

CHAPTER 1

Access to International Division of Labor in East Asia

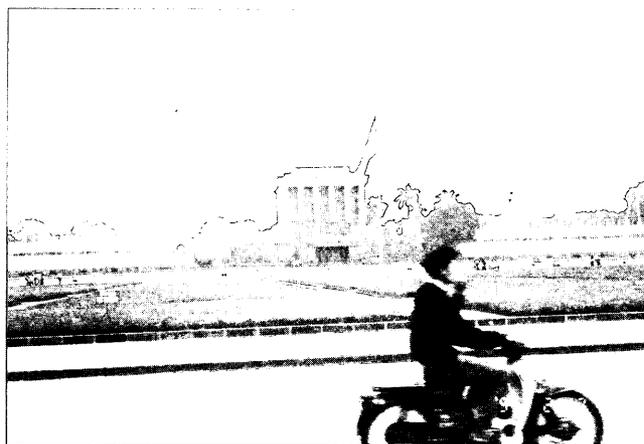
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Going through the turmoil period of a shift to market-oriented economy, Vietnam is at the starting point of economic development. Whatever its subjective intention, Vietnam has no alternative but to develop the economic construction within the framework of international division of labor in East Asia. The construction must be greatly influenced by the international environment in East Asia. In this report, I would like to clarify the conditions which Vietnam has to undergo to gain access to the international division of labor in East Asia.

1. Four Stages in the Construction of Socialism after Unification

In 1976, South and North Vietnam were unified, and the construction of socialism began throughout the country. The Vietnamese economy after the year of unification can be divided into four stages in terms of the period concerned.

The first stage falls on the period from 1976 to 1979 and just coincides with the period of the five-year economic plan. It was during this period that the socialist transformation was made from the economy of the South in an effort to integrate the economy of the South, which had been under a capitalist economy, with the economy of the North, which had been under a socialist economy. Big firms, that were once held by big capitalists who fled to foreign countries together with leaders of the old regime, were nationalized. And small- and medium-sized enterprises, which had been under capitalist management, were also controlled under the joint public-private sector or organized as the handicraft cooperative. Retail stores were absorbed into the state commercial network. On May 3, 1978, the new currency was issued and exchange with the old currency was put under control while deposits were



Ho Chi Minh's Mausoleum in Hanoi

frozen.

These measures gave a devastating blow to the private economy in the South. In this respect, I should point out what happened in the wake of these economic matters. The Hoa (overseas Chinese), supporters of industry and the distribution system in the South's economy, fled overseas as boat people. During the period from 1978 to 1979, an estimated 150 thousand to 270 thousand people fled from the South. Most of these people were reportedly Hoa. But nobody knows the exact figure. According to Tran Khanh, stored goods held by 50 thousand retail stores and enterprises operated by the Hoa were confiscated. And 300 thousand people were sent to the new economic zone and subjected to hard labor. Before 1975, the size of the Chinese population engaged in commerce and the service industry in Ho Chi Minh City was 422 thousand. It accounted for 70% out of the total Hoa population. But in 1988, it decreased to 100 thousand and accounted for only 24% of the total (Tran Khanh, *The Ethnic Chinese and Economic Development in Vietnam*, ISEAS, Singapore, 1993, P.87).

The second stage coincides with the period of the

New Economic Policy, starting from September 1979, when the Sixth Central Party Committee Plenum convened and amended policies, to the period when the Doi Moi program was implemented. During this period, the Vietnam Communist Party modeled after Russia's case to proceed with socialism after taking a rest for a while, and aimed at promoting productivity as a step toward this. As a consequence, a conflict arose and lasted between conservatives promoting socialist transformation and reformists taking advantage of the market-oriented economy to improve productivity.

The third stage is the period of the Doi Moi program aimed at renovation of economic strategy and the macroeconomic structure as a whole.

The fourth stage is the period of industrialization which was clearly confirmed in July 1994 by the Seventh Central Party Committee Plenum. It is the period for Vietnam to aim at modernization. Some analysts may contend that the beginning of the fourth stage should be June 1991 when the Seventh Party National Congress was held or January 1994 when the Mid-Term Party National Congress was held. However, it was in the Seventh Central Party Plenum in July 1994 that the strategy for industrialization was made clear.

2. Doi Moi : the Process for Study and Trial and Error

The Doi Moi program has a wide range of contents. The way emphasis placed is different depending on each stage. In this report, I would like to take up three points contained in the program. The first is market-opening measures for foreign countries, including the abolishment of the central government's monopoly of trade, encouragement of foreign investment and a shift to floating exchange rate system. The second is autonomy given to farmers, merchants and enterprises in terms of manufacturing and sales. The third is the abolishment of price control and use of interest as an macroeconomic variable. The items which are subject to price control now are only four, consisting of electricity, petroleum, fertilizer and steel, and freight. The "Doi Moi" is not to renovate everything in the short term, but a process to study and experience trial and error. It is a repetition of an advance

and retreat. I have the impression that the speed of the Doi Moi program has been reduced since the Seventh Party National Congress and its direction also has changed to some extent. This is the reason why I set up the fourth stage for state controlled industrialization or modernization.

Taking a look at economic performance under the Doi Moi program, I noticed that the economic growth rate has maintained an eight percent level since 1992. I also noticed that while the growth rate has somewhat declined in agriculture, it has exceeded 10 percent in manufacturing. Grain production exceeds 25 million ton. Thus, Vietnam has become a rice-exporting country. And thereby rice production contributes to the improvement of Vietnam's trade balance along with crude oil. Above all, Vietnam was able to stabilize inflation to single digit level. Now that the United States' economic sanctions were lifted, Vietnam's economic environment has taken a turn for the better and foreign investment has increased. It seems that Vietnam has just fulfilled conditions for economic growth.

3. Strategy for Industrialization : Aiming at the Acceleration of Growth

Encouraged by the good economic performance as mentioned above, the Vietnam Communist Party decided to accelerate economic growth in July 1994 the Seventh Central Party Committee Plenum. The growth rate was fixed at 8 to 9.5%, while the growth rate in manufacturing was raised to 13~15% so that it may account for 30% of the GDP in 2000 (*Tap Chi Cong San*, August 1994, P.5). The total investment amount is estimated at US\$ 40 to 50 billion, of which US\$ 20 to 22 billion are based on foreign investment and US\$ 10 billion on ODA. This means that dependence on foreign investment and aid is very high. Vietnam decided to change the policy placing emphasis only on agricultural, forestry, and marine processed products and resource development, to a new policy giving priority to the development of the manufacturing industry. Consequently, besides the export consumer goods industry, machinery industry and electronics industry were added to the new policy. Furthermore, it emphasizes that industrialization or modernization should be promoted under the leadership of State - owned

enterprises(SOEs).

4. Vietnam's Economic Structure

Is it possible to materialize the industrialization proposed in July 1994 Seventh Central Party Committee Plenum? It is necessary to take a look at its structure to assess Vietnam's potential. Going through share occupied in GDP by each sector of industry, it becomes clear that the shares occupied by the service industry increases. This is not the usual pattern which can be seen at the beginning of industrialization. In usual cases, the share occupied by agriculture decreases while the manufacturing share increases. The share occupied by manufacturing is 21.5%, and it increases very slowly. The population of workers was 26.02 million in 1985. It increased by 6.7 million to 32.72 million in 1993. Agriculture absorbed the increased number of workers by 4.92 million, manufacturing by 722 thousand and the rest by the service industry. The population ratio between rural and urban areas was 19.5% to 80.5%. This means that there was no significant change in this ratio. In fact, industrialization brings with it a rather small capacity to absorb workers. As a result, large-scale mobility of population from rural districts to urban districts has not yet taken place.

Let's take a look at the share occupied by individual industries among the manufacturing industry. The electricity, fuel and food industries increase their share.



Japanese - Vietnamese joint venture's textile mill in Vung Tau

The fuel industry occupied 5.6% of its share in 1990 and increased as high as three times to 16.4% in 1993. The share occupied by the food industry increased from 22.0% to 31.3%.

Meanwhile, let's take a look at individual industries that decrease their shares. The share occupied by textile decreases from 11.3% to 6.7%, machinery and equipment from 7.7% to 3.3%, chemical fertilizer and rubber from 9.9% to 7.8%, lumber and wood products from 5.6% to 3.3%, and sewing from 2.7% to 1.6%, respectively. The share occupied by these sectors is declining.

Now let's take a look at the gross industrial product by management. The share occupied by state sector expanded from 57% in 1989 to 71% in 1993 or increase by 14%. Incidentally, in the case of China, the share occupied by SOEs is less than 50%. In Vietnam, the share occupied by SOEs expands under the Doi Moi program while the share by the non-state sector shrinks. Of the non-state sector's industries, construction materials, foods, and textiles expands its share respectively.

The characteristics of the Vietnamese economy, as seen from its structure, can be summarized into five points: (1) it is under the leadership of state sector, (2) it is operated centering around oil and food processing industries and has weaknesses in the manufacturing industry, (3) non-state sector lack vitality, (4) key export commodities are not manufacturing goods. Those are crude oil, rice and marine products, and (5) in view of the fact that the domestic saving rate is more or less 10%, future industrialization depends on foreign capital.

5. Investment Strategy Causing Mismatch with Foreign Capital

In promoting industrialization, Vietnam has high expectations for foreign investment. But what investment environment does Vietnam have?

By the end of September 1994, a total of 1,000 foreign investments, equal to US\$ 10 billion, had been authorized. But of the authorized investments, only 600, equal to US\$ 3 billion materialized. The difference between the authorized investments and the materialized investments may be explained by the following comments: "There is a lot of red tape which requires time and causes inconvenience,"

"Infrastructures have not yet been fixed," "Law system has not been established yet," "It requires a lot of various kinds of cost, and furthermore the actual wage scale is not low compared with other developing countries," "It is difficult to find partners for joint ventures," and "the domestic market is small in scale." These problems always arise in case of an economy which has just been liberalized and begun to shift to a market-oriented economy. They should be solved one by one. In fact, they are being solved in Vietnam too. Apart from these problems, what causes real barriers to foreign investment is the mismatch existing between the Vietnam side and foreign investors' side over the objective of industrialization and how to promote it.

The first point is that Vietnam aims at following the industrialization pattern which NIES in Asia and ASEAN had taken by the first half of the 1980s. In other words, the pattern is firstly to establish export-processing zones, then invite foreign enterprises and finally build export bases to manufacture export goods for Western advanced nations. This pattern is what is called "enclave" type industrialization introducing a complete set of manufacturing processes. In such a case, it is noteworthy that access to the Western market is not as easy as it used to be. And naturally there is no contact with the domestic market. Under the circumstances, foreign investors have to consider what position they should give to Vietnam within the framework of international division of labor (also involved with in-house division of labor) in East Asia. In view of the fact that they have to handle the manufacturing process at various places in East Asia, they should be very careful in choosing Vietnam as a country for investment. It is probably for this reason that no manufacturing industry which requires a certain level of technology has advanced into Vietnam.

The second point is that the Vietnamese market is too small for foreign investors. Vietnam itself only thinks about its domestic market and does not aim at industrialization based on the huge market of the Greater Indochina Economic Block with a population of 200 to 250 million. If Vietnam competes in the huge market of the Greater Indochina Economic Block and establishes a foothold there, the possibility will arise for both Vietnamese enterprises and foreign investors to develop. In this connection, the Asian Development Bank's recent idea for the development

of the Mekong Basin will provide a convincing hint. And it is not Vietnam's SOEs but its private sector that will become leaders to promote this concept.

6. Difference from China's Development Pattern

Characteristics of the Vietnamese economy, as I mentioned above, will become much clear when it is compared with the development pattern China has followed. Vietnam and China compete with each other over oil resources, smuggling and foreign investment. As for smuggling, Chinese products (thermos bottles, bicycles and porcelain and earthenware) flood the whole of the Indochina market as well as the Vietnamese market. Vietnamese products are defeated in the market even if they are better or the same level of quality, because they are higher in price. Vietnam's consumer goods and light industry have, first of all, to restore competitiveness in the Indochina market.

State-owned enterprises are more powerful in Vietnam than in China. The reason for this difference is the existence of the "township and village enterprises" in China. Unlike China, Vietnam has no such system. As a result, there are no powerful competitors in Vietnam who can compete with SOEs. This means, in turn, that Vietnam should nurture powerful enterprises equivalent to township and village enterprises as in the case of China. In addition, the North-South problem are far more serious in Vietnam than they are in China. However, the way the authorities of both countries deal with them are different. While China adopts the "xian fu lun" theory - a theory supporting an idea that is good for a handful of people or communities to become rich in advance of others, Vietnam, by contrast, is in favor of a "Balanced Growth Approach" and places emphasis on the development of the North without thinking about the economic aspect to prevent the disparity between the South and the North from expanding. In fact, it is only in the South that we can expect the establishment of powerful private enterprises. In its industrialization strategy, Vietnam places much dependence on foreign capital. Accordingly, this causes wariness arising to such situation. Economic nationalism can easily arise at any time. A good example can be felt in

the 1992 amendment of the foreign investment law, which intends to increase the share of the equity of the Vietnamese side in the joint venture's prescribed capital. (Tsutomu Murano, "Vietnam's New Industrialization Strategy and Its Problems". *Asian Trends* 1994-IV P.108). In a sense, market liberalization means anarchy. In case of Vietnam, government controls, compared with China, are so strong that they prevent private citizens from having free ideas and carrying out economic activities.

There are two conditions which are advantageous for Vietnam. Firstly, its leaders are well aware of the fact that, compared with neighboring nations, Vietnam is far behind in economic development. As a matter of fact, they are very eager to learn and adopt international rules and morals, and listen to outside opinions attentively. Secondly, as the size of its total land is limited, it is easy to move around Vietnam. Therefore, communications between the central and regional areas can be smooth. Thus, the central government's instructions reach local districts with comparative ease.

7. Direction of Industrial Development : Waiting for the Emergence of Entrepreneurs

Vietnam's external conditions for the promotion of industrialization are favorable. Each country expects Vietnam as a new frontier. The emergence of India and Myanmar, however, means that Vietnam comes to have

rivals. In any case, Vietnam has the competitive advantage of a cheap and high-quality labor force. To make full use of this advantage, we should bear in mind the following three points:

- (1) it is necessary for Vietnam to adopt an industrialization strategy, adjusting to the tendency of in-house division of labor which has been promoted by enterprises of advanced nations in East Asia, and to prepare the environment for investment. This is the direction to try to develop the machinery industry and electronics industry toward advanced nations' market.
- (2) at the same time, it is also necessary for Vietnam to build up international competitiveness in the consumer goods and light industry fields, directed toward the wide range of Indochina economic block.
- (3) Vietnam should aim at two courses in promoting industrialization: in the directions of both high-tech industry and consumer goods and light industry. But it is for the private sector to assume consumer goods industry and light industry.

For industrialization, the emergence of entrepreneurs in the private sector is essential. In this respect, the Hoa has not yet shown enough activity. Meanwhile, the industrialization, under the initiative of state sector may write off the potentiality of the Vietnamese economy. Importantly, an atmosphere of liberalization needs to be further created for the emergence of entrepreneurs.