VIETNAM AND THE REGIONAL CRISIS: THE CASE OF A 'LATE LATE-COMER'

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In the 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 now restoring and enhancing relations with its neighbours and the rest of the world. The economy was thriving with GDP growing at more than nine per cent per year. The flow of foreign direct investment was accelerating. The country was able to jump from importing rice to becoming the world's second largest exporter. The poverty rate was declining. All these positive achievements were seen as a result of *doi moi*—the process of economic reform—and of successful cooperation between the country and the international financial institutions. Vietnam, like other countries in the region, was harbouring the dream of becoming the 'fifth tiger', i.e., joining the club of the fast growing newly industrialising economies (NIEs). However, already before the onset of the regional economic crisis, relations between Vietnam and the international financial institutions had become critical.[1] The international agencies and a number of scholars started to blame national authorities for a slow-down in the reform process. A decrease in economic growth in the wake of the regional crisis, connected to a shrinkage of foreign direct investment, was assumed by Western observers to be the sign that these criticisms were legitimate. Thus, when the effects of the regional downturn on the Vietnamese economy became evident, the international financial institutions gained more leverage in pressuring the country toward a bolder implementation of market-oriented reforms.

On the basis of an empirical analysis, this paper aims to expose the way in which the 'common wisdom' on Vietnamese economic and political conditions is strongly influenced by ideological assumptions and proves rather inconsistent when closely scrutinised. Biased by the political intent to push Vietnam toward the implementation of a specific reform agenda (based on neo-liberal orthodoxy), the international financial institutions have insisted upon an ideological interpretation and have failed to take into account wider regional

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and international dynamics, an understanding of which would be crucial for the identification of sustainable long-term development strategies.

In the Wake of the Regional Crisis

This section starts by discussing the 'common wisdom' which has arisen concerning the lesson that Vietnam should learn from the regional crisis. This common wisdom is based on the mainstream interpretations of the regional crisis: i.e., 'crony capitalism' in East Asia and unstable international financial markets, which eventually made the mixture of unchecked globalisation and ill-regulated local institutions collapse into confidence tricks, speculation, and panic.[2] After the crisis many of the worse-hit countries—including Thailand and South Korea—have started to implement systemic reforms and, by doing so, have succeeded in restoring growth. Therefore, if Vietnam wants to take advantage of the new regional economic trend, it should address basic issues which are a hindrance to growth. Vietnam—continues the mainstream interpretation—has its own form of 'crony capitalism', a 'cosy' relationship between the state and state-owned enterprises (SOEs), which results in distortions and a sub-optimal allocation of resources (e.g., credit from state banks).[3] The deceleration of economic growth in 1997 (from 9.3 per cent to 8.2 per cent of GDP[4]) had already been considered a result of a slower pace in the reform process by the mid 1990s.[5] The evidence that something was starting to go wrong in the Vietnamese economy was the shrinkage in foreign direct investment (FDI) commitment and disbursement already *before the onset of the regional crisis*. A World Bank report indicated that this slowdown was 'unusual, as the pattern in other developing countries is that disbursement continued to grow even after approvals begin to decline, due to a 2–3 years implementation lag'. And this could be linked to the 'cumbersome procedures that still exist for the approval, registration and implementation of foreign-invested projects, and to the perception that the "costs of doing business" in Vietnam are too high'.[6]

After the crisis, a sharp decline in FDI disbursements was again explained as being the result of investors' uncertainty, because investors did not know if 'the government will adopt accelerated reforms'. Thus, investment returned to 'Korea, Malaysia and Thailand but not yet to Vietnam'.[7] A 1999 World Bank report conceded that the 'biggest decline came in foreign direct investment from East Asia and Japan, which is not surprising given the crisis in the region'. However, the report immediately reminded its readers that 'declines in FDI commitments had started as early as in 1996'.[8] That is to say, the regional crisis made problems existing prior to the crisis, essentially for domestic reasons, more dramatic and severe.

It is interesting to note the insistence of the international financial institutions in this explanation of FDI decline. The issue is a very sensitive one in the Vietnamese economic reform debate, given the country's need for investment. This paper—in contradiction to the wisdom presented above—argues that the supposed causal nexus between a slowing pace in the reform process and shrinkage in FDI flows has probably been largely overestimated. In fact, the empirical analysis of foreign direct investment composition can support an interpretation quite different from the one normally accepted.

The first point in our analysis concerns the dynamics of FDI commitments. The data state that FDI commitments to Vietnam increased rapidly during the early 1990s and reached their peak in 1995. As was widely reported, the data for 1996 were inflated by two large real-estate projects approved in December, one of which—it alone accounting for about US$ 1 billion—was subsequently cancelled in November 1998.[9] In 1997 a decline in FDI commitments became evident, marking a worrying change of direction. This decline, however, should be considered while also taking into account the sectoral composition of commitments. The major factor in the decline was actually real estate, which dropped form 40.1 per cent of the total in 1995 and 42.8 per cent in 1996 to only 7.6 per cent in 1997. Thus, by subtracting the real estate commitment from the total, one finds that in 1997 there was practically no shrinkage in FDI outside this specific sector. This is especially interesting considering that the regional crisis had already unfolded in the second half of the year (Table 1). Commitment in agriculture, services, construction, transport and telecommunications actually increased. Investment in industry, however, declined in all the sub-sectors.

Table 1: FDI Commitments, 1995–98 (in US$ millions)

	1995	1996	1997
Total	6722	7702	4456
Real estate	2698	3300	338
Total, real estate	4024	4402	4118

Source: Re-elaborated from International Monetary Fund, *IMF Staff Country Report No. 99 / 56, Statistical Appendix* (1999).

A drop in real estate in 1997 is consistent with a description of the pre-crisis East Asian economy as being dominated by elements of 'bubble economy'.[10] The real estate market in Vietnam was largely speculative in the mid 1990s, as in the rest of the region, and it was dominated by the same East Asian financial groups which defaulted in 1997, thus promptly cancelling former FDI commitments in Vietnam and elsewhere.

The contraction in FDI commitments in industry is something more complex. It could be the result of at least three different factors, or combinations of these. It could derive from a decline in the attractiveness of Vietnam as a productive location—this is the 'official wisdom'. It could derive from a (temporary) decreased propensity to expand production abroad by countries which had traditionally represented a major source of FDI in Vietnam. It could derive from over-investment in the Vietnamese productive system, beyond the absorption capability of this small economy. In the following pages, this work will claim that all of these three elements played a role,

Table 2: Disbursement of Foreign Direct Investment, 1992–98 (in US$ millions)

	1992	1995	1996	1997	1998
Real estate	53	433	366	423	113
Oil and gas	73	582	301	1	50
Total, real estate and oil	190	1245	1296	1650	637
Total	316	2260	1963	2074	800

Source: Re-elaborated from International Monetary Fund, *IMF Staff Country Report No. 99 / 56, Statistical Appendix* (1999).

Table 3: FDI inflows, by selected Asian economies, 1993–98 (in US$ billions)

	1993	1994	1995	1996	1997	1998
Hongkong	3.66	4.13	3.28	5.52	6.00	1.60
India	0.55	0.97	2.14	2.43	3.35	2.26
Indonesia	2.00	2.11	4.35	6.19	4.67	–0.36
South Korea	0.59	0.81	1.78	2.33	2.84	5.14
Philippines	1.24	1.59	1.48	1.52	1.22	1.71
Taiwan	0.92	1.38	1.56	1.86	2.25	0.22
Thailand	1.81	1.36	2.07	2.34	3.73	6.97
Vietnam	1.00	1.50	2.00	2.50	2.95	1.90

Source: UNCTAD, *World Investment Report* (1999).

and that it would be erroneous to focus on a single explanation. It is also important to note that a sectoral analysis of FDI commitment reveals that the shrinkage in industry was compensated for by investment in other sectors (notably agriculture), thus redressing a negative tendency rightly criticised by the international donors and the international financial institutions.

The data regarding FDI disbursements too show a picture slightly different from the one described by the international financial institutions. First of all, the negative trend reported in 1996 was already partially reversed in 1997. But, again, it is the sectoral distribution of FDI that provides the most useful information. The historical series of FDI disbursement is strongly affected by the instability of the oil sector where—considering the high costs of projects in the field—a single initiative can alter significantly the total for one year. Thus, to study the consistency of trends it could be useful to subtract the disbursement for oil and real-estate projects from the total (Table 2). This simple operation reveals that before 1998, i.e., before the effects of the Asian crisis became apparent, there was no substantial decrease in FDI in Vietnam. The attempt, therefore, to use an alleged contraction in FDI inflows as an indication of national deficiencies in implementing the necessary reforms proves rather inconsistent.

Further, a point surprisingly neglected by the current literature on Vietnam is that before the regional crisis the country was a host for FDI inflows that were disproportionately high considering the limited dimensions of its national economy. A comparison with other larger Asian economies can be illustrative in this regard (Table 3). Although

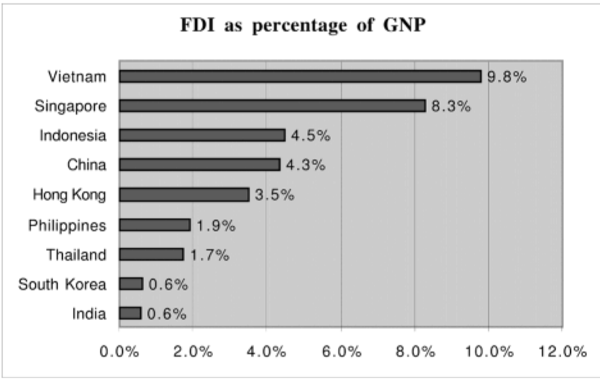
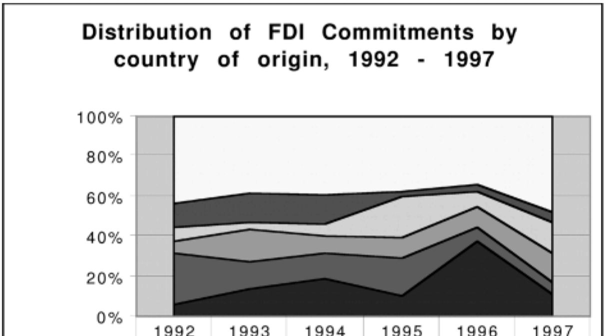


Figure 1: Re-elaborated from data: World Bank, *World Development Report* (countries GNP in 1998), 1999; UNCTAD (1999) *World Investment Report* (countries FDI inflows in 1996), 1999.

the data provided by the UNCTAD *World Investment Report* do not concord exactly with the Vietnamese statistics, they enable a rough comparison to be made. Thus, it appears that FDI inflows to Vietnam in 1996 were higher than those to much larger economies such as India, South Korea, Taiwan and Thailand. This consideration raises the legitimate suspicion that, in the mid 1990s, Vietnam might have been involved in a rush for investments, which might have been above the realistic economic conditions of the country. Figure 1 shows that FDI inflow to Vietnam in 1996 was higher than the regional average as a percentage of GNP.

A sharp drop in FDI disbursement is visible in 1998. The negative trend is confirmed by the available figures for 1999, which report a further contraction to US$500 million. These data will be discussed in the next section, dealing with the impact of the regional crisis on Vietnam. However, some observations can be added along the same lines. Once again, the reported 'wisdom' that investments are not returning to Vietnam simply because the national authorities are not sending the right signals about their commitment toward enhanced reform requires some qualification. In fact, it can be easily shown that the shrinkage of FDI flows to Vietnam is also connected to a parallel decrease in outward investment from those countries which had represented the dominant source of FDI to Vietnam. Therefore, to tell Vietnam of the need to *restore confidence* among investors as a



	1992	1993	1994	1995	1996	1997
Other	43.3%	38.5%	38.9%	37.7%	33.8%	47.5%
Hong Kong	12.3%	14.7%	15.1%	2.4%	3.5%	5.3%
Japan	7.0%	3.5%	5.6%	20.8%	8.2%	15.4%
South Korea	5.7%	15.8%	8.9%	10.4%	10.3%	15.0%
Taiwan	25.4%	13.9%	13.2%	18.6%	6.7%	5.3%
Singapore	6.2%	13.5%	18.4%	10.1%	37.5%	11.4%

Figure 2: Re-elaborated from: IMF, *Vietnam: Statistical Appendix*. IMF Staff Country Report No. 99/56, 1999.

panacea could be misleading. (This is not to deny that in a regime of falling investments and increasing competition it is important that Vietnam should be able to adopt measures to attract investments).

Figure 2 shows that over 60 per cent of FDI to Vietnam before the regional financial crisis originated from East Asian countries (in the chart 'other' includes also China, Thailand and Malaysia). Table 6 indicates that these countries had a contraction in their overall investment outflows after the onset of the crisis. In most of these countries the contraction in FDI outflows between 1997 and 1998 is remarkable. South Korea stands out as being the only exception: in this case there is a slight increase in the global outflow of FDI. However, closer investigation reveals a relocation of investment towards Europe and North America, and a reduction in flows towards Southeast Asia.[11] These considerations make it possible to argue that the shrinkage of FDI inflows to Vietnam in 1998 was connected to a general regional trend. This is illustrated by the chart contained in Figure 3, where the curves of the FDI outflows from selected Asian countries (in the case of South Korea the data on outflows to Southeast Asia have been used) are compared with the curve represented by FDI inflows to Vietnam. The correlation is clearly visible (Figure 3).

The arguments presented above seem to indicate that the 'official wisdom' has produced an oversimplified explanation of investment flows to Vietnam by neglecting the wider regional economic dynamics. This paper does not deny that national deficiencies and shortcomings have played a major role in producing discontent among investors at a critical juncture: i.e., in the wake of a regional economic crisis, when gloomy economic indicators led investors to reassess the rationale for their presence in the region. Once the regional perspectives had become less encouraging, the difficulties of doing business

Table 4: FDI Outflows, by Selected Economies, 1993–98 (in US$ millions)

	1993	1994	1995	1996	1997	1998
China	4,400	2,000	2,000	2,114	2,563	1,600
Hong Kong	17,713	21,437	25,000	26,531	24,407	18,762
Japan	13,834	18,521	22,630	23,428	25,993	24,152
South Korea	1,340	2,461	3,552	4,670	4,449	4,756
Malaysia	1,464	2,591	3,091	4,133	3,425	1,921
Singapore	2,152	4,577	6,281	6,274	4,722	3,108
Taiwan	2,611	2,640	2,983	3,843	5,222	3,794
Thailand	232	492	887	931	447	122

Source: UNCTAD, *World Investment Report* (1999).

in Vietnam also assumed more visibility as a reason for discontent among foreign investors and entrepreneurs. The Vietnamese authorities came to be blamed for unclear administrative regulations, excessive red tape and corruption. While not contradicting the need to address these national shortcomings adequately—a need that was also recognised by the Vietnamese authorities, as witnessed by a number of reforms introduced during 1999 and 2000—this paper tries to draw attention to the regional dimension of the crisis, which has been largely neglected.

Our evidence suggests that Vietnam might have been more closely integrated into the regional economic dynamics before the East Asian crisis than previously accepted. This might have resulted in a large flow of FDI to the country—a flow probably exceeding the absorption capability of an as yet small economy with significant infrastructural bottlenecks. In other words, Vietnam might have been affected by the same over-investment tendencies existing in the region.[12] That part of the FDI flow represented by real estate had a speculative nature, as in the rest of the region. This speculative nature was further suggested by an abnormal share of investment commitments (17.8 per cent on the 1996 total) from offshore locations such as the British Virgin Islands. The contraction in FDI disbursement after the onset of the crisis in East Asia was correlated to a regional trend.

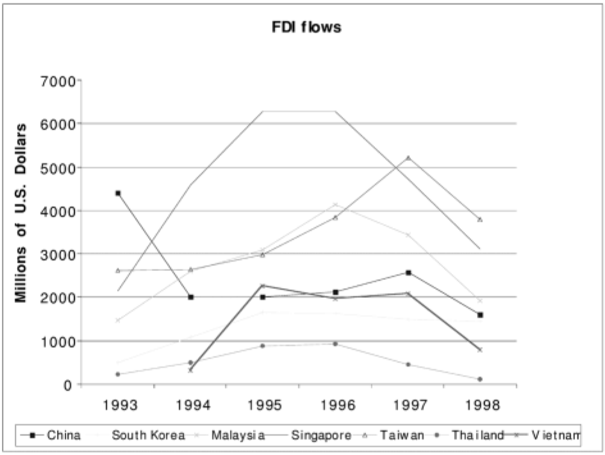


Figure 3: World FDI outflows from China, Malaysia, Singapore, Taiwan and Thailand; FDI flows from South Korea toward Southeast Asia; Total FDI inflow disbursement in Vietnam. Re-elaborated from: UNCTAD *World Investment Report*; National Statistic Office, Republic of Korea, 1999. *Korea Statistical Yearbook.*; IMF, *Vietnam: Statistical Appendix*, 1999.

Further, the fact that investors have returned to South Korea and Thailand is a consideration of no real significance for Vietnam: this trend is clearly connected to the acquisition of local corporations after these countries have been forced to liberalise their markets as a condition for receiving IMF bail-out loans. Nor does Malaysia provide a strong case to support the indications of the international financial institutions: as is well known, Kuala Lumpur has actually moved in a rather different direction from the one suggested by Washington (by imposing controls on short-term capital flows), and has therefore been repeatedly criticised.

Finally, another consideration could be added to clarify the background for an assessment of Vietnam's economic performance. A comparison with the regional data gives grounds for relating the partial deceleration of the Vietnamese economy in 1997 to a regional trend. In fact, the figures in Table 5 show that many other countries in the region—as has been reported in numerous studies—were already facing economic difficulties before the crisis, difficulties that exploded in the form of financial crisis.

The Impact of the Regional Crisis

The interpretation of the data presented above indicates that the association of Vietnam with the regional economy was more pronounced than normally reported. Correctly, two considerations have often been presented to explain why the impact of the crisis on Vietnam has been less severe than on other countries. First, the non-convertibility of the *dong* and the regulation of trade and exchange transactions have partially insulated the country from the vagaries of the financial market and averted speculative attacks. Second, Vietnam

Table 5: Real GDP Growth (%)

	1996	1997	1998
China	9.6	8.8	7.8
Indonesia	8.0	4.5	–13.7
South Korea	6.8	5.0	–5.8
Malaysia	8.6	7.5	–7.5
Philippines	5.8	5.5	–0.5
Thailand	5.5	–1.3	–9.4
Vietnam	9.3	8.2	5.8

Source: World Bank, *Asian Recovery homepage* (2000).

is a country where a large part of the economy is still 'informal' and family-based. Thus, many analysts have supposed that the 'return to the village', the protection of traditional safety-nets, and the flexible urban 'informal sector' have largely absorbed the negative impact of the crisis on the living conditions of the poorest. This second issue brings us back to one of the key questions in the crisis and post-crisis debate. It has implications not only for the policies to adopt in periods of crisis, but also involves an assessment of the very foundations of the past and future developmental dynamics of Southeast Asian countries. However, this discussion would lead us beyond the immediate compass of this article.

The first question—the relative insulation from the regional financial meltdown—is discussed here. The focus we intend to adopt is not an assessment of the short-term impact of the crisis, but an analysis of the medium and long-term development implications. The questions at stake are the conditions for Vietnam's future economic development and the policies to be implemented in order to achieve the goal of accelerated industrialisation. Before the crisis Vietnam was moving fast along the path taken by other regional 'success stories'. The basic assumption—of national authorities and of foreign investors—was that Vietnam could further integrate into the regional economy and benefit from new rounds of investment from countries whose comparative advantage was shifting towards more technology-intensive and labour-intensive production. Therefore, discussing the impact of the crisis means discussing the way in which this long-term plan has been affected. This paper will make three basic points:

1. In the medium term, the impact on the Vietnamese economy has been severe. The crisis has implied not only a halt to further productive relocations but also a reverse trend, with companies retrenching to their original productive bases. The appreciation of the *dong* against most regional currencies has partially reduced the attractiveness of the cheap Vietnamese labour force.
2. In the longer term, Vietnam will probably succeed again in becoming an attractive location for labour-intensive production, especially because of its large population and its well-educated labour force. However, Vietnam faces and will face strong competition from China and other Southeast Asian countries.
3. The broad implications of the crisis should be considered against the background of an increasing political confrontation between Asian economies and Western capital represented also by multilateral organisations (such as the WTO) and the international financial institutions. Vietnam will come under increasing pressure and

will be requested to adopt a 'liberal' economic policy. A number of elements signal that this confrontation between Vietnam and the West has already begun.

The Regional Crisis and Vietnam's Macroeconomic Standing

In autumn 1997, when the financial contagion was spreading through the region, Vietnam—which was partially insulated by the fact that its currency was not freely convertible—seemed more concerned with two other internal problems. The first was Typhoon Linda, the worst tropical storm to hit the country in five decades. The second was the tense political situation—with peasant demonstrations and riots against corrupt local officers—in the northern coastal province of Thai Binh. Typhoon Linda devastated central and southern provinces. A few months later, the typhoon was followed by an extended drought that further jeopardised the economy of those areas, affecting cash crops such as coffee in particular. The other 'typhoon', the peasant uprising in Thai Binh, represented a very worrying signal of potential political instability, forcing the leadership to react. The peasant demonstrations received support not only from war veterans and retired party officers but also from the army, who clearly resisted the use of force to repress disturbances. Eventually the party leadership intervened, removing controversial local officers, and put a great deal of effort into reopening a political dialogue within the province—the effort included several visits to Thai Binh by top party and government leaders.[13]

During 1998, however, the effects of the regional crisis on the Vietnamese economy became increasingly evident: at the end of the year all major macroeconomic indicators suggested that the situation was becoming critical. Currency devaluation in many neighbouring countries exposed Vietnam to increased competition at the same time as export markets for its national products, two thirds of which consist of East Asian countries, were shrinking. Export growth in 1998 slowed to 0.3 per cent, compared with about 22 per cent in 1997.[14] After a further decline in the first four months of 1999, with a 7.5 per cent year-on-year drop, exports recovered appreciably in the second part of the year. The higher price of oil in the international markets and the increased volume of exports in agriculture, garments and footwear resulted in a 23.6 per cent export growth rate in 1999.[15]

To avoid aggravating the trade deficit, which was already considered to be too high before the regional crisis, the government intervened to restrict imports. This resulted in a negative growth in imports in 1998 (–1 per cent) and a marginal increase in 1999 (1.1 per cent). The shrinkage in imports brought the trade deficit down to US$ 2,171 million in 1998 and only US$ 100 million in 1999. However, although these figures indicated some relief for the national current accounts, the shrinkage of imports also signalled a downturn in productive investment in machinery and capital goods.

Vietnam did not enter a recession, unlike many other countries in the region, but GDP growth declined sharply. During 1998 the government was forced to readjust its expectations downward from the planned nine per cent to about six 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.[16] In 1998, in order to regain some competitiveness for its exports, Vietnam devalued the *dong* by about 20 per cent against the US dollar. Notwithstanding this devaluation, in the midst of the regional crisis the Vietnamese currency appreciated consistently against most regional currencies. By the end of 1999 the Vietnamese *dong* had risen by about 20 per cent against the currencies of Thailand, Malaysia and the Philippines and by about 60 per cent against the Indonesian *rupiah*, compared to pre-crisis exchange rates. The Chinese *renminbi* and the Hongkong dollar remained stable against the American dollar, thus resulting in a *dong* devaluation of about 20 per cent against these two currencies (Table 6). The

Table 6: Changes in Exchange Rates During the Financial Crisis, December 1999 (%)

	National currency versus US $			National currency versus VN Dong		
	appreciation Dec 96– Dec 99	appr. Jul 97– Low	appr. Jul 97 – Dec 99	appr. Dec 96 – Dec 99	appr. Jul 97 – Low	appr. Jul 97 – Dec 99
Vietnam	–27	–20	–20	–	–	–
Philippines	–36	–42	–35	–18	–39	–22
Malaysia	–33	–44	–34	–16	–41	–20
Thailand	–34	–53	–35	–16	–50	–22
Indonesia	–67	–85	–66	–59	–84	–60
Hong Kong	–1	0	0	26	5	20
China	0	0	0	27	5	20
Taiwan	–13	–20	–12	10	–4	6
Korea	–26	–49	–22	–6	–47	–6
Japan	13	–22	11	43	–7	33

Source: Socio-economic Bulletin—UNDP Hanoi Office, March 2000.

medium-term implications of these exchange-rate readjustments in the region, which evidently imply a change in comparative advantages, will be discussed further in the next part of this article.

In the emergency situation created by the regional crisis, the Vietnamese government proved quite successful in maintaining macroeconomic stability. This was recognised 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…[17]

However, as the World Bank's report also indicated, the impact of growth contraction has been significant in many regards. A major effect—probably with longer term implications—was a fall in 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 the aforementioned shrinkage in foreign investment flows.[18]

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.[19] This decrease forced the government to cut expenditure accordingly in order to avoid fiscal instability, thus curtailing resources for an expansionary economic policy (of the kind attempted, instead, by China). However, to reduce the impact of the recession on the population, the government sought to protect social expenditures.[20]

The attempt by the Vietnamese authorities to attract more official development assistance (ODA) in order to compensate for the drop in FDI was not successful enough to relieve the balance of payments deficit. The regional economic crisis unfolded at the moment in which the dialogue between the Vietnamese government and the international financial institutions was characterised by deep disagreements on the reform agenda and on the timing of its implementation. In 1997 the IMF withheld the sum of roughly US$176 million, which had been agreed in 1994 as the third instalment of a three-year Enhanced Structural Adjustment Facility (ESAF) amounting to US$530 million. Negotiations for a new ESAF have not restored consensus, leaving Vietnam without an important support to relieve the balance of payment deficit. In turn, the lack of IMF agreement resulted in an obstacle to a fresh World Bank Structural Adjustment Credit (SAC), which would also provide balance of payments support.[21]

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, less than the US$2.4 billion committed in 1997. However, the CG offered a further $500 million package during the year in the event of an acceleration of the reform process. In December 1999, the annual Consultative Group meeting, held in Hanoi, further increased the share of ODA conditional on an acceleration in the reform process. Donors pledged US$2.1 billion, and promised a further US$700 million if the government proceeded in the direction prescribed by the 1999 World Bank-coordinated report 'Preparing for Take-off?'.

The shrinkage in external trade and FDI, the lower than expected level of ODA, the lack of specific support from the IMF and the World Bank—all of these factors made the country more vulnerable to the risk of running short 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 to make the country unable to repay the short-term debts accumulated by state-owned and private enterprises. However, the measures adopted by the Vietnamese authorities to control import flows and maintain a low trade deficit proved successful in averting the most pessimistic prediction of an impending financial meltdown or high increase in the balance of payment deficit (World Bank 1997).[22]

The positive results in the macroeconomic position and the improved trade balance did not conceal the negative impact of the crisis. The need to curtail the fiscal deficit and avoid an inflationary upsurge led Vietnamese authorities to adopt a strict monetary policy and renounce anti-cyclical interventions. This was effective in containing inflation which, after rising from 3.8 per cent in 1997 to 9.2 per cent in 1998, went down to 0.1 per cent in 1999.[23] The drastic cutback in inflation—to the verge of a deflationary drive—was largely motivated by a drop in food prices (in part as a result of a record rice harvest), which account for the largest portion of a basket of goods and services on which the price index is based. However, it also resulted from a drop in the aggregate demand for investments and national consumption. Reports of stock-piling and of industrial plants producing far below their potential output were recurrent themes in the national and international media throughout 1998 and 1999.

The economic slowdown also had an impact on the people's living conditions, though a precise account is limited by the scarcity of data and would require an ad hoc investigation. Many sources indicate that a protracted economic downturn could compromise the important results achieved in terms of poverty reduction, given that many people live slightly above the poverty line.[24] The existing official data indicate that urban unemployment rose from 6.85 per cent in 1998 to 7.4 per cent in 1999.[25] However, a calculation of unemployment or underemployment in rural areas or in the non-official sectors in urban areas is not available.

Vietnam and the 'Flying Geese' Pattern in the Post-Crisis Environment

In the pre-crisis period Vietnam successfully increased its integration into the regional productive system. East Asia absorbed about two thirds of Vietnam's exports and was the origin of over 60 per cent of direct investment in the country. To fully appreciate the importance of the association with the region it should be recalled that Vietnam is a rather outward-oriented economy: in 1996 foreign trade amounted to 89.7 per cent of GDP.[26] Its exports-to-GDP ratio is higher than that of the other 14 East Asian member countries of the World Bank, including South Korea, Indonesia, Malaysia, Thailand and China.[27] The high level of integration into the regional economy was inspired by the so-called 'flying geese' pattern, a process whereby Japanese companies—and increasingly those of the Asian NIEs—relocated labour-intensive production in order to cope with the shifting of their comparative advantages towards more technology-intensive production. Being a 'late late-comer', Vietnam tried to benefit from these productive relocations, particularly from South Korea, Taiwan and Singapore, with positive results from 1990 to 1997. Since the beginning of the 1990s, in fact, it has been quite evident that the Vietnamese attempted to look at the experiences of the Asian NIEs as a source of inspiration for national development strategies. There is a large consensus indicating that the 'flying geese' dynamic played a central role in laying the foundation of East Asian economic growth since the l960s. However, as a number of convincing studies have proved, these favourable regional contexts produced significant results only when complemented by and related to effective national planning.[28] The pattern of regional economic integration was not led by the autonomous development of market forces, but was assisted and directed by governments both in Japan—the source of the first waves of labour-seeking investments—and in the other East Asian countries. The importance of national planning and state guidance to market forces has been evident not only to East Asian policy-makers in the recent past but also to Western 'late-comers' of the late nineteenth century such as Germany. It should not be surprising, therefore, that the Vietnamese authorities, while renouncing Soviet-style economic planning, have been trying to relate to this model—although, the modality of its implementation has not always been either coherent or adequate. However, while countries like South Korea and Taiwan could heavily rely on a 'developmental state' model during the cold-war regime, Vietnam now faces criticism from the international financial institutions, whose current orthodoxy is dominated by neo-liberal thinking.[29]

An analysis of changing comparative advantages in East Asia and the reorganisation of regional productive systems in a post-crisis environment represents a necessary condition for the identification of policies capable of restoring economic growth in Vietnam and for the planning of medium-term and long-term strategies. But the 'common wisdom' based on neo-classical economics tends to confute the need for such planning, supporting the view that reforms serving further liberalisation and a more 'neutral' trade regime would *per se* increase Vietnamese competitiveness. Thus, the international financial institutions, which would have the means for a large-scale investigation, remain silent in providing elements useful in understanding the dynamics characterising economic restructuring in post-crisis East Asia. This is also evident in the studies produced by mainstream scholars and institutions to assist the Vietnamese authorities in furthering the process of economic reforms. These studies do not provide consistent indications regarding the productive sectors to which Vietnam should direct its resources in order to increase its exports towards regional and international markets.

A study of the reorganisation of East Asian productive systems in the midst of the regional crisis is outside the scope of this work. However, the following text presents some elements with the aim of supporting the need for more exhaustive and systematic research in this direction. China is generally the first country to be examined in order to understand not only the changes in regional trends but also more specifically the changing environment for the Vietnamese economy. With its enormous reserve of cheap labour, China has been Vietnam's principal competitor as a location for labour-intensive production. China's relatively higher technological level and higher productivity has made production cheaper in many low-range industrial sectors. This has resulted in large-scale smuggling from China to Vietnam (estimated at about 20 per cent of Vietnamese imports).

During the regional crisis China visibly strengthened its position as a leading force in East Asia. Not only did the country succeed in maintaining growth of over seven per cent, but it also played a significant role in supporting regional economic stability. China, which had devalued the *renminbi* in 1993, made it very clear during the regional financial meltdown that it would defend the exchange rate of its currency (and that of the Hongkong dollar) with its large foreign reserves. The stability of the Chinese currency averted a new round of currency depreciation that would have certainly resulted from any *renminbi* devaluation. China's stance was further reinforced by a comparison with the economic and political impasse visible in the other East Asian giant, Japan. In June of 1998, for instance, at a time when the low value of the Japanese *yen* was putting great pressure on the exports of other Asian nations, China played a major role (behind the scenes) to reverse the trend. The Chinese threat to devalue its currency induced the US administration to dispatch the (then) deputy secretary at the US Treasury, Larry Summers, to Tokyo in order to convince Japan to intervene in defence of the *yen*.

The stability of the *renminbi* during the crisis resulted in a significant appreciation of the Chinese currency against all other major regional currencies. By December 1999 the value of the *renminbi* had increased over 30 per cent against the currencies of Thailand, Malaysia and the Philippines, 22 per cent against the South Korean *won*, and 12 per cent against the Taiwanese dollar. However, notwithstanding currency appreciation, China avoided a major shrinkage in its exports. The data for 1998 suggest that this was done thanks to a *significant shift in export composition, moving towards more technology-intensive and higher value-adding production*.

An analysis of export composition in the midst of the East Asian crisis indicates that textiles and garments—typical labour-intensive production—have suffered the most from currency appreciation. Exports of machinery and electrical equipment, on the other hand, continued to grow, indicating that China is increasingly becoming a big player in a sector long dominated by other East Asian countries. Growth in the export of automotive and transportation equipment was also remarkable, suggesting a successful diversification into more advanced industrial production. At the time of writing, data on the composition of Chinese exports are available only for 1998, and it is not known if the trend has been maintained in the following years. Notwithstanding the important diversification in export composition, the available data show that China did pay a price for the devaluation of other regional currencies: export growth was only 0.5 per cent in 1998 and turned negative in 1999 (but the preliminary data indicate a recovery in 2000).

Thailand is the next country to look at in order to understand how the reorganisation of the regional productive system will affect Vietnamese growth perspectives. In recent years, Thailand has been a competitor to Vietnam, but also a source of foreign investment. Before being hit hard by the regional crisis, Thailand—together with Malaysia and Indonesia—was known as a 'second tier' country, one following a path of accelerated industrialisation led by the other Asian NIEs. According to the 'flying geese' model of the regional productive order, Thailand was just one step ahead of Vietnam and China. Thus the upgrading of Thai production towards more technology-intensive production would leave room for Vietnam in the labour-intensive sector. At the end of 1998, notwithstanding wide currency devaluation, Thai exports were still below pre-crisis level in US dollar terms. Imports had appreciably decreased, thus allowing a readjustment of the trade balance, but exports apparently failed to take advantage of increased competitiveness in terms of labour costs.[30] A rapid overview of the composition of Thai exports, however, seems to indicate that currency devaluation boosted exports less than might have been expected because *Thailand did not re-engage in labour-intensive production but carried out further industrial upgrading*. The overview of data contained in an IMF statistical report released in February 2000 indicated that exports in garments, footwear and other labour-intensive production declined in dollar terms in line with a trend started before the regional crisis. Exports in more advanced sectors such as computers and vehicles had grown rapidly instead.

As with China, the compositional pattern of Thai exports seems to indicate that the crisis has not undermined and has probably even extended Vietnam's potential for increasing its market share in the export of labour-intensive production.[31] The data do confirm that this potential has been exploited successfully: in 1999 the growth in Vietnam's exports in the garment sector was over 103 per cent and, in footwear, it was over 34 per cent (Table 7). The data is also confirmed by a qualitative investigation conducted on behalf of the Norwegian trade unions in the summer of 1999. Using a survey carried out in Ho Chi Minh City and Danang on enterprises engaged in textile, garment and footwear production, the research showed

Table 7: Vietnamese Export Growth, 1995–99 (%)

	1995	1996	1997	1998	1999
Garments	–9.45	51.04	19.82	10.00	103.61
Footwear	63.93	165.50	81.73	6.94	34.88

Sources: IMF, *Vietnam: Statistical Appendix*, 1999; UNDP Statistical Bulletin 2000 that the crisis did not have a very severe impact on these companies. In particular, foreign-affiliated companies, whose production was mainly directed abroad, could rely on foreign partners in finding new markets. The wage increase in dollar terms compared to neighbouring countries was not considered by those managers interviewed as a factor important enough to motivate production relocation out of Vietnam. Although foreign investment in these labour-intensive sectors tended to originate in other East Asian countries, foreign entrepreneurs were acting as middlemen in an international production chain controlled by large Western multinational corporations (e.g., Nike), whose markets were largely located in OECD nations.[32]

The data on Vietnamese export growth in 1999 seem to indicate a favourable trend in the reorganisation of regional production systems. This may imply that Vietnam could succeed in further extending its market share in labour-intensive production, benefiting from industrial upgrading in other East Asian countries. In order to be sustainable, this trend will require a higher level of investment, including FDI. However, it is possible to foresee a return to higher levels of investment if present favourable conditions are confirmed. At the same time, it should be noticed that such a rapid export increase in 1999 may indicate that the investment level before the crisis (including FDI) had resulted in an expansion of industrial output potential, which might not have been entirely exploited yet.

Conclusion

This article has presented the hypothesis that the Vietnamese economy may be more integrated into regional production systems than is normally suggested. Already, in the wake of the regional economic crisis, Vietnam faced a mild deceleration in economic growth and shrinkage in FDI inflows. This was largely a result of the economic imbalances mounting in the region (overproduction, speculative bubbles in the real estate sector, etc.) which eventually unfolded in the form of financial and economic crisis. However, the economic downturn was interpreted by the international financial institutions (and by a number of mainstream analysts) as an indication of national shortcomings in the process of economic reform. Although shortcomings were undeniable—and they may have resulted in discontent among foreign entrepreneurs, thus reducing their propensity to make further investments—the interpretation provided by neoliberal analysts was excessively unilateral, failing to take adequate account of the regional dimension of FDI shrinkage. This unilateral interpretation may be understood as an attempt to push Vietnam towards a more 'orthodox' development strategy.

This article suggests that, although shortcomings such as corruption, red tape and excessive bureaucracy must be addressed, Vietnam can reinforce its position within regional production systems only on the basis of a well-defined industrial strategy. Here the experience of other countries in the region—following a line of analysis inspired by the 'developmental state' debate—may offer a useful source of inspiration for Vietnamese policy-makers.

Contrary to the predictions of the international financial institutions, in the wake of the Asian crisis Vietnam has been fast recovering its role as exporter of labour-intensive production (in particular, garments and footwear). However, upgrading its industry towards more value-added forms of production requires industrial strategies that are able to save the country from the tyranny of static comparative advantages. The experience of the region in this regard has been successful—following what has been described as a 'flying geese' path—also due to favourable geopolitical conditions. The reorganisation of regional production systems following the East Asian economic crisis will be the decisive factor in determining the conditions for Vietnamese industrial development.

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1. Although evidence is difficult to find, it could be argued that this change is related to broader geopolitical conditions. The United States (and thus the international financial institutions, over which Washington exerts a great deal of influence) had probably been quite favourable to Vietnam in the early 1990s because the country was considered important in a role of anti-Chinese 'containment'. However, Hanoi's careful foreign policy, which balanced improved relations with the West and admission into ASEAN with warmer relations with China at party and state levels, might have disappointed the American administration.

2. For a critical review of the debate about the East Asian economic crisis see P.P. Masina (ed.), *Rethinking Development in East Asia: From Illusory Miracle to Economic Crisis* (London: Curzon Press, 2001).

3. It should be noted that there are only a very limited number of international analysts working on independent interpretations of Vietnam's current economic development. This makes it possible for a small group of scholars and international financial institutions officers to lay down an interpretative frame that is constantly repeated in reports, media, studies, etc. This is what can be schematically defined as 'common wisdom'. Within this general 'common wisdom', however, significant differences exist in the interpretation of specific issues.

4. In March 1999, the General Statistical Office of Vietnam revised the historical series of economic data for the country. The real GDP growth rate for 1997 was reported at 8.8 per cent in the old series and at 8.2 per cent in the new series (see IMF, *Vietnam: Statistical Appendix*, IMF Staff Country Report No. 99 / 56, 1999).

5. See World Bank , *Vietnam: Deepening Reforms for Growth* (Washington DC: World Bank, 1997).

6. World Bank, *Vietnam: Deepening Reforms*, p. 3.

7. World Bank, 'Vietnam: Preparing for Take-Off?' (Hanoi: World Bank, December 1999).

8. World Bank, 'Vietnam: Preparing for Take-Off?'

9. I would like to thank Curt Nestor, Göteborg University, for his information and comments on FDI flows. He should not be held responsible for the interpretation presented in this work.

10. See N.L. Sum, 'A material-discursive approach to the "Asian crisis": the making and re-making of the productive and financial orders' and C.P. Chandrasekhar and J. Ghosh, 'Finance and elusive recovery: lessons for emerging markets from South Korea and Thailand', in Masina (ed.), *Rethinking Development in East Asia*.

11. FDI outflows from South Korea to Southeast Asia were US$1,625 million in 1996, $1,497 million in 1997 and $1,441 million in 1998. Cf. *Korea Statistical Yearbook* (National Statistic Office of Korea, 1999).

12. In pre-crisis East Asia there was an over-investment tendency, visible in key industrial sectors and motivated by a strong 'catching up' drive (see the discussion presented by the different contributions contained in Masina [ed.], *Rethinking Development in East Asia*). This, however, does not imply that the region—and Vietnam in particular—does not have the potential to further expand industrial production.

13. In an interview with a high official in the Ministry of Foreign Affairs in October 1997, the author was told that the management of the Thai Binh disturbances showed that the Vietnamese democratic system was functioning well, the state being able to react and respond to the people's demands.

14. Le Dang Doanh, 'Vietnamese economy in 1998 and perspectives for 1999', *Vietnam Review*, (January 1999).

15. United Nations Development Programme (UNDP), 'Socio-Economic Bulletin (Vietnam)' (2000). Web site of the UNDP in Vietnam.

16. The international financial institutions have suggested on several occasions that these figures should be revised downwards. They have estimated growth at about 3 per cent or 4 per cent in 1997 and about 2 per cent or 3 per cent in 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 push the government to accept their prescriptions. The fear expressed by a World Bank report in December 1999 ('Preparing for Take-off?') that 'Vietnam now faces the possibility of becoming one of the slower performers in the region' is not confirmed by the available data.

17. World Bank, 'Preparing for Take-off?'

18. World Bank, 'Preparing for Take-off?'

19. UNDP, 'Socio-Economic Bulletin' (Vietnam), Homepage of the UNDP in Vietnam, 2000.

20. World Bank, 'Preparing for Take-off?'

21. The IMF and the World Bank resumed their structural adjustment lending to Vietnam only in April 2001.

22. UNDP, 'East Asia: from Miracle to Crisis. Lessons for Vietnam (Hanoi: UNDP staff paper, 1998); World Bank, *Vietnam: Deepening Reforms.*

23. Agence France Presse, 23 February 2000.

24. Vietnam's Working Group on Poverty, *Vietnam Development Report: Attacking Poverty*, *Joint Report by the Government–Donor– NGO Working Group* (Hanoi: World Bank, 1999).

25. Reuters (6 October 1999).

26. E. Fukase and W. Martin, 'A Quantitative Evaluation of Vietnam's Accession to the ASEAN Free Trade Area (AFTA)' (Washington: Development Research Group, World Bank, 1999), p. 2.

27. A. R. Khan, 'Integration into the global economy', in K. Griffin (ed.), *Economic Reform in Vietnam* (Basingstoke: Macmillan, 1998), p. 23.

28. E.g., R. Wade, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization* (Princeton: Princeton University Press, 1990) and A. Amsden, *Asia's Next Giant: South Korea and Late Industrialization* (New York: Oxford University Press, 1989).

29. For a wider discussion of this point, see Masina (ed.), *Rethinking Development in East Asia*.

30. The last available data on the composition of exports, contained in the Statistical Annex of an IMF Staff Report published in February 2000, cover the period until 1998. In that year, the Thai economy had a contraction of about 10.4 per cent. GDP growth turned positive only in 1999.

31. This is also confirmed by analysis of the export composition of another important 'crisis' country such as Korea. Not even in 1998, with an economic contraction of 5.8 per cent, huge devaluation and shrinking exports, did South Korea see a growth in export performance of its light industry. (See data contained in the IMF Staff Country Report No. 10 / 00, *South Korea: Statistical Annex.*). The largest Southeast Asian country—Indonesia—was at the end of 1999 still in the midst of economic recession and political instability, which reduced its ability to compete in international markets.

32. See I. Nørlund, 'What's the Impact of the Asian Crisis? Economy and Living Conditions in Joint Ventures in the Ho Chi Minh Region and Da Nang'. Passau: Universität Passau. Paper presented at the Fourth Euroviet Conference, 16–18 September 1999.