



Initiative for Policy Dialogue

Viet Nam Country Dialogue

November 20-30, 2004

Summary Report

Introduction

Since the start of the economic reform program *doi moi* (renovation) in 1989 Viet Nam has experienced consistently high growth rates and extraordinary achievements in poverty reduction. Viet Nam is on a steady path of integration into the world economy and is currently negotiating its terms of accession to the WTO.

As a part of its Country Dialogue program, the Initiative for Policy Dialogue (IPD) organized a visit to Viet Nam in November 2004, in partnership with UNDP who provided financial and logistical support. The visit coincided with the launch of the Vietnamese translation of Anya Schiffrin and Amer Bisat (eds.) *Covering Globalization*, Columbia University Press, 2004. The volume is a journalism textbook aimed at reporters who cover finance and economics in developing and transitional countries. The book is part of the Journalism Training program within IPD, headed by Anya Schiffrin.

The IPD team was comprised of Joseph Stiglitz, Anya Schiffrin, Kira Brunner and Francesco Brindisi (all from Columbia University) and Robin Burgess (from the London School of Economics). This Dialogue was a follow-up to IPD's two previous Country Dialogues in Viet Nam, in 2001 and 2002. Many of the issues raised at our 2004 Country Dialogue were first introduced in previous years. The prior discussions have helped formulate the current debate.

The dialogue took place at the eve of the second Socio-Economic Development Plan (SEDP) for 2006-2010, and preceded the twelfth donors Consultative Group Meeting. Professor Stiglitz and Professor Burgess gave lectures at universities in Ho Chi Minh City, Da Nang and Hanoi, including lectures at the Media Department of the National

University of Hanoi, and a public lecture in Hanoi at the Opera House. The IPD team met with the Prime Minister's Research Council, the Economic Commission of the Central Party Committee, the Deputy Prime Minister Nguyen Tan Dung and other key government officials. The IPD team also held meetings with the donor community and representatives of Vinafood, Viet Nam's southern food corporation.

Viet Nam is a country transitioning from a central planning to a market economy. Therefore, the main issues discussed were those surrounding the principles that contribute to the right balance between the state and the market, the role of government intervention in the economy and the appropriate approach to economic planning during transition. The topics of international economic integration, in particular WTO accession, structural change and inclusive growth were debated at length. The accountability of civil servants and the role of the media in political and economic processes were two issues also brought to the fore during the dialogue.

The Role of the State

One recurrent theme throughout the dialogue was the role of state planning in a transition economy. As the involvement of the state in production is gradually reduced, the government's economic plans should focus on qualitative rather than quantitative objectives. Modern planning aims to organize and regulate the inputs for production, rather than set output targets. The small size of the Vietnamese economy facilitates the design, control and evaluation of economic policies.

Informational asymmetries, externalities and other market imperfections provide a rationale for government intervention in the economy. The state can initiate new markets, ensure the availability of credit, provide access and investment in education and health. Governments have a role in maintaining the social and environmental sustainability of the growth process by regulating the regional and rural/urban distribution of economic activity, providing urban plans and infrastructures, and putting into place a system of safety nets.

The new approach to planning should focus on three main aspects. First is a reappraisal of the rationale for government involvement in each area of public intervention. In particular, the regulatory framework can be overhauled and public service provision can be made more efficient by incorporation of private elements.

Second, the plan should be concerned with the budget allocation of resources. Third, the plan should provide qualitative targets for government intervention. Examples relevant to Viet Nam are the development of mortgage and insurance markets, the provision of credit to small and medium sized enterprises (SMEs) and in rural areas, the promotion of technological research. The discussion in these areas followed-up on the earlier country dialogues, when many of the ideas were first introduced.

Planning should not be solely concerned with preserving the current areas of strength but should also be carefully aimed at stimulating new areas of comparative advantage. This objective can be achieved within the broader qualitative framework of the economic plan through experimentation, competition and innovation in the market. Therefore, economic plans should take into account the needs of the private sector and provide a fertile environment for investment, through regulation and anti-trust legislation.

One important role of economic planning is to regulate the location decisions of firms. Particularly important for Viet Nam is to favor the development of the tourism industry in locations away from industrial development areas. Tourism is a labor-intensive sector and one where Viet Nam has a comparative advantage.

Innovation is favored by investments in education, competition between universities and by the creation of technical colleges and knowledge centers. The creation of industrial parks around universities would increase the flow of information. Knowledge spillovers from foreign direct investments should also be exploited. Agricultural programs of as well as manufacturing extension services should be put in place. These policies act to stimulate the accumulation of human capital, which plays a substantial role in the emergence of areas of comparative advantage.

The institution of advisory bodies composed of academics would help in the management of the economy and would provide a relatively unbiased analysis in comparison with state bureaucracies, which often prove to be resistant to change.

Integration and WTO accession

WTO accession is a high priority for the government. While the agreement with the EU has already been signed, negotiations are still taking place with Japan and the US, among others. The veto power of current WTO members on new applicants can make accession particularly costly. Therefore, Viet Nam should adopt an aggressive bargaining strategy oriented towards sectors that would undergo reform in any case and sectors where concessions have low costs.

The IPD team observed that even though the WTO regulations are still imperfect they can be actively used to protect Viet Nam's interests in current and future sectors of comparative advantages, for instance by resorting to dumping duties. In this sense, bargaining should not only precede but also follow accession. Finally, in light of the expiration of the multi-fiber agreement, accession is important to avoid being at a disadvantage with respect to competitor WTO members.

Particular attention should be devoted to the consequences of competition with WTO members. In the agricultural sector, the competition from the subsidized producers in the US and the EU will have limited adverse effects because Viet Nam is already a food exporter.

In the area of global financial integration, potential strains could follow the opening of financial markets to foreign financial institutions. Adherence to international standards should be accompanied by a regulatory effort to put foreign and domestic banks on a level competitive ground. One regulatory measure that would exploit the informational advantages of local domestic banks is the requirement of a fraction of credit to be reserved to finance SMEs and community development. This measure would be similar to the community reinvestment act in the United States. Banks could also be required to open branches in rural and remote areas.

It will be crucial to sustain the supply of credit and to guarantee access to credit across sectors and geographical areas. The banking sector in Viet Nam is still dominated by state-owned banks, which provide almost all the credit received by state-owned enterprises (SOEs). While the growth of the private sector will gradually reduce the importance of state-owned enterprises in the economy and subsequently the share of credit to these state-owned companies, the provision of subsidized credit should also be reduced. The burden of directed financing should be gradually removed from the banking sector and transferred to the banks for priority lending.

The IPD team suggested that, while the inflow of foreign direct investment is beneficial for growth, foreign borrowing could result in some loss of political independence in the area of domestic economic policy decisions.

Inclusive growth

The processes of transition and globalization can bring about increased inequality. Viet Nam should take preventive measures to insure the equitable distribution of the benefits from economic development.

Social sustainability relies on maintaining the economy at full employment, which provides an effective insurance policy against inequality and poverty by guaranteeing the easy transition between jobs. Moreover, while social tensions undermine economic growth, inclusiveness within the growth process provides political legitimacy.

In Viet Nam, widespread access to land has been achieved through the concession of land-use rights, which, compared to other agricultural contracts such as sharecropping, increase productivity. Access to land also provides a cheaper source of calories, which represents a more effective insurance mechanism than redistributive policies. Land is currently the only form of social security in rural areas and also provides the funds for investment in non-agricultural activities and human capital. These factors are preconditions for economic diversification. The IPD team stressed that the introduction of full property rights could increase landlessness, which generates poverty, migratory movements and uneven regional growth. Full property rights should therefore be introduced only when there are strong alternative employment opportunities. This view put forward by the IPD team is at odds with other advisors to Vietnam such as the IMF.

The IPD team emphasized that education and health are two areas where there is no trade-off between equality and growth. Social insurance should be aimed at providing equal opportunities through infrastructures, education, health and credit. Access to education at the secondary and higher levels should be made widespread. Curricula should emphasize areas of education such as English, computer skills and technical subjects. Competition in tertiary and higher levels of education should be fostered. Viet Nam is in need of a basic public health system, complemented by the private provision of specific services.

Structural change

The process of structural change is spurred by encouraging entrepreneurship and by promoting and facilitating entry. The achievement of these objectives will gradually reduce the importance of SOEs in the economy. It is therefore important to maintain the flow of credit to SMEs. The IPD team used the example of northern Italy to show how the promotion of cooperative movements provides contractual power to SMEs and can be an engine of growth for the economy.

While SOEs are not, on average, inefficient, they are still facing soft budget constraints, partly channeled through the banking system. Moreover, the governance of SOEs still seems to be weak and will not necessarily be strengthened by the selling of minority shares through the government program of equalization (or privatization). Again, IPD expressed views that were contrary to those of the IMF program. This in turn helped to expand the debate by showing the different perspectives on the issue.

Another area of weak governance is in the banking sector, where the adoption of accounting standards is particularly important. Non-performing loans, though not as disquieting as in other fast developing countries such as China, can be an undue burden for domestic banks especially as the sector opens up to foreign competition.

At the same time, the supply of credit should be insured during the reform of the banking sector. During the development process, credit tends to grow at a faster pace than GDP, as Viet Nam is currently experiencing. While credit growth does not seem to have generated inflation, a better indicator of inflationary pressures is the excess demand for goods and services.

Productive diversification in rural areas curbs large migratory movements and prevents the uneven geographical distribution of economic activity. In conjunction with access to land, the availability of credit to non-agricultural enterprises is a powerful tool for encouraging diversification. Access to credit can be guaranteed by requiring banks to establish rural branches. This policy has also proved effective in stimulating saving rates in other developing countries such as India. Savings can also be increased through the development of an insurance market, where entry of domestic firms should be promoted and a reinsurance institution should be put into place.

Structural change benefits from the diffusion of information. In Viet Nam, the access to timely information on prices and weather conditions has already contributed to raising the price of rice. High-quality economic reporting helps to spread ideas that can spur competition between regions. Accurate knowledge of the economic situation also affects aspirations and incentives to change.

The media has a role in explaining new concepts related to economic reforms such as, the WTO accession. Extensive media coverage increases the accuracy of information on the costs and benefits of reforms and facilitates adaptation to the new economic environment. Viet Nam should take advantage of its high literacy rate, which can facilitate the diffusion of information.

Accountability and the media

The government of Viet Nam has announced a widespread effort to curb corruption. Though there is lack of data to measure the extent of graft, the allocation of funds to local authorities seems to be reasonably transparent while the allocation of funds within localities is less so. This point is of particular relevance because Viet Nam is implementing a program of decentralization. The IPD team stressed how trust in the government should be viewed as a capital stock and an engine of growth.

It is important to guarantee that public officials act in the interest of the population and are responsive to its needs. Establishing accountability is one important step in achieving this objective and can be promoted through a variety of means. Choice between candidates is one obvious mechanism and has already been put in place at the local level. The activity of officials also needs to be monitored, through the use of surveys, report cards and internal audits. The pay of public sector employees should be increased to ensure quality provision of public services.

The media exerts a critical role in conveying information on political processes and provides a channel that connects society and political decision makers, ensuring the monitoring and alignment of incentives. The provision of relief services after natural disasters is an example where media coverage influences the allocation of assistance.

Since market prices reflect information, the information provided by the media should be accurate. Secrecy is an artificially created scarcity that generates economic distortions and rents. Even biased information gives a signal on the behavior of politicians, after a media has established its reputation for accuracy. Competition between media tends to reduce the extent of the biases.

While journalism training is currently centralized, it would be beneficial to localize formative programs and also to spur entry and competition in the market for local information.

Projections for the world economy and Viet Nam

There was considerable interest in the state of the world economy in the near future. Professor Stiglitz expressed his belief that the world economy next year will exhibit a lower rate of growth than in 2004, already not an exceptional year. This will be partly due to the high price of oil.

In the US, the end of the tax incentives and the twin trade and fiscal deficits will dampen growth. Sustained borrowing to finance the deficits will bring about a phase of instability of exchange rates. The EU will maintain conservative fiscal and monetary policies due to the stability pact and the strict focus on inflation of the European Central Bank. Moreover, the EU accession of new countries will weaken the German economy due to wage competition.

The combination of high US deficits and a sluggish world economy implies that the flow of aid finance will be reduced. It is therefore even more important to promote pro-development international trade agreements and support effective domestic economic policies.

China will experience a lower growth rate in the context of an economic program of soft-landing. Nonetheless, the growth rate in China will still be around 8%.

Viet Nam, being a small economy with export relatively unaffected by cycles can maintain its growth trend despite the weaker world prospects for 2005. Viet Nam will also benefit from the positive association of its currency with the US dollar, which is on a declining trend.