

INSTITUTE OF SOCIAL STUDIES

Working Paper Series No. 199

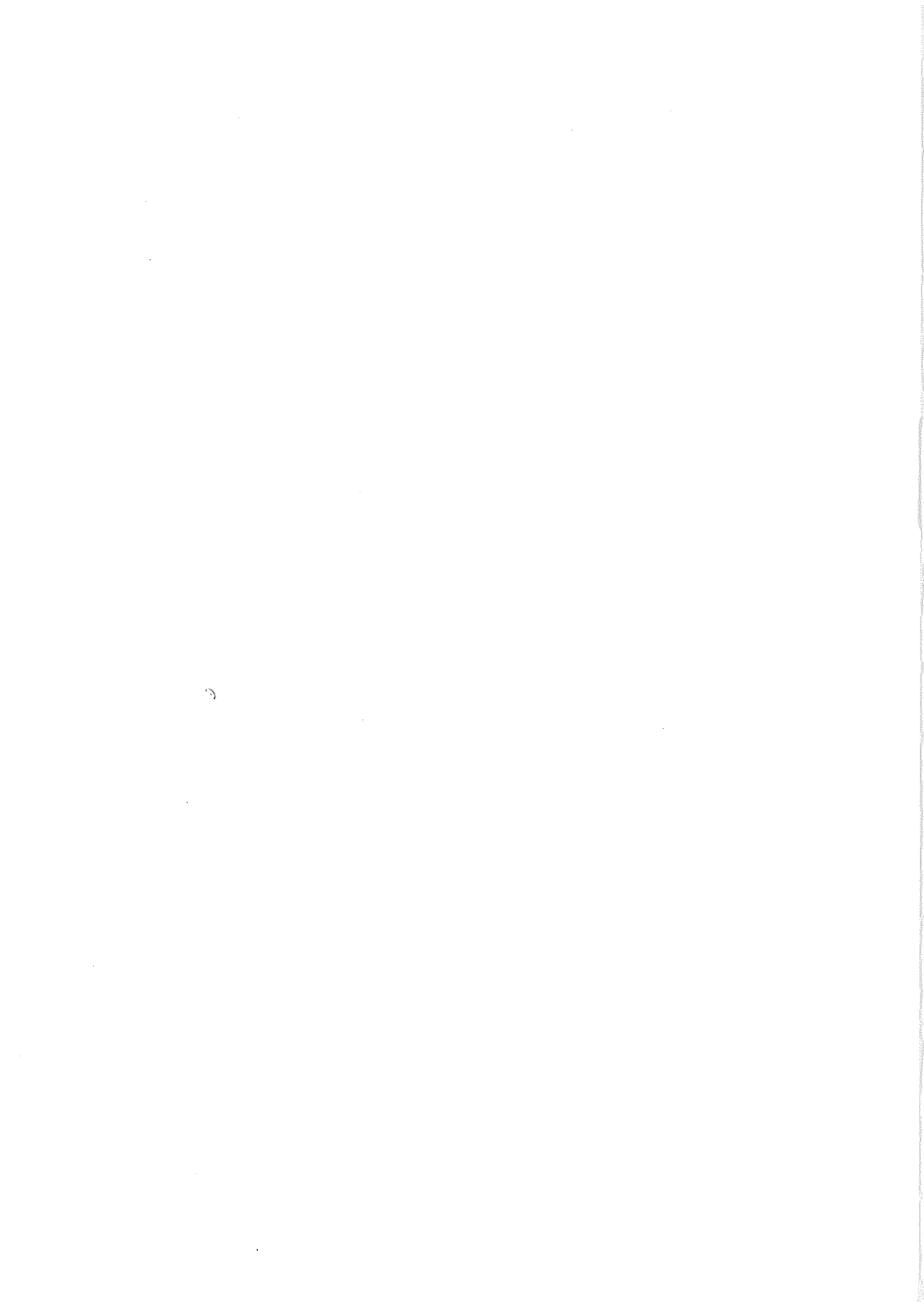
VIET NAM: ADJUSTMENT, GROWTH AND RICE

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May 1995

WORKING PAPERS

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***Abstract:** Agriculture and more particularly the rice economy has been central to 15 years of reform encompassing the **doi moi** period, the 1989 stabilisation package and the consolidation of the market economy now in progress. Since stabilisation, Viet Nam has moved from being a net rice importer to the world's third largest rice exporter. A review of the reform process is accompanied by an assessment of the current constraints on food agriculture and rice's future prospects. While physical and marketing infrastructure need strengthening, modernising rural credit is of key importance to sustaining improved foodgrain terms-of-trade. However, recent data suggests that the surge in rice output may now have peaked and that future per capita output growth could be low. Given the high income-elasticity of foodgrain demand typical of a poor country, Viet Nam probably will cease being a major exporter in the coming decade. With rapid export diversification, this development is unlikely to constrain foreign exchange availability; however, increased wage good prices may begin to squeeze profits unless there is sustained growth in the productivity of labour.*

Introduction¹

The decisive shift towards a market-based economy which marked the 1988-89 reforms and the period since has transformed Viet Nam from a net rice importer to the world's third largest rice exporter after the US and Thailand. This paper examines the background to that transformation, arguing amongst other things that the growth of the rice economy was of decisive importance in cushioning the costs of stabilisation and in overcoming the foreign exchange constraint. Moreover, the roots of this growth precede the "breakout" period;² the transformation of Viet Nam's agriculture is not an overnight phenomenon but rather the result of the cumulative effects of over a decade of piecemeal reform. At the moment, foodgrain agriculture is constrained by poor infrastructure, an inefficient export licensing system and, above all, access to credit. Most important, the growth in domestic demand for rice may soon exceed that of output such that, within the decade, the importance of rice as a foreign exchange source will diminish. This may be no bad thing since, if properly managed, such a development could have a favourable effect on food-agriculture's domestic terms of

¹ This paper draws upon material in a report prepared at UNDP, Hanoi, entitled "Macroeconomic and Institutional Context for the Rice Sector" drawn up by two of the authors in October, 1994.

² The phrase is used by Adam Fforde; see VECA (1994).

trade, thus channelling a larger share of the benefits of growth back to the countryside.

The paper is divided into four sections. Section 1 looks at the current economic situation. Section 2 examines the reform process in Vietnam with particular attention to agriculture. Rural credit is considered in section 3 while 4 looks at the current picture and future trends in rice consumption, production and export. Concluding remarks appear in section 5.

1. The Current Economic Situation

Agricultural production is spread out over all provinces and districts, but the two deltas of the Red River Delta in northern Viet Nam and the Mekong River Delta in south and the land along the Eastern coast are the dominant producers. Food production in the Central Highlands and border regions is not sufficient to meet the needs of population. Rice is the most important crop; other important food crops include maize, sweet potatoes, cassava, and sugar. Livestock are important as a protein source (including fish and other sea food and fresh water products—also a significant source of export earnings). There is very little dairy production. Industrial crops include tobacco, coffee, coconuts, tea, rubber, sericulture and cashew nuts.

Reforms in rural development policies, and resulting increased investments in agriculture, have contributed to agricultural growth, particularly the production of food-grains. This growth has been important in ensuring national food supply and holding down prices, providing the raw materials needed for growth in food processing industries, and has made an important contribution to foreign exchange earnings. From being a net importer of rice only recently, net exports of rice now amount to about 1.5-2.0 million tonnes per year. In 1992, staple food production was 24.2 million tonnes (paddy equivalent), of which paddy was 21.6 million tonnes, while exports amounted to 1.95 million tonnes of rice. Using a conventional conversion factor of 1:0.65, this results in an estimate for total rice production of 14.0 million tonnes, suggesting that rice exports were about 14% of total rice production in 1992.

Despite the growth in agriculture, during the past ten years agriculture's share of total economic activity has been declining; this is a typical feature of successful growth in a low income economy. The agricultural contribution to GDP fell to 33.0% in

Table 1: GDP Growth Rates (per cent p.a.), 1991-1994

	1991	1992	1993	1994
Total GDP	6.0	8.3	7.3	8.0
Agriculture	2.2	6.3	2.0	4.0
Industry	9.9	12.6	9.9	12.0
Services	7.9	8.1	11.4	12.5

Source: VECA (1994), Table 2, p 28.

1992 (and to 29.3% in 1993—a poor harvest year), down from 39.5% in 1990. Agriculture's share of total exports is 32.3% (1992), decreasing from 35.4% in 1985. The collapse of the CMEA trading block in 1991 had a negative impact on exports of industrial ("cash") crops, and Viet Nam was forced to develop other markets for such crops as rubber, tea and coffee. However, increasing rice and shrimp production and the successful identification of new markets for industrial crops have sustained agricultural export earnings following the collapse of CMEA.

Performance in terms of economic growth and reductions in inflation has exceeded the projections of the Government and multilateral donor institutions. Improved economic performance has resulted from the ongoing program of reform, including an opening-up to international markets. The medium-term (1991-1995) growth target was an annual growth rate in GDP of 5-6 per cent. In fact, in recent years growth exceeded that target, with an average annual growth of GDP of 7.4 per cent between 1991 and 1994. Recent growth by broad sector is set out in Table 1. There has also been a dramatic reduction in macroeconomic imbalances since the 1980's, with an improvement in the fiscal situation, quite orthodox interest rate policies, and inflation being brought down to manageable levels.³ In addition, the nominal exchange rate against the US dollar has been relatively stable and external reserves have increased to a more secure level.

³ A detailed account of stabilisation appears in Irvin (1994).

Given the government commitment to reform, recent economic performance, and continued improvements in international economic relations, the government is seeking to sustain an annual growth of GDP of at least 8 per cent during the next few years. The government aims to promote continuing structural change, with the share of industry and services expected to increase, and that of agriculture to decline. The growth rate of industry is expected to be 1.5 times that of total GDP.⁴ The projected change in the structure of the economy is shown in the accompanying table.

Table 2: Share of Sectors in Total GDP, 1993 and 2000

Sector	Share of Sector in total GDP (%)	
	1993	2000
Agriculture, incl. forestry	36	25-27
Industry	21	28-30
Services	43	45-47

Source: General Statistics Office (Hanoi) and authors' estimates.

The industrial sector accounted for just 21 per cent of GDP in 1993, but the sectoral growth rate of 12.2 per cent per annum has been considerably higher than agriculture and service sector in recent years and industry is expected to continue to be the major contributor to strong economic growth. Industrial growth has been broadly based in both state and non-state sectors, with expansion in power generation, coal, oil and gas, cement, electronics, light industry, and the processing of agriculture, forestry and fishery products. Economic reforms have also contributed to the lively expansion of the service sector. Strong growth has also been recorded in trade activities, tourism and

⁴The industrial sector, broadly defined to include construction, accounts for more than one quarter of GDP. The organization of the industrial sector is quite diversified. It was estimated that already in 1990 two fifths of industry was non-state owned (including co-operatives), while three fifths was state owned (including joint ventures with the private sector). There are also diverse proven mineral deposits. Large coal deposits provide the basis for a substantial coal mining industry. There are deposits of iron ore, bauxite, copper, chrome, apatite, gold, rare earths and semi-precious stones. Most important for medium term prospects, is the development of Viet Nam's petroleum and natural deposits. Commercial exploitation of oil deposits began in 1986, crude oil exports exceeded 1.5 million tonnes by 1989, and topped 6.2 million tonnes in 1991.

financial services.

Rice has been a significant component of Viet Nam's external trade, in the past as an import item and more recently as an important export during a period in which Viet Nam's balance of payments situation was subject to considerable stress and uncertainty. The expansion of rice exports has been one factor which helped Viet Nam manage a very difficult transition, following the collapse of support from the CMEA countries, and before the build-up of assistance from the OECD countries. An important consideration in assessing the future of rice processing and marketing is the future possible significance of Viet Nam's involvement in the international rice trade. This is partly a question of the availability of an exportable surplus, but it is also a matter of the possible pressures on the sector to export.

In recent years, the pattern of Viet Nam's external trade has been going through a dramatic transformation, both in terms of its direction and its commodity composition. There have been quite dramatic improvements in Viet Nam's international economic relations. One of the most notable achievements of the reform process has been the growth and diversification of foreign trade. The ratio of trade to GDP exceeded 50 per cent in 1993, putting Viet Nam's degree of 'openness' nearly on par with South Korea. With new markets being created and existing markets being developed, exports have been growing at over 20 per cent per year. Trade with the Asia-Pacific region has been particularly important, with trade with countries in this region growing at 30 per cent per year. Relations with the International Monetary Fund, the World Bank and the Asian Development Bank were normalized in the last quarter of 1993. The USA lifted its trade embargo against Viet Nam at the beginning of 1994.

A decade ago, the major part of Viet Nam's external trade was with the CMEA countries. A large negative balance of trade was funded by credits from the CMEA countries; 1984-89 Viet Nam's imports from the CMEA countries were three times Viet Nam's exports to the area. It is difficult to judge the relative importance of trade with the CMEA and the convertible currency area, as it involved comparing values in dollars and transferable roubles. However, it seems likely that in the mid-1980's Viet Nam's imports from the CMEA countries were running as much as four times the level of imports from the convertible area. The trade deficit with the CMEA countries was of the order of USD

1 billion by the end of the 1980's. In addition, Viet Nam received technical assistance from the CMEA countries; DAC estimates suggest that by the end of the 1980's total assistance received by Viet Nam from CMEA sources was around USD 1.5 billion including technical assistance, (valued at the USD 1 = Rouble 1 rate). Throughout the 1980's by far the largest bilateral support from a DAC member came from Sweden (which accounted for USD 51 million of the USD 93 million reported as bilateral contributions from DAC members in 1987).

From 1990 onwards, aid from the CMEA countries declined precipitously. The effects of the collapse were serious, but the transition to a new trading pattern was made with remarkable success and with only modest external assistance.⁵ Exports to convertible markets jumped from USD 463 million in 1988 to USD 978 million in 1989. The bulk of this increase was explained by two commodities: petroleum and rice. Exports grew almost threefold between 1988 and 1993, from just over USD 1 billion in 1988, to around USD 3 billion in 1993.⁶

Alongside the fast-growing crude petroleum exports and the continuing rice exports (which peaked at just under 2 thousand tonnes in 1992), there has been a lively growth in a number of other exports to convertible markets. There was a two-thirds growth in frozen shrimp exports between 1989 and 1992 (in 1989 the value of marine product exports to convertible markets was USD 134 million) and exports of clothing grew from USD 62 million in 1988 to USD 301 million in 1993. This expansion was achieved despite the continuation of the US trade boycott, which was only lifted in February 1994. The buoyancy of convertible currency exports, and the likely increase in petroleum exports, provided a cushion for the economy in the face of the disruption of CMEA imports and has since provided an export-led growth stimulus to the economy.

In the late 1970's Viet Nam had been the recipient of significant assistance from DAC sources, but the flow declined sharply in the 1980's, when a number of donors suspended their programmes; this situation began to change around 1990, when a

⁵ Up to 1994, assistance mainly came from a limited number of bilateral donors—notably Japan, Sweden, Finland, France and Australia, with the main multilateral support coming from the EC, through its special programme to support returnee refugees.

⁶ See World Bank (1994b).

number of bilateral donors responded to Vietnamese reform efforts by resuming aid, but it was not until late 1993 that the main multilateral financial institutions moved to resume their lending programmes. Viet Nam received commitments for greatly increased levels of Official Development Assistance (ODA) at the Donor Conferences held in Paris in November 1993 and November 1994.⁷ Additional commitments have been made since then by both bilateral donors and international institutions. The intention is that ODA grant and loan assistance should be used for rehabilitating and developing social and economic infrastructure and should have an important impact in promoting economic stabilisation.

Foreign investment cooperation has also increased significantly. By 30 June 1994, some 950 foreign investment projects had been licensed with a total approved investment of more than USD 9 billion, some USD 2 billion of which has already been implemented, of which about USD 1 billion was implemented in 1993. Oil and gas projects account for about one-third of the total implemented investment capital, with the remainder in industry, services, tourism and other economic activities. Some of the oil exploration projects have yielded results and production has started one block with two further blocks coming on stream this year.⁸ More generally many other foreign invested projects are beginning to generate output, employment and exports.

As Viet Nam has opened up to foreign investment and become increasingly keen to develop exports to convertible currency markets, and as political relations with Asian neighbours have improved, the potential for economic integration within the region has become increasingly evident. While initially most foreign investment was in the oil sector, great and increasing interest has been shown by investors from the region, including Australia, Hong Kong, Indonesia, Malaysia, Philippines, Singapore, Taiwan and Thailand, with the initiation of a large number of contacts as well as the implementation of a number of concrete projects, with a shift in non-oil foreign

⁷ For a detailed account of recent aid pledges, see *Far Eastern Economic Review* [1994]. In particular, the aid pledge from the Japanese was seen as a major achievement by the Vietnamese.

⁸ Two new fields (Rong, Hai Hong) have been tapped and will come onstream in 1994 according to PetroVietnam's Director; output in 1993 was 6.3 mn from the Bach Ho field, the only one currently producing. Production by year 2000 may reach 20 mn tons. [*Agence France Presse*, 15 Feb. 1994].

investment, from an early concentration on services and trade to a more balanced mix, with increasing foreign investment in light manufacturing. Given rising labour costs elsewhere in the region, Viet Nam is a natural location for labour intensive light industry, producing for the export market.

The significance of the growth of oil earnings, the diversification of exports, the fast growth in private investment and the resumption of aid programmes from the DAC countries from the point of view of the food-economy is that in the coming period there will not be the same imperative to export rice to contribute to the trade balance as was the case in the period 1989-92. Put another way, rice exports are likely to be of declining relative importance as a part of the overall balance of payments picture. Moreover, the fast development of export trade is likely to be one influence in opening increasing opportunities for farmers to diversify into higher value products.

One specific influence on the rice export trade and through that on the domestic price level of rice will be the future trajectory of the exchange rate. Over the last two years, the nominal exchange rate vis a vis the USD has been remarkably stable, implying a slight overvaluation in real terms. Currently, there has been some indications that the government wishes to achieve a modest devaluation as a further stimulus to the export trade. However, it is not evident that it will achieve that. The inflow of foreign capital, the buoyancy of exports, the current high world price levels for some of Viet Nam's export commodities (eg, coffee) and the increased willingness of the public to hold dong rather than dollars may all exercise some upward pressure on the real exchange rate.⁹ It is difficult to offer any firm prediction of the medium term movement in the nominal exchange rate, but there seems little reason to suppose that there will be a downward trend acting as a significant stimulus to the rice export trade.

2. The Reform Process in Viet Nam and in Agriculture

A key element contributing to Viet Nam's growth has been improvements in economic policy and the institutional and legal framework which have encouraged production efforts and higher levels of investment in commercial production and

⁹ This trend is of some concern to the multilateral donors; see World Bank (1994b).

services. After tentative beginnings in the 1980's, the reform process gathered strength as the government has implemented a pragmatic programme of wide-ranging measures to create the conditions necessary for the successful operation of a market economy. The reforms have been comprehensive, involving both opening up the economy to international economic influences and encouraging decentralized, market orientated decision-making in the various sectors of the economy. The Government has greatly reduced central controls over economic life, gradually abolished most subsidies to state enterprises, and intends to concentrate public investment on the improvement of the social and economic infrastructure required to promote efficient commercial investments.

Reform has been remarkably successful partly because an orthodox central planning system had not established deep roots, having been attempted throughout Viet Nam for only a brief period--- from 1976-80.¹⁰ The severe economic difficulties experienced in Viet Nam at the end of the 1970's prevented the consolidation of the centrally planned system. The fact that the centrally planned economy was not consolidated and never worked effectively in its own terms in many respects made the process of *doi moi* easier. Although elements of the Soviet style central planning approach had been adopted and plans were formulated as if Viet Nam were a centrally planned economy, the degree of control over economic activity remained incomplete. Effective control was never established over rural production throughout the country, even before the reform process started. Especially in the southern half of Viet Nam, the state planning apparatus never penetrated effectively into the rural economy, and throughout the country Viet Nam in the 1980's was never a planned economy in the sense that the activities of the various productive units in the economy were integrated through the plan.

The prelude to the reform process was the critical conditions in 1979-80, which were partly the result of the cessation of Western and Chinese aid. As early as January 1981, a decisive shift in agricultural policy (Decree 100) generalized the end-product

¹⁰ A somewhat different view is taken by Fforde and de Vylder (1988) who provide a comprehensive account of the evolution of Viet Nam away from the 'DRV model' towards a market economy. See also Truong and Gates (1992) while a good literature review is Vo Nhan Tri and Booth (1992).

contract system, already in widespread use. That involved a significant move towards autonomy for the farm household production unit, with peasant households farming collective land under contract, and supplying to the market produce in excess of contracted deliveries. In the same period, the role of the informal private sector in such areas as retail trade, handicrafts and artisanship was officially accepted. Thus began a process of liberalizing agricultural and small scale trade and craft activities which fundamentally changed the character of the economy, providing a basis for resilience during the subsequent decade of economic difficulties. In the early 1980s, therefore, the Vietnamese economic system was already partially reformed.

The substantial autonomy of the farm household and the emergence of a widening range of small business activity meant that *de facto* towards the end of the 1980s a growing amount of economic activity fell outside direct state control. However, a number of key issues regarding the legal status of private economic activity remained unresolved (eg, longer term security of access to agricultural land). Important policy issues relating to the management of the emerging economic system had still be to addressed (eg, price controls, exchange rate management) and the political legitimacy of the emerging system clarified.

A further phase of reform was heralded in the September 1985 by the Central Committee and amplified at the Sixth Party Congress in December 1986, when a clear political commitment was made to a process of economic reform (*doi moi* or renovation).¹¹ The implementation of *doi moi* involved a number of new reforms. The Government cut consumer subsidies, with compensating adjustments in wages. Price reforms were introduced to reduce the dualistic structure under which prices within the state sector were set much below open retail prices. Public sector output prices were increased and many input prices were adjusted to levels more in line with their scarcity. In principle it was intended that state enterprises should operate on a commercial basis, covering their costs and being allocated credit by the banking system according to sound financial criteria, although prices in the state sector continued to be set administratively. In early 1987, internal trade barriers were removed. The external

¹¹ Amongst the various accounts of the *doi moi* reforms, see the collection of papers emerging from an early conference on the subject held at ANU in Forbes, D.K. et al. eds (1991).

trading system was liberalized, and enterprises and local authorities were given much greater freedom to establish direct contacts with overseas markets.

Agricultural reform was consolidated in 1988, when, under Decree 10 (April 1988), farmers were given 15-year rights of land occupancy. At the end of 1987, a law on foreign investment was approved, and in 1989 the State Commission for Co-operation and Investment was set up, to license and co-ordinate foreign funded projects. In 1989, an ambitious macro-stabilization programme was implemented. As the government accepted an increasing role for the private sector, it had to establish an appropriate legal and administrative environment. A new role for the private sector was formally endorsed in July 1988, with the issue of "new regulations for the non-state economic sector". Many new laws have since been passed (eg, in December, 1990, a company law was enacted, along with a law defining rights of private ownership and transfer of property and in early 1991 a new law was enacted defining the role of private trade) although the legal framework necessary for the orderly operation of the private sector is still incomplete, and the application of many laws still depends on the discretion of local governments.

Following the reforms of the 1980's, the organization of agriculture shifted to a system with the family farm as the basic production unit.¹² Co-operatives continued to control access to land and water and the farmer bartered a portion of the farm output with the co-operative for input and services supplied. State farms are restricted to about 4% of Viet Nam's agricultural land and concentrate on the production of industrial crops; by and large the expansion of "industrial" or "cash" crops has been much slower in recent years than that of the household sector. Over time, the role of the cooperative has declined, particularly in the South, but in some areas (particularly in the North and Centre of the country) remains in a strong position as a source of input supply; moreover, the cooperatives in some cases are in a position to withdraw land from households if, for example, they fall into debt. The household has control over production decisions and the surplus left after meeting various obligations to the cooperatives and to local authorities (which can be onerous). The private sector has

¹² A very interesting piece of research tracing the evolution of agricultural organisation from independence in 1955 to 1988 is Ngo Thi Men (1994).

become increasingly involved in the marketing and transport of agricultural output.

The Seventh Party Congress (July 1991) committed the Party to continuing with the implementation of *doi moi*. The commitment to strengthen and extend the reform process was made in the face of the continuation of a difficult external economic situation, given the decline of assistance from the CMEA and the continuation of the US trade embargo.¹³ At that time, it was decided to end subsidies to state enterprises and to allocate credit according to commercial criteria. The state enterprise sector was to be consolidated and concentrate on key sectors and the environment for private business was to be improved. The Government administration was to be restructured and streamlined to provide more effective management of the economy. Since then the government has continued to implement reforms on many fronts, and made a clear commitment to continue the process. Thus, some of the most difficult policy decisions related to the creation of a functioning market economy have already been taken. Some of the most pressing challenges in the next few years will be in developing the institutions required to support the new economic system which is emerging, including public administration reform, development of social services, improvements in the legal framework and the development of commercial courts, and the development of financial institutions.

Even without the implementation of any large-scale privatization programme, the Vietnamese economy is now only to a minor degree under the direct management of the central government. For the southern part of the country, the attempt at central planning was brief. By 1989 the situation throughout the country was such that with the household production unit and co-operative at the core of the rural economy, with significant amounts of urban petty production and trade in private hands, and with important segments of industry outside government management or under the decentralized control of local governments, the economy was already capable of a much more flexible response to market opportunities than the highly bureaucratized and

¹³ The detailed implications of *doi moi* for economic policy were set out in the government's Socio-economic Stabilization and Development Strategy to the year 2000 (1991).

centralized Soviet system.¹⁴ Since then, the continuing lively response of a fast growing private sector to investment opportunities and the fast inflow of foreign capital, particularly from the East Asian region, the economy operates predominantly as a decentralized market economy. The impact of the reforms are to be observed in all aspects of rural economic life. The development of the households farming unit as the core of the rural production has profoundly changed the nature of the rural economic system. The growth of the private trading and transport system has already resulted in a competitive, low cost and innovative rural trading system in many parts of the country. The reduction in subsidies to state owned enterprises has resulted in widespread rationalisation of labour forces, with the shedding of many redundant workers. This has also resulted in a response from the state owned enterprises, which have shifted into new lines of economic activity under increasingly commercial pressures. An anecdotal example of such changes include a state owned post-harvest research institute which had shifted to the production of instant rice-noodle soup as a survival strategy. More generally, a number of state owned food companies have adjusted their product mix in response to commercial considerations, allowing much of the milling and storage capacity to lie idle, concentrating their efforts on the polishing and refining of milled rice for export.

There are a number of specific implications of the ongoing government reform programme for public interventions in the post-harvest rice sector. The continuing process of economic reform should further extend the openness of domestic markets; it will strengthen stated national policy goals, as well as further the interest of consumers and farmers if any interventions support the development of a competitive, innovative and flexible food trade and processing system. As the government intends that state enterprises should be operated increasingly as autonomous, financially and economically viable businesses, and that they should not be recipients of subsidies, either open or hidden, the access of state enterprises to donor resources should be on the same basis as non-state businesses. There will be a continuing pragmatic process of adjustment in the rural trading system, which will involve a continuing shift in the

¹⁴ Further elaboration of this argument appears in Van Arkadie (1993).

balance between the state owned and non-state owned sectors and further pressures on state owned enterprises to operate on a commercial basis; in this situation, it is important that donor interventions should not hinder this process of change by providing a "soft budget" option for the state sector.¹⁵

Inevitably, during the transitional process, there will be many areas in which the process of reform will be incomplete and the pace of further movement uncertain. In relation to the rice trade, the shift to the private sector has been substantial. In relation to the export trade, the government has maintained a key instrument of control through the export licensing system, whereby rice can only be exported under license from the central government. The way the licensing system currently operates is as follows. Most of the available quotas are allocated among publicly owned trading companies (different sources estimate anything between 14 and 17 companies); these may be owned by the government, the provinces or other public entities. There may also be an *ad hoc* allocation of quotas to other public companies. The government also sets a minimum export price which the companies are expected to achieve in the export markets in order to utilize their quotas. The quota companies are formally responsible for the export of rice, which may be processed, packaged and transported by other companies who pay the enterprises with the quotas what amounts to a brokerage fee. This system provides an instrument for the government to intervene in the rice trade. The system is likely to come under growing criticism in future in that it provides those publicly-owned companies with quotas with an opportunity to derive a rent from selling these to the private companies doing most of the actual trade. Against that, it might be felt that such a "tax" might be a reasonable cost to keep some state capacity in the sector, allowing for possible future government interventions in the sector (eg, to divert rice from export to the domestic market as happened after the 1994 Mekong floods).

While much of the discussion of reform is couched in terms of liberalization, it is important that the longer term transition should not be interpreted solely as a retreat

¹⁵ One might argue that this has already happened in the general sense that large commitments of foreign aid (savings) have discouraged domestic savings. While superficial evidence exists to sustain some version of the 'Griffin hypothesis', we doubt its significance. First, aid has been made largely conditional on a secular decline in the government deficit; second, as Fforde argues in VECA (1994), while official figures show the share of private domestic savings as low (12%), when unrecorded informal sector savings are included the figure is probably more of the order of 20%.

from state institutions. In education and health, Viet Nam has traditionally been one of the best-performing Asian economies.¹⁶ However, as the rural economy has moved in the direction of a decentralized market system, a number of gaps in the provision of public services become apparent, particularly when a comparison is made between Viet Nam and the "normal" state interventions in established market economies. It is the existence of such gaps which suggests the need for sustained donor support in the rural economy.

In particular, there are four critical areas in which the state will continue to play the leading role, but which currently performance is ineffective because of inadequacy of resources and inappropriate institutional structures.

One area is the system of research and extension, both in relation to agricultural and to post-harvest activity; although Viet Nam is relatively well endowed with qualified professional staff and there are many research and training institutes, the existing levels of finance are insufficient and system of organisation inappropriate for playing the required state role in providing support to the decentralized agricultural system. Second, the availability of resources for the rural areas, a relevant policy framework and professional skills for the provision of agricultural credit are quite inadequate. Third, given the nature of the agricultural systems in the Deltas, massive public investment will be required in water management and storm protection, and the development of improved policies to influence efficient and environmentally sound water utilization. Finally, a growing agricultural sector will require sustained development of other kinds of public infrastructure, most notably the maintenance and upgrading of transportation; eg, the development of better port facilities for the export of rice.

3. Rural Credit

Viet Nam has only slowly moved towards an effective two-tier banking system, and does not yet have a fully operational system of competitive, autonomous commercial banks and other financial institutions. The continuing weakness of the banking system is likely to result in inefficient resource allocation, and in so far as the

¹⁶ See UNDP (1990) and UNDP (1994).

mechanisms for controlling total credit supply have proved weak, the banks can readily become the driving force for inflationary credit expansion.¹⁷

The financial sector in the rural areas consists of the Viet Nam Bank for Agriculture (VBA) with a well developed branch network, a number of farmer's commercial joint stock banks and semi-informal money lenders. VBA also operates through intermediate financial agencies such as credit cooperatives and shareholder banks. VBA interest rates are decided upon locally, but funds for on-lending depends heavily on allocations from the State Bank of Viet Nam (SBV). Formerly, interest rates were in the range of 4-10% per month, but recently rates have declined to a level of approximately 2-3% per month. With the 12-month average rate of inflation now running around 15% per annum, this suggests that the real interest is now strongly positive—in the range of 13-26% per annum. SBV sets the average difference between deposit and loan interest rates (0.7% per month) and the required bank reserve as 10% of deposits.

The ongoing reforms of the state enterprise sector have still not been carried out to the point that state enterprises are subject to the same market conditions as non-state banking clients; interest rates and allocations for SOEs are still dictated centrally and this severely inhibits sound banking business. A large proportion of loans to state owned enterprises are not serviced, constituting a serious problem to the banks. Loans are mainly restricted to short term contracts of 4-5 months. Medium term loans are rare and long term loans virtually non-existent, mainly due to lack of funds in the banks. However, VBA prolonged short-term loans in 1993 in the face of a bad harvest, to carry debtors over to the next harvest. There is an absence of credit to fund longer term investments; eg, in paddy driers and storage facilities. Although real interest rates are probably now quite high, the critical constraint at the moment appears not so much the cost of borrowing but rather the limited *availability* of formal credit. One reason for the shortage of credit from the formal financial institutions is the widespread distrusts of banks. Savings deposits, either in the form of cash deposits or bonds, are only a small proportion of total bank liabilities. Suspicion of state financial institutions and the chequered record so far of private financial ventures have led many Vietnamese

¹⁷ See World Bank (1994c), particularly section VI(B).

holding savings in foreign currencies or in gold and jewellery (a practice not uncommon in other parts of Asia). Furthermore, the VBA does not have sufficient assets from official sources to fill the gap left by the limited functioning of financial intermediation.

High real short-term interest rates increase the cost of finance for storage and trading stocks. This makes it difficult for farmers to carry stocks, forcing output onto the market immediately after harvest, lowering the farm-gate price and exaggerating peaks of handling and storage by traders. Moreover, the high cost of funds also limits the possibility of traders to play an arbitrage role, carrying over stocks to stabilize price fluctuations. One source of upward pressure on interest rates will be mitigated, if the government improves its fiscal and monetary performance, reducing inflationary pressure, thus reducing the need for high nominal interest rates. Also the ongoing reforms of financial institutions to which the government is committed should result in a steady deepening of the structure of financial intermediation, increasing the sophistication with which the financial system can respond to particular financing requirements. Hopefully, after a period of relatively stable prices and with the increasing credibility of banking institutions, the general public will be increasingly willing to hold their savings in bank deposits and financial assets, allowing the financial institutions to play a more effective role in providing financial intermediation between savers and those who can productive use of investment funds.

To obtain a loan from the VBA farmers must prove creditworthiness and offer full collateral. Land is held on the basis of a lease contract, which has not been acceptable as loan collateral. Leases are *de facto* transferable and therefore have a market value, but the legal status of the tenant is still too uncertain to provide a very satisfactory asset for mortgage purposes. Producers therefore have to mortgage their buildings and even such consumer durables as they possess. Poor farmers and farmer's groups without formal recognition from the People's Committees have little possibility of gaining access to the formal credit markets, and only the informal market to fall back on.

The management of VBA appears competent, but the skills of the employees will need upgrading to undertake the full range of commercial banking tasks, including risk assessment, accounting and handling computers. Several aid projects, including ADB,

SIDA, EC-IP¹⁸ and French programmes, address the training of bank staff, but the need for training remains considerable. Loan recovery rates are generally very impressive, in the range of 95-98%, reflecting strict procedures and generous levels of bank staffing. The EC-IP credit programme to returnees and others, in association with VBA and ICB, has also managed to raise recovery rates to high levels as experience was gained in managing the credit programme; in the EC-IP programme the highest recovery rates have been achieved from loans to smallholders. Recovery rates could well decline in the future as funds become more available and banking services becomes available to a larger proportion of the farmers. However, the high rates of recovery currently being achieved is an indication of the possibilities for using donor assistance to provide initial funding for rural credit programmes, which could be expected to be subsequently self-funding on a revolving credit basis.

A crucial issue to be addressed is whether, given the high levels of nominal (and substantially positive real) interest rates there is a case for (donor) interventions to subsidize rural credit. There are a number of reasons why that would probably not be a good idea. Even at existing interest rates, there seems to be considerable unsatisfied demand for rural credit, so that rural lending could be extended without subsidizing the interest rate. At a time when the main thrust of policy reforms is to put as many institutions as possible on a commercial footing, including financial institutions, it would send to the wrong signals to introduce a new form of subsidy. Moreover, as seems likely, if it is the quantity of available credit rather than its price which is the binding constraint on rural credit, then the funds are more likely to grow if the interest structure is such as to enable the financial institutions to attract funds from depositors and accumulate reserves through profit (of course, a subsidy would allow banks to offer deposit rates above lending rates, but that would not lay the foundations for a healthy, endogenous growth process of autonomous financial institutions). The above analysis above suggests that the main area of intervention lies in supporting the development of institutional capacity for rural credit rather than increasing its supply or lowering interest rates.

¹⁸ EC-IP stands for European Community International Programme for the Reintegration of Vietnamese Refugees; it grants credit to 'returnees' and its current phase is the period 1992-95.

4. Rice Production, Consumption and Export.

Rice is not only the main product of Vietnamese agriculture and the dominant food staple, but also provides the basic income source for a large segment of the population of poorer farmers. Data from the Viet Nam Living Standards Survey (see Table below) indicate that almost three-fifths of the per capita income of people in the lowest expenditure quintile is generated by agricultural activities, compared to less than one fourth for the highest quintile. The reverse is true for income generated through non-agricultural self-employment activities. These activities account for 15% and 52% of total per capita income for the lowest and highest quintiles, respectively. For all quintiles, the income from wage labour activities is around 20%.

Table 3: Per Capita Income by Sources of Income and by Expenditure Quintile, 1992-93

Sources of Income	Expenditure Quintile					Total
	1	2	3	4	5	
Agriculture	59.3%	56.9%	47.9%	39.6%	17.5%	36.2%
Non-agr. self-empl.	15.3%	19.6%	29.1%	34.7%	52.1%	37.0%
Wages	22.6%	19.7%	18.9%	22.2%	23.3%	21.7%
Subsidies & Stipend.	2.7%	3.5%	3.8%	3.2%	3.1%	3.3%
Other	0.1%	0.3%	0.5%	0.4%	4.0%	1.8%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Viet Nam Living Standards Survey, 1994.

Paddy production is concentrated in the two deltas of Red River Delta and the Mekong River Delta, the latter being the most important producer for marketable surplus for domestic consumption and export. However, rice fields are found in almost every province and district throughout the country. Maize and cassava are the two main food staples after rice and are also mainly grown in the deltas.

Paddy rice production accounted for some 45% of Gross Value of Agricultural Product in 1992. Total production has increased from a level of 16 million tonnes in the 1980's to over 21 million tonnes in the 1990's. Land used for paddy production has increased through the increase in multiple rice cropping. Although the wet season paddy area declined marginally (4%) 1987-92, area planted for the winter-spring crop increased by 24% and for the summer-autumn crop by 59% over the same period.¹⁹ Data in Table 4 shows the official estimates of land sown to paddy each year.

Table 4: Sown Area of Rice, 1985-1993

	1985	1990	1991	1992	1993
Total	5,704	6,028	6,303	6,475	6,387
Spring Rice	1,765	2,074	2,160	2,279	2,326
Autumn Rice	857	121	120	125	121
Winter Rice	3,082	2,739	2,760	2,748	2,623

Source: Statistical Data of Agriculture, Forestry and Fishery, 1994

As a result of the increases in multiple cropping and of productivity growth, average annual yield of paddy per hectare increased from 2.8 tonnes per hectare in 1985 to 3.4 tonnes per hectare in 1993; the average annual yield figures cover wide regional differences, ranging, from 2.4 in the Central Highlands and 4.0 tonnes per hectare in the Red River Delta (1992). Variations between provinces are even greater, ranging from 1.5 to 5.0 tonnes per hectare. Through investments in irrigation facilitating multiple cropping, the introduction of new varieties and improved cultivation methods, yields in some areas may still rise significantly, although further large increases of yield cannot be expected in regions which already have highly intensive land use and high yields due to triple cropping. The conclusion of the World Bank study of agricultural marketing was that:

¹⁹These figures are taken from the World Bank report (1994): Viet Nam Agricultural Marketing Study.

"..in the absence of substantial new investments in irrigation and drainage, in the mid-1990's yields are likely to peak at 3.4 tonnes per hectare, multiple cropping increases will slow, and total production of paddy will level off at around 23 million tonnes. Even with new investments (given the time required to complete systems), for the next years, production growth may decelerate to average 1.9% per annum over the decade."²⁰

The Vietnamese view is that this is an unduly cautious estimate of future production prospects. However, while this projection may be based on fairly pessimistic

Table 5: World Rice Exports, 1984-1993 (million tonnes)

Calendar Year	1986	1987	1988	1989	1990	1991	1992	1993 (est)
Thailand	4.3	4.4	4.8	6.0	3.9	4.0	4.8	4.2
USA	2.4	2.4	2.2	3.0	2.4	2.2	2.1	2.4
Viet Nam	0.2	0.1	0.1	1.4	1.6	1.0	1.0	1.9
Pakistan	1.1	1.2	1.0	0.8	0.9	1.3	1.4	0.9
China	1.0	1.0	0.7	0.3	0.3	0.7	0.9	0.9
Burma	0.7	0.6	0.4	0.5	0.2	0.3	0.3	0.3
Others	2.9	3.3	2.8	2.7	3.3	3.5	3.6	3.5
USDA Reported Total	12.6	13.0	11.9	15.0	12.2	12.8	15.1	14.6
Viet Nam as % of Total	2	1	1	9	13	8	13	13
WB Indicator Price	259	258	316	338	287	308	270	253

*Thai 5% broken expressed in 1990 constant dollars per tonne

Source: World Bank (1994a), Viet Nam Agricultural Marketing Study, Table 3.8.

²⁰ See World Bank (1994a), page 23.

assumptions regarding the potential for further productivity improvements, it does not address the possibility of actual growth falling below physical potential should farmers decide it makes economic sense to shift their attentions to other activities.

Table 6: Change in World Rice Exports from 1986-88 and 1990-92

	1986-1988		1990-1992		Change Over Period	
	Million Tonnes	%	Million Tonnes	%	Million Tonnes	%
Thailand	4.5	36	4.2	31	-0.3	-13
USA	2.3	19	2.2	16	-0.1	-12
Viet Nam	0.1	1	1.5	11	1.4	962
Pakistan	1.1	9	1.2	9	0.1	1
China	0.9	7	0.6	5	-0.3	-35
Burma	0.6	5	0.3	2	-0.3	-57
Others	3.0	24	3.5	26	0.5	7
USDA Reported Total	12.5	100	13.4	100		

Relative change in proportion of world exports (eg, a country declining from 20% of world trade to 10% over the period would be shown as -50% in this table).

Source: World Bank (1994a): Viet Nam Agricultural Marketing Study, Table 3.9.

Although total production of rice increased 40% between 1985 and 1993, annual population growth of 2.2-2.5% and growing rice exports have kept total per capita rice availability (defined as rice production adjusted for import/export) constant on a level of 275-280 kg/year. Total rice production did not meet domestic demand up to 1988, necessitating imports of 700,000 to 1,600,000 tonnes annually. Since 1989, exports of 1.0 to 2.0 million tonnes of rice per year have made Viet Nam the third largest rice exporting country in the world, but export prices have been 20% lower than those of neighbouring countries such as Thailand, mainly due to uneven quality and irregular

supply. Large importers of rice from Viet Nam in 1990 included France (162,000 t), CIS (147,000 t), Iran (95,000 t), India (45,000 t) and Japan (15,000 t).

The success in exporting rice should not be a source for complacency regarding the security of future domestic supplies; agriculture remains vulnerable to climatic conditions, nutritional standards are still low and output increase must be maintained at 2% per annum just to match population growth. In the longer-term, sustained agricultural growth will require massive infrastructural investment, in water management and transport infrastructure in particular, and the strengthening of research, extension and other agricultural support services. While Viet Nam is now a large player in the world rice export market, total exports are only around 15% of total production. The domestic demand for rice can be expected to rise considerably in coming years; rice is a staple, and as such is unlikely to have a high income elasticity of demand, but at existing low income levels and poor nutritional standards, income elasticity is likely to be significantly positive.

The Viet Nam Living Standards Survey provides some evidence on expenditure elasticity of demand for cereals, based on cross-section data. As the preliminary published results are only presented in terms of five quintile expenditure bands, the results are somewhat crude. Using this data, four expenditure elasticities can be calculated, based on average increases in expenditure on cereals between households in the five quintile groups. The four expenditures elasticities resulting from this calculation are shown in Table 7.

The overall expenditure elasticity will depend upon the distribution of any income growth as between the various expenditure groups; if the growth in income was concentrated in the lower quintiles the expenditure elasticity would be much higher than if the growth were concentrated in the higher quintiles. If growth is evenly spread between quintiles (ie, growth does not change relative income distribution), the overall expenditure elasticity would be the arithmetic average of the elasticities, of 0.25. Rough projections of possible medium-term growth of domestic demand is based on the following assumptions:

- i) Population can be expected to grow at 2% per annum;

Table 7: Expenditure Elasticities for Cereal Consumption, 1992-1993

Expenditure Quintile	Mean Cereal Consumption in percent of total expenditures	Elasticity*
1	64.1%	0.54
2	57.4%	0.30
3	51.3%	0.10
4	42.3%	0.08
5	26.4%	
Arithmetic Average	48.3%	0.25

*Defined as percentage increase in cereal consumption divided by the percentage increase in total expenditures between the quintiles

Source: Calculations based on Viet Nam Living Standards Survey, table 6.5.1

- ii) per capita incomes will grow at a high rate---a projection of 4-6% seems a reasonable basis for projection (and higher rates of growth are not unlikely);
- iii) on the basis of the VLSS data above, with an expenditure elasticity of 0.25, income growth would result in an increase in per capita demand of 1.0---1.5% per annum.

In short, it will be reasonable to assume that domestic demand for rice will grow at between 3.0% and 3.5% per annum. Combining this figure with estimated output growth of 1.9% per annum, the conclusion is that over the medium term domestic demand will grow between 1.1% and 1.6 % per annum faster than domestic supply; ie, the export surplus will be absorbed in the domestic market in about a decade.

Whether rice production can be expected to grow at any given rate is not only a question of the technical potential for further productivity growth, but also a matter of the choices made by farmers. In general, Vietnamese farmers perceive paddy as a poor

man's crop and believe that access to higher incomes is likely to be more possible through producing higher value crops. Willingness to commit effort to expanding paddy production will be dependant on the movement of the paddy price, which in turn will depend on the efficiency of the processing and trading system in exploiting international markets—a major theme of this piece. The tentative policy conclusion is that investments in processing capacity for rice exports should not be based on expectations of high rates of future growth of rice exports. Increases in revenues from rice exports should be sought from increases in the price received for a given tonnage, rather than on expectations of large increases in quantities.

Table 8: Export Quality Grades, 1989 and 1992

Quality Grade	1989 (%)	1992 (%)
5% Broken	negative	19
10% Broken	0	21
15% Broken	0	11
20% Broken	2	4
25% Broken	5	13
35% Broken	86	26
Broken Rice	7	6
Total	100	100
Average Export Price (FOB)	225 USD/t	161 USD/t

Source: World Bank (1994a), Viet Nam Agricultural Marketing Study, Table 3.2 and World Bank (1994b), Public Sector Management and Private Sector Initiatives.

Regarding quality, the rice processing industry had adjusted in recent years with commendable speed to the requirements of the international market. As a result, the quality of rice exported has increased significantly as indicated in the accompanying Table. This increase has been achieved through a combination of initiatives by private

rice traders and adjustments in the activities of the state owned food companies. In the coming years there will be a need for further improvements; as Viet Nam attempts to enter more sophisticated markets, for example in the development of bulk-handling facilities and in more sophisticated processing equipment, such as colour sorters and more sophisticated packaging.

In a purely technical sense it is relatively straightforward to identify the possible investment requirements for such an improvement in capacity. However, the formulation of a donor project aimed to support such investment would need to take account of the evolving institutional arrangements within the sector and to be sensitive to the government's goal of creating an efficient multi-sector market economy. That is, donor supported investment should be such as to allow the further development of the private trading sector, along with state enterprises operating on a fully commercial basis. As such it will be necessary to establish funding mechanisms which allow for donor resources to be lent on to both private and public enterprises on the same commercial terms.

5. Conclusions

Vietnam's economic performance over the past five years has been marked by a radical departure in commercial and exchange rate policy, prudent fiscal-financial management and the consolidation of the legal and institutional framework necessary for successful market transition. Indeed, as has been emphasised, Viet Nam was never truly 'centrally planned' along the lines of the Soviet model and this has greatly facilitated market transition. The roots of this transition go back to agricultural and other reforms initiated in the early 1980s; their cumulative impact over the decade culminated in the "breakout" of 1988-89.

Since then, the pace of reform has been maintained. As the impact of past reforms permeates economic life and with further reforms under implementation or being planned, the rural economy is very much subject to continuing transition. Already, farmers make production decisions in response to market opportunities. In the processing and trade of rice—Viet Nam's key staple—the private sector plays an innovative role in improving product quality in response to international market

opportunities. The agricultural sector, particularly the rice economy, is central to income growth since it encompasses nearly 80% of the population and provides the main wage good. However, the 'easy' part of the reform process (the freeing of prices and trade) has come to an end. From now on, interventions will need to be more finely tuned if key constraints are to be removed. Over and above the renewal and extension of rural economic and social infrastructure, three areas are of crucial importance.

First, the current system of export licences requires careful examination: as the system now functions, it tends to promote rent-seeking behaviour, reducing the share of the benefits from agro-exports accruing to farming families. The second priority area is the strengthening of the rural credit system. As has been argued, this is not a matter of more or cheaper credit but, in essence, of extending the institutional basis of its availability both through further reform of the agricultural banking system and the encouragement of small-scale group credit schemes. Third, interventions are required in pricing policy; ie, both in favouring foodgrain terms of trade and stabilising farm incomes. Though exchange rate policy has an important role to play, if inflation is kept low it is likely that the real exchange rate position will not deteriorate.

Most important, to the extent that the growth of domestic demand for foodgrains outstrip supply, the authorities must allow prices to clear the market rather than attempt sustained administrative intervention. The 'cost' of such a policy may be higher wages; however, these are unlikely to exercise strong pressure on the general price level given, first, the highly competitive nature of much of the country's new, informal urban industry and service sectors and, second, the sustained growth of labour productivity in non-food sectors. The 'benefit' of improved foodgrain terms-of-trade will be higher output, higher farm productivity and the diversification of rural employment and incomes.

More generally, at the current stage (1994-95) Government priority programmes include, first, state enterprise reform including restructuring state enterprises and abolishing remaining subsidies, to improve the effectiveness of the state enterprise sector; promoting the development of a strong public corporate sector (increasing managerial autonomy from line ministry control) and privatization of selected state enterprises. Second, the development of the non-state sector is to be furthered by introducing legal provisions to support domestic investment; reducing bureaucratic

obstacles to private sector investment, and eliminating remaining differences in the treatment of state and non-state enterprises. Third, there is to be a deepening of the open economic system and extension of foreign economic relations: this includes restructuring export and import institutions and reforming the system of import and export taxes to simplify procedures; and promoting exports (including reducing structural barriers to exporting). Fourth, by continued improvement to the investment environment it is hoped to attract increased levels of foreign investment and to increase the efficiency of investment. Fifth, the local capability to utilise official development assistance is to be strengthened and there is to be continuing reform of the financial, banking and monetary sectors. Finally, Government has identified priorities for public investment to include social and economic infrastructure, especially energy, transport, water resources, telecommunications, water supply and social programs (education, health care, science and technology, population and family planning, and employment creation).

In short, at a conceptual level, Vietnamese foodgrain production is nearing a 'turning point' to market-driven wage determination akin to that theorised by Lewis (and classically by Ricardo). Assuming the Party maintains political cohesion and control by timely advancement and deepening of the reform process, institutional bottlenecks to agricultural growth will continue to be overcome while the future of export-led non-food growth looks promising. It is noteworthy that of all the MTE experiments---from the FSU to China---it is the Vietnamese version of 'market socialism' which appears currently to be that most strongly backed (on an aid per capita basis) by the international donor community, particularly the World Bank. Equally, as Stalinist central planning is put to rest, it seems ironic that the 'Vietnamese model' is also that most consistent with Bukharin's theorisation of "rural-led market socialism" espoused by such anti-orthodox economists as Kalecki and Nove, so long disregarded by the academic elites of both East and West.²¹

²¹ See for example Kalecki (1976) and Nove (1983).

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