CDPR Discussion Paper 2102

United Nations Development Programme
Regional Programme for Asia
On the Macroeconomics of Poverty Reduction

Case Study of Viet Nam:
Seeking Equity within Growth

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Draft: 16 August 2002

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Executive Summary

Chapter One: Vietnam in Transition

Introduction

The Purpose of this Study

Accumulating evidence suggests that growth in the developing world over the last two decades has been slower than for the previous twenty years, and accompanied by increasing inequality. The slower growth was not the case for many of the Asian countries before the financial crisis of 1997, but increased inequality appears to apply to the region with few exceptions. Increasing inequality has been particularly notable for Viet Nam, a change we consider below in some detail.

Concern over increasingly inequitable growth promoted the United Nations Development Programme to initiate its Asian Regional Programme for Macroeconomic Policy for Poverty Reduction. The programme's emphasis is on policies to generate a growth pattern which, at the least, would be less inequitable, and, at best, would redistribute the gains from growth toward lower income groups. The fundamental point of departure for the country studies within the programme is that 'trickle down' growth accompanied by 'targeted' programmes for the poor is not satisfactory by either social or economic criteria. There are obvious reasons for relegating such an approach to the past. First, increasing inequality after some point can prove dysfunctional, resulting in social exclusion, crime, and political unrest.

Second, economic growth is desirable in and of itself, though increasing the rate of growth is not always desirable or economically rational. Increasing growth has an opportunity cost (most obviously in foregone consumption). In all countries, the growth target set by public policy should be linked to judgements about the social rate of time preference.[1] Rational public policy maximises the growth rate subject to the constraint of opportunity cost; seeking to maximise the growth rate unconstrained by allocative considerations is the domestic equivalent of merchantilism. Thus, a poverty reduction strategy should be developed through a rational consideration of the

[1] This was demonstrated by neoclassical growth theory some four decades ago. See, for example, the seminal article by Swan (196x).

resource tradeoffs between the costs and benefits of increasing the growth rate and the costs and benefits of redistribution (see Box 1, *Distribution Matters in Viet Nam*).

Box 1: Redistribution Matters in Viet Nam

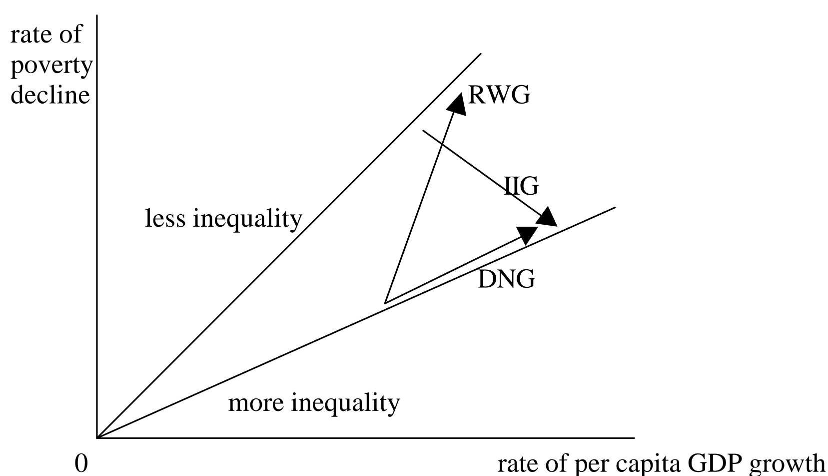
Contrary to what the prevailing orthodoxy might suggest, income redistribution can have a major impact on poverty. The validity of this general principle is demonstrated in the diagram below. The relationship between economic growth and poverty reduction is determined by the overall distribution of income and the distribution near the poverty line. The economy-wide distribution sets the potential for redistribution, while the distribution near the poverty line determines the impact of a redistribution on the poor. If the poor are clustered just below the poverty line, then a given distribution will reduce poverty more than if most of the poor are well below that line.

The diagram treats the distribution near the poverty line as an extension of the distribution function for the entire population. The steeper line reflects a more equal distribution of income. Three possible growth paths are shown. On the basis of recent empirical work (Kornia 2001), it would appear that a common outcome in the 1990s was growth with increased inequality (line GII). In this case, the poverty- reducing effect of growth declines. Alternatively, growth can be distribution neutral (argued by Dollar & Kraay 2000), and the rate of poverty reduction is constant as the economy expands (line DNG). Most favourable for the poor is redistribution with growth (line RWG), in which any growth rate is associated with more poverty reduction.

The practical importance of these logical possibilities is substantial for Viet Nam. On the basis of reasonable assumptions, in 2000, a rate of growth of one percent per capita that was distribution neutral would reduce poverty by .6 percentage points. That same rate of growth, were it distributed in equal absolute amounts across all households, would reduce poverty by 1.2 percentage points. In other words, with regard to poverty reduction, a one percent per capita redistributive growth is equivalent to a distribution neutral growth rate of two percent.

The difference between poverty reduction with distribution neutral growth and redistributive growth has important resource implications. To achieve the same poverty reduction as a one percent increase in redistributive growth, DNG must rise by an additional one percentage point. Assuming the aggregate capital-output ratio in Viet Nam is 3.0, this increase would require a rise in net investment of three percentage points. By any reasonable estimate of the administrative costs of redistribution, the opportunity cost of reducing poverty through redistribution should be less than for growth alone.

Alternative Growth Paths and Poverty Reduction



For further discussion, see Dagdeviren, van der Hoeven & Weeks (2002).

Common Analytical Mistakes about Transitional Economies

Prior to considering growth and poverty in Viet Nam, it is necessary to dispel a few common analytical fallacies about transitional economies. The first step is to clarify terms. It is unfortunate that in the literature on transitional economies, terms which had previously had straight-forward, dictionary-based meanings, have to come to assume heavy ideological implications. One of the most important of these, and particularly relevant for Viet Nam, is 'reform'.

Strictly speaking, a 'reform' is a policy change of any type. For example, a trade regime can be reformed through tariffs or quotas to alter the level and composition of imports; similarly a trade regime can be reformed by cutting tariffs and eliminating quotas. However, in the discourse of current economics, 'reform' always mean actions of the former type, and is by definition a 'good' thing. Thus, those in favour of the latter are described are called 'reformers', and viewed as progressive (typically judged to reflect the 'national interest'), while those in favour of the former are branded as 'anti-reform' and reactionary (typically judged as motivated by 'special interests'). These value-laden terms are misleading, because, for example, at times it may be rational to for tariff reduction, and other times rational to oppose it. This study avoids use of 'reform', in favour of specific terms: tariff reduction, enterprise restructuring, financial sector reorganisation, etc.

Other ideologically-abused terms are 'open' and 'closed' economies, 'controlled' and 'liberalised' economies, and perhaps most value laden of all, 'market-friendly'. To take but one example, the Vietnamese economy is extraordinarily open if one describes openness by the ratio of trade to gross domestic product. However, many would judge it as relatively closed because of its tariffs and non-tariff barriers to trade. Thus, attempting to encapsulate the trade position of Viet Nam as 'open' or 'closed' is an essentially ideological exercise that provokes controversy without providing insight. Controversy with insights can be achieved by debating specific policy measures without assigning them value-laden labels.

Perhaps the most fundamental analytical mistake in analysing transitional economies is to treat centrally planned economies as if they were more extreme versions of market economies with a large public sector and numerous regulatory

interventions. The two types of economies are not on the same analytical spectrum. The purpose and outcome of centrally planned economies was to eliminate private ownership and, by doing so, to eliminate the market as a regulating force in society to the extent possible. In such economies, prices were not 'distorted', because they had no allocative function. They served merely as accounting tools. The purpose and outcome of regulated market economies was and is to manage and control private markets. The effect of regulatory interventions can accurately be described as 'distortionary' if one accepts neoclassical general equilibrium welfare economics.[2]

The qualitative distinction between centrally planned and regulated market economies is essential to understanding transitional economies. Such economies pass through two phases of policy change before an market based economy is institutionalised: first, there is the radical shift from central planning (the term 'controlled' economy strictly applies) to market based (a 'regulated' economy); and, second, public policy then addresses the question of what degree of public intervention is required for effective functioning of the new, market economy. We shall refer to these two phases as the regime change transition and the regulatory transition. In Viet Nam, some confusion arises because the term *dio moi* is sometimes used to refer to both phases. The fundamental policy difference can be illustrated by referring to public sector enterprises (aka, state owned enterprises, SOEs). Within central planning, enterprises (the modifier 'state' is redundant) are part of an integrated system of non-market production, in which market demand, even household demand, is largely irrelevant. In a regulated market economy, state enterprises (now the adjective becomes necessary) are part of a market system. The central government may grant SOEs monopoly positions, protect them through trade policy, and extend them subsidies, but such enterprises remain market-based.

The mistake of not distinguishing between regime change and regulatory change gives rise to a closely related one, concluding that if regime change stimulated growth, then a rapid programme of deregulation will bring more growth. When the

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[2] The term 'distortion' has meaning only in relation when one specifies a non-distorted outcome. To take an analogy, one can say that mirrors in carnivals distort one's reflection because a true image can be defined scientifically. Similarly, a price is said to be distorted if it varies form the price which would prevail under conditions of full meployment general equilibrium. However, if that equilibrium is not unique, or if one does not accept the analytical framework that generates it, then the term 'distortion' loses objective meaning. Rejecting the term 'distortion' does not stop one from describing prices and allocation to be dysfunctional, but the judgement is empirical and specific, not general and theoretical.

system of central planning collapsed in Europe and Central Asia, these systems were defined as inefficient in all aspects, and all problems during the central planning period were the result of those inefficiencies. It was a short step to conclude that all subsequent problems of transitional countries result from the lingering effects of central planning. The dominant tendency was to presume that post-central planning problems would not arise from inappropriate changes in regulatory policies ('reforms'), or from changes made too hastily or in the wrong order. This approach ignores the distinction between regime change and regulatory change. Market deregulation is not the continuation of dismantling central planning, and the impressive gains in Viet Nam from the latter would not necessarily be associated with the former.

Finally, one must avoid the error of 'policy optimism', which is especially virulent in transitional countries. We support the common view that the Vietnamese government managed the process of regime change notably well. However, at many points in time the growth rate of a country may be only loosely related to its policies, unless those policies are unusually dysfunctional. Many factors beyond the control of the government influence growth, such as the state of the international economy, weather, and the efficiency of national markets. With regard to the latter, 'good policy' may fail to achieve its intended outcome because the instruments available to the government have limited impact on private decisions. Further, there is the fundamental issue of the stochastic element in policy. Assume that the government seeks to achieve an inflation rate not higher than five percent. It sets monetary policy such that the mean outcome will be two percent. If the standard deviation associated with the policy outcome is three percentage points, then about one-third of the time the outcome will be 'bad', even though, technically, the policy was 'good'. When this report makes its recommendations, it should not assign to the government more influence over the economy that its policy instruments, exogenous environment, and efficiency of markets allow it.

Analytical Framework

Inequality in Transitional Societies

As in all policy analysis, the goal sought by this study is human welfare. The most important outcomes affecting this welfare are levels of household income, inequality and poverty. Growth, trade, and structural change are instruments to achieve those outcomes. In the context of human welfare, per capita income provides limited information, especially since the more unequal the distribution of income, the less accurately it approximates a measure of the welfare of the majority of the population.[3]

Our policy judgements and recommendations on the desirable level of inequality derive from the context of Viet Nam as a transitional economy. Centrally planned economies had low levels of inequality, because prices and incomes were set administratively to generate that outcome. Major items of household subsistence were provided outside mechanisms of exchange, notably housing, education, and health care.[4] Further, employment was guaranteed for all, though much of it may not have been productive. By contrast, exchange based on private ownership of assets is the fundamental distribution mechanism of market societies, even ones with a large public sector. For reasons beyond the scope of this study to develop, an unequal distribution of assets is inherent in a market economy.

Therefore, one should expect asset and the associated income inequality to increase during the transition from central planning to a market society. Part of this increase reflects the inherent inequalities of market societies, and is essential to their effective functioning. Another part arises from an emerging differential access to assets, services, information, political power, and, it should be added in light of corporate behaviour in the developed countries, from fraud and theft. Thus, the increased inequality associated with the transition from central planning to the market

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[3] That is, the more skewed the distribution of income, the greater the difference between mean and median income, by definition.

[4] The fact that the level of income inequality in socialist economies was quite low is not controversial. Relative magnitudes are indicated by calculations that show that the Gini coefficients in the early 1990s for twelve European and Central Asia countries in transition were all lower that for thirty-eight developing market countries, with the exception of only two, Sri Lanka and Rwanda (Dagdeviren, van der Hoeven & Weeks 2002, 406-407).

can be divided conceptually been that which is functionally necessary and that which is not. Further, that increased inequality which is not necessary for the operation of a market system can be divided between that which is judged by society to be acceptable and that which is not. For example, it might be decided by explicit or implicit social consensus that inherited wealth is acceptable, even though much of it might not be necessary on strictly technical and functional grounds.

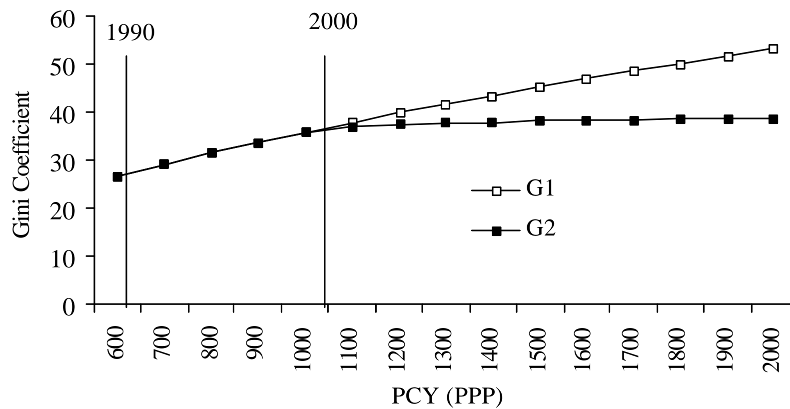
Among the many social choices unavoidably presented to Vietnamese society is the degree of inequality that would be acceptable. All societies face this choice, but in established market societies the division of political power associated with a country's degree of inequality may restrict the debate over the issue. In transitional countries, the situation is quite different for two reason: first, asset and income distribution undergo rapid change, which major impact on all other social policies and choices; and, second, the temporary and transitional nature of distribution makes it amenable to public policy.

The social choice confronting Viet Nam is illustrated in Figure 1, which calibrates a measure of degree of income inequality on the vertical axis (the Gini coefficient in this case), and per capita income in Purchasing Power Parity US dollars of 2000 on the horizontal. As indicated in the diagram, Viet Nam's income inequality in 1990 was quite low (a Gini coefficient of about .25).[5] By 2000, the Gini had risen to about .35, suggesting a substantial increase in inequality. Were inequality to increase in the future as it has done in the past (curve G1 in Figure 1), Viet Nam would reach a per capita income (PPP) of US$ 2000, with a Gini coefficient of over .5, which would be similar to that of Thailand in the early 1990s. This would represent a low level for Latin America, but quite high for Asia. The curve G2 represents an alternative scenario, in which the rate of increase of inequality progressively slows, and inequality converges toward a Gini of .4, slightly below that of the Philippines in the mid-1990s.

[5] As discussed in Chapter 2, in Viet Nam there are limited data with which to calculate measures of inequality, and there are no such data for 1990 and 2000. These years are chosen for illustrative purposes, and the Gini coefficients assigned to them are what one would expect from the years with data.

Figure 1:

Alternative Growth Paths of Inequality for Viet Nam



Since determine by the institutions of society determine the income distribution in any country, one can treat the alternative growth paths as converging to a 'steady-state' degree of inequality. The key question for social policy, and for this study, is, first, which path of inequality and growth is implied by the institutions of Vietnamese society. If those institutions would result in a steady-state degree of inequality that is contrary to social consensus, then the policy issue is how they might be changed.

It might be argued that in the early 2000's, inequality was relatively low in Viet Nam.[6] Thus, socially excessive inequality can be addressed by policy once it is reached, following the principle of 'sufficient to the day is the evil thereof'. There are several problems with this approach. First, the information needed to identify changes in distribution typically reach policy makers well after the inequality has been established.[7] Second, and following from this, once a high degree of inequality has established itself, the power relations implied by it may make policy action politically difficult or impossible without social strife. This would seem the lesson from Latin America, where inequalities are huge and policies to alter them have been ineffective through democratic processes. Third, virtually all other social and

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[6] This view, which was expressed by several officials from both donor agencies and the government, recalls the well-known joke in which one woman says to the other, 'how is your husband?', and receives the reply, 'compared to what?'

[7] The results of living standards surveys typically are not in usable form until a year or more after the surveys were carried out.

economic policy action is based on the principle of implementing ameliorating policies before an undesired outcome is realised. For example, the multilateral financial institutions advise governments not to wait to act until excessive inflationary pressure manifests itself, but to take action in anticipation of such pressures. The same principle would apply to the prospect of excessive inequality.

From the experience of East and Southeast Asian countries during their period of rapid growth, 1970-1996, it would appear that the growth rates to which Viet Nam aspires in the future are consistent with the level of inequality currently prevailing in the country. Thus, there is no obvious argument for greater inequality on the grounds that it would be necessary to maintain a strong growth performance. On the other hand, arresting the growth of inequalities would contribute to social cohesion, and growing inequality would cause the poverty reducing effect of growth to decline.

In consequence of the foregoing considerations, the recommendations of this study are based on the policy judgement that inequality in Viet Nam is close to its socially optimal level, and mechanisms are required to ensure that inequality reaches a steady state not far above that level. Even in a low-income country, which Viet Nam is, fiscal and monetary policies, trade policy, and the structuring of state enterprises and the financial system can be effective instruments to achieve this objective.

Dynamics of Poverty in Transitional Societies

The distinction between the phase of regime change and the phase of regulatory change provides insights into the dynamics of poverty in Viet Nam. During the central planning period, Viet Nam was an extremely low income country, though characterised by relatively high indicators of human development (e.g., life expectancy and literacy). The poverty of that period was not of the type that a market economy manifests. In order to understand the dynamics of poverty in Viet Nam, it is necessary to distinguish between two different sources of poverty.

Poverty before Viet Nam's regime change might be called 'basic poverty', which resulted from the country's very low level of development. The rapid, market-based growth of GDP that followed the regime change created new income generating

activities, especially in trade and services, and also redistributed income from the public sector to households, through the reorganisation of agricultural production from administrative allocation to market control. The vast majority of Vietnamese enjoyed rising incomes as a result of the fundamental reorganisation of economic activity. The impressive fall in the national poverty level, discussed in detail in Chapter 2, resulted primarily from economic growth as such. The government used various targeted welfare programmes to protect and subsidise those households not benefiting from this process, or benefiting only marginally (for example, the Hunger Eradication Programme and programmes for 'disadvantaged' areas). This process, 'a high tide raises all boats', is the typical consequence of economic growth, and the tidal metaphor is more accurate than the frequently used term, 'tickle down'. One would expect basic poverty to decline towards a steady-state level determined by the social mechanisms that determine the exclusion of household from the benefits of growth.

Market-based economic growth also generates poverty, especially in transitional countries. Unlike in low income market societies, prior to the regime change Viet Nam had little or no poverty resulting from landlessness or unemployment. Fundamental to the transformation of the economy to market-regulated was a reallocation of assets on the basis of private ownership. On the one hand, this created new mechanisms from private income generations; on the other it produced a phenomenon new for Viet Nam, poverty resulting from loss or lack of access to productive assets. Gainful employment became dependent upon use rights to land, employment by those who had productive assets, or access to credit for self-employment. The poverty resulting form unemployment and landlessness might be called 'market generated' poverty.

This distinction between basic and market generated poverty can be used to interpret the impact of economic growth on poverty reduction. On the positive side, growth reduces basic poverty by raising incomes in existing economic activities, and creates new activities into which people are drawn. On the negative side, inherent in the creation of new activities are allocative changes that generate unemployment and landlessness. A schematic presentation of these two effects is shown in Figure 2 (where BasPov is basic poverty, MarPov is market generated poverty, and TotPov is the sum of the two). The vertical line labelled '2000' is an approximate indication of

poverty levels by that year (levels are sensitive to the income measure used for the head count estimation, see Chapter 2).

The rapid fall in poverty during the 1990s was the result of economic growth reducing basic poverty, while the emergence of market based poverty was incipient. Whether poverty levels will continue to decline with economic growth depends on two broad processes: 1) the steady state level to which basic poverty will decline, which might also be called 'structural poverty'; and 2) the balance between market-based employment creation and market-generated landlessness and unemployment. These latter processes are the primary focus of this study. From this analysis it follows that the rapid poverty reduction associated with economic growth of the 1990s is not a trend that can be projected into the next and subsequent decades. Increasingly, the relationship between poverty reduction and growth will reflect the balance between employment generation and poverty-generating structural change.

There are several reasons to anticipate a fall in the elasticity of poverty with respect to growth. In the densely populated areas of rural Viet Nam, a shift from rice cultivation to 'higher value added crops' *may* result in land and labour use systems that reduce employment per unit of land. The restructuring of state enterprises, including their privatisation, could generate considerable unemployment, especially if implemented rapidly. These and other structural changes, which are discussed in subsequent chapters, create the possibility that rising household incomes for the population as a whole could be accompanied by a period of rising poverty levels.

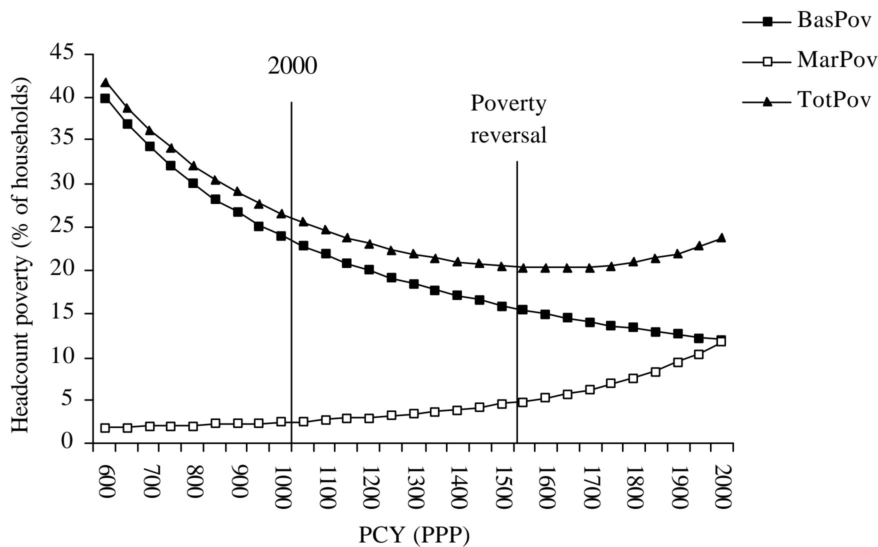
This possibility is indicated in Figure 2 by the area to the right of the line, 'poverty reversal'. The diagram should not be taken to suggest that growth is not poverty reducing. The point is that in a transitional society, structural changes, some generated by public policy, some the inexorable outcomes of impersonal markets, can result in a period of substantial labour dislocation that overwhelms the poverty reducing effect of growth. Further, if the structural change is associated with income growth biased against lower income deciles, to unemployment and landlless poverty could be added the 'working poor'.

Poverty reduction in Viet Nam in the 1990s was impressive, generated by rapid growth based on an equitable distribution of land, *ad hoc* limits to private concentration of income, and social safety nets. Sustaining poverty reduction may require a more focused policy combination. Market-generated poverty is considerably easier to prevent that to remedy once it is institutionalised, because it

derives from the distribution of assets and power associated with that asset distribution. Therefore, Viet Nam has a great advantage that most of the countries covered by the Regional Programme do not: with market-generated poverty in its incipient stage, it is open to the government of Viet Nam to 'nip it in the bud'.

Figure 2

Poverty and Growth During Viet Nam's Transition:
A possible scenario



Growth Prospects for Viet Nam

Of the wealth of confusion about the relationship among growth, distribution and poverty, perhaps the richest vein of obfuscation is the debate over whether growth or redistribution are 'more important'. In a market economy, growth always involves redistribution, because the price system associated with a market economy is a mechanism of resource allocation, and the reallocation of resources results in the redistribution of incomes. Thus, the issue is not redistribution or growth, but whether

growth generates a redistribution which is neutral, biased against, or biased in favour of the poor.

Anticipating likely changes in income distribution and economic growth are central to projecting poverty reduction in Viet Nam. Applying the distinction between regime change and regulatory transition facilitates assessing the growth potential of the economy in the medium and long term. While centrally planned economies had periods of rapid growth of production, the controlled economy is characterised by the suppression of the dynamic flexibility of a market economy. As a result, the potential exists for a rapid growth 'spurt' immediately following the regime change, as the dead weight burden of the controls is shed. This arises from a fundamental change in the incentives for production, organisational restructuring, and access to previously unavailable technology. In practice, very few centrally planned systems realised this growth spurt, perhaps only China and Viet Nam. During the growth spurt, an economy can achieve a rate of expansion well in excess of its inherent potential, which is determined by the growth of technology, capital accumulation, growth of the labour force, and external conditions.

Slowly or rapidly, the advantages of regime change are institutionalised, and the economy will seek a sustainable growth rate dictated by its inherent potential. The rapid growth of the Vietnamese economy in the 1990s should not be viewed as its sustainable rate that was interrupted by the Asian financial crisis, to which it will return in due course. Rather, thee growth potential of the economy should be viewed as presented in Figure 3. From the late 1980s to the mid-1990s, the economy grew impressively on the basis of a sound strategy of regime change and the shedding of the deadweight losses associated with central planning (dead weight loss phase, DWL), and this was followed in the 1990s by a slowing of growth as the economy adjusted to the new institutional structure ('Adjustment Phase'). In the present decade, one can anticipate a further decrease in growth, towards the country's long term potential.

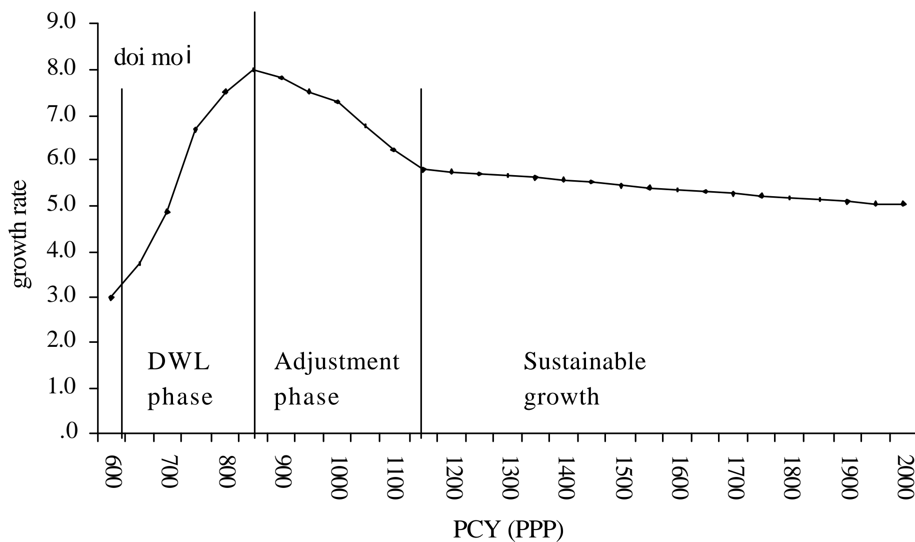
While one cannot precisely specify the sustainable long-term growth rate, the factors determining it can be identified. First, there is the rate of capital accumulation and the capital-output ratio associated with that accumulation. On the basis of historical experience in the Asian region, this factor will probably set a growth rate in the range of five to eight percent. Complementary, rather than additive, will be acquisition of more advanced technology and raising the skills of the labour force.

However, external conditions, and particularly export demand, are likely to be considerably less favourable that during the rapid growth period of the so-called Asian miracles, at least in the medium term. The world economy entered a recession in 2001, with the pace of recovery uncertain. As a result, growth of world trade declined, and foreign direct investment flows fell sharply (the down over four percent and the latter over fifty percent in 2001 compared to 20000). Viet Nam is unlikely to be unaffected by these declines. Thus, an optimistic but realistic assessment of Viet Nam's growth potential in the medium term would be about five percent per annum.

This drop in the country's sustainable growth rate implies that poverty reduction will be slower, even should its elasticity with respect to growth not decline (see previous sub-section). This likelihood makes the consideration of a pro-poor growth policy, including redistributive mechanisms, all the more timely.

Figure 3

Conceptualising Viet Nam's Long-term Growth Potential



Chapter 2: Macro Economic Performance, Inequality and Poverty Since *Doi Moi*

A. Growth, trade and Structural Change

covers 1980-2002; per capita income, export and import performance, sectoral distribution of GDP, urbanisation, population growth, changes in poverty (statistics only & brief discussion), inequality (size distribution of income, regional differences, brief)

B. Sources of Growth

As noted in the previous section, the strong growth performance of the Vietnamese economy was accompanied by an even stronger export performance. For most observers this represented more than coincidence, resulting in the conclusion that the transitional growth performance of the Vietnamese economy was export-led, and continued to be through the 1990s.

Therefore, it is somewhat surprising to read the following in the July 1999 IMF report, *Vietnam: Selected Issues*,

> During the high-growth period…the main impetus to growth came from private consumption and FDI inflows…The external sector, by contrast, made *a large negative contribution to growth* in this period. This suggests that the mid-1990s were a period of domestic demand-led growth…
>
> Exports were growing [during 1993-97] rapidly…but were outpaced by growth in imports. (IMF 1999, 5, 7, emphasis added)

The report goes on to reach a gloomy conclusion,

> In summary, the structure of output growth in the mid-1990s has been relatively unfavourable: growth has been to a large extent generated by import-substituting and nontradable industries. (IMF 1999, 10)

The rather surprising conclusion reached by the IMF was that an economy that enjoyed an annual average growth rate of exports in constant prices of 28 percent (for both goods and goods and services) was insufficiently export oriented. It is instructive to inspect how the IMF reached this unexpected conclusion. The method

employs the standard national income identity. If we assume inventory change to be zero, then by definition GDP is equal to the sum of consumption, investment, government spending, and exports minus imports, or:

$$GDP = C + I + G + (X - M)$$

The report treats these as additive, and (X-M) as a single term (see IMF 1999, p. 7). For 1993-1997, the period for which the IMF growth calculation is made, (X – M) was negative. Therefore, 'the external sector…made a large negative contribution to growth'. The conclusion is invalid for several reasons. Were the conclusion to be accepted, it would follow that the external sector contributes to growth if and only if there is a trade surplus. Accepting that argument is to endorse the discredited eighteenth century merchantilist position, that trade is good for a country only if it results in the next accumulation of foreign exchange.

One need not revert to merchantilist to assess Vietnam's growth, because the procedure is theoretically invalid. First, the calculation does not refer to the 'contribution to growth' (title of the table on page 7), but to the components of effective demand; a contribution to growth analysis would, strictly speaking, require consideration of the supply side. Second, it is not valid to treat imports to be the result of exports, which is implicitly assumed by combining exports and imports into a single term. In graphical presentations of the simple Keynesian model the external sector is sometimes presented in a single term, (X – M), but it is a reduced form, not a full behavioural specification. Both theoretically and practically, one knows that imports result from all the categories of effective demand, not exports alone. Indeed, the component of import demand generated directly by exports is typically smaller than for either consumption or investment.

The interaction between imports and the other parts of effective demand point to a third problem with the IMF method. While the components of effective demand are additive for accounting purposes, one knows that they are not independent of each other. When considering changes in GDP it is not valid to write the following total differential and treat each component as independent of the others,

$$d[GDP] = d[C] + d[I] + d[G] + d[X - M].$$

In all macro analysis, Keynesian, neoclassical or new classical, it is recognised that consumption and imports are a function of GDP itself (as well as other variables). If one assumes interest rates, expectations, and real wealth to be given, then the GDP identity can be converted into a simple behavioural model:

$$GDP = \alpha[GDP - tGDP] + I + G + X + \beta GDP$$

Where α is the propensity to consume out of disposable income, t is the tax rate (so [GDP – tGDP] is disposable income), and β is the marginal propensity to import. This simplifies to:

$$GDP = [I - G - X]/[1 - \alpha + \alpha t + \beta]$$

The denominator of the expression on the right is the so-called multiplier. For changes in GDP,

$$\Delta GDP = \Delta[I + G + X]/[1 - \alpha + \alpha t + \beta]$$

And the growth rate can be written as:

$$y = [S_i i + S_g g + S_x x]/[1 - \alpha + \alpha t + \beta]$$

Where the S symbols stand for shares in GDP, and the small letters are the growth rates of GDP, investment, government consumption, and exports, respectively. Using this model, one can investigate the sources of effective demand in the Vietnamese economy. We do so over the period 1995-2000, because for these periods there are internally consistent statistics for all the national income aggregates required for the calculations.[8] The result is shown in Table 2.x. First, we can note that the multiplier for the economy over these years was quite low, 1.08 (a one unit increase in autonomous expenditure increases in GDP by 1.08 units). This low value reflects the high marginal propensity to import, of slightly over three-fifths. A low multiplier resulting from a high propensity to import is neither good nor bad. It tends to be a characteristic of low-income countries undergoing rapid industrialisation. The underdeveloped nature of the industries producing intermediate and capital goods dictates a high import coefficient.

Inspection of the table shows that growth during 1995-2000 was strongly export-led, in the sense that two thirds of final demand arose form export growth. Aggregate investment generated an additional twenty-one percent, with government current expenditure eleven percent (with inventory change the residual category). The contribution of aggregate investment less from the central government budget than from the category ‘other’, which includes capital expenditure by state owned enterprises, joint venture firms, and the private sector as such. The second column in the table converts these percentages into components of the aggregate growth rate of

[8] The table on which the IMF calculation is based does not include gross national savings or government revenue.

6.7 percent per annum. With regard to the components of net expenditure, non-total investment minus private savings was negative (contractionary), fiscal policy was expansionary on current expenditure (a current account deficit, expansionary), and exports minus imports were negative (contractionary).

Data are insufficient to repeat the exercise for 2001, but one knows that for the entire year exports increased by only four percent in current value, and declined in the last two quarters (World Bank 2002, p. 10). This was slightly below the GDP growth rate of 4.8. Since exports were about 55 percent of GDP in 2001, it follows that exports contributed about 45 percent of final demand. Two important factors will determine the contribution of export growth to overall growth in the coming years, one positive and one negative. On the positive side, because exports grew faster than GPD during the 1990s so that its share in GDP rose, a given rate of growth of exports will impart a greater growth impetus than before. For example, in 1995 a ten percent rate of growth of exports would have contributed 3.3 percentage points to the aggregate growth rate, and 5.5 percentage points in 2000. On the negative side, in the medium term the world economy is unlikely to recover sufficiently to generate the export growth of the 1990s.[9]

If during 2002-2010 Vietnam's export growth sustains and average of ten percent per annum, then an aggregate growth rate of seven percent is both feasible and likely (requiring growth of other sources of demand of less than four percent). In the more likely case that exports grow at seven percent or less, investment and government current expenditure must expand considerably faster than in the past.

On the basis of our analytical framework presented in Chapter One, we conclude that the export performance of the 1990s cannot be repeated. Those extraordinary rates were part of the once-and-for-all growth gains were associated the transition from central planning to a regulated market system. Further dampening export performance will be the state of the world economy. Thus, if a seven percent rate of growth is achieved, it will not be export led to the degree it was in the 1990s. As the government of Vietnam sets its growth target, it must seek sources of demand to replace the previously dominant role of exports.

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[9]A World Bank report on Vietnam (World Bank 2002, p. 4) notes that 'The deceleration in world GDP growth in 2001 was the sharpest in the last forty years, except for the first oil crisis in 1974. This slowdown coincided with an unprecedented 14 percentage point deceleration in world trade, from 13 percent growth in 2000 to a 1 percent contraction in 2001.' It goes on to the obvious implication, 'Vietnam's economy was adversely affected by these development *due to its openness…*' (p. 5, emphasis added).

This shift in economic strategy is a necessary that can prove to a virtue for poverty reduction. Various government instruments could be used to make foreign direct investment more employment generating, which would be poverty reducing if its labour market effect is to raise the average level of incomes of the poor. Two factors limit the extent to which this would be realised. First, as for exports, direct investment inflows have been extraordinarily high, again reflecting the particular nature of the transitional period. Second, there can be little doubt that such investment would be concentrated in the most developed regions, so the impact on poverty would be indirect, indeed.

Central government investment could be expanded to replace the lost impetus from export growth, used to enhance (crowd-in) employment-generating foreign investment, while channelled to projects that are directly poverty reducing (pro-poor investment). This benign combination would require conscious and purposeful planning of central and regional government investment. Complementary to this, there could be a reorientation of government current expenditure away from targeted 'safety net' spending to activities that result in sustainable poverty reduction.[10]

The expansion of government investment and current expenditure should face no serious budget constraint. The constraints that bind some other governments in the region, high service payments on internal and external debt (especially Indonesia), are not serious in Vietnam. In 2000, total government expenditure was 24 percent of GDP, and total revenue 21 percent (with a current account surplus of over four percent of GDP). A percentage point rise of three-to-four percent for both would be feasible, and not out-of-line with the size of the public sector in other countries of the region (Weeks 2001).

Sound policy and good fortune combined to make Vietnam's transition to a regulated market economy relatively smooth with impressive growth rates. The extremely rapid growth of exports has resulted in an economy that is at or above its optimum ratio of tradable to non-tradable goods. For the economy to continue to be export-led, in the sense of the export share rising, would border on merchantilism. Changes in the trade regime should be aimed at altering the export composition and reducing imports, rather than promoting exports.

[10] Such a reorientation could be part of the changes in fiscal rules that involve greater autonomy to provincial authorities (World Bank 2002, p. 18).

If we compare across countries, Vietnam's export share far exceeds what one would expect form its level of development and the size of the country.

Table 2.x: Sources of 'Growth': Vietnam, 1995-2000

Category	Macro-Analytical Percentage	Growth rates
Private consumption	napp	napp
Total Investment	**20.6**	1.4
Public budget	8.2	.5
Other	14.0	.9
[inv'tory change]	1.6	.8
Public current expend	**11.2**	.5
Net External	napp	napp
Exports	**66.6**	4.5
Imports	napp	napp
Total	100.0	6.7

Notes:

marginal propensity to consume = .69
marginal propensity to tax = .12
marginal propensity import = .61

Source: National income aggregates from IMF August 2000, pp. 3, 4, 16; and IMF July 2002, pp. 30 and 33.

Table 2x: Low Income Countries, Average Export/GDP Ratio, 1995-1999

	Countries number	Share>VN	Average
Africa	30	3	24.0
Asia	7	0	21.9
Latin America	2	0	23.7
In transition	9	3	36.0
	48	6	26.1
Vietnam			41.9

List of countries with shares > Vietnam, excluding petroleum exporters & those without data, population in millions in parenthesis, 1999:
Africa: Cote d'Ivoire (15.5), Gambia (1.2) & Mauritania (2.6)
In transition: Moldova (4.3), Mongolia (4.8), & Ukraine (50.0)
Veitnam, population: 77.5

B. Changes in Ownership Structure

state and private ownership, using standard and new categories; analysis of changes & discussion of possible trends for 2002-2015

C. Social Structure and Emerging Civil Society

How much have the political actors have changed in VN since doi moi? Brief discussion of important political actors and the process by which these actors influence public policy

Chapter 2: Policy, Inequality and the Characteristics of Poverty and the Poor

A. The CPRGS, Millennium Goals and Public Policy

summary of IDT/MDG report, with some additional comments, summary and analysis of CPRGS

B. Inequality and Characteristics of the Poor

based on household living standards surveys; size distribution of income, regional inequalities, changes in inequality; description of the poor; critical analysis of the survye results (known biases, possible biases, problems of intemporal comparison); box on poverty lines (perhaps repeat of box on page 8 of IDT/MDG report, with additional comments)

Chapter 3: A Pro-poor Development Strategy

A. Pro-poor Growth

will be written later, if necessary; if a project synthesis report covers the analysis in detail, this chapter will become a brief introduction to to the VN case study;

B. Policies for Pro-poor Growth

public investment, financing investment, pro-growth monetary & fiscal policy, exchange rate policy, external and domestic debt policy (in general, not treating financial issues)

Chapter 4: Fiscal Policy & Monetary Policy for Pro-poor Growth

A. Fiscal Policy

Fiscal performance since *doi moi*, increasing fiscal revenue, increasing the progressiveness of the tax structure, distributional implications of expenditure;

B. Monetary Policy

Non-financial aspects of monetary policy – interest rates and credit

Chapter 5: Trade Policy and Poverty

A. Changes in the trade regime, 1985-2002

basic regime change; NBT, tariffs &commericalisation of foreign exchange; commits under ASEAN and WTO

B. Trade liberalisation and the Poor

impact of further trade liberalisation on the poor (urban and rural); employment effects in agriculture and manufacturing; impact on SMEs (including discussion of whether micro enterprises and SMEs are more/less competitive than large enterprises, which probably varies by sector)

Chapter 6: Financial Sector Reform and SOE Restructuring

A. Gains and Dangers of Financial Restructuring

capital account liberalisation, bank restructuring in other countries, potential dangers; exchange rate policy

B. Reorganisation of the Banking system

current credit policy, 'bad' loans, recapitalisation plans, credit for the poor & SMEs;

C. State Enterprise Restructuring

employment effects, implications for exports, corporate governnace, including role of trade unions, relaitonship to FDI and private sector

Chapter 7: Conclusion

Annex 1: List of People Interviewed and Consulted

Annex 2: Data and Statistics

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