Chapter II The Experiences of Five Asian Transitional Economies

1 Introduction
In this report, the transition process from centrally planned economies to market-oriented ones in Cambodia, China, Laos, Mongolia and Vietnam is analyzed. These countries started their reform and transition process at different times. Some, like China and Vietnam, started rather early while others like Mongolia started rather late. As is explained later, the reform processes have taken different courses with varied performance. The economic performance of these countries is relatively good compared with that of Russia and the Eastern European countries. There are many plausible reasons for this: historical background of the countries, speed and method of reform, geographical location, political system, social structure and so on. But we have to look more closely at the link between the reform process and economic performance in these countries.

Taking into account the above, we have tried to analyze the transition process from both country-specific aspects and common issues associated with the transition process, such as macroeconomic stabilization and institutional reform.

It should be noted that there are other economies in Asia which are in transition process. Countries such as Bhutan, India and Nepal, though those economies were by no means market-oriented, were not operating under strict centrally-planned systems so their reform processes are not comparable to those of the countries analyzed here. The Central Asian Republics after independence went through similar transition processes as Russia and the Eastern European countries but information about the Central Asian Republics is limited. The transition process in Myanmar has not yet advanced. We will therefore concentrate our analysis on the aforementioned five countries.

2 Background
Although the timing and the process of the reforms differ from one country to another, still it is common to all the transitional economies that they were faced with the economic difficulties: stagnation of production, inefficiency of the economy, and macroeconomic imbalances when they started the reforms. These economic difficulties are attributable to the demerits of the planned economy, namely the lack of an efficient resource allocation mechanism and the lack of incentive. In addition, the inefficiency of the international transaction system among these economies was a negative factor (see Chapter I 1-2).

Transitional economies started their reforms to tackle and correct such defects. However, outcomes or macroeconomic performances very much differ by country, reflecting the differences in the reform process and other background conditions among them. Leaving the analysis of the relationship between reform process and economic performance to the following sections, we will mention briefly the differences in background conditions of the reforms.

Roughly comparing to Eastern Europe, we can point out the following three points as the general characteristics of Asian transitional economies.

The first is the political continuity. In the case of the Eastern European countries, political reform led the transition process, reflecting Eastern European priority of political
liberty over economic affluence. Thus in Eastern Europe drastic changes in the political system occurred and the dictatorship of the communist party collapsed. However, such drastic political change brought about confusion in the economy. To the contrary, in Asia economic reform is leading the transition. The people of Asia seem to be demanding economic development rather than political democratization. As a consequence gradual but steady economic reform has been implemented under the continuing dictatorship of the communist party.

Some argue that without political reform, real economic reform cannot be achieved. But the facts suggest that drastic political reform sometimes brings confusion to the economy; it is possible that economic reform can proceed gradually but steadily under political continuity.

The second point is geographical location. Asian transitional economies are located in the dynamic developing area of the Asia-Pacific. Thus Asian transitional economies can expect a large spillover effect from the region by adopting open policies. China's open policy since 1979 has greatly contributed to the development of the coastal area of China, and Vietnam is now making good efforts to attract foreign direct investment.

In Eastern Europe, however, the collapse of the CMEA affected and they could not make use of the merit of the economic openness.

The third point which characterizes the transitional economies in Asia is that they are not only transitional economies but also developing economies. The reforms taking place in these economies therefore have two aspects: reforms as transition measures and reforms as development policies.

In these economies the development of heavy industries is limited; light manufacturing and agriculture occupy a large part of the economy. Those small manufacturers and farmers are more responsive to the market than the huge heavy industrial enterprises which are used to the easy situation of the planned system. It may be possible to say that those light industries and agriculture in the Asian transitional economies helped absorb the shock of the reforms by actively responding to the market, while in Eastern European economies a sharp decline in the production of heavy industries were observed.

It should be mentioned that Mongolian background conditions are more similar to those of Eastern Europe than those of other Asian transitional economies. Mongolia experienced a drastic change in its political system and is geographically disadvantaged, with a land-locked territory far from the dynamic Asia-Pacific. It is interesting to point out that Mongolia is facing the same kind of difficulties as Eastern Europe, such as drops in production (see Chart 1-II-2), hyper-inflation, etc.

3 Historical Review
3-1 Reforms carried out in the transition process

Reforms were carried out in many mutually related areas. For example, tax reform, which aims at reducing the distortions associated with irrational tax structures, also has a significant impact on fiscal consolidation, which is badly needed to restore macroeconomic balances.

In what follows, we will review the policies taken in each of the countries analyzed here.
The timing of the reforms taken in each country and achievements in each field are depicted in Chart 1-II-1 and Table 1-II-1.

3-1-1 Fiscal reform

It is often argued that the fiscal burden caused by state enterprises, which were under soft budget constraints, was one of the most important reasons for the demise of the central planning system. During the process of transition there were large-scale changes in the structure of tax collection and expenditures. This can negatively affect the balance of the public sector. This is especially important because the budget deficit is often financed by the lending of the state bank, leading to very high inflation. The need to consolidate fiscal structures should be well recognized. It should be noted that price liberalization might have aggravated the fiscal situation through increased subsidies to state enterprises.

The experiences of these five countries are varied but one common feature is the reform in tax systems. In the centrally planned economies, profit remittance from the state-owned enterprises was an important source of government revenue. With more autonomy to the enterprises and the increase of enterprises not under direct government control the need to change the system to profit from taxes became clear. Thus, changes in tax systems along this line took place during the transition process. On the expenditure side, cutting subsidies such as direct subsidies to state enterprises, is the most important feature of the reform process.

Cambodia

Before the economic reform of 1989 took place, total government revenue covered about 95 percent of expenditures, of which revenue from abroad represented 60-65 percent of the total revenue. Up to 1992, fiscal revenue in Cambodia covered only 60-65 percent of total expenditures. The fiscal situation actually deteriorated after the reforms started, due to the increased expenditures of civil service wage reform implemented in 1991 and 1992, and the inelastic and narrow tax system. In order to broaden the tax base, the Cambodian government decided to tax the income of individuals whose income exceeds 300 dollars per month from 1994, and to introduce a 25 percent tax for corporate profit in the near future.

China

Reforms in public finance started in early 1980s with the introduction of treasury bonds as a system of finance. This was followed by the shift from a system of profit remittance to a system of profit retention and corporate taxes in 1984. During the reform process, local governments have more autonomy with the introduction of the fiscal contract system. This, however, created another problem of local governments’ tendency to put too much emphasis on revenue-generating projects. In 1985 the indirect tax base was broadened by additional turnover taxes, a value-added tax and a business tax. The most important issue in China’s public finance is the negotiation between the central and local governments. The introduction of a new tax scheme, which will replace the existing contract system, was decided in November, 1993. This is expected to reduce the portion of distribution of tax income decided by negotiation.

Laos

Fiscal reform was one of the most important aspect of the New Economic Mechanism started in 1986. It consists of two parts: renovation of government expenditure and increase
of revenue. On the expenditure side, reduction of the number of officials by 20 percent in
1988-1990, the abolition of the petroleum subsidy, donation of agricultural machinery and
fertilizer to “cooperative farms” and subsidies to state enterprises were accomplished. On the
revenue side, tax reform and revision of public utilities fares were carried out. In 1989 system
of transfer from state enterprises was abolished and profit tax was introduced. In 1991 all
enterprises, both public and private, were taxed by profit tax (45 percent) uniformly, and tax
rates were simplified. Electricity, water and telephone charges were raised to strengthen the
finance of these enterprises, which have not been privatized.

**Mongolia**

The pre-reform budget deficit was entirely financed by COMECON aid, mostly from
the former USSR. The financial situation deteriorated rapidly after the second half of the 1980s.
In 1988, the budget deficit as a share of GDP was more than 20 percent. The tax structure
was changed from the command economy system to a new one appropriate to a market
economy first in 1991. Further reform came into effect in 1993. The old “turnover tax” on
price differential was eliminated. Under the new customs law, exports are not taxed, while
imports pay uniform 15 percent tax. A 10 percent sales tax on imports and domestic
production has been introduced. The sharp decline of government expenditure (22 percent in
1992) was the result to the cut in subsidies and transfers to eliminate the price distortion
transferred through fiscal measures.

**Vietnam**

Before 1988, Vietnamese government revenue largely depended on transfers from state
enterprises, accounting for more than three quarters of the total revenue. Since 1989, with
the deteriorating performance of state enterprises these transfers have declined. In order to
decrease dependence on this revenue, the Vietnamese government made efforts to establish a
uniform tax system which is suitable for a market economy. Still, because of imperfect tax
collection and the existence of an ad hoc tax concession, reform in the tax structure remains
insufficient. It should be noted that the revenue from crude oil is increasing, now accounting
for about 20 percent of total revenue. On the expenditure side, the most important part of the
reform is the abolition of three subsidies —export subsidies, food procurement and direct
subsidies to state enterprises — in 1989. However, the reduction of government expenditure
has shown little progress because the direct subsidies were merely replaced by subsidiary
loans.

The relationship between the central and local governments has similar problem as in
China. Large expenditures by the central government combined with small tax revenue
derived from the decentralized tax collection system puts large pressure on central
government finance.

### 3-1-2 Price Liberalization

Price reform, or price liberalization, is one of the most important microeconomic measures,
which is targeted toward improvements in the smooth functioning of market mechanism in
the economy. In centrally planned economies, the price of commodities, services and
production factors are basically set by the public sector. There is no room for the price
mechanism to work, resulting in an imbalance of supply and demand (in most cases
shortages). The black market is the only place where supply and demand equalize, with a big difference between official and black market prices.

In most countries the liberalization of price was typically done in several steps. One important feature is that it started as the adjustment of increased agricultural prices. This had the effect of raising agricultural production, and is thought to be one of the reasons for the initial success of reform. Also the use of a dual-track (two-tier) price system is one feature that characterizes the reform process. The gradual approach has its costs, the most significant of which is a heavy fiscal burden. Since there were liberalized and controlled prices within the economy at the same time, the distortion of relative prices could be large, thus increasing the subsidies.

Cambodia

Though all prices were controlled under the Heng Samlin administration, the free (black) market existed. The government raised the prices of farm products in 1989 but were not yet liberalized. The price of agricultural products were completely liberalized in 1992 but those of manufactured goods were not liberalized.

China

Price reform was first implemented as a form of raising the purchase price of agricultural products. Although the price structure was adjusted to reduce price distortion, the government still retained the controlling power of price. The dual-track pricing system was then introduced, in which a pre-determined quantity of products are purchased by the government at planned price, while the excess is traded at market price. This system was very effective in advancing reform. Step by step, the role of the market became larger and more important in Chinese economy. There were some retreats in price reform during the period 1989-1991, with a revival of price control on goods formerly freed, because of high inflation. With the reacceleration of reform after 1992, price restrictions were again released. Although dual-track pricing still remains today, market-determined prices play a more important role in the economy.

Laos

Before the New Economic Mechanism during the period of 1985-1987, the government was giving guidance to public enterprises to calculate the prices of their products using the cost-plus pricing system. But this produced many disadvantages, namely the tendency of public enterprises to increase their cost of production, thus creating inefficiency and high prices. In 1988, it was decided that all prices of goods and services were to be market-determined, except for a small number of strategic goods including electric power, potable water, postal and telecommunication, some mineral products, air passengers and air freight.

Mongolia

The first round of liberalization of price was carried out at the beginning of 1991, with roughly 60 percent of the price of goods and services free. Farm gate prices were increased by 30-70 percent, while fixed wholesale prices were adjusted by 55 percent. All the retail and wholesale prices, with the exception of 35 commodity groups, were freed. The second step in price liberalization was taken in October 1991. The number of goods subject to price control at the retail level was reduced to 17. Energy prices, rents and tariffs for public utilities and services remained under control. The third and fourth steps in price liberalization occurred
in October and December 1992. The last and decisive step was made in June 1993, when almost all prices were made free.

**Vietnam**

In the past a dual price system of fixed official prices and free market prices was adopted. Under this system, the official prices guided production while free market prices were applied for production outside the plan. Later, in 1981 and 1985, price reform policy was implemented with limited results. After the narrowing of the price gap between official and market prices in 1987 and 1988, an almost complete price liberalization was carried out in 1989, with a few exceptions such as electricity, oil products, public transportation fares, and so on. It should be noted that the relative price between industrial and agricultural products moved in favor of the agricultural products.

3-1-3 Public Enterprise Reform and Privatization

Public enterprise reform takes various forms depending on the conditions of each country. Various measures were taken to improve the efficiency of the public enterprises with mixed results. The basic trend in enterprises reform is to give more managerial autonomy to these enterprises. It should be emphasized that the increased autonomy should be accompanied by the enforcement of responsibility such as bankruptcy law to actually improve performance. Privatization is implemented using various schemes at various paces but with the exception of Mongolia, where a voucher scheme was effectively employed to privatize state enterprises and livestock, mass scale privatization was not conducted as in Russia and the Eastern European countries. Other countries preferred a slower process, and privatization has been more or less in experimental stage.

To sum up, in most countries the emphasis was on management rather than ownership. Considering the weak social and legal infrastructure, it is rather difficult to foresee that private ownership will immediately lead to improved performance of enterprises. Another important aspect of enterprise reform is the encouragement of new emerging industries. A typical example is the township and village enterprise in China.

**Cambodia**

The government introduced a new system of financial autonomy of state owned enterprises in late 1989. Although the state-owned enterprises could retain all the proceeds after the tax and half of the their amortization is paid to the state in this system, government control on investment, price fixation and so on still remains. Privatization of state owned enterprises began in 1989. The government has placed great hopes on foreign investment as a provider of know-how and capital. Leasing has been the most popular method for privatization, and about half of the state-owned enterprises have already been leased to private companies. The fixed assets of enterprises are leased for periods 15 to 26 years. There were 69 state enterprises before the enforcement of the new policy. Currently, 35 factories have already been leased to private companies.

**China**

The direction of state-owned enterprises (SOEs) reform in China is towards more autonomy. At first there were trials of giving more autonomy to management and profit distribution. Then, influenced by the agricultural household responsibility system, the product
responsibility system was introduced in 1981-1982. The profit remittance system was replaced by an enterprise tax system with profit retention in 1983, which provided incentives to the SOEs. During the period of 1984-1988, the autonomy of SOEs gradually expanded. The main accomplishments of this period were the gradual introduction of the contract responsibility system and the approval of “bankruptcy law” and “enterprise law”. In 1988 the constitution was amended to permit private enterprises. In spite of the thriving “township and village enterprises”, the problems of loss-making SOEs and of soft budget constraints still remain.

Laos

The Lao economic reform had their origin in the reform of public enterprises, because in the 1980s public enterprises generated most of the internal revenue of the government. The main focus here was to improve the efficiency of SOEs. The period from 1984 is characterized as one of increased autonomy for the SOEs. The most striking features were the allowance of the free circulation of goods across the whole country, and the assurance of full equality for both government and private economic entities with respect to trade and taxation.

Government ordinance No. 17 in 1990 promotes well-performing state and public enterprises, with the exception of the strategic sectors. By March 1994, more than 50 percent of the total public enterprises had been disposed of in various ways. Most of the small ones were sold and the most of big and medium ones were leased, partly soled or converted to joint ventures.

Mongolia

A privatization law was passed in 1991. According to the government’s plan, all small businesses, numbering about 3750; all livestock in state agricultural enterprises and cooperative farms; 100 percent of the assets of 340 large scale state-owned enterprises and part of the assets of another 354 large-scale enterprises were to be privatized. The privatization scheme was to issue vouchers worth 10,000 tuglig to every person in the country. The vouchers are of two types: pink voucher, worth 3,000 tuglig, is transferable and used for small enterprises, and blue voucher, worth 7,000 tuglig, is non-transferable and used for large enterprises. As of end of July 1993, more than 307 large-scale enterprises had been auctioned off. About three-quarters of blue vouchers held by the public had been redeemed, representing 60 percent of the total stock of such vouchers.

Vietnam

Several reforms to improve the efficiency of state owned enterprises such as transfer of management to enterprises, introduction of self-supporting accounting system and so on were implemented. However, a monopolistic situation of state enterprises has been maintained, and there has been little competition among enterprises. Moreover, the autonomy of state enterprises has been spoiled by frequent ad hoc tax concession, and easy access to low interest preferential loans provided by state banks. Consequently, the efficiency of state enterprises showed little improvement.

Privatization in Vietnam is still in the experimental stage, with just a handful on the list. The basic stance of the government towards privatization is to keep the important sectors of the Vietnamese economy intact, while privatizing unimportant and unprofitable sectors. In 1992, the government announced an experimental plan of privatization. Seven enterprises
were listed. Small private enterprises are emerging, but there is still a gap between large, state enterprises and small private ones, and the difference of treatment discourages strong private sector development.

3-1-4 Liberalization of External Trade

Liberalization of external trade is also an important step because import competition is expected to improve the efficiency of the economy. An increase of exports is also expected through the abolition of the export tax. The important institutional reform in this area is to allow the private sector to engage in foreign trade activities, which were under state monopoly in the old regime. Restrictions regarding foreign trade have vastly decreased in most countries, with some restrictions remaining for basically strategic products. It should be noted that the degree of dependence on COMECON trading system differed: China was the least dependent on it.

Cambodia

From 1980 to 1987, foreign trade was conducted through a state monopoly along traditional socialist lines. After 1989, liberalization of foreign trade marking took place, but permission is still needed for exports of rice, logs, cut wood, livestock, red corn, fish, soybeans, and rubber; for agricultural imports, permission is needed only for fertilizers and pesticides. Although assistance from the former Soviet Union has dried up, exports and imports to the convertible area grew 10 times and 13 times respectively between 1989 and 1991. This resulted from trade liberalization measures, and the opening up of the Sihanoukville Port to international shipping.

China

Open policy in China first began from the idea of establishing “Special Export Zones” in Guangdong and Fujian provinces in 1979. This idea was soon changed to the “Special Economic Zones,” realized in four places. Later on, fourteen coastal cities were opened to foreign investment. The idea was further expanded with the announcement of the “Coastal Area Economic Development Strategy” in 1988. With the creation of the special economic zones open to foreign direct investment, liberalization in trade activities took place. In 1984, an initial push on the decentralization of trading decisions was carried out, leading to the creation of many provincial foreign trade companies. As in agriculture and SOEs, a trade responsibility system granting more trade rights to local authorities was introduced. Trade subsidies to major sectors of export potential were abolished in 1991 and the import tax was reduced in 1992.

Laos

Restrictions on foreign trade have been reduced gradually. Measures to liberalize external trade were enacted through 1988, including the removal of quantitative restrictions, except for motor vehicles; partial removal of quantitative export restrictions; a reduction in import tariffs, and the exemptions of export taxes other than certain types of products such as timber and mineral products. People have been able to engage in trade by getting licenses, while the quantitative restriction of import goods was abolished in substance.

Mongolia

In 1991 a new customs law was passed. Export duties were abolished and a uniform 15
percent customs duty was imposed on most of the goods. In the new enterprise law that was passed in 1991, all enterprises were to have foreign trade rights. By the end of May 1993, all quantitative export and import controls were eliminated, the scope of import licensing reduced to cover only four categories of goods, and export registration was abolished. In addition, the private sector was permitted to import goods for internal sale or export.

**Vietnam**

In 1988 the state monopoly on external trade was abolished and restrictions to establish trading companies were eased. In 1990 permission toward foreign trade was again loosened to enable all firms, including the private sector to trade directly. Quantitative restrictions on exports and imports were relaxed in 1989, and trade regulations and quotas were reduced drastically.

3-1-5 Exchange Rate Policy

Exchange rate control is moving toward one unified system in every country except in Cambodia. Currently, the difference between official and market rates is almost non existent. The sharp depreciation during the process of transition, which is often both the cause and effect of high inflation, has subsided and the exchange rate and inflation have stayed rather stable recently.

**Cambodia**

The government can barely control the money market. Cambodia operates under plural monetary system. The dollar, baht or gold, as well as the national currency, are used as medium of exchange. The existence of multiple exchange rates is another feature of the country’s monetary system; there is a free market rate and an official rate set by the central bank. Under these circumstances, it is difficult for the government to reap the benefits of the dollar influx following the arrival of UNTAC personnel.

**China**

The exchange control system was first characterized by quotas and foreign exchange certificates. In 1984 exchange rates were unified into one official rate. In 1986 foreign exchange adjustment centers (FEAC) were introduced to trade retention quotas between approved enterprises. The participants of this system increased gradually and the system began to function like an “exchange market” between the Renminbi and the US dollar. From 1994 foreign exchange changed to one based on inter-back exchange rates. Foreign exchange certificates, which were introduced in 1980 to enforce the currency control, were abolished.

**Laos**

Laos moved to the single exchange rate scheme in 1987, earlier than Vietnam or other socialist countries. The seven previous exchange rates were unified into one rate near the market exchange rate. In addition, the official rate became flexible, i.e., the parallel market rate would be taken as feedback to determine the official exchange rate from time to time. The exchange rate between the kip and the US dollar has been stable for the past four years, ranging between 700 to 740 kip per one US dollar.

**Mongolia**

Before the reform, official exchange rates between the tuglig and the “transferable rubles” for trade with the COMECON countries existed. Trade with convertible-currency
countries was based on the rate between the tuglig and the US dollar. There were two types of rates: commercial and non-commercial rates. In March 1992 these two exchange rates were unified into one but there still was a difference between the official and parallel rates. Further on, in June 1993, the exchange rate scheme moved to floating system, adjusting the official rate to the parallel rate.

**Vietnam**

Until 1988 Vietnam had multiple exchange rates according to the types of transactions. The Vietnam currency (dong) was deliberately overvalued to enable subsidiary imports. After several adjustments of the official rate towards the parallel rate, Vietnam unified the exchange rate and moved to the floating system in 1989. The government is trying to retain control of foreign currency, but weak government control enables the continued existence of parallel market.

**3-1-6 Foreign Direct Investment**

The importance of attracting foreign direct investment should not be over emphasized. These countries face massive capital shortage to finance the development and foreign direct investment is one of the most important measures in addition to export promotion and official development assistance. Therefore, they enacted foreign direct investment law and special economic zones that give special advantages to foreign investors. We must note, however, that other factors, such as physical infrastructure and market conditions, can have a significant influence on the decision of foreign investors.

**Cambodia**

As was pointed out in the section of SOE reform, the government realizes that foreign direct investment is an important part of reform. The main legal basis for this process was the “July 1989 Foreign Investment Law” and sub-decree enacted by the government. The four priority areas are (1) exporting or import substituting industry, (2) services to prompt income in foreign exchange, (3) infrastructure such as power stations, bridges, ports and airports, and (4) agriculture and animal breeding.

**China**

At first, attracting foreign direct investment was associated with setting up of special economic zones, with preferential treatment for enterprises investing there. These zones was characterized as “Four Windows” (technology, knowledge, management and foreign policy). Now the government is trying to spread development in the coastal area to the inland. These “opening” policies activated the economy of the coastal areas, but the gap between coastal and other areas was widened. Local government are also opening special economic areas at their discretion without the central government’s approval. It should also be pointed out also that the approval procedures are still excessively slow and bureaucratic.

**Laos**

A foreign investment law was enacted in 1988 to encourage foreign investment by giving investors preferential treatment in taxes and other benefits. A 100 percent foreign investment was admitted, with a guarantee that foreign capital affiliated enterprises would not be nationalized. In other to facilitate foreign investment, “The Foreign Investment Management Committee” was established in 1989.
Mongolia

Foreign investment law was first enacted in 1990 but proved insufficient because of the lack of tax incentives, guarantees and protection measures, and the investment promotion zone. A new foreign investment law was passed in 1993 to attract foreign capital, with the same rights as Mongolian enterprises, and provided incentives of tax and remittances to overseas countries. An announcement was made in February 1991 of the government’s intention to establish four “free economic zones,” but little progress has been made on this.

Vietnam

The law on Foreign Investment, proclaimed in 1988 and amended in 1990 and 1992, offers advantageous conditions to foreign enterprises. It allows 100 percent foreign invested capital, gives guarantee to invested capital, and allows remittance of profit. It also gives preferential tax treatment according to the degree of priority of projects. To facilitate export oriented foreign direct investment the government is giving several types of preferential treatment to the export oriented enterprises in export processing zones.

3-1-7 Financial Reform

In order to mobilize the necessary funds for development, it is important to foster a sound and efficient financial market. The areas of reform are: the banking sector, capital markets, monetary policy measures, and so on. In centrally planned economies there is no distinction between the central bank and commercial banks. This led to inefficient allocation of funds and often monetization of fiscal deficits, the source of high inflation. Thus, reform in this sector is needed to restore macroeconomic balances and improve microeconomic efficiency. In every country the separation of central banking activities and commercial banking activities was accomplished, and private banking activity, sometimes as a joint venture with foreign banks, has been permitted. There are several criteria for financial reform: interest structures such as positive interest rates, term structure and difference in long-term and short-term interest rates. Capital markets are still underdeveloped. The stock exchange is open only in China and Mongolia. The development of a secondary market is of significant importance because of the need to finance the still-large budget deficit.

Cambodia

Major reform in the banking system took place towards the end of 1989. The Cambodian banking system is composed of the National Bank of Cambodia, its foreign trade subsidiary, 19 provincial branches and two joint venture commercial banks. Up to 1993, 22 joint venture banks and branches have already been established. The majority of the joint ventures involved banks from Thailand, Malaysia, Hungary, France and other countries.

China

Since 1979, specialized banks were established under the mono bank system, and many non-bank financial companies like the “CITTIC” were permitted. The People’s Bank of China became the central bank in 1984. From 1985, transactions between the People’s Bank and other banks were transferred to a normal “Lending and Borrowing” relationship from former “Money Distribution System.” Since 1986 many commercial banks were set up. In order to encourage deposits, index-linked savings deposits were introduced and the base interest rate was raised in 1990. In 1988, limited share markets were introduced and, in 1989,
stock exchanges were established in Shenzhen and Shanghai.

Laos

In 1981, the name of the central bank was changed to the State Bank of Laos, when it became the only institution with the exclusive right of note issue and to grant loans of any kind. In 1988, reform in Laos extended to the financial sector with a government decree to convert the banking system into a business unit. Its salient features were: (1) convert the banking activities to commercial banks, (2) convert the mono bank system to two-tier banking system, (3) convert state bank branches to autonomous banks or branches of them, and (4) remove the large pricing differentials between cash, bank drafts, bank balances and transferred money.

Mongolia

The former Mongol National Bank, which was the only bank in Mongolia, was split into two parts in 1991 under a new banking law to create the Mongol Bank (central bank) and two commercial banks. The Bank of Mongolia’s chairman is responsible to the legislature, thus making the central bank independent of the government. The interest rate on central bank loans to commercial banks has been increased to 35-60 percent in August 1992. All commercial banks enjoy the right to set interest rates according to their own policies and commission for money deposits and credits.

Vietnam

The law for the Vietnamese State Bank, together with the National Law on Banks, Cooperative Credit Institutions and Financial Institutions, provide legal basis for the separation of central banking activities from commercial banking activities. The specialized banks had differences in functions, but the difference was later removed and those specialized banks are now operating as commercial banks.

3-1-8 Agricultural Reform

Agriculture is one of the most important aspects in the transition process of these countries, since most of them have a large agricultural sector in the economy. This is most apparent in China and Vietnam, where the success of agricultural reform was vital to the success of reform itself. In these countries reform started by adopting a “responsibility system” in which the farmer can sell surplus products at market prices. This had a positive effect on the farmer’s incentives and agricultural production increased. Another important point is the privatization of land ownership. Although property rights on land are not recognized in China and Vietnam, the right to use it is well recognized.

More recently, agricultural production in China is stagnating. This is because the early advantage in relative prices vis-a-vis the industrial sector is diminishing with the advance in price liberalization. It should also be pointed out that common infrastructure such as irrigation is deteriorating.

Cambodia

The period from 1979 to 1986 is characterized by the power of the solidarity groups. Under this system, land tenure remained the exclusive property of the state. In the period from 1986 to 1989, the situation began to return to normal; the collectivization process was put into reverse in order for the government to respond to the aspiration of farmers who
found that the solidarity formula was not suited to the realities of the second half of 1980s.

Agricultural reform in Cambodia started in early 1989 with new legislation aimed at restoring property ownership rights, including the right to inherit property and build on privately owned land. By the end of 1989, fully collectivized farms disappeared, and private and family-based production became the primary form of agricultural production. As for the prices of agricultural products, price liberalization was permitted for farm surpluses after supplying to the government at below-market prices. This regulation was abolished in 1992 and the price was liberalized completely.

**China**

In order to give farmers incentives and to increase agricultural production, a “Household Responsibility System” was introduced. Under this system, farmers can sell surplus products at the market price, which is higher than the official buying price. The introduction of the household responsibility system brought big changes to the rural economy. Agricultural production increased and the structure of Chinese agriculture changed toward one suitable for the commodity production system. Labor productivity also improved. During the period of 1984-1991, agricultural reform gradually proceeded, with more emphasis on the market. But the slowness of reform resulted in stagnant production during this period. It should be noted that the success in rural areas promoted the development of township and village enterprises, which absorbed excess labor and accelerated the commodity economy in rural areas.

**Laos**

Agricultural reform started at the end of 1988 with the government policy “the family farming,” undertaken after analyzing the successes (increase of rice and livestock production and some infrastructure buildup) and failures (underutilization of land, low productivity and so on) of the agricultural policies of the past twelve years. The state had given the right to the farmers to use the lands which can be inherited by their relatives. The farmers can even transfer them to any other person in return for some reasonable compensation. This policy was further strengthened in 1992 to authorize property rights on land. By early 1989 all farming cooperatives were dissolved, and all land was given back to the former owners to carry out their own production.

**Mongolia**

Contrary to other countries analyzed in this report, Mongolia has a smaller proportion of agriculture in the economy with approximately 30 percent of labor force and 20 percent of GDP. Main reform measure in agricultural sector is the privatization, which is reviewed in another section of this report. Because of the nomadic nature of animal husbandry in Mongolia, land for agriculture has not been privatized.

**Vietnam**

In 1981, a product responsibility system was introduced in the agricultural sector. In this system, farmers rent farmland from a cooperative and are required to supply a certain level of production. The surplus was left to farmers’ discretion; they also got incentives to increase the production. The prices of agricultural products were also raised, up to five times. This reform produced good results for a while but the remaining control spoiled the incentives of farmers and agricultural production stagnated. The reform in 1988 gave more autonomy to
farming households, and agriculture shifted from a cooperative basis to a household basis. Furthermore, compulsory procurement by the government below market prices was abolished in 1989. Although the now approved land-use right is long (twenty or fifty years, depending on the crops), transferable and inheritable, the ownership of the land still belongs to the people.

3-2 Macroeconomic Performance

In this section we will review the macroeconomic performance of the five countries, and look at how it is related with the reform process. The performance of key economic indicators is depicted in Chart 1-II-2, together with that of the Eastern European countries.

3-2-1 Inflation

Most of the countries have experienced high inflation, although they differ in magnitude and timing during the reform. Price liberalization almost always caused high inflation, and if combined with loose monetary policy it became hyper-inflation, as in the case of Mongolia and Vietnam. On the other hand, China has been successful in suppressing high inflation mainly through slowing down the speed of the reform process. It should be stressed that the period of high inflation did not last long in all of the countries reviewed here. This is perhaps because the effect of price liberalization is temporary and the monetary policy was tightened relatively shortly after the inflation occurred. Now, inflation seems to be under control in most of the countries. The experience of these countries can be summarized as follows.

Cambodia

Cambodia suffered a very high inflation in recent years due to expansionary monetary policies to finance the budget deficit. The central bank is under the direct authority of the Council of Ministers, and it is difficult to resist the pressing demands of the administration. The liquidity growth was 61 percent, 79 percent and 239 percent in 1990, 1991 and 1992, respectively. Since most of the money supply remained in currency (at the end of 1991, currency accounted for 91 percent of total liquidity), the increase in currency is almost proportionally reflected in the increase of money supply. The inflation rate was 70 percent, 157 percent, 121 percent and more than 200 percent in 1989, 1990, 1991 and 1992, respectively.

China

China’s inflation has not been as high as other countries. Even in its worst period, it did not exceed 20 percent a year. The Chinese government has been cautious in its economic management, and when there is a signal that the economy is overheating, it tries to tighten macroeconomic policy. This is in sharp contrast with other countries, which experienced very high inflation (sometimes-three digits) in some phase of the transition.

Laos

Laos experienced very high inflation of over 100 percent in the first half of 1989 due to increased money supply caused by lending to public enterprises. But following the tightened monetary policy of the central bank, the inflation rate has decreased to only 6 percent in 1993.

Mongolia

Inflation was virtually non-existent prior to 1991, but accelerated sharply to an annual average rate of 120 percent in 1991 and 320 percent in 1992. This acceleration reflected the
impact of price liberalization and the devaluing of the national currency, tuglig, in both the official and market rates. This inflationary pressure was compounded by initial monetary overhang and by an accommodating monetary policy until the last quarter of 1992, when the monetary policy turned restrictive. It took some time for the tight monetary policy to take effect, and the inflationary pressure continued until the middle of 1993. Finally, inflationary pressure began to wane substantially recently.

Vietnam
Vietnam experienced hyperinflation in the year 1987, with an annual inflation rates of around 700 percent. This was caused by the rapid liberalization of prices and loose monetary policy. The period of hyperinflation, however, did not last long and inflation is now well under control, with a one digit annual increase rate of CPI.

3-2-2 Growth
Here the Asian transitional economies greatly differ from their Eastern European counterparts. Most of them have secured acceptable growth in the transition process. This growth was led mostly by the agricultural sector and light industry, which also led exports. The only exception among these countries is Mongolia, where there was a sharp decline of production. The possible reasons for this are: 1) higher dependence on COMECON trade and aid than other countries; 2) economic structure based on Soviet-style state enterprises, and 3) remoteness from the center of the rapid growth in East Asia.

Cambodia
After the liberation from the Khmer Rouge, the first five-year economic development plan was presented in 1985, covering the period 1986-1990. In general, the Cambodian economy smoothly developed during the planning period but the growth rate was somewhat low, considering the very low basis from which the started. Relatively slow growth in real GDP in 1989 and 1990 changed to moderate growth (7 percent) in 1991 and 1992.

China
In the first stage of the reform (1979-1983) the average annual growth rate of GDP was 10.1 percent. In the second stage, when the reform process was accelerated, the average annual growth rate of GDP was 19.5 percent. This high growth also caused problems like regional inequality and high inflation. In the third stage of 1989-1991, the emphasis was on cooling down the overheated economy. The average GDP growth was 11.9 percent, much lower than the previous period but still quite respectable. In the fourth period, which began with the spring tour to the southern China of Deng Xiaoping, tightened policy ended and China began to accelerate its economy again.

Laos
Agriculture plays a significant role in the economy of Laos, with a share of GDP of about 60 percent. Bad crops and confusion associated with policy changes were the main reasons for negative growth in 1987 and 1988, but in the following years growth has been stable. The growth rates were 11.5 percent, 5.9 percent, 4.3 percent and 7.3 percent, respectively for each year of the period 1989-1992. It is expected the GDP growth would have reached 7 percent in 1993.

Mongolia
Mongolia has been suffering negative growth from 1990. By 1993 the real GDP had fallen about 20 percent from the peak level of 1989. Mongolia has had experiences quite different from the other transitional economies analyzed in this report. In this sense, Mongolia's experiences are very similar to those of the Eastern European countries. Although the drop in production seems to have stopped, fast recovery is still not in sight.

**Vietnam**

Economic growth in Vietnam has been stable since the reform process began. With the acceleration of the reform process that began in 1989, annual GDP growth also accelerated to the 5-8 percent range. This is partly due to favorable agricultural production and oil production.

### 3-2-3 External Balance

Signs of a badly behaving economy can appear in its external balances. In the past, the trade deficit was financed mainly by aid and long-term commodity loans from the Soviet Union and the Eastern European countries. Since the flow of funds dried up after the collapse of the Soviet Union, these countries should seek other sources. China and Vietnam followed the path of export promotion, and their trade balance is now on the surplus side. Other countries are still burdened with deficit: financing is a pressing issue for them.

**Cambodia**

The trade deficit has continued throughout the second half of the 1980s. The figure increased to two to three times in 1991 and 1992. This is one of the effects of the liberalization of external trade.

**China**

In the first stage, the current account was generally in surplus. But in the second stage, with the overheating of the economy, the current account showed a deficit. In 1985 the ratio of the current account deficit to GDP reached at percent, considered to be respectable compared with other countries. In the following stage, current account became positive through increased exports.

**Laos**

Laos had a huge trade deficit (131.4 million dollars) in 1992. This volume is roughly the same as the previous year.

**Mongolia**

The current account as a percentage of GDP was high even before the reform process began, when the deficit was financed by the Soviet Union and other COMECON countries. Both exports and imports are declining, with the net effect of a reduced trade deficit. The first half of 1993 even showed a surplus. The current account deficit is decreasing, but the overall balance is still negative due to termination of aid from the former Soviet Union.

**Vietnam**

The trade balance has improved significantly with the rapid growth of exports of agricultural products and light industrial goods.

### 3-2-4 Budgetary Balance

Another area where bad economic management can appear is the fiscal deficit. This is
more important because, with the lack of a financial market, the government usually finances the budget deficit through money creation, thus causing inflation. In most countries, the budget deficit still remains high and it is one of the most lagging features of the reform process. Some kind of inflow of capital might be necessary to tide over the critical situation of the government budget. The relationship between the central and local governments is an issue which requires careful study because there are several possibilities of transfer of funds between them.

Cambodia

The ratio of fiscal deficit to GDP remained at the 3-5 percent level during the period of 1990-1992. Four major factors have contributed to this substantial deficit: 1) the rapid privatization of the economy, which reduced the role of SOEs as a traditional source of taxation, 2) the weak elasticity of many of the established sources of revenue, 3) the gradual abolition of forced procurement at below market prices from the agricultural sector, and 4) the elimination of Cambodia’s credit facility.

China

The balance of the central government budget was slightly negative or slightly positive before 1987, but it turned to positive beginning in 1987.

Laos

The ratio of budget deficit to GDP has been declining, from 20.3 percent in 1988 to 8.9 percent in 1992, but it still remains high. Most of the budget deficit is financed by foreign assistance.

Mongolia

In spite of the government’s effort to reduce fiscal expenditure and to implement a new tax regime, the ratio of budget deficit to GDP, while it is decreasing, has stayed high (around 10 percent).

Vietnam

The ratio of government expenditure to GDP remains roughly stable between 1988 and 1992. That of government revenue has gradually increased during that period. As a result, the fiscal deficit gradually decreased.

(Sugita, Mihira)
### Chart 1-II-1 Overview of Transition Process

<table>
<thead>
<tr>
<th>Year</th>
<th>Fiscal</th>
<th>Financial</th>
<th>SOE</th>
<th>Agricultural</th>
<th>Foreign Exchange</th>
<th>Foreign Trade</th>
<th>Foreign Investment</th>
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<td>1981</td>
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<td>V</td>
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<td></td>
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</tr>
</tbody>
</table>

(Note)
- CH: People's Republic of China
- M: Mongolia
- V: Socialist Republic of Viet Nam
- L: Lao People's Democratic Republic
- CA: Cambodia
- ●: Turning point in reform process
- : Progress of reform not significant
Table 1-II-1 Achievement of Reform

<table>
<thead>
<tr>
<th></th>
<th>Cambodia</th>
<th>China</th>
<th>Laos</th>
<th>Mongolia</th>
<th>Vietnam</th>
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<td><strong>Price Liberalization</strong></td>
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<tr>
<td>Share in Value of Turnover</td>
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<td>79%</td>
<td>?</td>
<td>more than 90%</td>
<td>?</td>
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<td>Non-Liberalized Items</td>
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<td>?</td>
<td>3</td>
<td>quite a bit</td>
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<tr>
<td>Liberalization of Lending Rates</td>
<td>?</td>
<td>×</td>
<td>×</td>
<td>×</td>
<td>×</td>
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<tr>
<td>Entering Liberalization in Banking</td>
<td>?</td>
<td>×</td>
<td>○ Licensed</td>
<td>○</td>
<td>×</td>
</tr>
<tr>
<td><strong>Share of State Enterprises</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Value of Production</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>in Non-Agricultural Production</td>
<td>?</td>
<td>48.4%</td>
<td>?</td>
<td>Heavy Industry 15%</td>
<td>Light Industry 30%</td>
</tr>
<tr>
<td>in GDP</td>
<td>?</td>
<td>--</td>
<td>?</td>
<td>?</td>
<td>33.3% in GNP</td>
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<tr>
<td>Employment</td>
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<td>18.3%</td>
<td>?</td>
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<td>Admission of 100% Foreign Investment Enterprises</td>
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</table>
Chart 1-II-2 Comparison of Economic Performance

GDP

GDP ASIA
CURRENT ACCOUNT (PERCENT OF GDP)

CURRENT ACCOUNT (PERCENT OF GDP) ASIA
Chapter III Lessons of the Experiences in Asia

The purpose of this chapter is to consider what kind of lessons can be drawn from the experiences of transitional economies in Asia. The observation of the previous two chapters leads to a couple of points to be noted. First the experiences are highly diverse. This reminds us the fact that transition to a market economy is a fundamentally diverse phenomenon and closely related to the specific conditions of respective countries. This point should be fully taken into account when we design a reform program of a specific country. Second there are three major determinants of the patterns of transition and the macroeconomic performance of transitional economies: (a) initial conditions at the beginning of transition/reform, (b) international environment, and (c) strategy of transition/reform, in other words speed and sequence in reform programs.

1 Diversity

When we review the experiences of former centrally planned economies in Asia, we find that the situation is quite different from one to another country. The implication is that we should pay due attention to specific country conditions when we deal with the issue of transition, and we should be careful not to easily apply a standard prescription for reform. The recognition of diversity, in our opinion, leads to a “pluralistic approach”, which allows multiple types of reform programs as alternatives.

Let us review several major aspects of diversity:

1-1 Political and Economic Reform

In China and Vietnam, the dominance of communist parties are still secured. In other words, in these countries, the two dimensions of reform, political and economic, are basically separated. On the other hand, in Mongolia and Cambodia, particularly in the former, political and economic reforms have been implemented in parallel.

1-2 Initial Conditions

When Asian countries started their attempts of transition to market economies, the socioeconomic conditions were significantly different each other:

(1) Duration of the Centrally Planned System

Mongolia, “the second oldest communist country in the world”, became a people's republic in 1924, introduced a centrally planned economic system just after the World War II. On the other hand, command economy was adopted in the southern part of Vietnam in 1975, only several years before the beginning of the reform attempts, which developed afterwards into transition to the market economy. The duration of centrally planned economies in other countries are placed somewhere between these two cases.

(2) Legacy of the Days before the Introduction of Command Economy

The residents of southern Vietnam or the coastal regions of China experienced, at least, “some kind of” market economies before their leaders established centrally planned systems. It is assumed that the memories of the rules of games in the old days had been maintained among them, consciously or unconsciously, until the beginning of transitions. On the other
hand, the Mongolians basically moved from nomadic society to centrally planned system, without enough opportunity of experiencing market economy. This was the big handicap when they tried to move toward a market economy.

1-3 Speed and Sequence of Reforms

In Asia, many countries spent rather long time in their reforms within the framework of centrally planned system, and afterwards shifted to transition to market economies. The fundamentally similar “piecemeal” reforms were initiated around 1980, in China, Vietnam, and Laos, almost simultaneously. These reforms developed into transition to market economies in the late 1980s. Although these three countries shared the period of gradual reforms composed of piecemeal measures, they experienced different speed of reforms afterwards. Since 1989, the speed of the reform in Vietnam has been accelerated remarkably, in accordance with the suggestion of the IMF and the World Bank, whereas such acceleration is not notable enough in China and Laos. On the contrary, Mongolia started its transition without significant record of the reform within the framework of centrally planned system.

In China, open door policy was an important part of its reform program from the very beginning. In this regard, the reforms of Mongolia and China share the common features. In contrast, Vietnam and Laos postponed the reform in eternal economic relations until the late 1980s.

1-4 Macroeconomic Performance

The macroeconomic performance of Asian transitional economies is also diverse. Throughout the 1980s and the early 1990s, China has shown an impressive record of rapid economic growth and export growth. In the meantime, since the mid 1980s, the threat of inflationary pressure became chronic in China, and they had to have periods of stabilization through tight-belt policy periodically. The performance of Vietnam has been impressive too as far as economic growth is concerned, particularly when we take into account that Vietnam had to overcome the adverse impact of the collapse of the CMEA system. While the Vietnamese economy suffered from hyper-inflation until recently, they finally succeeded in pulling down the inflation rate to single digit. This was another great achievement made by Vietnam.

On the other hand, the Mongolian economy has been faced with serious macroeconomic disequilibria composed of reduction of GNP, high rate of inflation, and deficit of international balance of payment. Originally such imbalance was caused by the collapse of the CMEA system, particularly the fact that the capital flow from the former USSR ceased entirely in 1991. The stabilization efforts under the guidance of the international institutions such as the IMF and the World Bank could not lead to any remarkable recovery.

1-5 International Environment

Most of the transitional economies in Asia were related to CMEA. Their relationship with CMEA which determined the basic structures of these economies played important roles as the determinants of the paths of reforms. The dependence on CMEA was extremely large in the case of Mongolia; the trade with CMEA accounted for over 90 percent of the total
amount of trade during the 1980s\textsuperscript{1} and in addition CMEA was by far the largest donor. It was also significant in Vietnam, although to a lesser extent; until 1988 the trade with CMEA had accounted for more than 50 percent;\textsuperscript{2} and CMEA was by far the largest donor. These economies were inevitably hit severely when CMEA collapsed in the late 1980s.

At the same time, most of these transitional economies were geographically close to the dynamic economies of the East Asia (Japan, Asian NIES, and ASEAN countries). The merit of the proximity is especially apparent in the trade and capital inflow China and Vietnam, as we will discuss in 2 below.

2 Determinants of Macroeconomic Performance

What caused the aforementioned difference in the macroeconomic performance among the transitional economies in Asia? It should be pointed out that the initial conditions and international environment mentioned above played crucial roles. This is the point Jeffrey Sachs and Wing Thye Woo stressed regarding the reform in China in their recent article.\textsuperscript{3} However, at the same time, it should be admitted that in addition to these two factors the strategies of transition adopted in Asia, particularly in China and Vietnam, contributed to a large extent.

The purpose of this section is to analyze these three determinants of macroeconomic performance.

2-1 Initial Conditions

(1) The Penetration of the Principle of Command Economy

The more the principle of command economy is established the heavier the burden of reform. Let us adopt the share of labor force working in state enterprises as an indicator of the penetration of the principle and compare the figures among China, Vietnam and Mongolia.\textsuperscript{4} It was 18.8 percent when China started its reform attempts (1979). It was 14.2 percent when the reform attempts were under acceleration in Vietnam (1988). On the other hand, in Mongolia, just before the beginning of the reform (1990), the figure was 70.1 percent. These figures suggest the difficulty of transition attempts in Mongolia, in comparison with other two countries.

In Russia, before Perestroika (1985), 93.1 percent of total employment was in state enterprises.\textsuperscript{5}

(2) Experiences of Market Economy

As was explained in 1-2 above, the experiences of market economy before the introduction of centrally planned economic system were advantages of China and Vietnam. In this regard, Mongolia were severely handicapped.

2-2 International Environment

After the adoption of open door policies, China and Vietnam became integrate parts of rapidly developing intraregional economic networks in East Asia. In particular, the association with overseas Chinese (in the case of Vietnam, overseas Vietnamese too) enabled these two economies to increase export and attract foreign investment. At the same time, they fully enjoyed the advantage of the late comers, as they learned the effectiveness of outward
oriented development strategy from the experiences of the neighbouring predecessors (Asian NIES and ASEAN countries), and repeated similar measures to realize outward oriented growth which were already tried and proven effective by these predecessors. In other words, they could take advantage of the external economy of dynamic development in this region.

Unfortunately, Mongolia was physically remote from the spreading dynamism in East Asia, and it did not have sufficient size of overseas entrepreneurs, as China and Vietnam did. On the other hand, the close association with CMEA placed Mongolia in a highly distorted trade system and made it difficult for Mongolia to restructure its industrial structure in accordance with comparative advantage. Mongolia suffered from external diseconomy of CMEA seriously.

2-3 Mode of Economic Reform

In spite of the importance of the initial conditions and international environment, it is not possible to entirely explain the superior macroeconomic performance of China and Vietnam by these two elements. There is another crucial determinants, that is the mode of economic reform. Although we observe various features of the reform attempts in these two countries, in our opinion, three aspects explained below are the most important:

(1) Gradual Implementation

As we saw in 1-3, since the initial stage of reforms (still within the framework of centrally planned system), China and Vietnam spent long period before the beginning of full-scale transition toward market economies. Although these two economies might suffered from the piecemeal characteristics of reforms without clear blueprint, the careful and gradual changes of the rules of the games could avoid damage to the real sectors through giving enough time to adjust to the new situation. This presents a striking contrast to what happened in Mongolia as a result of sudden and fundamental changes of the rules. By the way, the case of Mongolia resembles the experience of Russia.

(2) Agriculture First

In these countries the first effort of the reforms was made in the agricultural sectors. A “contract responsibility system” was introduced with the objective of restoring the family as the basic unit of production instead of “the Commune system of socialized agriculture”. At the same time, procurement prices of agricultural products were raised. The purpose of these measures was to give incentive to farmers, who were the majority group. The improved agricultural production as a result of these efforts provided firmer basis for the following stages of reform as both economies were basically agricultural economies. Particularly in China, capital accumulation in rural areas led to the evolution of township and villages enterprises which became an engine of the rapid growth afterwards.

If reforms were started simultaneously in all the sectors, agricultural sectors had to experience deterioration of terms of trade (this was what happened in the later stages in both economies), and there could be less stable real sectors.

(3) Slow Progress of Privatization of State Enterprises

Perhaps state enterprise reform if the most difficult subject in transition to a market economy for many reasons including the lack of social safety net. Most transitional economies are faced with serious problems in this field. The feature of the reforms in China and
Vietnam is found in the fact that the transfer of ownership has not been the major issue, unlike Mongolia (and Eastern Europe and Russia), where ambitious mass privatization attempts through voucher or coupon have been popular. Instead China and Vietnam focused their attention on the promotion of private sector on the one hand, and gradual restructuring of state enterprises on the other hand.

This approach seems to be a realistic and pragmatic one, as they can expect rapid and sustained increase of private investment which will finally reduce the magnitude of the problem of state enterprise substantially within the total economy so that the governments can tackle the subject in a more drastic manner. In other words, the basic idea is to “contain” the problem of state enterprises. Under such a strategy, a central issue is how to restructure or rationalize the management of state enterprises without causing social unrest or financial collapse. Although the situation of state enterprises are serious especially in China, these countries seems to have good chance to succeed in containment of the problem heavily relying on the development of private sectors. (Shimomura)
FOOTNOTES

1/ source: World Bank
2/ source: IMF
3/ SACHS and WING, 1994
4/ sources: World Bank
5/ SACHS and WING, 1994
6/ In China the agricultural production has grown at the average rate (1980-1992) of 5.4 percent. Vietnam became the third largest exporter of rice finally.

REFERENCE

## APPENDIX (Selected economic indicators of five Asian economies)

### 1. Growth Rate of GDP (per cent per annum)

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<tr>
<td>China</td>
<td>1978</td>
<td>7.9</td>
<td>10.4</td>
<td>11.8</td>
<td>4.4</td>
<td>3.9</td>
<td>8.0</td>
<td>13.2</td>
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### 2. Sectoral Share of GDP (per cent)

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### 3. Changes in Consumer Prices (per cent per annum)

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### 5. Growth Rate of Merchandise Exports (per cent per annum)

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### 6. Growth Rate of Merchandise Imports (per cent per annum)

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8. Balance of Payments on Current Account ($ million)

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9. Balance of Payments on Current Account (per cent of GDP)

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10. Debt-Services Ratio (per cent)

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11. Government Expenditure (per cent of GDP)

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12. Total Revenue (per cent of GDP)

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13. Overall Budget Surplus/Deficit of Central Government (per cent of GDP)

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Source: Asian Development Outlook 1994
Note: Date for 1993 are Preliminary. Those for 1994 and 1995 are estimates.