

Does Viet Nam Provide *Big Bang* Lessons to China?

Nazrul Islam

*International Centre for the Study of East Asian Development
(ICSEAD)*

Working Paper Series Vol. 2005-06
August 2005

The views expressed in this publication are those of the author(s) and do not necessarily reflect those of the Institute.

No part of this book may be used reproduced in any manner whatsoever without written permission except in the case of brief quotations embodied in articles and reviews. For information, please write to the Centre.

Does Viet Nam Provide *Big Bang* Lessons to China?

Nazrul Islam*

International Centre for the Study of East Asian Development (ICSEAD)

Abstract

This paper examines Sachs and Woo's (2000) claim that Viet Nam's experience shows that China would have done better if followed the *Big Bang* approach to reform instead of the *Gradual* approach. The paper scrutinizes this claim from the point of view of (a) factual correctness, (b) appropriateness of characterizations, (c) appropriateness of the analogy, and (d) the validity of the conclusions. It finds that Sachs and Woo's claim falls short of meeting these criteria. The Vietnamese economic reforms do not lend support to the Big Bang approach. Instead they provide further evidence that the Gradual approach is the appropriate route to reform.

Key words: Economic Reforms, Transition, Viet Nam; *JEL Classification Codes:* O, P.

Nature does not jump! "Quantum theory does not require the existence of discontinuities: neither in time (quantum jumps), nor in space (particles), nor in spacetime (quantum events)." *Physical Letters A*172, 189 (1993)

1. Introduction

This paper examines Sachs and Woo's (2000) claim that Viet Nam's experience shows that China would have done better if followed the Big Bang approach to reform instead of the Gradual approach. The paper scrutinizes this claim from the point of view of (a) factual correctness, (b) appropriateness of characterizations, (c) appropriateness of the analogy, and (d) the validity of the conclusions. It finds that Sachs and Woo's claim falls short of meeting these criteria. The Vietnamese economic reforms do not lend support to the Big Bang approach. Instead they provide further evidence that the Gradual approach is the appropriate route to reform.

The discussion of the paper is organized as follows. Section 2 provides the background and splits the question posed in the title of the paper into four constituent questions. Section 3 considers the issue of factual correctness of Sachs and Woo's assertions. Section 4 considers the issue of appropriateness of their characterization of 1989 measures as a Big Bang. Section 5 discusses the issue of appropriateness of the analogy that Sachs and Woo draw between Viet Nam and China. Section 6 examines the validity of the broader

* The author is a research professor at ICSEAD. He is grateful to Vo Tri Thanh, Le Dang Doanh, Vu Thieu, Vu Huy, Trinh Quang Long, Steve Parker, Adam McCarty, Jonathan Pincus, Eric Ramstetter, Shoichi Yamashita, and Raymond Mallon for long discussions that helped me have a better understanding of the Vietnamese reforms. Thanks are also due to the participants of seminars at Asia Pacific School of Economics and Government of the Australian National University and at Economics Department of Queensland University, Australia, for their helpful comments. None of them however is responsible for the errors that may remain and the views expressed in this paper. Send your comments to nislam@icsead.or.jp.

conclusions that Sachs and Woo want to draw based on their allusion to Viet Nam. Section 7 offers some concluding remarks.

2. Background

In a recent paper, Sachs and Woo (2000) (henceforth SW) draw upon Viet Nam's experience in order to support some of their views regarding the Chinese economic reforms. In particular, they argue that Viet Nam's experience show that China would have done better if she had followed the *Big Bang* approach to reform instead of the *Gradual* approach.

Jeffery Sachs is well known as the architect of the Big Bang approach and has played an active role in actual implementation of this approach in several countries. The Big Bang approach has however drawn considerable criticism because of 'disappointing' results in many East European countries, particularly in Russia. The critics of the Big Bang approach have instead pointed to the success of the Chinese reforms as evidence of the superiority of the Gradual approach.

Sachs however remains defiant in face of the contrasting experiences of Russia and China. In fact, SW argues that even China's experience supports Big Bang. According to them, the Gradual approach has hindered Chinese growth, rather than facilitating it. In their view, China would have grown faster had she adopted Big Bang.

Unable to provide evidence for the claimed counterfactual from China's own data and information, SW turns to Viet Nam's experience for support. They claim that Viet Nam's experience shows that Big Bang would have accelerated Chinese growth, and not resulted in dislocations (that many apprehend). The following passage contains their arguments:

"Suppose that China had in fact pursued more rapid liberalization of the economy, including a harder constraint on state enterprises and a faster unification of product markets and the market for foreign exchange. How much larger would have been the dislocations in the economy? While we cannot answer this crucial question with any precision, it is instructive to look next door at the case of Vietnam. During 1985-88, Vietnam implemented a gradual reform strategy that did not address serious macroeconomic imbalances. The program failed: inflation and import of rice accelerated while growth performance remained unchanged. In 1989, Vietnam enacted an Eastern-Europe style "big bang," including across-the-board price liberalization, 450 percent devaluation to unify the exchange market and a tight credit policy. The collective farms were returned to family farms with long-term leases. Growth accelerated, inflation ended, agricultural productivity soared (turning Vietnam into a rice exporter in 1989), and small, non-state enterprises proliferated. The "big bang" did not cause an output decline in Vietnam as in Eastern Europe." (p. 16-17)

This paper addresses the question how correct these assertions of Sachs and Woo are. It may be noted that the assertions in this passage are multi-faceted. It is therefore necessary to split the overall question into the following four constituent questions. First, how correct are Sachs and Woo with regard to the *facts*? Second, how correct are they with regard to the *characterization* of the Vietnamese reform? Third, are Sachs and Woo correct in their *analogy* between Viet Nam and China? Fourth, how correct are Sachs and Woo with regard

to their overall *conclusion* about Big Bang vs. Gradualism debate, as viewed from the Vietnamese experience?

3. Are the facts correct?

We begin with the issue of facts. For that purpose, we first list the factual points that SW makes in the passage above. The passage gives the impression that:

- a) The gradualist reforms of Viet Nam began in 1985.
- b) The return from collectivist farming to family farming took place in 1989 and was part of 1989 Big Bang.
- c) The pre-1989 reforms were of no (positive) effect. As SW puts it, “inflation and import of rice accelerated” while “growth performance remained unchanged.”
- d) Pre-1989 reforms did not address “serious macro-economic balances.”

We argue that instead of the above, the following are true.

- a’) Gradual reforms in Viet Nam did not start in 1985. They date back to much earlier 1981, in some sense even to 1979.
- b’) The return from collectivist to family farming did not occur in 1989. It started in 1979 and was by and large complete much before 1989.
- c’) The gradual reforms preceding 1989 did have significant *positive* effects. In fact, without the positive benefits of these initial reforms it would not have been possible to adopt the 1989 steps.
- d’) The pre-1989 reforms were directed to problems of macro-economic imbalances too.

In order to validate these counter-assertions, we need to take a brief look at the history of Vietnamese reforms.

3.2 Pre-1989 reforms in Vietnamese agriculture

As in China, reforms in Viet Nam also started with the rural sector, and they began in 1979-81¹. Already in January 1981, Viet Nam introduced the ‘end product contract system’ in its agriculture. The actual process of transiting to this new system started even earlier. ‘Fence breaking’ was going on since 1979. As Arkadie and Mallon (2003, p. 78) inform us, Viet Nam introduced the ‘output contract system’ into the agricultural cooperatives as early as in 1979-80. Under this system the individual farmer had more rights within the cooperative and the cooperative had more rights vis-à-vis the state. The system replaced the compulsory deliveries by a ‘contract’ under which families were allocated plots of land and

¹ It is an interesting question why reforms started at that time. While other factors obviously played an important role, one cannot but see some influence of the Chinese reforms that began in 1978. For discussion of Chinese agricultural reforms, see Lin (1992).

were obliged to supply a certain amount of rice to the cooperative. The farmers were free to dispose the surplus in any way they wished. The system therefore provided incentive to increase production at the margin and to respond to markets. Thus in broad outlines the Vietnamese “output contract system” was similar to the “household responsibility system” introduced just a few years earlier in China.

These reforms, beginning in 1979-81, continued to deepen in the run up to the Sixth Congress of the Vietnamese Communist Party (VCP) held in 1986. Adoption of the *Doi Moi* (Renovation) program at the Sixth Congress allowed for consolidation of the changes already made and cleared the way for further reforms. For example, following the Congress, the National Assembly in its December 1987 session passed a Law on Land, which was enacted in 1988. The Law created long-term private land use rights (for agricultural purposes) and conferred these rights to rural families. Also, the Party Resolution No. 10, passed in April 1988, greatly enhanced the rights of rural families and reduced the legal authority of village cooperatives. This resolution was also important for accompanying price and trade reforms. It gave a greater role for individuals and private entrepreneurs in the agricultural sector. Under this Resolution, farmers were given long term rights to land. Also farmers could no longer be coerced into joining cooperatives. Finally, centrally planned targets were abolished, and farmers were allowed to sell their produce on the open market. (Arkadie and Mallon, p. 69)

The above shows that the transition of the Vietnamese agriculture from collective to individual family farming started early and was complete much before 1989. This was a very crucial step affecting the vast majority (almost 90 percent) of the population. It signified a decisive shift of economic power from the cooperatives to the households.

Were these pre-1989 rural/agricultural reforms of no positive effect, as Sachs and Woo seem to suggest? The facts show otherwise. Table 1 reports some statistics regarding the performance of the Vietnamese economy during different pertinent sub-periods. More detailed (year-to-year growth rates) are shown in the Appendix Table A1. We see from Table 1 that reforms introduced in 1981 boosted agricultural output. The average annual rate of growth of agricultural output increased sharply from 1.9 percent during 1976-80 to 5.3 percent during 1981-85. Even during the subsequent 1986-90 period, average annual agricultural growth rate was close to 4 percent, which is double the rate for 1976-80. In fact, the robust agricultural growth in 1989 of 6.9 percent proved to be very important in offsetting the contraction of industrial output (by 4.0 percent) experienced that year due to tight monetary policies introduced to control inflation. Thus it is factually incorrect to state that the pre-1989 reforms did not produce significant positive results.

3.2 Pre-1989 reforms in trade and crafts

The agricultural reforms initiated during 1979-81 by their very nature extended to the spheres of trade and crafts. As we noticed, the “end product contract system” allowed farming household to dispose their ‘surplus’ output in whatever way they wished. It is not difficult to see how this stimulated production and marketing of handicrafts by individual rural households. As the Say’s Law states, “Supply creates its own demand.” Thus a direct consequence of the agricultural reforms was a large expansion of trade and market.

Table 1: Average annual indicators of growth and inflation (per cent)

<i>Period</i>	<i>Inflation (CPI) (%)</i>	<i>GDP growth (%)</i>	<i>Agri- culture growth (%)</i>	<i>Services growth rate (%)</i>	<i>Industry growth rate (%)</i>
<i>Col. No.</i>	(1)	(2)	(3)	(4)	(5)
<i>1976-80</i>	21.2	0.4	1.9	-0.1	3.3
<i>1981-85</i>	74.2	6.4	5.3	4.7	9.3
<i>1986-90</i>	298.7	3.9	3.7	8.7	4.7
<i>1991-95</i>	23.5	8.2	4.3	9.5	12.6
<i>1996-01</i>	3.4	7.0	3.9	7.3	12.2

Also, the government took proactive, complementary measures to facilitate the process. For example, in early 1987 many checkpoints established earlier to restrict domestic trade were removed, enabling private markets for agricultural goods develop rapidly. Many administrative restrictions on private trade were also lifted. Thus reforms in the area of trade were a direct corollary of the agricultural reforms. The process of dissolution of production cooperatives and return to household-farming went hand in hand with liberalization of trade. Further expansion in trade resulted from the reforms of the industrial sector that we discuss below.

These reforms in the area of trade and crafts had significant positive impact too, as can be seen in the service sector growth rates reported in Table 1. We see that the average growth rate of the service sector (that includes trade) rebounded from a negative 0.1 percent during 1976-80 to 4.7 percent during 1981-85, and increased further to 8.7 percent during 1986-90.

3.3 Pre-1989 reforms in industry

Pre-1989 reforms encompassed industry too. Industrial reforms have two main components. One is the reform of state owned enterprises (SOE), and other is the reform related to the development and functioning of non-state owned enterprises (NSE). Of course, there is considerable interconnection and overlap between the two.

Pre 1989 reforms in the management of SOEs

Already in January 1981, the Vietnamese government issued a decision providing some autonomy to state enterprises by introducing the 'three plan' system. According to this system, enterprises had the right to operate outside the plan after they have met the centrally planned targets. Enterprises were allowed to retain up to 85 percent of the profits

made from outside-plan production, and to use these retained profits for paying bonuses to workers. Another decision issued around this time allowed enterprises to link managerial salary payments to output. In order to enable enterprises to engage in beyond-plan production activities, the system of ‘full allocation and full delivery,’ whereby the state provided all inputs and recovered all profits, was substituted by a system whereby enterprises could get additional resources from banks.

Just as was the case with rural reforms, *Doi Moi* adopted at the Sixth VCP Congress helped consolidate these changes and paved the way for further reforms. The Decree 217 promulgated in late 1987 was an important step in this regard. It set forth a broad reform program aimed at putting SOEs on a commercial footing, with increased autonomy and financial responsibility. This Decree and subsequent implementing regulations clarified the relationship between the state and the enterprises. It explained that while the state retained the ownership of SOEs on behalf of the entire people, enterprise assets were placed under the direct management and utilization by the workers (including the managers) of the enterprises. The Decree 217 introduced a profit based accounting system, according to which profits were to be based on actual costs and revenues and not on plan directives. It replaced the physical output targets with profit targets for most SOEs, and increased the autonomy for enterprise managers in personnel and financial decision making. It abolished budgetary support as well as the state supply of inputs, and restrictions on selling in the open market. The Decree also curtailed subsidized lending from state owned commercial banks and instead required such lending to be conducted on a commercial basis.²

The above changes also implied altogether different type of relationships among SOEs and among business entities in general. These relationships were now on the basis of economic contracts instead of implementation of directives issued from above. The government established economic arbitration offices to assist in enforcing contracts. As mentioned above, state enterprises now had to purchase inputs directly from suppliers, instead of getting these supplied by the state. State enterprises also could sell their output on the market, except for a few products that had to be sold at government mandated prices. All these changes created a fundamentally different environment for SOEs to operate and led to significant improvement in their performance, as we shall see.

Reforms with regard to non-state owned enterprises (NSE)

Urban industrial reforms of the pre-1989 years were not limited to SOEs. Another important dimension along which these reforms proceeded lay in the development of the non-state owned enterprises (NSE). First of all, there was a basic change in the understanding of the role of government in the industrialization process. There was already the recognition that the role of the government was more in creating the conditions and “building the necessary premises” for industrialization than in carrying out industrialization itself. Second, in line with the changed attitude, the government took measures favorable

² The Decree also allowed most SOEs, except those with high levels of public investment, to retain depreciation charges. “Follow up regulations helped to define an economic role for state enterprises independent of the broader functions of the government, to clarify corporate governance provisions and to permit state enterprises to enter joint ventures and form economic cooperation with other entities, including private enterprises and foreign investors.” (Arkadie and Mallon, p. 125)

for setting up of enterprises under cooperative and individual ownership. This led to a large increase in the number of NSEs and the volume of the output produced by them.

Positive results of pre-1989 industrial reforms

The statistics presented in Table show that the industrial reforms conducted along both lines above had significant impact. The average industrial growth rate increased sharply from a meager 3.3 percent during 1976-80 to 9.3 percent during 1981-85. Though this growth rate decreased to 4.7 percent during 1986-90 because of the contractionary policies of the period, even this rate was higher than what prevailed during the pre-reform years of 1976-80.

3.4 Reforms in the external sector:

The pre-1989 reforms spread to the external sector too. First of all, there was a significant relaxation of restrictions about who can engage in external trade. State owned enterprises were now allowed to engage in international trade on their own. At the beginning, only large scale enterprises were allowed to do so, and they were permitted to retain only a portion of foreign exchange earnings. However, soon further reforms ensued with a goal to boost exports. These reforms extended the right to engage in external trade to a wider set of state owned enterprises and to retain a larger portion of their earnings. In 1988 a Foreign Investment Law was passed by the National Assembly and was enacted. Earlier, we noted that state owned enterprises were allowed to set up joint ventures with foreign firms. Together these measures made it easier for foreign capital to flow into Viet Nam.

3.5 Macroeconomic reforms

Contrary to assertions by SW, some of the pre-1989 reforms were directed to addressing macro-economic balances. Among these were reform of prices and the exchange rate. In addition, there were reforms in the area of administration and institution building. Price liberalization reforms also started much earlier. As early as October 1981, steps were taken to move official prices closer to market prices and to decentralize trade to local enterprises. In mid-1987 substantial price reforms were implemented raising the official price of most consumer goods close to market prices. The scope of rationing was drastically reduced. At about the same time, Viet Nam implemented substantial devaluation of its currency, *Dong*. The government also took steps to streamline the administration by reducing the number of line ministries, state committees, and other central government agencies, and by rationalizing their structure.

3.6 Conclusion regarding facts

We thus see that Sachs and Woo are quite off the mark with regard to facts. First, reforms started much earlier than 1985. Second, they are completely wrong to suggest that the conversion of collective farms into family farms with long-term leases was an event of

1989. This conversion started in 1979 and was completed much before 1989. Third, Sachs and Woo are wrong to suggest that pre-1989 reforms did not yield results. Much to the contrary, these reforms proved very beneficial. They brought about a marked improvement in the economy, and the improvement was across the board, encompassing agriculture, industry, and service sectors. In fact it is the positive results of these prior reforms that made the 1989 steps possible. Other researchers have also voiced their dissent to the excessive importance given to 1989 measure and the accompanying neglect of the importance of the pre-1989 reforms. Here is what Van Arkadie and Mallon had to say in this regard:

“While some commentators focus on the reforms implemented from 1989 onwards, important micro-level reforms were introduced from 1986 that resulted in a strong supply response that greatly improved the environment for the successful implementation of the subsequent macro level reforms.” (Arkadie and Mallon, p. 69)

4. Is the characterization correct?

Next we consider whether it is correct to characterize the 1989 measures as an “European-style Big Bang.” According to SW, the Vietnamese Big Bang of 1989 consisted of the following four elements: (a) across-the-board price liberalization; (b) devaluation by 450 percent and unification of the exchange market; (c) tight credit policy; (d) return of the collective farms to family farms with long-term lease.

We have already seen in the previous section that inclusion of item (d) above is not correct. This leaves us with (a)-(c). In considering these, we may first note that all these concern changes on the monetary side, so to speak, and none entails changes in the nature of ownership of productive assets. Yet it is changes of the latter type that are usually considered to be the heart of the transition process. We will come back to this issue later. Meanwhile, let us accept Sachs and Woo’s list of changes and see whether they may be characterized as a Big Bang.

The notion of Big Bang usually has two connotations: First, it has to be Big, and second, it has to be the *beginning* of a fundamentally new process. Let’s examine whether the 1989 changes satisfy these two requirements.

4.1 The year 1989: neither the beginning nor the end

We have already seen that 1989 was not the beginning of the Vietnamese reform process in general. They were not even the beginning of the narrower process of price reform too. As we have noted above, there were price reforms in mid 1987, when official price of most non-essential consumer goods were raised close to market prices, the scope of rationing was reduced, and *Dong* was devalued. So the price and exchange rate reforms of 1989 were more of a *continuation* of previous reforms in these areas rather than something entirely new.

The price changes of 1989 were also not the end of the process of ‘getting the prices right.’ As Arkadie and Mallon note, the price reforms were “neither instantaneous nor a

smooth process.” There were two sources of worry. The first was on the side of enterprises, which could prematurely collapse under the impact of the price shock. The second was on the side of consumers, who would be fully exposed to the vagaries of the open market. The government therefore first took steps to put “a more appropriate machinery of fiscal and monetary policy” in place, and only then pull the brake on the raging inflation.

It needs to be realized that all prices in Viet Nam used to be controlled, administered prices. Viet Nam therefore had no prior experience in influencing free market prices, nor did it have the institutions and policy instruments necessary to do so. In fact, absence of such institutions and policy instruments was one of the important reasons for the inflation in the years immediately preceding 1989.

Also, price reforms were not over by 1989. They required to be followed up with other reforms. During 1989-92 more follow up steps had to be taken in order to keep the right alignment of prices. Thus, the price changes of 1989 were by no means the beginning of a new process. They rather represent a correction that needed to be made in the area of prices for further success of the on-going reform process.

4.2 The 1989 reforms: were they big?

It may be argued that while the price changes of 1989 were not the beginning of a process, and Viet Nam had already implemented a series of price changes before, they were of a different *order of magnitude* and hence deserve to be characterized as a Big Bang.

Of course, 1989 price reforms were apparently radical, and they played an important role in the progression of Vietnamese reforms. Despite earlier price reforms, prior to 1989 the economy remained ‘segmented between production within and outside the central plan.’ It was to an extent a dual track economy. The 1989 measures unified the markets, brought the official exchange close to the market rate, yielded positive real interest rates, and helped balance the budget by reducing the burden of the subsidies. It is on the basis of the above, that Sachs and Woo claim that Viet Nam implemented a Big Bang in 1989.

The question however is whether these price changes were that radical *in essence*, and whether these price changes constitute the defining moment in Vietnamese reforms so as to be characterized as the Big Bang. As we noted, revision of prices is only a part of the reform process, which is a much more comprehensive, multidimensional phenomenon. Prices represent the nominal side of the process. The changes on the real side were progressing from before. As we saw from Table 1, GDP, agricultural output, industrial output, service sector output, -- all experienced a rebound as a result of the reforms initiated in 1981. However, there was an accompanying process of inflation. In a sense, this inflation was a natural outcome of the reform itself. Under the previous system of controlled prices, such inflation would be repressed. The reforms opened up the space for it to get revealed. The reforms led to the formation of a market, where both surplus agricultural output and the surplus industrial output started to be exchanged. The government initially did not have the policy instruments to influence the market prices. At the end, it decided to accept the market determined prices. What the 1989 reforms did was to unify these two sets of prices, by giving up altogether the effort to plan prices.

So though the 1989 price reforms looked dramatic from the outside, they were not so dramatic from the inside. Most of rural sector, which had been operating outside of the plan

from much before, were already permeated thoroughly by the market prices. That is why the price changes of 1989 did not have any adverse effect on the agriculture sector. As we can see from Table A1, the agriculture sector witnessed a phenomenal growth of 6.77 percent during 1989. Similarly, the service sector also maintained a very robust growth of 7.61 percent in 1989. For these sectors, which constitute the vast part of the Vietnamese economy, price changes of 1989 were more or less formalization of what was already there in reality.

Of course the price changes and the accompanying contractionary/deflationary monetary policies impacted many SOEs. Those SOEs which were dependent on the plan prices, either on the input side or the output side, or both, for their profitability had to suffer. They now had to rely almost completely on the market prices. As a result of these adjustment difficulties of the industrial enterprises to the new price and monetary policy situation, the industrial output experienced some contraction (by 2.81 percent) in 1989. However, the Vietnamese GDP in 1989 still posted a respectable growth rate of 4.69 percent, because of the robust growth in the agriculture and service sectors, as noted above. This again goes to show the importance of the pre-1989 reforms in creating the conditions and in offering the cushion to absorb the impact of price changes and tightening of credit in 1989.

4.3 The 1989 measures: not a Big Bang

It is therefore a mischaracterization to call 1989 reforms a Big Bang. Such a characterization is based on a rather superficial understanding of the Vietnamese reform process. The 1989 reforms can be seen to a large extent as a formalization of the changes that had already taken place in reality. The new prices were not imposed from above; they amounted as recognition of what already existed in reality. The same is true with the exchange rate. That is why these apparently big price changes did not cause too much of dislocations for most parts of the economy.

More importantly, 1989 measures did not start anything new. They represented yet another step in the ongoing Vietnamese reform process. Sachs and Woo are wrong to disparage the pre-1989 reform efforts and the results these reforms produced. Yes, the pre-1989 reforms were in many cases partial. For example, the right to land given to the farming households was for a limited period (not perpetual) and did not include the right to sell (i.e. the right was not transferable). However, the actual actors did not seem to mind these restrictions too much and instead tried to make the best use of whatever opportunities were opened up. The robust growth in agricultural output provides the evidence. Also robust growth of the service (including trade) sector showed that the actors had enough confidence in the continuation of the reform process forward. The existing institutions might have been inadequate and flawed, but the actual processes were moving forward despite these limitations.

In addition to the output enhancing effects, the pre-1989 reforms provided important learning and unlearning mechanisms that were necessary for planning and executing the more decisive switch to market. Pre-1989 reforms created an alternative market in the economy, and the prices formed in this market provided the necessary benchmark for hinging later reforms. As mentioned earlier, without such a market already in place and market established prices already available, the price reforms of 1989 would not have been

possible.³ The characterization of 1989 measures as the Big Bang, implying that these measures initiated Vietnamese reforms, is therefore a mischaracterization. Sachs and Woo over-interpret the 1989 measures by calling them a Big Bang.

4.4 Doi Moi of 1986: the real turning point

Viet Nam therefore did not adopt the Big Bang approach, as this approach is commonly understood. Viet Nam instead basically followed a Gradual Approach. However, if someone wishes to identify a decisive point in Viet Nam's reform process, it is probably provided by the VCP Sixth Congress in 1986 that adopted the *Doi Moi* program.

Even though many reforms got under way from 1981 (or even 1979), in some respects these reforms had a 'tentative' nature until 1986, because it was still not clear whether the VCP and the government as whole have committed themselves to a switch to the market system, and how far they were ready to go in this new direction. The reforms during pre-1986 years were hesitant steps towards breaking away from the past. VCP was not yet fully sure which direction to take: whether to hold on and improve the central planning system or to move to the market mechanism. The fact that the reforms began under pressure from below showed that the entire Party was not yet convinced about the appropriateness of the reforms.

In fact, Viet Nam witnessed contradictory processes during the initial years of reform. There was a clear paradox in the situation. After the victory and political unification of the country in 1975, Viet Nam went through an interim three-year (1978-80) plan. As that plan period was coming to an end, Viet Nam drew up its first Five Year Plan for 1981-85. This Plan was supposed to lay the foundations for "a more complete socialist transformation," and it set out to construct "a strict central planning system with state allocations of capital and inputs and even labor being allocated centrally." Similarly, the Second Party Plenum of June 1977 took the decision "to accelerate the development of state farms throughout the country and to implement agricultural collectivization in the south." Even as late as 1985, the Second Five Year Plan drawn up for 1986-90 continued to emphasize the leading role of the state sectors, the need to broaden the collective economy and to restrict the negative aspects of the private economic sectors." (See Arkadie and Mallon, pp. 45-48)

There was therefore a contradiction between "high official thinking" expressed in these Plan documents and what was actually done (or taking place) at the ground level. As we noted, events overtook the plans and planned directions. Instead of further collectivization, there started out a process of de-collectivization. Instead of a stricter central planning system, there started a process of moving away from plan. There was thus a clear contradiction between official intentions and the "ground reality."

It is an interesting question as to why this contraction arose and why the real Viet Nam moved away from the theoretical Viet Nam described in high official thinking. This paper

³ As Arkadie and Mallon note: "The strong open inflation of the late 1980s facilitated the shift from official to market prices, as official prices became increasingly irrelevant even before they were formally abolished. There was increased competition as voluntary transactions between enterprises replaced central planning and state orders. A fundamental change took place in the entire economic environment, with profound effects on the behavior of economic agents. The former sellers' market was replaced with the shift toward market-clearing prices." (p. 83)

is not the place to pursue a full answer to this question. However, the following few observations may be made. First, Viet Nam could not avoid the inefficiencies resulting from collectivization imposed on agriculture that was still characterized by very primitive level of productive forces. Second, Viet Nam could not avoid the inefficiencies arising from an industrial policy that emphasized heavy industry at the cost of light industries, where Viet Nam's comparative advantage lay. Third, efficient management of the state owned enterprises continued to pose problems despite the attempt to overcome them through formation of unions.⁴ Fourth, exodus of the Chinese population following the unification in 1975 added to the economic problems. Fifth, military conflicts with Kampuchea and China in 1978 made things worse. Sixth, Viet Nam could not avoid the impact of the reforms already introduced in China since 1978. Finally, Viet Nam could not avoid the influence of successful market economies of the neighboring East Asian countries.

As a result of these influences, the realities on the ground were moving in a very different direction than that envisaged in Viet Nam's First Five Year Plan. There were spontaneous moves towards production and trade outside the official channels (fence breaking). Thus the reforms initiated in 1981 were to a great extent foisted on the planners from below. There was a disjuncture between what the Party thought of doing and what the ground level reality demanded, and at the end the Party had to concede to the demand of the reality by adopting *Doi Moi* in 1986. From then onwards the move towards markets became official.

However, just as things do not jump in practice, they do not jump in thinking either. Although the decision for restructuring was taken at the Sixth Congress, there was a gradual process in VCP thinking that preceded this decision. The Party did initiate a critical reevaluation of the economic strategy early on, as was reflected by the discussion of the 1979 (August) Sixth Plenum of the Fourth Party Congress. However, the First Five Year Plan showed that the debate has not then reached a conclusion, and Party was still not sure about the direction to take. This found manifestation in some of the policy reversals that took place in 1983 in order to contain 'anarchy' in the market. Similarly, as we already noticed, the Second Five Year Plan for 1986-90, formulated prior to the adoption of *Doi Moi*, continued to emphasize the leading role of the state sectors, the need to broaden the collective economy and to restrict the negative aspects of the private economic sectors. This uncertainty found reflection in the often tortuous language that was used to describe the ongoing processes: for example, instead of 'market economy,' official documents would use such expressions as 'multi-sector commodity producing economy.' This uncertainty and vacillation continued right up to 1986.

By 1986, however, the VCP was ready for a strategic switch from central planning to the market system. Two sets of circumstances led to this development. The first is the encouraging results from reforms that were already implemented. The Vietnamese economy witnessed a significant turn around as a result of these reforms. Second, alongside

⁴ Partly as a result of these inefficiencies, "economic output declined in 1977 and 1978 and actually declined in 1979 and 1980. There was particularly pronounced decline in output from state-owned enterprises, with production declining by an average 2 percent per year between 1977 and 1980. By the late 1970s, Viet Nam was facing a 'major economic crisis, with acute shortages of food, basic consumer goods, and inputs to agriculture and industry, and a growing external debt.'" (Arkadie and Mallon, p. 47)

the positive results these reforms have also led to new problems, particularly the problem of inflation. Faced with this problem, the government had two routes to take. One was to put a brake on the reforms and return back to central planning and administered prices. However, time and experience have made that route unacceptable. The other route was to accept the market, and make the best use of market mechanisms to solve the problem. The issue of choosing between plan and market could not be postponed any longer. The moment came, and the Party had to make a commitment. The Sixth VCP Congress made the choice in favor of reforms by adopting *Doi Moi*. The Party decided to switch from a “bureaucratic centralized management based on subsidies” to a “multi-sector, market-oriented economy with private sector competing with the state sector in the non-strategic sectors.” A corollary of this switch was that government could no longer think of relying on command and administrative orders to fix prices. Rather it had to think of using market based levers (monetary and fiscal policies) in order to address the inflation and other problems. It is for these reasons that the Sixth VCP Congress can be termed as a decisive event in Viet Nam’s gradual transition from central planning to market. It is in this sense that 1986 may be regarded as the real turning point.

However, even though the Sixth Congress can be viewed as a turning point, we saw that this decisive departure from past thinking in turn was a culmination of soul searching for a long period involving internal debates about the causes of the failure of the old system and the potential that the new ways of arranging economic life have shown in bringing about tangible improvements in the material living standard of the people. Similarly, things did not end with the Sixth Congress. The Sixth Congress only gave the strategic direction. The details were worked out at subsequent plenums.

5. Is the analogy correct?

Next we examine whether Sachs and Woo’s analogy with China is correct. Recalling the passage quoted at the beginning of this paper, we note that SW invokes Viet Nam in order to argue for a “more rapid liberalization” of the Chinese economy. What does that entail? The list that SW provides include: (a) (imposition) of harder budget constraint on state enterprises, and (b) faster unification of product markets and the market for foreign exchange. Let’s consider each of the items in turn.

5.1 Imposition of harder budget constraints

First of all, we note that it is incongruous to cite Viet Nam’s 1989 measures to argue for “harder budget constraint” for SOEs in China, because as we observed earlier, 1989 reforms of Viet Nam were focused more on price reforms, even though tightening of credit did imply some hardening of the budget constraint.

However, even if this interpretation is accepted, it may be noted that so far as SOE reforms are concerned, Viet Nam is moving in a much more cautious and slower (Gradual) manner than China. We have already noticed in Section-2 some basic facts regarding SOE reforms in Viet Nam. We noticed that Vietnamese SOE reforms started back in 1981, and that as a result of pre-1989 reforms, the performance of SOEs in Viet Nam improved. Viet

Nam has not taken any rash step regarding her SOEs. In fact, so far as SOE reforms are concerned, by 1989 China was as ahead as Viet Nam, if not gone further, in hardening SOE budget constraints. Hence, so far as SOE reforms are concerned, Viet Nam cannot be an example of Big Bang for China. To the contrary, Viet Nam is moving even more slowly and cautiously than China with regard to SOEs.⁵

5.2 Unification of product and foreign exchange markets

Can Viet Nam be a Big Bang example for China with regard to unification of product and foreign exchange markets? Here at least we have a more valid comparison, because Viet Nam's 1989 measures were indeed directed towards unification of various prices.

We already noticed that it was not accurate to present the unification of the product markets and foreign exchange markets in Vietnam as something that happened overnight in 1989. It was rather a long drawn process, in which measures of 1989 were a major step, followed up by many subsequent measures and steps. Thus if 1981 is taken to be the beginning of the process, the unification required more than a decade to be achieved.

How does this process compare with the experience of China? This requires us to delve a little bit into the history of Chinese reform. Sachs and Woo themselves dwell at length on the dual track features of the Chinese reform process. They note that the dual track approach "pervades almost every aspect of policy-making: sectoral reform, price deregulation, enterprise restructuring, regional development, trade promotion, foreign exchange management, central-local fiscal arrangements and domestic currency issuance." (Sachs and Woo 2000, p. 9) They offer detailed discussion of some of the dimensions of this dual track policy. However, unfortunately they do not provide enough information about the dual track with regard to prices.⁶

For more information in this regard we may turn to Lau, Qian, and Roland (1997, 2000). These authors distinguish two types of market liberalization. The first is "Limited Market Liberalization (LML)," which they define as the situation when "market resales of plan-allocated goods and market purchases by planned suppliers for fulfilling plan-mandated delivery quotas are not permitted." The second is the "Full Market Liberalization (FML)," which refers to the situation when "market resales and market purchases for redelivery are all allowed by a planned supplier or a rationed user, as long as its obligations under the plan are all fulfilled." (1997, p. 1) Lian, Qian, and Roland think that the Chinese product market liberalization was close to being FML, because resale, sub-contracting, and purchases for redelivery were not prohibited. They further note that such FML began with the agricultural sector, whereby farms were allowed to purchase grain and other output from the market to be redelivered to the state in order to fulfill their quota since 1979. The authors' Table 1 provides very useful information in this regard. It shows that by 1988, the volume (43.8 million ton) of state procurement of grain at market price has almost caught up with the volume (50.5 million ton) of state procurement of grain at plan price. Their Table 2 shows

⁵ For discussion on Chinese SOE reform, see Groves, Hong, McMillan, and Naughton (1994).

⁶ They however inform that in January 1994, China ended its "unusual dual currency system," and by 1996 yuan was effectively convertible for current account purposes. SW also informs that in 1996 China also ends dual stock market.

that by 1988 transactions at plan prices comprised 24.0 percent of the total output value of agricultural goods, transactions at market prices comprised 76.0 percent. Thus product markets of the agriculture sector were quite integrated in China by 1988, i.e. even before the 1989 measures of Viet Nam.

Similarly, integration of industrial product markets also proceeded in China at a rather brisk pace. Lau, Qian, and Roland (2000) inform that already in 1984, the government allowed market prices of all industrial goods to deviate from planned prices within a range of 20 percent of the latter. In 1985 the latter restriction was removed. (Wu and Zhao 1987) The share of transactions carried out at plan prices in the overall transaction volume decreased from 100 percent before the reform to 64 percent in 1985 and further to 45 percent in 1990. (China Reform and Development Report 1992-93, p. 54 and Xu 1998, p. 292) This shows that market prices were already reigning over more than half of even the industrial output in China by 1989. The brisk pace at which open market prices of industrial goods gained importance in China can be seen from the example of coal and steel, the two of the most tightly controlled items under central planning. The share of planned allocation for these two important commodities decreased to 42 and 30 percent, respectively, by 1990. Based on their estimates, Lau, Qian, and Roland (2000) report further that the share of plan prices in total retail sales declined from 97 percent in 1978 to only 30 percent in 1990.

The study by Lau, Qian, and Roland therefore shows that unification of product markets in China proceeded pretty fast, and there is probably not much that China could borrow in this regard from Viet Nam. The same conclusion is reached by Lin and Cai (1996). They note that by 1988 only 30 percent of retail sales was conducted using plan prices, and even the SOEs obtained 60 percent of their inputs and sold 60 percent of their output at market prices. Thus we see that the product markets in China were integrated quite rapidly.

Lin and Cai (1996) show further that the foreign exchange markets in China were integrated rapidly too. They note that a dual exchange rate system was introduced in 1981. After 1985, the yuan was gradually devalued. Also, the proportion of foreign exchange that exporting enterprises could retain was increased, and these enterprises were allowed to swap their exchange entitlements with other enterprises through the Bank of China at rates that were higher than the official rate. Also in 1985 a “foreign exchange adjustment center” was established in Shenzhen in which enterprises could trade foreign exchanges at negotiated rates. By late 1980s, most provinces of China had such centers, and more than 80 percent of foreign exchange earnings were swapped through such centers. Thus de-facto a market exchange rate could emerge and prevail.

Thus we see that so far as unification of product and foreign exchange markets are concerned, the analogy that Sachs and Woo draw between Viet Nam and China is permissible, however that analogy does not allow drawing conclusion in the direction that they want. China moved towards unification of product markets and foreign exchange markets at a fairly brisk pace. In fact it is Viet Nam that was proceeding rather slowly in this regard and hence required the large correction 1989. In contrast, China proceeded at a brisk pace from the very beginning, and hence did not need such large correction at a particular point of time.

Overall, we see that Sachs and Woo’s analogy is in part not valid and in part not of the right direction. First, with regard to hardening of budget constraint of Chinese SOEs, the analogy is not quite valid, because Viet Nam’s 1989 measures were focused more on prices.

Second, while there may be an analogy with regard to the unification of product and foreign exchange markets, the import of the analogy runs in the opposite direction to what SW implies. China had been proceeding at a brisk pace in unifying these markets and hence did not require a large move at a particular point of time like that of Viet Nam's 1989 measure. In that sense, Viet Nam's 1989 measures did not have much lesson for China.

6. Are the conclusions correct?

6.1 Broader conclusions that Sachs and Woo want to reach

Finally we come to the issue of the validity of the broader conclusions that Sachs and Woo want to reach using their allusion to Viet Nam. The list of such broader conclusions of their paper is as follows:

“(H.1) China's rapid growth has come *despite gradualism*,⁷ in areas of the economy characterized by radical rather than gradual reforms. China's ability to grow rapidly despite gradual reforms reflects China's particular structure;

(H.2) China's gradualist strategy is not transferable to Eastern Europe and the former Soviet Union (hereafter EEFSU), because of fundamental differences in economic structure;

(H.3) China's experiments in non-capitalist institutions are proving to be unsuccessful in (a) agriculture; (b) rural industry; (c) state industry, and are therefore in need of further reform toward *more typical capitalist* institutions;

(H.4) China is gradually harmonizing its economic institutions with those of East Asian market economies.” (Sachs and Woo 2000, pp. 4-5)

The allusion to Viet Nam pertains directly to (H.1). However, it is not difficult to see that the conclusions listed above are interrelated, and the conclusion (H1) helps reach conclusion (H2) and (H3), and to some extent (H2) too. Hence the allusion to Viet Nam serves as an important link in the causality chain that Sachs and Woo strive to build.

The conclusion (H1) is a paraphrase of the claim noted earlier that China would have grown faster had it went for Big Bang. At another place of the paper, the authors make their point very blunt stating, “*Since reforms unleashed growth, even more reform would have unleashed faster growth.*” (Sachs and Woo 2000, p. 13) Their allusion to Viet Nam is to support this claim. So the question is: Does Vietnam's experience proves that Big Bang would have been a better strategy for China than Gradualism?

6.2 What is a Big Bang? Asking the Question Again

⁷ They also repeatedly emphasize that “favorable outcomes have emerged (in China --ni) *not because of gradualism, but despite gradualism.*” (Sachs and Woo 2000, p. 3, italics --ni)

Earlier we have seen Sachs and Woo providing the list of measures taken by Viet Nam in 1989 that comprised, according to them, an European Style Big Bang. However, at a different place in the paper, they provide a more general definition of Big Bang. This is how that definition runs:

“In our usage, Big Bang reforms include: rapid and comprehensive price and trade liberalization, macroeconomic stabilization, alignment of the official exchange rate to the market rate, ending legal discrimination against all types of non-state enterprises, and an early commitment to mass privatization of SOEs, recognizing that actual privatization will take several years in practice.” (Sachs and Woo 1997, p. 5)⁸

Many things may be said with regard to this definition and the accompanying statements that Sachs and Woo make. First of all, the definition is disputable. While the policy package usually named Big Bang has many components, most of the Big Bang vs. Gradualism debate has centered on the privatization issue. It is the whole scale and rapid privatization of productive assets that has been generally regarded as the hall mark of the so called Shock Therapy or Big Bang. It is therefore interesting that in their current definition of Big Bang, Sachs and Woo include only “an early commitment” to mass privatization, leaving *actual* privatization out.

A notable corollary of this de-emphasis of privatization in Big Bang’s definition is its rendering of Russia as a non-Big Bang country.⁹ The authors argue that though Russia implemented a rapid mass privatization program in 1993 (in addition to the rapid price liberalization in 1992), she still did not qualify to be a Big Bang country because she lacked

⁸ They further add that “The avowed long-term aim of big-bang reforms is to create a ‘normal’ capitalist economy, based on private ownership, commercial law, and substantially open trade. In the case of Eastern Europe, normalcy is typically defined as the economic institutions of the mixed capitalist economies of Western Europe. In the philosophical approach of ‘big bang’ advocates, *the key point is that little experimentation is needed or desired. The long-run goals of institutional change are clear, and are found in the economic models of existing market-based economies.*” According to them, “By these standards, the only transition countries to have actually implemented a big-bang reform are the Czech and Slovak Republics, Estonia, Poland, Slovenia, and arguable Hungary. ... These, then, are appropriate counterparts for comparing ‘gradualism’ in China with ‘big bang’ in Eastern Europe. Russia does not offer an appropriate comparison: the unending struggle in Russia between reformers and conservatives has produced the confusing combination of big-bang *rhetoric* and mostly *gradualist* practice: rapid price liberalization in 1992 and rapid mass privatization of state industry in 1993, but vacillating macroeconomic policies and the absence of extensive enterprise and financial reforms as late as 1996.” (Sachs and Woo 1997, p. 5-6) In Sachs and Woo (2000, p. 6), the authors modify the discussion at this point to some extent. However, in defining the Big Bang approach, they again mention that “An immediate commitment to mass privatization at the start of the reform is desirable, but immediate privatization that results in *klepto-klatura* privatization is not.”

⁹ As the authors explain, “By these standards, the only transition countries to have actually implemented a big-bang reform are the Czech and Slovak Republics, Estonia, Poland, Slovenia, and arguable Hungary. ... These, then, are appropriate counterparts for comparing ‘gradualism’ in China with ‘big bang’ in Eastern Europe. Russia does not offer an appropriate comparison: the unending struggle in Russia between reformers and conservatives has produced the confusing combination of big-bang *rhetoric* and mostly *gradualist* practice: rapid price liberalization in 1992 and rapid mass privatization of state industry in 1993, but vacillating macroeconomic policies and the absence of extensive enterprise and financial reforms as late as 1996.” (Sachs and Woo 1997, p. 5-6)

in other areas of reform, such as ‘macroeconomic policies,’ and ‘enterprise and financial reforms.’

In the literature, however, Russia figures as the foremost example of application of the Big Bang approach, precisely because of the epochal (and egregious) privatization of state assets carried out in that country in the name of reform. Sachs himself served as the adviser to the Yeltsin government that carried out this privatization, so that he had a role not only in offering the theory for the step¹⁰ but also in overseeing the actual process.

Given this history, Sachs and Woo’s definition of Big Bang may appear to be self-serving, crafted to allow them to argue that Russia is not a Big Bang country, now that it has proved to be a failure. To claim that it is not Russia, but Czech and Slovak Republics, Estonia, Slovenia, etc. are the true cases of Big Bang, appears as an after-fact proposition, based on a definition of Big Bang, the elements of which seemed to have been cherry picked to suit the purpose. The definition appears to be meant to absolve the architects of the Russian Big Bang of the responsibility of its failure.

5.3 Revisiting Viet Nam in the Light of Sachs’ Definition of Big Bang

Privatization of SOEs

Suppose we do not want to get into the issue of the appropriate definition of Big Bang here.¹¹ Let’s instead accept Sachs’ definition that mere “commitment to privatization” is enough for Big Bang, as long as other requirements are satisfied. We now ask whether the Viet Nam experience allows Sachs and Woo to argue for Big Bang for China.

It is interesting that among all formerly centrally planned economies now undergoing reform, Viet Nam has proved to be the most reluctant to embrace privatization. Viet Nam is nowhere near to “an early commitment to mass privatization” of her SOEs. Instead, Viet Nam still thinks of its state sector to be the “leading sector.” Instead of mass privatization, Viet Nam is making an all out effort to reform the management in a way that SOEs can become efficient. The main thrust of this reform process is on improving the performance of SOEs through commercialization, corporatization, re-registration, restructuring, development of enterprise groupings (state corporations), creation of appropriate legal framework for SOE operation, etc. The reform process does include leasing, divestiture, and privatization of some enterprises through equitization. However, the latter are still not the dominant component of SOE reform in Viet Nam. Thus, so far as privatization of SOEs is concerned, Viet Nam is moving in a more conservative way than China, not to speak of Russia.¹² Viet Nam is nowhere to committing to a mass scale privatization.

Viet Nam indeed has some reason for not embracing mass scale privatization yet. Among the transitional countries, Viet Nam is unique in the sense that the share of SOEs in the industrial GDP has *increased* during the reforms. This shows that under altered business conditions (competition, hard budget constraint, etc.) many SOEs of Viet Nam have been

¹⁰ At that time, Sachs justified the privatization campaign referring to the maxim that “you cannot cross a precipice with two jumps!”

¹¹ The issue of what constitutes Big Bang or Shock Therapy is a much larger issue. It goes much beyond the scope of this paper, and hence we do not attempt to engage in a full blown discussion of this issue here.

¹² For more comparison of different reform approaches, see Li (1999) and Ronald and Verdier (1999).

able to improve their performance.¹³ Therefore, apart from ideological reasons, Viet Nam has practical reasons not to commit to wholesale privatization of SOEs yet.

Thus, first of all, it is quite incongruous of Sachs and Woo to call 1989 measures of Viet Nam as a Big Bang, when these measures had nothing to do with privatization. Second, even going by the overall experience of Vietnamese reforms, there is no scope of putting forward Viet Nam as an example to China, so far as commitment to mass scale privatization and/or carrying out such a privatization is concerned.¹⁴ We thus see that even going by Sachs's controversial, self-serving definition of Big Bang, Viet Nam cannot be portrayed as an example of Big Bang. Viet Nam cannot be used to preach Big Bang to China. The logic of Sachs and Woo's argumentation breaks down.

What Remains of Big Bang?

The list of other requirements of Big Bang, as defined by Sachs and Woo, includes price liberalization, trade liberalization, foreign exchange liberalization, macroeconomic stabilization, and end of discrimination against NSEs. We have already dealt with most of these issues in our discussion in previous sections. We saw that with regard to price liberalization and foreign exchange liberalization, China proceeded at a brisk pace from the beginning of the reform, so that it did not require a large correction such as the one we saw in Viet Nam in 1989. So far as end of discrimination against NSEs is concerned, again China is probably ahead of Viet Nam, not behind. Thus, with regard to other requirements of Big Bang too, Viet Nam's experience does not lead to the suggestion that China should have done better if followed the Big Bang approach instead of the Gradual Approach.

In this regard, we may note that SW's claim that "since reforms unleashed growth, even more reform would have unleashed faster growth" (p. 13) verges on the point of being silly.¹⁵ China's own experience shows how wrong such mechanical, simplistic extrapolations can be. In fact, China's experience demonstrates that under certain conditions the opposite may be true. Lack of reform, as understood in the SW sense, may yield higher growth rates! Take the case of liberalization of interest rates. According to Lin and Cai, the main area of sluggishness in China's unification of markets concerns the interest rate. Lin and Cai explain that maintaining the interest rate at artificially low level led to higher demand for credits. Previously, such excessive demand used to be curtailed by administrative means. However delegation of credit approval authorities made such rationing difficult, leading to a "rapid expansion of credit and an investment thrust."¹⁶ This Lin and Cai description of the situation in 1984 rings very true of current China too. For quite some time now, the problem with policy makers has been how to restrain the

¹³ Another reason for the rising share of SOEs is that initially foreign direct investment into Viet Nam was allowed only in the form of joint ventures with SOEs.

¹⁴ For more on China's privatization process, see for example Cao, Qian, and Weingast (1999).

¹⁵ This is almost like arguing that since (according to some studies) moderate drinking leads to less cardiac problems, one should start binge drinking!

¹⁶ "Maintaining the interest rate at an artificially low level gave enterprises an incentive to obtain more credits than the supply permitted. Before the reforms, the excess demands for credit were suppressed by restrictive central rationing. The delegation of the credit approval authority to local banks in the autumn of 1984 resulted in a rapid expansion of credits and an investment thrust." (Lin and Cai 1996, p. 208)

investment boom and thereby the GDP growth rate. Rather than lack of growth, it is excessive growth that has become China's problem! Thus under the circumstances, Gradualism has led to excessive growth and not to lack of growth! To argue that gradualism has been hindering Chinese growth is therefore very much out of sync with the reality. Thus neither China's own experience nor Viet Nam's experience of reform lend support to the counterfactual that Sach and Woo propose in their paper.

7. Concluding Remarks

The analysis of this paper shows that Sachs and Woo's allusion to Viet Nam's experience in order to argue for certain viewpoints with regard to China's reform, and the reform process of transitional economies in general, is deeply flawed. The allusion suffers from inaccurate facts, inappropriate characterization, inadmissible analogy, and invalid conclusions.

Sachs and Woo's paper does a great job in elucidating different view points with regard to Chinese reform. It contains a wealth of information. It helps greatly in understanding China's economic performance. However, so far as its allusion to Viet Nam's experience is concerned, it definitely suffers from serious problems. A scrutiny of their arguments and checking into facts make it clear that it is not appropriate to allude to Viet Nam's experience to argue for Big Bang for China, and to argue for the Big Bang approach in contraposition to the Gradual approach, in general.

This revelation has wider implications. It suggests that if put under microscope, as we try to do here their assertions regarding Viet Nam, perhaps similar weaknesses may appear in other parts of their assertions and analysis. However, we leave it for other papers and researchers to check that out.

An underlying source of the inappropriate reasoning and conclusions on Sachs and Woo's part is their reluctance to take into proper cognizance the interaction between politics and economics in the reform process.¹⁷ For example, they emphasize that Gradualism was dictated more by political conditions. How can that be an argument against gradualism?!

First of all, this is a half truth, because Gradualism is also necessitated by economic conditions. Take the case of privatization. On the economic side, it requires purchasing power of the people who will buy the productive assets. It also requires their managerial capability to run these productive assets as private enterprises. It also requires the right kind of economic environment for efficient functioning of these assets as private enterprises. However, on the political side, it also requires legitimacy in the eye of the society. And, the two sides are interrelated. The political legitimacy depends, to a great degree, on the ability

¹⁷ For example, they observe that "The convergence school also holds that China's gradualism results primarily from a lack of consensus over the proper course, with power still divided between market reformers and old-style socialists; and that the 'innovative' non-capitalist institutions are responses to China's political circumstances and not to its economic circumstances." (Sachs and Woo 2000, p. 1) Also, they think that "Gradualism, in this (i.e. Convergence school -ni) view, has not been a strategy so much as a result of continuing political conflict and other difficulties inherent in setting a policy course in a country of some 1.2 billion people." (Sachs and Woo 2000, p. 3)

of the purchasers to buy the assets with *legitimately (if nor honestly) earned* money. However, to earn legitimately the kind of money necessary to buy productive assets that millions and millions of Soviet, Chinese, or Vietnamese people have built up through their labor over many decades requires time. If in the impatience of carrying out a Big Bang or Shock Therapy, one does not want to allow for such time (which is what the Gradual approach allows), then one is bound to have illegal insider purchase (loot), which in turn cannot provide the legitimacy required for effective functioning of these enterprises in the society. This has been more or less the case with Russia.

Second, reforms never take place in some kind of a political vacuum. In fact, correct interaction between the economic and political sides is the most important requirement for the success of the reform process. An adviser called upon to advice on reform has to therefore take into account both the economic and the political situation. He or she cannot just say that all the recommendations were perfect, but failed because of the prevailing political situation. Reforms also represent an art of the possible. It does not make much sense to argue that Gradualism is not good because it was dictated by political necessities, even though, as we have just noticed, political and economic necessities are often closely intertwined. Political constraints are part of the landscape. It is rash to prescribe reforms without taking into cognizance the political parameters.

Sachs and some other researchers have pointed out that the Gradual Approach gives rise to new problems.¹⁸ That is perfectly natural and expected. That is actually how things progress. Resolution of one contradiction leads to the generation of new contradictions, and so forth. So emergence of new problems cannot be an argument against the gradual approach. The issue is whether the new contradictions are resolved at an appropriate time. Otherwise, they may create a crisis. So far it seems that both China and Viet Nam have been more or less successful at deciphering the new contradictions and resolving them in time.

Also to be noted in this regard, the transitional institutions that arise in the Gradual reform process are not without value just because they will not last eventually. A case in point is the Chinese Township Village Enterprises (TVE). Just because TVEs are privatized in the end does not mean that setting up TVEs were a mistake! At a particular point of the reform process, given the particular configuration of economic and political conditions, TVEs were necessary and played out a very vital role. The same applies to other transitional formations, such as the Special Economic Zones. Fading out of these special, transitional institutions at a later point of time cannot be an argument against the Gradual approach.

Sachs and his associates are also mistaken in their view that ultimate institutional forms are known, and hence little experimentation is necessary.¹⁹ First of all, experimentation, in the sense of devising innovative institutions appropriate for the current conjuncture of political and economic conditions, are necessary even if the ultimate institutional forms are

¹⁸ See for example Murphy, Shleifer, and Vishny (1992).

¹⁹ According to Sachs and Woo (2000, p. 8), “the key point is that little experimentation is needed or desired. The long-run goals of institutional change are clear, and are found in the economic models of existing market-based economies.”

known. However, more importantly, the ultimate institutional forms are often not fully known.

For example, suppose that transitional economies are all headed toward capitalism and there is no third way between socialism and capitalism.²⁰ Much room still remains with regard to the particular type of capitalism to build. Even after several centuries of capitalism in developed capitalist countries, there is no full institutional congruence among them. The institutions of capitalism differ. The debate between the so-called “European social model” vs. the “Anglo-Saxon model” of capitalism during the recent European Constitution referendum illustrates the point. To these we can probably add the Japanese (or the East Asian) model, which many have argued to be different from both the Western models.

So the ultimate institutional forms are not given even if one assumes that capitalism is the goal. What role the banks should have vis-à-vis stock market in channeling citizens’ savings to companies and corporations, what kind of labor institutions to adopt, what kind of social safety network to put together, etc., in all these spheres there are plenty of models to choose from. There may be scope for even to develop new ones! It all depends on the concrete situation of a country, its specific history, its culture, and its physical, socio-economic, and other conditions. Only through a gradual process of change, trial and error, experimentation, evolution, can a country attain the configuration of institutions that are best suited for it. Institutions cannot be supplanted ready made from outside. They have to be home grown, and growth requires time. Nature does not jump!

Finally, the claim that all transitional economies are heading toward capitalism is just a claim. There are counter claims too. For example, the leadership of both China and Viet Nam refuse to characterize their reforms as a journey toward capitalism. Instead they want to think that the current transformations are intended toward some variant of socialism, be it market, progressive, or harmonious. Many western scholars are still busy constructing theory of more egalitarian/socialist societies. There are conceptual projects of post-capitalist societies too. Why should these claims be thrown out without adequate scrutiny?

References

- Arkadie, V. Brian and Raymond Mallon (2003), *Viet Nam: A Transition Tiger?* Canberra: Asia Pacific Press at the Australian National University
- Cao, Yuanzheng, Yingyi Qian, and Barry R. Weingast (1999), “From Federalism, Chinese Style to Privatization, Chinese Style,” *Economics of Transition*, Vol. 7, No. 1, pp 103-131

²⁰ Sachs and Woo thinks that despite the official pronouncements to the contrary, China is heading towards being another normal capitalist country. “The other (convergence –ni) school of thought holds that Chinese institutions are in fact gradually converging with those of non-socialist market economies, especially those in East Asia. We therefore use the term ‘convergence school’ to characterize this point of view. This convergence, it is argued, is occurring despite official pronouncements to the contrary (including the stated intention to build a ‘socialist market economy’) as well as despite inconsistencies of many reforms in the short run. In this view, the faster the convergence, the better will be the outcomes.” (Sachs and Woo 2000, p. 2)

- Groves, Theodore, Yongmiao Hong, John McMillan, and Barry Naughton (1994), "Autonomy and Incentives in Chinese State Enterprises," *Quarterly Journal of Economics*, Vol. 109, No. 1 (February), pp. 183-209
- Lau, Lawrence J., Yingyi Qian, and Gerard Roland (1997), "Pareto-improving Economic Reforms through Dual-Track Liberalization," *Economics Letters*, Vol. 55, pp. 285-292
- Lau, Lawrence J., Yingyi Qian, and Gerard Roland (2000), "Reform without Losers: An Interpretation of China's Dual-Track Approach to Transition," *Journal of Political Economy*, Vol. 108, No. 1, pp. 120-143
- Li, Wei (1999), "A Tale of Two Reforms," *RAND Journal of Economics*, Vol. 30, No. 1 (Spring), pp. 120-136
- Lin, Justin Yifu (1992), "Rural Reforms and Agricultural Growth in China," *American Economic Review*, Vol. 82, No. 1 (March), pp. 34-51
- Lin, Justin Yifu and Fang Cai (1996), "The Lessons of China's Transition to Market Economy," *CATO Journal*, Vol. 16, Issue 2 (Fall), pp. 201-219
- Murphy, Kevin M., Andrei Shleifer, and Robert W. Vishny (1992), "The Transition to a Market Economy: Pitfalls of Partial Reform," *Quarterly Journal of Economics*, August, pp. 889-906
- Roland, Gerard and Thierry Verdier (1999), "Transition and the Output Fall," *Economics of Transition*, Vol. 7, No. 1, pp. 1-28
- Sachs, Jeffrey D. and Wing Thye Woo (1997), "Understanding China's Economic Performance," NBER Working Paper No. 5935, Cambridge MA
- Sachs, Jeffrey D. and Wing Thye Woo (2000), "Understanding China's Economic Performance," *Journal of Policy Reform*, Vol. 1, No. 1, pp. 1-50
- Wu, Jinglian and Renwei Zhao (1987), "The Dual Pricing System in China's Industry," *Journal of Comparative Economics*, Vol. 11, pp. 309-318

Appendix

Table A1: Average annual indicators of growth and inflation (per cent)

<i>Period</i>	<i>Inflation (CPI) (%)</i>	<i>GDP growth (%)</i>	<i>Agri- culture growth (%)</i>	<i>Services growth rate (%)</i>	<i>Industry growth rate (%)</i>	<i>Export of rice US (\$mln)</i>	<i>Total Export Growth rate (%)</i>
Col. No.	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1986	774.7	2.33	2.39	-2.83	10.28		
1987	223.1	3.64	-0.52	5.25	9.15		
1988	393.8	5.98	3.94	9.09	5.29		
1989	34.7	4.69	6.77	7.61	-2.81	317	
1990	67.1	5.09	1.00	10.19	2.27	272	23.5
1991	67.5	5.81	2.18	7.38	7.71	225	-13.2
1992	17.5	8.06	6.88	7.58	12.79	300	23.7
1993	5.2	8.08	3.28	8.64	12.62	363	15.7
1994	14.4	8.83	3.37	9.56	13.39	425	35.8
1995	12.7	9.54	4.80	9.83	13.60	496	34.4
1996	4.5	9.34	4.40	8.80	14.46	855	33.2
1997	3.6	8.15	4.33	7.14	12.62	870	26.6
1998	9.2	5.76	3.53	5.08	8.33	1020	1.9
1999	0.1	4.77	5.23	2.25	7.68	1025	23.3
2000	-0.6	6.79	4.63	5.32	10.07	667	25.5
2001	0.8	6.84	2.79	6.13	10.32		3.8
1976-80	21.2	0.4	1.9	-0.1	3.3		
1981-85	74.2	6.4	5.3	4.7	9.3		
1986-90	298.7	3.9	3.7	8.7	4.7		
1991-95	23.5	8.2	4.3	9.5	12.6		
1996-01	3.4	7.0	3.9	7.3	12.2		

Sources: Arkadie and Mallon (2003), Various Tables