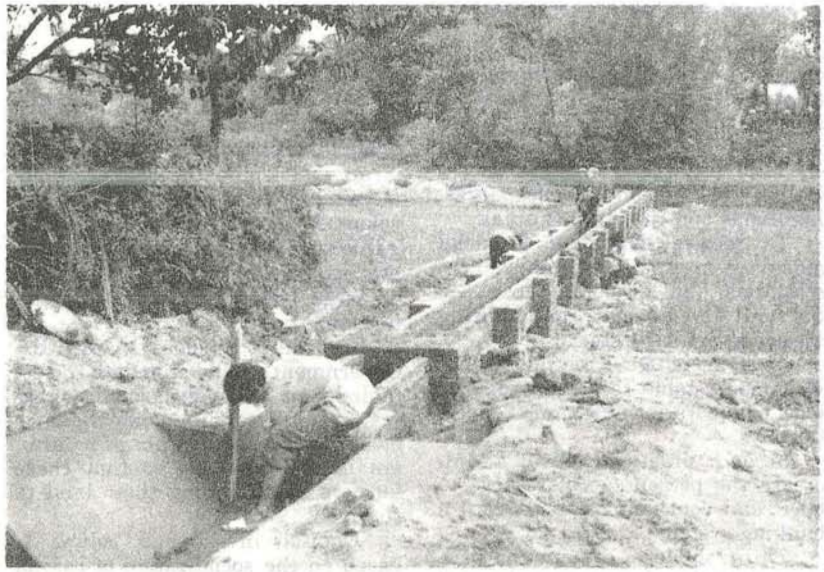
SOME FINANCIAL MEASURES FOR RURAL MODERNIZATION AND INDUSTRIALIZATION

by MEcon SỬ ĐÌNH THÀNH



I. FACTS OF VIETNAM'S RURAL ECONOMY

Over the past 10 years, the agricultural sector has made progress in line with *đổi mới* policies launched by the Party sixth congress and enhanced by its seventh and eighth congresses:

-The farming GDP annually rose from 3.6% in the 1986-1990 to 4.5% in 1991-1995 period. Since 1989 Vietnam has solved the food problem fundamentally and even exported rice.

-The export of agricultural, forestry and marine products saw an average increase of 20% per year. Rice, coffee, peanut, tea, cashew nut, pepper...became Vietnam's major exports.

-The rural economy is shifting to the trends of increasing the ratio of industry and service, from the close and self-providing structure to goods production meeting requirements of local and foreign markets. The plant cultivation and fisheries have been boosted for export.

-The rural living has been improved due to economic growth.

The achievements are encouraging but so far Vietnam's agriculture reveals a lot of difficulties and shortcomings greatly affecting the country's process of industrialization and modernization.

-The growth rate in the agricultural sector has shown a downward trend in recent years, especially in the 1996-1998 period, up 3.9% only. The sector's contribution to the GDP fell sharply, from 40% in 1991 to 25% in 1998. As a result, the wealth gap between rural and urban areas is widening. The rural areas where 80% of the country's population live have accounted for 25% of GDP; while the remaining 20% living in cities generated 75% of GDP.

-The economic structure, especially regional and industrial ones, faced a serious imbalance; the uneven development between regions was increasingly apparent.

-The rural infrastructures were poor, not satisfying requirements of goods manufacture. Fifty percent of 10,000 communes across the country lacked supply of electricity and water, schools, health stations, marketplaces...

-The rural social problems have become urgent. Fifteen percent of farm households nationwide hit poverty and hunger. The system of education and health care is both insufficient and downgraded seriously.

-The unemployment indicates an upward trend; the army of techno-scientific staff was inadequate to develop the agriculture into industrialization.

-The legal system concerning the farming sector is not complete, more than 13,000 farms came into being but not recognized; the insurance of farmers is not paid full attention to.

The above evidence is derived from the fact that financial policies for rural development remain inefficient and slow to renovate.

II. VIETNAM'S POLICY ON CAPITAL MOBILIZATION FOR RURAL DEVELOPMENT INVESTMENT

Over the past years, the rural sector has attracted capital for its development investment from following sources:

1. The state direct investment

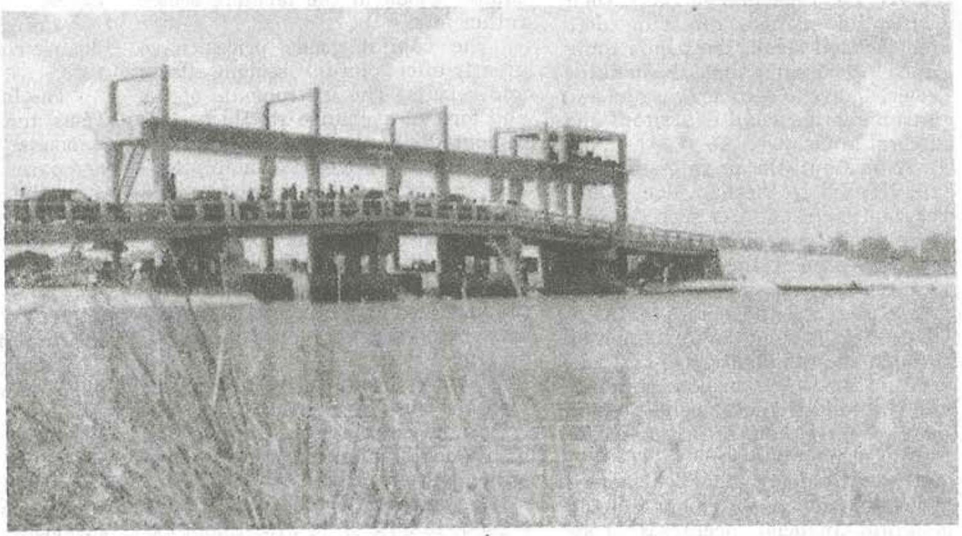
According statistics, in the 1990-1997 period, the farming sector's capital of VND12,000 billion came from the State budget, representing 15% of the Government's gross investment and 40% of the sector's investment capital, equal to 1% of GDP. The state money was spent mainly on socio-economic infrastructures, health care programs, cultural development and relocation programs...As such, regarding investment scale and content, over the past ten years, the state capital has played a very important role in the Vietnam's process of rural development. Nevertheless, to meet the requirements of the rural industrialization and modernization, the state investment remains too low.

2. Credit capital

Due to its limited budget, the Government has flexibly used the credit instruments mobilizing the public money by issuing government bonds...Thereby it gave soft loans to the projects developing mountainous, remote and challenging villages; and implemented its programs 327, 120, and 773. Together with the state lending channel, the network of commercial banks, and people's credit funds have made great contributions to the rural development and restricted informal credit forms such as usury and paddy futures. There are now above 6.2 million farming households having credit relations with the Vietnam Bank for Agriculture and Rural Development, accounting for over 65% of the bank's total outstanding loans.

3. Investment capital of economic sectors

In recent years, the new economic policy has been active in encouraging economic sectors to enhance their investments. However, because the macro-economic environment is not favorable, non-state sectors' investment capital compared to the country's gross investment indicated a downward trend, from 50% in 1991 to 21% in 1998. In addition to foreign-invested enterprises, non-state enterprises are of small size and engage mainly in commerce and services in big cities.



4. Foreign investment

The Vietnam's market economy has recorded significant achievements in its shift to the open system. In this situation, the attraction of foreign investment capital shows initial positive signs.

-Regarding foreign direct investment:

In addition to the promulgation of the Law on Foreign Investment in Vietnam, the Government has generated incentives in its financial policies that strongly allured foreign investors. As a result, from 1988 to 1998, the foreign direct investment soared fast. The total registered capital reached US$35 billion by 1998 or two-thirds of the total foreign capital. Nevertheless, the foreign funds invested in the farming sector represented a low ratio, some 3.64% with effective 264 projects and US$1,292.5 million.

-ODA (official development assistance) capital:

After Vietnam's integration into the international financial community, from November 1993 to 1998, foreign donors made commitments of US$14 billion to Vietnam, 80% of which are loans, and non-refundable aids 20%. Vietnam has so far disbursed above US$5 billion. However, the farming sector has received only 13% of this source.

In short, the above analysis of capital mobilization for rural development in Vietnam suggest that the country's investment capital is attracted in diverse and abundant forms. The channels of capital mobilization have been expanded: the state budget, credit, direct and indirect foreign investment...Nevertheless, this policy is too far behind the requirements of rural development. The percentage of rural investment saw a declining trend, from 13.7% in 1991-1995 to 8.5% of GDP in 1996-1998. Consequently, the regional restructure progressed very slowly. As compared to the 1986-1990 period, the investment capital for regional restructure faced a little change. The Hồng River and Mekong Deltas and Southeastern region always take the largest share of investment capital (more than 60% of the country's gross investment). Those challenging regions such as the Northwest, Central Coast, former 4th Zone, Central Highlands have insignificant fraction of investment (combined 38% of the country's gross investment). Due to lack of investment capital, these regions' economy is increasingly lagging behind and takes no opportunity for development. The percentage of poverty-stricken households is high.

III. FINANCIAL MEASURES TO BOOST RURAL DEVELOPMENT

According to the Ministry of Agriculture and Rural Development's estimation, VND 17,000-21,000 billion and VND 28,000-43,000 billion are required to implement the rural industrialization and modernization in the 2000-2010 and 2010-2020 periods respectively. With such a huge demand, the following financial measures are proposed:

1. Financial and monetary stabilization and inflation control

Financial and monetary stabilization and inflation control are always prerequisites for attracting investment capital effectively. The stabilization of financial and monetary environment is clearly observable if macro-economic balances must be maintained between state revenues and expenditures, saving and investment, and payment balance. If these balances are in fact destroyed beyond the safety limit, great market fluctuations will take place and the economy's development investment projects in the long run will be deformed. The decisive measure to reinforce the macro-economic balances is the Government has to strictly control its collecting and spending and stabilize budget deficit. In fact, the stabilization of budget deficit need not require to keep a budget balance or fix a deficit rate but requires the Government to adjust it flexibly within the limit beneficial to the economy and the deficit can be offset by credit. In the current condition, Vietnam's economy encounter a danger of recession, its aggre demand drops, and the balar tween saving and investment is broken seriously, the Government should thus increase its budget deficit. The deficit rate is though higher, but it is used for economic restructure and growth, and investment in farming sector. Once the deficit rises, the central bank has to establish a dynamic money market to make a ground for streamlining instruments in the monetary policy, thereby it can strictly control the money supply, regulate interest rates, secure the value of local currency and balance the relation between money and commodities in the market.

2. Policy stimulating saving and investment

Saving policy:

The key measure to increase saving in the private economic sector is macro-economic stabilization. In addition, the financial intermediaries should be consolidated and their quality intensified, removing deficiencies that slash the public confidence. At the same time, the banking services have to become so useful and convenient for small depositors and in rural areas.

At present, the private saving is still limited in Vietnam due to low per capita income. As such, to preserve the economic growth and expand investment, the Government is required to make great efforts to increase the percentage of its saving in GDP. This saving is implemented through the combination of tax policies and the Government's spending, and the reduction of expenditures is more effective than the tax increase.

Investment policy:

The developing countries' experience suggests the government should generate financial incentives to attract investments in the farming sector.

-First, giving tax incentives:

Tax is always a very important financial instrument to encourage private investments. To attract private money for rural development, the Government should cut rates of taxes on farming land use and income; and the tax imposed on the capital granted to state-owned enterprises engaging in the farming sector should be canceled. The above practice will make necessary conditions for increasing accumulation and investment for intensive farming, technological innovation and additional tax revenues in future.

The tax on farming land use currently accounts for 2.5% of the state budget collection, while the execution cost for this tax is huge because the collection is carried out in vast areas. Moreover, the Government annually spends more than 50% of the farming land use tax revenues on agro-product price support, in addition, this support system is not highly effective and wasteful due to intermediaries. As a result, the tax reduction is to create a better support mechanism for rural evolution. The income tax levied on farmers is still deficient and required to change. The number of households with mass production and high income (the output value of VND90 million and income of VND36 million per year) is still modest; moreover, farming production is not stable, investment cost large, risk high and agro-product shaky. That is not to mention that the farmers' spiritual life (education, health care, culture) remains far behind urban residents.

-Second, keeping the prices of capital goods in the farming sector rather low:

The capital goods prices have greatly effects on investment efforts and results. The instruments of tax and foreign exchange should be manipulated effectively to maintain the capital goods prices reasonably low. The import duty and valued-added tax on materials used for farming production that cannot be made locally should reduced. The machinery and equipment processing agro-products and exploiting marine products should face tax reduction and exemption.

-Third, boosting state investments in rural infrastructures:

In the next stage, the Government should enhance the percentage of budget earmarked for investment in the farming sector, from 15% at present to 20% of its investment expenditure. This source is concentrated mainly on building and upgrading rural infrastructures, especially roads, irrigation, electricity...in the trend of building and developing large specialized areas and securing comprehensive and equal development in different regions. All revenues from farming land use tax and rural charges must be used for rural development, not for other purposes. In the meantime, most of ODA capital should be earmarked for programs on rural development and hunger eradication and poverty alleviation; and private farming progress.

-Fourth, encouraging research and development in the farming sector:

With a starting point of a backward farming production, science and technology are important factors to improve labor productivity, product quality and agro-product competitiveness in the market. Just because of this, the Government should offer incentives to the scientific research and technological application, especially post-harvest technology. Initially, the Government should restructure its budget, put the spending item of scientific research and technological application in that of development investment, secure the growth rate of the expenditure on this area in line with that of the state budget; and increase the budget for scientific research and technological application from 1% to 2% of the total State spending. At the same time, the enterprises are encouraged to speed up their investments in scientific research and technological application via tax credit and preferences.

-Fifth, giving assistance and reducing risks to investors in agriculture:

The farming business faces many risks and low profit ratio because it depends much on natural factors compared to other sectors. As a result, the Government should share risks with the farming investors directly or indirectly by soft loans, tax credit, and price support.

3. More investment in education for rural development

Human resource development plays an extremely important role in the rural development. The poverty is positive to the illiteracy. More than 90% of farming labor has not been trained; the technical officials working in remote areas are lacking seriously. As a result, the Government should earmark its financial investment for education and training.

4. Export enhancement to expand markets for agro-products

The condition for export stimulation is that the Government should adjust the exchange rate beneficial to local producers when they export their goods. Moreover, the R& D activities for export should be boosted with a view to increasing product quality, package design and cost reduction. The Government should establish the national export assistance fund. The money for the fund will come from the state budget, credit institutions, enterprises, nationals and foreigners■