Vietnam and Japan: A Path to Prosperity

By Tetsusaburo Kimura

Relations between Japan and Vietnam have been rapidly improving ever since Hanoi's 1986 decision to abandon central planning and open its economy to the outside world. Though Japan is now Vietnam's largest trading partner, it is only ranked eighth in terms of investors. The prime reason for this discrepancy is that the Japanese government has yet to enact a major ODA program for Vietnam. There is plenty of room for the relationship to blossom, and in this article we will look at some of the options that are open. Before we do that, however, it would be best to give a brief rundown on the Vietnamese economy and what its problems are, and review Japan-Vietnam relations so far.

Doi moi

One glance at Table 1 should be enough to convince anybody that Vietnam's centrally planned economy had ceased to function by about 1980. The Vietnamese authorities were convinced too, and so they began partial reforms. These reforms boosted production between 1981 and 1985, but they brought in their wake rampant inflation. Clearly, the system itself would have to be reformed before sustained growth would be possible.

Vietnam began the process by introducing a contract system into its agricultural sector, under which farm managers were given vastly increased authority over their own operations. This resulted in sharp gains in agricultural output in 1982 and 1983, but the trend peaked in 1984 because of stagnation in the industrial sectors that should have provided farms with capital goods and consumables they needed. The solution, of course, was to cede more authority to the state-run companies that produced capital goods, but to do so would require improvements in the wage, cost, profit and price formation mechanisms–and the dong, Vietnam's currency, would have to be given an objective value as well, which meant bringing exchange rates into line with prevailing rates on the market. Improvements to the state-owned companies that formed the bulk of Vietnam's industrial sector were, in short, tantamount to reforming the economic system as a whole. And thus *doi moi* was born.

The sixth congress of the Communist Party gave formal approval to *doi moi* in December 1986, but it was not until 1988 that things finally got under way. The experiment is still young and will need more time if it is to succeed. The chief articulation of the policy is to be found in the Foreign Investment Law, though it has been further expounded in a number of Politburo decisions and ordinances.

Legislative approval for the Foreign Investment Law came at the end of 1987 and the law took effect in January 1988. Trade was liberalized at the same time, and in November 1988 the government devalued the dong by 86%, from 368 to the dollar to 2,600. Since that time, Vietnam has revised the rate to take subsequent price rises into account, which in practice has made the dong a floating currency.

On April 5, 1988, the Politburo announced "Decision No. 10," which mandated agricultural reforms designed to boost farmers' incentives to work and invest. The government recognized farmers' long-term right to use their land in exchange for commitments to produce specified quantities of rice, allowed farmers who wanted to manage larger plots to bid on some of the land held by cooperatives, and increased farmers' share of their crops to 40%.

This was followed on July 15 by Politburo Decision No. 16, which ordered reforms in the policy and management systems for the non-state economic sector. The order gave private firms the right to hire such employees as required by their production methods and technology regardless of the firm's size.

Reforms at state companies began a bit earlier, with a November 14, 1987 cabinet decision to overhaul the planning system and socialist managerial practices. The follow-up came with the March 22, 1988 Order Regarding State-run Industrial Companies that gave state-run firms the right to decide for themselves how much of what products they would produce. In exchange for this, the government left them to sink or swim on their own. No longer would loss-making companies be able to hide their red ink with state subsidies. In the months that followed, the government began issuing fewer and fewer orders to companies, and in 1989, the only order it gave them was to specify how much their contribution to the national budget would be.

Vietnam also moved to reform its distribution industry, eliminating price subsidies and ration coupons and allowing the prices of most commodities and equipment to be set by the market. It even deregulated trading in gold.

At the end of 1988, the state eliminated all direct funding of nationalized corporations. Since then, they have had to turn to banks to finance their operations.

The results so far

It is hard to evaluate just what *doi moi* has accomplished. It is hard even to agree on what sort of criteria should be used to evaluate it. Some of the most important questions, however, are whether production has increased, inflation subsided, and unemployment shrunk. Market-oriented economic reforms tend to grate on the sensibilities of hard-liners, but as long as production is on the increase, the right wing has no choice but to go along. It was production gains, for example, that allowed the partial reforms of 1981–1985 to succeed and gave the reformers a springboard to the next step.

Table 2 looks at *doi moi* in terms of production. Since *doi moi* policies began to be implemented in 1989, inflation rates have fallen, exports are up, and the trade deficit has contracted, but growth rates

Table 1 **Annual Average Growth Rate and Food Production**

	1976–80	1981–85	1986–90
National income (%)	0.4	6.4	3.9
Gross production of agriculture (%)	1.9	5.3	3.5
Gross production of industry (%)	0.6	9.5	6.2
Food production (million tons)	13.4	17.0	19.7
Soviet aid and loans (bil. rubles)	1–2.5	4.8	7.0

Note: Figures for Soviet aid and loans are five years' total on an expenditure basis.
Sources: Tong Cuc Thong Ke, *So Lieu Thong Ke 1976–1990*, Hanoi, 1991; *Nghiep Cuu Kinh Te*, so 182; *Far Eastern Economic Review*, February 21, 1991

have slowed for national income and production. Even disregarding agricultural production, which is heavily dependent on the weather, it is hard to explain away the drop in the industrial production growth rate. With their subsidies gone, state-run companies have had to rationalize their operations, which has meant large staffing cuts. Non-state companies, meanwhile, have been unable to compete with black market goods and cheap Chinese products, and many have gone under as a result. The upshot has been a rapid decline in the number of industrial workers from a peak of 2,945,000 in 1988 to 2,115,000 in 1991. Many of Vietnam's soldiers have also been discharged from the military, adding another 1.2 million people a year to the labor market. Estimates say that more than 20% of the Vietnamese labor force—roughly seven million—is unemployed.

The second criteria to look at is how the non-state sector has fared and whether state-run companies have grown more independent of the national finances. Success in this area, in fact, is the present goal for the market-oriented *doi moi* policies.

In agriculture, independent entrepreneurs are making gains. Between 1988 and 1990, the number of people employed in state-run agricultural enterprises declined by 58,000, from 416,000 to 358,000. During the same period, the number of independent farmers rose by one million. In 1988, there were 52,800 agricultural cooperatives of various sizes, but by 1991 their number had declined to 29,820.

In industry, however, the picture is bleaker. Between 1988 and 1991, the labor force in the state sector declined by 130,000, from 844,000 to 714,000. The non-state labor force, too, dropped by 700,000, from 2.1 million to 1.4 million. In 1988, non-state companies accounted for 43.5% of Vietnam's industrial production; in 1991 their share was only 38.4%. The share of the state sector, meanwhile, has gone from 56.5% to 61.6%. So far, the net result of *doi moi* seems to have been to strengthen state-run firms.

An equally important question is whether state firms have become more financially independent. State companies contributed 66.9% of the Vietnamese government's budget in 1987; in 1990, they contributed 49.9%—this means that half of the national budget still came from state firms despite the fact that the share accounted for by the commerce tax has risen from 8.9% to 10.8%. The government still protects state-run companies. They may have lost their subsidies, but they account for 84% of bank lending against fixed assets and 88% of lending for operating funds. State corporations also command better terms and interest rates on their loans than do their non-state counterparts.

Table 2 **Results of *Doi Moi***

	1987	1988	1989	1990	1991
National income (%)	2.5	5.8	2.4	2.4	2.4
Gross production of agriculture (%)	0.3	4.3	5.8	1.2	-0.1
Gross production of industry (%)	9.5	12.5	-4.0	4.5	5.3
Food production (million tons)	17.6	19.6	21.4	21.5	21.7
Inflation (%)	223.1	398.8	34.7	67.4	67.6
Exports (million $-Rub)	854.2	1,038.4	1,946.0	2,404.0	1,970.0
Imports (million $-Rub)	2,455.1	2,756.7	2,565.8	2,752.4	2,239.3

Sources: *Tap Chi Cong San*, No. 9, 1990; Tong Cuc Thong Ke, *Nien Giam Thong Ke 1990*, Hanoi, 1992;
Tong Cuc Thong Ke, *So Lieu Thong Ke 1976–1990*, Hanoi, 1991;
So Lieu Thong Ke Cong Nghiep Viet Nam (1986–91), Hanoi, 1992;
So Lieu Thong Ke Nong, Lam, Ngu Nghiep Viet Nam (1976–91), Hanoi, 1992;
Tran Hoang Kim, *Economy of Vietnam*, Hanoi, 1992

To sum up, *doi moi* has resulted in a contraction of the state sector in commerce and agriculture, but has strengthened it in manufacturing. Accordingly, the state sector's share of the national income produced has gone from 22.5% in 1988 to 28.0% in 1990. That is not what the *doi moi* supporters had in mind, and could signal that the conservatives, who want to maintain a strong state sector, have used the declines in production to strengthen their hand.

Capital accumulation structure

Key to the development of the Vietnamese economy will be its investment and capital accumulation structure.

Between 1988 and 1990, investments by private companies accounted for only 5% to 10% of the country's total investments. The rest came from the state. But while capital expenditures commanded 41.6% of the budget in 1988, they were only 23.0% of it in 1990. A large part of this is because the government quit funding capital investments by state-run companies. Some of that money was diverted to investments in infrastructure (mostly roads and telecommunications), but not much.

In terms of 1982 prices, the government of Vietnam invested 95.2 billion dong between 1981 and 1985, but this fell 5.8% to 90.6 billion dong during the 1986–1990 period. This decline in state investments is in line with *doi moi* objectives, since the idea is for the state to

Table 3 **Origin and Distribution of National Income** (%)

	Origin structure		Distribution structure		
	National income	National income from the rest of the world	Accumulation funds	Consumption funds	Wastage and loss
1987	93.4	6.6	7.6	92.0	0.4
1988	87.3	12.7	9.9	89.3	0.8
1989	90.7	9.3	7.4	92.2	0.4
1990	89.5	10.5	10.2	89.3	0.5
1991	91.1	8.9	9.7	89.8	0.5

Source: Tran Hoang Kim, *Economy of Vietnam*, Hanoi, 1992

withdraw and free, private investments to take over. But while the first half of that goal has been accomplished, the second half—independent investments by private and state-run companies—has not, and unless private and state firms start investing more, *doi moi* could very well fail. The accumulation rate (the ratio of investments to national income) is a good indicator of investment trends for the Vietnamese economy as a whole. It has tended to bounce around aimlessly between 1988 and 1991: 9.9%, 7.4%, 10.2% and 9.7%. Assuming an incremental capital output ratio (ICOR) of between 3 and 5, these accumulation rates do not augur strong growth.

But there is more involved in declining accumulation rates than just lower production. Vietnam is heavily dependent on other countries for its investment funds, whether they come in the form of ODA or private-sector investments, and is reeling from the aid cuts that followed the disintegration of the Soviet Union. The country's national income comprises domestically produced income and foreign savings, and it is this grand total that is distributed between capital accumulation and consumption. As Table 3 clearly illustrates, most of Vietnam's accumulation has been funded from foreign savings. In 1988, foreign aid accounted for 17.2% of the government budget, rising to 21.6% in 1989 and falling back down to 18.0% in 1990. Most observers expect an even sharper drop in 1991.

Japan and Vietnam

Vietnam's de facto split with the ex-Soviet Union came in 1991. The previous year, 1990, Vietnam's exports to the Soviet Union were worth 914.2 million $·Rub ($1 = 1 ruble), which represented 38% of its total exports. In 1991, that dropped to only 10%. At the same time, imports from the Soviet Union went from 43% of the total to 14%. In contrast, exports to Japan rose from 14% to 26% during this period, which made Japan the largest foreign market for Vietnamese goods. Hong Kong was in second place with 15% and Singapore in third with 12%. Imports from Japan went from 6% of the total to 8%, placing Japan fourth. First was Singapore at 28%, followed by the ex-Soviet Union at 14%. Most expect Japan's share of total Vietnamese imports to expand in 1992.

As of the end of June 1992, Vietnam had approved foreign investments in 384 projects worth a total of $2.97 billion. Only 24 of these projects involved investments from Japan, however, and their combined worth was only $159.4 million. These meager investment figures are one of the principal reasons why imports from Japan are so low. Granted, much of the blame for this lack of investment in the Vietnamese manufacturing sector must be shouldered by Vietnam itself. It has favored resource (mostly oil) development and not gone out of its way to create an attractive climate for investment in manufacturing. Still, Vietnam will need more ODA from industrialized nations in order to develop its infrastructure.

One thing that Japan can do is to use all of the channels open to it to encourage the U.S. to normalize relations. Japan and other Asian countries recognize the need for a U.S. political and economic presence in Indochina, and the three Indo-chinese countries want it as well.

In fact, it is in Japan's interests for the U.S. to be involved in the economic reconstruction and development of this area. If Japan tries to use its economic and technological clout to go it alone, all it will do is undermine relations with the rest of Asia, including Indochina itself. It is also in Indochina's interests for Japan and the U.S. to compete fairly in its markets. Japan should therefore refrain from enacting any large aid programs until the U.S. normalizes its relations with Vietnam and returns to Indochina.

But is not good enough to just sit around and wait for normalization. Rather, we should consider this to be a preparation period. The hard-liners are trying to stage a comeback in Vietnam, but they too will need time to turn *doi moi* in the direction they would like it to go. I think there are several things that Japan could be preparing for with regard to Vietnam right now. First and foremost, it could start selecting possible ODA-funded infrastructure projects, preferably the kind that would spur private-sector investment in the country. True, there are obstacles to overcome. It is by no means certain that Vietnam has developed the organizations and legal framework that will make this possible, and there will have to be a certain amount of give-and-take between different Vietnamese government agencies and regions, and between Vietnam and aid donors. Nonetheless, this is a process that could begin right now.

We could also begin training the Vietnamese people who will be taking part in future projects. There is room for Japan to provide the country with more cooperation for its training programs in languages, science and technology. Japanese aid could go for both Japanese and English language training, for example, and subsidies could be given to Vietnamese scientists and engineers to allow them to attend international conferences and training sessions regardless of the country they are held in.

(Note: Japan resumed official loans to Vietnam on November 6, after a 14-year hiatus.)

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