



Vietnam in Denial Over Economic Woes

by Long S. Le



V IETNAM IS IN trouble. At around 23% for the first nine months of 2008, the country's inflation rate is at its highest level since 1991, when inflation hit 67%. The inflation rate jumped to a high of 28.3% in August from a high of 25.2% in May. Similarly, CPI has soured at more than 24% so far this year, whereas on average CPI from 2001-07 had stayed well below the country's GDP growth rate. Inflation and higher prices have clearly started to undermine recent gains in poverty alleviation. Currently, the country's social-insurance system only covers 11% of the workforce. The percentage of the population living on less than \$1 a day is around 20%, or double what it was a year ago. Due in large part to inflation, the number of labor strikes by factory workers at mostly foreign-invested factories in Ho Chi Minh City has risen by more than 300% over the past two years, according to government statistics.

Yet Vietnam's communist government, concerned about political stability and legitimacy, has concluded that the current situation is due to bad luck, not bad policy.

As a result, the government must shore up macroeconomic problems and implement inflation-fighting measures to put the country on the path to recovery.

At a roundtable discussion with the country's economic experts on Sept. 13, 2008, Prime Minister Nguyen Tan Dung emphasized the "global economic turmoil" as the source of Vietnam's economic problems this year. While acknowledging that the economic situation is still volatile, the prime minister was emphatic that government measures were working, as monthly inflation rate dropped to 1.6% in August from 3.9% in May; CPI rose only 0.18% in August (the lowest monthly increase since the start of 2008); and the trade deficit in September is expected to widen at a slower pace than it did in August, when it fell to \$500 million from \$900 million. Moreover, he said, the decision to lift the cost of gasoline on July 21 by 31% did not raise the inflation rate or the CPI as expected. Some had thought that the CPI for

∞ *Mr. Le is a professor and director of international initiatives for Global Studies at the University Houston, where he is also a co-founder/lecturer of Vietnamese studies courses.*

August would be as high as 3%.

In this closed meeting, a few experts from the more “independent” economic think tanks raised fundamental questions about the issues underlying the troubled economy, including inadequate measures to ensure quality of economic growth, the lack of good governance, and the shortage of unskilled workers. However, Mr. Dung sidetracked their comments stating that efforts to address these issues are not a priority and would be very difficult to implement at this time. The priority, he said, is to encourage localities and sectors to meet a GDP growth of 7% for this year.

Mr. Dung then delivered the above policy outlook in a working session with representatives from key international organizations on Sept.20. He expressed confidently that the government’s measures will ease inflation in the next 16 months. It is logical to continue pursuing a high growth-rate target in order to bring back macroeconomic stability, he said. Mr. Dung stated that his office is scheduled to submit a policy proposal to the National Assembly for its approval. Without any specifics, the proposal has been designed to prioritize inflation reduction to an ideal rate of 12% by next year and to a single-digit inflation rate by December 2009 or January 2010, and to get the country back on track as the next Asian tiger.

On the ground, there appears to be a growing discontent about the country’s economy, leading to private discussions about the effectiveness of government solutions and its leaders’ ability. But, at the same time, many believe that inflation has reached its peak and for now the economy no longer faces a severe downturn. They

were relieved after retail petrol and diesel prices were cut twice in August, although domestic prices are still nearly one quarter higher than at the beginning of the year.

Still, many are experiencing an anxiety about their family’s economic situation that they have not felt for over a decade. And there appears to be a growing confusion among Vietnamese on both domestic and international economic situation, as there is no consensus about what is to be done.

For analysts, the “unknown” includes the forecasting of Vietnam’s inflation rate since the government’s macroeconomic



Pictured here, Vietnamese Prime Minister Dung has been accused of not listening to economic experts.

policy is hardly transparent. The prime minister has also taken a contradictory stance—namely fighting inflation in a “flexible way” to achieve high growth rate. For economists, there is a trade-off between inflation and economic growth. “If you look at historical lessons of many countries in controlling inflation, stabilizing macro economy, actually you will almost never find any country which has succeeded

in controlling inflation and at the same time promoting growth,” warned Ayumi Konishi, the Asian Development Bank’s country director for Vietnam.

This perspective was echoed by the Economist Intelligence Unit. Its forecast projects Vietnam’s GDP growth will slow to 4.9% for 2008 and 4.6% for 2009, and CPI will drop to 15.2% in 2009 from 25%. Meanwhile, the ADB believes that Vietnam can exceed the ADB’s GDP projection of 6.5% for 2008 and 6% for 2009. However, Vietnam would do so with “the cost of higher inflation and widening trade deficit,” according to Mr. Konishi.

In the case that “global economic turmoil” is the source of Vietnam’s economic

problems, that turmoil is not going to go away anytime soon. To be sure, the recent easing of global food prices as well as world oil prices has meant that inflation and CPI quickened less than expected. Yet, the financial turmoil on Wall Street is expected to have certain repercussions for Vietnamese market institutions (i.e., local banks and large state corporations seeking partners and foreign capital) and trade activities. Vietnam is vulnerable to a demand-contraction of the United States' economy and the falling dollar.

This means that some of the current positives—such as the nine-month exports that increased by 39% and the foreign investment that hit a record of more than \$40 billion—will be negatively affected. The slowdown in U.S. and Europe and the growing inflation rates in the Philippines, Indonesia, India, China, and Thailand will likely take its toll on Vietnam's traditional export markets and its FDI channels.

In all, it seems that Vietnamese Communist Party leaders don't want to face the truth. Thus far they have opted to see the problem as primarily external and have used stop-gap administrative measures and subsidies. Furthermore, they want to get back to rapid economic growth but are not willing to admit that the current economic woes are the result of the economy growing too fast. Specifically, its institutions, infrastructure and manpower have been inefficient in transforming rapid growth into quality growth.

Vietnam was supposed to become the next Asian Tiger. The country's economy has grown, on average, 7.5% every year over the past decade. Also, GDP per capita had increased to \$833 in 2007 from \$100 in 1990. Contributing to economic growth and poverty rate reduction is its success in attracting FDI. In recent years, Vietnam became the third largest recipient of FDI inflows among the members of the Association of Southeast Asian Nations.

However, other things being equal, Vietnam's miraculous growth is based on one-time changes of adopting capitalism as the basis of economic life; in that respect the country started from a very low base. Although these changes were by no means easy or painless, they cannot be replicated. Moreover, the country's rapid growth was, more or less, characterized by inputs, such as mobilizing the rural labor force for industrialization, attracting FDI inflows, and heavy investment.

Vietnam's miraculous growth has not been accompanied by appreciable gains in efficiency or productivity growth. A study by the ADB found that Vietnam's growth from 1996 to 2004 was largely the result of capital and labor. Meanwhile, total factory productivity—measuring the efficiency with which labor and capital are combined in the output of the economy—decreased to 16.6% from 62.1% over the same period. This illustrates Vietnam's inefficient use of scarce public resources, weak governance resulting in higher transaction costs, and lower labor costs that insufficiently compensate for the lower level of productivity.

To be sure, today's economic problems do not necessarily signal an end to the country's miraculous growth. They do, however, signal the need for party leaders to create an environment conducive to quality growth. The problem with the current environment is that it is smothered by the party's socio-political interests. That is, while 90% of job creation and 70% of industrial output is generated by the private and nonstate sectors, the state financial system discriminately allocates a majority of credit and capital to the state sector.

Here, the inefficiency is that the amount of capital needed to create one job in a state-owned enterprise is more than eight times higher than what is needed in a domestic private firm; and the potential cost savings in transport and technical services could easily be more than 30% if the various priv-

ileges of SOEs were to be eliminated, according to the World Bank. As noted by academic Ari Kokko, “it is very likely that Vietnam could generate considerable gains in terms of job creation and productivity if it was possible to establish a level playing field for all types of enterprises.” By some estimates, if not for vested political interests to hold back privatization, Vietnam could be growing at 11%—as fast as China.

It is noted that in transitional economies—those outgrowing communist or capitalist dictatorships—there are certain reforms that governments may pursue to better promote economic growth. And that certain styles of government are better able to create and enforce those reforms consistently. A seminal study by James Riedel and William Turley in 1999—which focuses on Vietnam’s problematic reform—notes that sustainable economic growth will require the strengthening of control in fiscal, monetary, and revenue matters, as well as transparency and accountability. These pillars of economic growth will be called on when the usual triggers of crisis occur—such as balance of payments difficulties, accelerating inflation or revenue losses.

But the government’s ability to produce comprehensive reforms only when unfavorable or severe economic shocks occur has stifled Vietnam’s economic development. Since 1979, crisis has been the main catalyst to abandoning orthodox socialist policy. Even then, inefficient outcomes have resulted.

Growth Begins at Home

TODAY, WHETHER PARTY leaders will once again allow for more political openness to address the emerging crisis seems unlikely, at least in the prevailing social climate. As noted by economist Jonathan Pincus with the United Nations Development Programme in Vietnam, “there is no short-

age of people in Vietnam who understand the causes of the current economic instability and the steps needed to quell price inflation and restore stability to the markets” but “these people are not in a position to do much about it.” As such, party and government leaders are to blame for the current economic situation.

In the past, Vietnamese premiers utilized a board of independent economists, but when Mr. Dung came into office in mid-2006 this board was disbanded. However, he did request the Harvard Vietnam Program to conduct a critical analysis of Vietnam’s socioeconomic development strategy. The report was published in January 2008. It concluded that the “organs of the Vietnamese state, political, administrative, and academic are increasingly co-opted by interest groups who use them for self-enrichment and aggrandizement,” so that “the greatest threat to the state is its own failings.” Importantly, the report warned that “inflation in Vietnam is a problem of the government’s own making, being largely the result of poor macroeconomic management and inefficient investment decisions.” This requires the formation of “a new pro-growth, pro-reform consensus,” which “will not be easy,” given the absence of a serious economic crisis and that the consensus of 1986 no longer exists.

In the case that Prime Minister Dung becomes unable to deal with the current situation, Party General Secretary Nong Duc Manh may be allowed to undertake a “fresh start.” Mr. Manh and his coalition will likely revert back to a more basic monetary policy that assumes inflation is not a “monetary phenomenon” but largely the result of supply shocks by large FDI inflows and significant increases in domestic credit. Of course, while such a consensus may allow the one-party-state to “march forward,” it will not achieve efficiency or sustain economic development. ■