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Growth with Equity: "Double Click" for High Economic Growth and Quick Poverty Reduction

The Case of Vietnam

Do Duc Dinh
Developing Economies Study Department
Institute of World Economy, Hanoi

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UNRISD, Palais des Nations
1211 Geneva 10, Switzerland

Tel: +41 (0)22 9173020
Fax: +41 (0)22 9170650
info@unrisd.org
www.unrisd.org

Since the late 1960s, though there have been in the world various theories on development, particularly the growth or "trickle down" theory, the Washington Consensus and the socialist "egalitarian" doctrine in the mainstream development economics, there has been no place for a double effect thinking that tries to solve the two critical and contrast issues at one time - high economic growth and rapid poverty reduction in a developing country. During such a long period of time there have been only two principal choices: The first relates to the "trickle down" and/or the Washington Consensus theories that promoted growth with a widening gap of the rich and the poor or, in other words, the not-for-poor growth model; and the second based on the "egalitarian" theory which focused on redistribution rather than on production and business, hence resulting in equality without growth or, as it was ironized by some economists, "equality in poverty".

Today, the world has witnessed at least one country - Vietnam – that has proved the ability to turn this dilemma into a double gain policy: *the Policy of Growth with Equity* which has successfully turned a significant part of the benefits and opportunities of high economic growth into rapid poverty reduction. This new development model which has been successfully tried, mainly in practice rather than in theory since there has been no such a theory so far, seems to be more appropriate to developing economies than the old theories. Therefore it could arguableably be recognized as the alternative to the "trickle down" theory, the Washington Consensus and/or the "egalitarian" theory, for it has tackled or *"double clicked"* on not just one problem, but on both the two very essential issues of socioeconomic development with an aim to achieve both, the high economic growth and quick poverty reduction at one time in one developing country.

Bearing in mind that new and successful case of development, the author of this paper is making an effort to find the evidence and approach of this "*double click*" development alternative which has been implemented through the process of 20 continuous years of renovation in Vietnam from 1986 to 2007, and very possibly beyond. In order to do so, the author will firstly trace back to the old model of low growth with increased poverty adopted in Vietnam prior to the renovation period which started in 1986; and secondly, look at the renovation model of growth with equity development which has become the principal drive of rapid poverty reduction in Vietnam; then thirdly, concentrate on the approaches that Vietnam has adopted to address its poverty; and finally, draw out some conclusions which may be used as the experiences, lessons and/or recommendations for Vietnam and other developing countries that really want to make double gains with one policy to achieve both the high economic growth and rapid poverty reduction at one time under their own conditions and in the current context of globalization.

I. The Old Model of Low Growth with Increased Poverty Prior to Renovation

After the liberation of the whole country in 1975 and the reunification in 1976, Vietnam was in the high mood of victory, yet facing at the same time serious difficulties, since it was faced with a new and very difficult task, that is, the reconstruction of the terribly war-torn country.

One of the most important questions at the time was how to manage such an economy. Some people realized the old system of management was no longer appropriate and recommended change from a war-time to a peace-time management system, while many defended the old system, trying to prove that what was good for the war could be good for the peace. The latter made up the majority, their voice was heard, and the old management system was retained.

The old system was characterised by following typical features:

1. The centrally planned management mechanism which led the economic performance by orders and commands, neglecting and discouraging all market impulses and motivations;
2. The relatively equal redistribution system by which everyone got almost the same slice of the pie, but on the other hand it did not encourage the good worker to work better, hence demolishing the work motivation and prolonging the low productivity system;
3. The subsidized regime which turned a large number of people to be lazy, not working hard and working creatively, just waiting for their turn of allowance to come;
4. The biased international relationship by which the country was depending heavily on only few old socialist countries, hence loosing most of the opportunities offered by the world at large.
5. Following the old system, Vietnam was curbed by the US embargo, hence facing more and more serious difficulties and hardship.

Though the planned system did help Vietnam to maintain the economy, especially the production of food and essential consumer goods to serve the cause of the struggle for independence during the war time, it did not help much during the post-war period when the country no longer relied on the minimum needs, and required a better life. In contrary to the increasing needs, the prolonging of the old system had worsened the social and economic conditions, leading to the socio-economic crisis which was for the first time officially recognized by the Government at the end of the 1970s. During this period, GDP per capita was about US$100 a year. Inflation accelerated, reaching 600-700 per cent per annum. Agricultural production declined, the country had to import around one million tons of food but still could not provide sufficient food for the people (during the war time when the country was separated into the North and the South, each part had to import roughly around one million tons of food a year). The lack of consumer goods was widespread, while industrial production faced a sharp drop. The living conditions of most of the people deteriorated, except for some speculators who benefited from others' difficulties and those whose living was relatively subsidized by the Government.

The difficult situation at the end of the 1970s generated strong pressure for reforms at the beginning of the 1980s, though not a small number continued to protect the old pattern. Some partial reforms were adopted in a number of areas like agriculture, industry, price, wage, and currency, but they were not yet throughout the whole economy. The partial reforms were insufficient to reinforce each other, resulting in a mixed performance.

The most important reform during this period was the implementation of *the contract system in agriculture*, which emerged for the first time in Vinh Phu Province during the first half of the 1960s, but it was stopped for it occurred in a wrong time when the country was not liberated and the old management system was stabilized, not ready for change. Ten years later the contract system appeared again by the end of the 1970s. At this time, it was developed not just in one province, but in several provinces of North Vietnam. The main idea of the contract system was to change the inefficient performance of the cooperatives from collective management to household contracts, by which the cooperatives changed their role from direct intervention in production and business to indirect management, while the households took charge of the direct production and business based on long term contracts from 20 to 99 years depending on the length of crops. Under the old system, all the results of production and business belonged to the cooperatives, the members were allowed to get their shares based on their work points and work days, which were normally below their labour, hence did not motivate them to work hard. In contrary, under the new contract system, the households were fully responsible for their production and business, they had to pay only certain amount of their products to the cooperatives as cooperative funds and a low tax rate to the Government, and kept the rest of the results for their own, including using the extra parts of their results for free market sale at market price which was four times higher than that fixed by the State under the subsidized price scheme. This new policy offered important incentives and encouraged the cooperative members to work as hard as possible to get as much as they could.

As a result of the contract system, each year rice production increased about one million tons, almost equal to the amount of food imported, and created millions of jobs, even without much additional physical investment, thus helping reduce the serious food shortage and the large unemployment. For that reason, the contract system was then transformed into a nation-wide policy for agricultural development since 1981.

In industry, some subsidies were gradually reduced and abolished along with the *expansion of the autonomy of industrial enterprises*, most of which were State-owned. Under this policy, industrial enterprises were allowed to have greater decision-making, including the access to capital and labour markets, the supply and distribution of their inputs and outputs, and even the decision of their products' prices. However, due to the heavy dependency on State subsidies and the poor development of the markets at the time, only a small number of enterprises improved their performance, most others continued to make loss and rely on State subsidies. In many cases, enterprises could not provide sufficient jobs for their workers, while they were, under the socialist management, not allowed to lay off the workers, so tens of thousands of workers became semi-unemployed and lived with what was called the "hungry salary".

The most unsuccessful reform during this period was *the package of price, wage and currency adjustments*, which were tried twice in 1981 and again in 1985. The Government made great efforts to combat inflation, to raise the wages of the workers, and to devalue the currency, expecting that these measures combined would help stopping the high rate of inflation, improving living conditions of the people. The reform started from the change of the Vietnamese currency (the Dong) from ten to one (1000%). Each time the adjustments were made, the economic and social conditions were improved a little and for a few months, then quickly deteriorated, with a continuing drop of industrial production, increasing shortage of consumer goods, and insufficient supply of food (even though there was an improvement in agricultural production).

Stronger and stronger debates went on, many of which referred to the renovation of thinking as the necessary driving force of all reforms, without which reforms could not succeed. Various alternatives were discussed. Those who did not want to change emphasized the negative impacts and failures of the reforms; while an increasing number of people argued that though not all the partial reforms were successful, "some initial achievements" were made. The majority started to concentrate that *the old system which was characterized by such anti-development features as centralization,* *bureaucratization, subsidization, egalitarianism and inward-looking* could no longer work in the new situation when the nation went out of war, in need of development and integration rather than dependency and subsidy. They therefore called for further reforms, especially the reform of thinking to identify proper alternatives.

The difficulties during the 1975-1985 period became the strongest pressures and the most critical lessons for Vietnam to find out the alternative policy of renovation to be adopted since 1986 which has led to the current successful domestic reform and international integration.

II. The New Model of High Growth With Equity since Renovation

The Sixth Congress of the Vietnam Communist Party which was held in 1986 made a strategic and determined choice that the country was to move forward to implement a "*comprehensive renovation*" (Doi Moi Toan Dien), though recognising it would be very difficult to realise. This decision was the turning point, marking the transformation of the Vietnamese economy from a "centralized, bureaucratic and subsidized" system toward a "*multi-sector commodity economy,*" which implied the recognition of the multiple ownership structure and the commodity market. With *the multiple ownership structure*, no longer was only one form of ownership recognised, that is public ownership, although State ownership was still confirmed as the leading one. Under the new perception, *ownership no longer represented the content of the society, instead it became an instrument* that would be used as appropriate. This new perception became the initial basis for the gradual elimination of the monopoly ownership mechanism that has been protected so long in the country. As a result, ownership was diversified to include the six main forms such as the State, private, collective, individual, joint venture, and foreign ownership.

With the acceptance of the commodity market, then the market economy, the market principles have been recognised and most of the markets were accepted, including the labour and capital markets which were hardly accepted previously for it was supposed to be the main source of exploitation. Today, enterprises including State and private are no longer limited by the number of workers and the sum of capital as previously, instead they hire as many workers and invest as much capital as they can. As the labour market is developed, labour institutions have also been developed, including the freer labour law and the more active trade union movement.

This new concept of ownership stimulated people from every sector of the society to work with the State to carry on the tasks of the 1986-1990 Five Year Plan, including the recovery from the socio-economic crisis, the stabilization of the political, social and economic situation, and the preparation of prerequisites for development. In accordance, the planning system has also been changed from fully direct plan to half direct or indicative plan, by which the direct plan is applied to Government budget, while the indicative plan is applied to non-Government investments.

A number of very important short-term and long-term macro-economic policies and major measures were adopted during the 1986-90 period, including:

- *The application of positive interest rates and the reduction of money supply* aiming to combat the high inflation of 700-800% per annum;
- *The implementation of the three major economic programs* to overcome the serious shortage and to promote the development *in the three areas of essentially economic and social importance, namely the Program for Food Production and Processing,*

the Program for Consumer Goods Production, and the Program for Export Development.

- *The opening of the economy through the issuance of the Foreign Direct Investment Law* in 1987 to attract foreign capital and to expand the markets for Vietnamese exports and imports.

With these measures, and the implementation of the policy of agricultural contracts and the expansion of industrial enterprises' autonomy, Vietnam had, by the end of the 1980s, recovered from the social and economic crisis and gained "initial important achievements" such as slowing-down of inflation, improvement in the supply of food and consumer goods, starting to attract foreign direct investments, the development of foreign trade, and the preparation of initial conditions for subsequent development.

Following the five years of recovery and stabilization, the Ten Years of Social and Economic Development Strategy (1991-2000) brought Doi Moi (Renovation) to a higher stage through the implementation of the *market mechanism* where *the role of the State was changed to be more indicative, with less direct intervention* or, in practical management, the State gradually reduced its direct intervention to focus mainly on public investments, whilst adopting more indirect management measures on private investments, using more market instruments such as tax and other incentives. The multi-economic-sector economy continued to be developed. Market interest and exchange rates were introduced.

During this period, two problems occurred: the drop of school enrolment and the lack of health care for the poor due to the reduction of Government spending for these two areas as the market mechanism was applied. After a few years under the new market mechanism, the Government realized that though the market economy has significantly improved the economic performance, it has not been in favour of education and health care unless the Government continued to take care of these areas, and for that reason, the Government again raised its spending for education and health care to re-activate the development in these two areas.

Equitisation has been increasingly strengthened year after year, though not as fast as a number of people expected, due to both social and economic matters. By the end of 2006, the number of equitized State-owned enterprises (SOEs) increased to 2,935, most of these were small and medium enterprises, the capital of each was less than VND10 billion (less than US$600,000 each), the total equitized capital was thus about 12% of total State-owned capital. This situation however continues to maintain the low rate of efficiency of the unequitized SOEs, hence it calls for further equitization. But such "further" equitization should hardly be realized in a "big bang" approach without big risks as it was planned to equitize 20 general corporations and 400 large and crucial SOEs by the second half of 2007.

One of the main reasons of the slow equitization in Vietnam is the protection of the interests of the workers. That is why the Government has been very careful about the "big bang" approach to avoid the laying off large numbers of workers, which would in its turn lead to the increased unemployment, and hence increased poverty. This again means that in Vietnam, each economic policy has always been placed under high social consideration.

The stock markets were opened in Ho Chi Minh City and Hanoi, mobilizing a relatively large amount of money provided by domestic enterprises, coming in from foreign sources and the money hidden under the people's mattress, with a total of roughly VND30,000 billion or US$20 billion, equivalent to about 1/3 of the current Vietnam's GDP. In 2006 and at the quarter of 2007, these markets turned to be so hot with a growth rate of over 70%, much higher than the normal rate in world stock market of around 20%. However, from the second quarter of 2007 to the first quarter of 2008, the sharp downturn of the stock markets and the higher rate of inflation shows new signs of an unstable and bubble economy which should not be overlooked. Though there is a great need of capital to serve the fast growing economy, the risk of an exploded bubble economy as the one that occurred in Asia in 1997-1998 should be avoided.

The *new industrialization and modernization strategy* no longer saw heavy industries as a fixed target or the key to development, instead it has gradually moved to base on comparative advantage. Under this strategy, industries have been diversified to include not only heavy industries, but also labour intensive and natural resource-based industries, like textile and garments, food production and processing industries, fishery and cash crops such as tea, coffee, rubber and others. Greater mobilization and allocation of resources for industries has been made, including both internal and external resources, through the implementation of various investment laws, the increase of savings and by both sources "the State and the people working together" under which all the sectors in the economy contribute their parts for the development of the country. As for the area of food production, fishery and cash crops, the Government encouraged scholars from research centres and universities to identify proper area of land and made plans for the development, offering incentives and assistances such as freeing of land taxes, signing of long-term land contracts for up to 99 years, or making low-interest rate loans through the Social Policy Bank or the Agricultural Bank, so the peasants would be able to grow crops and raise fish, either by their individual household efforts or by setting up farms.

In the external sector, the Government reduced the monopoly of State-owned trade companies and allowed companies from every sector, including private and foreign firms, to take part in export and import activities, cut all taxes on export and reduced taxes for intermediate goods such as materials for processing and assembled industries. These policies motivated companies and households from all sectors to increase their production for export, hence leading to the quick expansion of export of about 20% per annum and reduced the trade deficits.

Though Vietnam decided to develop the market economy, under the term "socialist-oriented market economy", it continued to apply *the concept of socio-economic comprehensive development in which economic growth is combined with social equity*