



## Viet Nam

**R**apid economic growth in Viet Nam continued in 1995, led by the industry sector. Considerable progress has been made in economic liberalization, and 1996 marks the beginning of the new five-year plan that will guide the country into the next century. However, the attempt to create a socialist market economy remains strained by conflicting efforts to maintain government control of the economy to achieve equity objectives and the desire to let market forces increase efficiency. Viet Nam has so far succeeded in maintaining macroeconomic balance with high growth, although the current account deficit has been expanding as a share of GDP. Allowing greater liberalization of financial and capital markets, reducing favoritism to public sector enterprises, and encouraging more private and foreign participation in key infrastructure developments will help to sustain that balance in the future.

### **Recent Trends and Prospects**

*Growth, Investment, and Employment.* Growth in GDP continued to accelerate from 8.8 percent in 1994 to 9.5 percent in 1995. Agricultural output grew by 4.7 percent despite drought, severe typhoons, and flooding. Besides record rice output of 27.5 million tons, aquacultural production increased by an estimated 4 percent and that of livestock by an estimated 8 percent. Industrial crops also posted strong gains as export incentives continued to be exploited. New tax policies on agricultural land use, along with recognition of land transfer rights, had a positive impact on increasing the effective use of agricultural

land. Industrial output grew by 14.2 percent, especially manufacturing, processing, and construction, and was broadly based with both light and heavy industries performing well. Industrial products with high levels of output growth included electricity, coal, crude oil, and cement. Output of many consumer goods such as soap, paper, beer, and bicycle tires grew even faster. Services sector growth increased by 10.7 percent, raising the sector's share of GDP to 38.4 percent, thus continuing the shift in the structure of economic activity from agriculture to industry and services as the country modernizes and urbanizes.

With rapid economic growth, the demand for investment and mobilization of financial resources became more problematic in 1995. Although rising, domestic saving remains well below domestic investment. The share of gross domestic saving increased from 17.6 percent of GDP in 1994 to 19.1 percent in 1995; but this is still well below the share in other countries of the region. The contribution of foreign saving continues to account for about one third of gross national saving.

While there has been rapid growth in the private sector, capital shortage remains a main problem. Also, output from centrally managed enterprises continues to grow more rapidly than that from non-state enterprises.

Gross domestic investment rose to 27.6 percent of GDP and the resource gap widened to 8.5 percent of GDP. Efforts are being made to increase the share of domestic investment in total investment to more than 60 percent from its current level of 55 percent. One problem is the lack of a stock exchange, the creation of which has now been deferred from 1996 to

**Table 2.13 Major Economic Indicators: Viet Nam**

|  |                 | 1993 | 1994 | 1995 | 1996 | 1997 |
|--|-----------------|------|------|------|------|------|
| Gross Domestic Product                 | % change        | 8.1  | 8.8  | 9.5  | 9.8  | 9.9  |
| Agriculture                            | % change        | 3.8  | 3.9  | 4.7  | 4.5  | 4.5  |
| Industry                               | % change        | 13.1 | 14.0 | 14.2 | 14.6 | 14.6 |
| Services                               | % change        | 9.2  | 10.2 | 10.7 | 11.0 | 10.9 |
| Gross Domestic Investment              | % of GDP        | 20.5 | 24.1 | 27.6 | 32.0 | 34.0 |
| Gross Domestic Saving                  | % of GDP        | 14.8 | 17.6 | 19.1 | 21.1 | 22.0 |
| Inflation Rate                         | % change in RPI | 5.3  | 14.4 | 12.7 | 13.5 | 14.0 |
| Money Supply Growth                    | % change        | 18.9 | 28.1 | 34.4 | 27.3 | 25.3 |
| Merchandise Exports                    | \$ billion      | 2.9  | 3.6  | 5.2  | 6.9  | 9.5  |
|  | % change        | 15.2 | 26.3 | 45.0 | 32.2 | 37.7 |
| Merchandise Imports                    | \$ billion      | 3.5  | 4.5  | 7.1  | 9.7  | 12.5 |
|  | % change        | 38.3 | 28.4 | 58.3 | 36.1 | 28.9 |
| Current Account Balance                | \$ billion      | -0.9 | -1.0 | -1.7 | -2.2 | -2.5 |
|  | % of GDP        | -6.7 | -6.2 | -8.9 | -8.9 | -7.9 |
| External Debt Outstanding <sup>a</sup> | \$ billion      | 24.4 | 25.1 | 26.8 | 30.8 | 36.0 |
| Debt-Service Ratio <sup>a</sup>        | % of exports    | 13.6 | 6.1  | 10.5 | 9.1  | 8.1  |

<sup>a</sup> Debt and debt-service figures depend heavily on the ruble to dollar conversion rate applied to debt held in rubles which is currently under negotiation.

Sources: Nguyen van Quy, "The Economic Outlook for Viet Nam, 1995-1997," paper prepared for the Eighth Workshop on Asian Economic Outlook (mimeo, November 1995); data collected from the General Statistical Office of the Socialist Republic of Viet Nam by EDRC for the Asian Development Bank *Annual Report 1995*; World Bank, *World Debt Tables 1996*, Vol. 2 (Washington, DC, 1996); and staff estimates.

1997. This is compounded by the lack of securities to trade since privatization efforts have been limited and generally ineffective.

While the majority of the population and employment continues to be rural, urban employment has grown from 23.7 percent in 1993 to 24.5 percent in 1995, as the structure of economic activity shifts further from agriculture to industry and services. The unemployment rate has been estimated at 6 percent. Rural employment programs include reforestation and resettlement, while urban employment centers have been established to help reduce urban unemployment, estimated at 7 percent of the urban labor force. Employment in foreign-financed enterprises increased from 65,000 in 1994 to 90,000 in 1995, while an additional 100,000 laborers or more were engaged in construction or in providing services for foreign-financed projects.

Growth in GDP is expected to continue rising to 9.8 percent in 1996 and 9.9 percent in 1997. The increase in industrial output is expected to reach 14.6 percent in both years, with annual agricultural growth at about

4.5 percent, and services sector growth at about 11 percent per annum. Rapid growth in the private sector will be essential if the large annual increases in the labor force are to continue being provided with job opportunities. To achieve such growth, gross domestic investment will have to continue growing to 32 percent of GDP in 1996 and 34 percent in 1997, approaching the rates of growth of the other rapidly growing Southeast Asian economies. However, it will take time to restore confidence in the financial system and to raise domestic saving substantially. Therefore, gross domestic saving is expected to rise only slowly to 21.1 percent of GDP in 1996 and 22 percent in 1997, widening the resource gap and raising the level of external indebtedness (Figure 2.16).

*Budget, Money, and Prices.* Government revenues fell slightly as a share of GDP, from 24.7 percent in 1994 to 24.5 percent in 1995, despite improved collection efforts and changes in revenue policies. Among the more significant of these changes were the inclusion of

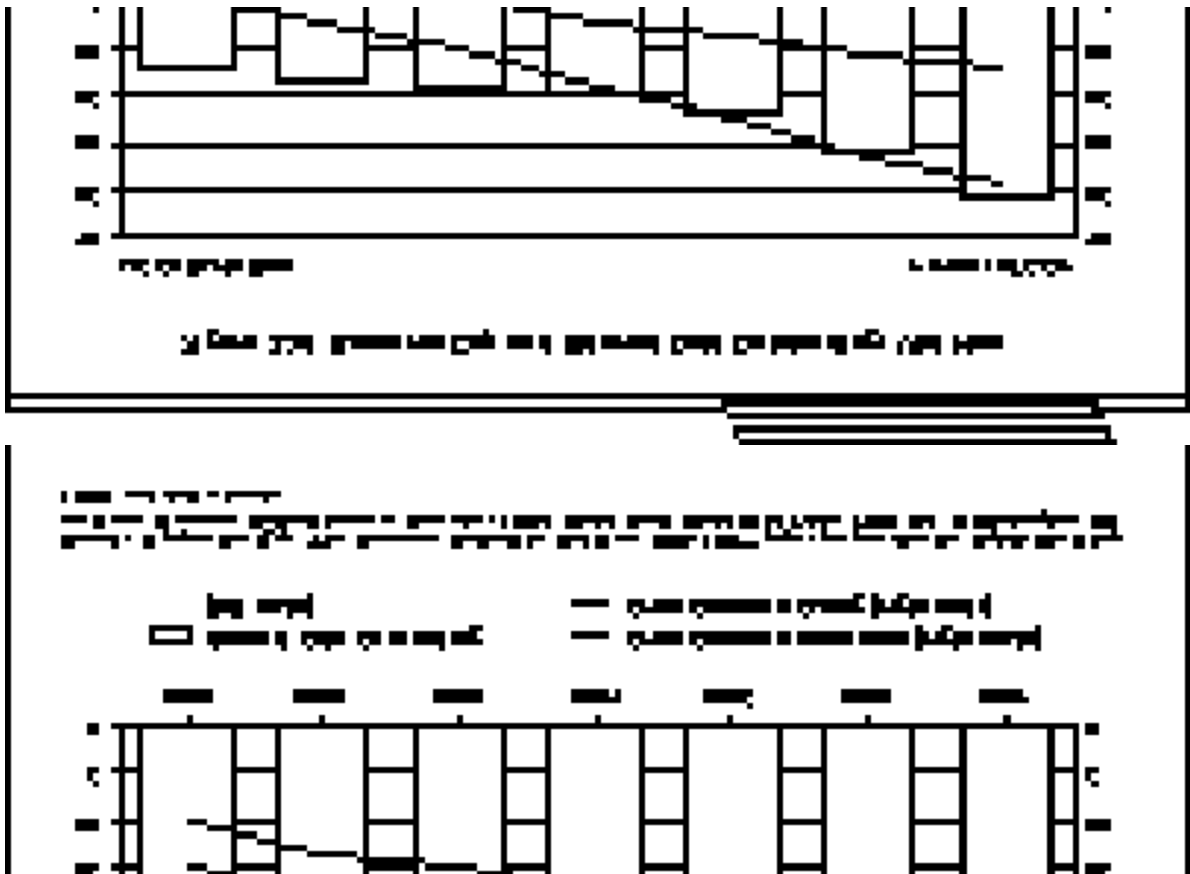
a transport fee in petroleum prices and allowing enterprises to retain depreciation allowances for reinvestment. Revenue collections still remained below target, however, partly because crude oil production was lower than planned. Also, there was increased smuggling of consumption goods, which meant excise taxes were not paid.

Expenditure policy aims to give priority to physical infrastructure and social sector spending while at the same time repaying loans. Recurrent expenditures increased in 1995, especially for health, education, and science and technology, and accounted for 19.2 percent of GDP. Meanwhile, private entrepreneurs complain that state-owned enterprises receive many special privileges, which are not available to the private sector. Even obtaining bank loans is difficult for private companies as credit controls discriminate against them.

The Government tries to follow a principle in which domestic resource mobilization covers all current expenditure and a small portion of capital expenditure, while foreign loans and financial assistance are used only for capital expenditure. However, a resource

shortage for capital expenditure in 1994 pushed some spending planned for that year into 1995. With disappointing revenue collection and heavy demand for public expenditure, the budget deficit surged from 2.4 percent of GDP in 1994 to 5.5 percent in 1995. The deficit was financed by foreign grants, concessional loans, and domestic borrowing. Since 1992, the State Bank of Viet Nam no longer officially issues money to cover government budget deficits, and instead organizes Treasury bill auctions to mobilize capital. In practice, however, the State Bank usually has to provide credit for the Central Government when deficits arise, and late repayments of this credit contribute to growth in the money supply.

Credit policies aim to achieve positive real interest rates to reduce the incentive for use of the US dollar instead of the Vietnamese dong. Another aim is to decrease the gap between the interest rate for foreign currency loans and that for local currency loans to encourage more borrowing in local currency. Removing the turnover tax on banks' credit operations has helped to lower interest rates



on bank loans, with little effect on deposit rates. The Government continues to set interest rate floors and ceilings for commercial banks; different interest rates are set for each project, and credit constraints are increasingly binding, especially for the rapidly growing private sector.

In general, the Government has paid more attention to encouraging foreign investment than it has to domestic resource mobilization. The exchange rate has been kept relatively stable in recent years, and this stability is expected to continue. However, use of monetary policy to maintain a stable exchange rate contributes to keeping interest rates relatively high. As a result, banks frequently accept only short-term deposits since borrowing is limited by the high interest rates.

The rediscount rate for commercial banks was increased in 1995 in an attempt to slow money growth. Even so, growth in broad money (M2) rose from 28 percent in 1994 to 34 percent in 1995 as credit expanded rapidly. Rice prices remained high and a jump in cement prices in the third quarter, induced by temporary supply shortages and price speculation, helped to maintain strong growth in the consumer price index. Nevertheless, inflation continued its downward trend – from 14.4 percent in 1994 to 12.7 percent in 1995 – although it was still above target levels.

Government revenue will be affected by various tax changes at the beginning of 1996. First, the number of turnover tax rates was reduced from 13 to 11. Second, the maximum level of import duties was lowered from 200 percent to 60 percent in line with requirements arising from membership in ASEAN. Third, excise taxes were expanded to cover additional luxury goods and some rates were raised, partly to offset the expected revenue decline from tariff reductions. An important tax change in prospect is the introduction of a value-added tax which is to be proposed at the National Assembly meeting in late 1996.

As a result of improved tax collection and the expanded tax base, revenue should rise gradually to almost 25 percent of GDP during 1996 and 1997. Current expenditure will continue to grow. However, its share of GDP will decline as pressing infrastructure needs demand greater capital expenditure. In absolute value, the domestic resources mobilized for capital expenditure in 1996 are expected to be roughly twice those of 1995. Total

government expenditure will thus continue to increase its share of GDP to 30.3 percent in 1996 and 30.4 percent in 1997. The overall budget deficit will remain at about the same level as in 1995 at 5.5 percent of GDP over the next two years, financed roughly at 15 percent by foreign assistance and 85 percent by domestic borrowing.

Monetary policy over the next two years will concentrate on managing credit expansion and foreign currency. Lending to non-state enterprises is to become greater than that to state-owned enterprises; credit lines will be maintained for commercial banks while medium- and long-term lending is liberalized; and attempts will be made to use open market instruments more effectively.

In 1996, reserve requirements will be imposed on all financial institutions. Also in 1996, different credit ceilings for long- and short-term credit will be maintained, and interest rate floors will be removed. The same rediscount rate will apply to all commercial banks, while the credit line extended to each bank will vary. A pilot program allowing some enterprises to issue bonds in domestic markets in 1995 is likely to be broadened in 1996.

The money supply will tighten gradually, with growth in M2 slowing to 27 percent in 1996 and 25 percent in 1997; however, this is unlikely to prevent the expansion in credit from pushing up inflation to about 13.5 percent in 1996 and 14 percent the following year.

*External Trade and Payments.* In the external sectors, major events in 1995 included joining ASEAN and normalizing relations with the US. Viet Nam also experienced an explosion in its international trade. In 1995, exports grew very rapidly and were 45 percent higher than in 1994, reflecting increases in both quantity and price. Major exports in 1995 included rubber, coffee, rice, peanuts, aquaculture products, crude oil, coal, and textiles. Garment exports increased by 20 percent. Rice exports were again around 2 million tons, and benefited from stronger world rice prices. Vigorous demand for raw materials and capital goods led to imports growing even more strongly than did exports, increasing by over 58 percent and resulting in the trade deficit more than doubling from \$900 million in 1994 to \$1.9 billion in 1995. As a result of the higher trade deficit, the current account deficit rose to \$1.7 billion, or about 8.9 percent

of GDP, sustained by higher inflows of both FDI and external assistance as well as by increased short-term borrowing.

Foreign investment commitments since 1988 total \$18 billion, of which \$7 billion were committed in 1995. However, projects accounting for only about 30 percent of committed funds have been implemented so far. Actual FDI inflows in 1995 were \$1.4 billion, mostly in the form of capital equipment. The shortage of domestic resources has resulted to some extent in a shortage of counterpart funds, implying a need to use foreign resources more efficiently.

Trade links with China were reopened in early 1996 after a hiatus of 17 years. Official annual bilateral trade has risen to around \$900 million since road links were opened in 1992. Trade growth is expected to slow down, although it will continue to outpace the rapid GDP growth. Growth in exports will remain strong in 1996 and 1997 at about 32 percent and 38 percent, respectively. Crude oil will remain the major export earner for the next two years. Import growth will also continue to be strong, at 36 percent in 1996 and more slowly at about 29 percent in 1997, as a wider variety of goods is produced domestically. As a result, the trade deficit should contract. The current account deficit is projected to be 8.9 percent of GDP again in 1996; however, it is likely to fall to 7.9 percent in 1997. Together with greater FDI, this will help foreign reserves to increase from their current level and reach 9–10 weeks of import cover.

### **Policy and Development Issues**

A major issue is that of reducing the government budget deficit, an essential requirement if inflation is to be restrained. Two other macroeconomic issues that need to be addressed in the near future are the improvement of domestic resource mobilization through banking and finance reforms, and the treatment of state-owned enterprises. The two issues are interrelated because most banks are owned by the Government and preferential treatment given to state-owned enterprises results in disincentives for private saving and investment.

The ability of joint-stock banks to repay loans cannot be assessed by foreign banks which are, therefore, hesitant to advance substantial loans. This is because there are

no laws requiring these banks to match international accounting standards. Tight government control of credit allocations is gradually being loosened; however, so far, with deposit rate ceilings and uncertain banking regulations, savers have little incentive to trust their saving to the formal financial system. Meanwhile, subjecting each investment proposal to close government scrutiny is delaying important investments, restricting welfare-enhancing opportunities, and overburdening government offices.

A contentious issue for private entrepreneurs is the preferential treatment accorded state-owned enterprises such as temporary tax exemptions, government guaranteed assistance in borrowing domestically or abroad, and subsidized credit. Also, almost all foreign joint ventures are with state-owned enterprises, and the state sector's rising share of GDP suggests that the Government's grip on economic activity may be increasing even as gradual liberalization proceeds.

Considerable progress has been made in improving the environment for private sector development although much more remains to be done. With the advent of market activities, the lack of an effective legal system has become an obvious lacuna and a special problem for foreign companies. Reforms in banking and finance may be able to be implemented more quickly and would help domestic resource mobilization; however, legal reforms are just as necessary. An antitrust law is being prepared, although it is not expected until 1997. A new enterprise accounting system was also implemented by the Ministry of Finance in 1995, to become nationwide in 1996.

Viet Nam's membership in ASEAN is being greeted with some ambivalence domestically. While the benefits of cooperation are appreciated, there is also concern that Vietnamese producers will face difficult competition from their new partners who produce similar products, and that the required tariff reductions may frustrate efforts to raise government revenue. The great increase in interest by foreign investors and the dynamism in the traded goods sector have also highlighted the country's infrastructure constraints. Road, rail, and port problems are being addressed; however, this will require substantial time and funds. Communications have improved significantly, but remain monopolized by the Government.