Rethinking Development in East Asia

From Illusory Miracle to Economic Crisis

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DEALING WITH THE CRISIS IN VIETNAM

THE RETHINKING OF DEVELOPMENT STRATEGIES

Pietro P. Masina

INTRODUCTION

In mid-1990s Vietnam seemed to be blessed by a benign fate and was looking forward to a prosperous future. After decades of war and international isolation, the country was restoring and enhancing relations with neighbours and the rest of the world. The economy was striving with the GDP growing at more than 9 per cent per year; the flow of foreign direct investment was accelerating. The country could jump from rice importer to a position as the world's second largest exporter of the product. The poverty rate was declining. All these positive achievements were considered as a result of *doi moi* – the process of economic reform – and of the successful cooperation between the country and the international financial institutions. And Vietnam, like other countries in the region, was embracing the dream of becoming the 'fifth tiger', i.e., joining the club of the fast-growing newly industrializing economies (NIEs).

Already some months before the onset of the crisis, however, dark clouds were gathering in the Vietnamese sky. Since early 1997, in fact, it became increasingly clear that the road to prosperity was going to be full of obstacles and adversities. Foreign investments to Vietnam started to shrink and the GDP growth began to decelerate one year before the financial crisis hit the rest of the region. And the international financial institutions started to voice their criticisms and to ask for a faster pace in the process of economic reform.

The 'official wisdom' has explained recent developments in the Vietnamese economy in the following terms. Vietnam was suffering before the regional crisis because the national authorities did not implement the needed bold reforms, and because the country was plagued by inefficient bureaucracy, corruption and red tape. During the regional crisis the country was partially shielded by its scarce integration into the world economy. But in the post-crisis environment, it must implement the needed reforms rapidly to avoid been excluded from the successful recovery foreseen for other countries.

This chapter aims to challenge this official wisdom supported by mainstream economists and international financial institutions. The slowdown of Vietnamese economy before the regional crisis will be analysed against the background of the regional overproduction malaise, which reduced the need for foreign companies to invest in a 'new entry' like Vietnam. This chapter will also urge a critical reading of the measures that Vietnam should take to reshape development strategies. The country has avoided being hit too hard by the regional financial meltdown. But the future, in the aftermath of the regional crisis, is beset with challenges and risks. Therefore the adoption of a development strategy involves difficult decisions regarding the modality of integration into the world economy and the process of economic reforms.

THE REFORM AGENDA BEFORE THE CRISIS

At its Sixth Congress of December 1986, the Vietnamese Communist Party decided on a major political reform under the title of *doi moi* (renovation). Already since 1979, a number of reforms in industry and agriculture had been anticipated, especially in the South. The official adoption of *doi moi* – also a result of a change in the leadership of the VCP – added new momentum to the reform agenda. Thus, from the late 1980s Vietnam embarked on a number of policy changes, which in a few years transformed international relations, the development strategy and the socioeconomic structure of the country.

These changes derived from national and international factors, and have been explained by the analysts in different – and sometimes contradictory – ways.[1] Briefly, we can recall the two main elements behind this transformation. First, there was the need to cope with the crisis in the Soviet Union, which involved a drying-up of economic aid, the loss of the traditional export market, and a dangerous isolation in political and military terms. Second, there was the economic impasse which affected the country from the late 1970s, partially deriving from the high cost of the war in Cambodia, but also by deficiencies in the economic management and difficulties in integrating the Southern provinces into the economic system of the North.

In the field of international relations, Vietnam reached the indubitable achievement of not only avoiding being hurt by the end of the Cold War but also enhancing its strategic regional position. The withdrawal of Vietnamese troops from Cambodia (September 1989) paved the way for the re-establishment of economic and political ties with many countries in the region and beyond. In the few months following the Paris agreements on Cambodia in October 1991, Hanoi reached a full normalization of diplomatic relations with most countries, including China, with which Vietnam had a brief but intense armed clash in 1979.

The rapprochement with the nation's Southeast Asian neighbours, already initiated in 1992, was successfully concluded with formal admission into ASEAN (July 1995), which eventually opened the way for participation in the AFTA (ASEAN Free Trade Area).

The normalization of relations with the United States proved somewhat slower. Washington maintained an embargo against Vietnam until February 1994, and full diplomatic relations were not reinstated until June 1995. However, already in July 1993, the American administration removed the barrier to multilateral aid, allowing the World Bank to resume lending to the country during the following October.

The overall achievement of this global revolution in the Vietnamese international relations seems to motivate two considerations. First, this revolution was carefully managed, *improving simultaneously the relations in all directions*. While Vietnam showed great ability in playing the 'Chinese card' – i.e., letting Southeast Asian countries and the United States understand the importance of a common front with Vietnam – at the same time Hanoi was able to achieve a remarkable improvement in relations with Beijing.

Second, this enhanced international position of Vietnam proved to be a key resource for receiving financial support for economic reforms within the country. From the moment in which it again received official development assistance (ODA) until a few months before the regional economic crisis onset, Vietnam seemed to benefit from a kind of preferential treatment that some considered to be connected with its strategic position and careful foreign policy.[2]

The process of economic reform proved to be more complex and contradictory than the change in the political external relations. On this ground the debate within the Vietnamese leadership has been very intense and disagreements have surfaced at each critical juncture in the reform process. This debate has resulted in a very careful approach, which has been often depicted by foreign analysts as an excessively slow tempo in addressing the necessary reforms.

The pace of the reform process has been in fact the major criticism that international financial institutions have made to the Vietnamese authorities, while officially claiming the existence of a substantial agreement on the overall agenda and on the measures to be implemented. However, since the mid-1990s the existence of a major disagreement between the Vietnamese government and the international financial institutions has been proved by the difficulty in signing new structural adjustment programmes and by the repeated withholding of soft loans pledged on the basis of conditionalities (discussed below; 'The impact of the crisis').

The artifice of a general agreement with the international financial institutions has been maintained also by the Vietnamese side by not voicing openly an alternative development strategy, while retaining considerable autonomy in the implementation of its own national policy. This attitude can probably be traced in the traditional Vietnamese pragmatism apart from the need not to compromise relations with international donors. The nature of the Vietnamese decision-making process – based on the search for consensus within the leadership and a balancing of the different interests at stake – has also contributed to an avoidance of too binding a pronouncement and to an emphasis on a careful implementation of the agreed measures.

THE IMPACT OF THE CRISIS

The non-convertibility of the dong and the regulation of trade and exchange transactions successfully shielded Vietnam from the vagaries of international financial contagion. In the months immediately following the dramatic events of July 1997, Vietnam appeared as a serene island in the middle of a region plagued by a severe economic downturn. Though, in the course of 1998 – when the financial meltdown evolved into a crisis affecting the real economy of the region – the impact on the Vietnamese economy became increasingly evident. At the end of the year all major macroeconomic indicators revealed a rather critical situation. Vietnam did not enter into a recession but GDP growth declined sharply. During 1998 the government was forced to readjust its expectations downwards from the planned 9 per cent to about 6 per cent. The official data indicate that real GDP growth was at 5.8 per cent in 1998 and at 4.7 per cent in 1999.[3]

In the emergency situation the Vietnamese government proved quite successful in maintaining macroeconomic stability. This was recognized by the international financial institutions, which also admitted that their pessimistic forecasting had been avoided:

> In the two years of East Asian recession, Vietnam has followed a cautious economic stance, giving priority to ensuring macroeconomic stability rather than taking risks in order to achieve higher growth. This has led to some successes. Contrary to the fears of eighteen months ago, Vietnam has avoided the serious balance-of-payments, fiscal or banking crises that have been common in the region. (World Bank 1999a)

However, as the quoted report also indicated, the impact of the contraction in the growth rate has been significant in many regards. A major effect was a fall in the investment as a share of GDP: from 29 per cent in 1997 to an estimated 19 per cent in 1999, with half of this decline attributed to shrinkage in foreign investment flows (ibid.).

Another major implication of the crisis was a slump in government revenues from 23 per cent of GDP in 1996 to 17.8 per cent in 1999 (*UNDP Socioeconomic Bulletin* 2000). This decrease forced the government to cut expenditures accordingly in order to avoid fiscal instability, thus curtailing the resources for expansionary economic policy (as it was attempted, instead, by China). However, to reduce the impact of the recession on the population, the government sought to protect social expenditures (World Bank 1999a).

Shrinkage of FDI inflows became a major reason of concern for the Vietnamese authorities already months ahead of the regional crisis. Fading interest by foreign companies to invest in the country was interpreted by the international financial institutions as a sign of an impasse in the reform process: foreign entrepreneurs were put off by excessive red tape, corruption and a faltering legal system. Thus, international agencies and mainstream Western analysts pressured the government to restore confidence by addressing needed reforms. Given the country's hunger for investment capital and foreign technology, Western criticisms touched a nerve: conditions for making Vietnam more attractive to foreign investors occupied the centre-stage in the national policy debate at the height of the regional crisis. This led to the approval of a new legislation on foreign direct investment (2000) and to the simplification of administrative rules. However, there are reasons to believe that the understanding of the FDI shrinkage promoted by the international agencies was excessively one-sided and thus not able to assist policy-making adequately. The analysis of FDI commitment and disbursement to Vietnam indicates that investment shrinkage in the months before the regional crisis was essentially due to the real estate sector: i.e., reflecting a regional bubble economy malaise, which in other countries was partially concealed by short-term capital flows until July 1997. Contrary to what was normally understood, FDI disbursement to Vietnam – excluding the real estate sector – did not contract before the regional crisis. And after the regional crisis had unfolded, the sharp decline in FDI inflows to Vietnam was closely related to a decline in FDI outflows from those Asian countries who had been the major source of investment to Vietnam (Masina 2001). Thus, the analysis of data indicates that Vietnam was more closely integrated with the regional productive system than is usually reported, and was therefore vulnerable to the external economic trends. In the pre-crisis environment, Vietnam was also the object of a foreign investment rush – with the highest ratio to GDP in the region – probably disproportionate to the country's absorption capacity (ibid.). These considerations suggest that the medium- and long-term economic perspectives will largely depend on the post-crisis reorganization of the regional productive system. Therefore, an attempt to restore confidence would barely reach its goal in attracting new investment, if this is not supported by a realistic understanding of regional economic dynamics and by an effective industrial policy (we shall return to this point later).

After the onset of the regional crisis, the FDI inflows to Vietnam contracted sharply, falling from over US$2 billion US in 1997 to about 800 million in 1998, and well below that figure in the following two years.

The vulnerability of Vietnam in the midst of the regional crisis was exploited by the international financial institutions, which tried to push for a bolder implementation of pro-market reforms. Since 1993, when the US government removed its opposition to international financial institutions' lending, official development assistance (ODA) to Vietnam grew fast. Annual commitments reached US$2.4 billion in 1996 and 1997, making Vietnam one of the largest recipients of multilateral concessional loans. The rate of disbursements remained low, but on the eve of the regional crisis Vietnam improved its ODA absorption capability and implementation speed, allowing the disbursement to grow from US$430 million in 1995 to 1 billion in 1997. However, Vietnam did not succeed in attracting further aid to cope with the effects of the regional crisis.

The regional crisis unfolded at the moment when the dialogue between the Vietnamese government and the international financial institutions was characterized by deep disagreements on the reform agenda and on the time of its implementation. In 1997 the IMF withheld the instalment of roughly US$176 million, which had been agreed upon in 1994 as a third instalment of a three-year Enhanced Structural Adjustment Facility (ESAF) amounting to US$530 million. At the time of writing, negotiations for a new ESAF had proved insufficient to restore consensus, leaving Vietnam without an important support to relieve the balance-of-payment deficit. In turn, the lack of IMF agreement resulted into an obstacle for a fresh World Bank Structural Adjustment Credit (SAC), which also provides balance-of-payment support.

Official development assistance to Vietnam was discussed in Paris in December 1998 by the Consultative Group for Vietnam (CG) – the coordination meeting of international donors. The CG pledged US$2.2 billion of development aid to the country, i.e. less than the US$2.4 billion committed in 1997. The CG offered a further US$500 million package during the year, but only in case of acceleration in the reform process.

In December 1999 the annual Consultative Group meeting held in Hanoi further increased the share of ODA, subject to the condition of an enhancement of pro-market reforms. Donors pledged US$2.1 billion, and promised a further US$700 million if the government proceeded in the direction prescribed by the World Bank-coordinated report, *Vietnam: Preparing for Take-off?* (World Bank 1999a).

The shrinkage of external trade and FDI, the lower than expected ODA, and the lack of specific support from the IMF and the World Bank, all made the country more vulnerable to the risk of a shortage of foreign exchange in the midst of a regional financial crisis. Therefore, the national reserves in foreign currencies and gold were put under strong pressure, threatening the country's capacity to pay the short-term debts accumulated by state-owned and private enterprises. However, the success of the measure adopted by the Vietnamese authorities in controlling import flows and maintaining a low trade deficit prevented the most pessimistic predictions of an impending financial meltdown (UNDP 1998) or a major increase in the-balance-of payments deficit (World Bank 1997).

The positive results in the macroeconomic standing and the improved trade balance did not conceal the negative impact of the crisis. The need to curtail the fiscal deficit and to avoid an inflationary upsurge led Vietnamese authorities to adopt a strict monetary policy and to renounce anti-cyclical interventions. This was effective in containing inflation, which after rising from 3.8 in 1997 to 9.2 in 1998 went down to 0.1 in 1999 (Agence France Presse, 23 February 2000). The drastic cutback in inflation – to the verge of a deflationary drive – was largely motivated by a drop in food prices (also as a result of a record rice harvest). Proportionally, food represents the largest element in the basket of goods and services on which the price index is based. However, it also depended on a drop in the aggregated demand for investments and national consumption. News stories of stock-piling and industrial plants producing far below their potential output recurred in the national and international media throughout 1998 and 1999.

The economic slowdown had also an impact on the population's living conditions, though a precise account is limited by the scarcity of data.

In the years before the regional crisis, macroeconomic stabilization was achieved together with fast economic growth and poverty reduction. In the decade 1987–96 GDP growth was on average 7.3 per cent, increasing to over 9 per cent in 1995 and 1996. Over the decade, this result translated into an annual average per capita real income growth of about 5 per cent, increasing GDP per capita from US$100 in 1987 to over US$300 in 1996 (World Bank 1997: 17).

Some regions grew faster than others, and the gap between urban and rural areas increased to some extent, but the positive results of the economic reform were spread out all over the population. This led to outstanding results in terms of poverty reduction: no other country has recorded so sharp a decline in poverty in so short a period of time (with the possible exceptions of China and Indonesia in the 1980s) as Vietnam did between 1993 and 1998 (World Bank 1999b: iii). The proportion of people living below the poverty line dropped from 58 per cent in 1993 to 37 per cent in 1998. Reduction of poverty was confirmed not only by quantitative data on rising per capita expenditure and improving social indicators, but also by participatory poverty assessments (PPAs) which reported poor households' perception that their overall well-being had improved (World Bank 1999b). Notwithstanding these important achievements, Vietnam remained a country where a large proportion of the population live either below or slightly above the poverty line, and where poverty reduction results could be easily reversed by adverse events. Poverty was still widespread, particularly in the rural areas; but pockets of severe poverty persisted in urban areas as well, especially among poor migrant groups whose conditions are not easily reported in statistics.

How the economic downturn connected to the regional crisis affected the living conditions of the Vietnamese population is difficult to assess precisely and is still being debated among scholars and policy-makers. In urban areas some of the population had accumulated savings in the last few years of fast growth, securing them a temporary respite in a period of economic downturn. For those with savings in dollars, the currency devaluation even resulted in increased purchasing power. Some sources (e.g., ADUKI September 1998) have hinted that the urban bourgeoisie maintained its loyalty to the system (i.e., depositing the saving in dollars into Vietnamese banks instead of exporting capital abroad). This loyalty was explained by the fact that the urban bourgeoisie perceived its long-term interests protected by the Communist Party, in whose ranks it is overrepresented both among members and the leadership.

The more destitute urban population, instead, was forced to depend on the informal sector for survival in increasingly difficult conditions. However, the socioeconomic dynamics affecting the urban poor are relatively unknown for the lack of adequate investigations in the field (see Kilgour and Drakakis-Smith, Chapter 13 in this volume). Studies on poverty in Vietnam have mostly focused on rural areas; however, the ways in which the rural socioeconomic systems have absorbed the impact of the economic downturn is not very clear either. While data on urban unemployment in the formal sector do exist – and indicate that the rate grew from 6.85 per cent in 1998 to 7.4 per cent in 1999 (Reuters, 6 October 1999) – a calculation of unemployment or underemployment in rural areas is not available. Some sources have indicated a reason for optimism in the fact that Vietnamese agriculture has been only partially modernized, and therefore maintains some elasticity in employing manpower beyond limits sustainable in a fully-fledged market economy. Other scholars, however, stress that a number of workers were already redundant in agriculture before the crisis, and they have been pushed to seek seasonal or permanent employment in cities. Therefore, a reverse migration of these workers towards their home villages as a result of a deteriorating national economy would place an unbearable burden on their families and their villages.

This discussion is paralleled by a similar debate regarding other countries in the region (see Rigg and Parnwell, Chapters 11 and 12 in this volume). For Vietnam the issue is particularly dramatic because the country remains one of the poorest in the world, with about US$300 GDP per capita. The existence of informal 'coping mechanisms' able to shelter the most vulnerable in a situation of distress represents a matter of survival for many. How these informal 'coping mechanisms' are evolving in the midst of a radical process of modernization and how the state will be able to guarantee adequate levels of social protection remain major questions for an assessment of *doi moi.* Recent studies (e.g., World Bank 1999b), while confirming the important results achieved in terms of poverty reduction, have also indicated that a protracted economic downturn could compromise these results. At the same time, there is evidence that the quality of social services has been declining (e.g., health and schools) in crucial areas (World Bank 1998), while the reform process has involved the dismantling of traditional safety nets provided by family, villages and communes (Kolko 1997).

In search of a new strategy?

The relation between the Vietnamese government and the international financial institutions from the early 1990s to a few months before the onset of the regional crisis has been likened to a long 'honeymoon' (Fforde 1998b). However, in 1997 this 'honeymoon' ended, with one of the two parties openly stating its discontent and the other keeping silent. A World Bank report of 1997, for instance, pointed out that 'present trends' could be 'inconsistent with long-term rapid growth with appreciable reduction in poverty and with greater equity' (World Bank 1997: iv). The criticism expressed by the agency (but also by the other multilateral institutions) was that with the current policy 'substantial inefficiencies [would] persist and growth [would be] inward looking, increasingly capital intensive and biased in favour of urban dwellers' (Ibid.). This pattern would be in contrast to the declared government objective to achieve 'significant improvement in the efficiency of the economy and promoting outward-oriented, broad-based, labour-intensive growth' (Ibid.).

Behind the World Bank (and other international agencies') declarations, there was an attempt to force Vietnam to adopt more coherently an export-led growth strategy. According to the World Bank interpretation of the 'East Asian miracle', the country was encouraged to gain from its comparative advantages, consisting of well-educated and cheap labour force. However, any element of dissent with Vietnamese authorities on long-term development strategy was concealed. The World Bank agenda was promoted as a way to avoid distortions and mistakes, in order to implement more effectively the Vietnamese authorities' own objectives of economic growth and poverty reduction. Three priorities were indicated as:

- reform of the state-owned enterprises (SOEs);
- creation of a neutral trade regime;
- development of a strong financial system.

The need for a reform (i.e., privatization) of the SOEs was supported on the basis that the existence of a large, state-owned enterprise sector – with close connections to the political leadership, non-regulated support from the state financial sector, and preferential access to FDI – was draining an excessive share of national resources. Therefore, the SOEs were an obstacle to the development of the nascent private sector and were hampering a broader-based and sustainable growth. The existence of restriction to free trade – through quotas and duties – was also considered as an impediment to the full exploitation of the country's comparative advantages. And a banking system too influenced by political constraints was considered as dangerous both for the risk of non-performing loans (especially through lending to SOEs) and for the limited access to capitals for the small and medium private enterprises.

The questions raised by the international financial institutions were not different from those raised in many other countries within and outside the region. To a large extent, they were pointing to the normal pattern of structural adjustment interventions. A number of the criticisms, however, were based on real problems, and were as such recognized by the Vietnamese authorities.

The same agenda was confirmed after the crisis by the major international agencies (e.g., World Bank 1999a; IMF 1999a; UNDP 1999), actually using the worsening of the economic conditions in order to acquire more leverage in laying down conditions to the Vietnamese government. Officially, the Vietnamese authorities subscribe to this agenda; in reality, significant resistance on key aspects of this package does exist. In the words of Tran Xuan Gia, Minister of Planning and Investment, at the donors' Consultative Group meeting in December 1999:

> We all agree on *what* reforms need to be done. The discussion is about *how*. We agree that without accelerated reforms we cannot grow rapidly and therefore the question is how best to accelerate the *doi moi* process. (World Bank 1999a, emphasis in the original)

The role of 'agenda setting' played by the international financial institutions should be considered against the backdrop of a relative impasse within the Vietnamese leadership in promoting a clear-cut reform strategy. Although the state and party leaders maintain a broad commitment to the *doi moi* policy, the complexity of this task and the existence of conflicting economic and political interests, have resulted since the early 1990s in a rather contradictory trajectory. A number of scholars (e.g., Fforde, Kokko and Ronnås) maintain that the implementation of bold reform measures in the period 1989–91 was the result of the pressure deriving from fading Soviet and Eastern European aid. The positive results of these reforms, accompanied after 1992 by increased development assistance from bilateral and multilateral donors and large flows of FDI, decreased the pressure for a furthering of *doi moi* and reduced the leadership commitment to implement sensitive measures. This interpretation led Adam Fforde (1998b) to voice openly the view that a too large ODA to Vietnam would maintain the status quo and delay needed reforms.

The belief that the Vietnamese economy was reaching a situation of impasse even before the regional crisis, led a number of scholars and the international financial institutions to take the lead in defining a new reform agenda. Ari Kokko, for instance, described the situation in the following terms:

> Even before the advent of the Asian crisis in July 1997, it had become apparent that it might not be possible to sustain the high growth rate without further reforms. The reason was that serious structural weaknesses had begun to endanger the stability of the economy. The problems included inefficient SOEs and banks, growing current account deficits, and a trade policy bias in favour of import substitution. The development of the private sector was also obstructed by unclear rules, often favouring SOEs, excessive red tape, and corruption. (Kokko 1998b: 3)

The difficulty of the Vietnamese leadership in finding a broad consensus on a policy able to give new momentum to the reform process is quite evident. Given the careful (and rather successful) macroeconomic management in the midst of the Asian crisis, it is possible to imagine that the Vietnamese authorities are maintaining a firmer control on the economic policy than might at first appear likely. It is also possible that – given the internal divergences and the need to avoid conflicts with the international donors – a cautious and pragmatic approach to policy-making is considered by leading Vietnamese forces as to be safer than embarking on highly theoretical and programmatic prescriptions.[4]

The cautious attitude of the Vietnamese leadership was confirmed after the onset of the regional crisis by avoiding major statements indicating a change of strategy. However, a number of hints indicate that the crisis has increased prudence in furthering the process of economic liberalization. The experience of neighbouring countries has signalled that liberalization – especially in a key sector like finance – would expose the country to the vagaries of international markets. Therefore, Vietnam has been reluctant to carry out unreservedly the reform agenda proposed by the international financial institutions, also considering that the prestige of these institutions has been largely undermined by the poor handling of the East Asian crisis. The implementation of reforms in the priority areas defined by the international financial institutions has been circumspect, although key issues have been addressed.

The reform of the state-owned enterprises has accelerated in the aftermath of the regional crisis. This reform started in 1989 with the merging and liquidation of about half of the more than 12,000 SOEs, reducing their number to about 6,000. In the early 1990s SOEs lost direct subsidization from the state budget, although they maintained de facto privileged access to capitals through state-owned banks. SOEs' paramount position in the national productive system made them attractive to foreign direct investment: by mid-1990s about 85 per cent of foreign invested joint-ventures were with SOEs. However, the monopolistic privileges enjoyed on the national market and the 'soft budget constraint'[5] from state banks exposed SOEs to risks of inefficiency and made many of these companies run into deficit. At the end of 1995 the aggregate debt of the SOE sector amounted to VND 279,000 billion or about 20 per cent more than the sector's aggregate turnover in the year (Kokko 1998a). This level of indebtedness represented a risk for the ailing banking system. It also undermined the efficient firms in the state sector, who were burdened by the internal debt within the SOEs sector – 'the internal debt alone was nearly seven times larger than the aggregate value of the sector's working capital' (ibid.).

To deal with this critical situation, the government embarked on a programme of restructuring and equitization. Equitization was mostly planned for small and medium firms, where it often encountered resistance from workers and managers for fear of losing state support and uncertainty about job security. By the end of 1997 only 17 enterprises had been equitized, but the number rose to 370 in 1999 according to the Vietnamese authorities (VNA, 19 February 2000). According to the government's plans the figure was to rise further, with another 500 enterprises equitized in the year 2000.[6] The goal is to reduce the number of SOEs to 3,000 in 2003 and to 2,000 in 2005 (BBC Summary of World Broadcasts, 24 May 2000). At the end of this streamlining programme, which also includes consolidation and mergers, the Vietnamese state-owned enterprises should consist of companies operating in strategic sectors and mostly organized within large corporations.

The regional crisis and the increasing pressure from the international financial institutions have certainly contributed to accelerate the process of SOE reform. However, the underlining strategy at the basis of the government plans is not easily intelligible, probably because it is based on the attempt to accommodate contradictory interests. The reorganization of a large number of enterprises operating in priority sectors within 18 General Corporations and 70 Special Corporations, realized after 1995, was largely inspired by the South Korean model. Prior to the regional economic crisis – when they came to be depicted as a case of 'crony capitalism' – the South Korean *chaebol*s have been a remarkable example of successful industrialization, able to exploit national monopolies as a basis for competing in international markets. However, the Korean case – and the Taiwanese one, for that matter[7] – was based on a careful national planning able to discriminate among contrasting interests and to guide industrial strategies (for a discussion of the 'developmental state' model see Putzel, Chapter 8 in this volume). The lessons coming from the 'developmental state' experience in other countries of the region is not easily replicated in Vietnam. This would require a coherent definition of priorities and power in implementing policies that involve the sacrifice of non-strategic sectors. This is difficult to achieve in a country where political stability is constructed by cautiously balancing the different interests at stake. And this is particularly true in the process of SOE reform, given the importance of this sector in the national economy:

> [SOEs] are, in practice, sites of de facto joint ventures between various 'insiders' groups. It is the complexity and incoherence of these alliances that give the political economy its stability, as it permits for adjustments as and when resources availability shifts: insiders can co-opt outsiders (such as sources of FDI), when they wish. (Fforde 1998a: 6)

The other question regarding the implementation of 'developmental state' strategies in post-crisis East Asia is connected to a major claim made in this volume in interpreting the foundation of the regional crisis: i.e., the incompatibility between 'developmental state' policies and financial liberalization. The adoption of 'developmental state policies' demands a very careful management of the participation of the country within the world economy. Clearly, post-crisis Vietnam is under strong pressure from the international financial institutions and Western countries, and does not benefit from the same favourable conditions enjoyed by post-war Taiwan and South Korea (see Li *et al.*, Chapter 2 in this volume).

The watchful approach by the Vietnamese authorities in opening a stock market in July 2000, and the sound regulatory frame adopted, indicate that Vietnam is aware of the problem and is willing to take appropriate initiatives. However, Vietnam cannot easily resist international pressure without risking a new dangerous isolationism.

Foreign trade is another critical area in the reform process and one where the conflict with Western countries has been clearly visible. The international financial institutions have been pushing hard towards trade liberalization, pointing at the (undeniable) distortions produced on the Vietnamese market by import substitution policies. The World Bank and IMF have been indicating the need for a 'neutral trade regime', as they have done constantly in other developing countries as a precondition for financial support. Vietnam moved many steps ahead in this direction during the 1990s: exchange rate unification, elimination of export quotas, reduction of import quantitative restriction, elimination of export duties (apart from a small number of strategic products) and rationalization of import duties. However, the country has maintained a number of non-tariff barriers – especially quotas and licences – to control imports, and to discourage the import of consumer goods (this leverage proved crucial in reducing the impact of the regional crisis).

As in the case of SOEs, the process of the trade regime reform seems to reflect contradictions and ambiguities. Vietnam has formally accepted the principles of free trade, and has joined the ASEAN Free Trade Area, which is due to realize a significant trade liberalization in the region. And it has applied for membership in the WTO. At the same time, however, the government has tried to maintain a regime of import substitution. The successful experiences from the region indicate the need for the selective use of import substitution and export orientation, with a mix guided by a careful strategic planning (e.g., Wade 1990; Amsden 1989; Putzel, Chapter 8 in this volume). The Vietnamese government seems to be too dependent on revenues from import duties (up to three-quarters of state budget) and too much constrained by the need to defend contrasting interests within the system to promote a clear-cut trade policy. However, the major event in the post-crisis trade debate – the negotiation of a trade agreement with the United States – has shown a remarkable resistance by the Vietnamese leadership and the ability to achieve significant results. The story of this negotiation is very significant. In July 1999 an 'agreement in principle' for a trade pact which would have granted Vietnam Normal Trade Relations (formerly Most Favoured Nation) with the US was announced by the two countries' negotiators. But when the venue and the date for the signature had already been fixed and the negotiators were working on 'details', the Vietnamese authorities rejected the draft. Although the Clinton administration initially refused to reopen the negotiations, eventually a new trade pact was drafted – and signed in July 2000 – where Vietnam obtained improvements in key areas, namely in the protection of the national telecommunications sector.[8]

The reform of the banking system is the other major area of reform indicated by the international financial institutions. This is also an area where reforms have become more urgent following the Asian crisis, due to the high level of non-performing loans and the general fragility of the system. While there is no disagreement about the need to consolidate the financial sector, the main concern centres on the role of the banking system in supporting development strategies. The sector is dominated by four large state-owned banks; the state-owned banks account for about 80 per cent of all domestic lending and tend to take credit decisions on the basis of political rather than risk criteria, as bankers are pressured to lend to ailing state-owned enterprises.

Again, the experience from the region would indicate that loans based on political motivations are not negative *per se,* as long as they are functional to a clear industrial policy and they do not exceed a too risky threshold (see, e.g., Wade and Veneroso 1998). But this, once again, indicates the need for a clear-cut strategy, and even the ability to distinguish between a *productive* 'cosy relationship' between banks and enterprises – productive in that it supports strategic industries and is able to turn long term investment into profit – and a *backward* 'cosy relationship' supporting rent seekers and non-viable economic activities.

The role of the banking system is also pivotal for the growth of the developing private sector, which often struggles to access credit from state banks. Despite a new law to regulate and support the development of the private sector (January 2000) and an increased number of private enterprises, there is some truth in the World Bank criticism that the Vietnamese government is offering a preferential treatment to SOEs and is creating an uneven playing field for private companies (World Bank 1997: 34; see also World Bank 1999a). The private sector is still viewed with suspicion by national authorities and an excessive – and often contradictory – number of administrative regulations curtail the initiative of private entrepreneurs. Here again the experience from the region could indicate that giving priority to the state sector – as the Vietnamese authorities still intend to do – should not necessarily be in contrast with the development of an efficient private sector. On the contrary, the development of the private sector could be directed towards objectives defined by the state planning:

> To say that public enterprises [in Taiwan] have often played a central role in creating new capacities is not to say that private firms have been left alone. Incentives and pressure are brought to bear on them through such devices as import controls and tariffs, entry requirements domestic content requirements, fiscal investment incentives, and concessional credit … And large-scale private firms are often exposed to more discretionary government influence, taking the form of what in Japan is called administrative guidance. (Wade 1990: 111)

In conclusion, post-crisis Vietnam is in search of a coherent development strategy. The traditional Vietnamese pragmatism, the need to mediate among different interests, and the will not openly to challenge international donors, have prevented the national authorities from enouncing a too-binding and elaborate strategy. The government has reacted to the crisis by maintaining firm macroeconomic management and by implementing a number of specific reforms. At the same time the government has resisted to a wholesale implementation of the reform agenda supported by the international financial institutions. Behind this resistance can be detected the desire to emulate (at least in part) the 'developmental state' model followed by other Asian countries.

However, the adoption of such a model is constrained both by conflicting interests within the system and by the external pressure coming from Western countries and from the international financial institutions.

NOTES

1 An overview of current interpretations of *doi moi* is contained in Masina 1999a.
2 This interpretation has been confirmed to me by officers of the UN system in Hanoi, during informal talks in the spring of 1998.
3 The international financial institutions have suggested in several occasions that these figures should be revised downwards. They have estimated growth at about 3 or 4 per cent in 1997 and about 2 or 3 per cent in 1999 (e.g., see Yates 1999). Vietnamese authorities might have tried to adjust figures upwards for political purposes. The international financial institutions, instead, might have presented a bleak scenario in order to force the government to accept their prescriptions. The fear that 'Vietnam now faces the possibility of becoming one of the slower performers in the region' expressed by a World Bank report in December 1999 (World Bank 1999a) is not confirmed by the available data. According to Vietnam's General Statistical Office, quoted by the Chinese news agency Xinhua on 30 March 2000, GDP growth in the first three months of 2000 was at 5.6 per cent, i.e., in line with the other countries in the region.
4 The famous exhortation by Deng Xiaoping to 'cross the river by sensing the stones' would sound familiar in a Vietnamese context, although there exist important differences between China and Vietnam.
5 For a definition of the concept of 'soft budget constraint', see Kornai 1986.
6 A World Bank report released at the end of 2000 gives a lower estimate: 'Equitization has been accelerated over [the last two and one-half years] with 450 equitizations completed and half of them selling more than 65 per cent of shares (World Bank 2000: 32–33).
7 Interestingly, in the recent debate about the Vietnam economic strategy, the experience of Taiwan has been presented as opposed – and thus more successful – to the Korean one (e.g., Leung 1999: 6; Riedel 1999: 26). This does not take into account the reality of the first phase of state-led industrialization in Taiwan, when the state-owned enterprises played a central role (as demonstrated by Wade 1990).
8 For a more detailed accounting see Masina (forthcoming).

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