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International Economic Integration, Competitiveness and Rural Livelihoods in Viet Nam



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FOREWORD BY THE UN RESIDENT COORDINATOR

This paper is part of a series of discussion papers produced by the United Nations Country Team in Viet Nam. Drawing on the various substantive and technical expertise of UN agencies in the country, these papers examine priority development concerns in Viet Nam, offering a snapshot of some of the major challenges and opportunities in responding to these key issues. The papers are meant to generate discussion and debate in an ongoing effort to develop a better response to address these problems.

This current discussion paper on Viet Nam's international economic integration, competitiveness and rural livelihoods is the first of this series. United Nations agencies in Viet Nam have recently supported a set of studies relating to international economic integration and agricultural development.¹ The latest of these is a policy study that focuses on means of improving the competitiveness of four key export crops through improvements to quality and to the efficiency of processing and marketing.² This discussion paper draws extensively on this study.

To view the full series of discussion papers, please visit the website of the United Nations in Viet Nam at www.un.org.vn.

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¹ *The Competitiveness of the Agricultural Sector of Viet Nam: A preliminary analysis in the context of ASEAN and AFTA*, Ministry of Agriculture and Rural Development and Ministry of Fisheries/FAO, Ha Noi, October 2000; *Developing an Export Food Inspection and Certification Programme in the Republic of Viet Nam*, Directorate for Standards and Quality/FAO, Ha Noi, April 2001.

² *Policy for International Competitiveness of Agricultural Products in Viet Nam*, UNDP/FAO, Ha Noi, November 2001.

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EXECUTIVE SUMMARY

Over the past decade, Viet Nam has demonstrated that its agriculture is competitive internationally in that it has been able to grow its share of the world market in a number of important agricultural commodities. However, recent falls in the world prices of the majority of Viet Nam's key agricultural exports have highlighted problems inherent in the nation's new, market-based agricultural sector. In particular, the areas planted with perennial export crops tend to be of low productive potential in terms of both quality and quantity; there has been insufficient development of the structures of national marketing systems; and many farm households lack the capacity to cope with the highly unstable net incomes that they derive from the production of perennial export crops. As a consequence of these deficiencies, Viet Nam's major agricultural exports tend to realize unit values that are below those achieved by other countries.

This paper examines these problems, discusses means of addressing them, and proposes possible policies and measures. These potential policies and measures will be studied in more detail in follow-up UN-assisted research, and the conclusions will be the subject of a future UN discussion paper.

GLOSSARY OF TERMS

- Arabica coffee:* A species of coffee that accounts for some two-thirds of world output. It is grown principally in Central and South America. Small amounts are produced in Viet Nam
- Border prices:* Price paid for export commodities at the Vietnamese border
- Green coffee:* The form of coffee in which the majority of world trade takes place, obtained by removing the outer flesh and inner ‘parchment’ skin from the coffee cherry
- Perennial plants:* Plants that live for more than two years, such as coffee and cashew trees, tea bushes, and pepper vines
- Producer prices:* Prices paid to farmers and farm enterprises for sales of farm products made either at the farm or at a point off the farm, such as a processing plant
- Projected yields:* Estimates of future yields
- Robusta coffee:* A species of coffee that accounts for about one-third of world production. It is grown mainly in West Africa and South-East Asia. Viet Nam is the world’s largest producer. Robusta is less susceptible to disease and normally has higher per-hectare yields than Arabica. However, it is considered to be of inferior quality and trades at lower prices on world markets
- Seasonal stockholding:* The holding of stocks during the crop year in which the commodity is produced
- State marketing board:* A Vietnamese Government marketing board to promote agricultural products

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I. THE IMPACT OF INTERNATIONAL ECONOMIC INTEGRATION ON AGRICULTURAL DEVELOPMENT IN VIET NAM

The contribution of international economic integration to agricultural growth

Agricultural output in Viet Nam has grown at a rapid pace since the initiation of the *doi moi* reforms in 1986, driven by the progressive liberalisation of the national economy and the recognition of farmers as autonomous economic agents. This growth has led to a marked reduction in rural poverty and to Viet Nam switching from being a net importer of foodstuffs to a major exporter.

The substitution of domestic production for rice imports was a major feature of the early period of growth. More recently there has been a limited amount of further import substitution for commodities such as sugar. Increases in domestic demand for foodstuffs and beverages stemming from growth in the national population and in per capita incomes have also provided further outlets for increases in national agricultural output. However, over most of the past decade, the main outlet for such increases has been the world market. During this period, Viet Nam has moved from being an importer of rice to the world's second largest exporter. It has also moved from being only a minor producer of coffee to by far the largest exporter of the Robusta variety. Its export volumes of all coffees are now on a par with Colombia, the world's second most important coffee exporting nation. In recent years Viet Nam has also become a major exporter of cashewnuts, pepper and aquatic crustacea.

The domestic markets for coffee, cashewnuts and pepper are all small. As such, they could not have provided an outlet for the large increases in production that Viet Nam has achieved. In the case of rice, the growth of production would have been substantially slower in the absence of exports, since the large surpluses generated would have depressed prices in the domestic market to well below those that have been realised for exports. Thus, it is evident that the existence of global markets and the integration of Viet Nam into these markets has been a prerequisite for the rapid expansion of the agricultural sector.

Problems faced as a consequence of the rapid pace of growth

Viet Nam's agriculture has proved itself to be highly competitive internationally in the sense that the nation has been able to expand its share of world trade for a range of important agricultural commodities.

Notwithstanding these achievements, the rural sector has grown less rapidly than the economy as a whole and remains the most problematic sector in terms of the prevalence of poverty and its manifestations. In 1998, an estimated 94 per cent of Viet Nam's poor lived in rural areas. Since poverty is the main factor limiting the access of households to food, the incidence of food insecurity and malnutrition is also higher in rural than urban areas.³

During the past decade, the Government has continued to publish development plans containing growth targets for individual agricultural commodities and it has attempted to support and guide the development of agricultural production through the provision of soft loans and other financial support to farmers. However, the remarkable pace of agricultural expansion has principally been the result of small-scale farmers reacting spontaneously to market incentives. One manifestation of this is that farmers have moved into crops in which they have little or no prior experience and for which the Government has been unable to provide all necessary extension support. In the case of processing and marketing, although physical capacity has largely kept pace with the nation's rapidly expanding farm output, this has mainly been achieved simply by replicating the basic structures and systems that existed when production was only a fraction of its present level.

The end result of this process of rapid, spontaneous expansion is that:

- farm households tend to lack the capability to cope with exposure to unstable and unpredictable world market prices;
- the capacity of much of the present stock of perennial bushes, trees and vines is sub-standard in terms of both yield potential and output quality;

³ See: *The State of Food Insecurity in Viet Nam: progress since the 1996 World Food Summit*, Department of Planning and Projection, Ministry of Agriculture and Rural Development.

- highly intensive production methods have been employed which are thought to be unsustainable⁴;
- processing and marketing systems are unsuitable for the present level of output and, in some instances, for the major influence that national exports have on world prices; and
- as a consequence of these deficiencies, Viet Nam's major agricultural exports tend to realise unit values that are below those achieved by other countries. This is the case for the country's two main agricultural exports, rice and coffee, and also for other export crops, such as tea.

II. RECOMMENDED POLICY MEASURES AND ACTIONS

Improving the ability of Viet Nam's farmers to cope with exposure to world market forces

A key characteristic of agricultural growth during the 1990s was that, other than for rice, it was concentrated heavily on perennial crops. By 2000, Viet Nam had 517,000 hectares under coffee, 407,000 hectares under rubber, 250,000 hectares under cashew nuts, 90,000 hectares under tea, and 25,000 hectares under pepper.

Viet Nam's opening up of its agricultural economy to the world market has necessarily been accompanied by the progressive withdrawal of the Government from direct intervention in pricing. Together, these changes have resulted in the country's farmers being exposed to international price instability. This, in turn, has led to their facing producer prices that are both less stable and less predictable than before.

The combination of unstable and unpredictable producer prices and the long-term nature of most agricultural investment creates major problems for farmers, especially those growing perennial crops. These problems are of two distinct types. The first relates to the allocation of agricultural resources. In the absence

⁴ The intensive use of chemicals is a major cause for concern in the case of coffee and tea production. Physical sustainability is not discussed further in this paper but is an issue that needs to be urgently addressed.

of advice to the contrary, farmers tend to invest in crops that they observe to be profitable at the time that they make their investment decision. Thus, they tend to commit themselves to a crop when its world price and the profitability of production are high. In Viet Nam, small-scale farmers have been particularly prone to making a commitment to new perennial crops on this basis since their main experience is often of rice production, where the production cycle spans months rather than many years. This tendency has been exacerbated by the fact that they usually have not had access to marketing extension advice. Investing on the basis of peak prices means that some farmers plant in unsuitable areas where, taking good year with bad, they will make lower profits than those obtainable from other activities. This represents a misallocation of resources.

Even for those farmers who end up planting the crop most suitable for their location, planting at the time of peak prices is inadvisable since producers worldwide tend to do the same. The farmers' new output consequently then comes on stream as world prices are starting to decline as a result of the maturation of new capacity worldwide. Efficient investing requires production to come on stream in the upswing of the price cycle.

There is great potential to assist farmers to improve their decision-making on investment through the provision of advice. Viet Nam's extension services currently focus on production and provide farmers with little or no advice on marketing. The establishment of an effective marketing extension service would be likely to lead to a major improvement in the quality of the investment decisions made by small-scale farmers.

The second problem stemming from world price instability applies to all farmers producing the crop, even those for whom it is the most appropriate alternative. All will face the problem of coping with an unstable stream of gross annual incomes that leads to great instability in annual net income, possibly with a run of several years when net incomes are negative.

The high instability in the world price of perennials and the severe impact that this has on the margins earned by farmers is exemplified by the experience of Vietnamese coffee farmers over the past three years. In 1995, nominal world coffee prices reached their highest level for ten years. This followed a fall in world output that stemmed from the lagged impact of the low international

prices experienced after the collapse of the International Coffee Organisation's export quota system in 1989. The prices for both Arabicas and Robustas then remained reasonably buoyant until 1998, stimulating planting worldwide. As new production came on stream, world prices declined, falling to their lowest ever levels in real terms in 2001. The impact of this on the mean price paid to Vietnamese coffee farmers in the immediate post harvest period in each of the past four years will be seen from the table below.⁵

DERIVATION OF THE NET MARGINS OF AN EXPERIENCED COFFEE FARMER WITH MATURE TREES, 1998-2001 (US\$)

	1998	1999	2000	2001
Price per ton into processing plant	1,525	1,144	854	472
Cost of production per ton	500	500	500	500
Net margin per ton	1,025	644	354	-28
Net margin per hectare	3,280	2,061	1,133	-90

Sources: VINACAFE, Institute of Agricultural Economics.

If Viet Nam is to remain internationally competitive in those commodities for which it has established a world market presence, it is essential that farm households have the ability to maintain output and production capacity during periods of low international prices. It is also essential that farm households, despite radical changes from year-to-year in the net income that they generate from export crops, are able to maintain an ability to fund household expenditures, including the purchase of food and other necessities.

⁵ The price data refer to the price in January of the year shown at which farmers sell their green coffee to processing plants. The cost data refer to *an experienced farmer in a good growing area with mature coffee*. Net margins from 1998 to 2000 will have been smaller and the loss in 2000 greater for the many inexperienced farmers who entered the industry in the late 1990s and remain saddled with the cost of financing their initial investment. The costs in the table refer to 2000 and are assumed to be the same in each year. In practice, costs will have increased annually with inflation, leading to greater instability in net margins than that shown.

The problems created by instability in the world price of a particular commodity can be addressed at six different levels. Efforts can be made to:

- reduce instability in the world price;
- reduce instability in the export price at Viet Nam's borders, given a particular level of world price instability;
- reduce instability in producer prices, given a particular level of export price instability;
- mitigate the impact of producer price instability on the stability of the net income of the farm enterprise;
- mitigate the impact of instability in the net income of the farm enterprise on the stability of the farm household's income;
- compensate the farm household for instability in its income.

Stabilising world and border prices. Universally, attempts over the past half-century to stabilise world prices have met with little success. Viet Nam could reduce instability in the prices at which it exports through measures to improve quality, since the prices of high qualities tend to fluctuate less than those of poor qualities. Other than for this, there is probably little scope for measures to stabilise export prices. This applies to minimum price arrangements, such as that attempted unsuccessfully for coffee by the Viet Nam Coffee and Cocoa Association in early 2001. It also applies to conventional risk management instruments since these cover short periods only and cannot insure farmers against price downturns spanning several years.

Stabilising producer prices. For export commodities, producer prices are normally *less* stable than border prices because of the deduction of fixed domestic marketing and processing costs. Worldwide, national attempts to reduce instability in producer prices through price stabilisation schemes have a history of failure. Such schemes require an ability to forecast world commodity prices, something that few if any governments have. Both Viet Nam's central government and some provincial state-owned enterprises have made attempts in the recent past to stabilise producer prices through *ad hoc* measures, but these have proved either expensive and/or unable to do more than delay a reduction in these prices.

Stabilising the net incomes of farm enterprises. Traditionally, small-scale farmers reduce their exposure to price and output risk by producing a mix of

commodities. In Viet Nam, the scope for this is limited due to the small size of most farm plots. However, there may be some scope for interplanting perennials with other crops and for diversifying into intensive livestock production.

Mitigating the impact on farm household income. Notwithstanding the limited potential for diversification, the greatest scope for reducing the impact of international price instability would seem to lie at the level of the farm enterprise and household. There would seem potential for innovative measures that reduce the burden of unstable crop revenues, such as loan schemes for crop establishment that have flexible interest and repayment schedules linked to the ruling level of the crop's world or domestic producer price.⁶ There is also potential for measures to expand rural employment in activities that are neither linked directly to the major export crop of the area nor are sensitive to income levels in the locality. Such measures would go a long way to preventing severe hardship by allowing the income of one or more household members to be independent of the farm-gate price of the household's main crop.

Compensating the farm household for instability in its income. As a last resort, safety net schemes could be triggered rapidly by pre-researched and determined changes in commodity price indicators.

In summary, instability in the incomes of farm enterprises and households is arguably the most important single problem faced by Viet Nam's rural households as a result of the integration of the agricultural sector into the global economy.⁷ Thus, it is recommended that, for each major agricultural export commodity, the Government develop programmes to mitigate the impact of international price instability on (a) the efficiency of farm investment decisions, (b) the ability of the nation to sustain production capacity and remain competitive during price downturns, and (c) the welfare of farm households.

⁶ Experience with such schemes is reviewed in *Financing Term Investments in Agriculture: A report prepared for the World Bank by the Marketing and Rural Finance Service of FAO*, Food and Agricultural Organisation of the United Nations, August 2001

⁷ Many agricultural commodities, including tea and coffee, have experienced a downward trend in real prices over the long term. Should such declines continue, they will pose additional problems for Viet Nam of a different nature from those caused by short and medium-term price instability.

The starting point of such a study would need to be a thorough examination of the impact of recent falls in the prices of key export crops and of the means by which these have been addressed to date by central Government, state-owned enterprises, local authorities, private sector enterprises, financial institutions, non-governmental organisations and farm households.

Improving the quality of existing perennial crop capacity

Spontaneous planting in the absence of adequate extension advice has meant that the present stocks of perennial trees, bushes and vines tend to comprise mainly low-yielding, low-quality varieties, the output of which has been further compromised by inadequate establishment practices and subsequent poor maintenance. As a consequence, by international standards, both per-hectare yields and quality are typically low.

A key issue is how the inadequacies of the current productive stocks of perennials should be addressed and, in particular, whether replanting or rehabilitation is the most appropriate course of action. This will vary from crop-to-crop and, for each particular crop, it will differ between agro-climatic zone and between individual farmers within zones.

In the absence of advice, the large majority of farmers will be unable to make a rational choice between replanting and rehabilitation since, for each of the activities, this requires an ability to make projections for each future year until output stabilises of (a) the costs involved, (b) projected yields, (c) producer prices, and (d) how quality change will enhance producer prices. It also requires an ability to evaluate and discount costs and benefits to present values.

Systems to provide such advice need to be established by government or on a contract farming basis since the adoption by farmers of efficient perennial crop development strategies is likely to yield major benefits in terms of increases in agricultural sector value added, farm household income and national export earnings. The first step must be to make an assessment, using the best data currently available, of the physical impact of rehabilitation and replanting for each level of existing yield in each of the main producing areas. This would most appropriately be undertaken by Ministry of Agriculture and Rural Development (MARD) at the provincial level but should be supported by methodological development and training by MARD national staff.

Enhancing the efficiency of processing and marketing

For some export commodities, such as coffee and pepper, the rate of expansion of national production has been spectacular. The successful establishment of a capacity to process, transport and market the rapidly expanding output of such commodities has been equally impressive. However, the race to keep pace with production increase has meant that processing and marketing systems have remained relatively basic and inappropriate to a country that has established itself as a major world producer. The end result of this, as noted above, is that many of the country's agricultural commodities tend to sell on world markets at large price discounts. If Viet Nam's major agricultural exports are to remain competitive, it is essential that these discounts be reduced, thereby increasing national export earnings and the incomes of farmers.

The price discounts are partly a result of the physical quality of the commodities exported. However, they are also caused by a lack of systems that ensure an orderly supply of the commodity to the world market. This is particularly the case for coffee and pepper. For these commodities there are no private or public institutions beyond the farm gate that play a major role in seasonal stockholding. There are no marketing boards and the state and private enterprises that process and trade the crops aim to hold no more than working stocks. The result is that a disproportionate amount of Viet Nam's annual production is supplied for export in the immediate post-harvest period. This was not a great problem when Viet Nam's contribution to world export supply was small. However, now that Viet Nam has a major share of the world markets for both commodities, it depresses world prices and reduces the prices at which the country sells a large part of its crop.

As production has expanded, farmers have tended to take on the role of seasonal stockholder, reaping benefits from the rising markets experienced in the late 1990s. However, they will be less willing and less financially able to do so following recent sharp falls in international prices. Thus, the problem of seasonality of export supply is likely to worsen, unless corrective measures are introduced.

For storable commodities, such as coffee and pepper, the need is for Viet Nam to develop marketing systems that provide an orderly flow to the world market. In many countries, this was achieved until recently through the compulsory

use of state marketing boards. These boards proved difficult to manage efficiently and tended to spawn high cost, inefficient domestic systems of marketing. Assuming that the Government will not seek to establish marketing boards, given their history and given Viet Nam's intention to join the WTO, an orderly supply for export will require a system in which trading enterprises see it as in their interest to hold seasonal stocks. This will require that traders both have access to the funds needed to finance seasonally a substantial proportion of annual production and are able to hedge the risks of stockholding.⁸

The foundation of a system of hedged stockholding would be a set of certified warehouses where traders would deposit their stocks in return for an official receipt that stated the quantity deposited and its precise grade. Such receipts could be deposited with banks as security for inventory-based loans, would be tradable, could ultimately be bought and sold at a domestic auction, and could form an element of a system of Viet Nam-specific futures contracts that could be used to hedge the risk of domestic stockholding.

It is recommended that the Government undertake a detailed study of the potential of such a system for coffee, with a view to subsequently extending the concept to other storable export commodities. While this recommendation may seem unnecessarily ambitious, it should be viewed in the context of the high value of Viet Nam's exports and the important role that Viet Nam now plays in the world market for a range of commodities. In 2000, national export earnings were over US\$140 million for rubber, cashew kernels and pepper, and in excess of US\$500 million for rice and coffee, despite depressed world prices. For all these commodities Viet Nam now has a major share of the world market.

⁸ The holding of stocks is risky since the price of the commodity may fall leading to the stockholder incurring a loss. The risk of incurring such a loss can be eliminated by selling forward at a pre-determined price, by selling and buying on a future market, or by purchasing an option to sell at a future date at a predetermined price.

III. CONCLUSIONS

Over the past 15 years, Viet Nam has achieved a rapid growth in agricultural output that has enabled it to move from being a marginal food importer to a major exporter of agricultural commodities. Although this has increased rural incomes and improved the welfare of the majority of rural households, recent downturns in the world prices of some of the country's main agricultural exports have highlighted problems inherent in the nation's new, market-based agricultural economy.

This paper has highlighted three major deficiencies:

- the high level to which perennial crop farmers and their households are vulnerable to price risk;
- the poor quality of a large proportion of Viet Nam's established perennial trees, bushes and vines; and
- the inability of the current processing and marketing systems of major export crops to ensure that the prices received by farmers are maximised.

UN agencies recognise the importance of these problems and the need for the international community to support Viet Nam in urgently seeking solutions. It will be essential that the Government, the private sector, non-governmental organisations and the international community work in partnership to develop measures to ensure that Viet Nam's rural communities reap the full benefits of the successful expansion of agricultural output, while not compromising their access to food and other necessities.

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