Whither Vietnam: In Search for Development Paradigm

An Issue Paper for Discussion

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0. Introduction

An interesting question arises from the theme of this seminar (Factors holding back and factors favorable to Development) is how do we approach this issues efficiently. And this is one of the reasons I want to come to the seminar where I want to compare notes with my friend/participants. Anh Vu Quang Viet has tried to look at history of the development in the World[2], to find out the factors other than economic that hold back or stymie development after citing D. North complaining about neoclassical economics's failure to explain what causes underdevelopment. Viet however did not suggest what should then be an appropriate strategy to development, only says politely, that VN should also look to development taking into account of civil society, and scientific basis. I wish he could elaborate a little more.

The factors, especially policy factors, that work in favor or against development would depend what type of development being aimed at. For example, "industrial policy" that is advocated by old type of development economics would work against export-oriented development strategy. Hence, it matters to identify what is the nature of Vietnam current type of development being pursued. Vietnam has gone through different types of development, from centrally planned economy, to development economics' policy, to current market-based economy.

This short paper suggests an approach focusing on VN 's policy history itself to see if VN has a choice other than current thinking of economics, which is basically "neoclassical" or a variety of it, or simply has to go all the way with this 'capitalist readers' policy to find out what are the remaining impediments to further growth, and what are the favorable factors that can take VN to higher growth path.

1. The death of a discipline

The apogee of "Development Economics" was in the 50's and the 60's when detailed planning, an integral part of Development Economics, had been popular and indeed an

[1] The Institute of Economics and Institutional Development (IEID) in Washington. I would like to thank Sarath Rajapatirana for his comments and important suggestions to the early draft.

[2] Vu Quang Viet: "Cac yeu to thuc day va kim ham phat trien", mimeograph, July 2004

important tool kit for development practitioners to make a living around the "underdeveloped countries". For nearly 40 years, the discipline started with such vigor and strong political backup around the world that a large volume of literature and research were done in both "theory" and policy.

There seems to be no formal definition of Development Economics anywhere, except attempts to groping with various attributions to the term. (For example Ian M.D. Little in his large book Economic Development[3].) There is even less consensus about the reasons or causes of underdevelopment (Why poor). The issue still remains such a mystery that the debate is now expanded to non-economic, such as institutional (Douglas North), social factors and even religion and superstition (Vu Quang Viet, paper for this seminar), etc., to look for the real causes of underdevelopment. Neoclassical economists, or "new development economists" don't seem to bother to look for the reasons of underdevelopment, but focus on the mechanism of development through Saving, Efficiency, and Technology.

In any case, if Development Economics can be seen as a separate discipline before its death, it seems to have the following main elements in terms of what development economist do, or recommend:

a. The government plays a large role in resource allocation, in particular for investment. Central planning was practiced, more or less in details for non-socialist countries. (Socialists countries do this by definition)
b. "Industrial Policy" in the sense of government promotion and direct investment by government is advocated. (The term "Industrial Policy" now has a specific connotation of government intervention in industrial activities; for example in this sense, the US has no industrial policy)
c. Small-scale industry is of particular importance of the industrial strategy with strong support from government. "Small is Beautiful" was the slogan of the day. This practice still survives in several countries.
d. At the same time, in several countries heavy industries were established regardless of present cost-benefit and of future maintenance cost. Examples: Steel mills in Pakistan, Egypt, and Vietnam. Heavy industries complexes in Pakistan, Vietnam.
e. Under the slogan of self-sufficiency, import substitution policy was practiced to protect domestic industries. For 40 years, this last policy item flourished most in South Asia, still survives in some countries, particularly in Africa, although other policies above have been changed or eliminated.

Until about 1992/93, and under Doi-Moi, Vietnam has still basically followed this kind of economics, which is of course very old, but novel to a socialist Vietnam trying to get out of centrally planned economy.

The origin of development economics was of course was in the need felt by newly independent states after World War II, that their underdeveloped economies had to be

[3] Ian M.D. Little: Economic Development, Basic Books, New York, 1992

developed fast, and that a different economics (than either Keynesian popular at the day, or neoclassical or Marxist) had to be worked out on the basis of the particular conditions of underdeveloped countries. According to development economists, these conditions range from desperate situation caused by deficiency in food supply to severe unemployment despite resource abundance to "disguised unemployment", and infant industries. These conditions are reflected in such development theories as "Development with Unlimited Supply of Labor" with W.A. Lewis, to the theory of "Big Push" by PN Rosenstein-Rodan, to "Unbalanced Growth" with Albert O. Hirschman, and of course the important/unimportant role (he changed his mind) of foreign assistance by Gunnar Myrdal.

All the above theories were put in practice at one point in time or another in various countries[4]. The results were short term success in the form of feel-good industries set up at high cost, and producing at high cost, before these industries lost their competitiveness beginning 1970's and become industrial pigmies. For sometimes afterwards, these import-substitution countries remained undecided to whether to leave import-substitution and the old development economics and the policies it generated. The wake-up call came only after the first and the second oil crises, when the macro-economic fundamentals as underlined and damaged by old development economics could not sustained the external shocks. Old Development Economics faded away. In a way, it died a natural death, a slow death (funeral perhaps in mid-1970's as outward looking strategy emerged), as it did not change despite failures seen empirically in developing countries in terms of industrialization or raising standard of living as expected.

As mentioned, Vietnam has pursued this type of development economics right after Doi-Moi, particularly regarding foreign trade, as the Initial Reform Program highlighted below had no mention of trade policy. For the first few years following the initial Reform, Vietnam's trade coming out of the COMECON system and had transformed from barter trade to L/C-based trade, but the underlying thinking was very much import-substitution[5].

When I first came back to Vietnam with a World Bank's mission in early 1990's and then in several subsequent missions, we spent considerable time to "fight" with the authorities to persuade them to leave import substitution, to forget about heavy industries, to reduce SOEs, and generally to reduce the role of government. As old habit dies hard, the vestige of old development economics (e.g. industrial policy of Korean type) still remains until today, although central planning has long gone.

2. A "New Development Economics"?

[4] A good review but rather severe critique of Development Economics can be found in Deepak Lal: The Poverty of Development Economics, MIT Press, 2000

[5] See Centre for International Economics, Canberra and Sydney for a chronological description of Vietnam Trade Reforms. CIE has done a number of studies to document on Trade Policy of Vietnam, including Tariff, QRs, etc. The World Bank annual economic reports (now called Development Report) also discuss Trade Reform year after year.

So there may exist a New Development Economics after the death of the old one? No, because what is currently advocated and practiced to develop the underdeveloped economies is but the normal, standard mainstream economics, which is plain old neoclassical economics.

What in a name?

What is Market Economy with Socialist Direction? When one looks into the constituting elements of it, then despite the name, it is basically a variety of neoclassical economic policy, or an application of neoclassical economics. At best the label Market Economy with Socialist Direction only adds cosmetics to the current policy, at worst, it can hold back the process for a while, and to the detriment of further development.

What is neoclassical economics? For the purpose of this paper, we simply say that neoclassical economics is market economics[6], which is also the current mainstream economics of capitalist economies. Simply put, neoclassical economics equals market, since the classical only look at supply, and neoclassical added demand that is like the other blade of the scissors that make the market. With respect to development, neoclassical economics is not so much a body of knowledge, but more of a method of analysis and reasoning. It provides a basis for the price mechanism to work (consumer's utility and producer's efficiency) to clear the market. Because it emphasizes the market, it does not embrace planning. A central idea of neoclassical economics, which is relevant to economic development, is a small role of government and a big role of private sector. It is however not "Laissez Faire". It recognizes the Government has a role to intervene to get rid of distortions in the economy due to say, externalities (and other forms of market failure when they are external to the industry), when there are information failures and when there are coordination problems.

Neo-classical economics warns against intervention, cautions that intervention be made only when there are no other alternatives, The intervention must be done carefully so that different interests will not capture the policy makers to maximize their one profits or utility and lead to such phenomenon as rent seeking. Laissez-faire school today (e.g. Lal and liberaltarians) argue that it is dangerous for the Government to dabble about in specific markets because that will lead to capture of policy making by interested parties. Public Choice theory of Buchanan, Tullock and others belong to that school. In the case of Vietnam, its seems that the Government still has a role but the mechanism for it to play that role must be very carefully defined and designed, (a) do it openly for everyone to see (b) have all the interested parties come to the table so that interests are balanced (e.g. producers and consumers). (c) Have sundown regulation that government interventions disappear once the problem is fixed. Coase among others argue that there will be market solutions even in this case but this seems a far fetch position.

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[6] A complete definition of neoclassical economics can be found in any textbook, e.g. Samuelson Introductory, 9th edition, or MIT Dictionary of Modern Economics, 3rd Edition. For origin of this concept, see any book of History of Economic Thoughts, e.g. by Eric Roll, 5th Edition, or History of Economic Theory and Method by Ekelund, Jr. and R. Hebert, 3rd Edition

As regards trade, neoclassical favors trade liberalization and integration as these would create or enlarge market. A set of rules governing entry to and exit the market and market transactions is part of a market legal framework that have now become an integral part of modern development economics.

Vietnam's economic policy through reform programs now contains main elements of modern development economic strategy based (or biased in favor of –as some would say) on neoclassical economics despite its official name (Market Economy with Socialist Direction). This neo-classical development economics has been practiced in one form or another, and indeed reflected in the "conditionality" required by international aid agencies such the World Bank, the IMF, USAID etc. from recipient countries, including Vietnam. Once the type of development policy has been identified, it would not be hard to find out what are the impediments for further development in this framework. The factors that work in favor of development can be identified, as one looks at Vietnam's factor endowments. (See below)

Vietnam's reform started with one big initial program in late 1998, and evolved in further additions and fine-tuning in the 1990's and accelerated in recent years after 2001.

The Initial Reform Program, 1989

The initial reform program was consisted of:

a) Elimination of price control for most goods and increased prices for agricultural products;
b) Limiting most subsidies to State-Owned Enterprises (SOEs) and state employees - ending what is known in Vietnam as "kinh te bao cap", or subsidized economy.
c) Devaluation of the dong (the Vietnam currency) and adoption of a floating exchange rate;
d) Granting limited autonomy to **SOEs** and forcing them to finance their investment and working capital through credit from the banking system instead of appropriations from government budget; However, "compensation" by the central budget for SOEs' losses still in practice
e) Reorganization of banking system to move it away from the Socialist mono-bank concept; and
f) Reducing restrictions to allow the private sector to reemerge to do business.

The above program is conveniently referred to as the Price Reform Program as, for its most important parts, it involved price changes, including price of labor (wages) and price of money (interest rates and exchange rates).

These reform measures are drastic as they have the effect of challenging some fundamental tenets of the socialist economic system through the removal of most subsidies, and they do away with the centrally planned system and adopted price system. But it still does not yet have all the trappings of neoclassical, including trade liberalization, until the years later with the introduction of trade liberalization and integration, and regional cooperation

3. The continuing, evolving reform program beyond price reform

The second phase of Vietnam 's reform is characterized by efforts to liberalize trade, by reducing the role of SOEs, reducing import tariff based on the concept of effective protection, and eliminating QRs (quota and licensing). Tariff changes have not been consistent, but rather zigzagged over the years as a result of sporadic efforts to hold back trade liberalization. Similarly, with nostalgia for import protection, Vietnam's QR policy reform has known periods of fine-tuning with decontrol interlaced with periods of increased control (1996-97)[7]. But the general trend is clear: Vietnam as a country coming out of the Comecon system has done remarkably well in trade reform by transforming a system of substantial controls and prohibitions to elimination of most QRs by 2001; 1998 was a watershed, when the government decided [8] to abolish targets and licenses for the import of consumer goods, and used tariffs and taxes instead of QRs, to limit non-essential imports.

Great efforts, sometime strenuous, have been made especially during the last three years by the government to lower protection by both lowering tariffs and eliminating all QRs. To complement the initial program of price reform, the combination of trade liberalization with a program of SOE reform aiming at reducing the size of the public sector, of financial liberalization, and deregulation of investment in 2002 (only registration is required instead of investment permit), has taken Vietnam deeper in neoclassical road, and integration to world trade.

Let's also look at the speed and the sequencing of changes. Not all reforms started at the same time.

Macro and Banking (stabilized since 1997)
Trade Policy (most advanced as compared to other areas)
Price deregulation (fast and almost completed in 2 or 3 years, 1989-1993)
SOEs reform (slow start, still lingering). Crowding out of SOEs
Legal Framework (begins with DFI law, a lot of laws promulgated, inconsistent substantive laws, poor enforcement, poor legal infrastructure)

Speed of Policy changes and progress, 1993-2003

Fast progress	Slow changes	Disappointing Paces
Trade Liberalization BTA	Unstable Legal & Regulatory Framework	SOE privatization and other SOE reforms

[7] For a description of the evolution of Vietnam's QRs up to 1998, see **Vietnam' Trade Policies 1998,** Center for International Economics, Canberra and Sydney, December 1998
[8] Decision 11/1998/QD-TTg of January 23,1998

implementation is going well Price Deregulation	Administrative/ Red tape Banking sector	Corruption Unchanged Political control tightened

Achievements: Output, Export, Employment, and Poverty

Good	Medium	Poor
Output growth*	FDI flow increased up to 95-96, then declined	**Employment High unemploy Ment**
Export growth **Poverty alleviation**		

*Growth rates unstable, growth not inclusive (gap between rich and poor tends to widen.)

As Vietnam is now firmly under neoclassical economic policy, it seems to have no choice but follow through with what has been started in various policies of deregulation and decontrol. The next step is to find out what are the impediments as well as the factors for improvements along the lines of this policy framework. One can also explore other avenues such as Institutionalism, New Marxism, and HochiMinh Thoughts. As it is, the last line of thinking would have to be substantiated before it could become practical policy mix, or a system of thoughts. I hope somebody will explore these other possibilities in another paper. For the rest of this paper, I only propose to look at the remaining agenda for changes, given the policy position Vietnam has adopted so far. This of course assumes Vietnam is unlikely to go back to the old type of development economics as this seems not a viable option in view of internal pressures and external constraints (e.g. the BTA, AFTA, and eventual WTO accession).

4. Continue with Current Policy Framework: The Remaining Agenda.

If Vietnam pursues this route, what remains to be done? Four 4 areas can be of broad consensus:

. Complete Trade Liberalization. Started 1992, now very advanced thanks to AFTA, BTA commitments, WTO preparations. 2005 will be a crucial year, as Vietnam has to meet its AFTA commitments

. Accelerate Banking Reform, Started in 1992 to break up mono-bank system, but slow in development of solid commercial banking. Still not completed

. State-Owned Enterprises (SOE) reform. Started about 1995, very slow. Privatized only small SOEs. Established General Corporations (conglomerates), which may go against reform.

. Legal Reform. Several obstacles to further reform, including ideology

Of all the issues above, the most serious impediment continues to be the “SOE problem”. SOE crowds out private sector in industry and service. It not only crowds out private sector in banking credit, but as the largest bad borrower, is also a big obstacle to banking reform. The “SOE problem” is more of a reflection of government attitude vis-à-vis private sector, rather than technical problems encountered in SOE reform process.

The Real Issue: A Tiger or a Wild Cat

The old-fashioned way of looking at an economy in terms of factors endowments can be useful to shed some more lights into the discussion. The conventional wisdom attributes underdevelopment to the deficiency of one or more of the three factors, namely, Land, Labor, and Capital, and technical progress. Latecomers in the discipline added entrepreneurship and technology. Vietnam while having no real problems with land (except legal problem regarding land use rights) and labor, it has a curious problem of “capital abundance”, or at least plenty of “loanable funds” availability in the form of aid commitments in various forms. It has a backlog to the tune of $13 billion. This has been the result of unused funds caused by the lack of bankable projects, which in turn was caused by the lack of in-country expertise for project development and preparation. In the short term, this seems the most serious factor that impedes further development. This happens in a context where Vietnam possesses a very large pool of overseas Vietnamese talents that can be of great use. But this is a different issue.

The point here is simply that Vietnam currently has all the “traditional advantages” in land, labor and capital necessary for development. If its economy doesn’t grow faster it must be for reasons other than factor endowments. With a population growth of less than 2 percent per year, it should have no problems of sustaining a rate of growth of 5%-6% on the average of a decade, giving a relatively decent increase in per capita income. The issue for Vietnam after reunification is not to have enough to feed and clothe the population, but to make the economy grow at high rate, which would make the country become another tiger (country) as the government once wishes, or remain a simple wild cat.

Can Vietnam afford to do nothing? i.e. no more reform? This is quite doable economically in that this negative sounding strategy would not cause famine or endanger a moderate growth, given the country’ favorable endowments including its pool of dynamic entrepreneurship with its ability to deal with institutional constraints. This do-nothing-more strategy may also be politically sound and safe from the Party’s point of view. But this is also the best recipe to remain a wild cat.

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