Vietnam: External Liberalization, Structural Change & Economic Performance

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External liberalization: Pro

- By exposing the economy to foreign competition, external liberalization will stimulate economic growth, improve resource allocation, drive out inefficient producers, discipline domestic producers to be more competitive, bring in more effective rules and systems from abroad, provide a counterbalance to domestic monopolies, and protect the government from political capture by interest groups. Expansion of labor-intensive and export-intensive sectors will create more employment and stimulate a more efficient reallocation of resources across sectors.

External liberalization: Con

- Rapid integration in the context of weak policy capabilities and weak domestic institutions, and when there is not adequate preparation, including having a clear picture of which industries and enterprises are likely to succeed and which are likely to fail, could lead to sudden and destabilizing loss of output and employment.

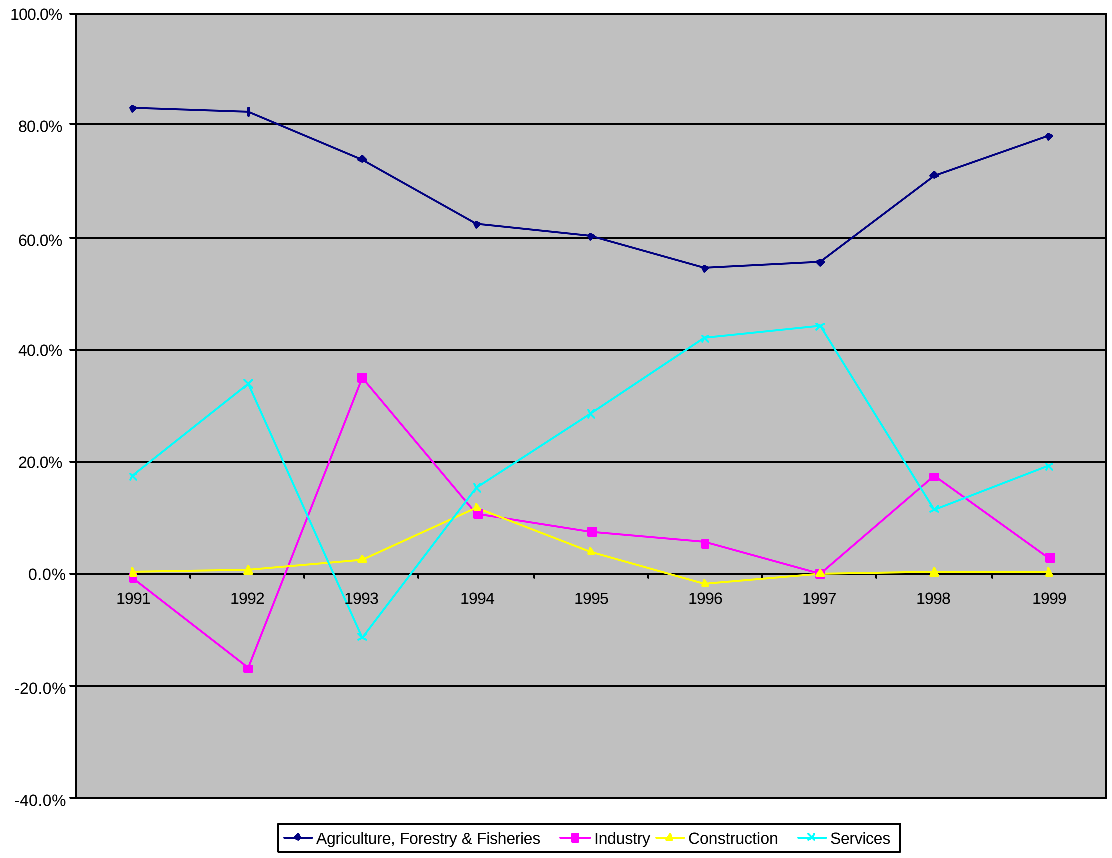
Remarkable speed of VN’s global economic integration ...

- Trade to output ratio rose from 24.7% in 1988, to 58.2% in 1989, to 111% by 2000
- FDI sector’s share of gross industrial output jumped from 2.6% in 1989 to 35.5% by 2000

Can external liberalization create enough good jobs for a rapidly expanding labor force?

- Despite gains from trade liberalization, not enough jobs were created in higher wage sectors because output growth in the higher value-added sectors -- although high -- was *not high enough* relative to the productivity increases required of VN enterprises to survive more competitive environment of 1990s.
- Even during period of rapid industrial growth & swift transformation into a very open economy, the industry sector's contribution to overall employment growth was generally negative or small
- Lessons for next phase of external liberalization

Sectoral Contribution to Overall Employment Growth ...



Sectoral Disaggregation:

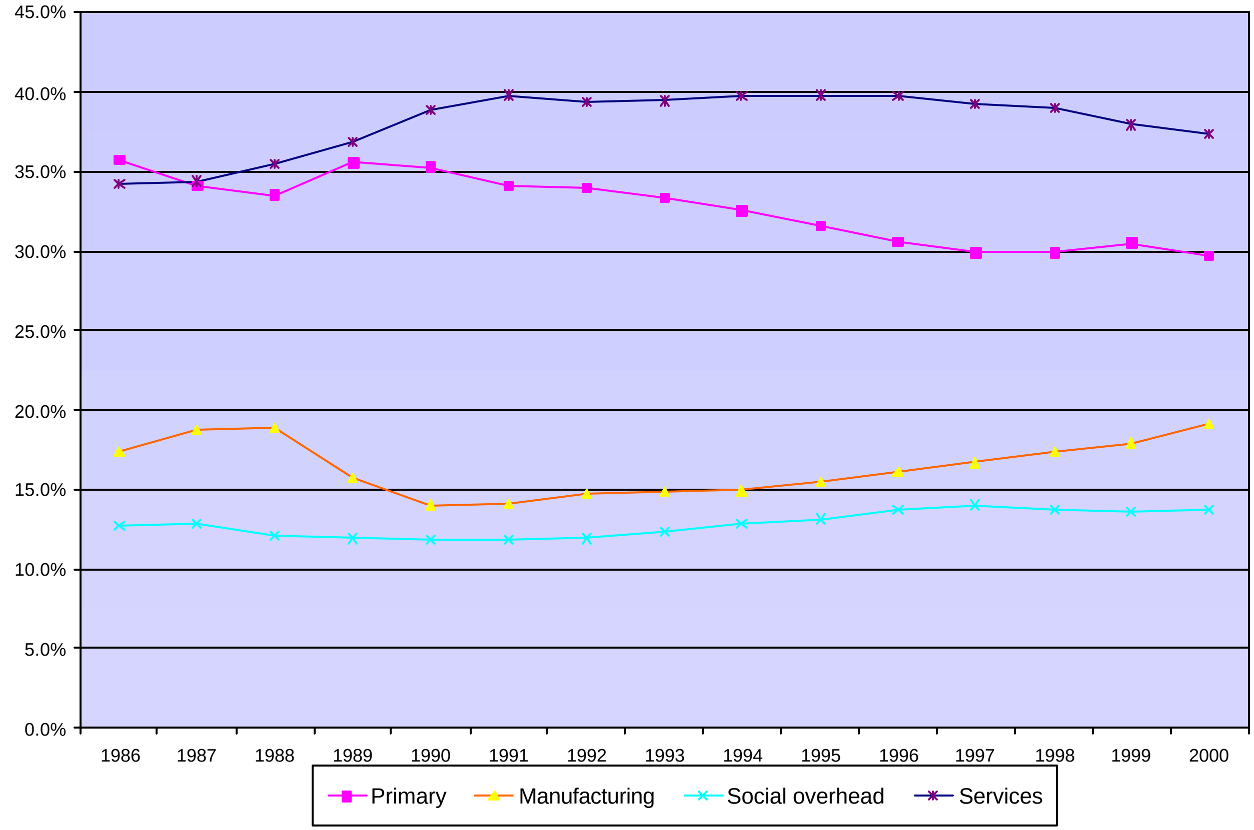
Tradables

Primary	Agriculture	
	Mining (including oil & natural gas)	
Manufacturing	Light industry	Food processing & tobacco
		Consumer goods
	Heavy industry	Producer goods
		Machinery
Services	Software? (future possibility)	

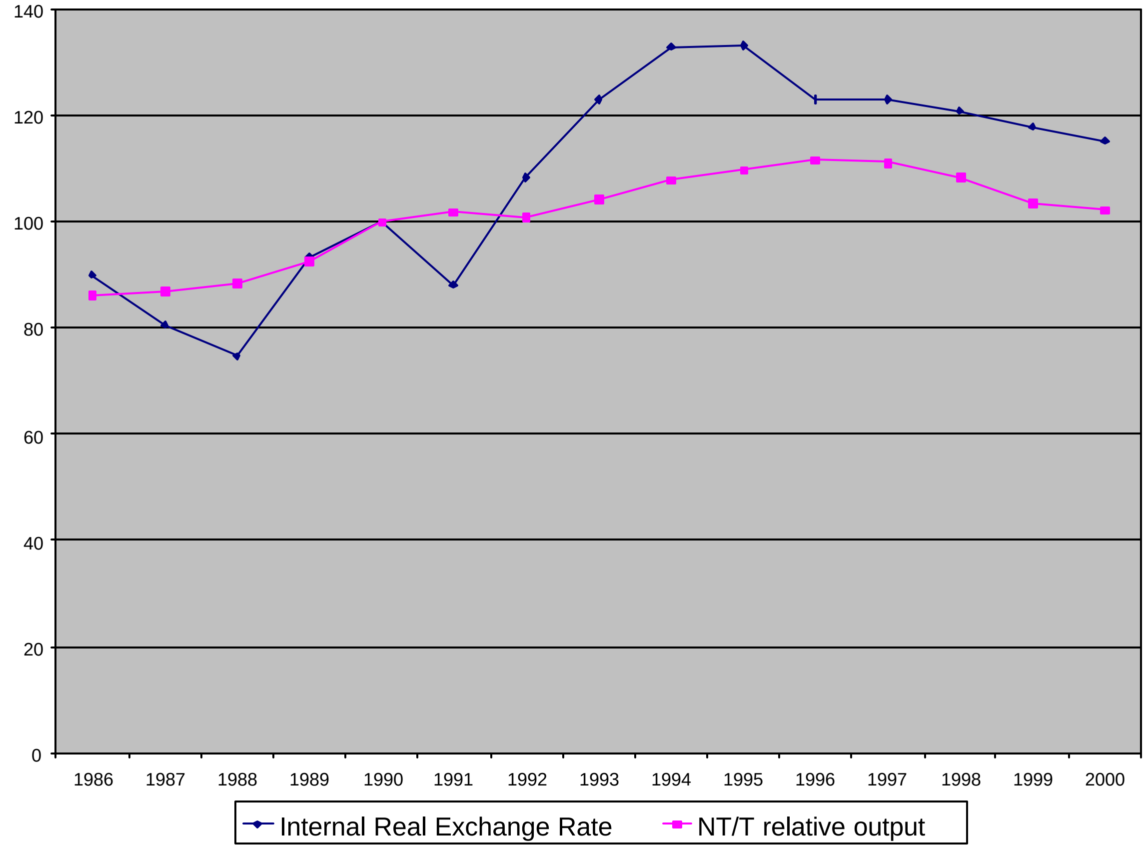
Nontradables

Social overhead	Construction
	Electricity, gas & water
	Transport & communication
Services	Trade
	Real Estate
	Other services

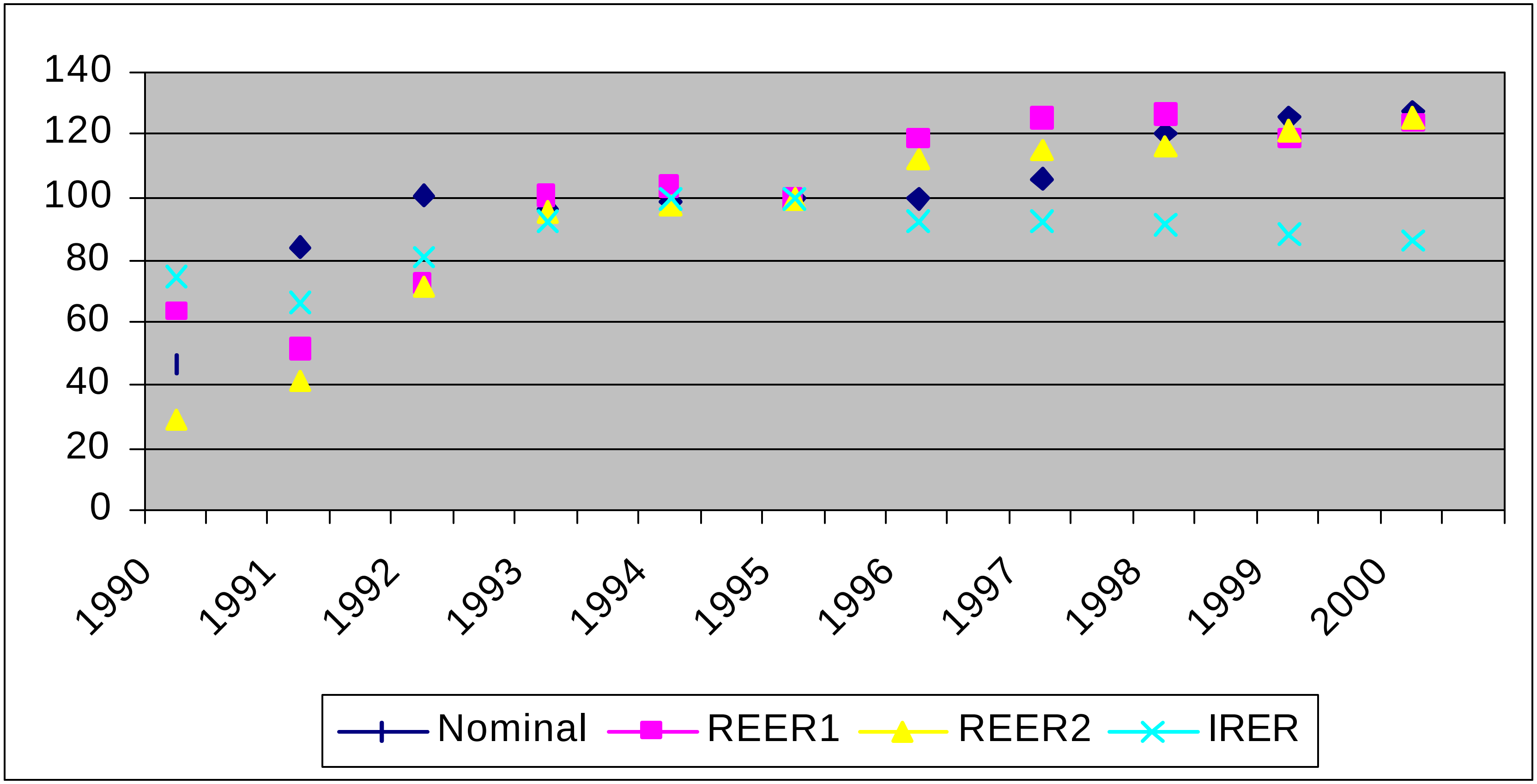
Evolution of sectoral shares of GDP



Relative Price and Relative Output of Non-traded to Traded Goods ...



Comparison of internal & external real exchange rates



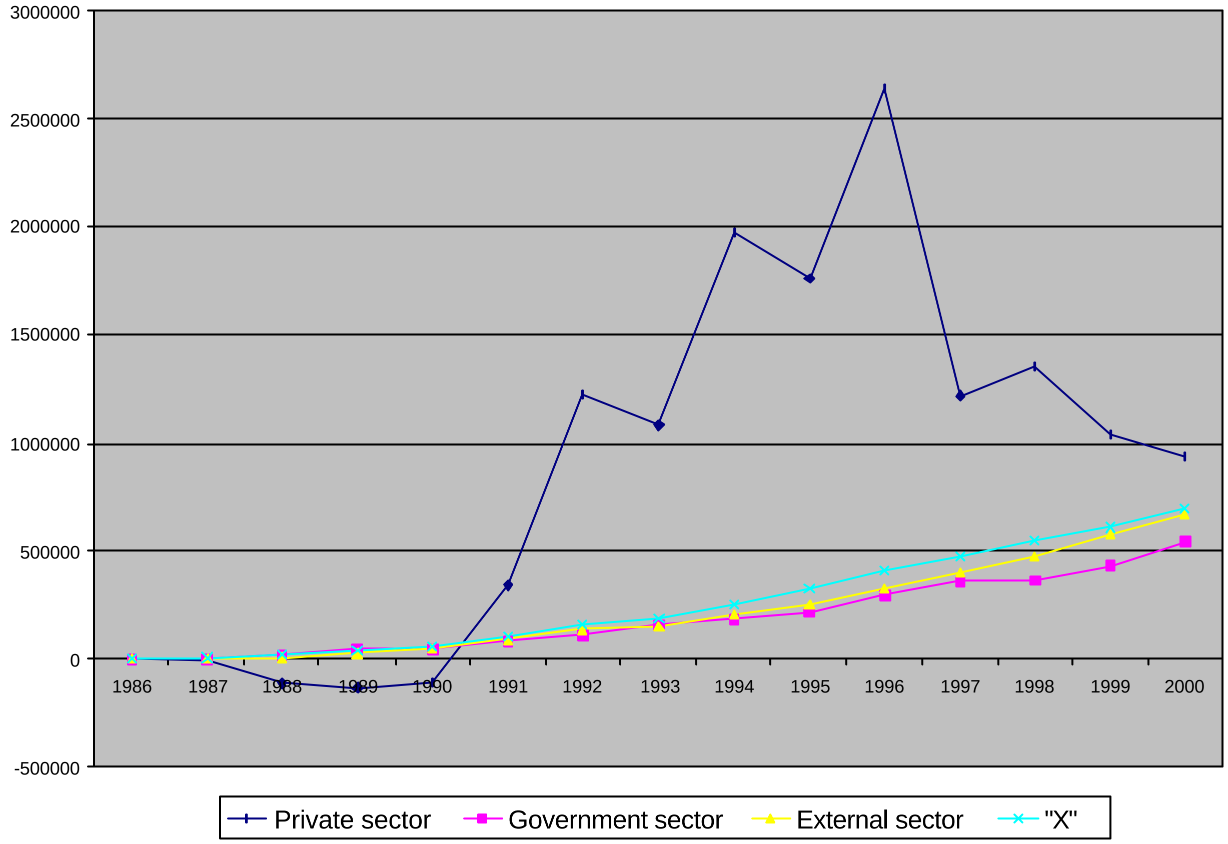
Keynesian income multiplier:

(aggregate supply X = sum of each sector's demand injections scaled by corresponding "leakages")

$$X = \frac{s_P}{(s_P + t + m)} \cdot \frac{I_P}{s_P} + \frac{t}{(s_P + t + m)} \cdot \frac{G}{t} + \frac{m}{(s_P + t + m)} \cdot \frac{E}{m}$$

Comment: This decomposition of a basic national income accounting identity is used to gain insights about key factors that drive an economy. I/s, G/t and E/m are demand injections; s/(s+t+m), t/(s+t+m) and m/(s+t+m) are the corresponding leakages for the private sector, government sector and external sector respectively.

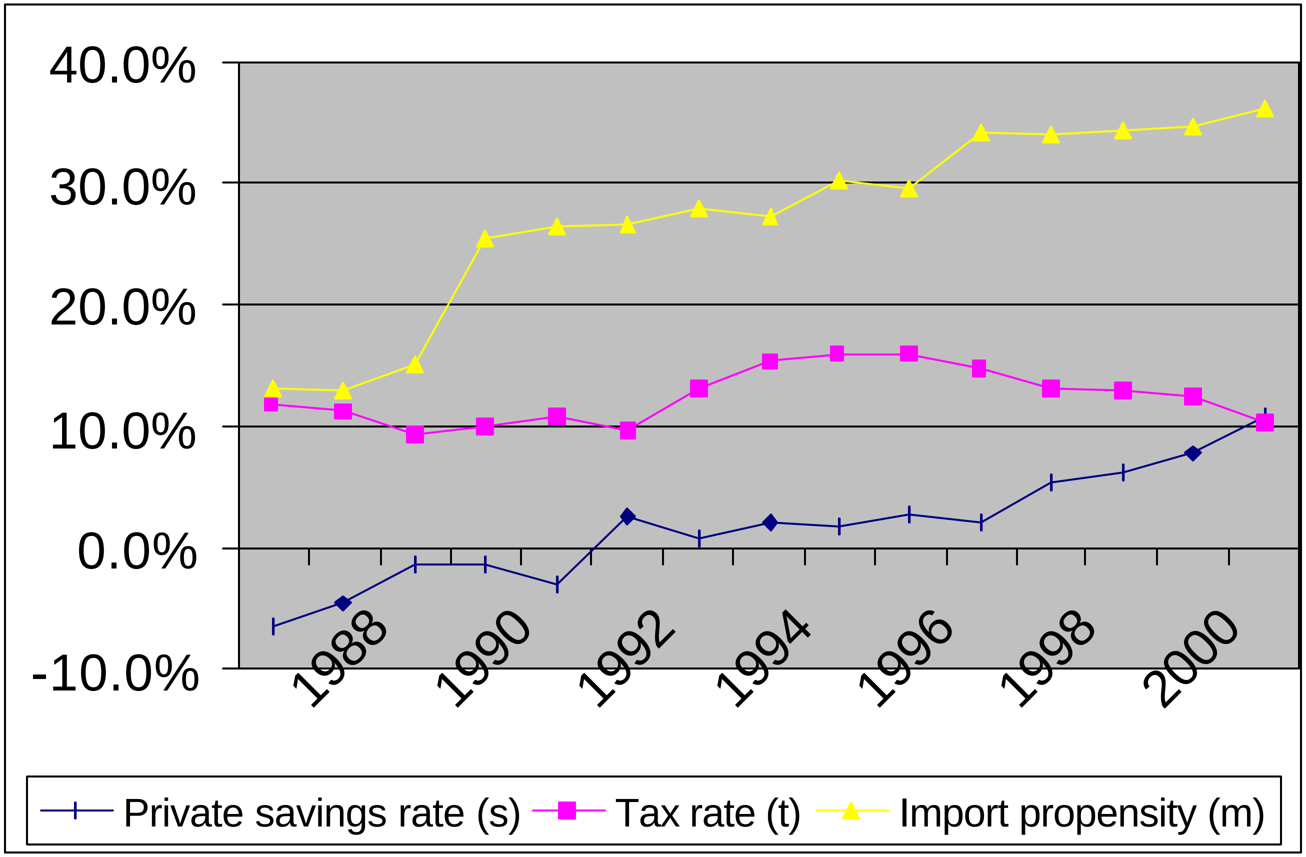
Decomposition of Demand Injections



Critical but volatile role of investment spending ...

- Most important stimulus to GDP growth during the Doi Moi decade (1990s) came from private investment, particularly FDI
- Investment spending jumped to 24.3% of GDP in 1994 from less than 15% in 1988-91 period
- Volatility of investment cycle quickly felt: FDI capital inflows dropped from over US$ 2 billion in 1997 to about US$ 700 million in 1999

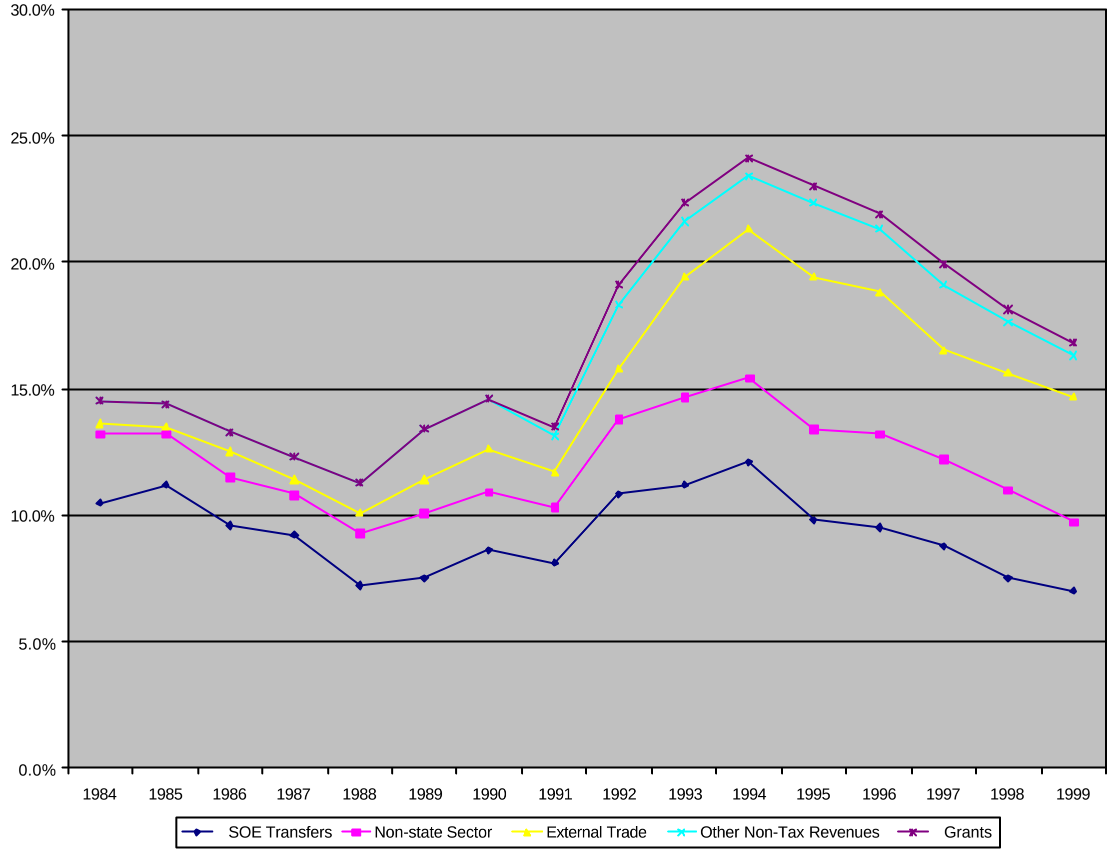
“Leakage” Parameters: Savings, Tax & Import Propensities



The fiscal challenge ...

- Potentially dangerous erosion of state's fiscal position has emerged (IMF attributes to structural weaknesses in revenue system)
- During transition period, government's ability to tax emerging non-state sector still weak; declining contributions from SOE sector
- Possible continuation of trend decline in customs duties as VN implements trade liberalization commitments

Revenue components as share of GDP (stacked) ...



Main findings & conclusions

- External liberalization measures should be appropriate to the level of economic development, domestic policy capability, and state of domestic institutions
- Vietnam's successful macroeconomic outcome and significant social welfare gains during 1990s was accompanied by a widening income gap between rich and poor, between urban and rural areas, and between regions