CHAPTER 25
VIETNAM

Introduction. Vietnam's economic performance remains well below its potential. What's the problem?

- Slow economic reforms continue to discourage foreign investors.
- Without a recovery in foreign investment, a return to the rapid economic growth rates of the mid-1990s is unlikely.

Background on Growth. Prior to the Asian economic crisis, Vietnam enjoyed strong economic growth. On average, the economy grew at an 8.8% annual rate in the five-year period from 1993 to 1997. At this rate, Hanoi was starting to make a dent in its poverty.

- In the wake of the Asian economic crisis, Vietnam recorded GDP growth rates of 3.5% in 1998 and 4.2% in 1999.
- While the economy grew at a 5.5% clip in 2000, 7% to 9% GDP growth is needed to reduce Vietnam's poverty.
- The slowdown in the U.S. and Asian economies is dampening Vietnam's economic performance.

Economic Problems

The reasons why growth is currently not faster can arguably be linked to economic weaknesses in five main areas:

Foreign Direct Investment (FDI) Shortfall. Strong inflows of foreign capital drove the economy in the mid-1990s. These have drastically fallen away.

- According to World Bank figures, foreign investment inflows fell to an average of $600M per year in 1998-2000 compared to $2B per year between 1995 and 1997.
- Until foreign investment increases significantly again, growth is likely to remain below the highs of the last decade.

Agricultural Impasse. External and internal factors are hurting farming.

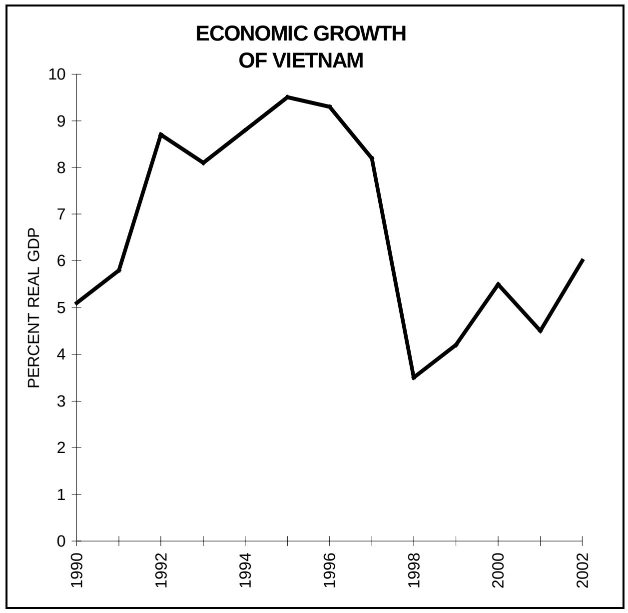
- On the global front, low world commodity prices hurt farming incomes.

Figure 25-A. Selected Historical Data

$ Billions (or %)	'97	'98	'99	'00
Gross National Income	24.0	25.6	28.2	31.4
Purchasing Power	1220	143.5	136.1	159.1
Real Growth (%)	8.2	3.5	4.2	5.5
Inflation (%)	3.2	7.3	4.1	-1.7
Exports	9.2	9.4	11.5	14.3
To U.S.	0.4	0.6	0.7	0.9
Imports	11.6	11.5	11.6	15.2
From U.S.	0.3	0.3	0.3	0.3
FDI from U.S.	0.015	..	-0.014	-0.054
In U.S.	0	-0.004	-0.006	-0.007
Cur Account /GDP %	-6.5	-4.6	4.1	1.7
Fiscal Balance /GDP %	-4.8	-2.6	-2.8	-4.5
External Debt /GDP %	78.9	82.8	81.1	..

Sources: IMF, ADB, World Bank, U.S. Commerce

Figure 25-B



- Domestically, rural areas are consistently failing to secure higher levels of public and private investment.

Red Tape. Vietnam is still a high transaction-cost economy. This is linked to the large amounts of government red tape that affects both domestic and foreign investors.

- Obtaining the necessary permit or license is frequently time-consuming and inevitably increases costs.
- The fact that businesses often see the payment of bribes as necessary to speed the licensing process, or simply ensure its success, also pushes up overall costs.

Public Sector Mismanagement. Inefficient use of public resources is also exerting a drag on the economy.

- Ironically, the partial dismantling of the centrally planned economy has not produced a fall in the size of the public sector—rather it has grown. This reflects government moves to 'gate keep' the market economy.
- Similarly, while soft budget constraints have generally been tightened during the reform years, soft credit constraints operated by the state-dominated banking system have remained in place. Consequently, capital has continued to find its way into inefficient state enterprises.
- The corrupt allocation of capital has also persisted, despite a number of high-profile prosecutions in which some bankers have paid with their lives for lending in this way.

Weak Capital Markets. The undeveloped nature of Vietnam's capital market represents an additional constraint on development.

- **Banks.** Vietnamese banks dominate the capital market. These banks are generally weak and in need of reform.
  - While there is some progress towards closing and merging joint stock banks, there is little progress in tackling the high level of indebtedness among state banks.
- **Stock market.** Despite the recent opening of a stock market, there are currently just three companies listed on the stock market, and there are tight restrictions on the extent to which shares can fluctuate. Therefore it is likely to be some years before the stock market is a significant source of business capital.
- **Bonds.** Moreover, in a recent auction of five-year government bonds, there were no bidders. It had been hoped that the bonds would be traded on the stock market as an intermediate step towards its development.

Politico-Economic Policy

***The Ninth Congress*.** Does Hanoi have any plans to change things? One opportunity was the Ninth Communist Party Congress in March 2001. This event is held once every five years and sets policy direction.

- Unfortunately, the main policy document of the Congress, the Political Report, did not contain any surprises in terms of economic reform.

Clinton's Visit. Can Washington shape things? President Clinton hoped to move Hanoi in a more market-oriented direction during his visit in November 2000.

- The visit showed a welcome readiness for Washington and Hanoi to engage each other 25 years after the war.

The Good News: A Trade Deal

Of course, the highlight of the visit was a sweeping trade agreement between the U.S. and Vietnam that took four years to negotiate. Who gets what?

- Vietnam gets improved access to the U.S. market.
- Hanoi agreed to provide foreign investors with some respite from murky approvals processes, dual pricing hurdles, and bewildering obstacles to joint ventures. This added clarity should increase foreign investor confidence.
- The pact also provides a boost for Vietnam's credibility—signaling a willingness to push ahead with urgently needed reforms.
- The trade deal also clears the way toward Vietnamese membership in the WTO.

The Bad News: No Quick Fix

But optimism about the trade deal is being tempered with pragmatism on both sides. Fact is, dramatic gains in trade and investment may well take years. Why does it take so long?

- **On the Vietnamese side**, their exporters are latecomers to the U.S market. They must set up distribution networks, and establish business relationships. They must also reduce costs, improve quality, and stabilize supply. It will take time to do all this. In short, the trade deal is bad news for Vietnamese exporters without patience.

- **On the American side**, U.S investors are still far from sold on Vietnam being a good place to do business. They see many of these negative factors as all too common.

***A Divided Politburo*.** For instance, President Clinton encountered first-hand confirmation of the tensions that exist within the senior leadership of the Vietnamese government over the wisdom of economic reform.

- Vietnam's politburo permits only low-risk, superficial economic reform—the minimum needed to attract a first round of optimistic foreign investors.
- But its leaders are far from accepting the more radical economic freedoms needed for Vietnam to sustain strong economic growth, hold on to investors, and avoid lagging badly behind Asian competitors.
- In short, the Clinton visit confirmed the fact that Vietnam will not fling open the window to market forces anytime soon.

Modest Reforms. That said, Hanoi does deserve credit for a trade agreement (cited earlier), the opening of a small stock market in Ho Chi Minh City, and less red tape for new businesses getting a license.

- But on balance, these achievements are a modest response to a sharp decline in FDI now at one-sixth of its mid-1990s peak.
- In other words, this is not like China's boldness in its economic reforms.

Old Realities. In most ways, Vietnam's communists have not changed their economic mismanagement.

- The economic management team is just as intrusive and corrupt but more cautious than their Chinese neighbors.
- The private sector's access to credit is restricted by banks' preference to lend to party-related companies for the benefit of a rich elite.
- The party controls government, judiciary, and the media and argues that it should retain that grip for the sake of stability.

***Social Unrest*.** As a result of the economic mismanagement, some cracks are starting to show in Vietnam's system.

- Rural poverty has led to social unrest.
- Expectations of change in the more entrepreneurial south are rising.
- It's unclear how long Hanoi can keep the lid on these pressures.

The Way Ahead. To keep Vietnam from once again becoming a source of economic and social instability, the USG should try to shape Vietnam's economic transformation.

- USG should link economic carrots to Vietnamese economic reforms.

Conclusions

Vietnam's economic performance remains well below its potential.

- A return to the rapid economic growth rates of the mid-1990s is unlikely without a recovery in foreign investment.
- Foreign investors will likely remain on the sidelines until the government speeds up economic reforms.
- Economic problems include: FDI shortfall, agricultural impasse, red tape, public sector mismanagement, and weak capital markets.
- No bold economic reforms developed at the Ninth Communist Party Congress in March 2001.
- Despite the trade deal, the Clinton visit did not move the divided Vietnamese Politburo to fling open the window to market forces.
- USG should link economic carrots to Vietnamese economic reforms.