Vietnam's Economy, After the Asian Economic Crisis

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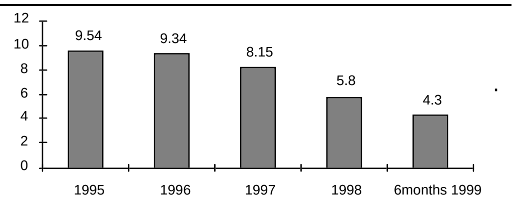
The year 1989 marked an important turning point in Vietnam: the market mechanism began to take the place of centrally-planned resource allocation. To secure sustainable economic growth at a high level, Vietnam needs further comprehensive reform towards a market economy. The paper argues that the Asian crisis should not be blamed for the recent slowing of the economy. It also raises some other questions, in particular whether the government is still trying to fit the market mechanism into a socialist model.

The slow-down in economic growth

The Asian crisis, which began in July, 1997 when the Bank of Thailand announced that it was abandoning the pegging of the baht to the US dollar, raised fears, especially among foreign economists, that the crisis could spread to Vietnam or at least have severely negative spillover effects on the Vietnamese economy. However, these fears did not weaken the confidence of the Vietnamese government in the growth prospects of the economy, even when the storm blew over other Asian economies. Nonetheless, as time passed, the available data show that the economy did experience a slow-down. The GDP growth rate fell from nearly 9.6 per cent in 1995 to below 5.8 per cent in 1998 and to 4.3 per cent in the first six months of 1999 (Figure 1).

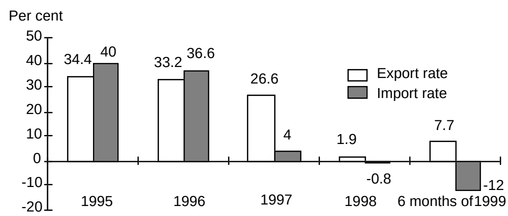
Exports, imports and foreign direct investment also fell sharply in 1998 (Figures 2 and 3). From the perspective of the first six months of 1999, the slow-down can be seen more clearly and has two notable features: while agriculture, forestry and fishing have enjoyed better growth than in the same period of 1998, the industry and services sectors have

Figure 1
GDP growth rate
(per cent)



Source: Vietnam, General Statistical Office (1998, 1999).

Figure 2
Export and import growth rate
(per cent)



Source: Vietnam, General Statistical Office (1998, 1999).

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Table 1
Economic growth in the first 6 months of 1998 and 1999, by economic sector
(per cent)

	Jan–June 1998	Jan–June 1999
Whole economy	6.16	4.31
Agriculture, forestry and fishing	2.12	2.70
Industry and construction	9.98	7.47
Services	5.84	2.81

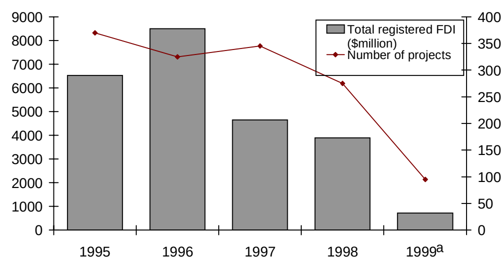
Source: Vietnam, General Statistical Office (1998, 1999).

Table 2
Industry sector growth rates in the first 5 months of the year, 1996–99, by investment source and ownership
(per cent)

	Jan–May 1996	Jan–May 1997	Jan–May 1998	Jan–May 1999
Industry sector	14.0	13.9	12.8	10.3
State-owned	13.0	11.1	10.5	3.7
Private	12.6	9.8	6.3	6.4
Sectors with foreign investment	17.2	22.8	21.6	22.5

Source: Vietnam, General Statistical Office (1998, 1999).

Figure 3
Direct foreign investment in Vietnam



a First five months of 1999.
Source: Vietnam, General Statistical Office (1998, 1999).

slowed down, especially in state-owned enterprises (SOEs) (Tables 1 and 2).

Many of the major state-owned industries are now heavily burdened with unsold inventories. Some are even temporarily shutting down, sacking large numbers of employees, as in coal mining. Among these state-owned industries, coal, cement, steel and building materials have given headaches to the government, as have a number of consumer goods manufacturing industries such as sugar, garments and vacuum flasks. From the early stages of the Asian crisis, the government has blamed negative spillovers for the deterioration in aggregate demand and consequent massive unsold inventories in the state-run industries. As a result an array of demand-boosting policies has been put in place.

The Asian crisis: making or revealing trouble?

While the Asian crisis has been blamed for reducing aggregate demand in the Vietnamese economy, no clear explanation has been given by the government as to how it has done so. The two main channels through which the Vietnamese economy could be affected are trade with the crisis countries and foreign direct investment (FDI) inflows. Examination of Vietnam's trade patterns with the Asian crisis countries shows the following:

- The share of the Asian crisis countries in Vietnam's trade is large, ranging from 45 per cent to 61 per cent (Table 3), suggesting the possibility of a significant impact from the crisis countries.
- The growth in trade between Vietnam and the Asian crisis countries changed suddenly in 1997: growth of exports fell from 37.9 per cent in 1996 to 8.24 per cent in 1997, and to -4 per cent in 1998; import growth fell from 38.8 per cent in 1996, to 1.43 per cent in 1997, and to 2.76 per cent in 1998. Over this period, Vietnam's trade deficit with the Asian crisis countries grew by 40 per cent in 1996, declined by 9 per cent in 1997, and rose by 15 per cent in 1998 (Figure 4).

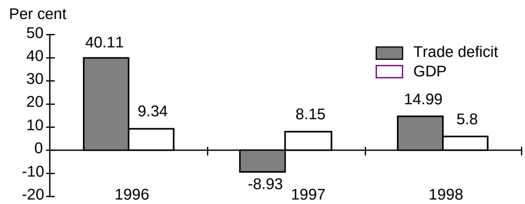
The changes between 1997 and 1998 might suggest that the crisis increased Vietnam's trade deficit with the Asian crisis countries in 1998, resulting in a fall in aggregate demand. But why did a rise of 15 per cent in the trade deficit in 1998 reduce the GDP growth rate from 8.15 per cent in 1997 to 5.8 per cent in 1998, while a huge increase of 40 per cent in the trade deficit in 1996 was associated with a very high rate of GDP growth (9.34 per cent) in that year (Figure 4)?

Table 3
Exports to and imports from the Asian crisis countries, as a share of total Vietnamese trade, 1995–98
(per cent)

	1995	1996	1997	1998
Exports				
Share in total exports	54.14	56.07	47.95	45.16
Growth rate		37.93	8.24	-4.00
Imports				
Share in total imports	59.57	60.51	59.00	61.14
Growth rate		38.78	1.43	2.76

Sources: Vietnam, General Statistical Office (1998, 1999). Customs (1998).

Figure 4
Growth rates of GDP and trade deficit with the Asian crisis countries, 1996–98
(per cent)



Source: Vietnam, General Statistical Office (1996b, 1997, 1998).

FDI, in terms of registered capital, reached a peak of $8,479.3 million in 1996, which was 30.1 per cent higher than in 1995, but dropped sharply by 45.3 per cent in 1997 and 16.2 per cent in 1998. Between 1996 and 1997, FDI from the Asian crisis countries fell by $3.4 billion, accounting for nearly 90 per cent of the decline in total FDI into Vietnam. The decline in FDI from the crisis countries in 1998 more than accounts for the fall in total FDI. The share of FDI from the crisis countries declined from 70.5 per cent in 1996 to 55.5 per cent in 1997, and to 33.4 per cent in 1998 (see Figure 3 and Table 4).

The share of FDI in total investment has been comparatively large, at 32.3 per cent in 1995, 28.6 per cent in 1996, 31.3 per cent in 1997 and 25.2 per cent in 1998. Thus, not only has FDI fallen sharply but also domestic investment has fallen sharply. The sharp drop in FDI in 1997 and 1998 could have reinforced the rise in the trade deficit with the Asian crisis countries in 1998, pushing down aggregate demand and the economic growth rate.

But the movements in total FDI or in FDI from the Asian-crisis countries are dwarfed by the changes in total investment. Total investment peaked in 1996 at $29.7 billion and fell to $14.9 billion in 1997 and to $15.5 billion in 1998. The reduction in total FDI accounts for less than one-third of this decline. FDI from the crisis countries accounts for all of this decline in total FDI. Hence, there appears to be a good case for looking at what caused the decline in domestic investment of almost $10 billion between 1996 and 1998.

It is possible that the Asian crisis of 1997 sharply reduced profit expectations of domestic investors. But all the decline in domestic

Table 4
Foreign direct investment (FDI), 1995–98

	1995	1996	1997	1998
Total FDI				
Total registered value ($ mill.)	6,530.76	8,497.30	4,649.10	3,897.40
Growth rate (per cent)		30.11	-45.29	-16.17
Share in total investment (per cent)	32.33	28.60	31.28	25.21
FDI from crisis countries				
Total registered value ($ mill.)	2,698.53	5,989.60	2,578.00	1,301.30
Growth rate (per cent)		121.96	-56.96	-49.52
Share in total FDI (per cent)	41.32	70.49	55.45	33.39

Sources: Vietnam, General Statistical Office (1998, 1999); Customs Office (1998).

Table 5
Growth rates of GDP components
(per cent)

	1995	1996	1997	1998
GDP	9.5	9.3	8.2	5.8
Investment	17.1	14.2	9.4	6.3
Government	8.4	7.4	4.0	3.2
Consumption	7.2	9.1	5.9	5.2
Net exports	6.0	12.9	-12.0	-3.4

Source: Vietnam, *Statistical Year Book*, Statistical Office, 1998.

investment occurred in 1997 while the crisis began in Thailand in mid-1997. If there was some other trigger for the downturn in domestic investment in 1997 leading to reduced GDP growth in 1998, what might it have been?

Vietnam's national accounts provide a clue. Table 5 shows that the growth rate of consumption declined much faster than that of GDP in 1997, suggesting that people had been spending part of their income on products which are not reflected in the national accounts. One explanation for this is smuggling across the national border, while the unsold inventories of the SOEs accumulate. Presumably domestically produced products were not able to compete with those produced overseas. This inference is strongly supported by the government's recent attempts to prevent smuggling, especially from China, and the significant sale of overseas-made commodities that one can observe in the domestic market. The reduced competitiveness of Vietnamese-made products can hardly be attributed to the large currency devaluations in the Asian crisis countries; how otherwise can one explain the competitive pressure on Vietnamese products from those made in China where the yuan has been kept stable? These inferences suggest an examination of the supply side of the economy.

A centrally planned economy hiding behind market economy rhetoric

Three major questions all economies have to answer are: which goods and services are to be produced and in what quantities; how are such goods and services to be produced; and who will receive the goods and services produced? One can contrast the answers of a market economy to those of the centrally planned economic model. In a market economy the answers to the questions of which goods and services are to be produced and in what quantities are based on the interaction between producers and consumers through markets. In Vietnam, in contrast, the government's planners decide—based mainly on their views as to which goods and services are significant to the economy—what must be produced by SOEs.

In Vietnam, in an attempt to strengthen the state-owned enterprises as the backbone of the socialist economy, many of the small SOEs have been affiliated into large corporations producing particular products. At the same time, protection against competition from the rest of the world for these 'infant' industries and sectors of interest to the government has been employed. Destruction of the competitive environment in this way is one of the main reasons for the weakening of the state-owned sectors and the whole economy.

Prices of goods and services and other market variables such as interest rates, the exchange rate and wages are still under government control, although controls have been relaxed somewhat recently. In a number of cases, prices also function as a device for achieving social security goals, as in the case of subsidised charges for the transportation of a number of commodities such as iodised salt, kerosene, paper, medication, coal, fertiliser, and insecticide to highland, remote and interior areas (Price Committee 1996). Pricing in this way distorts market information, resulting in inefficient decisions in consumption and production and resource allocation.

The economic model Vietnam is following is definitely not a market one. One may argue that the model is one of transition to a market economy, because many market instruments have been increasingly employed and the system needs time to adjust. But this is questionable. Rather, it is argued that market mechanisms are being used to further the goals of the socialist state.

This can be illustrated through examples of policy affecting the industrial sector.

One-million-ton sugar program The program's target—to produce one million tons of sugar by the year 2000—was simply based on the estimated demand, that is, a goal of self-sufficiency. The policy was implemented regardless of the comparative disadvantage of the economy in producing sugar, both in terms of growing sugar cane and in processing it. Further, very old technology was imported at high cost for the sugar factories. As a result, compared with state-of-the-art technology, up to 40 per cent more sugar cane is required to produce refined sugar. Because of shortfalls in cane supplies—which pushed up the price of sugar cane—and the costly old technology imported, the sugar industry has run into significant problems: too much sugar has been produced at a high unit cost and, therefore, inventories have accumulated. As of June 1999, about 300,000 tons of sugar were unsold, three times more than in the previous year. Although the retail price of domestically produced sugar has been reduced to VND 6,400/kg—which is close to its unit cost—the price is still much higher than that of imported sugar. The cause of the unsold sugar inventory is clear. However, the state-run sugar factories' directors and government officials argue that the imported sugar is undermining demand for domestic production.

Vacuum flask production By the end of June 1999, the Rangdong (Dawn) Vacuum Flask Factory, a state-run factory, had to put about 715,000 units (equivalent to three months' production) into inventories, and called upon the government to stop imports of the product—both legal and smuggled—because the overseas-produced vacuum flasks were causing the inventory build-up. The retail price of the factory's products is uncompetitive, even after being pushed down to break-even level (VND 29,026, while that of the Chinese-made product, including import tax, is only VND 21,000). An interesting question is why the factory has been allowed to run at so much higher a cost than the Chinese and other factories in the region (Vietnam television, VTV 1, 27/6/1999). The answer appears to be that the protection against competition from outside the country and the resulting monopolistic power that the government has granted (by raising import tariffs and imposing strict quotas on imports of vacuum flasks, and by closing all other factories producing the products) has removed any motivation for the company to reduce its production costs. About ten years ago there were five factories producing vacuum flasks. Four factories were closed in an attempt to improve the economic situation of the remaining factory. The existing difficulties of the company, with a capacity of 2.5 million units a year, and with unsold inventory of at least three months' production, is still not burden-some enough to force the government to review its policy. In fact, the government plans to invest more money in this business to raise its capacity to 4 million items a year and to remove the remaining quotas on imports (Ministry of Trade 1999).

Motorbikes At present there are five foreign joint ventures and 36 domestic enterprises assembling motorbikes, with a total registered output of 1,867,000 motorbikes a year, comprising about 30 different brands. However, only 230,000 motorbikes were sold in 1998 and the unsold inventories are becoming massive. All the assemblers and many government officials are calling for a ban on imports of motorbikes to protect the industry. The government's protection of domestic assemblers, by raising tariffs up to 60 per cent and then banning the import of motorbikes completely for more than half a decade, has brought the domestic producers so much benefit that they do not want to change (Rodrik 1999:151). For a long time, domestic producers have had the power to charge very high prices for their products, leading to huge profits. Even with lower labour costs, the Vietnamese-made motorbikes have been priced at $1,990 each—a price already reduced by about 10 per cent for a few months—while the higher quality Thai-made motorbikes sell for $1,000 to $1,100, and the Chinese products are being sold in the Vietnam–China border provinces at a much lower price, around $700 each.

Coal By June 1999, about 4.8 million tons of coal, which was 40 per cent of the 1999 planned coal production, were put into unsold inventories. The cause of this problem, as pointed out by the government, was the mistakes made by the Vietnam Coal Corporation, a solely state-owned corporation, in forecasting the demand for coal and planning production. Where there is a single producer there is no competitive pressure to carry out these tasks efficiently.

Cement A notable point about cement production is that while the sole state-owned cement enterprise had one million tons of cement and clinker inventory in June 1999, other non-state cement enterprises have been performing very well. The Chingfong Company, a joint-venture with Taiwan, sold 800,000 tons of cement and clinker in the first 6 months of 1999, increasing sales by 16 per cent compared with the same period in the previous year. The problem with the state-run cement industry, as in the case of sugar production, lies in poor planning of investment and production, and price distortions caused by non-competitive policies.

Enamelled tiles In 1999 the demand for enamelled tiles was predicted at 21 million m^2 while domestic supply would reach 33 million m^2. A number of tile factories therefore have had to run at about 50 per cent of capacity. Imported tiles and the decline in foreign investment have been blamed for this problem.

There are many similar examples such as steel, textiles and garments, bicycles, electric appliances, jute-related products and paper. Their problems may differ, but they are all rooted in the same deception: a directed economy dressed in market clothing.

Stimulating demand to save state-owned enterprises?

On 9 July 1999, the government handed down Resolution 08/1999/NQ-CP which set out measures to accomplish the social and economic tasks for the last six months of 1999. Demand stimulation was seen as the most crucial measure to get the economy back to high growth. Since then, numerous policies to boost demand have been officially and unofficially proposed, ranging from lending to poor people to increase their consumption to increasing the money supply at a faster rate. Reduction of working days from six to five days a week, which will be effective as of 1 October 1999, has been put forward as a way to expand demand and create new jobs, based on the argument that people will spend more when they have more leisure time and additional workers would be employed to complete the same amount of work as before (VTV 1, 25/8/1999). The tight money policy has been criticised in the media, with some commentators arguing that those who are following this policy should be 'corrected' (Vu 1999). The case for these policies is the decline in demand—for which the Asian crisis has been blamed—and the frequent employment of demand-boosting policies in market economies, especially in those which are developed and enjoying high economic growth rates.

In developing countries where economic resources are wasted and misallocated, supply-side related policies are used to promote sustainable economic growth. So long as supply-side policies militate against the efficient use of resources, all the current problems of Vietnam's economy will remain and the economy is unlikely to secure sustainable economic growth. Demand-stimulus could get the SOEs (Table 6) out of their current troubles and increase economic growth, but only in the short term and would lead to a resurgence of inflation.

Stimulus demand will help domestic SOE production only if imports are restrained. (Otherwise the increase in demand will be channelled into the more competitive imports.)

Table 6
The SOE sector's performance, 1990 and 1995–98

	1990	1995	1996	1997	1998
Number of the SOEs	12,300	6,052	5,800	5,790	5,700
Contribution to the Budget (per cent of GDP)	8.6	9.1	8.9	8.7	7.1
Loss-making SOEs (per cent of total)	22.0	17.0	22.0	30.0	30-35.0
Over-employment (per cent of total)	..	15.0	25.0	25.0	25-30.0
Profits / capital (per cent)	9.6	19.1	11.2	10.6	8.0

Source: Vo 1999.

As SOEs become more inefficient the level of import protection has to be increased. Incentives to smuggling also increase. Vietnam's geography suggests that the cost of restricting smuggling would be prohibitive.

A recent study of the competitiveness of Vietnam's economy shows that Vietnam's tariff system is still complex, with an average rate of 33.5 per cent on its main imports in 1998 (Vo 1999:9). More importantly, non-tariff barriers, such as Customs surcharges, foreign exchange restrictions and surrender requirements, quotas and bans, and special Customs formalities (McCarty 1999) have been put in place and are becoming more and more significant features of trade policy.

It is to be hoped that all of these barriers will be reviewed and removed when Vietnam faces up to the obligations of economic integration in the region and the world to which it has committed itself within the Common Effective Preferential Tariff scheme (CEPT) and in the ASEAN Free Trade Area (AFTA). The actions taken will indicate which economic model is to be followed.

Conclusion

The shock of the cessation of foreign aid during the period from 1975 to 1981 was a turning point for the economic regime in Vietnam. The central planning model was seen not to be working well; the market mechanism appeared to be the key to progress in the economy. However, while central planning could be temporarily discarded, socialism would never fail. Accordingly, the market mechanism has been seen as a means for the country to advance under a 'socialist orientation' and an indefinable thing has been created that is neither a market model nor a central planning model. It is not really an economy in transition to a market economy. This centrally planned economy in disguise must in the end be revealed if Vietnam lags far behind other economies in the region. The question is when. The Asian crisis, although not causing a significant economic shock to Vietnam, has revealed the severe problems of an economy still rooted in central planning. Will Vietnam's economic integration into the region and the world in the next few years lead it to discard the central planning philosophy?

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