

I. OVERVIEW

Viet Nam is preparing to participate in a globalized world. Most of its market-based economic policies and the supporting legal frameworks are in place, and Viet Nam is preparing to join the World Trade Organization (WTO) later this year. This development marks the culmination of wide-ranging reforms of economic and legal policies which were initiated only 20 years ago and which have since become known as *Doi Moi*, or renewal.

Viet Nam is a transitional economy and currently situated in a lower income category. When *Doi Moi* was initiated in 1986, the Government decided to adopt an export-led, market based economy and to turn away from the Council for Mutual Economic Assistance (CMEA) which was already rapidly evaporating at the time. Having observed the success of China's earlier experiments with market oriented reforms since 1978, Viet Nam has rapidly put in place its own structures for a market economy.

The years leading to *Doi Moi* were extraordinarily difficult with widespread food shortages and hyper-inflation despite extensive food rationing systems covering all essentials and many consumer durables.¹ With the gradual removal of these rations and subsidies under *Doi Moi*, incentives were restored for farmers who responded with large output increases and greater diversification which allowed Viet Nam to quickly become self sufficient and, just as quickly, become a major food exporter. The first important cornerstone of the legal framework towards a market economy was the Foreign Direct Investment (FDI) Law of 9 December 1987.² This FDI legislation was very progressive and served over the years to attract new investments and provide international market access for Viet Nam's export-led development.

The period of the early 1990s was one of accelerated development with market oriented reforms being implemented in a progressive manner. While industry initially stagnated due to the withdrawal of Soviet aid, its recovery was then bolstered as oil production was brought on stream. Service industries expanded at a healthy rate and the economy began to provide export industry jobs for those workers who were surplus to the agriculture sector. At the same time Viet Nam became the world's second-largest rice exporter and a major exporter of several other agricultural commodities such as coffee and pepper. In general, Viet Nam's performance has been better than that of most transitional economies.

While the Asian Crisis slowed down economic development, Viet Nam was not affected by the crisis to the degree of other Asian countries. While the resulting economic contraction in Asia affected export levels from and FDI inflows to Viet Nam, the overall impact on the economy was quite small and was fully dissipated by 2001.

¹ The system of distributing food products encompassed virtually all individuals under the *Bao Cap* (subsidy system) economy. Each food distribution unit was to serve one community made up of registered family members, while considering employment status (persons of higher status received larger rations). Queuing was a major aspect of food distribution requiring lining up at midnight the day before the rations were to be made available. Rice, the staple food, was often mouldy, smelly or worm-eaten but people had no choice but to accept what was available. Ngo Duc Thinh, currently Professor at the Institute of Cultural Research, noted from his personal experiences, "After I bought the rice home, I opened the sack immediately. If it was not smelly, I felt so happy that full day." Quoted at the exhibition *Life in Ha Noi in the Subsidy Period (1975-1986)*, Viet Nam Museum of Ethnology, Ha Noi, June 2006.

² The FDI law is now being amended firstly to correspond with the new Enterprise Law which, in turn, enables accelerated private sector participation in the economy by giving enterprises a suitable legal framework, and secondly to enshrine equal treatment for both domestic and foreign investors.

Throughout this period, economic growth has averaged 7-8 percent per year and the benefits of this growth were distributed widely, which led to poverty levels dropping from almost total poverty under the hyperinflation in the late 1980s to less than 20 percent currently. In some areas such as equitization (the selling of shares in state-owned enterprises to the public) progress has been slow. The more effective route of creating competitive markets with hard budget constraints (i.e. no subsidies from the Government) is progressing well and will prove to be the more effective, politically neutral solution in the longer term. And despite an upsurge in corruption, including the recent Project Management Unit (PMU) 18 scandal, the Government has confronted this problem openly and transparently and, as a result, social stability has not suffered.

Throughout this period, Viet Nam has been operating with sound macroeconomic frameworks that include very high rates of savings and investments. For example, gross capital formation, as a percentage of GDP, double between 1992 and 2004. While the bulge in infrastructure investments in 2004 did result in some excess demand pressures, the resulting inflationary impacts are now being carefully contained. Budget deficits have always been manageable, even in downturns, with high priority investments being protected. Monetary policy has been equally effective, although it will be challenging in the coming years to ensure that the State-Owned Commercial Banks (SOCBs) develop a credit culture which restricts the creation of non-performing loans to sustainable levels.

There has also not been any build-up of commercial external debt as most external loans have been contracted on concessional terms so that Viet Nam's external debt service obligations remain manageable. At the same time, international reserves have been increasing, albeit modestly. Viet Nam has accepted that its exchange rate needs to be appreciated in real terms so that the export sector will further enhance its competitiveness. Such exchange rate appreciations will also provide the benefits of lower import prices to both the Vietnamese industry and consumers.

Another endorsement of the macroeconomic framework is found in the circulation and free use of the U.S. dollar in the Vietnamese economy. Recourse to the U.S. dollar has not been increasing and the expectation is that with continued good macroeconomic policies, the use of the U.S. dollar will gradually decline as confidence in those policies and in the dong build over time. The use of the U.S. dollar provides the economy with a built-in early warning system as changes in the use of the U.S. dollar can be read as a signal of market reactions to macroeconomic policies.

Looking ahead to 2008, economic projections show a continuation of the high rate of real GDP growth at 8 percent. At the same time, inflation is expected to remain moderate, declining from over 8 percent in 2005 to 6 percent in 2008, as excess demand pressures have already been corrected. Fiscal and monetary policies will remain focused on high investment rates,

particularly in infrastructure, and on macroeconomic stability. The expected continuation of the real appreciation of the dong will lead to a further substantial increase in international reserves, which should more than adequately insure against potential international demand and supply shocks.

Viet Nam is a well run transition economy. WTO membership later this year will reinforce the challenges for the competitiveness of Viet Nam's industry by, for example, removing subsidies to the garment industry. However such changes are very beneficial in the longer term as Viet Nam's industry will face and adjust to full international prices that will ensure international competitiveness for the entire economy while opening up unencumbered access to new markets under international rules. The future is bright for Viet Nam, not least due to its energetic people with their continuing thirst for knowledge.