The Medium-Term Macroeconomic Trends and Outlook in Vietnam

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This paper first analyzes the trends in domestic developments of the Vietnamese economy, then moves on to address the foreign economic relations, including trade, FDI and ODA and the joining of Vietnam into ASEAN and the AFTA process, focusing finally on projections for future developmenttoward the market economy and industrialization.

Domestic Developments

The renovation process in Vietnam has been underway for more than ten years, with two five-year plans completed and the third being undertaken. Although the targets of the first five year plan were not fulfilled due to factors such as the war, poor economic management mechanism, a heavily subsidized and bureaucratic system and voluntarist thinking, relatively good economic growth was achieved during the 1986-90 five-year plan period. Gross social product increased by 26.4% (an average of 4.8% annually) and national income increased by 21% (an average of 3.9% annually).

By 1990, Vietnam had basically done away with the old economic management mechanism, and built up a new market mechanism on a nation-wide scale. Thanks to the timely changes made prior to the all-around crisis that affected the former USSR and East European states, Vietnam was able to diversify her international cooperation and obtain new assistance, which greatly helped the economy to remain stable and grow in face of the dry-up in old sources of aid and the narrowing-down of old main markets.

The 1991-95 period was regarded as a new period of economic development. In these five years, GDP increased by 48.3%, an average of 8.2% annually, surpassing its planned target rate (5.5-6.5% annually), and, indeed, surpassing all targets of outstanding results. Goods production increased from 21.5 million tons (1990) to 27.5 million tons (1995), an average increase of 1.2 million tons annually. During the same period, industrial production increased by 88.4%, an average of 13.5% annually. In 1995, exports reached $5.2 billion, an increase 2.16 times that of 1990. Imports reached $7.5 billion, increasing 2.72 times. By the end of 1995, permits had been issued to 1,500 FDI projects with capital totaling $19 billion (Table 1).

Table 1: Fulfillment of the Main Economic Targets of the 1991-95 Plan

	Targets Laid Down in 1991-95 Five-Year Plan	Fulfillment During 1991-95 Period
GDP Growth Rate	5.6-6.5%	8.2%
Average Annual Growth Rate of Agricultural Output	3.7%-4.5%	5.4%
Average Annual Growth Rate of Industrial Output	7.5%-8.5%	13.5%
Export Turnover in 5 Years	US$12-15 billion	US$17 billion
Import Turnover in 5 Years	US$16 billion	US$22.1 billion
Food Production 1995 (in paddy equivalent)	24-25 million tons	27.5 million tons
Power Output in 1995	15-16 billion kwh	14.7 billion kwh
Crude Oil Output in 1995	7-8 million tons	7.7 million tons
Steel Output in 1995	270-300,000 tons	380,000 tons
Cement Output in 1995	4-4.5 million tons	5.8 million tons
Population growth rate in 1995	1.87%	2.0%

In 1996, GDP grew by 9.5 %, inflation held steady at 4.5%, industrial production was up by 14.1%, foreign investment reached US$8.5 billion, some 29% higher than that of 1995, and food output reached approximately 29 million tons.

During the first half of 1997, compared to that period in the previous year, GDP grew at 9%. A successful crop led to the production of 14.6 million tons of food and an export of 1.8 million tons of rice (an increase of 46 %). Industrial production grew 13.6%. Exports during this period reached $4.1 billion, an increase of 30.2%, while the trade deficit is equal to only 60.5% of levels in the first six months of 1996.

These figures show that the economy in 1997 continues to grow at a high rate and the following targets set forth for the year are likely to be achieved:

- 9-10% increase in GDP
- Less than 10% inflation
- 15-4-15% growth in industrial production
- 29-29.5 million tons of food output
- 27% increase in exports

One of the most important factors that contribute to the stabilization and high growth of Vietnam's economy is the ability to control inflation. The high annual inflation rate of 800 in the first half of the 1980s was gradually reduced to double digits at the beginning of the 1990s and to 4.5% in 1996 (appendix Chart 1). This inflation control exerted great impact on the increase of GDP from 4.8% annually during the second half of the 1980s to 8.2% annually during the first half of the 1990s and 9.5% in 1996 (appendix Chart 2).

Since the middle of the 1980s, the Vietnamese Government has carried out a number of policies and measures to reduce the inflation rate, among which, as analyzed by Vice Prime Minister Phan Van Khai, are the following "subjective factors which play a decisive role in controlling inflation:"[1]

- Strict management of the state budget, which involves increased revenues, decreased expenditures, and reduced budget deficit.
- Improving and enhancing the capacity of the State Bank to manage and control money circulation, shifting the commercial banks to the business mechanism, taking greater initiative in the areas of interest rates on credits and in attracting savings deposits, resorting to more and more non-cash payments and improving the management of foreign exchange, including the adjustment of foreign exchange rates and making better use of foreign capital.
- Assure a harmonized combination of supply and demand of those goods which are important and have a major impact on the general consumer price index, and strive to prevent the recurrence of price fevers, such as those relating to food and foodstuffs during the Lunar New Year and the lean months, cement during the dry season, paper at the beginning of the school year, etc.

[1] VER, No. 3 (33) 1996

Along with the control of inflation, Vietnam has greatly improved performance in other macro-economic activities, particularly in the areas of finance and banking. In the ten years of renovation, most subsidies have been canceled; the printing of money has been placed under strict control; interest rates and exchange rates have been gradually adjusted; periodic treasury bill auctions have been launched; the two-tier banking system has been developed; and the stock market has been prepared for opening in the coming year or two (appendix Charts 3 and 4). These policies and measures have facilitated the transformation from a planned toward a market mechanism and, particularly, helped raise domestic savings and attract foreign capital.

The revenue/GDP ratio in Vietnam was raised from 13 % in 1991 to 24 % in 1995 and, thanks to this, total development investment in Vietnam during the 1991-95 period grew to $18 billion (in 1995 prices), of which State investments (including state budget, state credits, and investments by state enterprises) made up 43%. In accordance with the multi-sector economy, more and more actors increasingly participate in the market, leading to the relative reduction of state budget investment from 35.7% in 1992 to 21.14% in 1995. The state budget has in recent years concentrated mainly on infrastructure development projects, including those concerning social and human resource development.

A major trend in development of the Vietnamese economy in recent years is its structural transformation. After years of almost no change, the economic structure has started to move in the direction of industrialization, with the share of agriculture, forestry, fishery and aquaculture decreasing from around 40% in 1990 and 1991 to about 1/4 of the GDP in 1995 and 1996, while that of industry and capital construction increased from less than 1/4 to 1/3 of GDP and services from less than 40% to more than 40% of GDP (Table 2).

Table 2: The Ratio of Agriculture to GDP (%)

Item	1990	1991	1992	1993	1994
Total GDP	100	100	100	100	100
Agriculture, forestry, fishery & aquaculture	38.7	40.5	33.9	29.9	28.7
Industry and capital construction	22.7	23.8	27.3	28.9	29.6
Services	38.6	35.7	38.8	41.2	41.6

Source: Nguyen Dien, VER, no. 3 (33) 1996

This trend was strongly promoted by Vietnamese policy-makers under the planned economy, but did not occur until the implementation of the renovation policy to transform the economy toward the market mechanism beginning in the mid-1980s.

The contract system has been the decisive factor that turned Vietnam's agricultural sector from food-shortage, to food-surplus and into a rice-exporter. Since 1989, Vietnam has been free from chronic famine, and this has created the prerequisites for restructuring the agriculture in order to give it greater efficiency, to raise the income of the peasantry and to develop the rural economy. The most outstanding achievement lies in the rapid and relatively steady growth in food production: average food output of 23 million tons/year, an increase of one million tons per year; national food security in the context of continue high population growth rate (1.5 million per year) and natural calamities in various parts of the country; and rice exports amounting to 1.5 and 2 million tons per year, reaching 3 million tons in 1996. (appendix Chart 5).

Since 1990, Vietnam's industry has developed relatively rapidly. The growth rate of heavy industry is 22.4% (1991), 18% (1992), 27.2% (1993), 17.8% (1994) and 11% (1995). The growth rate of light industry is: 9.4% (1991), 17.65% (1992), 16.6% (1993), 19.38% (1994). This is an average growth rate of 14.7% annually. The growth rate of the energy industry is 5.4% (1992), 10.4% (1993), 15.13% (1994) and 14.5% (1995). The above figures do not include the production of FDI projects in Vietnam.

In 1996, total industrial production was valued at VND 113,075 billion, a 14.1% increase compared to 1995 (according to 1994 fixed prices), of which central state-run industry increased 14.39%, local state-run industry, –7.49%; the non-state sector 11.87%; and the foreign invested sector, 21.7%. The local-run industrial sector increased 9.97%. As for nationwide industrial value: state-run industry made up 52.02% of the total; the non-state sector made up 24.16%; and the foreign-invested section contributed 23.8%.[2]

Total exports of industrial products in 1996 are US$3.9 billion, of which US$ 1.2 billion was made up of petroleum; US $1.1 billion, garments and textiles; US $0.5 billion, coal (some 3.2 million tons) and $0.5 billion, industrial and mineral products (this relatively low level is due to the sharp decline in color metal prices worldwide). Imports in 1996 rose to around US$997 million (of which fuel and material value was estimated at US$ 600 million), increasing by 6.8% over the previous year, yet equal to only 90.23% of the plan.

Some industrial products such as power, coal (consumed 8.69-9.0 million tons), steel (1.1 million tons), phosphate (78,800 thousand tons) and writing paper managed to keep prices stable and meet the demands of the market. Others, like a number of basic chemicals (soda, acid) and consumer goods (clothes, match boxes, plastic packaging material, canvas sports shoes, household ceramics, lamps, instant, noodles, detergent) were improved in terms of both quantity and quality. There remained, however, many industrial products (tool machines, transformers, electric fans, television sets, processed glass) that were unable to compete in the market and these reduced their production compared with that of 1995 (Table 3). The main reasons were the slow renovation of technologies and the high costs of production, leading, hence, to high prices.

In the service sector, tourism has been set as one of the priorities. Because of this, the number of overseas tourists traveling to Vietnam continued to increase, from 250,000 in 1991 to 1.4 million in 1995, and to 1.6 million in 1996. The number of domestic tourists has also been rising, from 5 million in 1995, to 6.5 million in 1996.

In Decision No. 307/ITG, dated 24 May 1995, the Prime Minister has approved a comprehensive plan for the development of tourism in Vietnam from 1995 to 2010. As envisaged in this plan, the number of foreign visitors to Vietnam in 2000 would rise to 3.5-3.8 million persons and the business turnover of the tourist industry would be $2.6 billion in 2000 and $11.8 billion in 2010 (not including earnings in transportation). It is estimated that the ratio of earnings to GDP in the tourist industry would increase from 3.5 (1994) to 9.6% (2000) and 12% (2010). If earnings of tourism-related industries are also included, the above ratio would reach 18.6% in 2000 and 27% in 2020.

[2] The exchange rate during the year was around $1.00 equal to VND 11,500.00

Table 3: Main Industrial Products

Product	Unit	1996 (implemented)	1996/95 (percentage)	1997 (planned)	1997/96 percentage
Production electricity	Million kwh	16,910	115.51	19,100	112.95
Clean coal	1,000 tonnes	8,600	105.46	9,000	104.65
Steel	1,000 tonnes	929.3	226.99	1,253	134.83
Urea fertilizer	1,000 tonnes	120	108.11	125	104.17
Phosphates	1,000 tonnes	820	102.6	830	101.22
Various electric fans	1,000 tonnes	319	94.1	330	103.45
Electric motors	Unit	37,174	126.26	43,328	113.86
Cigarettes	Million packs	2,142	102.08	2,165	101.07
Hard covers	1,000 tonnes	221.2	95.92	238	107.58
Beer	Million litres	402.5	122.34	415	103.11
Silk	Million metres	287.7	139.46	311	108.10
Sweetened condensed milk	Million cans	155	89.6	160	103.33
Automobile production & assembly	Unit	8,000		18,000	225.00
Motorbike production & assembly	1,000 units	67		120	179.40

To this end, the development of tourist infrastructure, and first and foremost the construction of an adequate number of hotel rooms meeting international standards, would be of decisive importance. According to the General Department of Tourism, such infrastructure development would require a huge amount - $500 million annually from 1995 to 2000, and $620 million annually from 2001 to 2010. Investments worth $3 billion would be required to construct and develop hotel facilities from 1995 to 2000; $6.2 billion would be necessary from 2000 to 2010. To this end, it is essential to encourage both foreign and local investors to develop tourism. Besides tourism, other services, including those that help earn foreign exchange, such as money remitted by overseas Vietnamese, postal services, insurance, banking, aviation, navigation, juridical consultancy and auditing are also being promoted.

Foreign Economic Relations

Vietnam’s foreign economic relations have developed and diversified since the renovation process started in 1986. Trade during the second five years (1991-95) compared to that of the first five years (1986-90) was doubled, with exports increasing 2.89 times and imports increasing 1.8 times.

Countries that have had trade relations with Vietnam increased from 40, prior to 1990, to 105, by 1995. Vietnam had signed trade agreements with 58.

From 1991 to 1995, export turnover was estimated at $17 billion - this is 113.4% of the target set by the National Assembly ($12-15 billion), thus increasing by an average 20% annually, and in particular, by 31% in 1995. During the early years of this period, exports were scattered and fragmented, as the commodity economy was still underdeveloped. Since 1993, various branches of commodity production have gradually grown, turning out products of high export value. Substantial volume has also been achieved in these items, which include: crude oil, rice, coffee, rubber, pepper, sea products, textiles and garments. By 1994, additional products were added, which had a substantial volume of production and which could, because of their competitiveness, secure a place in world markets. Cashew nuts and footwear, Vietnam's main exports, which each earn a minimum of $100 million annually, increased from a handful of 3-4 products, to 12-13 products in recent years.

During the 1991-95 period, heavy industry products and minerals accounted for 32.8% of total exports; light and small industries and handicrafts, 18.1%; and agro-forestry and aquaculture products, 49.1% (appendix Chart 6). The ratio of industrial goods grew, particularly in garments, footwear, and other light industrial goods.

In 1996, exports reached $7,255 million, an increase of 32.9% compared to that of 1995. Moreover, during the first seven months of 1997, exports were estimated at US$4.863 billion – 25.2% higher than the same period in the previous year. Most of the growth in both industrial and export sectors was attributed to enterprises with direct foreign investment. Foreign invested joint-ventures recorded 23.2% growth in industrial production and 14% in export value. Meanwhile, a downward trend was recorded in domestic industrial plants, particularly in the electronics sector, because of fierce competition from foreign invested enterprises. At the same time, according to the General Department of Statistics, Vietnam's trade deficit was high for the January-July period. It was estimated at $1.77 billion, and 45.7% of the trade deficit was related to the import of equipment for foreign-invested joint-ventures.

Imports during the 1991-95 reached $22 billion, 158.1% of the target set by the National Assembly ($12-14 billion), an increase of 22% annually. Changes in the structure of imports were reflected in the increased ratio of full sets of equipment and separate equipment (from 25.2% in 1991 to 39.5% in 1995). The import of full sets of equipment for such major projects as the Hoa Binh Hydroelectric plant, the 500 KV power transmission line, construction material producing plants, factories for processing agro-forestry and aquaculture products, etc., played an important role in promoting the industrialization and modernization of the country.

Imports also consisted of raw materials and fuels which were necessary for production but were not sufficient or available in the country: oil and lubricants, iron and steel, cement, fertilizers, basic chemicals, cotton, and yarns. These imports basically met requirements in domestic production and helped avert long-drawn-out shortage fevers. Imported essential consumer goods helped to satisfy the consumption requirements of the population. Strict limitations were put on the import of luxury goods, which fluctuated between 13.9% to 16.5% of the total import figures.

During 1996 and the first half of 1997, Vietnam's trade continued to grow (see appendix Charts 7 and 8). With the new trend of expansion toward the Asian-Pacific region. Prior to 1990, more than 80% of Vietnam's trade was with the former Soviet Union and East European countries. In recent years, the Asian-Pacific region accounted for 80% of Vietnam's foreign trade, Europe for 15%, Africa, West Asia and South Asia for 3% and America, 2%. Five major trade partners of Vietnam are in the Asia-Pacific region: Japan, Singapore, Hong Kong, Korea and Taiwan (appendix Chart 9).

Foreign direct investment (FDI) in Vietnam increased fast since 1988 to 1996 with registered capital grew at an average of 50% per year, but reduced by 6.3% during the first six months of 1997 compared to that of 1996. Total foreign investment in Vietnam was raised from $.35 billion in 1988 to over $30 billion by mid-1997. The average size of each project (excluding oil and gas projects) increased from US %3.5 million a year in the period from 1988 to 1990 to $16.38 million in 1995, and 17.6 million in 1996.

During the early years, foreign investment in Vietnam focused mainly on oil and gas (32.2%) and tourism (20.6%). Since 1991, and especially since 1994 and 1995, investment in industry has increased considerably. By 1996, 65% of foreign invested, capital licensed projects covered heavy industry, light industry, oil and gas, cement, agriculture, forestry, processing, facilities, communication and transport, postal services, infrastructure. The remaining 35% covers services such as hotels, office to be rented, banking, finances, technical services, etc. In other words, 65% of foreign capital is devoted to production and 35% to services. Of these, 60% are intensive investments to improve and upgrade existing production capacity. Foreign partners have also become more diverse. By the end of 1996, more than 700 companies in over 50 countries and territories invested in Vietnam including several corporations with great financial and technological potential.

Joint enterprises account for 64.6% of FDI projects and 65.3% of total invested capital: enterprises with 100% of foreign capital account for 27.1% of FDI projects and 17.8% of total invested capital, while business cooperation contracts account for 8.3% of FDI projects and 16.9% of their capital. State-owned enterprises have participated in 98% of cooperation or joint venture projects with foreign countries and contributed 99% of the total capital investment. As a result, they have been able to consolidate and develop their leading roles in key economic sectors. Realized capital from 1988 to 1996 is $10,061 million, 36 % of the total registered capital of nearly $30 billion, not yet including the Vietsopetro oil and gas joint venture.

The proportion of enterprises with foreign investments in GDP increased from 5.5% in 1994 to 6.3 % in 1995 and 6.9 % in 1996(excluding basic investments). This sector, in 1996, produced 25.1 % of industrial output, 100% of crude oil, 60% of steel, 63% of vehicles and 40% of electronic appliances. In 1996, exports in this sector increased 78%, reaching $1400 million, and covering 25% of total industrial exports (excluding oil and gas and on-spot exports). In 1996, FDI projects contributed $300 million to the budget, a 50% increase over 1995. FDI turnover in 1996 was $1.8 billion compared to $1.5 billion in 1995. Exports from FDI rose from $400 million in 1995 to $600 million in 1996. FDI projects have also provided direct employment to about 100,000 people and indirect employment to 200,000, not yet counting large numbers of people engaged in services related to such projects.

Having realized the benefits of FDI and the difficulties faced by foreign investors, the Government has continually improved procedures, laws and other conditions to attract greater foreign investment. The New Law on Foreign Investment was passed by the National Assembly in 1996 with an aim to improve legal and administrative procedures to facilitate foreign investment. Regulations have also been eased through new decisions made by the Government to assign Hanoi and Ho Chi Minh City authorities the approval of projects of $10 million or less, and to assign seven other provinces the approval of projects of $5 million or less.

In 1996, new forms of projects were witnessed, namely the south Thang Long New Urban Project (Hanoi), the City Hope project (Ho Chi Minh City), BOT (Build-Operate-Transfer contract) and BT (Build-Transfer) involving infrastructure facilities such as Sao Mai – Ben Dinh Port, Phu My Thermo motorway, and some portions of Hanoi ring roads. These are complex technical projects involving large areas of land and big volumes of capital. In 1996, the State also allowed the construction of about 10 concentrated industrial zones with the total are of 2,000 hectares and 35 new projects worth US $80 million.

So far, foreign investment has focused mainly on three key economic zones near Hanoi, Ho Chi Minh City and Quang Nam – Da Nang. These areas accounted for 84 % of total foreign investments. In recent years, the Government has set new incentives for priority regions, especially mountainous and rural areas, with an aim to promote more balanced development across Vietnam.

When relations between Vietnam and the international financial community resumed in October 1993, the latter held 4 conferences on development aid to Vietnam and, to the end of 1996, pledged to provide Vietnam with $8,400 million worth of ODA. This amount is being channeled into the country gradually through projects dealing with the restoration and renovation of existing facilities as well as the construction on new facilities in the fields of economic and social infrastructure (energy, transport and communication, including roads and seaports, and water supply to cities and towns), agricultural irrigation, education and training.

By the end of 1995, Vietnam had signed International donor agreements worth $4.6 billion. Nearly 25% of the ODA was allocated to industry (mainly electricity $1,177.69 million). Agriculture, forestry, and water conservancy accounted for about 12.15% ($563.35 million); while transport and communication, made up 14.62% ($678.38 million,), and other sectors provided the remaining 47.84% ($2,219.18 million).

About $1,730 million of this ODA was disbursed, across a wide variety of sectors (Table 4). Japan, the World Bank and the Asian Development Bank have been the three largest ODA providers to Vietnam. Since 1991, Japan has been Vietnam's leading donor, committing US$ 2.677 billion to 12 large projects. Between 1991 and 1995, at least US$566.6 million of Japan's ODA was disbursed – the highest level of disbursement among ODA donors. In fiscal year 1997, Japan has pledged to grant Vietnam an ODA package of US$ 850 million. Several Japanese-funded ODA projects implemented in Vietnam include: the Pha Lai thermo-electric power plant (US$ 830 million), the Phu My thermo-electric power plant (US$ 600 million), the Ham Thuan-Da Mi hydroelectric power plant (US$ 527 million). There are a number of additional projects with a capital investment of US$100-200 million each. Most of these projects are in the form of soft loans, with the exception of the Cai Lo fishing port project, valued at US$ 10 million, and other technical assistance projects worth US$ 10 million, which use non-refundable aid.

Vietnam's second largest ODA provider is the World Bank, which established relations with Vietnam in October 1993. The World Bank has offered Vietnam US$ 1, 350 million in ODA to date. This huge sum has been concentrated in the fields of communications, irrigation, energy, agriculture, education and healthcare. The World Bank has provided preferential credit supply conditions to Vietnam, which are being implemented via international bidding. Over the past few years, the World

Table 4: Disbursement of ODA

Sector of ODA disbursement	Amount disbursed (Million US$)	Total ODA disbursed (percentage)
Industry	105	6.07
Agriculture, forestry and water conservancy	115.3	6.66
Transport	138.7	8.92
Water supply	88.99	5.14
Public health and social activities	248.83	14.26
Education, research and cultural activities	126.24	7.29
Other sectors	655.13	38.44
Programs and projects funded by NGOs	170.8	9.87

Bank has worked out a cooperative development strategy with Vietnam, and on that basis, delineated annual lending programs. The World Bank assists Vietnam in renovating and upgrading its economic infrastructure, strengthening institutions, developing social services and human resources, as well as effectively controlling Vietnam's abundant natural resources and protecting the environment.

The Asian Development Bank (ADB) is the third largest donor. Since October 1993, the ADB has supplied Vietnam with US$1,006 million in ODA. In the coming years, the ADB is expected to offer Vietnam US$300-350 million in ODA and approximately US$9-10 million in technical grant aid annually. This level will remain intact until the end of the century. In fiscal year 1997, the ADB undertakes to grant Vietnam US$ 422 million, while showing its commitment to help Vietnam obtain and utilize ODA resources more effectively. The ADB has helped Vietnam in the fields of infrastructure, construction, agriculture and rural development, technical aid and economic structural transformation. The ADB has taken part in upgrading Highway 1 via two projects valued at a total US$ 310 million (US$240 million of which is financed by the ADB). The first project involves the restoration of 435 kilometers of road from Ho Chi Minh City to Nha Trang (this project involves US$141 million, $US120 million of which is financed by the ADB). The second will upgrade a 168 kilometer long section of the Hanoi-Lang Son road (valued at US$162 million, again with US$120 million in funding controlled by the ADB). Moreover, the ADB has financed two additional projects dealing with flood control and irrigation capitalized at US$136.5 million. The ADB has officially granted US$69 million within 40 years, with an annual service fee of 1% to help build a clean water supply system for seven cities and towns. The Thu Duc water refinery is being built using ADB loans.

By 1994, Vietnam had borrowed US$80 million from the ADB in an attempt to accelerate local agricultural development and this was expected to be completely disbursed in late 1996. An ADB-funded rural finance project was planned for early 1997. The project is funded by a US$93 million loan with an annual interest rate of 1% and a 40-year duration. US$50 million is committed to rural credit development. The amount of capital committed to projects on technical assistance and economic restructuring by the ADB in the fields of finance, banking, and administrative institutions reaches tens of millions of dollars each year. The ADB recently adopted a financial assistance program for Vietnam. Accordingly, Vietnam will be given US$90 million in loans and approximately US$850,000 in technical aid. The program is aimed at strengthening managerial skills in Vietnam's financial system and mobilizing/utilizing domestic savings. Other donors have also contributed a great deal to socio-economic adjustment in Vietnam over the past several years. Each donor has operated its own program commensurate with its financial ability and interest in promoting cooperation with Vietnam.

To facilitate external economic activities, the Vietnamese Government has adjusted its mechanisms of import-export tariffs and quotas, revised the law on foreign investment, and issued a number of regulatory documents on ODA and foreign debt management. This can be attributed to administrative reforms aimed at shortening time and simplifying procedures for licensing foreign investment projects. Vietnam has been attempting to adjust its legal system, bringing it in line with international practices.

Vietnam Joining ASEAN

Vietnam had meaningful relations with the ASEAN countries even before becoming a full member of the Association, particularly in the areas of trade and foreign direct investment. Up to December 1995, Singapore was ASEAN's largest investor in Vietnam, with total pledged investment capital of more than US$1,524 million. Malaysia held US$847 million; Thailand, US$463 million; the Philippines, US$217 million; and Indonesia, US$ 194 million. ASEAN accounts for about 18% of FDI in Vietnam.

Ministry of Commerce statistics show that since 1990, trade between ASEAN and Vietnam has been growing at an annual rate of 26.8%. Exports to Vietnam make up 30-50% of Vietnam's total exports. Trade flow between Vietnam and ASEAN underwent a 20-fold increase over the last ten years, rising from US$120 million in 1986 to US$ 2.5 billion in 1995.

In July 1995, Vietnam became a full member of ASEAN. In keeping with the agreed-upon scheme of tariff reduction from 1 January 1996 to 1 January 2003, Vietnam is to apply import tariff rates from 0 to 5% in the following 15 commodity groups: vegetable oils; cement; chemicals; pharmaceuticals; fertilizers; plastics; rubber products; leather products; wood pulp; textiles; ceramics and glass products; gems and jewelry; copper cathodes; electronics; and wooden and rattan furniture.

What is of concern to everyone is whether an economy with the limited competitiveness of Vietnam would be shocked by the massive penetration into its markets of goods from neighboring countries, and how the government would protect domestic production. Preliminary figures indicate relative optimism. According to Ministry of Finance statistics, 57% of the above-mentioned 15 groups of commodities are presently being levied import tariff rates between 0 and 5%. In fact, the tariff rate for 52% of them are already at zero. As such, for the initial period of 1996-99, the projected loss of tax revenue owing to lower tariff fates will not be sizable – it will range from VND 1000 billion to VND 2000 billion, of the VND 10,000 billion of import taxes from ASEAN countries, because the new CEPT tariff rates on the initial items chosen for tariff reduction do not differ substantially from current rates. The Government may reduce the tax base for lower tariff rates (0-2%) and expand the tax base for 3-5% tariff rates in order to make up the losses. As for various items that undergo drastic tariff cuts, such as automobiles (from 200%, to 60%), an excise tax will be levied.

Automobiles assembled in Vietnam will be exempt from excise taxes, but subject to a 4% sales tax. In addition, the participation of the 13 joint ventures in Vietnam's automobile industry helps meet the demand for automobiles in the domestic market and enhances the possibility of continued tariff cuts for automobile imports in the early 21st century. A Temporary Exclusion List includes some sensitive items for which tariff cuts will be delayed according to an agreed upon time frame.

Based upon the practical developments described above and preliminary calculations, several remarks about Vietnam-ASEAN and/or Vietnam-AFTA relations may be made:

1. Vietnam may take part in ASEAN economic programs, particularly the AFTA scheme, but it needs to take careful consideration and a gradual approach prior to "big-bang" action and full participation.

2. Vietnam may also cooperate in other socio-economic and environmental programs in Southeast Asia, such as the Mekong Project, growth triangles, the trans-Asia route, and so on.

3. To participate in the AFTA process, Vietnam needs to overcome possible disadvantages, such as:

    - Reduction of budget revenues following tariff cuts
    - Weak competitiveness of Vietnam's products
    - Negative impact of smuggling on the domestic market
    - The intrusion of backward and polluting technologies from other ASEAN countries into Vietnam
    - Other disadvantages due to the low level of economic development and the constraints in capital and technology of Vietnam

Vietnam is now embarking on a new period of industrialization. It is, therefore, necessary to analyze the implications and impacts of AFTA on that new process.

Market

Market expansion is one of the biggest objectives of AFTA and a major requirement in Vietnam's industrialization. It is easy to understand that a ten-country regional market, with a population of 500 million, and a purchasing power of US$1,300 billion is more advantageous to production and business than ten separate markets with a few dozen million inhabitants each (only Indonesia has a population of 200 million) and a puchasing power of a few hundred billion US dollars.

Vietnam is one of the least economically developed countries in ASEAN, with one of the lowest levels of per-capita purchasing power. It has just begun the first phase of industrialization, while other members are in their second phase of industrial revolution. For Vietnam, expanding the market for exports and imports is crucial.

One can now see, in retrospect, that even prior to Vietnam's entry into AFTA, the ASEAN markets made an important contribution to Vietnam's switch to the market economy, particularly at a time when markets in the former USSR and East European countries were almost closed, while access to those in Japan, Western Europe and the USA was still hindered by the US embargo. For five years now, the ASEAN markets have accounted for one-third of Vietnam's total foreign trade. In the next 20 years, this ratio may decline due to possible growth in trade with Japan and the US, but it will not become less than one-fourth of total foreign trade. This means that the ASEAN market continues to play a major role in Vietnam's industrialization. (Table 5) Hopefully, AFTA's steps for trade liberalization, including tariff reduction and curtailment of non-tariff barriers, will create an even more liberal and favorable framework for regional trade.

Table 5: Trade between Vietnam and former 5 ASEAN members (US$ million)

Country	1991		1992		1993		1994		1995		1996	
	export	import	export	import	export	import	export	import	export	import	export	import
Indonesia	21.0	49.4	10.9	70.5	18.9	84.5	44.4	102.7	55.8	190.0	45.7	154.3
Malaysia	15.3	6.2	68.4	35.9	.8	24.8	67.5	64.5	104.5	190.5	7.7	372.3
Philippines	1.21	10.6	1.0	0.5	1.6	1.9	4.0	21.2	42.5	24.6	132.0	173.0
Singapore	428.0	722.2	510.3	876.8	380.3	1058.3	592.8	1170.7	678.8	1425.2	1889.4	2660.6
Thailand	78.1	14.2	75.4	41.2	71.8	99.5	116.6	236.0	100.8	440.0	107.4	532.6
ASEAN 5	543.6	802.6	666.0	1024.9	528.4	1269.0	825.3	1595.1	982.4	2270.3	2252.2	3892.8
With the world	2087.1	2338.1	2580.7	2540.7	2985.2	3924.0	4054.0	5825.8	5448.9	8155.4	7255.0	11143.0

Sources: Department of Planning and Statistics, Ministry of Commerce; General Department of Customs; **Foreign Trade**, Weekly, 22-28 January 1997; **Nhan Dan Daily**, 20-12-1996; Vietnam-Indonesia **Seminar, Hanoi, 21 March 1997; International Weekly**, 2-8 April 1997

At present, intra-ASEAN trade remains small, accounting for only about 20% of ASEAN's foreign trade. This is still far behind the ratio of intra-NAFTA (40%) and intra-EU (60%) trade. The following limitations account for the low ratio of intra-ASEAN trade:

- ASEAN economies remain less developed
- The purchasing power of the ASEAN market is still small
- The degree of liberalization of ASEAN markets is not as high as that of the EU and NAFTA

By the year 2020, more developed ASEAN economies such as Singapore, Malaysia and Thailand, will have completed the second stage of industrialization and will become developed economies. Less developed economies, such as Vietnam, will have completed the first stage of industrialization and will become newly industrialized economies similar to the present NIEs. Under such conditions, the above-mentioned limitations will have been overcome and intra-ASEAN trade will grow to 30% or more, though not possibly 40% or 60% as is the present case with NAFTA and the EU. By this time, Vietnam's trade with other ASEAN members would again account for one-third of its foreign trade, possibly even more. One may conclude that ASEAN is and likely will continue to be one of the three or four largest markets for Vietnam, until at least the year 2020.

Production

Unlike previous ASEAN industrialization projects (such as AIP), AFTA is designed to impact first on the market, and this in turn, will stimulate production. In other words, AFTA aims first at expanding demand, while the AIP focused initially on supply and, consequently, could only achieve low levels of efficiency, because supply could not find sufficient demand. For AFTA, expanding the market means expanding demand. The question is, will expanding demand truly lead to the expansion of supply and increased production?

According to authors Truong Chi Trung and Vu Tuan Anh, Vietnam's exports to ASEAN have accounted for one-fourth of Vietnam's total exports, while imports from ASEAN have accounted for one third of Vietnam's total imports, thus resulting in a trade deficit on the part of Vietnam. While Vietnam's exports have registered some growth, particularly thanks to crude oil exports to Singapore, there is little prospect of a strong rise in exports, due to their composition. Vietnam's exports to ASEAN comprise: crude oil; rice; beans; rubber; tea; maize; cashew nuts; pepper; fresh vegetables; aqua-products; steel, wood, coal, tin, tanned leather; and handicrafts. Vietnam's agro-exports, which the other ASEAN partners have included in the CEPT list for immediate effect, only acccount for a small ratio. Its main exports, however, crude oil and non-processed agro-products, account for nearly all of its export turnover. As major tax cuts envisaged under CEPT only apply to manufactured goods, the main incentives provided by CEPT ignore these other goods, so important to Vietnam's trade balance.

Thus, with its existing export composition, Vietnam can derive only negligible benefit from AFTA. If Vietnam's export composition could be restructured in such a way as to bring about strong growth in manufactured goods, a substantial tax cut would consitute a valuable incentive to producers of export goods. Only after such a restructuring could Vietnam produce and export goods included in the tax cut list of the CEPT and Vietnamese exporters enjoy favorable price conditions.

In its exports to non-ASEAN markets, Vietnam may benefit from AFTA in terms of lower production costs, resulting from cheaper inputs acquired from ASEAN countries. Of course, one should remember that other ASEAN countries also export similar goods to foreign markets and these countries could enjoy similar benefits from AFTA and also increase their own competitiveness.

Vietnam mainly imports raw materials, production materials and industrial goods from the ASEAN economies, including: aluminum; cement; chemicals; electronic goods; chemical fertilizers; medicines; paper; oil and lubricants; insecticides; plastics; steel; and transport equipment. More than half of the imports from ASEAN countries are subject to a tax rate of less than 5% and comprise materials for production and essential consumer goods; 857 items belonging to this group have been added for inclusion in the CEPT list beginning in January 1996, and they do not impact in any way on domestic production and trade.

There is ground for apprehension that Vietnam will face serious challenges due to its lower level of economic development and competitiveness as it joins AFTA. At present, Vietnam is flooded with foreign goods (cloth; footwear; mechanical goods; electric appliances; ceramics and glassware; cement; laminated steel, etc.) which trouble many domestic industries, even while considerable tariff barriers are being maintained. More worrying still is the case of capital-intensive and high-tech industries, where the gap in development levels is still very obvious.

As protective barriers are removed, domestic production will certainly experience greater pressure. This would go a long way in stimulating the improvement of techniques, technology and business efficiency of production units and moreover, would compel Vietnam to restructure production by ending the production of goods which are not competitive and increasing the production of competitive ones. Of course, preferential treatment, in terms of development loans and other incentives, must be given to labor intensive units which produce staple consumer goods and goods with high value added.

Capital from ASEAN countries also plays an important role in Vietnam's development. While ASEAN countries have not yet attained the level of the industrially developed countries and do not have a large volume of capital and are still actively inducing foreign investment, some have accumulated relatively substantial capital, can invest, and are investing in less developed markets like Vietnam. By mid-1997, ASEAN direct investment in Vietnam reached about $7 billion (of the $30 billion in total FDI in Vietnam). Three ASEAN members, Singapore, Malaysia, and Thailand, are among the top ten foreign investors in Vietnam (Table 6).

Table 6: Top 10 Foreign Investors in Vietnam (1988 – 8 May 1997)

	US$ billion
1. Singapore	4.82
2. Taiwan	4.21
3. Hong Kong	3.46
4. Japan	2.89
5. South Koea	2.50
6. U.S.A.	1.12
7. Malaysia	1.10
8. Thailand	1.03
9. British Ireland	0.95
10. France	0.85
Subtotal	22.93
Total number of projects	2030
Total capital	30.5

Other ASEAN member investments in Vietnam: Indonesia, $340 million; Philippines, $230 million; Brunei, $10 million; Laos, 3 small projects; Kampuchea, 1 small project.

Source: Ministry of Planning and Investment

ASEAN investment projects focus on assembly industries, hotel and tourism. They do not involve large single amounts of capital and few involve high-tech industries. They are labor-intensive projects with technologies that are appropriate and can generate earnings quickly. In the coming years, it is possible that ASEAN direct investment in Vietnam will grow vigorously in services, trade, and small-medium size manufacturing.

At present, most ASEAN countries have entered the second phase of industrialization, involving both industrial expansion and technological improvement. Many ASEAN investors envisage the relocation of many labor-intensive industries, as they have seen their comparative advantage in cheap labor eroding, and as a result, are interested in developing production in the Vietnamese market. Vietnam's entry into AFTA creates some favorable conditions for these investors in terms of administrative procedure and mentality. In addition, non-ASEAN businesses will increase investment in Vietnam and other ASEAN countries, where dynamic development and an improved investment environment are further enhanced via AFTA. In this context, Vietnam will also be able to increase investment, and hence, production.

Structural Complementarity

Through the above analysis, one sees that implementing AFTA would lead to market expansion and trade liberalization, which would, in turn, play an important role in increasing the flow of goods, capital, labor and technology among ASEAN members, thus helping to promote restructuring and industrialization in ASEAN countries, including Vietnam.

The restructuring may involve a "structural complementarity" among ASEAN members: more developed ASEAN members try to overcome the limitations of labor-intensive, low-tech industries by gradually relocating them to less developed countries in order to shift rapidly to more advanced industries and a higher degree of modernization, while the recipient countries take advantage of their own abundant, inexpensive labor, appropriate technologies, and the experience of their predecessors in order to accelerate their industrialization and "narrow the gap". This conclusion by no means ignores the difficulties and limitations, such as competition, between more and less developed members – the difficulties of "mutual complementarity" due to structural similarity. Yet, in our view, the obstacles engendered by such difficulties cannot hinder the progress of economic complementarity and "narrowing the gap" which has evolved, and continues to evolve, just as ASEAN countries have succeeded in shifting from confrontation, to dialogue and cooperation for the sake of development.

During the debate on Vietnam's joining ASEAN, generally, and more particularly, in joining AFTA, many argued that ASEAN members would face more competition than cooperation because of their economies' structural similarities. This arguement was based mainly on analysis of sectoral structure, which assumed that all the countries in the region are developing economies which have surplus labor and which produce and export the same tropical products and compete with one another for foreign direct investment. In practice, the ASEAN countries have undergone a great deal of change. Development levels now vary and comparative advantages in the factors of production and commodity structure are quite different from those of the 1950s and 1960s, when these economies began to industrialize. Based on these changes in commercial and production factors, it is reasonable to assume the possibility of structural complementarity among the ASEAN economies, although to a lesser extent at the present stage.

A 1991 study entitled “A Free Trade Area – Implications for ASEAN” by Imada Pearl, Seiji Naya and Manuel Montes predicted change, albeit minimal change, in production patterns of the ASEAN economies following the implementation of AFTA. The study argued that the following shift in the distribution of industrial activities in ASEAN would occur:

1. For Indonesia, the largest percentage increases in overall production would occur in labor-intensive and resource-intensive industries, such as textiles, garments, wood products, paper and paper products.

2. For Malaysia, production increases would occur in relatively labor intensive sectors, including clothing and wood products. Also, significant increases would occur in the more capital-intensive machinery sector and declines would take place in food products, paper and paper products, glass and glass products, non-metal goods and machinery.

3. For the Philippines, the largest production increase would be in more capital-intensive production, including non-metal manufactures, electrical and non-electrical machinery, with small declines in wood products and industrial chemicals. The impact could be small for the Philippines, because of little or no trade with other ASEAN countries in many industries.

4. For Singapore, production in capital and skill intensive industries would increase. Significant declines in labor intensive industries were also expected. A caution is in order when examining the impact on Singapore’s economy, as Singapore’s production for the domestic market is relatively small when compared with its imports.

5. Thailand would substantially increase production in food products. Smaller increases were expected in electrical machinery, leather products, metal and non-metal products. There would be a decline in wood products, non-electrical machinery, and industrial chemical industries.

Though the change is not large, it demonstrates a new trend of structural complementarity among ASEAN economies. It is also likely that the more ASEAN economies industrialize, the greater the extent of their structural complementarity will be. As analyzed above, with the implementation of AFTA, Singapore and Malaysia would increase capital and technology-intensive industries and high-skill services, while reducing (or at least slowing their growth rate) in labor and natural resource-intensive industries. As for the Philippines, Indonesia and Thailand, production increases would occur at a higher rate in labor and natural-resource-intensive industries and at a lower rate in capital and technology-intensive industries and skilled services. Vietnam, Cambodia and Laos would be included in the latter group, along with the Philippines, Indonesia and Thailand.

The above-described trends were analyzed by scientists, but were also expected by policy makers. In a meeting of Malaysia’s Minister of Foreign Affairs and the Vietnam-Malysia Coordination Committee on 19 October 1996, Prime Minister Vo Van Kiet urged businessmen in both countries to cooperate in developing the areas of labor, tourism and natural resources – particularly oil and gas, the rubber industry, and agriculture. ASEAN Secretary General Aris Sinh, during his visit to Vietnam in October 1996, also stated that the Vietnamese economy would complement shortages in other ASEAN economies, thus increasing trade with other members. In his view, Vietnam would have great prospect for ASEAN investment in a number of areas, particularly in tourism, infrastructure, natural resources, and production. These trends would, of course, change as the comparative advantage of each country changed. Structural complementarity has also grown in recent years through the formation and operation of new growth triangles among a number of countries in the region.

Since Vietnam joined ASEAN in 1995, and AFTA in 1996, economic cooperation between Vietnam and other ASEAN members has become more active. Dozens of bilateral economic and trade agreements have been concluded. Both trade and FDI have grown faster than in previous years. In 1996 alone, Singapore's investments in Vietnam increased to nearly US$3 billion. Singapore thus became Vietnam's number one investor, replacing Taiwan which had occupied the position for years (appendix Chart 10).

Finally, it is necessary to stress that Vietnam, having joined ASEAN and AFTA, is in the same boat and should cooperate with other members in observing the rules of the game. These rules have found their reflection in three major trends governing the process of development in ASEAN – namely, liberalization, export-orientation and economic complementarity. These three factors are key to ASEAN's past, present and future success in the race to new heights of development.

Future Prospects

At present, there are at least three projections for future development in Vietnam. The first is the Strategy for Socio-Economic Development toward the year 2000. One of the key targets in this strategy is to acquire an annual GDP growth rate of 9-10%, doubling per capita income from $200 in 1990, to $400 by the year 2000 (Table 7). This plan is likely to be fulfilled, based on achievements so far from 1991-97 and given likely trends of development in coming years.

Table 7: Capital requirements to achieve annual GDP Growth of 9-10.5%

	1994	1995	1996	1997	1998	1999	2000
Domestic sources	2,585	3,497	3,971	4,568	5,431	6,658	8,185
Domestic sources (% of GDP)	16.7	18.9	19.7	20.6	22.4	25.0	27.8
Government investment	789	1,096	1,474	1,937	2,568	3,375	4,365
Sources from other sectors	1,787	2,401	2,497	2,625	2,863	3,283	3,820
Foreign loans	272	53.5	690	904	900	900	900
FDI	650	900	1,080	1,296	1,490	1,714	1,971
Total investment sources	3,748	4,892	5,747	6,763	7,821	9,272	11,056
Total investment (% of GDP)	24.2	26.7	28.5	30.6	32.3	34.8	37.5

The other two offer variant plans for development from the year 2000 toward 2025 (Table 8, appendix Charts 11 and 12). The first is to acquire an annual growth rate of 8-9%, reaching a per capita income of about $1,900 by the end of the period. The second aims at a growth rate of 10-12% and a per capita income of $3,559 by 2025. Many people in Vietnam now believe the first alternative is more realistic and feasible than the second, taking into account the difficulties Vietnam has faced during its

Table 8: Vietnam's Long Term Economic Development

Variant 1	1994	2000	2005	2010	2015	2020	2025
GDP ($US billion)	15.5	26.1	41.6	65.8	100	150	220
Average growth rate, 5 years		9.1%	9.8%	9.6%	8.7%	8.4%	8.0
Per capita GDP ($US)	214	320	466	677	952	1,337	1,872
Urban per capita GDP ($US)	727	986	1,324	1,790	2,154	2,409	2,716
Rural per capita GDP ($US)	93	115	145	180	230	320	500
Rural GDP ($US billion)	5.4	7.2	9.4	12.1	15.1	18.4	22.3
Growth		5.0	4.7	4.2	3.7	3.3	3.3
Degree of urbanization	19.2	23.5	27.2	30.8	37.5	48.7	61.9
Variant 2							
GDP ($US billion)	15.5	26.9	46.1	81.2	148.9	259.4	417.7
Average growth rate, 5 years		9.7	11.4	12.1	12.8	11.7	10.0
Per capita GDP ($US)	214	330	515	839	1,418	2,320	3,550
Urban per capita GDP ($US)	727	747	686	1,227	1,886	2,845	4,118
Rural per capita GDP ($US)	93	130	200	300	450	700	1,100
Rural GDP ($US billion)	5.4	7.2	9.4	12.1	15.1	19.2	23.9
Growth		5.0	4.7	4.4	3.9	3.7	3.7
Degree of urbanization	19.2	32.3	47.2	58.1	67.4	75.5	81.5

transition toward a market economy and a new period of industrialization. This is particularly clear, given the problems concerning poor social and economic infrastructure, bureaucracy and corruption, and most especially, the most recent indicators of less competitiveness: increased trade and current account deficits, the slow-down in the growth rates of GDP and FDI and regional monetary and financial turmoil. In conclusion, I quote Manuel F. Montes: Though there are problems and difficulties, the Vietnamese economy is in "relatively fast growth" and "can continue to grow quite vigorously."

Table 9: Vietnam's Economy
1997 Achievements and 1998 Plan

	1997*	**1998**
GDP Growth - % over previous year	9	9
Agriculture Growth - % over previous year (million tons)	4.8 (30.6)	4.7 (31.0)
Industrial Growth - % over previous year	13.2	13.5
Service Growth - % over previous year	9.5	
Total Investment (% GDP)	28	34.7
FDI (US$ billion)	5.548[a]	
Exports, US$ billion (% increase)	8.9 (22)	11 (25)
Imports, US$ billion (% increase)	11.2 (0.5)	13.2 (18)
Trade Deficit (%)	37.5[b]	20[c]
Inflation	3.6	< 7
State Budget (%)	5.3[d] 10.1[e]	20[f]
State Budget Deficit (% GDP)	4.8	3.5-4
Population Growth	-0.08	1.8

*Targets not reached in 1997: Industrial growth (14-14.5%); Services (12-12.5%); Exports (27%)
[a] Registered capital reduced 40%; realized capital increased 34%
[b] Decrease compared to 1996
[c] Less than exports
[d] Revenue increase
[e] Spending increase
[f] Revenue/GDP

Source: Nhan Dan, 1 January 1998

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