

VIETNAM'S ECONOMY IN 2017

CREATING A FOUNDATION FOR RAPID AND SUSTAINABLE GROWTH

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Ending 2017 – An important transitional year of the 5-year Socio-economic Development Plan (2016-2020) and a year of the sprint for the 10-year Socio-economic Development Strategy 2011-2020, Vietnam's economy has achieved impressive development results such as high economic growth, macroeconomic stability and further integration into the region and the world.

The above results are attributable to many reasons, in which the most important reasons are the significantly-improved investment and business environment, the improved competitiveness of the economy, increasingly completed institutions of the socialist-oriented market economy, and the process of economic restructuring coupled with the transformation of the growth model towards sustainable development continued throughout the period. (Nguyen Quang Thuan, 2017a, 2017b).

However, our economy is facing many problems and barriers which need to be solved in order to maintain sustainable growth and achieve socio-economic targets for the 5-year plan and the 10-year strategy.

This report focuses on assessing the results achieved in Vietnam's economic development in 2017, analyzes the main driving forces of economic growth, forecasts the economic outlook for 2018 and points out the major issues that the economy is facing, and finally suggests solutions to create a solid foundation for rapid and sustainable growth in the coming period.

1. Economic results of 2017

2017 is a rare year that 13 socio-economic development targets for 2017 are achieved and surpassed the plan set by the National Assembly. Of these, the two

most important and most concerned economic targets, namely economic growth and inflation rate, achieved impressive results. The economic growth in 2017 reached 6.81%, the highest in 10 years. The inflation rate was low at 3.53%. In recent years, low inflation has contributed significantly to the macroeconomic stability of our country.

Total goods export – import turnover of our country reached a record of USD 425 billion. Export turnover of agricultural products reached USD 36 billion, foreign exchange reserves reached a record of USD 51.5 billion, the securities market reached the level of 950 points and the service sector growth was at the highest level (reaching 7.44%) since 2008, contributing to the high economic growth of 2017.¹

Also in 2017, the development of some economic indicators show that the stability of the economy has been clearly improved. The debt-to-GDP ratio fell from 63.6% in 2016 to 62% in 2017. The debt growth is on the downward trend, if in the period 2011-2015 the average debt growth rate reached 18.4%, in 2016 it dropped to 15%, and continued to decline to 9% in 2017. State budget deficit fell and remained low, reaching about 3.5% of GDP. Recurrent expenditure rate in total state budget expenditures decreased from nearly 70% to 64.9% in 2017 and is expected to decline to 64% by 2018.²

It can be seen that the reduction of budget deficit and debt in 2017 is gradually consolidating the stronger macroeconomic foundations, contributing to improving the business environment and creating a driving force for sustainable economic growth in the coming time.

Reasonable policies and aggressive actions by the Government have brought initial positive results in 2017. The key impetus for the economy is the built-up market confidence, enhanced competitiveness and markedly improved business environment. This resulted in impressive economic results, such as

¹ Data taken from General Secretary Nguyen Phu Trong's speech at the Government's online conference with localities on 28/12/2017.

² Data taken from the question and answer session at the 4th session of the 14th National Assembly of Minister of Finance, Dinh Tien Dung.

high economic growth rate, low inflation rate, high stock index, and sharply-increased number of newly established enterprises.

2. Improved doing business – An important driving force for economic growth in 2017

There are many reasons to contribute to the impressive results of our economy in 2017: macroeconomic stability, expanded international trade, high output growth in agricultural and service sectors, etc. However, the underlying cause or motive is the dramatic improvement in the doing business of the economy.

Improved doing business will reduce transaction costs, improve competitiveness and boost the economy in the medium and long term. Vietnam's investment-business environment has achieved impressively high ranking in many reports of international organizations. Vietnam is highly valued not only for its *upswing* over itself, but also for significantly narrowing the distance to frontier in ASEAN-4 (including Singapore, Malaysia, Thailand, and the Philippines), as well as overtaking China.

According to the World Bank's Doing Business Report 2018, Vietnam's Doing Business ranking is 68th out of 190 countries, an increase of 14 ranks compared to the previous year (82nd out of 190) and 23 ranks compared to 2015 (91st out of 189). Vietnam's doing business has not only improved dramatically in terms of rankings, but has also seen significant improvements in the distance to frontier score over the same period (reaching 67.93 points in 2017, increased 2.9 points and 5.7 points compared with 2016 and 2015, respectively). The statistics show that the rise of the ranking and the distance to frontier score in Vietnam's doing business in 2017 is the highest achievement since the early decade of 2010 to date.

According to the World Bank, Vietnam's doing business in 2017 significantly narrowed the distance to frontier in the ranking when compared directly to ASEAN-4 in the same period. In particular, if in 2015 "the distance to frontier" of Vietnam compared to the average level of ASEAN-4 group ranked 47th in doing business, by 2017, the rank of Vietnam improved to 27. In fact, Vietnam has improved positively not only in narrowing the distance to frontier in

the ranking but more importantly narrowing distance to frontier scores when compared to the ASEAN- 4 in the same period (the distance to frontier score fell from 12.4 points in 2015 to 8.2 points in 2017).

Particularly, Vietnam's doing business in 2017 was first appreciated by the international community for its remarkable improvement as compared to China in the same period. If in 2015, Vietnam's doing business still lagged behind China, in 2017 Vietnam not only advanced but also surpassed China 10 rankings. It is also the first time in more than a decade that Vietnam's doing business scores (reaching 67.17 points in 2017) have been higher than those of China (65.29 points) in the same period.

Improved doing business also contributes to enhancing the competitiveness of the economy. According to the World Economic Forum's (WEF) Global Competitiveness Assessment Report released on September 27, 2017, Vietnam's competitiveness index rose from 4.31 in 2016 to 4.4 in 2017. The competitiveness of Vietnam's economy has increased five places in ranking compared with 2016 and increased 20 places compared to five years ago. Also, the investment performance of the economy has been improved markedly. The ICOR of 2017 was 4.93, lower than 2016 of 5.15 (in constant prices). The lower ICOR reflects the higher investment efficiency of the economy.

The upswing in doing business in 2017 is the result of the enduring efforts and determination of the Government in recent years.

Firstly, the high political determination coupled with efforts to improve the governance capacity of the Government of Vietnam in the direction of building a constructive, honest and righteous Government to serve the people and businesses is one of the most important causes which governs (directly and indirectly) the dramatic improvement in Vietnam's doing business in 2017.

Secondly, the improvement of the quality of policy making for improvement of doing business towards publicity, transparency, consistency, public consultation and high accountability is considered one of the other leading causes which is decisive for the outstanding improvement in Vietnam's doing business in 2017.

Thirdly, the collective response to the spirit of reform of the Government of the ministries and sectors by specific policies and actions. Some typical examples include: Ministry of Finance reformed tax and customs regulations and procedures; The State Bank of Vietnam improved the quality of credit information system for better protection of the interests of borrowers and lenders; The Ministry of Construction intensified the application of measures to shorten the time limit for granting construction permits and related procedures; The Ministry of Planning and Investment shortened the procedures and time for completion of business registration procedures; The Ministry of Justice improved the quality of civil judgment enforcement, contributing to improvements of indicators in the judicial sector, etc. More than 5,000 procedures have been cut in the whole country in 2017, in which leading agencies in reducing procedures to create more favorable conditions for doing business are the Ministry of Industry and Trade, the Ministry of Agriculture and Rural Development, the Ministry of Construction (cutting more than 1/3 procedures).

Fourthly, the enhancement of effective implementation and policy coordination on improvement of doing business with a focus on capacity building for implementation and monitoring *based on the application of information technology* by ministries, sectors and localities (in the following five reform areas: access to electricity, access to credit, tax payments, cross border trade, and contract performance) is also considered as one of the decisive causes to the rapid improvement of Vietnam's doing business in 2017.

Fifthly, consistent macroeconomic stability coupled with socio-political stability is also one of the important causes as a prerequisite for improving the quality of Vietnam's doing business in 2017.

3. Prospects and challenges for Vietnam's economy in the coming time

Some prestigious international agencies have made forecasts about the prospects for Vietnam's economy in 2018. In general, forecasts are giving positive signals to our economy. ANZ forecasts that Vietnam's economic growth in 2018 will reach 6.8% and inflation will be at 3.5%. In addition to main macroeconomic indicators, namely economic growth and inflation, ANZ

forecasts that the USD/VND exchange rate will be stable, and foreign exchange reserves will increase, and the FDI inflows will be high (Hong Quan, 2017).

HSBC forecasts that our economy may shift from “high growth, low inflation” to “stable growth, high inflation”. HSBC forecasts that high inflation in Vietnam is attributable to rising hospital fees, rising oil prices and rising food prices. However, the inflation rate is projected to be only 3.7% in 2018, lower than the 4% target, and in general inflation below 4% is acceptable to stabilize macro economy and stimulate growth of the economy.

According to the latest Asian Development Bank (ADB) Report on December 13, ADB adjusted its forecast for Vietnam’s economic growth in a more positive direction. Specifically, according to forecasts published earlier, economic growth of our country is only expected to reach 6.3% and 6.5% in 2018; however, the latest report forecasts economic growth will reach 6.7% (Ha Thanh, 2017). Thus, most forecasts show that the outlook for Vietnam’s economy in next year is relatively good. It is more likely to achieve economic growth of 6.7% and inflation rate of about 4% as set out in the *Resolution No. 01/NQ-CP dated January 01, 2018 of the Government on major tasks and solutions for the implementation of the Socio-economic Development Plan and State Budget Estimation in 2018*.

In the coming time, our economy may be affected by global trends. Geopolitical conflicts, protectionist tendencies, rising world oil and fuel prices, and the Fed’s third rise in interest rates as the US economy has recovered steadily may adversely affect our economy. However, with confidence in the economy being strengthened, improved business environment and more efficient allocation of resources, the economic growth and macroeconomic stability in the short term will remain relatively resilient, regardless of negative shocks from the outside. The more important issue in the coming time is to design policies, solutions and actions to solve the problems and challenges of the economy in order to create the foundation for rapid and sustainable growth. Challenges for Vietnam’s economy include:

Firstly, Vietnam’s labor productivity is much lower than that of other countries in the region despite high economic growth. According to the General

Statistics Office of Vietnam, Vietnam's labor productivity in 2016 was "equivalent to 7% of the labor productivity of Singapore, 17.6% of Malaysia, 36.5% of Thailand, 42.3% of Indonesia, 56.7% of the Philippines and 87.4% of Laos. The biggest worry is that the labor productivity gap between Vietnam and other countries continues to increase" (Bach Duong, 2017).

Mr. Ousmane Dione, World Bank Vietnam Country Director, in his opening speech at the Vietnam Development Forum 2016, said: *In recent years, after the global recession, Vietnam has regained its spectacular growth momentum. But the downward trend in labor productivity has remained a concern. Vietnam's labor productivity growth rate has not reached 4% and tends to decrease, while China's labor productivity is above 7% and South Korea's 5% when these two countries are still at the same level of development as Vietnam. The current productivity growth rate is unlikely to guarantee growth for Vietnam to catch up with the growth trajectory of Korea or Singapore* (Dione, 2016).

It is worth mentioning that the challenge of Vietnam's labor productivity in Ousmane Dione's speech was put ahead of other challenges such as environment, poverty reduction, social welfare, and capital mobilization for development.

Secondly, equitization of state-owned enterprises (SOEs) was large in terms of quantity (96.5% of equitized SOEs), but in fact only about 8% of SOEs were equitized and transferred to the private sector. This also means that the involvement of private sector in the executive apparatus of SOEs and in the design of production and business strategies of equitized SOEs is also limited. Therefore, the efficiency of SOEs is slow to improve, leading to the production and business environment being distorted³ (Tran Dinh Thien, 2017).

Thirdly, building capacity to take advantage of the opportunities from the fourth industrial revolution is slow. The fourth industrial revolution has had a strong influence on our economy. The Party and Government are aware of the

³ Refer to the study by Nguyen Quang Thuan (Editor-in-chief) (2014) on the current situation of reform of state-owned enterprises and issues posed after nearly 30 years of renovation.

importance of the fourth industrial revolution, as well as its opportunities and challenges. However, efforts to prepare and implement internal capabilities to take advantage of the opportunities and overcome the challenges of the fourth industrial revolution are low. Economic and social infrastructure is still limited by the wave of new technologies, new enterprises and new types of businesses. The education and training system from primary to higher education has been slow to innovate. State governance at all levels based on digital technology is not yet commensurate with the potential and demand of the fourth industrial revolution. Legal and regulatory systems are also struggling to cope with conflicts between traditional business practices and new technology-based practices on the digital age. Security issues on the digital space also pose new challenges that require high levels of digital innovation. Slowly building the capacity to take advantage of the fourth industrial revolution will reduce the chances of catching up with developed countries in the region and the world, as well as the chance of getting out of the middle income trap in the long run.⁴

Fourthly, the connection between FDI enterprises and domestic enterprises is not tight, leading to fact that the attraction huge FDI enterprises such as Samsung into the economy has not created a positive spillover effect on technology and not created production capacity for the economy in the future.

Moreover, the benefits brought by FDI enterprises are not matched with the incentives provided by the State for this sector and the negative extraneous effects that some FDI enterprises have caused are still very large (especially in terms of environmental protection). In other words, the costs created by FDI enterprises are borne by the society, which reduces the benefits that FDI enterprises bring to the economy in the direction of sustainable economic development.

4. Policy orientations for creating the foundation for rapid and sustainable growth

⁴ Refer to the studies of Vietnam Academy of Social Sciences (2016) and Central Economic Commission (2017) for more information about the fourth industrial revolution and challenges and opportunities for Vietnam.

Business environment plays the backbone role for stable development and growth of the economy. Policies that build trust and improve the business environment to reduce transaction costs are also policies that encourage the development of business sectors, promote investment and expand production.

2017 marks a breakthrough in the business environment of our country compared with ourselves and with other countries in the region, making our economy more attractive in luring foreign direct investment, enhancing the competitiveness, and promoting trade in the process of international and regional economic integration.

In order to maintain rapid and sustainable growth in the coming time, policies should focus on improving the quality of the investment and business environment, addressing outstanding issues in the economy, and strengthening the internal capacity building to actively take opportunities and overcome challenges from the fourth industrial revolution.

Below are major policy orientations for establishing and continuing to consolidate confidence, improving the quality of the business environment, enhancing national competitiveness and preparing the necessary capacity for the fourth industrial revolution.

Priority should be given to establishing a firmer macroeconomic foundation.

Macroeconomic stability combined with socio-political stability should be considered as a priority, as this is a “prerequisite” for improving the business environment and enhancing national competitiveness by 2020 and beyond.

Monetary policy should aim at inflation as set out. To maintain the inflation rate of 4%, the total means of payment (M2) should grow at a reasonable rate (about 15%) depending on internal and external economic shocks. In addition, monetary policy should also aim to ensure liquidity in the financial market and the banking system.

The State Bank of Vietnam needs to control the credit flow into the economy to improve credit quality and at the same time contribute to reducing bad debt rates. Credit flow control involves monitoring credit flows into state-

owned enterprises or large private enterprises, monitoring the performance of large loan-funded projects because if the project is ineffective or bankrupt, it will create a negative external effect on the economy in general and the financial system in particular.

Fiscal policy should continue to reduce the budget deficit, gradually reduce public debt and foreign debt. In order to carry out this task, the Government should be determined to implement *hard budget constraints*, assign responsibility to the project leader or owner; and when the project is ineffective, the Government may let the project go bankrupt instead of financing the project to continue to operate ineffectively.

Focus on improving the business environment and enhancing competitiveness.

In order to further improve the quality of the business environment and enhance the competitiveness of the economy, the Government should carry out the following solutions and policies:⁵

- + Actively improve the capacity of modern state governance and strengthen the application of digital governance in building a constructive, honest and righteous government to serve the people and businesses.

- + Intensify the application of information technology to enhancing the quality of policy making for improving the business environment in the direction of publicity, transparency, consistency, public consultation and high accountability.

- + Prioritize the application of information technology to improving business start-up goals and solving bankruptcy of businesses in Vietnam right from the beginning of 2018 in order to not only shorten the distance to frontier of Vietnam in ASEAN- 4, but more importantly contribute to the promotion of innovation, creativity and entrepreneurship in the context of the fourth industrial revolution.

⁵ For scientific and technological solutions, refer to the study by Do Hoai Nam (2016).

- + Establish a roadmap for effective implementation of e-commerce development strategy in parallel with the network security and international payment assurance strategy based on modern information technology.

- + Encourage innovation, creativity and entrepreneurship in general, in which emphasis should be placed on the establishment of centers for innovation and creativity, and linkage of universities and research institutes to the business community, while increasing the share of spending for R & D in both the public and private sectors, as well as focusing on improving the enforcement of intellectual property right protection policies and enforceability of business contracts in line with international auditing standards.

Put more importance on raising the competitiveness of Vietnam in the digital era.

2017 marks an important step in Vietnam's perception of the fourth industrial revolution (4IR), which is clearly demonstrated by the promulgation of Directive No. 16/CT-TTg dated May 04, 2017 of the Prime Minister on "the strengthening of the country's ability to access the Fourth Industrial Revolution".

In 2018, further steps need to be taken to realize the vision of senior leaders:

- + It is necessary to continue to study the experience of the world, especially countries in the region with practical strategies and programs to overcome the challenges and grasp the opportunities of 4IR.

- + Assign research institutes and statistical agencies to coordinate with ministries, branches and localities to conduct surveys, researches and assessments in order to identify where Vietnam is in 4IR in general, and where businesses, governmental agencies and people are in 4 IR in particular.

- + Based on the determination of the position of Vietnam in the digital revolution as well as the summary of international experiences, propose appropriate action plans to help governmental agencies, businesses and people to promote their potentials in the digital era in order to help Vietnam narrow its development gap with advanced countries.

Promote the equitization of state-owned enterprises and strengthen the connection between FDI enterprises and domestic enterprises.

+ *Equitization of state-owned enterprises should be made more thoroughly and instead of focusing on equitization in quantitative terms without major changes in quality, the Government should promote equitization in qualitative terms, i.e. focusing on equitization of capital and allowing private sector's greater involvement in the executive apparatus of equitized enterprises.*

+ *The government should actively design a mechanism to attract strategic investors who are able to improve the capacity and efficiency of SOEs after equitization, instead of targeting the sale of capital or equitizing SOEs in terms of quantity.*

+ *The government should actively select high-quality FDI enterprises instead of FDI enterprises investing in the economy to take advantage of the loosening of environmental management and preferential policies. In addition, there should be a strategy to improve the capacity of domestic enterprises to strengthen connection between domestic and foreign enterprises; strengthen the transfer of technology from FDI enterprises to domestic ones as FDI enterprises - in most developing and open economies - play an important role in improving productivity and transferring advanced technologies to domestic enterprises. The promotion of technology transfer should be closely linked to policies such as policies on scientific and technological development of domestic enterprises, policies on education and training, and policies on promotion of entrepreneurship.*

Convey messages of policies to people.

Finally, good policies will be ineffective if the message of the policy is not best conveyed to people in general and affected agents in particular. The Government in this term has done a very good job of conveying messages of policies to people through media. The Government will need to continue to interact more strongly with people, convey clear and continuous policy messages, and create a government that is keen to listen to and work for the people and enterprises in order to win trust from the people and enterprises, as well as investors as committed by the Government at the beginning of the term.

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