CHAPTER –II

The Genesis of Economic Reforms

As a result of failure in reaching targets during the second five year plan (1976-80) and the third five year plan (1981-85), the economic position of the country had entered a crisis point. This prompted the Vietnamese leaders to think seriously about the limited options that were available to restore the economy and the party image in the eyes of the people. A major section of leadership was in favour of a change in the socialist model of development.

The Vietnamese leadership thought of introducing reforms in the socialist model of development. The sixth party congress in 1986 formally decided to bring changes in the system. The economic reforms to which they termed Doi Moi (Renovation) meant a new way of thinking. It was an endeavour to introduce the principles of market economy in a socialist system. The main motive of reforms was to harmonize the socialist system with the market forces and to attract outside force to strengthen the economy and gradually join the globalization process. Vietnam so far was pursuing the orthodox Marxist approach which proved a barrier in the path of integration. The change in its orientation had gradually allowed Vietnam to join the world economic system. The changed ideological position can be clearly understood from the statements of the General Secretary Le Duan. He said that “there was a single world market in which socialist and capitalist economies are becoming increasingly interdependent and have an increasing direct effect on one another, the global scientific and technological revolution is making it possible for developing countries to take a relatively short path to economic modernization.”

1 Gareth Porter, “The Transformation of Vietnam’s World view from Two camps to interdependence;” Contemporary Southeast Asia (Singapore) vol. 12, no.1, June 1990, p-5.
The Reforms in the Agricultural Sector

The agriculture sector occupied high priority in the national development strategy of Vietnam, as more than 79 percent of the labour force depended on agriculture sector which contributes 35-40 percent of the Gross Domestic product (GDP).²

The Agriculture Sector has been linked with the development of other vital sectors in Vietnam economy because of the following reasons:-

1. it provides raw materials for other non-agricultural sector
2. the sector growth, ultimately determines a market for the products of other sectors such as that of consumer goods industries and encourages the development of rural industries.
3. the agriculture sector is a prime source of capital formation in the form of voluntary financial saving and compulsory taxation.

The agriculture sector is an important source of foreign exchange.


♦ the shift away from a cooperative managed land system to a household managed system.

♦ most inputs were supplied by the cooperatives with households obliged to return output quotas to the cooperatives.³


The farmer felt that the contract system did not benefit them. They showed interest in rejoining the cooperatives. The household management system resulted in a slow growth rate of the agriculture output.

The politburo of the Communist Party of Vietnam adopted a resolution on 10th April 1988, which abolished the product contract system.

- privatization of output markets and introduction of the land tax
- the household became main controller of their production, accumulation and investment. Farmers were required to pay tax in food grain based on the assessed value of their land. Land was categorized on the basis of soil acidity, elevation, and irrigation access to land.
- emphasis was given for decentralization of input supplies Inputs of agriculture had been controlled by the state trading corporation in the past which state used to allocate inputs. At the provincial level the national land use plans ultimately determined allocation to the cooperatives which resulted in complete failure of timely allocation. Under this system, inputs were available locally from private stores.

The 1988 reforms in agriculture did not bring about big changes in production mainly because of low motivation for farmers, as it did not recognize land as a property to be traded. This was the main reason the investments in the land conservation did not receive attention. Hence there was a need to introduce more reforms and the government on 10 June 1993, issued a resolution (05 NQ/HNTW).

Accordingly, the main changes which were introduced, were the following:-

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The new law allowed private transfers of land use right including exchange, transfer, lease and mortgage. Reduced taxes on land utilization by fifty percent extension of land utilization permitted, like using it as security for loans, leasing, in heritage etc. the tenure period was still limited to twenty year for annual croplands and fifty years for perennial croplands but was to be long as the allocated lands were lawfully used (Articles 20). In the event that the lands were recovered by the government, the land users will be dully compensated for the damage that they may incur (Article-270).

The General Department of land management had laid down a scheme for completing the land allocation and issuing of land use rights certificates by mid 1995.

The 1993 reforms avoids the tendency towards privatization of land that prevailed prior to its enactment.

The Reforms in the Industrial Sector

In 1981, the communist government had introduced “three plan” system categorized as A, B, and C. The “A” plan meant that the State Owned Enterprises (SOE) receiving inputs from the government were allowed to keep 50 percent of the profit, companies that fulfilled ‘A’ target, were permitted to produce more under the ‘B’ plan, under the ‘B’ plan the SOE’s were allowed to buy the inputs from the private non-state firms; and keep 60 percent of the profit. In the ‘C’ plan the government had no influence on production and selling output and firms were allowed

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to retain 90 percent of profit. These reforms had helped to improve the production in SOE’s, but overall results were not satisfactory.

In 1989, the Vietnam faced crisis as a result of the withdrawal of Soviet aid, which in various forms constituted 40 percent of the budget. Many industries which were so far running with the help of Soviet supplied raw materials were forced to close-down. To overcome the problems, the ruling communist party started introducing reforms, and restructuring firms. By 1989, there were 12084 state-owned enterprises under the central and provincial ownership, many of them were small size. 88 percent of these firms employed less than 500 workers and only 22 percent enterprises employed more than 3,000. Centrally operated SOEs were in the capital intensive heavy industry and large scale light industry. They were involved in oil, electric, power, cement, coal mining, and paper industries and were located mainly around Hanoi and Ho Chi Minh city. The aim of reforms in the industrial sector was liberalization of market relations and decentralization of economic decision making powers to the enterprises level, replacing government’s direct control by enterprise autonomy, based on market adjustment. Vietnam’s state owned enterprises has a significant role in the economy. SOE’s were the major contributors to state revenues, a sizeable source of employment. 1989 reforms entailed the following,

1. the SOE’s were given greater autonomy for financial management of firms, the government allowed the managers of the individual enterprises to use their “initiative” in managing capital funds.

2. they were also given freedom to mobilize capital resources for its firms within a framework that did not any way effect a change in the ownership of the firm.

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3. the right to issue bonds, and shares in accordance with the law.¹⁰
4. wage setting
5. price decision regarding output selling
6. cost minimization
7. profitability and productivity,

**Dismantling administrative price controls:**

Price control regime was dismantled, but control over official (state) customers, such as those of cement, steel and power, remained with the government.

Again subsidy to various state owned enterprises was one of main reasons for a deficit budget for long time. Economy was not in position to bear the problems which were arising out of subsidies, but the state was determined to continue and provide subsidies to some enterprises, like energy, fertilizers, transport.¹¹ Under the system, the SOE's were transferred into a state owned corporation regulated under company law and government accelerated diversification of ownership through the issue of shares.¹²

**Joint Ventures**

In the beginning, it was only the SOE's that were allowed to form joint ventures with foreign firms. In 1989 for the first time, the government permitted private or non-state firms to join hands with foreign firms.

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The 1992 constitution and the company law allowed the private business to operate in the economy.\textsuperscript{13} The importance of the private sector in the overall transformation of the model was crucial. Private sector was strengthened between 1992-95. By early 1995 some 22,000 private business establishments were registered. They included joint stock and limited liability companies. The private sector was strengthened after 1993, with the changes in the financial sector. Private firms were allowed to make Joint ventures.

The seventh plenum in 1991 had decided to close down SOE’s those industries which were not economically viable and bankrupt (Degree No:388). The criteria for determining economic viability included a minimum of US$ 200.00 in assets, clear ownership of those assets and proven demand for the product or services which, the SOE’S produced. SOE’S units not re-registering under the degree had to re-register as companies or private business or go into liquidation. The result of the degree, over 2800 SOE’S vanished between 1990-92, and an additional 3,000 in 1993. By 1992-93 fewer than 5000 enterprises had met the necessary conditions to escape liquidation. A second round started in 1994. In this round around 500 SOE’S cases were considered, with that the total number of SOE’S increased to seven thousand.\textsuperscript{14} Out of 7000, 1,920 were under provincial management.\textsuperscript{15}

They were allowed joint ventures with foreign firms. A new, foreign investment act was passed. Accordingly.

- same taxes were imposed on both state and private firms.
- both state and private firms were allowed to carry on foreign trade.

\textsuperscript{13} Jocelyn Probert and David Young, n.9, pp.516-517.

\textsuperscript{14} Jocelyn Probert and S. David young, p. 513.

\textsuperscript{15} Ibid., p.513.
Hence, an integrated SOE’s reform committee was established in the ministry of finance to manage SOE’s assets, and the annual report on their activities and finance.\textsuperscript{16}

\textbf{The Reforms in Public Administration}

The decades old administrative system was considered to be one of the main reasons for the fall of the socialist system. After entering into the transition period, the system “developed serious trouble particularly in the management of economic affairs.”\textsuperscript{17} Since public administration occupied a significant place in Vietnam, the communist government introduced reforms in the sector through promulgating laws for administrative tribunal. The change supported a system in which merit was given importance. They decided to recruit civil servants and bureaucrats through conducting public service examination.\textsuperscript{18} All the civil and administrative personnel who were below 45 years were advised to learn a widely spoken foreign language.\textsuperscript{19} The knowledge of foreign language was linked with promotion of the bureaucrats. Foreign language study at the secondary level schools has been made mandatory.

\textbf{The Monetary Reforms}

Controlling inflation was a major problem for the government. The hyper-inflationary rates of the 1980s\textsuperscript{20} were reduced to 67.7 in 1990 and then brought down further to a single digit level of 5.2 in 1993. The government wanted to control it

further through a tight monetary policy and improved fiscal management. Expenditure through subsidies to state enterprises, considered to be the main reason for rising inflation was eliminated.

**The Banking Sector**

The decade old socialist banking system underwent a sea change after 1990. The reforms which were introduced in the sector, strengthened the banking industry. In 1990 the government had approved two directives which motivated the restructuring of the banking system. On 1 October 1990 the state banking system was evolved. The state bank served as a central bank and the channel of state run, commercial banks. This bank issued currency and acted as a banker. It was also given the responsibility of managing Vietnamese foreign exchange reserves. In addition, a series of shareholding commercial banks were established as Joint Ventures with the foreign bank subsidiaries.

The newly created state-owned commercial banks were separated from the one channel banking system. They were allowed to be self-governed and were responsible for their own monetary business operations. The state owned commercial banks were: the Bank of foreign trade (BFTOR) Vietnam bank and investment and construction (ICB).

By 1994, around 60 banks, owned by the state shareholding and Joint Venture banks operating in Vietnam. In addition to this number, 20 foreign bank branches and 67 representative offices from 21 countries were opened.\(^{21}\) Full membership was granted to those banks which had registered capital of at least US$11.8 million.

\(^{21}\) *SWB, FEW, December 20, 1995, p.1*
The Banking industry was however still dominated by the State Owned Commercial Banks (SOCB). By the end of 1993, the SOCB accounted for almost 41 percent of the total financial assets in the banking industry. The share of market by SOCB’s had 49.5 and the other banks only 5.5 whereas assets concern, the SOCB’s hold 90 percent. The state owned commercial banks, which had a large network, compared to other banks, were confined to just branches mainly in Hanoi and Ho Chi Minh City.

The bank’s loans to non-state sectors increased 51.5 per cent and its long term and medium-term loans increased by 14 per cent. In addition, the banks extended loans to the students. Poor families and to programmes for job creation.

All trade, investment and development banks were licenced to trade in foreign currency and open time deposit accounts in foreign currency in foreign banks. Companies were authorized to take out from Vietnam US$500.00 in cash or travellers cheques or foreign currency. In case of an individual from the country were allowed to take out from the country US$ 5,000 to 10,000. Taking out large amount of foreign currency out of the country required central bank authorization. Vietnamese banks decided to start a stock market in 1996 in Collaboration with Korean International Cooperation Agency (Koica) and the Korean stock exchange.22

Vietnam joined the Society for worldwide Inter Bank Financial Telecommunication (SWIFT) on 6 March 1995, the local division had 14 members including the State Bank of Vietnam and the SOCB. Vietnam became the 121 member of SWIFT which helped Vietnam banking system and established links with 4,8000 institutions allover the world in the field of international payments and commercial funds.23

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22 SWB, FEW, March 19, 1996, pp.1-2
These changes helped overseas Vietnamese and those who were working or studying abroad. They could now open current account at any bank, which had been licensed to deal in trading foreign currencies in Vietnam. All the capital and interest could be transferred abroad if needed.

The fiscal reforms

The budget had always run large deficits before 1989. This made the macroeconomic system very weak and inflation went from bad to worse. Various measures were introduced to control deficit. The government tried to curtail investment in loss making industries. As a part of these measures, it introduced the re-registration of SOE's in 1993. This resulted in the closure of more than 5000 SOE's. The government tried to control expenditure on the Armed Forces also. Their number were reduced to half the size and 500,000 were removed from the services. This was one of the radical steps undertaken by the government.

The government undertook various measures to improve the tax collection. The income from oil exploration made it possible to reduce the overall deficit from around 8 percent of GDP in 1988-90 to 3.5 by 1994.\textsuperscript{24} Three kinds of taxes were established namely direct taxes (Income Taxes), indirect taxes (goods and services), and the import and export Tax.\textsuperscript{25} Taxes turnover from income Tax and import-export Tax alone generated 70 per cent of tax collections.

The government tried to reform the exchange rates, which was a system multiple exchange rates with different rates for trade transactions till 1989 for the

\textsuperscript{24} Transition to a Market Economy, (IMF), p-22.
private non-state sector. Due to this system exchange rates fluctuated, and cost of production increased. Importers were able to make large profits based on the differences between imports and domestic prices, while exporters were provided subsidies to offset the losses realized on the artificially low (dong) export price. The changes outside the planning systems had forced government to bring drastic reforms to overcome the problem. The government devalued the exchange rate for trade transactions within the central planning system. In September 1988, the dong was devalued against the dollar. From dong 225 per US$ to dong 900 per US$ dollar again in November, 1988. And in March, 1989, the dong was devalued against dollars and brought unified system putting an end to a parallel market rate. By the end of 1991, the effective exchange rate was very stable, dong 11000 per U.S. dollar. In September 1992, government had prohibited the imports of 17 commodities means to curtail the trade deficit.