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Viet Nam: a transition tiger
Economic performance and key issues

Abstract for chapter 3

From the late 1980s, Viet Nam experienced an economic turnaround in terms of growth, food production, stability, resource mobilisation, and the opening up of the economy to trade and foreign investment. This chapter addresses the key issues that led to the improvement of economic growth performance.

After a historical overview of macroeconomic data, two questions are posed: 'What determined the timing of the up-turn of the economy?' and 'Why did the economy respond so energetically to the opportunities offered by the new policy environment and why did that initial response set the economy on a path of sustained growth?'

The answer to the first question is straightforward: the *Doi Moi* economic reforms sparked the turn-around in the economy. The answer to the second question is more complex: while the change in the economic policy regime determined the timing and direction of the change in economic performance this does not in itself explain the pace and sustained character of subsequent growth. A good part of the explanation of the Vietnamese performance lies in the role of institutions, and in human capital.

The chapter closes with a discussion on entrepreneurship and innovation in development and the removal of barriers to entrepreneurship and innovation, specifically by the *Doi Moi* reforms

Keywords:

Doi Moi, economic growth, economic reforms, entrepreneurship, human capital, inflation, reform, Seventh Party Congress, Sixth Party Congress, state institutions, Washington consensus

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3

ECONOMIC PERFORMANCE AND KEY ISSUES

A HISTORICAL OVERVIEW OF MACROECONOMIC DATA

Table 3.1 highlights Viet Nam's economic turnaround from the late 1980s in terms of growth, food production, stability, resource mobilisation, and opening up of the economy to trade and foreign investment. This was achieved while maintaining progress in social development. This strong performance took place in an international context where median growth in per capita incomes in developing countries fell to zero over 1980–98 (compared with 2.5 per cent per year from 1960–79) (Easterly 2001).

Following an initial economic recovery immediately after formal reunification in 1976, annual economic growth averaged only 0.4 per cent in the five years to 1980. With population increasing by about 2.3 per cent each year, per capita income declined. Prices increased by an average of more than 20 per cent each year.

Economic growth performance improved during the early 1980s, but macroeconomic imbalances increased and inflation accelerated. As the government sought to stabilise the economy in the early years of reform, growth rates declined. Average inflation remained high, but had been greatly reduced by the end of the 1980s. The 1990s were marked by accelerating growth and price stability.

When *Doi Moi* was introduced at the Sixth Party Congress at the end of 1986, Viet Nam was facing a major economic crisis. The annual rate of inflation

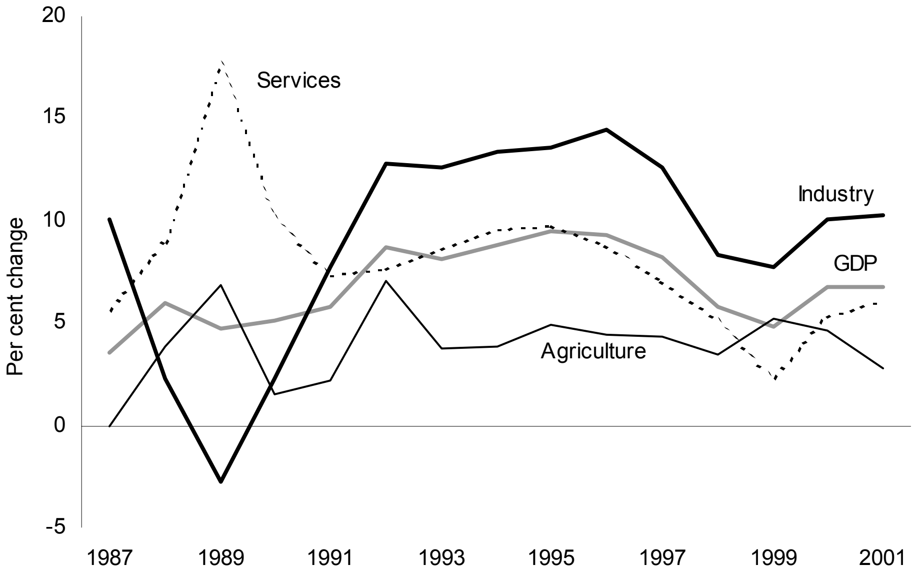
Table 3.1 **Average annual indicators of growth and inflation, 1976–80 to 1996–2001 (per cent)**

	Inflation (CPI)	GDP	Agriculture	Services	Industry
1976–80	21.2	0.4	1.9	-0.1	3.3
1981–85	74.2	6.4	5.3	4.7	9.3
1986–90	298.7	3.9	3.7	8.7	4.7
1991–95	23.5	8.2	4.3	9.5	12.6
1996–2001[a]	3.4	7.0	3.9	7.3	12.2

Note: [a] 2001 data is based on end-year government estimates. Services before 1986 only included trade.

Sources: General Statistics Office, various issues. *Statistical Yearbook*, Statistical Publishing House, Hanoi.

Figure 3.1 **GDP growth by sector, 1997–2001 (per cent change)**



was over 700 per cent, exports were less than half of imports, there was virtually no foreign direct investment (FDI), and only limited official development assistance. When the Seventh Party Congress met in 1991, economic growth had begun to accelerate, the value of exports had quadrupled, and inflation had been brought down to 67 per cent. From the early 1990s, the picture improved markedly, with stable macroeconomic conditions and a dramatic acceleration in growth of income and employment. Trends in economic growth and changes in key indicators since *Doi Moi* are summarised in Table 3.2.

The transition has been accompanied by changes in the structure of major components of GDP. The share of agriculture fell from 44 per cent of GDP (current prices) in 1986 to 24 per cent in 2001, while the share of industry increased from 26 to 38 per cent. The share of services also increased as indicated in the Table 3.3.

More surprising, at least for most external observers of the Vietnamese economy, was the fact that the share of the state in economic output increased from 22 per cent in 1986 to 40 per cent in 1996, before declining marginally in more recent years. Possible explanations for this trend are discussed throughout this report.

WHAT NEEDS TO BE EXPLAINED?

At the end of the 1980s, the economy was stagnating, economic survival for most segments of the population involved a difficult struggle, infrastructure still showed the damage of the generation of warfare, and the nation's economic future seemed quite uncertain. By the turn of the century, there had been a substantial reduction in poverty, a fast-growing middle class enjoyed levels of consumption unimaginable a decade earlier, infrastructure had not only been rehabilitated, but in critical respects had been expanded and, perhaps most important, there was a widely held perception, both among Vietnamese and external observers, that the economy was firmly set on the path of economic development. This breakthrough is not only evident in the economic numbers, but for observers of the economy was palpable in all aspects of economic life.

This dramatic change in economic fortunes raises two questions. The first, and easiest to answer, is what determined the timing of the up-turn of the economy? The answer to that question is straightforward—the *Doi Moi* economic reforms described throughout this volume sparked the turn-around

Table 3.2 **Indicators of economic developments, 1986–2001**

Indicator	Sixth Party Congress 1986	Seventh Party Congress 1991	Eighth Party Congress 1996	Ninth Party Congress 2001[a]
Economic growth (%)	3.4	6.0	9.3	6.8
CPI (%, year to Dec.)	775	67	4.5	0.8
Illiteracy rate (% of population)	10.7	9.2	7.7	6.5
Income per capita (US$)	180	228	339	410
Food grain production (kg of paddy/person)	301	323	385	433
Budget surplus (% of GDP)	–6.2	–3.8	–0.7	–3.5
Budget revenue (% of GDP)	14.0	13.5	23.6	21.8
Gross domestic savings (% of GDP)	n.a.	13.2	16.7	24.0
Current account (% of GDP)	–2.7	–2.0	–11.1	1.5
Gross domestic investment (% of GDP)	n.a.	15.1	27.9	26.1
FDI inflows—US$ million	-	229	1,838	1,200
ODA inflows—US$ million	147	229	939	1,700
Exports—US$ million	494	2042	7,330	15,027
Imports—US$ million	1,121	2,105	10,481	16,162
Trade (% of GDP)	25.1	63.7	100.0	n.a.

Note: [a] Preliminary estimates.
Sources: General Statistics Office, various issues. *Statistical Yearbook*, Statistical Publishing House, Hanoi. International Monetary Fund, various issues. *Vietnam: recent economic developments*, International Monetary Fund, Washington, DC.

Table 3.3 **Structural changes in the economy, 1986–2001 (per cent of GDP at current prices)**

	Sixth Party Congress 1986	Seventh Party Congress 1991	Eighth Party Congress 1996	Ninth Party Congress 2001
Agriculture	43.8	40.5	27.8	23.6
Industry and construction	25.7	23.8	29.7	37.8
Services	30.5	35.7	42.5	38.6
Total	100.0	100.0	100.0	100.0
State	33.1	33.2	40.0	38.6
Non-state	66.9	66.8	60.0	61.4

Sources: General Statistics Office, various issues. *Statistical Year Book*, Statistical Publishing House.

in the economy. The implications of that process for the economic growth performance are clear enough. From the point of view of conventional economic interpretations, the easy part of the story to understand is the impact of market liberalisation and macroeconomic stabilisation. Viet Nam implemented 'sound' economic policies, and reaped the promised rewards. This could be seen as a vindication of the 'Washington consensus' and, indeed, has been presented as such.[1]

There is, however, a more difficult question to be addressed. While the change in the economic policy regime determined the timing and direction of the change in economic performance, it does not in itself explain the pace and sustained character of the subsequent growth. While bad policies can result in economic stagnation and good policies can encourage and accommodate growth, policy is only part of the story. Many countries have implemented ambitious reform programs without stimulating the same level of sustained response. The other part of the story is to explain why, in this case, the economy responded so energetically to the opportunities offered by the new policy environment and why that initial response set the economy on a path of sustained growth.

INSTITUTIONS, HUMAN CAPITAL AND ENTREPRENEURSHIP

This chapter does not claim to offer a definitive answer to the second question, but on the basis of the authors' observations, some clues are offered. Interestingly, it is easier to eliminate some possible explanations than to provide all the answers.

For example, the initial sharp acceleration in growth is not explained by any sharp increase in capital formation. True, investment increased significantly, but the increase in the productivity of given levels of investment was more important than acceleration in the rate of capital formation.

Nor is Viet Nam's performance to be explained by the flow of external aid (although the flow of ideas and exchange of experience were important). The story told here demonstrates that the crucial transformation and acceleration in growth took place in a period when external assistance was declining, so that, although it can be reasonably argued that the growth in foreign aid from 1994 on supported investments without which growth would have been constrained in the late 1990s, it is difficult to make a plausible case that foreign aid either initiated the process or determined the liveliness of the response.

The main difficulty in teasing out a credible thesis is that a good part of the explanation of the Vietnamese performance lies in two areas of analysis, which are important, but where evidence is imprecise—the role of institutions and human capital. The pragmatic willingness to adopt market-oriented reforms was combined with an institutional framework and a population which was able to respond to the opportunities provided by the market stimuli.

The description of the role of state institutions in various parts of this study suggests that the effectiveness of the institutional framework is difficult to explain within the orthodoxy of the Washington consensus. The semi-reformed state economic apparatus has done much better than proponents of faster reform predicted. Many state institutions have performed rather well in taking advantage of competitive markets and adjusting to the new economic realities. Of course, the proponents of accelerated market reform and pure models of market institutions argue that if only reform were faster and more complete, growth would have been even faster, and if further reforms are not implemented with some urgency, growth will falter. Alternative judgements are always possible about counter-historical options, although it should be noted that, given the growth performance actually achieved, it would be surprising if alternative arrangements would have achieved much more.

The actual strengths of existing institutions and the particular path to reform chosen were demonstrated not only by the responsiveness of the 'semi-reformed' system to the possibilities of export-led growth in the period 1990–97, but also in responding with speed and effectiveness to the East Asian crisis from 1998 onwards, when pro-active state economic management (reducing barriers to domestic private investment and curtailing lower priority public investments) allowed the government to manage the potential crisis rather well. Indeed, the caution in implementing advice to reform and deregulate[2] the banking and financial system appear to have helped shield the economy from the full consequences of the speculative financial bubble that shook neighbouring economies.

The danger is that, if institutions are judged largely on their conformity to a predetermined and somewhat dogmatic template, then there is likely to be a failure to understand how they work in practice. It is particularly necessary to make that effort of understanding when institutional behaviour and performance does not conform to preconceptions.

In turn, however, institutions performed well because of the use Vietnamese have made of them. The high quality of human capital and its importance is readily observable in Viet Nam in the facility with which so many actors in the economy—from farmers, to businessmen and state officials—have demonstrated entrepreneurial flair in grasping economic opportunities.

ENTREPRENEURSHIP AND INNOVATION IN DEVELOPMENT

There is a long tradition in the study of economic development that places entrepreneurship in the centre of explanations of development. Schumpeter's *The Theory of Economic Development* (1936), published before the First World War, argued that entrepreneurship was the critical factor in explaining how economic systems raised themselves to new levels of performance. And nearly fifty years ago, Hirschman (1958) returned to similar themes in his *Strategy of Economic Development*. More recently, discussions of human and social capital have laid new emphasis on those human factors that determine the capability of societies to take advantage of economic opportunities.

The difficulty in using entrepreneurship as an explanatory variable arises from the fact that, although economists are willing to recognise the crucial importance of human capital in general and entrepreneurship in particular, it is not easy to define what in practice that means, in terms either of making *ex ante* predictions of performance, or in terms of any policy implications. Effective entrepreneurship is recognisable when it occurs but it is not measurable and its appearance is not easily predictable.

However, convincing evidence has been presented of the importance of entrepreneurship and policies supporting it as a key explanatory variable in explaining the 'Asian economic miracle'. In an interesting analysis of the experience of rapid economic growth in East Asia, Nelson and Pack have distinguished two schools of thought in interpreting the performance. One school (assimilation theories) 'stresses the entrepreneurship, innovation and learning, all encouraged by the policy regime, that these economies had to go through...'. The other school (accumulation theories) 'emphasizes physical and human capital accumulation' (Nelson and Pack 1999:418).

Nelson and Pack develop a strong case in support of the assimilation approach. One point they make is that, even if these follower countries were able to borrow techniques developed elsewhere, this did not simply involve importing an existing technology 'off the shelf', but also involved an important element of entrepreneurship in adapting and assimilating the new production techniques.

Another recent study of the sources of economic growth by Parente and Prescott argues in a similar vein that

> [a] necessary precondition for a country to undergo a development miracle is that the country is not exploiting a significant amount of stock of useable knowledge and therefore is poor relative to the industrial leader. The stock of knowledge will be little exploited if barriers to the adoption and efficient use of this stock are high and have been in place for an extended period. In 1965, many countries besides South Korea met this precondition. Most of these countries remain poor relative to the leader because unlike South Korea, they did not adopt new policies that greatly reduced barriers to the efficient use of this knowledge (2000:4).

REMOVING BARRIERS TO ENTREPRENEURSHIP AND INNOVATION

While it is still early days to describe the Vietnamese achievement as an economic miracle, the economic achievement of Viet Nam in the 1990s is consistent with the views of these two sources. Prior to 1986, Viet Nam had gone through an extended period where there were enormous barriers to the adoption and efficient use of the stock of useable knowledge. During the 1970s and 1980s, most of the population had no access to international media, books, education, travel and research, and no contact with foreigners. The state barred most of the population from investing in skills (for example, foreign language training) and travel that may have opened up new opportunities.

The *Doi Moi* reforms removed barriers to the utilisation of the available and potential stock of knowledge, not only in the narrowly technical sense, but also in the broader sense of the possibilities of taking advantage of Vietnamese comparative advantage, particularly in the regional context. A combination of improved incentives, increased competition, and reductions in barriers to the adoption of existing knowledge are crucial to explaining the rapid improvements in economic performance over the last 20 years.

The other underlying institutional factor which must be addressed is that of the energy, liveliness and entrepreneurial skills of the population A pervasive and critical element in explaining the response to market reforms and the success in making imperfect institutions work is undoubtedly the quality of the Vietnamese workforce. It is, of course, characteristic of informal discussion of the economic performance of countries that, after allowance has been made for policy and such quantitative factors as capital formation, most commentators will offer a view about the characteristics of the national population, good or bad.

This is dangerous ground, as such observations can often be little more than *ex post* rationalisation of observed performance based on anecdotal evidence, and is sometimes no more than ethnic prejudice. Indeed, it is striking that the same institutions and national characteristics that are used to explain success in one period can also be drawn on to explain subsequent stagnation (for example, in the recent economic history of Japan and Germany).

Economists sometimes try to avoid such pitfalls by using the concept of investment in human capital, and in turn relating that to an observable and to a degree quantifiable phenomenon. And that is part of the story in Viet Nam. The rapid exploitation of the possibilities of 'catching up' with neighbouring economies through the adoption of existing knowledge was aided by past solid performance in promoting literacy, numeracy and broader human development in the pre-reform period. At the beginning of the reform period, Viet Nam had much higher levels of mass literacy, life expectancy and middle and higher education than most other countries with a similar level of per capita income. And although the large numbers who had received higher education in the former planned economies had received little business training relevant to operating in a market economy, cadres had been well-trained in a number of technical areas.

As Nelson and Pack (1999) argued in their interpretation of the Asian economic miracle, however, formal investments in human capital are not a sufficient explanation of performance—there was an additional element that put the human capital to work effectively. Nelson and Pack accept that investment in human capital played a role, but argue that it played a role in the context of policies and institutions that supported assimilation of technology and export-led growth. Their explanation stops short of explaining why factors conducive to assimilation of technology were to be found more in East Asia than other parts of the world. Interestingly, Nelson and Pack recognise that the impressive performance across a number of Asian newly-industrialised countries was not achieved through any one, homogeneous policy package, but involved a variety of tactics and agile policy adjustments. Even if the answer lies partly in effective policies, it is still intriguing why in East Asia such effective policy skills were exhibited by a number of differing political regimes. Perhaps speculation in that area takes economists into terrain that they are ill-fitted to navigate.

In Viet Nam, when policy changes opened up the possibilities of exporting, the energy and ingenuity with which new exports were developed was striking, despite the fact that for some years external contact had been limited by government restrictions and the US-led aid boycott. Initial successes by pioneers were quickly followed by others seeking to emulate their success. In Hanoi itself this was evident in such areas as the development of silk clothing and embroidery for sale to foreigners and in the rapid development of mini-hotels, after the first private hotel was opened in 1992. In the agricultural sector, change was equally rapid, with the explosive growth of coffee in the Central Highlands and the spread of aquaculture in the Mekong Delta. Not only was entrepreneurial spirit evident in the new private sector, but even within the state-owned sector there were numerous examples of aggressive adaptation to new market possibilities.

Various sorts of exposure produced an outward-looking stance that contributed to the alacrity with which exporting possibilities were sought out and exploited. For example, many families maintained contacts with the Vietnamese Diaspora in Europe, North America and Australia, and these contacts provided access to capital and information. There was also an awareness of developments in neighbouring countries. Even in the pre-reform days, while formal trading links were mostly with the CMEA countries, informal trade across the porous borders, particularly with China and Thailand, was quite active. Once restrictions were relaxed, entrepreneurs near the Chinese border, for example, were able to read Chinese magazines and books, to meet buyers, and later to travel to China to see production processes and customers.

Maximum use was made of the information and trading possibilities arising from the formal trading links with the CMEA and the knowledge gained from contacts with China before the Vietnam–China conflict of the late 1970s. A good deal of effort was made to cater to the tastes of the few Westerners resident in the pre-reform period (hence the appearance of Nordic folk themes in embroidery to be purchased in Hanoi).

Vietnamese entrepreneurs have been willing to invest time and money to acquire and study information, to study production techniques, and to travel to learn about new markets and techniques. Rural entrepreneurs have made sizeable unrecorded investments in terms of foregone agricultural production and/or wages. State enterprises and public agencies have made substantial unrecorded, but critically important, investments in reorganising management and business procedures, in adapting technologies and in providing on-the-job training to workers. Personal investments of time and money have been made by the aspiring middle class in upgrading skills, as evidenced by the dramatic increase in English language and computer skills in the last decade. Small manufacturers studied international design trends and later invested in direct contact with international buyers, and then invested time in travelling to see new designs and learn about new processes and markets. Some of the key impacts of these developments on business are discussed in later chapters.

As a consequence, a good deal of growth was achieved despite relatively modest but increasing levels of recorded capital investment.

NOTES

1 The World Bank report to the United Nations International Conference on Financing for Development in Monterrey argued that progress made by Viet Nam, China, and other strong performing economies as examples of official development assistance success stories even though many of these countries (especially China) experienced significant economic growth, while receiving relatively little assistance (Development Economics Vice Presidency 2002).

2 Some earlier attempts in Viet Nam to rapidly open up entry to new domestic banks led to rapid increases in the number of credit unions and small private banks, most of which subsequently collapsed.