



## The Last Asian Tiger

**Thirty years after the war, Vietnam's robust growth could stall unless the country gets serious about corruption and reform.**

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In the 1960s, Viet Cong guerrillas used to ambush U.S. Navy Swift Boats from the mangrove-lined shores of the southern Mekong Delta. Today, Vietnamese farmers rather than soldiers use the waters to grow shrimp, and their business is flourishing. In fact, the aqua-farmers are so efficient and competitive that the U.S. Congress has slapped anti-dumping duties on Vietnamese shrimp imports, which totaled nearly \$450 million last year. Tran Van Tuan, a 45-year-old shrimp farmer in the southern province of Ca Mau, netted nearly \$1 million in revenues last year from his 20 hectares of salt-water ponds. For all his success, he pads around his farm in a pair of old rubber flip-flops, a torn T shirt and mud-streaked shorts. Says Tuan, as he watches one of the four Japanese-made backhoes that he owns repair a leak in one pond: "Business is great and people are happy."

It would seem so. Given its strategic location on the sea lanes between India, China and Japan, its large and young population, and its strong Confucian work ethic, Vietnam has long been a tiger economy in waiting. But only now, 30 years after the communist North defeated the U.S.-supported Saigon regime, is the country beginning to grab hold of its vast potential. Thanks to a series of *doi moi* (renovation) reforms, Vietnam has been the world's second fastest-growing economy since 2000, trailing only China, with an average annual growth rate of 7.5 percent. The country's economic output has doubled in the past decade—and over the next five years Hanoi aims to double the country's per capita income, from \$500 to \$1,000. Vietnam's performance has largely been export-driven; exports rose to nearly \$25 billion in 2004, a jump of nearly 12 percent over the previous year. The economic spurt has had tangible social benefits: infant-mortality rates have dropped below those in China and Thailand, and the percentage of Vietnamese living in abject poverty has plummeted from about 50 percent in the early 1990s to less than 20 percent of the country's 80 million people today. "Vietnam is on the fast track," says Sesto Vecchi, an American lawyer based in Ho Chi Minh City, formerly known as Saigon.

Perhaps, but that doesn't mean it will stay there. Despite the export surge, say experts, the economy could be doing much better. It remains handicapped by corruption and inefficient state-owned firms that, analysts say, are preventing the country from attaining the double-digit annual growth rate that Vietnam should be achieving. The problem is that Vietnam still clings to a socialist economic model; the country has 4,200 state firms, which soak up half of all economic investment—and most of them lose money. Unless the country's communist leadership pushes privatization and legal reforms more aggressively, and truly opens the economy to more private and foreign competition, the analysts add, Vietnam could easily lose its momentum. "These next steps are so difficult for us because economic openness threatens so many vested interests and state monopolies," says a Vietnamese analyst in Ho Chi Minh City. "We have to make a bold leap over the shadow of our past."

Prime Minister Phan Van Khai seems to understand that. In speeches and public walkabouts,

he often acknowledges past government mistakes of reforming too slowly, and he exhorts the country's bureaucrats to stop obstructing state policies. He's declared "war" on corruption. He's also vowed that Vietnam will join the World Trade Organization this year. That is a crucial reform hurdle; WTO membership would boost exports dramatically—especially in the promising garment industry that already supports, either directly or indirectly, some 10 million people. But many are skeptical that the government can overcome the resistance of those who stand to lose if the socialist economy is dismantled—especially the well-connected executives of state-owned companies. Vietnam has dragged its feet on reform before, and if WTO membership is put off, investors will take it as another signal that the leadership is not fully committed to building a more dynamic economy.

Still, Vietnam has come a long way since the late 1980s, when the heirs to Ho Chi Minh began to experiment with free-market reforms, starting with agriculture. Collective farms were broken up, and Vietnamese peasants were given legal title to family farms. As a result, the country's agricultural production soared. Within two years Vietnam shifted from being a rice importer to a major rice exporter. The lifting of restrictions on the registration of private Vietnamese businesses in 2000, along with the signing of various bilateral foreign trade agreements, have also helped. In the five years since Hanoi and Washington concluded a trade pact, Vietnam's exports to the United States have soared from nearly zero to more than \$5 billion annually. Now one quarter of Vietnam's exports go to its former enemy. The country's foreign-investment climate has improved, though not enough. Last year direct foreign investment in Vietnam totaled only around \$3 billion—far below the more than \$50 billion shoveled into China.

Getting into the WTO will not be easy. "Compared with Thailand and Malaysia, Vietnam is still a closed economy," says a Japanese executive based in Ho Chi Minh City. According to experts, the country will have to allow 100 percent-owned foreign companies to participate in the distribution and retail sale of goods. It will have to streamline customs operations and make them more transparent. It will have to pass legislation that levels the playing field among pampered state-owned enterprises, foreign investors and the fledgling Vietnamese private sector.

The number of necessary legal reforms Hanoi has to make is staggering. One independent review of 262 trade- and investment-related documents found that at least 50 laws, ordinances and decrees must be modified or completely rewritten to make them compatible with WTO rules. And Vietnam will have to negotiate new bilateral trade pacts with its trading partners, including the United States, Japan, China and Australia. (It just successfully concluded one with the European Union.) "Now comes the hard part," says a Western diplomat in Ho Chi Minh City. "If the government does the right things to fully harness the country's considerable capabilities, then this place can really take off."

After oil, garment production is Vietnam's most important export industry. But it is vulnerable. A handful of Vietnam's 50 state-owned clothing manufacturers can compete with Chinese and other foreign competitors. But because Vietnam is not a WTO member, its clothing exports are subject to quotas that are robbing the country of global market share. China's garment exports have exploded this year, thanks to WTO membership—so much so that Beijing is mulling the idea of putting clothing-export restrictions on itself to quell protectionist sentiments in the United States and elsewhere. Chinese garment exports to the United States rose by 63 percent in the first quarter of this year, compared with a 4 percent rise for Vietnam. "We are facing an emergency," says Le Viet Toa, the deputy general manager of Ho Chi Minh City-based Viettien Garment, one of the country's largest clothing producers. He has informed his 20,000 employees that if they don't work harder

and reduce waste, then they could face layoffs.

The biggest threat to Vietnam's growth potential, though, is corruption. Prime Minister Khai has said that the problem is at "unacceptable levels, and if we don't implement effective measures, it will spread." Vietnam-based Western analysts estimate that 20 percent to 30 percent of all state investment in major infrastructure projects and in state-owned enterprises is siphoned off or squandered. With the government investing up to \$10 billion a year of its own and international donors' money in the economy, that means that perhaps \$2 billion or more is being raked off, a crippling sum. "Everybody who's anybody is doing it," says the Western diplomat. Corruption is also sullyng the Communist Party's reputation. Despite its authoritarian nature, the party does have legitimacy, thanks to the military victories over France and the United States, and more recently to the country's rapid economic growth. But senior party leaders realize that runaway corruption could seriously damage their reputation.

With the country's stock and capital markets in their infancy, the proceeds from corruption are largely being plowed into speculative real estate—new apartment and housing complexes that are sprouting up in the suburbs of Hanoi and Ho Chi Minh City. There is so much money chasing so few assets that land prices in Hanoi's suburbs now equal those in suburban Tokyo. "Vietnam is facing a classic and dangerous real-estate bubble," warns the Western economist in Ho Chi Minh City. High rents and real-estate prices, along with other rising costs, are hurting foreign and domestic investors. Pyramid Software Development, an IT company set up by Vietnamese-American Thinh Nguyen in a Ho Chi Minh City industrial park in 2001, is caught in a cost squeeze. According to Nguyen, 48, his rent is twice what he would be paying in Bangkok, his telecommunication costs are exorbitant, and he has to boost wages to keep key software engineers from being lured away by competitors.

Although he is not making a profit, however, he vows to hang on: "I'm still optimistic," he says. While Vietnamese software engineers don't get world-class educations, he continues, they possess "excellent raw talent" and, when trained, are innovative and relish intellectual challenges. The question is, does the country's cautious leadership share Nguyen's vision and competitive spirit? Their political willpower, or lack of it, will decide whether Vietnam becomes the last Asian tiger—or loses its claws.

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