THE ECONOMIC REFORM IN VIETNAM IN 1989:
“SHOCK THERAPY” OR GRADUALISM?

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ABSTRACT

The purpose of this study is to examine with both political and economic perspectives the economic reforms implemented in Vietnam during the period 1986-89. Specifically, the paper seeks to re-assess the the political and economic contexts of the then-Vietnam, with respect to the systematic changes in ideology and shift of power at the highest level of the Politburo during this critical period. In order to accurately examine the situation, this paper adopts a political science model to evaluate the competing factors in shaping the transition path of the economy, concerning divergent political philosophies, systemic stability, and reconciliation between socialist principles and market ideologies. As Vietnam gradually moved from a centrally-planned economy to a socialist-oriented market economy, it undertook a fast-paced and thorough reform that marked a new milestone in the history of the country. Since the Doi Moi movement in 1986, Vietnam has liberalized its economic policies, lifted investment restrictions and price controls, and embraced friendly economic relations with other countries. Despite the sudden turn in policies toward a “Big Bang” reform, it is significant to recognize the similarities and differences between Vietnam and its powerhouse neighbor - China, as it departed from the simple adoption of the Chinese reform and turned toward a combination of both Chinese and Eastern European and Former Soviet Union countries’ policies (henceforth, EEFSU). With the success of disinflationary plans and macroeconomic balancing in 1989-90, Vietnam’s economy since then has achieved tremendous successes. This paper argues that the decision to depart from emulating the Chinese reform and Maoist doctrines was a radical and necessary change for the Communist Party - and ultimately
the socialism-oriented Vietnam, and the reform in 1989, in fact, was an admixture of both the “Big Bang” and gradualist approaches.

The structure of the paper is organized as follows. Section I details the theoretical models and assumptions exacted by the argument in this paper. Section II provides a brief description of the historical description of Vietnam and the political and economic context of the country after 1975. Section III illustrates the history of economic reforms in Vietnam from 1975 to 1986 and their results. Then, section IV describes the popular radical (“Shock Therapy”) and gradualist approaches to economic reform in centrally-planned economies during that period. The next section discusses the reform in 1989, with regards to its context, policy, and results. Section V makes comparisons of the 1989’s reform with those in countries that adopted the Big Bang and gradual reforms and determine its validity. Lastly, section VI concludes with comments on the reform, with regards to its role as a pivotal point in Vietnam’s politics and economy.

I. THEORETICAL MODEL

1. ANALYTICAL MODEL

As communist states embarked on reforming and ultimately transitioning their economies from being centrally planned to embracing the mechanism of the free markets, each country chose a different approach defined by distinctive characteristics. This divergence in transition approaches, may it be due to initial conditions of the country or its leaders’ choice of policy, has led countries to different economic standing and performance in the world today. In this paper, initial conditions were considered important factors which determined the timeframe and circumstances for the adoption of a reform (or transition); and the ruling class’ ideology could be used to best explain the policy choices in the process and the pattern of transition. Recognizing
the three factors as a set of antecedent causal relationships, this paper adopts the analytical framework of Guo, Sujian which analyzes a transition using this model of causation:

\[ Z \rightarrow X \rightarrow Y \]

**Z: Structural Factors**

**X: Policy Choices**

**Y: Patterns of Transition**

Under this model, it is apparent each country began its transition with significantly different initial conditions. Albeit, these antecedent causes could still exhort a common policy choice from the communist elite class had they shared a common belief and ideology about the efficiency and appropriateness of that policy choice. Using Guo’s analysis and assumptions, this paper will give a description of the pre-reform conditions Z in Vietnam, and base its analysis of the economic policy choices X in Vietnam on three key variables: the power relationship between liberal and conservative reformers, the relationship between reform and stability, and the relationship between socialist principles and market ideology. In the end, an overview of the structural factors and policy choices X will allow for a conclusion about the transition path in Vietnam.

**2. THEORETICAL DEFINITION OF ECONOMIC TRANSITION**

This paper takes advantage of the theoretical definition of an economic transition set out by Grzegorz W. Kolodko, who defines the transition as “long-lasting, historical process of shifting from centrally planned economy, based on the dominance of state property and bureaucratic
control, to an open, free-market economy, based on market deregulation and the dominance of private property.” Kolodko argues that such a process must consist of three critical sub-processes, including:

i) Liberalization and Stabilization

ii) Institution building

iii) Microeconomic restructuring

And only when these three sub-processes occur simultaneously should a systemic change be considered a Transition. Otherwise, it remains an effort to retain the old system, yet renovate it with necessary reforms. In this paper, his assumptions shall be used as the baseline for analysis of the transition path, and determining the validity of the policy choices based on pre-conditions set out in the analytical model.

3. TRANSITION APPROACHES

a. The “Shock therapy” approach

The term “Shock Therapy”, or radicalist approach, refers to a sudden and dramatic change in economic policy that lead the transition of a state-controlled economy to a free-market one. Widely associated with the economist Jeffrey Sachs, the main characteristics of “shock therapy”, as demonstrated in his economic plan for post-Communist Poland in 1989, include

i/ immediate price and trade liberalization,

ii/ privatization of publicly-owned entities,
iii/ and comprehensive institutional restructuring and rebuilding.

These radical economic measures, which are to be executed in short period of time, according to Sachs, would “cure economic epidemics such as hyperinflation, deficits and other effects of market controls in order to boost production and growth, reduce unemployment in the long term and improve living standards”. (Sachs and Woo, 1997) Furthermore, in the case of Poland, the collapse of Communism in 1989 gave way for a period of “extraordinary politics”, during which its people would be more tolerant toward radical changes, and which would become an ideal time-frame for a complete transition.

However, the method of “shock therapy” might create severe institutional problems for new democracies. As explained by Jeffrey Sachs himself and affirmed by the experiences of countries, shock therapy includes within it a political strategy which set the stage for the convenience of implementing radical economic measures. This strategy emphasizes speed in pushing reform through a "window of opportunity”, and suggests an isolation of the reformers’ plan from political pressures during the reform, and that they be granted the power of decree overcome opposition by entrenched interest groups. This isolation is meant to allow socially-optimal policies to be executed rapidly, a process which might be prolonged and impeded by bureaucratic and democratic procedures.

b. The Gradualist approach

To the contrary, gradualists often references the example of China, which has consistently embraced the gradual reform since 1978. They argue, with clear evidences, that immunization of the Chinese economy to recessions and its outstandingly high growth rates are the direct result of the state’s gradual and bottom-up approach to transition. Seeking to achieve the same goals as
“Shock therapy” yet in a longer term, the gradualist approach wanted to overcome its shock-stimulating nature and introduce a swifter transformation of the command economy into a market economy. Shock therapists have long criticized the gradualist doctrine, quoting metaphor such as “one cannot cross the abyss in two jumps”, suggesting that prolonging the transition period would only lead to more painful and costly changes, when the country lays in the vacuum of the collapsing old economy and a not-yet-emerged new market economy.

Multiple studies have been conducted to examine the results of both doctrines. The availability of statistics have allowed the studies to regress the output changes during transition in liberalization indices on inflation and other measures to prove whether either approach was more successful than the other. In an effort like such, Feltenstein and Nsouli (2001) developed a model that allowed them to conclude that had China undertaken the “Shock therapy” approach (or radical approach), their economic progress might have been higher than reality at the time. However, attempts to find a link between the differences in output changes to the cumulative liberalization index and to inflation rate have not yielded impressive results. (Popov, 2003) Therefore, any research seeking to explain the economic transition in a command economy will need to rely more heavily on raw data and the specific initial conditions of that country.

II. VIETNAM’S ECONOMY AFTER 1975

1. A brief summary of the modern political history of Vietnam

The history of Vietnam is a relentless fight to protect its sovereignty against foreign powerhouses. From 1858 to 1954, the small South-East Asian state had struggled for its political independence in continuous wars with the French colonialism and the fascists of Showa Japan. In
1945, under the leadership of Ho Chi Minh, Vietnamese people successfully defeated the enemies and regained their independence. Following the end of World War II, the French colonists returned to re-establish their reign, which led to another eight years of war. At the Geneva Conference in 1954, the French government negotiated a ceasefire agreement with Vietnam, which resulted in independence being returned to the Indochina countries. As part of the agreement, Vietnam was temporarily partitioned at the 17th parallel. The administration of then-US president Dwight Eisenhower exploited the partition and quickly set up a US-backed regime governed by Southern Vietnamese and supervised by American advisors. However, from 1974, aid funds for Southern Vietnam was significantly reduced when Gerald Ford became US President. During Ford’s presidency, the American Congress impeded further U.S. involvement in Indochina, and ordered to send American troops home. In April 1975, President Ford declared that the Vietnam war had been finished “as far as America [was] concerned”, and on the 30th of July, Saigon and the Southern regime collapsed. After 21 years of domestic war, Vietnam achieved reunification, and the country officially became a Socialist state. Since then, the Northern Communists undertook the sole leadership, and maintained a command economy and political model replicated from the Soviet Union’s. The transition time in 1954 had allowed many Northern Vietnamese, mostly religion-associated groups, to migrate to the South as a consequence of their disagreements with the Northern government regarding free rights to practice their faiths. Constituted the majority of these migrants, the Catholic refugees became a powerful anti-Communist constituency who influenced the agenda of the Southern regime throughout the partition years. (Karnow, 1997) After the war ended, a significant part of their population fled the country to live as exiles in foreign countries, especially France and the United States. When the South was moulded to
the North, the annexation effort was met with strong resistance from the remaining Catholic Vietnamese. The country, which had been impoverished and exhausted from multiple wars and the outdated economic model that hindered strong growth and free trade, moved into the new independence era with multiple economic troubles and political chaos.

2. The economic slump after 1975

From the partition in 1954, Vietnam experienced two parallel economic models: free markets in the Southern Republic of Vietnam, and Communist command economy in the Democratic Republic of Vietnam. In 1961-65, the Northern communist regime implemented its first Five-Year Plan (1961–65), following the example from the Soviet Union, which prioritized the development of heavy industries and strictly prohibited private ownership. During the Vietnam War, air strikes from the US Army had done significant damage to the North’s economy: destruction of infrastructure, construction, petroleum storage, and interruptions in electricity supply. Consequently, these damages led to a period of slowdown in industrial and agricultural activities. Furthermore, as trading routes and transportation were destroyed by the bombing, the economy suffered from disruption in the distribution of materials and goods. During the war, most of the North regime’s trades were conducted with countries in the Comecon blocs, while it received substantial aids from the Soviet Union and China to support the implementation of Communism.

Meanwhile, the South Vietnam's adoption of free market ideology led it to conduct trade with Western and non-communist states, mainly the US, Canada, France, West Germany, and Japan. Agriculture accounted for 30% total output, and the most important products were rice, coffee and rubber. Conversely, the industrial sector contributed far less to the whole economy, approximately 10% at its peaks. (Dang, 2004) Gradually, the state became more dependent on
US and foreign aids to finance its military and cover the large deficit in balance of payments. Destruction and disruptions made by frequent confrontations with the North and US air strikes on suspected of Communist hideouts contributed to the deceleration of economic progress in the South, leading to large portion of financial aids and labor resource being exploited for reconstruction and restructuring. Consequently, the aid cuts put the Southern economy on the verge of catastrophic depression. With a strong decrease in demands for exports to the US’s and its allies’ markets, the budget deficit rapidly increased and hyperinflation incurred subsequently.


Since 1975, the economy of the united Vietnam had to face enormous difficulties in achieving growth, imbalances in payment, inefficiencies in collectivist distribution, hyperinflation, and rising debts. However, it was not until 1976 that the Vietnam’s economy began its new shift toward a new period. (Pham, Trinh, Nguyen, 2007) In December 1976, the Fourth Congress of the Vietnamese Communist Party (VCP) made an unanimous agreement on the direction for the economy: “[to move] directly from small-scale production to large-scale production without passing through the capitalist stage, to give priority to heavy industry, and to turn Vietnam into a socialist country with modern agriculture and industry within twenty years.” (Ton That Thien, 2005) An immediate “socialist transformation” was imposed upon the Southern provinces to establish a consistent ideology throughout the country: collectivization in agriculture, and nationalization of industry and commerce, with focus on heavy industries.

Meanwhile, the Communist Party launched its anti-bourgeoisie campaign against the “compradore bourgeoisie” and “feudal landholding class” in the South, specifically targeting business owners and land-owners previously related to the Saigon government and the US, and
those who were granted monopolistic control over a sector or market. As reported, roughly “670 families were arrested, and had their properties confiscated.” (Marr & White, 1988) Amongst these, almost 70% of the families rightly categorized as compradore bourgeois were of Chinese ethnicity. Hence, the government’s campaign were regarded as both “class oppression” and “national oppression of a colonialist type.” (Dao, 1984) This propaganda, in historical retrospect, might be the manifestation of the Northern leaders’ aim to “conform rigidly to Maoist doctrinal stereotypes.” (Vo, 1988). Such drastic Socialist conducts further fueled the resistance from Southerners in the coming decades against the government.

III. ECONOMIC REFORMS IN VIETNAM IN 1975 - 1986

1. THE ECONOMY FROM 1975 TO 1979

Beside the loss in human capital due to mass emigration to foreign countries, the new system forced upon the South rapidly turned the region into a slump. The first Five-year plan devised by the Fourth Congress was the primary step for Vietnam to transform into a socialist state with large-scale production in twenty years. With that objective, the national leaders, most of whom were ardent advocates of Marxism-Leninism, prioritized the “rational development of heavy industry on the basis of developing agriculture and light industry.” (Le, 1976) The basic tasks of the economy were outlined as following:

i) concentrate national forces on developing agriculture and light industry;

ii) exploit full capacity for heavy industry;

iii) complete socialist transformation in Southern Vietnam.
In the state of euphoria after the historic victory, the VCP’s leaders ambitiously set high targets for the economy, including increasing food production, raising industrial products by 16-18% per annum, productivity by 8% per annum, and total income by 13-14% per annum. As a Vietnamese reputable scholar put it, “we have somewhat lost sight of realities.” (Nguyen Khac Vien, 1984) This sense of overconfidence represented the leaders’ high expectations of foreign aid from Western states and international lending agencies, as well as tremendous economic assistance from its Communist allies.

The results of the first Five-Year plan turned out to be beyond disappointing. Firstly, food production failed short by over 30% (14.4 compared to 21 million tons). As the population growth during this period was 15.41% (approximately 2.91% per annum), the food production per capita was severely decreasing, which led to immense malnutrition and starvation. Regarding the emphasis on industries, there remained discrepancies between the VCP leaders’ rhetorics and practices. Despite the VCP General Secretary Le Duan declared the priority was given to heavy industry, then-Prime Minister Pham Van Dong stated in his speech at Congress that the state would give “light attention to heavy industry.” (Pham, 1976) In 1980, the state’s investment (compared to total investment) to heavy and light industries were, respectively, 29.5% (21.4% in 1976) and 11.5% (10.5% in 1976).

The state’s socialist agenda in the South was met with strong resistance from Southern peasants and business/enterprise owners. In agriculture, the efforts to “cooperativize" land uses was not widespread, with large number of cooperatives collapsed and local farmers boycotted the collective’s decision and price control over their crops and livestocks. Similarly, as the government relentlessly forced business owners to voluntarily offer their enterprises to the state, indus-
trial production had fallen at an alarming rate. Hence, the results of the first Five-year plan were exacerbated destitution and political conflicts in the South, and disappointing growth throughout the country.

Meanwhile, food shortages sparked the threat of coups and a comeback of imperialism. During this critical time, approximately 65% of the national resources, most of which came directly from external donors, especially the Soviet Union, were diverted to developing the heavy industry. (Pham, Trinh, Nguyen, 2007) This period of international political isolation posed tremendous difficulties for scholars to get access to accurate information, yet a fundamental assessment of the Vietnam’s economy was conducted by Marr and White (1988) to demonstrate the mentioned potential economic threats to the transitional state.

2. ECONOMIC REFORMS PRIOR TO 1986

The “socialist transformation” program in the South, along with the impulse of the so-called “socialist relation of production” in the whole country had economically failed, especially in agriculture. Since Vietnam was typically an agricultural country (by that time 80% of population were farmers), the fall in agricultural output directly affected the living standard. Burdens of the wars with Cambodia (ended at the late of 1978) and with China (1979) became extremely heavy to the exhausted economy.

In the summer of 1980, when poverty was spreading nation-wide, the first, small-scale trials of reforming the agriculture took place in Hai Phong, a port-city near Hanoi. That is the idea of making “end-product contract” with households (khoán hộ), a policy initially suspected by leaders as a dangerous deviation from the socialist path. However, this change in the incentive system had improved the efficiency dramatically. The immediate success encouraged the authori-
ties to expand “end-product contract” to other localities. In January 1981, Party Secretariat’s Directive No 100CT/TU was issued as an act of recognizing the idea. However, only until April 1988 was Politburo’s Resolution No. 10/NQTV on the “Renovation of economic management in agriculture” approved, and was the reformation in agriculture officially accepted. This revealed the persistent debate within the echelon level regarding the appropriateness of the policy. The process of the reform also shows that that is in fact a reform from the “grass-root,” or a “bottom-up” one.

Rozelle and Swinnen (2004) point out that success in agriculture for transitional economies plays an essential role in determining the success and pattern of the economy’s transition path afterwards. Most of the transition Asian economies have commenced their reforms in agriculture, but only few of them (including Vietnam and China) succeeded. Earlier, Riedel and Comer (1997) and Grifin (1998) have emphasized the significance of the initial conditions in these countries. Their argument could be proved valid, as both China and Vietnam had a big share of farmers in population (around 70%), compared to 30% in Eastern European and Central Asian countries. It was this level of agricultural jobs in stabilization that helped keep any shock to employment level in control. Therefore, the economy was stable enough to shift to another reform stage, rather than falling into political chaos. Moreover, and more importantly, the delivery of impressive performance in agriculture was more convincing than ideological dogmas, which allowed the ruling class to restore political order and gave them the required time to extend the reform to other parts of the economy.

3. THE “DOI MOI” REFORM IN 1986
Ten years into the new era, Vietnam had gone through extreme difficulties and a severe economic crisis. In 1986, the hyperinflation peaked at over 700%, with annual economic growth rate at 3%, and the country run a current account deficit. (Arkadie and Mallon, 2004) Moreover, the economic slump had been aggravated by the VCP’s failures to adopt apposite foreign policy and efficiently command the economy. As a result, Vietnam was ranked amongst countries with the poorest standards of living in the world. (Tran, 1998) In this critical time, the economic success of China and sudden decline in economic aids from the collapsing Soviet Union and other countries annunciated a pivotal change for the country.

The political breakthrough that reformists in Vietnam had been seeking arrived in June 1985, when Nguyen Van Linh joined the Politburo and announced moderately reformist objectives, including movements deviating from the signature dual-price system of China. The conservative leaders, a group of echelons led by To Huu tried to sabotage the implementation of the such programs and engineered a “currency conversion that confiscated wealth and tripled prices for some staples”. (Porter, 1990, p. 77; Fforde and de Vylder, 1996, p. 14). Their incompetent leadership and ill-willed intentions to impede reform efforts conversely helped the reformist Linh accede to power. In December 1986, Linh became the General Secretary in the Sixth Party Congress. The country now stood in front of an unprecedented opportunity for drastic reforms. During the Congress, the leaders agreed the gradual approach with market-like reforms were inefficient. In that context, the new reformist leaders initiated an extensive economic reform program to improve the economy’s performance. The Doi Moi (Renovation) reform was announced as a change of direction toward establishing foundations for a “market economy”. This level of openness signaled that “Vietnamese leadership [had] finally come to accept that prolonged peace and
constructive engagement with the outside world [was] the first step towards rescuing the country from its disabling isolation and economic backwardness”. (Tran, 1998) Nevertheless, it is noticeable how the program was named — Renovation — suggests the apparent reluctance against a conversion to capitalist market economy. At best, it illustrated a cautious willingness to accept market as the last resort to achieving growth and ultimately protecting the political control of the VCP.

Table 1: Growth Rates by Sector (1986-88)

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<tr>
<th></th>
<th>1986</th>
<th>1987</th>
<th>1988</th>
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<tbody>
<tr>
<td>GDP (%)</td>
<td>3.4</td>
<td>4.0</td>
<td>5.2</td>
</tr>
<tr>
<td>Agriculture (%)</td>
<td>1.5</td>
<td>-3.5</td>
<td>5.9</td>
</tr>
<tr>
<td>Industry (%)</td>
<td>4.6</td>
<td>11.4</td>
<td>3.9</td>
</tr>
<tr>
<td>Services (%)</td>
<td>—</td>
<td>5.6</td>
<td>8.9</td>
</tr>
</tbody>
</table>

Source: Nguyen and Bandara (1993)

In response to the implementation of the program, the economy experienced more radical changes and progress on important fronts, including economic stability, reliable GDP growth, and poverty alleviation. With regards to land and agriculture, Resolution 10 in 1988 allowed longer-term land use rights for farmers — a major step toward privatizing property rights, and lifted the mandatory contracts of farmers to sell harvested crops to state. The state soon confirmed households as the production unit and limited the role of cooperatives. Such measures successfully led to the privatization of the agricultural sector. Regarding the industrial sector, SOEs remained a dominant force according to the socialist orientation, yet the state began moving toward a multi-sectoral economy. Congress recognized the existence of non-state firms, especially in informal commercial sector, which enhanced people’s financial independence and au-
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Economy. The Law on Foreign Investment (1987) and Resolution 16 (1988) set clear conditions for the operations of foreign and private firms in Vietnam. Furthermore, the program abandoned the state’s monopoly of foreign trade, lifted most quotas, and established the Foreign Trade Organizations.

Table 2. Macroeconomic indicators from 1986-88 (in percentage)

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<tr>
<th></th>
<th>1986</th>
<th>1987</th>
<th>1988</th>
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</thead>
<tbody>
<tr>
<td>Government Budget/GDP (%)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue</td>
<td>13.2</td>
<td>12.2</td>
<td>10.4</td>
</tr>
<tr>
<td>Current Expenditure</td>
<td>13.4</td>
<td>12.7</td>
<td>13.6</td>
</tr>
<tr>
<td>Government Saving</td>
<td>-0.2</td>
<td>-0.5</td>
<td>-3.2</td>
</tr>
<tr>
<td>Capital Expenditure</td>
<td>5.6</td>
<td>3.9</td>
<td>3.8</td>
</tr>
<tr>
<td>Overall Deficits</td>
<td>-5.8</td>
<td>-4.4</td>
<td>-7.0</td>
</tr>
<tr>
<td>Foreign Loans</td>
<td>2.2</td>
<td>1.4</td>
<td>2.3</td>
</tr>
<tr>
<td>Central Bank Credit</td>
<td>3.6</td>
<td>2.9</td>
<td>2.9</td>
</tr>
<tr>
<td>Domestic Credit Growth Rate (%)</td>
<td>—</td>
<td>324.6</td>
<td>394.9</td>
</tr>
<tr>
<td>Inflation Rate (%)</td>
<td>487.3</td>
<td>301.3</td>
<td>393.8</td>
</tr>
<tr>
<td>Official Exchange Rate (Dong/US$)</td>
<td>18</td>
<td>225</td>
<td>900</td>
</tr>
<tr>
<td>Parallel Rate (Dong/US$)</td>
<td>425</td>
<td>1,270</td>
<td>5,000</td>
</tr>
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Source: Riedel (1993)
However, the partially compromised objective, which was a “Socialist-oriented market economy with the State’s intervention”, gave the government full authority over apparatus and kept precluding the nation from integrating itself with the world’s economy. Consequently, the outcome of the program was strong growth performance in 1987 and 1988, yet it was followed by severe macroeconomic imbalances illustrated in table 2. There were several causes for such issues. First and foremost, SOEs continued to be the main revenue source and also recipients of government subsidies, and its inefficiencies had led to financial imbalances. The government’s insistence on protecting the SOEs forced it to borrow from central bank to finance subsidies. Secondly, the state’s failure to completely eliminate the planning and dual price system in industry inevitably led to consequences similar to that of the first half of the 1980’s. Furthermore, the prolonged hyperinflation discouraged the demand for real money balances, and “increased the inflationary effect of credit expansion.”

With the political ascendancy of the reformists, the program of Doi Moi (Renovation) was expected to radically reform and renew the economy. However, in terms of policy, the program did not qualify to be considered radical. (Riedel & Turley, 1999) A majority of the party’s delegates remained attached to ideological orthodoxy, leading to political idleness and lack of vision for the economy. Multiple debates took place, and some even suggested the North to embrace a capitalist economy. (Nhan dan, 20 April 1989). Consequently, the policy choices for the reform neither paralleled what China had achieved, nor targeted a specific goal. A significant indicator of the crippling political environment was the Party’s criticism of the “bureaucratic centralized mechanism based on state subsidies” and promise of a new “multi-sector economic structure”. The state document declared the “most important thing” was “to strengthen and de-
velop the socialist economy, first of all, to enable the state sector to really play the leading role
and control the others” (VCP, 1987). Hence, multiple policy innovations - including enhance-
ment of SOEs autonomy, elimination of the state ‘s monopolistic control of foreign trade, and
encouraging private commerce in small scale - fell short of meeting the substantial objectives:
reduction of government control over SOEs, dismantling the planning apparatus, and abolition of
the dual price system. Regardless that the 1986’s Congress conceded to certain marginal changes,
the critical stages that defined a true transition were entirely overlooked: price liberalization, in-
terest rates control, devaluation of currency, microeconomic restructuring (including elimination
of inefficient firms and tightening of subsidies for SOEs) and stabilization of the macroeconomy.

IV. A SHIFT IN IDEOLOGY: THE ECONOMIC REFORM IN 1989

1. The effects and lessons of Doi Moi (Renovation)

In spite of several moderate accomplishments, the Doi Moi reform eventually failed to
abolish the dual-price system, which led to producers’s tremendous losses from selling to the
state at low prices, and had to rely on subsidies to cover the costs. Ultimately, the country suf-
fered from severe macroeconomic instability. Persistent imbalances were reflected in hyperinfla-
tion and deficits level during the period. Furthermore, the economy’s over-reliance on subsidies
and aids from the Soviet Union and countries in the Comecon bloc to resolve its foreign ex-
change gap problem (during 1986-1988 aids were used to pay for 62 per cent of Vietnam’s im-
port) resulted in exacerbating imbalance of payments and budget deficits.

Mentioned by Riedel and Turley, the question regarding the new reformist leaders’ failing
to implement radical and bold policies still remained puzzling. In fact, the required conditions for
a radical, ‘shock therapy’ transition was available to the nation. Similar to the situation of the first post-Communist government of Poland led by Mazowiecki, Linh and his peer reformists received the benefits of a period of “extraordinary politics”, which is “based on the assumption that major discontinuities in a country’s history…produce a state of mass psychology and a corresponding state of political system which are reflected in an abnormally high level of [political capital]”, which could give an exceptional opportunity for undertaking drastic reforms. (Balcerowicz, Blaszczyk, Dabrowski, 1999)

According to many analysts, this remained a question as to why Doi Moi could not herald an incipient breakaway from socialist ideologies, considering the severe crisis of the economy and leadership incompetence. Indeed, Nguyen Van Linh and his like-minded arrived with less constraints on their policy choices than ever before, and could have taken advantage of the political capital surplus to introduce bold reforms. A plausible explanation lies in the reformists’ attachment to the socialist principles: they were not intellectually and politically prepared to repudiate their inveterate beliefs in the superiority and nature of socialism, as well as to accept the problems of concomitant periods of unpredictable response by the people to radical changes. Most of the reformist members were deeply uninvolved in previous policy making still shared a common belief with their conservative opponents. Hence, the only subtle difference in their policy choice was their higher tolerance of larger marginal change to rescue the economy and promote growth. A second reason could lie in the consensus-based operation of the Politburo, which easily prevented any radical move in a divisive political environment. Additionally, the radical movement did not receive essential support, as the contemporary system had benefited many officials and bureaucrats and afforded them economic security and social status. Hence, their risk
aversion and hesitance toward the radicalism were comprehensible and predictable, and subsequently led to a compromised set of policy for Doi Moi. Arguably, the losses and crisis had to exert larger effects on a larger scale of the population in order to make way for bold reforms. This notion aligns with the “discontinuities” theory, as it suggests a comprehensive and major breakthrough in history, in this case - politics, should have occurred for Doi Moi to have been a true radical reform.

2. The Reform in 1989

The Doi Moi reform was executed with caution and disagreements within the Politburo, and the result was progressive macroeconomic instability and unbearable burden on the state budget. Adjustment of some prices to market forces along with growing private sector competition cut into state enterprise income, and the overvalued exchange rates caused deep losses to the export companies. The party central committee met to assess Doi Moi’s first two years in March 1989. The leaders agreed that extreme difficulties had arisen from poorly-governed finance, money, and credit regime: “If we cannot promptly check the rate of inflation and significantly increase the state economic sector’s efficiency, the situation may develop in a complex fashion.” (Nhan dan, 20 April 1989). Under the threat of an imminent crisis, the authorities decided to accelerate the transition process, beginning with massive structural reforms and stabilization policies.

The situation in 1989 called for an immediate liberalization of prices and elimination of the state procurement system, leading to the official abstention from the dual-price system. These measures gained quick positive response from the agricultural sector, with the level of rice pro-
duction rose by 12% between 1988-89. In a short period, the food shortages were resolved, and Vietnam became the third largest rice exporter in the world. Regarding the stabilization policies, the program consisted of two key measures: raising interest rates and devaluation and unification of exchange rates (official and black market’s rates). As a result, households began to convert their assets into the national currency, and cut the level of dollars and gold circulating in the country.

Table 3. Monetary indicators (1988-93)

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</thead>
<tbody>
<tr>
<td><strong>Growth of Liquidity</strong></td>
<td>443.3</td>
<td>237.8</td>
<td>32.4</td>
<td>78.8</td>
<td>3.7</td>
<td>8.9</td>
</tr>
<tr>
<td><strong>Share in Total Liquidity</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Currency</td>
<td>40.0</td>
<td>27.4</td>
<td>32.9</td>
<td>31.6</td>
<td>39.0</td>
<td>44.0</td>
</tr>
<tr>
<td>Dong deposits</td>
<td>50.7</td>
<td>48.1</td>
<td>34.7</td>
<td>27.2</td>
<td>41.5</td>
<td>33.0</td>
</tr>
<tr>
<td>Foreign Currency deposits</td>
<td>9.3</td>
<td>24.7</td>
<td>32.4</td>
<td>41.1</td>
<td>30.0</td>
<td>23.0</td>
</tr>
<tr>
<td><strong>Share in domestic credit</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Government</td>
<td>25.4</td>
<td>38.7</td>
<td>40.5</td>
<td>28.0</td>
<td>11.1</td>
<td>14.5</td>
</tr>
<tr>
<td>Non-financial SOEs</td>
<td>64.5</td>
<td>53.7</td>
<td>53.3</td>
<td>64.6</td>
<td>72.6</td>
<td>57.1</td>
</tr>
<tr>
<td>Inflation Rate</td>
<td>308.2</td>
<td>74.3</td>
<td>36.4</td>
<td>82.7</td>
<td>37.7</td>
<td>8.3</td>
</tr>
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</table>


During this period, the growth rate of credit was drastically reduced, and hyperinflation was under control after one year. A backsliding on inflation and credit was observed in 1991, yet since 1992 the state successfully achieved steady decrease in inflation, reaching 8.3% in 1993. The ac-
complishment stemmed from the change monetary policy, which demanded tight control of the money supply to cure inflation.

As mentioned, the public sector was the main source of deficits and cause of growth in money supply, and stabilization policies required the abscession of such deficits. As the aid from Soviet Union had been cut, the government needed to find new source to finance their deficit in the long-run. A further concern is the inability of inefficient SOEs to pay higher tax, as they already had suffered from increasing price and competition due to liberalization. Consequently, the only remaining solution was to cut government spending in large magnitude by lowering subsidies to SOEs, demobilization of soldiers, and wage increase restraints (below inflation rate) (Dollar and Litvack, 1994) Meanwhile, large revenues from oil products flew into the budget, and ample foreign investment influx allowed the state to finance their deficits without returning to the traditional inflationary monetary policies. The result was a deep cut in government spending, and a large decrease in the overall deficits in 1991.

Table 4. Fiscal Indicators in 1988-1991 (percentages of GDP)

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<tbody>
<tr>
<td>Revenue</td>
<td>11.3</td>
<td>13.8</td>
<td>14.7</td>
<td>13.5</td>
<td>19.0</td>
</tr>
<tr>
<td>Current Expenditure</td>
<td>14.0</td>
<td>15.4</td>
<td>14.7</td>
<td>11.4</td>
<td>14.0</td>
</tr>
<tr>
<td>Government Saving</td>
<td>-2.7</td>
<td>-1.6</td>
<td>0.0</td>
<td>-2.1</td>
<td>5.0</td>
</tr>
<tr>
<td>Capital Expenditure</td>
<td>4.4</td>
<td>5.8</td>
<td>5.1</td>
<td>2.8</td>
<td>5.8</td>
</tr>
<tr>
<td>Primary Balance</td>
<td>-7.1</td>
<td>-7.2</td>
<td>-5.1</td>
<td>-1.7</td>
<td>-0.8</td>
</tr>
<tr>
<td>Overall Deficits</td>
<td>-7.2</td>
<td>-7.5</td>
<td>-5.8</td>
<td>-1.5</td>
<td>-1.7</td>
</tr>
<tr>
<td>Domestic borrowing</td>
<td>4.8</td>
<td>6.0</td>
<td>2.8</td>
<td>0.5</td>
<td>-0.7</td>
</tr>
</tbody>
</table>
Having abandoned the state monopoly of foreign trade, the level of exports, accompanied by fiscal and monetary reforms, grew rapidly. Prior to 1989, Vietnam’s imports came mostly from the Soviet Union, and their collapsing economy brought the prospect of severe imports compression into a high probability. Hence, Vietnam desperately needed new export markets to find sources of foreign exchanges to pay for imports. Fortunately, the rising level of rice production and oil revenues afforded Vietnam such markets. From 1989 to 1993, the volume of exports’s growth rate was almost 25%.

Table 5. Trade indicators from 1988-92 (percentages of GDP)

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<tbody>
<tr>
<td>Exports</td>
<td>20.1</td>
<td>80.0</td>
<td>31.2</td>
<td>17.9</td>
<td>21.2</td>
</tr>
<tr>
<td>Imports</td>
<td>19.2</td>
<td>18.3</td>
<td>6.1</td>
<td>18.9</td>
<td>20.4</td>
</tr>
</tbody>
</table>

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</tr>
</thead>
<tbody>
<tr>
<td>Rice</td>
<td>0.0</td>
<td>23.9</td>
<td>18.0</td>
<td>11.0</td>
<td>12.5</td>
</tr>
<tr>
<td>Oil</td>
<td>10.7</td>
<td>15.1</td>
<td>22.5</td>
<td>28.5</td>
<td>30.5</td>
</tr>
</tbody>
</table>

3. Discussion

Many scholars have referenced Vietnam as an illustration of the superiority of the gradual approach over “shock therapy”. The development trajectory of the nation, as described in this paper, however, disagrees with such claims. From 1980 to 1986, VCP’s leaders sought to emulate the dual-track reform as executed in China, as a mitigating measure for the catastrophic con-
sequences of the typical Soviet Union’s economic model. The dramatic failure of the state to introduce market reforms gradually only resulted in deeper poverty and crises. Positive and steady results only came after 1989, when the pace of reform was accelerated rapidly, and the pace and scope of the 1989’s reform were beyond the limitation of the dual-track system. In 1989, Vietnam abandoned the dual-price system, raised interest rates, devalued its currency the dong to meet the market rate, liberalized trade, and restructured its economic institutions. Indeed, the stages of the 1989 reform, including:

i. Privatization of the largest sector in the economy (agriculture),

ii. The completion of price and trade liberalization,

iii. Sound monetary policy to tackle inflation and stabilization program

surprisingly followed the description of Jeffrey Sachs’ “Shock Therapy”. Hence, it is safe to say that from 1989, Vietnam experienced a radical shift from the Chinese gradualism toward radicalism during this period.

However, the reasons for this radical shift remains a question. The VCP undertook full control of Vietnam, and it was in their interests to prefer their own survival to the public goods and unpredictable, and possibly baneful, reactions caused by radical reforms. However, the event in 1989 was against this common belief. It is tempting to end the argument with the obvious answer, which lays grounds in the economic crisis and the promising results of radical reforms, as many countries had chosen to continue the expansion of credit and increasing borrowing to fi-
nance deficits and accept its consequences. Another possible choice, which was adopted by North Korea and Cuba in the same period, was to move the country into autarky.

To seek for a more plausible argument, other factors beside economics had to be taken into consideration. The first possible explanation might come from the political superiority and firm control of the VCP in Vietnam. Without a direct political threat to overthrow it, Hanoi had higher tolerance for risks than its peer regimes. The VCP did not face any significant domestic opposition, and the improvement in relations with China during this period assured Hanoi of its legitimacy and external support. Another significant contributor to the 1989’s reform was the deteriorating faith of echelon authorities in socialist economic orthodoxy. Neighbor countries with market economies in Southeast Asia, which were also victimized by colonialism and imperialism, experienced much more impressive economic progress than Vietnam. When Doi Moi failed to bring growth and thus defend the traditional economic thinking, the reformist leaders gained further support in 1989. Therefore, Vietnam’s embracement of radicalism came as an ineluctable event.

V. CONCLUSION

This paper has illustrated the progress in economics growth of Vietnam from 1976 to 1992, with strong focus on the 1986-1992 period. With data provided by international organizations, which could deviate from national statistics, the paper re-examines the change in economic ideologies, and describes in details the economic reforms which had taken place in Vietnam and exerted significant influence on the economy. From 1976 to 1980, Vietnam emulated the socialist command economy of the Soviet Union, with several insignificant adjustments to abate its catastrophic
consequences. Since 1980, the state adopted the dual-price system which had been characteristic to the Chinese gradual reform, as an attempt to introduce market gradually without causing any shocks in level of outputs or the political environment. The complete failure of the command economy led the country toward more liberal economic policies, and the Doi Moi (Renovation) reform in 1986 promised higher growth and economic prosperity. However, the limitations in scope and execution of the program could not solve the main problems with the economy: loose control of money supply, inefficient SOEs, remaining of the state-procurement price (dual-price), and budget deficits. Hence, the VCP’s leaders appealed to the strategy of the “Shock Therapy” approach, and the results achieved in the 1989-1992 period far exceeded any economic progress Vietnam had experienced before. It remains a controversial debate amongst political economic scholars regarding the gradual and radical approaches, yet the available evidences allows us to concludes that Vietnam’s adoption of radical reform was the main cause of its economic development and high growth rate. However, the question of whether Vietnam could have been more prosperous and developed had it taken the gradual approach more successfully and consistently, or whether it was a series of fortunate events that allowed the economy to escape inflation and deficits in such a short period of time without any major shocks, remain unanswered. Further researches will be needed to study such questions, and examine the completeness of the “Gradualist” and “Shock Therapy” doctrines.
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