Vietnam Grows In China's Shadow

ASIA

By Giovanni Pisacane and Stefano Riela

Vietnam's broad-minded interpretation of socialism has opened the door to its involvement international commerce scene. Imports and exports are up. Investment is thriving. Now, the country needs to build an infrastructure commensurate with its global potential

Despite world economy woes, the 21st century has seen the renaissance of Asia. Following in the footsteps of Japan, the most potent "Asian tiger" of the 1970s and 80s, China made its own remarkable advance last year, evolving into the world's third largest economy. China's rise has favored Vietnam, one of China's leading economic partners and competitors. With a population of 86 million inhabitants (28 percent of which under age 15), Vietnam has seen GDP grow by an average of almost 7.6 percent annually from 2000 to 2008. Meanwhile, purchase power parity (PPP) has almost doubled.

Post-war Vietnam has a complex history. The territory north of the 17th parallel declared independence from France in 1945 and became known as the Democratic Republic of Vietnam. The northern regime immediately nationalized foreign industry and expanded such sectors as basic education.

In the countryside, large estates were expropriated, cooperatives formed and state-owned enterprises developed. Soviet aid helped buttress the economy and led produce an all-out war with France to recoup the country's southern provinces, still in colonial hands. France's defeat in 1956 then led to gradual U.S. intervention to impede the advance of communism.

The Vietnam War, though never declared, lasted through 1974, when the U.S. finally withdrew and northern forces entered Saigon, what is now Ho Chi Minh City. The southern Republic of Vietnam ceased to exist and Vietnam was unified as the Socialist Republic of Vietnam. Despite assistance from socialist countries, Vietnam healed slowly from the scars of the war. American bombing destroyed a large part of the industrial north and countless key roads. Incendiary and chemical bombs incinerated vast areas of forest and jungle land.

The first phase of reconstruction was carried out under the principles of socialism. Organizationally, the country's capital and administration was set up in Hanoi. Government policies permitted a certain degree of private initiative in the southern regions, ownership was granted to some small farmers. Most of the rest of the country continued to emphasize cooperative management. The state was put in charge of all key sectors, including finance and commerce.

But the economic reform that began after reunification bogged down in the late 1970s.

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Vietnam found itself in border skirmishes with China in the north and Cambodia in the south. It was isolated internationally and unable to get necessary assistance from the Soviet Union and its Eastern European allies. The nation was plunged into crisis and many citizens, known as the Boat People, chose migration.

In September 1979, the Communist Party (the country's only party) held its fourth national congress and set out new priorities. What the state could not manage effectively, said the party, should be done collectively. Where collective measures failed, the private sector should be allowed to assist.

_The adopting of "Doi moi," or "renovation," in 1986 assisted with Vietnam's economy. Though per capita income remains low, some social indicators are promising.

Eighties Renewal

The institutionalizing of development and expansion within commercial market came with the sixth national party congress in 1986. With the adoption of so-called "Doi Moi," or "renovation," Vietnam made the transition from a planned economy to a centralized, socialist market economy.

Though economic growth is still linked to the development of heavy industry, the party no longer sees industrialization and development simply as trade-off for domestic organization. Increasingly, the party favors an open economy, participation in the global market and the reorganizing of the property sector on the basis of comparative advantages. In 1988, private companies were permitted in some sectors of industry, including construction, transport and services.

In 1992, the constitution was amended to give all citizens the freedom to manage business capital without limit to the number of workers they employ. The government moved to expand the free movement of goods, such as food, within the country and to promote exports. It also reviewed the system of property rights, land rights, with farmers allowed the rights of ownership, inheritance and sale.

In the period between 1992 and 1997, Vietnam posted an average annual gain of 8.8 percent of GDP. The number fell to 4.6 percent over the next two years, largely because of the Asian economic crisis, but rose again to average over 6 percent from 2000 with a 8.5 percent jump in 2007

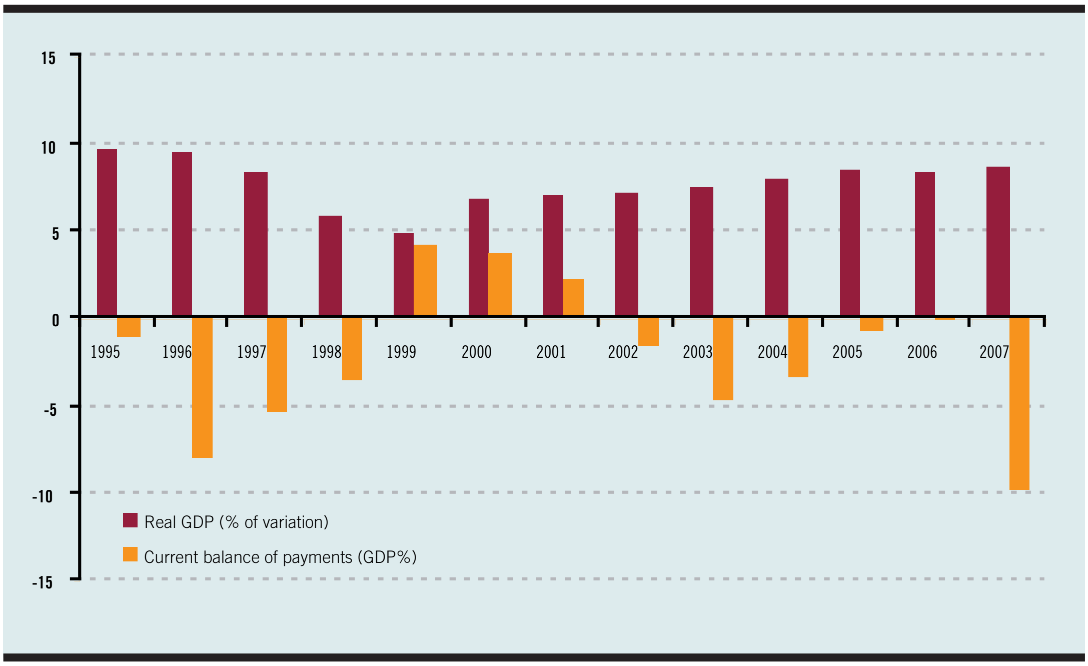
In 1989, it also eliminated price differential between domestic consumption exports, revoking some civil service privileges.

Monetary policy reform followed, and banks began profiting from loans made to public enterprises. Interest rates turned positive. In terms of international economic relations, the government began allowing businesses across sector lines to export to domestic provinces and organize import and export companies. A new legal framework regulating foreign direct investment helped attract industry to a country that until a few years earlier was considered unappealing.

Boom Years

Reform measures in play since 1986 have proved widely effective. Without renouncing its ideology, the Communist Party has liberalized both production and the market, while undertaking administrative reform ensure that growth is monitored more efficiently. The result has been marked economic improvement. In the period between 1992 and 1997, Vietnam posted an average annual gain of 8.8 percent of GDP. The number fell to 4.6 percent over the next

THE IMPORTANCE OF GDP

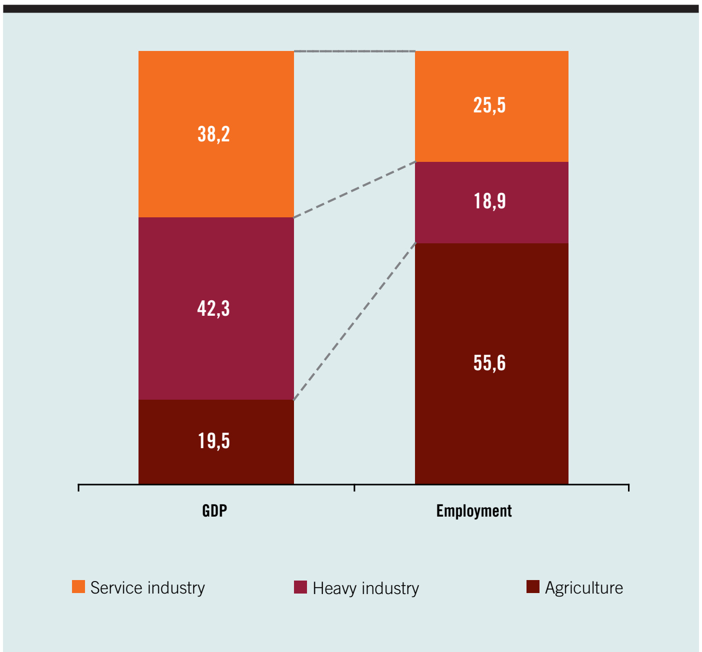


two years, largely because of the Asian economic crisis, but rose again to average over 6 percent from 2000 (see chart) with a 8.5 percent jump in 2007.

Despite low per capita wealth (less than $2,600 at PPP in 2007), over the last two years the country has improved at least some social indicators. Today, the country ranks 114th (out of 179 countries) in the Human Development Index, increasing its rating significantly compared with other developing countries. Since 1993, the population below the poverty threshold ($1 per day) has been reduced by 73 percent while high literacy rates have been maintained.

As shown in Figure 2, though the agricultural component of GDP is declining, the sector is still fundamental to domestic

IMPACT OF MAJOR SECTORS



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employment. Rice remains the most cultivated agricultural product (Vietnam is the world's second-largest net rice importer). Coffee and tea production are growing in the country's central regions. An expansion in light industry, including clothing and footwear, is taking place around major urban centers. The service sector is also growing. Tourism has played a key role (there were 4.2 million visitors in 2007, a number that has doubled in seven years), as have financial services and businesses. Publicly held companies, while still dominant in the energy, chemicals and general services sectors, have nonetheless decreased.

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International Trade

The commercial boom was given further stimulus by Vietnam's entry into the World Trade Organization (WTO) on January 11, 2007 and bilateral trade agreements signed with the United States and the European Union. From 2000 to 2007 Vietnamese exports were up 212 percent and imports 242 percent. Vietnam exports crude oil, textiles clothing, agricultural products, footwear and fisheries-based products. The U.S. and the EU provide most of the export market (close to 50 percent) followed by Japan, Australia and China.

Vietnam has also benefited from the Agreement on Textile and Clothing (ATC), which removed all quotas from goods produced and exported from WTO member countries. At the same time, the EU has levied a temporary 10 percent quota on leather shoes imports, mostly in an effort to protect the Italian industry.

Imports, meanwhile, are focused primarily machinery necessary for the operation of domestic companies and foreign companies with branches in Vietnam. These include oil and other fuels, textiles and materials for the textile industry, apparel and steel. The main suppliers are China, the EU, Singapore, Japan and South Korea. Vietnam is also a member of the Association of Southeast Asian Nations (ASEAN), which aims to create a free trade zone based on the EU model. The trade balance shows a deficit, however, mostly as a result of the rapid increase in trade that has seen exports grow at rates lower than imports. The 2007 trade deficit was just under 10 percent (see Figure 1).

Vietnam has also opened to foreign investment. In 2007, the United Nations Conference on Trade and Development (UNCTAD) ranked the country 43rd in attracting foreign direct investment (FDI). A multinational conducted by the same agency ranked it sixth in expected FDI between 2008 and 2010. The favorable perception of Vietnam may have been influenced by a May 2007 law that allows foreign and local companies to invest in infrastructure development as part of the "build, operate and transfer" (BOT) plan. The State Capital Investment Corporation, meanwhile, will manage the privatization of public enterprises.

Most of the investments are located in industrial parks and special areas of designed to specifically for the production of export, allowing investors to simplify administrative work. A foreign investor in Vietnam enjoys tax incentives in the form of total exemptions, rebates and preferential rates of tax on profits. The general rate from January 1, 2009 was reported as ranging from 25

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_A Vietnamese vendor in front of National Bank headquarters in Hanoi.

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percent to 28 percent, but dropping as low as 20 percent or even 10 percent depending on the location and size of the investment and the kind of activities undertaken by the company.

Vietnam's development has been backed by such agencies as the World Bank, the Asian Development Bank and International Monetary Fund. Japan and France are both major donors. In 2007, some $4.4 billion in backing supplemented the estimated $5.6 billion in wages sent home by workers abroad through banking channel (it's estimated that another $3 billion came home through unofficial channels).

Italian Ties

Italy was among the first nations to establish diplomatic ties with post-war Vietnam. The links came soon after the Paris peace accords and were intended to help rebuild relations with the country while it was still officially under international embargo. Two recent bilateral agreements have further reinforced the ties. One, which went into effect in 1996, calls for the promotion and protection of investments. A second, finalized in 1999, safeguards against

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_In January 2007, former Italian Prime Minister Romano Prodi met his Vietnamese counterpart Nguyen Tan Dung.

duel taxation and tax evasion.

Bilateral cooperation financed by aid credits from Italian businesses are helping with the country's waterworks sector, in flood prevention, and in the furnishing of hospital equipment. Three waterworks projects totaling about €38 million have been approved for the city of Tuan Nui in Quang Nam province and Ca Mau in Binh Thuan province.

A program financed through the United Nations Industrial Development Organization (UNIDO) aims to promote the development of small and medium enterprises and industrial districts in Vietnam, linking them to partnerships with operators and associations in Italy. Since both Italy and Vietnam have a similar manufacturing base, characterized by small and medium-sized enterprises, the two countries seem ideally suited in terms of ongoing co-operation and commerce.

Italy is Vietnam's 17th leading importer and its 16th leading supplier. It's mostly inter-sector trading involving textiles. Italy exports machinery, synthetic fibers and fabrics to then import the finished products. In 2007 exports stood at €515 million (up 83 percent from 2001). Last year saw Italy widening exports to include machinery, mechanical equipment, trucks and buses. Imports were valued at €695 million (up 85 percent from 2001) and centered on footwear, agricultural products, processed and

preserved fish, textiles and apparel.

Vietnam's had 28 direct investment projects in Italy as of late August 2008 with total commitments worth $114.5 million. As a result, Italy ranks 33rd in origin of investment commitments. In the first eight months of 2008, three new investments worth a total of $19.1 million were approved. These include the Piaggio, whose Vinh Phuc plant produces 100,000 Vespas annually. Also present in Vietnam are Merloni Termo Sanitary, Danieli, Metecno, Mastrotto, Cir, Bonfiglioli, Ferroli, Pacorini, Kluger International, and Gritti. Mapei Segis recently opened new plants, while Socotherm was awarded an $11 million contract thought an Argentine subsidiary.

In November 2008, Vietnam hosted a "system mission" promoted by the Italian Ministry of Economic Development and the Ministry of Foreign Affairs and supported by ICE, the Association of Italian Banks (ABI), Confindustria, the Vietnamese Chamber of Commerce and Industry (VCCI) and the Club of 15. Some 150 companies, banks and associations took part in the mission, intended to showcase Italian products. Its widespread success demonstrated the extent to which Italy's producers are looking toward Vietnam with increasing interest and attention as a potential market.

Cheap production costs, particularly in the labor-force sector (about $100 a month for a 48-hour work week, which is less even than the Chinese average), gives Vietnam its biggest competitive advantage. At the same time, a tightening of labor laws has seen the country drop five positions in the "Doing Business" World Bank index (Vietnam was 92nd place among 181 countries in 2009)

Tradition and Modernization

The global economic crisis is nonetheless making its presence felt. Vietnam's stock exchange, established in 2000, has lost 70 percent of its value in the last 14 months after reaching all-time peaks in 2007. The Economist Intelligence Unit Growth forecasts growth of 6.2 percent for 2008 and 3 percent for 2009. To counter the decline, the Vietnamese Central Bank has reduced interest rates five times since October 2008. It now stands at 8.5 percent. These moves definitively ended restrictive monetary policies imposed in 2008 to counter inflation, which had reached 29 percent in the third quarter of 2008. The government is compelled to ensure growth rates in and effort to maintain social stability. Failure to do so carries serious risks. Demonstrations of popular dissent were met by broad state repression, attracting the attention of the international community.

Vietnam still has a retrograde legal system that is ill-equipped to deal with such difficult issues such as the protection of trademarks and intellectual property (though Vietnam is a partner to the Madrid Agreement on international brands). Its banking and financial sectors still adhere to practices that don't comply with market rules. Its bureaucracy is unwieldy enough to cause companies additional costs. Investors and operators must also deal with the differences in the way foreign and local businesses operate. Another thorny issue is the exchange information. Public and private censorship abounds, as do regulation on free speech that extend to new media.

Violation of intellectual property rights is commonplace in many sectors (textiles, pharmaceuticals, the motorcycle industry, foodstuffs, consumer goods, audio-visual). The principle reason for this is failure by authorities to recognize the nature of the problem and the limited resources available to bring abuses to heel.

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But economic development and the addition of new capital and skilled labor are expected to lead to an increase in costs. To balance this off, companies must invest in research and development, diversify their products lines and improve quality. The Vietnamese government, in turn, should make a political commitment to invest in infrastructure (improving logistics) and give professional training to its younger generation. Only such investment will permit the market to absorb a million new workers annually while at the same time trying to reduce the massive gap between urban and rural areas. Unemployment in cities stands at 4.6 percent, less than half the 10 percent total in rural areas.

After more than 20 years of concerted reform and transformation, Vietnam continues to stride toward modernization while at the same preserving national political traditions. It combines a desire to adhere to socialism with an acceptance of the demands of a new economy and society. Vietnam, though it still has a long road ahead, is now fully linked to the demanding rhythms of the international community.