

DANGER OF A RECESSION IN VIETNAM AND SOME SUGGESTIONS

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Many economies in the world have had a flying start and reached high growth rates, but not all of them succeeded in maintaining a high growth rate for a long time. Some of them could avoid depression because appropriate adjustments were made on time but many others had to suffer for mistakes in managing the economy with the result that their economies went into decline for years.

By changing the mechanism for managing the economy and adopting the open policy, the Vietnam economy has made good progress. In the period from 1990 to 1996, its growth rate was 8.5% on average.

Table 1: Vietnam's Growth Rate (compared with price in 1989)

Sector	1991	1992	1993	1994	1995	1996
Agriculture	2.2	7.1	3.8	3.9	4.6	
Industry	9.0	14.0	13.1	14.0	13.9	
Service	8.3	7.0	9.2	10.2	11.5	
Growth Rate	6.0	8.6	8.8	8.8	9.5	9.5 (est.)

Source: General Department of Statistics

The table 1 shows that all three basic sectors of the Vietnam economy developed fairly evenly.

In recent years, many Vietnamese and foreign economists have estimated that the Vietnam economy wasn't as healthy as many people thought, and it would face a danger of recession in the coming years. This article would mention a disease that is common in nations rich in natural resources. This disease is called "Dutch disease" by economists. Vietnam isn't rich in natural resources and can't have the national income increased by a rise in prices of certain minerals, oil for example, but in recent years, it has received large sums of capital from abroad. The foreign source of finance will be of great benefit to the economy if it is employed effectively and reasonably, otherwise it will lead to economic recession.

I. FOREIGN SOURCES OF CAPITAL

In Vietnam today, there are many sources of foreign capital, however, only two main sources will be discussed here, they are FDI and ODA.

1. FDI

Since the promulgation of the Foreign Investment Law (December 1987), favorable conditions created in

Vietnam have encouraged foreign investors to do business here and attracted an increasing amount of investments. This FDI source has helped to stabilize and develop the local economy, introduce new technology and managerial skills, and facilitate the industrialization and modernization. FDI coming to Vietnam increased year after year, by 39% on average in the period between 1988 and 1996.

Table 2: Increase in FDI in 1988-1996 Period

Year	FDI (mil.US\$)	Compared with the previous year
1988	366	
1989	539	47%
1990	596	11%
1991	1,388	133%
1992	2,271	64%
1993	2,987	32%
1994	4,017	35%
1995	6,616	65%
1996	5,178	-22%

The table 2 shows that the FDI capital in 1991 increased strongly in comparison with 1989 (133%), and we could easily see that in 1989 there were major changes in the mechanism for managing the economy, and then, important adjustments were made to the Foreign Investment Law. FDI in Vietnam kept on increasing from 1991 to 1995. In 1995, the removal of US embargo and the admission to the ASEAN granted to Vietnam caused the FDI in Vietnam to increase remarkably. In 1996, it decreased by 22% in comparison with 1995 although it was still a big sum. This fact means that foreign investors became more cautious about doing business in Vietnam, because in 1996 the domestic currency rose against foreign currencies producing bad effects on local production and exportation, whereas foreign-invested projects used many local factor inputs (labor, raw materials, etc.). Moreover, tax rates, procedure for getting licence and law system in Vietnam didn't come up to expectations of foreign investors and therefore caused the FDI to decrease.

In the last three years, from 1994 to 1996, about US\$5 billion of foreign investment was licensed every year. This sum is remarkably big for the Vietnam economy.

2. ODA

This source of capital reappeared in Vietnam in 1993, ODA-givers have agreed to loan over US\$6 billion to Vietnam in 1996, however, only 30% of this sum has been disbursed so far. One of the causes of this lateness came from the fact that the task of investigating, making and evaluating investment projects was carried out too slowly and ineffectively.

According to the Ministry of Planning and Investment, from 1996 to 2000, Vietnam needs US\$42 billion of investment, 22 billion of which would come from domestic source and 20 billion from foreign one (13 billion from FDI and 7 billion from ODA), that is, annual gross investment would be US\$8 billion, and 4 billion of which would come from foreign sources (other sources of foreign exchange, such as sales of investments made abroad, loans from foreign commercial banks, immigrant remittances, tourist receipts, imports under deferred payment term, etc. aren't taken into consideration, although they also play a role in the national industrialization.

In recent years, foreign sources of finance have been employed fairly well, but we must employ them more effectively because: (1) most foreign loans are of short or medium term, and (2) in principle, international financial institutions only supply loans to countries with low per capita income. With an average growth rate of 9%, in the next decade Vietnam's request for loans will not be granted, therefore, if these loans aren't used effectively, they will become a burden to the next generation.

II. CAUSES OF A RECESSION IN VIETNAM

Until recently, Vietnam's manufacturing output and exportation started to show signs of decline. The following are two of them which could be considered as main causes of a recession:

1. The exchange rate

As we know, the exchange rate could produce profound effects on the economy as a whole, especially on foreign trade and local production.

Table 3: Vietnam's Foreign Trade (mil.US\$)

Year	Exports	Imports	Trade Deficit
1990	1,332	1,785	- 453
1991	1,572	1,863	- 291
1992	2,195	3,336	- 1,141
1993	3,068	4,644	- 1,576
1994	3,571	5,000	- 1,429
1995	5,620	8,450	- 2,830
1996 (*)	6,700	10,000	- 3,300

Source: General Department of Statistics.

(*) Roughly estimated data provided in November 1996 based on an increase of 4% in the price index.

Vietnam's foreign trade in this period increased pretty well: exports by 31% and imports by 33% annually. The table 3 shows that export turnover in recent years was big due to an increase in oil and rice exportation. Imports in 1995 and 1996 were high in comparison with previous years. According to foreign trade authorities, imports will keep on increasing and trade deficit widening in the coming years because of the great demand for imported technology and machinery.

The stable exchange rate of VND11,000 to the dollar since 1993 has caused the VND to rise high against foreign currencies (the Vietnam's inflation rate in this period was about 10% a year while that of the dollar was around 2-3%) with the result that many local companies met with difficulties because raw materials and other local factor inputs became dearer making the production cost higher, while certain surrounding countries such as Thailand and China had depreciated their currencies many times, so their products which were cheaper than Vietnam's goods of the same kind have flooded the home market officially or illegally and forced many local companies to stop doing business or go bankrupt.

2. The structure of Investment

According to economists, the Vietnam's structure of investment is unreasonable, most investments are concentrated in certain big cities and heavy industries, while other industries which could bring about export earnings, such as agriculture and agricultural product processing, are badly in need of new investments. The following are two examples:

Firstly, the infrastructure in rural areas, especially in the Mekong Delta - the main source of supply of rice for export - is very poor. Annual floods have caused a lot



of damage to the road network in rural areas while grants-in-aid are too small to upgrade or maintain this network. This situation has affected badly the agricultural production and people's living standard.

Secondly, the rice exporting business needs improvement: rice exporting companies haven't got enough money to buy up commercial rice supplied, they also lack a network of barns and modern machines used for processing rice for export. Moreover, the yield per hectare in Vietnam is low and the commercial rice is of low quality, therefore Vietnam's rice is sold at lower prices in comparison with current price in the world market, the difference in price between Vietnam's and Thailand's rice is some US\$70 per tonne.

In our opinion, in both the long and short run, the Government had better concentrate on developing agricultural production because this is still the main source of export earnings at present and in the near future. Moreover, developing rural areas and improving farmers' living standard is also a policy the Government advocated.

Industrialization is the right way for developing the economy, but the problems posed for policy-makers are: (1) What industries should the Government give priority to? and (2) How to make the best use of our limited source of capital?

The following examples will show that certain investments have been made wrongly:

- Fertilizer factories: in recent years, certain projects to build fertilizer factories have been taken into consideration or have been started, but many experts were of the opinion that the Government had better cancel these projects. According to the WB, in the 20-year period from 1976 to 1996, the average price of fertilizer on the world market was US\$153 per tonne, and developed countries can export some 100 million tonnes a year, while the Vietnam agriculture needs only one million tonnes a year, that is, Vietnam can easily import foreign fertilizer. If these factories with medium or obsolete technology are built in Vietnam, the prime cost will be about US\$200 per tonne, whereas a tonne of imported fertilizer costs only US\$165, that is, we will suffer a loss of US\$35 million a year (it's worth noting that in 1995, the total investment in rural traffic network was only US\$44 million).

- Sugar refineries: at present, there are some big sugar refineries in Quảng Ngãi, Khánh Hoà, Tây Ninh... and many others are under construction or will be built

in different provinces. The sugar price on the world market in 1996 was around VNĐ3,500 per kilo, whereas a kilo of locally-made sugar costs VNĐ6,000 although farmers had to sell sugarcane at a knock-out price (from VNĐ100 to 200 per kilo).

This issue hasn't received proper attention yet. In many provinces, and even in government bodies specializing in regulating investments, these tasks have been carried out mainly in the light of experience instead of expert knowledge or skill.



The price of Vietnam's sugar is so high because of many causes, such as the revaluation of the VNĐ, the quality of sugarcane in Vietnam, the technology and machines employed by Vietnam sugar refineries, etc. These factors have made Vietnam sugar less competitive on the world market. To improve the situation, we need a lot of time and money.

In recent years, the introduction of market economy has facilitated the realization of certain projects which are profitable and suitable to the market demand, however, we should recognize that many large-scale projects have ended in failure. If the Government finds no measure to manage and employ sources of finance effectively, the economy will certainly fall into a decline.

III. SUGGESTIONS

The danger of a recession has become apparent, but certain changes in the mechanism for managing the economy could help to prevent it, or limit its effects. The following are our suggestions:

1. Investment policy

- Supplying soft loans, giving tax incentives and increasing the investment in industries making goods for export are good measures to carry out the industrialization and modernization.

- It's necessary to increase investment in rural areas to develop profitable and labor-intensive projects, however, the Government needn't carry out these projects by itself, it had better create conditions favorable for private investment.

- The network of finance and banking services in rural areas needs improvement. Necessary measures must be taken to make the banking system more trustworthy in the eyes of farmers, thereby encouraging them to turn their dead money into bank deposits or productive investments.

Skills of officials in charge of investigating, making and evaluating investment projects must be improved with a view to helping them to cope with problems arising from the new mechanism and the market economy.

2. Exchange rate

- The exchange rates between the VNĐ and foreign currencies must be adjusted by depreciating the VNĐ step by step in order to encourage local production and exportation and reduce importation. The depreciation of the domestic currency will help to distribute wealth more evenly among sectors, however, it could lead to inflation affecting unfavorably waged workers and civil servants, but the Government, by using monetary instruments, could deal with these effects successfully.

At present, the best solution is to depreciate the VNĐ gradually and control strictly the money supply and budget deficit.

3. Budgetary control

- To cancel or reduce the amount of large-scale projects which are less profitable or slow to yield profits: this is a lesson from foreign countries that have spent too much money on large projects but haven't had enough capital to complete them.

- Certain budget expenditures must be kept well under control or reduced to the minimum, such as building large offices or buying expensive facilities. The Ministry of Finance had better put limits on regular expenditures and grants-in-aid given to local governments.

Carrying out the budgetary control is a difficult task, and not all governments succeeded in doing it, so it requires a joint and concerted effort from all departments and civil servants.

Thus, being rich in natural resources or capital is both an advantage and a disadvantage. Employing them effectively will help to develop the economy, otherwise the growth rate will decrease.

In short, achievements in economic development in recent years have proved the reform policy taken by the Government, however, in order to maintain a stable and high growth rate, policy-makers have to know how to make adjustments on time to economic policies with a view to preventing as many bad effects as possible.