

Reforms vital for Vietnamese economy to stay on track

16th April, 2014

Author: Suiwah Leung, ANU

After several years of macroeconomic turmoil, 2013 finally saw a return to some semblance of stability in the Vietnamese economy. There is no time to lose.



The government needs to push through significant reforms in key areas in order to lift long-term growth.

Macroeconomic aggregates have been mixed. Headline inflation averaged 6.7 per cent, due partly to subdued credit growth and an easing of food prices. Core inflation (excluding food and energy costs) stood at 10 per cent, after increases in a number of administrative prices, such as education and health costs. Core inflation is expected to continue declining this year and next due to below-trend growth.

Strong performance in both exports and remittances saw Vietnam's current account record a surplus of 5.9 per cent of GDP in 2012, and an estimated surplus again of 5.1 per cent in 2013. As a result, pressure on the dong has eased, and the official and black market exchange rates have converged. But overall GDP growth is at a sub-trend 5.3 per cent in 2013, rising to a forecast rate of 5.5 per cent by 2015.

There is now clear evidence that Vietnam has [climbed on to the production network](#) ^[1] in electronics and accessories, mobile phones and parts, computers, and automobile parts. Export of mobile phones and parts is estimated to have reached US\$18 billion in the first 10 months of 2013, surpassing even garment exports. This is the result of significant foreign direct investment over the past five years by multinationals such as Intel, Samsung and Nokia. Samsung has been the outstanding export performer so far, and Vietnam risks over-reliance on one company.

Nevertheless, all these multinationals have linked Vietnamese manufacturing to the global

production-sharing supply chains and transformed the composition of its export basket. Export of electronics, mobile phones and accessories grew from less than 4 per cent of total exports in 2003 to more than 32 per cent 10 years later. At the same time, traditional labour-intensive manufacturing has also done well, averaging growth of more than 17 per cent in 2013, with garment exports growing at 18.5 per cent.

Industrial policy is once again fashionable. It is claimed, however, that the new focus is not on 'picking winners' but on developing an [enabling environment](#) ^[2] for industries and firms to move into new products and into higher value-added activities within existing product lines. While there is certainly a role for trade facilitation in promoting industrialisation and growth in Vietnam, what will bring higher long-term growth are reforms in state-owned enterprises (SOEs), bank restructuring, and improved public finance and administration.

The costs of doing business — including but not limited to wages — must be kept competitive. These include the costs of telecommunications, insurance, electricity, gasoline, shipping and customs facilities, rentals for offices and expatriate personnel accommodation. But most of these areas are dominated by SOEs. Hence, the progress of SOE reforms will have a profound impact on the competitiveness of all Vietnamese firms.

In the garment industry, where the lack of domestic supply of both quantity and quality textiles is identified as one of the major constraints to development, SOE presence is still as high as 21 per cent. Removing state firms from activities that are purely in the private domain will help to develop backward linkages, enhancing flexibility in catering to changes in international consumer tastes, and reducing the reliance on imported textiles and fabrics. Finally, in the large conglomerates of state enterprise groups and general corporations, involvement in non-core activities such as real estate, insurance and banking raises the risks of contingent liability and fiscal bailouts.

Progress in reform is slower than expected, despite a number of decisions made during 2013 about the disclosure of financial and non-financial information, linking SOE manager remuneration with performance, and removing the requirement to sell state assets at least at book value. Current legislation is not clear about what information is to be disclosed, and to whom. The question of what to disclose is supposed to be addressed in Decree 61 to be implemented in 2014, but inter-agency coordination is lacking and needs to be resolved.

Case studies of the garment, footwear and electronics industries have all found that lack of finance is a constraint to small and medium enterprises (SMEs) and start-ups. In the case of Vietnam, simply removing the regulation forcing banks to lend (allegedly for prudential reasons) only to firms with a proven past history of operations would open the way for funding start-ups. This is not to say that bank managers necessarily have the skills or the risk preference for lending to start-ups and SMEs, particularly when they can make more profitable and secure loans to SOEs. But building a strong and commercially oriented banking sector by implementing the reforms that are already in the government's plans would encourage bank lending to all productive enterprises, including SMEs.

Here again, progress needs to be accelerated. The issue of non-performing loans (NPLs)

continues to undermine confidence in the banking sector and hinder credit growth. Moody's estimate in February 2014 of NPLs at 15 per cent of banking assets raised serious questions regarding the official estimates by the State Bank (SBV) of 4.6 per cent last October, and an even lower estimate of 3.6 per cent at the start of February 2014. The subsequent statement on the SBV website of a NPL ratio of 9 per cent if more stringent definitions were used, was in fact an admission of regulatory forbearance on the part of the SBV. One of the [problems](#)^[3] is 'gaming behaviour' on the part of some commercial banks which purchase bonds from their corporate borrowers so that those companies can use the funds to reduce their NPLs with the banks. Some banks over-value collaterals to minimise provisions for NPLs. The recent Decision 843 is supposed to give the State Bank more power in auditing commercial banks' NPLs, but the credibility of the SBV itself needs to be re-established first.

The setting up of the Vietnam Asset Management Company (VAMC) in July 2013 is generally viewed as another way of getting NPLs off the books of commercial banks. Whether the VAMC can resolve the NPL issue in due course depends importantly on the amount of capital that it is able to raise. Meanwhile, more relaxed foreign bank ownership rules should help strengthen the banking sector and make it more commercially viable.

In addition, improved government finance is necessary for investments in infrastructure and human resources — essential ingredients for long-term growth.

In short, continued stability on the macroeconomic front, together with impressive growth in manufacturing exports, indicates that the medium-term prospect for Vietnam has improved somewhat in the past 12 months, albeit with significant downside risks. Time is of the essence. Providing the government can move on with SOE reforms and bank restructuring while maintaining fiscal discipline — and providing that the world economy remains in an upward trajectory — it is still possible for Vietnam to succeed in lifting its longer-term growth.

[Suiwah Leung](#)^[4] is an Adjunct Associate Professor of Economics at the Crawford School of Public Policy, ANU.

Article from the East Asia Forum: <http://www.eastasiaforum.org>

URL to article:

<http://www.eastasiaforum.org/2014/04/16/reforms-vital-for-vietnamese-economy-to-stay-on-track/>

[1] climbed on to the production network:

<http://www.eastasiaforum.org/2013/12/13/vietnam-plays-catch-up-with-chinas-successful-reforms/>

[2] enabling environment :

<http://www.eastasiaforum.org/2013/12/13/vietnam-plays-catch-up-with-chinas-successful-reforms/>

[3] problems: <http://www.eastasiaforum.org/2013/04/07/bank-restructuring-in-vietnam/>

[4] *Suiwah Leung*: <https://crawford.anu.edu.au/people/adjunct/suiwah-dean-leung>