

# BTI 2008 | Vietnam Country Report

|                         |      |             |              |   |
|-------------------------|------|-------------|--------------|---|
| <b>Status Index</b>     | 1-10 | <b>4.45</b> | # 91 of 125  |   |
| Democracy               | 1-10 | 3.15        | # 112 of 125 | ➔ |
| Market Economy          | 1-10 | 5.75        | # 58 of 125  | ➔ |
| <b>Management Index</b> | 1-10 | <b>4.75</b> | # 74 of 125  |   |

scale: 1 (lowest) to 10 (highest)    score    rank    trend

This report is part of the Bertelsmann Transformation Index (BTI) 2008. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 125 transformation and developing countries are evaluated.

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## Key Indicators

|                          |        |      |                              |      |                      |    |       |
|--------------------------|--------|------|------------------------------|------|----------------------|----|-------|
| Population               | mn.    | 83.1 | HDI                          | 0.71 | GDP p.c.             | \$ | 2,732 |
| Pop. growth <sup>1</sup> | % p.a. | 1.2  | HDI rank of 177              | 109  | Gini Index           |    | 34.4  |
| Life expectancy          | years  | 71   | UN Education Index           | 0.81 | Poverty <sup>3</sup> | %  | -     |
| Urban population         | %      | 26.4 | Gender equality <sup>2</sup> | -    | Aid per capita       | \$ | 23.0  |

Sources: UNDP, Human Development Report 2006 | The World Bank, World Development Indicators 2007 | OECD Development Assistance Committee 2006. Footnotes: (1) Average annual growth rate 1990-2005. (2) Gender Empowerment Measure (GEM). (3) Percentage of population living on less than \$2 a day.

## Executive Summary

Unlike the personalist communist regimes of North Korea and Cuba, the Vietnamese regime is characterized by a long commitment to collective leadership. For almost three decades – from the North’s independence in 1954 to the sixth party congress in 1986 – the party’s top leadership remained virtually unchanged, a stability and continuity that distinguishes Vietnam from most other former and surviving communist states. Probably no more than 30 people served in the politburo between the party’s first congress in 1935 and its seventh in 1991. In the 50 years since independence, the position of party secretary general has been held by just six people.

Vietnam has not yet shown any clear signs of political liberalization toward democracy. The right of the Communist Party of Vietnam (CPV) to guide the state and society has been codified in the constitution since 1980. While decisions made by the CPV politburo used to have the power of law, today this is the case to a great – but not absolute – extent. The situation is complex; no longer able to make all decisions, the politburo does decide on issues of particular importance. However, the day-to-day exercise of CPV power is delegated to the secretariat. Also, decisions made by the politburo cannot be implemented without both government and National Assembly participation. This is the point where the bureaucracy takes over and much distortion and interference ensues. The tenth party congress of April 2006 also demonstrated the absence of far-reaching change to decision-making procedures. The conservative manner in which the congress was conducted – voting by a show of hands for a list of pre-selected candidates – ensured continuity in formality and gave reformists little opportunity to effect change.

At the same time, the party has grown more tolerant of criticism from within. But the same cannot be said for opposition from outside the party-state apparatus. Individual calls for a multiparty system are regularly and categorically rejected by the political

elite. While some observers have claimed that new pro-democracy groups have emerged to challenge the government's monopoly on power, and that Vietnamese authorities appear to have recognized the existence of an infant pro-democracy movement, the impact of these actors is still very limited and pro-democracy activists still risk detention. At present, the CPV has no rivals for power.

However, on the eve of the Vietnamese-hosted high-profile summit of the Asia-Pacific Economic Cooperation (APEC) Forum in November 2006, which was attended by President George W. Bush and heads of state and government from across the Asia-Pacific region, there were signs that the regime is tolerating pro-democracy efforts. According to various foreign media reports, several political parties have formed in Vietnam since early 2006 without seeking government approval. In a first sign of growing political openness, the government announced the abrogation of a decade-old law that allowed the government to detain people for two years without trial in the name of protecting national security. But there are clear limits to any pro-democracy activism. Officials have raided Internet cafés used by individuals to post underground essays. In November 2006, state media reported that a Vietnamese court sentenced a man to two years in prison for circulating pro-democracy leaflets.

Since the *doi moi* economic reform program was introduced in 1986, Vietnam's economy has been transforming slowly into a market economy. Of all former and current communist states in the Asian-Pacific area, Vietnam has expressed the clearest commitment to a market economy. Although reforms have taken hold in many areas, there are lingering concerns regarding SOE reorganization, the granting of loans, and the state's role in development. The reforms implemented have resulted in, among other things, one of the highest GDP growth rates in the region. GDP expanded by 8.4% in 2005 – the second fastest in Asia behind China and fell slightly to an estimated 8.1% in 2006 due to a number of unforeseen problems. Vietnam also has a desirable FDI rate. In 2006, the total foreign investment commitment rose to \$9 billion, up from \$2.2 billion in 2004 and \$4 billion in 2005.

## History and Characteristics of Transformation

After failed attempts at reform from 1979 to 1985, the Communist Party of Vietnam's (CPV) sixth party congress initiated the *doi moi* economic reform program. In doing so, the party conceded the failure of the centrally planned economy and paved the way for a market economy. However, economic reforms have been accompanied by only moderate structural changes to the political system, and no efforts to democratize have been made. To date there has been no indication of any move toward a multiparty system, and political reforms have focused largely on improving the rule of law, particularly on reducing the high level of corruption. While the government has scored

a number of high-profile successes toward eliminating graft, these efforts are almost exclusively tied to its efforts to attract investment and do not suggest a desire for grassroots political reform. The following description is therefore limited to the economic sector.

Initial reform measures, such as the significant reduction of internal trade barriers and steps toward liberalizing foreign trade, remained largely ineffective due to galloping inflation rates in the triple digits. Desired results came only after the role of agricultural cooperatives had been reduced, planned economy structures had been entirely abolished as prices for most goods and services were allowed to float, and additional trade liberalization measures were implemented in 1988 and 1989. These results included a reduction of the annual inflation rate to 3% per year (1990 – 2004), and Vietnam's rise to its current position as the third-largest rice exporter in the world and the world's second-largest exporter of coffee beans.

In a matter of a few years, Vietnam abolished the neo-Stalinist centrally planned economy introduced in North Vietnam in 1954 and imposed on former South Vietnam following reunification in 1975. Although state-owned enterprises continue to dominate key economic sectors, these sectors also operate on capitalist principles and compete with a growing number of private enterprises. Doi moi has not proceeded without setbacks intensified by external factors. The major economic crisis of 1985, which included hyperinflation, famine and the exodus of refugees from Vietnam (the "boat people" crisis), was followed by the collapse of the Soviet Union in 1991, which meant the loss of the country's most important trading partner and donor of development and military assistance.

Thanks to a successful foreign policy focused on diversifying international relationships, the Vietnamese government was better able to absorb the economic and political aftermath of international structural changes than were other communist regimes. In the 1990s, Vietnam quintupled its international relationships and joined the most important regional and global international organizations. In 1995, Vietnam scored a triple diplomatic success by joining ASEAN, establishing official relations with the United States and signing a framework cooperation agreement with the European Union, which contains a human rights clause and covers economic and trade relations. Because of accession to ASEAN, Vietnam became a member of the ASEAN Free Trade Area (AFTA).

Particularly important to the success of economic development were the normalization of relations with the United States, the lifting of the trade embargo in 1994, and the conclusion of a bilateral trade agreement in 2000. A framework cooperation agreement was signed between the European Commission and Vietnam in 1995. Vietnam's accession to the World Trade Organization (WTO) in January 2007 marked another major success of the government's internationalization strategy.

Since 1990, the Vietnamese economy has shown continual improvement, joining the ranks of countries with mid-range incomes. Despite the CPV's serious commitment to economic reform and its continual implementation of new reform measures, such as improving investment conditions and reducing corruption, not all goals of economic transformation have been reached. Indeed, a large informal economy continues to limit significantly the performance of market economic institutions in Vietnam.

## Transformation Status

### I. Democracy

#### 1 | Stateness

In the first few years after reunification, both the ideological conflict that continued to exist between the North and South and the minority problem, particularly the existence of ethnic enclaves in southern Vietnam, compromised the nationwide enforcement of the state's monopoly on the use of force. Since the dissolution of Front unifié pour la libération des races opprimées (FULRO) in the late 1980s, there have been few problems with state identity. There are some exceptions to the above, as some South Vietnamese, even three decades after reunification, do not want to accept Hanoi as the seat of the state's monopoly on the use of force. All citizens have the same rights, but discrimination against individual ethnic minorities is evident. The central government has a long history of suppressing the Montagnard hill tribes of the central highlands. These dozen or so tribes are distinct from the lowland Vietnamese both ethnically and culturally, many having become practicing Protestants after their introduction to the faith by missionaries accompanying U.S. soldiers during the American war in Vietnam. Under the terms of an agreement signed in Hanoi in January 2005 between the U.N. High Commissioner for Refugees, Vietnam and Cambodia, Montagnards who had arrived in Cambodia and were recognized as refugees could either be resettled to a third country or return to Vietnam, with the guarantee they would not be punished, discriminated against or prosecuted for illegal departure. It is unclear, however, whether Vietnam has adhered to this agreement. In June 2006, a report by Human Rights Watch alleged that Vietnamese authorities had been detaining and interrogating Montagnard asylum seekers who returned to Vietnam from Cambodia.

Monopoly on the use of force

The Vietnamese nation-state is the result of a long and painful anti-colonial and anti-imperialist struggle for independence. The communist revolution was the key to national liberation. As in China and Cuba, the CPV has indigenous roots. The party was not imposed upon the country by the Red Army, but gained power through a war of national liberation. But unlike its Chinese counterpart, the CPV

State identity

has not been discredited by turning on itself or turning the army against the people. National liberation, nation and communism are tightly intertwined and provide the state with a high level of legitimacy. Neither the legitimacy of the nation-state nor the concept of citizenship is questioned by any relevant state or non-state actor.

The political process is completely secularized, although Confucian teachings continue to be important as a framing principle of governmental organization. These teachings, however, are not part of a religious dogma in opposition to the state; rather, they form the basis for exercising power that enhances the communist ideology philosophically and traditionally, and that lends legitimacy to the exercise of authority.

No interference  
of religious  
dogmas

The party-state apparatus is present all over the country with a tripartite government and administrative infrastructure. Despite efforts to decentralize, political decision-making takes place in Hanoi. This centralization of power-brokering, combined with high levels of corruption, has hindered the implementation of many policies, particularly in the South and in Ho Chi Minh City.

Basic  
administration

## 2 | Political Participation

There are no democratic elections at the national or local levels. The most recent “elections” to the National Assembly (Quoc Hoi) in May 2002, however, did bring forth a broader spectrum of delegates than in earlier elections, including independent candidates, representatives of ethnic minorities and religious groups, and entrepreneurs. Three members of the National Assembly are self-nominated and are not members of the Vietnam Fatherland Front, and 51 seats were won by non-party candidates. Ethnic minorities hold 17.3% of seats in the National Assembly, and they enjoy a level of political representation higher than their actual percentage of the total population (14%). The National Assembly has 498 members who are elected to five-year terms. The assembly meets twice a year and has de jure control over legislation, planning and appointments, but in reality, it mostly just confirms the decisions made by party organs. The National Assembly has, however, been gradually emancipating itself from party leaders since 1996. Opposition parties are forbidden, as is the founding of independent unions and associations. Civic groups can operate under certain conditions as long as they do not explicitly question the CPV’s monopoly on authority. The government has reacted harshly to protests by ethnic minorities in recent years, but it has also announced greater accessibility and improved opportunities in political participation for ethnic and religious groups. Initial results of this policy include representation for some of the more moderate groups in the new National Assembly and the fact that the CPV’s general secretary is himself a member of an

Free and fair  
elections

ethnic minority. In 2004, the U.S. State Department ranked Vietnam as one of the most repressive countries in the world for religious freedom. Back then, only a handful of government-approved religions were allowed to operate in Vietnam, but several outlawed churches continued to exist. At the same time, the Catholic congregation has grown from less than 3 million before 1975 to somewhere between 7 million and 8 million at present; this growth has been tolerated by the state. In November 2006, Vietnam was removed from the U.S. State Department's CPC ("country of particular concern") list, which lists states that are "engaged in or tolerated particularly severe violations of religious freedom." Vietnam's removal from the CPC list was based on the finding that "sufficient progress" toward religious freedom had been made. Since 2004, the Vietnamese government has allowed hundreds of congregations to register, legalized hundreds of meeting places, allowed the training of new clergy and released prisoners held on the basis of their religious beliefs. In December 2006, the government officially authorized two Protestant churches (the Vietnam Seventh-Day Adventist Church and the Vietnam Grace Baptist Church) to operate freely.

Vietnam shows no clear sign of political liberalization toward democracy.

Article 69 of the Vietnamese constitution stipulates "The citizen shall enjoy freedom of opinion and speech, freedom of the press, the right to be informed, and the right to assemble, form associations and hold demonstrations in accordance with the provisions of the law." At the same time, these provisions are rendered meaningless by a whole arsenal of regulations and directives that criminalize the peaceful exercise of freedom of expression, religion, association, assembly and the press.

Public opinion exists in a basic form and has found an outlet in the last few years in increasingly critical press coverage. In 2006, newspapers pursued scandals in the ministries of transportation and education, as well as land deals and alleged nepotism by the governor of Vietnam's state bank. However, the media as a whole is still subject to serious manipulation and interference by state and party leaders. While the government controls the entire media, which consists of 600 newspapers and 100 radio and TV stations throughout Vietnam, its ability to control the Internet has predictably been very limited. Blogs have proliferated in Vietnam during the assessment period, though most are carefully apolitical. The most prominent exception is Bloc 8406, so named because the group was launched on 8 April 2006. Bloc 8406's "Manifesto for Freedom and Democracy" has since collected more than 2,000 signatures. The document calls for the restoration of civil liberties, the establishment of opposition political parties, the drafting of a new constitution and democratic elections to the National Assembly. Signatories reportedly include religious leaders, former military staff, scholars and writers. The movement is using the Internet to spread its message and

Effective power  
to govern  
Association /  
assembly rights

Freedom of  
expression



establish contact with dissident groups based outside Vietnam. While these developments partly reflect more freedom of expression, few Vietnamese know about the kind of Internet-based activism found at such sites as Bloc 8406. A great many websites with similar content have existed for some years now; however, these are maintained by overseas Vietnamese in the United States or France and are in fact banned in Vietnam.

### 3 | Rule of Law

There is no separation of powers in the Vietnamese state. In an attempt to introduce a system of checks and balances, at least on paper, a 2001 amendment to the 1992 constitution gave the National Assembly the right of no-confidence votes on the governmental personnel it elects. The no-confidence vote is more theoretical than real, since the party controls the composition of the National Assembly through the Vietnam Fatherland Front. In addition, the state budget law of 2004 made the National Assembly responsible for the approval of the budget and allocations to the lower government levels.

Separation of powers

The judiciary is clearly subject to the CPV. As Vietnam becomes increasingly integrated into international politics, its legal system has undergone some reforms. In general, however, the Vietnamese legal system does not conform to international standards. Provisions such as a law on investment in construction and a law on price shifting are still absent, but they are on the legislative agenda of the National Assembly. In addition, Vietnam's legal system is not sufficiently transparent and lacks consistency, stability and efficient implementation.

Independent judiciary

During the assessment period, the government made modest progress in its fight against corruption with some high profile public prosecutions of government officials, party members and people in business. In 2006, the Party Central Committee's Commission for Inspection decided to execute disciplinary actions against one party organization, 20 officials and eight centrally-managed cases. Up to 665 accused party members faced prosecution and 426 others were suspended from party activities. It seems, however, that the crackdown on corruption has been highly selective. The "private use" of offices and mandates, fostered by existing political, legal and procedural loopholes, is still possible despite intensified control within the party.

Prosecution of office abuse

While the state has improved on recognizing civil rights legally, the effective respect of these legal guarantees is only partial at best. Basic human and civil rights, particularly those of ethnic minorities, are violated. International human rights observers are not allowed into the country. The state demonstrated greater tolerance for religious communities during the evaluation period (see Free elections, 2.1). Legal action against a state official for human or civil rights

Civil rights

violations is near impossible, unless the CPV wants to make an example of or reprimand the accused. According to human rights organizations, trials in Vietnamese courts are not conducted fairly. The accused cannot call or question any witnesses, and the defense attorney's only option is to petition for mercy on behalf of his client.

#### 4 | Stability of Democratic Institutions

There are no democratic institutions in Vietnam. All central political institutions are embedded in the state party system, which was very stable during the assessment period and so far has not shown any democratization potential.

Performance of democratic institutions

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Commitment to democratic institutions

#### 5 | Political and Social Integration

In accordance with the constitution, the CPV maintains its monopoly on the leadership of the state and society. The CPV has approximately three million members. All national associations and interest groups, such as unions, farmers' unions, youth leagues, women's unions and other organizations, are encompassed within the Fatherland Front.

Party system

Intermediary actors have been emerging since the early 1990s as a result of economic transformation and the societal and socioeconomic changes associated with it. Most of them work exclusively on a local level and are tolerated by the state as long as their activities are in harmony with the framework set out by the CPV.

Interest groups

Non-governmental organizations, which are defined very broadly by the Vietnamese, are filling in gaps opened up by economic reforms. Due to limited state resources, problems related to the environment, education, health care, employment and basic social care can no longer be dealt with and solved by the CPV and its mass organizations alone. Social engagement helps to close these gaps. The official party line is that society itself should take on more responsibility. The government coined the term "socialization" (xa hoi hoa) for this strategy. State and private actors are engaged here in a symbiotic relationship that is defined in functional terms. This developing network of self-organized groups and organizations does not yet fulfill the criteria of civic autonomy, but it could be a preliminary step in the emergence of a civil society.

Associational activities

## II. Market Economy

### 6 | Level of Socioeconomic Development

Vietnam's HDI has been improving steadily as a result of the economic reforms in place since the mid-1980s, from 0.583 in 1985 to 0.688 in 2000, 0.691 in 2002 and 0.709 in 2004. These improvements enabled Vietnam to improve slightly its development ranking from 111th (HDI 2004) to 109th (HDI 2006) out of 177 countries during the assessment period. Vietnam ranked 41st out of 95 countries in the 2004 Human Poverty Index (HPI). During the period from 1990 to 2002, 17.7% of the population was living below \$1 per day (more recent data is not available). On the one hand, the government has recognized the need for targeted interventions in favor of disadvantaged groups, including ethnic minority groups. Among key national poverty reduction programs, the "Poor Communes with Extreme Difficulties in Mountainous and Remote Areas," known as Program 135, coordinated by the Committee for Ethnic Minorities and Mountainous Areas, directly targets the 1,000 poorest communes in remote and mountainous areas. On the other hand, despite the country's rapid economic growth and the government's efforts to improve living standards, poverty is still pervasive and persistent among ethnic minorities, which constitute only 14% of the population but account for more than 30% of the poor. Poverty among ethnic minorities is attributable primarily to geographical isolation as well as a limited access to credit, productive assets and quality social services. Income disparity and social exclusion have increased somewhat during the period under review. The Gini coefficient went up from 35.7 in 1998) to 37 in 2002). More recent data is not available. While regional differences have to be taken into account, the regional Gini coefficients remained remarkably stable. The data suggest that inter-regional income differences have become more important than intra-regional income differences.

Socioeconomic  
barriers

| Economic indicators |        | 2002   | 2003   | 2004   | 2005          |
|---------------------|--------|--------|--------|--------|---------------|
| GDP                 | \$ mn. | 35,058 | 39,672 | 45,210 | <b>52,408</b> |
| Growth of GDP       | %      | 7.1    | 7.3    | 7.7    | <b>8.4</b>    |
| Inflation (CPI)     | %      | 3.8    | 3.1    | 7.8    | <b>8.3</b>    |

|                           |          | 2002     | 2003     | 2004     | 2005            |
|---------------------------|----------|----------|----------|----------|-----------------|
| Unemployment              | %        | -        | -        | 2.1      | -               |
| Foreign direct investment | % of GDP | 4.0      | 3.7      | 3.6      | <b>3.7</b>      |
| Export growth             | %        | 11       | 19.6     | 27.9     | <b>16.5</b>     |
| Import growth             | %        | 22.2     | 25.3     | 25.2     | <b>17.6</b>     |
| Current account balance   | \$ mn.   | -604.0   | -1931.0  | -957.0   | <b>216.8</b>    |
| Public debt               | \$ mn.   | 12,178.6 | 14,363.3 | 15,613.7 | <b>16,512.6</b> |
| External debt             | \$ mn.   | 13,343.9 | 15,991.4 | 18,027.3 | <b>19,286.6</b> |
| External debt service     | % of GNI | 3.5      | 2.1      | 1.8      | <b>1.9</b>      |
| Cash surplus or deficit   | % of GDP | -        | -        | -        | -               |
| Tax Revenue               | % of GDP | -        | -        | -        | -               |
| Government consumption    | % of GDP | 6.2      | 6.3      | 6.4      | <b>6.2</b>      |
| Public expnd. on edu.     | % of GDP | -        | -        | -        | -               |
| Public expnd. on health   | % of GDP | 1.4      | 1.5      | 1.5      | -               |
| R&D expenditure           | % of GDP | 0.2      | -        | -        | -               |
| Military expenditure      | % of GDP | -        | -        | -        | -               |

Sources: The World Bank, World Development Indicators 2007 | UNESCO Institute for Statistics | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security

## 7 | Organization of the Market and Competition

The new enterprise law of 2000, which simplified the process of starting a new business by easing application procedures, marked a turning point in Vietnam's development toward a market-based economy. The law was followed by an amendment to the constitution granting the private sector the same status as Vietnam's public sector. Party members are also allowed to engage in private business. Both the new legal framework and a changed political climate have triggered a boom in starting new businesses. However, there are still several obstacles in private sector development. Discrimination in policy implementation regarding credit, real estate and training, result in discrepancies between private and public sector treatment. State monopolies are still common in the Vietnamese economy. While some forms of pricing have been liberalized, the state continues to set several key prices, including the (foreign) exchange rate, interest rate and

Market-based  
competition

the prices of some goods. Some economic sectors are market-driven, but many branches still depend on state plans, including telecommunication, finance and banking, transportation, electricity and water supply. The absence of legislation is a key problem. For example, current legislation does not allow foreign companies to register their local branches. A new decree announced by the government in July 2006 failed to provide guidance on the issue. At the same time, the implementation of new laws is sometimes hindered by the fact that disagreement between interest groups in the government and the CPV continues even after legislation has been passed by the National Assembly. It seems that many pieces of legislation in Vietnam are passed without proper evaluation of their impact.

A law on competition went into effect on 1 July 2005. It applies to all business enterprises and professional and trade associations in Vietnam, overseas enterprises and associations registered in Vietnam, public utilities and state monopoly enterprises, and state administrative bodies. The competition law has supremacy over all other enacted laws in Vietnam regarding restrictive business practices and unfair trade practices. The law prohibits five broad types of anti-competitive practices: (1) competition restriction agreements; (2) abuse of dominant or monopoly position; (3) “concentrations of economic power” that substantially restrict competition; (4) acts of unhealthy competition; and (5) anti-competitive behaviors and decisions by state agency officials who misuse their position. While the adoption of the competition law is expected to provide important tools to ensure a level playing field for all enterprises, observers have noted that the socialist government still has a strong interest in retaining control over the economy as one of its key assets. Consequently there is the constant political temptation to restrain the power of competition authorities in their efforts to implement the new law.

Anti-monopoly  
policy

Vietnam has made impressive efforts to liberalize its foreign trade. Vietnam has opened itself up rapidly to foreign influence since the 1980s, a process which has been accompanied by growing trade liberalization. This process has been marked by the following key events: ASEAN membership in 1995, APEC membership in 1998, the lifting of the U.S. trade embargo in 1994, and concluding a bilateral trade agreement with the United States in 2000 that gave Vietnam most favored nation status. After long, complicated negotiations and delays, Vietnam joined the WTO as its fiftieth member on 11 January 2007. As a member of ASEAN, Vietnam became a member of the ASEAN Free Trade Zone (AFTA), leading to sharp reductions in tariffs on imports from Southeast Asian states. In addition, under the U.S. Bilateral Trade Agreement, which was signed in 2001, average tariffs on Vietnam’s exports to the United States were reduced to 3-4% from some 40%, and Vietnam undertook significant commitments to reduce its own tariff and non-tariff trade barriers. These measures paved the way for a rebound in FDI inflows, a surge in imports for capacity expansion in foreign-invested

Liberalization of  
foreign trade

companies, and a revival of strong export growth. Vietnam's trade openness, as measured by its total trade in goods and services, reached over 150% of GDP in 2005, up from about 50% of GDP in 1991. However, the government controls trade through a licensing system. Restrictions also include quotas, excise taxes, reference prices and direct import bans.

Since 1988, and especially since 1992, Vietnam has moved to a diversified system in which state-owned, joint stock, joint venture and foreign banks provide services to a broader customer base. However, the four main state-owned commercial banks account for around 80% of all loans. Restructuring of the banking sector is proceeding slowly, mostly under pressure from the IMF, but it has not been able to keep pace with market economy reforms. Bank lending is often treated as an arm of government policy. During the assessment period, state-owned commercial banks continued to be instructed to finance large, government-approved state-owned enterprise projects. Banks are also regularly directed to offer preferential interest rates and debt relief to farmers. In more encouraging news, the rate of growth of credit to the economy decelerated considerably in 2006. A continuation of this trend would help contain inflation and slow the growth of non-performing loans. Under the terms of the WTO agreements, Vietnam had to liberalize the entry of foreign banks that will be allowed to open their own branches in the country starting in 1 April 2007. This step is likely to increase competitive pressures on domestic banks and highlight the urgency of banking sector reform.

Banking system

## 8 | Currency and Price Stability

Shocked by the hyperinflation of the mid-1980s, the government has made fighting inflation its highest priority and has been able to keep inflation at an average annual rate of around 3% (1990 – 2004). However, inflation has reached much higher levels since 2004, mainly because of higher food prices, the impact of rising international commodity prices (mainly oil) and also buoyant consumer demand. Concerned about the rise in inflation and the rapid expansion of net domestic credit, the government sharply raised the reserve requirement ratio for commercial banks in July 2004 to slow down lending. While the average rate of inflation edged down to about 7.5% in 2006, it remains higher and more entrenched than in most other Asian countries. The national currency, the dong, is not convertible. While the government manages the exchange rate to serving political purposes, the dong's exchange rate against the dollar, which averaged 15,859 dong to \$1 in 2005, is seen as realistic. The government has adopted a plan to make the dong fully convertible by 2010. The central bank is not independent from the government.

Anti-inflation /  
forex policy

Vietnam's financial fundamentals are relatively strong in relation to comparable emerging markets. Total external debt fell from 35.2% to 32.0% of GDP between 2002 and 2005. The current debt service ratio is manageable. With a stable debt service payment and strong growth in exports, the debt service ratio has been steadily declining since 1998 and stood at 5.6% of goods and services exports in 2005, down from 8.3% in 2002. However, despite a large oil revenue windfall during the assessment period, the stock of public debt has rapidly expanded and reached a level of about 45% percent of GDP in 2006, up from 38.2% in 2002. This trend is likely to continue in the coming years, as the Socioeconomic Development Plan (SEDP) for 2006 – 2010 envisages sustained heavy reliance on public investment to improve the infrastructure.

Macrostability

## 9 | Private Property

Property rights and the regulation of property acquisition are formally defined by law, but are not yet sufficiently protected from intervention by the state. As part of its bid to enter the WTO, Vietnam consolidated its confusing maze of intellectual property rules and regulations into a streamlined law that came into force in July 2006. The law covers copyright, industrial property and plant varieties. However, given the rapidity of change, it is difficult for the law enforcement agencies to keep up.

Property rights

The pace of privatization (the Vietnamese term is “equitization”) was rapid in 1999 and 2000, but has slowed since then. While the number of SOEs has fallen from 12,000 in 1998 to below 4,000, most of the SOEs that have been privatized are small, and the most important large companies are still controlled by the government. Almost 90% of current SOE assets remain under government control. The state owns all land and grants land-use rights to farmers, businesses and homeowners.

Private  
enterprise

## 10 | Welfare Regime

Substantial progress was made in fighting poverty during the observation period largely because of improved coordination between NGOs, international actors and the state. This progress was reflected in an increase in GDP per capita and improved HDI and Human Poverty Index ratings. Vietnam has succeeded in reducing poverty rates from over 60% in 1990 to 18.1% in 2004, largely due to its rapid annual economic growth, according to the UNDP. Vietnam's foreign donors have acknowledged the “pro-poor orientation of government investment.” Like other communist countries, Vietnam has established above average social networks and health care structures in comparison with other countries of a similar level of development. In addition, Vietnam has a strong tradition of

Social safety nets

education, which is not necessarily manifest in outstanding educational institutions, but rather in its comparatively high literacy rates.

Not all groups have equal access to social, educational and health care institutions. While gender-based discrimination is less common as compared to other states in the region (women have better access to higher education and public office than in any other Southeast Asian state), ethnic minorities and those living in isolated mountain regions are particularly disadvantaged. Vietnam's first National Millennium Development Goals report, launched in September 2005 and distributed at the 2005 World Summit, showed that social disparities and inequality among regions, genders and ethnic groups are on the rise. While urban areas have benefited most from reforms and the expanding economy, poverty is persistent in many rural areas and is extremely high among ethnic minority groups – 69.3% in 2002, according to the General Statistics Office. Economic reforms have led to, among other things, a commercialization of the health care system, resulting in a “two-class medical system.” In keeping with the communist ideal, Vietnamese society still demonstrates many very egalitarian characteristics in comparison to other Southeast Asian countries, but new inequalities worsened with increasing speed during the evaluation period. Access to public services, higher education, advancement mechanisms and public office is frequently dependent on ethnic and, increasingly, socioeconomic background. Preventive mechanisms such as entrance exams for universities, have had only a limited effect on balancing out social differences.

Equal opportunity

## 11 | Economic Performance

Vietnam's foreign donors have praised the country for its impressive overall record of economic performance in 2005 and 2006. GDP growth was sustained at around 8% in 2006. Brisk export growth and buoyant capital inflows have led to continued strengthening of the balance of payments, and poverty has continued to decline rapidly. After China, Vietnam has been the second-fastest growing economy in the world in recent years. In 2005, exports increased by 22% year after year to reach \$32.4 billion, while import volume increased by around 16% to \$33.3 billion. As a result, the merchandise trade deficit eased significantly from \$2.3 billion in 2004 to \$838 million in 2005. However, despite strong economic growth, the country's external position is considered to be generally weak, due to a lack of long-term export competitiveness as compared with other Asian economies. The average rate of inflation (7.6% in 2006) remained higher and more entrenched than in most other Asian countries. Despite a large oil revenue windfall, the stock of public debt has remained on a path of rapid expansion, reaching a level of about 45% of GDP in 2006.

Output strength



## 12 | Sustainability

In the past, environmental considerations were put on the back burner for the sake of economic growth. Vietnam did not begin to take steps in creating a strategy for sustainable development until very recently and it has done so only in cooperation with international donors. Rapid, unsustainable economic growth has resulted in the reduction of old growth forests, a continued loss of habitat, uncontrolled waste dumping and a massive reduction in farmland. While overall forest cover in Vietnam has been increasing in recent years from a low of 28% in 1990 to the current level of 37.6%, its quality is diminishing. Approximately 70,000 hectares of land area per year are lost through ground erosion and the expansion of urban megalopolises, which is a problem because only 22% of the total land area is available for agricultural purposes, and the arable portion of that land per capita is one of the lowest in the world, at 0.13 hectares. Sustainable management for the Mekong River, partly in cooperation with the other riparian states, has emerged as a main policy focus. The Mekong River basin has long suffered flooding, salt-water influx, forest depletion, groundwater deterioration, water pollution and other problems. According to the Asian Development Bank, the Vietnamese government has demonstrated strong commitment in strengthening the strategic, legislative and institutional context for environmental protection and management. Several high-level strategies, including the National Strategy for Environmental Protection to 2010, which acknowledges the links between environmental stakes and poverty, have enhanced Vietnam's strategic policy framework. However, there is a lack of clear prioritization among the various strategies, and the issues and objectives are numerous while targets, where given, are ambitious.

Environmental  
policy

While Vietnam's literacy rate of nearly 90% is high compared with most other low income countries, this figure is based on the number of people with three years of primary education. According to the United Kingdom's Department for International Development, a recent survey of reading achievement at Grade 5, the end of primary school, found that in some areas about 40% of children do not have sufficient skills for further learning. The country still has one of the worst-equipped education sectors in the Asian-Pacific region. It is ranked behind China, Indonesia, Thailand and the Philippines, to name a few. However, there have been some advances; the greatest success during the assessment period was the increase in number of children completing grade school. While only 55.5% of children completed primary school in 2000, the figure jumped to 87% in the 2003 (more recent data is unavailable). There were also some advances in the tertiary education sector. There is no information available on R&D expenditures.

Education policy  
/ R&D

# Transformation Management

## I. Level of Difficulty

Conditions for Vietnam's economic transformation were difficult from the outset. At the start of *doi moi* in 1986, the country was still quite isolated internationally and was almost completely dependent on the Soviet Union for trade and on donors for development assistance. After several decades of failed experiments in a planned economy and the high economic burden of two wars (against France and the United States), the country faced a new start in the 1980s. The lack of historical reference points made starting reform even more difficult. Vietnam did not have any experience with the workings of a market economy and could not, at first, count on the assistance of Western industrialized nations. The state's strong position was generally a benefit, helping to ensure the successful implementation of economic reforms.

Structural  
constraints

Rampant corruption, which has spiraled out of control despite the government's attempts to reduce it, is the main structural obstacle to governance observed during the assessment period. The misallocation of resources resulting from an inefficient and highly corrupt administrative sector constitutes a major obstacle to efficient reform. In 2005, the CPV undertook a survey on public attitudes towards corruption. The survey revealed that around 60% of respondents admitted to having paid a bribe for public services. And more than 30% of public servants who responded to the survey said that they would accept a bribe if offered. Rent-seeking behavior is commonplace.

Anti-corruption was the top agenda item of the tenth party congress in April 2006. Central Committee member Phan Dien noted in a press conference that "corruption is a threat to the survival of the Vietnamese Communist Party." However, the party-state apparatus seems to lack effective measures to succeed in the short term. At the end of 2005, the National Assembly passed Vietnam's first anti-corruption law. It is largely a re-statement of the 1998 anti-corruption ordinance, though it represents an improvement with regards to disclosure. The disclosure requirement is presently limited only to the public servant and excludes his or her immediate family. Another problem is that financial disclosures are to be submitted internally and are not subject to any external

review. The lack of an independent anti-corruption agency that can credibly seek out and punish corrupt officials hinders any effective enforcement of the law. Other constraints include the persistence of the North-South divide, high levels of poverty despite recent significant achievements in the area of poverty reduction, and the existence of conservative veto actors within the party-state system who, for example, successfully managed to slow the pace of the privatization of SOEs. Vietnam's infrastructure still suffers from the impact of the war and the lack of investment in the 1980s. The development of infrastructure, including roads, ports, machinery, telecommunications and the water supply system, is essential to reducing further structural constraints on governance.

There is no tradition of civil society in a Western sense. Vietnam's civil society organizations perceive themselves as working in partnership with the Vietnamese government rather than as being outside of and independent from the party-state system.

Civil society  
traditions

With a proportion of ethnic minorities between 13% and 16.5%, depending on the source, Vietnam is one of the most ethnically heterogeneous societies in the Asian-Pacific region. Conflicts, as well as ethnic, religious and social differences were mostly masked by communist ideology until only a few years ago, but have skyrocketed during the assessment period. Social and ethnic conflicts found their expression in several local protests. Since the government has embarked on a seemingly successful strategy to improve the livelihoods of the ethnic minorities, it can be assumed that the concerns of civil society actors, defined in the broadest possible sense, are at least partially being taken into account. Civic protest movements are generally limited to the local level, are spontaneously organized and are directed against ethnic and general socioeconomic discrimination, but they have not yet been able to challenge the political regime. Demands for democracy are increasing, but they are still largely limited to uncoordinated activities on the part of individual dissidents who, for the time being, lack a broader base. The government's willingness to work on social conflict grew during the assessment period. The government does not always react to protests with violent crackdowns, at least with some groups of actors. Instead, it engages in dialogue and demonstrates interest in cooperating. This could be the first sign of a gradual process within the CPV to re-think the relationship between the state and society.

Conflict intensity

## II. Management Performance

### 14 | Steering Capability

The government is following a clear goal of long-term economic restructuring. The doi moi program, which has been implemented consistently in many areas since 1986, speaks for the long-term character of reforms. This is manifest particularly in the advances made in securing private property institutionally and opening the Vietnamese economy to international markets, which culminated in Vietnam's accession to the WTO in January 2007. The objectives of economic transformation generally meet the country's development needs. The greatest success could be achieved in poverty reduction.

Prioritization

Reforms are limited to the market economy and do not include any political liberalization. Even economic reforms have not been implemented effectively in all areas. For example, according to the Asian Development Bank, the private sector accounted for over 50% of GDP, 27% of total invested capital and more than 90% of the total workforce in 2005. However, its potential for wealth creation is still largely undeveloped, as the country remains one of the lowest per capita income countries in Southeast Asia. Vietnam also maintains a large informal shadow economy, which analysts estimate at between 16-50% of the formal economy. These estimates indicate clear limits to the effectiveness of reform implementation..

Implementation

The leading political actors are capable of learning from mistakes, as the modifications of legal frameworks within relatively short periods have proven. A flexible and adaptable political system is simply not possible under the current situation, however, and efforts to bring it about have reached their limits repeatedly in the face of established stakeholders' interests, including CPV cadres and the military.

Policy learning

### 15 | Resource Efficiency

According to a UNDP study, the administrative sector is neither large nor bloated, which contradicts popular opinion. Federal employees make up only 3.5% of employees in the sector and constitute a small part of the total number of public employees when compared with other countries in the region, with smaller numbers than in Japan and Indonesia. The government recognized the

Efficient use of assets

necessity of administrative reform early on in the reform process, but there are still problems with the structure and organization of the bureaucracy. Superfluous intermediary administrative levels, a lack of transparency in the decision-making process, administrative rules, regulations and procedures that frequently change without notice or reason, insufficient coordination between offices, close formal and informal ties with the CPV, and patronage all result in wasted resources.

Although Vietnam has made considerable gains in improving its macroeconomic framework conditions, it is clear that institutional and administrative structures are lagging behind. In cooperation with the UNDP and other donor organizations, the government has been working on an administrative reform program (Public Administrative Reform, or PAR) since 1994 to support and strengthen the economic reform process. PAR focuses primarily on devolving power to the provinces. Minimal progress was achieved in the granting of more rights to implement their own development plans to regional and local administrative units. The military continues to eat up the lion's share of available resources, despite massive cuts in defense spending following Vietnam's withdrawal from Cambodia in 1989. The half-million strong People's Army includes the navy, air force, army, border troops and is supplemented by reserves of four million local self-defense troops. The People's Army is second only to the CPV as Vietnam's most important actor and has a strong presence in all of the country's political, economic and societal sectors. There are only a few areas in which the efficient use of resources can be detected. For example, the government reacted successfully to the need for inflation-fighting measures and a reduction in the budget deficit by implementing a strict fiscal policy and an anti-cyclical investment policy. State budget planning and execution is not entirely transparent. Although, since 2000, the General Statistics Office of Vietnam has regularly published the national budget, except for the budgets of the Ministry of Defense, the Ministry of Public Security and the Ministry of Foreign Affairs, the data is often overdue and only becomes available months after the respective fiscal year has ended.

Despite all of its success, this reform policy has not been universally consistent and coherent. SOE privatization is slow and is explained by the fact that the government wants to avoid a significant short-term increase in social costs, especially a rise in the already high levels of unemployment. Important strides have been made in financial and legal reforms, but they still lag behind the general thrust of the economic reform process.

Policy coordination

The greatest challenge is fighting corruption. Despite the CPV's intensified anti-corruption campaign, including the prosecution of some allegedly corrupt, and in some cases prominent, party functionaries and government officials for the sake of good publicity, patronage continues to be a significant distribution principal.

Anti-corruption  
policy

Corruption was discussed with unprecedented frankness at the tenth party congress in April 2006 as the biggest threat to the CPV's continued legitimacy. According to delegates, corruption is growing increasingly organized, common, and is spreading across all areas of government.

## 16 | Consensus-Building

All relevant actors agree about the general direction that economic reforms should take, although their notions about the scope and speed of the individual reforms vary somewhat. The slow-moving pace of SOE privatization is a clear indicator of the continuing conflicts within the party-state apparatus over specific interpretations of *doi moi*. Even the open, fundamental consensus within the party regarding the reform program is a relatively recent achievement. It was not until the ninth party congress in 2001 that the reformers finally improved their position vis-à-vis the communist hardliners within the CPV. Despite a National Assembly that is growing increasingly emancipated from the politburo, consensus continues to be found according to the rules of the communist regime. No major shifts among the key players in the party-state system took place during the assessment period, indicating the absence of major conflicts over the general direction of the reform process. There is consensus within society as a whole on *doi moi*, but only in terms of the rough objectives. While the entrepreneurs in the South, which is strongly dominated by the market, generally desire a considerable acceleration of the reforms, northern political actors are keen to prevent the economic reforms from spilling over into the political sector. There are hardly any civic traditions at all.

Consensus on goals

Vietnam's WTO membership and the general thrust of the economic reform program, which is clearly spearheaded by a market-friendly political elite, has reduced the power and influence of conservative anti-reform veto actors. The pro-reform powers have won the upper hand since the ninth party congress in 2001. Three groups can be broadly identified within the CPV. The first group can be described as hardliners. They are not in the majority anymore but maintain a powerful position within the state-party system and are thus the main veto actors. The hardliners reject any far-reaching reforms beyond structural adjustments that challenge the ideological foundations of the CPV. The second group is more moderate and promotes change while holding on to the one-party system. The third, most progressive and also smallest group of the three (mainly communist veterans turned dissidents) wants far-reaching reforms and favors democracy and a multiparty system.

Anti-democratic veto actors

A great majority of actors recognize the advantages economic reforms. However, certain sectors of the political elite are concerned that an overly rapid political integration process, due to potential influence from external actors,

Cleavage / conflict management

could have a destabilizing effect on Vietnam's political organization, posing a danger to the CPV's rule. While this cleavage between reformers and veto actors has been successfully managed to the extent that it has not escalated into serious conflict, it is, as demonstrated by the tenth party congress, still the main obstacle to deepening and broadening the reform process.

Civil society is not engaged in the political process, at least not in a Western understanding.

Civil society participation

Vietnam and the United States made significant progress in improving their relations during the assessment period as the U.S. Congress approved permanent normal trade relations with Vietnam, which was a precondition for Vietnam's WTO membership. However, there has been no official attempt at reconciliation within Vietnam's domestic context.

Reconciliation

## 17 | International Cooperation

Vietnam is the top recipient of Western and Japanese official development assistance in Southeast Asia in absolute terms. The government has effectively utilized international assistance for its domestic policy agenda to strengthen the doi moi reform program, particularly in poverty reduction and infrastructural improvements. Vietnam's donors pledged \$4.44 billion to help poverty reduction and economic growth programs in 2007, up from \$3.7 billion in 2006; of the \$700 million difference, about \$200 million was attributed to exchange rate movements. Japan is still Vietnam's largest single donor, pledging \$890 million. The European Union put up a combined \$948 million. The Vietnamese government believes it will need \$140 billion of investment capital for the 2006 – 2010 period.

Effective use of support

Cooperation with international donor organizations and other international partners is generally trouble-free and has resulted in considerable cooperative contributions to reform, such as programs to fight poverty and environmental protection programs. Willingness to collaborate on development with Vietnam has grown, especially since the party congress in 2001, which proclaimed a definite commitment to continuing reforms. The Vietnamese government is perceived as a generally reliable partner by national governments in Europe, North America and Asia, as well as international organizations such as the Asian Development Bank and the World Bank.

Credibility

The diversification of international relationships since the end of the Cold War and the end of Vietnam's general international isolation has been very successful. In 1989, Vietnam had diplomatic relations with only 23 non-communist states, a number that grew to 167 by 2004. Political actors have been

Regional cooperation

very active and success in building and strengthening as many international cooperation relationships as possible, as Vietnam's membership in ASEAN, Asia-Pacific Economic Cooperation (APEC), the Greater Mekong Subregion (GMS), and Asia Europe Summit Meeting (ASEM) and other organizations, along with its WTO membership demonstrate. Additionally, Vietnam hosted the APEC summit in November 2006 and the fifth ASEM summit in October 2004. Finally, major improvements were also made in Vietnam's previously problematic and often hostile relationships with Cambodia, Thailand and China.



## Strategic Outlook

Vietnam is still far from meeting even the most minimal requirements of a democracy under the rule of law. There has been no genuine democratization in Vietnam during the period under review despite some encouraging signs such as a growing advocacy of democratic reform among social actors. Also, several previously disadvantaged groups, such as ethnic minorities and religious actors, have won increased opportunity for political participation, and the party-state apparatus has opened itself up to external influence in opinion formation and decision-making. However, economic transformation has not, so far, induced political transformation. Stateness has remained at its former levels. The rule of law has improved slightly due to some new laws, which have the potential to increase the level of transparency and predictability, particularly in relations between the private sector and the state and among enterprises. There is, however, no separation of powers, and the judicial branch is still clearly subject to the CPV.

Vietnam's recent entry into the WTO is likely to provide enhanced opportunities for continued rapid economic development and sustained poverty reduction in the coming years. In 2005 and 2006, the prospect of WTO membership already encouraged a surge of foreign portfolio investment, contributing to an ongoing boom in Vietnam's nascent stock market. However, many obstacles to the development of the private sector remain, including discriminatory state policies, such as those determining access to credit and real estate, which continue to favor SOEs. After significant progress toward SOE privatization of SOEs was made in 2000 and 2001, the value of assets "equitized" since then has been rather small.

Apart from obstacles to SOE privatization, the biggest structural and institutional problems yet to be tackled seriously are corruption, the banking sector, the absence of the rule of law, the inefficient implementation of government policies aimed at the support of ethnic minorities, and the slowly but steadily growing disparity of income levels. Some success can be seen in the fight against poverty.

Banking sector reform should focus on creating a two-tier banking system, establishing viable private sector banks, and eliminating discrimination between the state and the private sectors as far as access to credit is concerned. Furthermore, administrative reform and the establishment of a modern legal system, particularly in the areas of land, trade, investment and company law, are an essential precondition for any serious step toward a consolidating a market

economy. There is no doubt that the CPV is prepared to continue with Vietnam's transformation to a market economy. It will focus on fighting corruption, intensifying the fight against poverty, and, increasingly, environmental sustainability in coming years. In addition, the government will have to look at the problem of asymmetric development and focus on socioeconomic disparities both within society as a whole and between regions. The latter still endangers the fragile nation-building process and could sharpen tensions between the North and South. Approximately two-thirds of GDP and 80% of tax revenues are produced in the industrial parks on the outskirts of Ho Chi Minh City and the rice fields of the Mekong Delta.

The fact that Vietnam is rich in natural resources and has managed to establish itself as a major exporter of oil, rice, seafood and coffee, but has yet to tap quite a number of resources, presents another challenge. Vietnam has a large farming sector in desperate need of modernization. Opportunities for expanding manufacturing industries and for building up an information technology sector have not been fully exploited. Vietnam's integration into the international community will continue.

While it is not as easy to make predictions regarding political development, it is highly unlikely that the country's system will open up to democratic reform in the short term. The CPV still agrees that liberalization should be limited to the economic sector and that political changes could, at best, be introduced to the internal relationship between the state and party organs. The CPV believes that development in the direction of a liberal democracy, however, should be prevented at all costs. Despite the population's growing willingness to protest and a seemingly increasing number of pro-democracy activists, there has still been no serious challenge to the CPV's monopoly on authority. In the coming years, the small civic sector is nevertheless likely to grow, and intra-party debate is likely to intensify.