The United Nations University

WIDER

World Institute for Development Economics Research

Working Papers No. 136

June 1997

Viet Nam: Transition as a Socialist Project in East Asia

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This study has been prepared within the UNU/WIDER research on the Transition Strategies, Alternatives and Outcomes (Economic Theories and Strategies of the Transition), which is co-directed by Professor Giovanni Andrea Cornia, Director of UNU/WIDER, and Professor Vladimir Popov, Senior Research Fellow.

Table of contents

List of tables and figures

Acknowledgements

This paper was written for the UNU/WIDER project on Transition Strategies, Alternatives, and Outcomes. Without impugning any responsibility, comments on a previous version from Prof. Tsuneaki Sato and Dr. Vladimir V. Popov, душевный друг, are gratefully acknowledged.

Abstract

In analyzing Viet Nam's recent economic adjustments, this paper attempts to distinguish events and policies that are properly assigned to the transition effort (defined as the process of increasing the market determination of economic outcomes) and those more properly associated with economic development (the relatively permanent increase in the average productivity of the economy). This distinction and the specific characteristics of Viet Nam's path are used to understand (1) why and how perhaps a transformational recession can be avoided, (2) why privatization is not absolutely necessary for the emergence of markets, (3) the role of state (and in Viet Nam's case party control) in implementing a hard budget constraint, (4) the importance of a dominant state role in protecting state capacity and revenue generation, and (5) a specific and so far successful path of labor market creation and adjustment.

The transition experience has also conditioned the future path of economic evolution and spawned a number of issues that need to be addressed in the future. The paper identifies the most critical of these as macroeconomic instability and the evolution of privatization and industrial policy. The paper also discusses the applicability of the East Asian public-private sector relationship to Viet Nam's subsequent development efforts.

1. Introduction

Coming on the heels of China's apparent success (measured on the metric of Anglo-Saxon economics), Viet Nam's transition has received a lot of attention, settling along the same patterns as Chinese analyses (for example see Riedel [1993], Dollar and Ljunggren [1995]). One can identify the following themes: (1) a celebration of successes in removing state controls and aligning domestic prices more closely to international levels, (2) measurements of the incompleteness in the reform process, and (3) appeals and warnings about the need to complete the reform process as the answer to perceived economic problems. These analyses are inclined to skirt the actuality that the marketization process in both these countries is being pursued (at least in public avocation) as a socialist project.

The "pop" political science of economists tends to resolve the issue in the following form: the continued pursuit of marketization, undertaken initially as a contingent policy, will eventually cause the socialist project to collapse. The vast difference in language, in which even bearers of the socialist project have had to rely almost *exclusively* on neoclassical terminology, suggests that even in domestic Vietnamese circles the gap is unbridgeable.

At the very basic level, the question about the sustainability[1] of the project should inform the analysis. At the practical level, it is important not to confuse (1) all shortfalls in economic performance with shortfalls in the marketization effort and (2) all shortfalls in the marketization effort with the implicit or explicit defense of the overall socialist project (whose shape is admittedly becoming more amorphous). This paper will not attempt to bridge this gap, but will attempt to be conscious of its existence.

In this context, this paper seeks to develop the following propositions on the basis of Viet Nam's transition experience:

(1) Transition can occur without a period of overall output decline. Though the traditional "development" industries will suffer, the declines

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[1] The problem of "reproduction" in the other language.

can be made up for (at least temporarily) by growth in other industries. Of particular importance is the conjunctural growth of non-tradeable economic activity financed by improvements or maintenance of household incomes as engendered in through labor market development (see proposition 5).

(2) Privatization is not necessary to create markets and to install incentives for reallocating the supply structure and increasing output.

(3) Drastic implementation of hard budget constraint in the context of party control is possible. (The theory of the hard budget constraint actually lies in its political economy, not in the confines of economics.)

(4) The maintenance of a dominant economic role for the state protects state capacity especially in the areas of enterprise and tax reform.

(5) Profound labor adjustments and creation of a labor market is possible through generous separation allowances.

The rest of this paper proceeds as follows: Section 2 addresses the question of characterizing Viet Nam's transition problem as one imbedded in issues attendant to economic development and proposes the manner in which transition can be distinguished from development. Section 3 provides a brief chronology of Viet Nam's transition path and strategy. Section 4 addresses issues of macroeconomic sustainability of the transition and beyond. Section 5 discusses trade and industrial issues. Section 6 discusses the labor market and welfare system aspects of Viet Nam's transition. Section 7 discusses key aspects of the emerging economy of Viet Nam and serves as a concluding section.

2. Development versus transition

In considering Viet Nam's recent experience it is important to deal with the issue of differentiating between "development" and "transition." "Transition" might be thought of as the process of increasing the market determination of economic outcomes, reducing the dependence of economic outcomes on orders from social agencies. "Development" might be thought of as relatively permanent increase in the average productivity of an economy, "average" being measured at least in per capita terms, more properly in per labor input terms, and even more strictly in terms of per unit of total input. The "Washington consensus" suggests that marketization (with a whole barrage of qualifications - including good governance - a formulation necessitated by the narrow reach of neoclassical analysis) is a necessary condition for development.

Economies of scale, indivisibilities, and first-mover hesitancies are well-known obstacles to the market's doing its development work. That is, marketization, including opening up the economy to foreign goods, can actually stand in the way of permanent increases in productivity. The movement toward the market in Viet Nam was launched in the context of disappointing economic performance after unification and the actual and expected further contraction in Soviet assistance. The subsequent spurt in growth appears to confirm the Washington consensus. It needs noting, however, that poor incentive arrangements and anti-market institutions have been known to strand even rabidly private economies below their production possibility curves. Removing many of these restrictions (and Viet Nam still retains many others) can move an economy closer to its potential output. Moving the whole production possibilities curve outward, "development", is a different matter.

With a "innappropriate" collection of capital stock and human skills, transition, if it also entails rapidly moving prices closer to international levels (thereby casting in stone the "wrongness" of the production structure), can shrink, at temporarily, a country's production possibilities curve. Transition can also move an economy toward greater output if the existing production structure is not too innappropriate for the new set of prices. Viet Nam, given the predominance of agriculture and other initial conditions, probably followed the second path, a path which might have been more politically taxing, but less economically complicated. Whether Viet Nam can escape the forces of international dis-convergence and succeed in development is the real question, especially from the point of view of the Vietnamese people.

Figure 1 attempts to characterize some of issues of Viet Nam's transition, including the question of resources required for transition, using production possibilities diagram. Here the two axes are labelled T for tradeables and N for non-tradeables only for semi-concreteness; the main point is that N are goods that were specific to and given great value in the planned socialist economy and could only be exchanged with difficulty elsewhere. Alternatively, N can represent goods that can be produced by the skills in the socialist economy, labor being the last non-tradeable in today's global economy. Before transition, the economy starts at point A, based on a socialist and trade-protected production possibilities curve and using resources represented by the line QR in which the fact that tradeables were underpriced in the socialist economy is represented in the slope. RR represents the international trade-off in these two goods, and if only the resources represented at point Q could be easily trade internationally, the country could move to a production possibility frontier tangent to RR.

Instead, the economy either experiences a shrinkage of production possibility to D on QQ, or if its production activities can be adjusted rapidly enough to produce tradeables to a point just a C or B, the latter representing full employment at the old socialist economic structure. Because we have defined level Q of goods of type N to be difficult to trade outside the socialist economy, to attain either C or B additional resources to the amount of QG or QF would be required, otherwise the economy can be stranded in C or stuck in low level equilibrium at D.

The analysis presented in this paper interprets the period 1986-91 as the high period of Viet Nam's transition. The narrative also points out that some key transition-related adjustments, such as introducing wage flexibility and liberalizing the planning mechanism occurred as early as 1981. The period from 1992 is interpreted as one in which development efforts became more important than transition, even though transitional issues such as privatization and financial system development continue to be critical.[2] The investment rate recovers after 1992 and the period sees the increasing clamour for attention being exerted by current account deficits and industrial development issues.

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[2] Attempting to apply the same periodization for China would be problematical since China has always followed a gradual price reform strategy. While China has had to undertake stabilization episodes, the investment rate in China has never declined drastically as it did in Viet Nam's 1988-1989 experience.

In the high period of transition, prices and price-setting were reformed and the relationship between the state and production units restructured. As shown in Section 5, this process involved production declines in the traditional development sectors, such as textiles, but which was substituted for by increases in agricultural, nontradeables (especially home remodeling and construction), and (by fortuitous timing) raw material exports. There were dramatic reallocations of labor, discussed in Section 6, away from the state sector but the maintenance of overall growth, increases in incomes in the rural areas, the generous separation allowances and consequent growth in nontradeable activities permitted only a gentle increase in the unemployment rate.

Viet Nam can be considered fortunate to have a production structure that adjusted relatively well to international prices. Popov [1997], using constructed indices, indicates that Viet Nam's initial industrial structure, extent of trade distortions, average number of employees per enterprise, and level of development when compared to the situation in other transition economies would have predicted a relatively smaller output loss.[3]

However, as pointed out in the paper, many of these transition-impelled adjustments in the vector of economic activities must be interpreted as temporary, fortuitous, and conjunctural, even though the institutional changes that have accompanied them have permanently improved Viet Nam's development prospects. For example, agricultural and natural resource exports cannot be the basis for future development and there is a need to address issues about continuing the recovery and further development of light manufacturing, the traditional development industries. Thus Viet Nam has traversed the easy part, economically, but must now face the difficult issue of development. The planned socialist economy has been known to increase the proportion of output from industry, as in the case of the Soviet Union. Viet Nam must now attempt to do it with an "unplanned" socialist economy, a different configuration of institutional arrangements which have, however, precedents in East Asia.

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[3] The only initial condition in which Viet Nam appeared to be at a disadvantage was the size of the defense expenditure as a per cent of GDP, which was at 19 per cent and higher than the 13 per cent in the former Soviet Union.

3. Initial conditions and *doi moi* reform process

The start of Viet Nam's transition is normally dated at the Sixth Party Congress of the Communist Party of Viet Nam in December 1986 when a contract system was introduced in the agricultural sector and state enterprises were permitted to swap and sell goods on their own to raise money to buy inputs or to increase the salaries of their employees. At the start of its reform process, Viet Nam's economy was predominantly agricultural; large enterprises did not dominate its industrial sector and the typical industrial operation was a locally controlled enterprise or cooperative. Agriculture accounted for 47 per cent of output in 1979 and around 48 per cent in 1989; in 1989, only 10 per cent of the labor force was in urban areas and only 3 per cent in a "modern industrial sector" (Fforde and de Vylder [1996, pp. 90-91]), even though these proportions are much higher than during the colonial period. State enterprises accounted for about a quarter of GDP in 1989; only 240 industrial enterprises (out of a total of about 360,000) had more than 700 employees (Dollar and Ljunggren [1995, p. 6]).

In 1988, Viet Nam began developing a two tier banking system, principally as a means to separate central bank functions from enterprise and trade financing activities. Bonds began to be issued. Officially from this point on, all enterprises would be able to borrow at the same interest rate; however, state enterprises still continue to hog the bulk of domestic lending. Until 1990, 90 per cent of outstanding bank credit were claims on state-owned enterprises; in 1994, this had fallen to 63 per cent (World Bank [1995b, Table 4.2]).

The next breakpoint in the reform process occurs in 1989, in response to the hyperinflationary process (inflation reached 411 per cent in 1988 (Dang [1994, p. 173]) set in train by the initial reforms. In 1989, the government phased out price controls, set interest rates on deposits above inflation rates and above loan rates (Nguyen [1994]), and instituted stricter controls over financial lending to state enterprises.

Measured on Anglo-Saxon norms, the reform process accelerated after 1989. The dong was drastically devalued in 1990. Money creation to finance the budget was stopped in 1991. When strict rules on lending to state enterprises began to bite, enterprises began to shut down or shed workers. Between 1988 and 1992, the number of enterprises decreased from 12,000 to 7,000 and a third of the enterprise work force, about 800,000 people, lost their positions in that sector (Dollar and Ljunggren [1995]).[4] Inflation is further brought down from 67 per cent in 1990 to 18 per cent in 1992 (Dang [1994]), in a classic devaluation-cum-tight money manoeuvre, but without IMF resources since Viet Nam was still under the U.S. embargo.

It is this episode that inspire Sachs and Woo [1994] to declare Viet Nam to be a case of shock therapy. The record of consistently positively growth rates (with slowdowns but still positive growth in 1987 and 1989) while the state share of output paradoxically increases from 33 to 39 per cent (Table 1) raises questions about the formulation "shock therapy." If "shock" is means rapid price convergence to international levels plus macroeconomic stabilization plus privatization, Viet Nam undertook two of the three sub-elements of shocking the economy in order to inflict therapy. What is evident from the accounts of the period (Dang [1994], for example) was that production breakdowns were already evident before the shock-type policies were finally accepted by officials, part in 1987 and part at the end of 1988. For example, the state committee on prices found itself being compelled to update prices monthly to engender production or supply (since rice can be hoarded for limited periods), an effort that eventually led to the abandonment of price controls. A comparison of the columns of total GDP growth rate and GDP excluding rice and oil (Table 1) reveals that in 1987, GDP growth rate *excluding rice* would have been *higher* than the overall growth rate, revealing the crisis in the agricultural sector. This comparison also indicates the vigorous recovery of rice production in the subsequent year.

It is therefore the case that the shock therapy interpretation is questionable on two counts: (1) in many cases there was no clear intention to inflict a shock, meaning simultaneous reforms including privatization; instead, it was a matter of abandoning rearguard actions

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[4] The contrast with China is striking. China's strategy was to open entry for non-state firms while maintaining employment in state firms. Viet Nam's rapid price reform undermined employment in state firms and coupled with the generous separation allowances this led to the large losses in employment. Viet Nam has opened entry only through investment into state firms.

and (2) the "shock" policies actually permitted production to continue or restart, even though these did mean an acquiescence to the shooting up of inflation rates and currency substitution (see below). In comparison with approaches in other transition economies, Viet Nam's experience suggests that privatization is not a precondition on an increased reliance on prices to foster production.

Viet Nam's transition path from a planned economy is particularly well-captured in Table 2, which traces the evolution of state resources provided to state enterprises from the budget and from the banking system. The implied success of these adjustments raise doubts about the appropriateness of obsessing on creating private production during the transition and focusing instead on protecting state capacity and fostering exchange and market activities, irrespective of ownership. In the period 1987-94, transfers to the budget by state enterprises actually increased by a modest 1.3 percentage points of nominal GDP, from 10.8 to 12.1 per cent. This modest increase saw a substitution away from budget reliance on enterprise operating surpluses from 10.3 per cent in 1987 to zero by 1991 to tax receipts from state enterprises which reach 9.2 per cent in 1994.

However, the key adjustment occurs in state enterprise receipts from the budget, which drastically fall from 7.9 per cent to 0.5 per cent, with the greatest drop occurring in 1988-90, when these transfers fell from 8.5 per cent 2.6 per cent and has not increased subsequently. Capital transfers are gradually reduced, to zero with a slight noticeable in the high shock year of 1989 while depreciation payments in the transfers portion begin a gentle increase up to 2.3 per cent by 1994. The cut in food subsidies between 1987 and 1989 reflects the dismantling of the system of providing real allotments to state employees (so many kilos of rice per month for example) as part of wages which became so prone to the inflationary processes spawned by the transition. Throughout this period, working capital transfers from the budget to state enterprises are reduced slightly but more or less maintained (there is a large increase in 1992 for example); in nominal terms, these subsidies can be quite critical to maintaining enterprise operation.

The net of the modest increase in budget transfers into the budget and the dramatic decline in claims on the budget results in an increase in net transfers to the budget from state enterprises from 3 to 11.6 per cent during the period. During this period, it should be noted that nominal values are increasing due to inflation, currency devaluation, and real growth, information that is lost in taking percentages of GDP. The last column of Table 2 shows the per cent increases in these nominal values to illustrate the importance of being able to conduct policy, perhaps dangerously, in a nominal world. In nominal terms, transfers from the budget still increase 283 per cent through the whole period, while transfers to the budget from state enterprises actually increase by over 6 thousand per cent.

The line on bank credit to state enterprises shows a 1,499 per cent increase in nominal amounts provided to enterprises. But in terms of per cent of GDP, there is decline in total budgetary and bank support for state enterprises from positive 6.6 per cent in 1987 to negative 9.2 per cent, implying that by 1994, the state enterprise sector had become a significant (almost 10 per cent of nominal GDP) net contributor to the state budget. (Oil-related revenues accounted for 1.1 per cent of GDP in 1989 and peaks at 3.8 per cent in 1992 and 1993 (Dodsworth *et. al.* [1996]) and thus might be associated with about one-third of the total contribution of enterprises to the government by the end of the period.)

In 1993, after the high tide of transition, a new land law guaranteed security of land tenure to families, instead of cooperatives. Viet Nam has had notable success in turning rice production into a competitive export sector and in increasing grain output. This is another indicator of the triumph of incentives, though regaining rice productivity (from high levels achieved before cooperativization/collectivisation in the South) does not constitute development.

Privatization and decentralization has taken specific Vietnamese characteristics, as a net result of Vietnamese approach of insisting on the leading role for state enterprises, while attempting to dramatically shrink central government subsidies to the industrial sector. This has produced a trend in which local urban economic activities have been drastically privatized, the cooperative sector which is by nature local basically dismantled, while state participation in trading and modern industrial sectors has increased (the latter a trend lamented by Dollar and Ljunggren [1995]). Table 3 presents trend in gross output by management level from 1985 to 1995. In 1985, 66 per cent of industrial output was locally managed; by 1995, only 57.5 per cent of gross industrial output is locally managed and the proportion of output accounted for by centrally managed enterprises has increased from 24 to 52.5 per cent. This trend is echoed in Table 4 in which the gross industrial output is broken down into state and non-state sectors. The percent of gross industrial output accounted for by the state increases from 56.3 per cent to 72.4 per cent. Table 5 shows that in the "non-state" sector the proportion of enterprises accounted for by cooperative have shrunk from 14 per cent in 1985 to minimal at the present time.

Viet Nam has a two-systems problem and, as in the case of its international image, the transition can be also be thought of as one of transforming Viet Nam from a war to a country. The northern economy functioned rather well in a mix of state planning-financing, agricultural activities under the control of cooperatives, and price control. While the northern system can be interpreted as a war economy, the economic activities continued (and continue) to perform well, growing steadily but unspectacularly, after unification. The years 1975 to early 1980s can be seen as an attempt to carry out a "transition" of the southern economy to the northern system, which came under increasing local resistance and accelerating instances of production failures and shortfalls. One way to see the reform process in the 1980s, a view that does not require allegiance to the "Washington consensus," is as a succession of central government actions of acquiescence to successful local experiments, mostly in the south, to solve production problems (Selden and Turley[1993], Fforde and de Vylder [1996]).

4. Macroeconomic sustainability

Macroeconomically, Viet Nam has managed to maintain positive growth rates and, since 1993, an increasing trend in investment as a proportion of GDP and a slower increase in savings (Table 6). However, current account deficits and fiscal deficits have been high. Viet Nam, as a consequence of its economic structure and a persisting public stance to maintain a high rate of growth, is likely to bear a Latin-American style or

Philippine-style macroeconomic fragility during its growth process, in which international accommodation will be important.

Unlike Latin America, and closer to the Philippine or Indonesian record, public authorities have produced a reputation of being able to carry our deep spending cuts in response to macroeconomic imbalances in combination with some Israeli-style heterodox approaches, such as acquiescing to currency substitution by permitting the widespread use of the U.S. dollar in domestic transactions (Van Arkadie and Montes [1995]). In its 1989-91 adjustment, Viet Nam carried out a drastic devaluation and exchange rate unification, combined with fiscal stringency that saw the number of state enterprises halved and almost a million employees separated from state enterprises.[5]

Even though savings in dollars and gold has a long tradition in the country, official dollarization exploded in 1988 when state banks were permitted on a "no-questions-asked" basis to open dollar bank accounts as a heterodox means of encouraging state trading enterprises to repatriate their export earnings and soak up balances in the informal sector. In 1994, dollar deposits represented 20 per cent of Viet Nam's M2, from a peak of 40 per cent in 1991. This policy has nevertheless reduced capital flight and made lending resources available in the formal market. In fact, dollarization has permitted the level of intermediation through the domestic financial system to increase, instead of declining (Dodsworth *et. al.* [1996]). I think it is also appropriate to say that the policy had a strong impact towards halving the velocity of money in 1989, a velocity that probably had a lot to do with state enterprise behavior in managing their cash balances. The fall in monetary velocity permitted the inflation rate to fall by half in 1989, in spite of the government deficit amounting to 6 per cent of GDP in the period.

Viet Nam's recovery, subsequent to the stabilization struggles of 1988-91, has been based on an increase in the investment rate from about 15 per cent in 1991 to over 22 per cent after 1994. Viet Nam's continuing struggle to engender an increase in its growth rate while keeping inflation, current account and fiscal deficits under control derive from the,

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5 The employment consequences are discussed in Section 5.

now more standard, development dilemma of how to finance a higher investment rate.

Montes [1996], using a 3-gap model, analyzes the macroeconomic constraints relating to Viet Nam's (and China's) growth based on 1995 results. This exercise is useful to the extent that it characterizes an economy's macroeconomic status, abstracting from year-to-year trends in setting elasticities and identifying a consistent set of ingredients required for future macroeconomic stability. The model is described in Appendix A.

Viet Nam's 8.9 per cent of GDP dependence on foreign savings (Table 7) is the key concern. In 1995, the merchandise trade deficit represented 12 per cent of GDP, the consequence the net of a 42 per cent of GDP import level and a 30 per cent export-to-GDP ratio. Imports increased by 58 percent alone in 1995. Two comments need to be made: (1) Reductions in the utilization of foreign savings can be expected to have a large impact on capacity utilization and the growth rate and (2) Viet Nam has become quite a trade-dependent economy in an order of magnitude more than China. The public sector borrowing requirement was also at an elevated level, representing 5.5 per cent of GDP.

In 1995, Viet Nam's total investment rate of 27.7 per cent of GDP compares unfavorably with a total savings rate of 19.1 percent which was estimated to consist of private savings rate of 15.4 per cent and a government savings rate of 3.3 per cent of GDP: The split between public and private investment is even more difficult to identify in the case of Viet Nam. Indications of the proportions of credit from Tran, Le, and Nguyen [1995] was used to allocate the private versus public investment contribution to investment. The 1995 Viet Nam economy was calibrated at 93 per cent capacity utilization to reflect the high rate of employment accompanying the growth rate.

Viet Nam's foreign interest payments are a significant 3.2 per cent of GDP. Viet Nam reported receiving $1.4 billion in actual inflows of foreign direct investment in 1995 (about 7.3 per cent of GDP).

What would be required to turn recent Vietnamese growth parameters to a more sustainable path? The calibration analysis suggests the following important challenges for Viet Nam:

(1) total investment has to be brought into line with domestic savings in order to reduce the dependence on foreign savings; in an alternative scenario, Montes [1996] lets the investment rate decline to 24.8 per cent down from the calibration value of 27.6 per cent;

(2) a reduction in the PSBR from 5.5 to 3.5 per cent of GDP could be consistent with the scenario, taking into account a reasonable movement of the fiscal gap with its own parameters;

(3) the import-GDP ratio to be kept constant at 42 per cent (though perhaps in the medium term there is the possibility of a decline given the large increase in 1995) and a 3 percentage point increase in the export-GDP ratio;

(4) that there would be a consistent reduction in the foreign savings utilization from 8.9 per cent to 5 per cent of GDP.

These changes can impose a large reduction in growth rates unless other elasticities can be adjusted. In order to do this, certain economics elasticities have to adjust in the positive direction (Table 8):

(1) The elasticity of the fiscal effort was increased by a quarter from 0.4 to 0.5; Viet Nam increased its fiscal effort by 50 per cent since 1989, but it is doubtful that comparable increases in the effort can be achieved in the future.

(2) The elasticity of private saving, anticipating presumably non-destabilizing efforts to improve the financial system, was permitted to increase to 0.7 from 0.5.

(3) The responsiveness of non-state investment to state investment was increased from 1.1 to 1.25;

In the negative direction, this exercise assumed

(1) that the proportion of investment sourced domestically would fall from 0.59 to 0.40, with the planned moves toward entry into the ASEAN Free

Trade Area (AFTA) and other reforms designed to improve acceptance by the U.S. into the world trading system;

(2) the elasticity if intermediate import demand with respect to economic activity would increase from 0.45 to 0.60, an assumption that might actually be conservative;

(3) an increase in the intermediate import demand elasticity with respect to exports was provided from 0.30 to 0.45.

The overall result of these adjustments suggest that growth in the range of 7-8 per cent continues to be feasible. The attainable capacity utilization level falls to a less inflationary 84.7 per cent. Based on the consistent level of trade and the ICOR relationship, the investment rate will permit a growth rate in the range of 8.4 per cent, which can be quite sustainable based on the continued access to foreign savings of about 5 per cent of GDP. The latter is an admittedly high amount, and quite problematical given the already elevated claims of debt service on GDP; much better success in improving the elasticity of the fiscal response will reduce dependence on foreign savings and foreign investment.

5. Industrial and trade issues

Viet Nam's recent growth has constituted the "easy" part of industrial adjustment; that part that has to do with finding a sustainable direction of building its industrial sector will have to be faced. Viet Nam's evasion of a transformational recession comes from a combination of existing excess capacity (rice production, energy and steel), loss of competing imports from CMEA countries (fertilizer and steel), luck (crude oil production), increase in household demand (construction materials and foodstuffs, particularly beer, liquor and cigarettes).

The main patterns are shown in Figure 2. Agricultural production, as included in the category "foodstuffs" in the figure owes it growth to the rapid growth in rice production in response to the dismantling of the rice procurement policies in the south. Rice production was growing at 3.8 per cent per year between 1980 and 1987, mainly due to increases in yield. Rice output grew by 8.4 per cent per year in 1987-90 with a growth rate in the yield of 5.7 per cent per year (implying both an increase in the rate of growth of productivity and the impact of additional land planted to rice due to increasing commercialization) and 5.2 per cent per year in 1990-94, with a yield growth rate of 3.1 per cent per year. The rapid rise in rice production meant that Viet Nam converted from a rice importer to the third largest rice exporter in the world. It also meant rapidly rising incomes in the rural areas. These higher incomes also boosted demand in household consumer goods such as liquor, beer, and cigarettes to which the initial joint ventures with foreigners helped.

The coming on-stream of the Bach Ho oil field (a joint venture between Viet Nam and parties from the old Soviet Union) accounts for the rapid rise in fuels production, which Dodsworth, *et. al.* estimate to have added 8 percentage points to the industrial value-added in 1988-89 and another 25 points in 1990-91. The new oil production does mask out the negative growth of the industry/construction sector (-6 per cent in 1990) before 1992; however, by 1992, industry/construction begins to grow at rates over 10 per cent per year. A consideration of the numbers in Table 10 permits a more nuanced understanding of the role of fuels production in maintaining overall positive growth rates. In the period where the industrial recession was the deepest, 1988-90, oil production grew by over 96 per cent; at that juncture, it could not pull the total growth rate too much because its proportion of industrial output was only 3 per cent in 1988 and 7 per cent in 1989. However, in 1990-91, as the transition adjustment continued, other industrial sectors (notably ferrous metallurgy, equipment and machinery, wood and wood products, glass earthware and porcelain, foodstuffs, and textile products) had already begun to recover and the overall growth did not depend very much on fuel production, even though fuel production continued to grow strongly, eventually accounting for 16 per cent of gross industrial output by 1995. If the fuels sector had grown in the period 1988-90 and 1990-91 at the same rate as it did in 1985-88, there would be about a 3 percentage point reduction in output in both 1988-90 and 1990-91 from the levels shown in Table 10. This means that in the second period, 1990-91, the growth rate of gross industrial output would already be positive in the order of a respectable 7 per cent. Moreover, oil also does not add much to employment absorption even though it added a new source of revenue, rising from nothing in 1988 to almost 4 per cent of GDP in 1993.

Viet Nam shares with China the boom in *"private"* housing construction as farm households began to upgrade. The subsequent demand-driven boom in construction materials, especially cement which had excess capacity, is evident in Figure 2. In the case of cement, housing demand more than made up for the fall in demand as government construction fell in response to the fiscal crisis.

The collapse of supply from CMEA had a specifically wholesome impact in redirecting demand to domestic suppliers and the growth shown in steel and fertilizers in Figure 2. The small steel sector, which produced inferior materials in comparison with those from CMEA but which were adequate for housing construction, experienced increases in demand; Table 10 shows a 57 per cent increase in ferrous metallurgy in 1990-91. The same was true for fertilizer earlier available at low prices and at high quality from the CMEA countries, growing at 21 per cent in 1990-91 (Table 10).

Figure 2 also shows one traditional industrial sector, textile, as an example of sectors that fared poorly in the industrial transformation. Similarly, the production of bicycles, sewing machines, and other products subjected to imports and smuggled goods followed the same patterns. Table 9 shows deep falls in output in 1988-90 in "equipment and machinery", "other metallic products", "wood and wood products," and small household goods included in "glass

Figure 3, a "convergence graph" provides a graph of the proportion of output in1985 and the subsequent growth rate of each industry until 1995. The horizontal line through the graph marks the growth rate of all industries so that industries falling above the line are growing faster than the average and those below it are growing slower than the average. The increase in oil production was fortuitous but geologically Viet Nam has no possibility of being an important oil producer. There are also oil resources in remote mountainous areas, but their development from the point of view of environmental integrity is problematical. This sectoral spurt is at most a medium-term development.

Food, dominated by rice, grew above average as a result of agricultural sector reform. Viet Nam's per hectare agricultural output and the extent of diversification of crops, especially in the south, are already extremely high and can compare to world levels. While the achieved levels in food productivity provide a basis for industrialization, the development of industrial sectors is still a separate issue. Textiles and processed food ("foodstuff"), among the more traditional sectors of development grew below the average during *doi moi* indicating the relative uncompetitiveness of this sector in which the state has a large stake.

The fastest growing industries were in the non-traditional group, marked by the symbol A, in Figure 3. Viet Nam potentially has a potential international competitiveness in light manufactured goods which include "sewing products," metallurgy, shoes, and small electric and electronic products. As was shown in Figure 2 and Table 9, these industries went through a period of intense difficulties during the transition. Table 9 also shows the subsequent recovery and the overall growth through the period is reflected in Figure 3. Small scale foreign investment inputs have played an important role in the recovery of these sectors.

Key aspects of Viet Nam's trade transition are shown in Figure 4. Fuels, agricultural products, and aquatic products are the fastest growing export sectors. As the economy develops, an increasing proportion of this output (whose growth will be tapering off) will be required domestically and reliance on export earnings from fuels must decline. Some specific patterns illustrate the transition occurring in response to international prices and comparative advantage. Beyond crude oil and rice, Viet Nam increased, between 1990 and 1994 the volume of its exports[6] of coal 2.65 times, chromium by 5.8 times, coffee by 1.96 times, footwear by 8.48 times, garments by 2.13 times. The following items experienced reductions: textile yarn by 41.8 per cent, rattan and bamboo products by 60.0 per cent, embroidery products by 64.2 per cent.

It is clear that light manufactured exports, which constituted the standard Asian way of development, are having a hard time taking off, in comparison with agricultural products as a result of increased competition from imports and smuggled goods. As an increasing proportion of the labor force moves into industry and rate of agricultural productivity tapers off, an increasing proportion of the tradeable-exportable agricultural production will be required domestically. In the

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[6] Figures are calculated from Table 214b of Central Statistical Office [1996].

case of aquatic products, cultivated shrimp exports to Japan have provided important impetus; as in the case of forestry products, these have important and possibly permanent environmental consequences (the destruction of mangroves and coastline in the case of shrimp exports) and do not really constitute a long-term comparative advantage for Viet Nam, precariously hugging mainland Southeast Asia's eastern coastline.

These provisional exports have helped to ease the severe macroeconomic constraints for required Viet Nam's transition, but these exports have to be replaced. Within the bounds of state supervision, the government is decidedly determined to diversify its light manufactured exports, a determination that incorporates a strong invitation for joint ventures. Dollar and Ljunggren [1995] interpret the insistence on state leadership as a millstone to this development (on the grounds of greater flexibility on the part of private actors). While the insistence on state supervision certainly has a slowing effect on export growth and diversification, should the issue be dismissed as a simple case of state intransigence? While there is a clear need to streamline procedures in easing joint ventures' access to factory land and facilities, Vietnamese authorities are reluctant to turn the whole country into a special export processing zone, with its unpredictable impact on domestic demands and on the labor market.[7]

However, the new international circumstances under which Viet Nam will be attempting a similar strategy indicate a more limited scope for the East Asian strategy. Access to the U.S. market for light manufactured exports while retaining industrial protection and state economic participation was a Cold War accommodation for Asian economies, which increasingly are compelled to operate within the more generalized rules of the world trading system. Viet Nam's need for foreign savings necessitates its accession to these rules. Viet Nam has not attained most favored nation (MFN) access to the U.S. market, and the danger that Viet Nam has to concede more in order to overcome lingering American soreness over the lost war in the 1960-70s exists; any trade

[7] China's learning-by-doing during its "both ends out" policy, in which foreign ventures were permitted to operate as long as these only required labor inputs is not an option.

concessions to the U.S. will constitute concessions on its overall trade regime.[8] Moreover, Viet Nam's new membership in ASEAN requires it to adjust to the ASEAN Free Trade Area tariffs. Finally, China will be continue to be a fierce competitor in light manufactured exports in the next decade and is in fact a source of a lot of illegal competition in the domestic market for light manufactured goods, such as garments, bicycles, etc.

The problem of competitiveness is pointed at the heart of questions regarding enterprise reform and privatization. As mentioned earlier, the state enterprise sector has seen significant cutbacks in employment, even while it share of output has actually increased. This indicates a remarkable improvement performance and productivity of state enterprises (Sun [1996, p. 4]). Viet Nam's classification of what constitutes state enterprise is especially skewed toward counting those whose productivity increases are effectively coming from joint ventures, in which the foreign contribution in terms of technical know-how, machinery, and access to both input and output markets are especially acute. Even where most of the capital is provided by the foreign partner, the enterprise is still counted as a state enterprise. An offsetting bias is the fact that many ministries and party organizations have effective control over enterprises (a prevalent business would be a hotel or a guest house, but some are large business services such as trucking) which are nominally private enterprises.

The enterprise reform process began in 1981 when Viet Nam has followed a 'path-seeking' compromise-ridden process, which has so far improved productivity for both state and private companies. In 1981, companies were officially permitted to produce under "A", "B" and "C" plans legalizing what was locally called "fence-breaking" activities in which enterprises sold their output and obtained their inputs outside of

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8 China's recent difficulties in joining the World Trade Organization can be interpreted equally as (1) an unprecedentedly high bar for a country at such a low per capita income for the right to access industrial markets and (2) a recognition that China's supply capacity into the world market is so large that industrial economies are well-advised to insist on prior reciprocal liberalizing actions. This is the context in which Viet Nam must attempt to obtain MFN access to the U.S. market, even though the European Union has been quite sympathetic to Viet Nam's exports.

plan-imposed channels. Production under the "A" plan consisted of state-provided inputs for sale to state-determined channels and keep 50 per cent of profits; companies that fulfilled A targets were permitted to produce more under the B plan where inputs could be acquired legally outside of state mandated channels and keep 60 per cent of profit. "C" plan output were beyond the state plan, could be sold at free market prices, and 90 per cent of profits could be retained. Most of the profits were of course distributed as workers bonuses. As expected, there were tremendous incentives to shift to C production before A and B levels were met. Nevertheless, the reforms lay behind the recovery of the industrial sector in the first half of the 1980s.

The removal of most price controls in 1989 and related macroeconomic reforms made legal fence-breaking unnecessary but generated heavy losses at the enterprise level. It also forced the issue of subsidies to enterprises, resolved in favor of liquidation and merger of many, but not all, loss making state enterprises. The period also saw a fresh entry of foreign companies, setting up joint ventures with state enterprises. The state also inaugurated an equitization umbrella program under which employees could invest in their own company and under which companies could eventually be privatized. The contrast with the European approach is that the program provides an umbrella, but is not an approach to wholesale movement toward private ownership of companies.

The debris of this process is a mix of firms with a variety of ownership structures and performance. In equitized firms, the state typically owns 30 per cent of the shares, employees and management around 50 per cent, and the public or foreign partners 20 per cent. Since 1993, individuals can obtain loans up to $300 to purchase shares in companies, effectively making a channel for investment in companies and greater control by the managerially-inclined to obtain control of the companies. There are still fully-owned state firms in manufacturing with the same tax obligations to the central budget as other types of companies. In the export-oriented areas, especially in garment production, there are many private companies.

Trading, retail, home and equipment repair are served by many small, often family, ventures. These were the first private ventures to emerge at the start of reform and it is estimated that a total of 300,000 either unregistered or registered under Viet Nam's Company Law of 1991 as "individual businesses" or sole proprietorships (Thuyet [1995]).

6. Labor market and social transition

At over 72 million, Viet Nam has a relatively large population on a relatively narrow land base whose total of 332,000 square kilometers masks the part that constitutes the mountains to the East of the country. Thailand has a population of about 60 million on 513,000 square kilometers. Thailand's per capita income in 1994 ($2,410) is ten times Viet Nam's ($200). However, Viet Nam has a relatively high level of human resource development in comparison to Thailand. In 1980, 40 per cent of females and 44 per cent of males of the corresponding age group were enrolled in secondary education in Viet Nam; in 1993, the corresponding figures for Thailand are 37 per cent for females and 38 per cent for males. (All data in this paragraph are from the 1996 World Development Report.)

These figures speak to some social-historical elements in understanding Viet Nam's transition/development effort: (1) relatively low incomes and the potential for internationally competitive wages for a significant period to come, (2) a potentially more flexible workforce, (3) a potentially greater capacity for social methods of controlling economic activities as opposed to heavy reliance on commercial relations, even possibly in comparison to China and (4) a greater potential for social cohesion in normal times (though possibly punctuated by periods of distinct breakdown as in Japan's development process).

At the height of the reform, between 1988 and 1991, state sector employment fell from 4.1 million to 3.1 million (a loss of 24 per cent); of this total, the loss of jobs in state enterprises was from 2.7 million to 1.9 million (a loss of 29 per cent). State enterprise losses were concentrated in local enterprises which experienced a loss in the same period of 38 per cent. (Table 11.) By any measure, these are significant job losses. The labour adjustment consisted in (1) increases in "nonstate employment" and (2) the voluntary nature of job leaving in the state sector.

Nonstate employment (which includes the cooperatives sector, mostly concentrated in the agriculture and the primary instrument of collectivization) increased by 3.5 million between 1988 and 1991, more than making up for losses in the state sector (Table 11). Employment in the cooperative sector shrank by 2.8 million, but private sector employment increased by 6.3 million. A significant amount of the job losses in the cooperative sector and also in the state enterprise sector consisted of workers already working part-time and moonlighting in other enterprises. Nevertheless, the redundancy rate in the state enterprise sector continues. O'Connor [1996, p. 9] cites a survey conducted by the Planning Department of the State Planning Committee which showed that in Hanoi 14 centrally-owned state enterprises (out of 43 surveyed) and 8 locally-owned state enterprises (out of 24) had excess workers; the number was significantly smaller in Ho Chi Minh City, with only 5 out of 81 enterprises reporting more workers than needed.

The voluntary nature of job leaving in the state sector was made possible by the relatively generous separation allowances. The fact that even before the *doi moi* transition flexibility had been built into the state enterprise wage system played a role in the establishment of labor markets (see below). For the state enterprise employees and civil servants, the severance pay consisted of one month's final salary for each year of service, with a minimum of three months' salary. There was also a 10 percent additional payment for health expenses and 15 per cent for education. In addition, there was an early retirement plan for those workers within 5 years of the mandatory retirement age (60 for men and 55 for women); these workers could opt for the standard pension in lieu of the severance package.

On the average, the World Bank [1993] estimates separated workers to have received the equivalent of one year's salary. The minimum 3-month scheme was particularly generous to younger workers who had already had alternative places of employment. Separated workers occupying enterprise housing were permitted to keep their units with the payment of rent. The severance pay package actually included an additional allowance based on the floor area of the apartment to cover initial housing expenses, a factor that relates to the housing boom in the industrial restructuring discussion above.

O'Connor [1996] estimates the cost of compensation to separated workers to have totalled Dong 610 million between 1989-93, or about 0.4 per cent of GDP for the period. The central government offered to fund half of the costs, but eventually paid 63 per cent in light of the financial difficulties in the state enterprises and the share of pensions and social relief in government current expenditures increased from 5 per cent in 1988 to 15 per cent in 1994.

In the rural areas, which in any economy is traditionally the unemployment-underemployment sink, the labor adjustment is more complicated. Incomes have risen and sparked a flourishing of informal activities in non-tradeables such as in home repair. However, the dismantling of the cooperatives has wiped out the implicit social insurance programs that they provided.

In 1992, after the drastic labor reallocations mentioned above, the government started a loan-and-training program. A network of 120 Centers for Employment Promotion (CEP) throughout the country offers low-interest loans, based on a revolving fund, for starting up small businesses. The loans are given to people who have completed a vocational training program run by the CEPs in a variety of trades such as truck driving, electronics and motorbike repair, fish-, eel-, and frog-raising, and jewelry making. In 1993, the fund disbursed about $18 million, generating employment for about 214,000 people, or about $93 per job if one assumes that all jobs are directly related to the loan-and-training program (O'Connor [1996]). The widely spread Vietnamese party organizations and ties with the local population in the less urbanized areas must be recognized as key resource to a program such as this. It is not clear if programs such as this are transferable to other transition or developing country contexts, where labor flexibility and social cohesion in local areas are constrained by the interaction asset inequalities, caste/other ascriptive divisions, and traditions of corruption.

As mentioned above, the payment systems in state enterprise sector had exhibited become uncharacteristically (i.e. for state enterprises even in market economies) flexible and helped in the re-emergence of labor markets in the late 1980s. In 1981, a government decree permitted enterprises to pay on a piece rate basis as a form of incentive for surpassing production quotas. These payments have evolved into bonuses through which performance is more closely linked to pay, beyond a guaranteed minimum wage. In addition, a major part of employee compensation took the form of new housing and housing maintenance, which allows enterprises flexibility on whether to undertake these expenses depending on their financial situation. A state agency sets and updates the minimum wage applicable to enterprises with more than 10 employees and in which the level required of foreign joint ventures is about three times that of purely local enterprises.

Thus, an operating labor market, with open unemployment, has emerged in Viet Nam, even while accepting the continued existence of excess labor in state enterprises in urban areas. The compulsory allocation of labor in the planned economy has been effectively superseded by (1) easing of registration in the urban areas, (2) strong growth of rural incomes, which improved the bargaining power of peasants (Fforde and de Vylder [1996]), the emergence of non-state enterprises that absorbed labor being shed in the state sector. (See Table 12 which indicates the gentle increase in the rate of unemployment to around 5 per cent.)

All firms employing more than 10 employees are required to provide social insurance to cover sickness, pregnancy, retirement, death, job accidents, and occupational diseases. Workers contribute 5 percent of his/her basic wage, employers contribute 15 per cent of the total wage fund, and the state is supposed to provide additional funds in what is in effect a pay-as-you-go system. Government expenditure in social security takes up as much as 3 to 3.5 per cent of GDP and 13 per cent of government spending (Jansen [1997]). The effective pension scheme is generous and comparable to that of Singapore and the United States and clearly higher than Korea and Japan: men at 60 with 30 years contribution and women at 55 with 25 years contribution receive 75 per cent of the last basic salary and every year of additional contribution adds 1 percentage point, to a maximum of 95 per cent.

Viet Nam has experimented with introducing user fees both for education and health services. In both of these instances, the total expenditures in education and health have increased significantly but a major share of the expenditure is now being borne by users. In the case of education, the immediate effect of the introduction of user fees in 1988 was a decline in enrolment in all levels, a recovery in primary enrolment, but a stagnation in other levels including in technical education (Jansen [1997]). The state contribution covers only 48 per cent of primary education, 30 per cent of secondary education and 78 per cent of post-secondary education. The salary of teachers has lagged behind the general increases in incomes and teachers typically undertake other income-generating activities. Unlike in the past, good students are less attracted to the teaching profession and many teachers are leaving the profession for salaried positions in joint venture enterprises.

The introduction of user fees in health services and reduction in public subsidies to health facilities (implying a reduction in the quality of service) was followed by a fall in utilization rates from 2.1 per 1000 persons in 1987 to 0.93 in 1993 (World Bank [1995a]). The increasing use of private health services has increased so strongly that by 1993 virtually all medicine are purchased from private shops and two-thirds of outpatient consultation are done by private doctors (Jansen [1997]). There has been a marked reduction of participation by the poor in health services.

The Vietnamese transition has then seen the retreat of the traditional socialist provisions for human welfare. Spending targetted for the poor is very small, since most of the social security spending is for retired civil servants and military personnel and the state has retreated from health and education subsidies.

7. On the so-called Asian approach/type of economy emerging

Viet Nam (and China) appear to have some ready-made Asian "models" on which to configure the future direction of their development/transition effort. One can list key elements of this model thus (Montes and Lee [1996]).

(1) strong state direction of the development process with a clear subsidiarity and supporting role for the private sector,

(2) trade policy in the service of industrialization (protection and state subsidy where potential exists, export orientation, including invitation of foreign investment, to raise resources and obtain technology for industrialization).

The problem with the Asian model is that the understanding of its social underpinnings and operability is rudimentary. This makes it to difficult analyze the feasibility of a Vietnamese and/or socialist version of the Asian model. Anglo-Saxon economics originally interpreted the Asian model as a case of industrialization occurring as a result of private response to an effectively neutral trade and industrial policy regime (Krueger and Akranasee, OECD [1980]). The "East Asian miracle" analysis (World Bank [1993]) supersedes this interpretation. It concedes an actual and important state role in industrial policy and development, but only if the state has the capacity for politically neutral and economically efficient intervention.[9]

By not identifying the bases for state capacity, this interpretation pushes the exogenous explanation one step farther away from analysis, the exogenous factor being state capacity.[10] If state capacity is endogenous to economic structure and socio-political configuration, then economies like Viet Nam should seriously ponder their approach to (further) transition.

At the present juncture, with liberalized price-setting and international trading freed of most licensing restrictions for export-oriented firms, Viet Nam can be pronounced has having successfully carried out a socialist transformation to the market (Dollar and Ljunggren [1995]) "mechanism" (the latter word being an favorite Vietnamese construction). According to this view, the surviving vestige of the socialist system is the continued

[9] The additional fillip added by this literature is the importance of macroeconomic stability. This permits the exclusion of Latin America and the Philippines, which had highly capable states and strong private sectors, but were unstable macroeconomically. In any list of potential factors, one would have expected Washingtonian economists to consider macroeconomic stability to be endogenous.

[10] See Montes [1995] for this type of critique.

growth of the state sector and state control of the financial companies.[11] There is easier access to credit by state firms and bureaucratic restrictions on renting land/property and business licensing arrangements on non-state firms. Evaluating whether state enterprises in Viet Nam have been more efficient or adjusted better is also made difficult by the fact that the contribution of genuinely private entities in industrial output is not significant. The clearest statement that can be made here is that except during the (brief) deep recession of 1988-90, state enterprises have managed to maintain positive rates of growth of gross output and to regularly pay wages to their remaining employees. The contrast with the experience of some other countries that have abandoned socialism is striking in this regard.

There is also one practical/technical reasons why the rapid privatization of state enterprises, as often demanded in journalistic treatments of Vietnamese economic problems, might be rejected: There are profound implications on tax revenue, as even an International Monetary Fund occasional paper (Dodworth, *et. al.* [1996]) warns. It is also important to point out that rapid privatization of the banking system will reduce government capacity to monitor earnings of both state and non-state enterprises for tax purposes. The problem compounded in a region with porous borders and long traditions in trading in gold and in offsetting accounts through the Chinese overseas networks.

With a significant state role in the economy in the foreseeable future, Viet Nam's politico-economic configuration shares many features with that of Latin America before the 1980s debt crisis and that of East Asia. The Latin American configuration can be described as having two elements: (1) state-created distortion of prices, often at the instigation of private parties,[12] justified by development objectives and (2) reliance on a vigorous private sector responding to the distorted prices as the agent of development. An illustrative case would be state policies to provide guarantees and subsides to capital inflows and various forms of external

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[11] Lee [1996] discusses the system of 'legal person socialism' in China in which profitable state enterprises are being transformed into shareholding corporations.

[12] See Montes [1995] for a description of the dynamics in the case of the Philippines.

borrowing justified by the *overall objective* of raising the domestic investment rate.[13] As has been proven time and again in Latin America and in the Philippines, this approach is susceptible to excessive private sector exuberance and exploitation leading to periodic stumbling into economic crisis and policy retreat.

Montes and Lee [1996] suggest that there are two East Asian styles - the Northeast style of Japan, Korea, Taiwan, and off-region Singapore and the Southeast style of Malaysia, Thailand and Indonesia (recognizing that there are differences even within each grouping). In the Northeast style, *overall objectives*, such as increasing the domestic investment rate, are broken down to some detail and budgeted state-controlled resources, if not actually carried out by state agencies themselves. In this style, state activism was based "not only on the political authority of the state, but more importantly on actual economic power derived from the state ownership of banks or loanable funds" (Montes and Lee [1996, p. 20]). In the Southeast style, with a weaker bureaucratic tradition and capacity, controls are applied on the total cost of policies, often flirting with Latin American style disaster[14] but with sufficient state dominance over the private sector to implement forceful responses to avoid economic reversals. In both cases, the private sector is neither the sole nor the primary agent of development.

The incidence of reports of difficulties in the banking sector, continuing losses in state-related enterprises coupled with stories of embezzlement by officials[15] remind of stories from Malaysia or Indonesia, except possibly in the aspect, ironically, of more open reporting by foreign journalists in the case of Viet Nam.[16] The government has been asking

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[13] Technically, this approach tests the Harberger externality, in which after a certain level of external indebtedness is breached foreign creditors call a halt to all lending to a country, irrespective of the nature of the project.

[14] As in Malaysia in 1988 (Montes and Lee [1996]).

[15] See Murata, Nikkei Weekly [1997].

[16] The ubiquity of international media coverage and the often unconsidered journalistic pressure on officials to speed up privatization and liberalization is the inescapable fate of all transition economies seeking to re-enter world trade and financial markets. In international coverage, transition officials risk being

companies from the thriving and profitable private sector to bail out some loss-making state enterprises, currently estimated to be about 30 per cent of the total number of the remaining 6,300 state companies.[17] Moreover, in the foreseeable future, much Viet Nam's continuing need for foreign capital; these resources will be funnelled (directly or indirectly) through the state guarantees, magnifying the potential macroeconomic impact of enterprise and financial losses. Vietnamese authorities recognize the problem and have assigned the most urgent priority to radical reform of the state enterprises.[18]

On the other hand, the privatization of the financial and industrial sector will continue as a point of discussion between Viet Nam and foreign financiers, just as Viet Nam will be economically dependent on such finance.[19] The argument that Viet Nam can grow faster, reduce the cost of inefficient state enterprises, gain more access to foreign resources will be made on the external side.

One makes this statement at great risk but it appears that Viet Nam has the potential to follow a Southeast Asia path. Viet Nam's overall macroeconomic stance is as "potentially" conservative as Thailand's; while Viet Nam has proven its capacity to swift adjustment it has been tempted in recent years to endanger macroeconomic stability for growth, something never seen in Thailand. Viet Nam has a credit allocation system, not by completely by design, that is like that of Indonesia or Korea through most of their own growth period. The banking system has not been privatized and the operation of the credit system draws significant resources from the state.

The East Asian miracle conception of "state capacity" depends particularly on the capacity for information processing and governance and, on the basis of human resources and governmental functioning,

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quoted in a skeptical tone if they do not mouth utterly market-oriented sentiments.

17 In comparison to China, the proportion of loss-making enterprises is seems to be smaller, but Viet Nam has a more fragile macroeconomic situation.

18 See Murata, Nikkei Weekly [1997].

19 That is, commercial borrowing will require an IMF program or World Bank sectoral programs to be in place.

Viet Nam has greater capacity than Thailand. But this conception is incomplete since information generation also requires a trustworthy (from the point of view of the state) private sector.[20] Viet Nam intends to consolidate the state enterprise sector into about 13 large groups, and configure the scope of the control to be comparable with that of Korea's control over the chaebols.[21] *The problem is that, unlike in the Asian model, the state sector does not really have an indigenous private sector with which to coordinate*[22] *investment/subsidy decisions.* The state will have to rely heavily on the pressures brought to bear by international agencies and foreign businessmen, including *Viet khieu* overseas Vietnamese, to obtain information not otherwise generated from within the bureaucracy.

The prospect is for continued difficulties in the state sector, with episodes of bankruptcies and large losses. The agricultural sector can be expected to remain robust and with a steadily growing savings rate, the losses from these episodes of enterprise bankruptcies can be absorbed, though with the usual recriminations and further calls to liberalize the trade regime from foreign financiers as has been the case of Indonesia.

In a more general framework, the nature of the state is of course endogenous (a point forcefully made in the case of Viet Nam by de Vylder and Fforde [1996]) and that what happened in the recent past and what happens in the future are both indications of the policy-and-

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[20] The East Asian miracle formulation has no theory about different kinds of private sectors and relies on the neoclassical assumption that all private sectors, given the right framework, are reliable development partners (Montes [1995]).

[21] The capitalist sector in most developing countries are creatures of the state (Boratav, Türel, and Yeldan [1996]), from whose control this sector continually struggles to free itself. One must qualify this for countries whose post-independence experience partook of strong neocolonial relations, where large and independent capitalist groups have preserved their independence of the state.

[22] Coordination with dominance by the state. The clearest example is in Malaysia where the business sector is dominated by ethnic Chinese. The Malaysian constitution restricts the scope for political participation of Chinese Malaysians.

pressure process being brought to bear on state organs which themselves are transformed because of these events.

The central Vietnamese state has lost much of its original capacity and financing in the area of rural development and rural industrialization. To permit faster development in this sector, it must find means by which its defense of the state industrial sector does not prevent the emergence of small industries in the rural areas. (The provision of infrastructure is a Vietnamese priority, but permitting the flourishing of activities in the rural areas is another matter.) As it is now, the state is configured more in the mode of obtaining agricultural surpluses through the banking sector to finance industrial ventures in the Korean style. This mode of development reserves the commanding heights of the economy for the state, but is a retreat from a previous emphasis on the rural areas.

We have also chronicled the significant state retreat, though the trend has been halted, from its responsibilities in providing social services in an equitable manner. This represents a loss for rural areas and for poorer members of society, though growth (and more variety in economic choices) has offset these losses to an unknown extent.

Is there a socialist road to the "market"? If functioning (as opposed to dysfunctional) markets are what are sought, if functioning markets require a state with a powerful influence over economic outcomes and if 'socialism' proposes a state with powerful control over economic outcomes,[23] then Viet Nam has, so far, illustrated a socialist path to the market. Each of the 'ifs' is subject to severe definitional problems. Do functioning markets, for example, require a state with a powerful but declining influence over economic outcomes? The state of Viet Nam stubbornly resists a decline in its economic influence. The impact of this insistence will not be on a successful transition, which according to the interpretation here is completed, but on development.

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[23] Socialist projects, while loud about outcomes, have tended to be suspicious and at least defeaningly silent about economic incentives.

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Appendix A: Macroeconomic model

The basic equations of the 3-gap macroeconomic model used in this exercise are the following:

$$i = i_p + i_g \qquad (1)$$

$$i_p = i_0 + \alpha i_g + \beta u \qquad (2)$$

$$i = i_0 + (1+\alpha) i_g + \beta u \qquad (3)$$

$$s = s_p + s_g + \phi \qquad (4)$$

$$s_p = \sigma_0 + \sigma_1 u \qquad (5)$$

$$s_g = z - j^* \qquad (6)$$

$$z = z_0 + z_1 u \qquad (7)$$

$$\pi u = i_g - s_g \qquad (8)$$

$$\phi = (m_r + m_k + m_o) - x - j^* - \eta - \Delta R \qquad (9)$$

$$m_r = a_0 + a_1 u + a_2 x \qquad (10)$$

$$m_k = (1-\theta) i \qquad (11)$$

$$q = q_0 + \kappa(t) i \qquad (12)$$

An overall supply constraint is represented by the activity variable 'capacity utilization', which is represented in the model by the variable **u** and takes a maximum value of 1. All the variables are measured as proportions to potential output, with the exception of the public sector borrowing requirement (PSBR) which is measured as a proportion of actual output.

In Equation 1, total investment, **i**, is the sum of private investment, $\mathbf{i_p}$, and public investment, ig. Equation 2 proposes that private investment is (linearly determined) through an "animal spirits" parameter, $\mathbf{i_o}$, as a complementary response to government investment through the parameter α, and through the accelerator term, β **u**. Equation 3 is total investment, being the sum of equations 1 and 2.

Total savings, **s**, broken into private, s_p, public, s_g, and foreign, ϕ, is given in Equation 4. Equation 5 characterizes private savings behavior as a function of activity, with the parameters σ_o and σ_1 being jointly determined by the income elasticity of the savings rate. Fiscal effort, **z**, defined implicitly in Equation 6 as revenues minus current expenditures excluding debt service on foreign debt, is specified as a linear function of the activity variable in Equation 7 through parameters z_o and z_1. In Equation 6, total government savings is defined as the fiscal effort less interest payments on foreign debt; in this equation, j^* is total interest payments on foreign debt and μ is the government share of these payments (which is basically set to 1 for the calibration). Equation 8 expresses the identity that the public sector borrowing requirement (PSBR) as a proportion of potential output, π **u**, is equal to the amount by which government investment expenditure exceeds government savings.

Equation 9 expresses the balance of payments as foreign savings (equivalent to the current account deficit composed of imports minus exports plus foreign interest payments and net capital inflows, η) minus changes in reserves and other unaccounted capital flows, Δ**R**. Imports are broken down into raw material imports, m_r, whose level depends on economic activity **u** and the level of exports, **x** (Equation 10); capital imports, m_k, dependent on the proportion of investment $(1 - \theta)$ that must be imported (Equation 11); and other imports, such as medicine, and consumer goods, m_o. The level of exports is exogenous in the model and assumptions in this variable have to be made jointly with the availability of external finance, even though it affects demand for intermediate inputs through the parameter a_2 in Equation 10.

Equation 12 relates the rate of investment, **i**, to the rate of growth of capacity, q, through a Harrod-Domar equation in which $\kappa(t)$ represents the inverse of the incremental capital-output ratio and g_o represents both the effect of depreciation of capital assets and the underlying growth prospects for the economy. While the values of the various elasticities in Equations 1-11 might evolve based on success/failure in development, the evolution of κ in this type of model can represent the overall impact of transition. There are various indices that can be associated with transition, such as the private versus public sector provision of goods and the level of foreign trade as a proportion of output. κ, of course, can also be related to development index; the relative proportion of output between agriculture and industry can be one index.

For purposes of analysis, one can combine Equations 1 to 5 with the condition

i = s

and solve for the level of investment to derive the domestic savings gap:

$$i_s = (\sigma_0 + z_0 - j^* + \phi) \quad + \quad (\sigma_1 + z_1)\,u \tag{11}$$

The fiscal gap is derived from Equations 2 and 6 through 8:

$$i_f = i_0 + (1+\alpha)(z_0 - j^*) + \left[(1+\alpha)(\pi + z_1) + \beta\right] u \tag{12}$$

and the foreign exchange gap comes from Equations 2, and 9 through 12:

$$i_e = \left[\frac{\phi - a_0 - m_0 + \eta + \Delta R + j^* + (1 - a_2)x}{1-\theta}\right] + \left[\frac{a_1}{1-\theta}\right] u$$

Table 1. Gross Domestic Product (GDP) by ownership
(at constant 1989 prices - billions of dongs and per cents)

	Total	Growth rate	Distribution		GDP Excl. oil & state growth rate	GDP Excl. oil/rice growth rate
			State	Non-state		
1986	24,431		33.33	66.67		
1987	25,291	3.52	34.09	65.91	3.3	5.3
1988	26,835	6.10	34.77	65.23	3.1	1.2
1989	28,093	4.69	33.18	66.82	5.3	3.8
1990	29,526	5.10	32.36	67.64	2.7	3.1
1991	31,286	5.96	33.16	66.84	4.3	4.9
1992	33,991	8.65	34.31	65.69	7.2	6.6
1993	36,735	8.07	35.42	64.58	7.5	7.9
1994	39,982	8.84	36.71	63.29	8.3	9.5
1995 est.	43,797	9.54	38.77	61.23	n.a.	n.a.

Source of basic data: Central Statistical Office [1996], Table 13 and Table 2.1 of Dodsworth, *et. al.* [1996].

Table 2. State enterprise adjustment (budget and bank transfers of state enterprises)

	1987	1988	1989	1990	1991	1992	1993	1994	Percent Change of Level 1987-94
Transfers to budget	10.8	7.9	8.4	8.6	8.1	10.8	11.8	12.1	6,916.0
Taxes					6.9	8.3	9.3	9.2	
Transfers	10.8	7.9	8.4	8.6	1.2	2.5	2.5	2.9	
Operating surplus	10.3	7.3	7.6	7.4					
Depreciating allowance	0.6	0.6	0.8	1.2	0.8	2.1	1.9	2.3	25,406.7
Capital user fee					0.3	0.5	0.6	0.7	
Transfers from the budget	7.9	8.5	4.8	2.6	1.0	0.9	0.6	0.5	283.1
Subsidies	4.8	4.9	0.5		0.1	0.2	0.1	0.1	93.8
Food	3.1	2.7							
Production	0.3	0.4							
Exports	1.4	1.9							
Working capital	0.5	0.6	0.5	0.3	0.3	0.7	0.5	0.3	3,942.9
Capital transfers	2.5	2.9	3.8	2.3	0.7				
Net transfers to the budget	3.0	-0.6	3.6	6.0	7.1	10.8	11.2	11.6	24,576.3
Growth in bank credit to state enterprises	9.6	9.2	7.1	4.0	5.0	3.0	2.3	2.4	1,498.8
Net bank and budget support of state enterprises	6.6	9.7	3.5	-2.0	-2.1	-6.9	-8.9	-9.2	-8,615.1
Memo: Nominal GDP (billion dongs)	2,708	14,535	26,620	42,093	76,407	110,109	136,320	169,729	6,168.5

Source of basic data: Dodsworth *et. al.* [1996] Table 3.2.

Table 3. Distribution of gross output of industry by management level

	Total	of which Central	Local
1985	100.0	34.0	66.0
1986	100.0	33.8	66.2
1987	100.0	32.8	67.2
1988	100.0	32.2	67.8
1989	100.0	36.4	63.6
1990	100.0	39.7	60.3
1991	100.0	48.1	51.9
1992	100.0	50.5	49.5
1993	100.0	51.9	48.1
1994	100.0	52.2	47.8
1995 est.	100.0	52.5	47.5

Source of basic data: Central Statistical Office [1996], Table 134.

Table 4. Distribution and growth rate of gross output of industry by economic sectors (in percents)

	Output (1989 Dong, mill.)	Growth rate	Percent of Total State	Non-State
1985	10,521,403.2		56.3	43.7
1986	11,170,876.3	6.2	56.3	43.7
1987	12,283,386.9	10.0	55.9	44.1
1988	14,042,955.7	14.3	56.5	43.5
1989	13,583,596.6	-3.3	57.0	43.0
1990	14,011,073.0	3.1	58.6	41.4
1991	15,471,092.0	10.4	68.5	31.5
1992	18,116,895.0	17.1	70.5	29.5
1993	20,412,035.0	12.7	71.7	28.3
1994	23,214,225.0	13.7	72.4	27.6
1995 est.	26,463,000.0	14.0	72.4	27.6

Source of basic data: Central Statistical Office [1996], Table 135.

Table 5. Number of non-state industrial establishments by types of ownership (establishments)

	In numbers				In percents of total			
	Total	Coop-erative	Joint venture	Private	Total	Coop-erative	Joint venture	Private
1985	242,721	35,629	920	206,172	100.00	14.68	0.38	84.94
1988	350,909	32,034	318	318,557	100.00	9.13	0.09	90.78
1989	356,522	21,901	1,284	333,337	100.00	6.14	0.36	93.50
1990	390,756	13,086	770	376,900	100.00	3.35	0.20	96.45
1993	457,625	5,287	3,322	449,016	100.00	1.16	0.73	98.12
1994	499,603	1,648	4,909	493,046	100.00	0.33	0.98	98.69
1995	524,299	1,729	5,152	517,418	100.00	0.33	0.98	98.69

Source:Central Statistical Office [1996], Table 131, p. 280.

Table 6. Recent macroeconomic data

	1991	1992	1993	1994	1995
GDP growth rate	6.0	8.6	8.1	8.8	9.5
<u>In per cent of GDP</u>					
Gross domestic investment	15.1	17.0	20.5	24.1	27.6
Gross domestic savings	16.5	19.6	14.9	17.6	19.1
Current account deficit			6.7	6.2	8.9
Merch. exports/GDP			20.4	23.3	30.7
Merch. imports/GDP			24.6	29.1	42.0
Central govt. budget deficit			6.2	2.4	5.5
Inflation rate			5.3	14.4	12.7

Source of basic data: ADB [1996] and Table A10 of Dodworth, *et. al.*

Table 7. Equilibrium data set, Viet Nam 1995
(as a per cent of potential economic activity)

Variable	Variable Definition	Value
u	Capacity utilization	93.0
g	Growth of potential economic activity	9.5
i	Total investment	27.6
i_g	Government investment	8.8
i_p	(Non-state) Private investment	18.8
s_g	Government revenue less consumption	3.3
s_p	Private savings	15.4
ϕ	Foreign savings	8.9
π	PSBR	5.5
j^*	Foreign interest payments (net)	3.2
x	Merchandise exports	30.0
m	Merchandise imports	42.0
m_r	Imports of raw materials and intermediates	26.5
m_k	Imports of capital goods	11.4
m_o	Other imports	4.2
η	Net foreign capital inflow	5.2
ΔR	Change in reserves/arrears/other items	0.0

Table 8. Assumptions and parameters

	For Equilibrium Data Set	Adjust Scenario
Elasticity of Fiscal Effort	0.4	0.5
Elasticity of Private Saving	0.5	0.7
Elasticity of Intermediate Import Demand		
with respect to Overall Activity	0.45	0.60
with respect to Exports	0.30	0.45
Accelerator coefficent, β	1.0	1.0
Private Response to Government Investment	1.1	1.25
Proportion of Investment sourced domestically	0.59	0.40

Table 9. Feasible adjustment
(in per cents and as per cents of potential economic activity)

Variable	Variable Definition	Value
u	Capacity utilization	84.7
q	Growth of potential economic activity	8.4
i	Total investment	24.8
i_g	Government investment	7.9
i_p	(Non-state) Private investment	16.9
s_g	Government revenue less consumption	4.4
s_p	Private savings	15.4
ϕ	Foreign savings	5.0
π	PSBR	3.5
x	Merchandise exports	23.0
m	Merchandise imports	42.0

Table 10. Average annual growth rates of gross real industrial output, by sector

	1985-88	1988-90	1990-91	1991-95
TOTAL	*10.10*	*-0.11*	*10.42*	*14.36*
Electricity	7.11	12.83	5.22	13.70
Fuels	14.83	96.34	38.01	19.00
Ferrous metallurgy	12.88	-0.03	57.00	18.96
Non-ferrous metallurgy	19.62	17.14	32.72	8.16
Equipment and machinery	16.91	-11.40	-1.62	13.42
Electric and electronic products	25.43	13.00	1.92	16.65
Other metallic products	15.66	-7.44	-2.56	8.47
Chemical products, fertilizers and rubber	5.04	2.42	21.02	19.86
Construction materials	8.82	3.89	16.48	16.46
Wood and wood products	9.97	-8.09	4.03	10.84
Cellulose and paper	8.01	-6.40	-6.25	18.30
Glass, earthware, and porcelain	6.35	-9.18	22.00	13.03
Food	10.92	9.63	9.25	14.73
Foodstuffs	7.77	-2.43	6.45	10.79
Textile products	5.88	-4.87	1.42	8.56
Sewing products	22.58	-4.34	8.20	31.03
Tanning and manufactures of leather products	26.71	-4.00	-39.88	45.71
Printing	26.39	0.32	11.36	26.55
Others	14.08	-10.29	-3.52	8.39

Source of basic data: Central Statistical Office, Table 139.

Table 11. Distribution of employment (thousands of persons)

	1988	1989	1990	1991	1992	1993	1994
			In thousands of persons				
Total employment	24,408	28,851	30,294	30,974	31,819	32,718	33,669
Nonstate employment	24,357	25,051	26,874	24,830	28,843	29,750	30,735
Cooperatives	20,998	19,674	19,380	18,174	...	...	...
Private	3,359	5,377	7,494	9,656	...	...	...
State sector employment	4,051	3,800	3,420	3,144	2,976	2,968	2,934
Government	1,342	1,295	1,241	1,227	1,193	1,199	1,192
Central	315	282	253	278	264	260	254
Local	1,027	1,013	988	949	929	939	938
State enterprises	2,710	2,506	2,181	1,916	1,782	1,761	1,740
Central	1,255	1,188	1,091	1,018	978	995	996
Local	1,455	1,318	1,090	898	804	766	744
			Distribution (per cent of total)				
Total employment	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Nonstate employment	99.8	86.8	88.7	80.2	90.6	90.9	91.3
Cooperatives	86.0	68.2	64.0	58.7	...	...	...
Private	13.8	18.6	24.7	31.2	...	...	...
State sector employment	16.6	13.2	11.3	10.2	9.4	9.1	8.7
Goverment	5.5	4.5	4.1	4.0	3.7	3.7	3.5
Central	1.3	1.0	0.8	0.9	0.8	0.8	0.8
Local	4.2	3.5	3.3	3.1	2.9	2.9	2.8
State enterprises	11.1	8.7	7.2	6.2	5.6	5.4	5.2
Central	5.1	4.1	3.6	3.3	3.1	3.0	3.0
Local	6.0	4.6	3.6	2.9	2.5	2.3	2.2

Source of basic data: Dodsworth, *et. al.* [1996], Table A-12.

Table 12. Employment statistics

	Growth rate of			Rate of
	Labour force	Employment	Unemployed	Unemployment
1985				3.1
1986	4.7	5.3	1.5	3.0
1987	2.7	2.1	16.4	3.4
1988	3.2	3.4	-0.6	3.3
1989	4.9	0.1	81.3	5.6
1990	4.2	4.7	-21.1	4.3
1991	3.1	2.3	11.4	4.6
1992	2.6	2.7	29.5	5.8
1993	2.5	2.8	-7.3	5.3
1994	2.8	2.9	-1.0	5.1
1995 est.	2.9	3.0	1.0	5.0

Source of basic data: Central Statistical Office [1996], Table 4

Figure 1
Viet Nam's transition

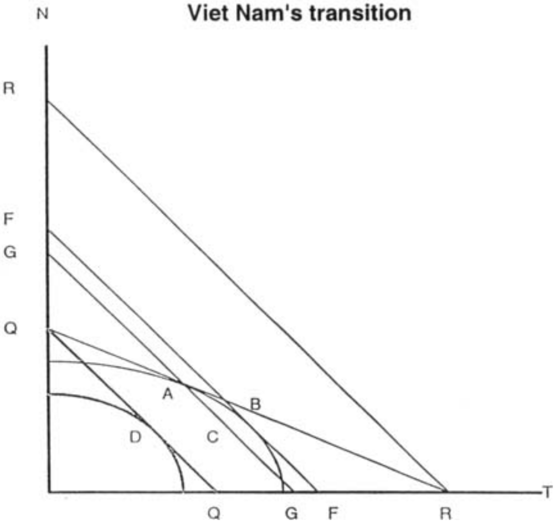
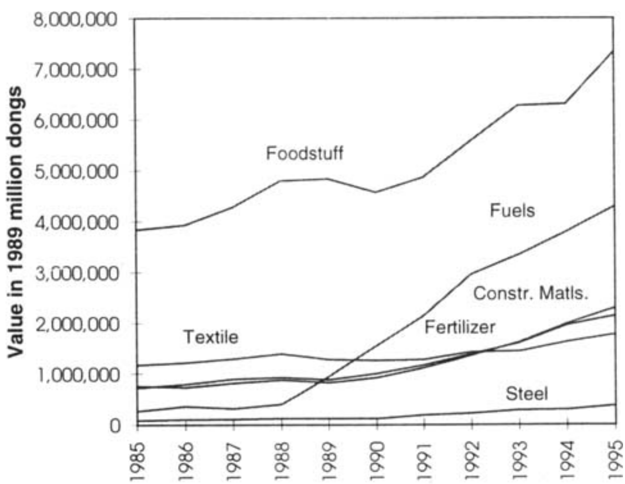
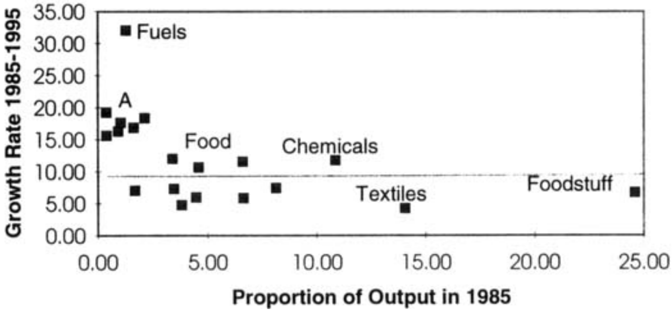


Figure 2
Vietnam, gross output of selected industrial sectors



Source of data: Central Statistical Office [1996], Table 139.

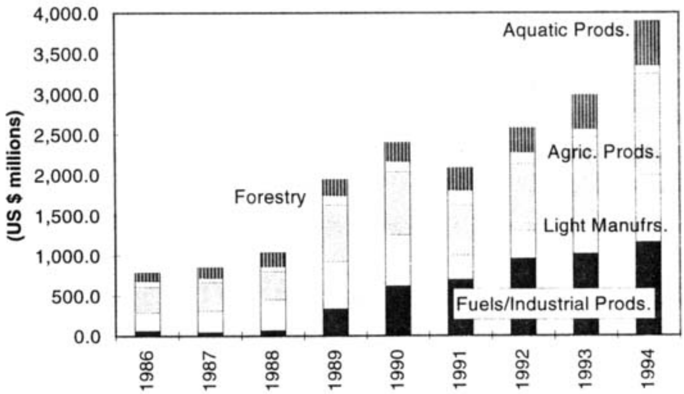
Figure 3
Growth rates and 1985 industrial weight, Viet Nam



A: Ferrous metallurgy
Non-ferrous metallurgy
Electric and electronic products
Tanning and leather products
Sewing products
Printing

Source of data: Central Statistical Office [1996], Table 139.

Figure 4
Changing structure of exports, Viet Nam



Source of basic data: Central Statistical Office [1996], Table 212.

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