CHAPTER 5:

THE ROLE OF GOVERNMENT IN ECONOMIC DEVELOPMENT AND INDUSTRIALIZATION IN VIETNAM SINCE 1954

From a development perspective, governments with the political will have to design and implement policies for economic development and industrialization. The role of government in the economic process has to recognize path dependence and proper sequencing to ensure sustainable economic development, and ensure that domestic forces are fully mobilized. The experience of building and developing the Vietnamese economy illustrates the changing role of government in economic development and industrialization through various stages of the country's development. This chapter presents the principal characteristics of this renewal process in economic policy as well as in industrialization strategy in Vietnam since 1954, particularly since 1986, when Vietnam initiated its renovation policy.

5.1. Economic Development and Industrialization Strategy Prior to Reunification (1975)

Prior to 1954, Vietnam mainly had small and artisanal industries. There were only a few relatively important industrial establishments such as small power stations, textile mills, engineering plants for making repairs, coal fields, tin mines, etc. mostly in North Vietnam. The total industrial labor force then was about 50,000.

After the defeat of the French colonial forces in the battle of Dien Bien Phu, under
the 1954 Geneva Agreement, Vietnam was temporarily divided into two parts: the North (Democratic Republic of Vietnam) and the South (Republic of Vietnam), with the 17th parallel as the demarcation line. In more than 20 years, the North and the South had two different political and social regimes, and carried out different economic including industrial policies.

Two major strands of thought came together in the Vietnamese revolution - anti-colonialism and socialism. Like other Southeast Asian countries achieving independence in the 1940s and 1950s, the Vietnamese government recognized that industrialization was key to modernization of its economy, and at least to some extent, industrialization should be state-directed to overcome what was seen to be the exploitative nature of foreign capital and the absence of a significant indigenous class of industrialists. The second strand derived from the Vietnamese government's roots in popular peasant and worker-based revolution under Communist Party leadership. This strand indicated the necessity for the creation of a planned economic system based on public ownership of the means of production so that benefits of industrialization and growth could be distributed more evenly among the whole population.

Consequently, from 1955 to 1975, the direction for development of the North was to advance rapidly, vigorously and steadily to socialism. This direction emphasized the central task of carrying out socialist industrialization (the Workers Party of Vietnam, 1960: 78-9). Thus, industry in the North was developed according to a policy of giving priority to rational development of heavy industry, while striving to develop agriculture and light industry (the Workers Party of Vietnam, June 1962). That meant initial industrial policy efforts were strongly based on the Soviet model of centrally planned and state implemented industrialization, with emphasis on building up domestic capital goods
and other heavy industrial activities. The objective was to achieve self-sufficiency, thereby largely neglecting trade and international specialization opportunities. Hence, Vietnam’s manufacturing sector was composed of state owned enterprises (SOEs), owned and operated either by the central government or by local governments at the province, district or local level or by cooperative-owned enterprises. Another obvious distinction was between heavy industry (group A), producing capital or producer goods, and light industry (group B), producing consumer goods. In rural areas, the peasantry, based in agricultural producer cooperatives, was to supply the food and industrial materials needed by state industry. These cooperatives\(^1\) presented a way of adapting traditional collectives that offered a solution to the problem of national economic development as it was then understood.

From 1958, the North\(^2\), under the leadership of the CPV, started undertaking socialist reform, economic centralization and public ownership of production. The government enforced a regime of distribution according to salary's norm and subsidies through ration coupons. The first-five-year plan (1960-65)\(^3\) was a period of construction in the North, with some achievements and the food problem basically solved (Table 5.1). By 1965, a few industrial centers, mainly focused on food processing and light industries,

\(\text{\(^1\) The cooperatives could also fulfill the welfare roles so important to the relationship between individuals and families, on the one hand, and to rural collectives, on the other. They would help the families of men in the army, and finance valuable services such as health and education.}\)

\(\text{\(^2\) Before unification (1975), the management of industry in South Vietnam was market-oriented. However, the managerial approach in these industries varied due to different sources of assistance in terms of capital and know-how for the development of production.}\)

\(\text{\(^3\) The First Five Year Plan was considered a period of comparative peace during which the institutional framework of the North was used to mobilize resources for the development program.}\)
had been established and built with foreign aid from socialist countries, worth about US$1 billion over a 11 year period (Honey, 1962: 115). Industrial operations, which depended on imported materials and technology, were run on an “on-the spot logistical basis” to meet the demands of war and to satisfy the needs of society, particularly the demands of cities and residential areas. Nevertheless, during the war of 1965-72, almost all these centers were either strafed to a serious extent or destroyed, evacuated or depressed.

**Table 5.1: Vietnam: Economic Growth During the First Five Year Plan, 1960-65**

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Average annual change (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total social product</td>
<td>9.1</td>
</tr>
<tr>
<td>Total agricultural output</td>
<td>4.2</td>
</tr>
<tr>
<td>- Staples Output (mainly sown &amp; rice)</td>
<td>3.4</td>
</tr>
<tr>
<td>Total industrial output:</td>
<td>13.6</td>
</tr>
<tr>
<td>- State industry</td>
<td>19.2</td>
</tr>
<tr>
<td>- Artisanal and light industry</td>
<td>4.0</td>
</tr>
<tr>
<td>Total population</td>
<td>3.0</td>
</tr>
</tbody>
</table>


In the early 1960s, the limitations and shortcomings of the centrally planned economic system of North Vietnam were already in existence. And by 1964, the Government of North Vietnam had launched a movement against embezzlement, waste and bureaucracy, and had worked out plans for the improvement of management, but implementation of these plans was disrupted by the war (1965-75), which the US conducted against the North Vietnam.

**5.2. Economic Development and Industrialization, 1976-85**

After national reunification, Vietnam mapped out a plan for socialist economic development and management on a nation-wide scale, in which national industrialization
was given top priority, with a view to eliminating poverty and backwardness. The course of socialist industrialization in Vietnam can be outlined below:

Table 5.2: Vietnam: Economic Targets and Performance of the Second and Third Five-Year Plans, 1976-85

<table>
<thead>
<tr>
<th>Indicators</th>
<th>1976</th>
<th>1980</th>
<th>1985</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Plan</td>
<td>Actual</td>
<td>A/P (%)</td>
</tr>
<tr>
<td>National income growth (%)</td>
<td>n.a</td>
<td>13.0</td>
<td>0.5</td>
</tr>
<tr>
<td>Agro-production growth (%)</td>
<td>n.a</td>
<td>9.0</td>
<td>1.9</td>
</tr>
<tr>
<td>Industrial growth (%)</td>
<td>n.a</td>
<td>17.0</td>
<td>0.6</td>
</tr>
<tr>
<td>Coal (million tons)</td>
<td>5.70</td>
<td>10.0</td>
<td>5.3</td>
</tr>
<tr>
<td>Electricity (billion Kwh)</td>
<td>3.06</td>
<td>5.0</td>
<td>3.7</td>
</tr>
<tr>
<td>Cement (million tons)</td>
<td>0.74</td>
<td>2.0</td>
<td>0.6</td>
</tr>
<tr>
<td>Steel (million tons)</td>
<td>0.06</td>
<td>0.3</td>
<td>0.06</td>
</tr>
<tr>
<td>Fabrics (million meters)</td>
<td>218</td>
<td>450</td>
<td>175.3</td>
</tr>
<tr>
<td>Fertilizer (million tons)</td>
<td>0.44</td>
<td>1.3</td>
<td>0.31</td>
</tr>
<tr>
<td>Paper (thousand tons)</td>
<td>75.0</td>
<td>130</td>
<td>46.8</td>
</tr>
</tbody>
</table>


In December 1976, the Fourth National Congress of the Communist Party of Vietnam (CPV) issued a report presuming to set the economic strategy for the entire transitional period. The policy for economic development during the 1976-1986 ten-year period was to give priority to the rational development of heavy industry on the basis of developing agriculture and light industry. Heavy industry instead of imports would equip agriculture and light industry (Le Duan, 1977: 59). Under this economic development policy, which consisted chiefly of stepping up socialist industrialization, the targets in Table 5.2 were set for the Second and the Third Five Year Plans for 1976-80 and 1981-85.

To implement these targets, the Government allocated over 30 per cent of the state
budget annually for industrial rehabilitation and construction. Thanks to such investments, the industrialization process was supplemented with 100 Mw of electric power, 2 million tons of coal and 0.5 million tons of cement. A few large-scale projects such as cement plants, power stations, shipyards, sugar, paper, and textile mills - that were near completion in second-five year plan - were to begin production in the third five-year plan. In the field of communications and transport, some 3,800 kilometers of roads, 30,000 meters of bridges and 4,000 meters of wharves were restored or constructed, while the railway network was extended by 1,700 kilometers.

*Table 5.3: Vietnam: State Investment in Capital Construction by Branch, 1976-85 (at current prices) (%)*

<table>
<thead>
<tr>
<th>Sector</th>
<th>1976</th>
<th>1980</th>
<th>1985</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Material production sector</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industry:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Heavy industry</td>
<td>21.4</td>
<td>29.7</td>
<td>10.9</td>
</tr>
<tr>
<td>• Light industry</td>
<td>10.5</td>
<td>11.5</td>
<td>20.3</td>
</tr>
<tr>
<td>Agriculture</td>
<td>20.0</td>
<td>19.2</td>
<td>18.5</td>
</tr>
<tr>
<td>Construction</td>
<td>5.4</td>
<td>5.4</td>
<td>2.1</td>
</tr>
<tr>
<td>Forestry</td>
<td>2.3</td>
<td>2.8</td>
<td>3.2</td>
</tr>
<tr>
<td>Transport</td>
<td>21.1</td>
<td>19.0</td>
<td>17.9</td>
</tr>
<tr>
<td>Post</td>
<td>0.7</td>
<td>1.7</td>
<td>0.6</td>
</tr>
<tr>
<td>Trade, material supply</td>
<td>4.5</td>
<td>1.6</td>
<td>4.2</td>
</tr>
<tr>
<td>Other material production</td>
<td>0.1</td>
<td>1.6</td>
<td>0.2</td>
</tr>
<tr>
<td>2. Non- material production sector</td>
<td>14.0</td>
<td>9.8</td>
<td>22.1</td>
</tr>
<tr>
<td>Total</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>


One of the main features of economic development and industrialization for the whole period of the centrally planned economy (roughly 1960-86) is that, perhaps, unlike
the Chinese and East European economies, Vietnam’s industrial sector remained relatively small. Nevertheless, there were substantial achievements in the establishment of a wide range of industries and development of an industrially skilled workforce. These contributed to the creation of a more complex and developed structure than would normally be expected in a society with such low per capita income⁴. On the other hand, although the industrial sector contributed over 40 per cent of national output, it employed only 12 per cent of the workforce in 1985 (GSO, 1993: 12, 19), and in the long run, proved to be too inefficient and not dynamic to cope with the enormous challenges to the Vietnamese economy during the 1970s and 1980s.

5.2.1 Initial Discovery of Weaknesses and Shortcomings of the Centrally Planed Economic Mechanisms

Although the system of “full allocation and full delivery”, which was abolished from 1979, and replaced by a new system, whereby the government reduced allocations from the state budget and factories increased their use of credit loans from banks, the reform still failed to increase efficiency in the use of capital, which was already at very low level⁵. Therefore, actual performance in the Second Five Year Plan period was quite far from the plan targets⁶ (see Table 5.2); the growth rate of gross social products was only

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⁴ This fact has frequently attracted comment and some confusion among economists using measures like GDP to estimate real incomes of populations.

⁵ In the five years 1976-1980, the efficiency of one VND of fixed assets decreased by 15.3% per year. Labor productivity of the industrial sector as well as industrial production decreased, and many enterprises operated at capacities of only 30% to 50% (GSO, 1981: 29; Norlund, 1984: 98-105).

⁶ This expressed the involuntary nature of the plan.
0.4%, compared with the 13% of the plan; average growth rates of both industrial and agricultural sectors were very low, even negative for state-owned industry, at both the central and local level (see Table 5.4). Plan implementation of the 1976-1980 period did not substantially reduce the serious imbalances in the national economy. National revenue could not cover consumption, and the national economy failed to advance accumulation. Food, clothing and other essential consumer goods were in short supply, while the population growth rate was high at more than 2.3% per year. The supply of energy, technical materials, communications and transport was quite unsuitable. Disparities between financial revenue and expenditure, between goods and money⁷, and between exports and imports⁸, remained very great. Hence, it could be said that in the late 1970s, Vietnam economy fell into crisis, due to the following reasons.

Firstly, in the Second Five-Year Plan, 1976-80, the investment measures to implement the industrialization strategy were still focused on increasing funding for heavy industry⁹ (see Table 5.3). There was a tendency to emphasize heavy industry and large scale-projects, rather than to solve the problems of food production, consumption and exports. As a result, the huge investments did not yield much.

Secondly, it should be noted that the capital investments had to rely entirely on foreign aid and loans in various forms. However, in order to absorb foreign aid, there

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⁷ Food shortage was serious. In 1980, the country was forced to import 1,756 tons of food. Due to shortage of goods, the increase rate of price was 20% per year (www.mofa.gov.vn, 2000)

⁸ On average, the volume of imports was from 4 to 5 times bigger than exports (www.mofa.gov.vn, 2000)

⁹ In this period, the rate of increase of industrial investment was 12.3% per year, compared to only 4.4% for agriculture.
must be enough capital funds available in the country. Therefore, in conditions, where little domestic accumulation could be made, the government resorted to issuing money to encourage investment by providing credit channels (the essence of government allocations), which was euphemistically called “healthy inflation”. This led to the indiscriminate industrial expansion, which caused a shortage of funds and growing budget deficits.

**Table 5.4: Vietnam: Average Annual Growth of Gross Output by Sector (at 1982 constant prices) (%)**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Whole economy</td>
<td>0.2</td>
<td>6.0</td>
<td>3.8</td>
</tr>
<tr>
<td>Agriculture</td>
<td>2.0</td>
<td>6.2</td>
<td>4.1</td>
</tr>
<tr>
<td>Industry, of which:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>State owned industry:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Central level</td>
<td>-2.7</td>
<td>7.8</td>
<td>6.0</td>
</tr>
<tr>
<td>- Local level</td>
<td>-4.2</td>
<td>7.5</td>
<td>5.3</td>
</tr>
<tr>
<td>- Group A (heavy industry)</td>
<td>3.8</td>
<td>9.9</td>
<td>6.5</td>
</tr>
<tr>
<td>- Group B (light industry)</td>
<td>6.4</td>
<td>6.2</td>
<td>1.5</td>
</tr>
<tr>
<td>Non-state industry</td>
<td>3.9</td>
<td>11.4</td>
<td>6.2</td>
</tr>
</tbody>
</table>


Thirdly, the structure of production and investment was promoted by desire to secure rapid growth without consideration to practical possibilities as well as the needs to rationally integrate industry and agriculture from the outset. The targets for capital formation and production were set too high, with inadequate attention given to reconstruction and restructuring of the economy. Consequently, actual performance was quite short of the plan targets.

Fourthly, centralized economic planning was excessive, while market mechanisms
were ignored and disregarded\textsuperscript{10}. At the same time, building socialism was identified with achieving egalitarianism with various consequences. The inefficient command economy model of the North was applied to the whole economy. In order to coordinate the management of public enterprises under ministries or provincial or municipal people's committees in industrially developed areas, many enterprises usually belonged to one of several "unions of SOEs". The union assumed the task of working out (long, medium and short term) plans for its member enterprises. All these became fetters to SOEs trying to develop production.

Fifthly, an outstanding symptom of industrial malaise during this period was its relative autarky vis-a-vis the rest of the economy. There were relatively few exchanges between the industrial sector and agricultural areas with roughly 80% of the population. In agriculture, both major inputs and consumer goods tended to be either imported or self-supplied. Conversely, agriculture supplied relatively few goods to the industrial sector. Most industrial enterprises received the most of their inputs and equipment in the form of imports. Capacity duplication compounded the problem of autarky and contributed - in the context of an input-constrained economy - to underutilization of capital equipment within the (public) industrial sector (Beresford, 2000).

Sixthly, apart from the above five endogenous causes, exogenous factors exacerbated the situation, such as the cut-off of Western aid, the US economic embargo, exhaustion of the supply of raw materials and spare parts left over from the old regime in

\textsuperscript{10} Under the provisions of the SOEs regulations promulgated in 1977, an SOE was entitled to the allocation of fixed assets and variable capital for production by the state, and to do business under principles of economic planning and cost accounting, and to fulfill eight compulsory targets order by the state (see more in Nguyen Anh Tuan, 1996: 25).
the South, the disruption of restructuring, the war in Kampuchea, rising tensions and then
the border war with China, leading to the exodus of skilled ethnic Chinese workers from
North Vietnam as well as many of the more commercially oriented Chinese from the
South, and cessation of trade with and aid from China. These factors had strongly negative
impacts on Vietnam’s economic and commercial activities.

Vietnam’s economic reality with its weaknesses and shortcomings in the late
1970s, was acknowledged - though still vaguely - at the famous Sixth Plenum of the
Central Committee in September 1979, which was the first great turning point in the
party’s post-reunification economic strategy. The Government discovered errors in its
guidelines for allocation of capital for investment and the decision was taken to redirect
investments. Projects with low or negative rates of return were to be suspended, and
investment capital was to be allocated to key projects demonstrating efficiency. However,
little was done before 1980. The new policy for industrialization advocated by the Plenum
was later endorsed and expanded at the Fifth Party Congress.

5.2.2. Systemic Change and Economic Reforms in the Third Five-Year
Plan, 1981-85

Vietnam’s economic development strategy during the next five-year plan derived from
reforms introduced by the Sixth Plenum in 1979, gave top priority to solving problems in
production of food and consumer goods. It was a mistake not to prioritize agriculture, but
it was also a mistake not to give serious attention to the central task in the transition to
socialism, that is socialist industrialization, especially the relationship of agriculture with
industry (Nguyen Van Linh, 1985: 56-7). Each strategy would be considered the basis for
the development of the other, with the long-term goal of becoming an industrialized economy (CPV, 1982: 42-5).

To implement this strategy, the economic policies and guidelines for this period were as follows: to combine economic development, reallocation and transformation, concentrating efforts on agricultural development\(^{11}\), to thus bring about large scale socialist production based on a rationalized agricultural-industrial structure and to combine agriculture, consumer goods and heavy industrial production from the start. It was also necessary to make fully utilize existing heavy industrial capacity and to rationally build other industries supplying chemicals, hand tools, semi-mechanized and mechanized instruments, building materials and so on. Attention was given to selected light industries producing the commodities to meet pent-up consumer demand or export objectives.

In reallocating investment, attempts were made to re-examine the structure of investment as well as the scale and pace of capital construction in terms of doing away with divergent, disproportionate and inconsistent investment with poor economic

\(^{11}\) In response to such pressures as the inefficiency of the old centralized cooperative management system and the attraction of high market prices, a new model for agricultural development - expressed in decree CT-100, called the "output contract" system (No 100 Contract) - was introduced in the agricultural sector. Accordingly, local adaptation of the old method of cooperative management extended to the scope of the family economy by increasing private plots beyond the statutory, 5 percent limit and by allotting of production quotas to groups and individual employees (Fforde, 1989; Dang Duc Dam, 1995: 23-25). CT-100's main directions included: (i) by partially decentralizing management of production within cooperatives, it sharply increased both the static and dynamic efficiency of agricultural organization; (ii) by granting cooperators greater freedom to sell their products in the free market, it improved the terms of trade facing agriculture, thereby improving producer incentives. As grassroots change progressed in the late 1979 and 1980, this process was simply extended (see Fforde, 1996: 139-41).
efficiency. Investments in new projects would be firmly disapproved if the existing capacity of similar enterprises was not being fully utilized, while others would be suspended or delayed if they proved to be unfeasible for implementation or did not have much prospects of viability when put into operational.

It was suggested that in a multi-sectoral economy, it was important to expand the scope of operations and highlight the leading role of the socialist economic sector, particularly to consolidate and improve SOEs in such a way that the state economic sector became good examples in terms of labor productivity, product quality and efficiency in production and business, and policy implementation and legal compliance. On the other hand, it was also considered essential to encourage, direct and assist the household economic sector. The government tried to make use of and guide the private sector to minimize its negative aspects. This involved consolidating the state economic sector as economy's nucleus, trying coordinate other economic sectors in complementary ways and bringing all economic sectors under state influence (CPV, 1982: 67-89).

While the main industrial sector had to wait until 1981 for the first major reform package, agriculture and consumer goods industries were immediately affected by the reforms of the Sixth Plenum of the CPV in 1979. Agriculture, in particular, benefited from abandonment of the southern collectivization drive and increased scope for legitimate "own-account" small private activities. Agricultural output and procurement began to increase after 1979. Although recovery in agriculture had begun, the industrial sector crisis still deepened during 1980\(^\text{12}\) (Beresford, 2000). By 1981, the new regulations

\(^{12}\) Before 1981, SOEs faced one other difficulty, namely much higher CMEA prices for inputs (e.g. the average unit price of imports rose 210%). Alongside the catastrophic fall in state industrial output, the spread of market and quasi-market relations throughout the economy appeared somewhat threaten the
(Decrees 25/CP and 26/CP) promulgated by the Council of Ministers in January 1981 allowed SOEs to obtain more technically sophisticated material required for production from non-state sources at negotiated prices instead of depending exclusively on state sector suppliers. The SOEs were also permitted to more fully utilize their facilities, labor, materials and other excessive capacity to manufacture subsidiary products and to market them at negotiated prices.\textsuperscript{13}

The government had identified three principles to improve planning and economic accounting at the enterprise level, namely: (i) Guarantee centralized economic management, while correctly using trade and market relations to create conditions for enterprises to strengthen production and profitability; (ii) Harmonize the interests of state, enterprise and individual workers by strengthening enterprise financial autonomy, enhancing workers' material interests to raise productivity, and guaranteeing revenue for the state; (iii) Create the conditions needed for enterprises to implement state plans (Fforde, 1994: 97-8). Beside affirming the central importance of planning for the socialist economy, these principles also accepted two new ideas into the legal framework conception of Vietnamese socialist notion of socialist industrialization under the ownership of the whole people. This dilemma seems to have been solved by growing acceptance of commercialization of economic activity to strengthen the state's economic position (Beresford and Phong, 2000: 26)

\textsuperscript{13} At that time, based on the extent to which the government could guarantee material supplies under the plan, SOEs were divided into three types, as follows: (i) important SOEs were to be centrally managed and guaranteed material supplies and other technical requirements for production; (ii) SOEs were not longer to be required by state to obtain supplies from other SOEs and were allowed to seek out alternative sources of supply, change composition of their output and generally establish trade relations with other enterprises and cooperatives; (iii) SOEs which could not carry out their activities could temporarily close down or reduce production. Workers could be put on a shorter working weeks temporarily in order to ensure the capacity to start up again (Fforde, 1994: 98)
governing SOEs, namely (a) the idea of the complementarity, rather than mere opposition between plan and market; (b) recognition of the separate interests of worker, collectives and enterprise, and the need to harmonize these (Nguyen Tri, 1981)

Therefore, the production plans of SOEs changed from the previous period, and were usually composed of three parts, namely: (i) products made from inputs supplied by the state were realized at prices fixed by the state, with half the profits remaining in the enterprises and the other half forwarded to state revenue; (ii) products made from inputs purchased at negotiated prices and were marketed at market prices, with 60% of profits for the enterprises and the other 40% transferred to the state; (iii) other output not included in the directive plan could be sold at negotiated prices, for which 90% of profits belonged to the enterprises, while the other 10% went to state revenue (Nguyen Anh Tuan, 1996: 27-28).

Hence, what was new in these decrees was the notion that SOEs could legitimately produce products outside the state's formal system of material supplies. The only stipulation was that such activities should not be allowed to undermine full implementation of the directive plan. SOEs could also use their profits to build up capital reserves. Thus, these decrees represented a marked shift in policy orientation towards SOEs, away from the pre-1979 attempts to obliterate the market, towards an emphasis on using economic incentives in order to strengthen the state's position within the economic system in which administrative planning and market exchanges were seen to be interdependent. However, further policy changes between 1982 and 1985 suggest that the latter point was dimly perceived, or at least, not yet widely appreciated (Beresford, 2000)

Owing to new regulations imposed from 1979 to 1985 in both agricultural and industrial sectors, the growth of agriculture and industry in the period 1981-85 averaged
6.2% and 9.2% per annum respectively compared with 2.0% and 0.6% in the previous period\textsuperscript{14} (see Table 5.4). Another sign of a more effective investment - involving a better structure of production and improved incentives - can be discerned from labor market activity that had begun to rise after a period of stagnation (Nguyen Anh Tuan, 1996: 27-28).

However, despite the dramatic increase in industrial production during the period, there were a few industries whose output decreased\textsuperscript{15} while the per capita output of some essential industrial products in 1985 was still very low, even below 1976. The annual inflation rate ranged between 30% and 50% in the early 1980s, then shot up to 587% in 1985.

At the same time, in the state sector, especially the SOEs at the central level, labor productivity was low, production costs were high, while the quality of some goods was worsening. The contribution of industry to national income was still relatively weak at 28.2% in 1985, whereas agriculture’s share was 50.8% (GSO, 1985: 27). In brief: “we are not satisfied with the present situation in the state sector of industry which has been growing slowly in productivity as well as in quality and efficiency. The SOEs operated at one-third or one half of their capacities because of the shortage of material, fuel, energy, and spare parts, although some of these materials are produced in the country itself” (\textit{Vietnam Courier}, No. 2, 1984: 2-6). The SOEs were managed worse than collective ones, which in turn, were managed worse than private enterprises as far as productivity as well

\textsuperscript{14} Some selected industries had grown rapidly, with annual rates as follows: textiles 14.8%, building materials 10.3%, paper 13.0%, electric power 10.3%, metallurgy (non-ferrous) 5.8% and ready-made clothes 4.8%.

\textsuperscript{15} The growth rates for food processing, leather, metallurgy and timber were -9.3%, -5.6%, -4.2%, and -3.7% respectively.

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as output quality were concerned (*Nhan dan*; 23 August 1983). The reasons for the sluggish development of the state run sector were as follows:

First, management was often haphazard, and training programs did not exist, while accounting procedures disguised serious inefficiencies.

Second, while attention was not paid to small-scale industries for consumer goods production, there was a tendency to favor large-scale enterprises and heavy industry even when their technical equipment, managerial skill and management capability were inadequate. However, heavy industry frequently failed to produce the machinery, equipment and other production requirements for agriculture and light industry.

Third, policies for production reallocation and investment restructuring were not fully executed. Inadequate attention was paid to consumer goods industries (group B), including handicrafts, which were still neglected in terms of organization, investment and policy during the period 1981-85 (CPV, 1987: 20). Furthermore, though few relatively large projects was suspended to benefit of key projects, a rational reorientation of investment was not accomplished; nonetheless, many urgent projects with low rates of return were continued (Institute of Economics, 1990: 75, 78).

Fourth, socialist transformation was impatiently advocated to eliminate the non-socialist economic sectors at one stroke by socializing the private capitalist sector. Emphasis was laid on changing ownership of the means of production without settling problems in management organization and the distribution system.

Fifth, the mechanisms of bureaucratic centralism, involving irrational state subsidies, were not entirely eliminated, and uniformly replaced by new mechanisms. Many outdated policies and institutions were not changed, and quite a few legal Institutions were patched up. Besides extreme bureaucratic centralism, instances of
anarchy and lack of discipline were quite widespread. Specific policies and regulations for private sector development were insufficient and poorly timed.

Sixth, by 1982, with the crisis and increasing growth of central SOEs' output, opposition to commercialization emerged more clearly. The policy switch, which resulted from a resurgence of conservative arguments, led to promulgate the Decree 146-HDBT of 25 August 1982, entitled “On modifying and supplementing decree 25-CP”. While supporting many measures of decree 25-CP, this decree, also aimed “to get rid of production and trade based on the unorganized market” (Beresford, 2000).

Therefore, at the end of 1985, the CPV decided to convene an important meeting in August 1986 to overhaul the economic development strategy, causing a strategic shift in overall economic policy.

### 5.3. The First Phase of The Renovation Policy (1986-1995):

**Import-Substitution or Export-Oriented Industrialization?**

**5.3.1. The Emergence of The Renovation Policy**

As a result of the shortcomings and mistakes of the previous period mentioned earlier, and the failure of the attempted re-centralization in 1985 as well as changes in the international situation\(^\text{16}\), Vietnam implemented a series of macro economic and structural

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\(^{16}\) The changes in the international situation were marked by the break down of socialist regimes in Eastern Europe and the former USSR; the centrally planned systems came to an end; market principles were widely introduced in these economies; and their governments conducted liberalization policies and a number of SOEs were liquidated and privatized. At the same time, the rise of Gorbachev in the former Soviet Union (in 1985) was having a profound impact on debates within Vietnam. For the first time, it became possible to
reforms in line with liberalization from the mid-1980s often called the renovation policy. These changes were first reflected in the 8th Central Committee Resolution of June 1985, which announced the intention to move decisively towards wider use of market prices in resource allocation. From 1985 onward, the more dynamic, market-oriented economy of the southern region around Ho Chi Minh City began to be looked to as a model for the whole country to emulate.

The strategy approved by the Sixth Congress of the CPV in December 1986 was essentially for “inefficient production which does not satisfy the needs of people and other negative aspects of the centrally planned economy should be overcome by modern management methods. Instead of promoting the development of heavy industry, the emphasis should from now be on food production and consumer goods as well as export promotion (basically it is known as export oriented industrialization) in order to earn the necessary foreign currency much needed for the importation of raw materials and other necessities. At the same time, government controlled prices17 and subsidies should successively be withdrawn” (CPV, 1987: 65).

The VII Congress of the CPV held in June 1991 approved the Program of Building the Nation in the Transition Period towards Socialism, and the Strategy of National Stabilization and Socio-Economic Development towards 2000, according to which there are various economic components in the economy, namely state-owned, state capitalist,

17 The price controls, together with the price-wage reform, which came into being in August 1985 led to the hyper-inflationary spiral. In 1989, the government phased out price controls, set interest rates on deposits above inflation rates and below loan rates, and instituted stricter controls over financial lending to state enterprises (Nguyen Thi Hien, 1994).
private, cooperative, individual and so on. Of these components, the non-state sector played an important role in economic development and industrialization, accounting for 60% of GDP (CPV, 1991).

Hence, the development of light and food processing industries was first of all, to be based on the reorganization of production with uniformly intensive and extensive inputs to fully utilize equipment capacity in existing production units, with importance attached to those with high labor productivity; and secondly, based on rational utilization of the potential of heavy industries and other enterprises to produce consumer goods; At the same time, heavy industries were developed to effectively serve the development of agriculture, forestry, fishing and light industry according to existing capacities and to prepare the prerequisites for future economic development. The engineering industries of all ministries and localities were restructured, standardized and specialized, and equipment gradually renewed.

Hence, with the strategies approved by the VI and VII Congresses of the CPV, there were seven goals to be fulfilled, namely (i) building a multi-sectoral economy; (ii) emphasizing the important role played by the market in the boosting commodity production; (iii) establishing new economic priorities, namely development of agriculture, promotion of consumer goods production, and increasing export production and trade; (iv) emphasizing industrialization and modernization of agriculture and rural development; (v) stabilizing the socio-economic environment, such as reduction of inflation and the budget deficit, and improvement of national living standards; (vi) implementing better external relations; (vii) paying great attention to developing communications and transport infrastructure to promote the production of export commodities and to attract FDI.
5.3.2. The Macroeconomic and Structural Reforms of the Industrial Sector Under the Renovation Policy

5.3.2.1. Reform of Macroeconomic Management

The transition from a centrally-planned to a market oriented economy in Vietnam has involved many reforms initiated during or re-affirmed in the post-1986 period, which are itemized below:

(a) First, re-organizing and improving the Vietnam's system of economic management. The number of administrative organs as well as employees in these organs has been reduced.

(b) The government gave up its unrestricted right to intervene directly in economic activities and shifted to indirect intervention through macro-economic policies and instruments. All enterprises - regardless of ownership - enjoy full equality before the law

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18 To ensure the autonomy of SOEs and self-management of non-state enterprises, the functions of ministries, government organs and peoples committees of provinces in terms of macroeconomic management were adjusted and limited as follows: (i) building up a social and economic development strategy, drawing out long-term economic plans by branch and territory, and ensuring the main annual macroeconomic balances of the national economy; (ii) promulgating, guiding and instructing the people to obey the law and implement economic policies, and to carry out the new system of managing the economy, science and technology as well as the main economic and technical norms; (iii) creating favorable conditions in the economy and society for trade, business and investment activities; (iv) carrying out the plans for and training management staffs, appointing and dismissing those under the direct control of the central government; (v) controlling, on behalf of the state, all economic activities, ensuring strict implementation of the law in all branches, at all levels and in all localities. Apart from that, local authorities at all levels have the right and duty to carry out economic management functions at the local level. They
and independent rights to finance; and can freely compete with one another on the market. That means Vietnam has established the mechanism for the development of a multisectoral market economy, in which the household economy can develop vigorously, the private sector sets up its own enterprises, the SOE sector gradually become mixed ownership institutions, and joint venture involve comprise domestic state companies and foreign capital.

(c) The economy has had open and ever more liberal mechanisms. At the beginning, the government liberalized prices (only fixing prices for essential goods). Then, the government reduced its remaining controls over prices. Consequently, domestic prices have approached world market levels, even though the Vietnamese economy has suffered from many price dislocations caused by the Gulf crisis and the disintegration of the CMEA.

(d) Along with economic restructuring, the government has initiated steps to stabilize the macro-economic environment. Firstly, the government attacked hyper-inflationary pressures by following the new policies of positive real interest rates, tightened credit and wage incentives in the SOEs. Then, financial and fiscal policies have been reformed to mobilize personal savings, increase taxes and reduce the budget deficit, and separate state finances from SOE finances.

(e) Vietnam’s banking system, which underwent important market-oriented renovation, has been restructured to separate central banking from commercial banking

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may not engage in business, violate or infringe upon the autonomy and self-management of various local economic units, and should carry out guidelines issued by the central authorities (Le Trang, 1991: 175-76).

19 Vietnam’s economy formerly only comprised the state sector and cooperatives.

20 Up to 1991, prices were only fixed for electricity, coal and cement used for major state construction projects. From 1991, only the price of electricity was fixed.
functions. Commercial banking has been rapidly expanding, and is composed of investment and development banks, foreign trade banks, trade and industrial banks, agriculture banks, joint-venture banks, shareholding banks, people’s credit funds and financial companies. At the same time, the central bank has reduced financial subsidies to the SOEs and conducted a policy of market-determined interest rates.

(f) Theoretically, in order to be more efficient, legislation has to keep abreast with economic reform. Therefore, a series of legal reforms have been promulgated in Vietnam, including laws on private business, on taxation, on shareholding companies, on FDI and so on. So far, Vietnam has created a comprehensive system of economic legislation.

5.3.2.2. Official Recognition of the Economic Importance of Private Production

One of the official strategies for economic development adopted in the VI and VII Party Congresses was to build up a “multi-sectoral economy" using the market mechanism under state guidance”. The development of a multi-sectoral economy has been undertaken since the period of economic restoration and growth in North Vietnam. Yet, prior to 1986, the main orientation was to give priority to the public sector, whose extent became broader and broader. Meanwhile, the private capitalist sector and the market mechanism were not recognized.

However, the VI Party Congress noted that in a developing country like Vietnam,

21 The term “multi-sectoral economy” comes from a description of the former Soviet Union, in which the private sector and the (socialist) state sector co-existed side by side and implied that the latter was still very much part of a planned economy.
where 80% of the total population lives in rural areas, the household must play a very
important role in agricultural production. Therefore, economic activities previously
centered in agricultural cooperatives were to be transferred to individual farming
households. The changes in the rural economy brought a series of socio-economic
transformations: (i) The use, allotment and apportionment of land have been given to
households for a long time; (ii) the role of organizing labor and production which
previously belonged to the cooperatives, has been transferred to households. Buying and
selling among farmers, cooperatives and state were no longer administratively and
vertically determined hierarchically, but according to market conditions; (iii) Many other
socio-economic aspects of the economy - such as labor relations, trade transactions,
urbanization, income differentiation and so on - have changed.

Together with the reforms in agriculture, the government has taken steps to
promote the private industrial sector. Up to 1986, there were almost no legal restrictions
on establishing and expanding private enterprises (PE). As to the promotion of private

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22 In April 1988, the Political Bureau of the CPV issued an important Resolution (Resolution No 10) on the
contract system (No 10 Contract) in agriculture. Since then, the contract system has been expanded
throughout the rural areas. Accordingly, land has been allocated to the farmer households now considered
as economic units. This resolution was one of the most important components of the renovation policy and
largely solved the agrarian problem that had been plaguing Vietnam. This resolution led to increasing rice
production and exports. Compared with the year 1988, when Vietnam imported 450 thousand tons of food,
the situation changed fundamentally as Vietnam became the third rice exporter in the world in the early
1990s (see Table 5.7).

23 The one exception is that the government does not encourage the private sector to operate in key
industries related to national defense and social security, such as weapons, explosives, mass media,
overseas shipping, air communication and the like.
activities, the main thrust of the VI and VII Party Congress’s resolutions (such as Resolutions 27/HDBT of March 1988, 28/HDBT of March 1988 and so on) on new regulations for non-state economic enterprises sought to fully tap the potential of the private sector and to turn them into important components of the national economy. This has been reaffirmed since at the VIII and IX Party Congresses (CPV, 1997 and CPV, 2001).

The Law on Companies, providing the basis for establishment of limited liability and shareholding companies, and the Law on Private Enterprises, allowing the private sector to be formally involved in business activities, were promulgated in 1990, but it has taken a long process of trial and error to implement these laws. In June 1991, the VII Congress of CPV reconfirmed the necessity for the private sector and for the long-term strategy of development in Vietnam to involved planned development of a multi-sectoral commodity economy. The term “planned development” does not have the sense of economic planning as in the period before renovation policy. The term “multi-sectoral commodity economy” suggests a market economy where the private sector is developed side by side with the public sector. Recognition of the multi-sectoral commodity economy was formally indicated in the new Constitution of 1992. In 1994, the Law for Promotion of Domestic Investment was amended to encourage domestic entrepreneurs to invest in the private sector\textsuperscript{24}.

With the Law on Companies, the Law on Private Enterprises and the Law for Promotion of Domestic Investment, the ownership of properties by individual producers, small workshop owners and the national bourgeoisie are recognized and protected by the laws. Their rights to inherit and to bequest properties are recognized, while the working

\textsuperscript{24} This Law is complementary to the Law on FDI, which only encourages the foreign private sector.
people’s interests are protected by the laws. The laws aim at putting private enterprises (PEs) on an equal footing with the state and cooperative sectors, by not discriminating against them in the supply of raw materials, spare parts, finance and taxes, and by allowing them to secure their own supplies of raw materials and spare parts, to procure supplies of machinery and equipment from SOEs, to take initiatives in disposing of their products according to economic contracts through networks of agents or their own shops, to directly sign economic contracts with foreign firms, and for some PEs to entrust specialized import and export activities to other economic organizations with the task to export and import for them.

The policies for obtaining the production inputs and selling products accord with state economic development policies, social needs, their own capabilities as well as material, technology, capital and labor endowments. No government administration at any level is allowed to set compulsory plan targets for PEs except to require contribution to state revenue in the form of taxes.

To encourage PEs to make scientific and technical progress in production and trade, the government, wholly or partly, exempted PEs from taxes for a certain periods of time, as for SOEs. The PEs have the right to purchase and keep the copyrights and licenses according to state stipulation. Like SOEs, if they are short of capital, PEs can borrow from banks, and draw capital from other sources, even from foreign countries in various forms. They can select a bank for opening business accounts and can make economic contracts with banks. They are bound to keep accounts and pay taxes as stipulated by the government. Since most preferential treatment for SOEs has been abolished, it became relatively easy for private firms to start new businesses to compete with SOEs (Vu Tuan Anh, 1995).
5.3.2.3. Enlarging SOE Autonomy and SOE Restructuring

The reform of SOEs\(^{25}\) may be the most important issue for Vietnam, which is in transition from being a planned economy to becoming a market economy. SOEs have been characterized as inefficient and therefore as a major cause of economic stagnation and instability. This has been attributed to factors such as lack of management autonomy and entrepreneurship\(^{26}\), soft budget constraints, state's self-sufficient policy and also in many cases, the lack of competition (Lavigne, 1999: 33-35).

It is widely believed that the complex nature of ownership relations between the government and SOEs, together with practices inherited from the days before the renovation, have created a lack of clarity about the rights to SOEs surpluses and mechanisms for transferring the surplus to stakeholders\(^{27}\). In a market economy, SOE profits should be taxed in the same way as private firms, with the after-tax surplus going

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\(^{25}\) In 1995 SOEs, which received concessional credits worth 35% of budgetary savings and ODA, contributed to 40% of GDP (see Table 5.9), and were particularly important contributors to output in the energy (99.9%), oil and gas (99.8%), manufacturing (64.3%), finance and insurance (99.3%) and transport and communication (63.0%) sectors. They were major contributors to the budget revenue, accounting for 43% of all budgetary revenues. But most SOEs were small, with half employing less than 100 workers and using capital of less than US$1 million. Less than 10% of SOEs had capital in excess of US$1 million. SOEs accounted for only 5.2% of total employment.

\(^{26}\) Normally, directors and managers of SOEs typically behave as bureaucrats, rather than entrepreneurs.

\(^{27}\) This has important implications for the operation of the tax system and the incentive that the system created
to the owner, normally the government. From a revenue point of view, it would not matter if revenues are received as profits or as taxes. But in Vietnam, the two revenue streams have quite different destinations. Tax revenues are shared among the three levels of government (see Figure 5.1), but SOE surplus is distributed between management and workers, or automatically retained for reinvestment. Moreover, some agencies that exercise rights of ownership and control - such as line ministries - receive no direct benefit from either revenue stream, and therefore have little interest in ensuring that SOEs maximize surplus or tax revenues, or minimize cost and, instead, have an interest in directing SOE activities in ways that offer benefits to them.

Thus, there is uncertainty in many cases about, firstly, ownership of the SOEs; secondly, the stream of profits; thirdly, the taxes from that stream of profits. This situation is further complicated by the fact that the regulations affecting SOE revenue streams - such as the extent of import competition determined by duties and quotas, or the extent of domestic competition determined by investment licensing - may be decided by different layers of government (see Figure 5.1). In these circumstances, regulations, which are in the hands of one section of government, may be used to determine revenues going to another section of government.28

Together with the above reasons, the reform of SOE is extremely difficult due to two other main reasons. First, SOEs have heavy social burdens in terms of providing social welfare such as medical or health care, pensions and social security for employees.

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28 This complicated situation has come more complex over the years with "renovation" as SOEs have formed joint venture arrangements with foreign firms. The allocation of SOE revenues and taxation of these revenues may be resolved by negotiation among of government and the SOEs themselves. However, such negotiations may be impractical when one party to the negotiations is a foreign party.
Figure 5.1: The Regulation of SOEs and the Allocation of Profits

Moreover, under a socialist regime, there is a strong tendency for workers to regard SOEs as a source of lifetime employment. As a result, as long as social safety nets, social welfare systems, as well as employment opportunities elsewhere are not available, resistance to SOE reform programs, which may result in worker lay-offs is likely to be strong; Second, in Vietnam, SOE reforms have been associated with ideological principles
involving a market economy and building socialism, for which the public sector is the mainstay. Vietnam currently considers the “socialism-oriented market economy” as its basic path to nation building. Therefore, any reform resulting in a substantial reduction of state ownership is not likely, at least in the foreseeable future (Tran Van Tho, 2001).

Yet, since 1986, the government has carried out a number of important policies and measures to broaden SOE production and business autonomy in the market mechanisms, which have mainly focused on resolution of three outstanding problems, namely (i) the relationship between the state and SOEs, to clearly distinguish between two types of state management: state macro-management and state micro-management of SOEs business activities; (ii) to reform the internal management mechanisms of SOEs in line with the conditions of the market mechanisms; (iii) to restructure and reorganize SOEs to overcome their lack of coordination, and increase the effectiveness and strength of the public sector29 (Dang Duc Dam, 1997: 123).

In line with the policies of a “multi-sectoral economy”, while the government is actively promoting PEs, the important role of the public sector will continue to be emphasized in Vietnam’s economy. Yet, unlike the past, public sector got greater

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29 According to Nakagane (2000), SOE reform in Asia, which has been different from Eastern Europe, was involved gradualism; The SOE reform in Asia may be summarized as follows: (i) along with enhancement of market development, the government should conduct gradual SOEs reforms of by providing autonomy to management, and gradually hardening budget constraints. This has been done in order to improve their efficiency, and this reform has been carried out without privatization (i.e. without change in the ownership of SOEs); (ii) in that process, gradual promotion of private sector to generate new employment and new fiscal resources for the government to conduct further reforms in the future is considered very necessary. This will gradually erode the share of SOEs in the national economy, and even though there is no equitization of SOEs, the economy as a whole is gradually becoming more private (see section 5.3.2.2).
autonomy in production, investment and pricing decisions. The first major decree, relating
directly to SOEs (public sector) came in the aftermath of the VI Party Congress was
217/HDBT of November 1987 (Beresford, 2000). According to this decree, and the
resolutions30 approved by the government in the following years, SOEs were given a
number of specific rights as follows:

(a) Since management independence of SOEs was established and the basic
apparatus of direct state control was abolished, SOEs were given freedom to make and
implement plans for long-term development, five-year plans, and annual plans within the
goals of state plans and in response to market demand. All SOEs activities should be
covered in these plans. Official planning targets assigned to SOEs can be reduced with the
exception of a few enterprises producing important products, which should only be
assigned two or three targets (output value, principal products and contribution to state
revenue). Most SOEs need be only assigned one target, i.e. contribution to state revenue
according to their business, instead of eight compulsory targets, as before31 (see section
5.2.1.).

(b) Since the government ended the preferential supply of raw materials and
intermediate inputs to SOEs at low prices, SOEs were required to obtain their inputs from

30 The 35 key industries, which the state initially maintained some direct control of for strategic reasons,
such as coal, electricity, steel, chemicals, fertilizers, transport, communications and several other consumer
goods, were included in further efforts to increase independence for SOEs in subsequent years.

31 By the late 1980s, the number of targets was reduced dramatically, while in 1991, prescribed targets were
abolished altogether and SOEs gained full management control of capital on behalf of the state owner.
Decree no 28-HDBT, dated 22 March 1989 allows the formation of joint ventures between SOEs and other
entities, including those from the non-state sector.
both international and domestic markets\textsuperscript{32}. They obtained the right to subcontract for production and inputs, to find markets for their products. For products produced by government order, the government is obliged to appoint consumers for the SOEs, but they have the right to sell other products\textsuperscript{33} on the markets with market-determined prices with economic contracts signed with foreign and domestic customers, through agents or their own shops. Within the state trading system, priority in input sales would be given to SOEs showing high product quality, efficiency and contribution to state revenue. SOEs with high export volumes are permitted to establish direct relations with customers and to retain part of their foreign exchange earnings.

(c) The government demanded that SOEs follow the principles of financial independence, according to which the working capital first received from the state budget corresponded to production needs. Then, the SOEs have to meet increases in both working and fixed capital by their own capital, bank loans or capital mobilized from other sources including from abroad\textsuperscript{34}. Further, the SOEs have the right to improve the structure of fixed capital to improve technology, output and product quality. They have the right to resell, transfer and lease out unused assets provided this does not reduce production capability.

\textsuperscript{32} By the end of the 1980s, all but the prices of imported inputs had been liberalized, and as Soviet aid began to be wound down, SOEs have had to get more and more of their inputs from outside the material supply system. The decision in 1989 to adopt the "one price" system - in which all prices would be market prices - was taken in the knowledge that Soviet assistance would soon end altogether and SOEs would have to face world market prices for imports.

\textsuperscript{33} Unlisted goods are minor outputs not specified in the directive plan and can be sold at negotiated prices products (see section 5.2.2.).

\textsuperscript{34} Non-export oriented SOEs that need foreign currencies to import equipment and necessary raw materials for production are permitted to buy them at banks for foreign trade.
and the general value of their assets. Simultaneously, changes in the system of "socialist business accounting" have allowed SOEs to retain part and, since 1996 all of their depreciation funds. Like PEs, SOEs can choose their own banks to open accounts. The profits that SOEs are entitled to utilize are the balance from total receipts after taking into consideration total expenses, contributions to state revenue and contractual liabilities, if any\textsuperscript{35}. The SOEs are fully entitled to deduct from these profits for rewards and bonuses, social welfare, product development and to open accounts for transactions with other banks.

(d) SOEs are also given the right to recruit workers and set wages in accordance with the demands of production and within the framework of the government's labor policy, to use various appropriate forms of organization and production, and to employ staff. The SOEs are to gradually switch from a system of recruiting workers and employees under life-long contracts towards a labor contract system. The SOEs are permitted to adopt proper forms of labor organization and payment of wages and bonuses on the basis of principles of distribution according to work done. The government sets minimum wages for each professional sector to ensure the basic interests of the working people, but refrains from setting maximum wages. Income tax is to be imposed by the state, partly to regulate excessively wide discrepancies in income among groups of workers (see more in World Bank, 1993: 48; Nguyen Van Huy and Tran Van Nghia, 1996: 42-44; Nguyen Anh Tuan, 1996: 31-33; Tran Tien Cuong, 1996: 5).

At the same time, in order to deal with hyper-inflation and prepare SOEs for the

\textsuperscript{35} The receipts of SOEs are determined by product prices fixed by the government for the sale of such vital materials as iron, steel, cement, electric power, oil and petrol, timber, and chemical fertilizers; and other goods based on their production costs and market needs.
shocks to come, the government has taken three further decisions, namely: (i) direct subsidies to SOEs from the state budget were ended, eliminating the single major source of the budget deficit; (ii) interest rates were raised above the inflation rate in order to mobilize savings; (iii) the two-tier exchange rates were eliminated, leading to a large devaluation of the official Vietnamese currency (dong) (Beresford, 2000). In early 1989, the government readjusted foreign exchange rates along with market prices, and expanded the right of SOEs to utilize their own foreign exchange. After paying taxes to the state, the SOEs are fully entitled to utilize their own foreign exchange assets, either by depositing them in banks or by exchanging them for Vietnamese dong. They may sell or purchase foreign exchange at the exchange rates announced periodically by the central bank in accordance with market prices. In order to encourage the SOEs to manufacture new products efficiently and to compete in foreign markets, they are entitled to exemption from or reduction of profit taxes for a period of one to three years whenever they bought new technologies (Nguyen Anh Tuan, 1996: 33-34).

5.3.2.4 Reform of International Economic Relations

*International Trade and Foreign Exchange*

Another important change under renovation policy has been in the area of foreign trade and foreign exchange. With the collapse of the CMEA, the Vietnamese authorities undertook a major reevaluation of international trade and foreign exchange management policies. The exchange rate was unified and a foreign exchange auction introduced (later followed by creation of a clearing inter-bank market) and restrictions on international trade were progressively relaxed. Thus, it is worth noting that the reform measures
directly addressing the industrial sector have been accompanied by a number of liberalization and deregulation moves concerning the overall economic framework, namely: (i) liberal laws allowing foreign investment were introduced; (ii) most import and export quotas were phased out; (iii) both SOEs and PEs producing exports or using imports were allowed to trade directly, rather than through state trading companies; (iv) import and export licensing arrangements were relaxed; (v) the coverage of the import permit system was reduced; (vi) tariffs and other trade taxes were rationalized; (vi) a duty drawback system for materials used in producing exports was introduced (UNIDO, 1996: 31).

Apart from that, the export of manufactured products to western markets was given high priority because of the economic difficulties in the Council of Mutual Economic Assistance (CMEA) countries in the late 1980s. Direct contracts with foreign companies, without going through the state trading agencies, became possible for SOEs manufacturing products of high quality, gaining the credit from foreign customers, achieving export turnover under current norms fixed by the government and having on their staff officers conversant with foreign trade operations\textsuperscript{36}. With respect to imports, a series of import restrictions were lifted, step by step, and the Vietnamese became more exposed to imported products and, hence, to greater competition than before. A new rational tariff schedule introduced in 1989 was meant to reduce the arbitrary nature of tariff applications.

Theses decisions together with the SOE reforms mentioned above resulted in a very significant hardening of SOEs budget constraints, leading a large number of SOEs to

\textsuperscript{36} The other SOEs conduct their exports and imports through the offices of institutions specializing in foreign trade operations or in cooperation with them.
cope with the new environment, and for many of them, it would be better if they ceased to operate. Nevertheless, the above reforms towards the gradual commercialization of the public sector of the economy helped SOEs respond to market signals rather than to plan directives and have a growing degree of autonomy in making decisions on production, purchase of supplies, investment, wages, employment, marketing and management organization.

*Foreign Direct Investment*

The recognition of the important role which FDI could play in Vietnam’s economic development and industrialization - by attracting foreign funds and providing access to technology, expertise and export markets - has been one of the main policy elements under the renovation policy (Mya Than and Tan, 1993: 84; UNIDO, 1996: 13-4). That is why FDI, especially from Western countries, has been actively promoted. Both the SOEs and PEs have been able to contact foreign firms and receive foreign investments. In the context of the region, there have been particularly favorable opportunities in Vietnam to attract FDI, such as the following:

- While labor costs are rising in other developing countries, they are still very low in Vietnam.
- Available natural resources have not been exploited in Vietnam, but are lacking in more developed countries.
- In the near future, Vietnam will become a major market for products from economies in the region

37 Much of the foreign investment has been targeted at supplying the domestic economy and participating in the process of infrastructure rehabilitation and development that is seen as a basic prerequisite for
The draft law on foreign investment passed by the National Assembly in 1987, which became effective in January 1988, represented a major shift from previous policies. According to the law and two amendments to the law made in June 1990 and December 1992, the government of Vietnam guarantees fair treatment to foreign investors (compared with domestic investors), capital and other legal assets of investors will not be expropriated or confiscated by administrative measures, business activities with foreign invested capital will not be nationalized, industrial copyright and intellectual property ownership interests of foreign investors involved in the transfer of technology in Vietnam will be protected by a number of effective measures, business activities by foreign investors can be operated independently without government intervention, and they can import machinery, equipment, materials and supplies needed for production, export and sell their products abroad and in Vietnam. The law allows foreign investors not only to contribute capital in the forms of machinery, equipment and technology, and Vietnamese dong derived from other investments in Vietnam, but also to guarantee the unrestricted repatriation of investment capital and profits, loan principal and interest, and other legal proceeds and assets. Expatriates working in foreign projects in Vietnam are allowed to remit their incomes abroad. The law offers generous tax concessions and duty exemptions, welcomes FDI in all economic sectors with the exception of defense industries, imposes no minimum capital requirements, and permits 100 percent foreign ownership. Where and when more favorable provisions were enacted, existing foreign investors will benefit from them. The law also permits FDI enterprises to use foreign accounting systems and other accounting measures. In case there are disputes between

devlopment to take off. Expectations of expanding demand for consumer products - as the income levels of the large Vietnamese population grow - have prompted investors to seek a position in Vietnam's market.
foreign investors and Vietnamese parties in joint-venture companies, they can be brought to either Vietnamese or foreign arbitration arrangements, provided that both sides involved agreed.

Hence, Vietnam’s law on FDI, while enacted somewhat later than comparable legislation in most other countries in the region, was one of the first major reform measures of the economic renovation policy. It came at a time when virtually no supporting legal framework was in place and numerous planning elements still pervaded the economy. The original law was liberal by international standards, and after two amendments, the legal regime for FDI in Vietnam was more favorable compared to corresponding regimes elsewhere in terms of tax incentives, import privileges, access to economic sectors, and permissible forms of ownership (IMF, 1995: 25-26).

The foreign investment law has several aims: to attract foreign capital and high technologies; to learn advanced economic management and to train economic cadres and skilled labor; to strengthen Vietnam’s economic potential and role within the international division of labor; to effectively explore natural resources; to increase employment; to promote export and foreign exchange earnings; and to increase capital accumulation for industrialization.

Almost all sectors of the economy have been open to foreign investors, but the government has given a lot of favorable conditions (e.g. reduction of income tax rates, tax holidays, waivers on export and import duties, and so forth) to those investors who have been conducting business activities in the following areas: (i) the major economic development programs involving both import substitution and export promotion; (ii) high technology industries using skilled labor; (iii) labor-intensive industries using local labor, raw materials and other resources; (iv) projects in mountainous and remote areas as well
as other areas with adverse socio-economic conditions; (v) environmental protection and waste disposal management; (vi) infrastructure projects such as roads, harbors, communication, and transport; (vii) service sector activities with the potential to generate foreign exchange, such as tourism, ship repairs, airport and seaport services.

At an early stage, the government designated the State Committee for Cooperation and Investment (SCCI) 38 to be responsible for receiving and responding to all foreign investment proposals as well as to be in charge of promoting, approving, facilitating and controlling all foreign investment in the country. Foreign investment may take various forms of business cooperation contracts between foreign and domestic firms, representing 8.3% of all projects and 16.9% of total investment capital; incorporated joint ventures with foreign equity participation, with 64.6% of total projects and 65.3% of total investment capital; and solely foreign-owned enterprises accounting for 27.1% and 17.8% respectively up to the end of 1995 (Đặng Đức Đạm, 1997: 100-102). In the past, the maximum share of foreign investors was 30%, but at present, contacting parties to joint ventures are free to determine their level of contribution to total paid-up capital and may later alter their ownership structure and become wholly foreign-owned companies. Initial joint-venture licenses are for 20 years with the possibility of extension.

Apart from that, foreign investment inflows surged further after promulgating Decree No 322-HDBT, dated 18 October 1991, on Regulations for Export Processing Zones (EPZs) and Decree No 192-CP in December 1994 on Regulations for Industrial Zones (IZs) that see the EPZs and the IZs as centralized zones specializing in the

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38 In early 1989, the State Committee for Cooperation and Investment (SCCI) was established to deal with all foreign investment in Vietnam, but in 1997, it was merged into the Ministry of Investment and Planning (MPI).
production of export-oriented goods and import substituting products, and offering services for this production. This created the basis for attractive incentives made available to both export oriented and import substituting FDI in manufacturing and support services and industries.

5.3.3. Results of Economic Renovation Policy

5.3.3.1. Achievements

After the first four years (1987-1990), the results of the economic renovation policy seemed more remarkable in the 1991-1995 period\textsuperscript{39} (see Tables 5.6 and 8.24). Most macroeconomic indices show the economy's stability improving gradually. Both the GDP growth rate and the per capita GDP growth rate achieved their highest levels. Growth was no longer solely based on subsidies, large-scale foreign assistance and loans, as before the renovation period, but rather based on total factor productivity (TFP) (see Table 5.5). On average, for the period 1990-1995, the contributions to GDP growth from labor, capital

\textsuperscript{39} In fact, successful economic performance in the period 1991-95 stemmed not only from the renovation policy, but also from two other major factors, namely: (i) the international environment surrounding Vietnam has been increasingly favorable for Vietnam. ODA and other resources from advanced countries and international financial institutions have been provided to Vietnam on a constant basis since 1993. This not only facilitated the construction of infrastructure and provided intellectual inputs for further reforms, but also reduced uncertainties in the investment atmosphere of Vietnam; (ii) since the early 1990s, Vietnam's economy has been increasingly intertwined with the dynamic Asia-Pacific region. Until the late 1980s, almost 70% of Vietnamese exports had been to the former Soviet Union and other Eastern European countries. Since 1990, the same volumes of exports have gone to the Asia-Pacific region (see Table 8.18), which also accounted for more than 70% of FDI inflows in the 1991-95 period.
and TFP were 22.3%, 43.1% and 34.7% respectively. These growth rates were indeed significant and reflected the economy’s nascent capacity for self-generating growth.

**Table 5.5: Vietnam: Growth in Labor, Capital and TFP, 1987-95 (%)**

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</tr>
</thead>
<tbody>
<tr>
<td>Labor</td>
<td>2.1</td>
<td>1.8</td>
<td>1.1</td>
<td>0.9</td>
<td>2.2</td>
<td>2.7</td>
<td>2.6</td>
<td>2.9</td>
<td>2.7</td>
</tr>
<tr>
<td>Capital</td>
<td>1.6</td>
<td>1.7</td>
<td>0.9</td>
<td>0.5</td>
<td>1.7</td>
<td>3.8</td>
<td>3.8</td>
<td>5.4</td>
<td>5.0</td>
</tr>
<tr>
<td>TFP</td>
<td>-0.1</td>
<td>1.3</td>
<td>0.7</td>
<td>0.9</td>
<td>2.1</td>
<td>2.1</td>
<td>2.0</td>
<td>0.5</td>
<td>1.6</td>
</tr>
</tbody>
</table>

**Source:** Calculated with data from UNIDO, 1996: 21-22 and GSO, 2000.

The success of the renovation policy in agriculture was already apparent as early as in 1989, only one year after the decision to shift from the cooperative system to a farm household system (see Tables 5.6). The World Bank (1991) appreciated this performance and considered this an export success and a good example of the relationship between institutional reforms and exports. Besides agriculture, most indicators of the economy, namely growth of the industrial, construction and service sectors, performed well. While hyper-inflation, which Vietnam suffered at an early stage of the reforms, had been curbed successfully, savings and investment ratios increased rapidly (see Tables 5.6 and 8.24).

It was more obvious to see the success of the renovation policy if compared the GDP with the volume of final consumption. Prior to 1990, GDP was smaller than final consumption, meaning that during that period, Vietnam could not produce enough to meet its own food needs, all its investment funds and part of its consumption were provided by foreign sources. Since 1991, GDP has been bigger than final consumption, and the country could accumulate savings thanks to the revival of domestic production and, more importantly, as the rate of savings increased rapidly (see Table 5.6).
Table 5.6: Vietnam: GDP Growth, Retail Price Changes, Investment Ratio and Saving Ratio, 1986-2001 (%)

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP Growth (% per annum)</th>
<th>Growth by sector (% per annum)</th>
<th>Inflation (% per annum)</th>
<th>Investment Ratio (% of GDP)</th>
<th>Domestic Savings Ratio (% of GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1986</td>
<td>2.8</td>
<td>3.0</td>
<td>10.9</td>
<td>-2.3</td>
<td>387.2</td>
</tr>
<tr>
<td>1987</td>
<td>3.6</td>
<td>-1.1</td>
<td>8.5</td>
<td>4.6</td>
<td>301.0</td>
</tr>
<tr>
<td>1988</td>
<td>4.8</td>
<td>3.7</td>
<td>5.0</td>
<td>8.8</td>
<td>308.2</td>
</tr>
<tr>
<td>1989</td>
<td>2.7</td>
<td>7.0</td>
<td>-2.6</td>
<td>7.9</td>
<td>74.3</td>
</tr>
<tr>
<td>1990</td>
<td>2.3</td>
<td>1.0</td>
<td>2.3</td>
<td>10.2</td>
<td>36.4</td>
</tr>
<tr>
<td>1991</td>
<td>6.0</td>
<td>2.2</td>
<td>7.7</td>
<td>7.4</td>
<td>80.0</td>
</tr>
<tr>
<td>1992</td>
<td>8.6</td>
<td>6.9</td>
<td>12.8</td>
<td>7.6</td>
<td>17.5</td>
</tr>
<tr>
<td>1993</td>
<td>8.4</td>
<td>3.3</td>
<td>12.6</td>
<td>8.6</td>
<td>5.3</td>
</tr>
<tr>
<td>1994</td>
<td>8.8</td>
<td>3.4</td>
<td>13.4</td>
<td>9.6</td>
<td>14.0</td>
</tr>
<tr>
<td>1995</td>
<td>9.5</td>
<td>4.8</td>
<td>13.6</td>
<td>9.8</td>
<td>12.7</td>
</tr>
<tr>
<td>1996</td>
<td>9.3</td>
<td>4.4</td>
<td>14.5</td>
<td>8.8</td>
<td>4.5</td>
</tr>
<tr>
<td>1997</td>
<td>8.1</td>
<td>4.3</td>
<td>12.6</td>
<td>7.1</td>
<td>3.7</td>
</tr>
<tr>
<td>1998</td>
<td>5.8</td>
<td>3.5</td>
<td>8.3</td>
<td>5.1</td>
<td>9.2</td>
</tr>
<tr>
<td>1999</td>
<td>4.8</td>
<td>5.2</td>
<td>7.7</td>
<td>2.3</td>
<td>2.0</td>
</tr>
<tr>
<td>2000</td>
<td>6.5</td>
<td>4.0</td>
<td>10.1</td>
<td>5.6</td>
<td>-0.6</td>
</tr>
<tr>
<td>2001</td>
<td>6.8</td>
<td>4.2</td>
<td>14.2</td>
<td>6.8</td>
<td>0.5</td>
</tr>
</tbody>
</table>

Sources: - GSO, 2000, GDP; Saigon Economic Times, 2 February 2002 for Growth and Growth by Sector;

During the 1991-1995, all sectors of the economy sustained growth with industry having highest growth rates, which was 4 to 5 percentage point higher than that of total GDP, to be followed by services, and then by agriculture whose growth rate was lowest.
but nonetheless quite goods (Table 5.6). The equivalent in paddy of food output which was about 18-19 million tons during the 1985 - 1988 period and 21 million tons in 1989-90, rose to 22 million tons in 1991, 24 million tons in 1992 and 27 million tons in 1995. Prior to 1989, Vietnam was a food importer, importing each year 0.5 million tons but after 1989 it could export up to 4 million tons of rice, becoming the third biggest world rice exporter (Table 5.7). The food output achievement guaranteed food security because any crop failure would reduce paddy output about one million ton that would only reduce a portion of rice exports but will not affect domestic consumption. With excess food production and convenient and easy transportation of food in the country, it is no longer necessary for various regions and provinces to achieve self-sufficiency in food at any cost. Instead, each region and province can select manufacturing industries as well as plants in accordance with its own potentials and comparative advantage to enhance the efficiency of production and business as well as industrialization.

**Table 5.7: Vietnam: Rice Exports By Volume, 1989-2000 (Thousand Tons)**

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<tbody>
<tr>
<td></td>
<td>1,420</td>
<td>1,624</td>
<td>1,032</td>
<td>1,980</td>
<td>1,946</td>
<td>1,983</td>
<td>1,988</td>
<td>3,003</td>
<td>3,553</td>
<td>3,793</td>
<td>4,200</td>
<td>4,000</td>
</tr>
<tr>
<td></td>
<td>310</td>
<td>275</td>
<td>229</td>
<td>405</td>
<td>335</td>
<td>420</td>
<td>539</td>
<td>868</td>
<td>891</td>
<td>1,006</td>
<td>955</td>
<td>668</td>
</tr>
</tbody>
</table>

**Sources:** Ministry of Trade, 2000; *Saigon Economic Times*, 15 February 2001

**Note:** Figures in italics are value of rice exports in US$ million

Industrial production became stable and developed rapidly. Starting with a low share (less than 20%) and negative growth (-2.6%) in 1989, industry was the leading sector in the growth of the economy in the period of 1991-95 (Table 5.6). The output structure had changed remarkably, with greater shares for the industrial and construction sector at the expense of the agricultural sector. While the industrial and construction
sector contributed 23.5% in GDP and agriculture 40.5% in 1991, in 1995 both agriculture and industrial sectors accounted for the same contribution of 28% of GDP. However, employment in the industrial sector accounted only for 13.3% of the labor force, much smaller than the agriculture sector's 69.7% in 1995 (Table 5.8). At the same time, it is noteworthy that the economic structure had undergone major changes. Thanks to reforms in the public sector, the SOE contribution to GDP increased rapidly from 29.3% in 1991 to 40.2% in 1995. Thereby, it could be said that the role of SOEs rose with the renovation process, which sought to build up a multi-sectoral economy (Table 5.9).

Table 5.8: Vietnam: Economic Structure by Sector, 1991-2000 (%)

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</thead>
<tbody>
<tr>
<td><strong>Total GDP</strong></td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>- Agriculture</td>
<td>40.5</td>
<td>34.9</td>
<td>29.1</td>
<td>27.4</td>
<td>27.2</td>
<td>27.8</td>
<td>25.8</td>
<td>26.6</td>
<td>25.4</td>
<td>24.1</td>
</tr>
<tr>
<td>- Industry &amp;</td>
<td>23.5</td>
<td>23.7</td>
<td>28.6</td>
<td>28.9</td>
<td>28.8</td>
<td>29.7</td>
<td>32.1</td>
<td>32.7</td>
<td>34.5</td>
<td>36.9</td>
</tr>
<tr>
<td>construction</td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Services</td>
<td>36.0</td>
<td>41.1</td>
<td>42.3</td>
<td>43.7</td>
<td>44.0</td>
<td>42.5</td>
<td>42.1</td>
<td>41.3</td>
<td>40.1</td>
<td>39.0</td>
</tr>
<tr>
<td><strong>Total Employment</strong></td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>- Agriculture</td>
<td>73.3</td>
<td>73.2</td>
<td>72.0</td>
<td>70.8</td>
<td>69.7</td>
<td>69.2</td>
<td>68.8</td>
<td>68.3</td>
<td>69.0</td>
<td>69.1</td>
</tr>
<tr>
<td>- Industry &amp;</td>
<td>12.4</td>
<td>12.3</td>
<td>12.4</td>
<td>12.8</td>
<td>13.3</td>
<td>12.5</td>
<td>12.5</td>
<td>12.7</td>
<td>12.1</td>
<td>12.4</td>
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<tr>
<td>construction</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Services</td>
<td>14.3</td>
<td>14.5</td>
<td>15.6</td>
<td>16.4</td>
<td>17.0</td>
<td>18.3</td>
<td>18.7</td>
<td>19.0</td>
<td>18.9</td>
<td>18.5</td>
</tr>
</tbody>
</table>

*Source:* Tran Van Tho, 2001

Besides, it should be noted that although FDI inflows started in 1988, a substantial amount of FDI was only recorded since 1992 (Table 8.24). The foreign-related sector had strengthened its position in the economy then, accounting for 6.3% of GDP in 1995
FDI contributed to economic growth of the country embodied in the following aspects. First, it constituted an important capital resource for Vietnam’s industrialization. During the 1991-95 period, FDI accounted for 25.7% of Vietnam’s total gross domestic capital formation. Second, FDI helped create a number of new productive capacities, in new fields of productions, with new technologies, and new business methods in Vietnam. Third, FDI accounted for 100% of Vietnam’s capacity in oil exploitation, in car and motorcycle assembly, in the production of condensers, printing machines, washing machines, refrigerators, air-conditioners, tape recorders, video tape recorders, FE and PES yarns and fibers. Fourth, FDI helped to rapidly increase exports and to revenue contribution. Starting with US$52 million in 1992, their exports rose to US$352 million in 1995. In 1994, FDI contribution to state revenue was US$128 million. Fifth, FDI created direct employment including managers, technicians and skilled workers, as well as indirect employment in related construction, trade and service activities with annual income of hundreds thousands US dollar for them. Thus, it increased domestic consumption, expanded production, and facilitated industrialization. Sixth, it made a

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</tr>
</thead>
<tbody>
<tr>
<td>Total GDP</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
<tr>
<td>- SOEs</td>
<td>29.3</td>
<td>40.1</td>
<td>40.2</td>
<td>40.5</td>
<td>40.0</td>
<td>38.7</td>
<td>39.0</td>
</tr>
<tr>
<td>- Non-SOEs (private, mixed enterprises and cooperatives)</td>
<td>70.7</td>
<td>53.5</td>
<td>53.5</td>
<td>50.4</td>
<td>50.0</td>
<td>49.1</td>
<td>47.7</td>
</tr>
<tr>
<td>- FDI-related</td>
<td>-</td>
<td>6.4</td>
<td>6.3</td>
<td>9.1</td>
<td>10.0</td>
<td>12.2</td>
<td>13.3</td>
</tr>
</tbody>
</table>

**Sources:** GSO, 2000; Nguyen Tran Que, 2000.

**Note:** Mixed enterprises are composed of private multi-owner limited liability and share holding companies.
positive contribution to Vietnam’s renovation and integration into the regional and world economy.

Apart from FDI, official development assistance (ODA) has also contributed strongly to economic growth and industrialization. Prior to 1990, ODA to Vietnam was mainly from CMEA countries, of which the dominant share was from the former USSR, amounting to about 12.6 billion of transferable rubles, from Western European countries (largely Sweden, Finland and France) and some other countries amounting to US$3 billion, and from UN and other international organizations. From 1991 to 1995, ODA grew increasingly in volume and by the number of donors. ODA assistance rose from US$218 million in 1991 to US$560 million in 1992, with UN organizations accounting for US$71 million. International donors agreed to provide ODA of US$1.96 billion in 1994. At December 1995 Consultative Conference in Paris, ODA committed to Vietnam was US$2.3 billion.

Hence, it could be said that Vietnam has been quite successful in mobilizing ODA. The support of the IMF, World Bank and Asian Development Bank for the country’s transition process has enabled Vietnam to access concessional financing from these sources, and facilitated tapping into balance of payments support from bilateral

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40 Vietnam’s major achievements in renovation policy and in foreign economic relations persuaded US businessmen to consider the new economy in Vietnam. In the new realities of Vietnam, many US companies, including some leading ones, urged the US administration to adjust its policies towards Vietnam. The open door policy and economic integration into the world economy should not be separated from the continued renovation of domestic socio-economic policies and mechanisms. They are two aspects of the development process and long term strategy designed to fully exploit the new comparative advantage of Vietnam in a multi-polar world full of complexity moving toward regionalization and globalization.
sources. On the top of this, donor agencies have been willing to provide credits and grants for a wide range of development projects⁴¹.

5.3.3.2 Obstacles

Many Western authors overestimate the significance of the reform package in Vietnam, usually overestimating its impact on industrialization and economic development. Nonetheless, reforms have also had other effects.

1. Although gross production in the economy gradually increased after the severe slump in the late 1980s, growth in production was not as large as expected, and was mainly thanks to developments in the fuel industry and rice production. Excluding mining and quarrying, manufacturing value added was still small, on average only contributing approximately 18%, of which foodstuff production accounted for 45% of manufacturing value added, followed by chemicals and fertilizers, and textiles accounting for 11% and 8.6% respectively. Manufacturing value added of other industries was very small (see Figure 5.2). Production in most manufacturing sectors remained stagnant. Only 15% of manufacturing sector products were exported. Export of industrial products in general accounted for over 30% of total exports of the country. Intermediate inputs, such as chemical fertilizers, steel, paper and building material, were particularly short, which had adverse impacts on other economic activities. The competitiveness of products in both

⁴¹ In order to ensure that ODA targets are met, three broad conditions must be complied with, namely (i) continuing the broad program of policy and institutional development supported by donors, and maintaining sound macroeconomic management; (ii) improving aid management and implementation; and (iii) ensuring the availability of domestic counterpart funds.
domestic and international markets was still weak. Furthermore, domestic consumer goods were gradually being driven out of the local market by foreign products (often smuggling) because of the low technical level of the SOEs, giving rise to low labor productivity, high costs (consumption of raw materials and capital per unit of product was too high), poor quality and weak competence. Technical renovation rates only reached 8% per year; therefore, equipment and machinery capacities were mobilized at a low level of about 40%-50%.

2. Despite major investments and institutional changes at the beginning of the 1990s, the service sector in Vietnam up to 1996 was quite rudimentary. Internal transport linkages had been limited, reflecting both the enormous backlog of infrastructure needs and the low priority given to developing a modern wholesale and retail trade sector under the pre-renovation regime. Transport infrastructure servicing international trade, such as seaports, airports, and international road and rail links, had been underdeveloped and created major bottlenecks for rapid economic development and industrialization. Telecommunications had been improving, but had been expensive and of limited reach throughout the country. A modern financial sector has only begun in the early 1990s to emerge from a monobank system with high transaction costs and limited reach. It was only beginning to gain the confidence of households as a repository for their savings. The energy and water supply systems had also been in need of major expansion to meet actual and projected demands. Electricity demand has been growing very rapidly, driven largely by household requirements, and major rehabilitation and expansion projects have been required to keep pace. The urban water supply system has had serious

---

42 Compared with other Asian economies at a similar stage of development, Vietnam’s infrastructure is poorly developed.
defects due to obsolete equipment and the age of distribution infrastructure, and only 50-60% of the population has had access to the system. The urban drainage system has been badly in need of upgrading and repairing, and there has not yet been the development for any comprehensive system of solid waste disposal.

Source: JICA-DSI Survey on production and trade of selected enterprises in Vietnam, February 1996

Figure 5.2: Vietnam: Share of Manufacturing Value Added, 1995
3. Due to the elimination of subsidies for SOEs, many SOEs and cooperative industrial units have declared bankruptcy, a large majority of which belong to the category known to the Vietnamese as "dead but not buried", thereby giving rise to severely decreasing industrial employment from 2.9 million in 1988 to 2.2 million in 1994. In 1995, labor employed in industry represented only 13.3% of the total labor force, while agriculture accounted for 70% (Table 5.8). The unemployment rate was more than 7% in 1995. Unemployment and under-employment in Vietnam has become critical, with more than one million new entrants to the labor force every year. An urgent social problem for the country has been to reduce urban unemployment, pressure from rural-urban migration, and to solve other social issues.

4. Apart from that, some SOEs enjoy monopolies in fields such as power supply, telecommunications, cement, oil, lubricants as well as other products and services. In a number of cases, one can detect some collusion between provincial authorities and local SOEs in order to maintain monopoly rights in certain provinces. There is no check on such monopoly practices or to curtail monopoly profits. Hence, monopolies distort production and supply in the market economy and further limit the positive impact of

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43 They had already effectively ceased operations (Beresford, 2000). Most centrally managed and larger local enterprises survived through their privileged access to state resources, chiefly in the form of cheap or interest free credit, and through tax avoidance (Hoang Cong Thi, 1992: 5). Over 60% of locally managed and 20% of centrally managed enterprises were making losses in the late 1980s (UNIDO, 1996: 38)

44 In urban areas, wages for workers were inadequate for survival so that SOE employees needed to take on work in the "outside" economy to make ends meets. In rural areas, average cultivated land area was 0.1 ha/person, i.e. the lowest per capita land ratio in the region, while population density was 220 person/ km², i.e. the highest density among agricultural countries. Half of the rural workforce was redundant, and 15% of the rural population was from poor households.
market mechanisms.

5. The taxation system still suffers from many weaknesses and is not in keeping with the market economy as it has various different tax rates involving large disparities and differences. This has made the taxation system very complicated and created loopholes that can easily be exploited. Various kinds of direct taxes, accounting for only a small share of the total tax revenues, were quite abnormal. The above situation, coupled with poor accounting, statistical and audit work, led to substantial differences in the profit taxes imposed on similar types of enterprises operating in different provinces with little sound rationale. Hence, instead of making efforts to enhance their efficiency and competitiveness, not a few SOEs and PEs have chosen the easy path of seeking preferential treatment in terms of tax, credit, house and land rents and so on to increase their incomes. This has given rise to unfair competition and evasion of the law, creating big loopholes for certain people to abuse state assets, to evade tax payments, and to openly earn illegal incomes. Taxation and the management of public property - such as land, natural resources, SOEs and so on - have not been able to promote the resource mobilization for industrialization and development.

6. There was considerable waste and losses in construction projects, particularly those financed by state budget allocations. Many big and important construction projects are of poor quality. Bidding for construction projects still involves many loopholes, which gives rise to rent-seeking activities. State capital is overextended in too many projects, which consequently cannot be completed in time. The projects’ prolonged execution, with final costs always exceeding initial estimates, is one of the main reasons for the vanishing of construction funds and inefficient execution of projects. Meanwhile, infrastructure for education, health care, transport and communication continue to deteriorate, particularly
in the highlands and rural areas.

7. Although the banking system has been reformed, switching from one-tier to two-tiers and ensuring positive interest rates, it has not been able to meet the requirements of the market economy. Banks have not adequately performed their functions as a central institution of the market economy designed to mobilize idle savings to provide short-term and long-term credit. Banks have only been able to mobilize a small percentage of the idle money in society with interest rates higher than the inflation rate. Some progress has been made in supplying of credit to PEs, but such credits still account for a low ratio compared to credit to SOEs. Long-term credit also accounts for a very small ratio and has not yet impacted on the emergence of a new economic structure of a multi-sectoral market economy. The ratio of overdue debts and bad debts of many commercial banks have risen to alarming levels and are estimated to account for more than 10% of total outstanding debts.

8. Although FDI in industry has increased rapidly since 1988, accounting for 50% total projects and 46.5% of total investments, in 1994-95, the value of FDI in industry is still far below industrial investment requirements for the period 1996-2000, for which US$18.6 billion would be needed, of which 50% was expected from FDI. Besides, up to 1995, FDI in Vietnam still had some problems: (i) Foreign investors were often slow in terms of financial contributions and meeting scheduled commitments. In many cases, equipments and machinery were not guaranteed in terms of quality and price. In some cases, imported equipment and machinery were old, and outdated. So far, foreign firms have easily been able to practice transfer pricing in Vietnam; (ii) In Vietnam, complicated procedures for obtaining land, site clearance and construction license granting have often delayed project implementation; (iii) Since the Vietnamese have little practical knowledge
of international markets in terms of export price, they usually give their foreign partners responsibility for selling their products.

Over time, it is to be expected that the proportion of ODA coming in the form of fast-disbursing adjustment support will decline. This means that achieving disbursement targets will require further improvements in project management, placing a premium on Vietnam’s ability to provide counterpart funding for projects. This, in turn means that fiscal reforms to improve the performance of the tax system and to rationalize spending will be key factors affecting the pace of economic development and industrialization.

9. Although there have been a lot of changes, Vietnam’s trade regime is still a long way from being irreversibly liberalized. Most systems for controlling trade in goods are still in force. While they have apparently been administered liberally, the scope for such controls to be applied on a discretionary basic may discourage long-term investments. Current account payments (interest and profit repatriations) are still not free of restriction, and capital repatriation for foreign investors is not guaranteed. For many goods, quantitative restrictions are still imposed. Overall, imports of consumer goods have been restricted to a value equal to 20% of total export earnings. Imports of key inputs - such as construction steel, cement, fertilizer, sugar and petroleum - were controlled according to administrative assessments of the basis of the balance between domestic demand and domestic supply. A similar balancing process is used in controlling rice exports. The import tariff system is quite distorting. The trade off between revenue and liberalization does not seem to have been fully resolved in tariff setting, and there have been large variations in tariff rates and considerable volatility in rates over time. Tariffs and quotas appear to be adjusted according to the “needs” of established SOEs. In this
way, protection has been "tailor made"45 with a view to meeting the requirements of SOEs to maintain employment and output at the least possible cost to consumers.

5.4. Conclusion

After the 1954 Geneva Agreement, consistent with Soviet-style central planning aimed at rapid industrialization, plus collectivization of agriculture and a centrally planned economic system was introduced in the Democratic Republic of Vietnam (North Vietnam) to advance rapidly, vigorously and steadily to socialism. The central task of socialist industrialization emphasized building up domestic capital goods and other heavy industrial activities. The objective was to achieve self-sufficiency in this area, largely neglecting trade opportunities and specialization

45 Tailor made protection can have a number of unfortunate effects, e.g. (i) it sends signals to investors that big returns may come from lobbying for protection as opposed to trying to be internationally competitive. This could be a particularly serious problem when foreign investors are pursuing opportunities in joint ventures with SOEs, which may have disproportionate influences on tariff setting. The risk here, of course, is that resources will be drawn into high cost activities that can only survive with protection (see sections 3.2 and 3.3); (ii) it creates a bias against export-oriented activities. Since taxes on imports of intermediate and capital goods are taxes on exports, every time tariffs are raised to protect an import substitution activity, the competitive position of all exporters is eroded. Made-to-measure tariffs are the hallmarks of an inward looking trade policy (see section 3.2.2); (iii) Downstream producers of final goods facing competition at world prices will influence decisions about setting high levels of protection for the production of intermediate and capital goods, which will raise costs to users. High protection of upstream activities may be examples of "shooting oneself in the foot". Demand for inputs can only exist if downstream producers are competitive. Raising the costs of inputs reduces their competitiveness, and hence their demand for inputs.
possibilities. In the early 1960s, limitations and shortcomings were already in existence. In 1964, the Government of North Vietnam launched a movement against embezzlement, waste and bureaucracy, and worked out plans for improving management, but implementation of these plans was disrupted by the war against the US invaders (1965-1975).

After national reunification (1975), the inward-oriented (import substitution) development strategy emphasized self-reliance, rather than comparative advantage, specialization and integration into world economy. The management mechanisms of the North were applied to the whole country, with special attention was given to conditions in the newly liberated South. By 1978-79, however, this management mechanism and strategy had clearly shown its weaknesses. Since the end of 1979, the CPV and Government of Vietnam have advocated a new strategy and reform of economic management. This reform process has been continuously conducted, and since 1986, it has involved fundamental, profound and comprehensive renewal.

With the official renovation policy, the inward-oriented development strategy was abandoned as inefficient, inappropriate and inadequate in a world moving towards greater productive specialization and closer economic integration (see section 3.3 on inward-oriented development and section 2.1 on economic integration). Instead, the new comprehensive development program was based on export-oriented industrialization as its principal strategy, but supplemented by development of the domestic market: "Vietnam does not opt for a strategy that is simply oriented towards exports or substituting imports. Instead, it endeavors to achieve an optimal combination of these two orientations in an open economy system, which paves the way for a smooth exchange of goods both inside and outside the country" (Luu Bich Ho and Nguyen Xuan Trang, 1991; Mai Van Dau,
In general, switching from an inward-looking strategy to a more outward-oriented strategy has not been easy. It has required strong political will from the Vietnamese leadership to reform the economy, and it is now up to the political leadership to ensure an optimal environment for domestic economic creativity as well as for foreign investment, trade and assistance to grow to the fullest potential. Fundamental options must be clearly defined by the political leadership, which has to make its intentions extremely clear with regard to developing market-oriented economy to achieve sustainable economic development and industrialization.

State intervention in the economic process should be limited, simplified and consistent (such as decree 217/HDBT; Resolution 27 and 28/HDBT; Resolution No.10 on contract system and so on) to avoid imposing additional costs on society in its efforts to reach higher levels of economic performance. The government can and must provide the necessary leadership in creating pre-conditions for economic renovation and the ideal conditions for sustainable long-term economic prosperity. However, the government cannot efficiently promote economic growth through direct and active involvement in the economy. If the state chooses to command the economy, it has to be aware that it cannot guarantee efficiency.

Vietnam’s renovation policy is aimed at shifting from a centrally planned economy to a market economy, from an inward-oriented to an outward-oriented development strategy to stimulate and achieve high growth rates. In the process of renovation, government policies have been the most important determinant of Vietnam’s economic success in the past ten years. Since 1979, the Vietnamese economy has developed gradually, mainly due to economic reforms introduced by the government.
However, there is a danger that the reforms from the end of 1980s and in the beginning of 1990s may lose momentum, as the comparatively easy phase of economic transition has largely been accomplished. As a result, the reforms cannot guarantee rapid economic growth in the following years when Vietnam has gradually integrated into the regional and world economy: after normalization of relations with the US (July 1995), Vietnam became a member of ASEAN in 28 July 1995, subsequently joining the AFTA on 1 January 1996, and APEC in November 1998, signed a Vietnam-US bilateral trade agreement in 2000, and will possibly join the WTO in 2005. In order to obtain high economic growth rates in the new environment of international economic integration since 1995, Vietnam’s government has carried out its second phase of the renovation policy, which has emphasized policies towards closer international economic integration as discussed in next chapter. The second phase may, in some respects, prove to be more difficult, as it will require complicated measures, which go against the short-term interests of the driving forces behind the initial reforms, in particular the SOEs. The new dynamics of the reform process may also lead to profound political and social changes, including a thorough democratization of the political system, the separation of the party from the state, and establishment of an independent judiciary and press.