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September 2005

Korea-Vietnam International Conference Report :  
**Economic and Social Reform of Vietnam  
and its Lessons for North Korea**

**KOR-VIET International Conference**

**Economic and Social Reform of Vietnam and  
its Lessons for North Korea**

**Organized by**

**Korea Institute for National Unification  
and  
Vietnamese Academy of Social Sciences**

**July 15 2005, International Conference Room,  
Korea Institute for National Unification, Seoul, Korea**

## Korea-Vietnam International Conference





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# Foreword

## Welcoming Address



Director of the Institute of Human Studies Academy of Social Sciences Dr. Pham Minh Hac, Experts and Scholars from the Vietnamese Academy of Social Sciences, Discussants and Presenters,

First and foremost, I would like to extend a warm welcome to you all and thank you for participating in this Korea-Vietnam international conference.

Despite the relatively short history of diplomatic relations between Korea and Vietnam, both countries display tremendous dynamism in their relationship, enthusiastically engaging in exchanges and cooperation. Against this backdrop, KINU is delighted to host this conference in collaboration with the Vietnamese Academy of Social Sciences. This exchange will serve as a forum for insights, in-depth discussions, and academic exchanges.

Since launching the Doi Moi Policy in 1986, Vietnam has achieved phenomenal sustained economic growth through the introduction of a market economy and open-door policies. Agricultural, economic, and social reforms in Vietnam provide many valuable lessons that can be applied to North Korea.

Today's conference is an important occasion for both institutions. The experts and scholars participating in this conference possess wisdom and keen insight across wide-ranging areas. I sincerely wish that this conference encourages a fruitful exchange of views that strengthens the academic ties between KINU and the Vietnamese Academy of Social Sciences, as well as contributing to the development of Korea-Vietnam relations, and economic changes in North Korea. I also hope this event will lead to further comprehensive and wide-ranging academic exchanges and cooperation between the two institutions.

I am particularly grateful to Director Dr. Pham Minh Hac, Deputy Director Dr. Pham Thanh Nghi, Experts and Scholars, and Presenters of the Vietnamese Academy of Social Sciences, whose combined efforts have made this conference possible. Finally, I would also like to thank Director Dr. Kim, Young-Yoon, Director Dr. Lee, Kyo-Duk, and staff of KINU for organizing this event.

Thank you.

**Dr. Young-Kyu Park**

President  
Korea Institute for National Unification

# Participants and Programme

## Participants

Dr. Young-Kyu Park, the President of Korea Institute for National Unification(KINU), gave a welcoming address.

On the Korean side, KINU was represented by Dr. Young-Yoon Kim(Director, Center for the North Korean Economy), Dr. Hyun-Joon Chon(Director, Division of Planning and Coordination), Dr. Kyo-Duk Lee(Director, Division of North Korean Studies), Dr. Jin-Wook Choi(Senior Research Fellow, Division of North Korean Studies), Dr. Moon-Young Huh(Senior Research Fellow, Division of North Korean Studies), Dr. Young-Tai Jeung(Senior Research Fellow, Division of North Korean Studies), Dr. Kang-Taeg Lim(Senior Research Fellow, Center for the North Korean Economy), Dr. Hyeong-Jung Park(Senior Research Fellow, Division of North Korean Studies), Dr. Young-Ho Park(Senior Research Fellow, Division of Northeast Asian Studies), Dr. Jae-Jean Suh(Senior Research Fellow, Division of North Korean Studies), Dr. Jeong-Ah Cho(Research Fellow, Division of Planning and Coordination), and Dr. Jeong-Ho Song(Senior Researcher, Division of North Korean Studies)

On the Vietnamese side, Vietnamese Academy of Social Sciences (VASS) nominated the following experts :

Dr. Pham Minh Hac (Director, Institute of Human Studies)

Dr. Pham Thanh Nghi (Deputy-Director, Institute of Human Studies)

Dr. Doan Hong Quang (Senior Research Fellow, Center for Analysis and Forecasting)

Mr. Pham Quang Dieu (Research Fellow, Institute of Agricultural Economics, Ministry of Agricultural and Rural Development)



## Programme

### Korea-Vietnam International Conference :

#### Economic and Social Reform of Vietnam and its Lessons for North Korea

July 15 2005 Seoul, Korea

Venue: International Conference Room, Korea Institute for National Unification

**10:00 hrs**

#### **Opening Session**

Speakers : Dr. Young-Kyu Park  
Dr. Pham Minh Hac  
Dr. Young-Yoon Kim

**10:15 hrs**

#### **Session One**

Concept and Contents of “Doi moi” Policy and Process of Vietnamese Reform  
Presentation : Dr. Pham Minh Hac  
Designated Discussion: Dr. Jin-Wook Choi, Dr. Young-Ho Park  
Discussion: All Participants

Agricultural Reform in Vietnam: Contents and Drive Method  
Presentation : Mr. Pham Quang Dieu  
Designated Discussion : Dr. Kang-Taeg Lim, Dr. Young-Tai Jeung  
Discussion : All Participants

**12:00 hrs**

#### **Lunch Break**

- 13:30 hrs**      **Session Two**
- Reform of the Distribution and Commercial Sector in Vietnam: Process and Challenges  
Presentation : Dr. Doan Hong Quang  
Designated Discussion : Dr. Hyeong-Jung Park, Dr. Moon-Young Huh  
Discussion : All Participants
- Social Change in Vietnam after Doi Moi  
Presentation : Dr. Pham Thanh Nghi  
Designated Discussion : Dr. Jae-Jean Suh, Dr. Jeong-Ah Cho  
Discussion : All Participants
- 15:30 hrs**      **Coffee Break**
- 16:00 hrs**      **Session Three**
- Recent Reform in North Korea: Get Lessons from Vietnam  
Presentation : Dr. Young-Yoon Kim  
Discussion : All Participants
- 17:00 hrs**      **Coffee Break**
- 17:15 hrs**      **General Discussion**
- 18:00 hrs**      **Dinner Co-hosted by Center for the North Korean Economy and Division of North Korean Studies**

# Concept and Contents of “Doi moi” Policy and Process of Vietnamese Reform

## Concept and Contents of “Doi moi” Policy and Process of Vietnamese Reform

**Dr. Pham Minh Hac**

Institute of Human Studies  
Vietnamese Academy of Social Sciences

### 1. The term “Doi moi”

The word “Doi moi” in Vietnamese has become a familiar term in many languages of the world. “Doi moi” is translated into English as “Renewal”. Numerous researches on Vietnam by foreign scholars refer “Doi moi” as “Reform” (see the References) like we use in this conference. I also use the term “reform” for “Doi moi”. In fact, after 20 years (1986-2005) implementation of the reform policy, the reform has brought about great changes in all aspects of society. It is a really comprehensive reform, a profound revolution in every field of the social life, creating the third historical turning point in the Vietnamese revolution in the 20<sup>th</sup> century.

### 2. Three historical turning points of the Vietnamese revolution in the 20<sup>th</sup> century

The first 30 years in the 20<sup>th</sup> century in Vietnam was marked by the people’s movements, especially the movements of scholars and royalists, against the French colonialism. In 1930, the Communist Party of Vietnam (CPV) was established, starting a new period in the Vietnamese history of struggle for national independence, a struggle of the people under CPV leadership. After 15-years of struggle, Vietnam has regained independence.

After the August Revolution in 1945, the Japanese troops withdrew from Indochina. On September 2<sup>nd</sup> 1945, President Ho Chi Minh declared the independence, establishing the Democratic Republic of Vietnam. This marked the first historical turning point of the Vietnamese revolution.

However, only 9 days after the day Ho Chi Minh declared independence, the French came back to invade the South and over one year later, on December 23<sup>rd</sup> 1946, they invaded Hanoi. The prolonged resistance lasted until July 1954 with the great Dien Bien Phu victory.

According to the Geneva Accord (July 1954), the French had to withdraw its troops from Vietnam and the country was divided into two parts: the Democratic Republic of Vietnam in the North and the Republic of Vietnam in the South. After two years of implementation of the Accord, there was no general election to unify the country as agreed in the Accord. On the contrary, the U.S invaders further committed

to the Vietnam battlefield. The fight between two regions became more severe and fierce. According to the Paris Agreement, in 1973 U.S troops withdrew from Southern Vietnam. On April 30<sup>th</sup> 1975, the government of the Republic of Vietnam totally collapsed and Vietnam regained freedom, independence and unification. This was the second historical turning point of the Vietnamese revolution in the 20<sup>th</sup> century, opening a period of building a unified nation in the peace. It was thought that there would have been more opportunities and the people's lives would have been improved, but on the contrary, the country fell into a serious socio-economic crisis, leading to the third historical turning point (CPV, 2001: 5-6) with the emergence of "Doi moi" policy.

### 3. The socio-economic crisis (late 1970s - 1985)

#### (1) The crisis situation

With the inspiration and pride of the Great Spring Victory in 1975, the whole country started implementing the 1976-1980 five-year plan (the 4<sup>th</sup> Party Congress) and the 1981-1985 five-year plan (the 5<sup>th</sup> Party Congress). However, "the initial optimism had not been realized and in the late 1985, the economy totally fell into crisis and inflationary spiral" (General Statistics Office, 2004: 15). Most of the people were short of food and clothing (Vietnam imported about 500.000 tons of rice every year at that time), short of accommodation, with extremely difficult transportation and inflation rate of about 800%. The economy actually did not grow (GDP growth in 1979: -1,7%, 1980: -1%; percentage of growth compared to previous year: 1977-1985: 102,1%-102,5%). All 15 national targets were only achieved 50-80% of the plan, 9 targets achieved 25-48% (General Statistics Office, 2004: 15,18).

Another five-year plan (1980-1985) made the crisis more severe as evidenced by:

- a. Low economic growth (4,6% per year), in reality there was no development.
- b. Production did not meet the demand (national production satisfied only 80-90% of national consumption, therefore, rice had to be imported) and reliance on foreign sources was greater and greater (1985: foreign debt of 8,5 billion Ruble and 1,9 billion USD, export was equal to 30% of import).
- c. Existence of over-inflation (1986:774%), prices increased by a geometric progression (1985: 191,6%) (General Statistics Office, 2004: 23-25), great imbalance between supply/demand, revenue/expense, export/import (CPV, 1986: 4).

#### (2) Causes of crisis

Nobody denied that at that time Vietnam had a very low economic starting point and just suffered from fierce wars, which seriously destroyed the country and people's mind. At the same time, Party, State and people realized sufficiently and profoundly that people's life was intolerable and the State could not get any further into crisis. A survey on the country situation and analysis of the causes had been quickly undertaken, materials were completed in the third quarter of 1986 and in December 1986, the 6<sup>th</sup> Party Congress convened.

The Congress analyzed causes of the crisis (CPV, 1986: 5) as follows:

- Subjectively and hastily conceived the transition period to socialism, desired to abolish at once all non-socialist economic sectors, quickly transformed a private capital economy to a state-owned economy, organized big-scale cooperatives; emphasized too much on ownership and less on management and distributive system;
- Did not abolish the centralized, bureaucratic and subsidized mechanisms in economic planning and management in particular and social management in general;
- Inaccurately assessed the country's socio-economic situation;
- Mistakenly, hastily and conservatively determined objectives and steps to transform society and to build material and technical facilities for socialism and to manage society as a whole;
- Allowed the existence of chaos, undisciplined situation and lack of laws and rules in social management, especially lack of legal awareness for too long;
- Focused heavily on economic development, disregarded the development of education, science, health care and other social areas (CPV, 1986: 6-8).

## 4. Concept and contents of “Doi moi” policy

(1) To my understanding, concept is a thought, a notion, an idea, an abstract or generic idea generalized from particular instances (Merriam - Webster Online Dictionary). Concept also means a theoretical framework (Paradigm, Thomas Kuhn, Doctoral thesis, 1947) used to solve problems. Applied in this discussion, it means a system of theory, idea, line, policy, etc. directly had led the Vietnamese socio-economic system since 1986, taking the country out of the socio-economic crisis. The reform policy initiated by the 6<sup>th</sup> Party Congress specified to begin from renewal of conception and thinking at first in economic thoughts in corresponding with a system of objective rules (CPV, 1986: 10), i.e. to rebuild the concept, finding out a theoretical system to build the political lines and policy for the country development.

(2) Since its establishment (1930), the Communist Party of Vietnam has determined the task in carrying out the people's democratic and the socialist revolution. The North regained independence in 1954 and started the transition period to socialism. In 1975, the country was united and built socialism in freedom and peace. Then in around 1980-1985, the Party was clearly aware of mistakes and concluded that: “The Party has committed a mistake of subjectivism and voluntarism, broke the objective laws” and affirmed that “from this moment every line and policy of the Party must come from reality, observing the objective laws” (CPV, 1991: 1-2).

An important content having decisive significance to the concept of “Doi moi” policy is that all policies have to originate from the country practice and refer to the experience from the former Soviet Union, Eastern European countries, China and also refer to the socio-economic development experience of East Asian countries, taking into account new characteristics and development trends of the world. Correctly understanding and applying the theory of socialism and pathways to it, Vietnam must concretely build policies in corresponding with the country reality and the objective rules.

The objective of socialism in Vietnam is now understood as “Rich people, powerful country, equal and civilized society” (1990) and since 2001 democracy has added to this concept: “Rich people, powerful

country, equal, democratic and civilized society”. That is the goal and essence of socialism being built in Vietnam. Everybody feels this is the slogan of his life and target to strive for his family with great respect for assurance of the working people’s interest. Everyone was penetrated and fully sympathized with President Ho Chi Minh’s saying: “independence and freedom means nothing without food and clothing”. A survey on value orientation among 2,442 respondents (837 high school students, 655 university students and 950 young workers) was conducted by the State-level Science-Technology Research Project KX.05.07\* in 2003 at 7 cities and provinces in the North, Centre and the South. Responding on question of whether the policy on socialist-oriented economic reform was correct or not, 80 percent of respondents chose correct alternative and only 20 percent of respondents evaluated the policy as incorrect.

Transition to socialism, as understood in Vietnam now, is a long and difficult period, not simply undertaken by administrative instructions to transform non-socialist forms to socialist ones, or not only by directions given by the Party and State leadership to instruct non-socialist forms of ownerships and immediately abolish the regime exploiting men by men and to build socialist forms of ownership. On the contrary, “on the way to socialism, to a certain extent, we have to accept non-socialist production relations and capitalist superstructure” (Le Huu Tang, 2002: 207,211), i.e. the economy in the transitional period to socialism comprises several sectors (state-owned, collective, householder, private capitalist, state capitalist, joint venture, foreign), not only state-owned and collective as before *Doi moi*.

We think that socialism does not contradict market economy. Market, together with democracy, is the greatest achievement of human’s modern civilization. In the second half of the 20<sup>th</sup> century and at the beginning of the 21<sup>st</sup> century, humankind has fostered these two processes, market economy and democratization, as Mr. Kim Dae-jung said, “are like two wheels of a cart: both must move together, and each depended on the other for forward motion” (Kim, 2001:1).

The main stream of “*Doi moi*” policy is to transform an economy emphasized on a self-sufficient, self-supplied mechanism to commodity economy; from an economy based on centrally planned, bureaucratic, command, subsidized mechanisms (asking-delivering; handing-delivering) to market mechanisms (according to laws of value, laws of supply-demand, laws of money-commodity and laws of competition), as many foreign authors called the development of Vietnamese economy under “*Doi moi*” policy an economic transition to a market oriented system (Litvack & Rondinelli, 1999:1). It should be added that in documents of our Party and State, the term of “free market” is not used, rather the market here is regulated by the State’s plan, i.e. the State’s interference, as concluded by the majority of economists including American economists in the last decade of the 20<sup>th</sup> century (Stigliz, 1995) about the regulating role of the State.

In short, the main content of the “*Doi moi*” policy in Vietnam is to build up “a multi-sectoral commodity economy, regulated by market mechanisms with the State regulation” (CPV,1991:21). By 2001, this content was shortly called “building a socialist-oriented market economy” (CPV,2001:30).

The socialist-oriented market economy has been actively discussed by Vietnamese scholars and at present it operate in the following policy frameworks:

- The general objective of the country as mentioned above is “rich people, powerful country and equal, democratic and civilized society”;
- In terms of the economic life, the people is aiming at escaping from poverty, getting rich legitimately and step by step becoming richer;

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\* The author of this paper is the Project’s Director

- There exists a multi-sectoral and multi-ownership economy where public ownership (state and collective) is a major part and the State economy is playing a decisive role (i.e. orientating role, creating environment for and regulating the economy);
- Economic development should go along with the social equity and social and cultural development should be enriched with national identity, and all of these are aiming at the sustainable human development.
- The economy is managed and regulated by the State according to market principles.

To build a commodity economy and a market economy naturally destroys the closed state of the subsidized economy and requires to enhance exchanges among localities in the country and also open to, integrate and cooperate with the regional and world economy. This is also a main content of the “Doi moi” policy.

In terms of internal affairs, in order to overcome shortcomings before the Sixth Party Congress, the Party and State pay much attention to socio-cultural policies in a broad term to include education and training, science and technology. In the Doi moi era, the development of education together with science and technology is considered as a prioritized national policy, and people and culture are seen as the target and driving force for socio-economic development. Democracy is upheld more and more, as discussed above, and it is introduced as the nation’s general target (Pham Minh Hac, 2005:1-10). Vietnam is aiming at forming a legal State of people, by people and for people, strengthening national security and defense.

(3) Step by step a policy on building the country when coming in the 21<sup>st</sup> century has been formed with the 5 following contents:

- Fast, effective and sustainable development, economic growth going along with performing social equity and progress and protecting the environment;
  - Economic development is considered as the central task, comprehensive construction the foundation for an industrialized country is an urgent demand;
  - Speeding up the “Doi moi” process, creating motivation to release and uphold all driving forces;
  - Building an independent and autonomous economy with proactive integration in the world economy;
- Closely combining socio-economic development with national security and defense.

## 5. Reforming process

### (1) General directions

- a. In brief, the reforming process in Vietnam from 1986 to 2020 consists three phases as follows:
- 1986-1995: Getting out of socio-economic crisis
  - 1995-2010: Breaking out of the under-developed condition
  - 2001-2020: Speeding up the country industrialization and modernization
- This process is aimed at building Vietnam as a basically industrial country by 2020.



- b. Always keeping political and social stability, creating favorable national and international environment for economic development; considering economic development as top priority and a central task; together with economic reform, undertaking reform in the political field and continuously extending socialist democracy [10].
- c. Economic development should be closely related to social progress and equity in each development step.

## (2) Main contents of economic reform at each periods

- a. **1986-1990:** Agriculture (including forestry and fishery) was defined as the first position in economic development in order to urgently provide food for usage and materials for production of consumer and export goods, and keep down inflation and stabilize the living standards. In this period, three national programs were implemented, namely:
  - Food program,
  - Consumer goods program, and
  - Export goods program (CPV, 1986: 30)
- b. **1991-1995:** the inflation was pushed back and was under control; the production was stabilized and developed; its effectiveness was improved; the people's living standards were stabilized and step by step were improved; and the capital was accumulated (CPV, 1991:62).
- c. **1996-2000:** high, effective and sustainable economic growth was going along with resolving social urgent problems, improving people's living standard, raising the capital accumulation, speeding up industrialization and modernization [9, p.10].
- d. **2001-2005:** the aim of this period is to keep the economic growth fast, effective and sustainable; to move the economic and labour structure towards requirements of industrialization and modernization; to solve well social problems; to develop the culture with rich national identity; to comprehensively enhance educational quality; to promote human resources - the fundamental factor for fast and sustainable economic development; to develop science and technology aiming at improving working productivity; building up the capacity of national technology (CPV, 2001: 36, 49, 53, 57).

## 6. Achievements of Reform

(1) Nearly 20 years of Doi moi policy implementation has brought about important achievements in all aspect of social life in Vietnam:

- Political and social stability has been maintained;
- A socialist-oriented market economy has been basically build; the commodity economy has been build from the self-supplying economy; a multi-sectoral economy with multiple forms of ownership has been build; a closed economy has been changed to an open, internationally integrative and cooperative economy.

(2) Some salient achievements are listed as follows:

- Changing the status from importing cereal to exporting rice (at the 2<sup>nd</sup> or 3<sup>rd</sup> position in the world)

- Keeping the inflation down: From 774.7% in 1986 to 383.8% in 1988, 67.4% in 1990, 12.7% in 1995 (CPV, 1991:1, 5, 75) and 2-3% in 2004-2005

- Increasing GDP per capita (General Statistics Office, 2004) and PPP per capita (UNDP, 2004)

1987:	100 USD	na.
1990:	116 USD	1,000 USD
2000:	241 USD	1,600
2005:	> 500 USD	2,300 USD

- Increase GDP yearly increasing rate: 8.2% (CPV, 1991:2)  
7.4% (UNDP, 2004)

- Increase HDI:

	HDI indice	Ranking
1990:	0.610	74/130 countries
1995:	0.649	120/174 countries
2000:	0.686	108/174 countries
2002:	0.688	109/173 countries
2004:	0,691	112/177 countries

- Life-span:1990: 62 years old

2004: 69 years old (UNDP, 1990)

- Changing the economic structure (Table 1)

**Table 1:** Economic structure change (%)

Sector Year	Agriculture	Industry	Service	Total
1987	40.6	28.3	31.1	100
1990	38.7	22.7	38.6	100
2000	24.3	36.6	39.1	100
2005	19.0	42.0	39.0	100

- Population growth (Table 2)

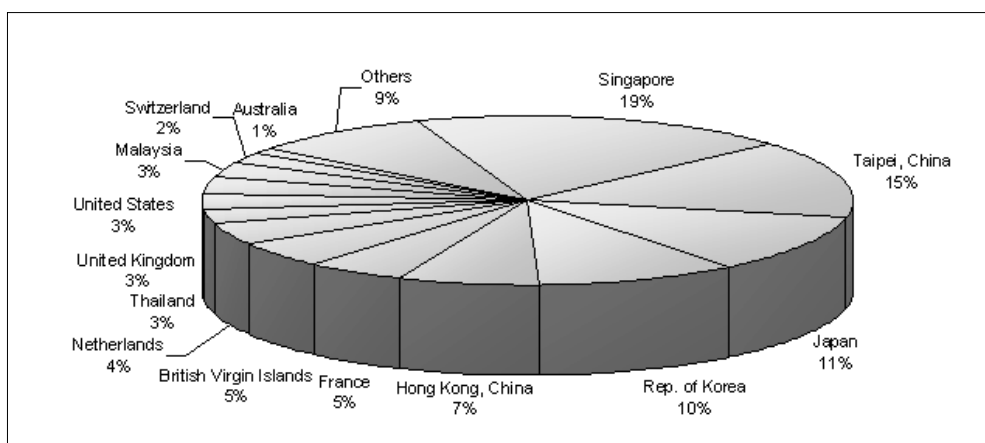
**Table 2:** Population growth

Year	(1,000 people)		
	Whole country	Urban areas	Rural areas
1990	66,016	12,880	53,136
2000	77,635	18,771	58,863
2003	80,902	20,869	60,032

- Ending the blockade and embargo situation, strengthening international relations:

- By now, having diplomatic and trade relations with over 150 countries and territories

## Investment Commitments by Economy, 1988-2003 (Leproux & Brooks, 2004)



- After 1990, re-establishing the relations with IMF, WB and ADB
- Normalizing relation with US (1995)
- Becoming a member of ASEAN (1995)
- Joining APEC, AFTA, ASEM
- Applying to enter WTO (possibly be admitted in 2005)
- In 10 years (1990-2000), attract about 37 billion US dollars FDI and 17 billion US dollars ODA (Leproux & Brooks, 2004:88-89)

(3) Overwhelming majority of the population has supported Doi moi policy. In a survey using the World Value Survey questionnaire, which has been done in 81 countries and territories in the world in 10 recent years, carried out by the Institute of Human Studies and the Research Project KX.05.07 in 2003, among 1099 workers, farmers and enterprises in 7 cities and provinces in the north, south and centre, 21.73% said they were relatively happy and 67% said they were happy; in terms of material life, 65% had average life and above and 35% had below average life (KX-05-07: 40).

(4) Evaluation of some foreign authors:

**David Dollar** (WB):

“Vietnam’s economic transformation from 1986 to 1996 was truly remarkable” ... “Vietnam’s economy has grown rapidly...” (Litvack & Pondinelli, 1999:31); “Vietnam society is in total and positive transition toward a modern market economy. While the pace of change and reform is slow, there is a steady determination of purpose reflected in a series of liberalizing economic, financial, and social decrees and laws.” (US Department, 2002:2).

**David O. Dapice** (UNDP):

“Vietnam has been widely praised as a success story.” (Dapice, 2003: 2)

**Vittorio Leproux** and **Douglas H. Brooks** (ADB):

“Since Vietnam started its transition from a centrally planned economy to a socialist-oriented market economy, many reforms have been implemented. The Foreign Investment Law signaled an important

step toward Vietnam's integration in the regional and international economic system.” (Leproux & Brooks, 2003:2)

**Jordan Ryan** (UNDP in Hanoi, 2005):

“Vietnam has seen great changes after 20 years of the renovation process... The country has become more prosperous and has integrated deeper into the world economy... In addition to great achievements for the country itself, the renewal process in Vietnam has increased opportunities for every individual.”

## 7. Overcoming challenges, continuing the Doi moi process

**(1) Challenges:** Beside opportunities, Vietnam is facing challenges:

Currently Vietnam is a poor, under-developed country with low income per capita and 75 percent of its population living in rural areas, rich human resource (about 40 million people) with just above 20 percent trained, average school years per capita is only 6.5; low living standard; commodity has low competitive capacity, economic effectiveness is low; educational quality is poor; science and technology is under-developed; the gap between the rich and the poor is expanding; numerous social problems: social evils, ethical degradation and legal awareness emerge; bureaucracy, corruption, wastefulness emerge as social diseases; the environment is seriously polluted.

**(2) Goals and targets for 5 coming years from 2006 to 2010** (CPV, 2005:12)

- Striving to increase economic growth with higher speed (GDP average growing rate is 7.5 to 8 percent per year), synchronously improving socialist-oriented market system, improving people's living standards and quality of life;
- Better solving social problems, extending democracy, strongly and fully reforming the education and training work, developing culture and science-technology;
- Building strong political system, maintaining political and social stability, defending the country;
- Opening international relations, actively and initiatively integrating into the world economy.

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## Discussion

### Dr. Young-Ho Park

Doi Moi is a version of reformed socialism. What is the difference between socialist market economy and capitalist market economy? South Korea is a good example for Vietnam because South Korea was a state-lead mercantilism. This is in common with socialist market economies in the world, particularly the third world economies in the 60's and 70's.

What is the Vietnamese definition of democracy? While the Vietnamese claim that democracy is when people are rich in a powerful, equal, democratic, and civilized society, the definition of democracy in developed countries focuses more on personal rights and personal freedoms. This is what Kim Jong Il is proclaiming in North Korea, and this may be the reason why the DPRK may refer to the Vietnamese economic reforms.

### Dr. Jin-Wook Choi

South Korea is interested in Vietnam because the DPRK is trying to transfer itself to a more free economy. Initially, we, experts, tried to compare it to the development of East Germany, but now we are beginning to associate more to the reforming process of Vietnam and China. What kind of political reforms did the government take in various stages of economic development? How did the role of the party change? How did you go about recruiting technocrats?

In addition to unification costs that all newly unified countries suffer from, what effects did the planned socialist economy contribute to political situations during economic development of Vietnam? In political aspect of the Doi Moi policy, do you think Kim Jong Il will challenge his previous policies? How did the Vietnamese leadership first take on the Doi Moi policy? What kind of challenges did the leadership face, and how did the leadership overcome them? In your presentation, you said that a strong political system is needed in developing situations. What kind of democratic system are you proposing when you say Vietnam will need a more liberal system?

### Dr. Pham Minh Hac

Socialist market economy means a parallel market economy. It pays more attentions to social development, and develops more documents. It is a policy to give the people equal legal rights, and a decree to equate social groups, giving a main attention to the educational development.

South Korea has influenced on Vietnamese growth. In 1961, South Korea's per capital was \$82, now much more. Many South Korean technologies are sent to Vietnam as a form of foreign investments. Using South Korea as an example does not have any contradictions to the development of Vietnamese economy.

As to Vietnamese Democracy, before 1945, the people had no rights. Only 5% were literate, now 94% are literate. Mentally, there's not that much difference in political mind-set from rural and urban region. Economically, there is a slight difference in mentality, and recognition of development in the South.

According to criteria from the outsiders, Vietnam is considered as a legitimate democracy. Democracy takes centuries to develop.

In the framework of the Doi Moi policy, the first focus was economic to get out of the crisis, and to increase production. As Ho Chi Minh said, if people don't have clothes, independence means nothing. The political system brought many good things. The people support the regime. Economic reforms are the first step. Political reforms come next. Throughout the years, Vietnamese politics has changed. More and more, the Congress asks for political advices from the people. Vietnam still has many challenges and mistakes to learn from. It has a very weak management of the county, primarily because there are not enough laws; our political system still has many problems.

Knowledge on North Korea is limited and therefore do not want to compare. Many outsiders have pointed out mistakes of the Central Committee. The North stopped the South from developing market economy and directly ordered the South to become socialist (crucial mistake). In law of the economy, the experts realized that there are contradictions between socialism and market economy.

# Agricultural Reform in Vietnam: Contents and Drive Method



# Agricultural Reform in Vietnam: Contents and Drive Method

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## 1. The Context of Agricultural Reform

### *The failure of collective model to attain food self-sufficiency*

After unification in 1975, Vietnam joined a new phase of development with formidable challenges in terms of low development base and the collapse of economic system caused by destructions during war period. It is important to stress that after the war, Vietnam's economy was largely an agricultural society with over 80% population living in the rural area. Therefore, agricultural production growth was seen as one of the most important issues in development strategy to maintain economic and political stability for the whole society. It was further noted that at the first time after the war there were two different economic models applied in two regions. In the South it was market system which was affected strongly by US's model and in the North it was central planning system following the Soviet's approach. Given this context the Vietnam's communist party has tried to unify the two regions not only in demographic area but also in economic modeling. Starting in 1976, the Vietnam's government reconstructed the South's economy in both urban and rural areas following the North's model. In urban areas, private companies has been forced to join into or changed to state-owned or collective ownership.

In the rural areas, the Vietnamese leaders have tried to apply the collective model that was prevalent in the North to the South areas. Farm households have been encouraged to become members of cooperatives, however, the collective model failed to stimulate the incentive of laborers that lead to the stagnation of agricultural production. Before reform in 1986, agricultural cooperatives solely dominated production activities in rural areas<sup>1</sup>. While those cooperatives managed and used 95 percent of cultivated land, it could not provide 50% of income for their member after fulfillment of obligations and contributions to the State. Farmers were not interested in production. They left their paddy fields unplugged and uncultivated (Nguyen Sinh Cuc and Nguyen Van Tiem 1996: 115). Many cooperatives in the South were existed in the name only while those in the North allocated land to cooperative members

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<sup>1</sup> Cooperatives provided raw material inputs, transferred technology and had the right to buy all output produced by farmers. During that time, there was no free market existed and farmers could not sell outputs to get cash income. In 1980, there were 110878 cooperatives in the North, covering 96.9% of the total farmers and for the whole country this number was 126.056 covering 65.6% farmers

for rent or illegal contract.

The stagnation of agricultural production had created concern for Vietnamese leaders. The poor performance of agricultural production led to the situation that economic targets in second five-year plan (1976-1980) by the IV<sup>th</sup> National Party Congress had not been reached. In 1976, the first year of peace, economic growth rate was very high 16.8%. However, this rate was not maintained in the following years and reduced to only 2.9% in 1980. Industrial production growth was only 0.6% per year (Le Mau Han 2000: 96). Agricultural production grew at a modest rate, nearly 1.9 percent per year. Aqua-product fell down with total salt-water fish output of 607,000 tons in 1976 reduced to 389,000 tons in 1980. Exports only valued 20-25% of total imports. The state budget was at high deficit. Many plans were not fulfilled forced the State to issue more money to cover expenditures. Consequently, the inflation geared up to over 20% per year. In 1980, the food production obtained only 13.4 million tons against the estimated output of 21 million tons. With over 2.17%/year of total population growth and stagnation in food production, Vietnam had to import on average 500,000 tons of food annually (Resolution of the VI<sup>th</sup> Party Congress, 1987). In 1980, imports of food reached to the highest level in the history, about 1.6 million tons.

#### Fence-breaking and agricultural reform

Realizing serious problems threatening the stability of the society during the late 1970s, the V<sup>th</sup> National Party Congress in 1981 adjusted many detailed targets of economy and development strategy in five-year plan 1981-1986 compared to of five-year plan 1976-1980. It emphasized that the main objective was to the expand production of consumer goods, exports and food, especially; priorities were given to agricultural development.

### The experiment in Hai Phong province

Hai Phong located in the North of Vietnam. In the early 1970, in some districts Kien Thuy, Tien Lang, Vinh Bao some cooperatives have informally released land to farmers. This has created incentive for farmers to invest in production and raise productivity. The success however has been against the formal approach that was collective model. During that time there was a strong debate among leaders of Hai Phong on the dynamism at district. The general secretary of Hai Phong has invited top leaders of Vietnam to visit pilot models in the province. The good reality had convinced top leaders to conduct an analysis on the model and develop it to the reform policy.

Source: Dang Kim Son. 2001.

Based on agricultural initiatives, the same reform was also proceeded in the industrial sector. The Decision 25/CP of January 1981 was issued in order to create opportunities for the freedom in production and business activities and the self-financing capability of State-owned enterprises (SOEs). A famous example was the “three-plan regime”: (i) Part A of the plan was decided by the State in accordance, the State fixed inputs, outputs and prices; (ii) Part B was conducted by the SOEs and sold at agreed prices and (iii) Part C was taken full advantage of their capacities and improve their incomes.

After enforcing the Directive 100, household economy developed strongly combined with excited movement of “three plans” that led to conflict between the flexibility of SOEs and the fixed plan of the

State. Therefore, since 1982, the State allowed non-State enterprises to conduct business activities in some cases and/or some commodities (Resolution of the V<sup>th</sup> Party Congress, 1983). The experiment in Long An province and other provinces created two kinds of markets existed in parallel that were “free market” and “organized market”. Policies to control prices such as exchange rate and interest rate of credit loans was reduced. However, the strict control over price and trade in domestic market was generally still alive until 1984. The State did not give up a monopoly power in trading essential commodities while SOEs and cooperatives still played a vital role.

During this time, institutional and policy changes in production, circulation, exchange rate and interest rate contributed to making the entire economy more dynamic. The economic growth highly grew up, on average 6.4%/year. The industrial sector increased by 9.5% annually. The agricultural sector still grew by 4.9%/year (Le Mau Han 2000: 96). Food production gained 18.2 million tons in 1985, the 1<sup>st</sup> year since Vietnam became a self-sufficiency in rice production.

However, this achievement was not sustainable due to the problem of fragmentation in investment. As a consequence, over-expenses with 25%- 45% higher than revenue budget was to blame for deficit budget. Vietnam confronted an embargo on economic and international aids. Total trade value was at very low level, about USD1.7 billion a year (Bui Tat Thang, 2000). The State had no choice and it had to issue more money to cover expenditures. Consequently, inflation rose rapidly, on average, 300%/year. In June 1985, the 6<sup>th</sup> Central Party Conference, number V decided to launch a money-exchange campaign all over the country with aims to control the inflation. However, the solution “price – salary – money” deteriorated the situation. The inflation rose up to an uncontrollable 774.7% in 1986. The net income of majority of public employees plummeted seriously. The quality of people’s life was poor and on the gradual decrease. In 1984, about 75% of the entire population suffered from poverty. Food shortage became permanent issue<sup>1</sup>.

## 2. Reform Period (1986–1989) and Overcoming Economic Crisis

In the late 80s, Vietnam was merely in a situation of crises. The VI<sup>th</sup> Communist Party Congress in 1986 realized that the centralized management mechanism was not only fail to create development incentives but deteriorate the entire economy; curb production, productivity and product quality; and push the circulation into turmoils. The Congress emphasized that the main task of socio-economic construction and development under the 4<sup>th</sup> 5-year work-plan (1986 - 1990) was not to further enhance investment as before but to renovate economic management institutions and policies. Many cases in the reality or the so-called fence-breaking showed the importance of private dynamism. For the first time the Congress officially recognized the existence and the role of multi-sectoral economic structure in Vietnam. The Vietnam’s government encouraged development of the private sector, first in agricultural sector, wholesale and retail, then followed by industrial sector and services. Besides, it was planned to shrink investment sources in heavy industries and control the role of State-owned enterprises. For 3 years

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<sup>1</sup> In 1987, farmers in many areas received only 20% or less in total output produced. Many of them did not obtain adequate output to pay duty for cooperatives. The incentives to produce was lost, resulting in lower agricultural production for the period 1985 – 1987. A number of households give back a part of their paddy field to the cooperative in order to concentrate in intensive cultivation for the purpose of higher productivity and benefits.

1986, 1987 and 1988, Vietnam has implemented institutional and policy changes to make a transition from planning toward market system.

Resolution 10 NQ/TW dated 5 April 1988 by the Politburo (the 6<sup>th</sup> Session) on renovation on agricultural management meet urgent needs of agricultural development. This was seen as a prerequisites condition contributing to create fundamental and in-depth changes for agriculture and rural development in Vietnam. The new policies under Resolution 10 NQ/TW have created further empowerment for farmers to manage main production materials and their products, to take initiative in implementing production proceedings and thereby have big opportunity to get benefits from their production. In fact, this was a new step to adjust the production relation: the management was transferred from cooperatives and production teams into farm households, at the same time the relation between production materials management and product distribution was initially changed. Households were entitled to manage land and main production materials and directly involved in the product distribution. Vietnam also stopped the food procurement with low price and started to apply market price mechanism. It reduced the State's inefficient prevention, increase the self-control of various economic components to attain their objective of economic benefits in the agriculture sector.

The implementation of the Resolution by the VI<sup>th</sup> Communist Party Congress on “abolishment of the State's subsidy mechanism for agro-forest state enterprises ...and adjustment of the scope of agro-forest state enterprises have positive impacts on infrastructure, technical qualifications and management skills. The land area available, as a result of the above-mentioned adjustment, was planned to be returned to local authorities, and then allocated to cooperatives, households, individuals or private sector for business”. The Ministerial Council promulgated the Decision 76/HDBT dated 26 June 1986 issuing provisional legal documents to ensure the autonomy of business in economic units at the grassroots level. In the period of 1986-1990, renovation on agro-forest state enterprises paid attention to: tightening management regime and giving self-control to their internal enterprises<sup>2</sup>.

The Resolution 10 suggested higher investment budget for agricultural sector, but the real investment was contracted. Nevertheless, spiritual and physical incentives and internal force of farmers were mobilized, production was quickly expanded. Farmers have took initiative in adopting and exploiting existing technical advances and infrastructure in order to improve labor productivity.

However, in general, key changes in institutions and policies for 3 years 1986, 1987 and 1988 mainly focused on the fields of production, circulation and distributions that were of experiment, partial and temporally inconsistent. Therefore, this failed to free the economy out of crises. High inflation continued occurring 223.1% in 1987 and 393.8% in 1988. In 1988, aids from Soviet Union was cut down, leading to the lack of production materials in State-owned enterprises (Governmental Office 1993: 214). Besides, unfavourable weather conditions caused bad harvests in 1987. And food production was down to nearly 1 million tons against 1986. Vietnam was in serious shortage of food. It had to borrow 800.000 tons of food and imported 322.5 thousand tons of rice. In 1988, the country continued importing 199.5 thousand tons. In 1988, around 9.3 million people in 21 northern provinces suffered from poverty, occupying up to 39.7% of farming households, of which 3.6 million people faced up extreme poverty.

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<sup>2</sup> Decision 76/HDBT dated 26 June 1986, Decision 507/TC/DTXD on 22 July 1986, Decision 217/hdbt dated on 14 November 1987 by the Ministerial Council, Decision 188/CT dated on 21 June 1988 by the Chairman of Ministerial Council and Decision 76/HDBT on 26 June 1986.

### 3. Export-Driven and Expansion Commodity Development Period (1989–1999)

In this period, agricultural production has changed from household economy to a broadly commodity and export-driven economy (increased raw exports, developed farm economy and strived for being well-off).

In 1989, a financial reform was conducted. The banking system was changed into 2 levels. The central bank enforced currency policies while commercial banks were entrusted to be self-financing. Foreign banks were permitted to operate in Vietnam. The exchange rate/interest rate was floated but still controlled. The State also imposed revenue and income taxes on banking operations in a multi-sectoral economy.

With respects to circulation, the Government revoked the policy strictly controlling trading in domestic market, implemented commercial liberalization, except for petroleum and gasoline, electricity and transport fees. Vietnam also tried to set up an integrated domestic market. It abolished the monopoly power of enterprises under control of Foreign Trade Ministry, allowing SOEs to import. The State reduced its control on export and import activities via quotas applicable to 12 main commodities.

In 1989, Vietnam started to carry out the SOE reform keeping key SOEs and gradually equitizing inefficient SOEs. In 1990, the National Assembly promulgated the Corporation Law. The apparatus of the State was re-organized by means of reducing 20-30% of the total payroll. Renovation policy on commerce, market and finance management created more new incentives for agricultural reform. Naturally, the policy system enabled natural resources to be more efficiently distributed and utilized under the market mechanism. Furthermore, the commercial relations between agriculture and other sectors become more fair.

A reasonable result of policies happened. The Resolution 10 promulgated in 1998 encouraging production expansion. Then, paddy rice was freely circulated and exported, narrowing the gap between international and domestic prices. Domestic price of agricultural products was increased by higher international prices. Prices of material imports decreased while benefits of farmers increased. The adjusted exchange rate promoted exports. Farmers had got benefits by taking initiative in production management and enabled to enjoy more benefits. Thereby, the effectiveness of the contract policy increased dramatically.

In 1989, the food production jumped up to over 21 million tons, average per capital food consumption returned to the level above 300kg/person for the period 1955 – 1958. The year 1989 was the first year when Vietnam resumed its rice export with the volume of 1.4 million tons. From that year, Vietnam increased additional 1 million tons of its export turnover every year. The export volume of the following year was higher than that of the previous year.

For 3 years, 1988 – 1991, the total area of paddy cultivation of the country increased by 10.06%, from 5,726,400 ha to 6,302,700 ha; the rice yield was up from 17 million tons to more than 19.6 million tons. Compared to 1976, the rice output in 1991 geared 1.5 times (65.9%).

Once more, there was a new opportunity. At that time, with soared growth of agricultural production due to long-lasting restrained internal force and expanding domestic and oversea markets, if having reasonable policy, farmers could have created themselves accumulation for reproduction that led to changing towards diversification and cash crops, overcoming barriers and improving jobs and incomes in populous areas. However, because of poor investment in agriculture combined with unequal terms

of trade in the 1990s led to the circumstance that farmers could not accumulate enough capital resources to develop non-farm activities in the rural areas.

During this time, there was a generally consensus that Vietnam's agricultural production had moved to a new position, it faced new opportunities and challenges as well. Farmer households were entitled to utilize natural resources and production materials in the context of commercial liberalization, bringing the agricultural sector into a commodity development period in an attempt to meet demands of both domestic and export markets.

Changing from self-sufficiency to commodity production, agriculture and rural economy faced up poor competitiveness of agro-products and poor infrastructure and absence of effective cooperative system. Poor investment in the agriculture sector resulted in slowly-improved production structure and poor services; un-clarified obligations to manage natural resources resulted in inefficient SOEs and farmers' low income.

The VII<sup>th</sup> Communist Party Congress in June 1991 clarified "The most important task was to develop agro-forestry, fisheries closely relating to processing industry and a comprehensive development of the rural economy and new rural areas is a major target to stabilize socio-economic conditions". The documents issued by the Party Congress set out concepts "industrialization, modernization of the agricultural sector and the rural economy". By the end of period 1991-1995, it noted that Vietnam has implemented to change its economic structure orientation toward industrialization and modernization in agriculture and rural development.

In order to continue supporting various economic stakeholders, the Executive Board of the Central Communist promulgated the Resolution 5 on "further renovation and rural economy development" aiming to abandon paddy monoculture, hand over the ownership of production materials and long-term land use rights to households; expand labor markets for farmer households, confirm roles/positions of economic components under the market mechanism administered by the State and provide more natural resources capital and scientific knowledge of agricultural production.

At the same year, the Land law was issued to confirm long-term land use rights for farmers, satisfying farmers' aspirations. Households were allocated land for use from 20 to 50 years depending on types of land. Households are granted land use rights certificate (red book) in a long-term. In addition, farmer households have 5 rights: to inherit, to transfer, to converse, to lend and to use land use rights certificate as a mortgage for loans

In 1993, the Government promulgated a series of legal documents to implement the Party's advocates: The Decree 13/CP dated 2 March 1993 on agricultural extension stipulated on establishment and development of agricultural extension to transfer technology to farmers. The Decree 14/CP dated 2 March 1993 allowed households to borrow loans in order to develop agro-forestry, fisheries and rural economy. The State Bank started to directly extend loans to farm households for production. The Decree 12/CP regulates on structural re-organization and management renovation on agricultural SOEs, contract for paddy fields, tree gardens and animals for member households on State farms, and fixed amount of revenue, output for processing activities.

In 1993, agricultural tax was reduced by 50%. The Law on land use tax was promulgated to replace agriculture tax, helping farmers to reduce their 30% of their contribution. In 1996, the cooperatives law approved by the National Assembly clarified the role of service-based cooperatives specialized in serving household economy.

The VIII<sup>th</sup> Congress in 1996 set out a task of agricultural and rural industrialization and modernization. The main objective is to set up a comprehensive development of agro-forestry and fisheries; establishment of specialized areas with appropriate crop structure and animals with high quality and efficiency; ensuring food security in the society in combination with processing industry of agro-marine products.

The Cooperatives Law dated 20 March 1996 by the National Assembly created a legal framework for operation of cooperatives. In 1999, the Prime Minister promulgated the Decision 187 on State Forestry Enterprise (SFE) reform. Once more time, the issued of SFE reform was raised again with 3 orientations as follows: forest business unit (mainly forests); forest management unit (under operation of non-business and self-financing units); and others such as service factory, procuring agro-forestry product stations... The year 2000 marked a remarkable progress in creating favorable environment and conditions for companies. After enforcing the Enterprise Law, Vietnam issued many important legal documents such as Decree on business registration, guide to some articles of the Enterprise Law or Decision on remove 145 kinds of licenses limited business performance. The Land Code was adjusted in 2001. Trading rice and fertilizer was liberalized with participant of all economic sectors. Enterprise reform was promoted. Thanks to these policies, foreign direct investment increased steadily. Total FDI made up 13% of GDP higher than 25.3% of industrial production and over 22% of trade balance with over 360.000 labourers.

This suitable policy continued making great changes. Budget investment for agriculture increased rapidly. In 1995, the State invested in agriculture 3,495 billion dong<sup>3</sup> (VND); 3,712 billion dongs in 1997 and this number increased to 4,591 billion dongs in 1998. Total budget for rural agriculture in 2000 was up to a very high record, accounting for 25% of total State investment. Credit for agriculture, especially for households also rose sharply. In 1995, total farmer loan from credit fund was 396.1 billion dongs, it increased to 1.311 billion dongs and 1,619 billion dongs in 1997 and 1998, respectively. Veterinary and plant protection system were reformed under new mechanism. By 2000, there were 70% of agricultural cooperatives were transferred following the law. In 2000, this number was 5,692 agricultural cooperatives, in which 58% were provided business licenses. The Decision 01 and 02 were issued to allow widely application of contract mechanism in state farm. Trade policies were more liberalized. License, quota, export right mechanism were loosened and replaced by other tools which were more suitable for international integration, particularly in case of rice and fertilizer. The Program 327 was implemented for forestation and job generation for people in mountainous areas.

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<sup>3</sup> Vietnamese currency unit

## **The State withdraws from business activities: A case study of rice**

In the 1990s, rice market in Vietnam was liberalized. Not only wholesaling and retailing system dominated by private sector but also import and export became more competitive; and private sector has been recognized as an important stakeholder, however, at that time, the State's presence remained important, especially through big State's enterprises.

The central Government regulated rice export by allocating quota to certain exporters. At first, the Vietnam Food Corporation received the biggest proportion. Then, allocating to provincial units such as enterprises in the Mekong Delta. In March 1997, the Government changed to allocate export quota to central and provincial organizations. The provincial government was instructed to allocate reasonably. In general, only the State's enterprises received rice export quota, although some private enterprises were allocated in 1998 and 1999. In 1999, private enterprises exported 185,000 tones of total 4.5 million tones (approximate 4%). As the result, in the early of 1990s, rice export remained at 2 million tones. Since 1995, the Vietnamese rice export increased to 3 million tones from 2 million tones.

Source: ADB, 2000.

Those above policies contributed to a stable growth of agriculture production, with average rate at 4–5% per year, industrial commodities were developed; food security was ensured; rice, coffee, cashew, pepper, rubber, tea became important export commodities. Farmer income increased considerably, poverty rate reduced averagely at 2% per year. Successes in agricultural production contributed strongly to the sustainability of the whole economy. Inflation was under control, macro financial policy was stable.

Rural economic structure changed slowly, science research and technology application capacity were weak which reduced livestock and crop productivity, competitive ability of forestry and agro-products was weak, people livelihood in remote and mountainous areas was very difficult as well... One of reasons is strong debate among many party members in terms of reforms, especially for sensitive issue such as role of economic sectors and land use management. For this reason, in order to enhance reform process in agriculture, in November 10<sup>th</sup> 1998, Politburo issued Decision 06 to confirm the permanent indispensable exist of multi-sector economy, pointed out the important role of economic sectors particularly households economy. Moreover, the Decision stressed the importance of investment in agricultural science technology, extended land use right and developed agro-product market. In 1999, 10.4 million farmer households, making up 88.55% of total households and 81.8% of agricultural area received land use license.

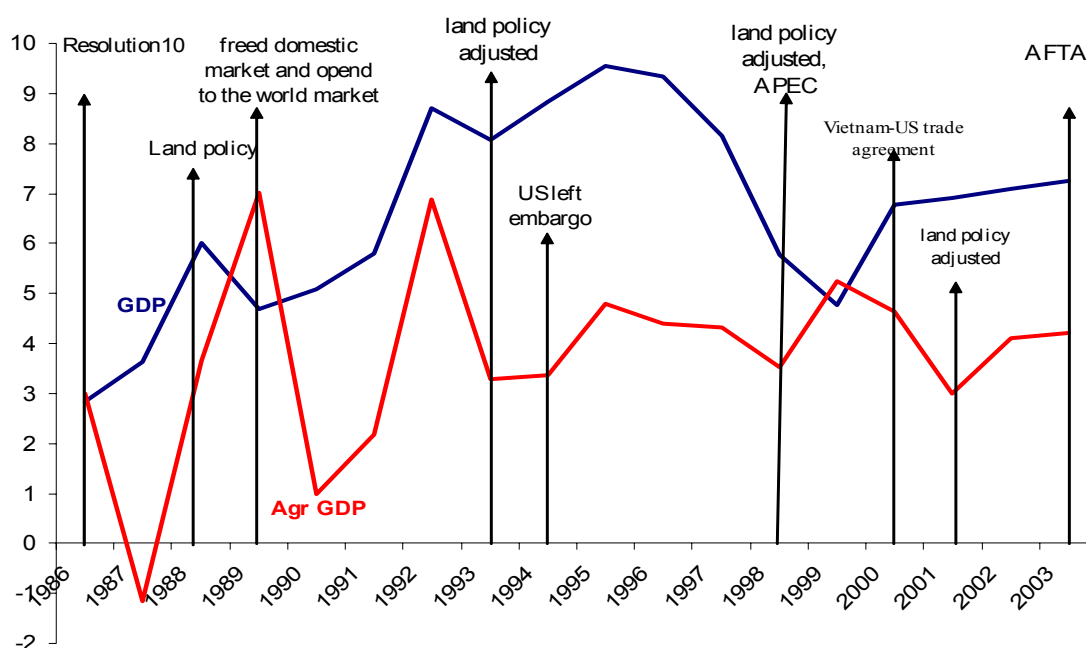
Implementing the Decision 06, investment in agriculture in 1999 increased by nearly 90% and it continued in 2000. The Government filled some supplementary articles of Land Law 1993 which gave people two rights: hire land and contribute land as joint-venture capital. To improve development of multi-sector economy, the Government issued Decision 03 on farm economy, Decree 187 on management reform State-owned farm and Decree 661 on forestry, approve and implement fishery program. In 2000, the Government issued Decision 09 on detail instruction of necessary contents to raise competition for agro-product and expand market.



In order to complete the legal framework for the economy, the Government continued building and issuing some important legal documents, such as Budget Law, Law of credit organizations, Enterprise Law, Commerce Law which created favorable conditions for every economic sectors to invest in production development, exploit the potential of the economy.

Owing to good momentum of reform policy, decade 90 marked an important period that was the agriculture sector changed from self-sufficiency to commodity and commercial production. During ten years from 1989 to 1999, agricultural production's growth was 4.3%/year; fishery production's growth was at 5%/year. Agriculture developed strongly. Productivity of many kinds of tree and animal increased, in which rice yield increased by 33%, coffee yield increased by 6-7 times, rubber double increased and pigs increased by 27%. National food security was ensured. From an average export of 600,000 – 1,000,000 tones of rice, Vietnam exported 1.4 million tones of rice in 1989 and it has become one of leading rice exporter in the world market. Total food output (paddy equivalent) was 35.64 million tones in 2000.

**Vietnam economy's growth and important events**



Source: General Statistic Office.

In some regions, agriculture has moved to the tendency of commodity-orientation. Specialized commodity regions were set up like rice in the Mekong Delta and Red River Delta; coffee in the Central Highland and Southeast region; tea in the mountainous and northern midland; rubber in the Southeast region, Mekong Delta and some northern provinces; vegetable in Lam Dong and provinces in the Red River Delta; sugarcane in the Central coast, old 4 region and South region... Many commodities export at very high rate such as coffee at 95%, cashew (100%), rubber (80-85%), pepper (90%), and tea (50%).

Commodity rate in agriculture in 1999 was over 40%. Export value of agriculture, forestry and aquaculture accounted for 38 – 40% of total annual export value.

In aquaculture, role of people fishery was soon identified. From 1981, aquaculture transferred business production to market mechanism, it implemented self-balance which combined shored and off-shored fishing with aqua cultural production and it made great progresses in aqua cultural economic structure and agricultural economy in coastal regions. Aquaculture economy including producing and fishing gained relative high growth rate. The Vietnamese aquaculture applied successfully quality management program under developing countries' standard. Export aqua-products of Vietnam were trusted in foreign markets as Japan, EU and the United State... Export value rose from \$205 million in 1989 to \$971 million in 1999 and \$1.4 billion in 2000.

In forestry sector, the most important change is a transformation in managing mechanism from state to society; allocating forest and land forest to household management, connecting responsibility of forest resources guards, managers to benefit from forest; encouraging development of bio-diversification (plant forest, regenerate forest, combine with agricultural production, etc.). More than 1 million ha of forestland was allocated to households and over 5 million ha were allocated for socio-economic organizations. The Government issued and implemented a lot of important instructions, decisions on forestry development, preventing the problem of deforestation, providing capital to protect and replant forest included the Decision 327, 661 (Replanting 5 million ha forest project), the Instruction 90TTg, etc. These programs were supported and invested by foreign countries and international organizations to implement planting forest projects as PAM, SIDA (Sweden), GTZ (Germany), WB, ADB, etc. However, regarding to the forestry sector there were remain problems such as there was still no market for forestry product and interests of stakeholders involving in forestry development were not ensured.

Beside positive impacts, new policies have not brought about results as expected. Some directions in the Central Decision 5 were slow to go into reality: although Land Law was revised, it has not reflected the real demand, so it could not create a healthy land market. Activities related to changing owning right, contributing capital as joint venture, refunding and restoring land for public purposes still faced a lot of difficulties. Investment in science was implemented slowly; investment in human resources was not considerable. Extension system was in slow adjustment.

The Cooperative Law was issued and revised but cooperative economy has not developed. The Prime Minister's Decision on State farm management went to force lately, management was still weak, and productivity and profit were slow.

## **4. Intensive Development and the Challenges ahead 2000 – 2005**

In this period, agricultural production transformed from expansion phase toward objectives of higher yield, better quality and higher value in order to create jobs and raise income for people in the rural areas.

The 4<sup>th</sup> Party Congress held in April 2001 summarized achievements in fifteen years (1986-2001) and also set two main targets for five year plan from 2001 to 2005:

- Building united institution and policy for the market economy under the State control;

- Enhancing economic modernization and industrialization.

In the field of agriculture, the Congress proposed to strengthen conduction and mobilize essential resources to step up agricultural and rural modernization and industrialization.

Under decrees of the 4<sup>th</sup> Party Congress, the central Government issued the Decree 5 on “stimulating agricultural and rural modernization and industrialization in 2001-2010: The Decree describes a general content for agricultural and rural modernization and industrialization as followed:

- Transferring agricultural economic structure towards big commodity production, connecting to processing industry with market
- Implementing mechanization, electrification and irrigation applying science technology achievements, especially biotechnology which applying machines, modern technique to agricultural production in order to improve yield, quality, effectiveness and competitiveness of agro-products in the market
- Transferring rural economic structure towards increasing industries and service;
- Building socio-economic infrastructure, planning rural development, protecting ecological environment
- Reorganizing production; setting up democratic, fair, civilized, improving material and cultural lives of people in rural areas.

To implement the central Decree 5, the State and people continued implementing target programs such as hunger alleviation and poverty reduction, breeds and plants program, clean water and environment hygiene program, etc. Ministry of Agriculture and Rural Development promoted and constructed movements including “establishing 50 million dong/ha fields”, “four-party association” which set up gradually market relation to connect producers with traders, with science technology and policy. In industries, slogan “standardizing office, planning work, informatics popularizing public service” was set up to bring administrative reform into practical contents. Building law and under-law documents were also expanded.

In July 2002, the Government promulgated the Decree 6 on development of education and training, science and technology. By this Decree, agriculture and rural content was emphasized. It pointed out one of hot problems in agriculture was intensifying investment and improving policies, regimes in researching management and science transference. MARD stepped to increase budget and recover researching management, prepare step by step to rearrange researching and extension system, etc.

Issuing the Enterprise Law helped increasing number of newly established enterprises. In 2001, 18 thousands of new enterprises registered to do business. As the result, GDP of non-state economic sector (including FDI) rose from nearly 0% in early years of Doimoi to 61% in 2001. In 2002, more than 20 thousands of enterprises registered to operate with total registered capital increased by 38% to 30 billion dong.

In agriculture, private and household sector have developed rapidly. Non-state economic sector accounted 96% of total agricultural GDP. By 2002, according to Cadastral General Office, granting land use license completed basically, forestland was allocated to 43.8% of owners.

Restructuring State-owned enterprises were strengthened, reduced from 12,297 enterprises in 1989 to nearly 5,300 enterprises in 2001 through merging or disbanding. This process was strengthened in 2004 and will continue by 2005 with estimation of 2,000 enterprises.

The rate of processed products for export increased to 40% in 2002. Agro - products for export decreased in quantity but increased in value. Fishery exported products shot up 12%. Exported handicrafts rose 34%, created jobs and income for labors in rural areas.

The VN - US Bilateral Trade Agreement have created a huge impetus for the Vietnamese export. US market has gradually become the big export market of Vietnam. Export to US rose 128%, account for around 82% of the total export growth in 2002.

Foreign investment in Vietnam recovered. Total capital of registered FDI in Vietnam in 2001 reached USD 3.02 billion, with the average growth of 25.8% against 2000. After nearly 16 years adopted the first foreign investment law, in December 2002, Vietnam has received 3663 projects with the total value of USD 39.09 billion from around 70 countries all over the world. FDI have created about 600,000 jobs that directly related to foreign investment projects and thousands more jobs indirectly related to construction and services.

However, the agricultural development process still reveals some shortcomings: The limited investment in agriculture blocks up the transformation in agricultural intensive development and restrains the effort to improve the competitiveness of Vietnamese agro - products. Due to the lack of investment in science technology, the rearrangement process of science research in agriculture has to face difficulties.

The development strategy in industry and services has not revealed the relationship with the agricultural industrialization and modernization that is the reason why it fails to bring about the income for farmers and fails to take advantage of rural market for agro - products.

There are not proper policy and regulation systems to improve the human resources in rural areas. The quality of education and training is still low and fails to build up labor forces to meet up the agricultural industrialization and modernization. Investment for the development of rural areas is still modest, the poverty rate reduces fast but still at high level, the gap between urban and rural areas, between flat and mountainous areas continues to widen.

## 5. Lessons Learned

What are implications can be draw from Vietnamese experience regarding to market reform? Over the past 20 years, success in agricultural reform has been served as a pioneer and basis for the overall sustainability of economic reform in Vietnam and one of the most important aspects for the success of the reform process is policy making and application process in accordance with the dynamism of farm household. A common remark on reform in Vietnam is that momentum for reforms have always been come from specific it challenges faced. In the late of 80s, threats of macro crisis combined with food insecurities led to the fierce decision on reform and agricultural sector was chosen as the starting point. This is also true in the later periods as policy reforms always related to difficulties either internally or externally. An important question is that why agricultural sector had been chosen as a breakthrough? It due to the reason that agricultural development played an extremely important role for sustainability of the society during that time regarding to large population engagement in and food security issue. It is worthy to note that reform of Vietnam had come from experiences at the micro-level or the so-called

bottom up process in some provinces. Those initiatives have been served as important and convincing suggestions for policy makers at the top level to expand the pilot model to other provinces.

The key policy implication during the reform period is a process of lifting constraints for market development ranging from land policy to freeing up trade. Though land policy is still controversial in Vietnam, the changes that have taken place in the property rights related to land are short of revolutionary, from a system of collective farming, the country has evolved to a household-based system where land use rights are given to individuals. Security of land access has been arguably the most important factor behind the strong and sustained growth of agricultural production in Viet Nam over the past 20 years. Moreover, the relatively equal distribution of land assets is a key ingredient for the poverty-reducing effect of market reform. While in other Asian countries the proportion of landless is around 20 percent of the population in rural areas, in Viet Nam the landless population is around 2 percent.

An export-oriented strategy can be consistent with food security and with smallholder production. Since 1990, quotas, tariffs, non-tariff barriers, and free entry have been the main subject of trade policy. With the exclusion of rice, all agricultural tradable products have been excluded from quota restrictions during last decade. This has allowed farmers to become increasingly export oriented, particularly in some products such as coffee, cashew nuts, pepper, and rubber. While this market orientation has often implied higher income for farmers, it has also increased their vulnerability to the fluctuations of world markets. Although export liberalization does create winners and losers, the net effect on poverty is negligible or slightly positive.

Moreover, the potential offered by market reform cannot be translated into actual growth unless other material and institutional conditions are in place. The government of Viet Nam invested heavily in irrigation infrastructure construction and rehabilitation even before market reforms were adopted. Its extension service was also relatively successful in disseminating modern technology such as high-yielding varieties, fertilizers, and plant protection techniques. The success of the technology dissemination was helped by the existence of a relatively well-educated labor force, with literacy rates much higher than in the majority of countries at a similar level of development.

The success of the renovation policies started in the late 1980s has been explained by the fact that policy makers in Viet Nam have realized that agricultural development is inextricably linked to rural development. Unless the various constraints limiting the growth of the rural economy are resolved, the scope for agricultural development is rather limited. The Communist Party put forward some important policy guidelines toward the end of the 1990s that reinforce the market orientation initiated by *doi moi* and strengthen the linkages of agriculture with rural development. The challenges presented by the Asian crisis have partly contributed to this new emphasis on rural development and poverty reduction. The two Party resolutions of 1997 and 1998 and previous policy debate have set in motion various programs related to rural development. Many of these programs have important implications for agriculture.

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## APPENDIX:

Year	Agricultural and rural policies
1979	<ul style="list-style-type: none"> <li>• Experiment of agricultural and industrial production mechanism by contract</li> </ul>
1980	<ul style="list-style-type: none"> <li>• Experiment of agricultural and industrial production mechanism by contract</li> </ul>
1981	<ul style="list-style-type: none"> <li>• Expansion of agricultural and industrial production mechanism by contract all over Vietnam</li> </ul>
1982	<ul style="list-style-type: none"> <li>• Cancellation of collaborate structure in the South</li> <li>• Adjustment of exchange rate according to market prices</li> <li>• Allowance of commercial participation in some fields for economic sectors</li> <li>• Experiment of free market in some places</li> <li>• Acknowledgment of multi - sector economy</li> </ul>
1885	<ul style="list-style-type: none"> <li>• Adjustment of planning prices according to market prices</li> <li>• Adjustment of managing structure in forestation yards</li> </ul>
1986	<ul style="list-style-type: none"> <li>• Experiment of the X<sup>th</sup> Party Congress in some places</li> <li>• Financial management tightening in State - owned enterprises (SOEs)</li> </ul>
1987	<ul style="list-style-type: none"> <li>• Experiment of the X<sup>th</sup> Party Congress in some places</li> <li>• Promulgation of foreign investment Law</li> </ul>
1988	<ul style="list-style-type: none"> <li>• Promulgation of land Law</li> </ul>
1989	<ul style="list-style-type: none"> <li>• Staff dismissal in SOEs</li> <li>• Banking system decentralization</li> <li>• SOEs innovation</li> <li>• Domestic market liberalization</li> <li>• Promulgation of sales and luxury tax Law</li> <li>• Conduction of exchange rate policy / State controlled floating interest rate</li> <li>• Commercial control through quota application of 12 main commodities</li> </ul>
1990	<ul style="list-style-type: none"> <li>• Promulgation of Enterprise and Company Law</li> <li>• SOEs rearrangement</li> <li>• Promulgation of State bank Law</li> <li>• Promulgation of other financial organization Law</li> </ul>
1991	<ul style="list-style-type: none"> <li>• Abolishment of support mechanism for SOEs (basically)</li> </ul>
1992	
1993	<ul style="list-style-type: none"> <li>• Promulgation of amended and revised land Law</li> <li>• Relationship normalization with international financial organizations</li> <li>• Floor rice price control</li> </ul>
1994	<ul style="list-style-type: none"> <li>• The United State called off the commercial embargo with Vietnam</li> </ul>
1995	<ul style="list-style-type: none"> <li>• Relationship normalization with the US.</li> <li>• Member of ASEAN</li> </ul>
1996	<ul style="list-style-type: none"> <li>• Promulgation of amended and revised foreign investment Law</li> <li>• Promulgation of cooperative Law</li> </ul>
1997	
1998	<ul style="list-style-type: none"> <li>• Promulgation of amended and revised land Law</li> <li>• Simplification of import and export licenses</li> <li>• Export allowance for economic sectors</li> <li>• Member of APEC</li> </ul>
1999	<ul style="list-style-type: none"> <li>• Rearrangement of State owned agro-forestation yards</li> </ul>
2000	<ul style="list-style-type: none"> <li>• Promulgation of amended and revised foreign investment Law</li> <li>• Mergence of enterprise Law and company Law</li> <li>• Promulgation of new tax system</li> <li>• Establishment of stock market</li> <li>• Abolishment of imported fertilizer quota</li> <li>• Promulgation of the 80<sup>th</sup> Decision concerning contract association between producers and enterprises...</li> <li>• VN-US bilateral trade agreement signed</li> </ul>

Year	Agricultural and rural policies
2001	<ul style="list-style-type: none"> <li>• Promulgation of amended and revised land Law</li> <li>• SOE equalization improvement</li> </ul>
2002	
2003	<ul style="list-style-type: none"> <li>• Tax and non-tax barrier lessening in ASEAN block</li> <li>• Rearrangement of state owned and equities commercial banks</li> <li>• Rearrangement and reformation of State owned agro-forestation yards</li> </ul>
2004	<ul style="list-style-type: none"> <li>• Promulgation of amended and revised land Law</li> <li>• Promulgation of business tax and revised value added tax 2004</li> </ul>

Year	Important macro events
1986	<ul style="list-style-type: none"> <li>• Super inflation</li> </ul>
1989	<ul style="list-style-type: none"> <li>• Change of VND/USD exchange rate</li> </ul>
1990	<ul style="list-style-type: none"> <li>• Oil price reached the highest level (40 USD)</li> <li>• Disintegration of Xo Viet Union</li> </ul>
2002	<ul style="list-style-type: none"> <li>• Coffee price down at the lowest level</li> </ul>
2003	<ul style="list-style-type: none"> <li>• Bird flu, SARS epidemic</li> <li>• War in Iraq</li> </ul>
2004	<ul style="list-style-type: none"> <li>• High oil price (more than 40 USD)</li> <li>• Bird flu</li> </ul>

Year	Main events affecting agricultural growth
1985	<ul style="list-style-type: none"> <li>• Historic flood in Hoang Long River in 1985 and scare flood in Red river Delta marked the first natural calamity in the last 20 years all over the country in the renovation period. The year 1985 witnessed serious disasters in Red River Delta and the forth zone, in which huge flood and waterlogged fields seriously losses related to human and property.</li> <li>• The eighth hurricane (known as Cecil) landed in Binh – Tri - Thien in 05/1985 with strong and long lasting wind killed 900 people, injured 215 (mostly in Tam Giang dam, Thua Thien Hue Province), sank 1,772 boats.</li> </ul>
1986	<ul style="list-style-type: none"> <li>• Red River Delta witnessed the hugest flood since 1971; floods in Thuong and Luc Nam Rivers were at the traditional highest level, floods in Cau and Thai Binh Rivers were at the similar traditional level (after the historic flood in 1971). Weather conditions in 1986 were serious, diversified and complicated.</li> </ul>
1989	<ul style="list-style-type: none"> <li>• The second hurricane landed in Da Nang on May 25<sup>th</sup>, 1989 with the 11<sup>st</sup> and more than 11<sup>st</sup> degree wind through causing heavy rains and floods in Vu Gia and Thu Bon Delta: 124 people were killed, 70 disappeared, 48,000 houses were collapsed, 60,000 houses were seriously damaged, 290 fishing boats were sunk.</li> </ul>
1991	<ul style="list-style-type: none"> <li>• North-east monsoon spell in late December, 1991 which swept through the north to the Central southern region caused serious damages in Thua Thien Hue, Quang Nam – Da Nang, Quang Ngai, Binh Dinh provinces: 150 people were killed, 70 disappeared and 592 boats were sunk.</li> </ul>
1993	<ul style="list-style-type: none"> <li>• Tropical low atmosphere in accordance with cold atmosphere in late October 1993 brought about a special heavy rain spell in Thua Thien Hue and Quang Tri provinces (rains lasted in 2 days from 7 a.m on October 30<sup>th</sup> to 7 a.m on November 01<sup>st</sup> with total volume of 800-1200 mm). That made flood in Huong River, Thua Thien Hue Province reached 4.89m (October 30<sup>th</sup>), 0.35m higher than the historic level in 1953. Flood killed 294 people in Thua Thien Hue and Quang Tri, flooded 22,500 houses.</li> </ul>



Year	Main events affecting agricultural growth
1996	<ul style="list-style-type: none"> <li>• In August, 1996, Song Da witnessed the hugest flood in the century; flood in Red River were at the approximate level of the designed level of Hanoi's dyke, exceeded the flood level in 1986 and known as the second hugest flood against the flood in 1971; there was also a flood swept through Muong Lay (Lai Chau); dyke in Buoi River in Thach Thanh (Thanh Hoa) was broken; huge flood in Cuu Long Delta... Natural disasters in 1996 caused great damages, killed 1200 people, and more than VND7000 billion (nearly USD600 million) was lost.</li> <li>• Floods threatened the safety of various main embankments, floods in accordance with waves from hurricanes eroded more than 390 dyke and embankment stretches of 142km (119km of dykes and 23km of embankments); flood broke the Thanh Hong dyke (under III grade) in Hai Duong.</li> <li>• There were 5 hurricanes in 1996, in which 4 ones were of tropical low atmosphere swept through 17 in 18 Central districts: 570 people were killed; 55 disappeared 353,600 households were affected; 13,800 houses were collapsed; 509,000 houses were damaged; 1,352 classes, 117 hospitals and infirmaries were collapsed; 323,000 hectares of paddy were waterlogged and damaged; 6.9 million m<sup>3</sup> of irrigation land, 4.9 million m<sup>3</sup> of road were damaged; 289 boats were sank. Total value of damages reached to more than VND2, 200 billion.</li> </ul>
November, 1997	<ul style="list-style-type: none"> <li>• The 5<sup>th</sup> hurricane, being known the century's hurricane brought about disaster for habitants in coastal Cuu Long Delta, seriously damaged the infrastructure, houses, crops, brought about long lasting salted soil and caused great damages in terms of people, boats and other fishery catching means.</li> </ul>
1998	<ul style="list-style-type: none"> <li>• The year 1998 did not witness the most serious natural disaster in Central region, but the most complicated change in climate and weather. It was the hottest and doughtiest year in most of coastal Central and Central Highlands provinces. Consecutively from the beginning of the year to August and September, there had been a shortage of rain against the annual average volume, but only in the two last months of the year, hurricane continuously brought about great flood in the region. In 8 hurricanes and 5 tropical low atmospheres in East Sea, there were 5 hurricanes (the 4<sup>th</sup>, 5<sup>th</sup>, 6<sup>th</sup>, 7<sup>th</sup> and 8<sup>th</sup>) and 1 tropical low atmosphere swept through and indirectly affected the middle in Central region and Central Highlands. Especially, within 2 weeks (from November 11<sup>th</sup> to November 26<sup>th</sup>), there were continuously 3 hurricanes including those 4<sup>th</sup>, 5<sup>th</sup>, 6<sup>th</sup> with cold atmosphere landed in southern Central region, causing heavy rain in a wide area, that resulted in huge flood in most of rivers in the region. Floods and hurricanes in 1998 resulted in 336 killed and disappeared; 10,560 houses collapsed; 490,600 houses damaged; 144 classes collapsed; 110,200 hectares of paddy damaged; 5.2 million m<sup>3</sup> of irrigation soil and 3.2 million m<sup>3</sup> of road eroded; 224 boats sank. The total value of damages was nearly VND1, 700 billion.</li> </ul>
1999	<ul style="list-style-type: none"> <li>• The historic flood in Central provinces was the hugest flood in this region from the beginning of the century, the flood crest in Hong River was 1m higher than the historic one and in other rivers, flood crest were higher than that in 1964, being known to be the highest before 1994.</li> <li>• The flood situation in Central provinces in 1999 was complicated and extraordinary. Those provinces ranging from Ha Tinh to Quang Ngai had to suffer the 1<sup>st</sup> hurricane, which caused heavy early season rain. Only to Quang Ngai, this was the heavies rain ever that comes in April since 1906. Especially, only in 1 month from November 1<sup>st</sup> to December 6<sup>th</sup> most of the middle and southern Central provinces had to suffer two very many heavy rains which brought about two huge flood spells continuously swept through those provinces ranging from Quang Binh to Khanh Hoa. The total volume of rainfall in two spells (from November 1<sup>st</sup> – 6<sup>th</sup> to December 1<sup>st</sup> – 6<sup>th</sup>) in Thua Thien Hue reached to 2,500 mm; Quang Tri, Quang Nam, Quang Ngai, Binh Dinh and Da Nang: from 2,000 mm to 2,500 mm; Quang Binh, Phu Yen, Khanh Hoa, Ninh Thuan: from 1,000 mm to 1,500 mm. The largest volume of rainfall in 24 hours in Hue was 1,384 mm (from 7 am, November, 2<sup>nd</sup> to 7 am, November, 3<sup>rd</sup>), in Son Gang (Quant Nagy): 1,009 mm (from 1 p.m, November, 3<sup>rd</sup> to 1 p.m, November, 4<sup>th</sup>). These above two heavy rains resulted in two special huge floods in Central region, water level in rivers exceeded the III emergency grade, in some rivers the water level were at the approximate or higher levels than that against traditional floods. In flood spell at the beginning of November, water level in rivers in Quang Tri, Thua Thien Hue exceeded the historic level, especially in Hue, water level was 1m higher than that in 1993; water level of flood spell at the beginning of December in rivers in Quang Ngai exceeded the historic level; these were two hugest floods within the last 70 – 100 years in these regions. 715 people killed, nearly 1 million house waterlogged and thousands of houses swept away, estimated economic damages reached to nearly VND5, 000 billion, this was also one of the most serious damages due to natural disasters in the twentieth century in Vietnam.</li> </ul>

Year	Main events affecting agricultural growth
2000	<ul style="list-style-type: none"> <li>• There was a huge flood in Cuu Long river system since the beginning of July; this was the most serious flood in the last 70 years in a crowded habitant region. This flood affected directly the lives of 5 million people. Flood in Cuu Long Delta in accordance with various sweeping floods killed more than 700 people, the total damage was up to more than VND5000 billion (US\$400 million)</li> </ul>
2002	<ul style="list-style-type: none"> <li>• The flood in 2002 was known to be the fourth hugest flood since 1971. Flood with a high water level created more than 250 troubles for dyke - lines in Red River and Thai Binh river in Red River Delta</li> </ul>
2003	<ul style="list-style-type: none"> <li>• Water level of floods in basins of rivers in Southern region in 2003 was at a rare low level. However, in the first half of September 2003, Red River Delta had to suffer a very much heavy rainfall, which lasted in a short time. The unusual heavy volume of rainfall sank most of cultivated area in Thai Binh, caused huge flood in Ninh Binh and Nam Dinh provinces. Some other provinces were also affected but not as serious as those above mention provinces. Damages due to flood were very serious, rice cultivated waterlogged area in these three provinces reached to more than 120,000 hectares.</li> </ul>

## Discussion

### Dr. Kang-Taeg Lim

In the beginning, the economic reforms didn't seem so good because of high inflation, constant policy change, and lack of resources for investments. What were the biggest factors that helped in the early stages of economic development? How did the Vietnamese government prepare its training and education of its specialists for reform? And, what kind of advice do you have for North Korean reforms? It is estimated that the move from agricultural to industrial economy would be slow in North Korea's case because food security is an important issue.

### Dr. Young-Tai Jeung

In explaining economic and future growth of Vietnam, you seem very interested in economic development of South Korea. Our rapid development is attributed to the formation of "*chaebol*" and large corporations led to big improvements. Do you have any plans for growing large corporations and taking advantage of a bigger international market? In terms of agricultural trade, do you have any plans to increase agricultural trade?

### Mr. Pham Quang Dieu

Vietnam is different in that companies are not as big as South Korea; the history of state-owned enterprise and management approach is very different.

### Dr. Hyeong-Jung Park

Usually in a growing agricultural economy, labor forces decrease. How did labor forces increase in the period of agricultural growth in Vietnam? Where did these people come from?

### Mr. Pham Quang Dieu

High birth rates in the agricultural areas may have attributed to the growth of labor forces.

### Dr. Young-Yoon Kim

What attributed to the sudden growth in service?

### Dr. Jin-Wook Choi

On p. 20 of your paper, you explain the Land Law. How is it different from ownership?

# Reform of the Distribution and Commercial Sector in Vietnam: Process and Challenges

# Reform of the Distribution and Commercial Sector in Vietnam: Process and Challenges

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## 1. Introduction

The introduction of “*Doi Moi*”, the comprehensive reform program of Vietnam, in 1986 has resulted in remarkable success. Inflation declined dramatically, from 160 per cent per annum in 1988 to less than 10 per cent in 1997, and the economy has been growing steady and rapidly since *Doi Moi* took place. Strong economic performance goes hand in hand with significant reduction of poverty. As the size of the economy roughly doubled between 1993 and 2002, the fraction of the population living in poverty declined by half, from 58 per cent to 29 per cent. Vietnam’s achievements in terms of poverty reduction are one of the greatest success stories in economic development.

Besides changes in production and supply side, reforms in commerce and distribution have made considerable contribution to the outstanding reduction of poverty incidence during the reform years. In general, there are three key channels through which reforms in commerce and distribution sector can affect poverty. First, better distribution has contributed to improvement of access to inputs and markets for outputs, and hence led to reduced transaction costs and increased profitability of business. With prices increasingly serving as market signals, the allocation of resources has become more and more market-based with increased efficiency and this enhances further economic growth. Second, the majority of newly established household and private business has been engaged in retail trade and distribution and these labor-intensive business entities have been a major income- and employment-generating source for unskilled labor in Vietnam in the reforming years. Third, improved distribution system has certainly been an important factor contributing not only to improved redistribution of increased income as a result of rapid economic growth but also to the improvement of the poor’s access to newly created opportunities. With better distribution mechanism and improved mobility of factors and resources, the poor has been able to obtain a reasonable share of the overall benefits generated by sustained rapid economic growth and this is an important underlying cause of the pro-poor growth pattern of Vietnam in the last two decades.

This paper reviews the process of the reforms in the commerce and distribution sector in the context of the comprehensive economic renovation taken place in Vietnam since the mid-1980s. The next section provides a brief overview of the commerce and distribution sector before *Doi Moi*. Section 3 and 4 discuss the structural reforms and reforms aiming at private sector development either in the commerce and

distribution sector or closely related to this sector. Section 5 analyses main reforms in the context of trade liberalization and economic integration directly affected the commerce and distribution sector. Section 6 concludes the paper and highlighting main success as well as identifying key challenges and issues facing this sector.

## 2. Commerce and Distribution Services before Doi Moi

In the past, Vietnam followed the centrally planned economy model in which almost all production and distribution decisions were made centrally. As achieving social equality is one of the most important objectives of building a socialist economy, great emphasis was put on the establishment of a state distribution system. The central goals of setting up a state distribution system are to ensure price stability and fair distribution of goods and services, especially making sure that every household has access to the most basic or “essential” goods.

To achieve these goals, a state-run distribution system had been established with three main components: (1) the system of trading state-owned enterprises (SOEs) and trading cooperatives, (2) the rationing scheme, and (3) the pricing scheme.

The system of SOEs in commerce and distribution services was rapidly developed in the post-Dien Bien Phu period. In 1958 the Department of Commerce was established to take charge of the management of the distribution and commerce sector. In each province, a provincial department of commerce was established under the management of Department of Commerce. In 1960, the Department was split up into two departments for domestic and foreign trade separately.

The business was run by a system of state-owned enterprises (SOEs). At central level, there were state-owned wholesale corporations that undertook the wholesale activities in North Vietnam. At provincial level, there were provincial state-owned enterprises responsible for both wholesale and retail services. The government had also set up a widespread network of trading SOEs in districts from the mid 1960s.

The scope of trading SOEs had grown very rapidly. In 1955, there were only 511 enterprises with 11,700 employees. By 1974, there were 6124 enterprises and 124,200 employees. The share of state sector in total retailing turnover also increased gradually in the post-unification period.

**Table 1:** Contribution of state and private sectors in total retailing turnover (%), 1976-1987

Year	Total retailing service	State Sector			Private
		Total	SOEs	Cooperatives	
1976	100	44.6	36.6	7.9	53.9
1980	100	39.1	29.9	9.2	59.9
1985	100	53.6	40.7	12.9	46.4
1987	100	56.8	41	12.6	43.2

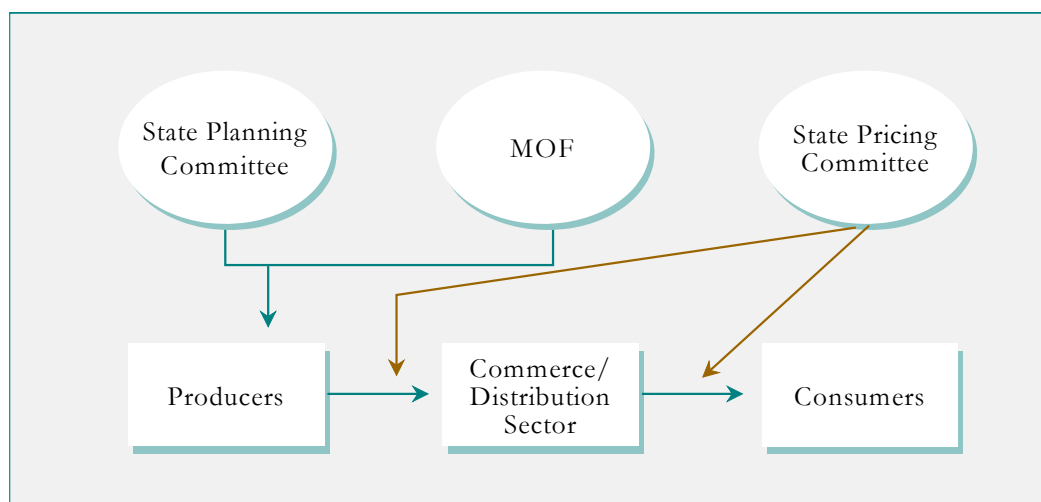
Source: GSO, 1996.

Distributing cooperatives represented another important type of business entities operating in the commerce and distribution sector. Characterized by communal ownership, the cooperatives have been seen as an important stepping stone in the building of socialism. The distributing cooperatives were operational in the rural areas to serve the peasants.

Another key component of the former distribution system in Vietnam is the rationing scheme which was applicable to the essential goods such as rice, foodstuff and kerosene. In principle, every individual in urban areas was entitled to some fixed amount of each type of the essential goods, depending on various factors such as age and the sector he or she is working for. Since the quantity of industrial production output or international trade was determined by the government via State Planning Committee, and grain domestic output was far below demand, rationing was introduced to ensure relatively fair distribution.

State-set pricing mechanism is also an important component of the former distribution system. Before 1986, the state set prices of goods and services and several items were subsidized with low prices. In the past, the trading SOEs could buy goods and services from several sources: production SOEs, cooperatives or agricultural cooperatives. There were different price setting mechanisms for each type of suppliers. The production SOEs were obliged to supply to the trading SOEs the production output as determined by the government and the price included the production costs, fixed proportion profit rate and taxes. The production cooperatives carried out subcontracting work, receiving raw material and deliver the final output as specified in the contract. Agricultural cooperatives had to sell to trading SOEs or cooperatives food and some other main agricultural products at norms and prices as determined by the government. In the 1970s, the government introduced the two-way exchange scheme, in which the farmers could exchange a proportion of their output for investment goods or industrial consumer goods.

**Figure 1:** Working of the Commerce and Distribution Sector before Doi Moi



In addition to the above mentioned three important components of the past distribution system, there were also important policies that had decisive impact on the distribution of goods and services before the mid-1980s. Among the most important ones were the restricted domestic and international trade policies. Especially after the liberation of South Vietnam in 1975, several regulatory measures were imposed to limit inter-provincial trade and address smuggling. Engaging in international trade was also one of the privileges of large trading SOEs and private enterprises were not allowed to transact internationally.

Despite such unlevelled playing field, the participation of private sector in distribution and commerce was considerable in Vietnam before Doi Moi. Even in the period of rapid expansion of the SOEs and cooperatives in the distribution and commerce sector, there existed a *parallel system of private small agents* participating in the distribution. Unlike the former socialist countries in Eastern Europe and the former Soviet Union, the distribution state sector was not in a dominant position as in the industrial production. The participation of private sector mostly in form of small traders or household business in retailing system has been a salient feature of the economy and consequently, a parallel distribution system was in place. Table 1 shows that when Doi Moi took place, the share of the private sector in the total retail turnover was still very high, indicating that the sector remained of crucial importance after many years of developing a state-run distribution system.

The existence and operation of the individual and household traders in the distribution system was closely linked with the structure of the economy. Until the end of 1980s, agriculture remained the largest economic sector of the economy producing about 40 per cent of GDP and employing more than 70 per cent of the labor force. Besides their own gardens, each rural household were allocated a small piece of agricultural land for their own use. Farmers also raise small stock of livestock at home and while a large proportion of the home grown vegetables and livestock were consumed at home, some of them were exchanged at local market places.



### 3. Structural Reforms and Distribution Services

The comprehensive economic reform formally introduced in the mid-1980s has led to fundamental changes in both production and distribution system in Vietnam. In fact, the reform process was initiated earlier with partial, unofficial relaxation of constraints on private activity and gradual moves towards production and trade outside of official channels (De Vylder and Fforde, 1988).

Some important reform measures were introduced in the beginning of 1980s that resulted in initial changes in the nature of the relationship between production and distribution in Vietnam. Limited autonomy was given to SOEs in efforts to gradually abandon the system of “full allocation and full delivery” where the state provides all inputs and recovers all profits. The number of mandatory targets was reduced and the SOEs can now operate outside the plan after the mandatory targets have been met. As an incentive to SOEs, they now could retain up to 85 per cent of the profits from activities outside plan for their own purposes. Attempts were also made to move official prices closer to market rates and decentralize trade to local enterprises.

The reform actually took place in the mid 1980s with comprehensive strategy and reform measures adopted with the conclusion of the Sixth Party Congress. The move away from central planning towards indicative planning and market-based economy was clearly stated and this represented a critical turning point in policy direction.

In relation to the distribution system, remarkable changes were implemented in the second half of the 1980s. In early 1987, many check point that had been established to limit domestic trade were removed. Consequently, the distribution of agricultural goods improved considerably and private markets for these goods also developed rapidly.

Substantial price reforms were introduced in 1987 with the official prices of most non-essential consumer goods being raised much closer to market rates. At the same time, the scope of rationing was considerably reduced. In 1989, most direct production subsidies and price control were removed, basically marking an end to the two-price system. Prices now increasingly serve as market signals instead of being set by the state. The use of market prices in economic contracts and in retail activity has made a significant contribution to changing the way the distribution system works in Vietnam.

In international trade, significant liberalization measures took place in the end of 1980s and beginning of 1990s. The system of quotas was replaced by tariffs and state monopoly in foreign trade was relaxed with increased access to foreign trade rights and licenses. Producers have been allowed to sell their exports to any licensed foreign trade company since 1989. In 1991, private companies were allowed to engage directly in international trade. Quotas were removed on all but ten exports and fourteen imports and tariffs were introduced in the beginning of 1990s. The number of foreign trade permits increased rapidly over a relatively short period of time, from about 30 in 1988 to 300 in 1991 and private firms held about 15 per cent of foreign trade permits by mid-1993 (World Bank 1993:77).

In the early 1990s, a private trading system gradually emerged alongside the state trading system, often acting in cooperation with the state trading companies to utilize the expertise of the state trading companies. Other causes of increased state-private cooperation during this period include privileges of trading SOEs in areas like access to quotas or subsidized credits. There were still considerable entry barriers to international trade in the 1990s. For example, the Ministry of Trade issued import and export licenses permitting enterprises to engage in foreign trade. Obtaining such licenses could be time consuming with cumbersome procedures with several requirements included minimum capital requirements, past foreign trade experience, and qualifications of enterprise personnel.

Perhaps one of the most important reforms in Vietnam in general and in distribution in particular is the reform of state-owned enterprises. For this crucial economic sector, a gradual reform approach has been adopted. The overall goal of the on-going SOE reform is to develop a multi-sector economy where the state sector assumes the leading role of the economy and comprises of effectively functioning SOEs. The SOE reform began with the gradual reduction of state intervention in the production and business decisions of state-owned enterprises. SOE managers have been granted with increased autonomy and freedom and SOEs can now engage in economic contracts mostly at their own willingness rather than being mandated to transact with pre-determined partners at fixed prices. Increased management autonomy obviously provides better incentives for state enterprises and is an important step towards the separation of regulatory independence from operation. Two important legal documents: the Law on Bankruptcy and the Law on State Enterprises were promulgated in 1993 and 1995 respectively with substantial progress being made in clarifying responsibilities and accountability of SOEs and establishing SOEs as limited liabilities entities. These laws aim at the facilitation of improvement of SOE governance as well as the closure of non-viable SOEs.

With state investment and operation of SOEs now prioritized in strategic industries and areas, SOEs in commerce and distribution services have been also rearranged and reformed. The strategic objectives of the state distribution services have been limited to the establishment of sufficient reserves and buffer stock of essential goods to mitigate the sudden shocks of demand and supply and therefore contribute to the stabilization of prices. The coverage of the state distribution services has also been reduced to distribution of essential goods that the other economic sectors have not been capable of supplying these goods. Since the beginning of 1990s, the state distribution sector mainly engage in whole sale, especially of strategic goods such as petroleum and fertilizer, and the share of this sector in retailing services has steadily decreased over time. The rapidly growing private sector has increasingly dominated the retail services with small and micro private enterprises and household business prove to be much more efficient in a dynamic environment than the less flexible central and local SOEs.

**Table 2:** Contribution of state and private sectors in total retailing turnover (% , 1991-95)

Year	Total retailing service	State Sector			Private
		Total	SOEs	Cooperatives	
1991	100	28.9	26.9	2	71.1
1992	100	12.7	11	1.7	74.7
1993	100	22.7	21.8	0.9	77.3
1995	100	22.5	21.7	0.8	77.5

Source: GSO, 1996

To further separate state ownership from state regulatory and public services functions, the administrative grouping of enterprises under umbrella organizations was adopted and the government issued Decisions 90 and Decision 91 in 1994 requiring state corporations and state enterprise unions to re-register either as State Corporations 90 or State Corporations 91<sup>1</sup>. The main objectives of these two Decisions are to consolidate enterprises for improved supervision and to facilitate the abolition of line ministry and local authority control over state enterprises. Arguments favoring the establishments of state corporations focused on the economies of scale and the improved administration over a reduced number of enterprises.

It has been argued that the establishment of large state corporations may lead to increased monopoly power. Especially where domestic market is concentrated or trade barriers remain significant, there is potential for corporations to coordinate the operations of their member enterprises to exploit possible monopoly position. In the distribution and commerce sector, the wholesale services for some essential goods were concentrated in one state corporation as in the case of Vietnam Petroleum Corporation and Cement Corporation of Vietnam. With limited competition induced by regulations, some corporations have continued to use monopoly pricing (Van Arkadie and Mallon, 2003).

Another effort to increase the effectiveness of SOEs in Vietnam is the move to harden SOE budget constraints. The possibility to get direct support from the state budget had disappeared already in the early 1990s, but the larger SOE still had privileged access to credits from state banks to cover their losses. Although data are fragmentary, it is clear that the financial system is still struggling with the overhang of non-performing loans from this period.

Since the beginning of 1990s, the reform of SOEs in Vietnam has moved to the next stage with measures aiming at the diversification of state ownership. This equitization process started with a pilot program in 1992. The program called for transformation of a limited number of viable or potentially viable small scale non-strategic SOEs into joint-stock companies. The adopted approach to equitization was selling off enterprises shares to employees on preferential terms and to other investors including domestic public and private investors. Foreign investors have also been allowed to buy shares of equitized SOEs but on a limited basis. In May 1996, the Government issued Decree 28-CP extending the scope of

<sup>1</sup> State Corporations 90 were required to have at least five members and total legal capital of VND 100 billion, and their establishment can be approved by ministers or provincial people's committees. State Corporations 91 were required to have at least 7 members with minimum of total legal capital of VND 1000 billion, approved by Prime Minister.

equitization to all non-strategic small and medium sized SOEs. Decree 28-CP was amended in March 1997 and replaced by Decree 44 in 1998. The equitization process has however been very slow. By the end of 1997, only 17 small and medium sized SOEs had been equitized (Van Arkadie and Mallon, 2003). Main reasons behind the slow equitization include the lack of transparent guidelines on the valuation of assets of the equitized SOEs, weak corporate governance and very limited liquidity of the shares due to the lack of an official stock market<sup>2</sup>. The pace of the equitization, albeit still slow relative to the target, has been proceeding much faster after 1998. Between 1998 and the end of 2000, there have been more than 450 equitizations (VDR 2001:33).

The Government also set up a special Social Safety Net Fund for redundant SOE workers, run by the Ministry of Finance (MOF). Workers who are either separated from their jobs or volunteer to leave them are offered two months of basic salary per year of service, plus a training allowance equivalent to six months of salary, plus six months of salary to support their job seeking process, plus a lump-sum of 5 million VND. The design of this compensation package was aimed at minimizing the expected welfare loss of separated workers. The Social Safety Net Fund has been in operation since mid-2002. It has assisted 8,000 separated workers from 230 SOEs, paying an average compensation package of 28.8 million VND.

## 4. Private Sector Development and Distribution Sector

Another significant move parallel to the reform of SOEs is the strategy to facilitate the development of a multi-sector economy where the private sector has increasingly received greater attention and more equal treatment. The view towards the private sector has changed fundamentally with Doi Moi and private sector has been officially considered as an important sector of the economy with the passage of the Law of Companies and the Law of Private Enterprises both in December 1990. The 1992 Constitution recognizes private property rights in a state managed market-oriented multi-sector economy and therefore was a milestone in laying the foundations for a private sector to compete with the state sector (Government of Vietnam:18-19).

A strongly response to the more enabling business environment and official recognition of private property rights is the sharp jump in household investment in agriculture and retail trade in early years of the reform and resulting in significant increase in output. Household business has been very important in rural and informal urban economic activity and provided employment for most of the population. This type of business has flourished especially in the early years of reform. The number of households increased from 0.84 million in 1990 to 2.2 million in 1996. (Van Arkadie and Mallon 2003: 159).

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<sup>2</sup> The first stock exchange centre of the country was established only in July, 2000 and only large equitized SOEs can be listed. At present, there are 29 firms listed in the centre.

**Table 3:** Average Annual Growth Rates by Service Sub-Sector: 1986-2003

Service Sub-Sector	Average Annual Growth Rate			
	1986-90	1990-95	1995-00	2000-03
Science & technology	9.6	7.5	5.5	9.2
Education and training	9.5	11.2	5.6	7.2
Finance and credit	6.2	16.4	7.5	7.1
Health care and social services	11.1	5.8	5.0	7.1
Commerce; equipment repair	4.2	7.4	5.9	7.0
Individual and community services	5.5	10.1	8.0	5.6
Mass and association activities	4.9	10.3	12.5	5.5
Cultural and sports activities	13.5	9.3	7.8	5.0
State management, security & defence, compulsory social protection	7.8	7.2	2.6	4.8
Business services; real estate	6.7	9.6	4.7	4.1
Hotels and restaurants	6.2	9.8	5.6	4.0
Transportation, warehousing, communications	3.4	7.2	6.5	3.8
<b>Total GDP</b>	<b>4.4</b>	<b>8.2</b>	<b>7.0</b>	<b>7.1</b>

Source: GSO, *Statistical Yearbook* (various years).

However, the degree of informality of private sector business remains quite high despite the fact that it has gradually decreased with the promulgation of the New Enterprise Law in 1999. Estimation using data obtained from surveys conducted by GSO in 1989, 1992, 1994 and 1996 show that the GDP of the informal sector is more than half the size of the formal sector's GDP (GSO 2001)<sup>3</sup>. The share of the formally registered private sector remained relatively unchanged and of about 7 per cent of GDP throughout the 1990s, indicating that a significant proportion of activity of the rapidly growing private sector was very likely not reported.

It should be noted that the private service sector seems to benefit most from the policies that facilitate private sector development. The share of private sector in the services sector has steadily increased and private sectors now accounts for more than half of service GDP. They dominate retail trade activities with their share increasing from 41 per cent in 1986 to nearly 76 per cent 1996 (Van Arkadie and Mallon 2003: 159). The role of SOEs in retail trade was reduced further after the New Enterprise Law was issued, from 30% in 1990 by nearly half to 17.2% in 2002.

Recent developments in Vietnam have indicated that the private sector has increasingly become the default alternative for further development, and the policies towards private enterprise have undergone significant reform. Official documents have upgraded the private enterprise sector to one of the

<sup>3</sup> In GSO's definition, informal activities include not only household and unregistered business but also not-reporting income, smuggling, NGO activities etc.

cornerstones of the economy, and efforts have been made to reduce some of the privileges of SOEs, to create a level playing field for private firms.<sup>4</sup>

**Table 4:** Percent of Vietnam's GDP by economic activity: 1995-2003 [constant price]

Economic Activity	Percent of GDP			Average Annual Growth	
	1995	2000	2003	1995-00	2000-03
Agriculture, fishing, forestry	26.2	23.3	21.0	4.4	3.5
Mining	5.3	6.7	6.1	12.2	3.6
Manufacturing	15.5	18.8	21.2	11.2	11.5
Utilities	1.7	2.3	2.7	13.4	12.1
Construction	7.5	7.5	8.5	7.2	11.3
Commerce	17.2	16.3	16.3	5.9	7.0
Hotels & restaurants	3.4	3.2	3.2	5.6	6.7
Transport, storage, communications	4.0	3.9	3.8	6.4	6.4
Financial services	2.0	2.1	2.1	7.5	7.1
Science & technology	0.6	0.6	0.6	5.7	9.2
Business services; real estate	5.0	4.5	4.1	4.7	4.1
Public administration	3.6	2.9	2.7	2.6	4.8
Education & training	3.6	3.3	3.4	5.6	7.2
Health & social services	1.5	1.4	1.4	5.6	7.1
Recreational, cultural	0.6	0.6	0.6	7.8	5.1
Community, personal services	2.3	2.4	2.3	8.0	5.2
Total GDP	100.0	100.0	100.0	7.0	7.1
Services - Vietnam's Categories	<b>43.8</b>	<b>41.3</b>	<b>40.5</b>	<b>5.7</b>	<b>6.4</b>

Source: Calculated by the author from GSO, *Statistical Yearbook 2003*, Table 27.

The new Enterprise Law, came into force in 2000, has considerably simplified the company registration process and enhanced the growth of private enterprise. On average, it takes only 17 days and less than USD 40 to have a new business registered that is in sharp contrast with 99 days and USD 660 in the past (VCCI, 2002). The considerable reduction of barriers to entry has offered a big push to the expansion of private enterprises. By the end of September 2003, more than 75,000 new private companies had been registered under the new law, most of them small and medium sized firms. By contrast, the total number of private firms registered during the preceding 10-year period (1990-1999) had not exceeded 45,000. Reports in Vietnamese press indicate that the private sector's share of total investments increased from 20 percent in 2000 to 27 percent in 2003 (to exceed that of the SOE sector), and that private firms created 1.6-2 million new jobs during this period (Saigon Times Weekly, Nov 8, 2003). In fact, it was estimated that only about 70 per cent of the newly registered firms are actually newly established and the rest 30 per cent had been operating informally before they decided to register. Again, this is another

<sup>4</sup> See for instance the discussions in Government of Vietnam (2002).

indicator of the extent of informality of private sector in Vietnam before the New Enterprise Law coming into effect.

## 5. Economic Integration, FDI and Distribution Services

Open door policy has been one of the main pillars of the economic reform in Vietnam and also viewed as one of the most important engines of Vietnam's outstanding achievements. At the onset of Doi Moi, the Law on FDI was promulgated in 1987 marking the first important milestone towards the official recognition of the foreign invested sector as one important sector in the multi-sector economy. The Foreign Investment Law has been amended four times to better promote and ensure investors' rights. Forty one (41) investment protection agreements and thirty eight (38) double taxation avoidance agreements were concluded with various countries and territories. The Government now allows foreign investors to make direct investment in Viet Nam in all forms, including the 100%-foreign-owned companies, in all sectors not prohibited by the law. With regard to the sectors where there are constraints (such as communications, crude oil exploitation and telecommunications), investors are entitled to make joint investment with local partners. The Government, on the other hand, only exerts prohibitions of foreign investment in sectors that are deemed harmful and threatening to (i) the national culture, (ii) the national security, (iii) public social benefits, and (iv) the environment.

**Table 5:** The Integration with the World Economy

	1994	1995	1996	1997	1998	1999	2000	2001	2002
Trade (percent of GDP)									
Exports	24.9	26.3	29.4	34.3	34.5	40.2	46.5	46.2	47.5
Imports	35.8	39.3	45.2	43.3	42.4	40.9	50.2	49.9	56.1
Total trade	60.7	65.6	74.6	77.6	76.8	81.2	96.6	96.1	103.6
FDI (US\$ million)									
Approvals	3,766	6,531	8,497	4,649	3,897	1,568	2,012	2,536	1,558
Inflows	1,636	2,260	1,963	2,074	800	700	800	900	1,100
GDP Growth	8.8	9.5	9.3	8.2	5.8	4.8	6.8	6.9	7.0

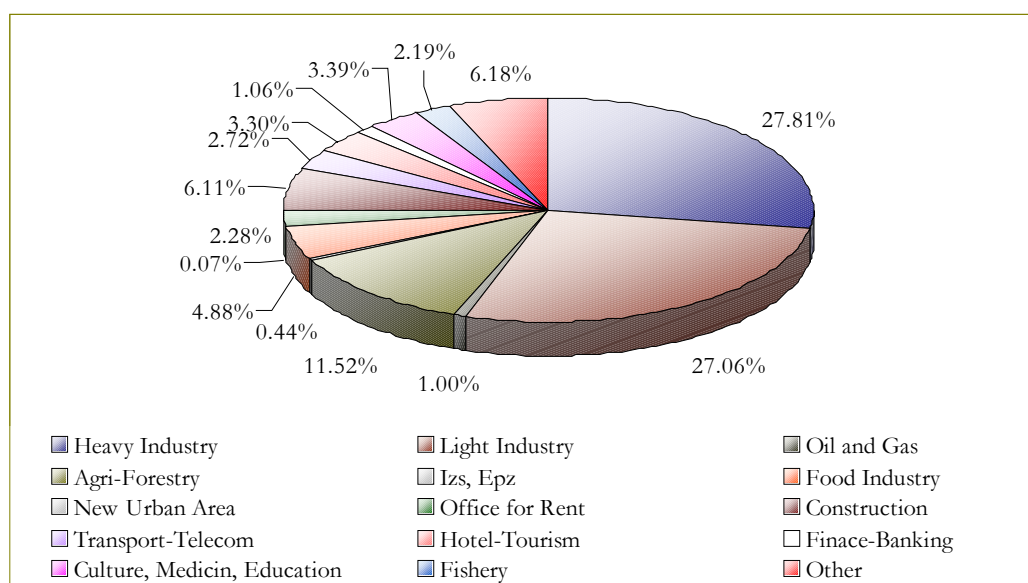
Note: FDI estimates are based on reported foreign equity inflows plus foreign borrowing by joint ventures.  
Source: Vietnam Development Report 2004, and GSO.

Trade liberalization and integration with the world economy has perhaps been the policy area with most advanced structural reforms. In the early years of the reform, the government had introduced several measures to remove trade barriers. The non-tariff barriers system was replaced by a tariff system in the end of 1980s and restrictions on foreign exchange controls have gradually been loosened. The monopoly of SOEs in foreign trade has been steadily reduced and private enterprises can engage directly in export and import. In the last few years, the government of Vietnam has clearly demonstrated its firm

commitments in further integrate the economy into world economy (participating AFTA, signing Vietnam-US BTA, supporting the establishment of ASEAN Economic Community (AEC), and negotiation efforts exerted to become a member of WTO at the end of 2005). By the end of 2010, it is expected that the average tariff rate under the Effective Preferential Tariff Scheme will be about 9.3%, and all commitments under AFTA will be completed. Accession to the WTO will be essential for fostering competition in all sectors, especially the service sector which is at present dominated by a few state-owned corporations.

Radical changes in international trade and investment regimes have resulted in remarkable success and Vietnam has been able to achieve double-digit export growth from 1990. Vietnam is also one of the success stories in attracting foreign investment. The contribution of FDI to the overall GDP has gradually increased in recent years, with FDI is picking up considerably since 2004 after a set-back in the years following the Asian financial crisis.

**Figure 2:** Composition of FDI 1998-2003



Source: MPI Website

However, barriers to foreign investors do differ across sectors and FDI in Vietnam tends to concentrate in some particular industries, especially the highly protected heavy industries. Despite recent liberalization, Vietnam’s regulations continue to place significant restrictions on foreign participation in the services sector in general and, in the importing and distribution sectors in particular. In this context, “foreign” refers to companies or organizations with foreign capital. To a large extent, import and distribution activities are reserved for Vietnamese entities, and offshore manufacturers must work through Vietnamese firms to establish distribution or retail operations inside Vietnam. However, foreign-invested companies licensed to manufacture in Vietnam may be permitted to distribute their products domestically. Investment licenses now may also allow foreign-invested companies to import raw materials for



manufacturing their products locally, as well as finished products before production start-up for the purpose of test marketing and developing the business over a limited period of time.

According to the U.S. - Vietnam BTA currently in force, U.S. firms are permitted to form joint ventures with Vietnamese partners in distribution services three years after the date of entry into force of the Agreement (i.e. on December 10, 2004) subject to some limitations on trading and distribution rights. One hundred percent U.S. invested capital firms may be established seven years after the date of entry into force of the Agreement subject to the same limitations, which shall be abolished over phase-out periods.

There is a general misconception that market-seeking FDI in domestic sectors such as retail yields little development impact. The opposite is true. FDI in retail has been a key driver of productivity growth in Brazil, Poland, and Thailand, resulting in lower prices and higher consumption. Large-scale foreign retailers are also forcing wholesalers and food processors to improve. And they are now becoming important sources of exports: Tesco in Thailand and Wal-Mart in Brazil are increasingly turning to local products to feed their global supply chains. Retail also happens to be a pillar of the tourism industry. The misconceptions about FDI are made worse by political economy factors: while attracting efficiency-seeking FDI does not affect incumbents, attracting market-seeking FDI usually does. In the future more and more FDI will be market seeking investment in service sectors as well as investment in tourism and offshore services.

Foreign investors have shown more interest in commerce and distribution services in recent years. A significant development in wholesaling is the launch in 2001 of a wholesale cash-and-carry operation to serve small retailers by Germany's Metro AG group. Metro Cash and Carry operates a members-only service restricted to businesses and offers a variety of both food and non-food items. Over the next three to five years, the company plans to build seven large stores spread throughout Vietnam. Currently, they have two large stores in Ho Chi Minh City and a new store opening in Hanoi on July 31, 2003.

Another fast developing area in distribution services is shopping center development. The Saigon Superbowl and Diamond Plaza in Ho Chi Minh City, the nation's first large-scale entertainment and retail centers, only opened in 1996 and 2000. French hypermart developer CORA has opened a complex anchored by its flagship mega-store in Dong Nai Province which is mobbed on weekends by shoppers from Ho Chi Minh City and the surrounding provinces. It has opened subsequent hypermarkets in Binh Chanh and Cholon Districts of HCMC and announced plans for several more stores (including outlets as far afield as Hanoi and Can Tho) over the next few years. Other recent developments include a very large retailing center (21,797 sq. m) in the mixed-use Thuan Kieu Plaza in Cho Lon, HCMC's "Chinatown", as well as SAVICO-Kinh Do Plaza, a pastel "strip mall" type development in the heart of District 1. Although Ho Chi Minh City leads this sector, similar developments are taking place in Hanoi. One major project is a \$30 million joint venture between CORA and Thang Long General Import-Export and Travel Company to develop a hypermart on eleven hectares of land only ten kilometers from the center of Hanoi. The project is presently in the phase of land compensation and site clearance.

Showrooms and service centers for specialized products such as electronics, appliances, automobiles, and industrial goods are also increasing. General Electric (GE) Company's Appliance Division and Lighting Division have launched chains of retail outlets in the past year, and industrial equipment manufacturer Parker-Hanafin and air conditioner giant Carrier have opened similar outlets in HCMC. All of this is changing the way the wealthier and more cosmopolitan segment of urban Vietnamese shops. But apart from these pioneering projects, retail outlets still consist mainly of family-run market stalls or small street-front shops.

## 6. Concluding Remarks

The reforms in commerce and distribution sector in Vietnam in the last 20 years have made significant contribution to the overall outstanding performance in economic growth and poverty reduction. The move towards a market economy in which prices are determined by market forces is critical in improving the efficiency of resources allocation, creating right incentives for economic actors to participate more actively and effectively in the production and distribution chains.

While the extent the improvements in the commerce and distribution sector contributed to the productivity growth, expansion of production as well as growth of the other services sectors remains to be studied, direct contribution of the commerce and distribution sector to GDP growth and especially employment growth has been very significant. Growth data of various sectors as provided in Table 4 show that over the period 1995-2003, GDP of commerce services grew faster than the average GDP of the services sector, and in the period 2000-2003, commerce service sector is one of the fastest growing sector of the economy. But perhaps more important is the role of this sector in generating employment. Over the period 1995-2002, commerce and distribution services sector experienced the highest rate of employment growth, almost three times of the national average. Commerce and distribution sector is now the third-largest employer behind agriculture and industry and the latest includes some other services sub-sectors such as construction and utilities. The commerce sector has also the highest growth elasticity of employment with one percentage point increase in GDP results in more than one percentage point increase in employment.

**Table 6:** Share and Growth of Employment by Economic Activity: 1990-2002

Economic Activity	Percent of Employment			Average Annual Growth	
	1995	2000	2002	1995-00	2000-02
Agriculture, fishing, forestry	70.1	68.2	66.1	1.3	1.0
Industry*	11.2	12.1	12.9	3.4	6.1
Commerce	5.8	7.4	8.0	7.0	7.0
Hotels & restaurants	1.6	1.8	2.0	5.4	5.5
Transport, storage, communications	2.3	2.5	2.9	4.1	10.4
Financial services	0.2	0.2	0.2	-0.4	18.5
Science & technology	0.2	0.1	0.1	-1.9	-0.9
Business services; real estate	1.9	0.3	0.33	-29.1	6.6
Public administration	2.5	2.5	2.5	2.2	1.8
Education & training	2.5	2.6	2.7	2.2	5.7
Health & social services	0.7	0.7	0.7	1.4	1.2
Recreational, cultural	0.2	0.2	0.2	2.9	2.8
Community, personal services	1.1	1.3	1.4	6.0	6.1
Total Employment	100.0	100.0	100.0	1.8	2.7
Services - Vietnam's Categories	18.7	19.6	21.0	2.8	6.2

\*Includes mining, manufacturing, utilities, and construction.

Source: GSO, calculated from various issues of the *Statistical Yearbook*.

**Table 7:** Employment and production increase 1996-2001. Index 2001=100

Sector	Employment increase	GDP Increase	Employment elasticity
Agriculture	104.9	121.3	0.23
Manufacturing	121.1	167.1	0.31
Construction	130.2	137.2	0.81
Trade	140.2	129.4	1.08
Hotels & Restaurants	130.4	127.3	1.02
Transport	129.4	136.8	0.80
Public Administration	109.5	112.2	0.90
Education	116.1	128.8	0.56
Health and Social Services	106.7	128.9	0.23
Total	111.6	133.8	0.34

Source: GSO, various issues.

With labor being the most important asset of the poor, creating employment is arguably one of the most important measures to reduce poverty. Available data from the Living Standard Surveys conducted by GSO show that people with farm jobs are much more likely to be poor. In 2002, 82.5 per cent of the poorest quintile were self-employed in agriculture. Richer quintiles have much higher proportion of people with non-farm jobs. About three in four people in the richest quintile are employed or self-employed in the non-farm sector (VDR 2004). The commerce and distribution sector is very labor intensive and generated 8 per cent of the total employment in 2002, therefore was an important factor behind the impressive poverty reduction in Vietnam in the last 20 years.

The success of the commerce and distribution growth can be attributed to two main factors. First, reforms aiming at facilitating the development of private sector are of crucial importance for the proliferation of the private firms in the distribution service sector. Small traders and household business had always been an important player in the retailing services even before Doi Moi took place. The entrepreneurship existing in the pre-Doi Moi period has been strongly encouraged to develop by the reduction of barriers to market entry and the gradual development of market institutions. In addition, important legal framework has been developed that set up the foundations for the operation of the private sector and boosting business confidence and investment by allowing individuals to exercise property rights over income producing assets and personal property.

The second important factor leading to the successful development of the commerce and distribution services sector is that the government has adopted a right approach emphasizing gradualism and appropriate sequencing. The comprehensive reform process has taken place in a context of stable macroeconomic environment. Political stability has been crucial in maintaining high level of private business confidence. The reform in the commerce sector has occurred gradually with initial reform measures were undertaken in domestic trade in which internal barriers to trade were removed in early years of reform. Autonomy of SOE managers has also increased step by step, and a gradual reduction of SOE monopoly in retailing services was accompanied by the facilitation of private sector development.

Despite important achievements mentioned above, there are some critical issues facing the commerce and distribution sector in Vietnam. The future development of the distribution services sector depends crucially on how Vietnam is going to address these issues to improve the sector's competitiveness and ready to stand out the increased foreign competition resulting from regional and international integration.

One widely acknowledged issue is the fragmentation of the commerce and distribution services. The sector has been made up of millions of household businesses and hundreds thousand small trading companies. As of December 2002, three in four micro firms with less than 5 employees and nearly 50 per cent of enterprises employed 5 to 9 workers are trading enterprises.

**Table 8:** Percent of Enterprises in Each Size Category, by Economic Activity: December 31, 2002

Economic Activity	Number of Employees					Total
	< 5	5-9	10-49	50-199	200+	
Commerce	74.5	48.4	27.3	13.0	8.6	39.4
Manufacturing	7.2	15.8	27.3	41.2	51.6	23.5
Construction	3.7	7.1	17.8	20.3	20.4	12.5
Agriculture, forestry, fishing	1.3	5.5	7.7	5.6	4.8	5.4
Transport/storage/communications	2.4	4.3	6.6	7.5	5.6	5.2
Business services; real estate	5.1	6.6	4.8	4.4	2.1	5.1
Hotels/restaurants	4.3	6.5	4.2	2.8	1.5	4.5
Financial services	0.2	4.0	1.0	0.6	0.6	1.7
Mining & quarrying	0.3	0.7	1.9	2.8	2.6	1.4
Other services	0.2	0.3	0.4	0.6	1.0	0.4
Recreation/culture/sports	0.3	0.2	0.3	0.5	0.4	0.3
Utilities	0.3	0.2	0.2	0.5	0.7	0.3
Education & training	0.2	0.3	0.2	0.1	0.0	0.2
Health & social services	0.1	0.1	0.2	0.1	0.1	0.1
Science & technology	0.0	0.0	0.0	0.0	0.0	0.0
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
<b>Services - Vietnam categories</b>	<b>87.2</b>	<b>70.8</b>	<b>45.1</b>	<b>29.6</b>	<b>19.9</b>	<b>56.9</b>

Source: GSO, *Statistical Yearbook 2003*, calculated from Table 237.

With underdeveloped infrastructure, small scale of trading firms together with simple services technology implies that the distribution system is a fragmented patchwork of state-owned import-export companies, private and state-owned wholesalers, independent Vietnamese agents and distributors, retail outlets, and street stalls with no or very limited link among them. For many products, nationwide distribution requires the establishment of separate networks in the North, the South, and the Central Region. Lack of physical infrastructure links among the major regions together with cultural and economic differences across the nation make it difficult to achieve “one-stop” distribution in many sectors.

Another issue is weak law enforcement. Weak law enforcement implies insecure property rights and an immediate consequence is a higher level of risk of doing business and transaction costs. Firms are forced to adopt a number of risk mitigation strategies to limit their exposure in case the other firms breach the contract. They may use short-term contracts with the promise of renewal upon successful completion or delayed payments to ensure future deliveries. It would take much more time to develop trust in partners. Besides wasting time and resources, firms will opt for short-term and small-scale activities and this clearly hinders the growth of private enterprises. In addition, small firms that account for the vast majority in Vietnam businesses have no effective way to protect themselves from breach of contract by the other party.

Weak business environment represents a further major issue for the development of private sector in general and the distribution sector in particular. The weakness in the business environment of Vietnam compared to other countries has been documented in a study of the World Bank. The report *Doing Business in 2005: Removing Obstacles to Growth*, cosponsored by the World Bank and International Finance Corporation, finds that investment climate reforms, while often simple, can help create job opportunities for women and young people, encourage businesses to move into the formal economy, and promote economic growth. Vietnam's business environment ranks in the bottom quartile of the World Bank list of 145 countries despite recent rigorous reforms of its business laws. Borrowers and lenders in Hong Kong (China) and Singapore enjoy all ten main types of legal rights that expand access to credit, while those in China and Vietnam have fewer than half as many legal rights.

**Table 9:** Indicators for Starting Business in East Asia

	Number of Procedures	Time (days)	Cost (% of income per capita)
Malaysia	9	30	25.1
Indonesia	12	151	130.7
Thailand	8	33	6.7
Singapore	7	8	1.2
Korea	12	22	17.7
<b>Vietnam</b>	<b>11</b>	<b>56</b>	<b>28.6</b>
Philippines	11	50	19.5
China	12	41	14.5

Source: WB, *Doing Business 2005*.

An important implication of weak law enforcement and business environment is the high level of informality. When contracts are not very enforceable and therefore the level of property protection is not high, relationship-based business is more popular and the degree of uncertainty is also not conducive for long-term investment. It partly explains why business remains small-scale and employment in Vietnam has been dominated by self-employment. Recent survey by MOLISA shows that in 2003 about 2 in three people in working age are self-employed or have household business. The share of self-employment has even increased by nearly 4 percentage points from 1999 showing that small-scale informal activities remain one of the most important sources of employment for Vietnam in the years to come.

Other implications of weak law enforcement and low quality of business environment include the increasing scale and scope of corruption. This can impose another much worrying sign and reduces incentives to invest, lower quality of public infrastructure and services and hence result in lower rate of growth and poverty reduction. Smuggling is another consequence of weak law enforcement combined with high level of protection for some industries and this has resulted in the creation of an informal distributing channel for smuggled goods.

## Appendix: Main milestones of Reform in Vietnam in the first few years of Doi Moi

	<i>Changes in trade and exchange system</i>	Other reforms
1986		- VI Party Congress declares beginning of Doi Moi
1987	- <i>Law on Foreign Investment</i> — introduction of ‘open door’ policy	- Land law established private use of allocated land in agriculture - Creation of a central treasury to execute the budget
1988	- Foreign exchange control decree liberalises retention of foreign exchange, opening of foreign currency accounts, use of transfers to pay for imports and repay foreign loans - Devaluation of trade and invisible payments exchange rates - Restrictions on establishment of foreign trading organisations relaxed and central government monopoly of foreign trade terminated - <i>Law on Import and Export Duties</i> introduces the customs tariff	- Creation of two tier banking system - Cooperative method of agriculture production abandoned in favour of households - Farming households given long term rights to use land for agricultural production - Encouragement of private enterprises becomes official policy - <i>Land Law</i> creates nontransferable, exclusive land use rights for agriculture
1989	- Quotas removed on all but ten export and 14 import commodities (subsequently reduced to seven export and 12 import commodities) - Requirement that SOEs fulfill CMEA export targets before exporting to convertible currency area removed - Number of export commodities subject to export duties reduced from 30 to 12 and most rates reduced - Producers of exportables allowed to sell to any appropriately licensed foreign trade company - Number of import commodities subject to duties reduced from 124 to 80, range of rates expanded from 5–50 per cent to 5–120 per cent - Foreign exchange rate system unified	- Nearly all forms of direct subsidisation of production and price control removed — end of ‘two price’ system - Domestic trading in gold legalised - <i>Ordinance on Economic Contracts</i> establishes rights for legal entities to enter into contracts - Bank interest rates made positive in real terms
1990	- Special sales tax introduced - Turnover tax and profit tax introduced - <i>Law on Foreign Investment</i> revised	- <i>Law for State Bank of Vietnam and National Law on Banks, Cooperative Credit Institutions and Financial Institutions</i> enacted, prohibiting SBV from commercial banking and empowering it as central bank - <i>Law on Private Enterprises</i> establishes legal basis for establishment of sole proprietorships - <i>Law on Companies</i> establishes legal basis for, limited liability and shareholder business entities
1991	- Foreign exchange trading floors opened at SBV - Regulation on setting up export processing zones (EPZs) promulgated - Export duty on rice reduced from 10 per cent to 1 per cent - Imported inputs used to produce exports exempted from duty - Private companies allowed to directly engage in international trade	- Agriculture Bank of Vietnam allowed to lend to households
1992	- Harmonised system of tariff nomenclature introduction - Foreign investment law amended to reduce discrimination in favour of joint ventures against 100 per cent foreign owned enterprises, and to introduce build operate transfer (BOT) concept for infrastructure projects - Trade agreement signed with European Union (EU) establishes quota on exports of textiles and clothing to EU and grants tariff preference on selected imports from EU	- New constitution allows individuals to exercise property rights over income producing assets and personal property - Pilot equitisation program for SOEs introduced

Source: Excerpted from CIE 1998:5.

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## Discussion

### **Dr. Hyeong-Jung Park**

How did the Vietnamese attract more FDI in heavy industries than small industries? Why is employment elasticity so low? When did the economic reforms begin in Vietnam? Did it start in the 1970s or in the mid 80's with the Doi Moi policy? When you say Vietnamese people have private property rights, does it mean that the farmers have ownership over the usage of land?

### **Dr. Doan Hong Quang**

Intensive foreign investments as studied by experts seem to be headed toward heavy industries because the profits are high since that sector has not yet been exposed to the international competition. Elasticity in manufacturing is so small. It was 1986 when the ruling party in Vietnam formally established economic reforms. Land is still owned by the government, no private ownership for land.

### **Dr. Moon-Young Huh**

Where is the Vietnamese economy heading? You said economic reforms are transforming central planning to indicative planning? What is indicative planning? There are three important things to success; (1) traditional structure, (2) the right policy, and (3) policy-makers' will. What do you think about North Korea's reform policy? If Kim Jong Il wants to make a recovery of his country's economy, what should he do in an economic sense?

### **Dr. Doan Hong Quang**

It's hard to say because no exact type of economic system will fit one society; an institutional reform takes time, the effect does not show up immediately, and it takes time to bring up confidence and credibility among businesses.

# Social Change in Vietnam after Doi Moi

# Social Change in Vietnam after Doi Moi

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*Doimoi* (renovation) policy implemented in Vietnam since 1986 has created strong impetus for socio-economic development. However, with economic achievements, social problems emerge. Nearly 20 years of implementation of the new social policy has led to significant social changes. In a centrally-controlled planning economy, all revenues were distributed equally; working people were employed; disabled were subsidized; all children went to school; social evils were very rare; and people were relatively equal. However, equal distribution and centrally-controlled management annulled motivation and creativity and society felt into crisis. This paper will present the reforms of Vietnamese social policy and social changes that have resulted from this policy change.

## 1. Economic development and social policy objectives

Theory and practice show that economic growth was insufficient either to inspire national development or to be considered as an end in itself. Economic growth is a necessary condition for solving social problems. But in a market economy, economic growth is not enough to ensure that its revenues would be distributed equally and this leads to social improvement and quality of people lives (Le Dang Doanh & Nguyen Minh Tu, 2001). Quality of life is a concept defined and assessed based on several indicators such as GDP, expenditure per head, reduction of poverty, expansion of accessed basic services such as health care, education, piped water, people participation in political activities, living in the healthy environment etc.

Although economic growth is always an important objective, social improvement is considered as an ultimate objective. To obtain social objectives, it is necessary to implement social policy to distribute economic revenues equitably and effectively and in its turn this equal distribution will have positive impact on economic development. Therefore, economic and social policies are the two sides of a coin; each of them contributing to the sustainable development of a country.

The term social *policy* incorporates objectives and strategies that address a number of social concerns and problems. These include health, education and training, employment, reduction of poverty and income disparity, crime, ethnic and community relations, family violence etc. Social policies do not merely address social problems; they also deal with the economic and political context of those problems. For example, the primary aim of poverty reduction programs is to upgrade employment skills and to improve education, housing and health care for the poor. This ensures better employment opportunities and

promotes micro or small businesses. The ultimate goal of poverty reduction programs, therefore, is to empower the poor (United Nations, 2003:2).

Another common factor of social policies is that they are usually initiated and administered by governments using public funds. While there is no dispute about the leading role of government in social policy, there is a continuing debate as to the size of this role: should it follow the institutional or residual model?<sup>1</sup>

Social policy in Vietnam from 1945 to 2005 can be divided into two phases. The first phase extended from 1945 until 1986. It was characterized by the absolute role of the Government in terms of providing funds and organizational infrastructure for educational and health services, welfare assistance for the poor and recognition of contribution of people in the war, social protection and other related programs. There was no contribution from NGOs to social affairs at that time. It is understandable that there were only two forms of ownership, state and collective.

During the second phase of social policy in Vietnam, which extended from 1987 to present, the fundamental role of the Government in developing and implementing social policies continues, but the role of the private and NGOs increases. The *doimoi* policy leads to improvement of living standards, and consequently, growing demand for education and health care. This demand is satisfied by non-public schools, institutions of higher learning, hospitals and medical centers. The Government also has to deal with problems in the areas of social policy such as employment, insurance, social protection and poverty reduction.

This phase of social change is closely related to the economic transition to a market economy. Recognizing the negative effects of the market economy such as growing unemployment, large gap of income between the rich and the poor, poverty and environmental pollution, the Vietnamese Communist Party and the Government set up social policy in linkage with economic growth. The Governmental role is to intervene and relieve negative impacts of the market and create a social foundation for sustainable development. The social policy was defined by the following conditions:

(1) Economic transition will go along with significant reduction of heavy welfare covered by the State in the past. The first priority of the social policy is to establish a system of social security for people, particularly for the poor;

(2) Vietnam has undergone decades of wars with severe consequences: 4.5 million war invalids, one million elderly whose children died in the war, 300,000 orphans and hundreds of thousands soldiers demobilized. Therefore, significant attention of the social policy is paid to groups related to the war;

(3) Vietnamese economy is still less developed with 70 percent of the population living in rural areas and heavily relying on agricultural activities, while natural disasters such as floods and hurricanes bring two to three million people to the list of those needing assistance every year;

(4) Although poverty reduction has achieved great results, the poverty rate in Vietnam is still very high and the unequal situation is still serious: in 1999, 20 percent of people with highest income earned 7.6 times more than 20 percent of those with lowest income; in 2002, this rate increased to 8.1 times (General Statistics Office, 2004).

Since the *doimoi* policy was implemented, social policies have been continuously adjusted, added to and modified and several forces including state, community, family and citizens have been mobilized

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<sup>1</sup> An institutional system provides welfare for the population as a whole; a residual welfare system, however, is one in which welfare is considered to be a safety net, provided only those who are unable to manage otherwise.

to participate in the implementation of social policies. The State is no longer the only provider of social services and the roles of individuals and NGOs are increasing.

Vietnamese social policies, including a range of policy instruments in various areas, have a strong impact on various groups of people in society. Compared with policies implemented before *doi moi*, these policies cover new areas such as insurance for working people, employment, poverty reduction and preferential treatment for credited people of the war, war invalids and war victims, etc. The implementation of social policies has contributed to redistribution of growth revenues and strengthened social stability and created further perspectives for development. The remainder of this paper will present social policies and their impact in the five following areas: education, health care, employment, poverty reduction and social protection.

## 2. Education

### (1) *Introduction*

The Central Government is responsible for policy making, monitoring and supervising education and providing finance for certain areas of education such as public higher education, certain forms of technical and vocational education; while provincial authorities are responsible financially for general education and other forms of technical and vocational education. Exceptional advances have been made with regard to the goal of increasing access to education and satisfying human resource needs of the economy.

### (2) *Major educational policies*

Since the *doi moi* policy was implemented, education has been considered a national priority. Long-term objectives of Vietnamese education are to provide education for all Vietnamese, to prepare adequate national human resources and to create an environment for talented people to develop. Education has focused on producing well-rounded personalities with ideals of independence and socialism, community awareness, individual activeness, creativity and industrial working styles, good health and having scientific and technological knowledge.

Renovation in education implemented since 1986 has made tremendous improvement in basic education and human resource development. Policy changes in education are derived from the strategic idea of shifting the education system from serving a central planning economy to serving a market economy with socialist orientations. Educational policies in this period can be classified into 7 groups:

(1) Restructuring the national education system which consists of pre-school education, general education, technical and vocational education, and higher education. Compared with the old system, new elements were added. Excellent institutions at all levels have been constructed; continuing education has been strengthened. The goal of the restructuring is to better serve learners and society as a whole;

(2) Reorganizing the educational network focusing on building new vocational schools and centers of professional orientation, new colleges and universities and new schools in remote areas. The new network has been reconstructed to serve the goals of human resource development;

(3) Diversifying forms and delivery modes of education. Educational institutions have been diversified by delivery modes (short term and long term; formal and informal; face to face and distance) and by forms of ownership (public, semi-public, people-founded and private). This policy has created more opportunities for people to access to educational services;

(4) Increasing social forces to participate in education. A major goal is to mobilize finance for education from individuals, communities and society, and to create opportunity for everyone to access educational services and an environment for community and society to supervise educational institutions;

(5) Decentralizing educational management and attracting more social organizations and individuals to become involved in education, paying more attention to disadvantaged groups, communities and regions;

(6) Strengthening links of education and training with research, production and practical life;

(7) Opening up to the world by cooperating with foreign institutions to open schools and universities in Vietnam, welcoming transfer of educational and training knowledge, skills and technology;

### **(3) *Current situation of education***

Educational achievements show that these policies have been implemented successfully. In 2000, the literacy rate of people 15 years old and over was 94.4 percent (UNDP, 2002), but it declined to 92.7 percent in 2001 (UNDP, 2003) and to 90.3 percent in 2002 (UNDP, 2004). The Government provides 9 years of free schooling as compulsory education and allows educational and training institutions to charge for providing services of professional education.

All levels of education have progressed during the *doimoi* period. Pre-school education and upper secondary education have made greater progress in the last five years. Cohort age enrollment rate in kindergartens is 81 percent in 2000 and expected to reach 89 percent in 2005, while the goal was set only 85 percent for 2005. This is considered a strong foundation for increasing the rate of primary education attendance among the population and universalization of primary education.

According to UNDP (2004), the cohort rate of enrollment in primary education increased 4 percent, from 90 percent in 1990-1991 to 94 percent in 2000-2001. However, the rate in lower secondary education in 2001-2002 was only 65 percent. Regarding upper secondary education, the enrollment rate reached 55.9 percent in Red river Delta and 54 percent in South Coastal Region, while in the other regions, enrollment rate was below 50 percent in 2002-2003. With exception of the North West region and Cuu Long River Delta the rate of enrollment was 31.4 percent and 31.8 percent respectively.

Technical education has expanded from 253 to 268 institutions; among them non-public institutions have increased from 7 schools in 2000 to 30 schools in 2003. Enrollment in technical education significantly increased from 255,400 to 360,400 students and numbers of students graduated also increased from 72,300 to 115,800 students in the same period (General Statistics Office, 2003, 2004).

College and university education is the fastest growing sector and has expanded from 148 institutions in the year 2000 to 187 in 2003; enrollments increased from 899,000 students to 1,131,000 in the same period; the number of non-public colleges and universities reached 27 in 2003 and at the same time, non-public students increased from 103,900 to 137,100. Quality of higher education remains a significant issue, but at least the quantitative growth can satisfy the growing demand.

Fast growth of informal education, especially centers for continuing education and community education, continues to contribute to strengthening achievements of illiteracy eradication, dissemination of business knowledge to farmers and small businesses and information on community health care to people, etc.

Vietnam is very close to gender equality. The literacy rate of 94 percent for females under 40 years of age is impressive in a country with US\$ 500 GDP. However, dropout rate among primary school female pupils is still high and their repetition rate is 40 percent (UNPD in Vietnam, 2003:10-11).

Vietnamese education is now facing challenges due to low developed economy and negative impacts of market mechanisms. There is a growing gap of educational access among people from different regions, ethnic groups, economic background and gender. According to a survey on living standards undertaken in 2002 (General Statistics Office, 2004:17), the literacy rate of people 10 years of age and older is divergent among 5 groups of population classified by income. The difference between the wealthiest and the poorest groups is 13 percent (97 percent and 83.9 percent respectively). Differences among provinces also are significant. The average enrollment rate in primary schools of 12 best provinces which are located in urban and developed rural areas is 98 percent, while this rate is only 83 percent in 12 provinces located in mountainous and remote areas. Cohort age enrollment rate varies among ethnic groups. This rate is only 41.5 percent in the H'Mong ethnic group, while it reaches 95 percent in the Tay ethnic group (UNDP in Vietnam, 2003:12).

(2) Results of compulsory education are not sustainable. Population in remote areas, (most of them are ethnic minorities) may easily become illiterate again; around 33 percent of disabled children never attend school. In order to increase cohort-age enrollment, disabled and ethnic children, consisting of 20 percent of the cohort-age, need to be enrolled in the educational system.

(3) Quality of education is one of the serious issues. Due to the lack of adequate budget for education, Vietnamese students study only 40 percent of the time that Thai peers do. Not all teachers have received teacher's manuals for teaching their subjects. Low income may be another reason for low motivation.

(4) Educational indices are relatively high, but quality of human resources is still low compared to ASIAN countries. Only 23 percent of the labor force has been trained.

(5) Financial shortages are another issue of Vietnamese education; a non-public sector has been established to mobilize more funds for education; financial assistance is provided in the form of fellowships or loans for students from low-income households, however, this assistance is not enough to cover all needy students.

## 3. Health care

### (1) *Introduction*

The economic transition has made a fundamental change in the health care system. In the past health care was fully subsidized by the Government, while in the new system the Government, community, family and individuals share health care expenses. Private individuals also are allowed to provide health care services.

## ***(2) Major policies and programs***

The Law on Health care was passed in 1989 declaring that every Vietnamese has the right to receive health care services and everyone is responsible for taking care of his or her own health and the health of others. The Government allows medical institutions to charge patients when providing services. Medical services are largely provided free of charge to the poor through medical insurance. Recently, the Government decided to provide children under 6 year old free medical curative services.

In 1992, the Government issued a regulation on medical insurance changing the subsidized health care system to a new system where citizens are partly charged for their health care. In 1993, an Act on private health care services was passed by the National Assembly to diversify the health care system. In 1997, the Government promulgated a policy on social participation in education, health care and cultural services. This policy encourages Vietnamese and foreign organizations and individuals to establish private hospitals and medical centers.

The Government has established several targeted health care programs:

### ***(a) Preventive health service programs***

It is Government policy to advocate preventive health services with the aim of reducing expenditures on curative services. The Government has launched an increasing number of health education and preventive health programs. These programs aim at raising awareness of environmental, occupational, socio-economic and behavioral factors that have potential impact on the health of all individuals.

The immunization program ensures that the following vaccinations: Bacille Calmette-Guerin (BCG), Diphtheria, Pertussis, Tetanus, Poliomyelitis and Measles will be administered to all children one-year of age. This program covered 95 percent of children in 1999 and 97.5 percent in 2003.

A food and nutrition program has been implemented to make sure that safe and hygienic food is provided in the home, market and foodstuff. A water program provides alternative safe water sources, such as community wells and facilities, to tap groundwater in rural areas where people cannot access piped water.

### ***(b) Medical care service programs***

Medical care service programs include construction and establishment of new medical facilities, as well as expansion and upgrading of existing facilities. Hospitals located in cities are equipped with modern medical facilities to ensure that the quality of diagnosis and care is improved. Medical centers in rural areas are being constructed to expand primary medical care services to every commune throughout the country. The Government is implementing programs to monitor and control production, trade and use of pharmaceutical and medical products, including traditional medicines.

The implementation of the above-mentioned policies leads to encouraging results. Although disasters happen every year, there has been no large epidemic spread. The malnutrition situation is being improved. If in 1997 weight malnutrition was 40.7 percent and height malnutrition was 44.1 percent, in 2003 these rates were down to 28.4 percent and 32 percent respectively (Ministry of Health, 2000; 2004). Life expectancy has increased from 62 years in 1987 to 69 years in 2002 (66.7 for men and 71.4 for women). The rate of one-year-old children fully immunized against measles and tuberculosis in 2002 is very high, 96 and 97 percent respectively. Under-five child mortality rate is down from 8.1 percent in 1970 to 3.9 percent in 2002 (UNDP, 2004).



## 4. Employment

### (1) *Introduction*

In the central planning economy, all working people were expected to be employed. There was no conception of unemployment. During the transition to the market economy, the national economy was restructured. In the early 1990, state-owned enterprises were reorganized to be effective and efficient and the urban unemployment rate grew to around 10 percent. In rural areas, farmers faced a shortage of 30-35 percent of work. Pressure for employment became stronger.

### (2) *Employment policy and programs*

Together with the policy of economic development which creates more jobs, the Government launched a program on job creation in 1992. The main element of the program is to establish a foundation for job creation with major contributions from the State budget. The Foundation provides small loans with a low interest rate for poor households, women and unemployed who are expected to propose small projects for income generation. This Program is expected to create equal opportunity for everyone to access financial sources for job creation.

In the period of 1992-1999, the Program had supported 90,000 projects with 3,000 billion Dong (VND) and 2.6 million jobs had been created - a quarter of the number of jobs needed. Practically, people invested two times more into the project than amount they had borrowed from the Foundation. This Program has helped disadvantaged people integrate into the market.

Job creation can be done through other targeted programs such as poverty reduction programs, programs of exploitation of uncultivated land, programs of economic development in particularly difficult communes, programs for planting 5 million hectares of forest and programs for aquatic culture etc. Job creation is also being done through a labor export program. This program has been renovated since 1988. Enterprises have full autonomy in selection and training of laborers and are fully responsive to them during the time they work overseas.

As a part of the policy on job creation, there have been 148 centers for job services established throughout the country which provide employment consultancy and short training for needed workers. These centers are considered as important means for facilitating and creating a positive environment for the labor market.

To facilitate implementation of employment policy and programs, the Government has undertaken several measures such as capital mobilization for economic development, attraction of foreign investment and reorganization of state-owned enterprises. In addition, the revised Law on Land, new taxation policy, policy on free trade and intensive development of infrastructure significantly contribute to creation of more job opportunities for the labor force and development of the labor market.

Besides achievements from implementation of employment policy, there remain problems to be solved: (i) Policy on economic development is not fully appropriate with employment policy. Policy on taxation and finance, policy on labor market and development of private sectors have not created motivation for expanding jobs; (ii) The labor market is still primitive; there is no legal environment for

labor mobility and insurance for unemployed; (iii) There is imbalance between demand and provision of labor due to the fact that educational and training objectives were not defined based on market research and so the educational system is unable to provide an appropriately trained labor force for the market; (iv) Financial loans are not appropriate to the need of borrowers.

*In brief*, the employment policy and programs implemented by the Government during the period of economic reform have had significant impact on creating more jobs for the poor in urban and rural areas. A sustainable way for Governmental agencies to help the poor gain income is to provide loans and consultancy and assist them in carrying out projects of income generation. The Government also has created a favorable environment for investors and job opportunities for working people by providing training courses and consultancy.

## 5. Poverty reduction

### (1) *Introduction*

Even as Vietnam seized independence in 1945, President Ho Chi Minh emphasized that poverty is an “enemy”, just as illiteracy and foreign invaders are considered enemies. Poverty reduction has been at the top of the national development agenda since the day of independence. Vietnam has made remarkable achievements in lifting its large number of the poor out of poverty. The number of people living below the poverty line fell from 58 percent in 1993 to 29 percent in 2002 (Fan *et al.*, 2004). But reduction of poverty is fragile. The income of a large proportion of population lies just above the poverty line, and even a small adjustment in the position of the line will put them back in the poverty category. Poverty is concentrated in rural areas and areas with unfavorable conditions for making a living such as mountainous, remote and isolated areas, so that most of the income of the poor comes from agricultural work.

Poverty is caused by limited and poor resources, low levels of educational attainment, insufficient and unstable employment, large families, insufficient access to laws and legitimate rights, disasters and other risks, gender inequality, disease and poor health. Although the poverty rate was very high before *doimoi*, it significantly decreased during the time of renovation.

### (2) *Achievements and challenges*

First of all, stable economic growth has been one of the major factors contributing to reducing the incidence of poverty. The annual growth rate of about 7 percent during the period of 1991-2000 has doubled the GDP per capita and increased the Government budget. Moreover, the Government has given priority to the development of agriculture in rural and remote areas where most of the poor live.

Secondly, despite budget constraints, the Government has financed national programs for poverty reduction through infrastructure development in poor communes. During the period of 1992-2000 the Government has made a total investment of approximately VND 21,000 billion for the Program of hunger elimination and poverty reduction. The Bank for the poor has been established to provide concessional credit to the poor. In recent years, more than VND 500 billion of the central budgets has been spent

for settlement, fixed cultivation and resettlement to new economic zones. More than 6,500 infrastructure projects were conducted in the poor communes in 1999-2000. Funds from the Government budget were transferred to 1,200 communes in 1999 and 1,870 communes in 2000.

Thirdly, the capacity of poverty reduction workers has been improved. Specialized poverty reduction workers have been made available to 1,798 communes from 22 provinces and cities (SRV, 2003). The staff equipped with basic knowledge is qualified to instruct people to implement poverty reduction programs.

It can be said that the Government has successfully implemented policies and programs to create jobs and opportunities for people to take initiative in finding jobs or to be self-employed with assistance from the State and the community.

### **(3) Challenges**

First of all, the incidence of poverty remains high. There are still about 2.8 million poor households, accounting for 17 percent of households in Vietnam in early 2001. Poverty incidence is found very high in mountainous, remote, isolated and ethnic minority areas where the improvement of infrastructure is expensive.

Secondly, poverty reduction objectives should be broadened in substance and encompass qualitative changes; they should include not only food sufficiency, but also the satisfaction of other needs such as clothing, shelter, schools for children etc.

Thirdly, the widening income and living standards gap between urban and rural areas, between mountainous and plains areas, among different population strata and between the rich and the poor regions is on a rising trend. The poverty situation in difficult areas thus becomes severe.

Fourthly, poverty reduction gains may not be sustainable. A very large number of households barely lies above the poverty line and have unstable income. Any natural disaster or unfavorable climate conditions increases the risk that these households will fall back into poverty category.

And finally, domestic resources remain extremely limited, while substantial investment is needed both for the overall development of the country and for poverty reduction.

*In brief*, although poverty reduction in Vietnam has achieved remarkable results and the poverty incidence has declined significantly, there are enormous challenges for the Government and communities to overcome. The poverty line is going up, and more and more difficulties are to be faced by the Vietnamese people and the Government in the process of poverty reduction,

## **6. Social protection**

### **(1) Introduction**

Economic transition leads to change in social protection. The old system of social protection used to be subsidized by the Government has been abolished and replaced by a new system which is covered partly by individuals.

## ***(2) Policy and programs***

There are 4 areas of policies on social protection including social and health insurance, compensation for working accidents and allowances for losing a job.

### ***Social insurance***

Just after the gaining independence, the Government promulgated a Temporary Regulation on social insurance for civil servants in 1961. The insurance covered the following areas: health care, pregnancy and giving birth, accidents, losing working capacity, pension and death by accidents. In 1985, there was a reform of the salary system and social insurance scheme in which more attention was given to people working in remote areas and in harmful conditions. Social insurance in this period was paid by the state using the Government budget and it covered only people working in the public sector. Only since 1995, when the Labor Law was passed by the National Assembly, social insurance has been paid by an independent agency. Employers and employees in all economic sectors are required to contribute to social insurance. Since that time, social insurance has served as a social security system for working people.

### ***Health insurance***

Health insurance has been used to cover expenses for health care in Vietnam since 1992. At the early stage, health insurance operated separately in each province without a network system functioning throughout the country. There was no regulation for people who wanted to participate voluntarily in health insurance. The amount paid for insurance used to be small, while the cost for health care was usually high, so that provincial health insurance could not balance the difference.

In 1998, the Government issued a Decision to change the health insurance system to make it appropriate to the requirements of the practice. Changes have been made as follows: (1) the system of health insurance has been unified to function throughout the country; (2) compulsory health insurance is applied to all civil servants and people whose income are covered by the State; (3) voluntary health insurance has been diversified with several categories to meet diverse needs of the clients; (4) costs of health care are shared between the client and the Government and the clients have the right to choose services and medical institutions with a certain amount of payment covered by the insurance agency; (5) responsibilities of parties involved such as persons who benefit from health insurance, employers, medical institutions treating patients are clearly defined.

There remain several issues related to health insurance in Vietnam to date. Health insurance for the poor is a serious challenge nowadays. Most of the poor cannot pay for their health insurance, while state budget is limited to cover it. Criteria and procedures for identifying the poor are not well-institutionalized. Receiving payment for treatment from health insurance is still a complicated process that discourages people to participate in the health insurance system.

## ***(3) Compensation for accidents when working***

Compensation for accidents was implemented in 1956 by the Government Decree 703/Tgg; it was changed in 1985 by the Decree 236/HDBT and since 1995 compensation has been made according to the Labor Law.

(1) The employer has to pay compensation to employees who died or lost 81 percent and over of their working capability. The payment includes all expenses for treatment, salary during the time of

treatment and 30 monthly salaries. If the employer has purchased accident insurance, the insurance agency will pay instead of the employer.

(2) The insurance organization will pay for people who paid accident insurance when they have lost more than 5 percent of working capability. The insurance organization will pay one time if the employee has lost 5 to 30 percent of working capability; they will get payment monthly if they have lost 31 percent and more of their working capability. A person who has lost 81 percent and more working capability will get monthly 80 percent of the minimum salary. Injured workers also receive facilities for alleviating their circumstances if functioning organs were seriously injured.

#### **(4) Allowances for losing jobs**

There has not been an unemployment insurance system in Vietnam. People who work for the public system will receive a pension when they retire and will get allowances from the Government when they go for redundancy. People working for business and production are supposed to get assistance from the company if they lose their job.

*In brief*, Vietnam already has social protection schemes some of which have existed since the day of independence. However, these schemes have not covered all working people. Social protection schemes do not include farmers, two thirds of labor force of the country and self-employed people in the cities.

## **7. Conclusion**

The ultimate goal of development is to improve the quality of people's lives. While continuous rapid economic growth plays an important role in this respect, it alone cannot guarantee social harmony. Therefore, the formulation of social policy must be integrated into overall development agenda. The successful implementation of social policy in the renovation period has contributed to redistribution of economic growth revenues, social stability and creation of premises for further development. Thanks to the economic development, particularly since the introduction of *doi moi* policy in 1986 with the transformation into a socialist-oriented market economy, people have greater access to education, health care, job opportunities and social protection. Above all, they have become aware of their civil rights and there is a greater need for people to participate in political and social activities. However, bureaucratic machinery and cumbersome administrative regulations still create obstacles for people's participation. Economic development and democratization need to go hand in hand to ensure that economic growth contributes to improvement of people's lives.

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## Discussion

### **Dr. Jeong-Ah Cho**

There are public-sponsored schools and schools created with foreign investments in Vietnam, and how do you deal with conflicting views that are taught in these two different schools? How can an education that seeks to teach loyalty and collectivism, and an education that focuses on creativity and imagination coexist? How come the number of students who take advantage of free schooling is so low?

### **Dr. Pham Thanh Nghi**

Many children choose to go work in markets, instead of going to schools for financial reasons. The Vietnamese government has tried to help them by creating night schools.

### **Dr. Jae-Jean Suh**

How do the Vietnamese people value the ruling ideology of socialism? What are people's reactions to this government system? How did changes in economic system influence social aspects such as way of thinking and behavior? How do the Vietnamese perceive their election system? Are there any civic groups that give voices to the people? Any opposing groups to the government? Is there mass media contending government policy?

### **Dr. Pham Thanh Nghi**

Most Vietnamese people are satisfied with the government. About 97% of the population approves the government. And, there is no official opposition in Vietnam. Mass media, although not opposing or belligerent, does make suggestions and write opinions of the government's policies. They do have special organizations, such as women's organizations.

# Understanding North Korea's Economic Reforms



## Understanding North Korea's Economic Reforms

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### I. Overview

Recognizing that policy changes were unavoidable to resolve its economic difficulties, North Korea implemented the “Economic Management Improvement Measures” on July 1, 2002. These measures were followed by further economic reforms, including the introduction of the market mechanism. The initial reforms included price increases (25-fold), wages increases (18-fold), a currency devaluation (70-fold), increased autonomy in the management of enterprises, reinforcement of the incentive system for agricultural management and phased abolition of the rationing system.

In the second half of 2002, North Korea designated Shineuiju as the “Shineuiju Special Administrative District” (September 2002), while designating the “Mt. Geumgang Tourism District” (October 2002) and “Gaeseong Industrial Zone” (November 2002) as special districts to expand the scope of regions open to the world. In March 2003, North Korea restructured the informal farmers’ markets into general markets, transferred the management rights of state-run stores to various institutions and enterprises, and initiated such commercial reforms as the authorization of service industries (restaurants, internet cafes) on the private level. Since January 2004, an agricultural management system based on family units has been implemented on a trial basis in the agricultural sector while corporate reforms have been implemented in the industrial sector.

By implementing such economic reforms, North Korea has improved productivity in such labor-intensive industries as agriculture and light industries while witnessing the activation of commercial transactions. However, various side effects have surfaced, including the aggravation of inflation resulting from a shortage of commodities and a steep rise in the unofficial exchange rate. In the social sector, certain detrimental aspects of capitalism have appeared including the widening disparity between the rich and the poor has widened.

### II. Status of the Economic Reforms

In order to assess the economic reforms being undertaken by North Korea, it is useful to divide them into four categories; economic management, the macro-economy, the industrial sector and foreign economic relations.

## 1. Economic Management

Following the adoption of “New Thinking” in January 2001, North Korea announced the “Principles for Economic Management Improvements” in October of the same year, paving the way for changes in its economic management. Subsequently, North Korea began implementing the “Economic Improvement Management Measures” in July 2002 while enacting and revising ordinances related to economic reforms. In September 2002, it presented the “Guidelines for Building the Economy in the Military-First Age” - with priority to defense industry, and simultaneous development of light industry and agriculture - as the new economic policy. In 2003, North Korea reduced the number of unproductive officials in the (North) Korean Workers' Party (KWP) as well as in the government, while appointing rising technocrats to implement the generational change. In 2004, the government strengthened the economic management authority of the Cabinet and empowered it to lead economic reform efforts, and opted to reduce intervention in the economy by the Workers' Party and the military.

Through such efforts, North Korea is striving to improve efficiency in its economic reforms. However, given the fact that North Korea has not officially acknowledged the reforms and given that these reforms have not been accompanied by administrative reforms (non-intervention by the KWP in implementing economic policies), the efforts toward reform can be regarded as being somewhat unsatisfactory compared with the reforms and openness being pursued in China.

The trends toward reforms in the economic management sector will be examined from the perspective of guidelines on the administration of the economy and the restructuring of ordinances and organizations.

### A. Guidelines on the Administration of the Economy: The Rationale for Reform, Including “New Thinking” and the Pursuit of Profits

While instituting the policy of “New Thinking” in January 2001, North Korea called for changes in its administration of the economy by encouraging changes in the thoughts and behaviors of the overall society. North Korea’s leader, Kim Jong-il, urged “reforms by approaching issues from a new perspective while discarding conventional methods.” The North Korean leader subsequently called for an alteration in perceptions through the development of such detailed concepts as the “*seed or core* theory,” “new self-reliance theory” and “economic take-off theory” that are more specific versions of the “New Thinking” theory.

**Table 1:** Three Theories of the “New Thinking”

	Core Argument
Seed theory	Encouragement of the development of “seeds” that can bear fruit in a short period in each field, including fish breeding (catfish), alternative crops (potatoes), and industry (computers, IT)
New self-reliance theory	Reinterpretation of cooperative relations with other nations as the new collective self-reliance and the application of science & technology as creative self-reliance
Economic take-off theory	Importance placed on science and technology; economic development achieved in a short period through concentrated development of the IT sector

Kim Jong-il first announced guidelines for improving economic management in October 2001. These provided the political and theoretical basis for the July 2002 economic reforms. These guidelines stipulate that the basic principle of economic reform is to “obtain maximum profits while maintaining socialist principles.” At the same time, the guidelines illustrate that the following reform measures are necessary: decentralization of planning, operation of the “socialist commodity exchange market,” corporate assessments based on profits, performance-based distribution, integration of science & technology with production, readjustment of prices and wages, and restructuring of the untenable social welfare system.

In September 2002, North Korea announced its new principles for the administration of the economy, the “Guidelines for Building the Economy in the Military-First Age,” which serves as the rationale behind the implementation of the economic reforms for the management and operation of key industries and the public welfare sector. North Korea has established the principle that although resources under state control are assigned priority for national defense and heavy industries, market-oriented reforms will be implemented in the light industries as well as the agricultural and commercial sector to ensure self-reliance. The government has also designated the military as the mainstay of the revolutionary ideal and will utilize the military in economic construction while making attempts to discard ideological stumbling blocks regarding the introduction of the market mechanism.

## **B. New and Revised Laws and Organizations: New Economic Ordinances, the Reinforced Authority of the Cabinet, and the Change of Generations**

Nearly half of all laws recorded in the code of laws in North Korea are related to the economy. In the “Code of Laws of the DPRK” (2000), 46 of 103 laws are economy-related while in the “Code of Laws for the Populace” (2004), 48 of 112 laws are focused on the economy. To systematically support its economic reforms and opening policies, in 2000, North Korea launched the enactment and revision of ordinances related to the economy.

From January 2000 to June 2002, North Korea enacted or revised 16 ordinances on the economy including the “People’s Economy Planning Act” (May 2001), “Compensation Act” (August 2001), “Inheritance Act” (March 2002), and “Agriculture Act” (June 2002), aimed at normalizing the administration of the economy while preparing for reforms and openness. The “People’s Economic Planning Act” recognizes the need for flexibility in the process of formulating government plans while the “Agriculture Act” stipulates the abolition of favorable treatment for work units and agricultural management based on sub-units. The “Inheritance Act” permits inheritance of personal consumption goods such as homes, automobiles and personal savings while the “Compensation Act” stipulates the protection of property rights.

Following the economic reforms of July 2002, laws have been revised to meet the changes dictated by economic reality, such as the increase of prices, management of enterprises based on profits, and strengthening of the market mechanism. Such laws include the “Foreign Investment Banking Act” (November 2002), “Accounting Act” (March 2003), “Finance Act” (April 2004), “Commerce Act” (June 2004), etc. A total of 13 economy-related laws have been enacted or revised.

In the “Foreign Investment Banking Act” (Article 18), the registered paid-in capital for joint venture banks was raised to over 2.25 billion won from the existing 30 million won. In the “Accounting Act”

and the “Finance Act,” the criteria for assessment of enterprises was changed from production volume to profits while autonomy in management of enterprises was guaranteed. In the “Commerce Act”, measures for the activation of the market including, commercial transactions, were stipulated.

In particular, following the enactment in November 2002 of the “Gaeseong Industrial Zone Act” related to the development of special districts in Gaeseong and Mt. Geumgang, a total of 20 subordinate regulations were enacted and announced through February 2005 including 11 regulations on the “Gaeseong Industrial Zone Act” and nine on “Mt. Geumgang Tourism District Act.” Also, for the purpose of increasing the recognition level for North Korean products, North Korea adopted the “Place of Origin Act” (August 2003) and pursued the stable implementation of inter-Korean economic cooperation and adaptation to the international economic system.

In other areas, North Korea reshuffled personnel in the Korean Workers' Party as well as the government to strengthen efficiency in government organizations while promoting the change of generations through the appointment of younger technocrats, who are the driving force of the reforms. North Korea downgraded the rank of certain organizations in the central and local party while drastically reducing the number of salaried party members by 20 to 30% and reassigning them to industrial work sites. The personnel in the cabinet and economic bureaucracy has also become more professional and younger in age, with experts in their 40s now in leadership positions, including, the Chairman of the Committee for the Promotion of Economic Cooperation (Baek Hyeon-bong, 47), the president of the Foreign Trade Bank (Oh Gwang-cheol, 44), the Director of Cheollima Steel Company (Kim Hyeong-nam, 40), who are all management-oriented. North Korea also changed its method for appointing civil servants from recommendations and interviews to selection through tests on political and economic subjects (January 2004). Those who are to serve in trade related positions are chosen through tests on such subjects as foreign languages, public finance, banking, and international commercial transactions.

North Korea also strives for efficiency in the implementation of economic reforms through organizational reshuffling, including a reduction in the number of economic projects handled by the KWP and military, and strengthened authority of the Cabinet to manage the economy. Some of the enterprises being operated by non-economic entities, such as the KWP and the military, have been downsized or transferred to the Cabinet while the “Committee for the Promotion of Economic Cooperation” under the wing of the Ministry of Trade was upgraded as an organization directly under the cabinet (May 2004). North Korea also established the “National Economic Cooperation Committee” under the auspices of the Cabinet through a merger of the organizations handling inter-Korean economic cooperation, including the National Economic Cooperation Federation (July 2004).

## 2. Macro-Economy

In 2002, North Korea transferred the responsibility for collecting funds for the government budget from the central organizations in each sector to the local governments, and reinforced the local budget system. Following the rise in prices and wages in July 2002 to conform with market realities, North Korea implemented measures to raise the exchange rate in August of the same year.

In March 2003, North Korea officially recognized markets, launched the “Foreign Currency Exchange Center” in June of the same year and expanded the application of market prices while operating

a dual price and dual exchange rate system. In May 2003, North Korea issued the “People’s Life Bond” to finance industrial investments as well as to control inflation. In September 2003, North Korea established the Tax Collection Agency. In 2004, North Korea launched reforms in enterprises on a trial basis that empowered them to set prices for the products they produced and to grant wage increases based on profits.

North Korea’s wage and price adjustments were the key to the July 1 Economic Reforms. However, since the implementation of the July 1 Reforms, delays have been experienced in the following areas: further liberalization of prices, wages and the foreign exchange rate; weak government finances and implementation of the tax system; and establishment of private commercial banks.

### **A. Prices and Wages: Market Principles and Expanded Decision-making Authority**

In July 2002, North Korea raised prices and wages to a more realistic level and reinforced a performance-based wage system. It also initiated measures that transferred part of the authority to determine prices to subordinate units. With the implementation of the July Reforms, state-set prices for daily necessities and services that had been set at an extremely low level, were significantly raised to reflect the actual costs. The price of rice jumped 550-fold, from 8 *jeon* (1/100th of one won) to 44 won per kilogram, pork rose 26 fold, while electricity rose 70 fold.

Wages were also increased at varying levels (an average of an 18-fold to 2,000 won per month) by sector, occupation and skill grade (classified into unskilled, skilled and highly skilled) to compensate for the increased cost of necessities. By establishing the wage system that is based on production performance, North Korea aimed at boosting the workers' enthusiasm to work. In March 2003, Kang Gyeong-soon, Director of North Korea’s State Price Determination Bureau, declared that “80% of the standard wage will be guaranteed if 80% of the plan is achieved, and 200% of the wages will be guaranteed if 200% of the plan is achieved.”

Meanwhile, in terms of state-set prices, North Korea allowed for the constant adjustment of prices based on supply and demand. North Korea also granted local governments, factories and companies the authority to determine prices for certain products. In a seminar held in Japan in September 2002, North Korea’s Vice Trade Minister Kim Yong-sool explained that prices would be determined according to market principles, and the State shall only make slight adjustments so that prices will not totally deviate from the economic management system and added that the fluctuation range of prices in the future will be within 5% to 10%. Director Kang Gyeong-soon of the State Price Determination Bureau also disclosed in March 2003 that “state-set prices will be adjusted when required in consideration of supply and demand.”

While reorganizing the traditional farmers markets into the so-called “general markets” in March 2003, North Korea permitted transactions according to market prices and is in effect, operating a dual pricing system. For transactions in stores, restaurants and general markets that are operated by individuals or independent companies, market prices or negotiated prices (the prices negotiated by the buyer and the seller) are applied. By announcing the maximum price for each item, the state controls indiscriminate price hikes but grants merchants the power to adjust prices autonomously within the set price range. However, in actual transactions, the maximum price set by the state is not being observed.

As the profitability of enterprises and peoples' hardships are being aggravated because of rampant inflation, North Korea took additional measures to loosen state authority in determining prices and wages.

Factories and companies were granted the authority to determine prices and standards for the goods they produced without receiving approval from the authorities. Companies were also given expanded authority in determining wage levels so that the wages of the employees could coincide with the level of the profits generated.

## **B. Public Finances: Rationalizing the Financial Structure**

What measures have been implemented in the public finance sector? First, following the adoption of the economic reform measures in July 2002, North Korea sought to inject a measure of soundness into its public finances by reducing the number of organizations run by state subsidies and establishing new sources of revenue. By raising the prices for rice, housing, energy and transportation services, which had previously been provided virtually free of charge, to a more realistic level, the expenditures needed for subsidies were reduced and efforts were exerted to raise additional tax revenues through the establishment of land use fees, etc. Revenue-generating businesses were permitted to be operated by organizations previously run solely on the state budget and classification was made between institutions run on a self-supporting account system and a semi-self-supporting account system. To this end, North Korea revised Article 30 of the Public Finance Act in April 2004, and added institutions run on the semi-self-supporting account system to the classification of enterprises.

Second, North Korea adjusted the items that comprise state revenue and expenditures by reflecting the changes in its economic system. In other words, by collecting government fees on the basis of “profit earned,” the “transaction revenue,” which is a type of indirect tax, was abolished, which, in turn, was integrated with the “state revenue from profit of enterprises,” which is a type of direct tax. The “state revenue from profit of enterprises” became a newly established taxable item and the sources of revenue were simplified. In March 2002, the Supreme People’s Assembly reported that for the 2003 budget, the profits of state-run enterprises totaled 77.6%, which accounted for the largest proportion of income generated under state-run socialist management. Subsequently, North Korea revised Article 13 of the Public Finance Act in April 2004 and revised the source of the budget funding to the “national income.”

Third, North Korea reinstated depreciation expenses for fixed assets into sources of state revenues. This measure was disclosed in the Finance Minister’s report to the latest Supreme People’s Assembly on March 11, 2005. In March 2002, North Korea had allowed enterprises to reserve depreciation expenses to use for re-investment

Fourth, by inducing companies to procure re-investment funds on their own (April 2004, Article 32 of the Public Finance Act), which had previously been paid from the state budget, North Korea has reduced financial burden. Back in 200, “supplementary welfare expenses” (mostly consisting of price subsidies) belonging to the “economic development expenses” were merged with the “social & cultural welfare expenses” to become the “people’s welfare expenses.”

Fifth, with regard to the budget receipt system, North Korea changed the “receipt system by sectors” (revenue collected by the ministries and management bureaus) to the “receipt system by regions” (revenue collected by the Local People’s Assembly) starting in 2002. It also strengthened the “local budget system” and initiated measures to alleviate the burden placed on the central government to secure finances to pay subsidies to local governments. Also, while granting the Local People’s Assemblies the authority to collect taxes from companies within their jurisdictions, North Korea has mandated that a certain amount be paid to the central government. According to the North’s *Economic Research* (Volume 2, 2002), “under

the receipt system administered by region, all factories and companies pay taxes through the local governments regardless of industrial sector.” On the other hand, North Korea granted local governments the discretion to draw up the budget and to handle social security and insurance for local residents. The *Economic Research* volume explained that “under the new method of drawing up the local budget, each local government is allocated a share to be paid to the government while the corresponding unit independently establishes the plans for income and expenditures for budget enforcement.”

Sixth, with a currency-based economy well underway and the increasing need to expand finances, North Korea has issued public bonds, focused on strengthening financial institutions and fostering human resources. As a first step, in May 2003, North Korea issued the “People’s Life Bond” for the purpose of securing finances for industrial investments and alleviating inflationary pressures. In July 2003, according to the (North) Korean Central News Agency, “revenues from the sales of bonds will be used for the modernization of the city of Pyongyang, construction of power plants, reallocation of land, the development of historic sites, production of passenger cars, and construction of spring water processing plants.

North Korea established the Tax Collection Agency under the Ministry of Finance to facilitate effective management of the tax collection system in September 2003. Two months later, North Korea reorganized the “State Finance and Bank Committee,” a comprehensive committee designed to deliberate matters related to public finances and financial affairs, into the “State Finance Banking Committee” for the purpose of reinforcing the role of the financial institution (April 2004, Article 48, Public Finance Act), and implied that the public financial and banking policies would supplement each other. As a reference, the chairmanship of the “State Finance Financial Committee” is held by the Deputy Prime Minister of the cabinet, the vice chairmanship is held by the Minister of Finance and the president of the Central Bank, and committee members are comprised of finance-related officials of the Workers’ Party, the government and the military as well as bureaucrats and scholars in the fields of banking, planning, labor and statistics.

### **C. Public Finance and Foreign Exchange: Raising the Exchange Rate to a Realistic Level and Preparing for Financial Reforms and Opening of the Economy**

As mentioned above, in the aftermath of the July 2002 reforms, North Korea adopted a single fixed foreign exchange rate by raising the currency rate to a realistic level. In August 2002, North Korea abolished the state-set exchange rate (US\$1 = 1 won) and unified the exchange rate for trade (presently the official exchange rate), and raised the exchange rate by a multiple of 70, from 2.2 won per US\$1 to 153 won. Meanwhile, when disparities between the official exchange rate and the black market exchange rate resurfaced again in 2003, North Korea established the “Foreign Currency Exchange Center” in the general markets and has since been operating a double-tiered exchange rates, exchanging dollars at the black market rate to North Koreans. In the second half of 2003, it liberalized the operation of pawnbroker’s shops, to accommodate the residents’ short-term loans for living necessities while also helping increase state revenues.

Along with these aforementioned measures, North Korea appears to be making preparations for financial reforms through manpower improvements by acquiring advanced financial techniques from overseas, learning from foreign countries’ experiences in financial reforms, and revising the educational curriculum on economic theories. Since the launching of the economic reforms, North Korea has sent

a large number of trainees overseas to such destinations as China, Vietnam and EU member countries to acquire knowledge of market economic theories, finance, insurance and commerce. In this context, the fact that the economic textbooks of Kim Il-sung University included theories on the market economy, such as “price determination through supply and demand” and “finances and banking in the monetized economy” is drawing keen interest.

### 3. Reforms by Sector

The reforms in the industrial sector implemented by North Korea can be divided into reforms in the agriculture, enterprise and commerce sectors.

#### A. Agriculture

In March 1996, North Korea introduced a new sub-unit work system on a trial basis in some regions. North Korea changed the composition of the work units from the previous combination of the elderly, the middle-aged, and the young (10 to 15 persons) to one comprised of family units (7 to 8 persons). Under the new sub-unit work management system, production plans are adjusted to a lower level in line with reality and work units were entrusted with authority to freely dispose of products that exceeded the production quota. Under the sub-unit work management system, work sub-units, which is the smallest farming unit in the cooperative farm, are allocated plots of agricultural land and farming tools, and receive shares of distribution sometime during November or December according to the level of fulfilling the quotas set by the plan.

In January 1999, North Korea expanded the range of its crop cultivation, which had previously been focused on rice and corn, and granted farms the right to choose crops while authorizing the cultivation of potatoes and medicinal herbs according to the circumstances in each cooperative farm. In July 2002, in an effort to increase agricultural output, it reduced the size of the work subunits once again to 4 to 5 family member units, and reduced the volume of the government’s purchase of grains. In January 2004, North Korea implemented the Family Farming System on a trial basis as part of its program to expand agricultural reforms.

North Korea, while maintaining the general framework of collective farming, reduced the responsibility of the State regarding grain production and distribution, reinforced the autonomous authority of cooperative farms and expanded incentives for farming. The reforms undertaken in the agricultural sector can be further subdivided into the production and distribution areas.

#### (1) Production: focus on improving efficiency in collective farming to increase agricultural output

With regard to agricultural production method, North Korea expanded the discretionary powers of individual farms by revising the “Agricultural Act” (June, 2002). It reduced the size of the work units and granted cooperative farms the authority to establish detailed production plans. Also, to increase farm production, it abolished preferential treatment for the unit-based system and shifted towards management and operations based on sub-units (Article 72, Agricultural Act).

More specifically, North Korea reduced the number of persons in work sub-units, which is the basic production unit of the cooperative farms (from the existing 10 to 25 persons to 7~8 persons in the sub-unit



work management system, and ultimately down to 4~5 persons in the pilot family-based farming unit), to mitigate collectivism while inducing a sense of responsibility among farming units. The North also expanded the rights of farmers to choose the crops they could cultivate. Kathi Zellwegger of the Hong Kong branch of the Catholic relief agency Caritas International, said in September 2003, “Unlike in the past, some farms in North Korea choose the crops they grow rather than planting only corn as instructed by the authorities.”

The second change in the production method in some cooperative farms is the pilot implementation of the family-based farming program. In January 2004, North Korea decided to mitigate the collectivism of the farming system and implement a pilot family-based farming unit. Cooperative farms in Suan, North Hwanghae Province and Hoiryong, North Hamgyeong Province were designated for the reorganization of the work sub-unit system into the family farming system (2 to 5 households). The family was allocated plots of land. In this regard, Vice Trade Minister Kim Yong-sool noted in December of 2004 that “cooperative farms were entrusted with the authority to reduce the size of the work sub-units or organize family-based farming units.”

Third, North Korea took measures to restructure the agricultural land system, including the expansion of private farming land as well as the introduction of land usage fees. The permissible size of plots of private land was expanded (July 2002) from 30 to 50 *pyong* (100m<sup>2</sup> to 165m<sup>2</sup>) to 400 *pyong* (1320m<sup>2</sup>), and the farming land belonging to institutions and enterprises were distributed to households. Furthermore, to make use of idle manpower in plants which have been shut down, workers were allocated land for tilling. Agricultural land in North Korea can be categorized into cooperative farms, farming land of institutions and enterprises and private land. A land usage fee or rent is levied at differential levels (minimum 53 jeon/pyong ~ maximum 60 won/pyong). The rent per *pyong* for category 1 (cooperative farms) is 54 jeon to 36 won, 88 jeon to 60 won for category 2 (institutions and enterprises), and 12 won for category 3 (private land).

## (2) Distribution: no equal distribution

The highlight of the reforms in terms of distribution is the abolition of both free food rationing system and the dual pricing system for grains, which was designed to reduce financial burden of the State. In the past, the North Korean government purchased grains at high prices (82 jeon per kilogram of rice) and supplied them at a low cost (8 jeon). However, since July 2002, the transportation expenses were added to the government’s purchase price (40 won) and rice is supplied at a significantly increased price (44 won). Thus, in the aftermath of the July reforms the purchase price of rice soared 50-fold (from 82 jeon to 40 won) and the price charged to the people skyrocketed 550-fold (from 8 jeon to 44 won).

In addition, North Korea is making efforts to motivate farmers to increase production by reducing the government’s purchase of crops in order to increase the income for farming households. In the past, 70 to 80% of the harvest was remitted to the State, but today, only 50 to 60% is collected by the State as the usage fee for the land, water and electricity, and the remainder is freely disposed by the cooperative farms. Choi Young-ho, Vice Chairman of Cheongsan Cooperative Farm said in January 2004, “As to the settlement and distribution in 2003, land usage fee and production costs accounted for approximately 50% of the total revenue.”

Another noteworthy fact is that during the year-end distribution at cooperative farms, the basis for performance evaluation was shifted from the work units (80 to 120 persons) to sub-units in order

to stimulate the spirit of competition among farmers. *Fatherland*, which is the monthly periodical of the General Association of Korean Residents in Japan, better known as *Jochongryeon*, reported in February 2004, “Prior to the economic reform measures, shares were distributed equally to work units and shares of the sub-units were equal. But now, shares are distributed for each sub-unit and disparities exist among the sub-units as well. In the case of Cheongsan Cooperative Farm in 2003, some received as much as 120,000 won, while the average worker received 60,000 won.”

In other areas, North Korea reinforced the responsibility of institutions and enterprises to procure food for their workers so that the State could reduce its financial burden. The State still provides food on a priority basis to the military, senior members of the Workers' Party and the government, citizens of Pyongyang and other special classes, while the general public is supplied below half (300g/day) of the standard amount (700g/day). The people are to resolve the shortage of food on their own through the marketplace. Also, institutions and companies with foreign currency income or those that can procure food from overseas are to supply food for their own employees.

## **B. Enterprises**

Since July 2002, North Korea has strengthened the management autonomy of enterprises, including strengthening the authority of the managers and reducing the scale of government planning. North Korea restructured relevant ordinances including the enactment of the “Accounting Act” in 2003, and recruited those in their 30s and 40s with professional expertise as managers of enterprises. Since 2004, it has been implementing enterprise reform measures at some of the factories and companies on a trial basis.

The enterprise reform measures being pursued by North Korea are focused on strengthening the role of the managers regarding overall management and on expanding the autonomy of companies through the introduction of market principles. Such enterprise reforms being implemented by North Korea are regarded to be similar to those promoted by China during its early stage of reforms and opening. China has been pursuing enterprise reforms gradually, starting with expansion of profit-reserve and autonomy of enterprises (1978-1983); shift from remittance of profits to the State tax payment system (1984-1986); contract management system (separation of ownership and management) (1987-1993); and privatization (post-1994).

The details of reforms being initiated among North Korean enterprises under the headings of administrative management, production management, financial management and labor management are examined below:

- (1) Administrative management: authority of the manager reinforced and management autonomy of enterprises expanded

With the implementation of the economic reforms in 2002, North Korea transferred management authority of enterprises, which had previously been concentrated in the party committee of the factory, to the managers. Accordingly, the role of the Secretary of the Party was restricted to political matters and the decision-making authority of enterprise management was entrusted to the managers. Since 2004, in particular, management autonomy in some factories and enterprises has been reinforced regarding the establishment of production plans, determination of wages and management of labor. According to a North Korean defector in September 2004, “Measures for the liberalization of management in factories

and enterprises have greatly advanced since early this year on a trial basis and the measures will be enforced at all enterprises by the end of December.”

- (2) Production management: scale of government planning reduced and conditions for material procurement by enterprises improved

Following the economic reforms of 2002, North Korea limited the central planning only to such major production indices as the total production amount of industries, investment in construction, production volume of electricity and steel, etc., and entrusted the local administrative units and enterprises with the authority to establish details of the planning. Enterprises were allowed to sell on the open market products produced in excess of the quota or products produced with independently procured materials, which was aimed at boosting profitability.

In 2004, in order to grant more flexibility in the administration of enterprises, the State Planning Commission established strategic indices and major indices in the “Kind Plan” while the rest indices in the form of a “Currency Plan”. The in-kind index indicates target in terms of quantity of production, such as tons, meters, and sets, while the currency index indicates target in money value. Also, direct transactions among enterprises were permitted for transaction of materials on the “commodity exchange market”, which improved conditions for enterprises to purchase raw materials. In addition, factories were entrusted with the authority to determine prices and standards for consumer goods produced on their own in order to meet market demand.

- (3) Financial management: authority of enterprises to engage in financial operations expanded, effective use of funds induced

Following the enactment of the “Accounting Act” in March 2003, North Korea adjusted the ultimate goal of enterprise management from “reduction of the prime cost” to “increase in net profit” (Article 34, Finance Act, April 2002) and has aimed to administer enterprises with the focus on generating profits. At the same time, the system of mandatory remittance by enterprises to the State was improved, as was the procurement system for investment and management funds. Discretionary powers of the enterprises regarding operation of capital were also expanded.

In order to expand the autonomy of enterprises, North Korea specified clauses that granted such enhanced autonomy in relevant ordinances or has directly granted such authority to enterprises. It also took measures to reduce the financial burden of enterprises. It loosened its strict financial control over enterprises and used both the existing ratio method as well as the fixed-amount payment system for the payment of government levies. In this context, North Korea revised Article 28 of the “Finance Act” in April 2004. Regarding the evaluation of the performance of the financial plan of enterprises, only the record of payment of the national tax was to be assessed and the achievement of the planned prime cost and profits as stipulated in the old law were to be deleted.

Meanwhile, by expanding the amount of cash reserves that could be accumulated by enterprises and permitting additional expenditures exceeding the set limit, North Korea is striving to reinforce flexibility in management by enabling the purchase of materials at a more suitable time on the market. In Article 29 of the revised “Finance Act” stipulates that “enterprises shall use capital rationally for the

management of production and welfare of their employees”. The old law, meanwhile, stipulated that funds of the enterprise be used strictly in accordance with the financial plan.

North Korea has, to date, supplied currency to enterprises through the state finances. However, by mandating the enterprises to procure currency through bank loans, North Korea is making efforts to eliminate wasteful usage of procured funds. According to a North Korean defector in July 2004, “Since both the principal and interest are required to be repaid for loans from operational funds, the managers who post deficits due to faulty management have no choice but to resign from their posts.” The North is striving to insure accountability in the operation of enterprises.

North Korea has also entrusted enterprises with the authority to transfer or dispose of small-scaled equipment after consultation with the supervising institution in the corresponding region, aimed at encouraging the revitalization of idle facilities that have become obsolete.

#### (4) Labor management: autonomous authority related to wage payments and management of the labor force expanded

In the category of labor management, North Korea authorized enterprises to autonomously determine the workers' wages within the minimum and maximum limits in its economic reforms of July 2002.

Prior to the implementation of the economic reforms, the State had the sole authority to determine wages in a uniform manner. However, since 2004, North Korea has significantly expanded the wage determination and payment authority of the enterprises by abolishing the maximum limit in wages, permitting enterprises to distribute wages from the surplus profits remaining after the government levy has been paid. This measure helped enterprises provide supplements for the living expenses of the workers in the wake of the soaring inflation. *The Fatherland*, the monthly magazine of the General Association of Korean Residents in Japan, reported in June 2004, “The wages of workers in a Pyeongyang footwear factory will be raised to 10,000 won per month, while the monthly wages of workers at the Seongyo Knitting Factory will be raised 3 to 5 fold, from the current 4,000 won.

North Korea had previously directly assigned the labor force in the factories and enterprises but it has recently allowed enterprises to dispatch idle manpower to mines and farms, thus increasing flexibility in labor management. At the same time, the North is also pursuing restructuring plans regarding human resources under the principle of reducing the number of workers in offices and managerial posts.

### C. Commerce

As part of its efforts to reform the commercial sector, North Korea enacted the “Socialist Commerce Act” in April 1992, which was revised in January 1999 and June 2004. In relation to the reforms in the commercial distribution sector, the most significant measure introduced so far is the establishment of general markets in March 2003.

The reforms implemented in North Korea’s commercial distribution sector will be examined below, under the headings of the management, distribution and administration structures of commerce.

## (1) Reforms in the management of commerce

One of the most significant reforms implemented in commerce management is that the system of state-controlled supplying of goods has been shifted towards attaching significance to the role and function of the market. In relation to this change, North Korea has converted the operation of commerce from the rationing system to the distribution and sales of products. In the past, North Korea regulated commerce as the “project for delivering supplies to the people” and the supply, production, distribution and sales of basic necessities were operated independently according to the rationing standards. However, North Korea recognized the inefficiency of the system which had been enforced as long as goods were produced, regardless of sales, since in the past, the production, distribution and sales sectors were all operated separately (*Joseon Sinbo*, January 2003). Therefore, North Korea adopted changes to this system and allowed people to purchase daily essentials from markets and stores which established direct transactions between producer and seller. Furthermore, by permitting the integration of the channels for production, distribution and sales, North Korea is striving to enhance efficiency. In fact, the transition being implemented by the North is reflected in a statement made by the Nakyeon Joint Venture Company, which revealed its intent to “link the systems of production, distribution and sales.” (*Joseon Sinbo*, April 2003)

Second, North Korea is recognizing the market as a legitimate system of product distribution. In the past, North Korea characterized the market as an “outdated form of commerce, which is nothing but a remnant of capitalism, which will vanish once the process of ownership of the people and industrialization is completed.” Recently, however, North Korea redefined the market as “a pillar for product distribution in socialism” (Choi Hong-gyu, General Director of State Planning Commission, April 2003). The market is no longer an entity controlled by the state. “In the past, we have shown a negative attitude toward accepting the market system. Now, however, it is recognized as a necessity for economic management and we are highly encouraging it.” (*Joseon Sinbo*, December 2003)

Third, in terms of product pricing, the single pricing system (state-determined prices) was previously applied throughout the nation for the same product sold anywhere. Following the reforms, however, a dual pricing system is being operated; state-set prices are applied for goods at state-run stores, while market prices for goods at markets.

## (2) Structural reforms in the distribution sector

One of the most visible and unique phenomena of the reforms in the distribution structure is the establishment of general markets and the fact that specialization and diversification of distribution are being pursued.

Previously, North Korea had given priority to state-operated stores and allowed the establishment of informal farmers’ markets as a means to supplement the faltering public distribution system. Since March 2003, however, the system was restructured to center on general markets and the distribution network has become more diversified to include state-run as well as regular stores. In other words, the farmers markets are undergoing expansion and restructuring into general markets. Accordingly, in December 2003, the *Joseon Sinbo* declared “the general market is an emblematic phenomenon which manifests the depth and extent of the economic management reform measures.” In line with the new reforms, North Korea transferred the management rights of some state-run stores with poor sales

performances to institutions and enterprises as a way of promoting development through competition between state-run and market-based stores.

Meanwhile, North Korea is taking the initiative to build large shopping malls and department stores in joint venture projects with foreign countries including Russia and China in such major cities as Pyongyang and Cheongjin. As a result, North Korea has added the sector of commercial distribution to its list for opening to the outside world. Furthermore, the emergence of new forms of distribution network such as specialized wholesalers and 24-hour convenience stores as well as luxurious boutiques for the rich are all considered to be part of the diversification and specialization process being applied to the distribution sector.

### (3) The Administrative system in each distribution sector

In relation to the administration of the market, North Korea is restructuring the existing farmers' markets into general markets with the goal of establishing over 300 general markets. Buildings that will be used as general markets are being newly built by cities, counties and districts, and stalls are being rented out to individuals, cooperative organizations and enterprises. Through the revision of Article 86 of the Commercial Act, the North Korean government has abolished the concept of the farmers' markets and converted them into general markets. In addition, the rights to the administration of the market were granted to respective commercial authorities. North Korea has "allocated approximately 5% of the stalls in the Tong-il Street Market to factories and enterprises", while 95% to individuals (*Joseon Sinbo*, Dec. 2003). In the case of general markets, the number of stalls and the location of the markets are determined in consideration of the size of the city, country, and district and the number of local residents.

**Table 2:** Number of market stalls according to the number of local residents

No. of residents	30-40,000	40-60,000	50-70,000	Over 70,000
No. of stalls	600	900	1,200	2,000

The items sold at general markets, which used to be limited to agricultural goods and products made from sideline activities, expanded to include all consumer products with the exception of a few state-restricted items such as military supplies. Prices are determined by the market as well as bargaining between buyer and seller. Prices of such popular consumer goods as rice, footwear and soap, however, are controlled. Although the general markets set maximum prices for major consumer goods such as rice and price adjustments are made every ten days, the actual circumstances make it difficult for the price limits to be observed. In the market, all operators of the stalls are required to pay a "market usage fee", which is a form of rent, as well as the "government levy", a form of income tax. In relation to these levies, the North Korean government stated, "In addition to the market usage fee, the act of selling goods in the market requires the payment of the government levy on the basis of one's income, which must be paid by the designated period." (*Joseon Sinbo*, December 2003).

In terms of shop operations, North Korea has introduced a dual store system, categorized by state-run stores and regular stores operated by institutions and enterprises. Under Article 81 of the Commercial Act, any company that intends to operate stores, restaurants or services must obtain a business license from the respective local authority in charge of commercial affairs, in lieu of getting approval from

the authorities of the central government, as was the case under the old system. Therefore, regular stores are classified into “consignment stores” which are state-run stores that have been let to institutions and enterprises to be operated autonomously, and “direct sales stores” operated independently by institutions and enterprises. In addition, the State leases or sells state-run stores performing poorly to institutions, enterprises or People’s Units and collects rents from such leased stores. In the case of pricing, state-set prices are applied to products distributed in accordance with state plans but for other products, prices are negotiated between product consignor and store manager. Stores operated under private ownership are not yet permitted, but there are known cases where individuals with the financial means directly operate the stores, using the titles of institutions and enterprises.

Restaurants have been categorized into state-run restaurants and restaurants under the “negotiation system.” In principle, the entity in charge of running state-run restaurants is the State while restaurants under the negotiation system are operated by institutions and enterprises. However, in some cases, individuals have taken over state-run restaurants under the condition that they remit part of the profits to the State. As for prices of food in restaurants, the basic menu determined by the State have state-set prices, while the specialties of the house developed by the restaurant are offered on the basis of a negotiated price (“Specialty of the House” *Joseon Sinbo*, December 2003). Profit-oriented management is spreading in North Korea as the State collects a certain portion of the profits from the restaurant as “government levy” and the restaurants flexibly adjust food prices to attract more customers.

Operation by individuals is permitted in the service industries including entertainment businesses. That is, individuals with financial power can lease beer halls, karaoke bars, public bath houses and Internet cafes from institutions and enterprises, and independently operate these businesses while some even open new businesses.

To sum up the details mentioned so far, it can be evaluated that all the recent changes taking place in the commercial distribution sector in North Korea are the result of North Korea’s shift in policies, which, while recognizing that the market as “a link of commercial distribution and not an object of restriction”, seeks “co-existence of planning and the market.”

## 4. Foreign Economic Relations

A series of reforms have been introduced to spur North Korea’s foreign economic relations. The reforms include the opening of the economy, overseas trade and attraction of foreign investment.

### A. Economic Opening: New Special Economic Zones and Active Inter-Korean Economic Cooperation

One of the most significant developments witnessed in the opening of the North Korean economy is the fact that North Korea has designated new special economic zones and is showing a positive approach towards inter-Korean economic cooperation. In order to attract more foreign investment, North Korea designated three special economic districts in Shineuiju (September 2002), Mt. Geumgang (October 2002) and Gaeseong (November 2002). However, in the case of the special administrative district in the Chinese border town of Shineuiju, China’s arrest of Yang Bin, who had been appointed as its first Chief Executive

(October 2002), as well as opposition by the Chinese government, forced the North Korean cabinet to officially withdraw its decision on the designation of the special economic zone (August 2004).

North Korea has so far adopted 14 agreements and 22 laws and regulations pertinent to inter-Korean economic cooperation. The first phase of the massive Gaeseong Industrial Complex is underway and overland tours of Mt. Kumgang began in November 2003, which made it quicker and less expensive to visit the North. Inter-Korean trade was estimated to total US\$700 million in 2004. In terms of inter-Korean trade, the dependency of North Korea on the South has steadily increased from 15.0% of the North's total trade in 2001, 22.1% in 2002, and 23.2% in 2003.

### **B. Foreign Trade: Reorganization of the Trade Management System including Trade Decentralization and Organizational Restructuring**

North Korea is seeking to activate trade by decentralizing its trade system. Trade-related activities, which had been controlled by the central government, were entrusted to cities, counties and companies to promote trade through management by subordinate organizations. The North, however, is unifying all trade-related administrative affairs, including import and export procedures under the control of the Ministry of Trade, to prevent excessive competition over trade issues and maintain order.

To increase efficiency through reorganization of trade-related agencies and insolvent offices, the North Korean government has reorganized the National Economic Cooperation Federation into the National Economic Cooperation Association in July 2004 and established specialized companies in accordance with different types of businesses. Meanwhile, in September 2004, the Samcheolli Corporation was partitioned into three specialized businesses, Samcheolli (specializing in IT and publications), Myeongji (specializing in heavy and mining industries) and Gwangbok (specializing in railroads and roads).

Under the auspices of the Ministry of Trade, the North Korean government established the Committee for International Trade Arbitration in January 2004. The Committee has taken measures to allow the establishment of foreign legal consulting companies in North Korea to deal with legal issues related to investments made in North Korea.

The North Korean government set up joint legal offices with such countries as the United Kingdom (August 2004), Singapore (October 2004) and Italy (November 2004). It has also closed or is in the process of withdrawing or merging overseas trading offices and restaurants that are performing poorly. In contrast, it has established incentives to foreign expatriates demonstrating outstanding business performance, such as extending the duration of overseas employment from three to six years.

### **C. Attracting Foreign Investment: Reforms, Reorganization, and Preferential Treatment to Companies of Overseas Koreans**

As part of its efforts to promote investments from foreign companies, the North Korean government drastically reduced the minimum wage of workers in September 2004, which previously had been set between US\$80-120 per month to US\$38, offering more favorable conditions than other developing countries such as Indonesia and Vietnam where the minimum wage stands at US\$72 and US\$35-\$45, respectively. As the next step, the government allowed joint venture companies to directly export goods and pay current account expenses including electricity bills and wages in North Korean



currency. In addition, the North Korean government is promoting a comprehensive revision of regulations related to the attraction of foreign investments including liberalization of requirements for insurance.

Second, the North is highlighting its preferential measures for taxes and charges which are assessed at a lower rate than neighboring countries. For instance, the corporate income tax set at 10-25% (versus 30% to 35% in Southeast Asia), transactional tax at 1% to 15% (30% to 60% in Southeast Asia), electricity charges at US\$67 per 1000 kwh (versus US\$80 to US\$120 in neighboring countries) and water charges are set at US\$38 per 1000 m<sup>3</sup> (versus US\$120 to US\$130 in neighboring countries).

Third, the North Korean government is organizing road shows to attract investments from overseas Koreans, offering various incentives. For the first time, North Korea organized an investment road show inviting 162 overseas Koreans (October 21 - 25, 2004 in Pyongyang) from 21 countries. A mutual cooperation agreement was also concluded between the Overseas Korean Trade Association (OKTA) and the Committee for the Promotion of International Trade. In addition, North Korea is making plans to develop an industrial site exclusively for overseas Koreans near the Gaeseong Industrial Complex. The North also announced its intent to provide free use of some 2.5 million *pyong* (8.25 million m<sup>2</sup>) of land to companies investing in the infrastructure of remote Najin- Seonbong economic trade zone near the border with Russia and China (statement made by Kim Yong-sool, Vice Minister of Trade). In addition, the North Korean government plans to allow the establishment of independent companies and banks in areas other than designated special economic districts and to attract direct investments for mining development.

Basically, the North Korean government appears to be pursuing the opening and expansion of its foreign trade by strengthening its efforts to adapt to the market economy by improving the regulations related to the international economy while focusing on finance and trade. In particular, it has become extremely active in activities to attract investments from overseas Koreans. Unfortunately, the level of incentives offered by North Korea is considered to be modest in comparison with the incentives offered by the Chinese government for overseas Chinese. China has offered various incentives by enacting such investment promotion regulations as the “Preferential Treatment for Overseas Taiwanese Investors” (April 1993), “Encouragement of Investments by Taiwanese Act” (July 1988), “Regulations for the Encouragement of Investments by Overseas Chinese and Compatriots of Hong Kong and Macao” (August 1990) and the “Act on the Protection of Investment by Taiwanese” (March 1994).

### III. Accomplishments and Challenges

#### 1. Accomplishments

##### A. Increased Awareness of the Market Economy, Strengthened Desire to Work

As the scope of the government control of the economy diminishes and the market mechanism expands, awareness of the market economy among individuals and businesses is rising and a change in perception has swept through society.

First, the criteria for evaluating enterprises that used to be centered on “the volume of manufactured goods” is shifting to “profits,” signifying that a management mind-set based on profitability is being

created. Regarding such changes, the North Korean government has stated, “In the past, companies needed to focus only on production. However, now that they are being evaluated by their earnings, it has become necessary for these businesses to focus on sales, which in turn, shifted attention to the quality of the manufactured goods.” (*Joseon Sinbo*, November 2003).

Second, with the abolition of the rationing system and introduction of a differentiated wage system which determines wages according to individual performance, the awareness of private ownership and people’s belief in the concept of “the more you work, the more you earn” has expanded. Moreover, “in North Korea, where economic reform is well underway, the number of housewives returning to work is rising (*Joseon Sinbo*, June 2003)” and “The average monthly wage of coal miners working at the Feb. 8 Jikdong Coal Mine (located in Suncheon, South Pyeongan Province) is estimated to be 30,000 North Korean won, while the highest earner makes more than 60,000 won per month (*Joseon Sinbo*, Oct. 2002).”

Third, it is believed that with the expansion of general markets, managers of enterprises should pay attention to selling their products at markets, and thus, need to acquire management skills related to the market economy such as the understanding of product quality, product brand and sense of competition.

As illustrated above, the change of consciousness brought on by the reforms is believed to have stimulated further potential for change as the people’s conceptions have shifted from “survival” to “profit” through private economic activities following legalization of some profit-oriented activities such as sideline activities and the sale of goods on an informal basis.

## **B. Improving Productivity in Agriculture and Light Industries, Revitalizing Commerce**

Although economic reforms are showing signs of limitations in driving further productivity growth in the overall industrial sector due to a shortage of investment funds, energy and raw materials, there is also the positive outcome of increased productivity in such labor-intensive industries as agriculture and light industries, which led to the revitalization of commercial transactions.

In the agricultural field, the rising enthusiasm for farming and the improved rate of land use have steadily increased crop productivity (3.95 million tons in 2001, 4.13 million tons in 2002, 4.25 million tons in 2003 and 4.31 million tons in 2004). The increased agricultural productivity has resulted in “farmers looking for ways to make effective use of the land since they are paying for its usage even though it is the same land that once sat fallow due to poor conditions.” (vice chairman of Cheongsan Cooperative Farm, January 2001).

In the industrial sector, as the managers of factories and companies were granted expanded self-governing authority in management, they focused on generating profits, which particularly led to a marked increase in the growth rate of light industries (2.3% increase in 2003). Regarding this phenomenon, the *Joseon Sinbo* in December 2003 reported, “In most footwear factories, including those in Sineuiju and Gangseo, 9 million additional pairs of shoes have been produced through July in comparison with the same period of the previous year.”

Finally, in the commercial sector, the revitalized general markets have witnessed 9.8% growth in both wholesale and retail businesses in 2003, exceeding the total growth rate of 1.8% by a large margin. According to a foreigner who visited North Korea in March 2004, “When you visit the markets on Tong-il Street, it would be hard to believe you are actually in North Korea.” It seems that the beneficial outcome of economic reforms is proving to be most conspicuous in the commercial distribution sector.

## 2. Problems

As North Korea undergoes the process of economic reforms, a number of challenges have surfaced. First, above all else, the unfavorable conditions that hamper economic reform exist. Although the North Korean leadership is determined to pursue further economic reforms, it is difficult to officially adopt policies advocating economic reform and opening, given the apprehension that these policies may adversely affect the regime. Not only are they largely dependent on foreign aid for such crucial supplies as food and energy, but North Korea's social overhead capital (SOC) is seriously in need of modernization. In addition, financial resources needed for investments have dried up. There is also a critical shortage of market economy management expertise. Meanwhile, the pressure on North Korea by the international community over the nuclear impasse has aggravated the North's ability to obtain economic assistance from overseas, making it difficult to gain the capital and technology required for launching economic reforms.

Second, the side effects of economic reform, such as inflation, the growing disparity between the rich and the poor as well as rampant corruption, are posing serious problems. The high inflation and a soaring exchange rate resulting from the limited supply of goods make life difficult, and signs of economic chaos can be seen as the rumor of a currency reform spreads. According to details of price increases disclosed so far, the market price of crops in September of 2004 rose as much as 5 to 8 fold compared to two years earlier in July 2002. The price of beef rose 4 to 7 fold, prices for apparel and household appliances rose 2 to 7 fold and the exchange rate soared from 250 North Korean won for US\$1 in August 2002 to 2,000 North Korean won. However, the rate has slightly dropped since January 2005.

Third, the increase in private economic activities, such as the sale of goods, and sideline activities have widened the financial disparity between the haves and the have-nots as well as among different classes and regions, and is considered the underlying cause of rising social discord. With the growing aspirations of accruing wealth, corruption prevails and burglaries, the byproduct of capitalism, are more frequently committed than before. In addition, as part of the illegal activities to earn foreign exchange, the number of restaurants newly opened in China has rapidly increased (from 26 restaurants in 2001 to over 90 restaurants in 2004), which is leading to lowered profitability, female employees deserting their jobs, and loosened ideology of the people. Consequently, it has been reported that some of those restaurants are in the process of shutting down.

## Discussion

### North Korean Economic Reform: Get Lesson from Vietnam

In order to examine North Korea's economic reform and the possible lessons from Vietnam, we will (1) evaluate the North Korean economic reform, (2) examine the characteristics of economic reform in Vietnam, and (3) focus on lessons for North Korea from the reforms of Vietnam.

In evaluating North Korea's economic reform, there have been some positive aspects of economic reform. For one, the North Koreans are "marketizing" in their own style. They are currently at the starting stage in system reform, and are still far from market economy. In addition, North Korea has officially emphasized their economic reform as they have used the word "reform" since June 2003. Other positive aspects of North Korean economic reform include specific reforms under the "Economic Management Improvement Measure" (July 1, 2002). Some important measures include inducement of self-imposed control system on factory management, differentiation of wages that could prepare for competition among companies, and changes from moral incentives to material incentive systems.

On the contrary, there are also problems of North Korean economic reform. For one, there is an uncertainty of reform and an unclear opening goal because the orientation for socialistic market economy is unclear. Furthermore, the people's sympathy towards reform is non-existent, the state's fixed price system is still maintained, and collective farming still exists despite family farming. In addition, there is no active opening policy besides an increasing of the exchange rate. Efforts inducing foreign investment, participating in international economic organizations, liberalizing trade, and decentralizing decision-making are not yet active. Finally, there is still no change in ownership.

In examining the characteristics of economic reform in Vietnam, one can learn that the Vietnamese reforms were created with three important aspects in mind: (1) reform attempt on the basis of "pragmatism," (2) highest priority on the reform of agriculture and development of light industries, and (3) an effective foreign economic policy. First, it is important to note that the Vietnamese reforms were based on "pragmatism." The reform focused on pursuing national self-decision and avoided political conflicts between conservative and innovative classes. Second, the highest priority of reform was focused on agriculture and the development of light industries. The establishment of production contracts on the basis of open tender in agriculture increased productivity, and the enactment of the "New Land Law" (December 1987) declared that while the state still has ownership, the right to use the land belonged to individuals for 15 years. Furthermore, the adjustment of the national economy and industrial structure to focus more on production of consumer goods led to the development of exporting goods and thus, rise in quality. Finally, the establishment of various enterprise forming such as state run, cooperative, capitalistic joint venture, private management, etc. led to effective exploitation of natural resources and development of labor intensive industry. Third, an important characteristic of Vietnamese reform is the implementation of an effective foreign economic policy. The establishment of foreign investment law promoted joint venture for inducement of foreign capital and technology, allowed learning of advanced management skills and training of bureaucrats and labor forces, increased participation in international division of labor, led to export diversification and capital accumulation, and finally helped the acquisition of hard currency from sight-seeing and airway services. In addition, Vietnam was able to improve its

relationship with foreign countries. Not only did this lead to improvement of relations with the US for accessing of FDI and assistance of international financial institutes such as ODA, it also led to the enlargement of economic interlocking with Asia-Pacific and Southeast Asian countries for capital and technology inducement. The improved relationship with foreign countries also allowed liberalization of exports and induced competitiveness among the state run companies. Finally, it also led to the development of an export processing zone and the offer of tax exemption.

Ultimately, the lessons for North Korea from the reform of Vietnam can be separated into four categories: (1) highest priority on agriculture, (2) development of light and manufacturing industry, (3) decentralization of economic system and structure, and (4) other drastic measures for economic reform. First, it is important to note that the Vietnamese reform had the highest priority on agriculture. It focused on increasing grain production and consumer goods, and allowed free disposition of agricultural products at market price. Second, the development of light and manufacturing industry was important in that the rearrangement of investment priority to light industry led to production increases of foodstuffs, consumer goods, and export goods. Third, the decentralization of economic system and structure led to additional changes. The state's fixed price system (price reform) changed the price system from management to cooperative price system, and also applied market price on agricultural goods. In addition, it also led to liberalization of family run companies, inducement of economic incentive system, reform of production subvention, and change of material allocation (employment, income) system. Finally, other drastic measures for economic reform include establishment of dual banking system and the building of National Investment Cooperation Committee. In addition, the reform of state run enterprises authorized independent management rights for state run enterprises and officially permitted profit seeking. And, the change of economic management system led to the recognition of the private sector as the engine of economic development, transition from dual price system to price liberalization, and wage reform with abolishment of price subsidy.

## **Dr. Doan Hong Quang**

Vietnam has placed emphasis on social aspects of reforms, not just on economic incentives. Social safety net has been a very important priority for the Vietnamese reforms, and this could be a valuable lesson for North Korea to look at. As Dr. Choi mentioned, a political stability will be critical for further success of reforms. North Korea is now in very difficult circumstances. Unless the North Korean nuclear crisis is resolved easily, it is hard to convince domestic and foreign investors to put lot of money into the country. How much is the share of population living in rural area in North Korea, as well as the share of agriculture in GDP?

## **Dr. Young-Yoon Kim**

38% of the population.