Increases in trade surplus and investment could cause the multiplier effect on economic development while trade gap, disinvestment and payments made to banks could cause economic depression. This could be justified by studying the Vietnam economy since 1985.

MULTIPLIER EFFECTS CAUSING ECONOMIC DEVELOPMENT AND DEPRESSION

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I. MULTIPLIER EFFECT PRINCIPLE

Assume that Vietnam's trade surplus is US$1 billion or an investment of US$1 billion is made. Exporters, after receiving this sum, will sell it in foreign exchange market in order to make payments in VNĐ to their suppliers who, in turn, will spend their income on capital and consumer goods, therefore, an initial US$1 billion of extra income will be turned over many times generating a lot of income, wages, interest or profits for households and businesses, that is, increasing the GDP. In short, an extra US$1 billion of export earnings could generate a 3-, or 4-, or 5-billion increase in national income. This is called the multiplier effect causing economic development.

Similarly, an US$1-billion investment also causes economic development, especially when it is used to buy capital goods made in Vietnam, instead of importing them. This investment will create new jobs, wages, income and profits. If this investment is used to import capital goods from abroad, the multiplier effect will be limited to wages paid to local workers.

The multiplier effect caused by disinvestment, deflation and trade gap will go in the reverse direction. An 1-billion trade gap means that an amount of domestic currency is paid to banks when importers buy foreign exchange to pay to foreign exporters. The spending power will decrease to a certain extent because an amount of domestic currency is withdrawn from the economy and isn't turned over to generate new income. This event repeats itself when investors or businesses make payments to banks causing deflation and multiplied decrease in national income. This leads to the multiplier effect causing economic depression.

In a certain period, exportation and investment always take place and cause economic development, and at the same time, many importers keep on buying foreign exchange to make payments to foreign sellers and many businesses repay bank loans. If export equals import and investment equals repayment to bank, the multiplier effects won't happen. When trade surplus and investment rise rapidly, inflation and economic development will take place. On the other hand, if there is an increase in trade gap or a decrease in investment, a period of deflation and depression will come. Changes in Vietnam economy in the last 12 years will justify this argument.

II. EXPLANATION OF VIETNAM ECONOMIC DEVELOPMENT PROVIDED BY THE MULTIPLIER EFFECT THEORY

In the mid-1980s, investment in Vietnam increased considerably because the exchange rate was fixed reasonably at low level and exporters were allowed to used 80% of their earnings to import goods and sell 20% to banks. This 20% was small in comparison with export earnings with the result that the dollar earned from export business could enjoy a floating rate. Exporters, after buying agricultural products (shrimp, pepper, cashew nut...) at low price and exporting them, could make more profit by using their earnings to import high-quality consumer goods (motorbike, color TV, etc) that weren't available in the domestic market. The boom in export business in this period helped to develop agricultural and maricultural production.

In the same period, the former USSR helped Vietnam carry out a lot of projects (Vietsovpetro; hydroelectric plants in Hòa Bình, Trị An, Phả Lại; cement factories in Bỉm Sơn, Hoàng Thạch; Thăng Long bridge: new rubber plantations, etc.). They were big projects that haven't seen before in Vietnam. The former USSR supplied equipment and expertise, and the Vietnam government had to increase the money supply to buy local raw materials and pay wages to laborers. The gross investment increased from VNĐ14 billion in 1985 to 29.9 billion in 1986, 30.7 billion in 1987, 33.8 billion in 1988 (in fixed price of 1982) equalling some 9% of GDP. The increase in investment has produced multiplier effect with the result that Vietnam's GDP in this period increased by some 6%, or even 8% per year, an unprecedented level up to the time. Vietnam's economy has really made good progress in this period.

Unfortunately, from 1989 on, the former USSR couldn't give more aid to Vietnam. In the period between 1989 and 1991, besides some unfinished projects initiated by the Soviets (a 6-million-tonne oil refinery in Bà Rịa-Vũng Tàu, the North-South high voltage line, and some steel mills), there was no large-scale investment project, and as a result, the multiplier effect caused by this situation led to depression and the growth rate decreased to somewhere between 2% and 3% in this period.

In 1991, the gross investment tended to increase again because projects completed in the previous period from 1986 to 1988 started to produce good effects: exports equalled imports; production of eletricity, cement, fuel, food... met the market demand. New sources of finance became available: they came from foreign investors, the government and the public. The gross investment in this period mounted to some billion dollars per year. It was bigger than that in the period 1986-1988 and became more diversified: great investments were put in hotel, tourism, transportation, construction and many consumer goods while most investments in the previous period were put in oil, power and some other industries.

In 1996 when the foreign investment and private investment slowed down, aid and investment from foreign governments and international financial institutions came to Vietnam. A total investment of US$6 billion were agreed on and 2.4 billion dollars were transferred to Vietnam in 1996. In 1997, Vietnam will receive more from the ODA source and many projects to improve the road network or build power plants financed by international institutions are under way.

However, the fixed exchange rate system adopted by the State Bank has made imports cheaper than locally-made goods and led to an increasing trade gap. In October 1996, many members of the National Assembly warned against the trade gap, but they failed to recognize the fixed exchange rate as the main cause of the trade gap. As a result, no effective measure was taken to reduce the trade gap which mounted to US$4 billion in 1996 and US$639 million in the first two months of 1997. The importation of such products as cement, fertilizers and automobiles has increased considerably compared with the corresponding period last year. In 1996, Vietnam imported 2,832,000 tonnes of fertilizer of all kinds. Together with 1.3 million tonnes of locally-made fertilizer, an amount of 4.1 million tonnes of fertilizer was available in the market but only some 3.5 million tonnes were sold. However, in the first two months of 1997, they kept on importing foreign fertilizer.

Moreover, the deferred payment term offered by foreign companies has encouraged Vietnam companies to engage in import business and cause great damage to local industries.

When a trade gap exists, it will produce the multiplier effect causing deflation and depression. Fortunately, an increase in investment has caused the reverse effect. Assume that the two multipliers are equal and have a value of 3, we can produce the following table reflecting developments of the Vietnam economy from 1991 to February 1997:

An estimate of multipliers caused by investment,trade gap and deflation.

Indicators	1991	1992	1993	1994	1995	1996	1997 Jan & Feb
Price index		17.6	5.2	13.1	12.7	4.6	2.6
Compared with 1991	100	117.6	123.7	139.9	150.9	157.7	161.8
VND/US$ rate	13,255	10,550	10,620	11,000	11,021	11,025	11,350 (a)
Compared with 1991	100	79.6	80.1	82.9	83.1	83.1	85.6
Increase in price index	100	17.6	23.7	39.9	50.9	57.7	61.8
Decrease in exchange rate	100	- 20.4	-19.9	-17.1	-16.1	-16.1	-14.4
Difference compared with foreign price		38	43.6	57	77	73.8	76.2
Trade gap		+40	-890	-900	-2,830	-4,000	-639
GDP (US$ bil.) (c)		9,656	11,770	15,478	19,100	21,751	
Investment/National income ratio (b)	10%	13%	14%	17%	20%	19%	
Investment		1,256	1,647	2,631	3,820	4,132	750 (d)
Investment - Trade gap		1,296	757	1,731	990	132	111
Multiplier value		3	3	3	3	3	3
Effect on income.		3,888	2,571	5,193	2,970	398	333

(a) Rate offered by HCMC Bank for Foreign Trade on March 6, 1997. Rate offered by commercial banks is VNĐ200 higher.

(b) *Thời Báo Ngân Hàng*, Dec.26,1996.

(c) *Asian Development Outlook*, GDP in 1995 and 1996 is worked out by multiplying GDP in 1994 and 9.5 (growth rate) and revaluation rate of the VNĐ.

(d) Estimated.

The above mentioned data have only relative meanings because statistics gathered by governmental bodies are not totally exact, and many data aren't publicized. However, the above table can reflect rather exactly recent developments in the Vietnam economy.

The root of the problem in the exchange rate fixed at a low level. The warning about trade gap could only make the exchange rate fall a little (the VNĐ was depreciated) in the end of 1996 and the first two months of 1997, but in fact the difference between domestic and foreign market prices is still large.That is why the excess of imports over exports kept on increasing in the first two months of 1997 (639 million US$).

The price index in the first two months of 1997 increased by only 2.6% but the government has started to worry about it. In fact, many papers (*Thời Báo Ngân Hàng, Tuổi Trẻ, Công An, Saigon Giải Phóng, et.)* remarked that the spending power had decreased in this first two months. We can see that it resulted from the multiplier effect caused by trade gap, especially the importation of goods that could be made locally and still glutted the market.

In short, the above - mentioned data show that the fixed and high exchange rate has caused trade gap and caused damage to local industries. This led to the multiplier effect causing depression, that is, a decrease in the value of the multipliter. The value of the multiplier will rise when exports exceed imports and the investment increases (this event happened in 1992). So, to adopt a reasonable and realistic exchange rate is a matter of great urgency and this will save local industries, and the economy as a whole, from a lot of losses■