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CHOICES AND OPPORTUNITIES: ROADS OPEN TO VIETNAM

EXECUTIVE SUMMARY

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Background

Vietnam's growth has slowed since the 9% rates up to 1997, and it has been getting a lot of advice from donors that suggests developing a private sector, lowering trade barriers, and improving capital markets so as to take advantage of the global economy. This advice seems sensible to many but also hard to follow given various concerns about socialism, equity, and stability. The intent of the US is thought by some to still be hostile, and better relations with China do not lessen concern about their increasing competition in many industries also important to Vietnam. The best way to take advantage of science and technology, including the Internet, is also under discussion. What is agreed by all is that Vietnam is still poor and it has little land. People will have to move out of agriculture to eliminate poverty and to begin to "catch up" with others. Even equal *per capita* growth rates (say 5% a year) means $20 extra in Vietnam, $50 in China, and $150 in Thailand.

Rather than repeat advice, this paper presents three plausible alternatives or scenarios of Vietnam's economic future. Each one is the outcome of a thought process and consistent, with its policies and outcomes. Whatever is decided, it is best to be clear about the implications.

The bias of the author is that he believes the combination of faster and cheaper computers and communication is causing a revolution equal in importance to printing or electricity. To decide not to take part in these is like deciding to charge $1 per kilowatt-hour for electricity. It can be done, but what government would want to keep people in the dark? However, taking advantage of these developments (it now costs five cents per HOUR to lease a voice line across the Pacific Ocean! Telephone calls will soon be nearly free.) requires that decision cycles be speeded up. This is very hard for governments, and even for old-style state enterprises. To be slow is to be dead. This is why FDI has fallen 80% to 90% in 1999-2000 from 1996, while it has doubled or tripled in Korea and Thailand.

Scenario 1: Business as Usual (Minus)

There are some in Vietnam who look back on the past decade with satisfaction and believe that a continued step-by-step approach is desirable. Most of these people would like the state banks to continue as they are, want large state enterprise monopolies, and are skeptical of the benefits of the Internet. They believe in self-sufficiency and protection. The author argues that this view is complacent because of likely slower growth in agriculture, the impact of the communications revolution, and the looming threat of foreign competition, especially from China. (There is a case study on the Motorbike Industry.) More of the same is likely to produce much slower growth, perhaps 4% to 5% a year over time, and 25% to 30% investment/GDP ratios, but with inefficient investment patterns. The most troubling aspect of this scenario is the implications for employment. There will have to be 1.4 million new jobs a year and few would be created in this scenario, much less helping to reduce under- and unemployment. The likely result would be falling behind and social evils. High income taxes (among the highest in the world) would also be sure to drive the most qualified workers overseas, and lower total income tax collections. Technical capacity would slip too.

There is a "box" asking what a leading role means now. It clearly is not in providing direct employment, since SOE jobs will fall. The position of the state in farming is slight, and even in industry is down to 41% and may be overtaken by FDI based industry in a year or two. Its share in services is also likely to fall. So, a "leading role" could mean state ownership of certain

"heavy" industries, electricity and telephones, and banks and railroads. However, trade concessions will make these positions weaken over time. Or, it could mean the state is moving into "path breaking" areas, but in software, it is clearly the private sector that predominates. A "leading role" is meaningful if it is defined as creating an environment in which all competitive firms can prosper.

Scenario 2: Business as Usual (Plus)

In this scenario, pragmatic and technocratic elements balance the more conservative groups. The result is a compromise. There is more of a willingness to specialize production for export, more attempts to lower high prices and improve service (as in telephone/Internet), and more of an attempt to make public investment more efficient. There would be some banking reform and a better capital market, so that investment would be used more efficiently. With about the same level of investment, growth would increase to 6-7%, although there might be higher FDI. In this scenario, growth (double GDP by 2010) and poverty reduction targets are taken seriously. However, it would take faster and smarter reforms than in the 1996-1999 period.

There is a long analysis of job growth. SOE's will probably have fewer jobs over time. FDI will do well to absorb 100,000 per year (up from 60,000 in the 1990's) and the same is true for the formal private domestic sector, though this implies 20% annual output gains. Agriculture might be able to take another 200,000 a year, even though its income or product per capita is a third or fourth of other sectors. This implies that the nonfarm rural/informal sectors will need to absorb 1 million a year, just to absorb new entrants! This is a large amount, and will require an analysis of existing constraints. Three mentioned are actual behavior by state banks restricting credit to private borrowers, restrictions on land use at the local level, and controls on export or high marketing and transportation costs leading to poor processing and lost sales. Even with these reforms, it would mean "crowding in" to these jobs and zero productivity growth, though incomes would still be much higher than if the workers had stayed in agriculture.

There is a brief digression on the actual savings rate of Vietnam. It is not clear how big trade deficits really are (IMF sources are twice the official figures) and *Viet Kieu* inflows are large, and some may be investments rather than gifts. While official savings are 25% of GDP, the actual figure may be in the 15% to 20% range. This matters if the investment climate becomes worse, because then some of the inflows would stop.

There is also a "box" on the Vietnam-US Bilateral Trade Agreement. The US imports 100 times as much as Vietnam, and lower tariffs on manufactured goods should lead to much higher export levels, and also more FDI for Vietnam. The author argues that the BTA *allows* Vietnam to succeed, but does not *ensure* it. Other steps will be needed so that the full benefits are realized, and the quantity and quality of FDI increase. Although Vietnam reached $4 billion of manufactured exports last year, the Philippines has had its manufactured exports rise by $4 billion a year recently due to its electronics sector. With respect to the "concessions" in telephones and banking, it is argued that the negotiated phase-ins are far too slow given technology and Vietnam's needs. A truly smart policy would move much faster than the treaty proposes, if it does not want to create a situation where Vietnam's firms pay ten times as much to talk to customers or suppliers as firms in other nations. The quicker a critical mass of foreign investors is reached, the faster the economy can create the jobs needed.

Another "box" deals with the impact of infrastructure in poor areas, and asks, "what kinds help?" Big projects like a LNG plant, a (little used) port or bridge, or a hydro-plant do little good for the regions they are put in. A better approach is to decentralize investment decisions, with some guidelines and oversight. The recent decision to delay completion of parts of the new North-South highway was wise. If east-west feeder roads are built and connect remote areas to markets and ports on the coast, their growth will eventually make completion of the north-south highway more productive.

Scenario 3 – A Decision to Leap?

While faster is usually thought better than slower, it often entails some cost. This section discusses the policies for faster growth but also the tensions and risks. One risk is "losing control" in the sense that once powerful changes are unleashed, they are hard to reverse. Another is, as Deng Xiao Peng said, "When you open the window, the flies come in." So part of opening up to information is getting messages that are unwanted. However, while the risks of this are well appreciated, the costs of moving slowly may not be. Increasingly businesses will need the Internet as a fundamental tool. This is why China, even while it tries to perfect "firewalls" (screens for the window), has decided to push the Internet. On a per capita basis, ten times as many Chinese as Vietnamese use the Internet. Are the Chinese naïve? Or have they weighed the costs and benefits more clearly?

The new technology does decentralize the power of information. Vietnamese firms will be able to grow faster. In scenario 3, the SOE's will also grow faster, but they will probably have a falling share of industrial output, since private firms have been less connected in the past. It is a political decision if faster SOE growth is worth a smaller share.

The policies in scenario 3 would aim to promote growth. The private sector would not be a regrettable necessity but a pillar of the nation's strength. Not only would good laws be passed, but they would also be implemented. There would be the emergence of a truly commercial banking system and capital market. Vietnam would aim to become one of the more connected nations (allowing for its income) instead of one of the least connected. Income tax rates would be cut to 25-30% to maximize revenues instead of punish skills. The extra taxes would be used to help the poorer regions and those displaced. High levels of FDI would still cluster in the growth pole areas, so provision would have to be made for those that move to follow opportunity – implying changes in land zoning, finance for multi-unit housing, provision of roads and utilities, etc.

In this scenario growth would be about 10% a year, and investment from 35% to 40% of income. This would follow similar experiences in China, Korea, and Taiwan at lower income levels. Savings would come from more FDI, more reinvestment of profits, and a shift in gold and dollars to banks, and greater portfolio capital flows, including from *Viet Kieu.* Millions of jobs would be created paying $50 to $100 a month, instead of the $10 to $20 a month for seasonal farm jobs that now employ 25 million workers. Such a leap will take some luck and skill, and has some risks. But it promises to lower poverty, build technical competence, and make the nation rich and strong faster.

There is a "box" on zero, negative, and positive sum games. Games refer to interactions between firms, nations, and groups of people, or individuals. A zero sum game is like football, where one

team winning means the other loses. A negative sum game is like a bad marriage or a situation where people ignore traffic rules. Everybody gets hurt. A positive sum game is like a good marriage or voluntary trade. Both sides benefit. Peasants view life as zero sum, because there is a fixed amount of output. But where technology exists to allow $30,000 per person output per year, it is not too hard to get to $3000 (Thailand) and if a nation stays at $300, it is destroying wealth and squandering its potential. In that case, the system has become a negative sum game. In the opposite case, people try to help (or at least not hinder) each other, expecting they too will get ahead. Then all can move forward faster. Ultimately, a society chooses the kind of game it plays.

Concluding Comments

This paper presents three different scenarios, based on three different views. The perspective of this paper is that the world economy is becoming integrated more quickly and completely than before, and that fast-changing technologies allow a nation to choose the level of income that it wants. Some choose to grow quickly. Others cannot or choose not to. [There follows an example of training 10,000 software Internet programmers a year at a cost of $10 million a year. Within a decade they would earn $2 billion a year and paying $500 million a year in taxes. This would add 1% to the national growth rate. In which scenario would this most likely happen?]

If we compare the three scenarios, #1 gets Vietnam to $540 by 2010, #2 to $650, and #3 almost to $1000. Poverty would drop sharply in #3, almost vanishing by the food-only poverty measure, so long as smart social investments were targeted on poorer areas and groups. As we saw from the 1990's, poverty falls fast when rapid growth and widespread social services are combined. But if the country is richer, stronger, more technically capable, and has less poverty, why not choose #3? One possibility is that some do not believe that 10% growth is possible, but with 9% growth up to 1997 and the BTA and fast growth opportunities in electronics, surely the target is reasonable. Is it SOE's having too small a role? But they have been falling relatively for a decade, and this is likely to continue. They would grow absolutely faster in #3 and be stronger and larger. Even if they take time to become competitive, higher tax revenues will allow subsidies.

The third reason for being cautious is that different groups may arise and be hard to manage. Vietnam may be seduced by a glamorous but empty consumer culture. In the extreme, even stability might be threatened. These are questions beyond the scope of an economist, but they are not foolish. However, they must be weighed against the benefits of faster job growth, better education, and greater national capacity. One source of concern has been corruption, and surely better civil service pay would reduce this more effectively than anti-corruption drives alone. The issues need to be weighed realistically.

There is a final "box" on the possible use of translation software that would take text from English to Vietnamese or Vietnamese to English. The quality of this software is improving to the point that it is usable for rough translations in narrow topic areas such as medicine or business. Funding this with ODA and distributing it free would allow a much faster rate of connection than waiting for tens of millions of people to become fluent themselves. It would be one way to accelerate connecting with global information.