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Vietnam as a Role Model for Development

John Thoburn*

May 2009

Abstract

Vietnam’s development performance since the early 1990s has been one of the strongest in the world, following the introduction of its *doi moi* (‘renovation’) economic reform programme in 1986. The core of Vietnam’s economic strategy has been rapid integration into the world economy, with a diversified portfolio of exports and the attraction of direct foreign investment. This open approach has been combined with successful domestic agricultural growth and a strong, continued role for state-owned enterprises while encouraging growth of the private sector. Following an ‘East Asian’ model, Vietnam has opened its domestic market only slowly while encouraging export growth.

Keywords: Vietnam, globalization, trade, poverty, economic reform, development

JEL classifications: F14, F16, I32, O53
Acknowledgements

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Acronyms

AFTA ASEAN Free Trade Area
ASEAN Association of South East Asian Nations
CAFTA China-ASEAN Free Trade Area
CIEM Central Institute for Economic Management, Hanoi
CPRGS Comprehensive Poverty Reduction and Growth Strategy, Vietnam
DFI direct foreign investment
ERP effective rate of protection
GSO General Statistics Office, Vietnam
GSP Generalized System of Preferences
MFA/ATC Multi-fibre Arrangement/Agreement on Textiles and Clothing
MOFA Ministry of Foreign Affairs, Tokyo
NEER nominal effective exchange rate
ODA overseas development assistance
REER real effective exchange rate
SOEs state-owned enterprises
USBTA US Bilateral Trade Agreement
VDR Vietnam Development Report
VND Vietnam dong
VHLSS Survey on Household Living Standards, Vietnam
VNSY Vietnam Statistical Yearbook
WDI World Development Indicators, World Bank
WDR World Development Report, World Bank

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1 Introduction

Vietnam’s development performance since the early 1990s has been one of the strongest in the world. Over the period 1990 to 2000 its annual rate of GDP growth of 7.9 per cent was exceeded only by China’s 10.6 per cent (World Bank 2007). Vietnam’s relative performance has remained strong in the 2000s compared to other Asian countries (Table 1).

In poverty reduction too, Vietnam’s performance appears to have been outstanding. Between 1992/3 and 1997/8, the proportion of the poor in the population fell from 58 per cent to 37 per cent. By 2004 poverty was down to around 20 per cent (VDR 2006: i). In terms of the internationally recognized poverty line of one dollar a day in purchasing power parity terms, the decline in poverty in Vietnam is also great, falling to under 10 per cent in 2004 (VDR 2007: 19).

This stellar performance follows the introduction of its doi moi (‘renovation’) economic reform programme in 1986. As a country starting the transition in the 1980s from a (partially) centrally planned to a market economy, Vietnam needed more extensive reforms than a ‘typical’ developing country at that time, which would have been moving from policies of import-substituting industrialization to a more open and market-based stance. Vietnam’s policies parallel those of China, whose economic reforms after 1978, with their quick successes, would have been familiar to Vietnam’s leadership. Vietnam, though, came to economic reform at a time of much greater economic difficulty than China, after several decades of war and having caused an economic crisis in its attempts to implement a thoroughgoing system of central planning in the late 1970s. Like China, and unlike the former Soviet Union, Vietnam preserved its strong structure of state institutions into the reform process.

By the early 1990s Vietnam’s doi moi policies had brought its economy close enough to the structure of other developing countries for its policies to offer lessons for development. By then, Vietnam had stabilized its economy, de-collectivized its agriculture, brought plan prices towards market prices, and moved towards a more market-based system of foreign trade, albeit with high protection against imports. It had also started to harden the budget constraints of its large sector of state-owned enterprises. The early combination of its stabilization programme alongside its other doi moi reforms is instructive.

1 Because of space limitations, this paper could usefully be read alongside Thoburn (2007a), which gives a more detailed economic overview of Vietnamese development.

2 The comparator countries in Table 1 are all countries which export manufactures and have quite large populations.

3 This uses the definition of headcount poverty of the General Statistics Office of Vietnam, based on the cost of a basic daily calorific intake of 2100 plus various basic non-food items (Thoburn et al. 2007), but the reduction in poverty is not sensitive to which of a number of alternative poverty lines is used (Litchfield and Justino 2004; VDR 2004: 9, 17).

4 A convenient and well-informed source on China is Wu (2005), especially the overview in ch.2.

5 See the discussion in Van Arkadie and Mallon (2003: 76)

6 Nevertheless, within the WTO Vietnam continues to be regarded as a non-market economy (VDR 2007: 53).
The core of Vietnam’s economic strategy since the early 1990s has been a rapid integration into the world economy: the development of a diversified portfolio of oil, manufactured and agricultural exports (Table 2), and the attraction of direct foreign investment. This open approach has been combined with successful domestic agricultural growth and a continued role for state-owned enterprises (SOEs) while encouraging growth of the private sector. Gross capital formation, largely from domestic sources despite substantial inflows of direct foreign investment, rose from just over a quarter of GDP in the mid-1990s to over a third of GDP in the early 2000s.7

Section 2 now looks at the genesis of the doi moi programme and at initial conditions. Sections 3, 4 and 5 discuss the key features of Vietnam’s development strategy—integration with the global economy, agricultural reform, and the use of state-owned enterprises in its industrial development strategy—and the reasons for its success. Section 6 looks at the future tasks for Vietnam, and section 7 draws lessons from the country’s development experience.

## 2 Initial conditions, the beginning of doi moi, and the early reforms8

Following the defeat of the French colonial power in 1954 after a nine-year war of independence, North Vietnam had a brief period of stability before the intensification of hostilities with South Vietnam and the entry of the Americans into the war in the early 1960s.9 It was during the late 1950s that agriculture in the north was collectivized, and

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8 Accounts of the early reforms in this paper draw heavily on Van Arkadie and Mallon (2003, especially chs 4-8).

9 For a thumbnail sketch of Vietnam’s political history, see Thoburn (2007a: 224-6).
most medium and large enterprises left over from the French time were nationalized to form the basis of a large sector of SOEs. After the formal reunification of the country in 1976, the North Vietnamese moved their economic planning system from a war footing and attempted to incorporate the south. Van Arkadie and Mallon (2003: ch. 4) record that the Vietnamese attempted in the late 1970s to establish a fully fledged Soviet-style planning system, with an emphasis on heavy industry, although in practice there remained considerable local autonomy, a legacy of the war economy. In the defeated south of the country, private enterprises were nationalized, and attempts were made to introduce collective agriculture through cooperatives, although the collectivization met with much passive resistance.

Although the war had caused damage to the economy, especially in the north, there were some positive legacies of the pre-reform period. Van Arkadie and Mallon (2003: 51-3) argue there were three main areas where later developments built on earlier ones. First, there was Vietnam’s long record of investment in human capital, both in education and in health provision. In 1990, the adult literacy rate for men in Vietnam was already 94 per cent, and 87 per cent for women (VHLSS 2002: 43). Beyond this, Vietnam had invested substantially in higher education, and there was a cohort of officials well trained, for example, in agricultural techniques and engineering—generating what Van Arkadie (2005: 125) has called a ‘receptivity to technical change’. Second, the collectivization of land in the north had provided more equal peasant holdings than in many developing countries, on the basis of which the doi moi de-collectivization provided incentives to increase output. Third, despite the war, there was a legacy of infrastructure in the north developed with Soviet help, such as electric power, and in the south by the Americans.

*Doi moi* was preceded by a number of partial reforms dating back to the late 1970s as the failures of the attempt at central planning became increasingly evident. In response to low, and then negative, economic growth by the end of the 1970s, various constraints were relaxed, in some case allowing what was happening anyway on private initiative (McCarty and Steley 2004: 4). These reforms included giving local state-owned enterprises some rights to operate outside the plan and keep most of their profits from doing so. In 1981 a contract system was introduced for agriculture, replacing contracts with collectives by contracts with households, and prices were brought closer to market prices. In 1982 the Fifth Party Congress approved moves away from heavy industry towards more stress on light industry, agriculture and exports. Nevertheless, these early measures were accompanied by uncertainty about what private activity was legal and crackdowns by the authorities on ‘economic anarchy’.

The *doi moi* reform programme was inaugurated at the Sixth Party Congress in December 1986 at a time of continuing economic crisis. Inflation was over 700 per cent per year, exports were only half the value of imports and there were severe shortages of food and consumer goods. Western aid and Chinese aid had not been available since the invasion of Cambodia and the war with China at the end of the 1970s, and the country was suffering from an American trade embargo, which lasted until 1993. The multilateral donor agencies did not enter Vietnam until 1993, although a few bilateral donors like Sweden came to Vietnam earlier (Van Arkadie and Mallon 2003: 95). The reforms formally moved the economy towards a new path incorporating agricultural development, light industrialization, and increased openness to trade and foreign investment—still the basis of Vietnam’s development strategy.
### Table 2

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Crude oil</td>
<td>1,232</td>
<td>13.2</td>
<td>3,821</td>
<td>19.0</td>
<td>7,373</td>
<td>22.7</td>
<td>6.0</td>
</tr>
<tr>
<td>Textiles and garments</td>
<td>1,450</td>
<td>15.5</td>
<td>3,609</td>
<td>17.9</td>
<td>4,838</td>
<td>14.9</td>
<td>3.3</td>
</tr>
<tr>
<td>Footwear</td>
<td>1,032</td>
<td>11.0</td>
<td>2,261</td>
<td>11.2</td>
<td>3,040</td>
<td>9.4</td>
<td>2.9</td>
</tr>
<tr>
<td>Marine products</td>
<td>858</td>
<td>9.2</td>
<td>2,200</td>
<td>10.9</td>
<td>2,739</td>
<td>8.4</td>
<td>3.2</td>
</tr>
<tr>
<td>Electronic products</td>
<td>0.0</td>
<td>0.0</td>
<td>855</td>
<td>4.2</td>
<td>1,427</td>
<td>4.4</td>
<td></td>
</tr>
<tr>
<td>Rice</td>
<td>1,024</td>
<td>10.9</td>
<td>720</td>
<td>3.6</td>
<td>1,047</td>
<td>3.2</td>
<td>1.0</td>
</tr>
<tr>
<td>Rubber</td>
<td>127</td>
<td>1.4</td>
<td>378</td>
<td>1.9</td>
<td>804</td>
<td>2.5</td>
<td>6.3</td>
</tr>
<tr>
<td>Coffee</td>
<td>594</td>
<td>6.3</td>
<td>505</td>
<td>2.5</td>
<td>735</td>
<td>2.3</td>
<td>1.2</td>
</tr>
<tr>
<td>Coal</td>
<td>102</td>
<td>1.1</td>
<td>188</td>
<td>0.9</td>
<td>669</td>
<td>2.1</td>
<td>6.6</td>
</tr>
<tr>
<td>Handicrafts</td>
<td>111</td>
<td>1.2</td>
<td>397</td>
<td>2.0</td>
<td>569</td>
<td>1.8</td>
<td>5.1</td>
</tr>
<tr>
<td>Cashew nuts</td>
<td>117</td>
<td>1.2</td>
<td>277</td>
<td>1.4</td>
<td>502</td>
<td>1.5</td>
<td>4.3</td>
</tr>
<tr>
<td>Fruit and Vegetables</td>
<td>53</td>
<td>0.6</td>
<td>151</td>
<td>0.7</td>
<td>235</td>
<td>0.7</td>
<td>4.4</td>
</tr>
<tr>
<td>Black pepper</td>
<td>64</td>
<td>0.7</td>
<td>105</td>
<td>0.5</td>
<td>150</td>
<td>0.5</td>
<td>2.3</td>
</tr>
<tr>
<td>Other merchandise exports</td>
<td>2,601</td>
<td>27.8</td>
<td>4,682</td>
<td>23.2</td>
<td>8,314</td>
<td>25.6</td>
<td>3.2</td>
</tr>
<tr>
<td>Total all merchandise exports</td>
<td>9,365</td>
<td>100.0</td>
<td>20,149</td>
<td>100.0</td>
<td>32,442</td>
<td>100.0</td>
<td>3.5</td>
</tr>
</tbody>
</table>

Source: VDR (2005: appendix Table 3.2) for 1998 and 2003, and VDR (2007: Appendix Table 3.2) for preliminary 2005.

### Table 3
Export destinations, Vietnam, 2005 and 1995
(percentages of total merchandise exports)

<table>
<thead>
<tr>
<th></th>
<th>USA</th>
<th>ASEAN</th>
<th>EU</th>
<th>Japan</th>
<th>China</th>
<th>Australia</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>18.3</td>
<td>17.7</td>
<td>17.0</td>
<td>13.4</td>
<td>9.9</td>
<td>8.4</td>
<td>15.3</td>
</tr>
<tr>
<td>1995</td>
<td>3.1</td>
<td>18.3</td>
<td>12.2</td>
<td>26.8</td>
<td>6.6</td>
<td>1</td>
<td>32</td>
</tr>
</tbody>
</table>

Source: GSO online statistical database.

Price reform, replacing plan prices with market prices, was quickly accomplished in the early days of doi moi, and by 1987 most non-essential consumer good prices had moved towards market prices. Important aspects of trade reform also took place in the late 1980s. The central government’s monopoly on foreign trade was abolished and in 1988 tariffs were introduced to substitute for quantitative restrictions on imports. Once tariffs are used instead of direct controls, domestic prices start to move in line with world prices, and the exchange rate then becomes significant in affecting economic decisions (Thoburn and Howell 1999). The Vietnamese dong was substantially devalued in 1987 towards the level of the parallel, free market rate. De facto trade liberalization was occurring through unofficial imports, and these provided an additional source of supply to dampen inflation. Like China, Vietnam quickly moved to attracting foreign investment, with a foreign investment law passed in 1988. Implemented inward direct investment had reached US$1 billion a year by 1993 (VNSY 2004).

Economic stabilization and the early doi moi reforms were closely linked. In 1988/9 a severely restrictive monetary policy was introduced, which rapidly reduced inflation to single digits, although it re-emerged briefly in the early 1990s as a result of fiscal deficits. Stabilization was greatly helped by the increases in agricultural production following de-collectivization, when land was leased to peasants by cooperatives or communes. Private land use rights were recognized by the state in 1987 and in 1988...
(under ‘Resolution 10’ of the Party) peasants were allowed to sell produce on the open market and no longer had to belong to cooperatives. The facilitating of private trade and the freeing of some constraints on SOE production outside the plan also strengthened the supply responses that damped inflation.

The trade shock of the late 1980s and early 1990s, when Vietnam’s major export markets (e.g., for textiles and clothing) in Eastern Europe and the then Soviet Union collapsed, was an impetus to export development to other destinations. Luckily, this was also a time when oil exports were starting, developed by Vietnam’s first influx of foreign investors, thus cushioning Vietnam against otherwise declining export earnings and the loss of Soviet aid. ‘Dutch disease’ effects of oil exports on the real exchange rates were avoided, as a result Vietnam’s heavy import needs. In the 1990s Vietnam had the highest annual export growth rate in the world, nearly 28 per cent, albeit from a low base (Thoburn 2004: 129).

3 Integration into the global economy

3.1 Trade agreements

Prior to joining the World Trade Organization at the start of 2007, bilateral trade agreements were an important driver of Vietnam’s export growth. The country’s initial export development focused on the European and Japanese markets. As a non-WTO member, it secured access to the European Union under a bilateral trade agreement in 1992, and was also given GSP (generalized system of preferences) access to the EU. Punitive tariffs on exports to the US were removed under the US Bilateral Trade Agreement (USBTA) signed in 2000, which gave Vietnam ‘normal trade relations’ status, after which there was a rapid change in export destinations in favour of the US (Table 3).

Vietnam’s trade development has also been influenced by the growth in the regional trade arrangements that have become so strong a feature of the international economy in the 2000s (Siddique 2007). Vietnam’s most important agreement is AFTA, the Association of South East Asian Nations (ASEAN) Free Trade Area. AFTA helps link Vietnam to the markets of the rapidly growing Asian region. The ASEAN countries collectively are Vietnam’s second main export destination after the US, although as Table 3 shows, their importance has declined slightly since 1995 even as mutual tariff cuts were implemented. Vietnam is now also part of CAFTA, the China-ASEAN Free Trade Agreement, which has been in existence since 2004. China has been increasing as an export market for Vietnam—again linking Vietnam to the dynamism of the Asian region.

3.2 Trade reform

Trade reform does not always take the form of simple import liberalization, moving towards a free trade regime (Jenkins and Thoburn 2003). Many East Asian countries have developed their exports while protecting their domestic market from imports (Chang 2002), and Vietnam has done the same during its rapid export expansion (Gainsborough 2004: 43). As Table 4 shows, import protection did fall between 1997 and 2003, but
effective protection (that is, protection on value added) in manufacturing remained high.\textsuperscript{10} Vietnam put in place, though, export processing zones and duty drawbacks on imported inputs so as to reduce the disincentive effects of tariffs on inputs used by exporters. In the 2000s it has been reducing import protection under the USBTA, AFTA, and CAFTA, and also under its WTO accession agreement.

It is often contended in the donor literature that import liberalization is necessary in order to drive export growth, because of the anti-export bias that import protection creates.\textsuperscript{11} This does not seem to have been the case in Vietnam. A World Bank study found that protection in Vietnam had caused the real exchange rate to appreciate by only about 3 per cent (VDR 2002: 94). And despite high measured anti-export bias in key export industries such as garments and footwear (Athukorala 2006: 186), export growth has been very rapid.\textsuperscript{12}

### Table 4

<table>
<thead>
<tr>
<th>Weighed averages</th>
<th>1997</th>
<th>2001</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nominal tariff</td>
<td>ERP</td>
<td>Nominal tariff</td>
<td>ERP</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>30.63</td>
<td>121.47</td>
<td>25.28</td>
</tr>
<tr>
<td>All tradables</td>
<td>20.95</td>
<td>72.22</td>
<td>19.92</td>
</tr>
</tbody>
</table>


### Figure 1
Nominal and real effective exchange rates, Vietnam

Notes: A fall in an index is a depreciation. 2007 is January-June only; indices for 1991-1994 are not available from publicly available sources.

Source: IMF

\textsuperscript{10} Athukorala (2006: 175) records that Vietnam’s average ERPs in manufacturing were higher than those of Thailand, Malaysia, Indonesia and the Philippines in various comparable years.

\textsuperscript{11} For discussion and references on anti-export bias see Thoburn (2007a: 237)

\textsuperscript{12} Athukorala (2006: 179) argues that anti-export bias may still be affecting some small and medium local firms in Vietnam, however.
3.3 Export development

Export growth

The stress on export-led growth has continued into the 2000s. The share of merchandise exports in Vietnam’s gross domestic product, which was around 10 per cent in the 1980s (Jenkins 2004a: 13), rose to 47 per cent in 2002 (VDR 2004:55). By 2005 the share had risen, as Table 1 shows, to 70 per cent, a figure higher than any of the chosen comparator countries except Thailand, although this exaggerates somewhat the openness of the economy.13 The Comprehensive Poverty Reduction and Growth Strategy for Vietnam contains the statement ‘Continue the open-door policy and actively integrate into the international economy for development’ (CPRGS 2002: 60).14 The Socio-Economic Development Plan for 2006-10 continues the strategy, with a projected 16 per cent annual increase in export turnover (Dinh Van Ahn 2006: 18).

Vietnam’s pattern of successive diversification from textiles and garments into footwear, and now into electronics, is common to some other successful exporting countries, such as Indonesia—also an oil exporter (Thoburn 2001)—until the Asian crisis, but what is striking about Vietnam is the sheer range of its exports. In contrast, some other low-income developing countries in Asia have a much more concentrated and vulnerable export pattern. For example, 84 per cent of Cambodia’s export earnings, 76 per cent of Bangladesh’s and 42 per cent of Laos’s come from garments alone (2003 figures from UNCTAD 2005: 4).

Export growth does not appear to have been driven by any depreciation of the real exchange rate (see Figure 1). The nominal effective exchange rate depreciated sharply in the early 1990s but the real effective exchange rate rose, and continued to appreciate throughout the 1997 Asian crisis while those of competitors depreciated (IMF 2002: 47). Following some depreciation after 1998, both the NEER and REER have exhibited a fairly level long-term trend, although the policy of the de facto tying of the dong to the US dollar has caused the market exchange rate of the dong to depreciate with the dollar against the euro and the pound sterling in recent years.

Global buyers and direct foreign investment15

Vietnam’s exports have been driven to a large extent by inward direct foreign investment. In 2006 foreign-invested enterprises accounted for 57.7 per cent of Vietnam’s total merchandise export earnings (CIEM 2006: 24). As Freeman (2004: 214) notes, they have, to a significant extent, substituted for a domestic private sector, since

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13 This is, of course, because the figures refer to gross exports divided by national output. Since gross exports include many imported inputs for such industries as garments, footwear and electronics, the figure would be much less for net exports. Jenkins (2004a: 205) estimates that the import content of all Vietnamese manufacturing was 32 per cent; and 48 per cent and 57 per cent, respectively, for garments and footwear.

14 The CPRGS, which ran from 2002 to 2005 alongside the 2001-05 Socio-Economic Development Plan, sets out policies agreed between the major donors and the Vietnamese government though it was not incorporated directly into the planning process (VDR 2007: ch. 1).

15 Foreign investment in Vietnam is not confined to the export sector, and it is discussed again in the next section.
state-owned enterprises account for nearly another third of (non-oil) export earnings (30 per cent in 2004, see VDR 2005: v).

Closely linked to foreign investment in the export sector is the role of global buyers. In many labour-intensive products like garments and footwear, production is undertaken within global buyer-driven value chains (Nadvi 2004). In such chains, production is organized and controlled by the final buyers, who usually have no production of their own. Instead, they have key first tier suppliers: in the case of garments, Hong Kong, Taiwanese or Korean garment companies who operate within the Asian region (and sometimes worldwide) and whom buyers will try to persuade to invest in new countries of sourcing.

Individual buyers, even very large ones, have the resources to operate only from a limited range of countries. When they decide to source from a new country such as Indonesia or China in the 1980s—or Vietnam in the 1990s—the build up of exports can be very rapid. Moreover, buyers often exhibit herd behaviour, so that once a few well-known buyers start to buy from a country, others will follow quickly. Many countries are competing for the attention of such buyers, and in the case of garments, to retain their attention now that the MFA/ATC has ended (Thoburn 2007b). Why have they been particularly attracted to Vietnam, and how has this been influenced by policy?

Global buyers’ sourcing decisions involve consideration of distance and lead times to the final market, and production costs, particularly labour costs (wages relative to labour productivity). Vietnam’s high labour productivity relates to the near-universal literacy of its workforce and its workers’ perceived industriousness, with wages lower than southern China’s (Boye 2002; Lord 2002; Nadvi and Thoburn 2004b). Buyers seem to regard Vietnam as a useful ‘insurance’ against relying too heavily on China—a ‘China plus one’ policy in which Vietnam is the ‘plus one’. Buyers, and the East Asian manufacturing companies investing in Vietnam to supply them, are strongly influenced by the country’s favourable investment climate, including its stable political system and consistent policy framework (see section 3.4).

Besides the ‘fundamentals’ of lead times, costs and investment climate, buyers are attracted by a country’s access to major markets—in the past by MFA export quotas in the case of garments—and now particularly the preferences it enjoys. In footwear exports, access to the EU market under the GSP helped to persuade global buyers to source from Vietnam. In contrast, footwear export competitors like China, Indonesia, Thailand and Brazil had all ‘graduated’ out of the EU GSP (Boye 2002). However, many countries with similar access did not develop footwear exports. In footwear the geographical pattern of production is concentrated on a much smaller number of countries than garments, and is a better indication of competitiveness in labour-intensive production and, for foreign investors, of a good investment climate.

Despite buyers’ preferences for suppliers they already know, state-owned enterprises too have been successful in their relations with buyers, including Japanese buyers. Buyers like the range of garments products that large SOEs can produce, although there has been a tendency for SOEs to focus on items like work uniforms, where the quality

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16 Electronics is an important exception, which is a producer-driven global value chain, where production is undertaken directly by major producing companies such as Sony or Sharp or Phillips.
issue (e.g., for dyeing) is not so important. In footwear too, SOEs were a significant minority presence (Boye 2002).

Finally, an important conduit in the global value chain for smaller foreign investors and for private sector producers is that there are many small traders from within the East Asian region operating in Vietnam, particularly of Taiwanese and Korean origin, who act as middlemen with larger buyers.

3.4 Direct foreign investment and foreign aid

Direct foreign investment

In 2006 Vietnam’s inward direct foreign investment (DFI) flows were accounting for 12.5 per cent of its gross fixed capital formation, compared to 8 per cent in China (UNCTAD 2007). Since 1994 Vietnam has been receiving at least US$2 billion a year in implemented DFI, and in 2005 and 2006 inward DFI flows topped US$3 billion, a peak previously only reached in 1997 before the Asian crisis had fully affected the region.17

Sectorally, manufacturing has been the most important area for DFI, with 51 per cent of accumulated registered foreign capital over the 1988-2006 period, followed by transport, storage and communications (9.6 per cent), mining and quarrying (8 per cent) and real estate (8 per cent) (GSO online statistical database).

The Asian region has been Vietnam’s main source of inward foreign direct investment. The top five investors over the 1988-2006 period are (in order); Taiwan, Korea, Japan, Singapore and Hong Kong. These account for 52 per cent of the cumulative foreign inflow (registered capital; see GSO online statistical database).

Paradoxically, Vietnam scores badly on conventional measures of competitiveness and investment climate, yet is highly regarded by foreign investors who operate in the country. The World Bank’s Doing Business survey ranks Vietnam as 104th out of 175 countries as a good place to do business. In contrast, the VDR for 2007 claims that Japanese inward investors see Vietnam as the third most attractive location in the world.18 It seems that Vietnam’s stable macroeconomic environment,19 high quality and low cost labour, and low levels of crime have been more important considerations for investors than the details of bureaucratic procedures which are often included in international surveys (VDR 2007: 24, 72). In 2006, as Vietnam prepared for WTO entry the following year, registered DFI inflows reached US$4.3 billion, a record. This is likely to reflect not only Vietnam’s more secure US market access as a WTO member but the strengthening of Vietnam’s legal institutions, which help to attract investors.

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17 In other respects, however, Vietnam survived the Asian crisis well, with its capital controls and lack of exposure to short-term overseas borrowing (Dapice 2003: 11).

18 Japan has also been making efforts to improve Vietnam’s investment climate via the Japan-Vietnam Joint Initiative, involving both the Vietnamese and Japanese governments and the Japanese private sector (MOFA 2007).

19 At least up to 2007.
Foreign aid

Vietnam is one of the world’s largest recipients of overseas development assistance (ODA), second only to Iraq and Afghanistan, according to the VDR 2007 (29-30). Certainly the donor community is very active in Vietnam and has been instrumental in greatly improving the flow of data and analysis about the Vietnamese economy. Japan has been the largest bilateral aid donor (MOFA 2007).

Yet Vietnam is by no means an aid-dependent country. Its per capita receipts of aid in 2005 were only US$23, little more than half that of Sub-Saharan Africa (US$43) (WDI online database). Its ODA receipts per head were about half of its DFI inflow per head (US$47), and by the end of the current decade Vietnam’s access to concessional support will be much reduced (VDR 2007: ii). In an engagingly frank admission, the 2007 Vietnam Development Report notes that the donors cannot ‘buy’ policy reform in Vietnam (VDR 2007: 29); Vietnam’s development strategy is strongly nationally owned.22

4 Agricultural development

The process of de-collectivization was largely completed by the late 1980s in the agricultural lowlands, although the VDR (2004: 38) reported that it was continuing in the 2000s in some upland areas. Under the 1993 Land Law longer-term land use rights were allowed for peasants. As in China, de-collectivization was accompanied by other measures. In the case of rice, whose output increased by 50 per cent over the 1990s, considerable state intervention continued. Export quotas and taxes were used to insert a wedge between the domestic and the world price, and state trading companies were used to develop rice exports. Private sector participation in rice exporting was not allowed until 1998 (Niimi, Vasudeva-Dutta and Winters 2004: 170).

Rice, indeed, is the great success story of the agricultural reforms. Vietnam changed from being a net importer of rice in the 1980s to the world’s third largest exporter (after the US and Thailand) in the mid-1990s, though there has been little further export growth since the late 1990s, particularly compared to other products (see Table 2). This lack of growth is not necessarily surprising or a sign of failure. In the late 1990s, when rice export growth was peaking, less than 15 per cent of output was being exported (Niimi, Vasudeva-Dutta and Winters 2004: 173). In an economy where around 70 per cent of households were both consumers and producers of rice, increases in rice output were important primarily for raising rural incomes and for food security, with the surplus available for export varying with fluctuations in domestic production.

The state has played a role in encouraging new crops such as cashew, and later coffee (Van Arkadie and Mallon 2003: 184-4). Coffee is not straightforwardly a success story,

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20 However, no year is given for these statistics, and according to the WDI 2007, in 2005 net ODA receipts were also higher for Nigeria, Indonesia and Ethiopia than for Vietnam.

21 Inflow of implemented DFI in 2006 from GSO online statistical database.

22 The study by the Harvard Vietnam Program (2008: 53) argues, in contrast, that Vietnamese policy priorities have been skewed by perceptions of donor priorities, but offers no evidence in support of this claim.
though, as the expansion of Vietnam’s coffee exports in the mid-1990s was a factor in causing a substantial fall in the world price.

5 Industrial development policy

5.1 State-owned enterprises and the private sector

Since the start of *doi moi* SOEs have improved their productivity substantially. The trade shock of the loss of Eastern bloc markets provided a strong impetus for those already engaged in exporting to improve their products and productivity to switch to selling in the Japanese and European markets. SOEs in the early 1990s raised their output by over 40 per cent while their employment fell by 13 per cent, and productivity increases continued, for example in textiles where labour productivity rose 48 per cent, 1995-9 (Thoburn et al. 2005; Nadvi and Thoburn 2004a: 119-20). However, there is still some way to go, and a study by the Harvard Vietnam Program (2008: 38) argues that the efficiency of Vietnam’s high level of investment (as a share of GDP), as measured by the incremental capital-output ratio, is low by the standards of East Asian countries at comparable levels of development.

Vietnam’s progress in divesting itself of state assets on a large scale has been slow. A programme of equitization was started in 1991, accelerated somewhat in the late 1990s, and developed more rapidly in the mid-2000s. However, this is still to some extent an ‘insider privatization’, as the 2006 *Vietnam Development Report* termed it (VDR 2006: 9). At end-2005 employees of equitized SOEs owned 38 per cent of the share capital, and outside shareholders only 15 per cent. The state’s holding of 46 per cent indicates that the privatization is, intentionally, only partial. By end-2006 the shareholdings of outsiders had risen to 24 per cent, presumably as workers had sold their shares on informal stock markets while the government retained its holdings intact (VDR 2007: 60).

The reduction in the numbers of SOEs looks impressive on the surface: from 12,000 in the late 1980s to around 3,000 in 2005 (VDR 2006: 10), but it is mainly the smaller

![Table 5](image)

<table>
<thead>
<tr>
<th>Ownership</th>
<th>1995</th>
<th>2005</th>
<th>2006 prelim</th>
</tr>
</thead>
<tbody>
<tr>
<td>State</td>
<td>40.2</td>
<td>38.4</td>
<td>37.3</td>
</tr>
<tr>
<td>Non-state</td>
<td>53.5</td>
<td>45.6</td>
<td>45.7</td>
</tr>
<tr>
<td>Collective</td>
<td>10.1</td>
<td>6.8</td>
<td>6.6</td>
</tr>
<tr>
<td>Private</td>
<td>7.4</td>
<td>8.9</td>
<td>9.4</td>
</tr>
<tr>
<td>Household</td>
<td>36.0</td>
<td>29.9</td>
<td>29.7</td>
</tr>
<tr>
<td>Foreign invested</td>
<td>6.3</td>
<td>16.0</td>
<td>17.0</td>
</tr>
</tbody>
</table>

Source: GSO online database.

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23 The ‘private’ sector as defined in Vietnam excludes the household sector of micro-enterprises, which have been important, for example, in garment production.

SOEs that have been equitized. The shares sold by 2006 only accounted for 14 per cent of total SOE capital (VDR 2007: 61). The industrial output of the state sector tripled between 1995 and 2006, although its share fell over the same period from nearly a half to a quarter, particularly reflecting the rapid growth of the foreign invested sector. However, as Table 5 shows, the share of the state sector in GDP only fell from 40 per cent in 1995 to 37 per cent in 2006, partly reflecting the growth of manufacturing and services where the state sector is important (VDR 2007: 59).

The performance of Vietnamese SOEs has prompted another revealing comment by the donors, who in other countries frequently advocate privatizations:

> (the only) gradual decline in the State share of economic activity, combined with the remarkably high rate of economic growth, implies that the performance of the State sector has not been dismal….Vietnam could not have grown the way it did if the State sector had not increased its efficiency (VDR 2004: 54).

Vietnam’s domestic private sector has grown fast (Table 6), although from a very low base. In 2005, the latest figures available, it was still only generating 22.7 per cent of industrial output, little more than half of the share of foreign-invested enterprises. The rise of the private sector has been accompanied by a decline in the share of the household sector, although the output of households doubled in constant price terms 1996-2006. Private sector development has been aided by the 2000 Enterprise Law, which greatly simplified the procedures for registering an enterprise. The 2006 Enterprise Law has been enacted to bring SOEs and the private sector into a common regulatory framework.

One area where Vietnam has lacked the dynamism of China’s economy is in its failure to develop rural industrialization. In the 2000s this has been addressed by new policies (Government Decrees 132 of 2001 and 134 of 2004) designed to promote industrial development in rural areas, and by Degree 66 of 2006 extending these measures to a wider range of non-agricultural activities. Also, recent labour shortages and rising

<table>
<thead>
<tr>
<th>Table 6</th>
<th>Vietnam industrial output by ownership (constant 1994 dong, and percentages of total)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1995 VND billion</td>
</tr>
<tr>
<td>State</td>
<td>51,991</td>
</tr>
<tr>
<td>Non-state</td>
<td>25,451</td>
</tr>
<tr>
<td>Collective</td>
<td>650</td>
</tr>
<tr>
<td>Private</td>
<td>6,610</td>
</tr>
<tr>
<td>Household</td>
<td>18,191</td>
</tr>
<tr>
<td>Foreign invested sector</td>
<td>25,933</td>
</tr>
</tbody>
</table>

Source: GSO online database.

25 At constant 1994 prices, see GSO online database.

wages in the major cities are encouraging industry, such as garment manufacture, to shift to nearby rural provinces. Industrial-aquaculture is also a partial exception to the failure to develop rural non-farm activities. Mainly an activity of the private sector, state-owned enterprises have provided various support services such as technical advice and supply of feed (UNDP 2002: 39).

5.2 The pattern of Vietnamese industrial growth: labour-intensive?

How far has Vietnam adopted a labour-intensive growth strategy, building on the country’s comparative advantage? At first sight this seems obvious, given the importance of labour-intensive manufactures and agricultural products in the export portfolio. Yet Vietnam also has maintained heavy protection against imports. To what extent has Vietnam engaged in import substitution?

Evidence from the late 1990s suggested that some industries have increased their employment by reducing their import penetration (such as fabricated metal products and ‘other transport equipment’). Yet overall in Vietnamese industry there has been a decrease in import substitution. This is in the sense that there has been increased import penetration, which has been an employment-reducing force in the economy while export expansion has increased it (Jenkins 2004a: 20).

Employment growth, though, has lagged behind output growth to a much greater extent than in other East and South East Asian countries. Vietnam’s elasticity of industrial employment with respect to output fell greatly; from 0.66 in 1985-90 to 0.22 in 1995-2000, compared to elasticities of between 0.4 and 0.8 for comparator countries. This is not the result of any shifts towards capital intensive import-substituting industries, but of within-industry labour productivity improvements in order to compete on export markets and to compete against imports in industries where import penetration is relatively high. Rises in the share of output accounted for by foreign investors, in relation to that for state-owned companies, is also a factor in this low elasticity as foreign-invested enterprises had higher value-added per worker than SOEs (Jenkins 2004b).

6 The future of Vietnam’s development strategy

Vietnam hopes to become a middle-income country by the end of the 2000s (VDR 2007: i). The experience of China and other East Asian countries suggests that stellar growth rates can continue beyond the first decade and a half. However, as a study by the Harvard Vietnam Program (2008, especially ch. 3) cautions, the growth of South East Asian countries has not been sustained over such a long period as those of East Asia. Elements of the Vietnamese political economy resemble those of South East Asian countries, including the capture of some state economic decisionmaking for personal gain, although Vietnam happily lacks the inter-ethnic tensions prevalent in much of South East Asia.

Vietnam’s initial growth spurt was fuelled by the de-collectivization and commercialization of agriculture and the partial freeing of private internal trade. These

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27 Information based on interviews in Vietnam in February 2008.
are once-and-for-all organizational changes and the increases in income that they caused are not easy to continue, although in Vietnam agricultural productivity has been improving further through high-yielding varieties and new products, and state organizations have continued to be involved in facilitating these developments (Van Arkadie and Mallon 2003: 190-8).

Similarly, once a country has been established as a new exporter of labour-intensive manufactures, and buyers’ world wide sourcing patterns have then stabilized, explosive growth may well level off, as happened in Indonesia in the early 1990s with successive waves of garments, footwear and electronics exports. Increasing domestic value added in export garment production by further development of the domestic textile industry, as is the current policy, is problematic and requires market and product development knowledge that most local firms lack at present, although inward foreign investment in textiles would help (Goto 2007). Diversifying into higher technology exports will require a more diversified and internationally competitive industrial base than Vietnam has at present.

Income inequality has been rising and this appears to be a continuing trend, although poverty has been falling. Migration from poorer to richer areas is a way of reducing poverty further, although it is not necessarily the poorest who migrate. Unregistered migrants are among the new poor in urban areas (Thoburn 2007a: 234), where exceptionally high land prices make it difficult for new arrivals to buy or rent housing (Harvard Vietnam Program 2008: 54).

One hopeful sign is that once Vietnam’s productivity levels have caught up towards those of its Asian neighbours, further growth from the private or SOE sector in the tradable sectors is likely to be more employment creating than in the 1990s. Foreign investment also surged in the early years of reform and then slackened, but it has risen again with Vietnam’s entry into the WTO.

Worrying, at least in the short-term, is that in 2008 inflation has been accelerating beyond that of other countries in the region, and in early 2008 there were signs of a macroeconomic and possibly financial crisis developing (Pincus and Vu 2008). Later in 2008 it has seemed that the likelihood of a financial crisis has receded (Credit Suisse 2008). Vietnam’s recent property and stock exchange booms have not been so dependent on short-term capital inflows as were Thailand’s in 1997, so mass capital outflows are less likely.

7 Lessons from Vietnam for other countries

Manufactures exports can be developed very rapidly by a country if global buyers make it a country of major sourcing and persuade their key vendors to locate there.

Buyers and inward investors are strongly influenced both by export market access and by the domestic investment climate. Perceptions of the investment climate

28 Foreign-invested companies already had high levels of productivity, whereas the SOE sector in particular was shedding labour at the same time as increasing output.
depend more on political and policy stability than on the details of bureaucratic procedures.

*Export development does not depend on import liberalization.*

Anti-export bias is an overrated concept, although it may have deterred some smaller firms in the private sector from exporting.

*Location in the rapidly growing Asian region is still a significant advantage,* offering both adjacent markets and inward investment.

*Successful reform of agriculture, particularly land reform, is still a key to development.*

It can be the basis not only for raising incomes and domestic demand, and reducing poverty, in countries with a predominantly rural population, but also a basis for expanding exports. Vietnam succeeded in maintaining agricultural output growth beyond the initial once-and-for-all spurt caused by land reform by investing in raising productivity, with state organizations taking an active role.

*State-owned enterprises can be reformed and made to raise their productivity.*

This depends both on incentives and on their external environment. Improvements in SOE productivity have not depended on competition from the domestic private sector, at least as yet. Privatization has little to offer if done prematurely.

*Educational development is important.*

Near-universal literacy, and selected technical and higher education, helps attract foreign investors and facilitates industrial and technological development.

*The ‘East Asian model’ still has much to teach us.*

An active role for the state, for example in the development of rice production, combined with a willingness to use market mechanisms, remains a powerful combination. Although ‘blue-prints’ for economic reform require adaptation to national circumstances, Vietnam’s reforms have been similar to China’s.

*Aid donors can be ‘managed’.*

They like being associated with success and in Vietnam they admit they cannot ‘buy’ policies. Vietnam has been able to retain strong national ownership of its development strategy.
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