As Communist-ruled Vietnam revels in rapid growth, rising prosperity and a surge in international favour, a Hanoi museum exhibition is drawing crowds to a remembrance of past rice rationing and material privation. “Hanoi Life under the Subsidy Economy” portrays the hardships of urban existence between 1975 and 1986, when Hanoi was still in thrall to Soviet-style central planning and state economic control.

The humble artefacts – old ration books and food coupons, a sweater knitted from scraps, a cherished Soviet-made pressure cooker and even a rock used to hold a man’s place in a rice queue – evoke the struggle to meet basic needs. In videos, ordinary Vietnamese recollect the joy of obtaining rice untainted by mould, the power of Provisions Department officials, covert manual labour to supplement salaries and the longing for a simple fan to combat Hanoi’s summer heat.

Nguyen Van Huy, director of Vietnam’s Ethnology Museum, says he wanted to convey the indignities of the pre-reform period to young Vietnamese – a mobile phone and motor scooter generation coming of age in an economy growing about 8 per cent a year that is pulling in big foreign investors such as Intel, Nike, Ikea and Canon.

“The young have so much more comfort today – they don’t know what a hard time their parents had,” Mr Huy says. “But if they come here, they feel their parents’ experiences. Then they respect the past – and they respect what they have now.”

But while food rationing, collective agriculture and other hardships created by the Marxist economy and the brutal war with the US have been literally relegated to museum pieces, Vietnam’s rulers have not renounced all aspects of their orthodox communist ideology.

Even as it joins the World Trade Organisation on Thursday, completing a three decade-long journey to
full integration with the global economic mainstream, Hanoi is formally committed to what it calls a “socialist-oriented market economy”. What that translates into is preserving a leading role for state-owned enterprises – a goal that could augur frustration for foreign companies clamouring to provide everything from banking services to hypermarkets to telecommunications for Vietnam’s youthful, increasingly affluent market of 83m people.

Economists warn that Hanoi’s determination to preserve state dominance in key industries may be a drag on its quest for prosperity, generate a strong protectionist impulse and stifle the fledgling domestic private sector, which is already confronted by difficulties in accessing land and credit and a deep official suspicion of private capitalists. But Hanoi’s leaders are undeterred.

“Their model is that the state controls the commanding heights of the economy – and that you can have mom-and-pop capitalism that can generate exports and jobs but it shouldn’t detract from the leadership role of the state in industry,” says Jonathan Pincus, a senior economist at the United Nations in Hanoi. “I don’t think it’s a model that will take them all the way to being a middle-income country. Either they will slow down or the model will have to change.”

Vietnam’s current dynamism and potential are indisputable. Its economy is being propelled partly by surging exports to the US, after a trade deal with Washington dramatically lowered US tariffs on Vietnamese imports. That bilateral deal, reached in 2000 after prolonged negotiations, allowed companies such as Nike, Victoria’s Secret and Disney to capitalise on Vietnam’s most attractive resource: its abundant supply of diligent, motivated young workers.

American figures show US-Vietnam trade reached $8.1bn (£4.2bn, €6.2bn) in 2006, out of which $7.2bn represented Vietnamese exports to the US. That compares with two-way trade worth just $1.1bn in 2000, of which Vietnam’s exports to the US were less than $400m. The export spurt – and the jobs it has generated – is fuelling a consumer boom. Vietnamese are buying television sets, computers and cameras, going on shopping trips to nearby Bangkok and on beach holidays. This consumer revolution is expected to power on as affluence spreads and deepens.

Yet Vietnam is still burdened by the legacies of its old centrally planned, state-controlled economic system. Its vast, sclerotic bureaucracy has ample discretionary power, yet is often reluctant to take big decisions. The media are restricted. Universities are moribund. The judicial system is opaque and subject to political interference. Corruption is rampant. Even after two decades of reform, the economy remains dominated by large and inefficient state enterprises, which account for 38 per cent of gross domestic product, exert strong anti-competitive pressure and squander scarce state resources.

WTO accession is supposed to help Hanoi wrestle with these problems, committing it to a long-term programme of reform, liberalisation and privatisation that will modernise its economy and government, while creating a level playing field for foreign companies. But
the multinational investors flocking to do business in Vietnam may find the path to profit long and littered with unexpected obstacles, as vested interests use bureaucratic and political tools to defend their turf and resist change.

“Everyone sees that foreign direct investment is good, bringing capital and management skills,” says Vo Tri Thanh, a trade policy expert at Hanoi’s Central Institute for Economic Management (CIEM), a government think-tank. “But some sectors may be more politically sensitive. So it is difficult. Our labour-intensive industries can benefit from integration and can exploit our comparative advantage. But capital-intensive heavy industries – like sugar, cement or paper – can lose their position.”

In spite of their WTO commitments, Hanoi’s communists are still divided over the extent to which state enterprises should be subjected to the pressures of market competition – let alone be relinquished. While giving up control of smaller businesses, the government is simultaneously pumping vast sums of money into some state enterprises, hoping to create national champions similar to the South Korean chaebol. Sectors targeted include insurance, minerals, oil, shipping, telecoms and electricity. Hanoi has set up a state holding company – ostensibly along the lines of Singapore’s Temasek – to manage its investments and maximise returns.

In its pursuit of state-led development, Vietnam is following the path blazed by its powerful neighbour, China, whose economy been transformed into what some call “capitalism by central committee”, in which the authorities carefully modulate market forces and direct growth. Many other east Asian countries have also achieved sustained growth and improved living standards for their people through an ad hoc mix of market reforms, statist policies and protectionism, often flouting the so-called “Washington consensus”, which pushes more aggressive privatisation and liberalisation.

Yet economists fret that Hanoi may simply be unable to transform bloated, inefficient and often deeply corrupt state businesses – which have never operated from a profit motive – into truly competitive companies. Instead, the risk is that they will suck up valuable capital that could be used more productively by others. State-owned banks, which account for about 70 per cent of banking system assets, are already burdened with high levels of bad debt from poorly performing companies.

“These state enterprises are not transparent and are not necessarily disciplined to produce profits,” Mr Pincus says. “South Korea said to the chaebol, ‘we will give you credit and preferential access to the domestic market, but you have to prove you are internationally competitive and win in the export market’. But what is the stick they are going to use to beat big state enterprises in Vietnam? Are they going to cut them off if they don’t make profits? Are they going to cut off their credit? Where is the discipline of the market going to come from?”

HSBC economists recently observed that Vietnam was already suffering from declining capital efficiency, the consequence of a poorly managed state investment drive in recent years. While the state’s share of fixed investment has risen to 52 per cent – up from 43
per cent – during the past decade, its share of economic output has fallen slightly, reflecting an inefficient use and allocation of capital.

**Corruption is one reason for the poor performance.** The government’s own CIEM last year estimated that 20 to 40 per cent of all state investment is lost in “leakage and waste”.

Le Dang Doanh, a senior economist and adviser to the Ministry of Planning and Investment, says the Communist authorities recognise the need to force state enterprises dramatically to raise their game, lest they become a serious drag on growth and erode Vietnam’s competitiveness. “It is the biggest challenge – and the government wants to push ahead,” he says. “The problem is, how can they overcome the vested interests?”

It is not just heavy industries that have established privileged positions. In recent years, state enterprises – and entities including urban and provincial administrations, the military and government ministries – have expanded into service industries such as telecoms, retail, hotels, resorts and property development. Many of these operations have murky ownership structures, with some private individuals participating. But nearly all have **politically powerful patrons** who may try to protect them as competition intensifies.

Even Vietnam’s appeal for labour-intensive, export-oriented industries is threatened by old mindsets. With WTO accession, local garment companies are likely to ramp up production, as are makers of furniture, shoes, computer printers and other manufactured exports. Intel’s plan to build a $1bn semiconductor assembly and testing plant in Ho Chi Minh City, the former Saigon, could presage more high-technology investments in the future.

**Severe infrastructure bottlenecks loom**, however, as facilities strain under existing demand. Electricity of Vietnam, the power monopoly, estimates a 1,700 mega-watt shortfall next year. Ports around Ho Chi Minh City, the country’s export hub, are already full and new ones are not due to open for three years at the earliest.

While Hanoi has ambitious infrastructural development plans, with a growing role for the private sector, progress is slow. As causing economic losses to the state is a serious crime – potentially punishable by death – bureaucrats and state company executives are loath to sign off on big deals lest they later be accused of agreeing to unfavourable terms.

“If you make the wrong decision you can be up against the wall, so no one makes any decisions and it just goes up the chain,” says Tony Foster, a Hanoi-based partner for Freshfields Bruckhaus Deringer, the law firm, and a veteran of many negotiations on infrastructure projects. “It’s a consensus system and consensus is not just horizontal – it’s vertical. All decisions end up going upwards because people say, ‘I can’t make that decision – I’ve got to ask the boss’.”

Infrastructure planning is also hindered by non-commercial factors, such as Hanoi’s desire to disperse investment equally around the country and incumbents’ worries that foreign entrants into the market will show up their own massive inefficiencies. “The
protectionist element is reasonably strong, but nationalism is sometimes a pretext to cover corruption,” says Mr Foster. “Some of the incumbents have lucrative patches, which they are loath to give up.”

Privatisation – or what Vietnam calls equitisation – is the prescribed remedy for both the protectionist impulse and modernising decrepit enterprises. Yet over the past decade, just 12 per cent of total state enterprise capital – mostly in small companies – has been turned into shares and just half of that has passed into private hands, mostly to managers and employees of the enterprises. The process is slowed by hesitant decision-making, an insufficient technical capacity to value large state businesses and continuing ideological resistance.

“Some people still say, ‘if you lose the key factors of production, how can you keep your socialist orientation?’” says the CIEM’s Mr Thanh. “There is consensus on the need for state enterprise reform, but [people see] the way and the target differently. It’s not easy to change the way of thinking overnight.”

Vietnam is, however, in the throes of an equity market revolution that is changing attitudes. Share values on the young stock exchange rocketed 144 per cent last year – making it one of the world’s best performing equity markets – after Merrill Lynch issued a bullish report calling Vietnam a “10-year buy”. While big investment banks rushed to assist foreign clients eager for exposure to one of Asia’s fastest-growing economies, the report also spurred heavy local buying.

The market dramatically expanded in size as local companies – mainly small former state enterprises previously reluctant to be subjected to too much outside scrutiny – rushed to list before Hanoi abolished tax breaks for newly listed groups at the end of 2006. Market capitalisation of the Ho Chi Minh City stock exchange hit $9bn at the end of 2006, up from just $510m a year earlier, while the number of listed companies increased to 106 from about 30. December alone saw 49 new listings and a peak daily turnover of $50m.

But the quoted companies are richly valued, with a weighted average price/earnings ratio of 32 times 2006 earnings. FPT, the information technology group that has become the market’s largest stock, has been trading on a p/e as high as 68.

Vietnam-dedicated investment funds are flush with cash to buy stakes in larger, more lucrative state enterprises that are due for partial privatisation in the coming years. Nyugen Tan Dung, the prime minister, recently gave in-principle approval to the public sale of shares in dozens of the bigger state enterprises by 2010.

But with precise plans yet to be drawn up, it is unclear whether Hanoi will sell just small minority stakes or allow in foreign strategic partners that can overhaul operations. The authorities are still debating whether to let an international bank buy into Vietcombank, the first big state bank slated for “equitisation”.
Even after share sell-offs, Hanoi may still treat these companies as state property, protecting them from rivals yet meddling in their operations. “The headline is, ‘They are opening up the state sector’,,” says Fred Burke, a partner with Baker & McKenzie in Ho Chi Minh City. “The fine print is, ‘Better watch out. The devil is in the detail’.”

Ultimately, though, the government’s strongest protectionist impulse is to safeguard its monopoly on political power, which means it is determined to keep the economy humming and deliver jobs and rising living standards. That overriding goal will eventually lead the Communist party to embrace whatever it believes will deliver the best economic results.

“The key is whether Vietnam seriously sees the commitment to openness as good for Vietnam or bad,” says Mr Thanh. “For Asian people, the theory is not important. They will come back and see reality. If things go well, they will support bolder measures. But foreign investors will need to have patience.” The risk is that it may take another hard lesson before Hanoi’s Communists truly give up on the last of their Leninist economic ideals.

ROUTE TO A WORLD ROLE

1975 North Vietnamese forces capture Saigon, capital of US-backed South Vietnam, unifying the country under Communist rule. Washington extends an embargo to all of Vietnam and severs diplomatic relations

1988 Vietnam begins to co-operate with the US to resolve the fate of US servicemen still listed as missing in action

1993 The Clinton administration clears the way for the resumption of IMF and World Bank lending to Vietnam

1994 Washington lifts the trade embargo

1995 Vietnam submits a formal written request for accession to the World Trade Organisation

1995 The US opens its first embassy in Hanoi, as does Vietnam in Washington

1996 The US presents Vietnam with a blueprint on a bilateral trade agreement

2000 Vu Khoan, Vietnam’s trade minister, and Charlene Barshefsky, US trade representative, sign the accord in July

2000 Bill Clinton in November becomes the first US president to visit Vietnam since the end of the war

2001 The US-Vietnam trade deal finally comes into force
2006 Washington and Hanoi agree in May on WTO accession. The US Congress later backs permanent normal trade relations.

2006 November brings approval by WTO members of accession terms and ratification by Vietnam’s national assembly in a vote of 444-3. Hanoi meanwhile successfully hosts the Asia-Pacific Economic Co-operation summit.

2007 Vietnam is to join the WTO on January 11, becoming its 150th member.

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