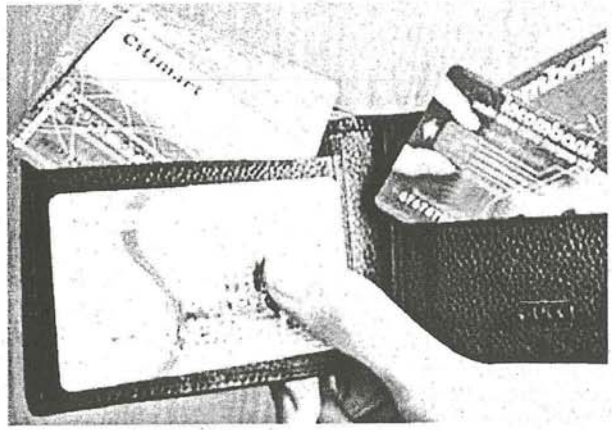
May Vietnam Catch Dutch Disease?

by NGUYỄN THỊ KIM OANH



1. Signs of the Dutch disease

High economic growth could come either from internal capital accumulation or external stimulus, but the most common case is a combination of external and internal resources. Most people are happy to see an underdeveloped country to discover suddenly a natural resource, exploit and sell it when its price on the world market is rising, or receive both short- and long-term investment along with soft loans, and aid from foreign countries. Within a short time, the face of this country changes remarkably. The poor country is flooded with imports, the public get more social benefits, high-ranking officials can use new sources of income at will, and everybody feels happy because of a sense of better living standard.

New sources of foreign finance and income from exports encourage everybody to enjoy the life to the full, and other sectors to serve production of staple exports. At the same time, the service sector develops quickly to serve the newly rich while most people know nothing about the instability of the new sources of income. Some can be aware of it but they think it is the government's business while many high ranking officials and businesspersons who can realize the situation will do their best to accumulate wealth and send it to foreign banks. The economy could collapse any time and symptoms of the Dutch disease are visible.

In fact, the natural resources are not limitless and easy to restore, and many of them could run out after some exploitation. In addition, the overexploitation certainly cause harm to the environment and sustainable development of other sectors. In recent decades, technological advances have allowed many countries to make use of raw material substitutes effectively, which made income from export of natural resources contracted. Changes in domestic and international markets could make the exporting country less attractive when the profitability ratio reduces, and foreign investors start withdrawing their capital. If the country in question has made no preparation for this situation the Dutch disease will cause the economy to fall in crises. It seems that it's luckier to have no natural resource in the first place so the country can spend more time and energy learning how to accumulate the capital, attract foreign investment and develop its competitiveness.

2. Can Vietnam catch the Dutch disease from external sources of investment?

At present, Vietnam is still a poor and populous country although the living standard has been improved in recent years. In the years 1990-2003 after the economic reform was launched, the GDP rose by 6.12% a year on average. Personal income in 2004 was US$485. Structure of industry changed favorably: agriculture accounted for 21.8% of the GDP in 2004, manufacturing and construction sector 40.1% and service 38.1%. However, the external debt equaled 40% of the GDP and Vietnam still suffers huge trade gap and budget deficit (-2.04% in 2003 for example).

Reliance upon foreign capital can lead to the Dutch disease, so let's take a look at flows of FDI, ODA and external debt in recent years.

a. Foreign direct investment:

After the Foreign Investment Law 1988 and many amendments, the flow of FDI to Vietnam experienced fluctuations: US$3,377.2 million a year on average in 1988-1996; 1,822.1 million a year in 1997-2002 after the Asian financial crisis; and some 4.0 million a year in 2003-05. According to a UN survey in 2005, Vietnam ranked 9th among the Asian most attractive destinations for the FDI flow.

Table 1: Ten leading investors in Vietnam up to October 2005 (US$ million)

Country	Project	Registered capital	Realized capital
Taiwan	1,348	7,739.90	2,961.44
Singapore	383	7,508.93	4,108.78
South Korea	1,044	5,391.92	2,504.74
Hong Kong	351	3,683.71	1,940.50
British Virgin Islands	243	2,623.56	1,267.26
France	162	2,136.86	1,165.36
The Netherlands	60	1,886.33	1,784.53
Thailand	125	1,474.38	716.82
Malaysia	175	1,471.38	843.51
USA	245	1,398.48	739.23

Table 2: The Vietnam's ten most attractive provinces and industry

Area	Project	Registered capital (US$ mn.)	Realized capital
HCMC	1,772	11,937.64	5,963.94
Hà Nội	636	9,326.43	3,154.63
Đồng Nai	688	8,408.88	3,731.94
Bà Rịa- Vũng Tàu	119	2,177.35	1,224.52
Hải Phòng	178	1,948.88	1,203.92
Oil industry	27	1,891.19	4,555.11
Vĩnh Phúc	87	726.42	413.67
Thanh Hóa	16	701.96	410.35
Long An	94	690.23	292.58
Hải Dương	72	627.50	376.01

Table 3: FDI in Vietnam by industry up to Oct. 2005

Industry	Project	Registered capital (US$ mn.)	Realized capital
Heavy industry	1,161	12,210.08	6,326.31
Light industry	1,633	8,206.71	3,189.37
Construction	304	3,942.21	2,157.90
Food processing	257	3,083.78	1,882.98
Oil industry	27	1,891.19	4,555.11
Agriculture	649	3,367.28	1,678.27
Aquatic products	110	303.47	152.22
Office building	110	3,884.11	1,692.61
Transport and post	158	2,907.51	716.68
Hotel and Tourism	171	2,849.07	2,121.81
Building of new towns	4	2,551.67	51.29
Other services	416	1,112.82	350.99
Health and education services	201	1,103.26	273.05
Building infrastructure in IPs	20	986.10	521.37
Finance and banking	53	702.55	611.93

Most of these leading investors are from Asia and they are not the most developed ones. They usually transfer obsolete technology and common managerial skills, and invest in industries that are limited in their home countries. Thus, their investment didn't lead to expected results.

All provinces are competing for the FDI while the central government has no plan to orient this flow, which causes harm to all provinces and the whole country as well, and lower efficiency and result of this flow. The FDI didn't produce direct and indirect effects on the Vietnam's economic growth because it is concentrated in labor-intensive industries that make import substitutes of low added value or exploit natural resources. The oil industry accounts for a large proportion of the FDI. Although the export of oil brings about 20% of the GDP, Vietnam has to import fuel because it has no oil refinery. This practice is less effective and more dangerous when the foreign investment is withdrawn because the oil reserve runs out.

Besides direct investment, the foreign indirect investment has started to come to Vietnam when foreigners were allowed to buy shares and stocks from the stock market. They could take control of certain companies that are underestimated in comparison with their expected profit in future.

Vietnam is also among the leading ten biggest ODA recipients. In 2004, international donors agreed to give US$3.4 billion to Vietnam. Vietnam also expects to get some US$25 billion in FDI and 15 billion in the ODA in the 2006-10 period. At present, some 60% of infrastructure projects are financed by the ODA source. However, according to a rough estimate, some 40% of this source used for these projects was wasted, which made them less effective.

Many high-ranking officials are optimistic about the use of the ODA because it has a maturity of 40 years and a low interest rate (0.75% a year) without paying attention to the fact that the policy making process could be influenced by donors and next generations have to repay these debts. And as a result, all provincial government have tried their best to secure the ODA debt while their have no ability to employ it effectively. The external debt amounts to some US$15 billion now and annual repayment of debt equals some 6.5% of the export value. In the near future, if Vietnam's competitiveness isn't improved and its GDP is high enough to be excluded from the list of poor countries, the flows of FDI and ODA will slow down. Vietnam will then face difficulties if it makes no preparation for the lack of foreign sources of capital.

3. What to do to prevent the Dutch disease

- Establishing a mechanism for controlling the external debt and supervising the use of the debt by both governmental agencies and companies.
- Orienting the FDI towards technology-intensive and export-oriented industries by policies on incentives.
- Giving preferential treatment to famous multinationals because they can attract more investors to Vietnam.
- The ODA source must be turned into real investment with a view to allowing the poor to enjoy cheap health care and education services as a measure to prepare the future human resource and ensure social equality.
- Struggling strongly against corruption, embezzlement and ineffective use of foreign sources of capital. ■