

VU HUNG CUONG¹

ECONOMIC RESTRUCTURE AND REFORM OF GROWTH MODEL IN VIETNAM

Abstract. Since the 1986 economic reforms known as "Doi Moi" (All Round), the policies of Vietnam have been guided actively towards a more open and integrated economy within the world economy. After a period of rapid growth, Vietnam has a number of global recognized achievements. In 2010, Vietnam emerged as a lower middle income country based on World Bank rankings. Economic structures have been progressively modernised; social-economic infrastructure has improved significantly both in quantity and quality; some new and high technology industries have been introduced and developed. Recent research, however, indicates that the Vietnamese growth model has reached an end point and in this new context, the model reveals some weaknesses which require fundamental changes to occur. This need to reform the growth model becomes more urgent than ever to avoid a middle income trap and to improve competitiveness in order to actively cope with external risks in an international integration process, to step forward quickly, and to narrow the development gap with other countries in the region and the Global Economy. This paper focuses on analyzing the weaknesses, shortcomings of the economic structure and current growth model in Vietnam with an aim to propose new directions and some key measures to implement economic restructuring in parallel with reforming the growth model for the period 2012–2020.

Key words: Vietnam, economic structure, economic growth model

WEAKNESSES AND SHORTCOMINGS OF THE CURRENT ECONOMIC STRUCTURE AND GROWTH MODEL

The success of economic reforms and integration of Vietnam for the last 25 years has been widely recognized nationally and internationally. In recent years, the economy, however, has faced a number of difficulties and challenges. GDP growth is still at a high level but is decreasing; inflation has always been at higher rate com-

¹ The Author is researcher at Vietnam Academy of Social Sciences (VASS) (e-mail: cuongvh@vass.gov.vn).

pared to the average inflation levels of other regional economies and other world economies; macroeconomic balances including the current account deficit, fiscal deficit, gaps between domestic savings and social investment, and national foreign reserves have been unstable for many years; enterprises have been coping with many difficulties and challenges in accessing credit at reasonable interest rates and in selling products leading to a real increase in the closing of business, suspension of business activities or downsizing production. There is also a rising level of bad loans and liquidity difficulties for some credit institutions.

These risk of economic stagnation and high inflation have become visible. Many reasons assessed objectively and subjectively in the short-term and long-term are the cause the current situation but it is suggested that these are mainly due to intrinsic issues accumulated in economic structure and growth model for many years. The current growth model is based on four main pillars: the exploitation of natural resources; cheap, unskilled labour; large and easy investment; and state owned enterprises with large advantages but low efficiencies. This has resulted, in a distorted structure with supporting industries and business elites unable or not capable of linking and joining regional and world production chains as well as an inability to compete and develop in normal way. The main weaknesses and shortcomings of the current economic structure and growth model can be summarized as following:

1. Horizontal growth. The motivation for high economic growth depends mainly on an increase in investment capital and the size of the labour force, however, the proportion of social investment has increased to a very large level, for many years up, to 40–42% of GDP. In 2008, the total investment of GDP of Vietnam ranked second among 145 countries of the world [CIA World FactBook 2009]. The contribution of investment to GDP growth increased dramatically from 5% in 1990 to above 60% in 2010 while the contribution of total factor productivity (TFP) to the growth decreased sharply from nearly 50% in 1990 to 40% in 2000 and around 16% in 2010.

2. The Government directly intervenes and influences investment and business activities while neglecting some important macro-economic functions of governance, planning, supervision, and management. The economy had as its main driving force state-owned enterprises (SOEs). During the period of 2006–2009, SOEs accounted for 45% of the total investment in corporate investment but contributed only 28% of GDP and 19% of GDP growth. They utilised 24% of the labour force and accounted for 20% of the total industrial production as well as 8% of the growth of industrial production value. The Vietnamese Government distributed around 33% of its fiscal budget as investment for development. In terms of the rate of public investment for GDP, Vietnam is one of the largest investor governments in comparison with others in the East and Southeast Asian regions [Vu Tuan Anh and Nguyen Quang Thai 2011].

3. Ineffective investment activities. The effectiveness of investment (ICOR – Incremental Capital-Output Ratio) in Vietnam is very low compared relatively to economic growth. Investment in the public sector is among the most inefficient. Ineffective public investment has accelerated at each stage of development in the race for GDP growth rate based on a which model relied heavily on investment. During the period 2008–2010, ICOR of the state sector is 4 times higher than that of private sector (Figure 1).

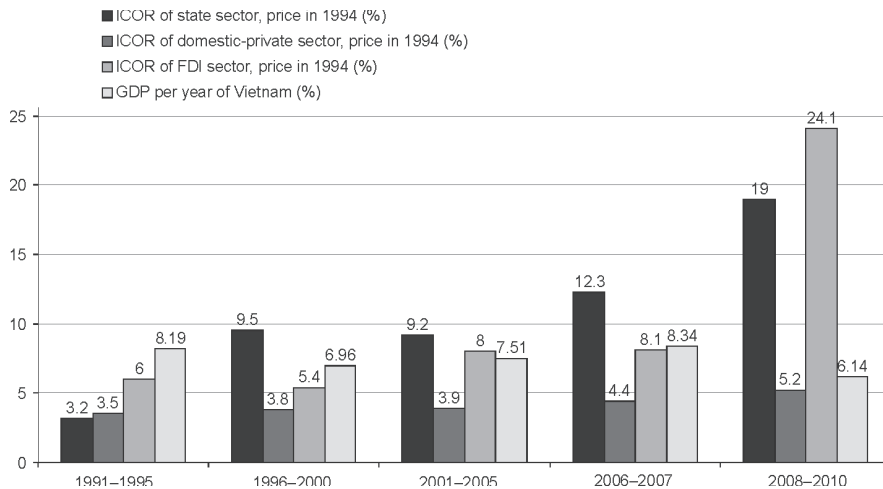


FIGURE 1. The effectiveness of investment in the state sector, 1991-2010

RYSUNEK 1. Efektywność inwestycji w sektorze państwowym, 1991-2010

Source: General Statistics Office and calculation by Nguyen Cao Duc (VASS).

4. Increasing credit with higher risk. The total cumulative investment of the year 1995 was equal to 100% of GDP, however, in the year of 2010, this level went up to almost 400% GDP. To supply such huge investment, the total outstanding level of credit increased from 25% GDP in 1995 to 50% and 135% in 2003 and 2010, respectively. The difference between domestic savings and investment in GDP in Vietnam improved during period 2001-2005, but it increased sharply during 2006-2010, revealing an alarm signal for the situation of the credit extension activities, in comparison with other countries in the region (Figure 2).

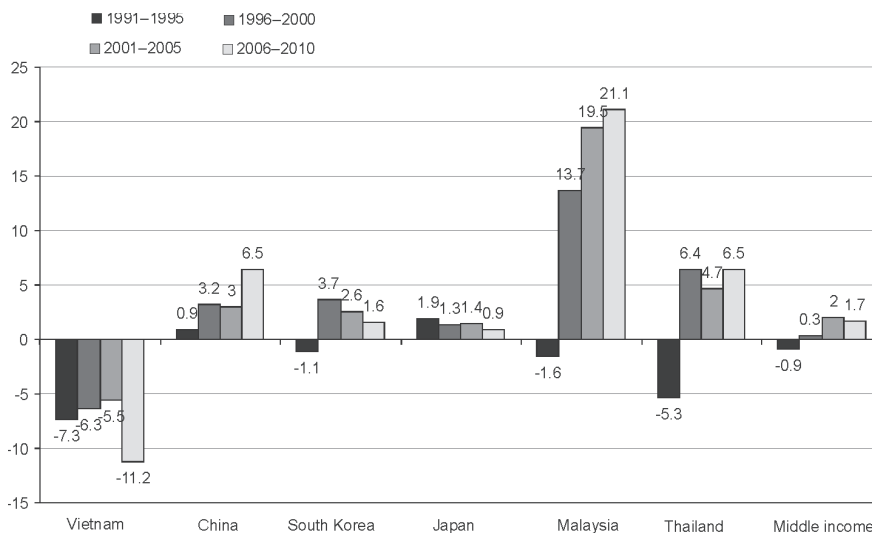


FIGURE 2. The difference between domestic savings and investment in Vietnam, 1991-2010 (% GDP)

RYSUNEK 2. Różnica między oszczędnościami krajowymi a inwestycjami w Wietnamie, 1991-2010 (% PKB)

Source: WB, IMF, OECD and calculation by Nguyen Cao Duc (VASS).

5. Shortcomings of macroeconomic management. Management had many of the same characteristics of a planned economy these being continued while the economy was gradually transformed to a open, integrated and market economy. In this newly emerged economy, the state sector only accounts for around 25% GDP. As a member of WTO, the Vietnamese open economy has an export turnover equivalent to 150–160% GDP with limited direct influence of government.

As a result, a number of macroeconomic instabilities have occurred during the period including imbalances such as high credit but lower savings, higher investment but lower returns leading to high inflation, high interest rates and the depreciation of currency; high budget and trade deficits; and property bubbles. From the above analysis, it is possible to draw two following conclusions about the current growth model:

Firstly, key factors of the horizontal growth model (increasing the scale of capital investment and labour) has reached its peak; the engine of growth relies on an increase of capital investment, and the labour force is weak and declining. While latent or new opportunities for horizontal growth of the economy are getting weaker and declining, the dynamics of vertical growth (including productivity and the efficient use of resources) are not improving to offset the deficient of horizontal growth. The challenges for Vietnam are to ensure that funds should be allocated to the economy through the most effective investments. Vietnam needs to reduce investment in non-making profit enterprises, including state-owned enterprises, at the same time strengthening the supervision of financial sector to ensure that capital investment is used appropriately for the most effective and highest profitable objectives.

Secondly, in addition to the maintaining of unsuitable horizontal growth in long-term, there has been little change over time, at all levels in other guidelines, policies as well as management and administration of the economy; Vietnam has been slow to overcome the bottlenecks of growth caused by infrastructure, institution, and a lack of highly-qualified human resources. These restrain the increase of productivity and competitiveness of both the economy and businesses. An increase of investment capital in various different forms and channels is a major tool to promote growth in the current growth model. To meet this requirement, the expansion of fiscal and monetary policies to be continuously maintained for many years. Currently this lack, is the one of the most important reasons that has lead to high inflation and macroeconomic instability in Vietnam.

ORIENTATIONS AND SOLUTIONS FOR ECONOMIC RESTRUCTURE ASSOCIATED WITH REFORMS OF GROWTH MODEL DURING 2012–2020

Approach methods

Economic restructuring refers to the reforming of mechanisms of sectors and areas as well as to reorganize the institutional system (sub-system) with a focus on retargeting to change the resource allocation system and its mechanisms. In terms of its function, economic restructure can be generally involve change of a number of key elements. Change can occur in:

- the system of macroeconomic governance including reforms in fiscal and banking system, in public investment, administration reorganizations,
- the central-local hierarchy management,
- the state enterprise sector which firstly prioritises State owned companies,
- the property system and the development of market system,
- the system of economic zones, industrial parks, industrial clusters,
- the infrastructure development,
- rethinking industrial structures and the development of supporting industries,
- regional economic development and the linkages among these local developments;
- human resource development. . .

It is, therefore, possible to initiate economic restructure through three dimensions as following:

First, as an aspect of resource distribution, economic restructure basically means changes in institutions, mechanisms, distribution tools, managements and usages of national resources, especially capital investment to build a better and more effective economic structure. Production factors of capital, land, natural resources and labour should be distributed and shifted from industries and business sectors with low productivity to the other sectors with higher productivity and more effective use.

Second, the State role in the economy, where economic restructure should be known be seen as a retreat of the State in the role of investors and business owners and a redeployment to strengthen government orientation and macro-economic management.

Third, from a growth dimension, the shift of the growth model changes the dynamics of economic growth based primarily on an increase in input factors to improvements in efficiency, labour productivity and total factor productivity in parallel with, and to ensure, benefits of growth that are more reasonable and have more equitable distribution among different areas and groups of population. An innovative growth model in Vietnam for the period 2011–2020 should have a unique understanding of the transition from a mainly horizontal growth model to a harmonized one between the horizontal and the vertical and further, approaching a form in which there is a basic deep rooted growth model designed to improve continuously economic productivity, quality and efficiency as well as the competitiveness of the economy. It also takes into account tendencies for international integration, green and sustainable growth, and for export-based development to be aligned more deeply in the production network and global value chain as well as having inclusive and equitable growth.

Orientations and some main solutions to restructure with attachment in the innovation of growth model

Growth model reform. In the period of 2012–2020, the reforms of growth model referred to “innovating the way to create resources for economic growth”, or in the other words, it is a more reasonable transformation of factors of growth caused mainly by increases in the size of inputs – especially the utilization of capital and unskilled workers (horizontal growth model) to the growth model that relies mainly

on: improvement of the technical efficiency; improvement of the allocation efficiency; and strengthening the scientific and technical progress (vertical growth model).

The objectives of the renovated growth model for the period of 2012–2020 were:

1. Promoting sustainable economic development which focuses on maintaining rapid growth at a reasonable, sustainable level and high growth quality, at the same time ensuring consistency with the progress of the economic structure and with environmental sustainability.

2. Ensuring social progress focused on social security, enhancing social welfare, and improving people's lives as well as especially achieving comprehensive human development.

3. Ensuring social justice with focus on reducing social inequalities and narrowing the income gap between rural – urban areas, between regions, ethnic groups, as well as providing equal access to economic chances, jobs, public services and the redistribution of wealth.

The innovation of the growth model in Vietnam is needed to meet the urgent demands in the medium term and additionally to overcome basic “defects. These defects include serious internal weaknesses” accumulated by maintaining a horizontal growth model for such a long time and include economic ineffectiveness, low productivity, low quality, low competitiveness, increase of macroeconomic instabilities, waste of energy, and environmental pollution. In addition the quality of institutions, policies and national governance have not yet kept pace with the extensive process of international integration. Institutional and Government reforms have other urgent needs in the long term such as:

- supporting the economy to avoid the risk of falling into a middle income trap,
- orienting the growth model based on exports but also to be associated closely and participating actively in production network and global value chain – integrating successfully into the world economy,
- adjusting and adopting the main characteristics of green and sustainable growth models,
- complying with the main principles of an inclusive and equitable growth model.

Economic restructure in association with the reform of growth model. Economic restructure involves an innovative process to reallocate national development resources of land, capital – credits, natural resources, and labours over the whole economy. This is mainly achieved through the improvement of allocative and technical efficiency over a certain period of time to increase the effectiveness, productivity, quality and national competitiveness together with support to progress in the economic structure towards sustainable, comprehensive and equitable economic development as well as active roles to integrate it into the world economy. To reiterate the economic restructuring involves reforms in the allocation of resources to enable the transfer of national resources from the inefficient use of resources to higher effectiveness based on advanced technical and allocative efficiency.

At each stage there is a need to identify clearly priority areas for development in order to improve the efficiency of resource allocation and it is important to consider providing additional financial resources and funding for economic restructuring

during certain time periods. The aims of economic restructuring during the period of 2012–2020 are focused on:

1. Improvement of the economic structure. The formation of a reasonable economic mechanism with higher effectiveness, more value added and greater competitiveness in accordance with extensive international integration, creating new growth engines based on innovative allocation of national development resources towards improving efficiency.

2. Developing social progress, including strengthening social welfare, ensuring social security and social justice.

3. Successful support for the reform of a vertical growth model which emphasizes high quality, rapid and stable growth and with green and stable growth based on exports and which is more associated and deeply involved in the production network and the global value chain. This as well, is connected with extensive and equitable growth.

In addition there is an urgent demand to be met in the medium term. This is to overcome “low investment efficiency and serious internal weaknesses in distribution mechanism of national resources” originated from maintaining for too long a horizontal growth model.

Economic restructure needs to meet the fundamental requirements in the long term including:

1. Supporting the establishment of an efficient economic structure (economic sector, ownership business sector, economic areas) within guide lines of higher performance, more value added and higher competitiveness.

2. Contributing to achieve more rapid growth at a reasonable and sustainable level with high growth also orientated towards green and stable development as well as inclusive and equitable growth.

3. Assisting domestic enterprises to participate effectively in the production network and global value chain, at the same time supporting domestic economy to integrate successfully into the world economy.

Economic restructure and reform of economic growth model have a close dialectical relationship. On the one hand, innovated economic growth model in Vietnam during the period of 2012–2020 has been identified as the overarching goal orientation (key direction) to implement economic restructure effectively during the period of transforming to market economy; on the other hand, economic restructure is one of the most important components and a breakthrough premise to implement effectively and sustainably the reform of economic growth model.

The reorientation to the economic structure in connection with a reform of the growth model for Vietnam in the period from 2012 to 2020 will focus primarily on breakthroughs in the following priority fields: restructuring investment with a focus on redefining public investment; restructuring state-owned enterprises and corporations; and restructuring the system of credit institutions with a focus on commercial banks, stock markets and other financial institutions.

There is a need of a macro approach to thinking and considerations for the economic restructure as it is not possible for reorientation of individual sectors and regions. The restructuring process address the whole system to avoid potential large

consequences faced with the start of a vertical growth model in which commercial banks, property markets, corporate sectors and public investment are the main pillars for the economy. The priority task is to accelerate the systematic restructure of credit institutions with the focus on commercial banks as well as the reorganisation of stock markets and other financial institutions.

SOME SOLUTIONS

From the above analysis, the main solutions for the implementation of an economic restructure associated and a reform of the growth model during the period of 2012–2020, which need to be emphasized, are:

Solutions to stabilize the macro-economy

The process of inflation control and macro-economic stabilization are priority tasks currently and during the first 5 years of 2011–2015 because this is a prerequisite for the process of economic restructure linked with the change in the growth model. In this some of the key measures include:

1. Continuing to implement a tightening monetary policy, controlling the growth rate of total credit and total payments with the appropriate scales and forms to ensure that credit growth is under 20%, and that total payments are at about 15–16%. This requires a active and flexible approach in the management of monetary policy and credit supply. It also relies on having an appropriate priority policy for credit allocation to agricultural production and other related sectors, export manufacture, small and medium enterprises as well as other priority sectors for development.

2. Implementing monetary policy measures, especially active use of the flexible tool of interest rates following market specific fluctuations in order to contribute positively to curbing inflation and stabilizing the value of the National currency.

3. Decreasing the proportion of use and dependence on the US dollar in the economy especially for international payments; implementing a flexible and active stabilization policy for interest rates with the priority being to curb inflation, to stabilize macro-economy and to reduce the import deficit so as to ensure a stable international balance of payment.

4. Strengthening and improving the State management of the gold market.

5. Implementing a tight fiscal policy to control aggregate demands and to reduce the inflationary pressures while continuing strict disciplines of other fiscal policies; strengthening expenditure management and enhancing the efficiency of budget spending; increasing state budget to 7-8% in comparison with the annual budget estimates and reducing the state budget deficit below 5% of GDP.

6. Coordinating closely and effectively the monetary and fiscal policy. Fiscal policy must have more complements and support more monetary policy to control inflation and stabilize the macro-economy.

New, thinking solutions for change, institutional reforms and resource distribution

1. Thinking reforms in which the key role of the state sector is considered with the private sector as a fundamental driving force for economic growth in the new stage of development.

2. Promoting economic institutional reform to create an essential premise where economic resources are to be distributed in the most effective way.

3. Innovating the methods of resource allocation in which thorough solutions for land distribution issues are among the most important premises for the economic restructuring process.

Solutions to investment restructure with a focus on public investment

1. Restructuring the public investment capital towards mobilizing capital investment for society, gradually reducing investments from the state budget and setting up an effective framework for public investment management.

2. Modifying the decentralization mechanism of economic management especially the management and supervision of public investment. There is an urgent need to thoroughly address problems and shortcomings in public investment programmes; together with strengthening decentralization, it is important to quickly enhance the management and supervision capacity of local authorities and communities as well as to improve the supervision capacity of the central authority.

3. Building a specific system of criteria to select, supervise and evaluate projects using public investment to enhance the capacity and effectiveness of selection, supervision, and also evaluation of the results and effectiveness of these projects.

Solutions for the restructure process of the business sector aimed towards state enterprises

1. Reducing the number and narrowing the scope of activity of state owned enterprises state-owned enterprises should not invest in activities that are not approved by government in should focus on their main investment activities which enhance their competitiveness and improve their investment efficiency.

2. Setting up the criteria for formation, operational principles and indicators to monitor and evaluate state-owned enterprises in the context of the economic restructure.

3. Create a necessary and favourable environment with appropriate mechanisms for restructuring process of businesses in both the private and state sectors in parallel.

Solutions for the financial – monetary system restructuring with the focus on commercial banking system

1. Restructuring the commercial banking system in parallel with the restructuring of State Bank.

2. Clarifying the financial resources needed for the restructuring process of the banking system and evaluating accurately the expenses – benefits of these resources.

3. Enhancing the effectiveness of the channelling of bank capital and strengthening the development of channels of non-bank capital for the operation of the economy, reducing the dependence of almost the whole economy on banking system.

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RESTRUKTURYZACJA I REFORMA MODELU ROZWOJU GOSPODARCZEGO W WIETNAMIE

Abstrakt. Od 1986 roku polityka wietnamska zaczęła zmierzać w kierunku gospodarki bardziej otwartej i zintegrowanej z gospodarką światową, a przeprowadzone reformy gospodarcze nazwano „Doi Moi” (All Round). Po okresie szybkiego wzrostu Wietnam wypracował szereg globalnych osiągnięć, aż w 2010 roku pojawił się na końcu listy rankingu Banku Światowego dotyczącego dochodów. Struktury gospodarcze zostały stopniowo zmodernizowane; infrastruktura społeczno-gospodarcza uległa znacznej poprawie, zarówno pod względem ilości, jak i jakości; zostały wynalezione i wdrożone niektóre nowe i *high-tech* gałęzie przemysłu. Najnowsze badania wskazują jednak, że wietnamski model wzrostu osiągnął punkt krańcowy, gdyż w tym nowym kontekście modelu ujawniły się pewne słabości, które wymagają wprowadzenia zasadniczych zmian. Potrzeba zreformowania modelu rozwoju gospodarczego staje się ważniejsza niż kiedykolwiek indziej, aby uniknąć pułapki średniego dochodu i wzmocnić konkurencyjność oraz by uniknąć zewnętrznych zagrożeń w procesie integracji międzynarodowej, szybkim postępie i zmniejszeniu luki rozwojowej w porównaniu z innymi krajami w regionie i gospodarką światową. Artykuł ten skupia się na analizie słabych stron, wad struktury gospodarczej i obecnego modelu rozwoju gospodarczego w Wietnamie z zamiarem zaproponowania nowych kierunków i kilku kluczowych działań w celu wdrożenia restrukturyzacji gospodarki równoległe z reformą modelu wzrostu na lata 2012–2020.

Słowa kluczowe: Wietnam, struktura gospodarcza, model rozwoju gospodarczego