

WORKING PAPER

2003

Department of Economics
Tufts University
Medford, MA 02155
(617) 627 – 3560
<http://ase.tufts.edu/econ>



Vietnam Program
CENTER FOR BUSINESS AND GOVERNMENT
79 John F. Kennedy Street, Cambridge, MA 02138

tel: 617-495-1134
fax: 617-496-5245
david_dapice@harvard.edu

**Vietnam's Economy: Success Story or Weird Dualism?
A SWOT Analysis**

David O. Dapice

**Prepared for
United Nations Development Programme &
Prime Minister's Research Commission**

May, 2003

Vietnam's Economy: Success Story or Weird Dualism? A SWOT Analysis¹

By Professor David Dapice, Tufts University and Senior Fellow, Kennedy School
Vietnam Program

Background

Vietnam has been widely praised as a success story. The previous country director of the World Bank, Professor Joseph Stiglitz, and many government officials in Hanoi point to various indicators of success: a projected 7% rate of growth, healthy exports, good progress with poverty reduction, improving social indicators and low inflation. Vietnam is now the second largest borrower from the World Bank – a sign to many of its superior management and prospects. Indeed, in the first four months of 2003, exports were 38% higher than the year-earlier period! Foreign tourism is approaching 3 million and Vietnam is getting benefits from having a low terrorist risk profile and the Bilateral Trade Agreement with the US. (In spite of protectionist catfish tariffs, exports to the US rose from \$1 billion in 2001 to \$2.4 billion in 2002.) It also seems to be evading any long-lasting impact from SARS. Vietnam could be among the fastest growing “normal” economies in the world in 2003. This is surely success.

Others are more cautious, arguing that in spite of rapid private sector growth, there are several worrisome trends. FDI inflows have been modest compared with the 1990's and also relative to China. Ratings of Vietnam on corruption and other international lists are poor. The amount of investment needed to produce 1% of GDP growth has gone up sharply – suggesting major inefficiencies in investment allocation. Financial and SOE reform is very sluggish. Preparation for WTO accession is lagging, and delaying entry into the WTO would slow export growth. Progress in information technology and education is lagging far behind China. There is a huge and growing gap between rural and urban incomes, perhaps setting the stage for massive movements of people into cities that are poorly equipped to absorb them. Surely, here are reasons to be concerned.

A standard approach in business is to conduct something called “SWOT” analysis. This looks at the Strengths, Weaknesses, Opportunities and Threats facing a business. This paper will conduct a rudimentary SWOT analysis for the economy of Vietnam. Before beginning the analysis, there will be a brief digression to explain the word “dualism.”

¹ Acknowledgements: The author wishes to thank the Prime Minister's Research Commission and its Senior Advisor Luu Bich Ho; the UNDP and its Resident Representative Jordan Ryan, and the Asia Foundation and its Representative Jonathan Stromseth for various types of support, intellectual and financial, in the writing of this paper. The section on Danang was written by Nguyen Xuan Thanh and summarized by Pham Vu Lua Ha. Both Nguyen Tuan Anh and Lua Ha helped analyze provincial and regional development patterns. Truong Si Anh provided information and analysis of the IT situation in Vietnam. My four Vietnamese colleagues are members of the faculty and staff of the Fulbright School in Ho Chi Minh City. Any mistakes, however, are the responsibility of the author.

A Digression to Explain Dualism

The title of this paper uses the word “dualism.” This comes from economic development theory. It refers to an economy with a “traditional” sector such as agriculture with a lot of labor and low average and especially marginal returns.² This means wages are low, and work is often not available year round. This sector is said to have limited growth prospects. Then there is a “modern” sector such as industry or higher-level services. This sector will have better productivity and pay, growth prospects, and technology. It makes profits and reinvests them, absorbing a lot of labor from the traditional sector, thereby raising wages and productivity. This two-sector model, associated with Arthur Lewis and later economists who refined his ideas, is a classic description of how an economy might develop. Labor flows from a low productivity and slow growing sector to a fast growing and high productivity sector that uses technology efficiently to make profits to invest.

Strengths of Vietnam’s Economy

Vietnam had a very successful decade in the 1990’s, growing very fast in the 1990-97 period and avoiding the worst of the economic crisis afterwards. The degree of strength in the more recent period of the current decade is less dramatic but still striking.

1. GDP Growth: If we look at the period from 1998 to 2002, the Asian Development Bank estimates growth at 5.5% a year, about the same as India and much slower than China and Bangladesh. (Official data show over 6% growth; the IMF estimates less than 5%.) Projections for 2003 are 6-7%, with some uncertainty due to the world economy and SARS.
2. Exports: A bright spot has been exports, which have risen from \$9.1 billion in 1997 to \$16.5 billion in 2002, a growth rate of over 12% a year. This is much faster than most other countries, and about the same as China.
3. Manufacturing: Manufacturing growth has also been healthy, averaging about 10% a year in real GDP terms from 1998 to 2002. The growth of gross industrial output has been faster, at over 14% a year from 1998 to 2002.
4. Macroeconomic Stability: Inflation is low and fiscal deficits have been contained to acceptable levels. Reported bad bank loans are falling to levels that can be managed – less than 10% of total credit outstanding. External debt is acceptable.
5. Private Investment: The most dynamic sector since 2000 when the Enterprise Law was passed has been the private formal domestic sector. Industry for this form of ownership, which excludes household level activity, has since 1999 grown nearly 20% a year, albeit from a low initial base. The entire formal private sector created 1.75 million new jobs from 2000 to 2002, compared to near zero growth in jobs for the entire public sector.

² To be precise, adding or subtracting a few percent of workers would not change output very much.

6. Poverty Reduction: Poverty rates measured at international levels have declined from 58% in 1992/3 to 37% in 1997/98 to about 32% now. This near halving of poverty rates in ten years is a remarkable accomplishment, and has been accompanied by rapid increases in enrollment ratios at all levels and improvements in health and nutrition.³ Inequality, while rising, is still low by international standards.

This is already a considerable list, and one that can give the Vietnamese leadership a degree of justified pride. Other successes, such as a rapid increase in telephone lines and mobile handsets, or the robust doubling from 1995 to 2002 in tourism, are also noteworthy, though not listed in the six major points. Still more positive items could be listed such as progress in improving infrastructure and increased prosperity among many ordinary Vietnamese. It is not surprising that Vietnamese were the most optimistic people of the 44 countries covered in an international survey conducted by the Pew Research Center concerning their future expectations as reported in the International Herald Tribune on December 5, 2002.

Discussion

The success of Vietnam during 1998-2002 can be compared to the average for developing Asia, which of course is heavily influenced by China. The five-year average growth for this part of Asia was 5.8% according to the IMF, while they estimated growth for Vietnam at 4.8% a year during the same period. If the ADB figure of 5.5% for Vietnam is used instead, then Vietnam did slightly worse than average but better than most other nations. This is good but short of great.

Export growth, however, is an unambiguous success. During 1998-2002 developing Asia's exports in dollars grew at 8% a year while Vietnam's grew at 12% a year. Vietnam saw strong growth in garments and shoes, with one doubling and the other growing by 80% in the period. These are competitive industries and Vietnam's ability to take a growing share of global exports indicates its ability to compete in world markets. That Vietnam managed this growth even with rice and coffee exports down \$600 million is also encouraging, though the offsetting rapid growth (more than doubling to over \$2 billion) in sea products was a help and will not be repeated. The exports not accounted for by any of the major categories such as agriculture, coal and crude oil, garments, shoes, or sea products also managed to grow very fast – over 80%. This suggests that there are many other products and industries that are finding foreign sales. This is a good sign of healthy development, as it is risky to rely on just a few major exports.⁴

³ There are a number of ways to measure social progress, but the Human Development Index of the UNDP is widely used. With 1.0 being a perfect score, Vietnam was .68, up from .58 in 1985. This is higher than Indonesia and only a bit below China's .72. However, the Philippines, Thailand and Malaysia were all .75 or higher. (UNDP, 2002) The HDI does not factor in the quality of education, aside from literacy.

⁴ Vietnam is not a major oil exporter, but oil exports are the major export for a few nations. This is profitable but still risky for them. As a nation develops, it usually manages to diversify its portfolio of exports and this prevents sector-specific problems from causing major shocks.

The growth in manufacturing is certainly fast, but of uncertain quality. Quite a lot of the output gains have come from highly protected heavy industry that will have to lower their costs of production in the very near future if they are to compete with ASEAN suppliers. A number of state sponsored projects in oil refining and fertilizer continue this approach, even though they are likely to require subsidies and/or protection, either of which – if continued – would allow Vietnam's trading partners to retaliate by imposing higher tariffs. One major area of research is to determine which of these recent investments will be able to lower costs and which ones will face closure or contraction, or subsidies.

The growth in private investment has certainly been rapid. It was already showing signs of acceleration before the Enterprise Law came into effect, but really took off after that. With 54,000 newly registered firms and \$4.7 billion of newly registered capital by year-end 2002 from the end of 1999, this is clearly an important step for Vietnam. In 2001, there were twenty-four provinces that had at least \$10 per capita private investment just in that year. This shows a wider spread than FDI, and suggests that this most dynamic sector will spread its benefits more widely than some had feared. For example, in the Northern Mountain region, seven out of sixteen provinces had investment per capita in 2001 of more than \$10, while four provinces in the same region had well under \$5 per capita. One of the lowest provinces was Son La, which has a good road to Hanoi – so clearly it is not isolation alone that accounts for these differences. Similarly, in 2001 Thanh Hoa had only one-tenth the per capita private investment of Nghe An, and about one-twentieth of Quang Tri. The North Central Coast has drawbacks, but surely one province can do as well as another within the region.

The improvement in school enrollments has been impressive. According to official data, the net primary enrollment rate rose from 70% in 1994/5 to 94% in 1999/2000. Improvements in junior secondary (doubling to 68% in 1999/2000) and upper secondary (jumping from 13% to 32%) were even more striking. Enrollment ratios in secondary school continue to grow. Full-time students in college have also taken off to over 420,000 in 1999 from 173,000 in 1995. Health indicators have improved, with life expectancy now over 68 years, and infant mortality falling from 41 to 27 per 1000 births from 1995 to 2000. This, and progress in reducing malnutrition, all point to wide if not equal gains among broad groups of the population.

Of course, the list above refers to the recent past. Strength usually implies that there will be a capacity to deal with future challenges to growth. There is a tendency to believe that trends will persist, although many countries have found that periods of rapid growth are often followed by various problems that slow growth. There are exceptions to this – the “four dragons” and China all have managed to grow quickly for decades without slowing down, though even the smaller dragons now mostly grow 5% a year or less. SARS may or may not slow China down. (It is not just the disease, but also the under-investment in rural health that created the risk of a disease-related slowdown.) The quality of economic and social policy determines the robustness of an economy. A well-run economy will grow faster for longer because it deals efficiently with challenges and prevents some problems from growing to be too costly. By investigating weaknesses and remedying

them, it is possible to keep the economy and society strong. That is the reason for analyses such as this one.

SARS in Vietnam and China

There is a big difference in the evolution of SARS in China and Vietnam. SARS (Severe Acute Respiratory Syndrome) appears to have originated in southern China in the second half of 2002. Doctors there were aware that a highly infectious disease had taken root, but authorities were very reluctant to publicize it, much less to take aggressive quarantine measures. The result was that it spread into Beijing and Hong Kong as well as other parts of Asia in the early months of 2003. Vietnam had its first case in Hanoi in late February, but the response was very different. A WHO expert was called in, an Italian Doctor who made the diagnosis of a new disease, and who later died from becoming infected. However, his diagnosis triggered an aggressive quarantine and closing of the French hospital in Hanoi where the disease had spread. There was an intense public information campaign and the WHO named Vietnam the very first nation to have had SARS but contained it. In China, the delay of several months allowed it to seep out into rural areas where it may well become endemic. While treatments and a vaccine will eventually appear over the next several years, the damage done to China's economy will be measured in the tens of billions of dollars and has served as a wake-up call to the government about the costs of covering up serious problems. In contrast, Vietnam got highly favorable front-page coverage in the New York Times about its skillful response. It is likely, on balance, to gain from this episode. If the disease does take root in China, it may well again spill over into Vietnam due to the large amount of cross-border activity. However, an alert public, open exchange of information, and the timely use of best-practice global expertise can help contain any future problems.

Weaknesses of Vietnam's Economy

Any discussion of weakness, as of strength, must be relative to some benchmark. To what nation should Vietnam be compared? Obviously, Vietnam had grown very well up to 1997 and relatively well, compared to most nations, after 1998. One meaning of weakness is how sustainable the economic strategy is – will the sources of growth be broadened and renewed or run out of gas? In another sense, is the economic strategy politically sustainable – will it keep the various regions and groups more or less contented or lead to either pressure for unproductive policy changes or movements of people in large and difficult-to-manage numbers? A third way of understanding weakness is to compare Vietnam to the best rather than the average performers. China, for example, is an obvious comparator, but also a very tough one. If we compare Vietnam to China in terms of exports, we get the following table (Table 1):

Table 1*Annual Growth of \$ Exports*

	<u>1995-2002</u>	<u>1997-2002</u>	<u>2000-2002</u>
China	11.8%	12.2%	14.4%
Vietnam	17.9%	12.6%	7.0%

Clearly, Vietnam has slowed down while China has speeded up. Since both faced the same international economy, it must be internal and not external variables driving this disparity. One of the major differences in the two economies has been the trend in foreign direct investment. In terms of inflows, the patterns in \$ per capita terms are as follows (Table 2):

Table 2*Foreign Direct Investment per capita in US Dollars*

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>
China	\$36	\$35	\$31	\$30	\$34	\$41
Vietnam	\$29	\$22	\$18	\$17	\$16	\$17

Source: IMF, International Financial Statistics, line 78bed and estimates for 2002.

Table 2 on per capita foreign direct investment shows that Vietnam started fairly close to China in 1997, but lost far more ground afterwards. Indeed, China has gone on to surpass its previous level while Vietnam is stuck about 40% below its 1997 level. FDI per capita in Vietnam would have to *double* to get back to the same gap as in 1997. Here, again China and Vietnam are both low-income transition economies facing the same world economy. Neither suffered much from the Asian Crisis because of their capital controls and relatively low level of commercial short-term borrowing. Yet Vietnam has had a steep decline while China has fully recovered. Why?

It may be unfair or even irrelevant to compare Vietnam to China. After all, China is a huge market and has characteristics that few other nations can match. On the other hand, Vietnam gets much more foreign aid per capita, has the advantage of significant oil revenues, and also receives \$1 to \$2 billion a year in remittances from overseas Vietnamese. Together, these account for almost 20% of GDP. It also has only about half of the per capita income level of China. Normally, it is easier to grow faster if one's per capita income is low and other factors are similar. That is because borrowing technology or putting investment in place has a large percentage impact when starting from low levels. In other words, an economist would *expect* Vietnam to have certain advantages relative to China, even if China has other advantages such as its ethnic ties to Hong Kong, Taiwan, and Singapore.

If one does not want to compare Vietnam to China, it is certainly possible to compare Vietnam to itself. In 1995 to 1997, Vietnam grew 8.8% a year and invested an average of 27.8% of GDP. That is, it took about 3.2 units of investment to create 1 unit of growth. From 2000 to 2002, using Asian Development Bank data, it took 4.5 investment units to

produce 1 unit of growth – and the ratio is 5.0 if IMF growth rates are used. Why should it take 50% more capital in 2002 to produce the same amount of growth as in the middle 1990’s? One reason could be the slowdown in FDI. Even if the capital provided is not badly needed, the technology, management, and market contacts often are. Alternatively, there has been a growing share of total investment being directed by the public sector. If relatively inefficient infrastructure and poorly chosen heavy industry account for a larger share of capital formation, it would not be surprising if this were reflected in higher capital “requirements” to produce an equal increment of growth.

Another way to compare Vietnam with itself is in the area of FDI. There are several positive elements that should be helping Vietnam attract FDI - its political stability, freedom from terrorism, and advantages from the recent passage of the BTA (trade treaty) with the US. In spite of these advantages, the level of commitments have fallen sharply and are now only about one-quarter of the level in the middle 1990’s, and even 20% lower than immediately after the Asian Crisis. On the other hand, there has been an increase in realized FDI and FDI inflows in 2001-2 compared to 1998-2000. This is due mainly to large energy investments in 2002. Preliminary indications are that registered FDI in 2003 will be lower than in 2002, but inflows and realizations may be slightly higher. Data in the Table 3 are in billions of dollars.

The inflows from 1995 to 2002 equal about \$11 billion, of which \$3 billion are in the oil and gas sector. There are about 400,000 jobs in foreign enterprises, very few of which are in oil and gas. So it takes about \$20,000 in FDI to create one job, though it is very much lower in light industry (about \$2 billion in investment), which accounts for most of the jobs created. However, the level of inflows in recent years are still only about half of that in the middle 1990’s. In addition, a good deal of FDI has been in highly protected joint ventures, and these tend to resemble the high-cost state enterprises in many ways. Not all FDI is equally good for growth and jobs, as the later box on sugar suggests.

Table 3			
<i>Various Measures of FDI in Vietnam at Annual Rates</i>			
	<u>1995-97</u>	<u>1998-2000</u>	<u>2001-2002</u>
Registered FDI	\$7. 2	\$2. 5	\$2. 0
Realized FDI	\$2. 6	\$2. 1	\$2. 3
Inflows FDI	\$2. 1	\$0. 8	\$1. 1

These data are a mixture of IMF and MPI data that are sometimes inconsistent. This can be due to the periodic downward revision of registered FDI if the investments are delayed too long, or upward if increases are approved. In general, original registered FDI is used. Inflows are based on IMF estimates using foreign equity inflows plus foreign borrowings. The realized FDI includes all types of funds, including those from Vietnamese partners.

Weird Dualism in Vietnam

Why is Vietnam different from China and its own recent past? Recall the “dualism” model described earlier. First of all, if there has been a “modern” sector in the sense of having a large and growing share of investment, it is the state sector. It accounted for 41% of total investment in 1993-96 and 56% in 2001-02. Yet the state sector has accounted for few jobs in this period – only 2% of total employment growth since 1998. In spite of its large share of investment, the state has a falling output share in non-agricultural sectors relative to the others that had much less investment. For example, the state share in industry fell from 50% in 1995 to 37% in January-March 2003. Beyond this, the state enterprises often have a very high degree of protection yet need to borrow large amounts to maintain their growth. Most unregulated monopolists do not need high levels of borrowing because they have super-profits. Over half of SOE investment is funded by credits from state sources, including but not only bank credits.

When a country puts most of its investment funds and almost no labor into a sector that cannot generate its own cash flow or maintain its share of output, even with protection and other advantages, it is not a sign of good economic management. The high-cost state sector, illustrated in the sugar example, shows what happens when self-sufficiency is pursued at all costs. The non-state sectors could create more and more stable jobs and get more output per dong of investment. If they had a larger role, there would be more exports, less debt and higher profits without protection.

Sweet Success or Billion- Dollar Cavity?

According to the World Bank [2002, p. 101], the One Million Ton Sugar Program began in 1995 and resulted in 32 new mills being built for \$750 million, with an additional \$350 million put into infrastructure in the sugar regions. There were already twelve mills, so of the total of 44, “15 are run by central SOE’s, 23 by provincial SOE’s, 3 by joint ventures with foreign investors and 3 are fully foreign owned.” The Bank goes on to say, “But in 2000, market saturation and smuggling [of sugar!] reduced prices to around import parity. At this price, no mills cover all their capital costs, while all small mills can only cover at best 60 to 75% of cash costs.” In 2003, the Vietnam Sugar Association – a group of producers – announced a solution to their problems. They proposed that the state provide VND 200 billion [\$13 million] to cover their losses from exporting 200,000 tons of sugar. [[Saigon Times Daily](#), 2/10/2003, p. 1] That is taxpayers in Vietnam should help make exports of sugar cheaper for foreign buyers so that domestic prices can stay high! The recent local price was \$278 a ton while world sugar prices are \$210-\$218 a ton. Given that 1.1 million tons of sugar are produced, or 200,000 tons more than domestic demand, the cost of sugar production is \$66 million over its value at world prices. One director of a sugar company said that prices would have to come down from VND 7000 to VND 4000 per kg to boost exports and reduce smuggling of sugar. But many sugar mills would shut down and default on bank loans if that happened. So, consumers pay inflated prices while the government pays out huge amounts in annual subsidies or has to repay loans for most of the mills built since 1995. This is an excellent illustration of self-sufficiency and the target mentality colliding with more open trade (AFTA) and the desire of Vietnam to join the world economy.

In the 2000-2002 period there were 1.75 million jobs created in the formal domestic private sector with investment of \$4.7 billion for about \$2700 per job. In the same years, SOE investment from its own cash flow was over \$4 billion and **SOE employment was essentially unchanged. This excludes \$4 billion of “state directed credit,” outside of the banking system much of which flows to state enterprises.** The other state credits are from sources such as the Development Assistance Fund, whose growth is about as large as total bank loans.

It would be one thing if most of the state investment were in necessary inputs such as electricity, where not much labor is used. Some are for roads, which often use military contractors, keeping them busy. But consider the other sort of things that have been financed – sugar plants that cannot cover costs with prices well above the world price. Cement and steel plants complain that even with high tariffs they face losses and provide few jobs. Or consider the proposed refinery at Dung Quat. (See Box, below.) The conclusion regarding many public investments must be that many are not serious economic investments. They will need subsidies or protection to function over time, or they will earn returns lower than their real cost of capital.

What is a Refinery Worth?

In 2002, the value of crude oil exports from Vietnam was \$191/ton. The value of refined product imports was \$202/ton. The difference – also equal to the five-year average – is \$11 per ton. Thus the refining and transport of oil is worth no more than \$11 a ton, on average, to Vietnam. This means that a refinery that processes 6.5 million tons a year has a value of production at world prices, excluding crude oil costs, of \$72 million a year.⁵ [\$11/ton x 6.5 million tons = \$72 million.] The Dung Quat refinery, which will refine 6.5 million tons a year, will cost \$1.5 billion when the cost of interest incurred during the period of construction is added in. The rate of interest charged should be at least 10% a year. Deposits (in dong) are 8.5% for one year. Lending should cost more than deposits, and longer-term loans are more expensive than shorter-term loans. Even commercial borrowing in dollars is in the 8-10% range, but of course the earnings of the refinery will be in dong, as will much of the financing. Therefore, the interest cost alone will be \$150 million a year. In addition, costs of fuel used up in refining, chemicals, labor, repairs, etc. will be about \$50 million a year. Thus, the refined product will cost \$200 million to produce in Vietnam while it is only \$72 million in refining costs if imported. **Each year the refinery operates, on average the government or consumers will pay about \$130 million in excess costs.**

The employment impact of the refinery will be less than 1000 workers after construction is completed. A similar amount loaned to the private sector would produce 500,000 jobs.

An argument is made that Vietnam “needs” a refinery to be modern and industrial. If so, it certainly does not need one far from either raw materials or markets in a typhoon area. While

⁵ There will be times when the difference between refined and crude oil prices will be higher, such as the first months of 2003. There are also times when it is less. The average value is what matters for economic analysis.

foreign oil companies were interested in a refinery close to HCMC, they would not invest in one so far from major consuming centers. They are interested in commercial ventures.

Another argument is made that the refinery must go in its current location for regional balance and to help poor provinces. If oil products were imported and taxed so the cost to consumers was the same as with Dung Quat, there would be \$130 million to spend *each year* on roads, schools, irrigation, power, and markets in the poor provinces. This would have a far larger positive impact on regional development and the lives of the poor.

Investment decisions such as this one cause Vietnam to take on more debt, grow more slowly due to high costs, and create fewer jobs than it could. These decisions need to be reexamined.

The impact of this weird dualism is found in the pattern of incomes earned by rural and urban households. Since 1995 real rural incomes per capita had risen about 13% by 2001-02, while real urban incomes had risen 60%. Since urban incomes started much above rural incomes, the absolute *increase* in urban incomes during this period was **thirteen times** the rural increase.⁶ If more capital flowed to the private sector, there would be more non-farm jobs created and agriculture could reduce its labor force and increase the size of plots, thereby allowing higher income growth per capita. Instead of building high-cost and capital-intensive refineries, fertilizer, steel, sugar and cement plants with government money, there could instead be a greater flow of funds through banks or leasing companies to private firms. Likewise, billions of dollars of investment in infrastructure are being placed in the wrong projects or costing far too much.

Collectively, this explains why it now takes \$5 of investment to get \$1 of growth rather than \$3 or so. If capital intensity could be held to the previous level, growth would not be 5.5% but 8% or more. The slower rate of growth means less progress in reducing poverty and strains on social stability, as decent new jobs are hard to find.

If poverty reduction is a priority, then the stark difference in the *rate* of poverty decline should be of immense concern. In five years (1992/3 to 1997/8), the poverty rate fell from 58% to 37%. This is a decline of 21 percentage points. In the next four to five years, the decline was only about 5 percentage points. While some of the slowdown is due to the decline in certain raw material prices, the larger problem is a slower rate of GDP growth and a pattern of growth that concentrates incomes in the cities and too few jobs to a larger extent than previously. Without the Enterprise Law, the results would have been even less positive than observed. To regain traction in poverty reduction, the combination of improved health, education and infrastructure investment has to be combined with a better allocation of investment and more job creation. This, far more than targeted loans or special anti-poverty work projects, will lift more people above the international poverty line. This means not just a better national but also better provincial strategies.

⁶ The recent crackdown on street vendors in Hanoi is said to be partly due to the desire to discourage the migration of rural folk into the city. ["Neat Streets" in Far Eastern Economic Review, 5/29/03, p. 38]

Imitating Successful Provinces – An Opportunity

The importance of shrewd provincial economic policies may not yet be fully appreciated. There is an immense difference in the ability of provinces to generate growth without government subsidy. Some argue these differences are largely matters of luck or geography. For example, only a few provinces are very good at attracting foreign direct investment. It is widely sensed that FDI tends to be concentrated in a few places, mostly in or near the two major cities of HCMC and Hanoi. In a few other cases it is due to one or a few large projects or some natural resource such as food processing or tourism. According to the MPI at the end of 2002, Hanoi and HCMC and six other nearby provinces accounted for two-thirds of cumulatively implemented FDI.⁷ Another eight provinces accounted for 12% of total FDI, leaving only about 20% for the remaining 45 provinces.⁸ Just for 2002, the top ten provinces accounted for over 90% of FDI. Given that *on average* FDI inflows provide only \$10 to \$15 per capita each year while total investment per capita is \$120 to \$150, it is pretty clear that most provinces will do well to get as much as a few dollars per capita per year from foreign investors.⁹

This does not mean that all but a few provinces should ignore FDI or that they would not find it useful if it came. It only means that most investment and growth will not come from this source. This is not surprising. Many foreign investors want to be close to a major market or want the amenities that a major city provides. While some investors will be attracted to a tourist location, raw material processing, or some other unique local asset, most will prefer to locate where many others already are – or very close to them. Long An and Hai Duong can hope to attract “spillover” FDI but Yen Bai or Nghe An or Dong Thap cannot. Most provinces will not get much FDI in the near future.

What then is left? Clearly, it is DPI or domestic private investment – especially from the formal private sector. This investment has grown rapidly in recent years, especially since the Enterprise Law was made effective in January of 2000. The growth rate has truly been striking. On average, private formal domestic investment was under \$2 per capita in 1997 and just over \$3 in 1999. In 2000, it rose to \$7.40 and in 2001 to \$22, with a rise to about \$25 in 2002. From 2000 to 2002, there were 54 thousand new private firms registered with a capital of \$4.7 billion. As the World Bank points out, the rapid growth is impressive, but has to be balanced against the sector’s tiny initial starting position. Even by 2002, “it [the private formal domestic sector] accounted for less than 4% of total GDP, 6% of output in manufacturing, and about 3% of total employment.”¹⁰ Yet if ways could be found to further hasten this growth, it has one highly desirable aspect: it is more equally spread over Vietnam than FDI and can grow faster than state spending.

⁷ The other six provinces, in descending order, were Dong Nai, Haiphong, Binh Duong, Ba Ria-Vung Tau, Ha Tay, and Vinh Phuc. This is in total amount per province, not total per capita.

⁸ In terms of registered (not implemented) FDI, twelve provinces account for over 90% of the national total.

⁹ The IMF definition of foreign inflows – either equity or debt brought in by the foreign partner – is used here to define investment. Local contributions would be additional.

¹⁰ “Vietnam: Delivering on Its Promise,” World Bank, 2002, p. 36

Table 4 shows the top provinces for FDI in 2002 and DPI in 2001. It shows that FDI is much more concentrated than DPI among the various provinces.

It is clear that except for five provinces, domestic private (formal) investment is equal to or greater than FDI. Of course, in some years a few other provinces may find that FDI is higher, but for the overwhelming majority it is local private investment that is more easily attracted and is already coming. There are 25 provinces where private domestic investment exceeded \$10 per capita in 2001. That means 40% of all provinces are already able to attract nontrivial amounts of DPI, compared to only 10 to 15 for FDI. Moreover, while high FDI is usually associated with a unique feature or favorable geographic location, DPI is spread over every region and covers a much wider variety of situations. This suggests that most provinces should focus less on attracting FDI, though that it is desirable, and more on creating conditions that will be attractive to domestic investors. Notably, even very poor regions have some provinces doing well in attracting DPI and others doing very poorly.

Table 4		<i>Concentration of Different Types of Investment by Province</i>		
<i>Implemented FDI 2002*</i>		<i>Implemented Domestic Private Investment 2001, In Million \$</i>		
<i>In Million \$</i>		<i>DPI>FDI</i>		
1. HCMC	\$541	1. HCMC	\$ 642	Yes
2. Kien Giang	\$354	2. Hanoi	\$ 289	Yes
3. Dong Nai	\$281	3. Binh Duong	\$ 80	No
4. Quang Ngai	\$263	4. Haiphong	\$ 62	Yes
5. Binh Duong	\$261	5. Quang Ninh	\$ 58	Yes
6. Ba Ria-Vung Tau	\$126	6. Danang	\$ 45	Yes
7. Tay Ninh	\$ 46	7. Dong Nai	\$ 40	No
8. Hanoi	\$ 41	8. Ha Tay	\$ 31	Yes
9. Haiphong	\$ 39	9. Ba Ria-VT	\$ 30	No
10. Bac Ninh	\$ 36	10. Khanh Hoa	\$ 27	Yes
11. Long An	\$ 17	11. Hung Yen	\$ 27	Yes
12. Vinh Phuc	\$ 15	12. Long An	\$ 22	Yes
13. Lam Dong	\$ 14	13. Nghe An	\$ 21	Yes
14. Thanh Hoa	\$ 14	14. Binh Thuan	\$ 20	Yes
15. Ha Tay	\$ 12	15. Bac Ninh	\$ 17	No
16. Khanh Hoa	\$ 4	16. Binh Phuoc	\$ 16	Yes
17. Hai Duong	\$ 2	17. An Giang	\$ 15	Yes
18. Nghe An	\$ 0	18. Phu Tho	\$ 14	Yes
Top 10 as % of Total: 95%		Top 10 as % of Total: 75%		
*Takes cumulative implemented FDI in 2002 less cumulative implemented FDI in 2001 as an estimate of 2002 FDI implementation.		Domestic Private Investment under the Enterprise Law is the investment value shown.		

Is there any other hope for provinces that are not close to the major cities? Naturally, there is. One source – often viewed as their best hope – is state investment. This is allocated according to both economic and political criteria, as in most countries. State spending is spread even more evenly than current DPI. This reflects provincial policies and priorities that sometimes depress DPI, as well as the amount of government funds available. The range of government investment in 2000 ran from a high of \$272 per capita for Hanoi to \$19 per capita for Nam Dinh. After Hanoi, the next top six provinces, all over \$130 per capita, are familiar names – HCMC, Ba Ria-Vung Tau, Quang Ninh, Haiphong, Hai Duong and Danang. These are major urban areas or close to them and presumably they had infrastructure demands that required more spending. But once past these few, the spending per capita remains moderately high for many provinces. The 10th highest province had \$92 per capita and the 50th had \$44. (See listing in Appendix 2.) By way of comparison, the 10th highest province for FDI per capita had \$22 and the 50th had near zero. For DPI, the 10th highest had \$24 and the 50th had \$4. Thus, for many poor provinces, state spending is the major source of formal investment.

State investment is trying to do several things at once – creating vitally needed infrastructure where growth is fast and there is a clear need for it, while also balancing out laggard areas by investing well ahead of present need. But there is a limit to how much infrastructure can be justified without directly productive investment following. Danang, for example (see mini-case, below), has built a large amount of infrastructure but had not been very successful in attracting investment, perhaps until very lately. It would be difficult to continue building infrastructure year after year if there were only limited demand for it. This is a more general problem for poor provinces that hope to rely on state investment. It is not sensible to expand infrastructure if there is little use of what is there. Even state enterprise investment is likely to be slanted towards fewer and more efficient state enterprises. In any case, there are few new jobs from state enterprises and these are what poor provinces need. So, relying on state investment is risky.

Beyond this, there are real questions about the growth rate of state revenues. Oil revenues will grow, but perhaps not nearly so rapidly as in the past. Foreign aid per capita is also likely to stabilize, as major donors such as Japan and several European nations face various demographic and budgetary pressures. Other nations, with immediate humanitarian or post-war reconstruction needs are likely to compete with Vietnam for available funds. If state budgets grow little and there is little use of existing infrastructure, it will be hard for poor provinces to continue claiming resources when those regions where growth is fast will sorely need them. Thus, while a *survival* strategy is to rely on state funding, a *success* strategy is to try to attract more domestic investors in general, and perhaps foreign investors in particular cases.

Danang: Public Infrastructure as a Basis for Growth?

Danang is the “center of the center” or the major city in the central region of Vietnam. With a population of only 700,000 and relatively small effective hinterland, it is at

something of a disadvantage relative to the two major cities of Vietnam. Its domestic market is fairly small and there are not international schools, a large foreign community or concentrations of sophisticated financial services or marketing and consulting that Hanoi and HCMC are developing. But with a good harbor, ample skilled and semi-skilled labor, and international airport and highway connections, Danang has many potential advantages. Still, by 1997 when it was split off from Quang Nam and able to focus on its own development, Danang was well behind the other two cities. Its output per person was then only 5.7 million dong compared to over 9 million for Hanoi and over 14 million for HCMC. This reflected a low value-added industrial sector with few linkages, as well as an unsophisticated service sector.

From 1997 to 2000, the Danang government decided that it needed to upgrade its physical infrastructure in order to approach the other two major cities as an attractive location for investment. Infrastructure investments rose from VND 99 billion in 1997 to VND 600 billion in 2000. A new bridge was built across the Han River, the airport and seaport were upgraded, and preparations were made for other improvements. These will include the Hai Van tunnel, the East-West Corridor and the Tien Sa Port. All of these should be completed in the next two to three years. In addition, and after some delays, there were three new industrial parks built covering 861 hectares.

Table 5

Danang: Investment by Source
Average per year for two-year periods-Billion Dong

	<u>1997-98</u>	<u>1999-2000</u>	<u>2001</u>
Government Budget	202 (18%)	650 (53%)	300 (21.3%)
Directed Loans	145 (13%)	170 (13.8%)	230 (16.3%)
State Owned Enterprises	127 (11.5%)	135 (11.3%)	254 (18.0%)
<i>Sub-total: Public</i>	<i>474 (42.5%)</i>	<i>955 (78.1%)</i>	<i>784 (55.6%)</i>
ODA	30 (2.6%)	47 (4.0%)	18 (1.3%)
Foreign Direct Investment	432 (38.4%)	78 (6.3%)	154 (11.0%)
Private-Individuals	123 (11%)	102 (8.4%)	105 (7.4%)
Private-Enterprises/Mixed	61 (5.4%)	40 (3.2%)	350 (24.7%)
Total (Billion Dong)	1120	1224	1410
Total (Million \$)	\$85.7	\$85.3	\$93.5

Notes: Data from provincial sources. While overall comparable 2002 data are not yet available, newspaper reports are that DPI in 2002 was \$44 million. "Mixed" refers to cooperative ventures with a private element.

Several things are interesting from Table 5. First, **total** investment did not change very much when measured in US\$ over the period – a pretty good measure in real terms. What did change was the pattern of investment, with the expected bulge in government budget in 1999-2000 to over 50% of the total, and then a decline to 20%. FDI had been a major contributor, but then slid, and its share recovered only partially in 2001. Individual private investment fell relatively throughout. State enterprises and directed

loans together moved from a quarter to a third of the total. Public investment of all types remains well over 50% in 2001, in spite of a strong jump in formal domestic private investment. What can one make of all of this?

Danang is a work in progress. The “hard” infrastructure investment has created a potential for investors, and some of this is seen in the almost nine-fold jump in DPI (domestic formal private investment) from 1999-2000 to 2001. There are some indications that both DPI and FDI rose again in 2002. However, these are only indications of a possible success. To be completely successful, we should observe a steady growth in real investment. The increase in investment in dollars was only 2-3% a year from 1997-98 to 2001. This will have to pick up considerably to fully justify the large infrastructure outlays. *By 2000, per capita income relative to HCMC and Hanoi had fallen slightly compared to 1997.* One would hope to see stability or even gains.

Table 6
The Guidebook for European Investors in Vietnam

In a Guidebook written by Asia Invest of the Europe Aid Investment Office, the question of where to locate a business in Vietnam is addressed. Their summary table is as follows:

<i>Positives</i>	<i>Negatives</i>
<i>South</i>	
Business Friendly Environment	Far from Political Decision Centers
“Can Do” Attitude with Foreign Investors	Higher Competition
Better Infrastructure	
Major Concentration of Existing FDI	
Largest Domestic Market	
Good for Expatriate Living	
<i>Center</i>	
Lowest Costs for Labor and Land	Poor Infrastructure
Access to Specific Commodities	Limited Existing FDI and “Clusters”
Low Competition	Higher Regulatory Uncertainties
	Limited Local Markets
<i>North</i>	
Close to Political Decision Centers	Stronger Bureaucratic Hindrances
Most HQ of State Enterprises	Still “Defiance” to Foreign Investors
Most Efficient for “Special” ¹¹ Projects	Uncertainties on “Inside Political Issues”
Satisfactory Infrastructure	
Large Local Market	
Access to Mineral Inputs	

¹¹ By “special” they mean politically sensitive, or projects requiring connections or high protection.

To put the issue another way, consider the flows of population. According to 1999 Census data, 6% of the population living in Danang in 1994 were living outside of the city in 1999. Population growth of just over 2% a year is above the national average, but scarcely indicative of rapid growth in job opportunities. For a city with good human and physical capital, why is there not more activity and population growth?¹²

The leadership in Danang has asked this question, especially for FDI. They first realized that Danang lacked strong companies to supply and partner with foreign ones. Human resources needed improvements in certain skills and sea freight charges needed to be lower. It then moved on to make the “soft” infrastructure better with “one-stop shopping” for investors and easy terms in the industrial parks with low taxes. The results have been positive with registered FDI rising from only \$14 million in 2001 to \$52 million in 2002 and \$31 million in the first quarter of 2003. (This ignores rescinded projects, which were larger than new ones in 2000 and 2001.) Above all, they are said to be trying to cultivate a relationship in which problems can be solved quickly. These steps, as they become effective, should show results in implementation as well as approvals though it will be some time before the realized FDI investment levels of 1997-98 are surpassed.

The key to improving Danang further will lie in producing stronger domestic private companies to partner with foreign ones. The jump in DPI in 2001 to \$63 per capita from only \$7 per capita in 2000 certainly suggests that some changes are occurring. (The \$63 per capita level is nearly three times the national average and the fourth highest province in all of Vietnam.) Yet to sustain this and make it a source of continuing growth, further changes are needed. The financial system is still weighted heavily towards state enterprises and lending to the government. Notice that the phrase is “financial system” and not simply “banks.” The Development Assistance Fund is a major source of loans for projects and though in principle it can lend to the private sector, it usually lends to state enterprises and for infrastructure. Even within the commercial banks, the share of the private sector in total loans is dropping. (See Table 7.) While the private share in 2001 is higher than in 1999, it is still very small and much lower than 1997. State enterprises increased their share of bank loans to nearly four-fifths in 2001. If the Development Assistance Fund is added in, the results are even more one-sided. State firms similarly increased their share of ownership from 51% in 1997 to 58% in 2001. The share of privately owned output fell from 41% to 34% in the same years. (FDI at 7-8% covered the rest.) These trends do not suggest a healthy environment for private firms. Without access to credit and favorable regulation, they will have trouble competing.

¹² For comparison, the population of both Hanoi and Ho Chi Minh City grew over 3% a year from 1999 to 2001. This is also true of Binh Duong and even Binh Phuoc, a poor province with little FDI or state investment

Table 7
Share of Bank Loans and Output: State and Private Sectors in Danang

	<u>1997</u>	<u>1999</u>	<u>2001</u>
Private credit	32.6%	15.7%	21.5%
State Enterprise Credit	67.4%	84.3%	78.5%
Private Output	41.3%		33.8%
State Enterprise Output	51.0%		58.0%

So, Danang is doing better than average but overall is still heavily weighted (at least through 2001) towards the state sector. Its economic and population growth have been slower than other major urban areas. It has rightly identified some of the barriers to FDI over which it has some control, such as physical infrastructure, skills training and regulation. But, perhaps because of lingering attitudes that are suspicious of private domestic activity, it has been slow to provide supportive conditions for local private investors. In spite of this, private investors have used their own money to set up businesses – and at a far higher rate than most other provinces, at least in 2001. But as Vice Chairman Hoang Tuan Anh said, Danang needs strong companies to be partners for foreign investors. While private firms will start without much help, they will not grow strong without access to the same resources as their competition in other parts of Vietnam and China. This will mean access to land and credit, not simply permission to operate.

What of the future? One line of thinking is that strong companies can be – or *should* be state enterprises. The Master Plan of Danang calls for **major state investment in industries** such as textiles, seafood processing, engineering, electronics, construction materials, and shipbuilding. If state enterprises can generate their own cash from profits, this would be fine. If the plan is to rely on large state credits, then it might be both more difficult and more costly. It will be more difficult because poorer provinces will have an increasingly stronger claim on state resources. After good infrastructure is built, the richer provinces should be able to attract industrial capital themselves. It would be more costly because experience has shown that many state enterprises are set up without objective investment appraisals and end up being high cost and having trouble competing. But a large part of the expected industrial growth is projected to come from state enterprises. It is unlikely that unprotected (low-tariff) production will attract foreign investors to partner with state enterprises. So this Master Plan will undercut attempts to raise FDI by creating firms that rely on state support rather than competitive prowess.

An alternative is to create a generally favorable investment climate for business, **treating state and private businesses equally**. (This is difficult to imagine, but that would be the trend if not the reality.) By implementing further reforms and building on the success of the Enterprise Law, Danang could foster the strengthening of any competitive local firm. It would do this not by directing credit, especially cheap credit, but by allowing banks to make loans to those who are likely to repay. (Banks themselves need to improve their skills in loan assessment.) It can make land equally available. It could help business associations operate so they would do the marketing and technical studies that individual

small and medium firms find difficult to do individually. This strategy would result in a much larger private sector and more firms able to partner with foreign ones. This appears to be the direction that China is taking, as its private industrial share increases.

One way to implement this alternative strategy is to begin ranking provinces on their business friendliness, just as many nations now are. By interviewing business leaders confidentially, it should be possible to gather information on specific issues such as difficulty in getting land, loans, negotiating taxes, etc. This would help Danang see how it ranks relative to other provinces and suggest areas to focus efforts.

A third possibility is to focus on becoming a service center. Let Quang Nam, just a few kilometers away, offer cheap land and labor for manufacturing. Like HCMC, which has let its surrounding provinces take on much of the manufacturing, concentrate on lowering costs and improving service in finance, transport, trade, marketing, and other activities needed for production businesses. Already, more than two-thirds of the investments under the Enterprise Law are trading businesses. If a regional approach is taken, the volume of exports will allow more frequent port calls by ships and improve the cost and frequency of transport. [When every coastal province wants a major port, no province gets one!] In addition, there are amenities that eventually could be added to attract foreign residents such as better hospitals, international schools, and upscale housing. However, these are not immediately feasible, so it is probably more realistic to expect small-scale FDI projects in the next several years. These often involve nearby Asian investors less sensitive to these amenities.

In summary, Danang has made a good start by building hard infrastructure and beginning to address “soft” [regulatory and administrative] infrastructure for foreign investors. It needs to continue along this line, finding ways to expand fair opportunities for domestic private investors so they are more nearly treated equally with the currently favored state sector. If Danang can do this, with its history of conservative attitudes towards the private sector¹³, then many other places in Vietnam can do it too.

Of course, more is needed on a national level – indeed, some of these other issues are discussed below. However, if provinces learn not to “call” for investments in which they specify the output, scale, and partners for the foreign investor but instead work to attract investors by lowering costs, much can be achieved. If they learn to think of domestic investors as being more important in most cases than foreign investors, at least in the aggregate, they will begin to do more sensible things that some provinces have already done. In short, provincial level management is the key to growth. The central government can open the door, but the province has to make sure there is no barrier to the door and that the path is smooth. It is the individual firm that actually walks through the door.

¹³ In 2002, a banker remarked that one reason Danang grew less quickly than some other provinces was, “because they thought the private sector was criminal.” Though this was meant as something of an over-statement, it captures an actual historical attitude.

A Regional Perspective – Where the Investments Go

The argument of the preceding pages has been that there is a great deal of provincial variation, even within a region. The steps taken by provincial authorities and their outreach efforts to investors will have a major impact over time on their level and type of investment. However, it is sometimes useful to aggregate over regions. This is done in Table 8. It shows *per capita* regional investments of the state in 2000, domestic private investment in 2001, and FDI in 2002. (Obviously, as data become more available, the analysis should be done for each year rather than mixed.) The average total investment *per capita* in the country was \$123, with over \$300 in the area in and around HCMC, and \$140 in the Red River Delta with Hanoi and Haiphong. The South Central Coast, with \$115, was close to the average. The other regions averaged \$60 to \$80 per capita. Most of the investment in these below-average provinces came from state sources. While some of this is understandable upgrading of roads and other infrastructure, the hyper-reliance on state investment in many regions will make it hard for them to sustain growth, for the reasons already argued.

Table 8
Regional Trends in Per Capita State, Foreign, and Private Domestic Investments

<u>Region</u>	<u>State (%)</u>	<u>Foreign</u>	<u>DPI</u>	<u>Total</u>
South East	\$113 (37%)	\$117	\$75	\$304
Red River Delta	\$104 (74%)	\$ 6	\$29	\$140
South Central Coast	\$ 69 (60%)	\$ 33	\$14	\$115
Mekong Delta	\$ 50 (63%)	\$ 23	\$ 8	\$ 80
North East & West	\$ 62 (79%)	\$ 4	\$12	\$ 78
Central Highlands	\$ 60 (86%)	\$ 3	\$ 6	\$ 70
North Central Coast	\$ 56 (89%)	\$ 1	\$ 6	\$ 63
All Vietnam	\$ 74 (60%)	\$ 26	\$ 22	\$123

Notes: State investment is for 2000; foreign investment is realized FDI in 2002; DPI is enterprise law investment for 2001. See Appendix III for aggregate data. Data in parentheses are share of state in total regional investment.

The hyper-reliance of the poorer regions, and even the Red River Delta, on state investment suggests two conclusions. First, the efficiency of state investment is critical in achieving growth in these regions. Second, ways must be found to induce more private investment, perhaps especially private domestic investment, into these regions. There has been a distinct tendency to “gold plate” public investment, building unneeded roads or ports, building them to too high a standard, or incurring very high reported but not actual costs. It is easy to focus on public investment when other investment is low and there are public funds, but this attitude is not likely to induce provincial officials to focus on attracting private investors so much as to lobby for more superfluous public investment. This tendency can be seen as a weakness now and a threat over time, as it will contribute

to the tendency of different regions to have very different growth rates, economic opportunities, and job creation.

National Issues – Benchmarking Vietnam: A Way to Improve Service?

Vietnam does better when it wants to. It can attract more quality FDI. It can create better policy to support information technology (IT) use. It can get its schools and universities to teach to a higher level. This is true of all nations, but it is especially true of Vietnam. One thing that helps focus attention on the areas that need it is meaningful, current, and clear comparative data. Everyone understands the number of telephones per 100 people or the cost per minute of a telephone call to Europe. If Vietnam has many fewer telephones or is charging much more than others, and if that is widely understood, it is much easier to ask why and begin to close the gap.¹⁴ If Vietnam is going to succeed at IT, it will have to *benchmark*, or compare itself to other leading nations in the region.

Some of this has been done in terms of the number of telephones and the cost of international telephone calls. There has been a very rapid growth in the number of telephone users – to 5.6 million by the end of 2002, with an expected increase of 1.4 million in 2003. Given that penetration was just under 3% in 1998 (2.1 million lines), the rate of increase is 27% a year – one of the highest in the world. Growth at this rate will extend services quickly to all areas. Recent cuts in international telephone charges to \$1.10 per minute for “regular” service and 75 cents per minute for calls over the Internet similarly reflect sharp cuts from only a few years ago. Yet low-cost calls from China to the US **cost only one-fifth as much**. Vietnam is moving, but so are others. The main thing is to reduce the costs so that businesses can use telephones or the Internet as a tool and be competitive. This point has not yet been reached.

In terms of the Internet, there has been rapid growth from a very low base. At year-end 2002, there were 250,000 Internet subscribers, with an increase of 146,000 planned for 2003. Given that there are about three users for each subscription, that would imply 750,000 users reached from almost none in 1997. Still this is less than 1% of the population. The plan is to expand this to 3.2 million users by the end of 2005, implying a four-fold increase in three years. (China had about 60 million users in January 2003, or roughly 4.5% of its population.) In spite of these plans, international ratings of Vietnam’s “e-readiness” by various international groups suggest it has to do much better than it has so far. In one 2003 report, it was ranked 13th out of 14 Asian nations and remained at 56 out of 60 nations ranked, between Nigeria and Pakistan.¹⁵

The Internet experience for many users in Vietnam is unsatisfactory. Right now, aside from e-mail and small size downloads, the typical dialup connection speed is so low that even if costs are low (less than ½ cent per minute or VND 60), the unreliability and slowness make it unsatisfactory for capturing much information. Even leased lines,

¹⁴ China has much lower telephone charges and very fast service expansion. However, costs per minute are falling faster in Vietnam, but from a very high level.

¹⁵ The 2003 E-readiness Report, prepared by the Economist and IBM again ranked Vietnam at 56 out of 60 nations. However, most nations had a higher numerical score, while Vietnam’s declined from 2002.

which are still very expensive, rarely perform at their rated speeds – often only 20% to 30% of their rated (and paid-for) capacity. This drove Mr. Nguyen Huu Hien, the Director of Saigon Software Park, to buy a direct satellite connection. This was finally legalized in April of 2003. VNPT, the monopoly controller of the gateway via landlines, claims its 360 Mbit/second (as of July 1, 2003) gateway bandwidth is more than enough. They say that the firms in between the gateway and the end-user do not buy enough bandwidth from VNPT for the users they serve. The firms agree they buy less than they should, but only because VNPT's price for bandwidth is so high. A 2 Mbit/second local connection with charges for use as well as a high fixed rent can cost \$8000 a month, compared to about **a tenth** as much in China and even less in the US. Again in China, an ADSL “always on” line costing \$24 a month will download at 1.5 to 2.0 megabits per second, but a similar capacity in Vietnam would cost \$250 a month.¹⁶ The ADSL has no other charge in China, but has payments for use beyond a capacity limit in Vietnam.

Because of high costs and delays, there were only about 200 leased line users in Vietnam in 2002. Even those with leased lines often end up using the Internet far less than they should to increase their productivity. This shows up in various ways. Only 2% of businesses have a web page. This is serious since an increasing amount of commerce (\$300 billion in 2002) is being conducted over the Internet.

To take another example, the Hanoi University of Technology has 24,000 students and one 256 kilobit/second leased line. If 1% of the students at any given time wanted to use the Internet, then they each would have a capacity of about 1.1 kilobits/second. A 2000 kilobyte journal article (not an unusual size) would take four hours to download, if the user were not cut off.¹⁷ Hence students do not try to use the Internet for research. So there is no “excess” demand, and no pressure to improve connectivity. Essentially, Vietnam is in a low level trap in which users restrict bandwidth intensive use and suppliers say there is no demand. Again, China is providing broadband much more cheaply, at \$12 (with charges for use beyond a maximum) to \$24 (unlimited use) per month for ADSL or the equivalent. This allows users to access information easily. They now have about three million broadband users, and this could multiply by a factor of ten by 2006. It is good to have a high proportion of people on the Internet, but if they are poorly connected, this will not result in a big gain in benefits.

This comparison should not stop with IT. In education, many Asian nations take internationally standardized tests in high school. College graduates often take the Graduate Record Exam in their major if they want to pursue graduate study. These results allow the schools, universities and educational establishments to benchmark their students against other nations. Without such information, it may well be wasteful to simply spend more money on existing systems. How does one know if there is efficient use? There has been a tremendous expansion of university enrollments in Vietnam in the

¹⁶ An ADSL (asymmetric digital subscriber line) line downloads at 1.5 megabits per second but uploads data at a .13 to .26 megabits/second. A SDSL (symmetric DSL) would cost a few hundred dollars a month in most countries and have the same speeds each way. These lines need to be within 4 km of the switches.

¹⁷ Since 8 kilobits = 1 kilobyte, a 2000 kilobyte (or 2 Megabyte) article is equal to 16,000 kilobits. This would take four hours to download at a speed of 1.1 kilobits per second.

last several years and a lag in the human and physical infrastructure to handle it. The widespread desire of many Vietnamese to send their children abroad for education, now even extending from college to high school levels, suggests that there is a sense that the educational establishment needs reform. It is possible that these impressions are mistaken and that current results are good, in which case more money funding existing institutions is justified. It is possible that these suspicions are on target, in which case benchmarking of students is urgent, and reform of the schools and universities even more so. If Vietnam fails to provide quality education and only a small minority can go abroad, that will cause deep divisions and resentments in society that will be difficult to deal with. It will also mean that many very bright people will fail to live up to their potential, robbing Vietnam of their intelligence and energy and them of their future.

Conclusions

It appears from this brief survey that many things are being done right, but some critical ones need to improve. GDP growth is fairly strong, but the quality of growth is questionable and it is requiring ever more investment to get it. Exports are growing well, but delays entering the WTO would place Vietnam's exporters in an untenable position. Private firms are setting up business but slow reform of the financial system and state enterprises prevents them from growing up. Trade reforms lower protection while industrial policy creates high cost trophy projects. Poverty reduction has been strong but is slowing drastically. Enrollments have shot up, but the education experienced is of uncertain quality. Numerical coverage of Internet users is jumping, but it is hard to use the Internet productively. Telephone connections increase, but the cost of international calls remains well above those of China. Physical production in agriculture grows, but the gap in rural/urban incomes is widening alarmingly.

In all of this, perhaps the biggest threat to Vietnam's success is the internal perception that Vietnam is successful. A satisfaction with the results of current policies supports those who want to continue benefiting from them, even if it is necessary to change these policies to maintain the pace of growth or regain its quality. It is possible to summarize this in a table (See Table 9.):

Table 9	
Strengths:	Weaknesses:
Moderate GDP Growth, 1998-2002	Export Growth Slowing to 2002
Rapid Export, Industrial Growth	FDI Disappointing
Explosive Private Firm Formation	Rising Investment to Growth Ratios
Good Poverty Reduction to 1997/8	Weird Dualism
Macroeconomic Stability	Poor Industrial Investments
Good Social Indicators	Growing Rural-Urban Income Split
Opportunities:	Threats:
Better Provincial Policies	Overemphasis on Directed Investments
Sustain Private Firm Growth	Poor Education Quality (Likely)
Attract More/Better FDI	Need for More IT Progress (Quality/Use)
Funds Available for Efficient Use	Rising Regional and Urban/Rural Inequality
	Possible WTO Entry Delay

The title of this paper is “Vietnam’s Economy: Success Story or Weird Dualism?” The question is there because the economy has large elements of success, but also major flaws marked by the increasing use of state investment in costly activity that slows growth while making it less equal. Without further reform, these flaws will weigh on future progress noticeably and growth, which may already be less than officially estimated, could fall even more. The SWOT analysis reflects this duality. There are significant strengths and worrisome weaknesses. The opportunities would come from better provincial and national policies, leading to more FDI and DPI, and a fuller exploitation of the production possibilities inherent in Vietnam’s people and current situation. The threats come from a failure to improve poorly performing institutions. By comprehensive benchmarking and pursuit of best practice competitors, Vietnam can choose to grow faster and more equally. This equality would be in the social as well as economic sphere, in geographic and regional terms. It is hard to see what Vietnam gains by avoiding this set of choices.

Appendix I: The author has written a number of papers on Vietnam's economic prospects. The current paper does not repeat in detail certain points made in these previous papers. Recent papers include:

“Choices and Opportunities: Roads Open to Vietnam” This September 2000 paper projected three different futures for Vietnam based on a slower [than current] pace of reform, a slightly faster than trend pace of reform, and a still faster pace. It argues that very slow reform would produce only 4-5% growth and far fewer jobs than needed. In the moderate reform scenario, growth is in the 6-7% range, and in the fastest case it is 9-10%. “Decent” jobs and export growth also increase, along with investment levels *and efficiency*. However 6% growth does not create enough jobs to reduce poverty or lower underemployment much. Poverty as currently measured would all but disappear under the fastest scenario within a decade or so. Interestingly, SOE growth is fastest in the fast-reform scenario, though its share of output falls more than in the others. There is an extended discussion of the sources of job growth in this paper, looking at state, formal private, foreign, and farm jobs and their likely rates of growth. It appears that farm jobs may shrink or grow very little, complicating the progress in poverty reduction unless there is a rapid rate of growth and job creation.

“Economic Policy for Vietnam in a Period of Economic Turbulence” This paper, written in November 2001, was used in a January 2002 executive education class in Danang. It looks at reduced regional and global growth prospects and the implications for Vietnam. Looking back, it finds that past episodes of slow global growth ironically hit import- substituting economies worse than those that exported manufactures. Vietnam, already an open economy, needs to sharpen its skills to do even better with manufactured exports. To this end, it needs to rethink investments in high-cost heavy industry. These projects create a high-cost economy and hurt efficient exporters and consumers. The Chinese motorbikes vs. Honda is given as an example, with Honda prices having to drop more than 50% and Chinese prices still much lower. It notes that while China is a tough competitor, Vietnam has several strengths: A small state sector means modest restructuring costs. Multinationals want to diversify production locations. China is a good market for Vietnam's agricultural products. The Enterprise Law response shows capital and energy is available to drive domestic private sector growth. Since Vietnam is small, it can more easily find market niches growing faster than overall exports. It will need these strengths since it needs rapid and labor-intensive growth – about as fast in this decade as the previous one in order to deal with stagnant or falling farm jobs. To achieve this, it needs to lower barriers such as high income taxes and telephone charges, and promote better banking, business organization, and local (provincial) policies. It concludes with a matrix of “good” and “bad” domestic policies and a global economy that is more or less supportive. It is suggested that domestic policies are more powerful in influencing growth than external conditions, though obviously a stronger global environment would help. The worst case, of slow reform and a poor global economy would mean only 4-5% growth, while the opposite would be 10%, with 8% growth if policy is good and the world economy weak, and 6% if the world is

good but policy is poor. Job creation, poverty reduction, and overall stability improve with increased growth.

“Success and Failure: Choosing the Right Path to Export-Led Growth” This June 2002 paper argues that there are significant policy barriers impeding Vietnam’s progress towards rapid, export-led growth. First, actual growth may be 1-1.5% lower than officially reported. Second, the pace of manufactured export growth from 1999 to the first half of 2002 was disappointing. This was due to both internal and external factors, and beneficial impact of the BTA would cause a later 2002 and 2003 pickup. However, low rankings of Vietnam by international ratings groups (not of bonds but of investment desirability) shows that further reforms are needed. Relatively low FDI levels relative to the 1990’s and to China also indicate some real difficulties. Limited evolution of beneficial clusters, slow financial reforms, and inefficient public investment choices all restrain the growth of a dynamic low-cost economy. Finally, questions are raised about the institutional efficiency of education and a lack of IT sophistication. Lack of progress in these areas will hold back Vietnam’s competitiveness over time.

“Helping Vietnam to Make Better Choices: A Discussion Paper” This paper was written for a donor seminar in August 2002 at the UNDP in Hanoi. Drawing on the “Success and Failure” paper, it argues that aid should play a stronger role in promoting institutional efficiency. It observes that past aid has arguably helped to finance many dubious public investment choices and even policies - if not directly then by funding necessary investments so that less productive choices could make use of the released funds. The paper argues that aid should more explicitly be linked to further needed reforms.

Appendix II: *Investment Levels by Province for State, FDI and Domestic Private Investors*

Provincial investment

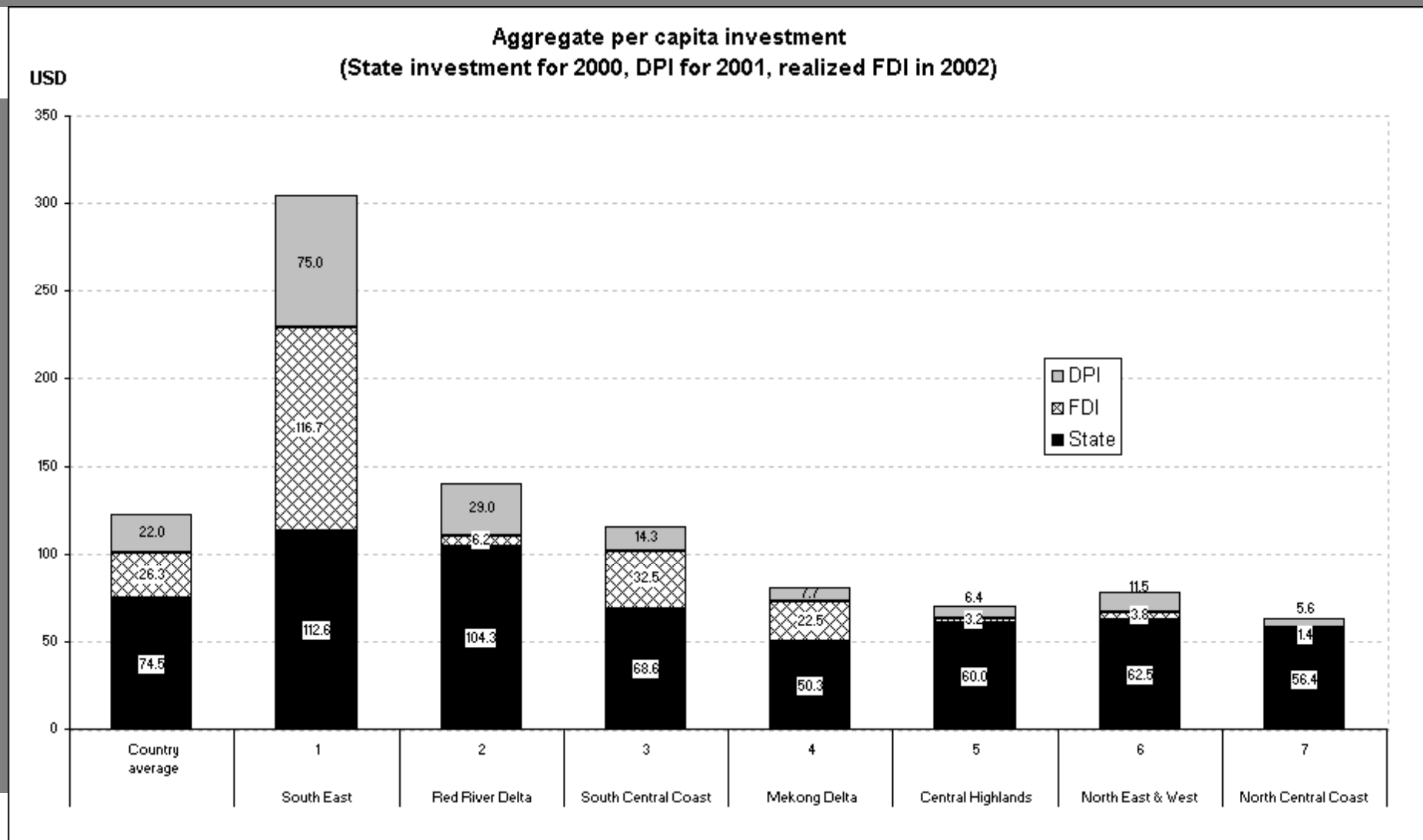
State investment for 2000, DPI for 2001, realized FDI for 2002

Province	Population, thousands of persons, 2000	Population, thousands of persons, 2001	TOTAL, millions of USD				PER CAPITA, USD			
			State	FDI	DPI	Aggregate	State	FDI	DPI	Aggregate
An Giang	2080.3	2,099.0	106.85		15.41	122.26	51.36	0.00	7.34	58.70
Bac Can	280.7	283.0	26.10		2.72	28.83	92.99	0.00	9.62	102.61
Bac Giang	1509.3	1,522.0	62.60		0.03	62.63	41.47	0.00	0.02	41.50
Bac Lieu	745.2	757.0	46.16		4.56	50.72	61.95	0.00	6.02	67.97
Bac Ninh	948.8	958.0	64.47	36	17.27	117.74	67.95	37.58	18.03	123.56
Ben Tre	1307.2	1,308.0	49.12		5.49	54.61	37.58	0.00	4.20	41.78
Binh Dinh	1481.6	1481.6	67.06		11.22	78.29	45.26	0.00	7.58	52.84
Binh Duong	738.4	768.0	66.47	261	80.04	407.51	90.02	339.84	104.22	534.08
Binh Phuoc	687.4	708.0	27.99		10.87	38.86	40.72	0.00	15.36	56.08
Binh Thuan	1066	1066	47.38		19.48	66.87	44.45	0.00	18.28	62.73
BR-VT	823.1	839.0	137.35	126	30.13	293.48	166.87	150.18	35.91	352.96
Ca Mau	1139.9	1,158.0	59.36		10.72	70.08	52.07	0.00	9.26	61.33
Can Tho	1838.7	1,852.0	130.33		17.06	147.39	70.88	0.00	9.21	80.09
Cao Bang	497.4	502.0	31.06		6.79	37.85	62.44	0.00	13.53	75.97
Da Nang	699.7	699.7	111.11	0	44.86	155.97	158.80	0.00	64.11	222.92
Dac Lac	1862.6	1,901.0	76.07		9.67	85.75	40.84	0.00	5.09	45.93
Dong Nai	2039.3	2,067.0	125.17	281	39.66	445.83	61.38	135.95	19.19	216.51
Dong Thap	1580.5	1,593.0	73.90		7.23	81.14	46.76	0.00	4.54	51.30
Gia Lai	1020.5	1,048.0	101.12		6.38	107.49	99.09	0.00	6.08	105.17
Ha Giang	618.4	626.0	41.59		6.84	48.42	67.25	0.00	10.92	78.17
Ha Nam	797.6	800.0	45.11		6.61	51.72	56.55	0.00	8.29	64.85
Ha Noi	2736.4	2,842.0	745.76	41	288.86	1075.62	272.53	14.98	105.56	393.08
Ha Tay	2410.8	2,432.0	87.27	13	31.10	131.37	36.20	5.39	12.90	54.49
Ha Tinh	1279.1	1279.1	67.46		5.51	72.98	52.74	0.00	4.31	57.05
Hai Duong	1657.5	1,671.0	275.87	2	4.40	282.27	166.44	1.21	2.65	170.30
Hai Phong	1690.8	1,711.0	217.09	38.8	61.76	317.65	128.39	22.95	36.53	187.87
HCMC	5222.1	5,378.0	775.33	541	632.22	1948.55	148.47	100.60	117.56	366.62

Hoa Binh	767.6	744.0	24.83		4.04	28.87	32.34	0.00	5.43	37.78
Hung Yen	1081.9	1,091.0	45.47		26.62	72.09	42.02	0.00	24.61	66.63
Khanh Hoa	1049.2	1049.2	91.70	4	26.51	122.21	87.40	3.81	25.27	116.48
Kien Giang	1528.1	1,543.0	76.36	354.6	12.48	443.44	49.97	229.81	8.09	287.87
Kon Tum	326.5	331.0	29.15		2.30	31.45	89.28	0.00	6.96	96.23
Lai Chau	613.3	616.0	43.03		1.49	44.52	70.17	0.00	2.42	72.58
Lam Dong	1038.4	1,050.0	48.37	14	9.39	71.76	46.58	13.33	8.94	68.85
Lang Son	710.7	715.0	37.97		6.31	44.28	53.42	0.00	8.83	62.25
Lao Cai	613.6	617.0	35.80		8.91	44.70	58.34	0.00	14.43	72.77
Long An	1330.4	1,348.0	80.34	17	22.09	119.43	60.39	12.61	16.38	89.38
Nam Dinh	1905.3	1,916.0	35.80		4.24	40.04	18.79	0.00	2.23	21.02
Nghe An	2892.2	2892.2	189.86		20.82	210.68	65.64	0.00	7.20	72.84
Ninh Binh	888.4	892.0	42.74		5.11	47.85	48.11	0.00	5.75	53.86
Ninh Thuan	515.7	515.7	23.30		3.34	26.64	45.18	0.00	6.49	51.66
Phu Tho	1273.5	1,288.0	67.99		13.87	81.85	53.38	0.00	10.77	64.15
Phu Yen	804.2	804.2	68.72		3.32	72.03	85.45	0.00	4.12	89.57
Quang Binh	803	803	69.22		8.76	77.98	86.20	0.00	10.91	97.11
Quang Nam	1388.7	1388.7	76.05		0.05	76.10	54.76	0.00	0.04	54.80
Quang Ngai	1199.1	1199.1	77.50	263*	8.70	349.20	64.63	219.33	7.25	291.22
Quang Ninh	1017.7	1,030.0	169.50		58.09	227.60	166.55	0.00	56.40	222.96
Quang Tri	580.8	580.8	30.79		7.74	38.52	53.01	0.00	13.32	66.33
Soc Trang	1193.9	1,213.0	44.44		5.98	50.42	37.22	0.00	4.93	42.15
Son La	906.8	922.0	35.98		1.95	37.93	39.68	0.00	2.11	41.79
Tay Ninh	978.7	990.0	49.04	46	13.85	108.88	50.10	46.46	13.99	110.56
Thai Binh	1797.2	1,815.0	66.54		11.36	77.91	37.03	0.00	6.32	43.35
Thai Nguyen	1054	1,062.0	71.49		9.57	81.06	67.82	0.00	9.01	76.83
Thanh Hoa	3501.1	3501.1	105.71	14	2.43	122.13	30.19	4.00	0.69	34.88
Thua Thien Hue	1064.4	1064.4	107.35		10.93	118.28	100.86	0.00	10.27	111.13
Tien Giang	1620.7	1,636.0	63.38		10.16	73.53	39.10	0.00	6.21	45.31
Tra Vinh	982.1	989.0	33.90		4.62	38.52	34.51	0.00	4.67	39.19
Tuyen Quang	685.5	693.0	26.23		5.75	31.97	38.26	0.00	8.29	46.55
Vinh Long	1018.9	1,023.0	58.97		10.92	69.90	57.88	0.00	10.68	68.56
Vinh Phuc	1103	1,116.0	63.40	15	7.91	86.31	57.48	13.44	7.09	78.01
Yen Bai	691.6	700.0	28.27		2.69	30.96	40.87	0.00	3.84	44.72
Country	77685.5	78487.8	5784.30	2067.40	1729.22	9580.91	74.46	26.34	22.03	122.83

* This high FDI value is likely to be Dung Quat infrastructure. Given the departure of the Russian oil company, it might better be put down as state investment.

Appendix III: *Aggregate per capita investment*



WORKING PAPER SERIES 2003

ase.tufts.edu/econ/papers

- 2003-01** BIANCONI, Marcelo. Private Information, Growth and Asset Prices with Stochastic Disturbances.
- 2003-02** BIANCONI, Marcelo. Fiscal Policy and the Terms of Trade in an Analytical Two-Country Dynamic Model.
- 2003-03** BROWN, Drusilla K., Alan V. DEARDORFF, and Robert M. STERN. The Effects of Multinational Production on Wages and Working Conditions in Developing Countries.
- 2003-04** BROWN, Drusilla K., Alan V. DEARDORFF, and Robert M. STERN. The Determinants of Child Labor: Theory and Evidence.
- 2003-05** BROWN, Drusilla K., Alan V. DEARDORFF, and Robert M. STERN. Computational Analysis of Multilateral Trade Liberalization in the Uruguay Round and Doha Development Round.
- 2003-06** BROWN, Drusilla K., Alan V. DEARDORFF, and Robert M. STERN. Multilateral, Regional, and Bilateral Trade-Policy Options for the United States and Japan.
- 2003-07** METCALF, Gilbert E., Mustafa H. BABIKER, and John REILLY. A Note on Weak Double Dividends.
- 2003-08** EGGLESTON, Karen, Nolan MILLER, and Richard ZECKHAUSER. Provider Choice of Quality and Surplus.
- 2003-09** DOWNES, Thomas. School Finance Reform and School Quality: Lessons from Vermont.

- 2003-10** GABAIX, Xavier and Yannis M. IOANNIDES. The Evolution of City Size Distributions.
- 2003-11** BIR, Anupa and Karen EGGLESTON. Physician Dual Practice: Access Enhancement or Demand Inducement?
- 2003-12** BIANCONI, Marcelo and Walter H. FISHER. Intertemporal Budget Policies and Macroeconomic Adjustment in a Small Open Economy.
- 2003-13** IOANNIDES, Yannis M. Complexity and Organizational Architecture.
- 2003-14** DRUSILLA, Brown K. and NORMAN, George; Optimal Intellectual Property Rights Exhaustion and Humanitarian Assistance during a National Health Emergency.
- 2003-15** DAPICE, David O. Vietnam's Economy: Success Story or Weird Dualism? A SWOT Analysis.
- 2003-16** METCALF, Gilbert E. Pollution Taxes in a Second-Best World.