

Step by Step: Economic Reform and Renovation in Vietnam before the 9th Party Congress

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1. Introduction

At the time of the 8th Party Congress of the Vietnamese Communist Party (VCP) in 1996, Vietnam appeared set to join the ranks of Asian Tiger and Dragon economies. A broad economic reform program implemented in several steps after the 6th Party Congress in 1986 had decentralized decision making and replaced central planning with markets and prices in much of the Vietnamese economy. The responses to the gradual liberalization of the economy had been predictably strong. In agriculture, the reforms turned chronic food deficits into large export surpluses. Industrial development accelerated when individual firms, mainly state-owned enterprises (SOEs), were given the right to decide about prices and production. Foreign trade grew rapidly, albeit from a small base, and thousands of foreign investors were attracted to Vietnam, bringing with them more than USD 2 billion per year in 1995-1997. Altogether, the reforms translated into annual GDP growth rates exceeding 9 percent in the mid-1990s, with corresponding improvements in living standards for large segments of the population.

However, the development during the last few years has looked less impressive. The GDP growth rate fell gradually from its 9.5 percent peak in 1995 to a trough of around 4 percent in 1998 and 1999. Both imports and exports stagnated, and the inflows of foreign direct investment fell by two-thirds between 1997 and 1998. The main reasons for the downturn were arguably found in domestic economic policies, which safeguarded the dominance of SOEs and provided high trade barriers encouraging excessive investment in import-substituting industries without comparative advantages. The result was a capital and import-dependent industrial sector, which generated large deficits in Vietnam's current account (Kokko and Zejan 1996). Although the Asian crisis that erupted in 1997 only had a limited short term impact on the economy (mainly because there were no markets for real estate, equity, and foreign exchange), it complicated the financing of Vietnam's trade and current account deficits, forcing the government to restrict imports (Kokko 1998). This, together with the slow-down in export growth, largely accounts for the rapid fall in the GDP growth rate. Without the Asian crisis, Vietnam might have been able to delay the downturn, but would hardly have been able to avoid it altogether.

The first signs of recovery did not appear until the end of 1999, when large increases in exports boosted production and allowed an import expansion that added further stimulus to the economy. Negotiations for a bilateral trade agreement with the US were also completed in July 2000, and the implementation of the agreement promises to raise Vietnamese exports significantly already from 2001 (assuming that the ratification of the agreement is not delayed). As a result, it is estimated that the growth rate for 2000 reached 6-7 percent, with continued recovery predicted for 2001. Does this improvement in economic performance mean that the structural problems plaguing the Vietnamese economy during the second half of the 1990s have now been remedied? Or is it a temporary recovery caused by high oil prices, unusually large capital inflows from ODA and overseas Vietnamese, and overly optimistic expectations regarding the effects of the US trade agreement?

One reason to be concerned about these questions is the upcoming 9th Party Congress, scheduled for March 2001, during which the VCP is expected to formulate a new ten-year

socio-economic development strategy for the period 2001-2010. This strategy will outline the character of Vietnamese economic policy and economic development for the coming decade. A draft strategy document that has been circulated since July 2000 signals high ambitions, including the doubling of GDP over the ten-year period, with corresponding increases in social welfare and poverty alleviation: the overall goal is “accelerating industrialisation and modernisation in the socialist orientation and creating a foundation for Viet Nam to become an industrialised country by 2020 (VCP 2000:1). However, the feasibility of the strategy is to a large degree dependent on whether the structural problems of the mid-1990s are recognized and resolved. In particular, it is important to identify what are the main obstacles for development in order to set priorities for the use of scarce resources.

Hence, with the ten-year Socio-Economic Development Strategy in mind, the purpose of this report is to make a brief assessment of selected economic developments in Vietnam since the 8th Party Congress in 1996. The focus of the report is on some of the structural reform areas that were identified in the mid-1990s by the donor community as well as by the Vietnamese authorities. These include primarily trade policy and the relative positions of state-owned enterprises and the private sector. One of the main questions is to what extent Vietnam has managed to complete the structural reform programs established in the mid-1990s, as summarized e.g. in the Policy Framework Papers prepared jointly by the Vietnamese government, the World Bank, and the International Monetary Fund. The answer to this question will tell whether Vietnam is better prepared today than in 1996 to enter upon a path of sustainable growth and development. A look at the outcome of past reform ambitions may also reveal which are likely to be the main stumbling blocks for future reforms.

The report is structured as follows: Section 2 provides a brief description of the Vietnamese economy in the mid-1990s, and outlines the reform programs and reform commitments made by Vietnamese authorities at that time. Section 3 looks specifically at developments in the area of international trade and investment, section 4 discusses SOEs, while section 5 looks at the private sector. Section 6 concludes and summarizes the report.

2. Vietnam in the mid-1990s: identifying the reform agenda

Economic boom with structural weaknesses

In the mid-1990s, Vietnam was considered one of the most promising markets and investment locations in East Asia. The gradual shift from traditional central planning to a market orientated economy, which had officially started with the introduction of *doi moi* at the 6th Party Congress in 1986, had led to dramatic improvements in the Vietnamese economy. The GDP growth rate averaged almost 8 percent per year during the period 1990-1995, with over 9 percent recorded in 1995. Domestic savings and investment increased, both in absolute amounts and as shares of GDP. Exports grew from 25 percent of GDP in 1990 to 33 percent in 1995, with even faster growth for imports. Foreign direct investment emerged as an increasingly important source of capital and technology, with the inflow of FDI reaching USD 2.3 billion in 1995 (corresponding to 11 percent of GDP, more than anywhere else in the region). In addition to high growth rates, the reform program produced macroeconomic stabilization. Most importantly, the rate of inflation was reduced from over 60 percent in 1990 to less than 13 percent in 1995, the current account of the government budget recorded a surplus by 1994, and the financing of the current account deficit in the country's balance-of-payments did not appear to be any major problem.

Moreover, the policy reforms contributed to Vietnam's integration into the world economy. Inflows of ODA increased significantly from the early 1990s, several bilateral trade agreements with foreign countries were established, the US embargo was lifted in early 1994,

and Vietnam joined the ASEAN in July 1995. Vietnam's relations with multilateral financial institutions such as the World Bank, the Asian Development Bank and the International Monetary Fund were also normalized, and by 1995, Vietnam held a Structural Adjustment Credit (SAC) from the World Bank and an Enhanced Structural Adjustment Facility (ESAF) from the IMF. These credits were important not only because they provided financial resources, but perhaps mainly because they signaled that Vietnam's economic development was progressing in a satisfactory manner. Both the SAC and the ESAF are normally granted under the condition that the recipient country pursues "appropriate" policies when it comes to structural reforms and fiscal and monetary management. One consequence of the strength of the reform process was that the Vietnamese authorities revised their economic targets for the period from 1991 to 2000. Instead of aiming for a doubling of the country's GDP over this period, as was originally intended in the early 1990s, the target was changed to a doubling of GDP per capita (SRV 1994). Assessing the achievements of *doi moi*, many foreign observers concurred, concluding, for example, that "Vietnam appears well-positioned to become a new East Asian 'dragon'" (Irvin 1995:725). Table 2.1 summarizes some of the advances made in Vietnam between the 7th Party Congress in 1991 and the 8th Congress in 1996.

Table 2.1 Macroeconomic Indicators, 1991 and 1996

	1991	1996
GDP per capita (current USD)	228	290
GDP growth (percent)	6.0	9.3
Inflation (CPI increase, percent)	67	5.6
Aggregate investment (percent of GDP)	15.1	27.9
Domestic savings (percent of GDP)	13.2	16.0
Foreign savings (percent of GDP)	1.9	11.9
FDI inflows (MUSD)	220	1800
Exports (MUSD)	2042	7330
Imports (MUSD)	2105	10480
Government budget revenue (percent of GDP)	13.5	23.3
Government share of industrial output (incl. JVs with foreign investors, percent)	68.5	68.0
Government expenditure on social services (percent of GDP)	4.4	8.0
Share of population with access to safe water (percent)	23.3	42.0
Malaria deaths per 100,000 persons	2.7	0.6

Source: GSO, UNDP (1996).

However, these impressive achievements could not completely hide some of the structural and systemic weaknesses of the Vietnamese economy. By 1996, donors and foreign observers had called attention to several problems related to the import substituting trade regime and the role of the state, in particular the continuing reliance on state-owned enterprises as the main vehicle of development (Kokko and Zejan 1996, Ljunggren 1996, Mallon 1996, UNDP 1996).

Regarding trade policy, concerns focused on the distorted incentives provided by the complex, non-transparent, and highly restrictive trade regime. In order of decreasing transparency, the instruments for import restrictions included formal tariffs, the use of reference prices in customs administration, excise taxes and surcharges levied only on import, formal quotas, other quantitative restrictions, import licenses, and foreign exchange controls (Kokko 1997). These policies created strong incentives in favor of import substitution in consumer goods and selected heavy industries and a bias against export-oriented production (not least because the interventions tended to overvalue the exchange rate). One paradoxical

result was a rapid increase in imports: import-substituting industry in Vietnam, as elsewhere, was heavily dependent on imported machinery, raw materials, and intermediates. Consequently, although exports grew rapidly, import growth was even faster, resulting in growing trade and current account deficits. For instance, in 1995, the current account deficit amounted to over USD 2.6 billion, or 13 percent of GDP. The large imbalances introduced several critical questions. Would it be possible to finance the large deficits without endangering future growth and macroeconomic stability? How would the far-reaching commitments to liberalize trade from around the year 2000 - mandated e.g. by Vietnam's membership in AFTA and the ambition to join the WTO - be realized? Would the protected industries manage to grow strong behind tariff walls during the few years remaining before significant tariff reductions had to commence? Or would the commitments to liberalize trade be neutralized by the emergence of strong interest groups benefiting from, and therefore lobbying for, continued protectionism?

The latter two questions were intimately related to concerns about the role of state-owned enterprises. These were the main beneficiaries of Vietnamese import substitution, in many cases in joint ventures with foreign investors. Although the foreign joint venture partners provided badly needed technology and skills, it was clear that most SOEs operated with obsolete machinery and equipment, with perhaps one-third of the capital stock being completely useless (Le Dang Doanh 1996). In combination with weak incentive structures and poor management practices, the result was very weak technical and financial performance. CIEM (1997) reported that most state enterprises were running at a loss and that only 300 enterprises accounted for 80 percent of the SOE sector's contributions to the state budget. Many SOEs were also forced to borrow capital from other state enterprises, the banking sector (which provided preferential credits to SOEs), and other capital sources, creating a significant debt burden (although the absence of transparent accounting practices still makes it impossible to quantify the total amount of SOE debt).¹ Donors were not only skeptical about the possibilities to achieve high and sustainable economic growth in a system almost entirely based on state-owned industry, but also about the additional problems caused by the combination of import substitution and SOE dominance. Protection from foreign competition was not expected to contribute to badly needed SOE reforms focusing on stricter performance requirements, harder budget constraints, and increased efficiency: on the contrary, it was feared that isolation from international markets would allow weak firms to survive without having to undertake necessary reforms.

The fact that the beneficiaries of protectionism were also the most powerful actors in the Vietnamese economy was another cause for worry. The SOEs and their foreign joint venture partners were not only economically important, but also intimately connected with various levels of political decision making, and in a position to use their political influence to oppose trade liberalization or other reforms that may reduce their privileges. In addition, they could to some extent influence future policy decisions through their own investment behavior, by influencing the costs for liberalization. The more resources the SOEs invested in import substitution before the removal or reduction of trade barriers, the higher would be the cost for future trade liberalization. Hence, they could force the government into a difficult time inconsistency problem. While a commitment to trade reform was desirable *ex ante*, it might

¹ At the end of 1995, unpublished data from the Ministry of Finance estimated the aggregate debt of the SOE sector at a staggering VND 279,000 billion, or about 20 percent higher than the country's GDP (MoF 1997). It is likely that this figure included non-convertible debt (to the former CMEA area), but it is not known what transferable ruble exchange rate the estimate was based on. The civilian debt obligations to the former Soviet Union alone amounted to over 9,400 million transferable rubles in 1994 (IMF 1995). IMF (1999) reports total debt of VND 101,439 billion in the SOE sector in 1997, to be compared with total state capital assets of VND 73,079 billion in the sector.

also be optimal to default on some or all of these commitments *ex post* if enough resources were sunk into the old production structure between announcement and implementation of trade reforms. The lack of a detailed publicized time plan for promised, future tariff reductions increased the risk for this kind of backlash, since it implied that the scheme for trade reform was still open for negotiation. The public investment plans discussed in the mid-1990s clearly revealed that these worries were relevant. More than half of the planned investment spending for the period 1996-2000 was expected to be connected with SOEs, often in import substituting industries (UNDP 1996:20ff).

Another area with severe problems was the banking sector, where lending to inefficient SOEs had created large stocks of problem credits. Official figures indicated that only 8 percent of the loans in the banking sector were non-performing at the end of 1995, but the real problems were significantly larger than that. However, weak regulations and accounting practices, together with the repeated roll-over of loans to SOEs (including the extension of new loans to service old debt), made it impossible to accurately quantify the problem (IMF 1999). Still, the pressure on the banks' balance sheets was beginning to affect their lending. Most private enterprises had to accept very strict collateral requirements but were still largely unable to get any medium or long term credits. SOEs, on the other hand, were not bound by collateral requirements and other restrictions - after all, the state was not expected to default on its obligations.

The development of the private sector in general was disappointing. Private sector growth was stunted by the complex regulatory environment and the competition from SOEs benefiting from political contacts and privileged access to capital, land, and other resources. The GDP share of the domestic private sector, excluding farmers and informal household enterprises, reached only about 7.5 percent in 1995, while the "modern" private sector, consisting of limited liability companies and shareholding companies, accounted for at most one percent of GDP (Webster 1999, Kokko 2000). The lack of a dynamic private sector was worrying, particularly since it was becoming increasingly clear that the inefficient SOE sector would not be able to generate enough jobs for the rapidly growing labor force. In 1995, the SOEs employed only 1.8 million people out of a total labor force of nearly 35 million, with over one million new entrants to the labor force each year. In addition, it was clear that thorough public administration reform would be needed in order to manage reforms in other sectors. Some of the reasons for these reforms were of a structural nature. For instance, at least half of government revenues were generated through protectionism, in the form of direct taxes on trade or profit taxes from SOEs that were profitable mainly because they could set their own prices. Other reasons focused on the efficiency of public administration. The Vietnamese business environment did not only suffer from excessive regulation and red tape: reports of outright corruption were widespread.

The reform agenda: PFP (1996) and SAC I

The structural problems and contradictions in economic policy were by no means unknown to Vietnamese authorities. On the contrary, the agenda for the dialogue between Vietnamese authorities and the donor community included all of the concerns discussed above, and several were also addressed in the government's reform plans in the mid-1990s. Some of these plans were summarized in, for example, two Policy Framework Papers (PFP 1994, PFP 1996) prepared with the assistance of the World Bank and the IMF. These documents laid out the country's general economic objectives for the medium term, including detailed reform commitments reflecting agreements with the World Bank and the IMF: fulfillment of these commitments was in fact a condition for both the Bank's first Structural Adjustment Credit to Vietnam (SAC I) and the Fund's Enhanced Structural Adjustment Facility (ESAF). A look at the reform program outlined by the latest of the Policy Framework Papers (PFP 1996),

prepared in January 1996 and intended to cover the period 1996-1998, is helpful in describing Vietnamese expectations and reform priorities half a decade ago.

Table 2.2 recapitulates some of the strategies and reform measures in the areas of international trade and investment, SOEs, the private sector, the financial sector, and public administration. Before commenting on each of these areas, it is useful to recall the optimistic growth and development forecasts that prevailed at the time. The projected average real GDP growth rate for the period 1996-2000 was 9.5 percent. Total investment was expected to rise to about 34 percent of GDP by 2000, from about 29 percent in 1995. The annual inflows of FDI were expected to reach about USD 2 billion, while export and import growth were forecast to average 16 percent per year. Hence, although there was an awareness of structural problems and imbalances, it was thought that the authorities had reasonable amounts of time and resources available for the adjustment process.

In the area of international trade and investment, the primary aim was to simplify trade regulations. The ambition to abolish import permits and import shipment licenses and to allow all enterprises to engage in international trade was particularly important. The measures focusing on the foreign exchange market, especially the aim to eliminate all restrictions on current account transactions, were also notable. One reason for these quite radical liberalization proposals was the expectation that the current account deficit (which expected to remain significant) would remain manageable: in fact, PFP (1996:7) expected significant improvements in the balance of payments, and noted that "over the medium term, some appreciation cannot be ruled out as productivity improves". This is interesting, because it suggests that neither the Vietnamese government nor the multilaterals were, at the time, very concerned about the distinctly import-substituting character of the Vietnamese trade regime. As a result, the measures intended to reduce the level of protection were relatively weak. Although the document discussed the need to start preparing to meet the AFTA tariff reduction commitments and future WTO accession, as well as the need to eliminate non-tariff barriers to trade, there were no concrete targets or time plans, except for a reduction of the maximum tariff from 100 percent to 60 percent. Evidently, the understanding that a reduction of tariff and non-tariff barriers is of central importance did not emerge until somewhat later. In the field of foreign direct investment, reform proposals were also marginal, which is not surprising considering the large inflows of funds to Vietnam. For instance, in 1996, inward FDI commitments still summed to more than USD 8.6 billion.

The objectives for SOE reform were more far-reaching, presumably because both the World Bank and the IMF considered this a priority area (World Bank 1995). The state enterprise Action Plan was expected to stipulate a clear timetable for the restructuring of the SOE sector, including the identification of strategic enterprises to be retained under government ownership and program for the divestiture of non-strategic SOEs. In particular, it was stated that the equitization of SOEs (which is a combination of corporatization and partial privatization) would accelerate, although no numerical targets were given. A review of the General Corporations, with the objective to limiting them to sectors where economies of scale could be reached without limiting domestic and international competition, was also announced.

While these reform objectives were widely welcomed by the donor community, it was also recognized that they contradicted the rhetoric of Vietnamese politics, and the possibilities to implement radical SOE reform as a first step in a broad structural adjustment program were questioned. For instance, the 8th Party Congress in early 1996 explicitly restated the objective that the state should hold a central position in the country's economic development,

Table 2.2 Structural Policy Reform Commitments in Vietnam 1996

Policy area	Objectives	Measures
International trade and investment	Trade liberalization	• Reduce maximum tariff to 60% • Reduce number of tariff lines • Reduce level of tariffs • Eliminate import permits • Abolish import shipment licenses • Open foreign trade to all enterprises • Apply excise taxes equally to domestic imported goods
	Simplification of international payments	• Remove restrictions on current account transactions
	Enhance efficiency of foreign exchange market	• Support unified market-based exchange rate • Limit official interventions in foreign exchange market
	Improve efficiency of FDI	• Amend FDI Law • Phase out tax on profit remittances • Reduce discrimination between domestic and foreign taxpayers
State enterprises	Improve SOE efficiency	• Adopt state enterprise Action Plan • Implement modern accounting rules • Accelerate equitization • Review experience with general corporations
Private sector	Create level playing field for private sector	• Enact Commercial Law • Amend Company Law • Amend Private Enterprise Law • Simplify procedures for establishing private enterprises without administrative approval • Simplify and rationalize regulations on land use rights • Issue land use certificates
Financial sector	Enhance effectiveness of monetary policy	• Develop secondary market for government securities • Regularize treasury bill auctions • Gradually liberalize interest rates • Introduce open market operations
	Improve efficiency of financial market	• Revise Central Bank Law and Commercial Banking Law • Improve banking supervision • Carry out international audits of state-owned banks • Carry out international audits of major non-state banks
Public administration	Improve efficiency of tax system	• Prepare reform plans for state banks • Prepare for VAT • Reform income and profit taxes
	Restructure outlays to priority areas	• Issue Public Expenditure Review • Prepare Public Investment Program
	Improve efficiency of public administration	• Continue government restructuring and retraining of civil servants
	Improve budgetary system	• Reform administrative procedures • Enact new Budget Law

Source: PFP (1996).

which many (though far from all) Vietnamese interpreted to mean that SOEs should dominate industry. Moreover, the establishment after 1994 of 18 *General Corporations* and some 70 *Special Corporations* – which are large conglomerates incorporating some 2,000 SOEs operating in specific industries or specific geographical areas – essentially identified all large SOEs as strategically important. Kokko and Zejan (1996) therefore argued that more radical trade reforms should precede SOE reform, because protectionism made many SOEs look artificially attractive to the organizations “owning” them. Their assessment was that “large-scale privatization of SOEs will meet fierce opposition as long as the government, individual ministries, regional authorities, and other public entities draw a large share of their revenue from the SOEs they presently control”.

The main thrust of the measures intended to support private sector development was on legal reform. Comprehensive revisions of the Commercial Law, Company Law, and Private Enterprise Law were announced, with special emphasis on a simplification of the regulatory framework for private enterprise. It was stated that “licenses will be required only in cases where public safety or national security are involved. For all other businesses, a registration procedure will be introduced that does not require administrative approval” (PFP 1996:8). In addition, the program included plans to strengthen land use rights and to improve the transferability of non-agricultural land, in order to develop a market with a level playing field for individuals, private firms, and SOEs.

The reforms in the financial sector covered two areas. First, the program included several measures to strengthen the instruments for monetary policy. The primary objective was to start a gradual move away from direct controls (interest rate regulations and credit ceilings) to the use of indirect instruments, such as open market operations. Second, it was clear that the banking system needed to be reformed. In addition to revisions of banking laws and efforts to strengthen banking supervision, a few more concrete measures were also outlined. The four state-owned commercial banks were to undergo detailed audits, and the findings of these audits were to be used to formulate and adopt detailed reform programs for each of the banks. The resulting reforms were expected to be quite radical: PFP (1996:9) stated that the programs “will include provisions for increasing bank capital through issuance of shares, recapitalization where necessary, and reform of operating procedures. These include holding bank management accountable for the commercial performance of the banks, giving the banks the autonomy to determine staffing and salary levels, and freeing them from specific lending directives”. Considering the weaknesses of the banking system, with intimate connections to SOEs, large but undisclosed problem credits, and a lack of experience with market based operations, it was obvious that the objectives for banking reform were also remarkably ambitious.

Public administration reform also covered two areas. On the one hand, it was necessary to make the mobilization of public revenue more efficient. In 1994, taxes on international trade accounted for one-third of total tax revenue, while taxes paid by SOEs comprised half of revenue (PFP 1996:4). It was understood that the impending trade reforms would reduce these sources of income, and a broader tax base was therefore needed. To achieve this, the program aimed to gradually eliminate tax exemptions and preferences, reduce the dispersion in tax rates between sectors and tax payers, and to replace the existing turnover tax (which had eleven rates) with a value-added tax with two or three rates. On the other hand, there was a need for reforms on the expenditure side as well. The most important objectives were to avoid an increase in the ratio of current expenditures to GDP (with a stronger priority for social and economic services) and to focus public investment infrastructure and other projects complementary to private sector investment. The main measures to achieve these objectives were a new Budget Law, a comprehensive Public Expenditure Review to facilitate more

efficient use of public funds, and an annually revised Public Investment Program to control the allocation of investment resources.

In addition to these core areas, PFP (1996) included a discussion of sectoral policy reform, with focus on agriculture, transportation, energy water resource management, and environment. Although health, education, and social safety nets were included in the program, there were few concrete commitments in these areas, apart from the intent to conduct a Living Standards Measurement Survey and use this to target poverty alleviation programs. As noted above, the document also presented forecasts for macroeconomic development up to the year 2000, including detailed projections for the development of Vietnam's external accounts. We will return to these in the following section.

Another official document reflecting Vietnamese reform and development objectives during the same time period is the Vietnamese government's report to the CG meeting in December 1995 (SRV 1995). Although the projections for medium-term macroeconomic development and the reform proposals largely coincided with those presented in PFP (1996), there were some interesting differences. In particular, SRV (1995) was more explicit in identifying some of the system's weakness and challenges. Some of the significant points were:

- Heavier emphasis on the weaknesses in the financial and monetary sectors. Apart from the observation that financial markets were still "embryonic", the Vietnamese authorities also noted that "the seeds of high inflation have not been completely dissipated".
- A more forthright discussion about shortcomings in state management. It was stated that "the legal system is not comprehensive, and there are delays in institutionalising some new policies. Enforcement of laws is not strict. Discipline in the state apparatus remains weak" and that "state management... is still cumbersome, bureaucratic, and lacking in capability. The knowledge and skills of public servants are inadequate to undertake assigned tasks. The problem of corruption has still not been overcome" (SRV 1995:7).
- The continued strategic role of SOEs was not questioned.
- The development challenges in the social sectors, including poverty alleviation strategies, were given more emphasis than in the Policy Framework Papers.
- The need for reforms and improvements in the fields of human resource development and science and technology policy were discussed more explicitly.

A common element in these points is that they stressed complications in the Vietnamese transition and development process, perhaps providing a more realistic setting for the reform program set out in PFP (1996). Another notable difference between SRV (1995) and PFP (1996) was the former report's more optimistic view regarding inflows of foreign capital, and, hence, the scope for investment. While the World Bank and IMF expected the sum of FDI and ODA inflows to average about USD 2.6 billion per year between 1996 and 2000, Vietnamese authorities forecast annual inflows of USD 4-4.4 billion. More than half of this was expected to be connected with SOEs, often in import-substituting activities, as noted above. Arguably, these observations imply that Vietnamese authorities were not extremely concerned about the possible dangers of import substitution, and that they were not about to engage in comprehensive privatization and divestiture of state enterprises in the short run.

No agreement about SAC II

The discussion above has pointed to some contradictions between the structural adjustment program outlined by PFP (1996) on the one hand - in particular, the plans for radical reforms of the state enterprise sector and the banking sector - and the views of various Vietnamese interest groups regarding the role of the state sector on the other hand. It is therefore not surprising that the implementation of the adjustment program was slow. A first indication of a gap between Vietnamese authorities and the multilateral donors was given during the first half

of 1997, when a World Bank pre-appraisal mission for a second Structural Adjustment Credit was undertaken. By this time, World Bank views on the relative importance of different reforms had changed somewhat, at the same time as there were signs of slippages in the Vietnamese reform commitments from the first SAC round. The new round of reforms was intended to focus on two areas: opening the economy to domestic and international competition to ensure improved efficiency in SOEs as well as non-state firms, and improving domestic resource mobilization to reduce the dependence on external resources.

There is no doubt that the shift in World Bank priorities from SOE reform to trade reform as the first major step in a comprehensive structural adjustment program was sensible. A more open and outward oriented trade regime was not only important to generate high growth rates, by allowing the economy's comparative advantages to determine the allocation of investment resources, but also because it facilitated the necessary institutional reforms. For example, trade reform would reduce the nominal profitability of SOEs that used to be protected from international competition, and thus make it easier to discuss reforms in SOE management and perhaps also privatization and divestiture of some SOEs that used to be considered "strategic" because of their ability to generate nominal profits. Meanwhile, state enterprise reform, private sector development, and financial sector development remained important items on the reform agenda, although the proposed SAC II conditions were, in some cases, more concrete and less ambitious than those established for SAC I.

In the trade area, the main new requirement concerned the formulation and implementation of a clear time-bound action program for trade reform, including schedules for the fulfillment of Vietnam's AFTA commitments regarding tariff reductions and phasing out of non-tariff barriers. In the SOE sector, numerical targets for the equitization program were introduced: at least 150 enterprises were to go through the equitization process during the 1997-1999 period. Strict requirements for the collection and analysis of key financial and performance indicators for the largest SOEs were also discussed. The reform proposals for the private sector and the banking sector were largely extensions of the programs agreed upon for SAC I.

However, it was clear already during the first half of 1997 that it would be difficult to reach a new agreement - the implementation of the adjustment program from PFP (1996) was weak, and it proved difficult to reach an agreement regarding some of the proposed new items on the reform agenda. Vietnamese authorities were unable to present any timetables for trade reform. The World Bank mission failed to get access to requested basic data on the financial status and performance of the SOE sector. These data were requested because of the need to ensure that SOEs were facing hard budget constraints. There was concern that the budget constraints of many SOEs were still soft because of transfers from the budget, preferential lending from the banking system, the National Investment Assistance Fund, and the Social Security Fund, external borrowing, or the build-up of inter-enterprise debt and tax arrears. Another key requirement was to increase the transparency of the state budget, which had never been published at that time.

It is likely that most of these problems would have been resolved during 1997 and 1998 if negotiations between the Bretton-Woods institutions and the Vietnamese authorities had proceeded "normally". This was not to be the case. In July 1997, conditions changed sharply because of the outbreak of the Asian crisis. Vietnam was not directly hit by the turbulence in asset markets, since these did not exist in Vietnam. The exchange rate was strictly managed through trade restrictions and controls on the allocation of foreign exchange, there was no real estate market, nor was there any asset market. Instead, the crisis was felt through a reduction in the inflows of foreign capital. The crisis reduced export growth (because of tougher competition from countries with depreciating currencies and weaker purchasing power among Vietnam's regional trade partners) and led to a dramatic fall in inward FDI, as discussed

earlier in this report. The reduced availability of foreign savings revealed some of the weaknesses in Vietnam's import-substituting development strategy and forced the authorities to introduce stricter controls on foreign trade - the opposite of what was called for in the structural adjustment programs. Another consequence of the crisis was that the more radical reform and liberalization plans were shelved for the time being. This also meant that the formal structural adjustment program, with SAC II and Policy Framework Papers covering the period after 1997, were abandoned. It is not until the last two years that notable progress in the area of economic reform has been seen again. The following three sections will summarize developments and reform objectives from the mid-1990s up to the present time, while section 6 will conclude the report with a discussion of the next stage of reforms. Although it is still uncertain how Vietnamese structural reform policies will develop during the coming decade, it is possible to foresee some of the elements that are considered at present, and discussed in the draft ten-year Socio-Economic Development Strategy and the first draft of the Poverty Reduction Strategy Paper (which replaces the Policy Framework Papers from the mid-1990s).

3. International trade and investment: developments and reforms

Trade reform in the 1990s: two steps forward and one step back

As noted in the previous section, trade liberalization was becoming an increasingly important element of Vietnamese economic reforms in the mid-1990s. The membership in ASEAN and AFTA included a commitment to reduce tariffs on regional trade to less than 5 percent by 2006 and to phase out non-tariff barriers to trade. Cautious negotiations about WTO membership were initiated. Trade reform was a central component of the World Bank and IMF supported structural adjustment program in the mid-1990s. The reforms requested by the donor community included simplification of the tariff structure, reduction of maximum and average tariffs, the extension of trading rights to all enterprises, and, from 1997, removal of non-tariff barriers and a fixed time-table for trade liberalization.

Although implementation was slow because of opposition from interest groups lobbying for continued protection, it is clear that some progress was made during the period 1995-1997. For instance, most domestic firms were given export rights in January 1997, at the same time as import licensing requirements for a large number of consumer goods were eliminated.²

The Asian financial crisis resulted in a backlash, as further reforms were put on hold. In fact, many trade restrictions were tightened between 1997 and 1999. The reason was that the crisis led to a fall in the export growth rate and the inflow of FDI, forcing authorities to restrict imports of "non-essential" goods in order to allocate the scarce foreign exchange to the import-dependent industrial sector. This way, Vietnam succeeded in maintaining macroeconomic stability, although the stagnation in export and import growth quickly led to a fall in the GDP growth rate.

However, concerns about the detrimental long-term effects of trade restrictions on the competitiveness of domestic industry grew over time. Another relevant concern was the need to meet the trade liberalization targets set up by AFTA. Until about 1999, Vietnam had been able to fulfil its formal annual tariff reduction commitments by listing goods that were either exported or that already met the 5 percent maximum tariff requirement. Real tariff reductions would definitely be required from 2000. Trade reform has therefore reappeared on the policy agenda, and advanced faster than what was perhaps expected a couple of years ago. The most important concrete result may be the agreement about a Bilateral Trade Agreement (BTA)

² See Decision 28/TTg of January 13, 1997. Trading enterprises were required to hold a minimum working capital of USD 200,000, which was a substantial obstacle for private sector participation in international trade.

between Vietnam and the US, which was signed in July 2000, and arguably makes up a key step in Vietnam's continuing economic reforms. The BTA is also an important step towards Vietnamese membership in WTO. Unlike the AFTA agreement, which is based on consensus and does not prescribe severe sanctions against member countries that do not fulfill their commitments, both the BTA and WTO membership are likely to come with stricter conditions, enforcement, and sanctions. Another important characteristic of the BTA is that it allows Vietnam to reap some of the benefits -- in terms of higher exports to the US -- early on, while the costs -- resulting from improved market access to US firms operating in Vietnam -- will come later. It is possible that this will strengthen the reform process: it will be difficult to default on reform promises once they have generated thousands of jobs that may be lost if promises are not fulfilled.

A further sign of increasing reform orientation is the draft Ten-Year Socio-Economic Development Strategy, which includes deeper international integration as one of the main objectives, and sets up the goal that export growth should be twice as rapid as GDP growth during the period 2001-2010. It will be impossible to achieve this goal without significant trade reform.

However, although various agreements and plans promise significant trade liberalization in the future, it must be noted that few concrete policy reforms have been implemented yet. There is, therefore, reason to look more closely at what concrete measures have actually been undertaken to reform Vietnam's trade regime since the mid-1990s. The following paragraphs provide an overview of the development of Vietnam's external accounts and provide a brief summary of the present trade policy environment.

Vietnam's external accounts: trade and capital flows

The main priority in Vietnamese trade policies during the 1990s has arguably been to provide effective protection for certain domestic industries and to avoid balance-of-payments crises. Until 1997, this did not stop exports from growing at a rate of over 20 percent per year. However, the impact of the regional crisis reduced export growth to about 2 percent in 1998. This had a serious negative effect on the country's GDP growth rate, since it forced a contraction in imports, which was exacerbated by a significant reduction in FDI inflows. A recovery started in 1999, when export growth bounced back to 23 percent, and has continued in 2000, when export growth has remained at almost the same level. Imports and overall growth reacted to these improvements with a lag of about a year. Import volumes were virtually unchanged from 1997 to 1999 but started to grow in 2000. Similarly, the GDP growth rate dropped from over 8 percent in 1997 to around 4 percent in 1998 and 1999, but began to recover in 2000.

Table 3.1 summarizes the Vietnamese balance-of-payments for the period 1995-1999, and provides a comparison of the actual outcomes with the projections for 2000 made in PFP (1996). Some observations are notable. First, although the overall growth rate has fallen far below the projections from the mid-1990s, it is not due to weak performance in external trade. Both exports and imports in 2000 exceeded the projections from PFP (1996) by a wide margin. The problems with lagging growth are not related to difficulties in managing an export-oriented development strategy, but rather caused by weaknesses in the import-substituting parts of the economy.

Second, it is clear that the main miscalculation in PFP (1996) concerned the possibilities to finance persistent current account deficits caused by an inward-oriented development strategy. It was expected in the mid-1990s that Vietnam would be able to finance a current account deficit amounting to 8-9 percent of GDP for an extended period of time, mainly by relying on annual inflows of FDI averaging more than USD 2 billion.

Table 3.1. Balance of Payments 1995-2000 (million USD)

	1995	1996	1997	1998	1999	2000 est.	2000 proj.
Trade balance	-3,155	-3,143	-1,315	-981	1,080	-820	-3,404
Exports f.o.b.	5,198	7,337	9,145	9,365	11,540	14,380	10,552
Imports	-8,353	-10,480	-10,460	-10,346	-10,460	-15,200	-13,956
Factor services (net)	-279	-427	-611	-669	-412		-1,344
Receipts	96	140	136	133	160		
Payments	375	567	747	802	572		
Non-factor services (net)	159	-61	-623	-539	-597		636
Receipts	2,409	2,709	2,530	2,604	2,668		
Payments	2,250	2,770	3,153	3,143	3,265		
Transfers (net)	627	1,200	885	1,122	1,181		1,271
Private	474	1,050	710	950	1,050		1,080
Official	153	150	175	172	131		191
Current Account	-2,648	-2,431	-1,664	-1,067	1,252		-2,396
Excl. Official transfers	-2,801	-2,581	-1,839	-1,239	1,121		
Foreign Direct Investment Inflows (gross)	2,276	1,813	2,074	800	700		2,390
Equity	1,287	891	1,002	240	301		
Loan disbursements	989	921	1,072	560	399		
FDI loan repayments	8	55	174	372	603		
Medium- and long-term Loans (net)	-253	98	375	432	605		715
Disbursements	443	772	1,007	1,121	1,036		1,030
ODA loans	189	336	550	796	970		
Commercial loans	254	436	457	326	66		
Scheduled amortization	-696	-674	-632	-690	-431		-315
Short-term capital (net)	311	224	-612	-644	-1,036		120
Capital Account	2,326	2,079	1,662	216	-334		3,225
Errors and omissions	299	71	-2	327	-150		
Overall balance (incl. Official Transfers)	-23	-281	-4	-524	768		384
Change in net foreign Assets (increase -)	-405	-260	-319	-15	-1,316		-384
Arrears and rescheduling	428	541	323	126	548		
Debt relief	0	0	0	413	0		
Memorandum items:							
Current account deficit in percent of GDP	-13.5	-10.5	-6.9	-4.6	3.9		-7.7
Export growth, percent	28.2	41.2	24.6	2.4	23.2	24	15.5
Import growth, percent	41.1	25.5	-0.2	-1.1	1.1	43	13.3
GDP growth rate	9.5	9.3	8.2	3.5	4.2	6.5	9.5

Source: IMF (2000) for 1995-1999. Projections for 2000 are from PFP (1996).

However, this forecast turned out to be seriously wrong, partly because the Asian crisis made investment capital more scarce, and partly because inflows of FDI fell as a result of the weaker than expected performance of many foreign-invested enterprise in Vietnam. In particular, it turned out that domestic demand was lower than forecast, at the same time as the problems with unclear and changing regulations were worse.

During the last few years, it appears that the foreign-invested enterprises have to some extent turned to exporting to compensate for the slow domestic demand, thus contributing significantly to the recent improvements in Vietnam's trade performance. *Vietnam Economic Times* reports that almost half of Vietnam's record exports in 2000 were accounted for by foreign-owned enterprises, and that the exports of the foreign-invested sector now exceed its imports by USD 2.5 billion.³ These figures are inflated by crude oil exports valued at USD 3.5 billion, which are all classified in the foreign-invested sector. Excluding crude oil, the FDI sector still shows a trade deficit of about USD 1 billion. This notwithstanding, it is clear that the export performance of foreign-owned firms has improved markedly compared to the mid-1990s, and the annual 20-30 percent increases in exports during the past couple of years are very encouraging. The ability of foreign-invested enterprises to redirect production from the home market towards foreign markets suggests that they may facilitate the large export expansions planned for the coming decade.

There are no reliable data to determine how the inflows of fresh foreign investment capital have reacted to the recent developments in Vietnam, but it is likely that the bilateral trade agreement with the US will contribute to a recovery in this area as well. Data for the first 10 months of 2000 showed new FDI commitments of only USD 550 million, but a few large licenses issued during the last two months of the year raised the total to a massive USD 2 billion.⁴ The problem with these figures is that commitments are not binding, and also that 2001 is the year for a Party Congress, when good news are particularly valuable – this gives reason to interpret the data with caution and perhaps a touch of skepticism.

A third point to note is that the contributions of Vietnam's donor community are likely to meet or even exceed the expectations from PFP (1996). ODA disbursements have grown rapidly since the mid-1990s, and are likely exceed USD 1 billion in 2000. In addition, there are reports of significant increases in private transfers in 1999 and 2000, although detailed data are not available. (It should be noted that the figures for private transfers are estimates, since only the part that is transferred via the official banking system is recorded.)

Can the export boom and recovery be expected to be sustainable? The most appropriate answer is probably that there is reason for caution, and that long-term trends can not be extrapolated from the development during the last two years. The main reason for the recovery has been the dramatic increase in international oil prices. The export earnings from oil grew by nearly 70 percent in both 1999 and 2000. This means that around 40 percent of the total export growth in 1999, and over 50 percent of the growth in 2000, were due to an increase in the volume and price of oil exports. Meanwhile, non-oil export earnings grew at around 16 percent in 1999 and 14 percent in 2000. Although this is a much more moderate rate of growth, it should be noted that there are very distinct differences between industries, with some sectors posting very impressive advances. Three sectors recorded particularly high growth rates in 1999 - garments, footwear, and electronics, which expanded by between 23 and 39 percent (IMF 2000). Garment and footwear exports have stagnated in 2000, while seafood and fruit and vegetables have appeared among the fastest growing sectors. Together with crude oil, these five sectors accounted for more than 85 percent of Vietnam's export

³ See Vietnam Economic Times web site, www.vneconomy.com.vn/en/ext_economic/import_export/, "TOTAL Import '2000" and "Total Export '2000", January, 2000.

⁴ Vietnam Economic Times web site, http://www.vneconomy.com.vn/en/ext_economic/fdi/, "Total FDI '2000", January 2000.

growth during the past two years. Export earnings from rice grew by only 0.1 percent in 1999, and fell by over 30 percent in 2000, due to weak harvests and a decrease in the world market price.

In addition to crude oil, exports labor-intensive manufactures, agricultural products and raw materials are the most important export commodities of Vietnam, as shown in Table 3.2. Since 1995 the most significant changes in export structure are that exports of garments and footwear have increased while exports of coffee have decreased. Crude oil, rice, marine products and handicrafts have kept their export shares almost unchanged.

Table 3.2 Main Export Commodities (percent of total exports).

	1995	1998	1999	2000
Crude oil	19.7	13.2	18.1	24.9
Garments	8.3	14.4	15.1	12.6
Footwear	3.8	10.7	12.1	9.7
Rice	9.5	10.9	8.9	4.6
Marine products	8.3	8.7	8.2	10.3
Coffee	10.9	6.3	5.1	3.4
Handicrafts	1.3	1.2	1.5	1.6
Rubber	3.1	1.4	1.3	1.2
Coal	1.7	1.1	0.8	0.6
Other	33.3	32.1	28.9	25.6

Estimates for 1999 and 2000.

Sources: IMF (2000) and Vietnam Economic Times web site

http://www.vneconomy.com.vn/en/ext_economic/import_export/, "Total Exports '2000".

The effect of the region's economic crisis on Vietnam's imports was severe, as seen in Table 3.1: the import growth rate dropped from over 40 percent in 1995 to around zero between 1997 and 1999. The slow-down was mainly a consequence of a deliberate restriction of imports. Temporary quantitative restrictions were imposed in 1997 in order to ration the shrinking resources of foreign currency and to avoid large trade deficits. Constraints on imports could be eased again by the end of 1999, when the supply of foreign exchange had increased due to higher oil prices and increased export earnings. As a result, the dollar value of imports is expected to grow by more than 40 percent in 2000. The size of the import expansion is related to the pent-up demand from the past three years, when many import decisions were postponed, and probably also the upcoming Party Congress, which can be held in a more positive atmosphere if import restrictions are relaxed.

Regarding the structure of imports, the most noticeable feature is the large variation over time in the relative importance of various import categories, as illustrated in Table 3.3. This is to some extent explained by fluctuations in world market prices – in particular, the share of petroleum products has increased dramatically because of the high oil price – but also a result of the changes in regulations. The import restrictions on consumer goods, motorcycles, and cars have varied depending on the availability of foreign exchange, and the import requirements of industry have also varied depending on the overall state of the economy. For instance, the recent increase in imports of motorcycles, cars, and trucks are due to relaxed quota restrictions, while the growing share of leather and garment materials comes from the export expansion taking place in these sectors. The very significant increase in machinery and equipment imports in 2000 is interesting, since it signals a higher rate of investment in the productive sector. At the same time, it raises questions regarding industry structure. The share of machinery and equipment imports was equally large during the mid-

1990s, but much of the investment undertaken at that time went into import-substituting sectors where the return to investment has been low. There is reason to hope that the heavier emphasis on export-oriented sectors during the last few years draws an increasing share of investment to these sectors, but the available data do not allow us to examine this issue in detail.

Table 3.3 Main Import Commodities (percent of total imports).

	1995	1998	1999	2000
Machinery and equipment	25.0	17.8	17.3	22.0
Leather and garment material	3.6	7.1	9.4	8.8
Petroleum products	8.6	7.2	9.1	13.3
Steel and iron	4.6	4.5	5.0	5.1
Fertilizers	6.6	4.1	4.0	3.3
Motorcycles	5.0	3.0	3.4	4.6
Textile yarn	1.6	1.5	1.7	1.5
Insecticides	0.8	1.1	1.1	0.7
Motor cars and trucks	1.8	1.1	0.8	1.4
Cotton	1.1	0.8	0.8	0.6
Cigarette material	1.0	1.0	0.8	n.a.
Cement	1.0	0.0	0.0	n.a.
Other	38.4	50.1	46.4	38.7

Estimates for 1999 and 2000.

Source: IMF (2000) and Vietnam Economic Times web site

http://www.vneconomy.com.vn/en/ext_economic/import_export/, "Total Import '2000".

The changes in the geographical orientation of trade, illustrated in Table 3.4, are also noticeable. Exports have clearly shifted away from East Asia towards Europe and the US. Japan is still the most important trading partner both for imports and exports, but the relative importance of some other Asian export markets, such as Singapore, Taiwan, and China, has diminished. The share of exports to other ASEAN countries has increased by five percentage points since 1995 and is not likely to increase substantially in the future, since most of the member countries, with exception of Singapore and Hong Kong, compete with similar labor-intensive manufactures and agricultural products as Vietnam. Geographical proximity plays a far more important role for imports, as almost 75 percent of total imports originate from other Asian countries.

The importance of the US as a trading partner is expected to increase once the US Congress passes the US-Vietnam BTA and the MFN tariff rates come into force. Exports of goods such as coffee and seafood are not affected by the lack of MFN status at present, but other goods such as garments, footwear, and plastic goods are presently subject to much higher import tariffs than similar goods from other countries, like China. In 1999, the value of exports to the US was about USD 670 million and imports from the US were valued at USD 290 million. According to estimates of the Vietnam National Textile and Garment Corporation, the potential of the US market for their industry alone is at USD 500-700 million per annum.⁵ According to interviews made by the World Bank, companies in the garment and footwear sector mention the trade agreement as the single most important current policy issue and almost all successful private companies have plans to substantially increase investment in the near future.

⁵ Oxford Analytica Brief 1999:1.

Table 3.4. Main Export and Import Partners

Exports	1995	1998	1999	Imports	1995	1998	1999
Japan	26.8	18.0	17.6	Japan	11.2	11.8	14.1
Germany	4.0	9.2	9.0	Singapore	17.5	13.4	12.9
Australia	1.0	5.4	8.4	Korea	15.4	12.1	12.4
US	3.1	6.2	5.8	Taiwan	11.1	10.8	11.0
France	3.1	5.8	5.1	China	4.0	9.1	8.6
Singapore	12.7	4.4	4.7	Thailand	5.4	5.3	5.4
UK	1.4	4.2	4.4	Hong Kong	5.1	4.5	3.9
Philippines	0.8	4.2	3.8	Malaysia	2.3	3.3	3.3
Taiwan	8.1	3.5	3.2	France	3.4	2.7	2.7
China	6.6	2.2	3.0	US	1.6	2.4	2.5
EU	11.9	32.1	30.9	EU	8.1	10.4	9.6
ASEAN	8.1	13.9	13.2	ASEAN	27.8	25.4	24.9

Source: IMF (2000).

The trade policy environment

Although the recent export boom is largely related to the increase in international oil prices, several other export industries have also posted quite impressive increases in output and foreign sales. As noted earlier, one reason is the disappointing development of Vietnam's domestic economy. However, some concrete changes in trade policies have contributed to the increases in exports as well as imports. Gradual improvements and reforms have been seen in an expansion of foreign trade rights, tariff reductions, the relaxation of quantitative restrictions and other non-tariff barriers, and improved access to foreign exchange. A revision of the FDI Law has also been welcomed, although implementation remains slow and erratic.

Foreign trade rights

As a remainder from the pre-*doi moi* era, foreign trade rights were until recently strictly controlled by the authorities. Firms were obliged to obtain a license from the Ministry of Trade to be allowed to import and export. In practice, this system gave SOEs preferential access to imported inputs and export markets, since it was difficult for private companies to fulfil all of the demands required by the law. However, these restrictions have gradually been removed. From 1997, all domestic producing enterprises and large trading firms were allowed to engage in exporting, and from 1998, these rights were extended to all domestic enterprises (with exceptions for goods subject to export quotas). As a consequence, the number of firms registered for international trade increased from about 3,000 to about 30,000. A similar liberalization for import rights was introduced in 1999, in the Enterprise Law - today, all domestic enterprises are allowed to import any goods not subject to quantitative restrictions. Foreign-invested enterprises make up an exception. Their operations are governed by the Foreign Investment Law, which grants them the same export rights as domestic firms, but is more restrictive regarding imports. Foreign-invested firms that are established for manufacturing are only allowed to import inputs for their production process, but no other goods, since they are not approved for trading activities. Amendments to the Foreign Investment Law, passed in May 2000, have not changed this situation (IMF 2000).

Quantitative restrictions

All imports to Vietnam were restricted by an intricate quota system until 1989, when most of the quotas were replaced by tariffs. However, quantitative restrictions were kept in place for 14 strategic import goods (as well as for 10 categories of export goods). The use of import quotas still continues, although the coverage of the quota system has changed over time. In 1996, imports of 7 product groups were restricted by quotas, but several categories were added as the Asian crisis put pressure on the balance-of-payments. In early 2000, quantitative restrictions were still in effective for 19 imported items, of which 8 were temporarily added to the list of licensed goods at the beginning of 1999, to maintain the trade balance. In April 2000, the 8 product groups were again lifted from the quota system.⁶ The tariffs introduced to replace the quotas were typically set at very high levels, between 80 and 100 percent, but the tariff on fertilizers was set at only 5 percent, to support the agricultural sector (IMF 2000). The 11 import items that were still subject to quantitative restrictions in April 2000 were petroleum, oil, motor cycles, automobiles, construction steel and iron, cement, vegetable oil, sugar, paper, alcoholic beverages and construction glass.⁷ All of these goods, except for petroleum, compete with domestic import-substituting industries, and quotas have generally been very restrictive or even prohibitive.

In preparation for the AFTA commitments, the Vietnamese government has recently drafted a schedule for the tariffication of the remaining import quotas in collaboration with Japan. According to the draft plan, quotas on fertilizers, cars, and cement are to be replaced by tariffs in 2005, with construction steel and iron quotas to be lifted in 2007, and those for sugar in 2010. However, the plan has not yet been published because of disagreement about the timing of reforms (Japan is reportedly encouraging a tighter timetable). The most likely development is that the tariffication date for some of the commodities is moved ahead by one or two years.

In addition to the quotas discussed above, it should be noted that imports of all consumer goods have been subject to another kind of quantitative restriction operating through the foreign exchange allocation system. During the first half of the 1990s, the quantitative target was to limit imports of consumer goods to 20 percent of current export revenues, but in 1996, the target was lowered to 9 percent. At present, imports of consumer goods may still be constrained by the allocation of foreign exchange, although it is unlikely that this makes up a significant trade barrier for the time being (see discussion of foreign exchange regulations below).

There are few quantitative restrictions on the export side. Exports of garments are restricted by quotas imposed by the importing countries. The Vietnamese authorities are in charge of allocating the national quota among producers, and there is concern that SOE are favored in the process. However, some signs of liberalization have been seen in recent years. Almost a fifth of the garment export quotas were auctioned in December 1998. The private sector represented 26 percent of the winning bids in that auction (World Bank 1999a). Until recently, exports of rice were also restricted by quotas, but these have been eliminated in 2000.

Tariffs

Vietnam's tariff structure has been subject to continuous revision since tariffs were introduced as the main instrument of trade policy in 1989 (although some quantitative restrictions have survived until the present time, as noted above). Because of the frequent adjustments of the

⁶ Degree 57/1998/ND-C is a policy instrument specifying the main NTBs along with Decision 254/1998/QĐ-TTg (UNDP 2000). The eight goods are consumer electric fans, ceramic sanitary wares, ceramic and glass consumer goods, packages in plastic, liquid caustic soda, bicycles, raw material for plastics, and fertilizers.

⁷ The quota on motorcycle imports has temporarily been lifted at several occasions during 1999 and 2000.

tariff system, it has been argued that the trade environment has remained unpredictable and unstable even when official policies have promised liberalization. Minor revisions of the tariff schedule are made quarterly, while more substantial ones have occurred approximately once per year. One of the main weaknesses of the Vietnamese tariff system has therefore been the lack of transparency and predictability.

The latest substantial revision of the tariff schedule was undertaken at the beginning of 1999. Three different sets of import tariffs rates were introduced at that time: a special preferential rate applicable to imports from ASEAN countries, a preferential rate for the imports from countries with MFN status and a normal rate, set 50 percent above the preferential rate.⁸ In addition, the maximum standard tariff was reduced from 60 percent to 50 percent, except for a few sensitive goods that are subject to higher tariff rates.⁹ The number of rates was also reduced to 12, from around 27 rates in the mid-1990s. In early 2000, a new revision was made to accommodate the tariffication of some goods that had been subject to quantitative restrictions. This increased the number of tariff rates to 19. However, the average (unweighted) tariff fell slightly, to 15.5 percent, since the number of items with rates below 20 percent increased as new product groups were added to Vietnam's CEPT list (IMF 2000).¹⁰ The dispersion of tariff rates, from zero to 100 percent, with high rates on import-substituting goods and lower ones on imported inputs, still provides very high effective rates of protection.

The most important future reforms of the tariff system are not likely to focus on individual product categories or tariff rates, but rather on the predictability of the trade regime. The Ministry of Trade is presently preparing the first five-year plan for tariff changes, including a time-plan for the remaining AFTA commitments, to be published by the end of the year. The plan, when approved and published, will constitute an important step to facilitate the long-term planning of Vietnamese producers. A clear time-bound plan will also reduce the scope for interest groups to lobby at the annual or quarterly meetings, where necessary adjustments to trade policy are decided.

In addition, it can be noted that export tariffs are levied on several goods. Formally, these tariffs remain for crude oil, wood and wood products, cashew nuts, minerals, gems, metallic waste, semi-processed metals, unprocessed leather, and botanical minerals (IMF 2000). However, the rates for most of these are reportedly set at zero percent and only exports of crude oil and scrap metals are taxed at positive rates.

Other non-tariff barriers

In addition to tariff and quota system, Vietnam applies some custom surcharges and special consumption taxes that are largely levied on *ad hoc* basis. Custom surcharges of 2-10 percent are levied on imports of petroleum, certain iron and steel products, and sometimes on fertilizers, as well as on exports of coffee, unprocessed cashew nuts, and rubber. The aim of these surcharges is to offset the negative impact of international price fluctuations, but it is likely that they have instead increased uncertainty (IMF 1999, UNDP 2000). Special consumption taxes are not, in principle, supposed to favor domestic products before imports. However, in practice, they have been used as a trade barrier, as the taxes can be waived or reduced for domestic industries in "economic distress". For example, the 100 percent consumption tax on automobiles and the 50-75 percent tax on beer are currently waived for domestically produced goods (IMF 1999). Customs officials are also reported to complicate

⁸ Most Favored Nation status has been attained by the EU, Japan, most Asian countries outside the ASEAN, and the US, despite the absence of reciprocity at present.

⁹ Tariffs for alcoholic beverages and used clothing were set at 100 percent, and those for automobiles and motor cycles remained at 60 percent.

¹⁰ UNDP (2000) estimated the average tariff rate to be 15.9 percent in 1999.

imports of televisions, bicycles, alcohol, tobacco and other goods by various stamping procedures.

The foreign exchange market

Foreign trade transactions can also be controlled and restricted by the allocation of foreign exchange. The State Bank of Vietnam controls and approves remittances of foreign currency abroad. State Bank authorization is required to borrow foreign currency, to convert dong to dollars, and to open offshore escrow accounts. It appears that state enterprises and agencies still have privileged access to foreign exchange (World Bank 1999b). Until May 2000, the Foreign Investment Law stipulated that foreign-invested firms should balance their foreign exchange needs with their foreign exchange receipts. This requirement has subsequently been relaxed; most classes of foreign invested firms now have the same right as domestic firms to buy foreign exchange from commercial banks. In addition to the restrictions that are stipulated in laws, there are some administrative practices that restrict the availability of foreign exchange. Importers of consumer goods are required to supply their own foreign exchange and imports of other “non-priority” goods have been constrained by the availability of foreign exchange.¹¹ However, the large increase in export revenues has allowed a more liberal interpretation of these restrictions during 2000.

One area that has not been discussed openly in the Vietnamese debate so far is the exchange rate system. During the past years, Vietnamese authorities have been able to combine the two objectives of the exchange rate system - stability and competitiveness - reasonably well. This has largely been due to the extensive controls on monetary as well as real transactions: the authorities have been able to use several different instruments to achieve external balance. This will be increasingly difficult in the future. The reason is that international trade will account for an increasing share of the country's GDP during the coming decade. If the GDP and export growth projections presented in the draft Ten-Year Strategy for 2001-2010 are realized (annual GDP growth of 7-8 percent and export growth of 14-15 percent), exports will reach around 90 percent of GDP by 2010. The sensitivity to fluctuations in international markets will increase markedly, and international competitiveness will be even more important than today. At the same time, many of the instruments used to manage external balance will have to be given up as a result of various trade liberalization commitments. The choice of exchange rate system will be critically important in this new environment, with consequences for all areas of macroeconomic management.

The Foreign Investment Law

The revision of the Foreign Investment Law in 2000 has arguably improved the Vietnamese FDI policy environment significantly, although the institutional reforms are still overshadowed by the difficult general business environment. Yet, some of the reforms are potentially important when (or if) the attractiveness of the Vietnamese market improves. First and foremost, it has been announced that registration, rather than licensing, will be sufficient for some forms of foreign investment. Increased flexibility with regard to changes in investment forms, permission to mortgage the land use rights of foreign investors, a relaxation of the foreign exchange restrictions applying for foreign investors, and tax reductions are also among the promised reforms. Investment by overseas Vietnamese is encouraged through special rebates on profit and remittance taxes. However, these new provisions have not been fully implemented, since all the necessary Decrees and Regulations have not been issued yet.

¹¹ The most recent renewal of these controls is found in Decision 242/1999/QĐ-TTg (IMF 2000). Representatives of the State Bank of Vietnam confirmed that these are still in use.

Foreign trade beyond 2000: where does Vietnam stand?

Is Vietnam in a better position to manage its international trade and investment relations at the end of 2000 than in the mid-1990s? Comparing the present situation regarding trade reform with the commitments from the mid-1990s, it can be seen that several important advances have been made, particularly in extended trading rights to all enterprises, but that success has been limited in other areas. The tariff structure is still complex and protects import-substituting industries with high effective tariffs, several quantitative restrictions and non-tariff barriers are in place, and, most importantly, there is still no time-bound plan for trade liberalization. At the time of writing, there is not even a published time-plan for the completion of Vietnam's CEPT commitments to AFTA. Exchange rate policy is another area where little progress has been made although reforms are essential.

There is, nevertheless, reason to be cautiously optimistic regarding international trade and investment reform. One reason is that Vietnam's experiences with outward-oriented development policies have, so far, been positive. Despite various obstacles, it is encouraging that Vietnamese exporters, as well as foreign firms exporting from Vietnam, have managed reasonably well in international competition and that several sectors have posted impressive growth records. The current windfall gains from oil exports may divert attention from other export industries and retard further growth in these areas, but the large earnings also provide badly needed investment resources. In fact, with continued trade liberalization along the lines outlined by Vietnam's present reform plans, these revenues could be invested to diversify the export industry and to facilitate the structural shift from import-substitution to a more outward-oriented environment.

Another reason is the expressed intention to join the WTO and the conclusion of a bilateral trade agreement with the US. These steps reflect a significantly higher degree of commitment to trade liberalization than any of Vietnam's earlier undertakings in this area. Somewhat provocatively, it can be argued that Vietnam can not turn away from these commitments once they have generated an investment response in the country without risking serious macroeconomic and social instability. But this investment response is unlikely to occur until concrete liberalization has taken place, or at least until a firm time schedule for tariff reductions and the elimination of non-tariff barriers has been scheduled. China's imminent entry into the WTO also puts pressure on Vietnam to move ahead with trade reform: export success will be more difficult to achieve if China benefits from more favorable treatment in the main export markets.

It is also important to note that the success of trade reform to a large extent depends on other elements in the country's structural reforms. During the high-growth period of 1992-96, the main impetus to growth came from private consumption and FDI flows. Much of the FDI flows were directed into heavy industry and real estate, and did not take an advantage of Vietnam's comparative advantages in labor-intensive manufacturing.¹² The import-content of these import-substituting FDI projects was very large. At the same time, foreign-invested enterprises accounted for only 8.5 percent of total exports in 1991-1998. As noted earlier, there have been great improvements in the export performance of the FDI sector. The greatest export potential for further gains during the coming years is found in labor-intensive light industry, where FDI has not played any central role so far. In recent years, there has been some increase in the relative importance of light manufacturing among foreign-invested enterprises, but the increase in the share of heavy industry has been even larger.¹³ In order to exploit the comparative advantages of Vietnam, more investment, both foreign and domestic,

¹² During the period 1994-1998, 34 percent of total FDI disbursements went to industrial sector, of which nearly half to heavy industry (IMF 1999).

¹³ The share of light industries in total FDI increased from 18.5 to 23.5 percent and the share of heavy industries grew from 20.1 to 45.6 percent between 1995 and 1998 (IMF 1999).

should be directed to light manufacturing. If the inward FDI flows do not increase very significantly during the coming years, then domestic savings will have a very important role to play in boosting the export-oriented industries. What is needed to allocate private funds into the manufacturing sector is political and macroeconomic stability, successful implementation of the trade reforms that have already been announced, reforms in the financial system, and the establishment of a level playing field for the private sector. To assess the prospects for this kind of development, the next sections will examine the reforms focusing on SOEs and the private sector.

4. State enterprise reform

The state sector continues to dominate the Vietnamese economy, in spite of the gradual shift towards a market economy that started in 1986, and despite the emphasis on SOE reform and privatization in the structural adjustment programs formulated since the mid-1990s. The dominance of the state sector is largely explained by two factors. Firstly, unlike in many other transition economies, Vietnamese SOEs were able to respond positively to the early economic reforms. The main reason is that the Vietnamese social, economic, and political institutions did not collapse as a result of the reform process, which allowed existing SOEs to adjust to the new set of rules in a reasonably stable institutional and macroeconomic environment. Another important factor was the particular structure of the SOE sector itself. The share of large, centrally controlled SOEs was small until the mid-1990s, and most enterprises in the state sector were instead controlled by provincial and municipal authorities. In most cases, it was even been possible to identify the specific “owner” of the SOE - a line ministry, a local People’s Committee, an army division, or some other part of the public sector or Party organization. This decentralization of decision making, with considerable managerial autonomy in operations as well as financial matters (including the right to decide how a significant share of the profits were to be used), explains why many SOEs were able and willing to respond to the opportunities opened up as a result of the economic reforms (Mallon 1996). Hence, many of the over 12,000 SOEs existing in 1986 expanded and diversified from their traditional sectors, such as heavy industry, to services and manufacturing of consumer products.

Secondly, the Vietnamese reform process has largely been driven by pragmatism rather than ideology. The official political doctrine is still communism, and public ownership of the means of production - at least in “strategic” sectors - remains an important element of the ideology. It is not until the last few years that the private sector has officially been recognized as an important element of the economy, and the SOE sector is still favored by various rules and regulations, particularly related to financing. In fact, there is an ongoing debate within the communist party about whether it is appropriate for a party member to own a private enterprise and “exploit” the labor of others. One result of the privileges afforded to SOEs is that the development of the private sector has been weak. Private investors have, quite rationally, remained cautious with long-term investments as long as they have been uncertain whether private property rights are protected and private sector activities are politically acceptable. It can also be argued that the inward-oriented trade regime has created a general bias against the private sector. The business environment has favored large and capital-intensive projects that may not survive without protection from international competition. Few domestic private investors have been able to accumulate the necessary investment resources, and even fewer have been willing to sink their own money into projects that may not survive in the long run. Neither of these problems has, at least until recently, been an absolute deterrent for SOE investment.

The objective of this section is to summarize the state of affairs in the SOE sector and to discuss the recent reforms in this area.

SOEs in charge, but weak leaders

The dominant position of the state is confirmed in official statistics on the Vietnamese economy. Table 4.1 shows that the aggregate GDP share of the state sector hovered around 40 percent during the second half of the 1990s. This is only about 4 percentage points lower than the state share in 1986, although the country's GDP has more than doubled in real terms since that time (Mallon 1997). One reason for the state's high GDP share is that most of the state sector activities are found in the relatively fast-growing parts of the Vietnamese economy: industry and services. Less than 250,000 of the 3.3 million state employees are found in agriculture, while about 1.7 million are engaged in SOEs, most of them in manufacturing. The non-state sector, on the other hand, is concentrated to the agricultural sector. More than 75 percent of the Vietnamese non-state labor force of 35 million workers are found in agriculture, where they produce less than one-quarter of the country's total output.

Table 4.1 GDP by Sector and Ownership 1995-1999 (percent of GDP)

	1995	1996	1997	1998	1999
GDP	100	100	100	100	100
State	40.2	39.9	40.5	40.0	39.7
Non-state	59.8	60.1	59.5	60.0	60.3
Agriculture	27.2	27.8	25.8	25.8	25.4
State	1.2	1.3	1.1	1.1	1.2
Non-state	26.0	26.5	24.6	24.7	24.3
Industry and construction	28.8	29.7	32.1	32.5	34.5
State	14.5	14.4	15.4	15.4	16.0
Non-state	14.3	15.3	16.7	17.1	18.5
Services	44.1	42.5	42.2	41.7	40.1
State	24.6	24.3	23.9	23.5	22.5
Non-state	19.5	18.3	18.2	18.2	17.6

Source: IMF (2000).

The apparent state dominance is less overwhelming if we look separately at the industrial sector, see Table 4.2. SOEs accounted for more than 50 percent of industrial output in the mid-1990s, but their share had diminished to about 43 percent by 1999.¹⁴ The reason was slower growth and productivity development in SOEs than in foreign-invested enterprises, which managed to increase their output share from 25 percent to 35 percent between 1995 and 1999. The sluggish performance of the SOE sector is closely related to weaknesses in technical and management skills, as well as to the bottlenecks that emerged between 1997 and 1999, when the Asian crisis led to the tightening of import restrictions to maintain the balance-of-payments. However, some problems with the SOE sector were evident already before the Asian crisis hit the region. Most importantly, the state sector has not managed to create any significant increase in employment opportunities since *doi moi* was launched. The inward-oriented trade regime has encouraged investment in capital-intensive import-

¹⁴ It is difficult to provide an accurate description of ownership structures in the manufacturing sector, since many FDI projects are set up as joint ventures with SOEs. For instance, Webster (1999) classified joint ventures into the state sector, which raised its shares of manufacturing GDP to well over 50 percent.

substituting industries where few jobs have been created. Pool (1999) reports that state enterprises accounted for over 85 percent of the total registered capital of all new firms established between 1991 and 1997. Yet, employment in state enterprises decreased from 1.9 million to 1.8 million jobs during the same period, although the total labor force increased by about 6 million people. The average capital cost to create one new job in SOEs during this period was about USD 7,500, whereas each new job in private small and medium sized industrial enterprises cost USD 1,000-2,000.

Table 4.2 Industrial Production by Ownership 1995-1999
(percent of industrial production).

	1995	1996	1997	1998	1999
State sector	50.3	49.3	48.0	45.9	43.5
Non-state sector	24.6	24.0	23.1	22.1	21.8
Cooperative	0.6	0.6	0.6	0.6	
Private	2.2	2.4	2.4	2.2	
Household	17.6	16.1	14.7	13.8	
Mixed	4.2	5.0	5.5	5.5	
Foreign-invested sector	25.1	26.7	28.9	32.0	34.7

Source: IMF (2000).

Another problem has been the accumulation of large debt, including non-performing debt, in the SOE sector. IMF (1999) reports that at least two-thirds of the SOEs were classified as permanent or temporary loss-makers in 1997, and that the aggregate debt of the SOE sector exceeded its total assets by a wide margin. The situation has deteriorated since that time. One indication is the increasing amount of non-performing loans (NPLs) in the banking system. According to official data, some 12 percent of loans were overdue in late 1998, but problem credits were underreported because of vague definitions and regulations. IMF (1999:29) estimates that the NPLs in state-owned commercial banks amounted to 30-35 percent of their total lending already in 1997, with a somewhat higher figure for joint-stock banks. If these estimates are correct, it implies that Vietnam's problems with bad credits are significantly worse than those in countries like Thailand and Malaysia before they were hit by severe financial crises.

There are two major reasons for the weak performance of Vietnamese SOEs. One is that Vietnam's comparative advantages in many of the industries where import-substituting SOEs operate are very weak. Another reason is that Vietnamese SOEs do not appear to be subject to hard budget constraints. Loss-making SOEs have systematically been rescued through the write-off of non-performing loans and cash injections from state-owned banks, the National Investment Assistance Fund, Social Security Funds, and other sources. For instance, IMF (1999) notes that several of the most severely indebted SOEs were able to increase their total outstanding debt by 50 percent or more in 1997, mainly by recourse to the state banking system. The softness of the budget constraint is particularly problematic because the incentives of SOE managers to maximize profit are weak. Financial profit is not always the only objective of SOEs nor is the remuneration of the managers directly related to the enterprise's economic performance. Lacking individual profit-oriented owners, the objectives of SOEs are often defined by politicians, and may include a multitude of specific targets ranging from maximization of employment to regional policy objectives. This means that performance is difficult to monitor, both because it is hard to find appropriate performance measures for all objectives and because the weights of the different objectives are seldom specified. Hence, managers are often free to set their own priorities.

It may be difficult to achieve high efficiency even if the Vietnamese state could establish profit maximization as the formal objective for the SOE sector. In the present environment, with complex regulations and limited competition, the SOEs are facing input prices that do not reflect underlying demand and supply. Moreover, the establishment of General and Special Corporations has created a situation where the SOEs hold enough market power to set their own prices. In these conditions, the nominal profit that is generated is not a good measure of efficiency. For example, a state enterprise that has a monopoly in its market may be able to generate a financial profit even if management and physical production practices are inefficient. With limited competition and lack of a level playing field for SOEs and their competitors, it is also hard for decision makers to determine what is a reasonable return on business operations in any specific industry.

Reform programs and reform results

Given the inefficiency and financial weakness of much of the SOE sector, there is no doubt about the need for reform. Section 2 discussed the comprehensive reform plans for state enterprises included in the structural adjustment programs outlined in the Policy Framework Papers in the mid-1990s. It is worth restating some of the reform objectives here before we summarize actual outcomes during the past years. In this context, it is also appropriate to emphasize the close connection between SOE reform and policies to promote private enterprise: it is hardly reasonable to discuss privatization and divestiture of state-owned industry unless measures are taken to improve the environment for private business.

Firstly, restructuring of state enterprises is essential. Mallon (1997) pointed to five particularly important measures that are still relevant:

- agencies responsible for regulating business should not be allowed to own enterprises,
- SOEs should be incorporated under the Enterprise Law under the same rights and obligations as private enterprises,
- most smaller SOEs should be divested or leased to private individuals,
- a significant number of large and medium-sized SOEs should be *equitized*, and
- corporate governance and incentive structures should be improved for remaining SOEs.

Secondly, there is a need for changes in the regulatory environment for private business to reduce disincentives to private sector development. This includes measures to strengthen property rights and contract enforcement, simplification of various registration and licensing requirements, and a reduction of the remaining privileges of SOEs, such as preferential access to credits, land, and foreign investment contacts. Reform of the financial sector also belongs to this group of institutional changes.

Thirdly, changes in macroeconomic policies are needed to avoid misallocation of resources. Trade and exchange rate policies should be formulated in such a way that domestic relative prices (for factors of production as well as for output) do not encourage investment in areas where the economy has no prospects of establishing competitive production. High trade barriers may be particularly harmful from this perspective. Import protection encourages domestic production, but it also puts a high premium on smuggling, which undercuts the profitability of “official” domestic producers.

Restructuring of the SOE sector: three steps forward and two step back

The reforms of the Vietnamese SOE sector during the 1990s have been somewhat contradictory. A major restructuring program was undertaken between 1990 and 1993, when direct budget subsidies to SOEs were discontinued and the number of state enterprises was reduced from about 12,000 to 6,300. Some 2,000 of the smallest and least profitable enterprises were closed, while the remaining 4,000 were merged with other SOEs. These measures introduced some discipline particularly among the smaller firms, but the effects on

larger SOEs were limited, since state subsidies were quickly replaced by soft credits from the state banks. In 1992, the government also introduced regulations to allow the equitization (the conversion of SOEs into joint stock companies) of non-strategic enterprises. However, the equitization process was remarkably slow, for various reasons. Only 17 enterprises had been equitized by the end of 1997, partly because of technical problems in the valuation of assets, but primarily because of the unwillingness of SOE managers and "owning" organizations to volunteer for equitization. Few SOE managers were willing to give up the protected position within the state sector, employees were afraid of losing their jobs, and few of the owning organizations saw any benefits in giving up control over "their" enterprises. The proceeds from equitization did not go to the "owners" within the state sector but rather to the central budget, and the state's ownership shares after equitization were not managed locally but instead transferred to a special department for the management of state capital assets at the Ministry of Finance.

In fact, by the mid-1990s, there did not appear to be any serious ambition to reduce the role of the state sector. On the contrary, the Eighth Congress of the Vietnamese Communist Party in June 1996 restated the objective that the state sector should hold a central role in the country's development. The establishment in 1995 of 18 *National Corporations* and 70 *Special Corporations* - which are large conglomerates created through the merger of large numbers of firms operating in various strategic industries or specific geographical areas - was a step in this direction.¹⁵ Another 8 National Corporations have been established since that time. Together, the National and Special Corporations absorbed around 2,000 of the 6,300 SOEs that existed at the end of 1994. Table 4.3 identifies the 26 National Corporations that had been established by early 2001.

The roughly 2,000 firms included in the National and Special Corporations are estimated to account for about half of the employment and some 80 percent of the resources and production capacity of Vietnam's SOE sector. The motives for the establishment of these conglomerates were to secure the leading role of the public sector by establishing state control over a number of strategic industries, to achieve economies of scale in production and management, and to make it possible for Vietnamese SOEs to compete on a more equal basis with foreign multinational corporations.¹⁶ The problem is that it is not obvious how centralized management and monopolization of important industries will lead to the necessary improvements in technical and financial performance. The unwillingness to undertake more radical SOE reforms was, together with the slow pace of trade reform at this time, the main reason for the failure to reach an agreement about a SAC II with the World Bank.

The SOE reform process gained some momentum in early 1998, when the regional crisis focused attention on the weaknesses in the SOE sector. Several Decrees introduced during 1998 included measures to curb the large losses in SOEs. Decree 20 stipulated that permanently loss-making enterprises should be divested or liquidated. A program to divest small SOE with registered capital below VND 1 billion, mainly by sales to employees was also introduced. It was estimated that this program might affect about 1,500 enterprises (IMF 1999). Decree 44 simplified the equitization process, and numerical targets for equitization were introduced. It was announced that the process would involve 150 enterprises by the end of 1998, 400 by the end of 1999, and 1,000 by the end of 2000.

¹⁵ The General Corporations are established under Prime Minister's Decision No. 91-TTg, dated March 7, 1994, while the establishment of Special Corporations is based on Decision No. 90-TTg of the same date

¹⁶ See Decision 91/TTg (7/3/94), "Pilot Work to Establish Business Groups". See also Mallon (1996).

Table 4.3 List of National Corporations

Corporation (number of member firms)	
Vietnam National Coal Corporation – VINACOAL (48)	Vietnam National Tobacco Corporation – VINATABA (5)
Vietnam Oil and Gas Corporation – PETRO VIETNAM (19)	Vietnam National Coffee Corporation – VINACAFE (68)
Vietnam National Steel Corporation – VSC (27)	Vietnam Sugarcane and Sugar Corporation II – VINASUGAR II (13)
Vietnam Cement Corporation – VNCC (19)	Vietnam National Vegetable and Fruit Corporation – VEGETEXCO (28)
Vietnam National Chemical Corporation – VINACHEM (66)	Vietnam Northern Food Corporation (36)
Vietnam National Paper Corporation – VINAPIMEX (21)	Vietnam Southern Food Corporation (36)
Vietnam National Textiles and Garments Corporation – VINATEX (57)	Vietnam General Rubber Corporation – GERUCO (36)
Infrastructure Development and Construction Corporation – LIGOGI (19)	Vietnam National Petroleum Import-Export – PETROLIMEX (51)
Vietnam National Gemstones and Gold Corporation – VIGEGO (11)	Vietnam Forest Corporation – VINAFOR (13)
Vietnam Shipbuilding Industry Corporation – VINASHIN (26)	Vietnam Insurance Corporation – BAO VIET (64)
Vietnam National Shipping Lines – VINALINES (23)	General Company of Construction No.1 (14)
Vietnam Water Transport Corporation – SOWATER (11)	Vietnam Post and Telecommunications Corporation – VNPT (36)
Vietnam Airlines Corporation (20)	Vietnam Electric Corporation

Source: Vietnam Economic Times web site, January 2001

www.vneconomy.com.vn/en/business/national_corps/

However, implementation of the equitization program was slow. Only some 150 enterprises went through the equitization process between the end of 1997 and mid-1999. Regulations for the divestiture program were not issued: consequently, nothing happened in this area. A review of the National Corporations conducted in early 1999 noted serious problems related to low productivity, high costs, and the emergence of monopolies, but did not conclude that restructuring would be needed. Instead, it was proposed that the National Corporations should be maintained and strengthened: in practice, this meant more bank credits and higher barriers to competition. It is estimated that the government provided about 2.2 percent of GDP annually between 1997 and 1999 in supplementary capital, subsidies, tax exemptions, debt write-offs and preferential credits to the SOE sector (World Bank 2000).

Yet another round of SOE reform was launched in early 2000. The equitization process accelerated, with a total of over 450 enterprises completing the process by the third quarter of 2000. The increase in the number of equitized companies is related to several factors. The choice of enterprises is no longer voluntary, but rather decided centrally. Equitized enterprises are allowed to keep some of the privileges of SOEs in the medium term. Programs to establish social safety nets - e.g. severance payments - for the redundant workers of these enterprises have also been introduced.

A state enterprise reform plan, called for already in PFP (1996) has also been prepared during 2000, although it has not been officially approved at the time of writing. This plan promises to lay out a framework for comprehensive restructuring of the SOE sector, including measures to accelerate equitization, proceed with sales or liquidation of permanently loss-making enterprises, restructure larger SOEs, and establish broader social safety nets for redundant SOE workers. Altogether, the plan envisages that 1,857 SOEs are to be equitized, divested, or liquidated, while another 423 are to be restructured or merged during the coming three-year period (World Bank 2000).

Looking ahead: SOE reform after 2000

Looking at the actual implementation of SOE reforms, Vietnam has progressed further than what PFP (1996) called for when it comes to the equitization of SOEs, but progress in other areas is minor. Few concrete measures have been taken to address the potential problems related to the market power of National Corporations, independent audits have not been undertaken and modern accounting rules are still missing. At the same time, it is clear that the proposed SOE reform plan includes most of the measures that are still needed. An assessment of SOE sector reform therefore depends critically on the approval and implementation of this plan. A not too bold forecast is that significant parts of the proposed plan will be approved, but that implementation will be slow due to resistance from those interest groups that face a reduction in their privileges. The question is whether there are any other interest groups within Vietnam that are willing to provide a counterweight to those opposing SOE reform, or whether this is to be the task of the donor community and possibly the highest levels of government.

5. Private Sector Development

In addition to the continuing dominance of the state sector and the rapid growth in the production share of foreign-invested enterprises, Table 4.2 also revealed the diminishing share of the private sector in industrial output. The aggregate share of private firms has fallen from nearly 25 percent in 1995 to less than 22 percent in 1999. This reflects the complicated business environment in Vietnam, where the domestic private sector is struggling not only against a complex bureaucracy but also against SOEs with various privileges. Moreover, the bulk of the private sector is made up of household enterprises, which operate at a very small scale and with very simple technologies. The modern private sector, consisting of domestic limited liability and joint-stock companies, accounts for less than 3 percent of manufacturing output, or less than 1 percent of GDP. The perhaps most remarkable characteristic of the private manufacturing sector is that only 466 private firms had manage to grow to a size exceeding 100 employees in 1998. Few of the largest firms sought their customers on the domestic Vietnamese market, presumably because they were unwilling or unable to challenge the SOEs active in these markets: instead, they were largely focused on food and beverages, garments, leather products, and wood products for exports (Webster and Taussig 1999).

Obstacles to private sector development

The complex and thoroughly regulated business environment in Vietnam makes it difficult to identify the relative importance of various obstacles to enterprise development. Still, it is easy to identify several problem areas that appear frequently in discussions about private sector development. A first issue is related to the legal framework for land use rights. According to the laws, all land belongs to the people and is administered by the state. Individuals and companies may have a legal right to use land, but never to own land. The right to use land is

documented in special land use certificates, which define the accepted uses of the land, e.g. agriculture, industry, or housing. These certificates can be traded with some restrictions, as well as inherited. They are also required if land is used as collateral. Without a certificate, firms - especially new firms - will find it very hard to secure loans from the banking system, and they will be restricted to operate on leased land, where the long-term user right are uncertain.

Private enterprises have typically found it very hard to come into possession of the documents required for land use certificates, particularly in urban areas. There are many complaints about the lack of a unified public registration system for the transfer, lease and mortgage of land. The government approval process for each application for land use rights were cumbersome, arbitrary, and it discriminated against private enterprises. The value of land use rights has been determined administratively by governmental officials rather than by market forces, and land lease procedures have varied from place to place. In urban areas, long-term land use rights have mainly been allocated to SOEs. This has enabled them to obtain the bulk of the credits from the banking system, and also contributed their ability to form joint ventures with foreign investors. In many cases, the only tangible contribution of the Vietnamese partner has their land use rights, which have surprisingly often been valued at 30 percent of the total project value. Private enterprises have not been attractive as joint venture partners because they have rarely had any land to offer (and, of course, because foreign investors have been well aware of the less than whole-hearted official support to private firms).

Another central problem area is taxation. Complaints about the complicated tax system, with differential sales tax rates for different sectors and much scope for discretion in assessing tax rates, were common before 1999. Some of these complaints have been abated by the introduction of the value-added tax (VAT) at the beginning of 1999. However, complaints regarding profit taxes remain. Profit tax rates differ between business activities, but there are also differences between different types of enterprises in the same economic sector. For example, profit tax rates on domestic private enterprises are often twice as high as tax rates levied on foreign-invested projects and SOEs.

Other common complaints focus on the extensive licensing requirements in all areas of business. At the beginning of the year 2000, it was estimated that the Vietnamese authorities required some 400 various kinds of licenses from domestic companies, many of which - printing licenses, photocopying licenses, etc. - applied to several areas of business. Although around 100 types of licenses were dropped from the books in early 2000, the remaining 300 licenses constitute a significant administrative burden for most firms. They also introduce an element of uncertainty into business planning, because of the discretionary decision making practices of Vietnamese authorities. In this context, it is necessary to note that complaints about red tape and corruption are still common, and that the Vietnamese legal system has been assessed as one of the weakest in the region.

Access to investment capital

The most common complaints, however, concern access to investment finance. Analyzing financing in a sample of 371 private enterprises, Ramamurthy (1998) notes that the great majority of enterprises relied on personal and family savings for investment and working capital. More than half of the surveyed enterprises relied solely on their own savings for the initial capital requirements. Only a few of the most successful enterprises were able to get any credits from banks and other financial institutions, and even in these cases, loans were small and of short maturity. Worker contributions, interest-free loans from friends and relatives, and loans from the informal sector were all much more important than the formal banking sector as sources of credit.

The main reason for the lack of formal credit is that most the available resources have been directed to SOEs, who have often failed to service their debt. The resulting NPL problems have forced banks to restrict lending to all but their strategically important customer, that is, the state. Private enterprises have also been directly discriminated by the rules in the banking system. For instance, private enterprises are required to present some collateral in order to obtain a loan, whereas SOEs are not. Moreover, private companies pay higher rates of interest than SOEs. Another reason is the low level of development in the private sector: the credit risks connected to loans to private SMEs are high because of the unfavorable business environment. It should be noted here that investment capital is a scarce resource in Vietnam, because the banking system has not been very successful in absorbing domestic household savings. Pool (1999) reports that while domestic savings increased from 7.4 percent of GDP 16.5 percent between 1990 and 1997, domestic banks only managed to attract one-fourth of these savings. The rest was reportedly kept in mattresses, invested in inventory and real estate, or channeled through the informal financial sector.

While the restricted access to credits has made private industry very self-sufficient- the average ratio of debt to assets among SMEs is around 25 percent, to compare with 60 percent for SOEs - it has also restricted their growth potential. Only the most successful companies are able to expand and invest in reasonably modern technology as long as the bulk of financing must come from retained earnings.

Science and technology

A further problem for Vietnam's private sector (as well as for Vietnam's SOEs) concerns the supply of scientific and technical expertise. Although growth and industrialization have been at the forefront of Vietnamese development strategy for a long time, there has until recently not been much emphasis on reforms and strategies in the field of science and technology (S&T) policy. With the increasing outward orientation of the economy and the recent global boom in information and communication technology, it appears obvious that more emphasis on the S&T sector will be needed to manage international integration and to benefit from the opportunities offered by the "knowledge-based economy". The upward trend in incomes and labor costs also suggest that new technologies and higher productivity are necessary for international competitiveness.

The historical development of S&T policy in Vietnam largely reflects the different stages of the economy's development since the exodus of the French in the late 1950s. Until the 1970s, the state had the exclusive right to organize S&T activities, establish the institutes that were needed, and manage human resource development. This top-down organization was modeled on traditional USSR and Eastern European structures, and most S&T programs were set up to match those in other socialist countries, where assistance could be found e.g. for human resource development. The main weakness of this system was that the development of science and technology was isolated from the rest of the economy, so that innovations were concentrated to priority areas identified by administrative decrees. In practice, this meant a bias towards producer durables and defense industries. The reforms undertaken since that time, and particularly after the introduction of *doi moi* in 1986, have focused on cautious liberalization and decentralization. As a result, the state monopoly of S&T has been eliminated, and the right of individuals to carry out scientific activities and to collaborate with foreign institutions has been recognizes. The Foreign Investment Law and Law on Science and Technology from 1995 are particularly important, and include rules focusing on the protection of copyrights, industrial property rights, and a legal framework governing technology transfer (Dam 1997, Annerstadt et al 1997).

Despite these reforms, it is clear that the present policy environment is not sufficiently good to generate a more dynamic S&T sector. There are several serious problems. Most S&T

institutes in Vietnam are dependent on government financing. For instance, out of 233 research institutes and centers surveyed by the Ministry of Science, Technology and Environment during the second half of 1995, 97 percent were wholly or partially dependent on government funds (MoSTE 1996). Yet, public investment in S&T has been very limited, with less than one percent of total public expenditure going to this sector. Not much R&D is carried out outside the public R&D institutions, but the linkages between enterprises and these institutions is limited. As a result, most of the research is "supply driven" and does not have any direct connection to the production needs of business and industry. Human resources are in scarce supply, and the average age of Vietnamese scientists is high, at around 57 years (as shown in Table 5.1). The opportunities for advanced overseas training have been quite limited since the 1980s, whereas much of the older generation of scientists received training and higher education in the Soviet Union. In particular, there is a need for policy coordination and supporting reforms in other areas, such as macroeconomic, financial, labor, and environmental policies. For instance, it was estimated in 1997 that there were some 4,500 separate regulations in various areas pertaining to technology investment, access, transfer and application, which were often in conflict with the explicit S&T policies (Annerstadt et al., 1997).

Table 5.1 Average Age of Professors in Selected Research Institutions

Ministry or Agency	All	Professors	Associate Professors
National Center for Science and Technology	53.8	55.1	53.3
National Center for Social Sciences and Humanities	50.9	63.1	49.1
Ministry of Science, Technology and Environment	55.6	57.3	55.2
Ministry of Industry	57.2	57.9	57.0
Ministry of Agriculture and Rural Development	57.3	58.9	56.8
Ministry of Marine Resources	54.7	56.5	54.0
Ministry of Health	60.9	64.5	58.9
Ministry of Construction	56.4	-	56.4
Ministry of Transportation	56.1	56.0	56.1
Ministry of Education and Training	59.1	61.8	58.4
Total	57.2	59.5	56.4

Source: NISTPASS (1997).

Private sector reform

While SOE reform has been erratic and, at times, disappointing, some aspects of private sector reform have progressed surprisingly fast during the past two years. A revision of the Law on Promotion of Domestic Investment in 1998, together with the implementation of the new Enterprise Law in 2000, have had a strong positive effect on the growth of formal private enterprise. The former law provided new incentives for domestic investment, while the latter has contributed to a transformation of the business licensing system to a business registration system, with automatic approval of all applications that fulfill the requirements. Together with the elimination of more than 100 business licenses that restricted entry in different sectors of industry, this has led to a very large increase in the registration of new private small and medium-sized enterprises (SMEs). More than 10,000 new SMEs were registered from January

to October 2000, with nearly one-fifth of these in manufacturing. It is likely that a large share of these new formal sector enterprises were former household enterprises, which means that the actual increase in private sector activity may significantly smaller than what the number of new SMEs indicates. Nevertheless, the higher propensity to register into the formal sector is encouraging. Household enterprises operate in the border area between the formal and informal sectors. The owner of a household enterprise is obliged to obtain a business license, but the required capital contribution is very small, there are usually few outside employees, and the operations are not governed by the Enterprise Law. This means that the rights of household enterprises are limited - they are e.g. not able to enter into binding business contracts - but also that their obligations are less imposing. For instance, the tax burden is lower than for more formal enterprise types.

When a household enterprise is successful and manages to grow larger, it is expected to register as a formal enterprise and fall under the Enterprise Law. However, many firms have in the past decided to remain in the household enterprise category and abstained from fully exploiting their growth opportunities. The incentives to register were limited because of the more complex bureaucratic procedures in the formal private sector. This meant that the growth potential of the quantitatively most important part of the Vietnamese private sector was severely curtailed. As long as household enterprises remained in the border area between the formal and informal sector, they were not able to qualify for external credit, sign long-term agreements with customers and suppliers, and employ additional workers in the formal labor market. The fact that a large number of household enterprises have apparently decided to register as formal enterprises indicates that they expect a future business environment with significant earnings and growth potential.

Another important development is the increase in donor support to capacity building in the private sector. Several donor-funded projects are now actively promoting the development of private small and medium-sized enterprises and providing business development services to the Vietnamese private sector. In addition to several bilateral projects, major ventures have been established by UNIDO and IFC. The Vietnamese government itself has also set up several bodies to support and supervise development in the sector. One of the more notable bilateral initiatives has been taken by the Japanese, who are promoting private sector development through the Miazawa plan. This plan was set up to support the post-crisis recovery of the Asian economies, and the USD 400 million pledged to Vietnam are tied to a broad program aiming to facilitate SME development.¹⁷ The establishment of the Private Sector Forum, a non-governmental body bringing together domestic and foreign private investors, government, NGOs, and donors, is another initiative that has contributed to a more lively and open discussion on private sector development.¹⁸ However, at present, it has somewhat of a bias towards issues of interest to foreign investors rather than to domestic private entrepreneurs.

The cautious - and very slow - reforms in the financial sector are also potentially important for private enterprise. The most visible reform has been the introduction of a stock market in July 2000. Although it only lists four companies, it provides an important signal regarding future reforms. In addition to an increase in the number of listed companies, it can be expected that an OTC market will be established in the future. The requirements for transparency and accounting practices on the regular stock market are considered too demanding by many firms, and an OTC market with somewhat less stringent rules would be a

¹⁷ It is likely that the 'carrot and stick' approach implicit in the Miazawa plan facilitated several of the reforms set up in connection with the new Enterprise Law.

¹⁸ It appears that the debates initiated by the Private Sector Forum have sometimes been too frank and critical of the government's weak reform policies: deputy prime minister Ngyuen Manh Cam suggested at a donor meeting in June 2000 that the PDF had 'outlived its usefulness'.

suitable first step for many firms. The number of company shares in circulation is also increasing rapidly with the progress of the equitization program, and there is presently no official market for these equities.

Banking reform has progressed slowly, which is not surprising considering the extent of NPLs in the system, but the plans for future reform are ambitious and important. The banking reform plan includes measures to restructure joint-stock banks and to reduce their number from the present 48 to about 25. (Three joint-stock banks have already closed and another two have merged.) Earlier in 2000, the aim was to complete an important part of this restructuring already during 2000, but implementation has been characteristically slow. The plans also include restructuring of the four state-owned commercial banks, with focus on modern accounting practices, annual independent audits, increased managerial accountability, phasing out of non-commercial lending, loan-loss provisioning, recapitalization, and other measures to implement commercial operating principles. Many of these measures were called for already in PFP (1996), and the slow progress in implementation testifies to the great difficulties involved. It is likely that measures on two fronts are needed to improve the private sector's access to capital. One essential reform requirement is to sever the connection between loss-making SOEs and the banking system, to avoid further weakening of the banks' balance sheets in the next few years, when the level of competition and losses in SOEs are likely to increase. In addition, it may be necessary to establish entirely new financial institutions focusing on the private sector: it is unlikely that the existing banks will be able to manage their debt burden in time to provide the necessary support to the private sector during the coming five years.

There are several other areas where progress has been equally slow. Land regulations should be revised to make it easier for private firms to obtain land for their business needs, and to use land as collateral for bank loans. Tax regulations, particularly for profit taxes, should be simplified, and the tax treatment of private and public enterprises should be equalized. Vietnamese S&T centers should be encouraged to establish networks with private business, to facilitate the diffusion of modern technologies. The most important requirement for stronger private sector development, however, may be a stronger political commitment in favor of private enterprise. At the same time as government and party documents - such as the draft Ten-Year Strategy - talk about leveling the playing field, they also state that "The leading role of the State economy will be strengthened". For sustainable growth in the private sector, it is essential that the ambiguous approach to the private sector be clarified. A first step is to define the long-term role of the state, and to make clear that the state sector is intended to be a complement to the private sector, rather than a substitute for it. Without political commitment to private sector development, growth will remain well below its potential: private entrepreneurs will shy away from long-term investment, and focus on retail trade and other areas where assets are easier to liquidate if policies change. This, incidentally, is the dominant characteristic of private investment in Vietnam today.

The private sector after 2000

An assessment of the state of private sector reform in Vietnam in 2000 must necessarily be somewhat contradictory. While the private sector operates at a level that is significantly below its potential, some important reforms have been implemented and have generated an encouraging investment response. The positive responses to the simplification of business licensing regulations in the new Enterprise Law are particularly notable, because they reflect the expectations and the understanding of Vietnam's private investors. The establishment of the stock market has an important symbolic value. The increasing donor support to the private sector is also notable, and may help Vietnamese private entrepreneurs overcome many of the remaining obstacles. Two major (and a large number of minor) problem areas remain. The

main challenge for policy making is the financial sector, where the problems and the resistance to reform have proved to be substantial. The technically less demanding - but politically more challenging - task is to resolve the ambiguous attitude towards the roles of the state and the private sector. This notwithstanding, it is clear that the situation at the end of 2000 is significantly better than it was at the dawn of the 8th Party Congress in 1996. At that time, several of the problems discussed today had not yet found their way onto the agenda.

6. Summary and conclusions: reforms after 2000

This report has attempted to make a brief assessment of selected economic developments in Vietnam since the 8th Party Congress in 1996. The focus of the report has been on some of the structural reform areas that were identified as development challenges in the mid-1990s by Vietnamese authorities and the donor community. The focus has been on trade policy and the roles of the state and the private sector. Against the backdrop of the Ten-Year Socio-Economic Development Strategy for 2001-2010, we have asked to what extent Vietnam has managed to complete the structural reform programs established in the mid-1990s. Arguably, answering this question also tells something about Vietnam's possibilities to enter upon a path of sustainable growth and development during the coming decade. In particular, it is hoped that a look at the outcome of past reform ambitions may reveal which are likely to be the main stumbling blocks for future reforms.

Section 2 summarized the reform programs established jointly by the Vietnamese government, the World Bank, and the IMF in the mid-1990s, and presented in two Policy Framework Papers in 1994 and 1996 (PFP 1994, PFP 1996). These reform measures outlined in these structural adjustment programs were also conditions for the disbursement of structural adjustment credit from the World Bank (and the IMF) to Vietnam. The reform commitments outlined by these documents initially had strong emphasis on SOE reform and banking reform, but shifted towards trade reform in 1997. However, due to domestic political considerations and the impact of the Asian crisis, Vietnam was not able to fulfill its reform commitments, and the reform process stalled as various controls and regulations were introduced from 1997 to avoid problems with external balance.

Section 3 outlined the reforms in the area of international trade and investment since the mid-1990s. The section concluded that several important advances have been achieved during the period, particularly regarding an extension of trading rights to all enterprises, but that progress in many other areas was limited. The tariff structure remains complex and protects import-substituting industries with high effective tariffs, quantitative restrictions and non-tariff barriers are still in place, and there are no published time-bound plans for trade liberalization. Exchange rate policy is another area where little progress has been made during the past half decade. Yet, our overall assessment of reform prospects in this area was cautiously optimistic. The main reason was that we interpreted Vietnam's recent trade reforms - in particular the BTA with the US - to reflect a significantly higher degree of commitment to liberalization than any earlier undertakings in this area. One remaining challenge concerns the macroeconomic management of a more open economy, with an especially important role for exchange rate policy, which is not included in the present debate. Another challenge is to manage the shift from an inward-oriented industry structure to one that is significantly more outward-oriented. Here, reforms focusing on SOEs and the private sector are likely to be particularly important.

Section 4 turned to a discussion of reforms of the SOE sector. The state sector dominates the Vietnamese economy, but is unlikely to be an engine of growth for the coming decade. One reason is that the state sector will not be able to generate enough jobs to absorb a

significant share of the annual 1.2-1.4 million new entrants into the labor market. Another reason is that the state sector has not managed to use scarce investment resources efficiently (and is unlikely to do so in the future). At the same time, the dominance of the SOE sector, both economically and politically, has curtailed the growth potential of the private sector.

Our assessment of Vietnam's SOE reforms was largely pessimistic. While equitization has progressed further than what PFP (1996) called for, there is little progress in other areas. A proposed SOE reform plan promises to rectify many of the shortcomings, but we are skeptical regarding the possibilities to implement the plan in the short to medium run. Earlier SOE reforms have met more resistance than expected, and it is hard to identify Vietnamese interest groups that are willing and able to counterbalance the influence of those groups that oppose or retard SOE reform.

However, our views regarding private sector reform, discussed in section 5, were more optimistic. Although Vietnam's private sector is severely undernourished and many serious challenges remain - particularly concerning the prospects for efficient banking reforms and the political attitude to private enterprise - we valued the positive signs higher. These include a simplification of the business registration system that has generated a very positive response from private entrepreneurs, and an increasingly strong commitment to private sector development from Vietnam's donor community.

One possible reform strategy suggested by these views is to focus efforts on the development of the private sector while accepting a more gradual reform approach regarding the SOE sector. The investments sunk into a significant share of the SOE sector can probably not be recovered under any realistic development scenario. The main task may therefore be to avoid investing more resources into these sectors, perhaps allowing some SOEs to continue operations in the medium term in spite of their inefficiency, and instead direct available resources to the creation of new enterprises and job opportunities in the private sector. While this strategy may be inferior to a first-best solution where reforms focus more distinctly on equitization, divestiture, and restructuring of SOEs, it may be politically more feasible. A key consideration in this context is, of course, to determine which is more difficult: in the first case, restricting investments in surviving SOEs that may still have considerable political influence, or, in the second case, overcoming the opposition to comprehensive SOE reform. Another major challenge, irrespective of which reform strategy is chosen, will be banking reform. While many important lessons about prudential regulations, transparency, and risk management can be drawn from countries that have recovered from banking crises, few countries have managed to reform weak and indebted banking systems before the crises struck.

At the same time as trade reform, SOE reform, and private sector promotion are essential to achieve rapid and sustainable development in Vietnam, it should be noted that the reform proposals discussed in this report only make up a first step on the road towards a better developed society. In the long run, reforms will also be needed in several other areas. The education system needs to adjust to the requirements of a more modern economy. For instance, vocational training programs will be demanded as soon as the private sector moves into industrial production with higher skill requirements. The demand for business training is already higher than the supply. Science and technology policies must be revised to provide the necessary inputs for a rapidly developing industrial sector. Reforms in the labor market will be needed to create stronger links between productivity and wages. Social sectors need to be strengthened, not only to protect redundant workers when SOEs are reformed, but even more importantly, to provide equal opportunities to all citizens in the areas of health care and education. Carefully designed support programs are needed to reduce poverty among the most disadvantaged groups in Vietnamese society, in the urban informal sector as well as in rural

areas far from the main metropolitan regions. These are all formidable challenges for Vietnam, as well as for the international donor community.

Vietnamese reform commitments for the 21st century

Given these challenges and reform requirements, what are likely to be the main reform areas in Vietnamese economic policy during the next few years? Acknowledging the difficulties in predicting policy, it can be argued that many of Vietnam's current reform plans are reflected in a set of draft government documents outlining the development policies and strategies for the medium and long run. These include the "Socio-Economic Development Strategy for the 2001-2010 Period", discussed earlier, as well as a "Hunger Eradication and Poverty Reduction Strategy for the 2001-2010 Period", a "Socio-Economic Development Plan for the 2001-2005 Period" and an "Interim Poverty Reduction Strategy Paper for the 2001-2003 Period". It is likely that the last of these provides the most accurate description of Vietnam's current development objectives and impending changes in policies. The I-PRSP (2000) has the same function as the PFP documents from the mid-1990s, and is supposed to reflect the joint views of the Vietnamese government, the World Bank, and the IMF. The reform program outlined in the document is also a condition for concessional loans from the World Bank's Structural Adjustment Credit and the IMF's Poverty Reduction Growth Facility.¹⁹

Table 6.1 summarizes a policy matrix on structural reform commitments from the draft version of the I-PRSP (2000). The announced reform objectives are grouped in the same policy areas as those in PFP (1996), to facilitate comparison with the earlier structural adjustment programs. Although there are notable similarities in the reform areas included in the adjustment programs, there are also significant differences. The most notable feature of I-PRSP (2000) is a new emphasis on poverty reduction and equity, to match donor strategies with the same character, but there are also changes regarding the policies focusing on the private sector, the state-owned enterprises, and the financial sector.

Regarding the private sector, it may be recalled that the policy objectives in the mid-1990s focused on specific regulatory reforms, including amendments to the Commercial Law and the Enterprise Law and simplification of various licensing requirements. Now that these objectives have been at least partially fulfilled, attention has turned to broader objectives, such as creating "equal conditions for access to capital, credit, land, technology, profession, information, and preferences provided by the State". This shift in attention could be seen as an indication of Vietnamese reform philosophy, which is explicitly based on gradual progress. Reforms are undertaken *step by step*, with changes in the formal legal framework as the first step, and gradual implementation of the new rules in subsequent steps. In this sense, I-PRSP (2000) reflects the progress that has been made providing a more favorable environment for the private sector, although the new reform measures presented in the document may appear too general and too abstract to satisfy outside observers. The most notable shortcoming is probably the lack of concrete measures to improve the private sector's access to investment capital. The exception is the aim to reform regulations for land use rights and to issue land use certificates (which may then be used as collateral for bank loans) but it should be noted that these specific measures were on the reform agenda already in the mid-1990s.

¹⁹ While the longer-term strategy papers also reflect Vietnamese policy objectives, they are less precise as indicators of immediate policy reform. The reason is that the draft documents appear to reflect the views of several different interest groups in Vietnamese society, with the result that they contain numerous contradictions. For instance, the draft Socio-Economic Strategy argues for a level playing field for all economic actors, as well as for continued state sector domination in the economy. Another way to express these contradictions is to note that the draft Strategy include most of the reforms called for by Vietnam's donor community, as well as a number of objectives, particularly related to the role of the state, that would make some of the reforms impossible. It remains to be seen whether the final versions of the strategy documents – to be presented at the upcoming Party Congress – are more consistent.

Table 6.1 Structural Policy Reform Commitments in Vietnam 2001-2003

Policy area	Objectives	Measures
International trade and investment	Trade liberalization	• Implement BTA with the US • Prepare for WTO accession • Open foreign trade to all enterprises • Continue removing non-tariff barriers • Phase out QRs on cement, clinker, steel, paper, construction glass, vegetable oils, and wall and floor tiles • Remove gradually QRs on rice exports • Remove licenses for rice exports and fertilizer imports • Organize quota auctions for garment export quotas
	External debt policy to limit debt burden	• Monitor all debts, including SOEs, joint ventures, and private sector
	Enhance efficiency of foreign exchange market	• Increase flexibility and transparency of the foreign exchange regime • Move towards market determined interest rates • Reduce foreign exchange surrender requirement
	Provide level playing field for FDI	• Gradually remove dual pricing system • Unify legal framework and policies for business and cooperation between domestic and foreign-invested enterprises
State enterprises	Reform SOEs to strengthen their efficiency and competitiveness	• Implement medium-term SOE reform program including equitization and divestiture of more than 1,500 SOEs • Promulgate decree on transforming SOEs into limited liability companies • Estimate costs of SOE reform and determine sources of funding • Establish system for employment reduction in SOEs • Develop and implement plan to restructure 3 general corporations • Establish system to monitor business performance and debts of SOEs • Audit large SOEs
Private sector	Create level playing field for private sector	• Continue removing unnecessary business licenses • Create equal conditions for access to capital, credit, land, technology, profession, information, and preferences provided by the State • Amend Private Enterprise Law • Simplify procedures for establishing private enterprises without administrative approval • Simplify and rationalize regulations on land use rights • Issue land use certificates

Cont'd...

Table 6.1 Structural Policy Reform Commitments in Vietnam, cont'd...

Financial sector	Implement prudent monetary policy to control inflation	• Oversee system of monetary and credit controls • Develop and implement plans to restructure state-owned commercial banks • Reform regulations for loan classification and loan loss provisions • Introduce independent annual audits for state-owned commercial banks • Separate policy lending from commercial banking system • Restructure 48 joint-stock banks, close or merge weak banks • Provide regulations allowing use of land use rights as collateral
	Improve efficiency of financial market	
Public administration	Improve efficiency of tax system	• Increase tax base • Increase efficiency of tax payment system • Implement recommendations from Public Expenditure Review • Increase expenditures for basic social services and rural infrastructure
	Restructure outlays to priority areas	
	Improve budgetary system	
		• Improve budgetary revenue and expenditure monitoring system • Increase information flows within government • Publish information on annual budgetary revenues and expenditures in more scientific manner

Source: I-PRSP (2000).

The reform objectives and measures for the state enterprise sector have changed in more or less the opposite direction. While the reform plans were expressed rather cautiously and in very general terms in PFP (1996), the I-PRSP (2000) includes much more concrete reform measure and policy objectives. The new policy document presents numerical targets for the number of SOEs that will be subject to equitization or divestiture and announces various measures to prepare fundamental restructuring of remaining SOEs, such as audits and new systems to monitor business performance. Similarly, the general reform objectives for the financial sector in PFP (1996) have been replaced by more specific reform measures in I-PRSP (2000). Instead of "improving banking supervision", the new document aims to restructure the four state-owned commercial banks and 48 joint-stock banks, and to separate policy lending from commercial banking operations. These changes are probably responses to the weak success earlier reform attempts. Establishing well-specified reform objectives reduces the scope for various interest groups to influence the character and content of reform programs. The cost is an increased risk for slippages in reform commitments if the opposition to reform is strong.

The reform measures in the foreign trade area are also very concrete, reflecting an ambition to insulate the reform process from lobbying by interest groups opposing trade liberalization. It is particularly important to note that the preparations for WTO accession have been introduced as an explicit policy measure, which is likely to strengthen the reform program. One of the steps in this preparatory process is the phasing out of non-tariff barriers to trade. The aim to remove quantitative restrictions on imports of cement, clinker, steel, paper, construction glass, vegetable oils, and wall and floor tiles by 2003 is very significant, and signals a strong commitment to complete the trade reform program. As discussed in section 3, Vietnamese authorities have earlier indicated that these QRs would not be

transformed into tariffs before 2005. What appears to be missing is a clear road map for the tariff reductions required to fulfil Vietnam's AFTA commitments.

Regarding exchange rate policy, it is significant that the earlier objective to remove all restrictions on current account transactions has been dropped, at the same time as there is a stronger ambition to establish a flexible and transparent exchange rate regime. This reflects the uncertainty caused by the Asian financial crisis, which brought attention both to the vulnerability caused by market-determined exchange rates and the need to maintain exchange rate flexibility and export competitiveness. As noted earlier, it can be argued that the uncertainty regarding Vietnam's future exchange rate system is one of the main weaknesses of the country's macroeconomic policy framework. The increase in the export share of GDP that will occur if export growth continues at double-digit rates requires more attention to export competitiveness, which implies more exchange rate flexibility. At the same time, it is clear that the high inflation rates of the 1980s and early 1990s are still fresh in the memories of Vietnamese decision-makers, which implies that stable import prices and stable exchange rates are desired. This is clearly an area where more work is called for.

Still, for several of the policy areas noted above, it can be argued that the new reform commitments are radical in comparison with the reform achievements of the past few years. There is no doubt that Vietnam's economic performance will improve significantly if these commitments can be realized. However, past experiences from the financial sector and the SOE sector suggests that reforms may easily fail unless there is strong and unambiguous support from the highest levels of political leadership. This focuses attention on the upcoming 9th Party Congress. Our tentative assessment of Vietnam's reform plans for the coming years – as reflected in the I-PRSP (2000) and other draft documents circulated before the Party Congress – is cautiously optimistic. A stronger positive conclusion is hopefully warranted after the Party Congress.

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