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Viet Nam: a transition tiger? Capital formation and external assistance

Abstract for chapter 13

Rising rates of capital formation played an important role in Viet Nam's growth process in two important ways: an increase of capital formation was necessary to accommodate the growth in output; and the inflow of foreign investment was important in providing the basis for establishing a number of new exports.

This chapter examines the role and performance of investment via external finance, both through foreign investment and assistance programs, and the effects of investment in foreign technical cooperation

Keywords:

aid, Asian Development Bank, capital, *Doi Moi,* domestic market, domestic private investment, donors, economic infrastructure, FDI, foreign investment, GDP, infrastructure, intangible investments, Japan, labour costs, National Assembly, oil and gas sector, policy-based lending, poverty, public goods, savings, social infrastructure, state investment, technical assistance, United Nations, US embargo, World Bank

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CAPITAL FORMATION AND EXTERNAL ASSISTANCE

THE ROLE OF INVESTMENT

The role of investment in the Vietnamese growth process may be interpreted as follows. Increases in the rate of capital formation did not initiate the acceleration in growth, and the high rates of growth achieved are not to be explained by the rate of capital formation. Nevertheless, rising rates of capital formation played an important role in the growth process in two important ways.

Once the pace of growth accelerated, increased levels of capital formation were necessary to accommodate the growth in output. For example, without an expanded program of infrastructural investment, output growth would eventually have been constrained by bottlenecks in the transport system, power supply, and so forth.

The inflow of foreign investment was also important as a vehicle for the transfer of technology to Viet Nam, in particular providing the basis for the establishment of a number of new exports. It would be a mistake, however, to interpret growth in the rate of capital formation as leading the overall growth process, as is implied by 'capital–output ratio' type growth models, which assume that an increase in the rate of capital formation will be sufficient to raise the rate of output growth. Moreover, at the critical period for growth acceleration, the factors that increased the productivity of capital were more important than increases in capital formation in contributing to growth.

INVESTMENT PERFORMANCE

After 1992, there was an increase in recorded investment. The ratio of gross capital formation to GDP is estimated to have risen from 15 per cent in 1991 to 25 per cent in 1993–95, continuing in the range of 25–27 per cent in subsequent years (Table 13.1). While this represented a significant acceleration, the investment rate remained well below the very high levels achieved by the East Asian Tigers in their periods of high growth and, for reasons argued in the previous section, does not in itself explain the output growth performance. However, it should also be noted that, even by conventional definitions, official series may underestimate capital formation. Given the rural structure of the economy and the growing importance of household and small enterprise activity, a significant amount of investment was probably not fully recorded.

In addition, aggregate investment figures miss important intangible capital investments. Parente and Prescott (2000) develop a powerful argument that conventional measures of investment greatly underestimate the level of capital formation, even in economies with fairly complete statistical coverage. They argue that the conventional measure of investment in terms of expenditures on new structures and equipment and inventories is misleading, particularly in underestimating the importance of intangible investments (for example, research

Table 13.1 **Gross fixed capital formation, 1991–2001 (per cent of GDP)**

Year	Investment
1991	15.4
1992	18.8
1993	24.5
1994	24.6
1995	25.4
1997	26.7
1998	27.0
1999	25.7
2000	27.7
2001 (preliminary)	28.9

Sources: Ministry of Planning and Investment, 1996. *Public Investment Program 1995–2000*, Ministry of Planning and Investment, Hanoi; and General Statistics Office, 2001. *Statistical Yearbook 2001*, Statistical Publishing House, Hanoi.

and development and software, the organisational capital of firms, investments in individual human and social capital).[1] They conclude that if such factors are taken into account as a general rule 'unmeasured investment is big and could be as much as 50 per cent of GDP and is surely at least 30 per cent of GDP' (Parente and Prescott 2000:47). Increased competition and openness to international information and technology flows can help accelerate growth in such intangible investments (Rodrigo 2000).

This is particularly important in a changing international economic environment where investments in information and know-how are becoming increasingly more important relative to investments in fixed capital. Examples include operations and maintenance (in Viet Nam many resources for the operation and maintenance of public infrastructure are mobilised at a local level and do not even appear in expenditure data). The average life of much physical capital in Viet Nam can be very high because of investments in maintenance and in adapting capital goods to local needs (the long life and wide variety of uses made of small tractors in rural villages is a case in point).

It is estimated that investment during the period 1991–95 totalled VND 206,000 billion, equivalent to US$16–17 billion, of which the state sector accounted for VND 96,000 billion (46.6 per cent).

The sources of investment activity in the period 1995–2000 are shown in Table 13.2. The figures suggest that foreign direct investment made a critical contribution to the surge in investment activity in 1995–97, but was of declining importance following the onset of the East Asian crisis. The period of high rates of foreign direct investment was associated with the period of the highest export growth.

When the relative contribution of foreign investment fell in 1998, state investment accounted for the major share in investment activity. This expansion of state investment is explained by the build up of official development assistance, reflected in the item 'credit' under the state investment category.

By contrast, the figures for domestic non-state investment suggest that the relative importance of the non-state sector is declining, a surprising finding given the evident growth in importance of non-state economic activity followng the *Doi Moi* reforms. There are a number of possible explanations.

One possibility is simply undercounting of non-state investment, particularly by households and small enterprises.[2] It is also likely that investment data exaggerate the relative productive impact of public investment, as it is strongly

Table 13.2 **Investment, by ownership, 1995–2001 (per cent of total investment)**

	1995	1996	1997	1998	1999	2000	2001[a]
State investment	42.0	49.1	49.4	55.5	58.7	57.5	58.1
Domestic non-state investment	27.6	24.9	22.6	23.7	24.0	23.8	23.6
Foreign direct investment	30.4	26.0	28.0	20.8	17.3	18.7	18.3

Note: [a] Preliminary estimate.
Source: General Statistical Office, 2001. *Statistical Yearbook 2001*, Statistical Publishing House, Hanoi.

Table 13.3 **Allocation of state investment, 1995–2001 (per cent of total investment)**

	1995	1996	1997	1998	1999	2000	2001[a]
State budget	44.6	45.6	44.0	40.4	41.3	41.3	42.5
Credit	19.9	19.9	19.3	23.7	28.3	32.1	32.2
Equity in state enterprises	12.2	14.8	16.8	17.7	17.4	16.9	17.9
Other	23.3	19.7	19.9	18.2	13.0	9.7	7.4

Note: [a] Preliminary estimate
Source: General Statistical Office, 2001. *Statistical Yearbook 2001*, Statistical Publishing House, Hanoi.

weighted with highly capital-intensive projects. Investments in the private sector have generated higher output and much more employment in proportion to outlay than state sector investments. This, however, would not explain the trend increase in the relative importance of recorded state investment.

Another factor may be the increasing importance of official development assistance in the state investment budget. By and large, aided projects are more expensive per unit of output than domestically financed activities, certainly compared with those in the non-state sector, but even in relation to state investments.

The data also reflect the reality that the government of Viet Nam throughout the 1990s tended to be more sympathetic to foreign direct investment than to domestic private investment and, until the implementation of the new enterprise law in 2000, persisted with a regulatory regime which was not encouraging to formal private business activity. The result was that much non-state activity was implemented by unregistered firms and appeared statistically, if at all, under the amorphous category of 'household' economic activity.

The investment strategy adopted by government in the Public Investment Program 1995–2000 and in the 1995–2000 Five-Year Plan was to focus public investment on economic and social infrastructure, particularly on critical economic infrastructure needs, such as transport, electricity, telecommunications, and water resources, and on investment in human capital through education and health programs.

The government also committed public investment funds to such basic industries such as cement, steel, mining and oil and gas processing, and provided loan finance from state credits, funded from domestic and foreign sources, for such activities. The main weakness in the government investment strategy was over-investment in some of the basic industries (for example, cement and coal) and some other state enterprise activities (for example, sugar refining). The government committed resources to stimulate investment in other industries by establishing industrial parks and by providing the infrastructural requirements of focal economic zones.

While it is difficult to draw firm conclusions from the investment data, they are consistent with the view that a strong role for state investment was not inimical to vigorous export led growth. This suggests that, at least in the Vietnamese case, an active public investment program can support the development of other sectors, rather than 'crowd out' their efforts.

Examination of the government investment program (not including investment in state-owned enterprises) indicates that a great deal of emphasis was put on investment in infrastructure—a rather traditional approach to development. Generally, government investment reflected the established doctrine that government investment priorities in supporting the growth process should be to ensure the supply of those resources which have a strong 'public goods' component, primarily infrastructure which cannot be readily funded by commercial mechanisms. Segments of economic activity which should be treated as public goods at this stage of Viet Nam's development, such as roads, flood control and major irrigation works, and water supply and sanitation (which have an important public health element), placed great demands on the government capital budget.

The priorities for public investment at the beginning of the 1990s were fairly obvious. The major component was the rehabilitation of basic infrastructure that had been damaged in the war years, a challenging task that had only been partly dealt with in the difficult years following unification.[3]

The flow of foreign direct investment following the opening up of the economy was mobilised for a number of different reasons. One strong impetus was regional investors seeking platforms for low cost labour-intensive exports. Another element was the attraction of investment in the oil industry (the major share of UK investment was made by British Petroleum in the oil industry). Such investments were important in helping finance the export boom.

Some of the investment to meet the needs of the domestic market was more problematic (for example, the over-investment in property development[4] and vehicle assembly), and the downturn in foreign direct investment in 1998 not only reflected the regional crisis, but also specific problems facing investors supplying the domestic market who had made over-optimistic assessments of the Vietnamese market.

Following the 1997 crisis, although government postponed a number of public investments and reduced the level of public investment below levels that had been planned, the relative importance of public investment in total capital formation increased sharply. State investment grew from 48 per cent of total investment in 1997 to an estimated 62 per cent in 2000. The expansion of state investment was fuelled partly by the increased flows of official development assistance, which fortuitously played a countercyclical role in coming on stream just as regional foreign investment flows were falling sharply.

In relation to non-state domestic investment, more work is required to increase understanding of the structure of the sector. Surveys undertaken on the private sector suggest that the growth of the sector has been more vigorous than the statistics suggest. Existing official data suggest that domestic non-state investment has consistently accounted for one-fifth of total investment annually over 1997–2000. The rapid registration of new enterprises under the new enterprise law may increase the information available.

One macroeconomic weakness identified by some observers was the modest domestic savings target set in the 1995–2000 Five-Year Plan. Although the GDP data suggest that savings have risen significantly, the savings rate still falls short of the very high rates achieved in other successful economies in the region, and may be too low to sustain very high growth rates in output over the longer term. As noted above, however, the data on private investment and savings is inadequate, so that actual savings performance may have been better than targets and available data indicate.

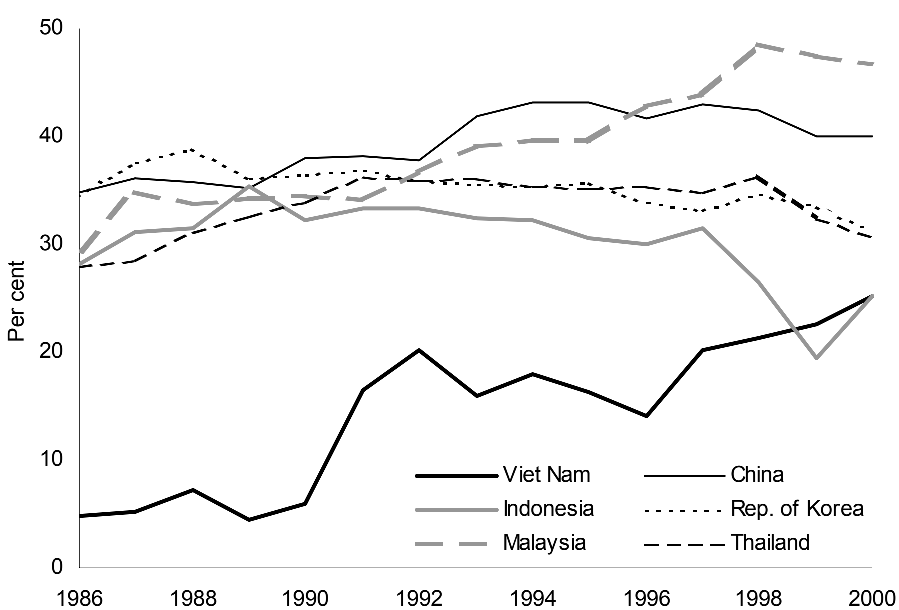
This is suggested by the macroeconomic data for recent years. IMF data indicate that gross national savings rose from 13.6 per cent of GDP in 1995 to 26.5 per cent of GDP by 1999. This also reflected the declining relative importance of foreign direct investment after 1997.

THE ROLE OF EXTERNAL FINANCE

Private foreign investment

In the period before 1994, the key foreign direct investment in Viet Nam was in the oil and gas sector, with peak investment in 1993. In the period until 1996, the growth in crude oil exports was the leading component of total export growth. The next two most important contributors to export growth in the first half of the decade, rice and marine products, were not areas that received much attention from foreign investors.

Figure 13.1 **Savings ratios in selected Asian countries, 1986–2000 (per cent of GDP)**



Source: World Bank, 2002. *World Development Indicators*, World Bank, Washington, DC.

In the second half of the decade, foreign investment became influential in a range of new activities. It was important not only in providing finance, but in introducing new ideas, processes, management skills and know-how, in providing models that have been copied by domestic investors and in facilitating access to export markets. Increased competition from foreign firms helped generate innovation.

Foreign investment in industry made an important contribution in the second half of the decade, when industrial exports took over the leading role in export growth. The foreign role in the industrial sector was important not only, or primarily, because of its financial contribution, but because of the catalytic role it often played in joint ventures, typically with state enterprises, in providing technology, designs and trademarks necessary for access to international markets. In addition to the impact of capital equipment introduced through foreign investment, the interaction with people with different ideas, skills and work practices has influenced domestic productivity (for example, transformation of service quality in many areas, such as domestic banking services).

Table 13.4 **Savings–investment balance, 1995–2000 (per cent of GDP)**

	1995	1996	1997	1998	1999	2000
Gross national savings	13.6	17.6	21.4	19.1	26.5	27.3
Gross capital formation	27.1	28.1	28.3	23.7	22.4	25.6
Savings–investment balance	-13.5	-10.5	-6.9	-4.6	4.1	1.7

Note: These data are taken from an IMF source which gives a somewhat different picture about the timing and magnitude of the change in national savings than presented in Vietnamese national accounts. A recent publication by the General Statistics Office (2002a) includes a detailed discussion of difference between government estimates and IMF figures, including a reasoned case for the validity of the Vietnamese figures. In particular, the IMF has estimated growth in the services sector at a somewhat lower rate than official estimates in recent years; the Vietnamese volume argues that on the basis of available employment and productivity data their own estimates are more plausible. Also, the IMF data show a sharper decline in capital formation after 1997. Both sources show a substantial rise in gross national savings, although the timing and magnitude of the changes varies between the two sources.
Source: International Monetary Fund, 2002. *Vietnam: selected issues and statistical appendix*, IMF Country Report 02/5, International Monetary Fund, Washington, DC.

Table 13.5 **Foreign direct investment: disbursement by economic sector, 1988–2000 (US$ million)**

(a) 1988–95

	1988–91	1992	1993	1994	1995
Industry	150	40	239	435	641
Oil and gas	68	62	369	304	353
Construction	39	6	43	35	113
Transport and communication	46	28	23	67	88
Real estate and tourism	143	51	106	157	458
Agriculture, forestry and fishing	54	11	27	30	107
Other[a]	70	97	62	20	21
Total	620	295	869	1,048	1,780

(b) 1995–2000

	1995	1996	1997	1998	1999	2000
Industry	801	1,141	1,326	922	835	910
Oil and gas	567	337	261	375	345	205
Construction	133	261	407	198	152	221
Transport and communications	155	82	101	80	106	28
Real estate and tourism	433	421	488	471	340	299
Agriculture, forestry and fishing	130	113	234	124	192	208
Services	120	95	61	77	71	87
Total						
Government estimates	2,341	2,490	2,878	2,246	2,041	1,959
IMF staff estimates	2.276	1,813	2,074	800	700	800

Note: [a] Includes banking and finance.
Data on foreign direct investment are somewhat inconsistent and unreliable. The two series, both taken from IMF documents, show differing totals for overlapping years. For the series for 1995–2000, there are substantial differences between official estimates from the Ministry of Planning and Investment and IMF staff estimates, particularly for the years 1998–2000. The official series is total reported disbursements less equity contribution by domestic partners and therefore includes domestic borrowing by joint ventures. This gives an indication of the actual importance of foreign enterprises, but exaggerates the external inflow. The IMF Staff estimates are based on reported foreign equity inflows plus foreign borrowings by joint ventures, an appropriate measure for balance of payments estimates.
Source: International Monetary Fund, 1998. *Vietnam: selected issues and statistical annex*, International Monetary Fund, Washington, DC; International Monetary Fund, 2002. *Vietnam: selected issues and statistical appendix*, International Monetary Fund, Washington, DC.

What is striking about the Vietnamese experience with foreign investment (in comparison, for example, with the history of foreign investment in Latin America or Africa, but in line with regional experience) is the degree to which it has helped promote new exporting activities, rather than producing import substitutes for the domestic market. This is partly because of the importance of investors from the region, whose main strategic interest is to produce for exporting to world markets. Thus, one powerful stimulus to foreign direct investment, particularly in the period 1990–97, was the conditions facing successful neighbours. In the boom preceding the crash of 1997 in Asia, rising labour costs meant that exporters of labour-intensive commodities in Taiwan, Korea, Singapore, Malaysia and Thailand were seeking out new locations for their production. Viet Nam proved an attractive location, particularly in clothing and footwear and more recently in electronic assembly.

The need to improve the environment for foreign investment has been a continuing topic for dialogue between the government and the international business and diplomatic community and has centred on such issues as dual pricing policies (steadily being reduced), restrictions on rights to invest in property and in areas of continued state monopoly. However, the investment regime was sufficiently conducive to attract considerable foreign investment between 1993 and 1997.[5] Evidently, the attractions of low labour costs, a relatively skilled and educable labour force and reasonable infrastructure outweighed the disincentives of a sometimes cumbersome, often opaque and restrictive regulatory environment.

Despite the rhetoric of international commentators, the downturn in investment spending in 1998–99 can be largely explained by the impact of the East Asian economic crisis, and the break in the Vietnamese property boom, which had involved unsustainable speculative foreign investment in property. In 1996, 58 per cent of FDI commitments were from regional investors (in order of importance—Singapore, Korea, Taiwan, Hong Kong, Thailand and Malaysia). The financial crisis and investment downturns in those economies explain most of the sharp decline in foreign direct investment in Viet Nam from 1998 onwards.

Nevertheless, it is evident that the difficult regional investment climate prevailing since the onset of the East Asian crisis increases the need to improve conditions for investment in Viet Nam if Viet Nam is to compete successfully for the diminished flows of investment funds.

Table 13.6 **Manufacturing output by foreign-invested sector, total and selected sub-sectors, 1995 and 2000 (1994 prices)**

Product group	Gross output of foreign-invested manufacturing sector	
	1995	2000[a]
Total	15,084	47,438
Of which		
Food products and beverages	5,158	8,256
Textiles and wearing apparel	1,606	3,211
Leather and leather products	1,274	3,817
Chemicals and chemical products	742	3,148
Non-metallic mineral products	450	3,288
Basic metals	1,014	2,619
Office, accounting and computing machinery	1	5,058
Radio and communication equipment	948	3,840
Motor vehicles and other transport equipment	1,884	6,827

Note: [a] Preliminary estimate.
Source: General Statistical Office, 2000. *Statistical Yearbook 2000*. Statistical Publishing House, Hanoi.

The impact of foreign investment was not all positive, particularly in relation to investments in production for the domestic market. The market mechanism did not prove very effective in coordinating real estate investment. Over-investment in urban construction (particularly in relation to investment in hotels) led to persistent overcapacity. The volatility of this sector might suggest that the government should use its access to licensing information to provide an indicative basis on which private investors could make more realistic judgments of project viability. It is unlikely, however, that the bureaucracy would show any better foresight in this regard than property speculators.

Another area in which investment mistakes were made which reproduced the earlier experience of many other developing economies was in relation to investment in vehicle assembly, where international firms wishing to gain a foothold in the Vietnamese market created great overcapacity.

While under-the-table payments are not uncommon in domestic business, the rapid growth in foreign direct assistance also increased domestic concerns about the wealth acquired by some public officials associated with foreign-invested projects, especially in the property sector.

External assistance: official capital flows

The Vietnamese authorities have shown self-confidence in handling the aid relationship, avoiding excessive aid dependence. Indeed, in the critical period of growth acceleration (1989–93), the Vietnamese economy experienced a sharp decline in official development assistance inflows as aid flows from the former Soviet Union and East Europe effectively ceased in 1990. During the first three years of the 1991–95 Five-Year Plan, Viet Nam received only limited development assistance. Sources of assistance were limited to the few established bilateral donors, with UN organisations and non-governmental organisations providing mainly technical and humanitarian assistance.

The implementation of the *Doi Moi* policies was welcomed by the international community, but aid commitments did not really grow significantly until 1993 when the US embargo was lifted. Aid from the multilateral agencies and from a number of development assistance community members resumed in 1993. A new pattern of relations between Viet Nam and the international donor community was established through the Donors' Conference for Viet Nam held in Paris in November 1993. The first Consultative Group Meeting was held in Paris in November 1994. Official development assistance and foreign direct investment inflows expanded significantly during 1994–95. Official development assistance commitments of US$1.8 billion were made in 1993, and annual commitments went on growing until 1996, when annual new commitments were estimated to have peaked at over US$2.4 billion.

In the mid 1990s, Japan, the World Bank and the Asian Development Bank became the leading sources of external assistance. Between November 1994 and August 1995 donors signed agreements on programs and projects with the total value of US$1,500 million, of which Japan accounted for 43 per cent, the World Bank for 18 per cent, the Asian Development Bank for 17 per cent and other donors for 22 per cent. A large number of bilateral donors and the European Union also expanded their programs in Viet Nam.

Disbursement, however, built up only slowly.[6] A great part of the initial growth in disbursements came from structural adjustment lending, budget support, and quick disbursing sector program loans such as the Structural Adjustment Credit (SAC) provided by the World Bank and the Enhanced Structural Adjustment Program (ESAP) run by the IMF, Japanese-funded commodity aid projects, and an agricultural sector loan from the Asian Development Bank.

Capital construction projects were concentrated in the sectors of energy, transport, and water resources, which together accounted for more than 70 per cent of the total value of donor commitments by 1995.

While the aid total has built up, foreign aid has played a relatively minor role in the Vietnamese development financing picture. Before 1998, private investment flows were well in excess of aid disbursements, and, despite the decline since 1998 FDI levels remain ahead of official development assistance according to official government estimates (IMF estimates suggest that since 1998 ODA has exceeded private investment flows). Moreover, remittances from Vietnamese people based overseas exceed flows of official development assistance.[7] Viet Nam has been able to avoid aid dependency because its exports have grown more rapidly than its aid flows; aid flows remain around 12 per cent of export earnings.

This does not mean that has not been effective because aid is at its most productive when playing a supporting role in the development process. There are no examples of successful development where aid has played the major financing role.

In practice, the aid provided in the 1990s was quite successful because the priorities were so clear. Decades of war and enforced economic isolation had left a large backlog of requirements in terms of rehabilitating basic infrastructure and investing in basic services. The government was realistic in its expectations about the level of aid and sought to fund mainly public infrastructure, social services and public support for rural development with the aid it did receive.

Thus, within the framework provided by the Five-Year Plan and the Public Investment Plan, the government aimed to mobilise official development assistance resources of US$7–8 billion over the period 1996–2000. Support was sought for the following main areas of the 1996–2000 Five-Year Plan

- infrastructure in the focal economic zones, industrial parks, and processing zones.
- expansion of major airports and seaports
- expansion of the main road and rail networks
- investment in electrical power production
- rehabilitation and extension of the water supply system
- improvements to the irrigation system
- support for animal husbandry, development and protection of forests, and key projects for ecosystem protection

- development of the telecommunications system
- upgrading and equipping medical facilities, including upgrading the two national health centres in Hanoi and Ho Chi Minh City
- upgrading and extending key education and training facilities.

It is difficult to make the case that financial assistance from the multilateral financial institutions and development assistance community members was a crucial factor in the initiation of successful growth in Viet Nam. Capital assistance only built up after the end of the US embargo in 1993, and with the usual lags between commitments and disbursements, it was only in 1997 that disbursements topped US$1 billion. As the acceleration in growth began even before the renewal of aid from the multilateral financial institutions in 1993, the decisive improvement in economic growth performance cannot be attributed to the subsequent expansion in aid flows. Indeed, given the initial sluggish growth in disbursements and the normal gestation period between the initiation of investment and productive results, little of the boom in growth 1992–97 can be explained by the expansion in aid from 1993 onwards.

Although it can be argued that donor finance lent support to the *Doi Moi* process, that process was not initiated by donors and was not, at its crucial early stages, influenced by aid conditionality. It was designed and led by the

Table 13.7 **Annual ODA commitments and disbursements, 1993–2001 (US$million)**

Year	New commitments	Disbursements
1993	1,810	413
1994	1,940	725
1995	2,260	737
1996	2,430	900
1997	2,400	1,000
1998	2,200[a]	1,242
1999	2,210[b]	1,350
2000	2,400	1,650
2001	2,400	1,711[c]
Total	17,540	9,728

Notes: [a] Excluding US$0.5 billion budget support for economic reforms.
[b] Excluding US$0.7 billion support for economic reforms.
[c] Estimate.
Source: Ministry of Planning and Investment

national authorities. When multilateral financial institutions resumed their programs in 1993, the reform process had already been carried far enough to have real credibility. Difficult reforms had been carried through with minimal external assistance, and the economy was already substantially market based.

The donor programs initiated following the lifting of the embargo in 1993 were important, however, in providing the support needed for Viet Nam to reap the full benefits of the earlier reforms, as well as lending support to the later stages of the reform process.

In particular, aid made a particularly useful contribution to the rehabilitation and expansion of basic economic infrastructure, ensuring that infrastructure bottlenecks have not acted as a constraint on growth. The emphasis on the finance of investment in physical infrastructure meant that the profile of the aid program in the 1990s was somewhat ‘old-fashioned’ in appearance, but was probably not the worse for that.

With the development of the aid program, the aid agencies (notably the multilateral financial institutions) have actively tried to introduce policy conditionality, attached long lists of conditions to loan agreements.[8] There is an extensive literature debating the effectiveness of such assistance, and it increasingly recognised that programs to support reform should not be seen as just a matter of rapidly implementing a standardised set of optimal market-based rules.[9] Senior World Bank staff have recognised that

> [o]n average market-oriented reforms worked, but not in a reliable fashion. Our reading of the 1990s is that the reform process too often neglected the institutional foundations necessary for markets to be effective for poverty reduction. It is not enough to focus on ‘getting prices right’, public action is needed to ‘get the markets right’ (Collier, Dollar and Stern 2000:2).

Stiglitz (1999) notes the importance of ‘knowing when you don’t know what you are doing’. There is also often an implicit assumption that everything is urgent, and that substantive change can be realised by a new regulation or policy document.[10] There is no evidence that policy-based lending has been instrumental in accelerating the reform process in Vietnam. In practice, much of the apparent conditionality is window-dressing by the staff of the agencies to convince their own managements that they are ‘buying’ sufficient reforms to justify the financing.[11] The Vietnamese government will probably continue to prove shrewd enough to avoid the consequences of dependency and the erosion in national policymaking capacity that have occurred in many other countries.

As flows have grown, questions have been raised regarding the effectiveness of the program, both on the donor and the Vietnamese side. At the National Assembly meeting in November–December 1999, questions were raised about the efficiency of foreign aid, and particularly its effectiveness in public administration reform and infrastructure construction projects (for example, roads, bridges, irrigation and rural water systems). Concerns were also expressed about the cost of some projects (particularly distortions resulting from donor practices such as tying procurement) and about the burden of debt arising from the development assistance program.

A number of donors have also expressed reservations about the effectiveness of capacity building activities. At the Seventh Consultative Group meeting in December 1999 the need to avoid the 'debt trap' and heavy aid dependency was raised, as was the need to give more attention to the efficient use of aid.

The quality of aid needs as much attention as the quantity. With the build up of support, efforts of various donors have often overlapped.The government has made considerable efforts to improve its aid management capacity in the face of the fast increase in aid commitments, but it has limited capacity to coordinate programs effectively, particularly in light of the shared interest of donors and particular beneficiary agencies to push 'their' projects.

Concern is expressed on both the donor and the government side that the identification and formulation of projects is too often 'donor driven', sometimes resulting in weak 'national ownership' of projects and limited commitment, concerns familiar in the donor world internationally. Despite this verbal recognition of the problem, pressures remain on both sides to push projects and to short-cut coordination.

One interesting feature of aid flows in the 1990s was the emphasis placed on investment in infrastructure and program aid to support the reform process and growth, and the relatively minor attention to poverty alleviation, which is now becoming a focus of donor attention. Despite this, the record of poverty reduction was exemplary during these years. This was because, under Vietnamese conditions, the achievement of high growth rates had a big impact on poverty. Now that donors are devoting a great deal more attention to poverty alleviation, it will be interesting to see if there is any improvement in performance in that regard. There is a danger that the channelling of investment to areas which are poor because of their low economic potential may be less effective in reducing poverty than a growth-oriented strategy.

EXTERNAL ASSISTANCE: TECHNICAL COOPERATION

Technical assistance made a more valuable contribution to policy and institutional development than capital assistance, particularly in the period prior to the re-entry of the multilateral financial institutions in 1993. At that stage, the UN system was particularly important as a source of useful advice to the Vietnamese. Even the involvement of Bretton Woods institutions at that time was mainly through UNDP support, with the Bretton Woods institutions acting as executing agencies for UN projects. Indeed, one of the interesting aspects of Vietnamese experience is the light it throws on the efficacy of technical assistance and the redundancy of policy conditionality (at least in Viet Nam). It is difficult to find tangible evidence that the effectiveness of external advice has increased as institutions such as the World Bank have become active in promoting their view of reform requirements through conditions attached to structural adjustment and program loans.

In the years before the end of the US embargo, Viet Nam sought assistance from the international community for training and for policy advice. Much of this assistance was channelled through the UNDP and other UN agencies, although the Swedish International Development Agency also played an active role. It is widely recognised that training and advice offered in that period was highly effective in aiding the Vietnamese in the development of their reform policies.[12] The Vietnamese government was able to select from the advice offered based on their own priorities and understanding of the local reality. Moreover, playing a purely advisory role, the various agencies avoided the arrogance that sometimes accompanies the allocation of large amounts of financial assistance.

A recent evaluation of donor technical assistance to Viet Nam concluded that

> …the TC program in Viet Nam has been successful overall, particularly when compared to the problems experienced with TC in many other countries. Areas of success include
>
> strong human resource development (HRD) through many kinds of training, including on-the-job training, short-term courses, training of trainers, and post-graduate training programs in Viet Nam and abroad.
>
> Policy advice supported changes in key areas, including: fiscal and banking reform, drafting laws essential to the transitional economy, rationalising the regulations relating to key ministries (MPI, MOJ, MOFI, National Assembly Office, the Judiciary Office, the Public Prosecutor

Office etc.), assisting with development plans and the Public Investment Program, assisting in regional and international integration, and public administration reform.

Assisting in many social aspects of development: including rural development linked to poverty alleviation, environment and natural resource protection, gender issues, HIV control and drug control, etc.

Assisting in a number of important surveys and statistical development (e.g. population census, Living Standards Measurement Survey of household incomes, national income data, etc.), greatly improving the availability of reliable information for planning and policymaking.

With the help of TC programs, many agencies at different levels—ministerial, provincial, sub-provincial levels—have developed their capacity (e.g. through skill upgrading and organisational strengthening) (Van Arkadie et al. 2000:5).

Although the contribution of technical assistance to Viet Nam development is evident, the greatest contribution came in the early years of reform, when flows were quite modest. The fast increase in technical aid in the 1990s was not reflected by anything like a proportionate increase in impact—diminishing returns set in and in some areas may have even reached negative returns at the margin. Disbursements on technical aid grew from US$76.7 million (12.9 per cent of total development assistance) in 1992 to US$209.4 million (34.2 per cent of total development assistance) in 1995, falling to 24.4 per cent in 1998, when US$287 million was disbursed for technical aid. Disbursements reached a peak in 1997 of US$ 294.8 million, equal to 31.4 per cent of total development assistance in that year.

From the Vietnamese point of view, too much of the typical project budget goes on costs for foreign experts (often seen as not more competent than local experts) and too little on local costs and non-personnel items, while the practice of some agencies leaves the selection of, and control over, consultants in donor hands.

Donors and Vietnamese also express concerns regarding the sustainability of projects over the longer term (that is the continued operation of facilities and flow of benefits after the project is 'completed' and external funding ceases).

Expressions of concern about aspects of utilisation of development assistance in Viet Nam are a healthy recognition of the risks of aid dependence. Viet Nam could still benefit from being a late participant in the aid game by studying the experience of other aid recipients.

A recent report on technical cooperation concluded that weaknesses in the aid system 'need to be addressed with some urgency' (Van Arkadie et al. 2000:17). However, there is a good deal of inertia in the international aid system, and the Vietnamese experience demonstrates how quickly a pattern of vested interests build up on both sides of the aid relationship (on the donor side, among the aid bureaucracies, suppliers, consulting firms and individual consultants, on the recipient side among the beneficiary agencies and officials who reap project benefits).

NOTES

1 Human capital refers to investments in individuals, whereas social capital refers to investments in business organisations, institutions (political, financial, market and industrial relations) and the social environment.

2 This is not special to Viet Nam, as it is often the case that national accounts data greatly underestimate the own account investment by farm households and in rural housing. This sort of activity has been of great importance to Viet Nam's development in the past 15 years. The figures included for 'non-state investment' in the official data is apparently a rough estimate, as there is no comprehensive survey of such investments.

3 In practice, government has been ready to seek out private funding for public services where they are commercially viable (for example, telecommunications) and has sought to expand private funding through such innovations as build-operate-transfer schemes (for example, in the power sector). Where some degree of cost recovery is possible through user charges, the government has been quite willing to introduce such charges. Large government investments are necessary, however, to prevent infrastructure becoming a bottle-neck that constrains growth in other sectors.

4 Somewhat ironically, in light of advice the Vietnamese received suggesting that it was likely that private investors would not make the same sort of investment errors as state enterprises, the inflow of foreign investment before the 1997 regional crisis included heavy over-investment in the hotel sector greatly in excess of any plausible market growth, resulting in persistent over-capacity in hotel space, leading to strong downward pressure on prices. At least the costs were borne by the investors (and their workers) and not the state.

5 The timing of the downturn in foreign investment can either be located in 1996, when approvals for new investment proposals peaked, or in 1997, when expenditures on foreign investments peaked.

[6] The report of the Government of Viet Nam at the Consultative Group Meeting organised in 1994 indicated the main reasons for delays in the disbursement of projects funded by development assistance. Bottlenecks occurred in project preparation, administrative procedures for the consideration and approval of projects; and issues of compensation and resettlement.

[7] A news item in Hanoi on 26 December recorded that '[r]emittances by overseas Vietnamese are expected to reach US$2 billion in 2001, US$300 million more than 2000, according to the State Bank of Viet Nam. Some 60 per cent of remittances were channelled through banks. General Director of the Eastern Asia Bank in Viet Nam, Tran Phuong Binh, said that remittances channelled through his bank were expected to reach US$260 million in 2001, a year-on-year increase of 50 per cent. It is estimated that there are more than 2.5 million overseas Vietnamese, mostly in the United States, France, Australia and Canada.

[8] Dollar and Svensson (1998) concluded that multiple tranches—and a large number of other design variables—play no role in effectiveness.

[9] Recent internal critiques of policy-based lending include Paul Collier (1998, 1999, 2000), Dollar and Svensson (1998) and Asian Development Bank (2001).

[10] Stiglitz, in reference to transition economies, noted that it is easy to 'make the facile recommendation that everything is important and everything should be done at once. But real choices are always necessary given the real limitations of any government's time, focus and resources' (1999:19).

[11] Such problems are recognised by the multilateral financial institutions. A World Bank report written by Paul Collier refers to the 'fig leaf' theory that policy change is costly and that aid finances upfront adjustment costs (Collier 2000; see also Asian Development Bank 2001).

[12] Dollar, who was in that period lead economist for the World Bank and played an active role in advisory work and in participating in policy workshops, was also lead author of a World Bank study of aid effectiveness, *Assessing Aid* (World Bank 1998c). The book includes a case study of experience in Viet Nam. The study records the successes of the *Doi Moi* process in promoting growth and in poverty alleviation, but notes that in the important reform period, 1989–93, Viet Nam was receiving only a small amount of aid. In that period, ideas were more important than money. One key role of external agencies was to help the Vietnamese access relevant regional and international experiences with economic policy.