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Viet Nam: a transition tiger? Strategic building blocks of *Doi Moi*

Abstract for chapter 7

The process of reform in Viet Nam went through three stages: agrarian reform, price reform, and foreign trade and payments reform.

This chapter outlines the agrarian reforms that were introduced in the 1980s, representing a decisive shift towards the family farm as the basic productive unit – the most crucial initial building block of the reform process. This impacted on the majority of the population as well as the core of the economy. The chapter also highlights the price reforms where, by 1990, commodity prices were largely market determined and direct subsidies had been all but eliminated.

In terms of foreign trade, the government created an 'open door' policy that focused on export development, opening up the country to inputs from world markets, encouraging national enterprise to take advantage of export opportunities, and exposing the local economy to the challenges made available through choice of commodity and technology. Tolerance of a free foreign exchange market provided an effective mechanism for the growth of market transactions.

Keywords:

agrarian reforms, agriculture, commodity prices, cooperatives, export development, foreign exchange, foreign trade, inflation, informal activity, informal reform, Ministry of Trade, price reform, rice, rural economy, shortages, the dong

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STRATEGIC BUILDING BLOCKS OF *DOI MOI*

AGRARIAN REFORM

Agrarian collectivisation was intended to be an important part of the socialist strategy. Great efforts were made to develop agriculture using cooperatives as the basic unit for organising production, as well as for the distribution of inputs and marketing of outputs. This was particularly true in the north, where the cooperatives were developed both as productive units and as providers of social services (such as crèches and kindergartens). Following unification, efforts were made to extend this system throughout the country. Agrarian reforms introduced during the 1980s represented a decisive shift towards the family farm as the basic productive unit. This was the most crucial initial building block of the reform process because it impacted on the majority of the population and the core of the economy.

There was some regional diversity in the agrarian reform process, as the history of agricultural organisation differed considerably between the north and centre on the one hand, and the southern provinces. Prior to the 1981 reforms, cooperatives in the north were organised based on farmers working in brigades for work points. Even then, however, there was considerable 'own account' (illegal) activity.

The experience of the south and in particular the Mekong was somewhat different. There were two successive waves of collectivisation in the Mekong. The first was stopped in 1979–80 in response to economic crisis, and although the second (started in the early 1980s) was declared successfully completed in 1985, cooperatives never played as decisive a role in the southern rural economy as they had done in the north.

Even in northern and central Viet Nam, farm households were important elements of the production system, although subject to policies aimed at establishing collective control through producer cooperatives. Reforms in 1981 and 1988 increased the autonomy of the farming household, with the 1988 reform decisively shifting most economic power from the producer cooperatives to households and essentially returning agricultural production to a family basis.

Under the 1988 reforms, cooperatives were still meant to provide a focus for various rural activities sponsored by the state, but probably in the majority of communes the cooperatives were reduced to only a minor role, their functions reduced to acting as local tax collectors, as the holder of residual property rights, and as an element of the formal state structure. A small group of cooperatives managed to shift successfully to a profitable service function. Some cooperatives retained some support from farmers, but were greatly diminished in importance.

Further measures introduced in 1989 reduced the direct involvement of the state in input allocation. The procurement of agricultural output at prices below those on the free market formally ended and the share of output procured by the state declined considerably. From 1989, there was a substantial surplus available for free market sales.

The reforms had a considerable impact on rural institutions. Farming families increased their control over land and other assets. The weakening of the state trading system at the local level permitted private traders to develop local markets, while many state trading enterprises became more responsive to market opportunities. Large-scale wholesaling often based upon access to foreign exchange and other key inputs (such as transport facilities) generally remained under the control of state agencies but these competed with each other.

The picture regarding land-use rights became clearer over many years. The formal legal position lagged behind events. While the formal legal framework remained ambiguous for some years, there was in practice a decisive shift in favour of family farms. Residual collective property rights remained socially important in northern and central regions, where it was common for families to hold their land on long-term contracts from the cooperative. In areas where the cooperatives were weak, enforcement of land-use rights probably reverted to the village or commune level. In the south, the situation was even more fluid, and land essentially returned to informal private ownership.

Other farm assets were privatised extensively. Livestock, machinery, brick kilns and other important sources of cooperative revenues were sold to farmers.

Liberalising agricultural and small scale trade and craft activities fundamentally changed the character of the Vietnamese economy, adding to the resilience of the economy during the subsequent decade of economic difficulties.

THE TRANSITION TO A MARKET SYSTEM—PRICE REFORM

For many years, the economy experienced repressed inflation, a typical characteristic of centrally planned economies. Open inflation surfaced during the late 1970s. For a decade, high open inflation was combined with the persistent symptoms of repressed inflation, such as rationing and shortages of inputs and consumer goods at official prices. As a result of the pressures on the planning system, there was a partial breakdown in the allocation of subsidised inputs and of state procurement of consumer goods to fuel the rationing system. Enterprises, agricultural cooperatives and individuals were thus forced to try to obtain the goods from non-official sources. State companies began to initiate direct relationships among themselves in order to obtain commodities, inputs and spare parts unobtainable through official allocations—an informal reform process in which the rules of the planning game were spontaneously modified.

Political leaders responded to spontaneous change by making a series of concessions while trying to regain control of the process. As early as 1981, industrial sector state enterprises were given the right to do business with each other and to sell their production freely after they had fulfilled their obligations to the state. Companies became increasingly interested in transactions on the parallel market where prices (and costs) were several times higher than official prices.

The 1979–81 reforms within agriculture and industry, simultaneous liberalisation of retail trade, a cautious price reform and limited decentralisation of foreign trade represented important movements towards a market system. Early attempts to reduce the extreme differences between free market prices and official prices were made in 1987 following the official announcement of *Doi Moi*.[1] Prior to the 1989 price reforms, however, the economy remained segmented between production within and outside the central plan. In the period 1989–92, 'step-by-step'[2] movement to reform institutions continued, cautiously in some areas (for example, in enterprise reform) but decisively action in other areas (for example, de-control of prices).

As a result of the increased economic autonomy granted to households and small businesses during the second half of the 1980s, the state sector was left in a sort of halfway house. Although state enterprises were still, in principle, subject to the planning mechanism, the central authorities lacked the instruments to enforce plan discipline. A good deal of autonomy was granted, and central plan targets and instructions were not rigorously enforced, but state enterprises were not yet subject to market discipline and their input/ output prices were not always market determined.

Even though a growing amount of economic activity fell outside direct state control by the mid 1980s, a number of key issues regarding the legal status of private economic activity remained unresolved (for example, access to land), many important policy issues related to the management of the emerging economic system had still be to addressed (for example, price controls, exchange rate management), and the political legitimacy of the emerging system needed clarification.

In 1987, the rationing system was abolished for many commodities, and official prices of non-essential goods were raised to a level close to free market prices. Administered prices of most consumer goods, and of a large number of agricultural and industrial inputs, were increased sharply in 1987 and 1988. However, differences between official and free market prices continued to be large in the markets for key agricultural products, such as rice, and for foreign exchange (and, as a consequence, in the markets for all imported goods).

By 1990, commodity prices were largely market determined and direct subsidies had been all but eliminated. These reforms were critical. Two central issues in the shift to a market system of economic coordination are the manner and timing of the shift from administrative to market prices, and the strategy for introducing a new set of 'rules of the game' whereby actors in the economy, particularly state enterprises, are constrained to respond to market prices by the discipline of a hard budget constraint. The economy was opened to the influence of international markets, although this partly involved official acceptance of a reality in which international trade was already much freer in practice than principle.

While price reform was highly successful, it was neither an instantaneous nor a smooth process. The authorities faced two dilemmas. The first related to the impact of price reform on those segments of the economy ill-adapted to respond to the new system. The potential political and social costs of collapse of large-scale enterprises were obvious and it did not make sense to force the premature collapse of enterprises which might, if allowed time to adjust, have a chance of viability. Another set of problems related to the impact of reform on consumers, in terms of both the risk of increasing open inflation as price controls were removed and the impact of large changes in relative prices.

The strong open inflation of the late 1980s facilitated the shift from official to market prices, as official prices became increasingly irrelevant even before they were formally abolished. There was increased competition as voluntary transactions between enterprises replaced central planning and state orders. A fundamental change took place in the entire economic environment, with profound effects on the behaviour of economic agents. The former sellers' market was replaced with the shift towards market-clearing prices.

First steps were made to put a more appropriate machinery of fiscal and monetary policy in place, while existing instruments were used to reverse dramatically the continuing very high inflation in early 1989. Price reform was accelerated. With the exception of a few social benefit items (such as electricity, house rent, medicines), consumer goods sold through state outlets were now sold at prices very close to the free market level and were frequently adjusted to keep pace with free market prices. The state budget was almost entirely relieved of the burden of directly funding price subsidies. A drastic devaluation brought the official rate of exchange close to the free market rate, resulting in positive real interest rates. With the 1989 price reform and increased autonomy for state enterprises, the attempt at to operate a centrally planned 'command economy', for all practical purposes, came to an end.

The speed and depth of the transformation of the price system were decisive for subsequent economic performance, both in terms of the move towards market determined prices and the shift in enterprise behaviour in responding to market opportunities and constraints. Viet Nam quickly moved to a price system as 'free' as those of many long-established and successful market economies. However, issues of enterprise ownership, management and control were confronted more cautiously.

EARLY REFORMS IN FOREIGN TRADE AND PAYMENTS

The decline and eventual collapse of economic aid from, and trade with, the CMEA compounded the macroeconomic problems faced in the late 1980s. In response, the government sought to diversify its external economic relations with an 'open door policy' that focused in particular on export development.

The transformation of the foreign trade regime was a potent force for change in the economic structures of the Vietnamese economy. Opening up to imports from world markets, encouraging national enterprises to take full advantage of export opportunities and exposing the local economy to the opportunities and challenges of technology available internationally have had profound effects on the commodity composition of production and on the choice of technology.

Planned economies which had been integrated into the CMEA could develop a structure of production with little reference to relative prices prevailing in world markets as prices were largely insulated from international influences. Exposure to world markets and to the price system prevailing in those markets could be expected to have powerful effects, both on activities which were no longer sustainable when faced with international competition and on those activities which benefited from the stimulus of international export opportunities.

In this as in other areas, the impact of Vietnamese reforms was conditioned by the fact that in reality, the system was at the end of the 1980s spontaneously adjusting ahead of the change in the policy regime. The central authorities practised what could almost be described as involuntary liberalisation. The flows of imports, both smuggled and countenanced by policy adjustments, provided the material basis for the rapid development of commodity markets and the ready availability of incentive goods, which was a striking feature of Viet Nam's economy towards the end of the 1980s.[3]

The high level of informal activity which characterised the foreign trade sector involved, among others, various actors within the state sector. Thus a good deal of the foreign trade which took place outside effective central state control involved state enterprises. Unrecorded trade is believed to have been of a similar size as official trade in some years.

In a sector in which the central government had little success in imposing its authority, it was perhaps not surprising that the direction of policy was unclear. The government made feeble attempts to implement a system of quotas and licenses. In 1989, it was officially recognised that informal trade had led to a great increase in goods supply on domestic markets, but some officials also argued that unregulated trade had resulted in the circulation of counterfeit goods, tax evasion and severe competition with domestic production. The government, however, concluded that mainly administrative measures, rather than trade restrictions, could reduce the deemed harmful effects of foreign competition. Certainly, the ready supply of low-priced imported goods throughout the country made a strategic contribution to expansion of the market and to decentralised growth in economic activity.

A critical determinant of performances of reforming economies is the degree of adaptability and resilience of the underlying real economy in the face of new trading opportunities and challenges. In this respect, Viet Nam's performance was in striking positive contrast to that of other CMEA members. The swift re-orientation and expansion of Vietnamese exports enabled the Vietnamese to withstand the shock of the sudden collapse of Soviet support, the continuing effects of the US-led trade boycott, and the absence of any compensating increase in non-Soviet assistance. This was partly the result of Vietnamese oil exports coming on stream, but was also the result of a rapid increase in non-oil exports to convertible currency markets.[4]

Opening up had particularly dynamic effects because of the Southeast Asian regional context. Neighbouring countries were experiencing very high rates of growth in international trade and were undergoing structural transitions, with rising labour costs providing incentives for them to move the more labour intensive export processing offshore. The potential for expanding trade and investment was enormous.

In the liberalised trading environment, state trading agencies remained powerful. They had access to financial resources and their 'owners' (either a line Ministry or a local authority) could retain control of foreign currency, depending on their negotiating position *vis-à-vis* central government. They were controlled by agencies at important levels of the state administrative system (line Ministries and local authorities) which also controlled other economic units as well as regulation and supervision of commercial activity. They were therefore a key part of a system of interlocking structures, which, combined with their access to cheap credit through the state banking system, gave them opportunities to reap economic rents in various ways.

In the subsequent process of reform during the 1990s, a private trading system grew up alongside the state trading system, often acting in cooperation with the state trading companies (for example, in gaining access to export commodities such as rice when the state enterprises continued to enjoy privileged access through quota systems and licensing arrangements).

Despite significant liberalisation, the Ministry of Trade retained considerable power to control business entry to foreign trade activities. The Ministry of Trade issued import and export licenses permitting businesses to engage in foreign trade.[5] Obtaining such a license could be a time consuming and expensive process.[6] Specified criteria to be registered to engage in foreign trade included minimum capital requirements, past foreign trade experience, and qualifications of enterprise personnel. While private manufacturing enterprises were permitted to trade directly in products closely related to their business, private trading companies found it much more difficult to obtain foreign trade licenses.

In addition, the government continued to operate a system of quotas and other controls on the import and export of some important commodities, including rice, textiles, garments, minerals, petroleum products, fertilisers, motor vehicles, equipment and machinery, and any second hand goods. Not surprisingly, securing favourable administrative decisions involved a less than transparent process.

The system operated more flexibly than might be apparent. For example, although most rice and garment export quotas were allocated to state enterprises, in many instances most of the actual work was subcontracted to private enterprises and the state enterprise just collected the rent associated with the quota (see, for example, ADB and IFPRI 1996). Export growth was an important priority, and steady progress was made in reducing private sector disincentives to participate in export trade, resulting in significant reductions in the share of foreign trade handled by centrally managed enterprises.

In the early stages of the reform process, as the trading system and domestic price system were liberalised, the exchange rate took on greater importance.[7] The evolution of foreign exchange policy was both unorthodox and successful. In contrast to widespread efforts in many developing mixed economies to defend official exchange rates at unrealistic levels and maintain exchange controls in the 1970s, the speed and degree of the movement towards uniform exchange rates and convertibility was remarkable.

The modification of the exchange regime involved a period in which private and official foreign exchange markets operated alongside each other, with large gaps between the parallel and official rates. In 1989, a dual foreign exchange system, with an official and unofficial rate, replaced a complicated system of multiple exchange rates. The formal system was based upon obligatory delivery, in principle, of a variable proportion of hard currency earnings to central authorities, whilst the large informal system included direct quasi-legal transactions between businesses, most of which were part of the state sector as well as an active small scale foreign exchange market, in particular served by the gold merchants. US dollars were held alongside gold as a monetary 'store of value'.

For a time in the late 1980s Vietnamese citizens had been free to hold dollars. After a period of relative laxity, in 1991 the central authorities attempted to enforce central control over foreign exchange markets, but without much success. Even after the holding of dollars and dollar transactions were made illegal, such activities continued quite openly. Moreover, many domestic transactions (notably real estate) were denominated in gold, which could be brought and sold freely in a well-developed free market.

In principle, the Dong remained unconvertible and enterprises that earned foreign currency were supposed to deposit it with the officially approved banks, retaining a right to use part. The system of control, however, was weak. The official foreign payments system was subject to a degree of risk, as banks were not trusted to honour obligations in hard currency. This encouraged those in receipt of hard currency to retain control over it, inhibiting development of an effective official exchange market.

Foreign exchange regulations were persistently and widely violated,[8] with currency not being deposited in banks, interest-bearing accounts being kept overseas and foreign exchange being used at the discretion of the institutions which earned it. The dollar circulated freely in the main urban centres and was used as an alternative, if not precisely legal, medium of exchange.[9]

It was typical for state enterprises to retain foreign exchange for lending, to finance joint ventures and even deposit abroad. Numerous attempts to tighten control over foreign exchange had little effect. Efforts to reduce the use of foreign currency within Viet Nam and to pressure Vietnamese to deposit foreign currency holdings in bank accounts were frustrated by the lack of trust in the banking system and the continuing gap between the state rate and the free market exchange rate.

Many of the dealers in foreign currency were state units, and their owners (Ministries and local authorities) were responsible for violations. Rates on the free market were reported in the official media.

By 1989 the margin between the official and free market rates was not high by the standards of many developing countries, although it continued to subsidise those who were able to gain access to foreign exchange at the official rate. During 1989, the margin averaged 12.2 per cent; in 1990 it was 9.4 per cent.

The Vietnamese experience illustrated how difficult it is to transform fiscal and monetary institutions at a stroke and that, irrespective of whether the rhetoric of 'big bang' stabilisation or gradualism is adopted, in practice a degree of financial instability and inflation is likely to be experienced during the transition. This suggests the need for second-best macroeconomic strategies, to live with financial instability and inflation and limit the damage done to the growth of market institutions. One second-best solution, implicitly accepted in Viet Nam, was a dual currency system. The free *de facto* circulation of dollars and gold not only facilitated foreign trade during the reform period but also provided a stable basis for transactions during periods of inflation, and by so doing increased the efficiency of domestic economic transactions.[10] Tolerance of a remarkably free foreign exchange market provided an unorthodox but effective mechanism for the facilitation of the growth of market transactions in a period (up to the end of 1991) in which it was not possible to stabilise the domestic currency supply and price level. Together with the movement of official exchange rates close to parallel market parity, the remarkable permissiveness in allowing the circulation of dollars provided a good monetary basis for the development of market transactions, sustaining growth in the real economy despite high levels of monetary instability.

NOTES

1 Free market prices tended to be several times higher than official prices.

2 A term much favoured by Vietnamese authorities in describing the *Doi Moi* process.

3 Already, in the early part of 1989, the availability of imported manufactures in Vietnamese markets was striking, both as a result of the initiative of state enterprises in speculating in imports outside their normal business and as a result of smuggling, particularly from China and Thailand. Large stocks of electrical and electronic equipment were to be seen not only in the big cities but in provincial centres. Clear evidence of the relatively free availability of goods at that time was provided by the sight of Soviet advisors returning to Moscow on Aeroflot flights loaded with consumer durables. The uncontrolled movements of goods could have slightly bizarre results, as in the case of one provincial trading enterprise in the

Mekong that had on display a collection of fine French cognac as a result of a whim of the management, or the quite unwitting sale of t-shirts displaying Rambo, smuggled from Thailand. The Vietnamese seemed to be quite astute in acquiring tradable commodities from CMEA trading partners. As a result, one author's home in Dar es Salaam is furnished with two charming Czech chandeliers.

4 The management of a state footwear firm, interviewed in Hai Phong in 1989, volunteered the information that the firm had substantially shifted its market from Eastern to Western Europe, despite its formal obligation to supply CMEA trading partners. The incentive for this shift was that the convertible currency generated by this trade was retained by the firm to fund its activities (including purchases from other state enterprises) rather than being surrendered to the State Bank as required by regulations.

5 Article 4 of Decree 89-CP (15/12/95), 'Revoking the Procedures for Granting Export or Import Permits for each Consignment', Government Gazette (15/3/96). Decree 33-CP (19/4/94), 'State Management of Export-Import Activities'.

6 Up until Decree 89-CP (15/12/95) was issued, traders also had to seek licenses for each individual shipment.

7 If the prevailing exchange rate does not realistically reflect the relationship between the domestic price and border prices, then rents will be available to be reaped. Governments can adopt a range of exchange rate regimes between strict controls and full convertibility, such as multiple exchange rate systems and selective export earning retention, in the attempt to influence the pattern of trade.

8 The realities of foreign exchange practice were brought home to both authors on separate occasions when visiting the State Bank with a senior international official and a number of government officials in early 1989. While waiting for our appointed interview, the international official decided to use the time to change dollars for dong at the official exchange rate. At that point the Vietnamese official reacted almost with alarm, urgently explaining that the official rate was much lower than the rate offered (illegally) by gold merchants—an early encounter with the pragmatism of Vietnamese officials.

9 Despite repeated statements of intent and reassertion of regulations, the dollar has remained as a currency in wide circulation, freely used for transactions.

10 The 'dollarisation' of the economy implied by the tolerance under this system was quite different from the dollarisation of the Argentine economy that ended in crisis in 2002, in which the peso was held at a fixed exchange rate with respect to the dollar. The cost to Viet Nam was the state loss of seigniorage on the money supply circulating in the form of dollars, but that was a reasonable price to pay for the flexibility achieved during the transition.