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Vietnam's Political Economy in Transition (1986-2016)

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By Quan Hoang Vuong

The transition economy of Vietnam enjoyed remarkable achievements in the first 20 years of economic renovation (*Doi Moi*) from 1986 to 2006. Notably, the economy grew at an average annual rate of 7.5% in 1991-2000 period. Vietnam's Amended Constitution 1992 recognized the role of private sector in the economy. U.S.-Vietnam Trade Bilateral Agreement (US-BTA) was signed in 2001. The country's stock market made debut trading in 2000. Vietnam became a member of Association of Southeast Asian Nations (ASEAN) in 1995, then proceeded to full membership of the World Trade Organization in 2007, following which registered foreign direct investment (FDI) reached an all-time high of US\$71.7 billion in 2008. Together with the impressive economic achievements, Vietnam also saw its diplomatic and political status constantly improved in the international arena. The country has established diplomatic relations with more than 170 countries in the world, strategic partnerships with 12 important economies, both developed and emerging, namely China, Japan, Russia, India, England, France, North Korea, Italy, Germany, Indonesia, Malaysia and Thailand. The country also successfully hosted important events including the Asia Pacific Economic Cooperation (APEC) in 2006.

Upbeat sentiment helped to send Vietnam's stock market index (VN-Index) to its peak of 1,170 in March 2007 before its nosedive to 250 in February 2009, auguring an imminent crisis. Since 2008 Vietnam's GDP pace of expansion has slowed down markedly, with 2012 rate declining to 5%, the lowest level in 13 years, while the macro economy faced paramount turbulence, large trade deficit, high inflation, overwhelming business closures, rampant corruption and transparency problems, demonstrations of enraged citizens, downgrading environment, and sovereignty confrontation with China in the South China Sea (politically correct: "the East Sea").

Since the world's geo-economics and geo-politics are entering an uncharted territory of evolving complication and rising uncertainty, not only Vietnamese entrepreneurs and households but also economists and policy makers are puzzled about what have happened, although the government has made a ten-year plan for 2011-20 socio-economic development. The ruling elites appear to have written this plan based more on "the desirable" than "the achievable" while a clear vision for farther future based on careful projections and profound solutions is needed. Vietnamese and outsiders

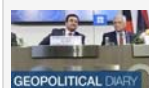
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Vietnam has been considered somehow an entrance geopolitical game of East Asia and a 600-million population ASEAN market, the keen eye of international players sticks to the Vietnamese political economic scene of the country, which will most likely define the economic and diplomatic paths in the coming years.

The four characteristic sub-periods of post-Doi Moi transition

From the adoption of *Doi Moi* in 1986 by the CPV's Sixth National Congress to present day, Vietnam's economy has transformed from a centrally-planned model to market oriented with four characterized sub-periods. We divide the sub-periods based on the economy's entrepreneurial perspectives, emerging cultural values, the building of market economy, and attitude toward global geopolitics and economics.

The period of "entrepreneurial policy-makers" (1986-1994)

In its history, Vietnam barely had economic prosperity that lasted for decades. Until early twentieth century, the feudalist nation was a small and outdated agrarian country with continuous wars and invasions from the North (China and Mongolia) and conflicts with the Southwest neighbor (Cambodia). In the 20th century, the French and American wars drew most national efforts to serve the combats. From the national unification in 1975 to 1985, the nation struggled with its five-year plans on collectivization of agricultural and industrial production. However, the real results were often far behind expectation because the guiding principles "violated the most important motivation for production development, that it is worked against the working people's vital vested interests," (Boothroyd and Pham, 2000).

Upon the failure of the 1985 price-wage-currency adjustment scheme, a severe economic crisis followed, resulting in hyperinflation of 775% in 1986, scarcity of staples and consumer goods, impoverished living conditions, industrial stagnation, and mounting foreign debts (Pham and Vuong, 2009; Vuong, Dam, Van Houtte, and Tran, 2011). The situation worsened as Vietnam could barely trade with the West due to the U.S.'s trade embargo (Cockburn, 1994). The chaos had put the CPV under immense pressure to get the country out of the crisis, and *Doi Moi* policies were an answer introduced in 1986, with which Riedel and Turley (1999) believed that there was no "political revolution or ideological conversion on the part of the leadership." The socialist ideology remained and was reiterated by the political leader of *Doi Moi*, the Communist Party of Vietnam (CPV) General Secretary Nguyen Van Linh that "It is not objectively necessary to establish a political mechanism of pluralism and multiparty government. Socialism is the only right decision" (Shenon, 1998).

However, *Doi Moi* leaders demonstrated some remarkable entrepreneurial characteristics in their economic thinking and implementation (Vuong et al., 2011) as "economic crisis and harsh realities were neither necessary nor sufficient conditions for the reform to take place" which enabled an undertaking process that had brought about the long-awaited extensive reforms, learning lessons of economic policies from Ho Chi Minh's times, 1945-1969, about the adoption of a multi-sectoral economy based on different types of ownership, encouraging for foreign investments, foreign trade (Pham and Vuong, 2009; Vuong et al., 2011).

Before *Doi Moi*, Le Duan, CPV General Secretary from 1960 to 1986, was already critical of economic models taught by the Soviet Union and China for chronic economic malaise and blunders, although despite some innovative thinking Le Duan himself was a strong opponent of market economy and much of his policy turned out counter-productive. But in his time, Kim Ngoc, Party Secretary of Vinh Phuc province from 1966 to 1967, was an accomplished entrepreneurial politician who soon recognized problems of the mass collectivization, which resulted in poor agricultural production, and the need to have property right in farm household. He 'invented' a pilot plan

American war. Ngoc's innovative ideas were basically not accepted by the North's collectivism, and for a moment was regarded as an offensive to the prevailing socialist ideology (Vuong *et al.*, 2011).

After the death of Le Duan, Truong Chinh, a high-ranked politburo member and who would then briefly serve as CPV General Secretary (July-December 1986), was another highly influential leader and "the one who laid down the first brick for the House of Reform of Vietnam," (Vuong *et al.*, 2011) by launching the program of extensive reforms during the 6th CPV Congress in December 1986. As Truong Chinh stepped down, Nguyen Van Linh, CPV General Secretary 1987-91, continued to bring concepts of reforms to the nation's economic life through a nationwide reform program with sweeping changes (Tran, 2002). The old-fashioned centrally-planned economy was replaced with socialist market mechanism, which promoted the concept of a multi-sectoral economy, open-door policies towards international trade and investment, and recognized private property rights (Vuving, 2012).

The new Law on Foreign Investment initiated in 1987 enabled a surge of the first wave of foreign direct investments (FDI) flowing into Vietnam, which then reached 10% of GDP in 1994. Vietnam was the largest FDI recipient among developing countries and economies in transition in proportion to the size of its economy (World Bank, 1999) thanks to its "macroeconomic stabilization resulting from *Doi Moi* and investor expectations of continuing reforms and improvements in the general investment climate" (Kokko, 1998). Corporate Law and Private Enterprise Law in 1990 'broke ground' the national private growth engine. From the old Confucian view imposed by the feudalist elites, which favors "educated scholars serving the government" (Vuong and Tran, 2009), by 1994 over 17,400 entrepreneurial firms started up. The 1992 Constitution extended human rights and recognized the multi-sectoral economy.^[1] Land Law in 1987 (revised in 1993) granted farmers land use rights. The milestones of *Doi Moi* from 1987 to 1994 can be summarized in the following table.

Vietnam quickly grew to become the world's third largest rice exporter in 1989 (approx. 1.2 million tons exported), after China and the United States. The entrepreneurial policy-makers had been the core element to bring about change in macroeconomic management in 1990s although the CPV reserved *status quo* as the unique ruler.

Economic integration and adaption of market economy (1995-1999)

An eminent reformer, Prime Minister Vo Van Kiet came in office from 1992 to 1997, and continued to advocate extensive reforms. Vietnam sought further economic integration and diplomatic relations within the region and the world. From 1995 to 1999, the normalizing of diplomatic and trade relations with the United States was among the most remarkable for Vietnam, opening up opportunities to work with the world's developed economies and international organizations around, including multi-lateral donors such as the World Bank and ADB.

While the conservative in the CPV may have been afraid of losing their control over economic development and the national politics, generally speaking the CPV adopted open policies as they saw benefits for the country while no direct threats to their power were seen. Despite existence of conflicting views within the CPV, *Doi Moi* momentum was retained for almost two decades with political consensus over three major principles: a) Political stability is a prerequisite of economic development, and the CPV remains to be the unique power; b) To achieve economic goals, Vietnam must keep its door open to foreign trade and investment; and, c) Gradualism is preferred to avoid 'deviation from the socialist path' (Riedel and Turley, 1999). These principles have been preserved and implemented explicitly through the CPV and government's socio-economic and foreign policies.

The U.S. also had some commercial interest in Vietnam's growing economy

East Asian order," (U.S. Congress, 2005). Over US\$10 billion of FDI entered the country in 1996 together with billions of dollars of ODA coming from the World Bank and Asian Development Bank. FDI enterprises played an important role in creating jobs (Athukorala and Tran, 2012), paying corporate taxes, encouraging consumption and competition, and contributing to export growth (Nguyen and Xing, 2008). Vietnam's GDP grew at 9.5% and 9.3% annually in 1995 and 1996 respectively, the highest rates recorded in the post-*Doi Moi* period.

The country also expanded its diplomatic relations within the region becoming member of ASEAN (1995), APEC (1998). The U.S. and Vietnam then expanded the relation into a US-Vietnam bilateral trading agreement (the BTA was later signed in 2001). The US-Vietnam BTA "had an important political economy impact" by "spurring political will to speed up negotiations on [Vietnam's] accession to WTO" in later years (CIEM-USAID, 2007).

Integrating in international markets has brought about new market opportunities and helped the country to deepen its reform, but at the same time exposed the country to contagious risks. Although less hurt by the Asian financial crisis in 1998 than other major Asian economies due to its young markets, Vietnam experienced GDP growth decline to 4.77% in 1998 and committed FDI fell by half in 1997-1998 to approximately US\$5 billion, compared to US\$10 billion in 1996 (Vuong, 2010). When the Asian financial turmoil broke out, Vietnam was still a nascent market model, without stock market; and the fledgling banking system was controlled by the state-run powerhouses who occupied 75% of assets and credit portfolio (Kokko, 1998). Inefficient SOEs still accounted for 50% of the country's output (Congress Research Service, 2005).

Economic boom and emerging cultural values (2000-2006)

Succeeding Vo Van Kiet, Prime Minister Phan Van Khai (1997-2006) continued to pursue further integration into the world economy, especially from 2000 to 2006. In 2005, Mr. Khai was the first Vietnamese leader visiting the U.S., strengthening diplomatic relations between the two countries. The U.S. then supported Vietnam's accession to WTO in early 2007 (Congress Research Service, 2008). Under Khai's leadership, Vietnam's economy experienced economic prosperity, quickly expanding financial markets and GDP, low inflation, surging FDI inflows and faster pace of privatization of SOEs. The capitalist symbolic finance machine – the stock market – was born in July 2000.

By the end of 2000, Vietnam stock market's capitalization was negligible in economic terms, less than 1% of GDP. But by the end of 2006, the figure rose to 22.7%. In 2006 VN-Index rose 150%. From 2006 to early 2007, investors considered stock markets a 'money machine,' and herd mentality triggered huge market bubble risks. Despite immense risks, the market continued to go high as capital gains were still made easily, and macro prospects looked bright with Vietnam joining WTO soon (Pham and Vuong, 2009).

An average GDP growth of 7.5% in 2000-2005 period and the economy ranked at 58th largest in the world in 2006 made Vietnam like a little tiger economy in Southeast Asia (GSO, 2011; UNCTAD, 2008). However, the rapid rate succumbed to 'resource curse' problem (Vuong and Napier, 2014) as there appeared more evidence that economic growth heavily relied on overconsumption of physical assets or/and capital endowments while innovation and productivity were not the main emphasis, leading to a decline of competitiveness. Vietnam's high incremental capital to output ratio (ICOR) of 7-8 times, compared to other Southeast Asian economies of 3-4, and rising investment to GDP over years, i.e., 4.9% (from 1996 to 2000) to 39.1% (2001-2005) to the staggering 43.5% (2006-2010) show its propensity to consume more resources while seeking growth. The absence of innovation and creativity together with resource curse will be destructive in

Under P.M. Phan Van Khai's leadership, although the state-led model was still advocated, he did not vow to establish the state-run conglomerates. (There were only two state-run conglomerates established under Khai's tenure that are Vinacomin and Vinashin.) In a stark contrast, his successor P.M. Nguyen Tan Dung established other eleven conglomerates within a few years after he took office. The breakdown of investment capital of the state-owned behemoths (Table 1) showed remarkably greater state budget investment in SOEs in 2008-09.

Still, combining the rapid growth and booming markets, Vietnam was successful in reducing poverty rate from 28.9% in 2002 to 18.1% in 2004 and 15.5% in 2006 (GSO, 2011). Inflation was kept under check with average CPI in the period at 4.5%, a remarkable achievement as inflation has always been a chronic disease of the post-Doi Moi period.

The US-Vietnam BTA and investors' projections that Vietnam would enter WTO in 2006 and *China plus one* strategy (Shimizu, 2007) contributed to make Vietnam an attractive destination for FDI (UNCTAD, 2008: 8). Political and social stability played a significant role in facilitating economic development and attracting FDI (Dapice, 2003). FDI started to recover from 2003 (US\$3.2 billion registered capital) to 2006 (US\$12 billion), generating growth and employment.

Privatization (politically correct: 'equitization') of SOEs also saw improvement in the 2002-06 period with 2,813 enterprises being privatized, compared to a handful in 1990s, 60 in 2011, and 16 from 2012 to 2013Q1 (Bao Hai Quan, 2013).

Globalization and attitudes toward global geopolitics and geoeconomics (2007-present)

After two decades of growth, the engine started to lose its steam in late 2000s. The contemporary state-run conglomerate model has shown serious problems ranging from poor efficiency and corruption to crony capitalism. The macro economy again experienced a period of high inflation, budget deficit, declining foreign exchange reserve, mismanaged fiscal and monetary policies, high unemployment and sluggish commercial activities.

Vietnam's unstable macroeconomics with two-digit inflation in 2008 together with spillover effect of the global crisis had made the stock bubble burst in 2009. The VN-Index went down to less than 250 in February 2009 from the peak of 1170 in March 2007; and it has never regained the expected 600-point level that experts, policy makers and investors had desperately looked for while the downtrend became unavoidable in mid-2008 (Pham and Vuong, 2009).

In a more complex financial system with interconnected stock markets, real estate markets and money market, the problems do not just stay with stocks. Vuong and Nguyen (2008) argued that there was an interconnectedness between Vietnamese stock market, properties market and money market, showing rising complexities. After the boom of stock market and skyrocketing stock prices, many realized capital gains and speculated on real properties. This had led to a boom on real estate market from 2007 to 2010 where home prices went exponential. A free fall in prices by almost 30% in 2012Q2, coupled with no liquidity, made speculators panic (Vuong 2012). The continuous fall of property prices by another 30% in 2013Q2 killed most speculators and developers. The government admitted that VND 108 trillion (\$5.1 billion) worth of real property become non-tradable in the second quarter of 2013 (Vietnamnet, 2013).

The banking sector immediately suffered, as about 50% of credits had been extended to real estate speculations and developments (Hong Suong, 2013a). Bad debts mounted, stifling credit flows to the economy and

the extent that the government was worried about social unrest caused by rampant financial failures in information economy and households. Government's stimulus package of US\$8 billion in 2008 and 2009 had temporarily backed GDP growth at 6.78% in 2010 before inflation threat became real in 2011. The growth rate fell to 5.03% in 2012, the lowest within 13 years (Nguyen, Nguyen and Nguyen, 2010). From 2011 to 2012, the economic crisis has pushed approx. 100,000 firms out of business, ~20% of the enterprise population (Vuong, 2012). Consumer price index (CPI) only slowed down in the recent years as a result of falling domestic demand.

From 2007 to present, the government's policies to use state-run conglomerates as the chief force to propel Vietnam's economy have degraded into problems of crony capitalism, interest groups and corruption, which induce rent-seeking and exacerbate the 'resource curse' problem in Vietnam. The state sector only creates 10% employment but consumes 70% total social investment, 50% total state investment, 60% commercial credit, and 70% of ODA (BBC, 2013).

The problems prevailed in banking industry and other essential industries of the country. A typical example is tycoon Nguyen Duc Kien, a senior commercial banker, who had manipulated the banking industry and gold market before being arrested in August 2012. His arrest sent a chill through the Vietnamese stock markets for three consecutive days, during which most stocks lost 20% of their value, and almost created a bank run at ACB that forced the State Bank to directly inject liquidity into the bank (Nguyen, 2012). Many state-run conglomerates, the government's expected to be their 'iron fists,' now turned out to be debt-stricken patients generating overwhelming losses, debt burdens or scandalous corruption worth billions of U.S. dollars, i.e. Vinashin, and Vinalines, Vietnam Electricity Group (EVN), Vietnam National Coal and Mineral Industries Group (Vinacomin). In Vietnam, when the rule of law does not catch up with the expansion of the financial sector, political connections are used to channel loans toward unprofitable sector, hindering impact of finance on investment growth (Malesky and Taussig, 2009).

Although Vietnam's GDP *per capita* reached US\$1,555/year in 2012 and \$1,700 in 2013, the new millennium's setting is far different from that of the 1990s (Dan Tri, 2013). Vietnam is now part of the world's bigger game, in which it has passed the point of no return. The economy has been becoming more open and engaged in international affairs. Vietnam has started to acquire important positions in United Nations and shown its interest in world geopolitical issues by joining the UN Peace Keeping Operation in early 2014. Vietnam's participation is prepared with the help of the United States, who supports the UN operation by its Global Peace Operation Initiative. The country's joining into UN peace keeping force may potentially open new possibilities for U.S.-Vietnam relation, a meaningful event in global geopolitics (Wilson 2013). The CPV and the government have tried to preserve political stability through domestic policies (despite the successes and failures) and seeking foreign supports via foreign relations. For these hard, expensive and painful lessons about market mechanism and ideology, the 'little tiger' has not roared yet.

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