

# CRS Report for Congress

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## **Vietnam: Economic/Political Developments and U.S. Relations**

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### **Summary**

Vietnam's experiment with economic reforms continues to outpace liberalization of its political system. The Eighth Vietnamese Party Congress, which ended on July 2, 1996, failed to resolve deep-rooted differences among the communist leadership concerning the pace and scope of economic reforms. These continuing divisions among Vietnam's top leaders likely will affect relations with the United States, including efforts to normalize commercial relations.

### **Background<sup>1</sup>**

Vietnam's political and economic reforms began in the latter 1980s. A major generational change in leadership coincided with grave internal difficulties and external pressures to prompt significant changes in Vietnamese policy. In late 1986, "old Guard" leaders were eased from power in favor of a new generation of communist leaders. The latter were more sensitive to the fact that their political standing rested to a considerable degree on their ability to improve the livelihood of the Vietnamese people through domestic reforms and international initiatives designed to reduce Vietnam's isolation stemming, in part, from its 10-year occupation of Cambodia. They acted to revitalize the Vietnamese economy, reform and improve the efficiency of the government-party apparatus, and to broaden Vietnam's economic and political contacts beyond the Soviet bloc.

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<sup>1</sup> This background section draws heavily from Sutter, Robert G. Vietnam in Transition and Vietnamese Relations with the United States, CRS Report 95-254 S. January 31, 1995. 10 p.

## Economic Developments

In an effort to avoid the stagnant production, shortages, and limited famine that characterized past, more orthodox Communist economic policies, Vietnam's leaders initiated an economic reform program in 1986. Known as *doi moi* in Vietnamese (literally economic renovation), the reforms attempted to replace a centrally planned economy with a "regulated market economy."

At the heart of the reforms were measures that eliminated price controls, gave farmers greater control over what they could produce, abandoned central planning, clarified the legal status of private businesses, and tightened government spending. As part of the latter attempt, efforts were made to limit subsidies to state-owned enterprises (SOEs) by providing them greater autonomy in production, investment, and pricing decisions. The authorities also moved to open the economy to foreign trade and investment and to attract foreign assistance.

Vietnam's economy has prospered since the reforms commenced. After years of negative growth, economic activity increased an average annual of 3.9% from 1986-1990 and of 7.6% from 1991-1993 in real terms. The economy grew by 8.8% in 1994 and by 9.5% in 1995. Another year of 9.5% growth is forecast for 1996. As a result, Vietnam's gross domestic product is projected to reach \$24 billion this year, a level that will raise its average per capita income above \$300 for the first time.<sup>2</sup>

Vietnam's rapid growth in 1996 is being accompanied by low inflation, due primarily to tight monetary policy and a fall in commodity prices. Through September, the cost of living increased by only 2.9%, in contrast to an increase of 17.1% for the comparable period in 1995. The drop in inflation has allowed the central bank to lower interest rates to around 16%.<sup>3</sup>

Against this favorable background, the Vietnamese leaders are confronted by both immediate and longer-run economic challenges. The immediate problems facing the economy include a rising trade deficit and declining foreign interest in Vietnam as an investment site. Reform of the state sector is a top longer-term challenge.

### *Near-term Economic Challenges*

Vietnam's trade deficit through the first eight months of this year totalled \$3.2 billion, nearly \$1 billion more than the deficit for calendar year 1995. This widening trade deficit is large by international standards (equivalent to 15% of GDP) and may force Vietnam's policymakers to consider slower growth, import restraints, or a devaluation by 1997. Any of these steps could prove controversial to different groups.

Lagging interest by foreign investors is a second near-term problem. Foreign investment approvals totalled \$3.58 billion in the first eight months of 1996, down 34% from the comparable period in 1995. A number of longstanding problems help explain the

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<sup>2</sup> Schwarz, Adam. "Promises, Promises: Vietnam's Leaders Come Under Pressure to Speed Up Reforms," *Far Eastern Economic Review*, October 24, 1996, p.46.

<sup>3</sup> The Economic Intelligence Unit, "Vietnam: Country Report," 2<sup>nd</sup> Quarter 1996, 30p.

declining interest of foreign investors. These include a constantly shifting legal structure, excessive and time-consuming licensing procedures, a huge amount of bureaucratic corruption, and financing difficulties.

This catalogue of problems recently led the Hong Kong-based Political and Economic Risk Consultancy to downgrade Vietnam's attractiveness as a site for foreign investment. In the process, Vietnam may be losing its image as an emerging "Asian Tiger."<sup>4</sup>

### *Longer-term Economic Challenge*

Despite progress in closing down some 6,500, mostly small and town-based SOEs since *Doi Moi* commenced, Vietnam still operates an estimated 6,000 state enterprises. Although the remaining SOEs account for less than 10% of total employment, they dominate strategic sectors of the economy such as banking, construction, trade, telecommunications, energy, steel, and chemicals. Altogether, the SOEs reportedly still account for 75% of Vietnam's assets, obtain about 65% of the bank credit, provide more than half of the government's budget revenues, and represent roughly 25% of the economy's total output.<sup>5</sup>

As about two-thirds of these enterprises are thought to be unprofitable, reform of the state sector is required for the modernization of the economy. Although most direct subsidies to state enterprises have been eliminated, the SOEs still retain immense advantages in gaining access to credit and land. This, in turn, handicaps privately owned small and medium size enterprises, which comprise the most dynamic sector of Vietnam's economy.

To improve the efficiency of the SOEs, the government is trying to put together several dozen conglomerates, known as general corporations, in industries such as rubber, steel, coal, power, and textiles. Patterned after the South Korean model of huge conglomerates or *chaebol*, the government hopes that combining several SOEs in the same field will allow them to compete more effectively internationally, while at the same time retaining control over their activities. Skeptics believe that the general corporations will act as monopolies, thereby undermining efforts to allow more scope for private sector activity.

So far the government has resisted outright efforts at privatization, but it has established a pilot "equitization program" in which it has sought to issue shares for 21 small state firms. The hope is to raise money, while retaining majority control. Any large-scale privatization program, however, faces formidable opposition from the army, individual ministries, and regional authorities that now control them.

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<sup>4</sup> Grant, Jeremy. "Political Pall Over Vietnam Investment," *Financial Times*, June 27, 1996, p. 7

<sup>5</sup> Ahearn, Raymond J. "Vietnam's Transition to A Market Economy," Congressional Research Service, Report 96-489 F, May 30, 1996, 6 p.

## Political Developments

Vietnam's experiment with political reform, begun in the late 1980s, lagged far behind economic changes, and has been largely superseded by an orthodox drive to maintain tight political control. Reform-minded leaders appeared following the Vietnamese landmark Sixth Communist Party Congress in December 1986. "Old Guard" leaders were retired and the new General Secretary set about to revitalize the ossified political structure and stagnant economy through reforms and experiments, reductions in central control, and curbs on the party's power over aspects of state and society. The reformers' standing remained uncertain as many senior-level leaders harbored concerns about the diminution of their control. The political crisis in China after the June 1989 Tiananmen massacre and the collapse of communism in Europe caused these leaders to reassert their views against the reformers.

The Seventh Party Congress, held in Hanoi in June 1991, saw a leadership emerge that was dominated by relatively younger political hard-liners anxious to reassert party prerogatives and avoid political changes incompatible with Communist Party control. A new constitution, which went into effect on April 18, 1992, confirmed the political monopoly of the Communist Party. Opposition to the Communist Party is not tolerated. Political and religious dissidents are jailed or otherwise repressed.

Vietnam today is not the highly regimented, centralized, and doctrinaire communist state that it was a few decades ago. People may not have political freedom, but the *Doi Moi* process has weakened the position of the party, particularly in economic and social affairs. In these areas, the Vietnamese people appear to have considerable personal freedom. Provincial and local officials also have considerable power, and often act contrary to decrees issued from Hanoi. Top party leaders are most often described as pragmatists who are focused on two overriding objectives: bringing economic prosperity to Vietnam and maintaining the party's monopoly on political power. The pace and scope of the economic reform process, however, is a matter of serious divide among Vietnam's ruling elite.<sup>6</sup>

### *Debate Over Economic Policy*

One group of so-called "reformers" advocates more active policy reforms that support development of a stronger private sector, the contraction of the largely inefficient state sector, and the country's continued integration into the regional and world economy. A second group of "conservatives" worry that an increase in the pace of economic reforms could undermine the country's "socialist" values, as well as undermine the party's monopoly on power through an increase in societal demands for political reforms.

The Eighth Party Congress held in July 1996 failed to resolve these differences over the pace and depth of the reform process. By maintaining the present top leadership team for at least another year, the Congress confirmed that while there will be no turning back of the liberalization process, reforms will also proceed in the slow and cautious manner that has increasingly frustrated foreign investors.

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<sup>6</sup> Pruzin, Daniel. "Vietnam's Communists Feud on Pace of Reform," Wall Street Journal, p. 2.

The current three top leaders of the Vietnamese regime -- President Le Duc Ahn, Prime Minister Vo Van Kiet, and party Secretary General Do Muoi -- are widely seen to represent different policy perspectives, with Prime Minister Vo Van Kiet seen as the most forward looking reform advocate. The inability of the Party Congress to determine the proper mix of "reformers" and "conservatives" in a successor leadership lay behind the Congress' decision to keep the current three top leaders in power, despite their advanced age.<sup>7</sup>

Signs of retrenchment also emerged from the Congress. Membership in the party's 19-Member Politburo includes more members from the military and internal security branches. The central committee's report also made clear that changes in the Vietnam's political system will be vigorously resisted and that foreign sources of instability will be closely monitored. In addition, although a controversial pledge to raise the state sector's share of economic activity to 60% by 2020 was dropped, the final report pledged to maintain the state sector's leading role in the economy.

A number of external forces, however, make it likely that the rhetoric of Vietnam's leadership will continue to be socialist while its practice continues to be increasingly capitalist. For example, Vietnam's membership in the Association of Southeast Asian Nation (ASEAN) and its application to become a member of the World Trade Organization (WTO) are strong incentives for keeping the country moving in direction of a more market-oriented economy. For Vietnam, membership in both groupings will help it gain wider access to markets and increase its acceptability to international investors. In addition, preconditions for loans established by the World Bank and Asian Development Bank serve as strong pressures for continuing the reform process.

Continuing divisions among the top leadership are likely to ensure that the pace of Vietnam's transition towards a market economy will not be smooth. A likely scenario, barring a crisis, is for a continuation of the two-steps forward and one-step back process where the state will continue to play a large role and where small entrepreneurs will continue to operate somewhat handicapped. In this context, Vietnam's leadership struggle will continue to condition relations with the United States, including efforts to normalize commercial relations.

## **Relations with the United States**

Since President Clinton ordered an end to the U.S. trade embargo on Vietnam on February 3, 1994, U.S.-Vietnamese economic relations have grown. Two-way trade doubled from \$224 million in 1994 to \$450 million in 1995, with the United States running a trade surplus of \$122 million in 1994 and \$54 million in 1995. From just \$3.3 million in 1993, U.S. investment in Vietnam increased to \$1.2 billion in 1994, making the United States the sixth largest foreign investor.

Future increases in trade and investment flows could depend on steps to normalize the economic relationship. A number of U.S. statutory provisions preclude Vietnam from

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<sup>7</sup> Grant, Jeremy. "Power of Vietnam's Leaders Criticised," Financial Times, July 2, 1996, p. 6.

being eligible for most-favored-nation (MFN) treatment, trade financing, and insurance guarantees for private investment.

To become eligible for U.S. export financing and insurance guarantees, the President must waive Title IV of the 1974 Trade Act, known as the Jackson-Vanik amendment. For the waiver, the President must certify that Vietnam has a liberal emigration regime. In this context, issues regarding refugee resettlement and the manner in which Vietnam processes exit permits are likely to be discussed.

During 1996, the Clinton Administration undertook preliminary discussions with Vietnamese leaders regarding a bilateral trade and investment treaty -- a necessary first step for granting Vietnam MFN treatment. Section 405 of the 1974 Trade Act requires that trade agreements with non-market economies include safeguard provisions, certain intellectual property provisions, and a dispute settlement agreement. In addition, the Clinton Administration is seeking commitments bearing on market access, government control over trade and investment flows, and protection of intellectual property rights.

While U.S. officials have reported making progress on the issues of intellectual property protection, much less progress has been made on some central market access issues such as import licensing and customs valuation. Vietnam's current systems of import licensing and customs valuation continue to provide major problems for U.S. exporters. U.S. negotiators are also seeking guarantees of market access for services, including insurance, legal services, banking, and telecommunications. In addition, U.S. negotiators are likely to insist that Vietnam's regulatory and administrative procedures become much more transparent.

Most reports indicate that Vietnam has a long distance to travel before it is ready for a bilateral agreement. Whether Vietnam will be able to enact the necessary reforms before the end of 1997 remains problematic.

In the meantime, a number of other issues will affect bilateral relations. Heading the list are continuing controversy over whether Vietnam has fully accounted for U.S. prisoners of war and missing in action (POW/MIAs) from the Vietnam War, and U.S. concerns about the Hanoi government's hard line against political dissent and arrests of religious activists. The controversy over the Clinton Administration's appointment of Congressman Pete Peterson to be Ambassador to Hanoi appeared likely to be resolved once Peterson's term ends and his appointment would no longer be subject to restrictions in the U.S. constitution barring the President from appointing a U.S. Congressman to such a post.<sup>8</sup>

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<sup>8</sup> For a full discussion of bilateral relations, see Sutter, Robert G. Vietnam-U.S. Relations: Issues for Congress," Congressional Research Service, Issue Brief 96033, [Periodically Updated].

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