COUNTRY REPORT

Vietnam

2nd quarter 1998

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The Economist Intelligence Unit

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Summary

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Outlook for 1998-99: Government pledges of comprehensive reform will continue to be belied by slow progress, particularly in the area of state-enterprise reform. The regional economic crisis has contributed to a sharp drop in foreign investment inflows and has curtailed export growth. As a result GDP growth has begun to decline, and is expected to be relatively weak by late 1998 and into 1999. The new leadership troika has sought to reassure investors, but a quick pick-up in flagging FDI inflows is unlikely. Continued small adjustments of the dong:dollar rate are likely over the forecast period. Favourable prices for some key commodities will help sustain export growth, but declining demand and competitiveness will hit labour-intensive manufactured exports. The current-account deficit is not expected to balloon out of control again.

The political scene: The leadership team has acknowledged that the grievances of protesters against corrupt local officials and excessive taxes in Thai Binh are well-founded. Local budgets are to be made public in an effort to enable the populace better to oversee the activities of officials.

Economic policy and the economy: Foreign-invested firms are commanding a rapidly increasing share of industrial output and exports. But there are signs of a slowdown as the regional economic crisis begins to bite. The Ministry of Labour has reported massive lay-offs by both state-owned and foreign-invested firms. The pace of foreign investment disbursements has dropped sharply. There is disarray among top officials over how to cope with the economy's problems. The rate of inflation has been accelerating since end-1997. The move to equitise state-owned enterprises seems to be gathering momentum.

Sectoral trends: Exports of rice rose rapidly in value and volume in the first quarter, boosted by a bumper winter-spring harvest, but drought may prevent the full-year target being met. Garment exports to the EU are to rise sharply in 1998, thanks to increased quotas. Some foreign firms have called for greater protection from imports, but the prime minister has resisted their appeals.

Money and finance: The State Bank of Vietnam has bailed out a small joint-stock bank, after a run threatened it with bankruptcy. Moody's is reviewing its ratings of Vietnamese bonds and foreign-currency bank accounts.

Tourism: The Dutch airline KLM has pulled out of the Vietnamese market, and Vietnam Airlines has been ordered to reduce its flights. Hotel occupancy rates in Ho Chi Minh City are below 50%.

Foreign trade and payments: The State Bank devalued the dong by 5.6% in February. Exports in the first four months were nearly 20% higher in dollar terms than the same period of the previous year, and officials are still forecasting that they will grow by 23% in 1998.

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Political structure

Official name	Socialist Republic of Vietnam
Form of state	One-party rule
The executive	The cabinet is constitutionally responsible to the National Assembly and both hold office for five-year terms
Head of state	The president, currently Tran Duc Luong
National legislature	Unicameral 450-member Quoc Hoi (National Assembly); elections take place every five years. The assembly appoints the president and the cabinet
Local government	Centrally controlled provinces and municipalities are subdivided into towns, districts and villages, which have some degree of local control under their elected People's Councils
Legal system	The regional People's Courts and Military Courts operate as courts of first and second instance, with the Supreme Court at the apex
National elections	July 20th 1997; next elections due in 2002
National government	The Communist Party of Vietnam, and in particular its Politburo, controls both the electoral process and the executive
Main political organisations	The Communist Party of Vietnam (general secretary, Le Kha Phieu); the Vietnam Fatherland Front

Main members of the cabinet	Prime minister	Phan Van Khai
	Deputy prime ministers	Nguyen Tan Dung
		Nguyen Manh Cam
		Nguyen Cong Tan
		Ngo Xuan Loc
		Pham Gia Khiem
Key ministers	Agriculture & rural development	Le Huy Ngo
	Construction	Nguyen Manh Kiem
	Culture & information	Nguyen Khoa Diem
	Education & training	Nguyen Minh Hien
	Finance	Nguyen Sinh Hung
	Foreign affairs	Nguyen Manh Cam
	Industry	Dang Vu Chu
	Interior	Le Minh Huong
	Justice	Nguyen Dinh Loc
	Labour, war invalids & social affairs	Tran Dinh Hoan
	Marine products	Ta Quang Ngoc
	National defence	Pham Van Tra
	Planning & investment	Tran Xuan Gia
	Public health	Do Nguyen Phuong
	Science, technology & environment	Chu Tuan Nha
	Trade	Truong Dinh Tuyen
	Transport & communications	Le Ngoc Hoan
Central bank governor	Nguyen Tan Dung (acting)	

Economic structure

Latest available figures

Economic indicators	1993	1994	1995	1996[a]	1997[a]
GDP at current prices (D trn)	136.6	170.3	222.8	258.6	292.0
Real GDP growth[b] (%)	8.1	8.8	9.5	9.3	8.8
Consumer price inflation (av; %)	8.3	9.3	16.8	5.6[c]	4.0
Population (m)	71.0	72.5	73.9	75.4	76.7
Exports fob ($ m)	2,985	4,054	5,198	7,337	8,850
Imports fob ($ m)	4,162	5,245	7,543	10,481	11,200
Current-account balance ($ m)	–1,395	–1,198	–1,876	–2,432	–1,682
Reserves excl gold ($ m)	646	908	1,062	1,513	2,156
External debt[d] ($ bn)	5.5	6.2	7.6	9.8	8.5
Exchange rate (av; D:$)	10,640	10,955	10,970	11,700[c]	11,745[c]

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Origins of gross domestic product 1996	% of total
Agriculture	26.2
Industry	31.3
Services	42.5
Total	100.0

Principal exports 1996	% of total	Principal imports 1996	% of total
Crude oil	18.5	Materials & fuel	56.1
Textiles & garments	15.9	Machinery & equipment	33.2
Rice	11.8	Consumer goods	10.7
Marine products	9.0	Steel	4.7
Footwear	7.3	Refined petroleum	9.7

Main destinations of exports 1995	% of total	Main origins of imports 1995	% of total
Japan	26.8	Singapore	17.5
Singapore	12.7	South Korea	15.4
Taiwan	8.1	Japan	11.2
China	6.6	Taiwan	11.1
Hong Kong	4.7	Thailand	5.4
South Korea	4.3	Hong Kong	5.1

[a] EIU and official estimates. [b] Constant 1989 prices. [c] Actual. [d] Excludes transferable rouble debt.

Outlook for 1998-99

The economy is at a critical moment—

Vietnam has not been in the eye of the storm, but the regional economic crisis has now begun to buffet the economy severely. In the view of the IMF representative in Hanoi, time is short and without a package of comprehensive reforms Vietnam could "go off a cliff". Certainly the country is now at a critical moment when many of the gains of the years achieved through the first phase of reform that began in 1989 are in danger of being lost.

—but the focus is on politics—

To all appearances, however, in a reversal of recent priorities the new leadership seems to be moving faster on political reform but is deeply ambivalent about economic reform. The members of the new leadership troika—the Communist Party general secretary, General Le Kha Phieu, the prime minister, Phan Van Khai, and the president, Tran Duc Luong—have all endorsed moves towards greater local democracy. Following the lead of the Communist Party's executive, the Politburo, the National Assembly will consider three bills aimed at increasing democracy at the grass roots during its current session. The laws are aimed at enhancing citizens' rights, by improving their capacity to make "complaints and denunciations", to be informed of party activities and state policies, and to supervise local bodies, particularly their budgets. These reforms are a response to rural unrest in several provinces, including most notably in what has been a bulwark of Communist Party support, the northern province of Thai Binh. It is striking that, according to President Luong's report on the events in Thai Binh, it was four years before the grievances which underlay the disturbances there were addressed.

The envisaged democratisation has definite limits. It falls within the terms of conventional party discourse, in which it is a basic task of party and government to uphold the "people's mastery". The main lesson that has been drawn from the events in Thai Binh is that they exposed "shortcomings" in the links between the people on the one hand, and the party, the state and social organisations, on the other. The upsurge of discontent has been followed by the criticism and self-criticism sessions for local party officials, and several hundred have been arrested. The Politburo has issued a directive on party control that would enhance the party's traditional role in "inspection and supervision".

By contrast the party has brushed aside the rather more fundamental challenge to the regime posed by the proposals of Tran Do, a retired general, former party Central Committee member, cultural apparatchik and native of Thai Binh. Although these proposals fall short of advocating "multipartyism", retired General Do has called for greater freedom of expression and more open elections, and challenged many of the stereotypes of party rhetoric, including the doctrine that outside "hostile forces" are plotting to undermine socialism through "peaceful evolution". (According to Tran Do, "most negative aspects of society today are caused by 'us', not by 'the enemy.")

—as the new leadership troika seeks a new consensus—

Tran Do's remarks have been tolerated; he even received a visit from the new party general secretary, Le Kha Phieu. Observers trying to gauge the significance of the election of Le Kha Phieu as party general secretary have concluded that General Phieu, the first career military man to hold the top party post, may not be the hardliner they had taken him to be. His apparent flexibility and willingness to tolerate dissent may raise the possibility of more far-reaching political change over the years ahead. It may also represent the sort of confidence, expressed by the new prime minister, Phan Van Khai, that Tran Do's views are those of a tiny minority which are no threat to the party state, and do not reflect "heated debate" in the Politburo. More likely, after a protracted and apparently bruising leadership transition, the new troika is trying to establish a new consensus that will form the basis of their working relationship. The main points of this consensus seem to be:

- the need for more grass-roots democracy;
- the need to enhance the effectiveness of the party's inspection and control organs;
- an economic agenda that gives the highest priority to agriculture and the rural areas;
- a belief in the need to foster economic development by keeping an "open door" to the outside world (dollar exports are targeted to grow at around 25% a year and foreign direct investment (FDI) is scheduled to provide about one-third of total investment);
- a gradual approach to economic reform that minimises the risk of serious social dislocations; and
- a "multisectoral" approach that encourages the development of the state, private and co-operative sectors; and
- a firm stance against the various kinds of "social vices" (ranging from drug addiction to corruption to "cultural imperialism") that are seen as a by-product of the economic reforms.

—which may be hard to achieve

There are a number of possible problems with the points of the agenda mentioned above.

First, it is vague and leaves plenty of room for differences. In recent speeches, for instance, the three new leaders have staked out distinct positions on the threats and opportunities involved in maintaining the "open-door" policy. A serious slowdown in economic growth could widen these differences, threatening the intricate factional balance of the new leadership.

Second, the new consensus excludes some still powerful voices among them, hardline opponents of economic reforms and the unreconstructed security apparatus.

Third, the reforms they envisage are partial. The lesson the party has drawn from the collapse of communism in eastern Europe is that shock therapies are definitely to be avoided, but even partial reform may unleash an unstoppable process of liberalisation. Partial liberalisation may also fail the ultimate test of effectiveness: the problems of the financial system and the state-owned enterprises are so interlinked that it may not be possible to apply different timetables to each, as seems to be envisaged. The limited political changes that the leadership has endorsed may not suffice. The reforms to date have created new vested interests, some of which are now heard in the more assertive National Assembly. The new laws on citizens' rights should further strengthen the National Assembly, as well as its equivalents on a local level, the People's Councils. A new political culture might emerge that might not take kindly to "inspection and control".

The regional economic crisis has begun to hurt—

The preoccupation with the problems of political transition comes at an awkward time for the economy. The regional economic crisis has affected Vietnam more quickly and more seriously than had been expected. Foreign investment commitments and inflows, which mainly originate in Asia, have fallen sharply and are unlikely to revive until an Asian recovery gets under waynot before 2000 at the earliest. Heightened competition in international markets for export goods such as garments, footwear and electronics is limiting Vietnam's ability to expand its production of these items rapidly. The inflow of low-price imports, often smuggled, from Thailand and elsewhere—stimulated in part by the depreciation of the baht relative to the dong—has put pressure on local firms. Together these influences have led to lay-offs at both state-owned and foreign-invested enterprises, and worse will follow.

—as FDI falls away—

A continued inflow of foreign capital and expertise is central to the new leadership's economic strategy, and the leaders have focused their efforts on this uncontroversial area. After holding meetings with large groups of foreign investors in Hanoi and Ho Chi Minh City in February, the prime minister introduced a series of measures designed to streamline the investment process and to provide investors with "hotlines" aimed at resolving problems as they arise. There is, however, much scepticism as to whether progress can be made on the more intractable problems of combating corruption and bureaucracy at the middle levels of the civil service.

Three decrees aimed at combating corruption were signed into law in March, and may be of some help in the long run, although it is not clear that the new rules requiring senior officials to declare their assets when they change their position or retire will be enforced. Published data on the results of efforts to counter corruption sound impressive—the party disciplined 18,000 of its members, mainly for corruption, in 1997 alone—but are believed to touch only the surface of the problem, underlining its pervasiveness. While Asia's downturn explains some of the recent waning of foreign-investor interest in Vietnam, potential investors from outside the region have also been staying away. Despite several rounds of amendments to the foreign investment law during the 1990s potential foreign investors cite reasons that have been familiar since the late 1980s for not investing—an obstructive bureaucracy, an ill-defined legal framework and poor infrastructure.

—and domestic savings fail to fill the gap

Government plans assume that half of the country's capital needs to the end of the century will be locally financed and half will come from foreign sources (predominantly in the form of FDI and secondarily as overseas development assistance). Mobilising the domestic component now also looks a forlorn hope unless the government carries through a radical overhaul of the financial sector. Reform of the financial sector is inextricably linked to state-enterprise reform. The banking system continues to be geared to the needs of the state enterprises. A distorted interest-rate structure muffles market signals and limits the system's capacity to mobilise savings. Lack of enthusiasm for equitisation among state-enterprise managers and workers has become a serious drag on the development of capital markets. The IMF has pointed out that the already weak banking system may well be pushed over the edge by an economic slowdown. The appointment of an economic reformer, the deputy prime minister for economic affairs, Nguyen Tan Dung, as acting governor of the State Bank of Vietnam (the central bank), has been taken as a signal of government intent to shake up the financial sector, but here as elsewhere the power of vested interests will put a brake on radical reform.

GDP growth is slowing—

GDP grew by 8.8% in 1997, and not by 9% as previously reported. Despite a robust start (another bumper winter-spring rice harvest and industrial growth averaging nearly 13% in the first quarter) there are already signs that the economy is slowing: the slump in new foreign investment (both disbursements and commitments), slower export growth and reports of large numbers of lay-offs. Economic growth is expected to slow down sharply in 1998 to just 5.2% for the year and to remain subdued in 1999, at 5%, the slowest rate in a decade.

Forecast summary

(% change year on year unless otherwise indicated)

	1996[a]	1997[a]	1998[b]	1999[b]
GDP growth	9.3	8.8	5.2	5.0
of which:				
agriculture	4.4	4.8	3.0	3.5
industry	14.4	12.3	7.5	6.0
Consumer prices (av)	5.6[c]	4.0	6.0	10.0
Exports fob ($ m)	7,337	8,850	9,735	10,817
Imports fob ($ m)	10,481	11,200	11,670	12,651
Current-account balance ($ m)	–2,432	–1,682	–1,829	–1,675
Exchange rate (av; D:$)	11,700[c]	11,745[c]	13,300	14,700

[a] EIU and official estimates. [b] EIU forecasts. [c] Actual.

—as is the growth of exports

Although exports of rice (weather permitting) and petroleum are expected to be buoyant in both value and volume terms, manufactured exports are expected to increase far more slowly in 1998-99 than in 1997, as they face heightened competition from other producers in the region. We expect the dollar value of exports to increase by 10% this year and 11.1% next. Vietnam's export prospects for the next two years will be heavily reliant on developing non-Asian markets for its labour-intensive manufactures, primarily in the EU and the US. Last year's textile quota agreement with the EU gives some scope for expansion of sales to that market during 1998-99. The Clinton administration's decision in March to waive the Jackson-Vanik amendment (which sets requirements on labour standards and freedom of emigration) is a step forward, but fully fledged trading ties with the US require a trade co-operation agreement and the granting of most favoured nation (MFN) status. There are still several more rounds of negotiation in prospect before US and Vietnamese officials produce a draft treaty which would then have to be presented to a possibly unreceptive Congress. A trade breakthrough with the US is not expected until late in the forecast period.

As already noted, foreign investment inflows will continue to slow over much of the forecast period. Aid disbursements will rise but only modestly: one major constraint will be a shortage of counterpart domestic revenue. This entails that the current-account deficit will have to remain below $2bn. A consequence is that imports will probably rise by just 4% in 1998 and a still relatively anaemic 8.4% in 1999.

Inflation will remain subdued

The government expects the annual average rate of consumer price inflation in 1998 to be no higher than 7%; based on the relatively modest price rises seen early in the year, this goal is achievable. Despite the depreciation of the dong to date imported inflation will remain low. The dollar prices of many legal imports, ranging from petroleum products to steel to consumer items imported from countries in the region, will be soft (as will be the prices of smuggled goods from those countries). There will some upward pressure on interest rates (as the government pursues its policy of increasing domestic savings mobilisation), although it will be constrained by a desire not to push too many vulnerable banks over the edge. Interest rates will be high enough to constrain inflation, however. Tight domestic liquidity and declining foreign investor demand have already burst the property price bubble. The government seems determined to maintain fiscal discipline even in the face of weak revenue growth: as in the past, the most likely casualty is public investment. The strongest inflationary pressure will probably result from the impact of the drought on agricultural output, but the government has already made it clear that it will cut back on rice exports rather than risk serious domestic shortages. Hence we expect year-on-year inflation to undershoot the government's target of 7% this year before rising to 10% next year. This is still high enough to require some further devaluation of the dong within the next few months, probably by about 5% once again.

The February devaluation will be the model for future ones—

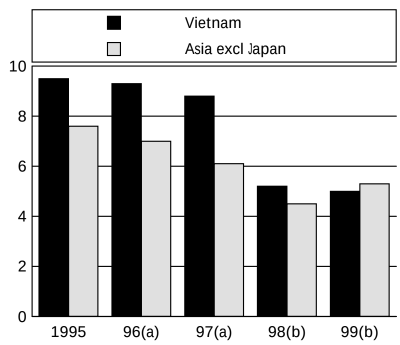
The rest of the leadership's economic strategy lags behind its efforts to lure back foreign investors. The "pivot rate" of the dong was devalued against the dollar by 5.6% in February, as the State Bank's reserves of foreign exchange showed signs of draining away. It immediately fell to the bottom of its trading band (it is permitted to trade within a 10% range on either side of the pivot rate). It is widely held that that the dong remains somewhat overvalued, particularly after the large devaluations that some of its main competitors have undergone. The black-market rate remains above the official rate, the interbank foreign-exchange market is moribund and firms and individuals continue to hold on to dollars as much as possible.

For many reasons the government will continue to continue to try to adjust the dong in small steps, as it has been doing since October 1996. The government is afraid that if it devalues the dong by much more than it has to date, it will spiral out of control, unleashing high inflation and increased "dollarisation" of the economy and thereby undoing years of (largely successful) effort to stabilise the currency. A large devaluation would also administer a drastic shock to the financial sector, particularly to banks which have borrowed abroad. It is true that Vietnamese producers (both for export and for the domestic market) are having problems competing with neighbours whose currencies have depreciated by 35% or more in the past year (compared with the 15% depreciation of the dong). However, the benefits of a large devaluation in terms of increasing export competitiveness are probably small. Vietnam's exports are still dominated by primary commodities (in 1996 they represented over 70% of the total) for which it is a price-taker. Its labour-intensive manufactured exports are also import-intensive. Foreign investors, and particularly investors from countries whose currencies have recently collapsed, are likely to be deterred by the fact that many of their costs, including labour costs, are linked to the dollar (the minimum wage in foreign-invested enterprises is set in dollars, for instance), and so a devaluation would have the effect of raising costs as long as the link was not broken.

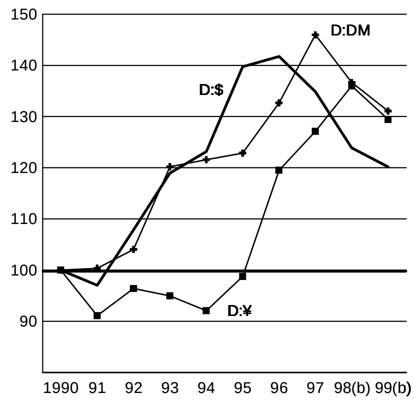
—unless a crisis forces the authorities' hand

As in China, for which many of the same arguments against devaluation apply, non-convertibility has provided the currency with some protection against currency speculation. Unlike China, however, Vietnam's foreign-exchange reserves are tiny (recent press reports suggest that they provide just ten weeks of import cover). The authorities will continue to defend the currency through import and exchange controls. However, a concerted shift from dong into dollars on the black market that opened up a wide gap between the official and free-market rates could force their hand. A large devaluation cannot be ruled out completely, then, but it would be a last resort and, given the government's rocky relationship with the IMF, would also probably be difficult to manage.

Gross domestic product
% change, year on year



Dong real exchange rate (c)
1990=100



(a) EIU and official estimates. (b) EIU forecasts. (c) Nominal exchange rates adjusted for changes in relative consumer prices.
Sources: EIU; IMF, *International Financial Statistics*.

Review

The political scene

President Luong sympathises with peasant grievances—

Serious disturbances erupted in the northern province of Thai Binh in May 1997, and the province remained unsettled for much of the year. In February 1998 the president, Tran Duc Luong, visited Thai Binh and gave a long and remarkable speech at a conference of provincial leaders. He began by noting that dissatisfaction had been mounting since 1994, when local people began sending letters complaining about party and government officials. No action was taken to resolve the complaints. The number of the complaints, and the fact that they came from an area known for its patriotism and loyalty to the party, gave them credence. As President Luong put it: "When such good people have to vent their grave dissatisfaction through mass protests against officials, the only explanation ... is that many of our officials and party members ... must have committed many wrongs."

—of corruption, bureaucratism, fraud and excessive taxes

Investigations turned up many cases of village leaders mismanaging public funds, including the overreporting of the number of projects completed and the pocketing of the unused funds. Many local officials were accused of "bureaucratism"—failing to keep in contact with local people and thus being unaware of the depth of popular dissatisfaction and distrust. Others violated the law, by spending money for unauthorised purposes and by selling and allocating land for the profit of district and village officials. Levies collected from the public between January 1994 and July 1997 came to D176bn (about $16m) more than had been authorised. Officials also levied unreasonably onerous taxes and charges on households, most of which were very poor.

The guilty have been disciplined and budgets are to be published—

The high levies were part of an ambitious drive to endow Thai Binh with modern infrastructure. The effort bore fruit. Between 1991 and 1996 the province constructed 4,408 km of roads, of which 2,831 km are tarred; it put up 3,712 km of electricity lines; increased the number of local schools by nearly 90%; and improved the supply of clean water. In its dash to modernise, however, the province ran up a debt of D245bn, much of it borrowed from local people. The president called for the inspections of village management to be completed expeditiously, for "corrupt, negative, immoral and incapable officials" to be replaced, for an end to all compulsory collection of "fees" from farmers, and for improved managerial practices. About 300 provincial officials have been disciplined for corruption and other offences, and 40 are being prosecuted. Foreign reporters were allowed to visit the province in February for the first time since the unrest there began.

—and "democratic structures" are to be built

Most revealing are President Luong's comments about the implications of the unrest in Thai Binh for political change. "The incidents in Thai Binh", he said, "have displayed the shortcomings of the political system led by our party ... The prevalence of undemocratic practices has widened the gap separating the party, state, and political and social organisations from the people ... Therefore the Politburo is drawing up a policy to build a democratic structure at the grass roots."

This will involve greater transparency in local budgets. A Politburo directive issued in March requires local authorities to report regularly to the people on the use of public funds. Similar rules have been proposed at the national level by the Ministry of Finance. They are to be enshrined in a law to be presented to the current session of the National Assembly.

There is dissatisfaction elsewhere—

Dissatisfaction is not confined to Thai Binh. For instance in Ha Tay province, just west of Hanoi, the public security force held a conference in March to discuss how to deal with "complicated public contradictions and hot issues". There were 75 incidents of "complicated contradictions" in the province in 1997, including cases where local authorities either did not respect regulations on land management or granted land illegally. Public indignation led to a number of "hot spots", typically related to disagreements about land rights. The fact that this conference took place and was reported in the party newspaper, *Nhan Dan*, indicates that the leadership is taking the problem of rural unrest very seriously. The problem of corruption is found in the cities too, and a newspaper recently reported on the anger of residents of Ho Chi Minh City at the rising number of fees levied by officials for which they are not given receipts.

—and corruption too

The Hong Kong-based Political and Economic Risk Consultancy (PERC) recently ranked Vietnam as the third most corrupt country out of the 12 Asian countries it considered, behind Indonesia and Thailand. PERC's managing director commented that although Vietnam, like China, is talking tough about corruption, the difference is that the Vietnamese authorities are not backing words with action. An earlier PERC report found that red tape in Vietnam has increased, providing civil servants with more opportunities for corruption.

Three new decrees are aimed at reducing corruption—

Perhaps that is changing. Three new decrees which are intended to reduce corruption were discussed by the Standing Committee of the National Assembly recently and signed into law on March 9th. The anti-corruption decree defines corruption (for the first time) and sets out penalties for those found to be corrupt. The decree on the practice of thrift seeks to reduce wasteful spending of public resources. The lengthy decree on state civil servants requires senior state officials to declare property owned before taking new posts and on retiring, forbids officials from depositing cash or gold with foreign banks, and does not allow them to establish or run private companies, hospitals or schools. It prescribes that criminal charges are to be brought against anyone found to have accepted bribes worth more than D500,000.

—and anti-corruption efforts bring results

Even without these laws efforts to combat corruption have borne some fruit. In 1997 the State Inspectorate General received 279,995 complaints from citizens and organisations protesting against civil servants and officials, "mostly for crimes of corruption, bribery or violations of people's basic democratic rights". Investigators recovered an estimated $11.2m and caught 4,419 state officials, including five provincial leaders, 16 ministerial department directors and 105 district heads. On March 14th officials from the state-owned Nam Dinh Textile Mill received sentences ranging from suspended jail terms to life imprisonment, for corruption that led to $17m in losses at the company.

General Do calls for elections and free speech—

An unexpected challenge to the regime came in the form of a letter to top party officials from a veteran party member General Tran Do (74), who urged "radical political reforms", including guarantees of freedom of thought and expression and free elections. In support of his call he quoted Ho Chi Minh's dictum that "independence without freedom and happiness is meaningless". General Do, who is from Thai Binh province, has impeccable party and state credentials. He is a former member of the party's Central Committee. Like Le Kha Phieu for much of his career he was a political commissar in the armed forces and subsequently held posts in the party, the government and the National Assembly, in which he had oversight of cultural affairs. More predictably similar sentiments were expressed by a well-known dissident, the mathematician Phan Dinh Dieu, who used to be deputy director of the National Centre for Scientific Research. More surprising was the fact that he had been invited to deliver his views to the Vietnam Fatherland Front, the umbrella organisation which groups approved mass organisations.

—and his dissent is tolerated

What is interesting is that the leadership, including the new party general secretary, General Le Kha Phieu, who came to the post with a reputation as a hardliner, appears to be tolerating the dissent. General Phieu has visited General Do. The reformist prime minister, Phan Van Khai, reacted by saying that “those people have a right to voice their opinions”. He noted that such views did not form the basis of “heated debate” in the Politburo, thereby implying that they were tolerated only because they represented a tiny minority.

The new general secretary shows unexpected flexibility

General Phieu remains only slightly less of an enigma than when he became general secretary last December, although his image as a hardliner is fading fast. He has said that “economic duties” are the party’s main mission at present. He has reaffirmed Vietnam’s commitment to remain open to trade and investment and has shown support for equitisation (but not necessarily for privatisation). He was praised last year by a dissident, Hoang Minh Chinh, who said that the general was an open-minded and humble man who had a “constructive attitude”. His willingness to allow at least a limited amount of dissent caused some observers to praise him for an approach which combined flexibility and subtlety. It would be remarkable if this protégé of two renowned conservatives—Do Muoi (whom he succeeded as party general secretary) and the former president, Le Duc Anh—manages to build on this newly acquired reputation.

Party recruitment is up, but many members are being disciplined

The Communist Party claims to have recruited 100,000 new members in 1997, the highest number in a decade, permitting it to maintain its membership at about 2.3m. The State Inspectorate reported recently that in 1997 the party disciplined 18,000 of its members in its efforts to root out corruption; of these 533 were prosecuted and 469 jailed.

Vietnam objects to the Chinese plan to lure tourists to the Paracels—

Vietnam has protested loudly at China’s efforts to develop tourism in the Paracel Islands. China has established a ground satellite station on Yongxing island, along with a telephone booth (which accepts magnetic debit cards). China seized control of the Paracels from South Vietnam in 1974, but Vietnam still claims sovereignty over the islands. A Hong Kong-based newspaper said that China intended to make the islands fit for foreign tourists. The Philippines’ foreign secretary, Domingo Siazon, dismissed the Chinese moves as not alarming, noting that “even our soldiers there [in islands in the South China Sea] use telephones, and the Vietnamese as well”.

—while border negotiations proceed

Despite this war of words over the Paracels the Vietnam-China Joint Working Group for the demarcation of borders in the Gulf of Tonkin held a “friendly and frank” set of meetings in late March, and agreed to accelerate negotiations in the hope of reaching a agreement by 2000. Since November Chinese troops have been clearing mines from areas along the border, successfully removing or exploding over 21,000 mines over a period of four months. The operation will continue until the end of May and is expected to clear almost 800 sq km of terrain.

President Luong visits Malaysia and Singapore

President Tran Duc Luong visited Malaysia and Singapore in March. Malaysia agreed to help Vietnam draw up the individual action plan required for membership of the Asia Pacific Economic Co-operation (APEC) forum. Vietnam wants to strengthen its relations with its Association of South-East Asian (ASEAN) neighbours, as a counterweight to the rising influence of China. Singapore and Malaysia may have asked President Luong to use Vietnam's influence with Cambodia's co-prime minister, Hun Sen, to ensure that the elections due to be held in July pass off smoothly enough to allow Cambodia to be admitted to ASEAN at the association's summit in Hanoi in December.

Fences with the Vatican are mended

Vietnam has been mending fences with the Vatican, after tensions between the two surfaced late last year when Cardinal Pham Dinh Tung of Hanoi set out a series of six concerns in a letter to the prime minister, including complaints about restrictions on the travel by priests and unreasonable limits on the number of youths allowed to enter seminaries. The Pope appointed Jean-Baptiste Pham Minh Man as archbishop of Ho Chi Minh City, presumably with the approval of the Vietnamese authorities, almost three years after his predecessor died in office. Etienne Nguyen Nhu The was named to the vacant bishopric of Hue. Vietnam has about 8m Catholics in its population of 78m.

Boat people return from Hong Kong—

The number of Vietnamese boat people in Hong Kong continues to fall, and now stands at about 1,200, with the continued repatriation of immigrants. A group of 238 Vietnamese, including 237 illegal immigrants, arrived back in Vietnam on March 31st under the Orderly Repatriation Programme; less than three weeks earlier another 274 boat people had been flown home, most of whom had arrived in Hong Kong in 1997.

—and the US interviews prospective refugees

US immigration officials are in Vietnam interviewing about 2,000 people a month under the Resettlement Opportunity for Vietnamese Returnees (ROVR) programme. Under the programme as many as 15,000 former boat people may be resettled in the US as refugees, where they would join the estimated 480,000 Vietnamese who have already made their homes there. Vietnam's willingness to allow the US to process ROVR cases was instrumental in the decision of the president, Bill Clinton, on March 10th to waive the Jackson-Vanik amendment to the 1974 Trade Act, which prevents the US government from extending trade or investment funding to countries that do not allow their citizens to emigrate or travel abroad freely. The waiver is likely to be challenged when it is discussed by the US Congress in June, but is expected to withstand scrutiny.

The US opens the way to further trade negotiations

The waiving of the Jackson-Vanik amendment opened the way for the Overseas Private Investment Corporation (OPIC), an agency of the US federal government, to provide insurance against war, expropriation and other political risks to US firms planning to operate in Vietnam. More than 19 firms are seeking OPIC support for projects in Vietnam that could generate up to $900m in investment. One of these is the Craft Corporation, which plans to build a $302m reduced iron plant. The waiver also permits the US Export-Import Bank (Exim Bank) to extend loans to US companies that export to Vietnam. The effects of this change should not be overstated; the Exim Bank finances just 2% of US exports.

The way is now open for negotiations on a more comprehensive trade agreement between the US and Vietnam. At stake for Vietnam is most favoured nation (MFN) status, which would have the effect of substantially lowering the tariffs which its manufactured goods currently face when entering the US. A quick agreement is unlikely. Talks about an aviation agreement broke down earlier in the year, and there is a lot of confusion about the current status of the copyright agreement signed between the two countries in June last year. US companies complain that software, music and film piracy is rife, while Vietnamese officials argue that the US has to act first in order to bring the agreement to life.

Economic policy and the economy

GDP growth remained solid in 1997—

GDP grew by 8.8% in 1997, slightly more slowly than the rate of 9.3% recorded in 1996. An IMF report released in April 1998 accepts the growth rate of 9.3% for 1996 but puts the rate at 7.5% for 1997. It is not clear why the IMF and the official numbers differ, but it provides a useful reminder that economic statistics on Vietnam must be treated with caution.

1997 performance and 1998 targets

(% change, year on year unless otherwise indicated)

	1997[a]	1998[b]
GDP growth	8.8	9.0
Industrial growth	13.2	13.0-13.5
Agricultural growth	4.8	4.6-4.8
Exports (in dollars)	20.6	25.0-26.0
Imports (in dollars)	6.9	18.0-20.0
Inflation (%; year-end)	3.6	7.0
Budget deficit (% of GDP)	1.8[c]	3.5-4.0

[a] Preliminary official figures. [b] Official targets. [c] EIU estimate.

Source: Press reports.

—and industrial momentum has been maintained so far—

The momentum of economic expansion continued into the first four months of 1998, although a marked slowdown is expected later in the year. In the first four months of 1998 industrial production rose by 12.8% over the same period of 1997, driven by very rapid (21.6%) growth in foreign-invested firms and solid growth in state-owned enterprises (10.8%). The officially recorded increase in output by non-state domestic industry (comprising private firms and co-operatives) was a modest 6.1%. To judge from the partial breakdown given in press reports covering the first three months of the year the performance of state industry was patchy, justifying the concerns expressed by the deputy prime minister, Nguyen Tan Dung, to the National Assembly about state-enterprise inefficiency (see below): there were strong increases in output of petroleum (19.6%), steel (15.6%) and power (15.3%), but in several other industries where the state still dominates—diesel engines, transformers, tobacco and fertiliser—output fell.

Industrial output growth, 1998
(% change, year on year)

	Jan	Feb	Mar	Apr	Jan-Apr
State-owned industry	6.0	19.8	11.2	7.9	10.8
Non-state industry	6.0	8.9	5.1	6.3	6.1
Foreign-invested industry	22.7	17.5	22.7	22.9	21.6
Total	10.7	13.0	13.0	11.8	12.8

Source: Press reports.

—but there are clear signs that the economy is slowing—

Ho Chi Minh City may now be about to lose its position as the country's fastest-growing industrial location. On a number of indicators the city underperformed the national average in the first quarter of 1998: industrial production recorded its lowest growth rate for four years—10.3% compared with the same period a year earlier below the 1998 target rate of 15%—as output from foreign-invested industry grew by 19.7%, about half the rate recorded in the first quarter of 1997; tourist receipts rose by 2.5%; and the value of exports and imports by firms based in the city fell in dollar terms, by 2% and 7.2% respectively. Rather than becoming a permanent laggard, however, it seems more likely that Ho Chi Minh City's comparatively slow rates of growth presage a similar more marked slowdown elsewhere in the country. Certainly the official view is that Ho Chi Minh City and the surrounding area will continue to be the country's most buoyant region: a Southern Provinces Master Plan, released in early March, envisages growth rates of 13-14.5% in the region over the next five years.

Officially the government is still committed to achieving real GDP growth of 9% in 1998, led by a 13.5% expansion of industry. However despite the strong showing of the first four months, it is widely accepted that these targets will not be met, as the fallout from the regional economic crisis will be felt more keenly. Several top officials, including the finance minister, Nguyen Sinh Hung, and the then acting governor of the central bank, Do Que Luong, have publicly expressed doubts about the feasibility of achieving such a high rate of growth, and many of the other related targets for the year will probably also be missed, among them those for industry (13-13.5%), agriculture (4.6-4.8%) and exports (25-26% in dollar terms).

—as the Asian economic crisis hits harder than expected—

The regional economic crisis has had a bigger effect on Vietnam than many had expected initially, and because the effects are occurring with a lag it has taken some time to recognise their importance. Export growth slowed from 23% in 1997 to 12% (in current dollar terms) in the first quarter of 1998 before picking up strongly in April (see Foreign trade and payments). Both state-owned enterprises and foreign-invested firms are reported to have laid off large numbers of their workers, as some firms struggle to remain competitive in international markets while finding it increasingly difficult to obtain credit and dollars. New foreign investment commitments have slowed to a trickle, and many existing projects have been postponed as companies in the (mainly Asian) investing countries scale back their overseas expansion plans.

—causing lay-offs—

According to a report issued by the Ministry of Labour, War Invalids and Social Affairs (MOLISA) in April, there have been massive lay-offs since the end of last year, involving 8% of the workforce at state-owned companies and 11% at foreign-invested businesses. As a proportion of the workforce, 18% of workers in enterprises under the wing of the Ministry of Industry have been laid off as well as 12% in enterprises under the Ministry of Agriculture and 9% under the Ministry of Construction.

A survey of 1,855 businesses undertaken by MOLISA earlier this year found that 747 firms (40%) could not find enough work for their employees, and that many firms have reacted by reducing working hours and granting extended leave. The report claimed that firms under municipal and provincial control had laid off an average of 20-25% of their employees. The timeframe for the lay-offs was not revealed.

—including in foreign-invested enterprises

According to a separate estimate in the *Vietnam Investment Review*, as of the end of March 28,000 workers had been laid off by foreign-invested enterprises, about 8% of the 350,000 employees working in these firms. The article predicted that lay-offs in the foreign-invested sector would rise to around 30%. The World Bank's resident representative in Vietnam, Andrew Steer, is more optimistic, arguing that the decline in jobs in the sectors such as the car industry and some export industries will be more than compensated for by employment generation from the small- and medium-scale industrial sector.

To some extent the lay-offs reflect changes in the structure of demand. For instance about 4,000 employees at subcontractors for Nike have been laid off (out of a total of 35,000), although total exports of footwear have continued to rise and total employment in that industry continues to increase. Another reason for lay-offs is that the regional economic crisis is having a more severe effect than had initially been expected. The crisis is forcing state-owned firms to become more efficient if they are to survive in an increasingly competitive market. In addition firms from South Korea and Thailand are reducing their presence in Vietnam, now that their financial crises have made home-based production more profitable and investment funds scarce.

Officially the unemployment rate was 6% nationally in 1997, up from 5.9% in 1996, not counting the underemployment that is common in rural areas at certain seasons. One of the official reasons for the slow pace of equitisation of state-owned enterprises is a concern that it may add to the ranks of the unemployed.

The prime minister heeds investors' calls for simpler procedures—

The prime minister, Phan Van Khai, has orchestrated the response to the economic slow down, mainly by listening to investors' complaints in a series of public meetings held in February, and then pushing for improvements in the rules and procedures that investors have to follow. His efforts seem to have improved the atmosphere for investment, but it is not clear whether he can rein in the middle-level bureaucrats who make life difficult for investors and traders.

—but is slow to act on the exchange rate and state enterprises

Moreover, not all of the pieces of the package required to attract investors are in place. The dong remains non-convertible, and the State Bank is trying to force or persuade firms to part with their dollars. As a result firms will bypass the banking system when they can. (There are said to be $8bn worth of dollars being held by firms and individuals outside the banking system.) The dong may still be somewhat overvalued. More seriously Phan Van Khai disappointed those who see him as a reformer when he asserted that the state-owned enterprise sector would be dismantled and privatised gradually, in order to avoid creating too much unemployment (see below).

The perceived slowness of reform led the IMF's country representative, Erik Offerdal, to say in mid-March that without a comprehensive package of reforms the country could go "off a cliff". Since last November the IMF has been blocking the release of the latest, $176m tranche of its enhanced structural adjustment facility (ESAF) loan. The finance minister, Nguyen Sinh Hung, told the *Vietnam Economic Times* that the government and the Fund were at odds over the pace of state-enterprise equitisation and the rationalisation of the tax system. Mr Hung's message was that the government needed time and that "the actual economic situation in the country is quite different from how the IMF perceives it". On the financial sector in particular the Fund seems to be of the view that time is short (see Money and finance).

There are signs of disarray on how to cope with the crisis

In his report on the economy at the April-May National Assembly session one of the deputy prime ministers, Nguyen Tan Dung, said that both the GDP and export targets would be difficult to meet, citing Vietnam's poor competitiveness, the sluggishness of many domestic enterprises, the drought and the impact of the Asian crisis. Echoing two of the themes of the most recent World Bank Country Economic Memorandum on Vietnam Mr Dung noted the "illogical" allocation of investment and the low efficiency of state enterprises. Although "temporary" factors had worsened the country's economic problems, it was facing difficulties that he described as fundamental. The solution, as far as he was concerned, was "bold action", which included state-enterprise reform and a shake-up of the banking system.

Resistance to a new round of fundamental reforms remains strong, however. In what sounded like an instance of the communist "voluntarism" that marked the failed economic policies of an earlier era, the new party general secretary, General Le Kha Phieu, while admitting that the regional crisis and the drought were having some impact, also reiterated the importance of holding to the 9% GDP growth target "despite everything". More surprisingly, Phan Van Khai struck a similarly obdurate tone in his first press conference with the foreign press in March when he also reaffirmed the 9% growth target while stressing the need not to be hasty in carrying out reforms, including state-enterprise reform. The apparent confusion suggested by this mix of views had earlier been confirmed by the prime minister when in a speech given in March he had acknowledged that there were differences on how to tackle the country's economic problems.

These differences cannot be ignored, however. At the policy level they are most likely to result in "hybrid" policies which satisfy no one. At the level of the real economy confusion over targets could have unfortunate consequences: settling for a lower growth rate should, for example, entail adjustments to the budget and the targets for the monetary aggregates if inflation is to be contained.

Inflation remains subdued

After rising 1.6% in January and 2.2% in February month on month (largely because of the annual acceleration in prices associated with the Tet—Vietnamese

New Year—holiday), consumer prices fell by 0.8% in March. This brought the year-on-year rate of inflation in March to 4.5%. In March prices fell more or less across the board: items ranging from vehicles to construction materials to home appliances were cheaper than in the previous month, as were the essentials, food (down 0.8% month on month) and foodstuffs (down 1.3%). There was some acceleration in inflation in April (to 1.6% month on month and 6.7% year on year).

However, when compared with the year-on-year rate of 3.6% at the end of 1997 these figures suggest that inflation, although rising, is still under control and that the government's goal of keeping the year-on-year rate below 7% throughout 1998 is still realistic, particularly as this target was based on the assumption that the economy would be much more buoyant than is likely to be the case (see above). Some acceleration in inflation is to be expected, as a result of the devaluation of the dong relative to the dollar (down 13.9% between March 1997 and March 1998) and the likely upward movement in rice prices later in the year (see Agriculture). However, in addition to comparatively weak domestic demand growth the dong's appreciation relative to the Thai baht, and the influx of cheap, largely smuggled, consumer goods from Thailand will help dampen inflationary pressures.

Consumer prices
(% change)

	1997		1998	
	Month on month	Year on year	Month on month	Year on year
Jan	0.8	4.4	1.6	4.3
Feb	2.6	3.7	2.2	4.5
Mar	2.1	2.3	–0.8	4.5
Apr	1.5	1.6	1.6	6.7
May	1.0	1.6		
Jun	1.1	2.1		
Jul	1.3	3.1		
Aug	1.4	3.6		
Sep	2.0	4.0		
Oct	2.3	4.3		
Nov	0.3	3.6		
Dec	1.0	3.6		

Source: Press reports.

Foreign investment commitments are falling—

Between January 5th and March 13th $1bn worth of new foreign investment projects were approved. This is in line with the rate of investment approvals in 1997. However, the numbers mask the fact that interest in investing in Vietnam has slowed to a trickle. Fully 70% of the new investment was for a single $706m tourism project in Dalat, to be developed by a company from Singapore. The other 22 projects from all other sources were worth just $308m. Compounding the problem, the Ministry of Planning and Investment has far fewer applications in hand than it did a year ago.

The fall in investment approvals has occurred across the board, as the table below shows, although the small flows from Taiwan and South Korea are particularly noteworthy. Reduced flows from South Korea, Malaysia, Thailand and even Japan might be attributable to the economic difficulties faced by their economies, but this is not a plausible explanation for the poor showing by the other investor countries listed. It is clear from these numbers that investors from most countries have largely lost interest in investing in Vietnam, at least for now. Not all of this loss of interest is Vietnam's fault; some of it also reflects the newfound competitiveness of countries such as Thailand in the foreign markets for garments, footwear and electronics where Vietnam also competes.

FDI approvals
($ m)

	New approvals (Jan 5th-Mar 13th 1998)	Cumulative approvals (Dec 1988-Mar 13th 1998)
Singapore	753.40	6,218.34
Taiwan	8.22	4,125.89
Hong Kong	17.84	3,735.76
Japan	81.26	3,571.10
South Korea	8.03	3,133.44
France	38.02	1,482.80
Malaysia	26.94	1,374.10
US	18.79	1,243.20
Thailand	25.33	1,105.53
British Virgin Islands	20.20	1,035.36
Others	16.02	4,491.07
Total	1,014.05	31,696.59[a]

[a] Net of revoked projects, worth $2,393.76m, and oil and gas projects. Total does not sum in original.

Source: *Vietnam Investment Review*.

—and the pace of disbursements has already slowed

There is a lag between investment commitments and investment spending. As a result although investment commitments peaked in 1995, actual disbursements on foreign-invested projects have begun to decline only recently. An estimated $2.5bn was spent on such projects in 1997. During the first two months of 1998 the figure was $250m, equivalent to an annual rate of just $1.5bn. Press reports put disbursements in the first quarter at just 56% of their level in the same period of 1997.

The rate will fall further as the year progresses, as more licensed projects are cancelled, suspended or reduced in scope by foreign investors, most of whom hail from countries in North-east and South-east Asia. A concrete example is the case of Hyundai-Vinashin, a joint-venture shipbuilder which recently reduced its registered capital from $95m to $50m. In the southern province of Dong Nai, 11 Asian companies had withdrawn from scheduled projects by mid-March. In part because of the economic problems at home Malaysia's Faber Group is not expected to be able to raise the $18m needed to complete the $79m Hanoi Sheraton Hotel.

The government introduces new measures to lure FDI—

The government is keenly aware of declining interest in Vietnam by foreign investors, and early in the year embarked on a systematic programme designed to improve Vietnam's image as a destination for investment and to attract new foreign investment. The prime minister addressed large meetings of foreign businesspeople in Hanoi and Ho Chi Minh City in March, listened to their complaints and offered reassurance about the country's commitment to economic reform. Since then a number of changes have been floated, some of which are firmer than others.

- Two "red tape hotlines" have been set up, one each in Hanoi and Ho Chi Minh City, to "take calls from investors and take their problems up with the relevant authorities". The hotlines are run by the Ministry of Planning and Investment, which promises to provide answers within a week to ten days.

- The General Tax Department has set up a hotline in Hanoi to provide advice to "businesspeople with tax problems".

- The prime minister has pledged that any agency or civil servant that "misinterprets" the laws or harasses investors will be punished.

- The number of provinces allowed to approve most foreign investment projects worth less than $5m has been doubled from eight to 16, with the addition of Ha Tay, Hai Duong, Nghe An and Thanh Hoa in the north, Thua Thien Hue and Quang Nam in the centre, and Khanh Hoa and Lam Dong in the south.

- The rules for providing compensation for site clearance for foreign investment projects are to be clarified.

- Land rental rates in industrial zones are to be simplified and made more flexible. They have also been reduced. For instance the maximum land rent in Hanoi's industrial zones has been cut from $1.00/sq metre to 27 cents/sq metre per year at the Dea Ha Business Centre office tower, from 60 cents to 16 cents at the Taiwan Fla Noi Industrial Park, from 50 cents to 13 cents at the Thang Long Industrial Zone and from 50 cents to 16 cents at the Daewoo-Hanel Industrial Zone. Vietnam has 48 industrial zones (including export-processing zones) where 550 enterprises employed 90,000 workers and produced 15% of the country's industrial output and 10% of its exports in 1997.

- Land leasing fees for projects approved after March 10th have been cut by 22-50% in urban areas and by almost 20% in rural areas.

- Once an investment licence is granted, the foreign investor may start business operations immediately, without being required to obtain any other licences.

- Foreign investors in projects which export at least 80% of their output need to wait only 15 days for a licence, and according to the *Vietnam Investment Review*, will be "free to select the investment project, local partner, investment form, locality, rate of registered capital contribution and market for their product".

- Customs procedures are to be reformed, simplified and made public.

- Export licensing is to end, although the details have not yet been issued.

- Import tariffs have been waived for all imported equipment, machinery and spare parts, including items required for replacement or for business expansion.

- In April the prime minister instructed government ministries to cut red tape in order to improve the business climate. Officials were ordered to deal with delayed investment proposals within 15 days and report the results to his office.

Suggesting that these changes are not merely the work of the reform-minded prime minister, the party general secretary, General Le Kha Phieu, has stressed that Vietnam will remain open—presumably to trade and investment. In an interview published in the party newspaper, *Nhan Dan*, he said: "In no place can people close the door themselves ... In this situation closing the door and carrying out modernisation and industrialisation ... is an illusion."

—but cautious investors want deeds to match words

Investors responded to these measures cautiously, waiting to see whether the government will follow up the reforms it has proposed. The vice-chairman of the American Chamber of Commerce in Ho Chi Minh City, Fred Burke, admitted to the *South China Morning Post* newspaper that investing in Vietnam was still difficult and expensive and that many prospective investors were "pulling back"—before adding that things were undoubtedly getting easier. He went on to note that because the long-term prospects remain quite good, many people wanted to "keep a toe in the water".

The unreconstructed bureaucracy remains a particular difficulty. In early March PERC of Hong Kong named Vietnam's bureaucracy as the worst in Asia, saying that the country's "clueless" cadres "conspire among themselves to make life miserable for anyone with a creative spirit".

State-enterprise "equitisation" is quietly accelerating

There are small, but compelling, signs that the government is becoming more serious about reforming the state enterprises, including through more extensive and rapid "equitisation". Under equitisation shares are issued equivalent to the value of the firm. It is distinct from full-scale privatisation, because the shares need not be sold to the public, and the government may keep a majority stake in the firm. As of April just 18 out of almost 6,000 state enterprises had been equitised and of these only the Saigon Hotel is entirely in private hands.

The government's stated goal is to push about 150-200 state enterprises towards equitisation in 1998. So far 178 enterprises have registered, or obtained approval, to go through the process; and as of March 30 state enterprises were reportedly undergoing the process of equitisation and another 30 were in line to join the process. It typically takes a company two years to complete the cycle from initial application to full equitisation, although the government wants to shorten this period to one year. The most difficult part of the process is coming to agreement on the value of a firm's assets: the state seeks to put a high value on the assets and prospective buyers look for a low valuation. State firms employ about 5m people and are said to absorb about half of the credit extended by the banking system, but do not create many jobs in the process.

State enterprises: selected indicators

	1987	1990	1991	1994	1995	1996
Real growth rate[a] (%)	5.9	3.0	11.5	13.5	12.7	n/a
Output[a] (% of GDP)	35.8	32.9	34.1	41.3	42.3	42.9
Domestic credit[b] (% of total credit)	70.7	53.3	64.7	53.9	51.2	48.5
Investment[a] (% of total investment)	n/a	n/a	n/a	n/a	n/a	20.0
Budget revenue[b] (% of total revenue)	75.4	58.8	89.8	48.8	41.1	41.4

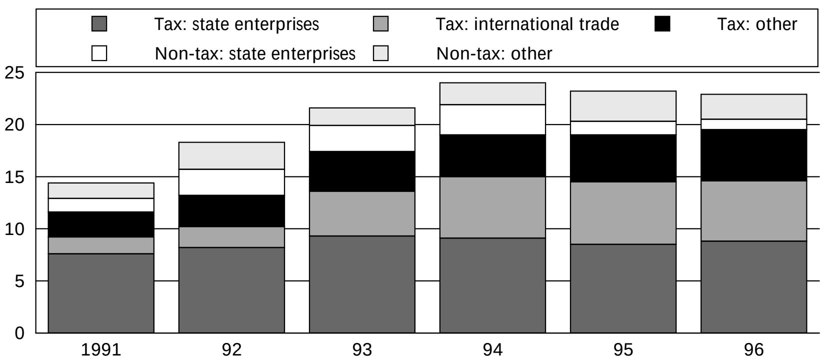
[a] Includes foreign-invested enterprises. [b] Excludes foreign-invested enterprises.

Source: World Bank, *Vietnam: Deepening Reform for Growth*.

The state-owned Garment and Textile Corporation (Vinatex), which oversees dozens of garment companies, employing a total of 100,000 workers, is pushing for most of them to be equitised. Vinatex's general director, Bui Xuan Khu, has said that the equitisation will help strengthen competition within the industry. Up to 45 companies are to be equitised, 18 of them in 1998.

In early February the deputy finance minister, Pham Van Trong, told the *Vietnam Economic Times* that all of the country's state enterprises, with the exception of a small number of core industries, would either be equitised or be declared bankrupt. He also said that the state would cease to provide capital for enterprises, thereby forcing them to undergo equitisation to mobilise investment capital. The strategy is to equitise "profitable and efficient" firms first, and then those that are "efficient but in financial difficulty", possibly after injections of capital. Loss-making firms are to be restructured, merged or closed down. The strongest opposition to equitisation comes from the managers and workers of the enterprises, who fear for their futures. The Ministry of Finance recently proposed some changes to the rules governing equitisation, to provide "incentive shares" to workers in a bid to soften their resistance to enterprise reform. The Ministry of Finance is believed to have drafted an amended decree on policies for equitisation which would limit individual shareholdings.

Structure of budget revenue
% of GDP



Source: IMF, *Vietnam: Selected Issues.*

Industry

A luxury tax may be imposed on cars—

Much to the consternation of local automobile assemblers and the Ministry of Industry, the Ministry of Finance is considering introducing a luxury tax on locally made vehicles. While details have not been published, it is believed that a tax of between 30% and 100% is planned.

The tax, if introduced, would come at a bad time for the domestic automobile assembly industry. Eleven of the 13 manufacturers licensed to produce vehicles have set up operations. The other two firms, joint ventures with Nissan and Chrysler respectively, have postponed construction, possibly indefinitely.

—in a shrinking, overcrowded market

Driven by overoptimistic projections of the size of the market, and a desire to establish a foothold in Vietnam ahead of their rivals, automobile companies have enough licensed capacity to assemble almost 150,000 cars and trucks annually (3rd quarter 1997, page 24). Yet in 1997 just 5,500 locally assembled cars were sold, in addition to about 20,000 (mainly used) vehicles. The threat of a luxury tax may help explain the fall in the number of new cars and assembly kits imported during the first two months of the year, down 29% to 1,722 units when compared with the same period of 1996.

In February Vietnam Motors (which assembles BMW, Mazda, Subaru and Kia models) laid off 318 of its 948 workers and more lay-offs are possible. It blamed the regional economic crisis, slack demand and an overcrowded market. According to the Voice of Vietnam radio, the company's Hoa Binh manufacturing plant officially ceased operations on February 10th. The company has lost money since it began operations in 1991, and has over 1,000 cars in stock. Vindaco, which assembles the Daihatsu Citivan, has had more success. After claiming a 22% share of the market by selling 556 of the seven-seat vans, for $18,000 each, in 1997, the company plans to launch more Citivan models on the market.

Competition in motorcycles intensifies

While cars remain luxuries, this is not the case for motorcycles, where the market is estimated at 500,000 units annually. Competition increased in February when Honda Vietnam launched its locally produced "Made in Vietnam" Super Dream on the market. As many as 5,000 were sold in the first week, as buyers were drawn by the attractive price (for Vietnam) of $2,100 and simplified procedures for registering locally made motorbikes. This is $200 cheaper than the virtually identical Dream II, which is imported in completely knocked down (CKD) form from Thailand. With the introduction of the Super Dream the price of other motorcycles has fallen. Honda plans to sell 133,000 units in 1998, and up to 300,000 by 2000.

Procter and Gamble resolves its dispute with its local partner—

The high-profile disagreement between the toiletries and detergents giant Procter and Gamble, and its local partner, Phuong Dong, has been resolved. The two firms formed the joint venture P&G Vietnam in 1994, with a legal capital of $14.3m. Although Phuong Dong held a 30% stake in the venture, much of its cash contribution was covered by Proctor and Gamble. As losses mounted the investment was raised to $37m in 1996 through a $22.7m loan. In October 1997 it was revealed that total losses during the venture's first two financial years of operation amounted to $28m and in January 1998 the central bank, the State Bank of Vietnam, reportedly ordered all commercial banks to freeze their loans to the company. The losses raised tensions between the partners. The local partner questioned the level of expatriate salaries and advertising spending, blaming part of the losses on excessive marketing costs. Procter and Gamble, the largest advertiser in the world, wanted to spend more on building up brand recognition.

—but falls short of acquiring 100% ownership

Proctor and Gamble proposed an additional investment of $60m, and said that if Phuong Dong could not come up with its share ($18m), then it would be prepared to buy out its Vietnamese partner and take 100% ownership of the firm. The Ministry of Planning and Investment was reluctant to allow Procter and Gamble to take 100% ownership, fearing that this would set a precedent which would lead other foreign partners in joint ventures to try to push their local partners aside. Yet a breakup of P&G Vietnam would send a signal to the foreign investment community that the government's new-found flexibility was mainly hot air.

Under the compromise reached, Procter and Gamble will increase its stake in the joint venture to 93%, and its representation on the six-member board will rise from four to five. This will still give Phuong Dong a veto over business decisions, but apparently the acrimony between the two sides has abated.

Goods smuggled in from Thailand hit local production

A more immediate problem facing locally made detergents and toiletries is the surge in smuggled imports from Thailand. Production at Lever-Viso, Unilever's joint venture in Vietnam, is reportedly down by 60% on last year. The sharp depreciation of the Thai baht, which since mid-1997 has fallen by about 35% relative to the dong, has made imported goods cheaper than locally produced ones. For instance a tube of Vietnamese-made Close-Up toothpaste costs D14,000 ($1.08), compared with D11,000 for the identical product made in Thailand. Procter and Gamble complained in 1997 that it was losing one quarter of its sales to its own contraband goods. The customs service has responded by extending the system of duty stamps from electric fans, bicycles and alcohol to include large import items (freezers, televisions, video sets, air conditioners and construction materials), but there is already an active market in counterfeit duty stamps.

The garment industry bulks large—

The future of the textiles and garments industry has become more uncertain. On the positive side the industry employs over 550,000 workers and earned $1.3bn from exports in 1997. Exports had been expected to rise by about 23%, to $1.6bn, in 1998, mainly on the strength of increased sales in the EU (which were worth $450m in 1997 and were expected to rise to $650m in 1998). Foreign investment commitments in the industry amounted to $1.79bn by March. Projects worth about $120m have been withdrawn, leaving 142 projects worth $1.67bn. The largest investors in the textile industry are South Korea ($703m), Malaysia ($477m) and Taiwan ($200m). Virtually all of the foreign investment in the industry has been in the south, particularly in Dong Nai province ($1.1bn). Existing producers have applied to expand their initial investments by $355m, which is evidence of confidence in the future of the industry.

—and slower expansion lies ahead

On the negative side the Garment and Textiles Association, which is based in Ho Chi Minh City, foresees "big trouble" for the industry later in the year. The number of sales contracts has apparently fallen, especially for non-quota products, and some small enterprises have shut down. The association has also criticised the government for its slowness in allocating quotas.

Agriculture

The Mekong Delta has another bumper rice crop—

In Vietnam's Mekong Delta the winter-spring crop reached a record level of about 7m tonnes (up from 6.7m tonnes in 1997). Even more pleasing for local farmers is the fact that by the end of the first quarter the price of export-quality paddy (unmilled rice) had risen sharply, and that unlike so often in recent years they seem to have benefited: their incomes are reported to be up by as much as half compared with last year. The higher local price reflects the rise in recent months in the world price of rice, which in turn is driven in large part by a 2m-tonne increase in demand for rice imports by Indonesia, where the global weather phenomenon El Niño has been blamed for a reduction in the crop.

—but drought could hit exports

The government is proceeding cautiously however, because drought in parts of central and southern Vietnam is expected to reduce, or at least limit the growth of, the summer-autumn crop. As a result it is keeping rice exports down to no more than 1.5m tonnes during the second quarter of the year. Vietnam exported a record 1.2m tonnes during the first quarter, and had originally intended to allow exports of 4m tonnes for 1998, up from 3.8m tonnes in 1997. To encourage rice exports, and to raise the price received by farmers, the tax on rice exports was reduced to zero in February. If the summer-autumn crop proves to be sufficiently large, the government is likely to relax rice export quotas for the rest of the year. It is expected to make a decision about this in September. The system of rice exporting is slowly being liberalised: three-tenths of the export quota is now allocated to centrally managed companies and the remainder to provincially run state companies. A decree issued in January opening the export trade up to private firms has not yet been implemented, but private traders already dominate the direct purchase of rice from farmers, which they then sell on to the companies that have been assigned export quotas.

Illegal Cambodian logs are said to abound

Large quantities of Cambodian logs are being exported illegally to Vietnam. This is according to the British environmental group Global Witness, which claims to have seen $130m worth of stockpiles of logs in Song Be and Gia Lai provinces, in Qui Nhon port, and by the Saigon river near Ho Chi Minh City. Cambodia banned all log exports on December 31st 1996, and Vietnam has a law which makes the import of Cambodian logs illegal.

There is a suspicion that the log exports are being used to fund the governing Cambodian People's Party of the second prime minister, Hun Sen, and possibly other political groups, in the run-up to the July election in Cambodia. Hun Sen's chief economic adviser admitted that illegal logging was taking place but blamed it on "corrupt businessmen". The Vietnamese foreign ministry, responding to the allegations, said that Vietnam has been co-operating with Cambodia since the end of 1996 in trying to prevent illegal shipments of logs into Vietnam. The apparent scale of the smuggling suggests that some quite highly placed Vietnamese officials are involved in the trade.

Coffee and tea exports stay strong

Drought has hit production of Vietnam's second most important agricultural export, coffee, but falling export volumes have been more than offset by strong prices. Early in the year, before the full effects of the drought had been felt, sales were already slow because farmers were holding back their beans in anticipation of a devaluation of the dong and higher international prices. In volume terms coffee exports fell by 19.8% in the first quarter, to some 105,000 tonnes, but in the same period prices rose by 36% over their first-quarter 1997 level to $1,500 per tonne, and there is little sign of them dropping back. Output in a number of leading producing countries, including Indonesian and Uganda, is expected to fall this year. Vietnam's production target for this year has already been revised down from 380,000-400,000 tonnes to 300,000-320,000 tonnes, and if the rains still have not materialised by the end of May, output could fall below last year's estimated 280,000 tonnes.

Most of the expansion of recent years (which increased the cultivated area from 44,700 ha in 1985 to an estimated 260,000 ha today) has taken place in the Central Highlands provinces of Dak Lak and Lam Dong, which normally have long dry seasons anyway. Exacerbating the water problem is the fact that many of the new trees have been planted on unirrigated hillsides.

Tea exports were up sharply (by 53% in volume terms in the first four months). Hence the targeted increase of 12% volume growth during 1998 (which would bring sales to about 35,000 tonnes) looks likely to be met. Moreover the EIU expects tea prices to increase during 1998 (rising by an average of nearly 9% in the case of the low-medium teas that Vietnam mainly produces), at least until an expected surge returns the market to surplus in the second half of the year. The Vietnam Tea Corporation has plans to expand the area planted with tea by 7% in 1998, and has raised the price paid for fresh tea buds by 10% compared with 1997.

Energy

Interest in petroleum exploration wanes—

A recent petroleum industry trade fair in Hanoi attracted only one quarter as many exhibitors as a year ago, and few visitors. The drop in interest reflects four factors: a more realistic, and lower, evaluation of the production potential of Vietnam's offshore deposits; the recent fall in the price of crude oil, to a level that makes much offshore exploration unprofitable; strong international interest in developing the petroleum resources of the former Soviet Union; and the bureaucratic hurdles that have slowed the development of Vietnam's offshore gas resources, and deter all but the most tenacious of investors. The slow negotiations on the appropriate price to be paid for natural gas brought onshore have in turn retarded investments in downstream industries.

—although output continues to rise

Oil production continues to increase gradually. It rose by 13.6% in 1997, from 177,000 barrels/day (b/d) in 1996 to 201,000 b/d of crude last year and is expected to increase by 20%, to 241,000 b/d, in 1998. Mitsubishi's Rang Dong oilfield is expected to begin to produce oil by the third quarter, with output there eventually rising to 45,000 b/d. The Hong Ngoc field is also expected to come on stream by the end of the year, managed by a group led by the Malaysian state oil company, Petronas.

Electricity projects progress

Two major projects to generate electricity are moving ahead. A consortium led by Japan's Sumitomo has won a $545m contract to build two 300-mw units for the Pha Lai II power plant, 45 km north-east of Hanoi. The units are expected to come on line in 2002. Engineering will be done by Stone and Webster (of the US), boiler technology will come from Mitsui Babcock Energy (of the UK), much of the building will be done by Hyundai (of South Korea) and the turbines will be provided by General Electric (of the US). In a separate deal Enron, a large US independent operator and builder of power plants, has received approval in principle to build a $270m power plant on a build-operate-transfer (BOT) basis in Soc Trang province, with a design capacity of 475 mw. Initially the plant will use fuel oil, shifting to natural gas in due course.

An estimated 19% of the electricity generated by power stations in Vietnam is lost in transmission. This is a high level of loss, although slightly below the 20% rate recorded in 1996. It is hoped to reduce losses to 16-17% of total supply by 2000. A loan of $199m from the World Bank's soft-loan affiliate, the International Development Association (IDA), was recently approved and will help achieve this goal.

The Russians offer finance for the Dung Quat refinery

The Russian Foreign Economic Association, Zarubezhneft, has agreed to help finance the proposed $1.3bn oil refinery in Dung Quat. The deal was promoted by the then Russian prime minister, Victor Chernomyrdin, when he visited Vietnam last year (1st quarter 1998, page 14). A joint venture is to be established with legal capital of $800m, shared equally by the two partners: Zarubezhneft will contribute its share through profits earned by crude oil exports, and PetroVietnam's contribution will be partly in the form of land-use rights with the rest coming from state funds. The remaining $500 is to be mobilised through bank loans and other sources.

Two consortia of foreign firms had earlier considered financing the refinery, and then backed down on the grounds that it was unfeasible. The location of the refinery, 900 km from the main oilfields, will add about $200m to the total cost, in addition to raising operating costs. As a result the refinery will be able to function only if heavily subsidised (1st quarter 1998, page 21). Ground-breaking has already begun in Dung Quat, but progress is likely to be slow, particularly if the government sticks to its stated intention of shifting the emphasis in investment from capital-intensive to labour-intensive projects.

Money and finance

The IMF sounds the alarm about the financial system—

Although it was not mentioned by the finance minister, Nguyen Sinh Hung, as one of the issues preventing disbursement of the latest tranche from the IMF's ESAF (see Economic policy and the economy), the Fund has made clear its frustration at the slow pace of reform in the financial sector in a recent report. In the report, entitled *Vietnam: Selected Issues* and published in April, the IMF highlights a number of failings of the banking system and warns that the regional currency crisis is likely further to strain its "fragile condition". The Fund regards the banking reforms as having lost momentum after an initial spurt during 1988-92. It notes the continued dominance of state commercial banks and the political direction to which their lending is still subject.

Discrimination in favour of state enterprises, poorly developed accounting practices, rules on collateral that make foreclosure virtually impossible, inexperienced personnel and poor supervision are among the problems mentioned in the report. Reform measures have not been followed up: implementing regulations for the two new banking laws passed by the National Assembly in December 1997 (1st quarter 1998, page 13) covering such crucial areas as foreign-exchange operations, loan loss provisioning and capital adequacy ratios are still awaited.

Overdue bank loans
(% of total credit; end-period)

	1994	1995	1996	1997[a]
State commercial banks	10.9	9.1	11.0	12.7
of which:				
state enterprises	9.7	7.3	8.4	8.2
other borrowers	13.1	12.0	14.5	18.1
Other commercial banks[b]	2.6	3.3	4.2	12.9
of which:				
state enterprises	4.2	4.3	4.9	18.3
other borrowers	1.4	2.7	3.7	9.6
Total overdue	9.5	7.9	9.3	12.7
of which:				
state enterprises	9.1	6.9	7.8	9.9
other borrowers	10.1	9.2	11.0	15.6

[a] End-September. [b] Comprising joint-stock banks, joint-venture banks and branches of foreign banks.

Source: IMF, *Vietnam: Selected Issues.*

—as banks' balance sheets deteriorate

Despite its rapid expansion since the early 1990s the report describes Vietnam's banking system as shallow compared with those of other ASEAN countries. Moreover, the report says, it is still not performing the functions of a market-based banking system. Finally on the question of soundness it finds that the available data indicate a steady deterioration in the banks' balance sheets since 1995. One measure of soundness is the ratio of overdue loans to total credit. As is shown in the above table, this ratio has been rising rapidly (only partly because of the one-off effect of the stricter enforcement of loan classification criteria since the beginning of 1997) and the Fund expresses concern at the (now very real) prospect of a further leap in non-performing loans if the economy slows or is subject to new shocks.

The central bank bails out a joint-stock bank

The IMF report notes with specific reference to joint-stock banks that this group of banks (of which there were 52 at the end of 1996) was experiencing difficulties as a result of overrapid credit expansion, often involving loans to their own shareholders. Illustrating the problem, the central bank has arranged for the bailout of the semi-private Nam Do Joint-Stock Commercial Bank, after a run on the bank in December threatened it with collapse (joint-stock banks are often in fact the banking arms of state enterprises). The former general director of the bank, Tran Van Phuoc, and his deputy were arrested on charges of mismanagement of a large loan to a private firm that turned sour. The small bank has just $4.2m in assets. More generally the then acting governor of the State Bank, Do Que Luong, noted in late March that some joint-stock banks had been in difficulty in recent months, and went on to suggest that many of them were undercapitalised and in need of consolidation. Public confidence in the banking system is low, and the State Bank faces the dilemma of whether to rescue poorly managed banks (in effect rewarding bad management) or allowing them to fail in order to weed out the weak ones (but temporarily eroding faith in the banking system even further).

Interest on two-year Treasury notes rises

On April 15th the Ministry of Finance raised the annual interest rate on two-year Treasury notes from 12% to 13%. The notes have a face value of D100,000

($7.70), and can be purchased at local Treasury offices and People's Committees by individuals and companies. A senior official with the Ministry of Finance explained the change as required by the need to raise money for the state budget, although he stressed that the ministry was not competing for funds with the commercial banks. No information on the revenue raised from selling two-year notes is available. Indeed the government does not publish the state budget, although under pressure from aid donors to increase the transparency of decision-making, it is expected to make the information public later this year.

Sales of one-year Treasury bills are slow

The government also holds auctions, almost weekly, for one-year Treasury bills. The nine auctions held so far this year (up to April 8th) have yielded an average of D10.2bn ($783,000) per auction, although the amount on offer at each auction was typically D50bn. The main reason for the weak sales is that the Ministry of Finance has been unwilling to pay more than 12% interest on the one-year bills, and this is unattractive to most banks. The absence of a secondary market for Treasury bills also reduces their attractiveness to buyers. The largest single purchaser of Treasury bills is the national insurance company Bao Viet.

The government projects a budget deficit of about 3.5% of GDP for 1998, which would require financing, from domestic and foreign sources, of about D11trn. Set against this, the revenue yield from the nine auctions undertaken up to early April ($7m) is minuscule. In 1997 the government raised about $256m through the auctioning of bills.

Pilot stock-exchange centres could open soon

Although a fully fledged stock exchange is unlikely to start up before the turn of the century, pilot "stock-exchange centres" could open in Hanoi and Ho Chi Minh City by the end of the year. These pilot exchanges would then evolve into full stock exchanges as more complete procedures and regulations are put in place. The move to introduce the pilot centres is being driven by the emergence of an informal (kerb) market in company shares.

London Club debt restructuring is completed

On March 12th Vietnam closed its Brady-style deal to restructure its debt with the London Club of about 120 commercial bank creditors (1st quarter 1998, page 23). Most of the debt was owed to Japanese banks. The deal reduces the real value of the debt by about half, and opens the way for Vietnam to borrow on world capital markets. The World Bank has advised the country against borrowing internationally prematurely. Vietnam's first international bond issue, which had earlier been expected to be launched soon after completion of the deal, may also be delayed since Moody's Investors Service has placed a review on its ratings of Vietnam. The agency currently rates Vietnam at Ba3 for bonds and notes and B1 for foreign-currency-denominated bank deposits in the country. The review was prompted by heightened uncertainty created by the possibility of a prolonged loss of balance-of-payments support from IMF and less active participation by foreign investors in Vietnam's economy. A review does not necessarily lead to a reduced rating, but it signals that such a move is a real possibility.

Tourism

Vietnam Airlines is to cut routes

After expanding rapidly over the past decade, Vietnam Airlines has been told to cut some of its loss-making routes at home and abroad. Partly in response to the declining value of the dong, the airline also plans to raise the price of tickets on its popular Hanoi-Ho Chi Minh City flights by 22%. The new price, at D1.1m ($84.70) one way, will still cover only about 80% of the cost of these flights. The number of foreign air travellers fell by 6.8% during the first quarter, compared with the same period of 1997 (and the number of tourists fell by 5% to 410,000). The Dutch airline KLM has ended its twice-weekly flights between Europe and Ho Chi Minh City. Garuda Indonesia and Emirates Airlines have also stopped flying to Vietnam. Air France is more optimistic about its prospects but is critical of the cost of Vietnamese airports which it claims are among the most expensive in Asia for the facilities on offer.

Vietnam and the US fail to agree on direct flights

Despite two days of talks in March aviation officials from Vietnam and the US failed to reach an agreement which would open the way to direct flights between the two countries. The US wanted an “open-skies” approach which would not limit the number of US carriers serving Vietnam. It also sought “fifth freedom” rights which would allow carriers to pick up passengers from other countries en route to Vietnam. The Vietnamese negotiators were unwilling to allow fifth freedom rights, noting that none of the country’s 45 civil aviation agreements with other countries and territories grant such rights. The deputy director-general of the Civil Aviation Administration of Vietnam, Dao Manh Nhuong, said that because of the poorly developed state of its aviation industry an agreement before 2000 would leave Vietnam barely in a position to enter into joint services with US carriers. Although the talks were cordial and are to resume, no date was set for the next round of negotiations. The failure to reach an agreement is likely further to delay any broader trade agreement between the US and Vietnam, and in turn to hold up Vietnam’s eventual entry into the World Trade Organisation (WTO).

Foreign trade and payments

Export growth slows—

The dollar value of exports rose by just 12.2% in the first quarter of 1998, compared with the same quarter of 1997, to reach $2.2bn. In 1997 as a whole exports rose by 21% compared with the previous year and they were targeted to grow by 25-26% this year. However, a spurt in exports in April brought their overall growth in dollar terms in the first four months to nearly 20%. On the basis of this improvement, at the end of April the General Statistical Office issued revised targets for exports and imports in 1998 that were barely changed from the original ones: exports up 24.3% to $11bn and imports up 17.9% to $13.2bn.

The export shortfall of the first four months has a number of explanations. One was the weakening prices of several of Vietnam’s main primary commodity exports not compensated for by output increases, including crude oil (which suffered a 21% price decline compared with the same period of 1997 at the same time as export volumes increased by over 12%), rubber (whose price was down by 43%), cashews (down 6%) and peanuts (down 31%). Earnings from other commodities continued to increase despite falling prices (most notably in the case of rice, sales of which increased in volume terms 2.5-fold) or despite falling volumes (as in the case of coffee which benefited from a price surge; see Agriculture).

There was some evidence that Vietnam suffered a loss of competitiveness of its new manufactured exports, chiefly textiles and garments and footwear. Textiles and garments exports rose just 12% in dollar terms in the first four months, as they reportedly came under particular threat in Asian non-quota markets such as Japan where buyers demanded price cuts of 5-10%. This was not far below the 13% growth they recorded last year, but on the strength of the new quota agreement with the EU they had been targeted to rise by 23% in dollar terms this year (see Industry). Growth of dollar earnings from exports of shoes slowed to 13.7% in first four months, compared with an 80% increase in 1997, as according to the *Vietnam Economic Times*, their prices rose to one-third more than those offered by Thai and Indonesian producers. Weak Asian demand also played a part in the slow growth of exports: according to data given by the deputy prime minister in his speech to the National Assembly in April, in the first two months of the year exports to ASEAN countries fell by 48%, those to China dropped by 20% and there was near 60% decline in exports to South Korea.

Of the $239m increase in exports in the first quarter, about 44% was attributable to a rapid increase (34%) in exports by foreign-invested enterprises, and the remainder to a surge in rice exports. Although the volume of oil exports increased rose by more than 15%, their value fell because of the slide in the world price.

—and imports fall

Imports fell by 2.6% during the same period, to $2.65bn. There were large declines in imports of cars, cement and medicines. The official data do not of course include the large amounts of goods smuggled into the country, which include such diverse items as consumer goods and logs and cement. Attempts to control official imports (see below) may only have increased the volume of smuggled goods. The reduction in official imports probably also reflects a marked slowdown in the amount of foreign investment flowing into the country (see Economic policy and the economy).

The customs service aims to please

The government's foreign trade policy pulls in two directions at once. On the one hand it tries to make importing less difficult by simplifying procedures and moving from quotas to tariffs. On the other hand there are still strong forces that favour protectionism and direct controls.

Phan Van Dinh, the director of the General Department of Customs, announced at a meeting with investors in Ho Chi Minh City in February that special goods clearance services would be set up in major cities, in order to speed up and improve customs procedures for investors. The customs service has been sharply criticised by investors, who have singled out the lack of clarity in tariff classification and exemption procedures, arbitrary changes by local customs officials and demands by officials for "unofficial" fees. The proposed changes would allow goods to be released from the port of entry within two hours of their arrival, and for inspections to take place at importers' premises. The valuation of imports would be based on the invoiced value of the goods, rather than on the Ministry of Trade's minimum check prices or any arbitrary values imposed by customs officers. When and whether these changes will be made remains to be seen, as experience from other countries shows that the reform of customs is a particularly intractable area.

The government replaces quotas with tariffs and forex controls

The government has begun to move away from using quotas to regulate imports, and to rely on tariffs and exchange controls instead. In future imports of consumer goods, rather than be limited by quotas, are to be regulated through tariffs and what are termed as "bank payment methods" (presumably foreign-exchange controls). The relevant ministries have been instructed to keep imports of non-essential consumer goods and of goods that can be produced domestically to a minimum. Import permits will no longer be needed for automobiles, but tariffs on these vehicles are to be adjusted with a view to limiting imports.

The calls for protection grow louder—

Calls for protectionism have become louder, particularly from foreign-invested enterprises that have come under increasing pressure as the dong has appreciated relative to other major currencies in the region, making imports from places including Thailand, South Korea and Indonesia cheaper. Some examples are as follows.

- Hyundai-Huy Hoang Pipe, a South Korean joint venture, has complained that imported pipes enter duty-free, compared with duties of 35% in Malaysia and 30% in Indonesia. The company has proposed a tariff of about 25%.
- Automobile assemblers have called for more restrictions on imports of new and used cars, along with less restrictions on the import of parts.
- Hangtin Enterprise, a 100% Taiwan-owned firm in Haiphong, produces money-counting machines, and has argued that it badly needs protection from the government.

The prime minister has resisted such calls for protection, arguing that Vietnam must prepare for the open market required by ASEAN countries by 2006, and telling manufacturers that they should offer lower prices to local consumers if they want to compete with imports.

—prompted in part by pervasive smuggling

The calls for protection are prompted partly by the pervasiveness of smuggling. The General Customs Department has said that it uncovered 16,000 smuggling operations in 1997, of goods valued at $44m. The scale of total smuggling, both detected and undetected, was certainly much higher. Significant quantities of drugs (including 78 kg of opium, 8 kg of heroin and 7 tonnes of marijuana) were also seized. The customs department is expanding the scope of its operation to apply duty stamps to easily smuggled imports, but it is not clear that this will have more than a temporary effect in staunching the inflow.

Talks with the WTO advance slowly

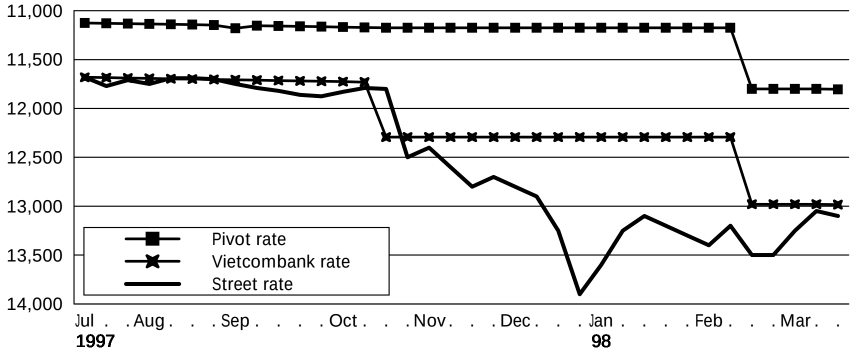
The government also wants to join the WTO by 2003. To this end a meeting was held in Geneva between Vietnamese and WTO officials in February, in part to discuss the 2,000 specific questions that the WTO team had filed about

Vietnam's trade regime. Progress is likely to be slow and will require a bilateral trade agreement with the US for Vietnam to win US support for its membership.

Another modest devaluation takes place—

A widely expected (1st quarter 1998, page 27) devaluation of the dong took place on February 16th, when the State Bank moved the central ("pivot") rate by 5.6% from \$1:D11,175 to \$1:D11,800. Actual trading is permitted within 10% of the pivot rate, and the dong quickly moved to its lowest permissible value, from \$1:D12,293 to \$1:D12,980.

Exchange rates (a)
D:\$; inverted scale



(a) Weekly data beginning July 14th 1997.
Source: *Vietnam Investment Review.*

—after the interbank market dries up—

In anticipation of a devaluation firms and individuals sought to hold on to their dollars, with the result that the State Bank had difficulty providing enough dollars for businesses needing them for imports or to service foreign borrowing. The volume of transactions on the daily interbank market for foreign exchange fell from \$8m per day during the first half of 1996 to \$2m per day during the second half of 1997 and just \$200,000 per day during the first five weeks of 1998.

—and the reserves decline—

One result was a decline in the foreign-exchange holdings of the State Bank, by around \$400m, to \$1.5bn or less. This is the equivalent of two months' import cover. The government introduced a number of measures designed to force firms to put their dollars into the banking system, including limiting foreign banks' foreign-currency holdings to no more than 10% of their registered capital, and lowering the interest rate payable by banks on dollar deposits while simultaneously raising the rate paid on dong deposits (1st quarter 1998, page 27).

—despite government efforts to extract "surplus" forex

On February 14th the government issued Decree 37-QD/TTG requiring all business units and social organisations to sell their "surplus" foreign-exchange reserves to a state-owned bank. Businesses are supposed to report their total holdings of foreign currency, and then declare their requirements for the month ahead. The decree also allows each organisation to open no more than one bank account for its foreign currency transactions. The rules were criticised by Le Dang Doanh, the head of the leading government-backed economic think-tank, the Central Institute for Economic Research, who suggested that the rules needed to be made more flexible. By late March the State Bank had backed away from the requirement of a single foreign-currency account for each firm.

Crédit Lyonnais is suspended for a month

One casualty of the strictures on trading foreign exchange is the French bank, Crédit Lyonnais, which was suspended from foreign-exchange dealing for a month after a surprise audit by the State Bank found that the bank was charging about twice the permissible margin of 0.1% on foreign-exchange transactions. One banker complained that it is hard to stay within the margin when for example, one buys in the morning and sells in the afternoon, and the exchange rate moves during the day.

The devaluation may not be the last—

The deputy prime minister called the devaluation "necessary and deliberate". However, the devaluation may, if anything, have been too cautious: it has not brought the interbank market for foreign exchange back to life, and the black-market exchange rate is still somewhat weaker than the official trading rate, although the gap is smaller than it was before the devaluation. The State Bank is trying to devalue enough to maintain an adequate supply of dollars, while not devaluing so fast as to lead to a massive flight out of dong or the bankruptcy of the many state-owned and other businesses that have borrowed heavily in dollars but sold their products for dong.

—as the dollar shortage continues

A recent incident suggests that the shortage of dollars is continuing. On April 6th the State Bank suspended quotes for one-way dollar-for-dong swaps. Two days later swaps were resumed, and an official said that State Bank staff had made some "errors" on April 6th and that the staff member responsible for posting the swap rates had not gone to work on the next day.

Under a typical swap arrangement banks provide dollars to the State Bank now in return for dong; between two weeks and three months into the future the banks can return the dong to the State Bank and get the dollars back, at an exchange rate that is guaranteed now. Swap arrangements protect banks against the devaluation of the dong, but the flip side is that the State Bank loses in the event of a devaluation.

A senior executive at the State Bank indicated that the State Bank has been making losses on its swaps, which average about $5m daily, since they were introduced in December. He added that sometimes the central bank was prepared to sustain losses on its swap transactions to achieve its objective of stabilising the currency. As of the end of February 27 banks had been licensed to enter into swap and forward deals for foreign currency.

Bankers speculated that the brief suspension of swaps may have been forced on the State Bank because of a shortage of dollars to repay swap deals when they fell due. An alternative explanation is that the central bank did not want to provide dong for dollars, in order to limit the amount of dong in circulation, and so force firms to cash in their hoardings of dollars in order to cover their expenses.

A debt deal with Russia remains elusive

In early March the State Bank's then acting governor, Do Que Luong, met the governor of the Russian Central Bank in Moscow. The semi-official *Vietnam Investment Review* subsequently reported that the two countries had signed an agreement to resolve the outstanding debt (of about Rb10.2bn and $30m) owed by Vietnam to Russia. The report did not give details, but hinted at the possibility of swapping a rubber plantation in return for some of the debt. The reports have since been denied, which probably means that any agreement is a long way off. Vietnam is currently servicing its debt to Russia through the supply of products at the rate of about $80m annually.

Japan comes through with foreign aid

Japan has made good on its commitment to provide ¥85bn (about $700m) in aid to Vietnam for 1998, despite cutting its overall aid budget by 10%. About half of the total amount will be devoted to road rehabilitation and the expansion of rural telecommunications. Most of the 40-year loan carries an annual interest rate of 1.8%, and repayment will begin after a ten-year grace period. Japan continues to be the largest aid donor to Vietnam, having pledged a total of $3.2bn in previous years. However, only 9% of these commitments have been disbursed so far.

Quarterly indicators and trade data

Quarterly indicators of economic activity

		1995	1996				1997				1998
		4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr
Agricultural production	Annual totals										
Rice	'000 tonnes	24,964	(	26,397		)	(	26,397[a]		)	n/a
Exports	Qtrly totals										
Rubber: net	'000 tonnes	21.0	20.0	19.0	23.0	26.0	26.0	21.0	23.0	15.0[b]	n/a
Foreign trade	Annual totals										
Exports	$ m	5,198	(	7,337		)	(	n/a		)	n/a
Imports	"	8,381	(	11,644		)	(	n/a		)	n/a
Exchange rate	End-Qtr										
Official rate	D:$	11,011	11,013	11,014	11,028	11,148	11,650	11,666	11,718	12,288	12,981

Note. Annual figures of most of the series shown above will be found in the Country Profile.
[a] Estimate. [b] Total for October-November.

Sources: FAO, *Quarterly Bulletin of Statistics*; International Rubber Study Group, *Rubber Statistical Bulletin*; IMF, *Vietnam: Selected Issues and Statistical Annex*; *FT*.

Foreign trade
($ m)

	Jan-Dec 1992	Jan-Dec 1993	Jan-Dec 1994	Jan-Dec 1995	Jan-Dec 1996
Imports cif					
Consumer goods	421	613	1,037	1,348	1,300
of which:					
wheat	59	51	52	60	n/a
sugar	4	14	39	61	n/a
monosodium glutamate	53	70	44	32	n/a
fertilisers	356	189	247	554	628
textile yarn	n/a	n/a	n/a	114	158
steel	116	210	204	389	529
Fuels & raw materials	1,573	2,389	3,068	4,710	6,044
of which:					
petroleum products	683	614	696	724	1,079
Machinery	547	922	1,721	2,097	3,800
Total incl others	2,817	3,924	5,827	8,381	11,644
Exports fob					
Marine products	302	427	551	431	651
Rice	300	363	425	496	855
Cashew nuts	41	44	59	130	n/a
Coffee	86	110	328	565	337
Rubber	54	74	133	159	163
Coal	47	70	75	90	115
Petroleum	756	844	866	1,024	1,346
Garments	190	239	476	431	1,150
Total incl others	2,475	2,985	4,054	5,198	7,337

Source: IMF; *Vietnam: Selected Issues and Statistical Annex*.

Trade with main partners[a]

($ '000; monthly averages)

	Singapore		South Korea		Taiwan		Japan		China	
	Jan-Dec	Jan-Dec	Jan-Dec	Jan-Dec	Jan-Dec	Jan-Dec	Jan-Dec	Jan-Dec	Jan-Dec	Jan-Dec
Exports to Vietnam fob	1995	1996	1995	1996	1996	1997	1995	1996	1995	1996
Foodstuffs	2,879	2,947	1,202	875	272	134	652	1,231	3,932	4,072
of which:										
cereals & preparations	1,113	947	212	491	31	66	543	1,067	1,698	1,186
Mineral fuels	51,890	39,600	4,549	3,004	1,526	1,857	3,150	2,687	519	1,812
Chemicals	14,654	15,771	13,931	16,872	11,288	14,189	7,712	7,705	9,431	10,895
of which:										
elements & compounds	4,088	4,866	1,645	2,110	998	1,323	2,090	2,112	3,267	3,385
plastics	4,251	3,462	8,116	9,578	5,761	6,324	3,357	2,916	573	540
Rubber manufactures	776	504	837	1,155	1,583[b]	1,606[b]	504	683	1,056	818
Paper, etc & manufactures	1,710	1,531	1,825	1,325	4,659	4,013	508	636	1,261	1,025
Textile yarn, cloth & mnfrs	2,404	2,174	28,160	36,391	30,347[c]	32,105[c]	8,200	10,888	4,442	5,672
Iron & steel	2,064	2,162	6,032	7,482	4,544	6,752	5,572	4,385	2,249	4,756
Non-ferrous metals	2,300	1,681	3,076	2,353	1,767[d]	1,693[d]	85	337	2,553	1,760
Metal manufactures	3,992	3,934	4,263	3,194	3,311	3,837	1,314	2,677	1,410	2,255
Machinery & transport eqpt	37,707	46,069	35,079	40,361	23,393	25,075	41,579	53,803	16,427	18,438
of which:										
transport equipment	2,840	5,321	11,176	13,566	3,059	2,303	16,835	18,396	1,790	1,549
Scientific instruments	3,367	4,596	571	642	488	429	2,241	3,212	823	677
Total incl others	149,166	143,009	112,585	133,262	97,717	107,444	76,825	94,905	60,025	70,179

	Japan		Singapore		Taiwan		France		China	
	Jan-Dec	Jan-Dec	Jan-Dec	Jan-Dec	Jan-Dec	Jan-Dec	Jan-Dec	Jan-Dec	Jan-Dec	Jan-Dec
Imports from Vietnam cif	1995	1996	1995	1996	1996	1997	1995	1996	1995	1996
Foodstuffs	36,013	36,244	12,414	11,028	3,746	3,550	3,712	3,833	10,908	5,062
of which:										
fish & preparations	30,449	31,974	2,127	2,235	306	400	400	566	349	346
coffee, cocoa, tea & spices	4,391	2,511	9,196	4,575	549	572	2,785	2,377	100	1,076
Wood & cork & manufactures	2,587	3,321	143	211	4,527	4,071	615	488	757	428
Mineral fuels	55,234	58,706	15,126	39,095	356	309	390	578	9,022	13,289
Chemicals	108	268	1,356	5,385	748	1,675	65	67	185	143
Clothing	30,941	40,757	920	1,044	3,879	6,160	4,659	6,979	23	92
Footwear	1,394	4,010	307	838	647	1,536	8,960	10,967	1	39
Total incl others	143,363	168,150	37,398	36,341	26,435	32,535	25,771	31,240	27,672	25,781

[a] Figures from partners' trade accounts. [b] Including crude rubber. [c] Including fibres. [d] Including manufactures.

Sources: Singapore Trade Development Board, *Singapore Trade Statistics*; UN, *External Trade Statistics*, series D; Ministry of Finance, *The Republic of China*, *Monthly Statistics of Imports/Exports, The Republic of China*, *Taiwan District*.