that needs to be disentangled, and the government seems very determined -- Miss Da, I am sure in the State Bank is really -- there are people really trying to now get on top of that, and one of the vice governors of the State Bank I think is sort of charged with really working on that. That's very good news.

Now, if there really is, and of course the other way they are subsidized is through protection. They are protected, and that is essentially taking money from the people that have to buy the products at a higher price and using that to subsidize the state enterprises. So there are very strong subsidies, it's just they haven't really been quantified yet, and they probably need to be quantified.

Now, if there is a seriousness, which I think there is in state enterprise reform for those that aren't going to be equitized, clearly there are ways of doing it, and in some of these areas the government is already starting to do it. I mean where there are potential domestic competitors, those domestic competitors should be allowed to compete. So, for example, until last year, there were monopoly exporters of rice that were state enterprises. Those now are going to have to compete with the private sector. That is going to be very, very healthy and it's going to demand an increase in efficiency, and so on. So, where there is scope for competition, it should be exploited, obviously. Where there is potentially foreign competition, as in obviously automobiles, as we talked about, but even cement, for example, fertilizer, all those things, what one ought to do clearly is to say, look, at the moment we feel there is protection necessary. Five years from today there will be no protection for the cement industry. We are going to stop all quotas on cement imports or fertilizer imports. And then that gives a time line. And if there is a sort of a seriousness of reform, there is no question that that could be done.

Third, where there are natural monopolies, some of the companies are already starting to make big progress, and the other ones simply want some financial targets. So EVN, the electricity generating board is a very good example of a company that in the last five years has become much more efficient simply by adding, imposing upon itself, or having imposed upon it, some clear discipline. For example, it's committed to go up to a self-financing ratio of 30%, which is not bad at all. That will require that electricity prices slowly rise to about 7 cents a kilowatt-hour -- they are currently about 5.2 cents a kilowatt-hour -- and that would be basically close to long run marginal cost, which would be very good. Now, you could do that for all the other natural monopolies if there is a seriousness about it. For example, railways would be a fascinating one to really go after. So I think, there is no question that real progress can be made.

Now, would this imply real social costs, I mean, would there be massive layoffs? I think the answer is for the most part, I mean, Vietnam is very lucky in having only 1.7 million to 2 million maximum people working in the state owned enterprises. That's very good news, because it means there aren't so many ... There used to be twice this number, and they were cut down, and now there aren't so many people to be laid off. For the most part, there wouldn't be massive social costs. In some industries, there would be layoffs, and those need to be thought through. To the extent those are thought through, my judgment is that there is a great willingness on the part of foreign donors to come in and provide fairly generous restructuring funds for retraining, social safety nets, and so on. Certainly, we'd be willing to do it. I know, Mr. Watzek has really sort of led the crusade on this side. So I think the time is right in general right now for a very serious plan, of sort of a next five years of serious reform throughout.

I do have one, one sort of puzzle to me. This is something that since I came to Vietnam I've never really understood and that is, on the one hand, Vietnam is one of the countries in the world that emphasizes cost recovery more than any other country. It's truly remarkable. The emphasis, as you probably know, on making the farmer make a contribution to irrigation much more than in other countries, on making the beneficiary from basic health care pay. The privatization of health is one of the highest in the world, something like 75% of all spending on basic health care is paid for by the person that takes the basic health care, and the same is true in irrigation, on education, and health. It's not so true yet when it comes to state enterprises earning their own way. And I think it would be interesting to do some calculations, maybe someone's done it, of sort of cost recovery in all the industries. My perception is there's probably too much cost recovery right now in basic health care and there is nowhere near enough cost recovery in cement production, or whatever, and I would like to see some serious thinking on that kind of issue. Thanks.

Mr. Offerdal: David?

Prof. Dapice: I am embarrassed to be in the same group as these people who have just spoken. I have very little to add to what has just been said and rather than take the time, why don't we simply open the discussion.

Mr. Offerdal: Sounds good to me. Let's do it the same way we did in the previous session. Any direct technical questions on the papers first, and then we will proceed to more general discussions and comments afterwards. So questions first please. Mr. Tajika?

Prof. Tajika: My comment goes to the research by the OECF team. Actually, I am very much impressed by the research. My question is how can we read from whole bunch of data of Mr. Wada's research? On page 3 (of Note 3-2), the authors classified SOEs into several ways. First, geographical; North, Central and South, and the types of government, and so forth. Let me for the moment stay on the classification according to geography, I mean, North, Central, South. The data seems to say that overall, labor productivity seems to be high in the South. My question is that how can we conceptualize or explain the differences whatever of the state enterprises over three regions? First observation is that SOEs in the South seems to be high productivity firms. And I go down to the rest of the tables, and Table 6 says that depreciation costs of SOEs in the South is much smaller than other SOEs. And then, Table 7 says that the average wages of SOEs in the South is very high in comparison with other SOEs, and so forth. So my question is, how can we characterize the SOEs over Vietnam, especially SOEs in the South? Could it be that just the differences of wages explains the productivity, or is there any other element which explains the differences of SOEs over Vietnam? That is my question.

The second question, simple question -- I will finish it -- is that I stay on the Table 6 in depreciation. And I am now on the electronics. My first reaction to it is that electronics industry is more innovative, that means, they should be investing faster, and depreciation should be higher than other sectors, whereas, what he found here is that depreciation costs

of electronics industry is the smallest of all the industries. How can we explain it? That's my question.

Mr. Offerdal: Do either one of you care to respond or does anyone else have specific questions on -- maybe we should take ... Do you care to respond?

Mr. Wada: The second question is really ... all the data here is a kind of fact, and the interpretation is different. But my interpretation for the second question, for the electronics, the depreciation cost is smaller, is that electronics industry in Vietnam is not like in Japan. It's really labor intensive industry. That means that most of materials or parts are supplied from outside of Vietnam and just processed by laborers, like employees, and just exported, or sold domestically. That is not so capital intensive industry in the case of Vietnam. Is this a good response to your second question?

And the first question, actually, I couldn't really get the point of the question. There were several regional differences in the formation process, and productivity and the cost. In this data, it's not clearly saying what kind of regional difference is there. The difference is, in the southern area, most of the state owned enterprises are kind of like private firms, especially nationalized one was really private firms. And I visited some salt factory near Ho Chi Minh City, and that was really a private firm, and operated by a former private businessman but nationalized by the state. So the technological status or the location is not planning state owned enterprise type one, that is really commercial one.

Actually, in the southern area, most of state enterprises don't get any investment after 1975. And labor productivity was, of course we have to make a regression for this to analyze more the fundamental causes. Actually, I admit our analysis is really partial. But in the case of real labor productivity for the northern area and southern area, in southern area, it's really, the labor productivity was really good, because they were really commercial during the planning era. But in the northern area, it's state owned, that kind of planning type state owned enterprises, and their labor productivity increased or improved after 1990 because of massive investment. I don't think I could answer his question, but that's my response.

Mr. Offerdal: Further direct questions?

Prof. Hirata: I have a very simple question to Mr. Wada. On page 6, you showed us Table 11. In my opinion, managerial autonomy is one of the corporate governance, because corporate governance includes internal control. How do you think?

Mr. Wada: It's really a theoretical issue. The corporate governance issue and the incentive issue like managerial autonomy, is of course closely related. But in my view, it's logically separated, because for corporate governance, especially from the legal structure, that is a mechanism which monitors the management of some companies. But for the case of managerial autonomy, that is kind of incentives for managers to improve the productivity. So in my view, it's really logically separated. But of course, even in

theoretical economics, there are so many controversies in this aspect, so I think there are so many different views on that.

Mr. Offerdal: O.K. Please. Mr. Tu?

Mr. Tu: Thank you very much. Now, in the equitization process in Vietnam, we have a lot of problems. The big problem is that in my country, we don't have stock market. How can you sell the shares? Another problem is we cannot find who should buy, because Vietnamese capital income is very low. So we cannot find who can buy the share of the company. This is why the process is very slow. So now we try to promote the equitization process, so my government try to establish the center of equity trade, and most investors will be able to buy share or equity from state enterprises. But big problem in my country is to find who should buy. How can you help us?

Mr. Offerdal: I think Andrew is dying to.

Mr. Steer: No. Well, first of all, on the stock market. It would be nice to have a stock market, but I dare say that in the United States, 5% of all companies would be listed on the stock market, I don't know, I am just making up that number, but I doubt it's even 5%. Ninety-five percent of companies would not be listed on the stock market, and they would be traded privately, so to speak. So you don't actually -- certainly not for the first thousand -- you certainly don't need a stock market in order to trade those. You need simple rules and legal structures that enable the transfer of assets. So, you clearly need that. But you don't actually need a stock market, although it would be nice to have a stock market.

Mr. Tu: We permit the person transfer stock. For example, my government has policy for the owner of bond can transfer. Actually, in Vietnam, nobody transfer. That's why, big problem, in our country.

Mr. Steer: Can you repeat that?

Mr. Tu: Actually, we have legal infrastructure, permission, the person who is the owner of bond or share can transfer to other person. But it's not transferred.

Mr. Steer: Is there shortage of buyers or sellers? There aren't people who want to buy them?

Mr. Tu: No transfer in our country.

Mr. Steer: Well, this could be a long discussion, but my own view is that people could get used to it if there is a clear legal structure, which there isn't really at the moment, that they could actually get, they could get very good at transferring these very quickly. But I do think there needs to be sort of some legal deepening.

With regard to your second question, I don't think its ever been, I mean you are saying as if you have to find out who should buy them. I dare say that the people ... I mean, you might just try a few things. For example, I believe the Minister of Finance is now agreed that on an experimental basis, one might auction some of the small companies. I would recommend that be done immediately. I think we might be quite surprised how many workers in the company would want to actually pay cash, and how many people outside the company would want to pay cash for it. I think one has to try it first of all.

Now, three weeks ago, we had this seminar and we brought Chinese specialists, lots of specialists from Eastern Europe, and we talked about all the different mechanisms, the different mechanisms that China is trying now. China is experimenting with all kinds of things. They have pilot programs, where for example, foreign companies are allowed to come in along with workers, and together, set up a business, to purchase the business and move on. The foreign purchasers have to bring in finance with them. That seems to be working extremely well.

Obviously, a lot of Eastern European countries are experimenting with a voucher system. I am not sure that's a brilliant idea for Vietnam. But there are certainly models out there, and I guess what needs to be done is simply pick from the models. It's not like no one has any ideas. There are plenty of ideas, and what one now needs to do is pick those ideas. David, you might have some points on this.

Prof. Dapice: Something like 85% or 90% of the industrial SOEs have less than a half million dollars in capital, which I think includes debt. So if the new owners agree to pay off the debt, or at least keep servicing it and so on, then, you might really not be talking about quite so much money to buy 85% or 90% of the industrial firms. People could buy them for really not very much money, if you are looking at the equity part of the deal. I think there are different kinds of accounting, and one reason I was so interested in what was said, is I think you do want a kind of rough accounting of minimum value. If you put things out to auction, you should make sure that you are not giving away too much. On the other hand, I think a lot of firms probably are not worth very much, if the debts are assumed. So really in a number of cases, you might almost give away the firms, and auctioning is equivalent to that. But you should know if in fact that's appropriate.

I think a much deeper kind of accounting and study such as we had in the second study is needed for the larger firms where you really don't just want to auction them and forget them as you can, I think with the smaller ones. But I think with the larger ones, you really do want to restructure, and there you will need supervision. It might be banks, it might be the new board of directors, or it might be some other mechanism. But with the larger ones, you really do have to pay attention, and that will be a different kind of sequence, and I think one that maybe you are more worried about it and more focused on, but again, probably five out of 6,000 are of the first kind where the disposal may be relatively easy. And as long as it's done without giving away too much, I think a lot of it could be done quickly and with very, very little disruption, because these smaller firms sort of manage themselves if the owners and the managers are more or less aligned. So I think actually, you could probably raise some cash. I am astonished really myself at the amount of

savings and gold and dollars and so on, that a lot of Vietnamese families have. If they were in an environment in which they felt it was O.K. to put some of those assets in these companies, I think you would -- I would be even surprised -- by the amount of money that would come out of the mattresses, so to speak. So I am kind of optimistic.

Mr. Offerdal: Mr. Wada?

Mr. Wada: That question is regarding the property rights -- who buys that company is who owns that company, right? But what discussion is really needed in Vietnam is who manages the company. So this is a problem of management. It's different from the problem of who owns the company. And even if the net assets of the company is negative, if the management is really good, somebody will buy that company. Even if the net assets or net worth of the company is really huge, but the management is really bad, nobody wants to buy that company. That's the basic principle of capitalist economy. But in Vietnam, that is mistakenly under-stood. Nobody buys the company, that is because there is a problem in management of the company. That is my answer.

Mr. Offerdal: Mr. Hagiū?

Mr. Hagiū: Would you look at page 4 of Note 3-3? I just picked up the reason of delay of equitization. There are several reasons. One is the resistance from concerned persons against uncertainty. This is mainly the people within the SOEs. Another is the difficulty evaluating the enterprises to determine share pricing, and incomplete legal procedures with respect to equitization. In order to promote equitization, concrete countermeasures for these reasons as well as the following issues should be considered. I picked up three items. One is equal treatment of all economic sectors and abolition of privilege for SOEs. Another is setting up a stock market, of course. And another important thing is implementation of an external audit and disclosure system. These are basic important matters to hasten equitization. There are many things to do, but you should be done step by step.

Mr. Offerdal: Mr. Verbiest?

Mr. Verbiest: I have a few comments then a question to Mr. Hagiū. Well, I think that the trading part about shares and so on, there are all sorts of mechanisms, as Andrew said, but I think you can actually start with a very simple mechanism, over-the-counter trade and so on. Maybe one should think about linking this to some of the reforms in the financial sector. You could use of course the financial sectors, but I am not sure anybody would like to trade his shares through banks in Vietnam today. So you might link this to some of the other reforms.

On the equitization, on the devaluation of companies, I think this is really one of the major issues. You have to know what to buy, otherwise I am not going to put money in. And if you buy it, you don't buy it for charity. You buy a share because you hope to make a profit. So if you sell your share, and as Mr. Wada said, you hope that the people who run

the company make a profit. So I think that has to be very clear. It's not charity. You hear sometimes, or you see text written saying that, OK, the equitization process is, one, to raise money, and so on. That's true, but you only will raise money if you pay a return on money. So it means you need to know what assets you have, and you need to know that your asset is properly managed.

The other comment -- actually it's more of a question -- I am a bit intrigued in Prof. Ishikawa's paper that it finishes by saying that general corporations, you were not asked to deal with general corporations, and that's something different from equitization. But it's an important part of SOEs. And if you read the resolution of the party, I mean, I don't remember the exact wording, but it says that general corporations will be reviewed, and it says that after that review, general corporations, the ones remaining, will become the backbone of the economy and will be used as sort of -- well it looks to me, and also from some other texts, that it's very close to building up something like a Chaebol system in Korea. I am wondering if we could have some comments of our Vietnamese friends on this. The recent experience would suggest not to go that way, but I am not sure.

Prof. Ishikawa: We have many important areas to be studied more, and one such important areas is general corporations. The other is small and medium scale industries inclusive of the supply situation of the entrepreneurship. These are something very, very important. Although we tried our best to cover various important aspects, we haven't yet ... So it's easy to list up the names of important investigation areas, but any way, it's not easy to cover. So I quite agree with you. The general corporation is a very, very important area. As far as I know, no systematic studies are made, and our information and knowledge are very fragmented. Some of these we know, we visited and investigated, and some other persons visited other corporations. How to organize these findings? That's something to be done in the future.

Mr. Offerdal: Please.

Dr. Thai: I have general comments, not directly to the SOE reform, because SOE reform is very complicated. We have to prepare some more, and step by step for implementing, and get experiences from practice, in order to make adjustment. Concerning the SOE, in Vietnam, there are two kinds of SOEs. One is business activities, and the second is public utilities. These are very important, because for the public utilities, we can keep it for the common good for the people. It is very difficult to equitize. And for some of the small companies in Lang Son province concerning environment, these private sectors can get it, however very little for the use for the public utilities. However, for business, it is very important. We have to select and rank SOEs for the equitization. For the general, we have two directions. SOEs have to reform. At the same time, have to make the good condition for private sectors can develop. In this case, you can share together, two directions. Not only the reform SOE, because reform SOEs already. And if we make the good condition for private sector, for the business, for the local private and for the foreigners, develop our country, this can make adjustment step by step, not only one direction, together. It is combined and can continue develop our country. If say about SOEs, we say loss money. However, if we can develop everything,

people can make business for themselves under legal framework. Legal framework is very nice. In this case, SOE have to reform. Cannot continue with that because another company can get benefit. In this case, they have to make the reform inside of the company, not another way. Now, it's subsidized too much from government and keep it as own for some person, cannot make it in this case, very complicated, comprehensive program for the revolution our country this idea.

And the last comment, I would like to make the edit from page 3 of Mr. Wada. Perhaps, you need not 100 million Vietnamese dong, one million Vietnamese dong only, on page 5. This is very important when you use these documentation.

Mr. Offerdal: If I could just use my chairmanship to allow a minute for myself, I would like to follow up exactly on what you just said, because I think, on the issue of SOE reform, obviously equitization is one key issue. But there is another issue that I think is, in one sense, equally important and far more urgent, and that is exactly what you mentioned, namely to find a way of dealing with that segment of the state owned enterprises that are currently in significant financial difficulties, and do so in a socially responsible way.

I must say, I am eternally grateful to the three first speakers, because a couple of months ago, I had the dubious honor of putting my name to a paper on SOE reform in Vietnam and we came out with conclusions based on very, very scarce data, but I am very glad to see that, basically, both Prof. Ishikawa, Mr. Wada, and Mr. Hagi provide data that essentially supports the conclusions that we came out with. Especially, I found the relationship in your handout (Note 3-2) between productivity growth in Table 3, and wage growth in Table 7, to a large extent explain this chart you have at the bottom of page 3. And clearly, that downturn in profitability or financial performance that you see in that figure or in that chart has been significantly worsened over the past few years. That is right now an issue that could significantly impair macroeconomic stability, and it's an issue that has to be dealt with on a pretty urgent basis. And wage increase. If you look at during the first two years, 1991 to 1993, productivity grew at an annual rate of 20%, and wages at 50%. However, from 1993 to 1995, labor productivity grew at 3% on an annual basis, and wages at nearly 30%.

Mr. Ishikawa: Is this the real term increase in labor cost of wages? I wonder whether the increase in wages is calculated in real terms or nominal terms.

Mr. Offerdal: In nominal terms.

Mr. Ishikawa: Then, I think the relationship between productivity increase and wage increase can't be compared directly, because labor productivity increase is measured in terms of the real terms.

Mr. Offerdal: Well, that's true, but as Mr. Hara pointed out we don't really have output price data, so that would have ...

Mr. Ishikawa: O.K., but your point is very essential point -- the relationship between productivity increase and wage increase.

Mr. Offerdal: No, but I agree. As he was speaking, I just did a quick calculation. Anyway, that's ...

Prof. Dapice: Could I just say that from 1993 to 1995, there was relatively little inflation in the economy, generally. So the rather large wage increase with the essentially stable, real productivity would suggest that his problem is in fact a problem in a later period. For the former period, I think it's uncertain. Your point is correct, because there was quite a lot of inflation.

Mr. Offerdal: Prof. Ohno?

Prof. Ohno: Labor productivity data are quite interesting, but I think, we have to be very careful in interpreting causality. Probably, between 1991 and 1993, probably the cause of labor productivity increase is not the productivity innovation but labor shedding. The redundant workers were laid off. And also the relationship between wages and labor productivity must be done more carefully. We can't really connect these two things without further analysis. Maybe they have done that already, but it's not in here.

Mr. Wada: We haven't done that. We identified that as a real problem, but we didn't do that for the case of Vietnam. In the case of China, we did the analysis.

Prof. Ohno: ... panel data, so here is the entire micro data, so you can do the firm by firm analysis.

Mr. Wada: Yes, of course. We have massive data, but we don't have any productive labor. That's a problem with us.

Mr. Offerdal: I think -- we basically have five minutes left of this session -- I am tempted to invite any concluding comments at this point. Prof. Ishikawa, would you like to perhaps round off?

Prof. Ishikawa: Let me make my concluding comments tomorrow.

Mr. Offerdal: O.K., very good. In that case I suggest we adjourn and proceed to the social aspects of the meeting. Thank you very much to all the speakers. This was to me very interesting.

Session 4: Agriculture / Rural Development

Chair: Dr. David Dapice

Prof. Dapice: Good morning. Yesterday, we discussed industry and state enterprises. This morning, or at least the first half of this morning, we are talking about the 80% of the people that live in rural areas. We are fortunate to have two quite good reports that are going to be discussed by Prof. Hara and Prof. Izumida. They will each take about fifteen minutes, and then Andrew Steer will make a brief intervention. I will probably interfere more than I should, because this is a topic of some interest to me, so I'll probably add some things myself, but only after others have spoken. So Prof. Hara, do you want to begin, please?

Prof. Hara: Good morning. Thank you very much. Last week I was in Bangkok and I stayed three days there in order to investigate the effect of baht's depreciation. Firstly, I was very surprised, to find that the rice export of Thailand have increased tremendously during the last year. The 5.5 million tons of paddy were exported from Thailand, mainly due to the increased competitiveness induced by the baht's depreciation. I don't know how this fact affected the Vietnamese rice export, but I think that might have strong impact on Vietnamese rice export. Also, due to the large increase of the export of rice, the domestic price of rice increased in Bangkok -- around 50% higher than previous years. Therefore, Thai government is now trying to implement some policies to reduce the domestic price of rice. Some people suggested that Thai government would once again introduce the so-called rice premium policies, which was abandoned in the middle of 1980s. Also, I found that the export of other agricultural commodities and also many kinds of agricultural processed commodities increased in the latter half of last year. The people who lost jobs in the urban areas are going back to the rural areas, and started to engage in agriculture production. My observation regarding to this Thai case is clearly showing us that the existence of the healthy and good rural agriculture is very important as the economic as well as social absorbers of the shocks such as currency crisis.

Then, I would like to turn to the major topics of our research. Agriculture in Vietnam has achieved rather high growth performance since the start of *Doi Moi* policies, and the systemic reform of managing productions and marketing has so far centered on relaxing the government command on the farming and market activities, and giving the freedom of decision making to the farmers and the merchants. Our basic hypothesis is as follows: that this systemic reform was a necessary condition for agricultural and rural development in Vietnam, but is not sufficient for further growth to develop the exportable sectors and also to reduce the poverty in rural areas.

It has been clearly demonstrated in the process of *Doi Moi* that Vietnam's farmers have enough capabilities of responding to the market incentives. However, it is not sufficient for promoting further growth, only to provide the market incentive to the farmers. The farmers are facing the underdeveloped market institutions and suffering from the so-called market failures caused by imperfect market or underdeveloped markets of products

and especially the credit. Vietnamese farmers are lacking the capability to gather the information regarding the international as well as the domestic market mainly resulted from the shortage of physical infrastructure such as roads and communications. Based upon these basic findings, we emphasized in our study that establishing the institution and organization which can effectively or efficiently intermediate the scattered farmers and the national and the international markets is urgently needed for agricultural development in Vietnam. And such institutional and organizational development might be past dependent, or dependent upon the initial conditions of Vietnamese societies. Such institutions or organizations could be efficiently developed only when they are compatible to the social structure in Vietnam. Later, I will return to these issues relating to the agricultural cooperatives.

The first main topic of our study is diversification of agriculture production. Diversification is one of or even the sole means of increasing cash income from agriculture in Vietnam. Still in Vietnam, the non-agricultural employment opportunities are rather limited. This diversification also represents a response to growing and changing demands for agricultural product in domestic as well as international markets. Exploitation of overseas markets of agricultural and rural products is very crucial for promoting agricultural diversification. We found that several products have a potential of further expansion in overseas markets, and we suggested in our study that efforts of the government in this area should be focused on the provision of assistance in increasing the access of farmers to market information, and also improvement of market-related physical infrastructure such as roads and storage and other facilities.

On the other hand, in view of smallness of individual farmers, such activities as promotion of products and negotiation with the purchasing companies, processors, and traders can effectively carried out only by farmers' organizations or groups. Agriculture cooperatives being established under the new cooperative law could play a role in this respect. It is proposed in our study that cooperative unions or federations should be established in some selected areas including several unit cooperatives, and covering one administrative district. These cooperative unions would assume the functions of coordinating production activities and the marketing of the areas. The government encourages and facilitates farmers and unit cooperatives to organize and participate in unions in drawing the guidelines and guaranteeing loans.

Provision of market information, particularly of the overseas markets would be handled by establishing an agricultural information center for cooperatives. This idea is mainly developed in our study by Prof. Sakurai, Prof. of Vietnam history, Faculty of Literature, University of Tokyo. Unfortunately, he is not here today, because he is now doing research in Mekong Delta in Vietnam. He has been heavily involved during the first five years in the intensive field surveys in a village in the Red River Delta. Through this investigation, Prof. Sakurai clearly found that Vietnam's farmers have developed their capability of organizing collective works throughout their history, at least since 13th century, especially in the Red River Delta. And maybe you might find out his paper in this box, and maybe you can easily catch his idea from this paper.

Based upon Prof. Sakurai's findings, we concluded in our study that non-governmental agricultural cooperatives could be effectively developed, because cooperative work ethics is widely shared by individual farmers, especially in the Red River Delta. I think the situation in Mekong might be quite different. As mentioned at the beginning of my presentation, institutional and organizational development is dependent upon initial and historical conditions of each region.

Next topic is the credit, but I don't say anything on this issue, because Prof. Izumida will explain later the details of our findings.

The creation of rural non-farm employment opportunities is another crucial element to improve rural economy. Of course, around 80% of the total population is still living in agricultural and rural areas. At present, a variety of rural traditional industries apart from some SOEs and a few labor intensive small scale manufacturing enterprises serve as a source of non-farm employment in rural areas. Findings based on several observations in our study, I think, to create and promote non-farm employment, physical infrastructure development, provision of credit, and strengthening market activities are very important. We arrived at such a conclusion.

Finally, I would like to touch upon a little bit about the rural infrastructure issues. I think the development of rural infrastructure is a key for improving rural economy as well as market functioning. Our study indicates some policy options for developing rural infrastructure including irrigation, drainage, flood control, rural roads, and electrification, especially centered in the Red River Delta regions. It is revealed that as the state's money plays a major role in the rural infrastructure investment, a continuing and increasing allocation of the state budget for this area is needed for maintaining the production increase at the recent pace. I don't know whether all of you might have this Executive Summary report or not, but in this report we insisted that the increase of public investment in this area is needed. So far, if our calculation is correct, annual increasing rate of capital investment in rural infrastructure is around less than 9% during the period 1989 to 1995. We found that ICOR of agricultural sector is around 2.3 or 2.4. This implies if the Vietnamese would like to achieve 4.5% of agriculture growth, then the increased public investment in rural structure should be increased from the level of around 8% annual growth rate up to 10% or 15%. Therefore, I would like to insist that the Vietnamese government should increase some allocation of budget to this area.

Anyhow, that's the brief presentation of the major findings or proposals in our report. Thank you very much.

Prof. Dapice: I am speechless. You were right on time, leaving plenty of time for your colleague and also for discussion. Could you continue please?

Prof. Izumida: Thank you Mr. Chairman. Good morning, ladies and gentlemen. My name is Yoichi Izumida. I am working in the Department of Agriculture and Resource Economics at Tokyo University. Today, I am going to talk about the rural finance in Vietnam. Please look at my note.

Before starting my presentation, I would like to quote one statement of General Secretary Do Muoi at that time. When Prof. Ishikawa and our team had a meeting with the General Secretary Do Muoi in June 1997, Do Muoi referred to the results of our research on agriculture and rural development. And he said that the agriculture bank could not meet the demand from farmers, but the amount of unpaid loans of farmers is just 4 % to 5%, much, much better than the repayment performance of SOE. As this statement indicates, the financial performance of agricultural household sector is rather good, so far. But of course, there are many problems and constraints.

Now, look at page 3 of my note (Note 6-2). Major players in rural financial market in Vietnam. In Vietnam, informal finance is very active, but from various surveys, including our own, the share of informal finance is now decreasing, because of the expansion of formal credit. However, I don't refer to it today. I don't refer to the activity of informal finance in rural Vietnam today

Formal lenders. The Vietnam Bank for Agriculture, VBA, is dominant, having the share of more than 80%. This VBA is a state owned enterprise, and also it's a commercial bank. It's getting many forms of assistance from the government. So it can be regarded as the government agricultural bank. And the second player in rural finance in Vietnam is the Vietnam Bank for the Poor, VBP. It was established in 1995 and started its operation at the beginning of 1996. The VBP has a very close relationship with the VBA, Vietnam Bank for Agriculture. It can be regarded as a kind of sister institution. And VBP supplies very cheap loan to the poor. Here, I don't want to refer to the activity of the VBP, because the operation period is too short. At this moment, it's too early to judge the performance of VBP. Number three, the People's Credit Fund. This People's Credit Fund is a cooperative-type financial institution. They receive the deposits from the public, and they disperse their loans to the members. This People's Credit Fund is a cooperative financial institution, but they only undertake the business of finance, not doing the business of marketing, and so on.

So, the VBA has been dominant, so I take VBA as the representative of rural finance in Vietnam. So I check the performance of VBA by looking at the growth of credit, growth of savings, and loan recovery performance.

Please look at page 5. This figure shows the growth of loans and savings of VBA. You can find the amount of loans and the amount of the mobilized saving by VBA increasing quite significantly.

Concerning the loan recovery performance, VBA's annual report, 1994 and 1995, describe the overdue ratio or the rate of bad debt is very, very small, say 2% or 3%. If these figures are correct, we can say that loan recovery performance of VBA is very good, excellent. But of course, there is some problem. They have the frozen debt, and the ratio of frozen debt is around 8%. So if we consider this frozen debt, loan recovery performance of VBA is not good. But the State Bank of Vietnam guarantees to repay the principal of these frozen debts, so we judge that frozen debts are not so dangerous to the

sustainability of VBA's activity. And from the interviews with many staff in branch offices, we didn't hear any serious problem of repayments. So, we had the impression that repayment performance of VBA is rather good and doesn't have any serious problem.

Next, the efficiency of financial intermediation. From the balance sheet and the income statement, we can calculate very roughly the interest and the percentage of average amount of outstanding loans and the interest paid as a percent of average amount of outstanding loans. The operating cost is about 5%. Looking at these figures, we have to say that the intermediary cost of VBA is not so good compared to the similar financial institutions in neighboring countries. So, efficiency of financial intermediation of VBA has some problems. Because of the small size of loans and because of the overstaff problem of VBA, VBA's intermediation cost is not so good. But judging from the performance of VBA at national level, we can say that the VBA's activities can be regarded as a kind of success. Of course, it has many problems, and it has many forms of assistance from the government, so it's not a success in a kind of commercial sense. But it can be regarded as a success in the sense that the VBA can sustain its business.

Next, I would like to explain the factors for the development of rural finance in Vietnam. I pointed out four factors, but the most important is the second one -- rural finance is supported by local administrative organization and indigenous group. Usually VBA loans go to the customers through group lending. The formation of group is very much influenced by the People's Committee, or by the women's union, or the farmers union, and so on. By using this group lending, VBA, they don't need to check the credit worthiness of customers, because the credit worthiness of the farmers is checked by these groups. So this group lending can reduce the lending costs of financial institutions. And at the same time, so-called peer monitoring system does work. So in rural finance of Vietnam, Vietnam use the very Vietnamese way of securing credit. This is the most important and most crucial factor for the success of VBA's lending activity.

But of course there are many problems. Smallness of loan size and the investment opportunity of farmers is very much limited, and the shortage of medium, and long-term loans, insufficiency of efforts of deposit collection.

I would like to add one thing from our observation of our field survey. We conducted field survey selecting three provinces, and the total surveyed farms in each province is one hundred. So the total number of surveyed farm households is three hundred. In these three hundred, the number of households which has a loan from formal financial institution is about 140. But the number of households which has the deposit account with formal institution is just thirty. So, many households borrow the loan from formal financial institutions, but they do not have deposit with formal financial institutions. But sometimes they have money. And in the villages, there is a shortage of money, so they can use their surplus money to lend to other rural people. We observed that there are many restrictions for VBA staff to collect deposit directly from farmers. So I think VBA does not have effort to absorb savings from rural areas.

I would like to discuss the final point of major problems of cooperative finance in rural Vietnam. As Prof. Hara explained, the future possibility of agricultural cooperative in Vietnam is very important, but also it's a delicate problem. Look at page 10. Because previous agricultural cooperative was very bad, the Vietnamese people have a very negative image of previous agriculture cooperatives. And also still there are debt problems of previous agriculture cooperatives. But I think there are some advantages for creating the agriculture cooperative. Number one, there is a very good tradition of mutual welfare and very good tradition of autonomy in rural Vietnam, as Prof. Sakurai described in his paper. And also there exists economies of cooperation in rural areas. When we visited villages, we encountered the case that if there is some kind of cooperation in marketing or in purchasing agricultural input, farmers can get benefit. It's a very big benefit. If farmers have some kind of joint marketing facility like a very big truck and so on, it's quite beneficial for farmers. And in the area of irrigation, and of course in the area of credit, I think there exists the economies of cooperation.

And also I have to point out, now the VBA's position is very much monopolistic. If we add the share of VBP to the share of VBA, the total share of these two institutions exceeds 90%. And in the future, this position makes the very bad effect to the rural finance in Vietnam. So I think there should be agricultural cooperative, and the types of agricultural cooperative, the multi-purpose one, multi-purpose agriculture cooperative is desirable. But considering the one constraint, a very big constraint, that the negative perception of previous agricultural cooperatives by Vietnamese people, I think the Vietnamese government shouldn't take a very strong initiative to establish agricultural cooperatives. Rather, they have to use the kind of prudential or kind of indirect measures to bring up agricultural cooperatives like the legislation or to give technical guidance to establish a kind of information center, and so on. I will finish my presentation. Thank you.

Prof. Dapice: Thank you very much, Prof. Izumida. I think Andrew Steer will make some brief comments before we open it up to general discussion.

Mr. Steer: Thanks very much indeed. These were very, very interesting papers, both those that were presented, and also Prof. Sakurai's, who is not here. Prof. Sakurai's paper actually has a great, gives a wonderful sense of life in the Red River Delta, and I would encourage anyone that really wants to get a feel of how grim it is actually in parts of the Delta to raise an income, to read that.

It's obvious that the stakes are very high currently in rural development and agriculture in Vietnam, and the government recognizes that very strongly. As far as I understand it, the government is very committed to accelerate rural development. And the reasons are obvious. The potential for massive urbanization over the next twenty years is huge in Vietnam. You could potentially see one of the greatest rushes to urban areas anywhere in the world when you think of how rapidly the income differentials between urban and rural areas are growing. The first five years of the *Doi Moi* reforms were clearly extremely healthy in the sense that agriculture was a real leading sector, so you didn't have differentials between rural and urban areas increasing. At least that's my understanding. More recently, one has seen that. And now that the differentials are four to six and higher

in some areas, and there is an increasing difficulty of promoting off-farm and on-farm employment, there is really the potential of turning a highly rural society into a very rapidly urbanizing one with enormous social costs. So it's very obvious for economic reasons and humanitarian reasons to try and do something in rural areas. And I believe it's very sensible as well. The progress has obviously been enormous in rural areas. It's important to remember in 1980, rice production was only 12 million tons, and last year, it was 27 million tons. That's a fabulous success by anyone's standards.

What should be done? There are some fairly straight forward things that should be done, but that doesn't mean they're easy. One is infrastructure. It's clear that public investments in irrigation still yield a very high rate of return. There's still about 900,000 hectares of unrehabilitated irrigation infrastructure. Our experience and I think the experience of everybody who've been in this area is that rates of return are quite high in the rehabilitation of infrastructure. And of course, it has been the rehabilitation of irrigation infrastructure that has led to the fact that of the huge increase in rice production, more than 80% has come from intensification, primarily double cropping in some places, triple cropping, obviously. So irrigation infrastructure requires public money. It will require shifts in the budget, and it's money well spent in my judgment. In the Mekong Delta, there is a massive new generation of infrastructure required associated with the Mekong Master Plan. But obviously, in the Red River Delta there is also a lot of work to be done. So first is irrigation.

Second is transport. Rates of return are quite high, both the rural roads, even more so, we are finding, for the inland waterways. We are just about to start an inland waterways project, supporting the government in that. The rates of return are approaching 30% in real terms. They're very high. These are rehabilitation of inland waterways basically, as some of the Prof.s have just said, trying to get markets for the rice, including export markets. I know the ADB is considering a similar support in the Red River Delta, which my suspicion will be harder actually to do than the Mekong, but I am not sure if that's the case, but I think so.

So, transport in rural roads. If there is to be a massive rural infrastructure thrust, the way of doing business -- central government to local government -- I think, will need to change. There is just too much of a bottleneck at the moment as funds go from central line ministries into the rural roads, for example, and so on. So there would need to be some institutional changes. Third area of infrastructure is power. The government is committed to bring rural electrification to just about all the communes in the next five years. That's going to be quite expensive, especially the more remote ones. We and other donors, I think, are very, very keen to support that. Some of the more remote communes clearly should be off-grid. If that is to happen, then the kinds of cost recovery I was talking about yesterday, will be required. I mean, there is no question that electricity prices would have to be raised to long run marginal costs and probably up to about 8 cents a kilowatt-hour, which would require about a 30% increase in tariff rates. And of course, obviously, if there were further changes in the exchange rate, that would be more difficult to do. Got to be honest about that.

So first is infrastructure, second is credit. I think we've had just a terrific presentation, so let me not say very much about that. I'd actually go out on a limb a little bit more than Prof. Izumida on Bank for the Poor. I think you were saying you didn't want to make a judgment on it. Bank for the Poor is not doing as good a job as it might. I mean, it just isn't. The reason for that is the interest rate policy which remains subsidized, nothing wrong with subsidizing interest rates as long as one has plenty of money to subsidize them with. The problem is there isn't that money. Consequently, Bank for the Poor is getting into an unsustainable situation. That's a great pity, I believe. Many of the non-governmental organizations involved in microcredit are urging in every way they can the VBA, as the bank for agriculture, and the government, not to subsidize these interest rates, because it's not helping the poor, unfortunately. So there are funds available for channeling through VBA. VBA is not yet in a situation where it can efficiently channel those funds. There needs to be a series of reforms that are made, and I think we will be discussing that in the next section.

Obviously, if credit is to be made available in the extent that is required, there are some sort of macro-economic choices. Currently, more than half of all credit goes to state enterprises. To the extent that's true, then it's not available for farmers and possibly even more important than farmers is those small entrepreneurs that are going to generate employment off-farms in the rural areas.

Another area in which progress will need to be made relates to collateral and the ease of land transfer, and so on. Land can be transferred now. The plain fact of the matter is it takes an awfully long time to do it. And that makes land altogether a less attractive collateral. It still is not efficient; the fact that a small entrepreneur needs a lot of collateral whereas a large state enterprise needs no collateral at all in order to get a loan.

So first was infrastructure, second is credit, third is just sort of reductions of barriers to economic activity. Progress is been made there, but it's progress made as I mentioned yesterday, rice trading for example, I think this year will be broken open, and Vinafoods and the Southern Food corporation who currently have had a duopoly on this, will no longer have that, and that will help a lot, I think. Similarly, export licenses at the moment have been extremely hard to get hold of, not just for rice, but for anything, and I think that is going to be broken open. The 200,000 dollar working capital that was required in order to get an export license, that will be reduced, and so on. So, I think there is progress there.

I would think that a very good idea would be to look at rural areas and say, what are all of the barriers that could be broken down, that we could then really work with the authorities to try and break them down. Now, you mentioned information systems and so on, I think that's an excellent idea; bringing information to potential exporters. I would suggest that this is an area where private experts might be really brought in to help on that.

On research and extension, I must admit, I don't have a strong view. I hear two different stories on research. I hear from some people that actually research is pretty well funded,

in agricultural research. In other areas I hear, no, no, there needs to be a big investment. I just don't have enough information on that. I would like people's views.

So it seems to me that there are three sets of things that just need to be done, and that's investment infrastructure, credit, and reduction of barriers. They will require some strategic choices in terms of allocation of resources within the economy, both credit and budget, and I think those choices need to be made, and I think the government plans to make them. I think there's a fantastic receptivity. I perceive there to be a window of opportunity in this country that is quite remarkable right now in rural development and it's a very, very exciting time.

I do think there are some tough strategic choices that need to be made by the authorities, and I don't have the answers to all of these. One will be what really is the long-term prospect for tree crops, say rubber. A year and a half ago, I would have been more confident that Vietnam will become one of the great rubber producing countries of the world over the next twenty years, because Malaysia and Indonesia needed to get out of the business, because their labor costs were rising very rapidly. It was clear, I think, that the Central Highlands of Vietnam offered a fantastic potential for income growth. I think that's still true, but it's less true, because Indonesia now probably shouldn't be getting out of rubber quite so quickly, because its real wages are not going to be rising as much as they were. Malaysia probably still will get out of it. It's not replanting very much rubber at the moment, I understand. But for Vietnam to get into rubber in a big way does require public funds. We've just got a rubber planting, a small holder rubber planting project in the Central Highlands we're just about to start. My guess is it's money well spent.

Second strategic choice relates to aquaculture. Vietnam obviously has had a spectacular growth in shrimp exports and shrimp domestic consumption at great environmental cost. One of the most dramatic sites in the whole of Vietnam is flying over the southern tip of the Mekong Delta, and seeing mangrove swamps that in ten years have disappeared with huge associated economic return, I should say. It's a textbook case of the tradeoff between economics and the environment. Now, of course over the long term it's by no means clear that that's sustainable, and it's not clear how much investment there should be in aquaculture up and down the coast. I suspect there is still a lot of scope for expansion there.

A third tough strategic choice relates to fishing. The conventional wisdom on fishing has been for the last five or six years that in-shore fishing -- there's too much of it. It's over-fished. Therefore, it would be good if fishermen went off shore. New scientific evidence suggests that the scope for off-shore fishing is not nearly as great as had been expected. I know this is a problem to Mr. Verbiest, because he is managing a fishing project, and it's a bigger problem for the government, because it's just not entirely clear what the future of the fishing industry will be. That's a tough question, I think.

The fourth sort of tough strategic choice relates to forest products and the management of the forest and timber industry. The government has recently passed a ban on logging, and I think that's a very bold act. I doubt that is needed over the longer term. I mean, there are

ways of sustainably managing forests, and that's something that needs to be worked on very hard, I think. A fifth and final strategic choice relates more generally back to the sort of broader development strategy of the government, and that relates to the kind of sort of growth triangle approach. The government has announced that it wants to invest in these three growth urbanizing triangles, and that will probably happen anyway. The question is whether or not that should be supported. To the extent it's supported it may tap off some potential growth in rural areas. So I think that needs to be done with great care, and I would love the wisdom of some of the people in this room as to the whole growth pole approach. My perception is that whilst barriers should be reduced within those growth triangles, no preferential treatment should be given to anybody that invests in the Northern Triangle nor the Southern Triangle, nor the Middle Triangle, that wouldn't also be given to someone that wants to invest in a rural area. Thanks very much.

Prof. Dapice: Thank you, Andrew. I would like myself to take about three minutes just to throw in a few comments about things that might be added to the stew of discussion.

Obviously, Vietnam has very little land per capita. That's a starting point. It has a fair amount of wasteland. It also has a fair amount of trouble with natural disasters like typhoons, and floods and draughts and rats, and things like that. It also has about 10% minorities that are culturally distinct from the majority population, and who often need to be dealt with in investment terms in somewhat more sensitive ways, because they are not as well integrated in all cases into the overall activity. It seems to me we need to ask ourselves if either government policy or ODA can deal with some of these questions, especially the question of risk with regards to natural disasters. I think many of the very poor areas that we've referred to in these meetings are poor because they are hit repeatedly by typhoons or natural disasters, and there is an inadequate ability of the whole village, not just an individual farmer, but the whole village to bounce back. The areas get progressively decapitalized, and the coping strategies which go to very low return and low risk kind of activities basically predominate, and the sort of more daring but potentially high return activities are shunned because it's simply too risky.

If we are going to speak about diversification, if we're going to talk about moving to higher value crops, about export markets and so on, it seems to me we have to bring these things together. We need to do everything that was said. I in no way disagree with the points that were made. But I would simply add that many of the areas that could be moving beyond rice alone, monoculture, into really a variety of higher value crops need certain kinds of either insurance mechanisms or disaster investment mechanisms. I think other strategic investments in veterinary services, for example, if you are going to develop livestock, are clearly needed. Certainly in fruits and vegetables and livestock, I think the research as opposed to rice is not as good as it might be for export markets. Again, for domestic markets it may well be adequate, but if you are going to meet rather demanding standards of higher income buyers overseas it seems to me you do need to invest more there.

On the credit side, a lot has been said. I think the question of equitization that we were talking about yesterday has a bearing on the rural development issues here. There is a tendency, if there is a state enterprise locally, for the local authorities to favor it understandably, and this often preempts significant competition. It's the competition that often brings in new ideas, new capital, creates higher prices for farmers. So I think it might be more difficult than we imagined to make progress in the rural areas without more progress on equitization of the smaller SOEs. I am not talking about the very, very large ones, but for the smaller SOEs, I think, part of the roadblock, part of the problem of bringing in the information and the inter-mediation of storage and processing, and so on, really comes from the bottleneck here.

The cooperative question, I think, is an important one. The suggestion that was made that it often is quite rational and quite productive for farmers to get together, especially when they have very, very small plots is a perfectly sensible one. I think striking the balance between government support and having too heavy a hand, is the real issue there. The history has not been terribly good in many cases. I think, making sure that any associations are voluntary is perhaps the best way to make sure that the cooperatives operate the way they are intended to. And I think there are models in Taiwan, for example, that are very positive there.

On the issue of minorities, I don't think we have time to discuss it adequately, but my sense is from the few trips I've made and the people I've talked to that have spent much more time in the Highlands and so on is that the current amount of money the government is spending is probably fairly ample, but the way it's being spent needs to be revisited. I think if there were a more sensitive series of investments with more participation, that the results from the existing level of spending would really be quite dramatically improved over what is now observed.

I think I've talked too long already, so why don't I stop since I am also chairman, and let people ask some questions. Thank you. Who would like to ask some questions? Please.

Mr. Tu: Thank you, Mr. Dapice. Thank you for checking our cooperation, researching about the agriculture in Vietnam. I would like to say one point. When you calculate about the formal financing, I think we have one resource... Every year my government to support to rural area, some intensive credit, for loan for expand production and find job, loan for afforestation, loan for difficult area, and subsidize for rural infrastructure. I think this should be included in the report of Mr. Izumida. It's better.

Another point. Last time, our government, we have some policies to improve agriculture. For example, we try to reduce barriers, most major improvement is export, we try to reduce the barrier in export. So, most companies can export, with no difference between the state owned companies and private companies. That's why I say we're trying to reduce the barrier.

The second is looking about the environment. We understand that now there should be more investment for environment. That's why government tries to protect the

environment. Now we just have a new policy to prevent the destruction of forests. Nobody can go to forest to cut the trees. So we try to improve the environment.

And another one, I would like to say, this is a big problem in my opinion, a very big problem, because budget resource is very limited. We cannot provide enough finance for rural area, so now we try to find how can we mobilize it into rural area for infrastructure, and how can we help them to create the mutual fund for them to do cooperative finance. So, that's a big problem. It's my job. Thank you.

Prof. Dapice: Thank you very much. Eric, I think you had an intervention?

Mr. Offerdal: Thank you. You actually hit the nail right on the head in terms of what I wanted to say as well, which is to some extent to follow up on what both Andrew and yourself said, namely the -- I very much agree. It's also obviously our assessment that the rural development and alleviating the income differentials between urban and rural areas is probably one of the most critical policy issues facing the government in Vietnam, and the potential for a massive urbanization over the longer term is one that is downright scary, actually. But the key points that I really wanted to follow up on this basically that the government's ability to address this critical issue is closely linked with the macro-economic situation, the macro-economic framework, if you like. I very much do agree with you that the potential social return on many of these infrastructural investments that are clearly critically necessary are high. The key is whether essentially the finance will be there to actually put it in place. I shall have a few more things to say about that in the next session.

Similar points really applies to the credit issues that have been raised in terms of bank performance, in terms of the maturity structure of lending, and in terms of mobilization of savings. This is really an issue of the monetary framework and of money markets to be able to make some of this finance available. Again, I'll have a few more things to say about that.

On the point that David raised on the management of risk, that also plays into the issue of the performance of the banking system. This is more really a question from a person that has no previous experience or knowledge about the issue. But I am wondering if some form of insurance scheme essentially is what is necessary to deal with the enormous risks that are faced by some of the agricultural communities in terms of alleviating or managing the natural disasters that they are hit with on a disturbingly frequent basis.

Prof. Dapice: Rather than having me answer that one, why don't we go onto more questions. Please.

Prof. Ohno: Could you give me some numbers? Everyone talks about the importance of infrastructure, roads, and irrigation and all that. But could you give me numbers in terms of either percent of GDP or budget or trillions of dong or U.S. dollars? How many oil refineries and highways do we have to give up in order to make a difference in the rural

economic dynamism that you are talking about? Not just one village, not just one province, but to make a difference, the kind of difference that we are talking about. What kind of money we are talking about?

Prof. Dapice: Can I respond to that, because I helped write Catching up in 1996, which was the UNDP document, and this was one of our major points. We went over the public investment program for 1996 to 2000, and the transport investments in Ho Chi Minh City and Hanoi alone were about ten times the total amount spent on rural roads. And if you looked at the amount being taken off by the rice quota system, it was more than the total amount being spent on irrigation in the entire Mekong Delta in the five year period. So the amounts -- it was an incredibly unbalanced investment program. I can't recall, unfortunately, the exact amounts, but if you went through it line item by line item, you would be really be struck by the fact that something like 90% of the transport investments were either urban, or to some extent the major roads, which of course are also needed and helpful to rural areas, but the amount being spent on rural roads is, if I recall correctly, was 7 or 8% of the transport total.

Prof. Ohno: My question was more on the needs, not the actual amount. Maybe the needs are greater, because most of the economic activities are taking place in Ho Chi Minh City and Hanoi. But you would spend 10 times more in these cities does not really mean that the needs and the actual amounts are balanced or not.

Prof. Dapice: At the risk of taking the wrong hat off, I am supposed to be the chairman, let me just say, if you are going to subsidize, normally cities with high economic activities can charge tolls for tunnels and bridges or major roads and so on. That's where you have an economic rate of return. Normally the reason you have a public investment budget is to, in a sense, move the transport and other infrastructures out beyond what can get immediate financial returns in terms of tolls into areas that have social returns as well. And I think ultimately, economic returns for the society if you count the avoided urbanization. I might also add that the economic returns that the Mekong Delta Master Plan and Red River Delta Master Plan estimated were very, very high, much higher than many of the industrial projects which were in the same public investment program. So to answer your question, if modest amounts were shifted from some of the heavier industry to some rural infrastructure, there would have been more employment, more exports, more output, and faster growth and more equity. And I think it's an absolutely clear call, honestly. And I am sorry I don't have the document in front of me to be more detailed. Let me stop. Who was next? Yes.

Prof. Hara: Please see the paper which I distributed today that is entitled Agriculture and Rural Development written by myself and Shindo-san. Please open page 12. You can find some figures. The 20 trillion Vietnamese dong is planned to be allocated in the rural infrastructure.

Mr. Shindo: Prof. Hara refers to Background Paper 6-1 on page 12. In very shortly that reviewed the past change in stock terms of rural infrastructure, and then referred to

the public investment program, also extracting all the amounts relating to rural structure, which comprises about 20.9% of the total expenditure. And this is on the macro terms we checked, compared to the past performance whether this amount expected in the public investment program would be realistic and also would be sufficient to ensure the estimated indicatively that the amount of capital needed to ensure that certain rate of agricultural growth.

And back to Prof. Ohno's question. Probably I am not taking exactly what he is asking, only that is still as indicative taking the rural road in the public investment plan, it is 2.7 trillion dong out of total investment of 96.8. Of course, that rural roads is a part of all the road investment. And unfortunately, I don't have total amount of investment for road for the public investment program. But it might be useful to know some magnitude. Thank you.

Prof. Dapice: Thank you very much. Please.

Prof. Ohno: I am not opposing or criticizing or anything. I think it's a presentational question. You said this is a very clear case, then if it is clear, I am not agriculturist, I am not sure if it's clear or not. If it's such a clear case, the government should allocate more funds or allocate funds more wisely. Then there should be a clear visual example of how it is underspent or misused. It's not very clear to me. Everybody says this issue is so critical that there should be more money, but if you have some very easy to understand numbers, that would be more dramatic. At present, given all these information, all the plans and actual amounts, I am not sure if it is misallocation or underspending.

Mr. Steer: At one level of the moment, it's not a misallocation, because the system couldn't absorb more money. So I don't think I could or anybody could say here is an area where if we could find another 300 million dollars given the present channels of responsibility, Ministry of Transport and the way the money goes down to the province level -- there aren't enough people in Hanoi that can check all the contracts, quite frankly. So in a way, that's the point that I was trying to make is that if this is to happen, there would need to be a slightly different way of doing business, analogous to what say Indonesia did 20 years ago in introducing the Impress Program, well, thirty years ago. I think there is some very exciting possibilities. ADB is preparing a project, a rural infrastructure project right now, that would enable some of that to happen.

Your point, your challenge is well taken. I think what we ought to do is go away and come up with some ideas. My judgment, if instead of the 1.3 billion that has been allocated in the budget for five years, if that were doubled, I would think that would be an extremely, extremely good idea. It would not be difficult to find the additional 1.3 billion dollars from some reduction in investment elsewhere, and then to play through the story, how do you get in this decentralization idea, how do you get the best of both worlds? How do you make the money available to provinces who have the capacity now to make some decisions in conjunction with the communes, but they still need the technical input from the line ministries? That's the real challenge. But the line ministries in Hanoi should not be designing every inch of road, clearing every contract, and so on. There are

ways of doing it. Other countries are moving very much in that direction. And the beautiful thing about going that route is not only do you -- well, you do lots of things. One, you promote small contractors, which is happening in a very exciting way in various parts of the country right now. But you also sort of make sure the money goes to where the local people feel they need it the most.

Prof. Dapice: Yes, Jean Pierre Verbiest.

Mr. Verbiest: Just to add one point to what Andrew said, I think the fact that it is a priority. If we talk about figures, we never reached it. But the fact that it is priority is that the number of people who live in the rural areas, I think it's their level of income which in many cases below poverty, and it's the externalities involved -- the fact that people might move to the cities, and then it will become very expensive. That, I think, convinces us.

Now, if we talk about money, then you have to talk about the level of services you are going to give or the level of infra-structure. When we talk about rural roads in many cases, what you want is a all weather road, but it's not a motorway, it's not an expressway. So we don't even have a half pavement in many cases. Again roads can go, I mean a good provincial road for us, the World Bank or ADB, would be about 400,000 dollars a kilometer. For the Vietnamese government, it's 200,000 dollars a kilometer, because the standards are different. And good unpaved rural road, maybe you go about a few 10,000, 20,000 dollars per kilometer. So it all depends what one wants to do. And that's where, I think the ... one general point here is that once we go into rural development, the importance of involving the communities, and involving, well, the communities, and for instance also NGOs, because they can define, depending on the area where you are, what kind of service, or what kind of flavor of infrastructure you want. So if we talk to figures, for instance, we are, all rural infrastructure is -- only our involvement is something like, together with the government, something like over 250 million dollars. That is 150 million dollars purely rural infrastructure, and 100 million dollars which are rural roads associated with Route No.1, and that is very small. That's a quarter of a billion dollars.

I just wanted to make a few comments. I was wondering, Andrew mentioned very briefly about the trade in commodities, and the rice trading. But I think one area one should look at in agriculture is the role of trading companies, of state owned trading companies, which are usually state owned general corporations -- their role in agriculture trade and pricing -- because I think in the case of rice where you have looked more in detail, it's clear that, I mean, Vinafoods was taking monopoly rents out of being able, the only one, the only institution being able to trade rice domestically and export rice. Now, ADB discussed that with the government, and we have reached an agreement that the monopoly of Vinafoods would be relaxed, and this year, well domestic trade has been liberalized and exports has been liberalized in a sense that nineteen companies have received export licenses. The idea, as I mentioned yesterday, is to get more income to the farmers. If you get more income to the farmers, well, you get into macro issues, you can raise their savings and so on. But I think rice is just one part of the economy. Very little has been done I think to look at, for instance, the role played by Vinacafe, or Vinarubber, Vinamilk. I mean, there are lots of large corporations there. What is their role in pricing, and how do

they influence income of rural areas? I think, it's an area which should be looked at very closely. I was surprised actually nobody mentioned it. For instance, in the tea area, there are very big differences between tea factories which have been, some have been sold off actually with foreign direct investment, and the state owned tea companies, because they might not lose money, but they are not working very efficiently, and they export poor quality products. So you don't get all the benefits you could get from the rural areas.

The other thing I would like to mention is that forestry is one of the priority areas of the government. But I think it's one of the three major national projects. If we talk about forestry, we have to talk about a whole area around forestry, because if just saying people can't cut trees won't work. You need to have the communities involved in policing the ban. They have to self-control it. They will only self-control it if you give them income. So you have to look at, like farm forestry, other sources of income. So you need to sort of look at the whole area around the forestry policy. It's not just looking at forestry. And I think that also joins what David was saying that one should look specifically also at the minorities. Obviously, they have a way of living which might be slightly different than the lowland people. If you look at the case of Thailand, it was only by providing support to these communities by showing them they can grow other plants, showing them also they can grow trees, which they can cut, I mean there are trees you can farm very easily, that more or less reduced pressure on the forest in Thailand. But even that was sort of not very successful. So basically community involvement and NGO involvement are very important in all of this. Thank you.

Prof. Dapice: Thank you. Are there other ... Yes. Please.

Mr. Shindo: Thank you. I know there are many ideas of future investment opportunities. Some we looked, and some we didn't look. So, I only have one or two questions, particularly on rural infrastructure or irrigation. Because I think apart from the amount or magnitude, we have strongly advocated the need of the investment of rural infrastructure in order to improve rural economy as well as improve market efficiency or market institutions. But also we realized there is an opportunity and also there is a potential to increase production by investing in irrigation and drainage. We also recognize that the problem is not only new investment but the operation and maintenance. This is also shown in the rehabilitation project. In that aspect, in connection we put an emphasis of the problem of water fee because of its effect to the maintenance and operations most seriously. This is just a question, that is how you think of this water fee or operation and maintenance in general, particularly as Mr. Steer mentioned that in connection with electrification, to increase the fee of electricity, that I think affects water fee, because of such a poor recovery of water fee, which affects to the actual operation and maintenance?

Prof. Dapice: Thank you. Do either of you want to address that? Taking off my chairman's hat once again, let me say a few things. One is that very few countries in the world collect adequate operations and maintenance fees for irrigation. So advising the Vietnamese to do it is the same advice given almost everywhere which is usually not followed, and that has to be acknowledged up front. Having said that, I think that there

are examples where operations and maintenance are collected and it does work, usually when there is some indigenous group, not unlike the cooperative in the Red River Valley, which has some sort of intrinsic traditional legitimacy. The water groups in Bali, for example, do very, very well. There are water societies that control it and do the maintenance. And I think there might be something similar in parts of Vietnam that could be built on and could actually operate.

The electricity issue is a complicated one, especially in the Red River Valley as you know, the river is higher than the land, and it's during the rainy season that you have to pump out to prevent flooding. It's also during the rainy season that the hydro-electricity is in surplus supply, and the marginal cost of hydro-electricity is very low. So there is a sort of social argument for taking low marginal cost electricity during the wet season, and using it to pump out land for poor farmers that might otherwise not be able to grow a rice crop and would become, in some sense, a public problem. So I think that kind of analysis needs to be done.

I think marginal cost analysis can be applied in the short-run as well as the long-run, and there maybe externalities as well. So it's a complicated problem, but I certainly wouldn't rule out having electricity less than 8 cents a kilowatt-hour for farmers pumping out water in the Red River Delta.

Where you are using fuel to pump the water indirectly through gas or something, then the calculation is somewhat different, and that would apply more in the Mekong Delta. But as I think we all know, if there were different electricity rates in the North and the South, it would be very difficult. So, there are levels of complexity here that need to be understood. Do any of the Vietnamese want to talk about this? Please.

Dr. Thai: I have some comments, general comments. I think, for Vietnam we can see in rural areas, there are two main categories.

First, the land in Vietnam is very limited and population is too much; increasing about 2%, by the JICA survey, about 1,000 square meters per capita. However, in fact, in many areas those are only 500 square meters or less. Everyday, only one square meter for living. In this case, what way for people to continue their work, and they cannot improve their living standard. As Prof. Hara said, diversification of agriculture is very important, and the non-farm, non-rice production in rural area is very important.

The second, the big problem now in rural areas is poverty and unemployment in rural areas. Younger people. In Vietnam, more than one million population join to the labor force, every year. However, mainly in rural area, they cannot find working places. And they cannot come to the urban areas. They have to live in rural areas continuously. Therefore, they have to share very limited works. The ways to solve this matter is not only diversification. But we have to make credit available for them, and provide training courses, and make some non-rice and non-farm production as well. In this case, we are very concerned about the services in rural areas, and some kinds of linkages between agriculture and industrial activities for the processing industry. In this way, we can raise

the value of the agricultural production, export, and meet the requirements of the domestic market in Vietnam in general.

However, in the papers of Japanese friends mention about the new laws on the cooperative, I would like to ask you foreign friends, what is your opinion about the new laws of the cooperatives in Vietnam? Does this meet the requirements or not? Because three years ago, Prof. Ishikawa came to Vietnam and said us about the necessity to have new kinds of cooperatives in Vietnam. So, what is your opinion about the new law, in this case?

Mr. Tu: Concerning about the water resources for rural area, I would like to raise two points. First, all companies which are providing water resources for rural area are public companies, and that is why the government subsidize these public companies. Second point is that the electricity price for water resource companies in rural area, is very low. It is about 60% of ordinary prices for most people who uses electricity.

Prof. Dapice: Prof. Hara, would you like to wrap up?

Prof. Hara: As Dr. Thai expressed his concerns on our idea of the agricultural cooperatives, this is rather controversial and delicate issue. But the Japanese team, has the feeling that especially in the field of collecting information or the credits or marketing, some voluntary cooperation of farmers are very effective. This is our idea. The rural society in the Red River Delta area seems, for us Japanese, to be very similar to the Japanese villages. Mekong Delta is quite different. Therefore, we Japanese have strong sympathies. When we were asked our ideas how to develop the rural areas in Northern Vietnam, Japanese people like me always look back to the past history of Japan. In Japan, as you know, since Meiji era, Japanese government, especially Ministry of Agriculture and Commerce and people in the rural areas jointly cooperated together for establishing some cooperatives beneficial for rural people. Anyhow, I am very sorry I couldn't say specific ideas or policy measures at this moment, but we Japanese have such a feeling. That is the final point which I would like to emphasize this morning. Thank you very much.

Prof. Dapice: Thank you, Prof. Hara. Thank you also Prof. Izumida for your summary. I should remind myself that Prof. Ishikawa suggested that at the end of the next session, just when we're hungry for food, we should also be hungry for thought at the end of the next session, and then the two visitors that are leaving early, that is Andrew Steer and myself, will make five minute summary statements since we may not be around at very end.

Mr. Watz: Do you want to close this session now?

Prof. Dapice: I was going to, yes.

Mr. Watz: It's good you did not do it. I would like to add something.

Prof. Dapice: Yes please.

Mr. Watz: We heard about, especially Prof. Thai just now, the need to increase non-farm activities in the rural sectors of the country. I think there is something that has to be underlined is also the role of ODA. I think the ODA has to much more develop in the provinces, and the ratio for the time being, I don't know exactly the figure, but it's clearly insufficient. ODA has tended to concentrate either on national projects or in the two big cities or three big cities in Vietnam. So at least as far as UNDP is concerned is for a 50-50 percent for the time being -- 50% for the upstream projects and 50% for provincial projects, and definitely we want to increase this proportion, because we feel that the time has come to help in creating jobs, as you said, rural credit, poverty elimination, and so forth, and to do capacity building and reform of administration in the provinces, because there, when you travel, there you can see in the reports where from our resident experts there, resident advisors, is that the *Doi Moi* has filtered down much less than it does in the top administrations. So to facilitate that, donors should really think more about provincial projects whether in terms of capital investment or capacity building. Thank you.

Prof. Dapice: Thank you very much. I think we've only gone five minutes over so we will take a break and come back to the next session. Thank you very much.

Session 5: Public Finance, Money and Banking

Chair: Mr. Jean Pierre Verbiest

Mr. Verbiest: Can we start this session on public finance, money and banking? What we will address in this session are more of the longer term issues and concerns relating to the financial system and fiscal issues, with minimizing, I guess, the short-term aspects of it. We are rather tight on time, so I would like the speakers to limit to, I think, Prof. Horiuchi, to about twenty minutes, and then after the two following speakers, Prof. Tajika and Watanabe, fifteen minutes. So if you can try to just stick to the timing. Thank you very much. So Prof. Horiuchi?

Prof. Horiuchi: Thank you, Jean Pierre. Our research team was in charge of investigating both the macro-economic capability and financial structure in Vietnam. Today, I would like to summarize quite briefly the content of our section dealing with the financial and fiscal reform in Vietnam. But before proceeding to my summary, I would like to say that our report does not contain the recent financial crisis occurred since early last year. Actually, our report was based on the information and observation we obtained until the early 1997. Fortunately, Prof. Ken'ichi Ohno has already prepared an analysis with respect to the influence of the current financial crisis in Southeast Asian countries on Vietnamese economy. This afternoon, he will talk about it. So, in my presentation, I will not deal with this point. At the same time, I would like to say that the problems of fiscal management are delegated to Prof. Eiji Tajika, and statistical analysis based on the household survey research will be briefly explained by Prof. Shin'ichi Watanabe. So they will take some time to explain their analysis in this session following my presentation.

The organization of our report is constituted by three sections. The first section is a review of macroeconomic performance in Vietnam until the mid-1990s. And the second part is the examination of the feasibility of the Vietnamese Five-Year Development Plan until the year 2000. According to the original Five-Year Plan, the annual investment over GDP is expected to be around 33% on the average until 2000, and a half of the capital formation is to be dependent on capital imported from abroad. If we look at this development plan from the side of capital import, this plan looks rather sufficiently feasible but if we look at this plan from the perspective of the trade imbalance, we are skeptical about the feasibility of this Five-Year Plan. According to our rough calculations, if the export will continue to grow at an annual rate of 28% from 1996 to 2000, the growth rate of import will have to be around 22% or less in order that the capital import at 16% of GDP is sufficient to finance the trade balance deficit. However, this level of imports seems unrealistic from the view point of Vietnam's past record. If Vietnam wants to promote the economic development according to the original development plan, they badly need to mobilize domestic savings, and at the same time they badly need to rationalize the financial system to make the fund allocation more efficient. This is the summary of the second part of our report.

The third part of our report discuss the fiscal/financial reformation to mobilize domestic savings and to rationalize financial intermediation with a view to making allocation mechanism based on the market more efficient. The third part of our report is the most important in our report, so I would like to make a few remarks on the content of this third part.

First of all, we are recommending that the government should concentrate its energy on building up the efficient financial system centered on the banking sector from practical reasons. The Vietnamese government is now promoting the development of security market. We don't disagree with this policy at all, but we are afraid that it would take a longer time for the security market to play an efficient role of mediating financial allocation in the Vietnamese economy. We think that it would be much easier for Vietnam to make use of the traditional banking system to mobilize the domestic savings. But needless to say, the government should pay sufficient attention to prudence of bank management. The current financial crisis in South East Asia teaches us very clearly that rapid expansion of bank financing without prudence of bank management will not only cause serious difficulty in the financial sector, but also destabilize the economy as a whole. So we are strongly recommending that the Vietnam government should strengthen the capability of supervising the bank management.

Also we pay some attention to the governance issues related to the state owned enterprises. The prudence on the side of bank management seems to be closely related to the efficient management on the side of borrower companies, especially state owned enterprises. Without the prudence or efficient motivation in the state owned enterprise management, it would be quite difficult for banking sector to implement their own prudent management. So in our report, we are recommending that the Vietnamese government coordinate between financial reformation and the reformation of state owned enterprise system, particularly to give the state owned enterprises a strong incentive for prudent and efficient management.

At the same time, we are concerned with the non-performing loans which have been already accumulated in the banking sector in Vietnam. Without disposing those non-performing loans, the banking sector would not be able to function as an able intermediary between depositors and investors or borrowing companies.

The government must grasp, the accurate situation of non-performing loan in the banking sector as soon as possible, and also have to prepare a reasonable scheme to deal with the bad loans in the banking sector. We think that the government will be able to do a lot of things to increase capability of financial system even at the present just like rationalization of the collateral system or to abolish the financial regulations which seem to hinder the efficient working of the financial system. Based on the orthodox economic theory, nobody could not deny the relevancy of financial reform to make the Vietnamese financial system more market-oriented. Our report provides some idea of financial reformation following the orthodox economic theory from the long-term perspective. But it would take a long time for us to realize an efficient financial system following orthodox economic theory. So we need to have some practical policy measures in order to keep the

substantially rapid rate of economic development in Vietnam, for the meantime. In other words, this is an issue of how to make use of scarce expertise accumulated in the Vietnam's financial intermediation. This is a quite important but very difficult issue.

We are proposing three examples of temporary measures before having a full scale efficient financial system in Vietnam. One idea is to establish so-called long-term credit banking system. The long-term credit banking system is a practical measure to introduce the division of labor between banks. Actually, we Japanese people have experience of, to some extent, enjoying the benefit of the long-term banking system immediately after World War II. So we recommended the long-term credit banking system in Vietnam. The rough idea is described in the appendix to our report (Background Paper 4-1).

The second idea is utilizing or promoting of the syndicated loan mechanism. We think that the BIDV, Bank of Industrial Development in Vietnam, has accumulated a substantial amount of expertise to inspect the investment project offered by the state owned enterprise sectors. We think that other commercial banks or other financial institutions should make use of the expertise accumulated in BIDV through a system of syndicated loan. This is a second idea.

The third idea is promoting the joint venture banking with foreign entities. Foreign bankers located in Vietnam have a good knowledge of advanced technology of financial services, so the government in Vietnam should promote joint ventures between those entities with the Vietnamese bankers.

These are just examples of economizing scarce capability of financial intermediation in Vietnam. At any rate, we should consider the possibility of some practical policy measures in order to deal with the financial difficulties before establishing the full scale efficient financial system.

I would like to say one word as a summary of my presentation. We need a good combination between policy of structural reform from the long-term perspective and the emergent policies to deal with the current difficulties for the time being. Without this kind of combination, the Vietnamese economy will, suffer from a rather serious slowdown in economic development in the coming decade. This is a summary of my presentation. Thank you.

Mr. Verbiest: Thank you very much for an interesting presentation. I think there were quite a few ideas we can take up in the discussion. And you kept on time. Prof. Tajika?

Prof. Tajika: Thank you, Mr. Chairman. Over the last several years, I have been quite in and out of Vietnam, and have been working on public finance. This morning, I would like to talk the way I look at the problems of public finance in Vietnam.

In the first session of this morning, we received a very good comment from Prof. Ohno. He asked us that we need good statistics, good statistics say, on infrastructure, investment, so forth. This is exactly the starting point of our research. One of the goals of my research

was to speak in numbers of public finance. With that, I would like to do as much as I can. I would like you to be equipped with Note 4-2, and the rest I will try to manage by OHP.

First, I go very quickly the overview of financial reform in Vietnam, and thereafter, I put emphasis on two things. One is tax policy, and second is central, local fiscal relations. And thereafter, I'd like to touch a bit on the prospect of public finance in Vietnam. I suppose, you people are equipped with Note 4-2, and flip the paper and go to page 2. Just let me go through this part, reforming fiscal management.

Vietnam embarked on a major tax reform in 1991, and introduced the law on such essential taxes as export/import tax, turnover tax, and profit tax. Though not in the form of laws, various other tax ordinances and government decrees were introduced in this first stage reform. These are mostly to frame tax administration in more transparent form. And these series of efforts that have been put toward modernizing the tax system and strengthening tax collection have led to the increase in the tax revenue. In fact, the progress has been significant enough to push the revenue to the GDP ratio up above 20%. Together with banning financing the fiscal deficit by means of money issuance by the Central Bank, the efforts paid on the fiscal management contributed to stabilizing the economy in Vietnam. We know that there is good, significant progress in terms of revenue collection. But, I'd like to discuss this way. Good achievement on the macro-economic front, however, have left some structural problems in fiscal policies. In a sense, one may say that fiscal issues of Vietnam are getting to be more intrinsic, that is, tax reform calls for more structural changes than mere frame construction. So far, the bulk of Vietnamese taxes have been coming from the SOEs in either profit or turnover taxes, or export/import taxes, or non-tax revenues from the oil.

Now, let me get into the picture. This is the tax structure in Vietnam. This is structure of revenue in proportion to the total revenue (Table 7 in Background Paper 4-2). This is transfers from SOEs and other things. But my point is that if you include up to the import and export taxes, more than 80% of the revenue of Vietnam comes either from transfers from SOEs own revenues or import taxes. We discussed yesterday that imports of Vietnam were kind of stopped. This will bite, this portion. So Vietnam, I guess will have very severe revenue problems. It might have already had last year. But this year, more so.

Then, another tax structural problem is this (Table 8 in Background Paper 4-2). I divided tax revenues from state owned enterprise sector by its value added, and the same exercise, to non-state sectors, agriculture sectors. So my observations here are two. One is, it seems to me that the state enterprise sector in Vietnam seems to me very much squeezed in terms of fiscal mobilization, I mean they are taxed. But an awkward thing is this. In agriculture, the rate of tax is divided by its value added is very small. What are these saying? Can we conclude from this that the agriculture sector in Vietnam has been very little taxed? Is that true? I don't think that way. Why then you have some rural areas unrest, say Thai Binh and those areas? Well, there are many hidden taxes, say at the commune level. How much we don't know. But to the extent of, farmers are frustrated enough to make some appeal to the government. This is not a tax seminar, so I don't like to bother you by details of VATs, but I think the future and the stability of Vietnamese

finance depends so much on the good performance of VAT. And VAT in Vietnam, we have to say, is not complete. But I have to skip this topic. But if you have questions, I will be glad to come back to this.

Then, I go to the central/local fiscal relations (Table 9 in Background Paper 4-2). In fact, I have been most interested in this aspect of public finance in Vietnam. And my observation is this. Over the reform period, Vietnam has come to have more strict grip of the local government. That seems to be different from Chinese experience. My observation is this. So this is central/local fiscal relations in terms of billion dong. Locality is mostly provinces and center. And the localities revenues transfers to and received from center and whatever. So what I calculated is, (d) is after in and out adjustment, net revenue localities, and (j) is the center's revenue. So, when you divide net revenue of localities by the counterpart of center, you get before period, localities receive or retain more revenue than center. This declines up to a half of the previous value, whereas, expenditures comparison, center to localities is the same. So what does it say? Localities has been losing their revenue capacity, whereas they are expanding maybe more or less the same magnitude as the central government. That means, localities revenues to expenditure. I divided revenue by expenditure. So, there is transfers, more transfers from the center to the localities. That's in the back of the story.

I put things in my paper, but then, I asked myself, is this transfer mechanism all right, I mean, conducive to more growth? So this I owe very much to our research. So we collected financial data from, by that time, 53 provinces. And I did something like this (Table 13 of Background Paper 4-2). This is expenditures. I categorized Vietnamese provinces into seven; North Upland to Mekong Delta. This says in North Upland, 1990 total expenditures, government expenditure is 11.3% of its GDP. So you can see this. Expenditures to GDP is very much small in this, whereas the total revenue here, South East, and this is so big.

And then, important thing is this. Then we went to this -- investment. First we looked at the local government capital expenditure by its GDP. So you can see that there is massive transfers, and the investment in these prosperous regions, like Red River Delta and South East, is much smaller than this. But problem is that this is provincial budget, right? So you have to include central portion of the investment. So local governments do two kinds of investment, one from central portion and another from local portion. Actually, you have a very big problem, and you will be very much frustrated with data. We happened to find that 1990 through 1992, we have two sets-of data; central and local state investment. And then you can see very small investment ratio of this region. And the rest I have to skip, but we did some regressions, and we found out that investment in South East and Mekong Delta are kind of discriminated against than other regions. You can see it in our paper.

Finally, I'd like to stress the Vietnamese decentralization process and the Chinese decentralization process. Here you have a recent Vietnam's budget law, tax assignment system in Vietnam. And first comes sources of revenue from the central government in Vietnam. Vietnam assigns central government can keep export/ import taxes, special

consumption taxes, like beer and tobacco, and profit tax of the centrally managed SOEs. But the important thing is here. Look at the shared revenues between center and localities. First, turnover taxes, and profit taxes other than centrally managed SOEs, actually every other state owned enterprise, and income tax from high income earners and so forth. The idea is this. When public finance people in Ho Chi Minh goes to Ministry of Finance in Hanoi, they discuss this portion -- how much Ho Chi Minh people can get. Well, maybe the thing is that this year, you have -- I know the number -- 18%, and Hanoi will give you 30%. So they make a lot of frustrating negotiations here. What about in China? This is China's budget law. Central portion is more or less the same, but look at the local government. They can keep, well, profit tax from local enterprises and income taxes and various things. I mean, this portion is much bigger. After lots of discussion in China, they came to the conclusion that 75% of VAT goes to the center, less to localities. Time is limited, so I cannot get into deeper story, but my observation is that Vietnam, over the reform process seems to me tends to have a stricter control of local government. And they still, well, you have your opinion, but still they are discussing very intensively where to go.

Final words about future prospect of the Vietnam finance. Number one, I cannot stress enough the importance of introduction of VAT in Vietnam. So that we have to keep a very, very close watch of the development of this tax. I didn't mention it, but for savings mobilization, I think social security system is very important. Presently, the country employs a pay-as-you-go system, actually it scatters around whatever surplus the social security system collected, but I would like to have the system switched to a more funded one. And I said local finance reform and some reform of the public expenditures.

At the end of my Note, I attached a CNN article, as fresh as March 20th -- "Former Vietnam president attacks power contract of Japan." The story is this. The former President, Le Duc Anh criticized the big project, Pha Lai power station project. He says that it's so costly and extravagant, and simply said no good. That project happens to be financed by OECF in Japan. But the point is this. I am sort of surprised what you guys are doing about your own project, and why the ex-President criticized that sort of big investment. Where is investment screening process? That clearly shows that the country needs better investment screening system. Thank you very much.

Mr. Verbiest: Thank you, Prof. Tajika. I think you gave us a lot of information, even though you had to cut a lot from your original paper. Prof. Watanabe, can you try to talk fifteen minutes or so?

Prof. Watanabe: Thank you, Chairman. Please prepare Note 4-3, and Background Paper 4-3. The Background Paper is also accompanied with about fifty pages of tables, which summarizes some of the data that we collected in the survey. You may not have that table in the handout.

In the previous summary of our team, Prof. Horiuchi summarized some of the policy recommendations in the last concluding remarks. The government should build up infrastructure as much as possible, such as an effective accounting standard for both

non-financial enterprises and for banking and other financial businesses, etc. Many questions raised since yesterday, centers around the question, how to build the social or institutional infrastructure that enhances the development process or historical process that is going on in progress in Vietnam from the locally fragmented traditional market economy toward a modern market economy. And our survey tried to document this historical process which is cumulative and irreversible. Some of the results we get in this survey does document this big change since 1993 until 1997. 1997 was the year when this historical VLSS survey, Vietnam Living Standard Survey, was conducted. But that year, the banking sector was at the bottom. Most of the credit cooperatives in the rural area collapsed completely from 1989, 1990, and there was a vacuum in the credit system in the rural area. This Vietnam Agricultural Bank was in shambles. The situation of the banking sector was at the bottom. And the VLSS was conducted exactly at that point. Since 1993, we can see various evidences, a variety of evidences, which demonstrates a significant advance in the banking sector, and that should give us some good reason why we need to investigate the financial system as of 1997. Four years of change, four years of time should have created a big difference, a big change in Vietnam. That was our starting point for this survey. The paper presents some of the findings.

In this report, we tried to present some of the findings of the savings and investment survey of households implemented from April to May in 1997 last year. We'll call it SISH 97 hereafter, the Savings and Investment Survey of Households, and examine the implication for the issues of financial policies in Vietnam. It turns out that many of the dramatic changes that happened in Vietnam during those four years support some of the basic conclusions, policy recommendations summarized by the paper given by Prof. Horiuchi. The SISH 1997 is distinct from all other surveys conducted in Vietnam in its focus on savings and investment behavior of the household sector. In one sense, it is much more detailed than the Vietnam Living Standard Survey in this focus. 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 SISH 97 is 1,788 households, which were chosen randomly from the entire nation to satisfy two different objectives. First, to find the changes of the household behavior between 1993 and 1997 over those four years by including the same panel households surveyed in the 1993 Vietnam Living Standard Survey conducted by UNDP and GSO. Our survey is conducted jointly with GSO and MPI, including Mr. Ly, who visited various villages to monitor this survey process. And secondly, to obtain the estimates of the behavior of households which best reflect the current conditions for the seven regions of the nation and for the whole nation. Seven hundred seventy-one households out of 1,788 households are chosen from the VLSS households, and the remaining 1000 households are chosen from the sample households of the multi-purpose household survey.

I summarize some of the findings from this survey as follows. First, from the very long-term point of view, that is the transition from the locally fragmented, traditional market economy to a nationwide, well-integrated modern market economy, from that view point, the most significant evidence seems to be the rapid progress of monetization of the economy. This is the very basic transition to the market economy. The fraction of households with positive stock of currency, dong, doubled from 44.9% in 1993 to 89.6%

in 1997 in the panel data common to VLSS and our survey. Furthermore, the average amount of currency held by households increased almost ten times as much from 300,000 dong -- this is per household, not per person -- to about 3 million dong between VLSS '93 and SISH '97 after adjusting for inflation. This is a big change. I should say that with such a big change, this transition to the market economy is something that -- we have seen here something very important -- an irreversible historical process is going on. And the many questions we are asking about the social or institutional infrastructure is how we can enhance this historical process, how we can support this historical process, how we can refrain from deterring or disturbing this historical process toward a market economy.

Now, from the point of view of fiscal policy, these figures imply that the government earned seignorage revenue as much as 4% of GDP each year from 1993 to 1997. That's the magnitude of monetization. People are willing, sort of hungry in some sense, in getting the safe savings instruments which serves as a part of the financial assets portfolio. However, the fact that almost 90% of the households now have positive dong stock indicates that rapid monetization process driven by 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 -- maybe equitization process may be related to this. 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.

A second one -- often the Vietnamese economy is characterized as a gold-dollar economy. Now it's related to that question. Well, is that characterization still true for Vietnam in 1997? In spite of the extensive and intensive monetization, I call "dongization," the fraction of households with positive stock of gold has remained almost the same for the nation as a whole -- about 30%. It was surprising to me. I thought it would decline, because of this massive monetization. However, a substantial change has taken place in the composition of households with positive stock of gold. In particular in urban areas, the fraction of households with positive stock of gold has declined from 63% to 28.7% -- less than half -- 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 a difference between the two areas in the accessibility to deposit facilities. Wealthy households in urban areas are found to have bank deposits substantially higher than those in rural areas. While the average amount of gold held by households has increased from about 700,000, 800,000 to 1.8 million dong over the four years, and this increase is equivalent to the import of gold worth about 400 million dollars each year, the importance of gold in the portfolio of money and the financial assets have declined from around 60% to 30%, because of the increase in fraction dong currency among the monetary assets from 14% to 40% for the average for the nation as a whole. The position of the U.S. dollar in the portfolio of household's assets is negligible -- only significant in the Hanoi area.

What do such observations imply for gold policy? Given that monetization is close to completion, and demand for quasi-money, that is, savings instruments easily convertible

to currency, that demand for some savings instruments, safe enough, the demand for quasi-money 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. And this links to some of the conclusions made in the previous presentation.

And perhaps this is related to the equitization issue. If equitization is prepared in a way that protects the investors, and in a way that reveals the information about the financial state of those business enterprises to the public, if these various arrangements are taken together, then this survey also supports some of these issues discussed yesterday. Because of the time constraint, I'll just stop here. You may ask questions if you have any later. Thank you very much.

Mr. Verbiest: Thank you, Prof. Watanabe. Eric Offerdal for ten minutes.

Mr. Offerdal: I have to confess that I am a little bit in the same situation as David Dapice was yesterday. I must confess I am a little embarrassed coming after these very extensive survey studies. Nonetheless, I am more boneheaded than David was, so I am going to go ahead and speak anyway, even though I am embarrassed. I am just going to limit myself to making essentially two very simple points, and I would like to start by basically tying it into the issue we discussed in the previous session, namely about rural development and the macro framework.

The first point I would like to make relates to fiscal policy. I would like to supplement the table that Prof. Tajika presented, because what Vietnam has seen over the past six, seven years is a combination of a significant decline in revenue and a significant decline in the fiscal deficit as a percent of GDP. I handwrote this table this morning. From a peak after the significant, if you like, renovation of state owned enterprises in the early 90s, total revenue to the central government as a percent of GDP increased from 19 to 24, almost 25%. Since then, we've lost more than four percentage points. This is essentially the official budget forecast for 1998. Combined with that, since 1994, the fiscal deficit has been reduced from 2.4 to about half of a percentage point in 1997-98. And the combination of those two things obviously mean that expenditures have gone down from 27.5% to 21%. That's a loss of more than six percentage points of GDP in the course of four years, five years. That basically is, in a sense, the tie-in to the issue we discussed in the previous session.

This is basically not a sustainable development. This means that the infrastructural investments and other public funds that are necessary to finance the rural development just isn't going to be there unless this trend is reversed. For that matter, public funds for public health, for social safety nets, for education, is just going to be squeezed to the bone. So the point I would like to make in this particular connection is basically that, one -- and this is very much along the lines of what you said -- the government of Vietnam cannot afford to, if I may be so frank as using a colloquial expression, screw up the tax reform

that is coming on-line from the beginning of 1999 -- the VAT and the enterprise income tax. This is a key step to reducing this trend, and it's imperative that the rest of 1998 is spent in adequate preparation for that tax reform, because the value added tax is, hopefully in Vietnam as most other places, going to be a very buoyant source of tax revenue. If I may just add one point to this. What this really means is that the elasticity of central government revenue with respect to GDP has gone down from -- basically the ratio of growth of revenues to the growth of GDP -- has gone down from about 1.6 to the area of 0.5.

Second, new revenue measures have to be found in addition to this tax reform. There is just no way around it. I think the two key areas that have to be thought about in this particular context is basically the imports tariff structure and the excise taxes. To some extent, this can be done in conjunction with the VAT implementation.

And the third, which is an issue that I must say I never heard discussed which is critical to this development, is simply export processing zones and industrial parks, which is, in Vietnam as everywhere else around the world, basically revenue foregone, because the very basis for these zones are tax incentives and other incentives, but to a large extent, tax incentives. And it is not at all clear, I don't know sufficiently, I don't know enough about these areas in Vietnam to really form a clear judgment, but certainly in many other countries that have experimented with such zones, this comes back to the opportunity costs idea, the value to the economy in terms of attracting foreign direct investments, and attracting export oriented growth, and so forth, has not been anywhere near the cost in terms of budgetary revenue foregone over a long period of time. Quite frequently, the tax concessions are granted for a period of ten to twenty years in these things, and if growth in the economy takes place primarily inside these zones, you can create a very significant gap in your budget.

Let me proceed to my second point which basically has to do with the monetary policy. I would like to make three observations. First of all -- this is in a sense just a trivial observation -- it is that the banking system in Vietnam is in a very bad situation basically. It's in a very bad shape. Let me just give you a quick illustration of this. This top chart shows, focus on the solid line if you will, illustrates the ratio of non-performing assets in the banking system, starting in the first quarter of 1996, the ratio of non-performing assets to total outstanding credits. This is the summer of last year. Since then, based on state bank statistics, its gone down from almost about 15% to about 13%. My contention is that this decline is essentially a mirage and it covers up the real extent of the problem. I do not believe that the real extent of the problem has declined at all since this point. Quite possibly, it has increased. This bottom chart basically shows the same issue -- the extent of non-performing assets as a share of the capital in the banking system. As an average for the banking system as a whole, that ratio of non-performing assets to capital is about 1:1, which effectively means that if the banking system wrote off the total extent of the non-performing assets, the capital base would be wiped out. That's just one of the three points I'd like to make.

The second point is that the early pillars of an effective money market in Vietnam do no longer function. The two markets I have in mind is basically the foreign exchange markets and the treasury bill markets. The extent of trading in those markets have essentially collapsed since late 1996, early 1997. There is virtually no trading going on in either market any longer. And the third observation is basically that interest rate policy is held in a strait jacket with caps on allowed interest rates.

These three things taken together, are basically part of the, if you like, it's not the whole answer obviously, but it's part of the answer to the problems that you raised about insufficient domestic savings mobilization. Basically there was already a significant degree of lack of confidence in the Vietnamese banking system. For example, during the first half of 1997, we witnessed a dramatic shift of deposits in Vietnam, both time and demand deposits, out of what are called non-state banks and into the state banks, basically for the reason that the state banks are assumed to have some sort of implicit deposit insurance, and a lot of people got scared by all the turbulence in the banking system that was published at the end of 1996.

I just don't think it is possible to mobilize in a significant manner more domestic savings, and I refer to Mr. Watanabe who basically just told us that this is really one of the key issues right now. I just don't think that's going to happen unless we see a significant improvement in the confidence in the banking system. And for that matter, unless we see a significant improvement in the functioning of the money market, we're not going to see a banking system that will be able to do basic asset transformation, meaning transforming short-term deposits into long-term credit. There is no way they can do it today, and they need an efficient money market to be able to do that.

In a sense, this just comes back to one of the most critical policy issues facing the Vietnamese government is exactly -- I take your point, Mr. Ohno, that we probably need to demonstrate exactly the extent or the importance of this a little clearer than has been done before. But if we just for the sake of argument take the importance of this at face value, getting some of these key macro-economic points in order is, unless that's done, it's not going to happen. Thank you.

Mr. Verbiest: Thank you, Eric. I would propose that the discussion, we divide, we take it up in two topics. I know the two topics are related, but I think it would be clearer if, for instance, we discussed first issues relating to the financial markets -- Eric just finished with that -- and then take up fiscal issues, unless you have strong opposition. So let's maybe have a sort of target for fifteen, fifteen minutes on each subject. Also I think everybody should participate including the people who are observers, otherwise we will not have lunch.

Prof. Ishikawa: Seven minutes and seven minutes.

Mr. Verbiest: O.K. And then, afterwards, Mr. Dapice and Mr. Steer will make some remarks, because this afternoon, I understand, they might not be here. Ten minutes each?

Prof. Ishikawa: As far as this session is concerned, starting one o'clock.

Mr. Verbiest: Do you want to stop at one o'clock?

Prof. Ishikawa: Yes.

Mr. Verbiest: O.K., so why don't you take some questions relating to financial sector development and reform? Mr. Ohno?

Prof. Ohno: Mr. Watanabe's presentation was very, very informative and interesting, but I have -- he was quite optimistic about what is happening, but Mr. Offerdal was much more pessimistic. I think I share the pessimism of Mr. Offerdal more than the optimism. The reason is as follows. There is an enormous monetization or dongization of the Vietnamese economy as the data shows. But I think this is a macro improvement, not the institutional improvement in the sense that the banking sector is getting any better, because we had much higher inflation before, and people positively avoid holding paper currency, and that was abnormally suppressed, and we are back to a normal level, because inflation expectation was eliminated. So this shows a macro improvement, but it doesn't show any institutional improvement in the confidence in the banking sector. So, I am more pessimistic about the windows of opportunity and all that. I might also add that the increase in gold holding in the rural area versus reduced gold holding in the urban area, I think can be explained by a more diversified asset holdings in the urban area, which is Honda Dream, too, and many hotels and these real assets, which are not simply available in the rural area. In this sense too, I don't think that it is the return of the confidence in the paper currency, dong, but it is just a macro development.

Mr. Verbiest: Thank you. Any other questions on financial?

Prof. Watanabe: I stopped in the middle, so you may have gotten the impression that I was extremely optimistic about what's going on. But if you read those third or fourth or fifth observations, then some of observations actually support what you are saying. But still, monetization is, I think, a very important institutional change. People change their daily activities from borrowing and lending by rice to the borrowing and lending of money. Now, when they begin to organize their daily expenses by using money, then their daily life will be integrated more closely with the market activities. The third observation I made in this report is that the fraction of households which have deposits in the banks didn't change at all over the four years since 1993 to 1997, only 4% in our survey, VLSS '93, 5.1% of households had deposits in the banks. In our survey, only 4.9% of the households have the deposits. So if you look at the number of households with deposits in the banks, no change. This was absolutely surprising to me when I looked at this data. There was really no significant change in this fraction of households which have access to the banking deposit facilities. You asked a question what is the cost of this gold imports. You can think of gold import as opportunity cost of lack of the safe, reliable savings instruments. It's about 400 million dollars, which is about 4 trillion, or 5 trillion Vietnamese dong. A tremendous opportunity cost is there.

But if people have safe reliable saving instruments in the bank or other assets, they don't have to import gold. This gold import is a tremendous opportunity cost that Vietnam is paying, because of the lack of this institutional reliable banking sector. So I totally agree with you in that respect.

Mr. Tu: Thank you. I think there are a lot of interesting problems to discuss, in terms of finance and monetary policy. So, I would like to explain about some points. First, I'd like to talk about tax. Mr. Tajika said that the tax in agriculture is very low. I think this is true, because as you know, in my country the tax in agricultural area, there's only one kind of tax, the tax for usage of land. The tax rates are very small, very low. And as you know, agriculture depends on the weather. When the weather changes, crops are ... so maybe they cannot ... the tax in land usage. That's why portion of agricultural tax is very low in total revenue. The second point is about decentralization he mentioned. Central budget and local budget are widely different between Vietnam and China. So, as you know, in my country, we have 60 provinces. But in 60 provinces, only five or six provinces have central industrial area. Therefore, most provinces are agricultural province. So, we cannot decentralize more to those provinces. Revenue must be collected from rich provinces by government, because most provinces are very poor provinces. That's why there is a difference between Vietnam and China on decentralization. Third point, I would like to touch about fiscal policy. Mr. Offerdal concerned about the finance and revenue reduced, and expenditure reduced and deficit reduced. This being finance for infrastructure reduced is not correct. Actually in this time, we continue to restructure budgets. We reduce the government expenditure. We don't reduce capital expenditure. It's not correct when you say that the government reduces capital expenditure for infrastructure. I don't think so.

Another one, I'd like to say about how the revenue reduced. Because as you know, if you increase the revenue, the portion between the revenue and GDP is limited, we cannot increase. So if you want to develop my country, you must reduce the portion between the revenue and GDP, to help the economic agency, to try to invest themselves. That's why we try to keep the revenue is fairly [...] We understand that first time, when you do economic reform, the revenue must be increased. Because when my country is planning economy, we depend a lot on foreign aid, so now we try to do autonomy in my country. That's why we try to increase the revenue. When we think this is enough, we must reduce. Now, our policy is stable revenue, the ratio between the revenue and GDP is about 20%. And when economy agency have so much profit, they can invest themselves to improve the economy.

Fourth point is that I would like to discuss about the monetary policy. Mr. Watanabe and Mr. Ohno were talking about a lot of gold and dollar economy in Vietnam. It was true in last few years, because when inflation was very high, most Vietnamese people tried to diversify their savings into gold and dollars. But from 1994, when we reduced the inflation, the domestic currency became more trendy. So, the demand for gold and dollar reduced. That's why when the financial crisis in Asian countries happened last year, the demand for gold did not increase in my country. When you see the gold price in my country, you can't say nobody buys gold, because the value of dong currency. What I

mean is that the expectation is reduced, because as you know, the expectation of inflation was reduced. Motorbike, too. Now in our country, motorbike is not important. They cannot put money to buy motorbike. Honda Company invests into Hanoi and now the price is reduced. Expectation on motorbike is reduced so much, that's why we cannot buy motorbike instead of savings. So, one big problem is, in this field, the non-performing loans. Because it's very difficult for banks, for most commercial banks, to try to provide loans, but they face risk, because there's a lot of problem when you provide loans to economic agency. This is why they are afraid to mobilize deposits. It's my opinion. It's my mind. Now, you try to reduce bad loans and improve consumer banks, and how can you do that. When trend is that the banking system, the consumer banks, should improve the deposit in our country. That's why Mr. Watanabe discussed on how we change a little bit. I think. It's some of my points. Thank you.

Mr. Verbiest: We have very little time left. There are several speakers but I would like to ask Mr. Todoroki to talk and then maybe Eric Offerdal ... So I have Eric Offerdal, Prof. Ryuichi Tajika, if you can make it in five minutes. That's it.

Mr. Offerdal: First of all, I didn't see my presentation and Prof. Watanabe's presentation as sort of being two opposites. But I did have sort of a suggestion. I thought your survey was extremely interesting, and I would encourage you to actually use some of your survey materials to try to estimate money demand, and shifts in money demand, because that's clearly one of the key difficulties in setting monetary policies is to get a sense of what money demand really is, and I think that would be an important contribution.

To your points, Mr. Tu, I didn't really say the government has reduced infrastructural investment. My point was that in the future, its ability to continue its current level would be limited, if that revenue decline continuously. But I am aware that infrastructure so far has been stable. On your second point, keeping a stable revenue to GDP ratio at its current level to stimulate the economy, I think, the key you have to look at is not really the revenue to GDP ratio, it's the structure of the tax system, and enforcement of the tax system. That's really the key in a sense to stimulate entrepreneurial activity in the economy more, and you can easily do that through the structure of the tax system, and at the same time, achieve a higher revenue to GDP ratio. Thirdly, inflation expectations. Yes, they are down. Confidence in the currency is absolutely not down. There is no question about that. I mean, just look at what's going on in the foreign exchange market.

Prof. Horiuchi: I would like to make very quick response to Eric's comments. I substantially share Eric's concern with the bad loan problems in Vietnam. Table 6 of my background paper may give a quite similar picture to your comments. So, the problem is how to deal with this problem as soon as possible. I hope we will discuss this point in the afternoon session. This is my comment.

Prof. Tajika: My replies to Mr. Tu. Well, two or three. One is that he raised a very interesting point that Vietnam's revenue to GDP ratio went up to more than a quarter, now

20%. He said 20% is getting to be enough. Well, I have a very different idea about it. In East Asian countries, revenue to GDP ratio is about 20%, but what is different from East Asian countries and Vietnam? The difference is savings. Here the importance of government revenue in Vietnam is that it's a part of savings, right? So in an economy which lacks savings, I think that public savings is very important. In this conjunction, I think 20% is far from enough. That is my reaction to it.

And as for the agricultural tax, I think here is a very important field of research. The question is that agricultural sector has been really taxed low or whether they are really heavily taxed. Two things to be considered. One is in the price differentials between export price and farm ... price. This is kind of an implicit tax. Another tax is ... I mentioned commune level, kind of fees and taxes. So we have to be very much careful about it.

And as for the centralization, if Mr. Tu agrees that Vietnam is going toward more centralization than China, I will be very much satisfied with that statement. It's very difficult to even conceptualize that sort of thing. If we agree in this meeting that China toward decentralization, and Vietnam towards more centralization, I think that is a big reward to my research. Thank you very much.

Mr. Verbiest: Thank you very much. I think we still have a lot to discuss on these two topics. I think this afternoon, actually, this is a good transition to this afternoon's session, because a lot of the issues will come back to haunt us this afternoon when we talk about the regional crisis. We want to keep you from lunch for a few more minutes, because two of our colleagues, Mr. Andrew Steer and David Dapice are leaving this afternoon, because they have a plane schedule. We would like them to very briefly say a few words on how they see this workshop and the discussions we had on the different topics, and maybe make a few remarks on how we can continue our collaboration with the Working Group on Vietnam, JICA, and with our Vietnamese colleagues, of course. So maybe David first?

Dr. Dapice: I think we are all hungry so I will be very brief. The thing I've had reconfirmed from the very useful research that has been done and the discussions we've had, which I've learned things from is that development can bog down. It can get stuck. A lot of our discussion has been finding a balance of state, foreign, and private economic actors that together create enough efficiency and market driven technical upgrading, and discovering and penetrating markets that you raise your level of income and create jobs, and so on. I think there is a danger of being stuck in what has been called the "twilight zone". You clearly have made progress on deregulating product and labor markets. There is a lot more to go on capital and land markets. They're more or less stuck, I think. I think there is a problem of urban bias in the economy. The way the banking system works, the way the exchange rate works, the implicit subsidies to state enterprises, I think all of these things, and I would agree with Mr. Tajika's comment, that the visible taxes on agriculture, well, they are low. The total burden of agriculture from the economic system including the exchange rate, including the trade monopolies, including the commune level taxes, can be, in many cases, quite severe. I would add to that, that when there are, and again I

come back to this point, when there are economic disasters, natural disasters, the burden on public infrastructure replacement is often shared out to the very people who have been hit by a kind of labor contribution. And this again in most countries, you replace public infrastructure and you pay wages, you know, to the people. You don't just provide the cement. I think that point needs to be considered.

I think ODA needs to be used and can be used to help continue and accelerate the process of reform by reducing the perceived risks of taking steps in that direction and also reducing the transitional costs of reform, which will be real. I think if the ODA is skillfully directed, you can refocus activities which in some cases are wealth destroying or merely re-distributive into wealth creating activities. You really do need again to get the firms and the farmers focused on doing things that are efficient or nearly efficient at world prices, not responding to distorted ones. I think there are many examples where you've managed to produce things but at very, very high costs, and I think the problem in Vietnam still is that many people's training is on the production and engineering side and they don't think in terms of profitability or whether or not it makes the nation richer. They think whether or not the thing can be produced. And there is a tension between those two things very often, and I think it needs to be understood more clearly.

The other thing I've taken away from this is that many of the problems we've discussed, and we've all admitted, are inter-related. The SOEs, the banking, the rural, small and medium, all of these really run into each other. To disentangle it we need really to think across the sectors as I think we've been trying to, think across the sectors, not just tackle one at a time. We need to be aware that one thing is really hitting another. Again, here I think the ODA can correct market failures, help correct market failures, but it must take care not to intensify government failure. Government can make things worse, and we don't want to do that. I think all of the warnings about needing to make sure that the financial system has better supervision, that the project selection is more careful, that the prices are reasonable and so on, are examples of potential government policy-induced failure.

The other thing that I think we have not maybe spent enough time on is the problems of information and transparency. There is simply no reason in the world why Vietnam, unlike Myanmar, Mongolia, Cambodia, and Laos should not have pages in the IMF book. You are as good as Laos. You really need to decide to play by the rules that everyone else in the world is playing by. You can't globalize if things are totally unavailable to investors. And this is true at a micro level and it's true at a macro level, and I think the Asian crisis, which we are going to talk about, just underlines that, and I think we need to simply recognize that and move on it. That would mean that if you force firms, especially SOEs, to publish meaningful financial statements, then I think you could equitize honestly and quickly. I think you need to follow China's lead here, get the state enterprises down to maybe a few hundred, maybe a few dozen big ones, I don't know, but certainly 5000 can be equitized safely without changing the fundamental center of gravity of what you want to do.

I think competitiveness requires competition. You really do need to think through the industrial structure. Right now, the way the banks work, the exchange rate, the electricity, it's hard for Vietnamese firms to compete with imports, and it's also hard sometimes for private firms to compete effectively with state firms for reasons we've discussed before.

I think the government would do best to shrink its focus and do better what it must do and not try to do what it would like to do but can't really do very well. I think obviously, preventive health and education, macro stability in financial development as we have discussed, crucial infrastructure, both physical and legal and regulatory, are things the government must do. I mean, there is no one else to do them. Other areas really are ones I think where you can either encourage private or foreign or joint venture activities, but not try to take so much of a direct role yourselves. And if you focus on the government's comparative advantage, it seems to me things will go much more smoothly.

Now, how to persuade others of that -- I think many sitting around the table understand these issues very, very well -- I think, needs a combination of research and persuasion, and I think the research could be collaborative. I think the persuasion will have to be by taking very, very clear, like Mr. Ohno was saying, we do need to take very, very clear comparisons of, you know, this is what one project is costing, this is what we could do with that money in a rural area or small and medium, or things like that. His implicit suggestion was exactly right. I think that kind of illustrative research, the persuasive research, which would be absolutely true to the truth but aimed at persuasion, is more of what is needed now to create more of a consensus in Vietnam, that these steps are really necessary. Thank you.

Mr. Verbiest: Thank you. Mr. Steer, please.

Mr. Steer: Thanks very much. This conference seminar has been terrifically relevant. This has been the ideal time for such a seminar, the subject matter has been perfect. I mean, what could be more relevant than financial sector reform, state enterprise reform, rural development, industrialization, right now in Vietnam? It's very, very relevant. I know when this study was started, Vietnam was on the move. It was rising quickly up its trajectory, all kinds of possibilities lay before it. Life now is much more difficult. And I was reminded of that as I looked in Prof. Horiuchi's paper where it lays out the five year development plan targets. It was assuming 8 billion dollars of ODA. I hope that's the ODA. I think it's highly unlikely. It's running at one billion a year. So it's probable that there will be a 2 billion shortfall of disbursements of ODA. FDI, 14 billion during the five year period. Realistically, ten would be good. So already there's five billion dollars gone. The investment-to-GDP ratio -- 30% was the target. Let's hope it's that, but I think realistically we have to assume that is not. So life now is much tougher for Vietnam than when this report and this research effort started, and I think it's to the great credit of the researchers in this room, and even more so perhaps the representatives of the Vietnamese government that we have been able to reorientate the discussion here to one in which things are just all together more urgent.

This is a very exciting time in Vietnam. Those of you who don't live in Vietnam won't know this, but if you spoke to Dr. Thai or Mr. Ly or almost any of these people, two weeks ago or three weeks ago, and you said, how was your Tet holiday, they sort of said, what Tet holiday? They didn't take one this year. Normally you take a month off. This year, everybody was working much harder from what I understand than normally. There are more decrees coming out, more actions going forward, and I think what we in this room ought to be trying to help you with is to make all these actions and these decrees add up to something, that sets this economy on a growth path again, and I think we really are very keen to do that.

As I look at the last day and a half, I see a really pretty strong consensus, actually. The strong consensus are there are a number of immediate actions that the government says it wants to do, and we all in this room think are important. They relate to liberating small and medium entrepreneurs, reforming state owned enterprises on a more rapid accelerated schedule than had earlier been planned, reform the banking structure in a very firm, strong way that recognizes bad loans and so on, switch expenditures away from capital intensive projects towards employment generating and rural projects. As far as I can tell, there is agreement in this room on that. There is also agreement that now more than ever, every yen, every dollar, every dong has to be allocated with thought about what its going to generate in employment and poverty, and so on. For that there is a desperate shortage of information to enable those decisions to be made accurately now, and it seems to me that one of the things that has come fresh again to me is how exciting it is when someone flashes some information on the board which, as David says, in most countries one would see this all the time, but in Vietnam we don't have access to state enterprise financial data, even to budget data. And it seems to me that, one, as we think about sort of a next era of work, that has to be one. And Mr. Tu is smiling, because he knows that his minister is determined to bring more transparency, and over the next six months, we really hope, and we will support you to bring the budget data, and Minister Hung of finance, he said, two weeks ago, he said, why should people pay taxes in this country and not know where their tax dollars are going, tax dong, are going for? We need to bring that transparency. We need to bring transparency in the state enterprise sector so workers in state enterprise can know what ... and if all this happens, it will be very exciting and would enable us really to make a bigger contribution together with you. So I think there's a lot of agreement, actually.

Is there disagreement at all in this room? Prof. Ishikawa and I, last night we were talking. He was suggesting, maybe the difference is in timing. Maybe people like Eric is sort of one side of the spectrum; don't do it today, do it yesterday, and some of the researchers may be a little more thinking, no, it needs to be thought through a little bit. I think that's true, although I think in general, all of us in the current climate recognize things have to be done more quickly rather than slowly. I think on trade policy reform that's the area where there still would be some disagreement about the pace of trade policy reform. But I suspect that even in the question I asked yesterday about what should we be advising the People's Committee in Haiphong in terms of setting up a special economic zone, my guess is, although maybe this will lead to a discussion that will totally end our lunch possibilities, my guess is we would probably agree. Let me say what I would understand.

We would probably say to the mayor or the People's Committee chairman, yes, have a special economic zone and plot all kinds of mechanisms that would make life easier for investor -- deregulate, give access to land, give access to credit in a sensible, modern way. And all of these mechanisms that we would recommend for Haiphong, later on should be applied to the entire country, to everybody. And the only reason you do it in Haiphong and you'd call it a special economic zone is because we need to pilot things before we do them countrywide, because we don't really know exactly what would work. That's an extremely important distinction from a special economic zone which would say, we are going to give tax breaks here, or we are going to put public money in here, which of course we couldn't do countrywide, because we don't have that money available. So in other words, a special economic zone is piloting what are sort of win-win or whatever options you want to call it, that really ought to be applied to the whole country. Now my guess is in this room, we would all agree that that's the best meaning of a special economic zone.

Now there may be a few people in this room that would say, no, you have to go further than that, you have to put public money in and pick the winner of Haiphong as opposed to Ha Tinh province, say, because we think that ... Now, if that is the view, then we do still have some professional differences in this room. My view is though you ought to do it the way of sort of piloting the win-win.

What would be the next steps? What struck me, Dr. Thai and Prof. Ishikawa, as I've spent the last day and a half here is the fantastic research data that had been accumulated in this project. It would be a tragedy if that were lost. The other thing that struck me is the fantastic human capital in the minds and brains of the researchers that has been built up in this project, and it would be a great shame if that were to be lost. So I hope some mechanism is found that the researchers that have been working on this project stay engaged with Vietnam. That would be a great loss if that didn't happen. And also it seems to me that the basic data needs to be made available. To some extent the data, the contribution from the project that I find the most useful is not in volume 1 of this fabulous 4 volume set. It's actually volumes, you know, in the annexes in volume 4 and 3. It's the sort of the raw data, some of those numbers put on the screen this morning really fascinating. And I would recommend that they get out into the research community more generally.

It struck me, Dr. Thai, that one thing we might want to consider is there ought to be a kind of a network of researchers working on Vietnam. You know, we might even consider having something like a research fair each year that would bring people researching on Vietnam, especially obviously Vietnamese researchers, but in addition, international researchers where we'd focus on rural credit and whatever, four or five topics, and it's something we might want to consider that it seems to me your group would be very well qualified to really engage in making the whole add up to something. My experience is that most of the people in the U.N. or the World Bank even, working on rural development wouldn't know the fantastic work that's being done at the University of Tokyo on rural credit in Vietnam. So it seems to me that's something that we ought to do.

With regard to the next stage of the actual project, I know this was Phase 2, and I know there is not planned to be a big Phase 3, but I hope there is some modest Phase 3. It seems to me that there are some really important issues that still need to be looked at using the skills of your team, the Vietnamese team, and the Japanese team. I won't go down them, but I mean, there are several, ranging from the highly technical like somebody ought to figure out what protection really is in Vietnam, not just using tariffs, for example. There are many, many other issues, so let me not go into them.

Let me finally say a word about frankness. I hope that we haven't been too frank on this side of the table. I mean, Eric has been too frank, but I hope that I haven't. I was really very, very struck. One of my privileges in my job is to chair the consultative group meeting, just as Mr. Watez chairs the monthly meeting of donors in Hanoi, and one of the things that really struck me when we were here last time in Tokyo was the fantastic affection that foreigners, especially the sort of the friends of Vietnam, the donors, the researchers that they have for Vietnam. I don't think there is another country on earth that researchers and donors are genuinely more fond of, that they genuinely like, partly because the Vietnamese authorities are working so hard to get it right, partly because there are all kinds of exciting innovations going on, and partly because we just like what's happening so much, we just like the country. Because there is that affection, there was a frankness and an honest interchange at the consultative group meeting that was in many ways more frank than it was -- and I have been to many consultative group meetings -- than it was in many other countries. And when I wrote to the authorities afterwards including the Prime Minister, I made that point that I hadn't seen that degree of affection, and I hadn't seen such constructive interchange. So I hope that you understand that when there's been some fairly tough statements, that it's made in a spirit of, "we are on your side" and trying to move things forward, which I believe this conference is actually playing a very valuable role in doing. So thank you very much.

Mr. Verbiest: Thank you, Andrew. I think this was an excellent end of the morning. I understand from Andrew that the World Bank will finance the creation of a web site on Vietnam on the internet, which we now have in Vietnam. Maybe we should do that. There are research networks specializing in different areas. Maybe we could, I mean some of the universities here could take some subjects, I think. Maybe you could do that. Anyway, I think at this stage we should break for lunch.

Session 6: Financial Turmoil

Chair: Mr. Watzel

Mr. Watzel: Good afternoon, everybody. As Prof. Ishikawa just announced to you, the subject is the financial turmoil in Asia, and the impact on Vietnam. As it is perceived both by external actors working in Vietnam and maybe even more important as it is perceived by the Vietnamese leadership itself, and the evolution of their thinking about this crisis which started roughly, at least formally, in July 1997. I think we spoke in a way in the previous sessions a lot about the ingredients of the impact of the crisis in Vietnam, and this subject comes very naturally towards the end of the discussion.

Is this crisis in a way a window of opportunity for Vietnam? Originally, as seen from within, like an ODA representative working in Vietnam, I had the feeling it was perceived first by the Vietnamese authorities like a threat from which to some extent -- and this is my foreign interpretation -- from which to some extent they were protected by the fact that there was a number of protection around the country. Some would call that rigidities, there was no stock exchange, so the threat, the financial threat in particular, was not felt as immediate. Now as time elapses, clearly the problems and the issues seem to be more next door, in particular, concerning the impact on the exports for Vietnam, and many other issues. So we have the feeling, again as foreign actors, that Vietnam has an evolving thinking about the crisis, maybe start to see it as a window for opportunity for continuous reform, and maybe more dynamic reform after what some people called a stalemate for some two years or so. So first, I would like to give the floor to Prof. Horiuchi, and then we will go to four other speakers, and we will terminate by Prof. Thai and his colleagues.

So, Prof. Horiuchi please.

Prof. Horiuchi: Thank you, Mr. Chairman. As the chairman talked to us, since middle of last year, some countries in Southeast Asian area have been suffering from the so-called financial turmoil. We are seriously worried about the so-called contagious effect of this turmoil on Vietnam's economy. Of course, this topic should have been a main target of our research group who were in charge of examining the macro-economic policies and the financial system in Vietnam. But unfortunately, we couldn't have much time to examine this phenomenon, because we had almost finished the second phase report until March of last year. So, we quickly organized ad hoc research committees consisting of some outside experts who have been majoring in international finance, financing and international trade, like Prof. Akira Kohsaka sitting behind us, and some other scholars in various universities. And Ken'ichi Ohno took the responsibility of drafting the report of our ad hoc committees. And our committees spent a few months to investigate to what extent the current financial crisis in Southeast Asian countries will influence the development process in Vietnam's economy. We are now just arriving at the final stage of preparing the ad hoc report. But unfortunately, we have not yet obtained the internal agreement regarding the publication of the report. So today, we are not distributing the final version of our report. But Ken'ichi Ohno will talk about the full

content of our ad hoc report, so I would like to pass the task of explaining our research to Ken'ichi.

Prof. Ohno: As Prof. Horiuchi just said, the report is completed, but it's being circulated and being cleared by both the Vietnamese side and the Japanese side, so it's not available at this point, but I will give you the full details, so you don't have to read the report. You'll get all the conclusions with numbers and concrete proposals. However, you have this Background Paper 5-1, which is basically the same as the completed report except you will notice that there will be some reshuffling of materials and some new materials and deleted materials, so basically the same. So you can follow this. Although this data contained here is up to January, we have updated to March, this year, and we have other new figures and tables, but I will talk about them without presenting them visually.

In the introduction, we just say that Vietnam's past several years' achievement of high growth was very impressive, and this was achieved basically by domestic liberalization, Doi Moi policy, and external opening, and ODA, FDI effect. This is basically a temporary spurt effect. As this effect wears out, there are two external constraints to growth. One is free trade commitments -- these are positive factors, but could become a constraint -- and the currency and financial shocks. So the idea here is Vietnam must manage these two new external constraints well in order to sustain the growth. I think this idea is just in line with what we've been talking about in the last one-and-a-half days.

We have four scenarios as agreed by the two governments, and we will discuss one by one. But at the outset, let me say that these four scenarios are presented separately, but they are very closely interdependent. So this separation of discussion is just nominal. They are actually, they are really closely related.

The first scenario is exchange rate management in order to avoid overvaluation. This is the most urgent topic, because it's already with us, and the remaining three scenarios are potential risks, but this first one is the one that we have to solve now. So I spent half of the pages to this scenario one. At the beginning, we set up a competitiveness monitoring system, basically the real effective exchange rates and its derivatives. Actually, we have Excel files contained in four or five diskettes, which I am sure will be available after completing the clearance, and monthly you can punch in numbers and you can just update, continuously update. We have calculated three overall competitiveness indexes. We have indexes for eight major exports like rice, rubber and so forth. We have indices for the individual trading partners and the group of partners. You can see these in the handout (Background Paper 5-1), pages 9 through 11. We have updated, but basically the formats are the same.

Overall index. Real effective exchange rate is the most common one used to look at the overall competitiveness. But there is one problem with Vietnam. Vietnam's extremely vertical structure of trade means that its major trading partners are developed countries, and NICs, like Korea and Hong Kong. But Vietnam's actual competitors are not developed countries, but ASEAN4, ASEAN countries and China. So if you use real

effective exchange rate index, then you will underestimate the impact of China and ASEAN4. That's why we have two additional overall indexes. The additional ones are FDI share-based. These are Asian index. This is the FDI received by several Asian countries. The competitors of Vietnam are weighted. That's the first additional one. The second additional one is the same Asian countries, but weighted by their global trade shares. So these two overall indices complement the real effective exchange rate, which underestimates China and ASEAN impact.

For example, if you look at the change of competitiveness between June 1997 prior to baht crisis to present time, March 1998, by real effective exchange rate index, Vietnam lost 13% of price competitiveness, by FDI share index, 16%, and by global trade share of Asian countries, 27%. So they yield different results. If you look at primary commodity exports one by one, the results are mixed and overall not too seriously affected. Some might object to this, but this is the impression we got from talking to many people and looking at many indices. I can go into details. It's in the draft of the paper. So primary commodity exports are relatively O.K., including rice because the world demand for Vietnamese-type rice is increasing, and the price is pretty strong, and the export contracts, at least for this year, is going very well in spite of the fact that they have lost 40 dollars per ton, because of the Thai baht impact.

If you look at the garment and other FDI related industries, contracted manufacturing, there is no serious short-term damage, but there is a serious concern about medium and long-term shift of production from Vietnam to other countries, like Indonesia and Thailand. So the short-term, immediate impact is small, but if the production basis moves, then that will be a damage to Vietnam.

Tourism is seriously affected. There is no doubt about that. But that is not only because of the Asian crisis but also just simply overbuilding of hotels and other facilities which is a natural consequence of bubble, real estate bubbles.

We say then that exchange rate policy in general, there is no perfect exchange rate management formula for all countries at all times. Exchange rate policy must always mix two contradictory goals. One is stability, the other one is flexibility. Exchange rate stability is very necessary to generate confidence in policies and the Vietnamese dong in order to reduce inflation, but stability tends to create overvaluation over time. Exchange rate flexibility is also needed to regain competitiveness. But if you use this too often, then this tends to accommodate price shocks too easily. So these are two difficult choices.

Vietnam between 1992 and 1996 was basically adopting the exchange rate nominal anchor policy by fixing the actual exchange rate very close to 11,000 dong to the U.S. dollar, and I think this was very successful at that time in reducing inflation and building confidence in the Vietnamese dong. But things have changed since 1997. The government has adopted more flexibility in exchange rate management. There are two ways to do this, actually they have done this in two ways. One is to change central rate, and the other one is to widen the band. They used these two techniques to what in effect is something like adjustable peg to the dollar. I strongly support this increased flexibility,

and escape from the complete rigidity. However, this is pretty ad hoc, and it's pretty unpredictable what will happen next to the investors and traders. Our proposal is to make it more formal, institutionalized, rule-based, rather than ad hoc political decisions.

Our policy proposal is as follows. First, devalue the dong. This is all based on March 1998 information. If the situation changes, then I will have different recommendations, but based on today's information, we propose to devalue the dong further, moderately. More specifically, central rate should be moved from 11,800 to 14,160. That means 20% devaluation of the central rate. However, this is not the actual rate. The actual rate is -- there is a band of 10%. We proposed narrowing of the band to 5% plus or minus. So the actual today's rate is something like 12,980 or something like 13,000. If you narrow the band but increase the central rate, you will get at the maximum 14.5% effective actual devaluation. If the exchange rate stays at the bottom of the band, it's only 3.6%. So what I am saying is the actual devaluation initially of between 3.6 and 14.5, and I would call this a relatively moderate devaluation. It's not 30%, it's not 0%. The reason we go for moderate devaluation initially in this month is we see dangers and risks in non-devaluation as well as very large devaluation. I can give you the details, but we want to strike the balance between the two. This is just the first part. First, devalue moderately.

The second is to introduce a new system. There are three options we have presented, and you can choose one of these. It's in the handout. One is multiple currency basket. The second is adjustable peg to the dollar, the continuation of the dollar peg, with monthly reviews. And the third one is currency basket with inflation slide. The first one automatically adjusts nominal movements of other currencies. It's automatic stabilizer of nominal effective exchange rate. The third one is a stabilizer of real effective exchange rate. And the second one just does it by manual, not auto-pilot, but by monthly reviews. Any of these will be O.K. if properly managed and executed.

We proposed one of these things in order to install a sort of semi-automatic mechanism to avoid systematic overvaluation. At present, exchange rate management is a political decision. It invites speculation, it invites resentment, and there is a pressure not to devalue and to devalue, and it's a whole political process. We want to take this political element out of the exchange rate management without giving up this adjustable peg flavor. That's why we propose that exchange rate adjustment should be small, frequent, and rule-based, and should be done daily by state bank of Vietnam rather than the highest level. And the highest level political decisions are needed only for revising the general rules or only in an emergency.

There is one other question of optimal weights for currency basket. If you adopt the first or third options of currency basket, then what are the appropriate weights? We have done simulations of five scenarios. The first two are actual historical scenarios, and the other three are hypothetical ones, 20% devaluation of the Chinese Renminbi, and Chinese devaluation plus ASEAN further devaluation, and then the last one is ASEAN currencies go back to a more normal higher level. And then we calculated -- we did it like this. There is a hard currency basket composed of yen, dollar, and ECU. Then, there's another basket called Asian basket which is composed of Chinese yuan, and the half of it is China,

and the rest is ASEAN4 equally divided. So we took the linear combination of these two varying weights from 0.1 to 0.2, 0.3, and so forth, and looked at how the exchange rate would have behaved if Vietnam adopted these baskets, and against these five scenarios. It's all in the paper, but we found out that if you just adopt the hard currency weights of Japan, and the U.S. and Europe, then you don't adjust very much if there's an Asian currency crisis, because there's no automatic following, obviously, because developed country currencies have not changed very much. But if you adopted the Asian basket of China and ASEAN4, I think you have overcompensated, your real effective exchange rate would actually depreciate rather than offset. There's an overcompensation, because Vietnam's competitiveness against other non-Asian countries will actually improve tremendously. So I think my guess is 0.6 weight to hard currencies -- hard currencies give you stability -- and Asian basket gives you flexibility or adjustment. So I think 0.6 weight to hard currency and 0.4 weight to Asian currencies is something that Vietnam can live with. I don't quarrel with the decimal points. It could be half-and-half and so forth. But something like that will give you an automatic nice offset against all these five scenarios. So the actual contents would be as follows, if you adopt this formula: Japan, U.S., EU and China, each gets 20% weight, and the remaining 20% weight will be shared equally by ASEAN4 countries; 0.05, 5% each. Something like this would have a very nice effect of not having to devalue so much manually. So that's our proposal in scenario one.

Scenario two is external currency crisis. This is very closely related to scenario three of domestic banking crisis. In fact, in a financially integrated world, external currency crisis and domestic banking crisis tend to occur simultaneously, but we've just discussed these separately. As you know, in the 1990s, we are living in the securitization world and the emerging markets. Private funds flow to LDCs, not mainly in the bank loans form, but in the securities form, the bonds market and security markets set up by these LDCs. Vietnam is not an emerging market yet. It doesn't have a stock market yet, but it is thinking of creating one. And the consequence of this securitization and emerging markets, which is only a 1990s phenomena, is a very volatile capital movements. And two major currency crises already happening in the developing world; in Mexico and Asia. So we are living in a very volatile world in the 1990s. There are phenomena like herding, overborrowing, bubbles, reversals, and so forth, and there is no rescheduling negotiation with these markets. When something happens, they just leave, the investors will leave. There's no negotiation possibilities.

There are merits and demerits to early financial liberalization, and that's in the handout. Merits are you can get more money, you can get knowledge spillover, and you can get the discipline in policy. However, the demerits of early financial liberalizers is instability inherent in these global financial market will be important, magnification effect -- a small mistake will be magnified rather than offset -- and then international contagion, and unequal distribution of funds.

So given this, we proposed the following two-part strategy for the Vietnamese financial opening. And this two-part strategy was actually borrowed from the World Bank publication, "World Development Report" of 1997, which discussed the institutional building, but we borrowed the idea and the term for financial opening.

The first part says, match the degree of financial liberalization to the existing policy capability and institutional capability. In other words, if you are not well-prepared, don't open so quickly. If you are well-prepared, open up. That's basically a static statement.

The second part says that over time, improve financial institutions and policy capabilities. These institutions and capabilities are not a given, but can be built, so build them. But we recognize that it will take time, especially for countries like Vietnam. I think Mr. Offerdal may have different ideas, because I have read his comments, and he says rapid financial integration is desirable for Vietnam. But Vietnam has to do many things before it opens up completely financially.

First of all, banking sector reform, and second, SOE reform, third, fiscal reform that we've been talking of -- we've been talking about all of these things -- and monetary policy reform, and then improving exchange rate management system, which is scenario one. These things cannot be achieved overnight. It will take a considerable time to upgrade SOEs, upgrade the banking system and down the line, except maybe the exchange rate management system that I discussed in scenario one could be implemented overnight. But other ones cannot be done overnight. So some policies, some reforms, can go ahead compared with others, but I don't think full financial liberalization is desirable if other aspects of the reforms are not significantly put into place. The important thing is that the Vietnamese government retain self-control of its own financial and economic destiny. If you open up too fast without preparation, you will lose your control, and look at what happened in Thailand and Korea and Indonesia and so forth. That's the main part of our financial opening story, a two-part strategy.

Additionally, we also have the currency crisis early warning system, which is just suggested in the handout, but we have actually created one with actual numbers, except that we couldn't get very good monthly data, so we used annual data, and then it's very crude and experimental, but we have some table in the completed paper. This currency crisis warning system is based on the IMF working paper done by Kaminsky and others.

Secondly, Vietnam should additionally curb a lending boom, if it occurs. If you open up with good preparation, but if the lending boom and overborrowing occurs, then stop it, curb it. This is just a copying of the ideas that was presented in the World Bank's 1997 report. It's not our idea. Everybody says so. That's scenario two.

Scenario three -- bad debt problem and domestic banking crisis. Now, Vietnam already had lots of financial crises in the past, so the important thing is to avoid new ones. When you open up financially, even gradually, the World Bank document says that financial openness will magnify shocks and costs of these banking crises. So you have to be extra careful compared with when your economy is more insular. So the first thing we say, I spend a couple of pages, is that prudential regulations and banking supervision are key. I am sure everyone agrees to this. And information disclosure is also very crucial. These are fundamental solutions to the weak banking sector.

But this is a long-term solution. We recognize this. We say this and we don't expect this to happen next month, or even next year, completely. So, as Prof. Horiuchi said this morning, we need short-term measures to improve Vietnamese banking sector when it is still imperfect. We propose three or four things.

First, as for state owned banks, we recommend rapid commercialization to make it real commercial banks, not the state allocated mechanism. But we do not immediately recommend the equitization or privatization. There may be some arguments still left within us about this one. That's the state owned banks. As for small private stock banks, we recommend bank re-registration like there were SOE re-registration. Require some information to be disclosed even not up to international standards, some essential numbers. If they don't comply, they will get no further registration. They will be closed. If they provide numbers, depending on the numbers, the government should decide whether to restructure, merge, close, or that it survive as it is. So even based on rather incomplete information, you should take a strong measure to close some of these private stock banks.

And the third point is when you do this, protect the depositors one hundred percent. In other words, even for failing banks, you should not let the depositors lose. This is an implicit deposit guarantee mechanism. And this is a very controversial point. Maybe, Mr. Offerdal may disagree. And there was also disagreement among us, too. But I think if you have a one hundred percent deposit insurance, we know that there will be a moral hazard problem. But on the other hand, in Vietnam, there is a problem of confidence building in the banking sector, which is completely lacking. We think that for Vietnam, moral hazard is less of a danger than confidence building. If you let the depositors lose, I don't think they will come back to the banks. So this is a tough decision, but I think the Vietnamese government should protect depositors a hundred percent.

And then, the remaining measures were already discussed by Prof. Horiuchi, that is, encourage joint venture banks, encourage syndicated loans, and try long-term credit banks. The report also has some section that says, if unfortunately a banking crisis occurs, then what to do. The important thing is, there are two things that should not be mixed. One is for a few days when the real crisis panic happens, then the state bank should provide liquidity unlimitedly, and unconditionally. This is the lender of last resort. But that's only for the panic period. Immediately after the panic period, start restructuring. Don't mix these things. Don't try to close banks when there is a panic.

Lastly, scenario four is about the saving and investment gap and external debt. We have constructed a simple savings investment external borrowing model, which is quite different from what the handout has. We have a high savings scenario, and a low savings scenario. A high savings scenario assumes that the savings ratio will go up from the current low level to nearly 30% over several years. Low savings scenario assumes that it will stay below 20%, goes up at most to 20%. So there's a 10% difference in savings rate. And then, I will cut the details, but the upshot is the big problem for Vietnam now and in the foreseeable future is not the debt burden problem. The problem is not the repayment, because most of the money that is coming in now is ODA with very generous terms.

There is a technical question of FDI related debt and the rural debt conversion rate, but I will not discuss this. Even in the low savings scenario, there's no big problem of debt repayment burden, debt service burden. The bigger problem is the savings shortage, that if you want investment of 30% or 35% of GDP, and a savings of only 20%, 15% gap must be financed externally, and I don't think ODA and FDI can fill this gap permanently. So you will face the problem of whether to squeeze the growth, or squeeze imports, or not paying the debt, running into arrears, all of which are undesirable.

So this leads back to the point that Prof. Horiuchi made that you cannot really borrow so much in order to grow at 8%, 9%, or 10%, and then also links up to the importance of domestic savings mobilization. But if Vietnam becomes an emerging market, and if Vietnam opens up financially and starts to borrow and overborrows, then it's a completely different story. As I said, in scenario two, I said, don't borrow, don't open up so quickly. But if you borrow too much in these securities ways, then these scenarios must be re-worked, because, in that case, you may have the problem of repaying the debt, and also the bubbles and the reversals. Thank you.

Mr. Watz: Thank you very much. So, without waiting, we're going to let Mr. Offerdal reply or speak or express his point of view.

Mr. Offerdal: I think I'm going to be very brief, in part, because the things I have to say basically are contained in this paper, so I think it's faster for you to just read it rather than having me repeat all the key points. And the second reason why I want to be brief is simply because I don't really think that I have all that many differences with Prof. Ohno. There may be some difference in terms of degree but not really on substance I don't think.

On the issue of what are the implications or the lessons for Vietnam on the financial integration, I guess possibly you could read what I've put in here as a plea for immediate implementation of currency convertibility or something of that sort. That would be a mistake. That's not really the point. The point I was trying to make is really far simpler. It is that Vietnam as well as the other countries in the region have benefited tremendously from the financial integration that has already taken place over the past six to eight years in the case of Vietnam. There's no question that the capital that has come into the country as a result of the opening to foreign direct investment for example, has been one of the pillars of the growth. And the same thing applies for the opening to trade. That's basically been the engine of growth for the economy. My point is really more the following. Don't fall into the trap of looking at the recent crisis as the reason to stop or reverse that integration process. It's not so much a question of how fast should you go in the future, but don't make the mistake of actually stopping the process, which there were clear indications that a lot of people in powerful positions, if I could put it that way, in Vietnam were actually thinking that maybe this whole idea of globalization or financial integration is, on the basis of what has happened in Thailand and Indonesia, simply a bad idea. I don't think it is. That doesn't necessarily mean that Vietnam should go for full convertibility tomorrow or next week.

And clearly, I absolutely agree with the points you are making here, that you have to, to some extent, to match your speed of integration to the institutional capacity you have in the country. I don't think I would fully agree with you that putting that institutional capacity in place is such a tremendously long-term process. Clearly, it does take some time. But Vietnam is in the fortunate position that there is an enormous amount of expertise in these areas that can be mobilized to assist you in this process. So in a sense, putting in place some of this institutional capacity isn't really such an enormously time consuming task. I would also point out that -- and this is actually very much in support of many of the points that Prof. Ohno made -- that it isn't only a matter of institutional capacity. It is also a matter of, if you like, flexibility in macro-economic policy making. This goes to, for example, the issue he spoke quite eloquently about on exchange rate management. But it also goes to a number of other points in fiscal policy management and monetary policy management where Vietnam currently has limited flexibility. But that is really one of the key steps that are necessary to take to protect the country from future crisis, if and when they occur.

Let me make two more points and then I'll leave the floor.

The first is simply that I think our view is very strongly supportive of the idea of a far more flexible exchange rate management. I am not sure that I have any strong views on which of the options that's outlined here, but I think either one of them would probably work quite well. But recent experience in Vietnam has shown us quite clearly that a more flexible exchange rate management in and of itself is not going to do you any good. That increased flexibility has to be supported by other policy measures both in the structural area and in the monetary and fiscal policy areas. Just look at over the past thirteen months, Vietnam has twice widened the trading band in the interbank market, and once shifted the official rate. This really amounts to three step depreciation over a period of 13 months. In terms of reviving the interbank market for foreign exchange, which in a sense is the barometer of the confidence in the local currency, this has produced absolutely nothing, absolutely zero. Quite the contrary, it's quite obvious that the confidence in the dong has continued to deteriorate through each of these actions. So enhanced exchange rate flexibility, yes, but supported by other policy measures.

The other point I would like to make is, if there is one lesson that comes out of this seminar in general, but also out of this regional crisis, it is that, and it's an extraordinarily relevant lesson for Vietnam, it is that more transparency is necessary, and it's necessary in a range of areas. I fully agree with the points David Dapice was making this morning that Vietnam needs a page in the international financial statistics that we publish. But that's just the beginning. It needs a more predictable and understandable regulatory framework. It needs a more understandable licensing arrangement, tax system. In every instance of these major crises we've seen over the past few years, in Mexico, in Thailand, in Korea, the fundamental contributing factor has been exactly the fact that people -- foreign investors, domestic investors -- didn't know what the reserve levels were, they didn't know what the policy fundamentals were. Basically everybody but a tight circle of policymakers were left in the dark as to what was going on. That is, I think more than

anything, one of the factors that have caused the erosion of confidence in the countries involved.

I was actually challenged on this issue on deposit insurance. I don't have any problems with deposit insurance as long as it's not a one hundred percent insurance for every depositor. But certainly, I don't think it's a terribly urgent issue, but I don't think basic deposit insurance for small depositors will be any problem in Vietnam. Thanks.

Mr. Wattez: Thank you Eric. I have the feeling that in fact you agree on what is written with Prof. Ohno, and you disagree on what is not in his paper. In fact, you expressed quite well, I think, what was expressed at the consultative group in Tokyo a few months ago in mid-December, that the techniques are there, and you don't fundamentally disagree. But what is more and more ... for donors, and made more and more clear is structural reform and transparency, and that I think is very difficult to argue, and would become pretty much -- I hate the word, conditionality -- but a precondition as we are going towards the next consultative group. Predictability, I heard you say Eric, transparency, and understanding of the systems, and I think that the words are very important and cannot be avoided. Jean Pierre, you want to intervene at this stage?

Mr. Verbiest: Yes. Let me just start with a small point, which is the one Eric left off. On the deposit insurance, actually, ADB has currently a financial sector restructuring loan going on, and the deposit insurance -- but at a minimum level, not 100% -- the minimum level is being discussed with the state bank. So it is part of that loan. If everything goes all right it should be put in place some time during this year. It's a very complex issue, also technically. GTZ for instance is working on that also. So there is a sort of a minimum level of insurance which is discussed under that loan.

Many of the things have been said before, so I am not going to say that I cannot agree with the Fund or I cannot agree with Prof. Ohno. In the beginning of December, at the request of the state bank and the Central Institute of Economic Management, we organized a high level policy seminar for a small number of people both in government and in the Party to discuss the crisis. The idea was not for the ADB or the IMF or the World Bank to give our ideas, but to have policymakers in Vietnam to discuss with academics and practitioners of the region, who had known the crisis. So we brought one person from Thailand, Dr. Naramsha Kasani, probably some of you know, one of the financial directors of one of the largest companies of Malaysia, and the director of research of Bank Indonesia. And basically the discussion was between these three -- I'm sorry and two academics from outside, one from Canada, and one from Australia -- and the discussion was basically between these five persons and government officials. We met at the technical level, so at the high level, like the vice governor of the bank, three were there during the whole duration of the meeting. It was two days. And then we met with Mr. Do Muoi, the prime minister and several of the ministers individually to discuss in closed door, the issue, because it's a very sensitive issue also when you have high level policy-makers talking about the evaluation, it's not easy. I think the conclusions, by and large, are what was discussed before, I mean, flexibility in exchange rate, and we all agree that for instance there doesn't seem to be a point of having huge depreciation of the currency, I mean, that

there would be flexible exchange rates, and that would include playing with middle rate and playing with the boundary, so you can actually widen the band, move the center rate, widen the band, narrow the band, so you can do it in a way which is sort of fairly smooth. But we considered very important, and in particular, I want to make a comment on Prof. Ohno's paper at these stages, that for instance, when we talk about the rice market, I mean, it's true that in a certain way, Vietnam is a bit fortunate that for instance the rice market is very good in the world, coffee is not too bad, and so on. The quotas on textile exports from the EU will increase this year. So in a sense it does not show too much, I mean, the impact of the overvaluation of the currency does not show too much. But I think one thing we should remember and we discussed before, is that when he mentioned that the ton of rice had fallen by 40 dollars to stay competitive with Thai rice, the person who is going to pay that is the farmer, and the farmers already had big problems before. And that is one of the big things in Thailand. The people are laughing now in Thailand are the farmers. They are the ones who benefited from this. So I think we should be very careful on whom an overvalued exchange rate affects, and it is what we discussed in the first session this morning, it is the rural areas.

The other point which I would like to make and the previous speakers have talked about, is the one between the pace of economic reform and the pace of opening the economy -- what degree you open the economy. So basically, here we are talking about the sequencing issue, which is very familiar in economics, and I think we all agree that the opening of the capital market or the liberalization of the current account at this stage would cause a very big problem, obviously. That is not a subject of debate. But on the other hand, one should be clear that the objective to achieve is to liberalize the current account eventually, because the country can enormously benefit from it. It's not because there has been a crisis -- well, this crisis we know -- there were a lot of benefits in the meantime. So one should not sort of think it's all black and white, I mean, the opening of the Southeast Asian countries to the capital market have brought enormous benefits and it's not finished. There will be externalities of the crisis.

So I think the sequencing is obviously very important, and I think we all have a consensus here, certainly, with the two previous speakers -- and I agree with them -- in what kind of order we want to do the sequencing and what we should do first.

Then we are going back to Mr. Dapice's point of the matter of the "Ministry of Timing," I mean, how fast he thinks we should go. That's a question we cannot answer. It is a question which our Vietnamese friends have to answer and your leaders; how fast you want to go in banking and financial market reform, in SOE reform, in the promotion of small and medium scale enterprises -- everything we discussed about in this seminar.

What the perception was at the meeting we had in the beginning of December, and also there have been a lot of meetings at the Asian Development Bank's headquarters in Manila on this, is that the world's post-crisis, we don't know exactly when that will be, but it will not be so long, maybe one year or a year-and-a-half. The Southeast Asia we are going to know at that time will be very different from what was before. The big uncertainty is Indonesia. But countries like Thailand are going to come out of the crisis

very competitive with quite sophisticated financial systems in place. They have learned something about the crisis. Also there is going to be more external technology, I mean, a number of foreign banks will invest in Thailand. So the competition Vietnam is going to face, let's say one year down the road, it will be more than just having a currency which is overvalued so, it will be institutional, so that the gap will increase. That's where we think that the reforms which we have talked about here, they are more pressing than before. In a sense, that maybe six months ago we talked about, we knew the number of reforms to be done eventually. What we think about this crisis is that it has made the reforms much more urgent, much more pressing, because competition for FDI, for instance, also, I mean, capital flows will return to Thailand, and that's not a problem, because as long as the mechanisms are in place to use them properly it's a good thing to have capital inflows, even short-term capital inflows. Vietnam will face that competition. I think basically the outcome of the crisis as we see it is that it will be Asia, or Southeast Asia, a lot of these countries -- and hopefully Indonesia's problem will be solved -- will be a much more competitive and challenging place to work in. It's a fairly simple thing, but that raises questions for Vietnam.

You have the paper and you can see some of the conclusions we have in there. Maybe one thing we also have to take into account is that, and related to what I said before, is that if you look at the financing of development over the next few years, ODA, official development assistance, will become increasingly scarce and expensive in the sense that the pool for concessionary lending is going to decrease very much. So probably sooner than later, Vietnam's ODA will be in the form of ordinary capital resources or what the World Bank calls IBRD, which means essentially LIBOR kind of interest rates. FDI will remain, I mean, it will come back eventually in the region and in Vietnam. But again, what you will get as FDI eventually will depend on the pace of the reforms you have done and the things I discussed just before, and that leaves you with borrowing on international capital markets. And that we think you should be very careful on looking at that aspect or relying on that, because once you get IBRD, so LIBOR loans, LIBOR-based loans, all you borrow abroad you are debt servicing and that is going to increase very, very fast. So it is something which we certainly would not support at this stage, and it's something you have to be very careful about, because then you can go rapidly in a debt crisis or in a debt problem. Even when you have LIBOR-based loans from us or the World Bank, the implementation of the loans have to be very fast, because the clock starts ticking the moment you sign. Now, the grace periods are so long, and the reimbursement periods are so long, it's largely ground base, so I think you have to prepare yourself and the institutions to progressively enter this world, and it's a different ball game altogether. Thank you.

Mr. Wattez: Thank you, Jean Pierre. I heard you were speaking a lot about timing, so before we come to an open discussion, maybe we could turn to our Vietnamese colleagues. Without wanting to jump to the final closing session, maybe Prof. Thai or one of your colleagues could tell us your present feelings and perspective about timing. Thank you.

Dr. Thai: Thank you, Mr. Chairman. From the beginning of currency crisis in Southeast Asian countries, we received many suggestions and supports from the international community, not only this workshop, but every month the IMF provides the analysis and report to us and to the leadership of Vietnam. And last December, the ADB held a very important seminar to discuss about some measures for the protection. And Japanese side held some seminar in Tokyo, and discussed about the currency crisis in Southeast Asian countries and protection measures for Vietnam. And after that, Prof. Ohno came to Hanoi last month. He gave a presentation around and had meetings with local experts for discussion, and after that he met some leadership to explain his idea, not only his idea but also some of the Japanese experts' ideas, concerning what way is good for the protection.

In general, I agree with the IMF's idea about an early and progressive policy. The very strong impact of this crisis affects, not only other countries, but also Vietnam, already. Yesterday I mentioned about some of the economic aspects, however, today, I talk about the social effects. For example, when the FDI to Vietnam slow down, the unemployment rate will increase, and it will be very difficult to find out jobs, and many other aspects as well.

I would like to ask you one question. Now, Vietnam does not have enough components of the market economy. When you have to create stock market, some people say, now we jointly have to prepare and implement the stock market creation, because for the SOE reform and for the mobilization of more and more resources for investment. However, other people say this is dangerous, if you have stock market and attacked directly, it will last only one day in Vietnam. When there's a shock in Thailand, it will come to Hanoi in same day. There's not enough measures for protection. What is your opinion about this matter?

And now for another concrete measure for the protection, I would like to ask Dr. Ly to explain about some new measures from Vietnamese government, concerning the protection from crisis. Please, Dr. Ly.

Dr. Ly: Ladies and gentlemen. I would like to talk about some additional points, because we are at the beginning of the economic crisis, as Southeast Asian countries. We have a group to research on economic crisis, and prepare the policies to our government. And we have a lot of chance to discuss about it between us Vietnamese and international experts. There are many different opinions. Some experts advise us to use quicker shock therapy, but some others advise us to take gradual measure. But I think as Vietnamese, we have our way. We hear and learn every experiences, and we found out I would like to talk about some measures we are proposing.

First of all, I would like to point out that our policy is to continue innovation. Our policy innovation follows the administration reform. We try to reform our administrative system, improve the quality of our staff, and to change our legal framework. We reform our economic policy and SOE policy. I will explain more detail on these issues.

First, on the economy, especially in relation to financial and monetary policy. As you know, for fiscal policy, we are now adjusting our tax policy. For example, our budget law, we are now in process of adjustment. For other law of taxation, we are now discussing about the adjustment which will be more suitable for new situation. For import/export tax, we are changing it suitable for participating in APEC in the future. For monetary policy, we are restructuring the banking system, especially commercial banks. We have a policy to combine some commercial banks, if they haven't got enough legal capital. We should combine two or three commercial banks together, in order to make bigger, stronger commercial bank. We try to control the foreign debt. We made limited borrowing and external debt management. We limited borrowing. We try to control commercial borrowing, short-term commercial borrowing. We are changing the policy for exchange rate, in order to mobilize more domestic resources into the banking system, and we encourage the population to invest into the business and for production.

We gradually change our exchange rate to make it more flexible to the new situation. However, we don't use the word "devaluation," because devaluation is very influential in our society, because as you know, Vietnamese people's confidence to the banking system is very weak. That's why, if the exchange rate policy pronounce to devalue, it is not good influence to the society. In other words, you have to keep gradual policy for exchange rate, because if we use shock therapy, a lot of company cannot survive. For example, I can find out that proposal of Prof. Ohno, for we should change our exchange rate from 11,800 Vietnamese dong per U.S. dollar to 14,100. It means that the value of one U.S. dollar will increase by 2,320 Vietnamese dong. It means that for one million U.S. dollar, Vietnamese company will lose 2,320,000,000 dong. No company can make any profit, if one million U.S. dollar equals to 2 billion Vietnamese dong. If we use that measure, many Vietnamese companies may bankrupt. It is problem. And I would like to focus, to take your attention that now in Vietnamese market, the exchange rate is 13,000 dong per U.S. dollar, and interbank market exchange rate is 12,980 dong per U.S. dollar. Black market exchange rate and interbank exchange rate market is very near each other. According to our accounting, foreign exchange supply in Vietnamese market is higher than foreign exchange demand. That's why we haven't got any idea and basis for devaluation, because supply is bigger than demand. Anyhow, I would like to make that point, and I would like to hear your comment about how we can devalue, when supply is bigger than demand. Thank you very much.

Mr. Wattez: Thank you. So now the floor is open to comments of any of you. Do you want to say something? Please, Prof. Horiuchi.

Prof. Horiuchi: Thank you. I would like to say a few words about two points. One is the extent of the deposit insurance system in Vietnam. Another is Jean Pierre's point regarding the sequence of policy.

We are recommending that the government should take an active policy role in the reformation of banking sector through so-called re-registration. Under this policy, as Mr. Ly mentioned, some private banks would be forced to merge into each other or be forced to liquidation. So, in that case, some bank depositors concerned with the capability of

their own banks to pay back their own deposit. As an emergency policy, we should take a generous policy of protecting all depositors in this process, because we should not destabilize the financial system by destroying public confidence in the banking sectors in the process of reformation. So, as an emergency policy, we strongly propose the introduction of the full-scale deposit insurance system. Of course, in the long run, we should rely on the disciplinary mechanism of markets by decreasing the coverage of the deposit insurance system. But we are now discussing about the emergency or short run policy, so I think the Vietnam government should not lose the public confidence in the banking sectors any more. This is my first point.

The second point is somewhat complicated one. As Ken'ichi said in his presentation there is not necessarily unanimous agreement about our policy recommendation in the ad hoc report. I am a little skeptical about the recommendation of the policy sequence in the ad hoc report. According to the ad hoc report, we should put the rationalization of domestic system before proceeding to the full-scale integration with global market. I think the international financial market could discipline domestic bankers or financial institutions. The government should be responsible for disciplining domestic financial institutions. But it's quite difficult for us to implement disciplinary policies for some political reasons in domestic market. I think we should not hesitate to open up the financial system to advance the efficiency of the financial system. There is some danger of the bad influence or contagious effect of some other country's crisis on the Vietnamese economy. We should recognize that kind of contagious effect. But, in my opinion, capital market disciplinary impact may be quite useful for some cases. In conclusion, I am ambiguous about how to proceed the sequence of two policy measures.

Mr. Watz: Prof. Kohsaka, and then Mr. Offerdal.

Prof. Kohsaka: Thank you, Mr. Chairman. I would like to endorse Prof. Ohno's proposals, and also elaborate a little bit more on his points.

I am in favor of the three points that the stability of the sustainable exchange rates, and also the cautious approach for domestic financial liberalization as well as capital opening up. I think these three points are very important. And having said that, I have three comments on some of his proposals. One is that the appropriate alternative exchange rate measures or target. Usually, the most common proxy for competitiveness is the trade-weighted CPI-based real effective exchange rate. But we have observed in various cases such as in Thailand, the observed real effective exchange rate and say, the relative unit labor costs, behaves very differently. So, we know now that the REER, real effective exchange rate, is not very reliable proxy for the international competitiveness. And Prof. Ken'ichi Ohno proposed the alternative exchange rate measure, that is, to take account of the competition in the third market instead of with the trade partners. I think this is very important. But at the same time, still we are relying on the CPI. I think that this is not the only available price deflators we have to rely on, and there may be some other room for using, say, the export prices and or some other labor costs proxy figures. The point is that still the usual real effective exchange rate might not tell much, because in the case of Thailand for example, what we have seen in the 1990s is that the real effective exchange

rate appreciate in the very recent period since 1995. But the degree of appreciation is just 10%. That is not as much as the 30% of the real appreciation in Mexico just before their financial crisis toward the end of 1994. Second point. What caused the Asian currency crisis, I mean, the first criminal, is not the securitization, but the short-term loans. So securitization may not be the very significant factor in the case of Southeast Asia. This is the second point.

Third point is that what we have seen in the Asian currency crisis is that, well, look at the inflation rate. Look at the fiscal balance. Look at the external imbalance. They are not very much deteriorated. For example, in the case of Indonesia, their external or current account deficit is less than 5%. Of course, we have seen a more than 8% deficit in the case of Thailand in 1995 and 1996, but that is not the case. And also Indonesia has been known that they maintain to stabilize the real effective exchange rate. So, what they had adopted is a crawling peg. So their resulting real effective exchange rate was very stable, even though there was an asset market inflation. Maybe that might not be very relevant in the context of Vietnam. But what we have seen is that the usual macro-economic indicators, such as inflation or fiscal deficit or current account balance, may not tell much about the vulnerability to the international capital speculation. And even though maintaining real effective exchange rate may not be sufficient to avoid this kind of currency attack. Thank you.

Mr. Watz: Thank you very much. We have ten minutes left for this session. So Eric, you wanted to ... ?

Mr. Offerdal: Yes. I just wanted to quickly respond to the few of the points that -- one question by Prof. Thai, one question by Dr. Ly.

On the stock market. I think that's very important for the next ten years. Today; no. Next year; no. Basically, developing a domestic equity market is clearly one of the elements that are necessary to increase the domestic savings rate by providing the public with a broader range of assets with different rates of return and different risk profiles. So, it's important to do, however, there are some other things in terms of -- you made a comment about legal framework yesterday -- but basically there are some issues of accounting and legal standards that I think have to be addressed before. One critical issue to keep in mind about stock market is that if you launch it prematurely and it becomes unsuccessful, it will take a long time before you can do it again, simply because you lose a lot of credibility in the process. So I would say you can easily wait with that a few years. I know my colleague in the IFC wouldn't agree, but that's certainly our view. I think developing a domestic money market is far more critical and urgent.

On the foreign exchange issue and devaluation, you've made this point before, I remember, and to be honest with you, again, maybe I'm exceedingly dunce, but I didn't understand it then and I don't understand it now. Are you referring to supply exceeding demand in dong or in dollars?

Dr. Ly: Dollars.

Mr. Offerdal: But that can't be true. That just can't be true. Absolutely no way that can be true.

Dr. Ly: Because we calculate our balance of payment. We find out that foreign exchange supply, because foreign exchange demand in our market.

Mr. Offerdal: Oh, you mean, just by virtual of having a surplus on the balance of payments?

Dr. Ly: Yes.

Mr. Offerdal: Oh, oh, I see.

Dr. Ly: I would like to make other point, in order to explain all these issue. We meet other difficulties when we change our exchange rate. One difficulty is that if we change it too quickly, liberalize too quickly, we will face a difficulty to mobilize domestic resources, because we cannot increase domestic interest rates, deposit interest rates. Because if we increase deposit interest rates, we have to increase loan interest rates. But loan interest rates, now any company have to pay high interest rates, they cannot pay high interest rates. The bank will not be able to borrow money from population, and the companies will not have capital to develop their production. Then they cannot produce products, they cannot sell products. Then unemployment rate increase, and social issue arise and other consequences will appear.

Mr. Offerdal: O.K. Let's take one thing at a time here. We don't even have ten minutes. But I don't think you can look at the balance of payments, especially in the case of Vietnam, and just say because there was an overall surplus, we have more supply of foreign exchange than -- Just look, as an alternative, look at the interbank foreign exchange markets, and both the rates relative to the band, and the volume of trading there. It's quite evident that in terms of the short-term situation, there was a huge excess demand of -- or to put it differently -- there virtually is no supply at all of foreign exchange. Let's leave that at that. Now I understand your point, at least. We can get back to this in Hanoi.

On the interest rate policy, I'd be happy to plunk down a hundred dollars in a bet with you that if you liberalize both deposit and interest rates, you will still find borrowers for both medium and long-term credit from the enterprise sector, basically because interest rates will find an equilibrium in a credit market, but you need to have that credit market, a functioning credit market or a money market going. I mean, that's just another example of how these things are interlocked. But again, we can meet in Hanoi any time and hash this out.

I'd like to get back to the point that Prof. Horiuchi made, which I think it's actually an excellent one in response to this issue of sequencing, that the disciplining effect of

international markets should not be underestimated in terms of the financial integration. I think that's an excellent point.

Mr. Watz: I think Mr. Tu wanted to intervene.

Mr. Tu: Thank you, Mr. Chairman. I have a short comment on the issue. When we talk about Vietnamese situation, I think we have to consider two points, two characteristics. One is how to assess current deficit, over the GDP ratio. That is about 13% now. But we cannot compare that with equivalent ratios in other Asian countries, for instance, with Thailand or some other countries. In Vietnam, most expansion in imports have been induced by FDI. FDI inflow into Vietnam induced many, many imports, imports of machinery and many other items. So, as Dr. Ly said, the supply of foreign exchange is also expanding in Vietnam. So sometimes the state bank of Vietnam intervenes in the market by buying dollars, not selling dollars, to avoid nominal appreciation of the dong, of the currency dong. That is I think very little known in foreign countries. That is one point.

Another point is that, as also Mr. Ly mentioned, that in Vietnam, a sharp devaluation of the dong is a taboo. That is, the social confidence on the dong has just regained about five years ago, since then Vietnam tried to maintain the confidence of the people in the currency. So, for instance, 20% or more of devaluation of dong will be very difficult to adopt in Vietnam. So, in the group supervised by Prof. Ishikawa and headed by Prof. Horiuchi and ... by Prof. Ohno, I also raised that opinion. Instead, I mentioned that we have to redefine the real exchange rate. Of course, Prof. Kohsaka also mentioned a little about this, but what I want to repeat here is that when we calculate the real exchange rate, we should not only take into account the CPI or inflation differential between Vietnam and foreign countries, but also we should take into account the differences in the labor productivity. First, in Vietnam if we compare the advantage in industries, we try to improve the labor productivity of our industries. In Vietnam, there is much room for further improvement in labor productivity. So, in the long term, I think Vietnam should have a more direct devaluation, and at the same time, we have to emphasize the improvement in productivity of labor in manufacturing industries. That was my point. Thank you.

Mr. Watz: Thank you very much. Jean Pierre?

Mr. Verbiest: Just a few comments. Let me first start with the stock market. When we talk about the stock market, there are different types of stock markets. We are not talking to establish tomorrow in Vietnam the Wall Street. So, I think what you should look at -- because in that sense I am not really agreeing with, I think Eric was sort of saying, no, not tomorrow, maybe ten years or so; ten years maybe Wall Street hopefully -- but I think progressively, you should try to establish a trading mechanism. That trading mechanism -- I think there are a lot of experiences you can look from, and I think Mr. ... knows them all, others in China, before in Thailand, where you need really very sophisticated control mechanisms when you open your capital account and you let people

come in your stock exchange. Then of course, you can have a huge impact of changes in other countries. But that's, I mean, that's I think that's what Eric meant that that is ten years from now, maybe, because it's not regulation, actually, it's much more than that and I think Prof. Horiuchi this morning mentioned it, it's human resources. You can buy the regulation of the New York Stock Exchange, but you won't be able to administer it. You need the people.

Then, I think the point made also about the sequencing and the opening of the financial system to competition, I think, it's a very important point and it's a difficult one, because either, well, you do like Thailand, which opened and said, OK, we want to become a financial place, and then of course you have some problems. But for instance you can open progressively like by introducing competition in your banking sector by allowing selectively -- well, actually you already do -- foreign banks to work in Vietnam, and allow them to compete with the Vietnamese banks. So, we are talking about progressive things.

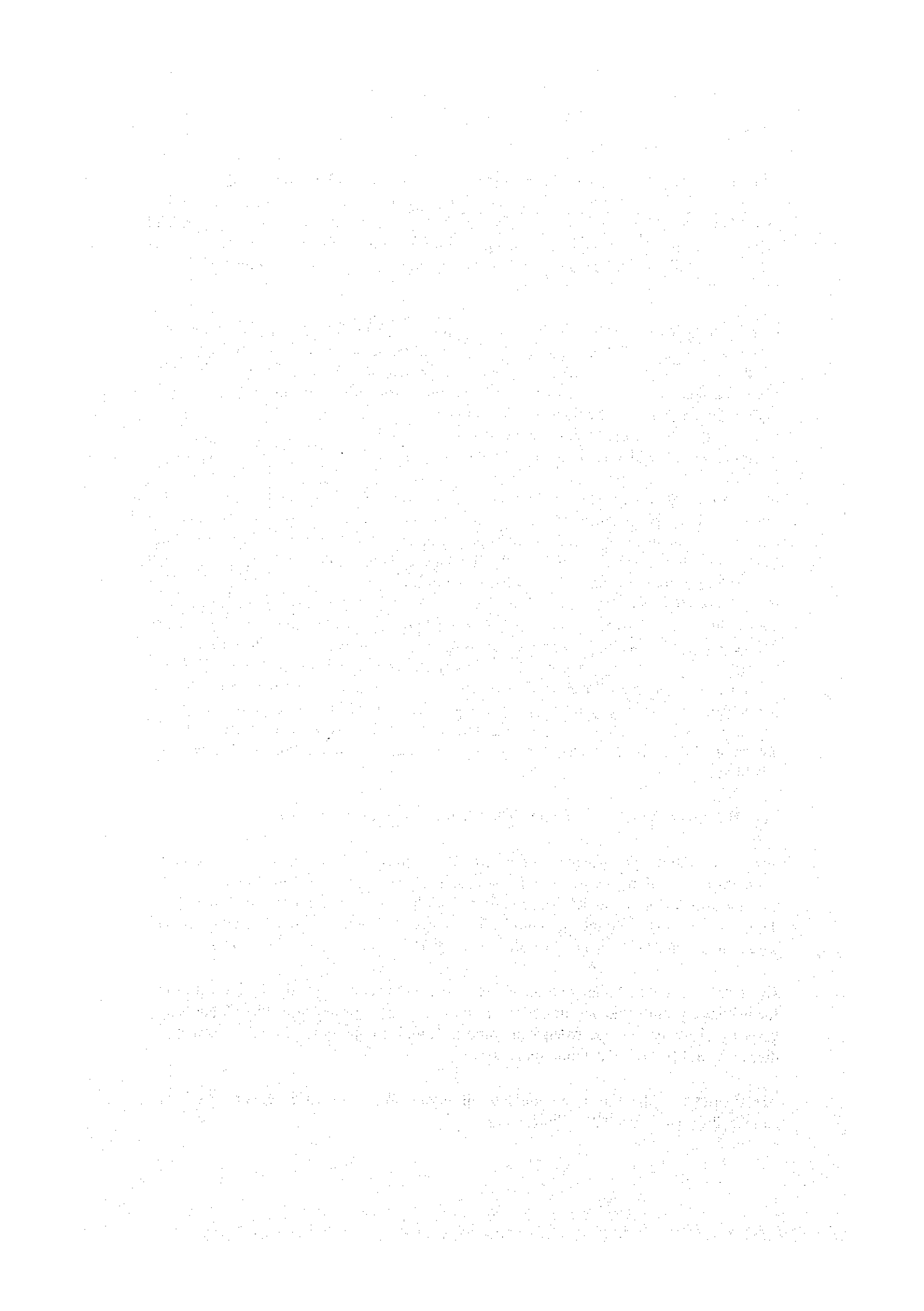
On the exchange rate, first of all, nobody has ever determined the equilibrium exchange rate in any country on a piece of paper. So, we don't know. All what we know is that we don't want to have a big boom. We are not talking about 30%, 40% devaluation. I think Prof. Ohno's paper was clear on that. I think what was interesting in his proposal is that he doesn't know, and none of us know what the equilibrium exchange rate should be. What is nice about his proposal is that it introduces some flexibility by moving the central rate, and as he said, if there's no need, if the exchange rate now is fine, you have a 3% depreciation, or something like that. So it's practically nothing. On the impact of an exchange rate on employment and the economy and so on, and savings, let me just give you a counterexample. Suppose your exchange rate is too high, it's overvalued. Your exporters can't export any more, your growth rate start falling, your exports is closed down, there will be unemployment, your fiscal deficit will increase, savings rate will fall, and so on and so on. That's a counterexample to what you are mentioning. But we can't talk about it ...

Mr. Watterz: Yes, just a minute. The Chairman of timing says yes.

Mr. Tu: Actually ... because I know when you study in Vietnam, you must select the Vietnamese situation. Two points I would like to add. First is external debt structure. You must look at external debt structure because short term debt is very small in external debt in my country. The second point is in my country, which has a new policy to prevent smuggling. That's why demand for dollar reduced. It's very important for statistics.

Dr. Ly: Thank you for all your ideas. My presentation and idea is that I raise a question for making up our mind and of course, to think about the proposal of Prof. Ohno. It is very useful for us. I hope when you come to Hanoi, I hope you will have a chance to discuss with Mr. Offerdal about many issues.

Mr. Watterz: Thank you very much to all of you. We will start the closing session as soon as Prof. Ishikawa will be back soon.



Session 7: Closing Session

Chair: Dr. Thai

Dr. Thai: Now, I have become the chairman of the closing session. We are moving into the last session. After two days working, I think this workshop in Tokyo was very useful for us, and you can receive many, many information from the international community and the high level experts directly concerning the current situation in Vietnam. I think this is very important. And I hope that this workshop is the beginning of cooperation with the international communities and the Vietnamese side. Now, I would like to ask some of my friends to make some speeches for the closing. First, I ask Mr. Offerdal from IMF, for your ideas to this closing session, please.

Mr. Offerdal: O.K. I will try to be brief and to the point. First of all, I would like to again say thank you very much for inviting me to come to this seminar. It's been a true pleasure and very helpful to me in my daily work in Vietnam. And I would like in particular congratulate Prof. Ishikawa. I think this has been a very, very impressive effort that in some form or another really should be continued into the future in some sort of Phase 3. I think it's probably true that we don't among us have and the study group, we may not necessarily have full agreement on all issues. But I think to some extent that illustrates what you might call a creative tension between the academic community and the practitioners of economics like the people around me here. And also I think the one output of this effort or this project, in addition to the report right here is clearly also a very extraordinarily interesting database in a variety of areas. I was in particular interested in seeing the data on the regional fiscal issues. So I think that's quite an impressive asset that really needs to be both kept for posterity and also maintained and updated on a regular basis. I think it will create a treasure trove of further research. That's my first point. I have four.

My second point is basically that I think this seminar has illustrated very clearly how the various issues that we have discussed are so closely interlinked. We have talked about industrialization, about SOE reform, about trade, about rural development, about banking sector reform, about macro policy issues, and I think in every one of the sessions we've had, all of these issues have come up in some form or another illustrating how trade policy is closely linked with SOE reform, and for that matter with rural development, and how banking sector reform is closely linked with industrialization and macro issues and the whole thing. For a long time I have walked around Hanoi and talked about the comprehensive policy package, and now I know why I've talked about it so much.

A third point has to do with stability and reform. My impression, and it's not only my impression, is that to no small extent, the slow speed of reform implementation that we have seen over the past few years has to do with an increased concern about the effects of the reform process on economic and social stability. And that is, I think both justified and an important concern. However, I would like to make two observations in that context. The first is that it's important while keeping these concerns about economic and social

stability in mind. It's also important not to fall into the trap of thinking that not moving forward on the reform process will not have any implications for economic and social stability.

Let me just point to you the situation in Thailand eight months ago and the situation in Mexico a few years ago to illustrate quite clearly the point that if certain reforms gets stale, or stalemated, that actually does have very serious economic and social stability consequences. Moreover, I would like to point out that it is actually possible to implement strong reforms, for example in the exchange rate area, and I am not talking about a huge devaluation but a strong reform in the exchange rate management area without triggering a significant loss of confidence in the currency and inflation. It is possible to implement trade reform without a huge revenue loss. It is possible to implement an interest rate liberalization without having interest rates going through the roof. But this basically comes back to my second point. To do all of these things requires a comprehensive policy package, supportive, mutually supportive measures in a variety of areas. And moreover, to the extent -- I would like to reiterate the point that already has been made several times -- to the extent there are important technical issues of design and implementation of these reforms in Vietnam. There is no question that the expertise to help you out is available and will be made available to you. Andrew made the point yesterday, it's just a matter of asking basically for the design and implementation of these reforms that we've been discussing for quite a while.

My last point basically has to do with this issue of speed of reform. I was talking to Prof. Ishikawa yesterday, and he said, well, it looks to me like our view is a gradual reform approach, and my view is one more of shock treatment. Actually, I guess we are all sort of clamoring for the middle ground, and I would like to sort of carve out a little piece of middle ground for myself, because I think our view is not shock therapy at all. It is thoughtful, but rapid and comprehensive policy reform to avoid shock therapy, because what we are suggesting and recommending for Vietnam is not shock therapy. That is what we had to basically force on Thailand and force on Korea, and it's an entirely different set of policies. Basically, I think the key issue is to avoid shock therapy, to have rapid but well prepared and well managed reforms to avoid shock therapy. Thank you.

Dr. Thai: Thank you, Mr. Offerdal. Now can I ask Mr. Watez ...

Mr. Watez: Thank you very much for this time. I will be very short. My organization does not work exactly, does not have the same mandate clearly as IMF, but we share some of their ideas. I will not go into the macroeconomic issues. As UNDP representative and UN coordinator in Vietnam I would insist on the fact that it seems to me that in terms of the management of ODA, and quantity of ODA, two messages. As an actor, and as an observer since fourteen months. As an observer clearly, the donors the same ones will meet, I don't know where, but they will meet next December, mid-December for the annual CG. I think a lot will depend on what is started to be achieved, I'm very careful about the words, because I know the task is daunting, but they will be very keen in six months time basically to see quite a few progress in terms of I would say less state as I said the first day in the allocation of resources, and more state in the liberalization of

many constraints. I don't think that they will demand a complete achievement of what they asked in Tokyo to be looked at, but they would like to have significant progress, and I do feel that the amount of ODA will depend very much on what they will feel by then. This is why we have proposed together with the World Bank to have a sort of group meeting in Hanoi in mid-June to review the situation six months after the last CG in mid-December 1997, so that the group dialogue would continue and would not be only once a year, but at least twice a year with the representative of the ODA based in Hanoi and the leadership.

My second point is more to deal with UNDP's assistance, but I think it does apply also to other sources of technical assistance aiming at capacity building. FDI might be another issue which is not of direct concern for us. As far as ODA is concerned, technical assistance capacity building, I would strongly advocate to manage it in a way that the provinces, as I mentioned this morning, do benefit more of ODA. The balance is not there yet. There have been improvements, significant improvements in the absorptive capacity, decentralization, but a fair balance between rural and urban areas is not there yet. And I think it's one of the main points of the Prime Minister, the six main points of the September program of the new Prime Minister. And we share entirely these views, therefore, as far as the UN system is concerned, a strong support for poverty alleviation, development assistance projects in the rural areas, we will support you very forcefully according to your needs. Thank you very much, and thank you very much to Prof. Ishikawa. I have the same feeling as my colleague from IMF, a wealth of information we received during this meeting. We met also very interesting Japanese specialists, and I am sure the relationship established here since our team in a way is new in Hanoi will continue afterwards when they come to Hanoi, and when we have the chance to come to Tokyo. So thank you very much for inviting us, Prof. Ishikawa. Thank you.

Dr. Thai: Thank you Mr. Watez. Now, ADB's Jean Pierre....

Mr. Verbiest: Thank you very much. I think I will join my colleagues obviously to thank Prof. Ishikawa, JICA, and our Vietnamese colleagues and all our other Japanese colleagues for inviting us here and for, I think having a really very interesting seminar. We have been very, very busy working in Hanoi, and it was difficult to come here, but it was certainly, we go back very happy about having been here.

As Andrew mentioned this morning, I think the timing obviously is a very good timing to have this review now, because it's just in the middle of really major changes in Vietnam, I think, or at least major conceptual changes. Also there are major changes in the world around in Vietnam. So I think it was very useful, made it even more useful. I think by and large the way I see it is that all areas of disagreement, I think, are very minimal and by and large, we have a consensus I think even on the Vietnamese side, all of us, on what are the priorities, and more or less how we go about it, whether it is rural development, we talked about where it is development of small and medium scale enterprises giving more priority to their importance in the economy, the reform of the state owned enterprise sectors in one way or another, I mean there are different steps there which can be taken. What we talked about today on financial sector reform, the fiscal problems So I think by and large, and

then also what we just talked about now, the impact of the crisis, the environment of Vietnam, the world environment, the changing world environment. We could, I think, go on for quite a few days, but there are a number of other interesting issues remaining. I think, basically we have still some differences among us, not even as groups. Even among the Japanese, among the Vietnamese, among the four or five of us, on some timing, and urgency and the timing. But I don't think it is much more than you would find, for instance, in any normal functioning government. I have never been a part of a cabinet, but I think when you read these agreements among government members it's probably even much more than what we have here. So I think basically, we have by and large a consensus.

I think for us it's important because, as we discussed, this work can help us a lot as Asian Development Bank to prioritize our work and our assistance to Vietnam. So we can actually give it a concrete impact in terms of our loan assistance or technical assistance, and that's quite large, I mean it's 350 million dollars of loans and about 10 million dollars of technical assistance per year. And we are starting this year reviewing our countries' assistance strategy. I think this kind of work can, of course, provide a lot of inputs and a lot of insights into what areas should be prioritized, and maybe how we should do it. There are not sort of easy answers sometimes. Speaking for the Asian Development Bank, we found it really very interesting.

Some areas we did not discuss enough, maybe, and maybe in further work you might consider taking it up. One area which is discussed here, but we have not discussed much, I think, is the problem of AFTA and Vietnam's tariff structure. I don't want to reopen the debate, but I think it's something important. It was mentioned in a paper, also if I remember, in Prof. Ishikawa's paper, but I think it's an important one in terms of international negotiations and the position of Vietnam.

The second area is one which was mentioned this morning by Prof. Horiuchi in the context of fiscal and monetary issues is the one concerning human resources, the human resource constraint on reform, let me put it like that. And in the sense that, and this is true not only for Vietnam, but I think for Vietnam it's particularly more difficult, is you can have the best foreign investment law, the best Decree number ten, the best stock exchange regulation, the best state banking regulations, you need the people and the people who can implement it, and that's difficult in all countries, but in Vietnam, because it's an economy in transition and coming from a very different background, it's very challenging.

I was struck, for instance, in Ho Chi Minh City when the Prime Minister had a meeting with the foreign investors, everything which was said either by the Prime Minister or by the other ministers was absolutely spot-on. There was no problem. The problem is that it is not easy to implement, because people at administrative level would not necessarily understand why the decisions are like that, and I think that's something very, very important. Well, I can give you many examples.

So although Vietnam on one hand has a tremendous advantage in Asia, or in Southeast Asia, in that it has a very educated population -- even now, the indicators are better than

Thailand -- on the other hand, there is a constraint on how fast you can go with the reform. It's not just texts, it's people.

And related to this, perhaps, an issue which is maybe more delicate is the one of the institutional setup, because the institutions, well in Vietnam like in other countries have built up over time either partly through tradition, partly in your case there is a socialist system and planned system. Now, there have been some changes, but maybe it's an area where you might still want to look at, in terms of the workings of the institutions, or the setup of some individual institutions. For instance, let's take the Ministry of Education, is that a setup which you might want to review as the economy enters more into the market system and international competition. You mentioned this afternoon the time for decision making. Now, every country has its own procedures for decision making. You know, some are fast and some are slow, and so on. But at least beyond the traditional way, the institutional setup also has an importance. As the country will enter more the international community, it's very important to look at that, maybe. I know, it's not an easy subject.

Let me finally say that I think the documentation -- everybody agrees that this was very impressive documentation -- both in the detailed papers and the fact that the presenters managed to summarize the major points very well and presented it like that. So it means the original papers are very good also. As a group here, one should increase the interactions among us. So in a sense, we can reap a lot of externalities out of this work. As Andrew mentioned, I didn't know Hitotsubashi University was doing so much work on Vietnam, or Tokyo University and so on. We might know some other places where there is research, and I think it would be interesting if we could increase the networking, maybe in some selected areas. People who are interested in agriculture don't necessarily have to talk about the financial system. So we might do it in some areas, but I think there is a core group or a critical mass or whatever you call it to increase this. We might do this through some technology as I mentioned this morning through the Internet, for instance. We might do it by having regular sort of meetings of working groups.

I might add if I can make some advertisement, that the ADB has set up an ADB Institute in Tokyo, and one of the purposes of the institute is to discuss Asian development experiences and look at how other countries can benefit from it. So I have talked to Mr. Ikeda also, and tomorrow I am going actually to the ADB Institute. You might want to look either at the research group on Vietnam or JICA or the individual universities on how you could collaborate with them. I am sure they would welcome it very much. And they are in a set up stage, so I think they are still looking for a lot of ideas. So I think it will probably be very useful. Thank you very much.

Dr. Thai: Thank you, Mr. Jean Pierre. We have one more Japanese friend ... If there's no more, I would like to say a word, before Prof. Ishikawa's speech. First of all, on behalf of Vietnamese delegation and all Vietnamese side, I would like to thank JICA and the international experts for coming to the workshop. The discussions were very useful for us. Of course, we got many benefits not only for our delegation group, but also for local experts and leadership in Vietnam. They will receive more support directly from this

Tokyo workshop. I would like to thank JICA for supporting us. Mr. Ikeda and the representative in Hanoi office, the former representative Mr. Todoroki, during the three years, he has supported us very strongly, and very concerned with JICA's joint venture with Vietnamese project. I would like to thank the academic group, professors from many universities and research institutes in Tokyo and in other places of Japan for supporting us with many ideas. In fact, during we work with Japanese side, we have received and transferred the know-how and skills from your side. This can add the certain capacity for our local experts. And I would like to thank Japanese consultant companies for their support in some surveys. This is very important because not only for the analysis, but they also could get information directly from Vietnam. This is one of the very famous JICA support for our projects, because we can conduct the study directly inside of Vietnam, by worked together with foreigners, now we can make analysis. I have suggestions after the workshop, if JICA can support and collect the papers in this workshop, and prepare them as proceedings of the workshop, that will be very nice. If you can make that, it will be very useful for us in the future. And when I come back home, we can make direct report to the leadership concerning the results of the workshop in Tokyo, and we can systematically prepare our policy in more detailed way, and comprehensive programs of the renovation in our country, not only concerning the financial and banking system, but for the whole country. This has the solution from the leadership already.

The last wish from us, we will continue the cooperation for this matter. I would like to request JICA and Prof. Ishikawa and all Japanese friends to continue the cooperation with Vietnamese side on the policy making process in Vietnam, and I hope next week when Vietnamese government can send an official letter to Japanese government, for the request of continuous support to Vietnam on policy, I think JICA can support us. For the international community who had the two-day discussion, I think we will make the network. We can make the cooperation network among the international community in Hanoi. It can be very constructive and more efficient. Lastly, thank you. Arigato gozaimashita.

Prof. Ishikawa: Thank you very much. I have many things to say, but I should refrain from this sentiment by limiting my remarks to only a few points. First of all, I should say that this workshop was very successful in mobilizing a great amount of intellectual inputs by international organizations, Vietnamese friends, Japanese friends, and also various organizations who attended this workshop as observers. About this point, I should express my deep sense of gratitude.

And the second point is relating to the remarks of Mr. Verbiest and Mr. Steer, that this workshop was held in a very timely situation. Probably they are referring to the period of time for the Vietnam economy which is very critical and needs various useful suggestions and advice from various sources. In that sense I think this workshop was really good. International organizations as well as Vietnamese and Japanese side participants expressed their very valuable suggestions and observations.

But from somewhat different point of view, this workshop was held somewhat too late. In order to explain this feeling, I should start by repeating what I said in my presentation

in the beginning of this workshop, namely that the idea of holding this workshop was suggested originally by the World Bank representative in Hanoi. I surmised at that time that the World Bank, at least some persons in the World Bank held some apprehension that two major donors to the Vietnamese government might be making some different policy suggestions to the government. So we considered that if it is possible to hold some international workshop on the views and policy suggestions, on our side and on the side of the World Bank, that might be very helpful. The holding of the international workshop was actually delayed for a number of reasons until yesterday. But as time went on, it became increasingly clear that what was feared as two opposing views and policy suggestions was actually originated from some misgivings or misunderstandings of our study approach and policy views derived from it. And this workshop seems to have substantiated it.

Namely that, all groups of participants inclusive of ours agreed on the desirable goal of economic reform of Vietnam, that are marketization and liberalization of economy and trade. The only difference might be, according to my impression, the timing or speed of the reform towards realizing these marketization and liberalization. During the tea break time yesterday, I specifically mentioned this difference between us in terms of the possible difference between the gradualist approach and the shock therapy approach. I noticed that Mr. Offerdal today referred to this remark of mine and said that IMF is actually trying hard to steering a middle ground between the two. I greatly appreciate this remark. Now I should probably say that the difference between the refined version of gradualist approach and the refined version of shock therapy approach is being reduced to a minimum extent.

In any case, when I said that the holding of this workshop was somewhat too late, I was saying that the disappearance of the misapprehension could have come earlier by holding the workshop much earlier.

At this point, I should stress that these remarks of mine are not saying that there was no difference at all between our study and policy suggestions and those of the international organizations. As a matter of fact, there is perhaps a significant difference between the two, which, however, is providing, very fortunately, the basis of the complementarity between the two approaches. To be specific, this difference is what is exhibited by the difference in research methods of the two sides. As you might have noticed, this Vietnamese-Japanese Study Team placed major emphasis of the whole study on conducting original empirical researches on the economic issues about which we felt a serious shortage of statistical and other kinds of information. In each of our four or five sub-groups, they are mostly micro-based behavioral surveys on farms and rural households, industrial enterprises in SOE or other sectors and the sector-or branch-based surveys on productivity and profitability of selected individual industries. Probably, this is contrasted to the generally macro-economy oriented study of the World Bank and IMF.

Behind this contrast seems to exist the difference in the experiences of economic development in Japan and other East Asian countries on one hand, and those of Western Europe and North America, on the other. Simply put, we may denote the experiences of

Japan and East Asia as those of "late-comer" and "late late-comer" countries, defined as those countries which achieved or achieving "take-offs" after the WW I and WW II, respectively. The experiences of Western European countries and the United States may be denoted as those of "early-comer" countries, defined as these countries achieved "take-offs" before the WW I (which is somewhat different from the definition of Gerschenkron, the founder of these concepts). In contrast to the "early-comers", where the market economy was already matured and capital accumulation was made to a considerable extent already on the eve of "take-off" (to follow the observation of J. R. Hicks's A Theory of Economic History), the market economy framework is more or less incomplete and weakly developed and capital accumulation in the earlier stages in the late-comers and late late-comers.

I personally consider that due to these characteristics of initial conditions of the "early-comers," Western economists are not seriously concerned about the conditions of the market economy development and of the degree of capital accumulation both of which must be greatly different among the developing countries. But we, born and raised in the late-comer or late late-comer environment, are inescapably concerned about these conditions. This, I personally believe is the reason why in conducting the policy-oriented studies on any developing country, we put great emphasis on the empirical fact-finding studies in many policy areas to be conducted prior to making any policy suggestions for resolving economic development issues of that country. For the same reason, with regard to the policy suggestions too, we are inclined to refer even to those areas which are often left aside in the policy proposals of the international organizations, for example, the question of how incomplete markets in specific product or factor markets can be raised and strengthened, and whether and how the inefficient state enterprises can be reformed and restructured within the legal framework of state enterprises?

These differences in the study approach and prioritized research aspects or areas are suggesting the possible areas for research cooperation in the future. Even for the policy recommendations there may be scopes for cooperation in policy studies. These areas and scopes seem to be wide.

My final comment is related in some sense to the issue as to what will be the future of our Japanese-Vietnamese study project. Nothing has been decided yet in a definite way, but there is no likelihood that this team, or this project will completely disappear. In some way, this team and this project will be continued. And what concrete form the continuation of this team will take, we are now continuing discussions not only among ourselves but also with JICA, foreign ministries as well as the Vietnamese counterpart. And I am sure that in the future, the close contact with the Vietnamese side will continue, and also the friendly relationship with the international organizations will also continue.

Before closing, I have to express, on behalf of the Japanese academic group, our sincere appreciation to Japan International Cooperation Agency (JICA) for making possible the holding of this international workshop. In this respect, I particularly mention Mr. Ikeda, Mr. Kaibara and Mr. Mori. Logistic support provided by Japan International Cooperation Center (JICE) and Secretariat of the Study Group on Vietnam is also greatly appreciated.

I would like to express my deep gratitude to some other organizations inclusive of the Ministry of Finance. And again, I would like to express my sincere appreciation to the participants from the international organizations stationed in Hanoi who came here sparing very busy time. We learned a lot from you. Also to our colleagues from Vietnamese side. Thank you very much for your participation and all other participants, too. Thank you very much.

Workshop on Vietnamese Economic Development Program

Day 1: March 22 : (10:00-17:00)		Doc. No.
Opening Session JICA Social Development Study Department		Tatsuhiko Ikeda
Session 1 :Introductory Session (10:20-12:00)		
1. A World Bank, IMF and Vietnamese-Japanese Study Team Workshop Introductory Remarks	Shigeru Ishikawa	Note 1-1 *B/P 1-1
2. New Economic Policies and Issues Raised for Further Study, New Measures Searched under the Conditions of Currency Crisis in East Asia	Nguyen Quang Thai	Note 1-2
3. Structural Changes Facing Viet Nam	Andrew Steer	Note 1-3
4	Erik Offerdal	
5. The Role of the State in Sustainable Development: Lessons for Viet Nam from the East Asian Miracle and the Crisis	Edouard Wattez	Note 1-5
6. ADB's Assistance to Viet Nam's Economic Development: Policy Point of View	Jean-Pierre Verbiest	
7	David Dapice	
8.General Discussion		
Session 2 : Trade and Industrial Policy (13:30-15:10)		
1. Participation in AFTA /APEC/WTO and Industrial Policy	Hideki Imaoka Koichi Ohno	Note 2-1 B/P 2-1-1 B/P 2-1-2
2. Industrial Policy Option for the Development of Export Industries in Viet Nam	Seiichi Masuyama	Note 2-2 B/P 2-2
3. Policy Alternative and Their Implications for Capital-intensive and Infant Industries in Viet Nam	Koichiro Fukui	Note 2-3 B/P 2-3
4. Development Policy on SMEs and Supporting Industries in Viet Nam	Masahiko Ebashi	Note 2-4 B/P 2-4
5. Brief Comments on Vietnam's Trade and Industrial Policies	David O. Dapice	Note 2-5
6. Enhancing Efficiency on Competitiveness of Vietnam's Industrial Sector	Pham Quang Ham	Note 2-7
7. General Discussion		

Session 3: SOE Reform (15:20-17:00)		
1. A short Note on SOE Reform -- Mainly Summarizing Chapter4, ESR	Shigwru Iahikawa	Note 3-1 B/P 3-1
2. Comparing Enterprise Reform in China and Viet Nam: Finance, Incentives and Corporate Governance	Yoshio Wada	Note 3-2 B/P 3-2
3. Study of the Current Conditions of Production, Management and Finance of the State Owned Enterprises in Viet Nam	Koki Hagiwara	Note 3-3 B/P 3-3
4	Andrew Steer	
5. Brief Comments on State Enterprise Restructuring in Vietnam	David O. Dapice	Note 3-5
6. General Discussion		

Day 2: March 23 : (9:30-16:40)		
		Doc. No.
Session 4: Agriculture/Rural Development (9:30-11:10)		Chair : Dapice
1. Summary of Findings and Suggestions of the Report: Agricultural and Rural Development	Yonosuke Hara	Note 6-1 B/P 6-1
2. Factors for the Successful Development of Rural Finance in Viet Nam	Yoichi Izumida	Note 6-2 B/P 6-2 B/P 6-3
3. General Discussion		
Session 5 :Public Finance, Money and Banking (11:20-13:00)		Chair : Verbiest
1. Reformation of the Fiscal and Financial System in Viet Nam	Akiyoshi Horiuchi	B/P 4-1
2. Economic Reform and Fiscal Finance of Viet Nam	Eiji Tajika	Note 4-2 B/P 4-2
3. Reexamination of Financial Policies in View of the Observations in Savings and Investment Survey of Households-1997	Shinichi Watanabe	Note 4-3 B/P 4-3
4. Brief Comments on Fiscal Policy and Financial Institution	Erik Offerdal	
5. General Discussion		
Session 6: Financial Turmoil (14:30-16:10)		Chair : Watzel
1	Akiyoshi Horiuchi	
2. Viet Nam's Policy Responses to External Economic Difficulties	Kenichi Ohno	B/P 5-1
3. The Asian Financial Crisis : The Impact and The Lessons for Vietnam	Erik Offerdal	Note 5-2
4. Proceedings of High Level Seminar on the Recent Financial Developments in Asia and Viet Nam's Economy	Jean-Pierre Verbiest	B/P 5-4
5. General Discussion		
Session 7: Closing Session		

* Although Background Papers (B/P) are not included in this proceedings, most of Notes in Part I as well as presentations in the Record of Discussion in Part II cover main points.

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Mr. Jean-Pierre A. Verbiest	Resident Representative, ADB
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