THE SITUATION:
VIETNAM DECIDES ITS FUTURE

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Introduction

Vietnam is pleased with its recent record of about 7% a year GDP growth, rapid gains in exports, and improving FDI performance. There is also progress in telecoms and the Internet, tourism, and infrastructure. Critics have made points about lagging WTO negotiations, slow SOE and financial reform, stratospheric land prices, problems in education and medical care, and regional and rural-urban income disparities. However, the general feeling is that – China aside – Vietnam has done about as well as any other country in the world – and maybe Vietnam has done better than China in dealing with poverty. If growth can be maintained, then many of the remaining problems will be solved over time and the praise of some donors is deserved. Is this a reasonable position?

As with any assessment, a good deal depends on what is wanted or expected, and what time period the analysis includes. It has been 16 years since Doi Moi began in earnest, and it might be reasonable to look out to 2020, rather than the usual five years. This helps focus thinking on longer-term tendencies. As to what is expected, it is useful to consider other nations. If resource-poor India with more than 1 billion highly diverse people, terrorism and a 40% illiteracy rate can grow at 6-8% a year, is it adequate to set a 7% target for a unified, literate and oil-rich Vietnam? Other concerns focus on regional differences. Is it desirable to have 2/3 of all realized FDI in six provinces? Still others ask about education. Is it healthy to have many with the means seeking to pull their children out of the widely criticized public educational system? Similarly, problems in health care have made headlines recently. A recent interview with an official in a poor but not remote province can be characterized as follows:

“Nothing works. The state enterprises lose money and nobody works hard. The private sector is weak and small. The public investments are not well planned or implemented at a reasonable cost, but more a result of an “asking and giving” process with Hanoi. In schools, you cannot do well without extra payments to the teacher. In the health system, extra envelopes are needed to ensure even average care. Most people just wait for the state to make decisions. Corrupt officials seldom face real consequences and talented people are excluded from real involvement. So, talented and young people leave if they can. Land prices are driven up to ridiculous levels by speculation… [These are not quotes, but give the sense of what was said.]

If any of these statements strike a chord, then one must conclude that a great deal remains to be done. Yet how does one even begin to organize the priorities? What are reasonable principles to use in understanding the current situation? Let us start by listing almost certain long-term trends before proceeding, reflecting the 2020 perspective argued for above. The trends described below are almost certain to occur, though the exact magnitude of change will depend on both policies within Vietnam and external developments. It is important to see how these trends tend to be inter-related rather than specific and isolated phenomena. Consider only five of the following trends:

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1 Why not compare Vietnam to Taiwan? It averaged 9% annual GDP growth from 1951 to 1987. Taiwan had no oil, trade surpluses for most of the period after 1963, and a heavy defense burden.
1. **Population growth will slow but the urbanization rate nearly double by 2020.**
The falling birth rate follows from rising education levels and housing/education costs, current trends, and comparative Asian experiences. The population growth rate fell 0.3% from 1996 to 2002, as the fertility rates fell below 2.0. At that rate population growth would be 1% a year in 2008 and would slow even more after that. Large urban/rural income differentials will support migration to urban areas. Rural population growth will turn negative, perhaps by 2010. The population will begin to age and cheap labor will disappear. Demand for services and education will be higher in urban areas.

2. **Providing urban infrastructure and housing will be very costly.**
One plausible estimate is that private urban residential and local infrastructure investment will amount to 20% of GDP by 2020, or $25 - $30 billion a year. If the current focus on greater Hanoi and HCMC continues, this will increase the cost vs. equal development of secondary cities. Hanoi and HCMC grew nearly twice as fast as secondary cities from 1987 to 2001, a trend that need not be repeated. In any case, capital will have to be allocated carefully if urban demands are to be met.

3. **The ratio of trade and capital flows to GDP will continue to grow for some time.**
Trade/GDP already exceeded 110% in 2003 and will rise even higher over time. This will mean that the economy is open to shocks (e.g., a “hard landing” in China), but will also able to take advantage of new information and opportunities. Low trade barriers will make it necessary to develop more efficient firms. Increasing capital mobility (e.g., an Asian bond market) will make it harder to “capture” savings for domestic low productivity investments. Developing more efficient industry and capital markets will be a necessity if production and savings are not to move to other nations.

4. **There will be a move towards a service economy.**
The share of agriculture is already falling and will likely halve to 10-12% by 2020. The prices of manufactured goods will decline relative to services, so even if physical output of industry grows rapidly, the share of manufacturing at current prices will rise less quickly or more likely decline. This will mean that the productivity and efficiency of services will assume an importance now assigned to industrialization. (Industry and construction are about 40% of Vietnam’s GDP in 2004, and this is already higher than in many richer nations. The ratio in Japan is only 32%.)

5. **Widespread and high quality education will be needed.**
If there are shocks and opportunities from a world economy that is highly influential for Vietnam, and if services become increasingly important, then education will be the key to coping with and exploiting these trends. Educated people are often more alert in spotting change and usually adjust more easily to it. They are the key raw material in services. Moving up the “value added chain” to higher income activities will require a much better and broader effort in promoting education. In any case,

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2 This is from a draft report to DFID in December 2003 by J. M. Cour. His paper is “Urbanization and sustainable development: A Demo-economic conceptual framework.”
urban parents will demand more education for their few children. Training and education for older workers will also assume increased importance.

If the general direction of these trends – and their implications – is correct, the question is if Vietnam should drift and wait for external pressures to force change or if internal reforms should prepare firms and people to take advantage of the trends. Generally speaking, it is preferable to anticipate change and prepare for it, since forced and rapid change is difficult and even destabilizing. Of course, many groups prefer to take an easier short-term view, even if this creates more problems over time.

The situation in Vietnam is complicated by the way the nation is organized. When a problem arises, the ability of provincial authorities to solve it depends on their own resources and attitudes, their ability to lobby for changes in Hanoi, and their need to please Hanoi. So, land in rich Dong Nai (25 km from sprawling HCMC) costs $7 per square meter while land in poor Bac Giang (over 50 km from downtown Hanoi) costs many times more. Both provinces have an abundance of agricultural land, but one can find ways to transform it into residential and commercial uses while the other does not. So land is not a serious barrier to growth in Dong Nai but is in Bac Giang. (The activity of land speculation by central government officials is also a factor, as is the lack of significant taxation of land based on its actual market value.) This is as clear an example as any of how policy failures are not necessary but simply frequent.

The land example is used because rapid rates of urban population growth are almost certain. If land prices are very high, then land becomes a barrier to rational urban development as well as economic development. Housing ends up being expensive, crowded, and a source of social problems. These problems can grow even while growth rates are relatively high – but problems are being created that will be expensive and difficult to solve. That is why it is treacherous only to rely on “macro” growth rates, enrollment rates, or mortality rates in assessing performance. They do give some important information but leave out crucial elements about sustainability.

This brief analysis of longer-term past trends and future possible outcomes allows us to create a framework for addressing the precise questions to which this paper is supposed to respond – the “five year” successes and failures, and medium-term barriers to development. In general, there have been great quantitative improvements but larger questions about the qualitative side of recent economic and social development. Any analysis can take several forms. A “SWOT” (Strengths, Weaknesses, Opportunities, Threats) analysis is a good way to summarize a lot of information and was used in the “Weird Dualism” paper that came out in 2003. That paper and this one will argue that many issues of sustainability are not being properly

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3 We were told that residential land on the edge of Bac Giang’s provincial capital is $300 per square meter, while land well outside of town for a residence is $60 per square meter. Land for residential use in Bac Ninh, as close to Hanoi as Dong Nai is to HCMC, goes up to $1000 per square meter; land inside of HCMC and a few kilometers from the downtown is $500 per square meter. (All land prices as of early 2004.)

4 The proper title is Vietnam’s Economy: Success Story or Weird Dualism? A SWOT Analysis. It was prepared for the UNDP and the Prime Minister’s Research Commission and came out in June, 2003.
addressed in spite of many positive developments. The solution to improving sustainability while maintaining or even accelerating growth lies at the heart of critical public policy decisions. A SWOT analysis is not used in this paper, but may grow out of the analysis and discussions about the points it raises.

Questions to be Addressed

The request for this analysis asked that the following topics be covered in a 20-30 page paper:

1. General Socio-economic development planning and management
2. Poverty reduction and progress in rural and regional development
3. Performance of specific sectors, e.g. Agriculture, Finance, Industry, Trade, etc.
4. International and regional economic integration
5. Regulatory reform, business development and private enterprises
6. Creation of a “level playing field” to tap all resources for development
7. Creation of good conditions for all firms to improve their competitiveness
8. Public administration reform
9. Public investment and expenditure management, including
   a. Effectiveness of public investment planning and implementation
   b. Effectiveness of ODA use, both for infrastructure and institutional capacity
   c. External debt management

Many of these questions can be analyzed with available data, although the quality of the data is often uncertain. Some must be studied more indirectly – there is no good index of regulatory reform or the smoothness of the playing field, so one must rely on international comparative rankings or other indirect measures. It is also true that several of the questions tend to “cluster” with each other. Questions 1-4 all revolve around socio-economic development, while questions 5-7 around the business environment and firm development, and questions 8-9 around questions of public administration and policy. The following sections will address three broad areas with sub-topics in each field.

Socio-economic Progress

Vietnam is one of the fastest growing countries in the world, with 6.6% average growth from 1999-2003. Investment to GDP is said to have averaged about 31%, and may have been even higher\(^5\), so it appears that it took 5 units of investment to produce one unit of growth, up considerably from the 3:1 ratio of the middle 1990’s.

Poverty as measured by the Vietnam Living Standards Surveys (GSO definition) declined from 37% in 1998 to 29% in 2002, with a steady national trend downwards, though at a slower rate than in the earlier 1990’s. The poverty levels are very sensitive to the income

\(^5\) I use Asian Development Bank GDP data, including investment and sectoral. However, the investment estimates are subject to change and may not include all residential investment and inventory change. Actual I/GDP ratios may well be closer to 35% than the 31% they report. The data are from the website, www.adb.org.
cutoff chosen, and if a high level of $2 a day\textsuperscript{6} were chosen, the decline would have been from 80% in 1993 to 65% in 1998 to 58% in 2002. The rate of poverty reduction had halved. If the poverty changes are broken down by region, most regions have made respectable progress in reducing poverty in the past several years. If we use the Vietnam Living Standards Surveys in 1998 and 2002, and take an international poverty line, the following pattern emerges:

<table>
<thead>
<tr>
<th>Region</th>
<th>1998</th>
<th>2002</th>
<th>Difference</th>
<th>Change (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>All Vietnam</td>
<td>37.4%</td>
<td>28.9%</td>
<td>-8.5%</td>
<td>-23%</td>
</tr>
<tr>
<td>Urban</td>
<td>9.2%</td>
<td>6.6%</td>
<td>-2.6%</td>
<td>-28%</td>
</tr>
<tr>
<td>Rural</td>
<td>45.5%</td>
<td>35.6%</td>
<td>-9.9%</td>
<td>-22%</td>
</tr>
<tr>
<td>North Uplands</td>
<td>64.2%</td>
<td>43.9%</td>
<td>-23.2%</td>
<td>-36%</td>
</tr>
<tr>
<td>Red River Delta</td>
<td>29.3%</td>
<td>22.4%</td>
<td>-6.9%</td>
<td>-24%</td>
</tr>
<tr>
<td>North Center</td>
<td>48.1%</td>
<td>44.4%</td>
<td>-3.7%</td>
<td>-8%</td>
</tr>
<tr>
<td>South Center</td>
<td>34.5%</td>
<td>25.2%</td>
<td>-9.3%</td>
<td>-27%</td>
</tr>
<tr>
<td>Central Highlands</td>
<td>52.4%</td>
<td>51.8%</td>
<td>-0.6%</td>
<td>-1%</td>
</tr>
<tr>
<td>Southeast</td>
<td>12.2%</td>
<td>10.6%</td>
<td>-1.6%</td>
<td>-13%</td>
</tr>
<tr>
<td>Mekong Delta</td>
<td>36.9%</td>
<td>23.4%</td>
<td>-13.5%</td>
<td>-37%</td>
</tr>
</tbody>
</table>


The percentage change (last column) is a better indicator of progress, as it tells what proportion of poor people in each region moved out of poverty in the period. Most regions had 24-37% of their population move out of poverty in just a few years, but the Central Highlands and Northern Central Coast were noteworthy for their single-digit changes and high initial levels of poverty – about half of the total population. However, the North Central Coast (13% of national population) has net out-migration while the Central Highlands (5.5% of national population) has high levels of net in-migration by ethnic Vietnamese. Normally, people do not migrate to become poor. This suggests that the poverty problem there is linked with ethnic minorities and may require special efforts to improve their situation, rather than to rely on overall economic growth. The Southeast had a slower rate of poverty decline than the national average, but started as and remains the richest area and a destination for immigration. Its poverty level was less than half that of the Red River Delta, the next best-off region. Still, overall, a reduction of one out of four Vietnamese leaving poverty in just a few years is certainly a positive achievement, even if it is much slower than the improvements in the 1993-1998 period.

\textsuperscript{6} The $2 figure refers to purchasing power income, which averaged $2300 per capita in 2002 for Vietnam. The source used is Vietnam: Growth and Reduction of Poverty, Annual Progress Report of 2002-2003, November 2003, p. 19. The $2300 per capita PPP figures comes from 2004 World Development Indicators, Table 1. It is a World Bank publication.
The poverty analysis above focuses on absolute and minimal levels of consumption. This is an important indicator of wellbeing. However, other measures are often used for poverty, especially as a nation’s per capita income improves. Relative measures of poverty often use a measure such as one-half of median income as a poverty income level. Recent surveys have found that urban and rural rates of increase were relatively similar, though the absolute gaps have grown enormously. It is not clear to what extent changing definitions and coverage have produced this “equal” growth rate or to what extent the underlying relative income changes are actually similar. This is an area for further research.

In terms of changes in mortality, the under-five mortality rate fell from 42 per 1000 in 1999 to 26 per 1000 in 2002. (World Bank data.) This is a very rapid decline and reaches a level typical of much richer nations such as China and Thailand. Life expectancy edged up from 69 to 70 years, again in the same range as China and Thailand. Malnutrition among children appears to have edged down modestly, but is still half again as high as Thailand’s. Overall, there are reportedly good levels of health relative to income and moderate to superior progress reported in the last several years. It is not clear if much of this improvement is due to the health care system’s efficiency or simply to more spending and better diets and cleaner water or living conditions. While child inoculations have gone up, other aspects of the health care system (poor quality of health care, a need for extra payments, and improper or costly medicines) have led to various criticisms.

In terms of education, enrollments have been growing rapidly. The net enrollment rate in primary education in 2001/02 was 94%, the same as the United States. (Thailand, with three times the income per capita, (PPP terms), had a 86% rate.) The gross enrollment rate at the secondary level rose from 57% in 1997 to 70% in 2001/02, in the same range as Malaysia and China. (Thailand was 83%.) Gross enrollment at the tertiary level rose from 7% in 1997 to 10% in 2001/02. This represents rapid growth but still leaves Vietnam’s university proportion below India (11%), China (13%) and Thailand (37%). The picture here is one of continued strength at the primary level and fast growth at higher levels. However, while the secondary enrollments are high relative to its income, tertiary enrollments lag behind some Asian nations with which Vietnam might wish to compare itself. However, this does not mean that Vietnam should try to reach the same enrollment levels as much richer nations, at least not right away. Questions of quality and the value of degrees should also be weighed in any policy discussions.

In other respects, there has been a continuing improvement in access of more places and people to basic services. Almost all communes will have a road, telephone and electricity by the end of 2005. Access to clean water in rural areas improved from 29% to 40% of population from 1998 to 2002, while urban coverage stayed around 75%. Over 90% of people have access to radio programs and 85% to television programs. These

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7 All of these data come from 2001 and 2004 World Development Indicators compiled by the World Bank. Net enrollment is all enrolled children in primary school of primary age over all primary age children. Gross enrollment is all primary students (any age) over all primary aged children. Gross enrollments can exceed 100%, but net is always under 100%, since primary students outside the age range of “primary” would be excluded.
improvements are important because they allow even the more remote places to find out about and take advantage of economic and social opportunities. In this respect, the relatively concentrated pattern of settlements along the major highways and rivers allow somewhat easier coverage of most people compared to some other nations with more dispersed living patterns.

The rates of growth of various economic sectors have been as expected. Value added in agriculture, as is true almost everywhere, grows more slowly than industry while services grow about as fast as overall output. That is, agricultural value added grows 3-4% a year, industry and construction 9-10%, and services 5-7%, on average over time. One interesting point is that industrial gross value is growing 12-15% compared to under 10% for value added, suggesting that many manufacturing activities have low value added. The share of agriculture has been falling for some time and dropped from 25% to under 22% in five years. Since about 60% of workers are in agriculture, this suggests that farmers’ income (or output) from farming is only about 1/3 of the national average output, while the non-farm sectors produce incomes (or output per worker) about twice as much as the national average. Unless new workers largely avoid farming, these productivity differences can be expected to intensify, since farm output is unlikely to accelerate and other sectors will probably continue at roughly similar output growth rates in the near future. For example, if we assumed that farm workers would not increase, then all the growth in the labor force would have to come from the 14-15 million non-farm workers. Since labor force is growing 1 million a year, that would imply 7% annual growth in non-farm workers, or nearly as much as non-farm output growth, while agricultural growth will remain at about 3-4%. Yet in absolute terms, 3% growth of farm output per farmer is equal in value to half of the likely 1% growth of nonfarm output per nonfarm worker!

One weakness in the value added and value data is that they are gathered at local rather than at world prices. For example, if the world price of sugar is $200 a ton but the domestic price is $300 a ton, then the value of one million tons of sugar production is said to be $300 million rather than $200 million. Yet, it would take only $200 million to buy that much sugar on the world market and any “extra” produced in Vietnam over domestic demand could only be sold at $200 a ton. Because many products are produced with various barriers to imports, much of the high growth in industry is an artifact of the tariff and quota system rather than the actual value at which the goods could be bought and sold. On the other hand, many trade barriers are supposed to be reduced by 2006 when Vietnam is supposed to enter the ASEAN Free Trade area with most of its tariffs lowered. Some of these reductions have already taken place. Nonetheless, there may be a downward bias to future growth rates as these lower world prices merge with domestic prices for many of the currently protected goods.

In general, Vietnam’s economy has become more open to and integrated with the rest of the world. Both exports and imports have grown as a share of output, with each more than doubling from 1998 to 2003. (This was slower than China, whose exports and imports this year will be about $500 billion each.) Exports at current prices rose from 45% of 1998 GDP to 56% in 2002, while imports rose from 52% in1998 to 60% in 2002.
These ratios rose in 2003 and now exports and imports together are 115% to 120% of 
GDP. This means that most tradable production is influenced by world prices and that 
firms must become more efficient if they are going to operate well or expand in the 
future. Lower trade barriers and smuggling mean that protected firms have a highly 
uncertain future. They must become more efficient or disappear.

In terms of regional integration, the share of both imports and exports with ASEAN has 
been falling since 1998. Exports to ASEAN fell from 22% of all exports in 1998 to 14% 
in 2002, while imports from ASEAN fell from 29% to 24%. Trade with China partly 
offset this decline, so the share of trade with developing Asia was roughly constant. 
(Exports to China rose from 4.7% to 9% of the total; recorded imports rose from 4.5% to 
10.9%. Actual trade with China might be higher due to unrecorded border trade.)

Exports to industrial countries remained at about 2/3 of the total, but imports from 
industrial countries fell from 65% to 56% of the total. Singapore and France were among 
the largest losers in terms of relative shares of sources of imports. Overall, China’s 
increase is one major development, while ASEAN’s share is falling, with both Vietnam 
and the world in general. The other major development is that US has become the largest 
single national export market with the ratification of the Bilateral Trade Agreement. The 
US share of Vietnamese exports rose from 4.4% in 1999 to 20% in 2003. From 2001 to 
2003, the US accounted 60% of total Vietnamese export growth. It is useful to keep this 
in mind, as the anti-dumping measures of the US – while unfair and very irritating – have 
not prevented this trend, which is of major importance.

The other major trade aspect of global economic integration is World Trade Organization 
membership. Vietnam has announced its intention to join the WTO in 2005. There have 
been eight rounds of talks and the Trade Ministry says that prospects for the ninth round 
are optimistic. However, many independent sources disagree and are not optimistic that 
Vietnam will be able to join in 2005. If Vietnam does not join in 2005, it will likely face 
much more difficult entry terms than those nations that do manage to get in by early 
2005. Some Hanoi experts speculate that there is a fear that many construction contracts 
would have to be given to foreign (often Chinese) contractors under WTO, disrupting an 
important source of patronage. However, with the end of textile quotas for WTO 
members in a few months, Vietnam’s garment exports will suffer greatly relative to other 
countries that will have no more quota constraints. Getting into the WTO sometime in 
2006 could set back garment exports by two or three years, as investments will be shifted 
and tend to stay in other countries. While much of garment export activity is situated in 
the South, many workers come from the poor northern coastal regions. A policy that 
hurts labor-intensive exports in order to preserve locally restrictive bidding practices, or 
other weak industries, is likely to worsen income inequality, maintain corruption, slow 
growth, and also send a highly negative signal to potential investors. It would be a major 
drag on the economy and a defeat for reform. This single issue might be the most 
important for Vietnam in the middle of the current decade.

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8 Some Vietnamese observers believe that the anti-dumping measures are unfriendly and aimed specifically 
at Vietnam. The recent imposition of anti-dumping tariffs on China for furniture exports shows this line of 
argument to be mistaken. The anti-dumping litigation is driven by domestic interests. Aside from 
aggressive legal representation, the best thing Vietnam could do is to get classified as a “market economy.”
The other major aspect of international economic integration revolves around the pattern and level of foreign direct investment (FDI). MPI data on disbursements have generally indicated levels of $2-3 billion a year since 1997\(^9\). IMF estimates are much lower, rising from around $800 million a year in 1998-2000 to $1-1.5 billion in 2001-2003. If GDP is taken at $40 billion, then gross FDI inflows are either about 3% or 6% of GDP. Recently, there has been much emphasis on the reinvestment or added investment by existing projects as opposed to new investments. It is certainly true that added investments should be counted, but since $25 billion of cumulated FDI has now been made, the depreciation on this past capital stock should also be calculated to arrive at a net investment figure. It is likely that depreciation on past FDI is about $2 billion a year, so any inflow less than this would represent a net decline in capital stock.\(^{10}\) If the MPI data are correct for gross investment, then net investment is less than $1 billion a year and net FDI is 1-2% of GDP. With total yearly gross investment around $14 billion, FDI is 10-20% of that total, depending on which data set is used. This is a moderate level of FDI, less than in the middle 1990’s, but high relative to several other ASEAN economies.\(^{11}\) Given that direct employment by FDI is approaching one million workers and FDI accounts for half of all exports, attracting the right kind of FDI is clearly beneficial. Since Guangdong province in China has the same population and education levels as Vietnam but $12 -15 billion a year in FDI, it is reasonable to expect that Vietnam could attract more FDI than it now does.

It is noteworthy that the relative stagnation in FDI in Vietnam is part of a regional pattern. While ASEAN had much higher FDI per capita and total exports than China in the early 1990’s, the pattern has completely reversed. Per capita FDI in China is now triple the ASEAN level (less Singapore), while China’s exports went from 69% of ASEAN’s in 1990 to 140% in 2003.\(^{12}\) While Vietnam has recently been one of the faster ASEAN economies, it is very much part of ASEAN in terms of falling FDI (from the middle 1990’s), relatively slower export growth, and also slower GDP growth than China.

The type of FDI attracted can be as important as the level. In the past, much of the FDI has gone into heavy industry with high levels of protection, resource extraction, or property and real estate. The highly protected industry has now partly shifted to state sponsored projects in steel, oil refining, fertilizer, and petro-chemicals, although in 2002 heavy industry was nearly 23% of total FDI, up from 20% in 1998. Light industry (excluding food) was 13.5% of total FDI in 2002, up from 9% in 1998. Lumpy investments in electrical generation or offshore oil and gas production can result in large changes from year to year in relative shares of each sector. If Vietnam hopes to generate

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\(^9\) MPI data are subject to extensive revisions. They sometimes at first show higher realized investment than is later reported after revisions.

\(^{10}\) This assumes a 12-14 year average life for all FDI project capital. A study is needed on actual capital use and lifetimes. However, the assumed figure is likely to be close to the actual one.

\(^{11}\) China has had FDI per capita of $30 to $40, while the Vietnamese level could be in the same range if the MPI data are correct. Obviously, if the IMF data are used, the levels are only about $15-$20 per capita.

\(^{12}\) ASEAN in this paragraph includes the “big five” of Indonesia, Malaysia, Thailand, the Philippines, and Vietnam. It excludes Singapore, Myanmar, Cambodia, Laos and Brunei. IMF trade data are sued.
high levels of employment, then further increases in light industry FDI create the most potential for growth. It would be especially important to develop component and supplier industries so that lower costs and flexibility would be built into the supply chain.

Attracting more FDI that is not resource, protection, or real estate motivated would be highly desirable. While the types of exports have been broadening somewhat, Vietnam still relies on a fairly small number of products for much of its export sales. Oil, garments, seafood and footwear accounted for 60% of exports in 2003. There are, of course, the usual raw materials such as rice, rubber, coffee, cashews, pepper, tea and coal. However, it is the rise of furniture, electronics, handicrafts, and other labor-intensive goods that are most likely to have large overseas markets that might generate many hundreds of thousands of new jobs. It will be difficult to move aggressively into these new products without some foreign involvement. It might be possible to use foreign buyers, who would provide information on technology, product design, and quality control as well as be the primary buyers. Or, it might be necessary to have foreign firms invest, and develop supplier networks and lower costs through local sourcing.

One aspect of economic performance that had performed well through 2003 is inflation. Partly this is because the world environment up to 2004 was deflationary, and partly it was because budget deficits were under control. However, credit has tripled from end 1998 to end 2002 and is still growing in the mid-20% range. Taken with the turn in world commodity prices, this is likely to result in higher – perhaps double-digit – levels of inflation in 2004. If China’s economy cools, there may be some relief on the world commodity price front, but credit growth may spill over from land prices to others. Inflation tends to hurt the poor and make rational business investment more difficult, so controlling excessive bank and Development Assistance Fund lending is of high priority if either growth or equity are important goals. Indeed, the inability of the financial system to identify good companies and support them is arguably even more important than some inflation. If unproductive capital is funded, little will be gained. This observation is relevant for both direct government spending and lending, and is covered later.

A final word in this economics section is needed. The availability of data in Vietnam has improved relative to the 1990’s, but is still poor in critical areas. The IMF stopped lending because (unlike virtually every other nation) Vietnam did not want its foreign exchange reserves audited. This attitude – that information that almost every country makes freely available, if with a lag – is likely to be exploited by speculators and hostile forces is incompatible with global economic integration. Markets do not like surprises and if there are no data or bad data, the scene is set for violent reactions. Likewise, in the banking sector, the informal estimates of bad bank loans far exceed the official figures. This reduces the confidence of others in the financial system and the entire economy. For FDI, there seems to be a large gap between IMF and MPI numbers, raising a number of questions that would be better to resolve. Export and import data seldom have sufficient detail for useful analysis in a timely way. Unless there is significant improvement in many of these areas, Vietnam will find itself ignored by suspicious investors. It should be a matter of concern that Vietnam is not even listed in the “Economic Data” section of
The Far Eastern Economic Review, for it communicates to its elite (and mainly Asian) readers that Vietnam is not yet a serious investment destination. Worse, if some Vietnamese leaders believe that all is well when it is not, policy might fail to take account of approaching problems that might have been avoided. Small investments in data are needed, but big political decisions are also needed to support the technicians. Vietnam will have “graduated” when GDP data sometimes indicate that a target has not been met, and when company accounts are credible. There is some considerable distance to go but more progress would be welcome and would have a larger payoff in improved economic performance than many now imagine.

**Investment Environment and Regulation**

The biggest success story of the last five years (or more) has been the passage and successful implementation of the Enterprise Law. By lowering the barriers to formal registration of a private business or company, a huge number of investors have responded. Since January 1, 2000 there have been over 70,000 new businesses registered and many billions of dollars of registered investment. Output of private (neither state nor foreign) industry has grown about 20% a year as well, much faster than the SOE rate. There have been many hundreds of thousands of new jobs created in all regions, not just the usual “hotspots” attractive to foreign investors. There is no doubt that making it easier to start up a formal business has resulted in many thousands responding – even some joint stock firms with state equity have set up under the Enterprise Law! In addition, many of the larger “private” firms have connections to important people and organizations and thus have better access to inputs or contracts than “real” private firms with no such connections. This helps them get started, but they cannot get very large and compete in world markets since subsidies cannot be extended indefinitely in time and amount, even if trade rules (AFTA, BTA, WTO) were to allow it.

So, the progress of the private sector is like a long journey that has only just started. There are virtually no large, competitive private Vietnamese firms of any size. In 2002, only five private companies had over 5000 employees and only 12 had capital of over $33 million. (This excludes joint stock companies with state capital investments.) There may be tourist or real estate developments driven by land deals that have a high value, but these are not easily replicable, nor is it clear that their profitability would allow continuing growth. The amount spent on research and development is miniscule. Most firms have weak technology and management. Marketing is a huge problem.

It is an interesting question why there are so few private firms of any size, especially if one also corrects for the connected firms that do not face full market discipline because they have better access to land, loans, regulatory restraint, or contracts. Some would argue that since it is only four or five years since private firms were really allowed, it is

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13 These data come from a 2004 GSO publication, The Real Situation of Enterprises Through the Results of Surveys Conducted in 2001, 2002, 2003. A firm near the bottom of the Forbes magazine top 2000 firms in the world like Ranbaxy Laboratories of India has $680 million in assets. An obscure Chilean retailer (Falabella) had over $1.4 billion, while WIPRO of India, the third ranked outsourcer had $880 million. None of these are state owned or linked industries. None use land as leverage for asset inflation.
early in the game. This is one possible explanation. My own view is that there is a decision in some, but not all, parts of the Party and government to use small private firms as a means of stability but to prevent the rise of large private firms to achieve real national economic success. The hope seems to be that the large firms can essentially be confined either to state enterprises or to “private” firms that have a semi-public character through state share ownership or connections to influential groups or persons.

This approach will almost certainly fail, but the failure will take the form of slowly declining growth rates, inefficiencies in investment, losses of talented people abroad, and unsatisfactory rural-urban income trends. Since none of these constitute a crisis, it will be easy to argue that this approach is justified, if only because its implications seem less threatening than the rise of a truly competitive private business sector. Such a sector, if it grew powerful, would push for a rule of law, less arbitrary regulation, and a voice in shaping policy. This tendency, which has nothing to do with foreign meddling, is called “peaceful evolution” by some, and they mean it to describe an evil trend rather than a welcome outcome. The fact is that any successfully developing society develops a middle class and those groups have different demands and expectations than peasants or state enterprise or government workers. The middle classes want political competition, though this competition can come within a single party (e.g. Japan) and need not involve an effective multi-party system. From such competition will come better public services, more responsive public spending and policies, and better governance.

The difficulty in reforming education offers a good example of why old-fashioned “top down” policies do not work very well. (It is no comfort that many other nations have similar difficulties, no matter what their political system. Problems can arise from several sources.) The only universities that are highly ranked in the world are those that have real autonomy and have to compete. Tsinghua and Fudan in China, for example, are becoming world-class. They are given money and autonomy and then held to account. Salaries and hiring are not within the “old” system, but based on world wage levels and merit. Vietnam has no real counterparts to these institutions and will increasingly suffer for lacking them. At a more humble level of primary and secondary schools, if parents are allowed to monitor performance and provide feedback to academic management, quality is likely to improve – if the management has some flexibility. Having identical national curricula, teachers with low pay (except for extra “tutoring” of the same students they evaluate), and no internationally comparable testing ensures failure. If the school quality is as bad as some within the system say it is, this will constitute a major barrier for Vietnam. The fact that widely used international secondary school achievement tests are not used in Vietnam – but are in Malaysia, Indonesia, Thailand and the Philippines – suggests a bias against meaningful outside evaluation of quality. This also prevents meaningful assessment of current status and progress or retrogression.

Going back to the regulatory issue, one might argue that the growth of many small private firms is a sign of success. It is certainly a sign of improvements. However, the achievements, while positive, look less impressive when viewed from a macro-perspective or through the lens of various international surveys of investment or business
climate. First, the macro-environment. The following data break from CIEM annual surveys break out investment by ownership for 1998 and 2003.

<table>
<thead>
<tr>
<th>Share of Total Investment by Ownership</th>
<th>Shares of GDP by Ownership</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Budget</td>
<td>22.8%</td>
</tr>
<tr>
<td>Other State*</td>
<td>31.2%</td>
</tr>
<tr>
<td>Total State</td>
<td>54.0%</td>
</tr>
<tr>
<td>Private/Non-State</td>
<td>21.1%</td>
</tr>
<tr>
<td>FDI</td>
<td>25.0%</td>
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</table>


We observe a situation in which the state share of investment, especially outside of the budget is increasing while the share of the state in GDP is decreasing. This is also true for the private/non-state sector. The most dynamic sector – FDI – is increasing its share of output but has a falling share of investment. Another way to think about this is to see how the ratio of the share of investment to the share of output looks. In 2003, the state had 1.5 units of investment share to get 1 unit of output share, up from 1.35 in 1998. The private sector moved from .42 to .56, while the FDI sector was 2.5 in 1998 but only 1.2 in 2003. A decline in this ratio is good, as it means there is less investment needed per unit of output. The FDI sector was doing very well, cutting its investment requirement in half. The state sector increased its investment requirement by 11%, and rose above the FDI sector! (This could be a sign of inefficient investment patterns, unless the infrastructure had to be as expensive as it was.) The private sector was the most sparing in its use of capital, but increased its capital requirement per unit of output by 33%. This does not suggest that their level of cost-effective technology is necessarily improving. While there are other explanations – an increase in the formal private sector relative to labor-intensive household production, for example – it does raise a flag about the efficiency of the private sector relative to FDI. Also, the rise in the state share of investment can be good news (in terms of economic growth) only for those who believe that state investment is more efficient than private or FDI investments. It is more likely that as aid, oil, bond sales, and other sources of finance become available, the government simply spends what it can, and often more for politically rational than economically sensible projects. If this view is more correct, then capital allocation is becoming less efficient and borrowing will be harder to repay since there will be no project benefits or cash flow to liquidate the loan. Inefficient use of funds is also incompatible with an open economy, WTO rules, and a longer-run ability to service debt. However so long as funding is available, there will be no crisis requiring better policies.

Another approach is to use international rankings to determine where Vietnam stands relative to other nations. The Swiss-based World Economic Forum produces annual competitiveness rankings covering over 100 nations. They have done this now since the
middle 1990’s. Their ratings are based on eight aspects of a nation that supports long-term growth. These include:

1. Openness of an economy to international trade and finance
2. Role of the government budget and regulation
3. Development of financial markets
4. Quality of infrastructure
5. Quality of technology
6. Quality of business management
7. Labor market flexibility
8. Quality of judicial and political institutions

Since the number of nations rated has increased over time, I will take ten relevant Asian nations and show their rankings relative to each other in 1998 and 2003.

<table>
<thead>
<tr>
<th></th>
<th>1998</th>
<th>2003</th>
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<tbody>
<tr>
<td>Taiwan</td>
<td>Taiwan</td>
<td></td>
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<tr>
<td>Japan</td>
<td>Japan</td>
<td></td>
</tr>
<tr>
<td>Malaysia</td>
<td>South Korea</td>
<td></td>
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<tr>
<td>South Korea</td>
<td>Malaysia</td>
<td></td>
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<tr>
<td>Thailand</td>
<td>Thailand</td>
<td></td>
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<tr>
<td>China</td>
<td>China</td>
<td></td>
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<tr>
<td>Philippines</td>
<td>India</td>
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<tr>
<td>Indonesia</td>
<td>Vietnam</td>
<td></td>
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<tr>
<td>Vietnam</td>
<td>Philippines</td>
<td></td>
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<tr>
<td>India</td>
<td>Indonesia</td>
<td></td>
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</tbody>
</table>

Obviously, there has been little relative change in the rankings down to China. India has moved up three places and the Philippines and Indonesia down two places each. The other changes are minor, up or down one place. China, of course, is the success story of the past five or ten years, so there is little surprise that it is ranked above Vietnam.\(^{14}\) India, however, is a different matter. India is a poor country with high rates of illiteracy, corrupt government, fractious politics, and terrorism as well as a heavy defense burden. Yet India has moved up to challenge China, while China has actually fallen in the global rankings though it maintained its place in this group of Asian nations. Perhaps the combination of English, the ability to finance and nurture competitive private firms, and a reasonably good legal system give India advantages that others lack. It goes without saying that both Indonesia and the Philippines have had political instability, riots and/or armed rebellions, and endemic corruption. These problems drag them down below Vietnam. Indeed, Indonesia has had negative net capital flows for several years, while FDI into the Philippines was higher than Vietnam for 1998-2001, but fell sharply after that as political instability and terrorist attacks intensified. Overall, it is not a strong

\(^{14}\) Mexico typically ranks a few places below China but well above India, and it is also a major destination for US and other FDI. South Africa was about tied with Vietnam in 1999 and had moved above China by 2003. In a larger sense, Vietnam is competing with every developing nation.
showing for Vietnam that it is only above two very troubled and slow-growing neighbors. It should do as well as India!

The international corruption ratings are another indicator of regulatory status. If a nation is regarded as highly corrupt, whatever the official rules, it is a more difficult and dangerous place to invest in. Of course, in a country like China with a huge internal market, investors might have to accept this type of risk. But smaller countries will have a harder time persuading investors (even local citizens!) that the risks are worth taking. Taking the same ten Asian nations, the following rankings were made in 1999 (Vietnam was not ranked in 1998) and in 2003. The number following each nation is the absolute corruption ranking. A score of “10” means there is no corruption while lower numbers down to “1” mean increasing levels of corruption. In 2003, a median corruption number was 3.4; the best rating (Finland) was 9.7 and the worst (Bangladesh) was 1.3. The ratings are compiled by a European based NGO, Transparency International, which averages surveys of business people to arrive at their ratings. (www.transparency.org)

Corruption Rankings in 1999 and 2003

<table>
<thead>
<tr>
<th>Country</th>
<th>1999</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>6.0</td>
<td>Japan 7.0</td>
</tr>
<tr>
<td>Taiwan</td>
<td>5.6</td>
<td>Taiwan 5.7</td>
</tr>
<tr>
<td>Malaysia</td>
<td>5.1</td>
<td>Malaysia 5.2</td>
</tr>
<tr>
<td>S. Korea</td>
<td>3.8</td>
<td>S. Korea 4.3</td>
</tr>
<tr>
<td>Philippines</td>
<td>3.6</td>
<td>China 3.4</td>
</tr>
<tr>
<td>China</td>
<td>3.4</td>
<td>Thailand 3.3</td>
</tr>
<tr>
<td>Thailand</td>
<td>3.2</td>
<td>India 2.8</td>
</tr>
<tr>
<td>India</td>
<td>2.9</td>
<td>Philippines 2.6</td>
</tr>
<tr>
<td><strong>Vietnam</strong></td>
<td>2.6</td>
<td><strong>Vietnam</strong> 2.4</td>
</tr>
<tr>
<td>Indonesia</td>
<td>1.7</td>
<td>Indonesia 1.9</td>
</tr>
</tbody>
</table>

The first four nations kept their relative rankings and improved their corruption rankings – that is, they are perceived as becoming more honest. All are well above the median level of corruption. The second group, at or below the median corruption level, changed the relative rankings with the numerical ratings fairly stable except for the sharp drop in the Philippines. Vietnam remains next to last in this group, and slightly worse in terms of its numerical rating. Its lead over Indonesia drops by nearly half a point. This strongly suggests that most of the anti-corruption efforts and administrative reforms have failed to improve practices. Various statistical studies have found that corruption has a negative impact on longer-run growth prospects, equality, and investment efficiency. This rating cannot be helpful and could damage Vietnam’s ability to attract investment.15

A final element of international perspective comes from various “information technology” ratings. These rate countries by their overall ability to profit from e-commerce, the

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15 One business school professor noted that many potential investors had said to her, “These people [officials in Vietnam] need a reality check!” They decided to invest elsewhere.
Internet, computers, and so on. The Economist magazine, in cooperation with IBM, has been producing these ratings since 2000. They integrate several elements including connectivity, legal and business environment, consumer and business adoption, socio-cultural environment, and supporting services. Vietnam has ranked near the bottom of the Asian nations surveyed (Pakistan is lower), and moved from 54 in 2000 to 56 in 2004 out of 60 nations reviewed. On the other hand, its absolute score rose from 2.76 in 2001 to 3.35 (the best score was 8.3) in 2004. Vietnam’s absolute increase was higher than that of Indonesia and the Philippines, about the same as China’s, but below that of India and Thailand. Overall, Vietnam is improving, but no more rapidly than many of its Asian neighbors who started ahead and remain ahead of Vietnam. A table below shows some of the scores. (In 2000, the scoring system used was not the same as in 2001-2004.)

“E-Readiness” Rankings of Asian Countries

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>South Korea</td>
<td>7.0</td>
<td>7.7</td>
</tr>
<tr>
<td>Taiwan</td>
<td>7.2</td>
<td>7.3</td>
</tr>
<tr>
<td>Japan</td>
<td>7.2</td>
<td>6.9</td>
</tr>
<tr>
<td>Malaysia</td>
<td>4.8</td>
<td>5.6</td>
</tr>
<tr>
<td>Thailand</td>
<td>3.8</td>
<td>4.7</td>
</tr>
<tr>
<td>India</td>
<td>3.8</td>
<td>4.5</td>
</tr>
<tr>
<td>Philippines</td>
<td>4.2</td>
<td>4.4</td>
</tr>
<tr>
<td>China</td>
<td>3.4</td>
<td>4.0</td>
</tr>
<tr>
<td>Indonesia</td>
<td>3.2</td>
<td>3.39</td>
</tr>
<tr>
<td>Vietnam</td>
<td>2.8</td>
<td>3.35</td>
</tr>
</tbody>
</table>

In summary, there has been an explosion of petty business formation in Vietnam, but few large-scale “real” private firms yet emerging that could become internationally competitive. The international view of Vietnam is that it remains only modestly competitive relative to its Asian neighbors, with deterioration or very slow gains in Indonesia and the Philippines explaining most of Vietnam’s “rise.” Indeed, in one key area – the share of software that is pirated – Vietnam is #1 in the world! Overall, Vietnam seems to be part of the lower tier of ASEAN. It is also regarded as quite corrupt, and perhaps slightly more so over the last five years. Even in information and communications technology, where gains have been quite rapid, it is only holding its own. This suggests a huge amount of unfinished business.

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16 In 2004, four European nations were added and Vietnam slipped from 56/60 in 2003 to 60/64 in 2004. However, its relative position had not changed from 2003 to 2004 among the original 60 nations.
17 The decline in Japan’s score is not an error. Low broadband penetration, limited use of e-commerce, and certain legal and policy issues resulted in a lower score. Malaysia, like Thailand, rose sharply.
18 See Appendix I for one more international ranking, not covered in this section.
19 This comes from a story in the July 8th, 2004 Financial Times, p. 6, reporting on a survey with 2003 data.
Unfinished Business

What then needs to be done? The government itself has set out goals for financial and SOE reform. These are generally areas that have lagged in terms of rapid progress. SOE reform is plodding as debts grow rapidly. Bank reform is sluggish. The choice and execution of infrastructure projects has also been criticized, giving too much weight to political rather than to economic considerations. One needs only to read about the proposed $8 billion new airport in Dong Nai, aimed at handling 100 million passengers a year, to see how devoid of realism the investment plans are. (All airports in Vietnam handled 4 million arriving passengers in 2002, up from 2.4 million in 1995.20 Growth rates will perhaps double passengers every six to eight years.) The “asking and giving” culture of project selection might actually have been strengthened in recent years and has little regard for realistic costs or need.

Underlying all three of these slow-reforming areas is a fundamental misunderstanding of what makes a nation rich. A nation gets rich when the savings of its own people, and to some degree of foreigners, are allocated to those who will compete and add value in efficient firms. Alternatively, infrastructure is added in appropriate projects at reasonable costs by a government concerned with its own efficiency and honesty. If capital goes to well connected but inefficient firms or if infrastructure is built as a reward for political and bureaucratic bargaining, the results tend to weaken economic performance over time. This can be seen most clearly in the oil-rich nations that have squandered literally tens of billions of dollars on poor investments and have little to show for it. Vietnam is not in their category, but is drifting closer to it. This drift raises major questions about the sustainability of current growth rates. Simply raising investment levels without directing capital more efficiently will be a strategy ending in failure.

The state enterprise sector is one that accounts for 3.6 to 4.3 million employees (depending on IMF or CIEM sources in 2002/2003) or roughly 10% of the workforce. It accounts for nearly twice as much of total investment21 and has had a declining share of industrial output. The SOE sector has been targeted as one in which many firms should “equitize” or set up on a joint stock basis. Progress in converting firms has been slower than planned in a 2001 “roadmap” but the numbers of firms equitized have been increasing. From 2000 through October 2003, there have been 1277 firms equitized, 134 taken over, 75 sold, 172 merged, 88 unified, and 58 converted into administrative units. Only 72 have been dissolved or put into bankruptcy. Since 1/1/2000 a total of 1927 have been dealt with in some way, with about 1300 since 2001 vs. a target of 1800. The targeted enterprises accounted for 11% of SOE capital and 10% of SOE debt.

In response, a revised roadmap was adopted for 2003-2005 for 2291 firms, of which 1747 were to be equitized, 151 divested and 91 liquidated. These firms had fewer average

21 There are conflicting data on this, but the IMF in 2003 reported that 25% of GDP was accounted for by bank and Development Assistance Fund credit going to SOE’s. SOE’s got 46% of DAF funds and 39% of bank credits in 2002. In current prices they account for 38% of industrial output and 35% of nonoil exports.
employees than the 2001-03 targeted SOE’s (170 vs. 317), 14% of total SOE capital and 3% of SOE debt. It remains to be seen how this revised roadmap is implemented.

To quote a recent IMF report: “There has been no comprehensive financial information on the SOE sector since the SOE Census of 1997, but indicators point to a loosening of budget constraints and continued inefficiencies and debt problems. One-half of SOE’s were reportedly loss-makers or marginally profitable [even with implicit subsidies such as free land]….Based on domestic accounting standards, about 20% of bank debt to SOE’s was estimated to have been non-performing at end-2000.”

A special survey of 200 (out of about 5000) heavily indebted SOE’s show debts doubling from year-end 1999 to March of 2003, suggesting very little effort at fundamental restructuring. (Total bank credit also doubled in that period.) In addition, measures to strengthen governance and accounting in 100 large SOE’s have made slow progress. To again quote the IMF: “The accounting, auditing, and reporting regime for SOE’s remains weak. The financial information available on SOE’s remains unreliable and dated, while financial accounts are generally not available…”

Can it be healthy to have 25% of GDP going to firms where the median firm is not making a profit under international accounting rules? Where many of the firms are profitable only because they have effective monopolies or (fading) protection against even ASEAN competitors? If equitized firms really do perform better, as the CIEM found in a survey of 422 SOE’s in 2002, why is it so hard to move more firms into an equitized state? Of course, there are valuation and debt issues, but many managers lack adequate incentives to equitize. They see danger and discrimination in changing their status and very little upside. This is especially true if the state continues to hold a large position in shares and they have only limited autonomy. Scandals in several SOE’s such as Petrovietnam and VNPT further intensify the reluctance to change one’s status. Overall, the landscape is one where most SOE’s (certainly by capital) will resist change. That means a major share of capital and output will continue to operate at far less than their potential and the overall economy will suffer for it.

While some fraction of SOE’s can be bullied into changing their status, the major ones will remain as “strategic” and unless there is considerable progress in accounting, governance, and management, they will also tend to lag in efficiency. Of course, so long as some part of their operations is a monopoly or implicitly subsidized, they may remain profitable. But having a large part of the economy tied down, either in semi-SOE’s whose shares are mostly owned by the government or “real” SOE’s that are poorly run will act as a drag on economic growth. It will undercut any attempt to allow larger private firms that could compete in world markets to develop. This is understandable as a short-term bureaucratic strategy but suicidal as a longer-run economic or socio-political strategy. If the government were to become associated with underperformance and even corruption, it would lose its legitimacy.

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23 Ibid., p. 44
Closely linked to the SOE issue is that of the state banks and the Development Assistance Fund. The DAF has become a major source of finance for SOE’s. Outside of both banking scrutiny and effective budget control, the quality of its loans are hard to assess since many of the projects are still in a “grace period.” Provincial visits and inquiries by this author give little reason for great optimism about the quality of DAF loans, though the sample is narrow. Its unknown status, but likely vulnerability, suggests that ODA use may not be efficient either. Simply focusing on “utilization” – hastening the pace of spending – without knowing the quality or efficiency of investment is not reassuring.24

Meanwhile, credit growth has been quite rapid. From the end of 1998 to the end of 2002, domestic bank credit has tripled, a compounded rate of over 30% a year. In 2003-2004, the rate has declined but was still over 20% and, as argued previously, now beginning to be linked to higher inflation levels. The state owned commercial banks continue to dominate (70%+ of deposits and credit) the overall banking system, even though they have weak balance sheets and questionable accounting of their non-performing loans. Because reforms have been gradual and credit growth rapid, the costs of recapitalization have risen from 4% of GDP in 2001 to 7% in 2003. Further increases are quite possible since capital to asset ratios have fallen. Regulation and supervision “remain a challenge.”25 Pretty clearly, until the SOE issue is resolved more clearly, it will be very difficult to create healthy state banks. Meanwhile, the clock is ticking given commitments already made in the BTA and likely to be made in even a delayed WTO in terms of financial services. Either a largely unprepared state banking system will have to compete with truly capable foreign banks or past treaties and agreements will be scrapped at considerable cost to Vietnam’s credibility and access to foreign markets.

All of this might be less worrisome if there were improving public investment selection by MPI. If there were a serious likelihood that the infrastructure being built would be used with some intensity and cost a reasonable amount, then perhaps slow financial reform might be acceptable, if regrettable. However, there is no evidence that the “asking and giving” mechanism is producing better investments or that the cost of implementation is even nearly reasonable. The statements that 20% to 30% of public investment costs are excessive have been made in the press. Periodic investigations find officials with impossibly large houses or land holdings. There is a planned $8 billion airport in Dong Nai to handle 100 million passengers a year, when a new terminal costing $300 million will handle 8 million passengers a year (and another could be built nearby for the same cost) at the existing HCMC airport. This gives some idea of the excess. Many other examples could be presented. The point is simply that a great deal of public investment is excessive, too expensive, and poorly implemented. This will become a drain on economic growth and aggravate corruption and land costs as well. The failure to improve public investment is yet another indication that “public administration reform” is not yielding its desired results.

24 To get some idea of the controls exerted by the World Bank, I visited a website giving construction costs in Asia. This Bank website said that upgrading a two lane dirt road to a paved road (of a standard width and quality) would cost from $70,000 to $700,000 a kilometer! Vietnam cannot rely on others to control costs.
25 IMF, Ibid., p. 52
Any discussion of external debt must start with the reality that the usual ratios are quite healthy. In 2002 for example, the debt-service to export ratio was only 11.5%, well below any level that would cause concern. Partly, this low level comes from writing off or reducing a huge amount of Soviet debt. It also follows from the large amount of low-interest ODA that has thus far comprised most capital flows. If Vietnam begins to tap commercial debt in large amounts, obviously the composition of debt will change and the amount of required annual payments relative to debt will rise. However, so long as oil provides billions in foreign exchange, remittances match this, and soft ODA continues, it is not likely that there will be any medium-term problems with external debt repayments. The other major positive element thus far has been the rapid growth in exports, which have averaged over 15% a year in US$ for the 1999-2003 period. In the most recent years, the Bilateral Trade Agreement accounted for most of the gains and those seem to be gradually diminishing. While the future export growth rate might slow down, if it can stay above 12%, it would take aggressive and high-cost borrowing to bring the debt-service ratio to a worrisome level any time soon.

The question of IF Vietnam should borrow by issuing a sovereign bond is complicated to answer. There does not appear to be any shortage of foreign exchange. Credit growth should slow down unless or until banks can do a better job of allocating credit. Many public investment projects should not be undertaken at all. Alternatively, more appropriate ones could be executed if costs were more realistic. In that environment, it is hard to see how additional resources would be well used. The opposite side (and not just self-interested investment banks) argues that it is helpful to have a benchmark bond rate for other issues, to diversify sources of finance, and to be able to respond quickly to emerging opportunities. It is also true that when ODA is tied to a particular national provider or burdened by complex requirements, using one’s own money (even at higher interest rates) might be cheaper. On balance, a small sovereign debt issue might be worthwhile, but it is difficult to make the argument for extensive commercial borrowing at the current time. A shortage of institutional efficiency rather than funds is the real issue.

Conclusions

Vietnam has done well but still lags in important respects. GDP growth has been good, though high investment levels are needed to sustain this growth. Export growth has been strong, but the lift from the BTA is diminishing and the late WTO entry is likely to slow future growth. FDI is probably modest in net terms, even when reinvestments from existing projects are included. Key reforms in public investment, state enterprises, and the financial sector are making only modest headway. Corruption is said to be worsening by outside observers and surveys, and land prices (probably linked to corruption) are wildly expensive in and around Hanoi.

In poverty and social terms, the quantitative data show distinct improvements, but qualitative considerations suggest that these gains may be less impressive than they first appear. The data themselves may be distorted. For example, did the poverty rate really
almost fall in half from early 2001 to 2003?\textsuperscript{26} Every province reported a reduction in poverty of at least 30% in three years – an unlikely result – and only three provinces reported more than a 20% poverty rate. Unfortunately, when progress is expected, progress is reported. Improving the integrity of data will help realistic assessments and improve the quality of planning and policy making. But perhaps the main decision to be made is whether or not to maximize short-term political stability and be satisfied with some economic growth or to choose fast economic growth and long-term stability.

\textsuperscript{26} Statistics on Hunger Eradication and Poverty Reduction, Labour and Social Affairs Publishing House, 2004, pp. 42-43. The national poverty rate falls from 17.2% to 9.5%, a decline of 45%. 
Appendix I: One More International Ranking

A conservative but influential US think-tank, the Heritage Foundation, creates an international ranking of its self-described “Index of Economic Freedom.” This index ranks economic freedom from 1 (best) to 5 (worst) by reviewing the fields of trade policy, fiscal burden, government intervention, monetary policy, foreign investment, banking and finance, wages and prices, property rights, regulation and informal markets. While they use the phrase “economic freedom”, it can also be viewed as a kind of rating of economic policy and conditions. For the ten Asian nations ranked in other tables, the 1998 and 2004 results are as follows: (A negative change means deterioration in economic freedom. There were 155 nations ranked altogether. North Korea was worst.)

<table>
<thead>
<tr>
<th></th>
<th>1998</th>
<th>2004</th>
<th>Change</th>
<th>2004 Global Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taiwan</td>
<td>2.24</td>
<td>2.43</td>
<td>-.19</td>
<td>34</td>
</tr>
<tr>
<td>Japan</td>
<td>2.16</td>
<td>2.53</td>
<td>-.37</td>
<td>38</td>
</tr>
<tr>
<td>South Korea</td>
<td>NA</td>
<td>2.69</td>
<td>NA</td>
<td>46</td>
</tr>
<tr>
<td>Thailand</td>
<td>2.56</td>
<td>2.86</td>
<td>-.30</td>
<td>60</td>
</tr>
<tr>
<td>Philippines</td>
<td>2.84</td>
<td>3.05</td>
<td>-.21</td>
<td>74</td>
</tr>
<tr>
<td>Malaysia</td>
<td>2.64</td>
<td>3.16</td>
<td>-.52</td>
<td>87</td>
</tr>
<tr>
<td>India</td>
<td>3.83</td>
<td>3.53</td>
<td>+.30</td>
<td>121</td>
</tr>
<tr>
<td>China</td>
<td>3.69</td>
<td>3.64</td>
<td>+.05</td>
<td>128</td>
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<tr>
<td>Indonesia</td>
<td>3.00</td>
<td>3.76</td>
<td>-.76</td>
<td>136</td>
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<tr>
<td>Vietnam</td>
<td>4.33</td>
<td>3.93</td>
<td>+.40</td>
<td>141</td>
</tr>
</tbody>
</table>

Several points about these rankings: While the Heritage Foundation is decidedly in favor of property rights, its analysis is not “political” in the sense that technicians have a standard methodology that is applied consistently to all countries. They claim, though I have not reviewed their studies, that higher ranked nations (in terms of economic freedom) tend to grow faster – though China, India and Vietnam are among the lowest ranked nations and among the fastest growing. On the other hand, the only three nations that have had improving scores since 1998 are the fastest growing, while the one with the largest decline (Indonesia) has been among the worst growth performers. Finally, notice that Vietnam has improved the most of any of these ten nations, but it is still among the lowest ranking Asian nation. (A few others, like Bangladesh and Myanmar are lower.)

Whatever one’s opinion about the importance of each type of activity ranked, this index tends to support the findings of the other ones – Vietnam ranks modestly compared to several other major Asian economies but has improved relative to its past, while many others have not or not improved as much. However, it still has a long way to go.

To review their details, go to [http://cf.heritage.org/research/features/index/countries.html](http://cf.heritage.org/research/features/index/countries.html) or simply put “2004 Index of Economic Freedom” into Yahoo or Google.