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The Politics of Economic Transformation in Vietnam

1.1 The politics of economic transformation

Vietnam is one of the poorest countries in Asia. Warfare from 1945 to 1989 with France, the US, China and Cambodia, bureaucratic socialism, a Stalinist preference for heavy industry and a corresponding neglect of agriculture, the eradication of private enterprise, the absence of financial intermediation, economic and political isolation as a result of the ongoing US embargo, a population explosion and hyperinflation have virtually ruined the economy. In a country endowed with a wealth of human and natural resources, the per capital income has dropped to US\$ 125 (1989) by official estimates. *The economy Operates at low efficiency, with serious inflation, unstable growth, underutilization of resources, and severe material, social and cultural deprivation*, notes an international consulting firm (Dataconsult 1991:16). Vietnam has many lessons to tell on the *art of underdevelopment*.

Is there a chance to develop for a country suffering from the combined effects of central planning, administrative control and financial repression? Vietnam's own goal, cast into a *Strategy until the Year 2000*, is poverty alleviation and the creation of the basis for a strong and developing nation, primarily relying on domestic strength rather than foreign assistance, encouraging at the same time foreign economic and political relations. Embargoed by the US and virtually cut off from Western aid, Vietnam has taken major steps of its own towards this goal, relying indeed on its own strength rather than external financial or technical assistance. During the last 12 months the international press has confirmed that the chances for Vietnam to succeed are excellent. Similarly most international experts seem to agree with Dataconsult (1991) which points to *the unique opportunities of Vietnam as a place for trade or investment*. But what has led to the turn of the tide in Vietnam?

Vietnam is not a unique, but an excellent example of determined goal-oriented policymaking, creating the right policy environment for economic development. It provides clear evidence as to the primacy of domestic policies - rather than capital transfer and foreign aid! There are three outstanding policies:

- a capital-generating policy, creating incentives to encourage capital formation, increase efficiency and raise production;
- a market policy, replacing the state-run subsidy system by a competitive market economy;
- an external economic policy, broadening external economic relations and building up an export orientation (cf. Dataconsult 1991:19-20)

Guided by these policies, Vietnam has vigorously embarked on a set of reforms including,

- a planning reform, substituting indicative for imperative plans, limiting the scope of planning and transferring decision-making power from the state to the enterprise level;
- a monetary reform, liberating the exchange rate, restricting the money supply and decontrolling interest rates;
- a banking reform, separating central and commercial banking and encouraging financial intermediation between savers and borrowers;
- a price reform, substituting market prices for administratively fixed prices
- a financial reform, cutting down on subsidies to firms which may now issue bonds (so-called *shares*) and retain part of their foreign exchange earnings;
- a reform of enterprise taxes, replacing compulsory profit transfers of state-owned enterprises by taxation;
- a domestic trade reform, eliminating customs and bureaucratic controls along the borders of the 40 provinces;
- an enterprise reform, legalizing private enterprise;
- a labour reform, introducing more flexibility in hiring and firing instead of administrative life-time allocations of

1.2. Conditionalities of development

Donor countries such as the *Federal Republic of Germany* insist on **political conditionalities** before they grant development aid.

Unless a country respects human rights and democratic principles, a country is to be excluded from among the beneficiaries. In addition, there are economic conditionalities, requiring a country to provide a policy environment conducive to development.

Vietnam has embarked at its own on human rights, political reform and policy adjustment, setting right the conditionalities for development. Barred from development aid in conjunction with a prolonged US embargo it has not been in a position of being pressured into reform and adjustment by carrot and stick techniques of donor countries and international creditors. Nor was it unanticipated political turmoil which might have enforced political and economic rethinking. It rather appears that **insight and necessity** were the prime movers behind policy changes in Vietnam. There are six major factors that have been instrumental in the transition towards a market economy. They are conditionalities for the transformation of a centrally planned backward economy into a market system:

- **Political stability:** Unlike other Eastern bloc countries, Vietnam did not postpone reform until the day of political collapse. It appears that political stability is perhaps the most important factor without which no policy reform can have a lasting effect. Reform in Vietnam started in 1981 - long before Perestrojka, the international debt crisis or the threat of IMF sanctions. Precisely *because* it was the Communist Party which initiated and implemented the changes, the Party stayed in power, the political

environment remained stable and the political system retained the capacity of carrying out reforms with unpopular side effects. So far no populist regime has found it easy to enforce the reforms deemed necessary during the transition to a market economy. Socialism and party dominance is perhaps the single greatest liability of Vietnam; but with regard to political stability, party dominance may also be its greatest asset, at least during a transition period.

- **Human rights:** Violence and authoritarianism are no environment in which a market economy can flourish. In nearly fifty years of war, oppression and resistance, millions of Vietnamese have gone through immense suffering. The wars have ended, political indoctrination is disappearing and civil liberties are being granted. In its new Constitution of April 1992 Vietnam has taken a giant step towards human rights and civil liberties. The new Constitution puts human and civil rights above everything else and establishes equality before the law. It declares basic freedoms such as the freedom of expression, freedom of the press, the right to be informed, to meet, to found associations and to demonstrate in conformity with the law, the freedom of business, individual rights to ownership of the means of production, freedom of belief as well as the basic rights to carry out business activities, travel abroad and be compensated for unlawful arrest or detention. At the same time the leading role of the Communist Party of Vietnam is reaffirmed, and the Constitution states that Vietnam remains a socialist society. Yet the Party is no longer above the law. The Constitution separates the party from the state and submits the party to the law.

As *human rights* are the single most important conditionality, it may be appropriate to quote from the most recent report of *the* authoritative source:

*In 1986 the Vietnamese Government adopted a general policy of renewal or "renovation" (doi moi) which had wide-ranging implications that changed the direction of government policy in many... In the political sphere, doi moi meant reform of the Vietnamese legal system by the introduction of the Vietnamese **Criminal Code** in 1986 and the Vietnamese **Criminal Procedure Code** in 1989. As a consequence of the reform program thousands of political prisoners associated with the former government of the Republic of Vietnam (RVN) in the south were released in general amnesties in 1987 and 1988. However, around 20 political prisoners remain in untried detention in a "re-education" camp...*

In late 1989, in the wake of political changes in Eastern Europe, the Communist Party leadership expressed concern that the hasty implementation of political reforms may lead to political instability...

In April 1990 the government announced that it would not hesitate to suppress dissent from people who try „to destabilize the socialist system." A series of crackdowns against critics of the government started with the arrest of several persons in April 1990 hitherto supportive of the government, such as Father Chan Tin who was placed under house arrest,... In April 1992, the National Assembly adopted a new constitution which aims to create a new post of president, curb the power of the CPV and give people new civil and economic rights... However, the new constitution also reaffirms the one-party rule of the Vietnamese Communist Party...

Amnesty International welcomed the release of around 100 political prisoners in late 1991 and early 1992... However, it has continued to receive disturbing reports of political arrests in Viet Nam, including prisoners of conscience, during

1990 and 1991. Amnesty International believes that most of them have been arrested (...or placed under house arrest...) for the peaceful expression of their religious and political beliefs. (amnesty international June 1992)

While the new Constitution ratified in April 1992 increases the power of the elected National Assembly, Vietnam may still be far from Western concepts of multi-party democracy and democratic accountability or Western practices of press freedom. The Vietnamese authorities fear that Western-style plural democracy may lead to chaos. (Dung 1992) Moreover there are questions of compatibility between Western political values and the prevailing Confucian ethic, with its emphasis on community, tradition, hierarchy, order and bureaucratic process, in addition to education, work, competition, risk-taking, parsimony and success (Weggel 1991:488-9). They might lead to a political order that differs from Western political systems.

- **Equality and equal opportunity:** Many of the least developed countries are leading in statistics of inequality. Abject poverty of the masses and outrageous wealth of the elites exist side by side. Any change in the system is likely to affect the overall income distribution, the composition of political constituencies and thus the position of those in power. Those elites will do everything to prevent a change that threatens their privileges. Inequality thus becomes one of the strongest obstacles to development. Market economies, on the other hand, require a measure of equal opportunities. (Seibel 1973) These do not lead to equality of outcomes, but developed countries do tend to occupy a middle position on the equality-inequality scale.

Vietnam is among those Socialist countries which excel, by Gini coefficient standards, in equality. Despite its exceedingly low per capita income, abject poverty, or penury, is virtually absent; there is also no great wealth.

One of the greatest obstacles to democratization and progress in some developing countries has been the unequal distribution of land, with most of the land in the hands of a small landowning class. Compared to those countries, Socialist, or the former Socialist, countries have at least one advantage: a socialist revolution abolished excessive wealth, a land reform abolished feudal and colonial properties. While this failed to lead to anything like development within the framework of a centrally planned economy, it has created the historically unique situation of equality and equal opportunity at the start of the transition to a market economy, which relies on equal opportunities at the start. There are thus no vested economic interests (vested political interests notwithstanding) in Vietnam which prevent change. To be sure: this kind of equality will be a transient phenomenon. Equal opportunity generates equity, but it will not breed equality, particularly not in a society where hard work, risk-taking and success are individual values. But whatever inequality emerges will result from market processes, not from family or class privilege, and be equitable in this sense. Once the process of rising inequality sets in, excesses must be prevented through progressive taxation and inheritance taxes as applied in most developed countries.

- **Privatization:** Entrepreneurship and private initiative, which are essential in a market economy, cannot emerge in the absence of private property or private control over property. The transformation of collective property into private property or

control over property is a long process which cannot be carried out overnight. Also, private initiative will not come about overnight. The Eastern European countries, together with eastern Germany, now realize how cumbersome a process the emergence of private entrepreneurship and the enactment of an appropriate legal framework is.

In Vietnam privatization has been a gradual and prudential process. It started in 1981 through *Contract system 100*, by which a first set of land use rights was transferred from collectivities to private rural households, and continues well into the 1990s with the issuance of land use certificates. Land is still publicly owned, but control over land has been privatized and is now becoming alienable. With regard to capital ownership, Vietnam represents a *mixed economy*, allowing for private, collective and public ownership of the means of production. In Vietnamese terminology, it is referred to as a *multisectoral economy*, with many forms of ownership alongside the state sector. Income is to be differentially distributed according to the quality and quantity of one's work input, with pecuniary incentives for individual achievement. The Constitution of 1992 accords Vietnamese citizens the right to own the means of production, to engage in their own business and to enter into joint ventures. After more than a decade, the vast majority of the population has been directly affected by privatization, *learning by doing* how to combine the factors of production in the most economical and profitable manner. The results of this learning process will be reported on in chapter 2. Given the breakdown of large numbers of collectivities and the public debate on the abysmal state of publicly owned enterprises, Vietnam is likely to experience a massive transformation in the ownership structure of the means of production during the 1990s.

• **Prudential deregulation:** Without an appropriate macroeconomic and monetary policy framework, development cannot ensue, assistance cannot be effective. Centrally planned economies do not possess such a framework. But where do they find the guidelines which tell them how to generate such an environment?

In his financial theory of economic development, McKinnon (1973:4) gives the answer: from internal rather than external resources; with the financial system, rather than the system of production, as the prime mover; through deregulation, rather than financial repression. When asked how to proceed, whether to deregulate gradually and partially or completely and immediately, his reply was unequivocal: Complete rather than partial liberalization is more likely to be ultimately successful (ib.). Yet the jump from excessive regulation to complete and immediate deregulation has led to major adjustment problems. As McKinnon himself noted in his 1986 review, there are pitfalls in financial liberalization; the cure has sometimes been worse than the disease: *In the late 1970s and early 1980s, Argentina, Chile and Uruguay all made serious efforts to end wild inflations while deregulating and privatizing their commercial banks. Interest rates... were completely freed... these attempted financial liberalizations generally ended in failure... our knowledge of how best to achieve financial liberalization remains seriously incomplete* (McKinnon 1986:387-8). His final and somewhat belated advise is *prudential* deregulation, meaning: deregulate, but use your own judgement in how to do it.

Had Vietnam uncritically followed McKinnon's earlier advise, it would not have escaped the fate of the Southern Cone. Instead it went its own way:

- Firstly deregulation in Vietnam has been a gradual process. Starting in 1981, it is still far from complete.
- Secondly deregulation started with agriculture as the dominant sector of production, not with the financial system.
- Thirdly financial deregulation followed stepwise.
- Fourthly this was accompanied by serious efforts to control inflation.
- Finally this was eventually paralleled by reforms in the trade regime. (Cf. chapter 3)

Whether all this adds up to new guidelines, more specific and better tested than McKinnon's, remains to be seen, perhaps in the context of positive experience from other Southeast Asian countries such as Indonesia (cf. chapter 8).

· **Striving for macroeconomic stability:** Macroeconomic stability is a long-term goal and challenge to any economy. Of the several dimensions which constitute stability, the inflation rate is by far the most important one. With inflation out of control, most policy measures are unlikely to take hold, investors will have no confidence in the economy, and development is unlikely to ensue. Vietnam has made serious efforts in that respect. While structural reforms focused on dismantling the extensive system of controls, financial policies were geared to reducing inflation from near hyperinflationary levels. *The initial success of financial policies was dramatic*, confirmed the IMF (1990:26). This resulted in an early response of exports and triggered inflows of foreign investment. While Vietnam did not immediately succeed in maintaining the relatively low inflationary level achieved in 1989, with money supply continuing to disproportionately exceed real growth, domestic and foreign investors appear to have little doubt as to the country's continued determination to bring down inflation as envisaged to 10 percent per year by 1995 and perhaps eventually to single-digit figures.

Last not least, the new Constitution of April 1992 provides a solid basis for a legal framework supportive of macroeconomic stability. It formalizes free-market reforms, assures both Vietnamese citizens and foreign investors of their right to own capital and assets in Vietnam and provides guarantees against the nationalization of enterprises with foreign-invested capital. Yet despite the rosy picture that most visitors and analysts tend to draw, Vietnam is of course full of contradictions. The language and ideology of central planning are still deeply engrained in the minds of politicians; the habit-forming effects of bureaucracy and administrative inertia are still rampant; socialist dreams and the realities of the market place clash in everyday life. The system of socialization, education and training does not prepare for life and work in a market economy. The cultural system, the social system and the personality system are far from well-integrated. Politics and economics do not always match, politicians and economists frequently pull in different directions. As one journalist described Vietnam's problem: *Learning how to walk on two legs of a different length*.