

## Vietnam's Reform Process: Implications for Thailand

David Stifel

In response to Vietnam's 1978 Christmas day invasion of Cambodia to "liberate" the people from the Khmer Rouge, the non-communist world reacted decisively with measures to isolate Vietnam. A month later, China responded violently with a punitive military action. And the differences of opinion among ASEAN members over an appropriate approach to Indochina were resolved with a firm commitment to resist Vietnam. Yet today, Hanoi and Washington are at the negotiating table, formal Sino-Vietnamese relations have been restored, and Vietnam is to sign the Treaty of Amity and Cooperation to gain observer status in ASEAN.

The new environment has created a plethora of opportunities for Thais in Vietnam. This paper examines the reform process in Vietnam. The factors motivating the policy shifts of the leadership in Hanoi give an indication of the durability of reforms, which in turn affect the trade and investment climate. Assuming that reforms are irreversible, the second part of the paper examines prospects for Thai economic interests in Vietnam, and the competition Thailand faces from other Asian economies there.

The situation in Vietnam today has evolved in large part from the decline and fall of the Soviet Union, as well as from fundamental weaknesses in its own economy. These circumstances have brought about a shift in policy, which places economic concerns over strategic and ideological matters. The collapse of the communist party in what was once the Soviet Union has reinforced the notion, weighing heavily in the minds of the Vietnam Communist Party (VCP) members: short term power may stem from the barrel of a gun, but long term power and political legitimacy stem from economic well-being. As one party member stated, "only as long as people see their life [sic] improve each year will they accept the leading role of the party."<sup>1</sup> The difficulties being experienced in the former Soviet republics and Eastern Europe in the transition from planned to market economies, however, are a caveat which has not been missed by the Vietnamese leadership.

The so-called "peace dividend," which has thus far eluded much of the world since the end of the Cold War, appears to be within the grasp of Thailand, Vietnam's closest capitalist neighbor. Now that the Vietnamese threat is no longer what it once was, and as economic reforms progress, Thailand can benefit from the prospects available there. The United States'-led embargo has also provided a grace period for Thailand to pursue its interests in Vietnam. A complacent approach to Vietnam, however, increases the likelihood of opportunities being missed.

### REFORM

*The central planning that enabled what was North Vietnam to beat the French and the Americans could not cope with peace.*<sup>2</sup>

Although no accurate figures on national income were available to the leadership before the Sixth Party Congress in December 1986, the visible disparities between Vietnam and capitalist countries in the region, as well as China, were striking. Per capita income in Thailand in 1985, for example, was over US\$720, and eight years of reform under the leadership of Deng Xiaoping had raised the level of per capita income in China to US\$320; the incomes of those living in the southern coastal provinces were undoubtedly higher. The success of Chinese reforms especially appealed to party leadership. "Seeking truth from facts" and developing the "forces of production" (the economy) before changing the "relations of production" (ownership of the means of production) appeared as face-saving means of extracting the Vietnamese party leadership from the quagmire they found themselves in following hasty attempts to put

their country—one without a proletariat, per se—through a socialist revolution.

Under its system of bureaucratic centralism and state subsidies, Vietnam has suffered many of the ills symptomatic of centrally-planned economies. Vietnamese state enterprises with soft budget constraints have characteristically proven to be inefficient and a strain on the economy. Disparities between market and official prices have also provided incentives for cadres with control over the distribution of supplies to seek rents available through illegal arbitrage. This has gone unreported in many state enterprises because employees have been given shares of the takes in order to "reduce the potential for whistle-blowing."<sup>3</sup> Although the break-up of the two-tier price system and the crack down on corruption in recent years have helped to alleviate the problem, it is far from solved. In a state where government officials control the distribution of scarce goods and where a black market thrives, misallocations of resources will inevitably continue.

The agricultural sector has also suffered the woes inherent in the Maoist collectivization model and the party's bias toward industrial development. Despite making agriculture a top priority in the Third Five Year Plan (1981-1985), the sector continued to be viewed primarily as a part of the process of socialist industrialization. Industry continued to receive over 40 percent of gross fixed investment from the state in "productive sectors"<sup>4</sup> whereas agriculture received less than 23 percent during this period.<sup>5</sup> Hasty elimination of private ownership and implicit taxes in the form of skewed urban-rural terms of trade affected the incentive structure, resulting in sub-optimum crop yields.

Following appeals for international assistance to avert a famine, the Politburo issued a resolution in April 1988, on the "Renovation of Economic Management in Agriculture." The resolution, inter alia, restored traditional incentives by providing farmers with 15-year land use rights. Investment in new fields and existing irrigation systems was also boosted. Although an urban-rural dichotomy remains, the results of the reforms are impressive. Vietnam has been the world's third largest exporter of rice since 1989. But success has created new difficulties for the state. Crop procurements have placed an added strain on the state budget, and the country's limited and outdated processing capabilities have lowered the value of exports as rice quality has been below international market standards. Limited capital has impeded the development of modern rice mills and other agro-industries. The government is now encouraging foreign investment in these areas.<sup>6</sup>

Declining real incomes, as well as rising "shoe-leather" costs,<sup>7</sup> have been the consequence of the high rates of inflation afflicting the population since the war. Subsidization of state enterprises and urban populations has been a major source of the rampant inflation. After defense spending, subsidies have, in fact, been the largest single item in the bloated budget, the deficits of which have often been financed through the printing of money. The State Bank of Vietnam in recent years has maintained a tighter money supply policy. But until state enterprises are privatized or confronted with hard-budget constraints, this policy will continue to result in a shortage of capital for productive enterprises. Another major source of inflation has been the excessive growth of a bureaucracy which protects superfluous officials. It was estimated that, prior to the Sixth Party Congress, the bureaucracy could have been cut in half without affecting its operations.<sup>8</sup>

At the meeting of the Politburo in August 1986, the VCP decided to initiate a major policy shift by adopting wholesale economic reforms. The VCP leaders admitted they had been overzealous in their pursuit of socialist transformation and that the economy had suffered for it. A renewed emphasis was placed on strengthening the economy before addressing social issues, such as ownership of the means of production. The recommendations from this meeting were endorsed at the Sixth Party Congress, held in December of that year. Reformist Nguyen Van Linh was also elected Secretary General at that Congress. The reforms aimed at developing all economic sectors by permitting the private sector to operate. The revised constitution, passed in April 1992, helped to institutionalize the participation of the private sector by fully legalizing private business ventures.

## **FOREIGN ECONOMIC AND POLITICAL RELATIONS AND REFORMS**

*Autarky and closed door policy is the path to backwardness and poverty. To cope with the*

*challenge of history, the only path for us is to associate the Vietnamese economy with the world economy. That was the lesson drawn by the Sixth Party Congress...[Henceforth, Vietnam is] determined to broaden its [economic] relations with the outside world for the purpose of development.*

*Foreign Minister Nguyen Co Tach  
January 1989<sup>9</sup>*

The Stalinist-Maoist approach to economic development, originally adopted by the Vietnamese, emphasized import-substitution industrialization. In rejecting this strategy in 1986, the VCP acknowledged the need to attract foreign capital and technology to raise the competitiveness of the country's production capacities up to international standards. The foreign investment law passed in 1987, however, is typical of the party's determination to proceed with reform, while at the same time vacillating over degrees and specifics. The letter of the law is extremely liberal, but it lacks much of the fine print needed to interpret the statutes. Nevertheless, many foreign businessmen have shown cautious enthusiasm.

Vietnam has much to offer foreign investors and traders: coal, gems, rubber, coffee, rice, oil, a cheap, disciplined labor force, and a potential consumer market of 69 million people. There are, however, still many weaknesses and risks in doing business there. The shortage of lawyers, for example, is compounded by the absence of bankruptcy laws, a lack of a mechanism for international arbitration in commercial disputes, differing interpretations of existing laws, and laws which are too prone to change. The infrastructure is inadequate in most parts of the country. The cumbersome bureaucracy makes project approval a time-consuming process, subject to competition between local and central governments.

The economic woes of the former Soviet Union have compelled the Vietnamese leadership to allow, and even encourage, greater foreign participation. Hanoi—Moscow's third largest debtor—had for many years relied on economic assistance from the Soviet Union to subsidize the state sector and prop up its fragile economy. Since January 1, 1990, however, Vietnam is no longer accorded preferential treatment; goods purchased from the former Soviet republics must be paid for in dollars at world market prices.<sup>10</sup> In 1991, the share of Vietnam's trade with the erstwhile Soviet Union fell to about 13 percent from more than 50 percent in 1990. To avert economic collapse, Vietnam has sought trade, investment, and financial assistance from the outside world. Much to the credit of the Vietnamese, the hardships were not as severe as might have been expected, thanks to higher agricultural production and the rapid growth of trade with, and investment from, the Asian capitalist economies.

Economic realities ensure that Vietnamese reforms are irreversible in the long term. The leadership has shown its willingness to pursue an open door policy and to address the system's many inadequacies. Steps backward do occur, however. For example, in an effort to stem the outflow of foreign exchange in the latter half of 1991, the Vietnamese government tightened its control over the handling of all foreign exchange. A "temporary ban" was also placed on the import of all consumer goods for the last two months of the year.<sup>11</sup> In another instance, an over-zealous attempt to hasten the development of the shaky banking system may have actually weakened it; in January 1992, the government banned the transfer of cash in excess of Dong 50 million between Vietnamese cities. Cash payments between clients who hold bank accounts have also been prohibited.<sup>12</sup>

The VCP finds itself in the uncomfortable position of being forced to pursue the separation of party and state to eliminate the arbitrary nature of decision-making in order to attract foreign investment. As the newly-revised constitution illustrates, the party is succumbing to pressures to create legal institutions which threaten its monopoly of power. In the party's effort to strengthen the rule of law, the document gives the National Assembly greater power to pass laws and to appoint officials—tasks previously carried out by the politburo alone. In fact, the new constitution has been labelled an "economic constitution."<sup>13</sup> Its numerous revisions clearly aim to create a more favorable trade and investment environment by strengthening the legal structure, setting up a more efficient decision-making process, and creating checks and balances within the government by separating the executive from the legislature.

Vietnam's efforts to open its economy to the international market have run into obstacles not only on the domestic front, but also in the international arena. As it has had to contend with the obstructionist policies of the United States, Vietnam faces a disadvantage most developing countries do not encounter. Although many countries have unilaterally disregarded the embargo, the Americans have the capability to influence economic powers such as Japan, and to prevent the International Monetary Fund (IMF), the World Bank, and the Asian Development Bank (ADB) from lending money to Vietnam. Lending from these institutions is important for two reasons. First, the Vietnamese infrastructure has been stretched to its limit. There is a shortage of capital, which prevents Hanoi from investing in the large-scale projects needed to alleviate the infrastructural bottlenecks. Private sector loans are not expected to be forthcoming for these needed projects. Once lending resumes from the multilateral institutions, resources can finally be directed at the areas that have thus far impeded growth and the inflow of foreign investment. Second, lending from these institutions also serves as a guide for private investors. Once the IMF, World Bank, and ADB resume lending, official and private capital flows are expected to grow substantially.<sup>14</sup>

The United States' linking of assistance from multilateral financial institutions, and the lifting of its embargo, to the settlement of the Cambodian conflict, appears to have pressured Hanoi into seeking a resolution to the conflict. For their part, the Chinese have also been willing to proceed cautiously with peace efforts. As the former Chinese Vice Foreign Minister, Han Nianling, told Vietnam expert Nyan Chanda in 1980, "it is only when the Soviets can no longer support the Vietnamese that a political solution to the crisis will be possible."<sup>15</sup> That condition has now been met.

Shortly after the signing of the Cambodian comprehensive political settlement in Paris on 23 October 1991, Vietnam and China normalized relations and talks between Hanoi and Washington commenced. The peril of economic collapse had forced the VCP leadership to adopt a foreign policy conducive to economic interaction with the outside world. The fundamental impetuses behind this shift—over a decade of economic mismanagement and the drying up of Soviet assistance—have left the Vietnamese with no choice but to seek amicable foreign economic relations with other countries.

## **THAILAND AND VIETNAM**

Until recently, Thai-Vietnamese relations have been wrought with tension. The belligerence of Vietnamese foreign policy in the decade following the fall of Saigon prescribed Thai policy toward Vietnam. It also helped to legitimize the influence of the Thai military on the domestic political scene. The diminishing Vietnamese threat in recent years, plus pressures on the Thai infrastructure brought on by the surge in foreign investment since 1987, have hastened the improvement of relations between the two countries. Although there is evidence that factions in the Thai military continue to be suspicious of Vietnamese motives, civilian leaders now preach optimism about Thai prospects in Vietnam. Prime Minister Chatichai Choonhavan's aspirations to transform the Indochina region from a "battlefield" to a "marketplace" envisioned a leading role for Thailand in the development of these countries.

Thailand is still in an advantageous position to gain from the potential of the Vietnamese economy, but complacency appears to have limited these benefits thus far. Factors contributing to the difficulties Thais have encountered in Vietnam include: 1) personal distrust among the people, 2) lack of government initiatives and policy coordination, and 3) competition from other countries.

Before discussing these issues, we must first ask what Thailand wants from its relations with Vietnam. Many in the Thai government and private sector envisage the Kingdom acting as a "gateway" to Vietnam by providing financial, processing, and trade-related services. The Bank of Thailand (BOT), for example, has ambitious plans to turn Thailand into a financial hub for the whole region. Within the next few years, the Bank intends to establish an international banking facility to direct overseas funds into Indochina. Although these plans are, of course, aimed at benefiting Thailand, the BOT sees Vietnam as gaining as well, since Thai intermediaries would assume some of the risk, thus making it easier for Vietnamese entrepreneurs to attain international financing. The private sector has also contributed. Finansia Thai Limited, a small, Bangkok-based financial consultancy, is establishing a US\$20 million Indochina investment fund—the "Southeast Asia Frontier Fund." Finansia intends to invest the entire fund in Thailand, bypassing the

uncertainties of the Vietnamese market until the U.S. embargo is lifted.<sup>16</sup>

The Board of Investment (BOI) is also formulating policy guidelines to promote Thai investment in Vietnam and the other Indochinese states. Possible incentives include income tax waivers for foreign exchange remittances from Thai investments abroad, duty waivers for imports of raw materials from Thai projects abroad, and exclusions from assessable income for operating profits of overseas investments.<sup>17</sup> The ease with which Vietnamese visas can be attained in Bangkok, and Thailand's proximity to Vietnam, are features making Thailand an attractive stepping-off point for multinational corporations (MNCs) interested in investing in, and trading with Vietnam. The idea behind the BOI initiative is that Thailand and Vietnam can fit favorably into corporate strategies. Thailand can attract initial investments in low technology production facilities and, as the Thai economy progresses upstream, these labor-intensive processes can be shifted to Vietnam, leaving the more technology- or capital intensive-factories in Thailand. An example of this is the Hong Kong-based garment company, Hua Fu, which established a factory (Hua Thai) in Thailand and has since moved part of its operations to Vietnam.<sup>18</sup> This need not be exclusive to foreign investors. Thai companies can also take advantage of the low labor costs in Vietnam by moving their low-end production processes offshore, as Thai wages and costs inevitably rise. Thus Thailand has the potential of becoming a "gateway" to Vietnam for at least the short to medium term.

### Thai Performance and Limitations

Following the announcement of Prime Minister Chatichai's Indochina initiative, Thai business activity with Vietnam picked-up rapidly. As can be seen from [Table 1](#), the value of trade between Thailand and Vietnam in 1989 grew by about four and a half times the value of trade in 1988. These figures, however, pale in comparison to the value of two-way trade between Vietnam and Singapore, Japan, Hong Kong, France, Australia, and South Korea, respectively.

The overall drop in Vietnam's exports in 1991, due to the collapse of the Soviet Union, was accompanied by the rapid growth of trade with all these economies. The bulk of this expansion came from Singapore, Japan, and Hong Kong— together accounting for half of Vietnam's trade in 1991. Singapore's trade with Vietnam grew from US\$111 million in 1989 to US\$868 million in 1991, while Japan's trade with Vietnam grew twofold to US\$709 million over the same period. Japanese purchases of Vietnamese oil accounted for much of the increase. Finally, Hong Kong's trade with Vietnam grew from US\$182 million to US\$502 million.<sup>19</sup> Even though actual two-way trade—including unrecorded illicit trade—between Thailand and Vietnam is undoubtedly underestimated, it does not approach the value of trade between these countries and Vietnam.

[Table 2](#) shows the origin of foreign direct investment (FDI) in Vietnam. As of June 1991, Thailand was the twelfth largest investor, accounting for only 1.8 percent of pledged capital (figures are not available on actual investment). Nearly 60 percent came from Taiwan, Australia, France, and Hong Kong. These figures do not indicate whether the investments were made through third countries. It is, therefore, difficult to determine if neighboring economies, such as Thailand, act as conduits. Yet it is clear that Thai investment in Vietnam has so far fared relatively poorly.

The first of the three factors, as discussed earlier, explaining this lackluster performance is the historical, political, and cultural animosity which has engendered a general distrust between the peoples of Thailand and Vietnam. Regardless of the veracity of the accusations, the "ugly" reputation of Thai businessmen has not only hampered Thai business with Vietnam, but has also raised questions over the viability of Thailand as an operations center for MNCs in the subregion; "foreign executives warn that being Thai-based can prove disadvantageous."<sup>20</sup>

The Vietnamese leadership is wary of Thai business interests. They observe the way natural resources in the other Indochinese states and Burma are being extracted by Thai businessmen and fear the same may happen to them.

Smuggling of gems and poaching by Thai fishermen do little to alleviate Vietnamese apprehensions. The Vietnamese want to develop their own capacities to process raw materials. They value Thai experience in

agro-industry, aquaculture, and gems,<sup>21</sup> but fear that the illicit trade and business activities taking place undermine their own efforts. In a move apparently directed against Thailand, the Vietnamese government restricted the mining of gems, but did urge foreign organizations and individuals to invest in processing facilities.<sup>22</sup>

Second, despite the rhetoric of the Chatichai administration, Thailand has yet to be transformed into a "springboard" or "bridge" to Vietnam. The government failed to take advantage of this early initiative. The BOI, for example, was bogged down with investment applications until 1991 and has only recently begun defining its strategy toward Vietnam. The first round of foreign exchange liberalization—though not directed at investment in Vietnam alone—did not take place until May 1990. The continued reform of the Thai financial market and banking system helps to facilitate Thai investment flows, but it will take time for these markets to mature—time is not on Thailand's side, however, given the competition from its Asian neighbors and the industrial economies.

Third, the Asian NIEs (newly industrialized economies)<sup>23</sup> and Malaysia are giving the Thais a run for their money in Vietnam. Until recently, Thailand held an absolute advantage over its regional neighbors. Bangkok was the only gateway for direct flights from the non-socialist world to Hanoi and Ho Chi Minh City. Today, however, Cathay Pacific—Hong Kong's de facto flag carrier—has nine weekly flights to Vietnam, Singapore Airlines has six, and Malaysia Airlines has two. And, as the Vietnamese rush to open a consulate in Hong Kong to process visas, Thailand's remaining advantages are weakening.

While Singaporean investors maintain extreme caution in investing in the Vietnam market, Hong Kong, Taiwan, and—recent evidence suggests—Malaysia are taking advantage of the U.S. embargo to gain footholds there. Cantonese and Fukienese entrepreneurs from these countries use their ethnic ties with Vietnam's Chinese to launch business ventures.

Now that the refugee situation and deference to China no longer inhibit Hong Kong from improving its relations with Vietnam, the colony has become an appealing location for MNCs to base their Vietnam headquarters. Hong Kong's attraction stems from its well developed financial and telecommunications systems, its efficient duty free port, and its energetic investing class—well-versed in dealing with reforming socialist countries.

Credit Lyonnais, for instance, was attracted to Hong Kong's financial markets and has established the Vietnam Growth Fund in the colony. Similarly, the Vietnam Fund has also been set up in Hong Kong to cash in on Vietnam's privatization efforts. Hong Kong's reversion back to China in 1997, however, makes its economic future far from certain.

Singapore and Hong Kong both offer ports free of duties and red tape, as well as highly efficient trade-related services. This poses a challenge to Thailand's role as a possible center for re-exports of Vietnamese goods in the short to medium term. In the long term, provided that Vietnam continues to develop its port facilities, it will no longer need to direct much of its trade through neighboring countries.

Recent evidence suggest that Malaysian investment in Vietnam has now surpassed Thailand's. This is the result of a strong government policy which has included Indochina as part of the country's overall industrialization strategy. Prime Minister Datuk Seri Mahatir Mohamad's delegation of 108 businessmen, 36 cultural attaches, and 20 government officials, which travelled to Vietnam in April 1992, was the largest foreign delegation to visit the Indochinese state, and is an indication of the Malaysian government's enthusiasm for the Vietnamese market. Like Thailand, Malaysia's experience in agro-industry is highly valuable to the Vietnamese. Malaysia's assistance is being sought to help revitalize Vietnam's rubber industry, with some 110,000 hectares of trees still untapped.

The Asian NIEs and Malaysia all have advantages over Thailand. Their leadership has remained stable and the sustainability of policies is not at issue. Furthermore, these countries—especially Singapore—provide successful models of growth and social discipline for the Hanoi government. Their "authoritarian-pluralist systems"<sup>24</sup> in which an elite maintains political power, while economic and social institutions remain

relatively independent, and in which opposition groups exist but have little power, appeals to the Vietnamese leadership. The invitation to Lee Kuan Yew to act as an economic advisor to Vietnam illustrates Hanoi's thinking. Given Thailand's political uncertainties, the rapport between these countries and Vietnam is unlikely to be matched in Thai-Vietnamese relations.

### **Thai Prospects**

Thailand is currently in a position to gain from potential opportunities in Vietnam. However, aspirations to make Thailand *the* gateway to Vietnam are unrealistic. Too many forces act against such a scenario. Competition from Hong Kong, Singapore, and Malaysia also assure that no one country will dominate as a regional middleman. Nor does Vietnam want to depend on a single country. Its experience with the Soviet Union taught the Vietnamese leadership that such excessive dependence is dangerous.

Thailand does have the potential to be *a* gateway, though. The Thai economy, on the verge of becoming an NIE, needs Vietnam's cheap labor pool and abundant resources. Seen as a package, both economies are attractive to foreign investors. Conflicting nationalist sentiments and mutual distrust, however, pose a threat to Thailand's role as a gateway to Vietnam.

Finally, in the medium to long term, Vietnam will be its own gateway. The Vietnamese are installing a state of the art telecommunications system which will make doing business from greater distances increasingly feasible and, when multilateral lending is resumed, the bottlenecks in the physical infrastructure can be realistically addressed. The government's efforts to open up the economy to market forces, although proceeding in starts and stops, and its enthusiasm for developing a market-oriented legal code, are making the country an easier place in which to invest directly. The implication for Thailand is that Vietnam is likely to be just another market with which the Thais can do business. Opportunities for Thai businesses indeed exist in many sectors, such as agro-industry, light manufacturing, and gem processing. Yet these prospects are by no means available to Thailand alone. A concerted effort on the part of both the public and private sectors is essential if Thailand wants to be a major player in Vietnam. This, however, will be difficult following Thailand's recent political unrest.

---

© Copyright 1992 *Thailand Development Research Institute*