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The Challenges Posed by Globalization for Economic Liberalization in Two Asian Transitional Countries: Laos and Vietnam

Nick J. Freeman*

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Abstract

This paper examines the impact of globalization on two transitional economies in Asia. Both countries have undergone a radical economic reform process over the past decade, assisted by increases in external trade flows, foreign investment activity, and external assistance. However, the pace of economic reform has decelerated since the perceived perils of globalization—as evidenced by the Asian Crisis—have become more apparent to the leaderships of these two avowedly socialist states. Although neighbouring and fraternal countries, adopting broadly parallel economic liberalisation programmes, the forces of globalization have manifested themselves in different ways in Laos and Vietnam. The paper discerns these differences, and assesses whether the two countries are likely to overcome the current hiatus in their economic reform programmes.

Keywords: globalization backlash, foreign direct investment, East Asia.

JEL classification: F21, O38, O53

*Senior Fellow, Institute of Southeast Asian Studies, Singapore. freeman@iseas.edu.sg

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Introduction

> Your country belongs to the Western seas, ours to the seas of the East. Just as the horse and the buffalo differ between themselves, so do we differ by our language, our writings and our customs. … Everywhere man has the same value, but his nature is not the same.[1]

It could be argued that few Asian countries are more aware of the potency of global forces, and the impact of external trends, than Laos and Vietnam. At first glance such an assertion may appear strange, particularly for two economies that were wholly closed to all foreign business before the late 1980s. Indeed, these two countries are regarded by many as insular, led as they are by avowedly communist parties that remain ambivalent towards the economic development orthodoxy held by most nations in East Asia.[2] But with the exception of highly externally-oriented economies like Singapore and Hong Kong (both of which have tended to embrace globalization), it is hard to identify other countries in Asia that have been more exposed to external economic and political forces this century than Laos and Vietnam. Both Laos and Vietnam were French colonies, and while the former was a 'colonial backwater', the latter was on the receiving end of substantial French capital inflows during the first three decades of the twentieth century.[3] Although neglected by French capital, the current Lao state was created by the French administration, at least in terms of its current borders and territorial extent, having previously constituted three petty kingdoms, outlying parts of which were subsequently absorbed by neighbouring countries.[4] The liberation struggle to eject the French from both Laos and Vietnam mutated and inflated into a conflict that became the primary cockpit of Cold War superpower rivalry throughout much of the 1960s and early 1970s. After the end of hostilities in 1975, both Laos and Vietnam had relatively brief flirtations with inward-oriented command economics, payrolled in large part by the Soviet Union. But since the late-1980s, both countries have sought—at least partially—to open their economies to foreign trade and capital inflows, propitiously timed to coincide with a global trend of rising investment and trading activity in emerging markets. And finally, as a result of substantial outflows of refugees during recent decades (particularly in the latter part of the 1970s), quite large Lao and

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1 Taken from an 1862 declaration, by the inhabitants of Go-Cong province in southern Vietnam, to the French, "warning the invaders that they would fight to the death for the return of the territory ceded the previous year". See Smith (1968), p. 183.

2 This orthodoxy might be summed up as broadly entailing economic liberalisation (including divestment of state firms, restructuring domestic corporates, encouraging the private sector to burgeon, allowing foreign corporates to enter, etc.), the fruits of which will subsequently be evidenced in improved economic growth. Evans has depicted Laos as being a 'post-socialist' regime, arguing that the term 'socialism' in Laos "no longer represents an economic program … Instead, it is a device of political rhetoric which proclaims … that the one-party state has no intention of allowing liberal-democratic reforms." Evans (1998), pp. 1-2. The same pertains to Vietnam.

3 See Callis (1942), p. 77. France invested as much as 8 billion francs in colonial Indochina, prior to the Second World War. Callis (1942), pp. 79-80.

4 Agreement by France and Siam to delineate much of the border along the Mekong River meant that a larger number of Lao found themselves living outside Laos than those left within its borders. See Stuart-Fox (1997).

Vietnamese communities now reside overseas, most notably in Australia, France and the US.[5]

The above notwithstanding, the leaderships in Laos and Vietnam are clearly not comfortable with the current forces of globalization, perceiving them to be—at best—a rather mixed blessing. While foreign capital inflows and other economic inputs are undoubtedly welcome, much of the additional socio-political 'baggage' is less well received. Vietnam's leadership frequently warns its people to be on the guard for 'peaceful evolution'; a process by which external forces will seek to covertly undermine the regime. It is implied that having failed to defeat Vietnam by overt and military methods, enemies are using more subtle means in a bid to achieve the same end. Given Vietnam's long history of resisting external aggressors, it is perhaps not surprising that Hanoi continues to be vigilant against hegemonic intent. The Lao government too has intimated its desire not to see the country overwhelmed by foreign interests, although seems quite willing to have Vietnam as its principal mentor.[6]

The leaderships in Vientiane and Hanoi tend to depict their concerns about globalization as primarily pertaining to its impact on issues like local traditions, national culture, and so on. However, the potential impact of globalization in diluting national sovereignty and contracting the authority of government are probably of even greater (and much more immediate) concern to Vientiane and Hanoi, although rarely expressed as such[7] The leaderships are also not helped by adhering to an ideology—now largely abandoned in the economic sphere, but still espoused in the political realm—that does little to equip them with the tools needed to comprehend recent changes in international business patterns, let alone notions of the 'new economic paradigm'. Instead, it allies them with a diminishing community of socialist states that have yet to deliver a convincing strategy to deal with the forces of globalization. The leaderships in Vientiane and Hanoi are certainly not ignorant of globalization, but seem unsure how to respond, and—as discussed below—seem more focused on the perceived perils of globalization.

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5 Overseas Lao and Vietnamese communities remit considerable savings back to relatives still living in the country, providing a useful fillip to both countries' current accounts.

6 It should be noted that not all Lao share the government's view of Vietnam as mentor and ally. As Evans points out, the Lao leadership "would not have come to power in 1975 without the long-term assistance of North Vietnam's own 'secret army' … in the closing stages of the war." Evans (1998), p. 3.

7 Such notions of weakening sovereign powers, stemming in part from forces of globalization, are by no means invalid. The World Bank recognises that "nation states are facing increasing limitations as territorial constructs". Rischard (2000), p. 3.

1 A brief economic profile of Laos and Vietnam

Sharing a common border, the Lao People's Democratic Republic and the Socialist Republic of Vietnam are states with some strong similarities, albeit with a few marked differences. Both are less developed countries, with average per capita GDP figures that are below US$350 per annum.[8] Both regimes were established in 1975, after years of military conflict, and have since been led by communist parties (the Lao People's Revolutionary Party and Vietnam Communist Party). Although political pluralism is not entertained, both countries have been enacting economic liberalisation programmes since the implosion of the socialist bloc in the late 1980s. Rather like China, they have sought to reform the economy, but not the political sphere. In Laos, this programme of economic reform is known as the ‘new economic mechanism’, and in Vietnam it is referred to as ‘*doi moi*’. Relations between Vientiane and Hanoi are fraternal, and the leaderships regard each other as close allies. Laos is a landlocked country, with a population of around five million, while Vietnam has a lengthy coastline, and has a populace of about 80 million. Laos's total land area is roughly 70 per cent that of Vietnam, resulting in a stark difference of population densities between the two countries. The ethnic profile of Laos's population is extremely diverse, whereas Vietnam's citizenry is relatively uniform in this regard.

By global standards, the economies of Laos and Vietnam are relatively small. The GDP of Laos is a mere US$1.4 billion, while Vietnam's is around US$25 billion. In Laos, the agricultural sector employs the majority of people and accounts for about half of total GDP, with the service and industry sectors representing about a quarter of aggregate GDP each. In Vietnam, the agricultural sector also employs the majority of people (about 80 per cent of the labour force), but only accounts for about a quarter of total GDP, with the industry and service sectors representing 34 per cent and 42 per cent of total GDP respectively. Prior to 1987, both countries operated centrally-planned economies, supported by not inconsiderable socialist bloc assistance, primarily sourced from the Soviet Union. Economic interaction with the West was minimal, with Laos in particular becoming relatively closed. Although some of the more extreme elements of central planning—such as obligatory collectivisation of agriculture and a complete ban on private sector endeavour—were phased out at the end of the 1970s, the economic performance of both countries remained extremely lacklustre, until the advent of economic liberalisation measures in the mid-1980s. These economic reforms succeeded in overcoming some of the efficiencies of the old system, thereby unleashing a commendable spurt of growth, as measured across a wide range of macro-economic indicators.

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8 Laos has a nominal per capita GNP of US$258, and Vietnam has a nominal per capita GNP of US$310, according to *Asiaweek* (24 March 2000), p. 65. The UNDP's most recent human development index, ranks Vietnam 122nd and Laos 136th in its ranking of 174 countries. See UNDP (1998), pp. 130-132.

Table 1:

Laos and Vietnam's Macro-Economic Profiles Compared

	1994	1995	1996	1997	1998E
Real GDP growth (%)					
Laos	8.1	7.0	6.8	6.9	4.0
Vietnam	8.8	9.5	9.3	8.2	5.8
Agriculture sector as % of GDP					
Laos	57.5	55.6	53.3	53.3	52.6
Vietnam	27.4	27.2	27.8	25.8	26.0
Industry sector as % of GDP					
Laos	18.1	19.2	21.1	21.2	21.9
Vietnam	28.9	28.8	29.7	32.1	32.7
Services sector as % of GDP					
Laos	24.4	25.5	25.6	25.5	25.5
Vietnam	43.7	44.1	42.5	42.2	41.3
Consumer price index (%)					
Laos	6.8	22.6	13	19.3	90.1
Vietnam	14.4	12.7	4.5	3.6	9.2
Exports (% of GDP)					
Laos	19.5	17.5	17.4	18.3	26.7
Vietnam	26.2	26.2	31.6	38.4	40.3
Imports (% of GDP)					
Laos	36.6	32.9	37.3	37.3	43.8
Vietnam	33.9	37.1	45.2	47.7	50.9
Balance of payments on current account (% of GDP)					
Laos	-14.3	-13.2	-16.1	-16.1	-10.4
Vietnam	-8	-11	-10.3	-6.8	-4.1
Foreign investment approvals (number of projects)					
Laos	130	55	63	66	68
Vietnam	367	408	370	313	-
Foreign investment approvals (value US$m)					
Laos	2,598	615	1,293	142	123
Vietnam	3,664	6,722	7,702	4,456	1,738

External debt outstanding (US$m)					
Laos	1,971	2,068	2,175	2,323	-
Vietnam	6,670	7,756	9,657	11,612	14,861
Debt service ratio (% of exports)					
Laos	3.3	5.7	5.9	9.5	11.9
Vietnam	13.4	12.2	11	11.4	13.4
Exchange rate against US$1					
Laos (kip)	730	940	975	2,205	4,750
Vietnam (dong)	10,978	11,037	11,032	11,683	13,297

Sources: *Asian Development Outlook 1999* (ADB); Various IMF Staff Country Reports; ING Barings.

2 Convergence of economic liberalisation and globalization, prior to the 'Asian crisis'

If one plots growing globalization by rising levels of external trade (as a percentage of GDP) or foreign investment inflows (as a proportion of domestic investment), it is clear that both Laos and Vietnam have become much more 'globalized' since the commencement of economic reforms in the late 1980s. Key pillars in the economic liberalisation programmes in both Laos and Vietnam were the opening up of the economy to foreign investment (to attract much-needed capital and business know-how) and the successful bid to increase external trade (to generate foreign exchange)[9]. For example, Vietnam's export earnings grew from less than US$500m in 1988 to slightly under US$9 billion in 1997; rising from less than 3 per cent of GDP to almost 38 per cent of GDP. Similarly, foreign investment pledges increased from less than US$400m in 1988 to over US$8.6 billion in 1996; rising from roughly 10 per cent of domestic investment to roughly 30 per cent greater than total domestic investment.[10] Laos's performance in external trade and FDI inflows has not been as impressive as Vietnam's, but showed broadly the same underlying trend during the first half of the 1990s.

The timing of the 'opening up' of the Lao and Vietnamese economies to foreign capital inflows and external trade was propitious, coinciding with an unprecedented rally in investment and trade flows across global emerging markets in general, and Asia in

9 To be precise, external trade volumes were not only increased, but also re-oriented, from trading with the socialist bloc countries to mostly Asian and European countries. Vietnam in particular did a remarkable job in re-orienting its external trade swiftly, and with little apparent dislocation.

10 One should note that the figures pertain to FDI inflow *pledges*, and not FDI *disbursements*.

particular.[11] The forces of globalization were regarded as being relatively benign at this time, with integration into the global economy deemed necessary to revive their ailing domestic economies.[12] While elements of the Lao and Vietnamese leaderships may have harboured reservations about this diversion in the socialist development path, these were subsumed by a more pressing need to re-invigorate their moribund and malfunctioning economies, at a time when the primary external sponsor (the Soviet Union) was unable to continue with its assistance.

The response of foreign venture capitalists to the 'opening up' of Laos and Vietnam was very favourable, discerning that some of East Asia's last frontiers were now being made accessible. The fact that Laos and Vietnam were located in a part of the world where so many other economic success stories were already apparent helped matters tremendously. For investors and traders seeking to penetrate new domestic consumer markets, Vietnam in particular offered the potential of over 70 million new customers. For investors seeking to find new low-cost labour platforms for producing manufactured goods, here were two countries where semi-skilled labour cost less than US$50 per month.

The role played by foreign investment—with its the value-added inputs of new technology, management know-how, access to foreign markets, and so on—in the economic liberalisation programmes of Laos and Vietnam should not be under-estimated. It is undoubtedly the case that Vietnam's '*doi moi*' programme would have been far less successful without the inflow of substantial foreign investment between 1988 and 1996. Indeed, FDI was a critical motor of economic growth and development in both Laos and Vietnam, during their first decade of economic liberalisation. To some extent at least, this trend mirrored a similar process—roughly sixty years before—with the inflow of French colonial capital in the 1920s playing a pivotal role in advancing the Vietnamese economy.[13] More than one author has noted that French capitalists were responsible for taking Vietnam on the "next step along the road of economic change" during the early part of the twentieth century.[14] A similar role could be played by FDI in the 1990s, assisting Vietnam in taking its economy to a new level of production, by supporting the creation of an export-oriented manufacturing and processing base.

The 1990s wave of foreign investment did not seek to emulate the colonial notion of *mise en value* that was associated with French capitalist penetration of Laos and Vietnam in the early twentieth century. But another parallel between the foreign investment activity of the 1980-90s and the early twentieth century is perhaps worthy of

[11] South and East Asia recorded average aggregate FDI inflows of roughly US$18.6bn in the period between 1987 and 1992, but this figure steadily increased each year, to almost US$88bn in 1997. UNCTAD (1999), p. 479.

[12] Globalization is commonly perceived to be a product of easier and more rapid flows of capital and technology across the world, resulting in the increased interdependence of national economies, and growing emphasis of transnational firms' cross-border production networks. In the words of Singapore's deputy prime minister, Lee Hsien Loong, globalization "does impose market discipline on the participants, which can be harsh, but is the mechanism that drives progress and prosperity". Quoted in Olds et. al (1999), p. 1.

[13] For a good overview of French capital in colonial Indochina, see Callis (1942), pp. 71-87.

[14] For example, see Smith (1968), p. 128.

note. More than any other colonial regime in Southeast Asia, France enacted various measures that virtually excluded all non-French foreign investors. As a result, one observer estimates that just 3 per cent of all investment in Indochina came from countries other than France.[15] Although no foreign power sought to dominate FDI activity in Laos or Vietnam in the 1990s, the former did encounter levels of Thai investment that far exceeded all others. But, more interestingly, in a sort of reversal of French colonial policy, the US maintained an investment embargo against Vietnam, until 1995.[16] This allowed European and several East Asian firms to steal a march on their US competitors in Vietnam, and added to the allure of this market.[17] Once the embargo was lifted, numerous US firms made a concerted bid to enter Vietnam, in a drive that was probably the last major 'FDI push' into the country, prior to the onset of the Asian crisis.

Finally in this section, both Vietnam and Laos joined the Association of Southeast Asian Nations (ASEAN) in 1995 and 1997, respectively. There is little doubt that the primary reasons behind both countries joining were the perceived political and strategic benefits to be derived from being a member, particularly regarding relations with mighty China—with which both Laos and Vietnam have northern borders. (ASEAN's well-established principle of mutual non-interference in the domestic circumstances of fellow members will also have attracted Vientiane and Hanoi.[18]) However, the political benefits of ASEAN membership also come with economic obligations, including compliance with the ASEAN Free Trade Area (AFTA) and ASEAN Investment Area (AIA), both of which will place additional demands on the two countries' economies. For example, reducing import tariffs to comply with AFTA will reduce one important layer of protection currently used to defend state enterprises from much leaner overseas competition. Given a choice, both Vientiane and Hanoi would probably prefer an ASEAN that does not include AFTA and AIA commitments, but that choice does not exist, and the perceived political benefits of membership are deemed to outweigh the less economic obligations of membership. (The extended deadlines given to Laos and Vietnam for AFTA and AIA compliance—Laos must comply with AFTA by 2005 and the AIA by 2010; Vietnam must comply with AFTA by 2003 and the AIA by 2010—has given the two countries some breathing room.)

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15 Lindblad (1998), p. 14. This compares with 10 per cent non-British investment in Burma, 29 per cent non-Dutch investment in Indonesia, 30 per cent non-British investment in Malaysia, and 48 per cent non-US investment in the Philippines, as at 1937.

16 For details of the US embargo, see Freeman (1993).

17 At the very least, the embargo resulted in a staggered inflow of foreign investment, with the first wave led by European firms, a second wave led by Japan and East Asia, and a third wave of US firms. In retrospect, this sequential inflow benefited Vietnam considerably, being easier to manage than a massive single wave of FDI, and extended the euphoria associated with a market opening up for the first time.

18 For a depiction of ASEAN's track record on non-interference, see Funston (2000), pp. 2-5.

3 The impact of the 'Asian crisis', and growing anxiety over globalization

If the substantial increases of investment inflows to, and external trade with, Laos and Vietnam were regarded by Vientiane and Hanoi as being broadly benign during the early 1990s, this perception seemed to change around the mid-1990s, and particularly after the onset of the regional economic downturn—the 'Asian crisis'—in 1997. While it would be incorrect to assert that leadership perceptions of the forces of globalization were transformed from being completely benign to thoroughly malignant, it is true to say that the potential perils of becoming integrated into the global economy were brought to the fore, if only by those elements within the leaderships that had harboured misgivings about the speed (and depth) of economic liberalisation measures all along. It almost became accepted wisdom that, had it not been for delays in liberalising various elements of the economy (such as foreign exchange and the finance sector), the impact of the Asian crisis would have been much harder. Or put another way, if Laos and Vietnam had been more integrated with the global economy, the adverse effects of the regional downturn would have been much worse. This interpretation of events is spurious, but nonetheless has gained currency in Vientiane and Hanoi, and partially undermined the platform of pro-reform elements within the senior leaderships.

3.1 Laos

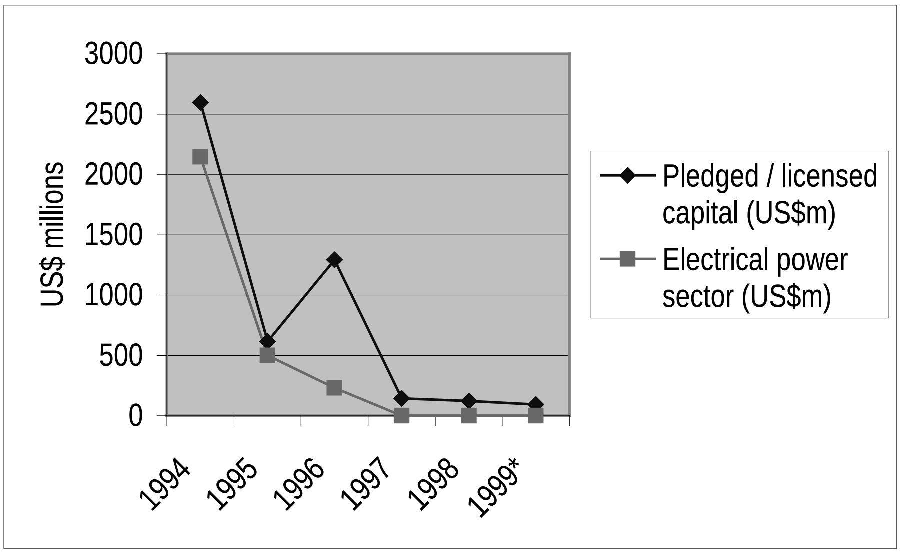
Despite having only the most rudimentary banking and financial system, the impact of the Asian economic crisis on Laos was marked, and most evident in the fortunes of its domestic currency, the *kip*. With an economy heavily oriented towards Thailand, both in terms of trade and investment, it did not take long for the Thai currency crisis to migrate across the Mekong River. Although officially illegal, the use of both the Thai baht and US dollars for domestic transactions (and savings) in Laos is widespread. At first, the Lao currency's value against the US dollar shadowed the decline of the Thai currency, but after the baht began to stabilise, the value of the kip continued to weaken against both the US dollar and the baht. This currency weakening persisted throughout 1998, resulting in a devaluation even greater than for Indonesia's rupiah. This in itself was quite peculiar, given that the fallout from the Asian economic crisis had an impact on Indonesia's economic, social and political spheres that was far greater than anything experienced in Laos. The sharp depreciation in the kip rapidly led to very high inflation, as imported goods (on which Laos is heavily reliant) became considerably more expensive in local currency terms. The spending power of urban Lao—including government officials—declined precipitously, forcing the government to enact a number of policies to mitigate the impact. These included reducing the hours of the working week, in order that civil servants could generate additional income from second jobs. While such measures may have helped a little, they did not wholly compensate for the woes felt by most urbanites. Displeasure at what had happened almost certainly played a part in the aborted demonstration that took place in Vientiane in October 1999, by students and teachers.[19]

[19] Demonstrations in Laos have been extremely rare. See *Asiaweek* (24 December 1999) and 'Tiny Splash Sets Wave in Motion', *The Nation*, 24 March 2000.

Having sourced the vast majority of its foreign investment from Thailand (72 per cent of aggregate inflows between 1994 and 1999), the sharp economic downturn in Laos's southern neighbour resulted in a sharp reduction in FDI inflows. The dire effect of the financial crisis on Thailand's corporates caused a number of Laos's largest foreign investors to revise back their plans for the country. To compound matters, a large proportion of total foreign investment pledges (and licence approvals) in Laos had been for an ambitious array of hydropower projects across the country. (Also see Table 2, below.) Although far in excess of Laos's own power needs, the electricity generated was to have been exported to Thailand. However, Thailand's power demand projections have subsequently been sharply revised down, and a substantial proportion of the approved hydropower projects will not now proceed. And for those that do proceed, Vientiane and Bangkok have been stuck in negotiations over the terms of the power purchasing deals. Laos's policy-makers had placed much emphasis on these power projects as a pillar of the country's economic development drive, which—with the benefit of hindsight—meant that they had placed 'too many eggs' in the hydropower 'basket'.

Figure 1

Foreign Investment Inflows in Laos, 1994-99



3.2 Vietnam

> "When *imperialism* speeds up trade and services liberalisation and globalization of investment, the rich countries become richer, and the gap between rich and poor countries widens."[20] [Emphasis added.]

The above quotation is taken from a speech by the General Secretary of the Vietnam Communist Party, Le Kha Phieu, given in early 2000. These words provide a telling

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20 Le Kha Phieu, speaking at the 70th anniversary celebrations of the VCP, January 2000. *Vietnam Business Journal*, February 2000. http://www.viam.com/02-2000/editorsnote.htm.

indication of the senior leadership's concerns about the forces of globalization, and the threat posed by “hostile forces” seeking to “wipe out the remaining socialist countries”.[21] While this concern was not wholly in abeyance prior to the Asian crisis, it was much less apparent. Perhaps the most tangible evidence of these concerns was the debacle that occurred at the APEC summit in Auckland, in September 1999, when Hanoi made an eleventh hour decision not to sign a ‘normal trading rights’ agreement with the US, having initialed a preliminary agreement a few months before (after nine rounds of negotiations).[22] Such an agreement would have been the most significant development in Vietnam's process of rejoining the international business community since the lifting of the US embargo in 1995, and been the penultimate stop in a process that had begun in 1987, with the promulgation of its foreign investment law. Hanoi's decision not to sign in Auckland came as a body-blow to already sombre sentiment towards Vietnam by most foreign investors, and took overseas business perceptions of the country to new lows, from which it will be hard to recover. On a more immediate note, the signing of a US-China trade agreement, just two months later, means that the latter will now have a distinct advantage over Vietnam in terms of its exports entering the US market. As a direct competitor to Vietnam in various exports, China now has the upper hand.

Unlike Laos, Vietnam did not witness a dramatic depreciation in its domestic currency (the ‘*dong*’), during and immediately after the financial crisis in Thailand. Hanoi's currency strategy has resembled that of China; to maintain the fixed exchange rate, regardless of the impact this may have on export competitiveness, resulting from the currency depreciations by other countries in East Asia. (Although Vietnam's policy-makers may insist that the dong exchange rate has the ability to freely move within a permitted trading band, the incremental movements are so minute as to be inconsequential.)

Probably the greatest impact of the Asian crisis on Vietnam was felt in the foreign investment inflow figures, which have almost evaporated over the last 2-3 years.[23] Although pledges of new FDI had probably peaked in 1996, both the pledges and disbursements of foreign investment began to trend down sharply after mid-1997. Unlike Laos, Vietnam's FDI inflows were not dominated by one country source and one sector: the industry sector (both light and heavy) comprises roughly a third of all approved foreign investment, followed by hotels and tourism, construction, telecommunications, and oil and gas exploration. (See Table 2, below.) Nonetheless, approximately 70 per cent of Vietnam's FDI inflows were being sourced from the Asia Pacific region, including those countries most affected by the financial crisis and subsequent regional economic downturn. Therefore, one would be right to attribute at

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[21] *Vietnam Business Journal*, February 2000 (editor's note). http://www.viam.com/02-2000/editorsnote.htm.

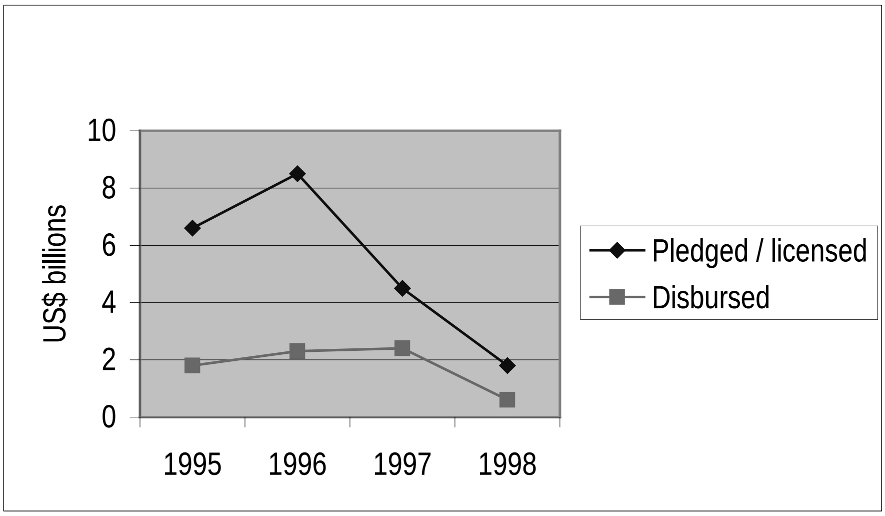
[22] Hanoi's last minute change of mind came as a complete surprise. Negotiations on a trade deal had been underway for several years. The US offer of lower import tariffs came with concomitant conditions on opening up the Vietnamese economy to foreign firms, and it was perhaps these conditions which prevented Hanoi from signing.

[23] Recent years have seen the official FDI inflow figures inflated by a few ‘big ticket’ investment projects, some of which are unlikely to reach fruition, but help in keeping the official figures for foreign investment at artificially high levels.

least part of the FDI inflow decline to the impact of the Asian crisis. However, the regional economic downturn was not the only cause of the contraction in foreign investment, as indicated by the fact that FDI inflows peaked in 1996, ahead of the Asian crisis. Much of the initial euphoria towards Vietnam as a new investment destination began to wear off in 1996 (see Figure 2 below), and it after the Eighth Party Congress of mid-1996 the economic reform process began to lose momentum, and it has yet to convincingly recover. As a result, foreign investors began to revise down their expectations for the country, as new economic liberalisation measures were not forthcoming, and foreign firms began to hold back on enacting new projects.

Figure 2

Foreign Investment Inflows in Vietnam, 1995-98



Perhaps one area of Vietnam's economic policy-making that best displays the leadership's general anxiety over globalization, and a reluctance to enact business liberalisation measures that go beyond what is deemed acceptable by the more conservative elements, has been in the field of capital markets. Since roughly 1991, Hanoi has been toying with opening a stock market. Yet despite establishing a securities regulatory commission in 1997, and issuing various pieces of regulatory paperwork, Vietnam has still to unveil a stock market.[24] While the reasons behind this delay are complex, and include genuine logistical problems, the fact that Hanoi has been so slow in overcoming various hurdles reflects in part a lack of leadership consensus on the issue. (And witnessing what happened to the stock markets of most East Asian countries during the Asian crisis has probably served to weaken leadership consensus even further.[25]) A Chinese dissident remarked in 1997 that his country's stock market “has that magic power that makes people concerned about the country's economic policy …

24 The State Securities Commission replaced a Capital Markets Development department, located within the State Bank of Vietnam.

25 The fact that the financial crises in East Asia were largely the result of excessive commercial bank lending, and that the damage inflicted on stock market valuations was a symptom (not a cause) of the crisis, is probably lost on many in the Vietnamese leadership.

once the will of the people is awakened, they will not sleep again".[26] But a stock market also has the potential to act as a conduit for foreign portfolio investment into domestic enterprises listed on the market, which may also pose concerns for some in Vietnam's leadership, despite the fact that a shortage of capital (both credit and equity) has been the single largest problem facing the country's corporate sector for the last few years.

Until 1998, the slow pace of stock market development in Vietnam was mirrored by a similarly glacial approach to the divestment of non-essential state enterprises, with a host of practical hurdles cited as the reason for sloth. However, the pace of state sector divestment—known as 'equitisation' in Vietnam—increased considerably in 1999, indicating that when sufficient political will is galvanised, economic liberalisation measures can move forward quite rapidly.[27] Recent progress on 'equitisation' was one of the very few bright spots on the economic liberalisation 'front' for Vietnam in 1998-99.[28]

Table 2:

Major FDI Patterns in Laos and Vietnam

Top Five Foreign Investors in Laos		Top Five Foreign Investors in Vietnam	
	% of total		% of total
Thailand	46.90%	Singapore	15.7%
USA	26.60%	Taiwan	13.0%
Korea	5.70%	Japan	9.5%
Australia	5.10%	Hong Kong	9.2%
Malaysia	4.90%	Korea	8.4%

Top Five Foreign Investment Sectors in Laos		Top Five Foreign Investment Sectors in Vietnam	
	% of total		% of total
Energy	66.1%	Construction	18.4%
Hotels/tourism	8.9%	Heavy industry	16.5%
Telecomms.	8.2%	Hotels/tourism	13.5%
Manufacturing	7.0%	Light industry	10.8%
Wood products	2.4%	Telecomms.	8.6%

Sources: OECF (1999) and *Vietnam Business Journal* (various issues).

[26] Quote by Wu'er Kaixi, cited in Chancellor (1999), p. 330.

[27] Between 1992 and 1997, just 18 state enterprises were equitised. But in 1998 alone, 116 state firms were equitised, followed by another 260 in 1999. Nguyen (2000), pp. 23-26.

[28] Not normally known for taking the lead on policy initiatives, Laos has a more impressive track record than Vietnam in the state sector divestment field, having been more willing to sell or lease state firms to private investors (both local and foreign).

4 The way forward for economic reform: coming to terms with globalization

The extreme opacity of the decision-making process in Vientiane and Hanoi make it difficult for external observers to judge how the leaderships of Laos and Vietnam are debating issues relating to globalization. It is therefore hard to forecast whether they will come to terms with globalization, and whether they will choose to re-invigorate the economic reform process. While there is probably little prospect of Laos and Vietnam actually reversing the economic liberalisation measures enacted since the late 1980s, it is conceivable that the recent 'non-policy' stance will persist in the coming years, until some sort of consensus within the senior leadership is arrived at, or events overtake the leadership. If so, we can expect to see the continuation of broadly pro-liberalisation utterances, with incremental improvements made to the legislative and regulatory regimes that pertain to the business environment. In other words, a continuation of the modus operandi that has been in place since roughly 1996.

A more positive and convincing economic liberalisation drive in the short term would probably be only forthcoming if the distress to the economies of Laos and Vietnam was of a level that prompted remedial action by the leadership, rather in the same way that the first tranche of economic reforms of 1986 was in response to dire economic plight. But such a situation in itself would not be a sufficient pre-condition, as it would also require a consensus within Vientiane and Hanoi that further economic liberalisation measures provided the best chance of economic improvement, and that the potential rewards outweighed the perceived risks. And even then, it would remain to be seen whether the economic liberalisation measures taken—regardless of their boldness—were the right ones for the job. At a time of increasing globalization, this not only requires competency, but also a degree of vision and imagination, in a field where the leaderships of Laos and Vietnam are relatively inexperienced.

One particular area of concern for this observer is that the sorts of 'micro' economic liberalisation measures now being enacted in Laos and Vietnam—fine-tuning a business law here, adjusting an implementing regulation there—in a bid to regain economic momentum is of little utility, and indeed may even be counter-productive. The economic growth spurt of the late 1980s and early 1990s was attributable in large part to the activity of the private sector (both domestic and foreign firms alike), after having been restricted or wholly excluded in previous decades. Changes in the various laws, decrees and regulations opened up an avenue of economic endeavour that was seized by everyone, from local farming families to major foreign multinationals. And the sorts of laws and decrees that were drafted broadly complied with an established 'blueprint' for economic development that had been tried and tested by other Southeast Asian countries in the 1970s and 1980s. In the specific case of foreign investment, particular emphasis was placed on encouraging export-oriented production projects (everything from electricity generation in Laos for sale to Thailand, to garment manufacturing in Vietnam for sale to Europe), as exemplified by the export processing zones and industrial zones that sprouted up across Vietnam.

Foreign investors had an appetite for this sort of approach in the 1980s, and although this had begun to wane, they still had some lingering interest in establishing new plant in Laos and Vietnam during the 1990s. However, forces of globalization—particularly with regard to new efficiencies of production and the economies of scale to be derived from cross-border production networks—are helping to ensure that such appetite is now much-diminished. At a time of global over-capacity in many of the fields where Laos and Vietnam were seeking to develop capabilities, appetite for new power plants and car assembly plants has been almost wholly satiated. Yet, the micro liberalisation measures being enacted by Vientiane and Hanoi are very much still within the mindset of the 'old economy blueprint'. While appropriate for that stage of transition in Laos and Vietnam, and appropriate for the business environment of the late 1980s and early 1990s, such policies may have less relevance in the next stage of transition, and in the new international business environment. In short, diminishing returns are beginning to set in for the reform agenda pursued by Laos and Vietnam since the late 1980s.

At worst, tinkering with existing laws and regulations—accompanied by poor performance in implementation—succeeds in only further complicating what has become a remarkably labyrinthine regulatory regime, for Vietnam in particular, thereby adding to the opacity of these host country business environments.[29] At best, the benefits to be derived from 'micro' tinkering are wholly discounted by on-going macro hurdles that confront both foreign and domestic business: non-convertibility of the currency; regulations that oblige firms to exchange any foreign exchange earnings into local currency; hassles incurred when dealing with a petulant customs service; scant recourse to law in areas such as intellectual property rights, etc. One observer recently commented that foreign "investors will return [to Vietnam] only when the government demonstrates the necessary seriousness of purpose to convince prudent executives to put their money at risk".[30] The policy-makers in Laos and Vietnam know this, but are wrong to think that repeated re-drafting of a few laws will be sufficient to display a seriousness of purpose. Above and beyond improving the legislative framework, the gestures have to be more convincing, more imaginative, and more oriented towards a rapidly changing international business environment. And they must not be discounted by references to 'imperialism' by the Secretary General of the Communist Party—the single most powerful man in Vietnam. A lot of foreign investors jumped into Laos and Vietnam with both feet during the early 1990s and promptly 'lost their shirts'; the next tranche are likely to be more cautious.

Laos and Vietnam's policy-makers do not seem to have developed a grasp of the sorts economic liberalisation measures that are necessary for a developing country in the global economy of today, as opposed to the global economy of a few decades ago. With most developing countries now offering liberal investment regimes and incentive packages as standard, the competition to attract foreign firms has moved on, to more macro-economic issues like: the quality—transparency and robustness—of the domestic financial sector (particularly post-crisis), the standard of infrastructure, the cost of communications, the level of human capital, and so on. In these sorts of areas, Laos and Vietnam do not score highly. While some in Vientiane and Hanoi might be sorely tempted to dispense with foreign investment as part of their economic development process, such a notion would be self-deluding. Both countries need foreign capital, and arguably more importantly, they need foreign export markets, technology, and know-how. While Laos might be able to consider relying on external assistance (eg. bilateral aid and multilateral agency grants) alone, this sort of assistance also comes with strings attached, often in areas that are socio-politically contentious. Multilateral agencies are

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[29] Excessive opacity of a host country's business regime can provide a fertile breading ground for corrupt practices. See Beattie (2000).

[30] Rushford (2000).

increasingly attaching conditionalities to assistance that relate to issues of economic and political governance, yet private investors rarely have conditionalities that go no further than corporate governance. Hanoi and Vientiane profess that they remain keen to attract foreign firms, but the ‘micro’ policy prescriptions being used are not of the sort that will galvanise overseas investors nor excite the creative juices of entrepreneurs.

5 Conclusion

Laos and Vietnam enacted economic liberalisation measures in a bid to transform their economies into versions of the more vibrant economic models that surrounded them in Southeast Asia. Half way through doing so, Laos and Vietnam's leaders saw the Asian crisis partially discredit the economic models that they were seeking to emulate. And to make matters worse, forces of globalization now seem to point to a much more demanding liberalisation agenda than was initially envisaged, with implications that may include various additional socio-political perils. Possibly having psyched themselves up for a relatively brief dash to reach the ‘transition line’, the leaderships in Vientiane and Hanoi have discovered that globalization is more like a long-distance endurance race. Whether Laos and Vietnam have the necessary stamina and volition to stay in the race remains to be seen.

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UNU World Institute for Development Economics Research (UNU/WIDER)
Katajanokanlaituri 6 B, 00160 Helsinki, Finland

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