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Southeast Asia

Economic Reform and Development in Vietnam

Le Dang Doanh

92/1

Research School of Pacific Studies ANU

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n.a.	**Not applicable**
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Le Dang Doanh is the Vice-Director General of the Central Institute of Economic Management in Hanoi, Vietnam. He visited the Economics Division in the Research School of Pacific Studies in March, 1992.

Abstract

Despite important initial achievements in reforms Vietnam is far from being a well operating market economy. As yet there is no capital market or efficient foreign exchange market. The dong is not yet convertible. The banking system is not yet up-to-date. Preconditions for a stock exchange need to be created. The labour market is developing only slowly: wages and salaries for employees of state and state-owned enterprises are still quite inadequate, stifling incentives.

There is a lack of a necessary legal framework. The supply of information to markets is not yet up to international standards, meaning that there is a shortage of information on import-export activities and foreign markets.

Land and housing are not yet commercialized. The values of land and housing rents are not yet realistically regulated. Therefore, there is serious wastage and abuse of state-owned land and housing.

The greatest shortcoming is the neglect of state management and financial control. Efficiency in accounting is low and accounting systems are unreliable. State taxation failure is widespread and few directors observe laws and regulations.

Reforms in Vietnam have brought a vigorous driving force and have contributed to the creation of the necessary foundations and premises for development and economic growth. Enterprises have undergone great changes in marketing, production techniques and technology, and produce a variety of goods. Vietnam has rich natural resources and a well-educated, skilful and hard-working labour force. Labour costs are low. For the long term Vietnam's prospects are favourable.

economic reform and development in Vietnam

In September 1979 Vietnam began to implement microeconomic reform within the framework of a command economy. Since 1986 - under the Doi Moi slogan of the Sixth Party Congress - Vietnam has carried out the most comprehensive and profound renovation in its modern history. This economic renovation, aimed at creating the fundamental conditions for economic development, has already helped Vietnam overcome severe difficulties, and substantial progress has been achieved. Nevertheless, the building of a market economy within a legal framework will be a long and demanding undertaking.

There are five main areas in which economic reform is taking place:

- the change from a centrally planned and controlled economy to a market economy regulated by the government;
- the shift from the policy of giving priority to the state and collective sectors to a policy of legal free enterprise, and promotion of private business;
- the change from investment policies which emphasize heavy industries in an autarkic economy to priority for food production, consumer goods and exports in an open economy;
- the development and diversification of international economic relations; and
- the democratization of the society, the reform of public administration and the eradication of bureaucracy, smuggling and corruption.

Table 1 GDP and GNI (million dong)

	1986	1988	1989	1990
GDP	333,399	374,196	381,497	392,665
GNI	174,789	188,874	194,012	198,747

Source: Central Office for Statistics, Hanoi, Socialist Republic of Vietnam

This report provides an overview in these five fields, including foreign trade policy and stabilization of the economy.

Table 2 Contribution to gross social product (GSP) and national income (NI) by sector, 1986-90 (per cent)

	1986		1987		1988		1989		1990	
	GSP	NI	GSP	NI	GSP	NI	GSP	NI	GSP	NI
State sector	35.7	30.4	34.4	28.1	31.1	23.0	34.5	26.3	33.8	25.8
Non-state sector	64.3	69.6	65.6	71.9	68.9	77.0	65.5	73.7	66.2	74.2
Industries	42.0	29.3	41.0	29.1	34.5	21.3	40.6	24.0	32.6	20.2
Construction	5.3	3.5	4.6	3.2	5.2	3.7	6.3	4.5	6.1	4.3
Agriculture	34.4	42.2	38.1	46.1	44.6	54.1	38.2	50.0	43.1	50.6
Forestry	0.9	1.2	0.9	1.1	1.6	2.0	1.3	1.7	-	-
Transport	1.3	1.0	1.3	1.0	1.8	1.5	1.8	1.7	-	-
Telecommunications										
Trade	14.3	20.0	12.7	17.5	10.8	15.1	10.5	15.9	12.0	17.6
Other branches	1.8	2.8	1.4	2.0	1.5	2.3	1.3	2.2	6.0	7.3

Source: Central Office for Statistics, Hanoi, Socialist Republic of Vietnam

Price and wage reform

One of the most significant achievements of the reform period has been the price reform launched in March 1989. Since then market prices have applied to almost all goods, and price subsidies have been abandoned.

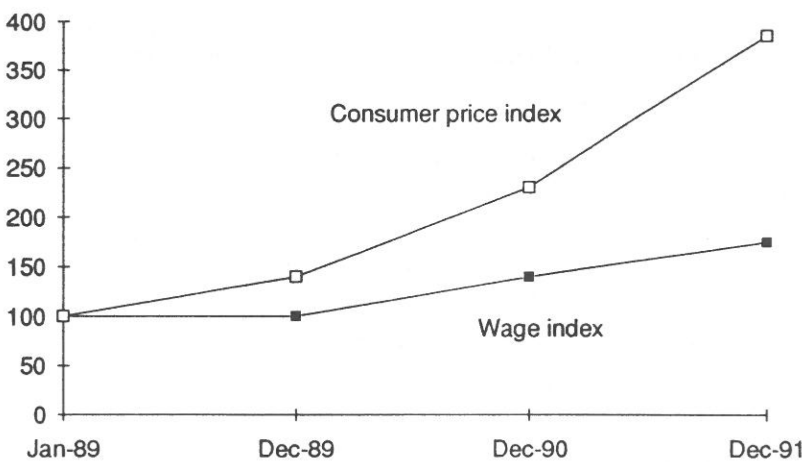
With the exception of fuel, electricity, transport (railways, air and cargoes) and postal services, the prices of goods and services, including rice, are set by demand and supply in the market without administrative intervention. Competition has been encouraged and distortions in price structures reduced.

Prior to this artificially low prices had restricted production, both in agriculture and industry (e.g. rice, pharmaceuticals, medical services). With the introduction of market prices, rice consumption has declined - in Hanoi, for example, the turnover of the State's food companies has been reduced by 30 per cent, while rice production has been stimulated. Along with other measures, price reform has turned Vietnam from a permanent food importer to a rice exporter. Sugarcane production has increased and cotton cultivation resumed. For a long time low prices had kept fertilizer and steel producers on the brink of collapse. Now they have reached record outputs. The supply of goods and services has clearly been improving: nobody needs to stand in queues for necessities.

In Vietnam's markets, monopolies still play an important role. Products such as electricity and cement, are supplied by monopoly companies which set monopoly prices. There is no 'anti-trust' legislation and government control over monopoly prices has been insufficient.

Indexation of administered prices (adjustment to inflation) is, however, a problem. Adjustment of prices of electricity, fuel, etc. is essential, but changes in these basic prices dramatically influences all economic activity - wages, finance, imports and exports. Wages of employees in non-state sectors and in some state-owned enterprises have been liberalized, but not the salaries of government employees and officials (Figure 1).

Figure 1 Consumer price and wages and salaries index, 1989-91



Source: Central Institute of Economic Management estimate.

The government intends to carry out a reform of wages and salaries during 1991-92, including the commercialization of housing, and the reform of both the health care and health insurance system. The object of the reform is to re-establish some order in the incomes of workers and employers and to widen the spread between minimum and maximum salaries from the present ratio of 1:3.5 to 1:11.

Reform of the banking system

Despite remarkable efforts and some progress, the banking system in Vietnam is still backward and inefficient. International assistance has been provided to help modernize the banking system and educate banking staff.

Competition with foreign banks should accelerate this process. Seven licences have already been given to foreign banks to operate in Vietnam (four French banks, one Thai bank, the ANZ Bank of Australia and a Taiwanese bank).

In 1988, a major banking reform was introduced, with the aim of separating the functions of the State Bank and the commercial banks. The banking system of Vietnam now consists of the following banks (Table 3):

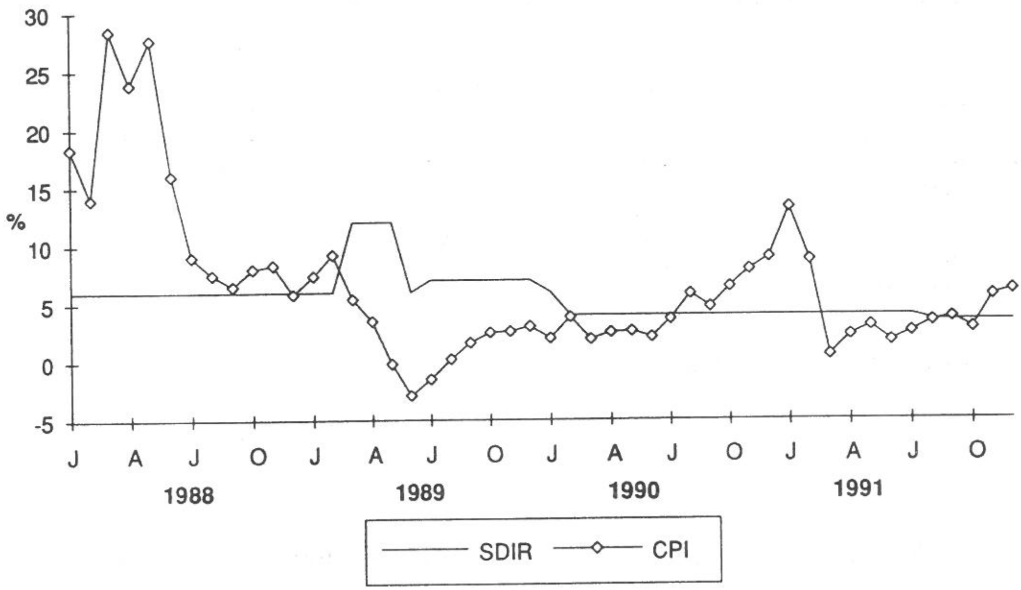
- State Bank of Vietnam (Central Bank);
- Bank for Foreign Trade (Viet Combank);
- Bank for Investment and Development (BIDV);
- Industrial and Commercial Bank (ICBV); and
- Agricultural Development Bank of Vietnam (ADBV).

Table 3 The structure and size of Vietnamese banks, 1989 (dong billion)

	Assets	Deposits	Per cent of total	Loans	Per cent of total
State Bank of Vietnam	5266	..	..	..	..
ICBV	1815	1185	39	1147	32
ADBV	2539	806	26	1298	36
Vietcom Bank	357	225	7	572	16
BIDV	2907	148	5	224	6
Other institutions	200-400	700	23	400	11
Total (approximately)	13000	3064	100	3641	100

Source: State Bank of Vietnam.

Figure 2 Relationship between savings deposits interest rates (SDIR) and the CPI, 1988-91



Source: Central Office for Statistics (CPI) and State Bank of Vietnam (SDIR).

Significant progress has been achieved in utilizing interest rates and the banking system to regulate monetary circulation. Figure 2 describes the relationship in recent years between interest rates and the price index. After March 1989, the price index has decreased because of the mobilization of considerable savings deposits.

The interest rate on savings deposits is higher than that on lending (mainly for state-owned enterprises) and this creates serious obstacles for the commercial banks. The government plans to lift the system of multiple interest rates for lending and to introduce a positive rate. This measure will pose a challenge for state-owned enterprises which receive 86 per cent of total credit.

Other reforms in the public finance system have been made. The establishment of the General Tax Department under the Ministry of Finance aims to centralize tax collection including all kinds of fees which are collected by local authorities and other ministries.

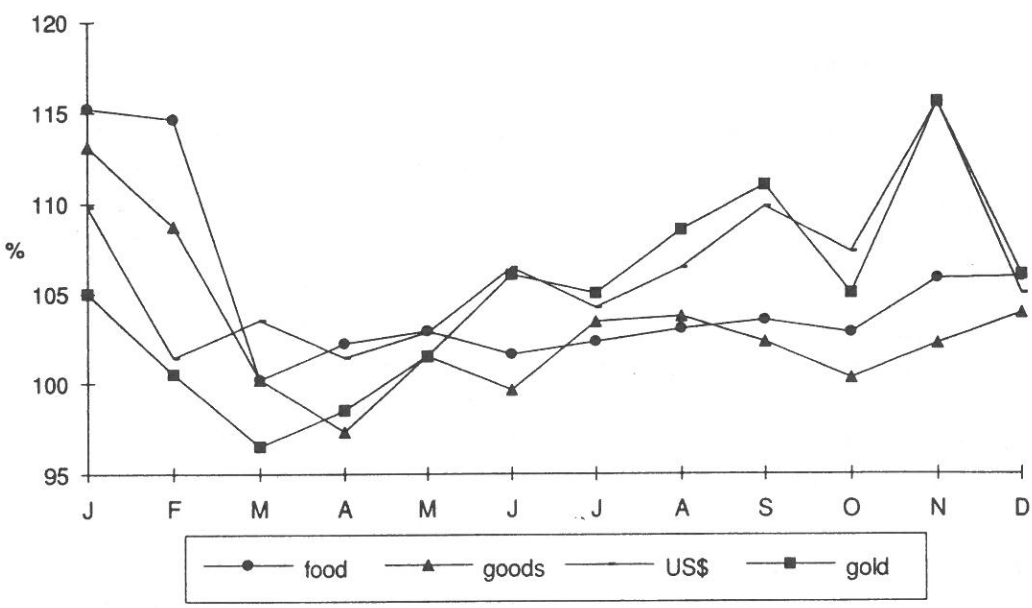
Another important reform was the introduction of a floating exchange rate (Table 4).

Table 4 Official and parallel exchange rates (dong per US dollar)

Year	Official rate	Parallel rate	Ratio
1985	15	115	7.6
1986	80	425	5.6
1987	368	1270	3.5
1988	3000	5000	1.7
1989 (Dec)	4400	4500	1.02
1990 (Oct)	6300	6500	1.03

Source: State Bank of Vietnam

Figure 3 Prices indices for goods and services, food, gold and US dollar, 1991



Source: State Committee of Prices and Central Institute for Economic Management.

The difference between official and parallel rates has declined to less than 3-5 per cent. This change has substantially helped to promote exports.

Because of high inflation and the low efficiency of the banking system, gold and US dollars play an important role in the domestic market. Figure 3 describes the dramatic developments in 1991. Since April 1991, the price of gold and the US dollar have been higher than the price of goods and food, particularly from June to November.

In late 1991, Vietcom Bank opened official exchange markets in Ho Chi Minh City and Hanoi. Following massive selling of gold and dollars from the state reserve, the price of gold and the US dollar stabilized (Figure 3).

Reform of state enterprises

Table 5 Structure of state-owned enterprises by economic sector

Branches	Number of enterprises	Share (per cent)
Total	12,884	100.0
Industries	3,566	29.5
Construction	1,331	11.0
Agriculture	1,576	13.1
Forestry	470	3.9
Transport	426	3.5
Post and telecommunications	54	0.4
Trade	3,864	32.0
Other production branches	44	0.4
Non-production branches	753	6.2

Source: Central Institute for Economic Management analysis based on data of Central Office for Statistics.

The role of state enterprises does not yet indicate a market economy. As Table 5 shows, 32 per cent of state-owned enterprises are engaged in trading activities. As Table 6 shows, state-owned enterprises dominate or have a monopoly on several products.

Table 6 Share of state-owned enterprises by selected product

Branches	Shares
Cement	100.0
Metallurgy	100.0
Oil exploitation	100.0
Electricity	99.9
Coal	98.2
Chemicals	69.5
Mechanics and electronics	52.9

Source: Central Institute for Economic Management analysis based on data of Central Office for Statistics.

The Vietnamese government is now preparing to reform state-owned enterprises by turning some of them over to mixed ownership (joint-stock companies with domestic or foreign shareholders) or to long-term leasing. Some bankrupt enterprises need to sell off their equipment. All these measures require careful preparation and appropriate legal regulations.

In the tough conditions of a competitive economy the low efficiency of many of the state-owned enterprises demands urgent solutions. Only 30 per cent are profitable, approximately 35 per cent of state-owned enterprises are loss-making. A bankruptcy law is now in preparation. The government has cancelled all direct subsidies and laid down the rights and responsibilities of autonomous state enterprises. They are therefore more dynamic. However, this has meant that the state has lost control over the finances of these enterprises. Directors and employees give priority to their own interests over those of the state.

The government wants to introduce boards of directors with representatives from the Ministry of Finance and independent scholars to improve the accounting system and to require audits by licensed auditing companies.

Reform of the agricultural sector

Since 1986, Vietnam has widely employed a policy of piecework contracts in agriculture and allowed farmers to use land on a long-term basis and to sell farm products at free market prices. The policy has mobilized farmers' capital, diligence and creativeness and the results are quite perceptible in agriculture, forestry and fishery (Table 7).

Table 7 Productivity of some agricultural and fishing products

	1986	1988	1989	1990
Food (million tonnes)	18.3	19.6	21.5	21.5
Coffee (thousand tonnes)	18.8	31.3	40.8	229.0
Pepper (thousand tonnes)	3.6	6.2	7.1	8.0
Buffaloes (thousands)	2657.2	2866.8	2871.3	2928.7
Cows (thousands)	2783.5	3126.6	3201.7	3281.7
Sea fish (thousand tonnes)	563.4	629.1	683.2	691.0

Source: Central Office for Statistics, Hanoi, Socialist Republic of Vietnam

Investment in agriculture has considerably increased. Farmers' incomes have risen two to three times. Over 70 per cent of farmers' durable goods have been purchased in the last four years. New legislation on prices secure legal rights to every Vietnamese to act as an entrepreneur. This is an enormous step forward economically and socially.

Service industries

Vigorous development has taken place in private services, which in 1991 accounted for 70 per cent of total retail turnover (as against 27 per cent by the State trading sector and 3 per cent by the cooperative sector).

The growth of small industries

Throughout the country, there are about 959 privately owned small industrial enterprises, accounting for 0.8 per cent of total industrial production value and employing a workforce of 18,533. There are 36,804 individual enterprises with 951,166 workers, accounting for more than 30 per cent of the value of industrial production. According to the General Department of Taxation, the number of small traders and service owners is estimated as high as 900,000. Ho Chi Minh City has 252 producers, mobilizing 58.87 billion dong of capital, and employing nearly 19,000 workers. Some of them have modern technology.

A large number of investors are family producers (in cloth making, weaving and handicrafts) enriching the variety and quality as well as the quantity of goods. Investment in houses and other consumer goods has also greatly increased. For

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A large number of investors are family producers (in cloth making, weaving and handicrafts) enriching the variety and quality as well as the quantity of goods. Investment in houses and other consumer goods has also greatly increased. For various reasons, one of them being inflation, citizens do not yet dare invest much capital in productive enterprises. Except for some shareholdings in banks (in Ho Chi Minh City, Thanh Hoa province) all private businesses are small companies, mainly family-run companies with simple structures and organizations.

The boom in the private sector has promoted more effective use of capital and higher productivity. Incomes in private business exceed those in State business by 100-400 per cent. Private business, of course, also has adverse effects, such as tax evasion, illegal trade and counterfeiting goods. Some private businesses have had to close down or reorganize.

The promotion of the private sector has happened at the expense of the cooperative economy which has continuously declined both in industry and commerce.

In the future, in order to mobilize the vast potential of the private sector in Vietnam, and to fight inflation, the legal conditions necessary for the transformation of state enterprises into public companies involving the private sector must be created. This must involve not only private capital, but also private experience and contact with foreign markets. Government should also assist the private economy in technology, management and employee training. In social attitudes, prejudice against a private economy should be discouraged and overcome.

Foreign trade

Compared to other countries in the region, Vietnam's foreign trade is small and underdeveloped. The large deficits in the trade balance were covered by credits from the USSR until the end of 1990 (Table 8).

The average annual growth rate of exports in the years 1986-90 reached 27 per cent, considerably higher than the annual growth rate of GDP.

The commodity structure of exports and imports of Vietnam is typical for a developing economy (Table 9). Exports are mainly raw materials, minerals or food and other agricultural products, while 86 per cent of imports are accounted for by four groups: fuels, fertilizer, chemicals, and machines and equipment.

The loss of traditional markets in eastern Europe and the former USSR was a demanding challenge to the exports of Vietnam and has had a marked impact on the commodity structure of exports.

Table 8 Foreign trade, 1981-91 (dong million)

	Exports	Imports	Ratio between exports and imports
1981	352.4	1325.2	1:3.76
1982	387.0	1320.1	1:3.41
1983	463.6	1323.0	1:28.5
1984	493.3	1488.3	1:3.01
1985	594.7	1552.4	1:2.61
1986	677.8	1829.3	1:2.70
1987	723.9	2132.5	1:29.5
1988	833.5	2539.5	1:3.05
1989	1524.6	2383.7	1:1.56
1990	1815.0	2474.0	1:1.36
1991	2081.7	2198.7	1:1.06

Source: Ministry of Trade and Tourism.

Table 9 Foreign trade by commodity group, 1990 and 1991 (per cent)

	Exports		Imports	
	1990	1991	1990	1991
Food and livestock	41.8	35.0	5.3	4.1
Beverages and cigarettes	-	2.1	0.6	1.6
Raw materials (except food)	20.5	18.3	0.7	5.7
Fuel and mineral oil	29.7	29.4	31.4	28.4
Animal and vegetable oil	0.1	0.2	0.4	0.6
Chemical products	0.1	1.2	24.1	29.9
Manufactured goods	4.1	6.3	10.1	13.2
Machinery, equipment and transport vehicles	0.7	0.9	25.6	21.8
Other finished products	3.0	6.7	1.8	1.7
Other goods	-	-	-	-
Total	100.0	100.0	100.0	100.0

Source: Ministry of Trade and Tourism.

The trading partners of Vietnam are limited and concentrated mainly in the southeast Asian region. The three biggest trading partners, Singapore, Japan and Hong Kong, share 58 per cent of total trade (Table 10). (These data do not include the huge volume of smuggling through the border which, according to estimates, is as high as US$300 million.) Vietnam wants to continue its traditional trade relations with the countries of the former USSR and has signed the first trade agreements with them.

Table 10 Foreign trade by destination and source, 1990 and 1991 (per cent)

	Exports	Imports
Singapore	26.8	33.9
Japan	20.9	9.8
Hong Kong	11.7	11.8
USSR	8.6	4.9
France	4.2	5.8
South Korea	1.5	8.7
Taiwan	3.2	4.4
Thailand	4.7	2.3
China	4.9	2.0
Germany, FR	0.5	3.0

Source: Ministry of Trade and Tourism.

There are realistic expectations for rapid development of trade between Vietnam and China and the ASEAN countries.

In recent years the government has lifted the state monopoly on foreign trade. Resolution No.64 (10.6.1989) encourages all sectors to participate in foreign trade. Private enterprises have been granted foreign trade licences. In 1991 there were 600 licensed foreign trading companies in Vietnam, however, only 400 of them were operating.

Table 11 Selected tariff rates on imports (per cent)

	General rate	Minimum rate
Trucks	20	0
Cars and tourist vehicles	50	5
Petrol	5	0
Paints	10	5
Cement	30	20
Alcohol	100	50
Cigarettes	100	50
Bicycles	50	40

Source: Official Bulletin of Socialist Republic of Vietnam, 1989.

The government regulates foreign trade by granting quotas products or providing licences. Imports are subject to tariffs. Table 11 shows selected tariff rates (according to Decree No.134 of the State Council, 3 March 1989).

Foreign direct investment

From December 1987 to December 1991, after promulgating a liberal law for foreign investment, licences have been given to 364 foreign investors with a total fixed capital of US$2.645 million. Australia is one of the biggest foreign investors in Vietnam (Table 12).

Table 12 Foreign investors in Vietnam, September 1991

	Invested capital US$m	Share (per cent)
Taiwan	505	22.0
Hong Kong	328	14.3
Australia	264	11.5
France	250	10.9
United Kingdom	131	6.0
CIS	130	5.7
Japan	96	4.2

Source: State Committee for Cooperation and Investment.

Fifty per cent of licensed projects are in the process of realization, 30 per cent are not realizable, 20 per cent have to overcome tremendous shortcomings or obstacles. The credit system is weak, and marketing skills amongst the population very low.

Table 13 Foreign direct investment (January 1992)

	Number of projects	Invested capital (US$ m)	Share of all investment (per cent)
Industry	126	382.7	14
Oil exploration	13	588.2	21
Agriculture and food	112	786.2	28
Manufacturing			
Tourism, hotels	92	707.2	26
Transport and telecommunications	35	293.5	11
Construction	5	5.4	

Source: State Committee for Cooperation and Investment.

The government has established four export processing zones: Linh Trung (Ho Chi Minh City), Tan Thuan (Ho Chi Minh City), Dinh Vu (Hai Dhone) and Fa Nang.

These export processing zones enjoy very favourable conditions: profit tax for industrial enterprises is less than 10 per cent (compared to 20-30 per cent for domestic enterprises) for the first four profitable years. The profit tax rate for non-industrial enterprises is 15 per cent (compared to 30-50 per cent for domestic enterprises) for the first two profitable years.

Democratizing society

With a view to managing a multisector market economy, the government of Vietnam has made great efforts to expand democracy and reform public administration.

The National Congress role has been strengthened. The law relating to the press has been liberalized, enabling it to contribute to discussion of policies and guidelines, to combat corruption and other social deficiencies in the bureaucracy.

The Council of Ministers and people's committees have attached importance to the use of indirect macroeconomic policies in preference to direct intervention in business.

However, these reforms have not adequately met the need for change.

State administration still leaves much to be desired. There are serious defects in the legal system. In practice, life is very different from the promulgated laws. Laws and policies, though correct and necessary, are not fully observed. The ban on foreign-made cigarettes, for example, or controls on smuggling and foreign currency, are not thoroughly enforced. Cooperation between branches of government, at local and national levels, is low, bureaucratic practices are cumbersome and administrative formalities impose enormous handicaps on economic activities.

In March 1992 the National Congress will adopt a reformed Constitution. Only 12 of the 147 articles of the old Constitution remain. The draft of the new Constitution has conceded a market economy but has not clearly ruled out confiscation of domestic private property, as demanded in public discussion recently.

Administrative reform has not yet been fully carried out. To run a market economy, the State should proceed by emancipating activities, and should collect social and economic data to formulate correct economic policies.

The State should delegate economic activities, especially foreign trade, and minimize unnecessary ministerial intervention in business activity. The State should concentrate on stabilizing the value of money, fighting inflation, ensuring macroeconomic balance and guaranteeing a legal framework for economic activity.

The State should intensify its guidance, where businesses are still inexperienced, assisting businesses in training cadres, and supplying information on international economic relations.

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