Chapter 2

Vietnam's Economic Performance

VIETNAM'S ECONOMIC PERFORMANCE

Chapters 2 and 3 examine the competitiveness of the Vietnamese economy in three levels, providing a comprehensive assessment of outcomes, drivers or intermediate indicators and underlying causes. Understanding these is critical to the formulation of a national economic strategy and a comprehensive supporting policy package. Chapter 2 focuses on the first two layers. It begins with an examination of indicators of economic well-being and the quality of life of the Vietnamese people. This if followed by an exploration of the intermediate indicators or drivers of prosperity such as trade and investment. The third layer of competitiveness, or underlying causes, is discussed in Chapter 3.

Economic Outcomes

Ultimately, the goal of economic development is a sustained increase in prosperity or the standard of living. Indeed, many economic plans, including the ten-year strategy for Vietnam, which is currently under discussion, also refers to specific goals in terms of the standard of living. Comparing these metrics across countries as is done below, provides a realistic competitiveness benchmark or a relative assessment of how competitive an economy is.

While the standard of living is a central element of the assessment, it is not a very informative tool to guide policy making. It only describes the combined impact of all the determinants of competitiveness on the quality of life of the average Vietnamese. Policy-relevant insights can be obtained from assessing both economic and non-economic measures of well-being and from decomposing the standard of living into various components such as the mobilization of resources, in particular labour, and how efficiently or productively these resources have been employed in order to achieve a higher standard of living.

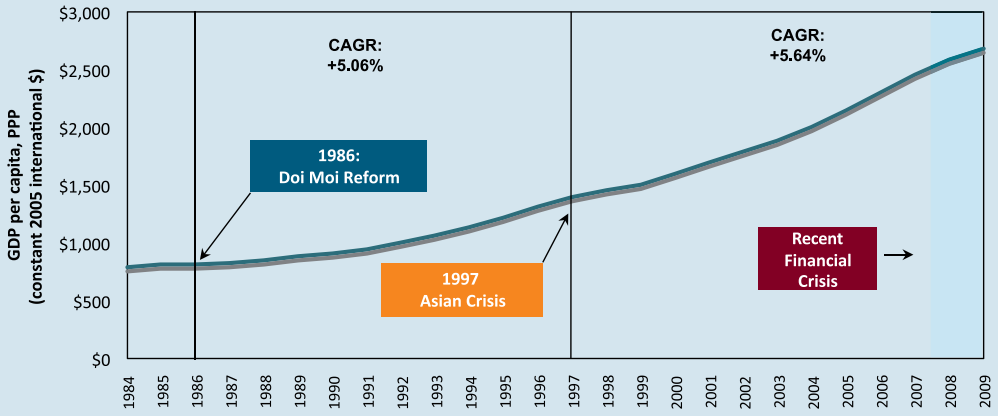
Standard of Living

Income: GDP per capita

- *GDP per capita has grown quickly and steadily over the last two decades, yet it is at a low absolute level*

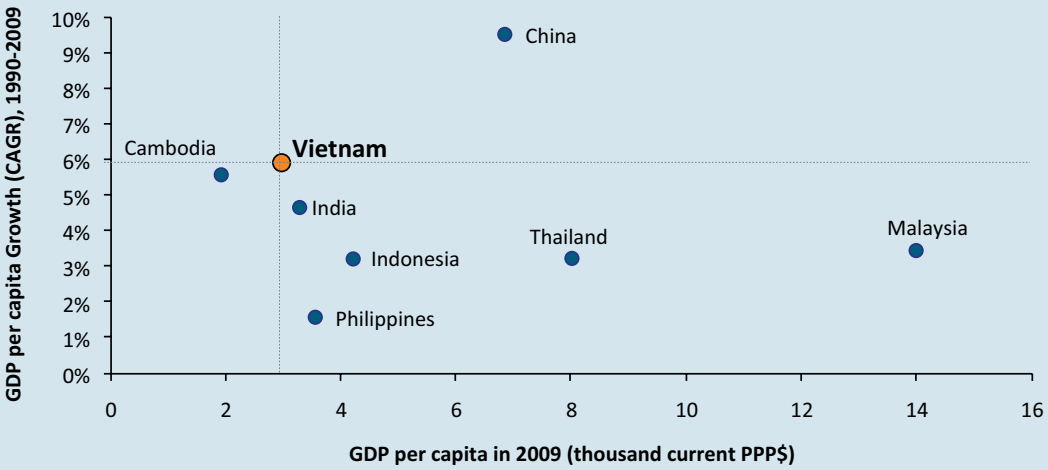
Vietnam's average income — real GDP per capita — has grown rapidly since the country launched the Doi Moi Reform, growing at an average annual rate of 5.06 percent between 1986 and 1997 (pre-Asian Financial crisis) and at the higher rate of 5.64 percent between 1997 and 2009 (Figure 2.1). Vietnam stood out as one of the fastest growing economies in the world during this period allowing it to reach the lower middle-income group in 2008 when its per capita income exceeded USD 1,000. And it continues to make significant progress since, despite the recent financial crisis.

FIGURE 2.1: GROWTH PATTERNS OF VIETNAM'S GDP PER CAPITA 1984-2009



Source: World Development Indicators.

FIGURE 2.2: COMPARISON OF GDP PER CAPITA GROWTH, 1990-2009



Note: GDP per capita growth (CAGR) for Cambodia is for the period 1993 - 2009.

Source: World Development Indicators.

While Vietnam's economic growth over the past two decades has been impressive in relative terms, the per capita GDP (measured using purchasing power parity) of the country remains low compared to other countries. In 2009, Vietnam ranked 113th in the world and it is still among the poorest countries in East Asia (Table 2.1). In addition, Vietnam's prosperity level lags significantly behind traditional tiger economies such as South Korea and even China's per-capita GDP is more than twice that of Vietnam's (Table 2.1 and Figure 2.3).

Non-income Measures of Economic well-being

Poverty Reduction

- *Significant successes in poverty reduction, however risk of re-impoverishment remains high*

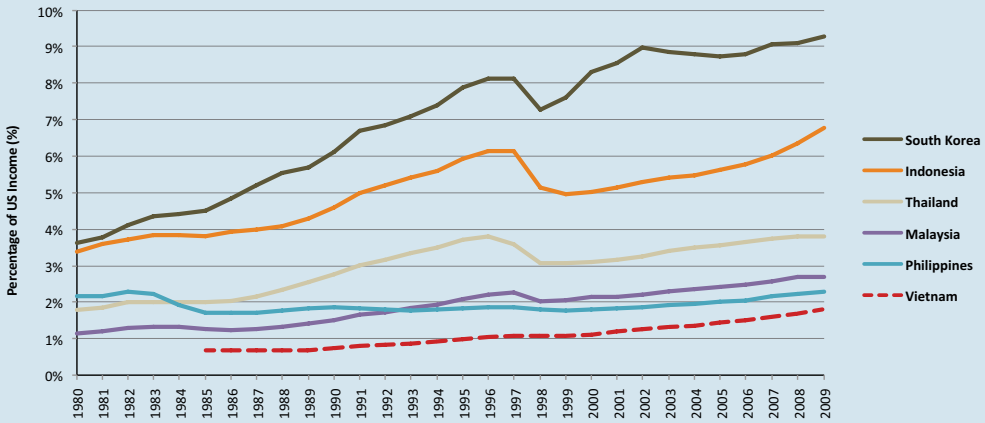
Vietnam is recognized as one of the early achievers of the Millennium Development Goals on poverty reduction. . Its poverty rate fell dramatically from 58.1 percent in 1993 to 14.5 percent in 2008 (GSO 2006)[1]. The country managed to significantly reduce poverty rate in both urban and rural areas as shown in Figure 2.4. In 2009, despite the slowdown in economic growth, the proportion of poor households continued to decline. This is estimated to remain at 11 percent by the Government's poverty standards[2] . However, it is worthwhile noting that while the country's successes in poverty reduction are significant, "these results are not really stable, the rate of re-impoverishment remains high" as candidly pointed out by Prime Minister Nguyen Tan Dung in his article written on the occasion of the New Year 2010 (Press Center 2010).

TABLE 2.1: COMPARISON OF PER CAPITA INCOME IN 2009

Economy	USD	PPP$	Group Rank ($PPP)	World Rank by ($PPP)
Singapore	36,537	50,705	1	4
Japan	39,727	32,443	2	20
South Korea	17,078	27,168	3	26
Malaysia	6,975	13,982	4	49
Thailand	3,894	8,004	5	80
China	3,744	6,838	6	83
Indonesia	2,349	4,205	7	106
Philippines	1,745	3,546	8	110
Vietnam	1,052	2,957	9	113
Lao	940	2,259	10	125
Cambodia	677	1,913	11	131

Source: World Development Indicators.

FIGURE 2.3: CATCHING-UP ON ECONOMIC DEVELOPMENT– VIETNAM VS. EAST ASIAN COUNTRIES



Source: World Bank Development Indicators; calculations by ACI.

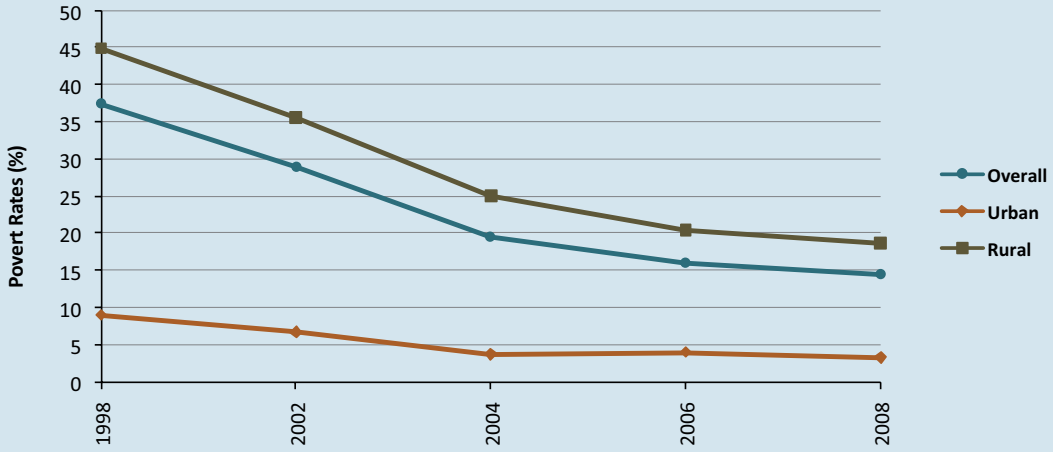
The risk of re-impoverishment is high for three groups. The first group includes poor households who rely solely on agricultural production and live in the coastal region of the Red River Delta or Mekong Delta. These areas are also more susceptible to natural disasters, floods and epidemics. The second group includes poor, mostly minority households living in the Northern mountainous region, the Central Highlands, islands, or places with difficult access to production sources or social services. The third group includes the urban poor with low education levels or professional skills. Income disparity among economic regions demonstrates that growth policies which aim at creating low value-added jobs will help reduce poverty, but will not bridge the income gap between rich and poor areas. Thus, policies need to target productivity improvement in poorer regions in order to improve their standard of living in a sustainable way.

Income Inequality

- *Overall, inequality is widening in the wake of economic growth, but remains lower than that of peer countries*

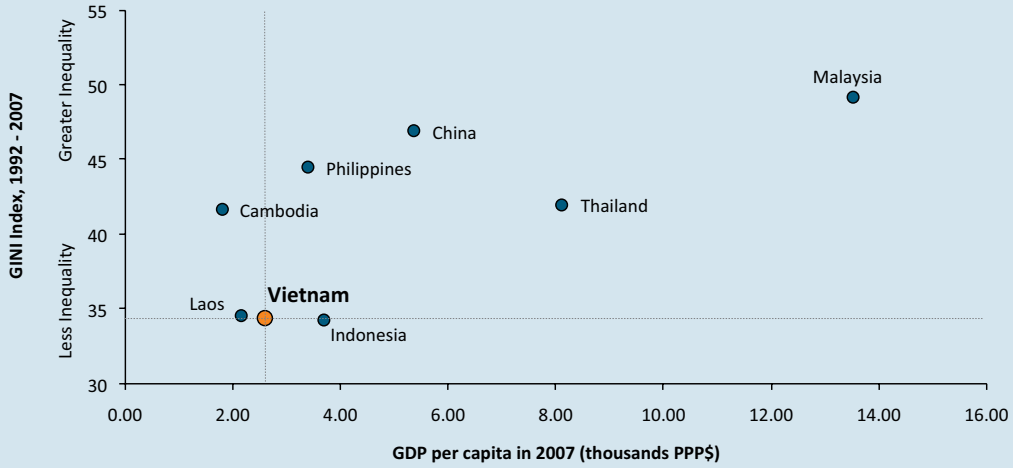
Income inequality has been widening and this is an expected result of Vietnam's high economic growth. However, the country's level of income inequality is still low relative to countries such as China, Thailand, Philippines, Malaysia, and Cambodia (Figure 2.5).

FIGURE 2.4: POVERTY REDUCTION, 1998-2006



Source: VHLSS, GSO

FIGURE 2.5:
GINI COEFFICIENT AND GDP PER CAPITA



Note: The Gini index ranges from 0 (absolute equality) and 100 (absolute inequality). Gini index in the latest period from 1992-2007.

Source: Human Development Report 2009, UNDP.

Quality of Life

The broader concept of "quality of life" is an important measurement of a country's competitiveness. The Human Development Index (HDI) represents an attempt to measure such a quality. In addition, other indicators include environmental quality, population characteristics, quality and access to health care services, education, and gender equality.

Human Development Index (HDI)

- *Moderate position on HDI ranking, lower scores than those of most Asian peer countries*

The HDI is compiled based on a set of indicators organized into three components: income, health, and education. Vietnam scored well in the health component, which is proxied by life expectancy, compared to its Asian peers (Table 2.2). However, Vietnam needs to do more to improve the education component where it continues to lag behind many of its Asian peers. For instance, the mean years of schooling is 5.5 and the expected years of schooling is 10.4 (an improvement of 4.9) for Vietnam, while these figures, respectively, are 5.7 and 12.7 (an improvement of 7) for Indonesia. In order to improve the HDI, it is essential for Vietnam not only to catch-up in GDP per capita, but also in terms of other indicators, especially education.

TABLE 2.2:
HUMAN DEVELOPMENT INDICATOR AND ITS COMPONENTS IN 2010

	HDI rank	Human Development Index (HDI) value	Life expectancy at birth (years)	Mean years of schooling (years)	Expected years of schooling (years)	Gross national income (GNI) per capita (PPP 2008 $)	GNI per capita rank minus HDI rank	Non-income HDI value
South Korea	12	0.877	79.8	11.6	16.8	29,518	16	0.918
Singapore	27	0.846	80.7	8.8	14.4	48,893	–19	0.831
Malaysia	57	0.744	74.7	9.5	12.5	13,927	–3	0.775
China	89	0.663	73.5	7.5	11.4	7,258	–4	0.707
Sri Lanka	91	0.658	74.4	8.2	12	4,886	10	0.738
Thailand	92	0.654	69.3	6.6	13.5	8,001	–11	0.683
Philippines	97	0.638	72.3	8.7	11.5	4,002	12	0.726
Indonesia	108	0.6	71.5	5.7	12.7	3,957	2	0.663
Viet Nam	**113**	**0.572**	**74.9**	**5.5**	**10.4**	**2,995**	**7**	**0.646**
India	119	0.519	64.4	4.4	10.3	3,337	–6	0.549
Lao PDR	122	0.497	65.9	4.6	9.2	2,321	3	0.548
Cambodia	124	0.494	62.2	5.8	9.8	1,868	12	0.566
Bangladesh	129	0.469	66.9	4.8	8.1	1,587	12	0.543

Source: United Nations, 2010.

BOX 2.1: POLLUTION IN THE DELTAS OF DONG NAI RIVER, CAU RIVER AND NHUE RIVER

The mining and mineral exploitation industry alone accounts for 55 percent of industrial waste. Twenty-five percent stems from metal production, 7 percent from paper production and food industry accounts for 4 percent. In the Nhue river valley (including the Hanoi region), 56 percent of total sewage is from households, 24 percent is industrial wastewater and 4 percent is sewage from trade villages. In the Dong Nai river valley (including HCMC, Dong Nai, Binh Duong), about 480,000 metric tons of waste water are released daily, with industrial and processing zones accounting for 24.6 percent of that total.

Source: World Bank, 2006.

Environmental Quality

- *Industrial pollution has resulted in a serious degradation of environmental quality*

Over the period 1998-2007, the emission of CO2 from energy consumption increased by 9.6 percent annually (UN Environment Programme). Air pollution is mainly caused by industries, transportation and other civil industries.

Water pollution is getting worse, especially in large industrial centers, industrial zones in the deltas of Dong Nai river, Cau river and Nhue river. Pollution causing agents include growing industrial production, rapid urbanization and high construction density[3].

The Elements of Prosperity

Prosperity decomposition is an arithmetic exercise which decomposes the sources of economic growth which include mobilization of factors of production and productivity. Since the different components of GDP per capita are driven by policy choices in different areas, the decomposition provides useful insights into which dimensions of competitiveness may need further analysis.

The Sources of Growth

Total factor productivity (TFP)[4] - an important measure of efficient use of capital and labor inputs- has tended to decline significantly since 2000 and capital deepening has become the main driver of growth.

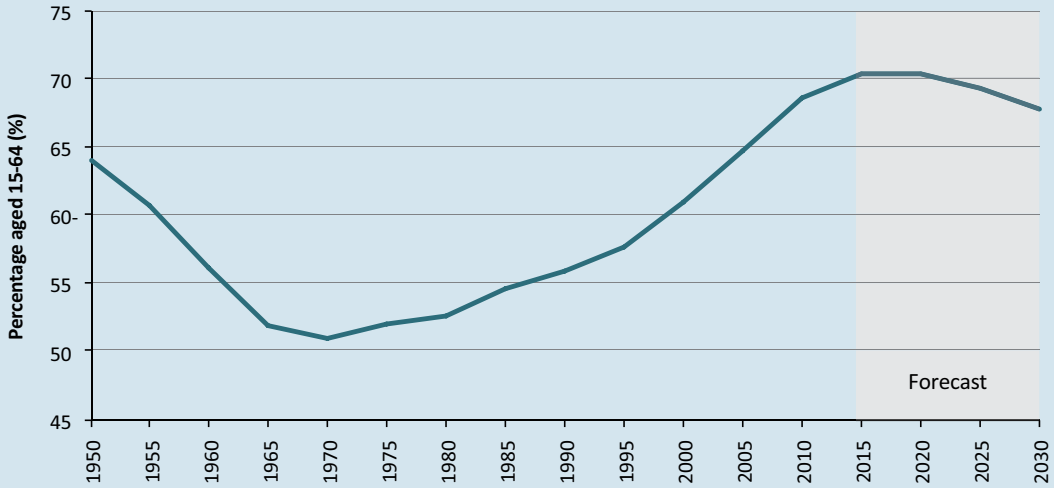
GDP growth rate of a country can be decomposed into three sources: growth in capital input, growth in labor, and growth in TFP. Over the period 1990-2000, 34% of GDP growth in Vietnam was accounted for by growth in capital input, 22% by growth in labour input and 44% by growth in total factor productivity (TFP). However, during the period 2000-2008, the contribution of capital increased significantly to 53%, while that of TFP declined sharply to 26% (Table 2.3). In comparison, in most of Vietnam's ASEAN peers such as Indonesia, Malaysia, Thailand and the Philippines, the contribution of TFP to economic growth increased quite substantially during the more recent period 2000-2008. Furthermore, in China, more than 50% of economic growth over the entire period 1990-2008, more than 50% of growth was accounted for by TFP growth. Clearly, Vietnam stands out in its reliance on capital accumulation and this suggests that the real return on capital is likely to be low in Vietnam and also calls into question the sustainability of the present growth trajectory.

TABLE 2.3: SOURCES OF GDP GROWTH, 1990-2008

Country	Period 1990-2000				Period 2000-2008			
	GDP	Sources of Growth			GDP	Sources of Growth		
	Growth	Capital	Labor	TFP	Growth	Capital	Labor	TFP
	Contribution in percentage points per annum (ppa)							
Vietnam	**7.3**	**2.5**	**1.6**	**3.2**	**7.3**	**3.9**	**1.4**	**1.9**
China	9.9	3.6	0.7	5.5	9.7	4.1	0.6	5
India	5.3	2.1	1.2	2	7.3	3.1	1.6	2.7
Cambodia	7.3	2.8	2.5	2	9	4.2	3.5	1.3
Indonesia	4.1	2.5	1.1	0.5	5.1	1.4	1.1	2.5
Malaysia	6.9	3.7	2.1	1.1	5.4	1.6	1.1	2.7
Philippines	3	1.3	1.4	0.3	4.7	1	1.9	1.8
Thailand	4.4	2.7	0.3	1.4	4.7	0.8	1.4	2.5
	Contribution share							
Vietnam	**100%**	**34%**	**22%**	**44%**	**100%**	**53%**	**19%**	**26%**
China	100%	36%	7%	56%	100%	42%	6%	52%
India	100%	40%	23%	38%	100%	42%	22%	37%
Cambodia	100%	38%	34%	27%	100%	47%	39%	14%
Indonesia	100%	61%	27%	12%	100%	27%	22%	49%
Malaysia	100%	54%	30%	16%	100%	30%	20%	50%
Philippines	100%	43%	47%	10%	100%	21%	40%	38%

Source: Data from WDI; calculations by ACI.

FIGURE 2.6: VIETNAM'S WORKING-AGE POPULATION



Source: UN Population Database Revision 2008.

Labor Mobilization

Labor mobilization measures the share of population engaged in generating value in the economy. As an aggregate, it captures the impact of two factors. First, the demographic profile determines the working age population. Changes in the ratio of the working to non-working population can have a significant impact on growth rates over time. Second, the employment intensity—labor force participation—depends on the effectiveness of labor markets in providing job opportunities.

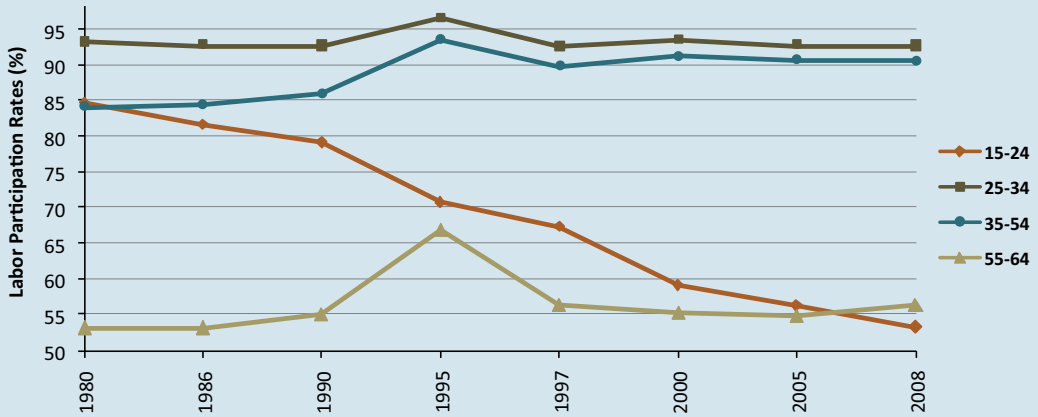
Demographic Trends

- *A young population with a high share of people in working age is an advantage, but initial signs of population aging and rising population density are posing challenges*

Vietnam has a large and young population, with 90 percent below or within working age. At the end of 2009, its population was estimated at 86.06 million; of which, 29.6 percent live in cities and 70.4 percent in rural parts[5]. It is the third most populous country in South East Asia and the 13th most populous country in the world.

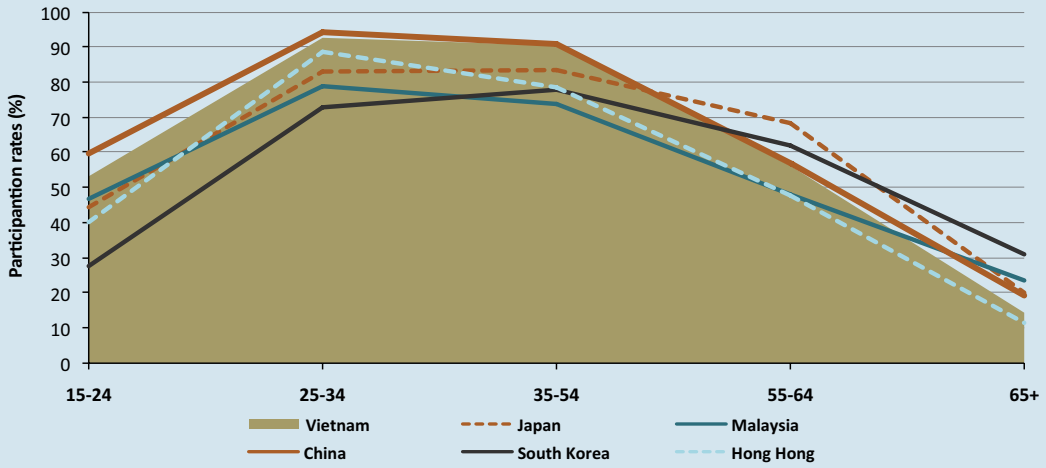
The share of the population below the working age (0 – 14 years old) has declined from 34.3 percent (1999) to 26.5 percent in 2009 (UN Population Database). Meanwhile, the share of the working age population (15 – 64 years old) has increased from 60.18 to 67.18 percent over the last decade. The senior citizens group (above 64) has increased slightly from 5.51 percent to 6.30 percent. Vietnam has entered the period of a "golden population structure" with a total workforce about double the size of the non-working population. This "golden" structure can be maintained for about 15 to 30 years, or up to 40 years at a maximum, depending on future birth rates. Vietnam needs to take advantage of this low dependency ratio and demographic bonus to develop a high quality labor force for boosting economic growth.

FIGURE 2.7: LABOR FORCE PARTICIPATION RATES BY AGE GROUPS, 1980-2008



Source: International Labour Organization

FIGURE 2.8: AGE-SPECIFIC LABOR FORCE PARTICIPATION RATES IN 2008, VIETNAM AND OTHER ASIAN COUNTRIES



Source: International Labour Organization

There are however some initial signals of an ageing population. The ageing rate of Vietnam has increased by 11 percent (from 24.5 to 35.9 percent) over the past 10 years. The current ageing rate is higher than the average rate for the ASEAN region (30 percent). An aging population will pose serious challenges for the social security system given the country's current low level of development.

Vietnam is among the most densely populated countries in the world—with the average population density of 254 people/km2 in 2007. This density is 1.86 times higher than that of China (136 people/km2), 10 times higher than that of developed countries and 6 to 7 times higher than the world's average density. High population density affects the quality of the living environment, especially in urban areas. This implies that land-intensive industries are no longer an advantage for Vietnam and Vietnam needs to use its land resources most efficiently.

Labor Force Participation

- *The labor participation rate is high but declining, as younger people can afford to stay longer in school*

Vietnam's labor force comprises 43.8 million people (April 2009), equivalent to 51.1 percent of the total population. As illustrated in Figure 2.7, the labor participation rate has decreased over time, primarily as a result of declining participation by the 15-24 age-group. However, although in 2008 this rate decreased by 2.5 percentage points compared to that in 1998, it still remained high at 77.4 percent, equal to the rate for many high-income countries such as Japan, Denmark, etc.

The lower participation rate of working-age population could be explained by the fact that younger people stay longer in school. Thanks to improvements in living standards. The participation rate for 15-24 year old age group has declined continuously since 1980.

In 2008, the structure of labor force participation by age-group for Vietnam resembled that of China, where 92.8 percent of the 25-34 year old age-group participated in the labour force. For the 15-24 age-group, the participation rate of high-income countries such as South Korea was lower than that of Vietnam; however, the rates for 55-64 and 65 and above age group were higher. The evidence from these and other countries implies that Vietnam needs to take full advantage of its golden population structure before the greying of the population emerges over the next two decades.

TABLE 2.4: COMPARISON OF EMPLOYMENT GROWTH RATES

Country	Employment growth (%)
Vietnam 1991 – 2007	**2.4**
Korea 1969-1988	3.2
Malaysia 1977-1996	3.5
Thailand 1976-1995	3.0
Taiwan 1963-1982	3.4
Indonesia 1977-1996	2.9
Philippines 1961- 1980	3.3

Source: Fulbright Economics Teaching Program, The Structural Roots of Macroeconomic Instability, September 2008.

Employment Growth

- *Employment growth lags behind GDP growth; a high share of self-employed and informal employment suggests that unemployment and underemployment figures may be underestimated*

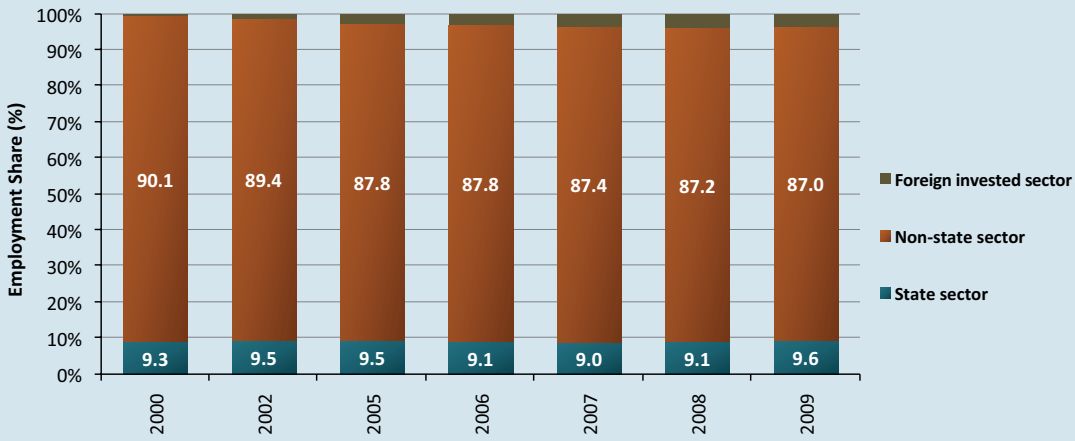
The growth in labor demand is relatively low compared to the Vietnam's high income and export growth. Compared to other countries in the period of their own rapid growth, Vietnam's performance on job creation is not as impressive. Vietnam's high labor participation rate (43.9% in 1991) as compared to peer countries (e.g. 29.4% for Korea in 1960 and 34.2% for Malaysia in 1977) may provide a partial explanation. However, Thailand started the take-off period in 1976 also with relatively high labor participation rate (42.6%) but still recorded the average job growth at 3.0% over two decades.

The sectoral distribution of investment explains much of the lackluster performance of the economy in creating jobs. Some 37 percent of total investment flows into the capital-intensive state sector, which accounts for only 10 percent of jobs. In contrast, the private domestic ("non-state") sector employs 87 percent of all workers, but its share in total investment is only 28 percent. Redressing that imbalance needs to be part of any strategy for accelerating job creation.

The serious challenge for facing Vietnam's economy is to create sufficient jobs in rapidly growing sectors that can absorb its large young labor force, without being trapped in low-productivity, labor-intensive industries.

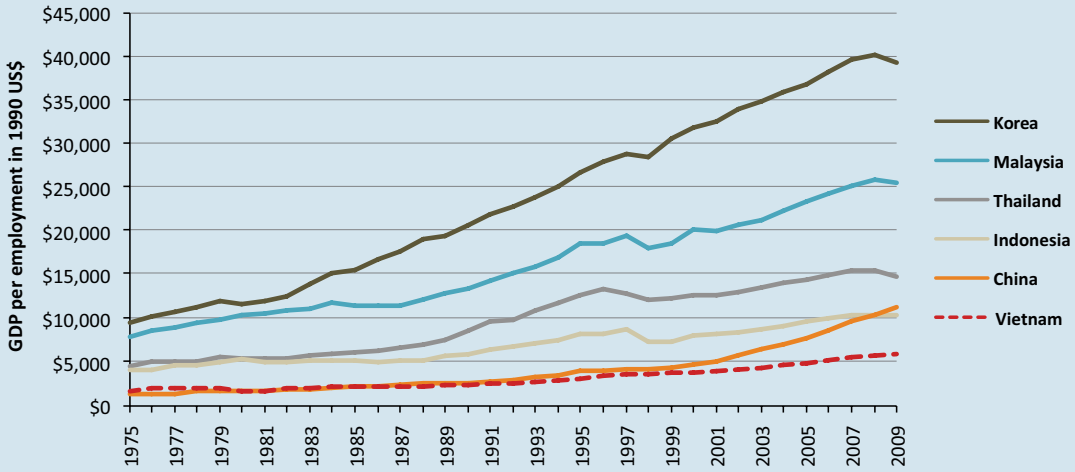
Salaried employees in the formal sector account for only 23 percent of the total number of workers (ILO's Employment Trends Report 2009). The remaining 77 percent are self-employed or unpaid family workers. Small, and mostly informal, family farms and enterprises comprise an unusually large proportion of employment in Vietnam. Therefore, the official unemployment statistics may underestimate the level of underemployment or unemployment of the self-employed workers (including people working in agriculture) and those who work outside of formal economy.

FIGURE 2.9: EMPLOYMENT STRUCTURE BY OWNERSHIP, 2000-2009



Source: General Statistics Office of Vietnam

FIGURE 2.10: PRODUCTIVITY GROWTH – VIETNAM VS. OTHER ASIAN COUNTRIES, 1975-2009



Source: The Conference Board,Total Economy Database 2010.

Labor Productivity

Labor productivity growth is ultimately the key for sustained prosperity gains as it is intimately linked to wages and the standard of living. Labor productivity—defined here as GDP per worker has three dimensions:

- First, higher labor productivity can be the result of better skilled employees, an increase in complementary factors of production such as capital, or better use of technology.
- Second, higher average labor productivity can be the result of either sectoral change — a growing share of labor in sectors with higher productivity levels, or within-sector growth — higher labor productivity within sectors as a result of innovation.
- Third, higher average labor productivity can be the result of changes in the composition of companies in the economy (foreign vs. local, private vs. government-owned) that have different levels of productivity or of productivity growth.

Overall Labor Productivity

- *Despite relatively high growth rate in overall labor productivity, the absolute level remains much lower compared to most countries in the region*

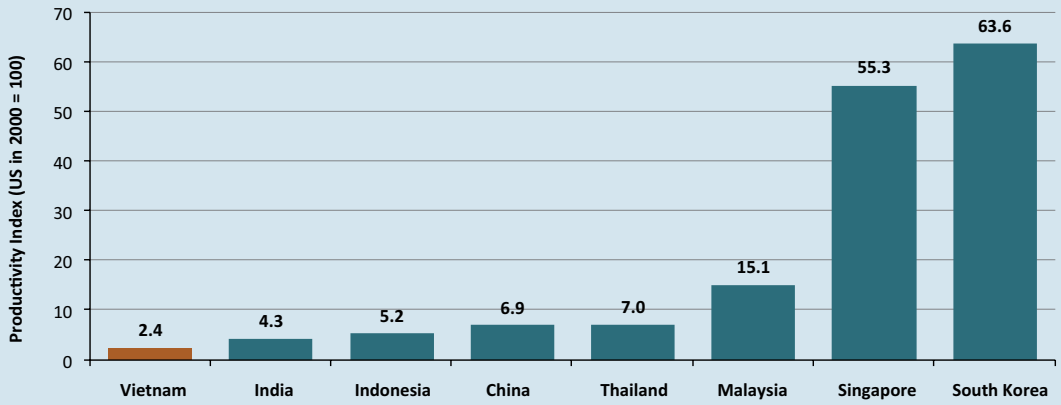
Labor productivity has continuously improved since 1986, with a relatively high rate of improvement compared to peers. Vietnam's average labor productivity growth during the period 1986 to 2009 was 4.67 percent; higher than that of other ASEAN countries (3.73 percent) but significantly lower than that of China (7.26 percent). However, the subsequent sections examine whether this growth was generated by a shift towards capital-intensive production or by improvements in skills and technological progress.

In absolute terms, Vietnam remains a low productivity country compared to the rest of Southeast Asia. In 2009, Vietnam's productivity was equivalent to only 14.9 percent of that of Singapore, 9 percent of that of the U.S., 40 percent of that of Thailand and 52.6 percent of that of China.

The comparisons look even worse for the manufacturing sector, which is expected to be the key driver of Vietnam's productivity growth. Taking the level of manufacturing sector productivity of the US in 2000[6] as 100, the relative productivity of the manufacturing sector in the same year was only 2.4 for Vietnam; whereas it was 4.3 for India, 5.2 for Indonesia, 6.9 for China, 7 for Thailand, 15.1 for Malaysia, 55.3 for Singapore, and 63.6 for South Korea (Figure 2.11).

The low growth rate of productivity within sectors raises a serious concern. The experience of NICs in Asia has shown that sectoral productivity growth should be the key driver of overall productivity growth. In South Korea for example, sectoral productivity growth accounted for 83 percent of overall productivity growth during the high growth period 1963-1973 while sectoral structural shift accounted for only 17 percent. The figures were 69 percent and 31 percent during 1973-1985 and 89 percent and 11 percent during 1985-1996, respectively (Van Art and Timmer, 2003). Similarly, 85 percent of Singapore's productivity growth during 1970-2005 was from sectoral productivity growth (ACI, 2009).

FIGURE 2.11: MANUFACTURING SECTOR PRODUCTIVITY IN 2000 – VIETNAM VS. SELECTED ASIAN COUNTRIES



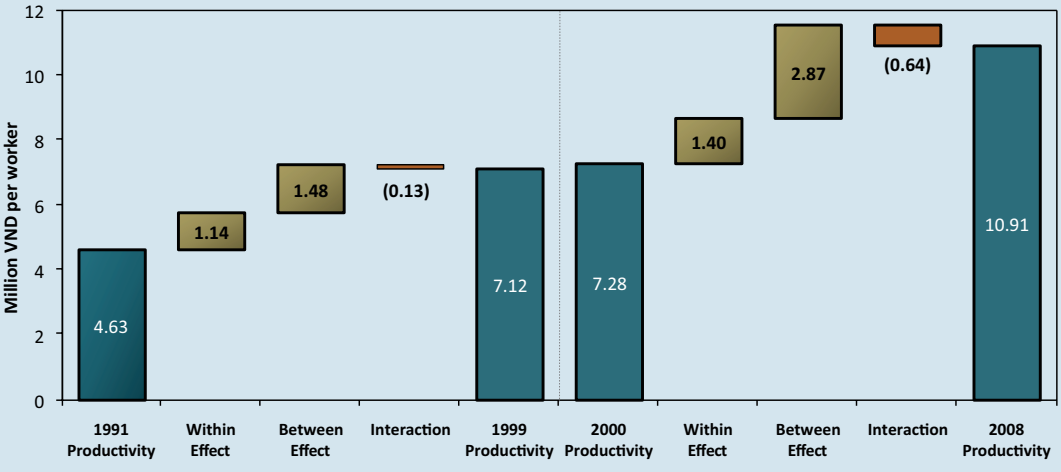
Sources: UNIDO; China Statistical Yearbook.

The Impact of Sectoral Shifts on Labor Productivity

- *The growth in labor productivity is largely due to the shift from agriculture to manufacturing and services; however, within-sector productivity growth remains feeble*

During 1996-2008, labor productivity increased at an average annual rate of 4.8 percent, from a low base. Much of this is accounted for by shifts in the sectoral structure, even while sectoral productivity growth has been lower. Compared with the period 1991-1999, the contribution of structural shift to overall productivity growth in 2000-2008 was even higher. Figure 2.12 below shows that structural shift contributed more than two thirds of the overall productivity growth over the 2000 - 2008 period, while sectoral productivity growth only accounted for one third of the overall growth. This was largely the result of labor moving from low productivity sectors to higher ones (static structural shift). Sectors which managed to increase both their productivity and their share in the total workforce (dynamic structural shift) were too few in number and had little impact to overall productivity growth. In other words, the structural shift over the last two decades has been mostly horizontal, with agriculture shrinking while industries and services expanding in terms of both sectoral contribution to GDP and sectoral share in the total workforce.

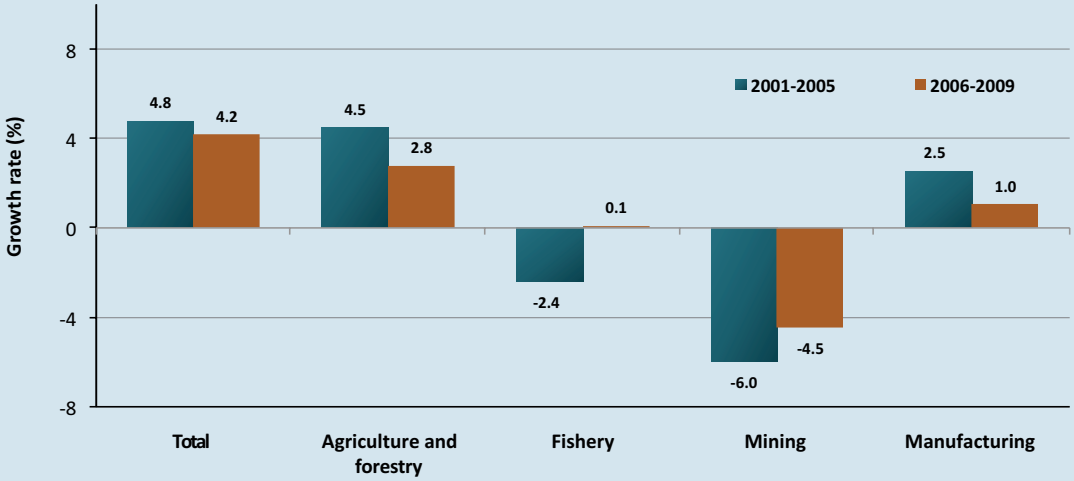
FIGURE 2.12: DECOMPOSITION OF LABOR PRODUCTIVITY, 1991-1999 AND 2000-2008



Note: Productivity is measured by GDP per worker at 1994 prices.

Source: General Statistics Office of Vietnam; calculations by ACI and CIEM.

FIGURE 2.13: GROWTH RATE OF OVERALL AND SECTORAL LABOR PRODUCTIVITY



Source: General Statistics Office of Vietnam.

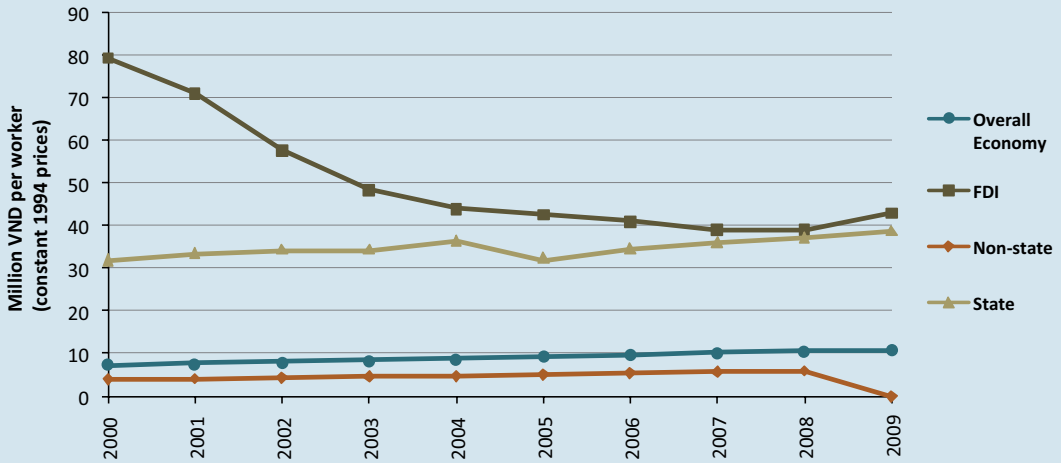
Figure 2.13 shows that the agricultural and forestry sector registers the highest rate of growth of labour productivity, yet the focus of both government and foreign investors is on the manufacturing sector where labour productivity growth has been much lower in comparison. In recent years, the processing industry has created many new jobs, and has contributed significantly to the shift in labor structure and sectoral structure. These achievements are due primarily to the expansion of production volume and the absorption of low-skilled workers, not from a shift to higher value-added products.

Labor Productivity by Ownership

- *Labor productivity varies among economic segments: it is much higher in the FDI sector, but declining sharply as FDI shifts toward more labor-intensive activities; labor productivity in the state sector is high because of capital-intensive production processes; it lags in the private sector*

In 2000, the average labor productivity in the FDI sector was more than double the productivity of the state sector, 20 times higher than that of the non-state sector and 10 times higher than that of the overall economy. But the gap has been narrowing, primarily because FDI has basically shifted toward more labor-intensive activities in the post-integration stage. Many FDI enterprises in processing industry use outdated technology, and also fail to comply with the current legislation on environmental standards, causing much pollution. This sector's productivity has witnessed a sharp decline during 2000 – 2007. By 2008, the sector's productivity was only 7 times higher than that of the non-state sector and was equivalent to 90 percent of the state sector, yet still 4 times higher than that of the overall economy. Labor productivity in the non-state sector lags, because it comprises a large proportion of informal and smallholder businesses with low capital-labor ratios and limited access to technology.

FIGURE 2.14: LABOR PRODUCTIVITY BY OWNERSHIP



Note: Data for 2009 are preliminary.

Source: General Statistics Office of Vietnam.

Assessment

Continuous growth has raised Vietnam's income per capita to over USD 1,000 since 2008 and improved other measures of living standards. However, despite these achievements, the growth process has encountered three serious problems that threaten national competitiveness. First, labor productivity has progressed continuously for the past 20 years. However, opting for capital-intensive production processes has raised labor productivity, but at the expense of capital productivity, with limited impact on growth and Vietnam remains an economy with low labor productivity. Second, the income gap between the richest and the poorest group has widened. Third, environmental quality is degrading, especially in key economic regions that are also the leading engine of national growth. Vietnam is also undergoing rapid urbanization, imposing serious pressures on urban infrastructure and on the creation of non-agriculture jobs.

Vietnam' sources of growth resemble those of other Southeast Asian countries; physical capital still plays a major role, while the contribution of technological advances is low and unstable. Vietnam has high labor mobilization rate and will continue to benefit from its golden population structure in the following decades. However, the fact that labor quality is low and has not seen much improvement, especially in the case of young workers, has been a bottleneck for labor productivity growth.

Moreover, the low contribution of sectoral productivity growth to overall productivity growth is a serious concern. Growth was mainly driven by structural shifts from agriculture to manufacturing and services. The process is still ongoing, but will ultimately be limited by the low productivity of the manufacturing sector. Experiences from developed countries show that in the long run, it is productivity growth within sectors rather than structural shifts that drives overall productivity growth. Thus, future policies need to target sectoral productivity growth in order to increase national competitiveness.

Intermediate Indicators of Economic Performance

Indicators like investment, trade, and innovation represent 'leading indicators' of future prosperity. Investment increases the capital stock and is often a sign of other improvements in the productive capacity of an economy. Competition through trade improves efficiency, exposes local companies to external rivalry and new ideas, and thus enhances productivity. Innovation leads to new products, new services, or new ways of production and marketing.

From the perspective of a competitiveness analysis, these indicators play a dual role. They reflect underlying competitiveness, but they also contribute to competitiveness. If there is more investment, more trade, or more innovation, the underlying competitiveness of a location tends to grow over time.

Intermediate indicators are too often misunderstood as policy objectives rather than as diagnostic instruments. Investment is a typical example: if it occurs naturally as part of the market process, it is a sign of and contributor to competitiveness. But if it is the result of government intervention, for example because of subsidies paid to investors, investment can undermine prosperity. A competitiveness assessment therefore needs to view these intermediate indicators as part of an overall diagnostic, not as an ultimate objective. This perspective also increases the value of looking at other indicators, for example the nature of investors or the productivity of their investments, to get a clearer sense on whether the intermediate indicator is a good indicator of (and contributor to) underlying competitiveness.

Investment

Investments, whether from domestic or foreign sources, are a sign that there is confidence in the future economic attractiveness of a location. Investments have a direct impact in terms of the capital deepening they represent. Quite often, new machinery and equipment lead to parallel improvements in organization and activities. And investment tends to increase the returns to skills, creating incentives for upgrading in other dimensions of competitiveness. Foreign investments have additional benefits in contributing additional capital, technology, and linkages to foreign markets.

Overall Investment Performance:

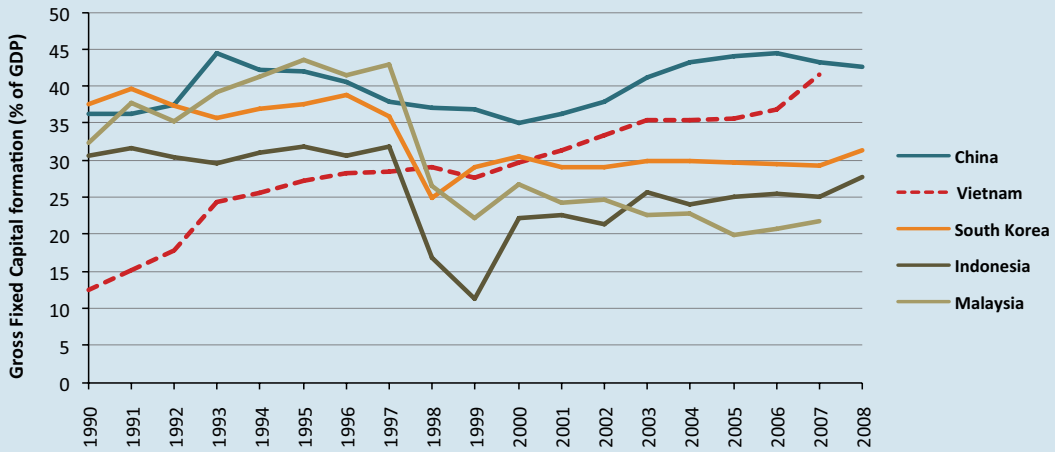
Investment Rate

- *The investment rate is high and growing*

Economic growth is accompanied by acceleration in investment. For Vietnam, the ratio of Investment to GDP increased from 18.1 percent in 1990 up to 46.5 percent in 2007. Inflation-restraint measures by the government brought the ratio back down to 41.3 percent in 2008.

This ratio was much higher than that for some NICs over the period 1960-1980, or for China and some fast-developing countries during the last few decades. For instance, from 1961-1980, the ratio of investment to GDP of South Korea reached an average of 23.3 percent, and Taiwan 26.2 percent, while their GDP grew by 7.9 percent and 9.7 percent, respectively. During 1981-1995 (before the Asian financial crisis), Thailand's GDP had an annual average increase of 8.1 percent, with 33.3 percent of investment to GDP. In 2001-2006, Vietnam registered an annual investment ratio of 37.2 percent, close to the 38.8 percent of China; however, annual GDP growth rate of China was 9.7 percent compared to 7.6 percent for Vietnam (Reidel, 2009).

FIGURE 2.15: INVESTMENT PATTERNS, 1990-2008



Source: World Development Indicators

Investment Efficiency

- *Investment efficiency is low and declining*

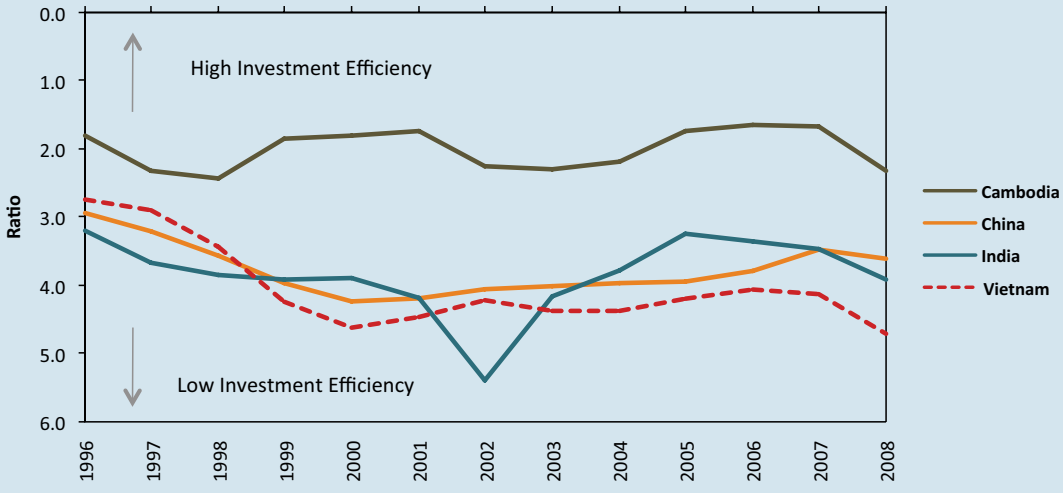
The incremental-capital output ratio (ICOR) which relates (net) investment in one year to subsequent gains in GDP may not be a solid analytical tool but nevertheless gives an interesting perspective: Vietnam's investment rate is high relative to growth. And the rate appears to be on the increase. Vietnam's ICOR averaged 4.8 during 2000-2008 and 5.4 for the period 2006-2008. At that level, it is much higher than that of NICs during the transition period from 1961-1980 such as Taiwan (2.7), South Korea (3) or some countries in the region like Thailand (4.1 from 1981-1995) and China (4 from 2001-2006). Incremental Capital-Output Ratio, Vietnam and selected Asian countries.

Investment of the State Sector

- *The state sector accounts for a high share of investment, but efficiency is low*

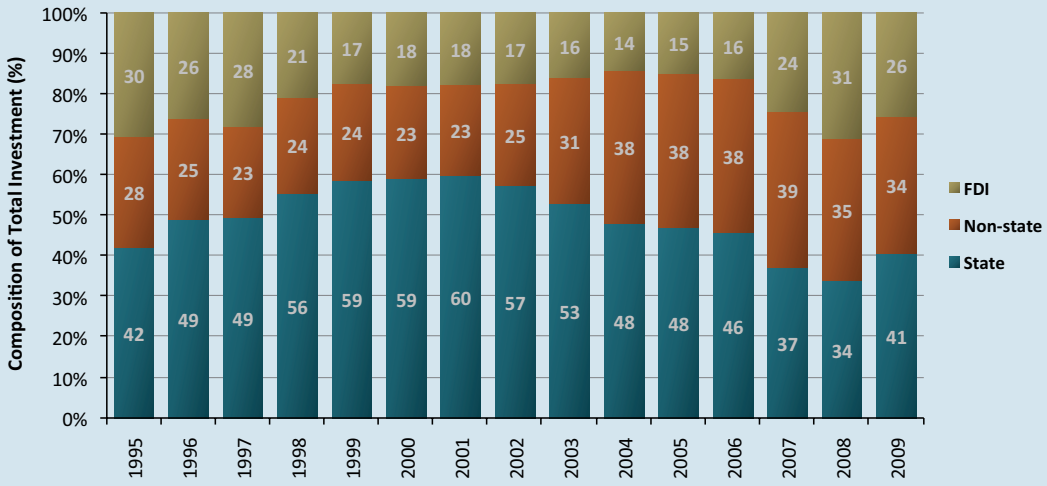
Despite the fact that the private and FDI sector's investments have expanded at a very high rate, 18 percent and 44 percent respectively, in the last two decades, the state sector still accounted for the lion's share of total investment. The efficiency of these investments therefore plays a key role in determining the growth rate and macroeconomic stability in Vietnam.

FIGURE 2.16: INCREMENTAL CAPITAL-OUTPUT RATIO – VIETNAM AND SELECTED ASIAN ECONOMIES



Source: World Development Indicators and Economist Intelligence Unit 2010; calculations by ACI.

FIGURE 2.17: COMPOSITION OF TOTAL INVESTMENT BY OWNERSHIP, 1995-2009



Source: General Statistics Office of Vietnam.

State investment comes from four sources—state budget, SOEs, state credit, and "the other."[7] The first two sources account for about three quarters of total public investment. State investment is declining[8] since 1996 as a result of the continuing equitization process. Even so, it still accounts for high percentage in total social investment, at an average of 49.3 percent from 1995-2008.

Investments in the state sector have been less efficient than in both the non-state and FDI sectors. For instance, according to some estimates, the ICOR of the state sector is 1.5 times higher than that of the whole economy, regardless of the ICOR calculation methods, whether by using gross capital formation or accumulative assets (Bùi Trinh 2010). Given its importance in terms of total investment, the low efficiency of state investment, especially of SOEs, drags down overall performance and undermines competitiveness gains in Vietnam.

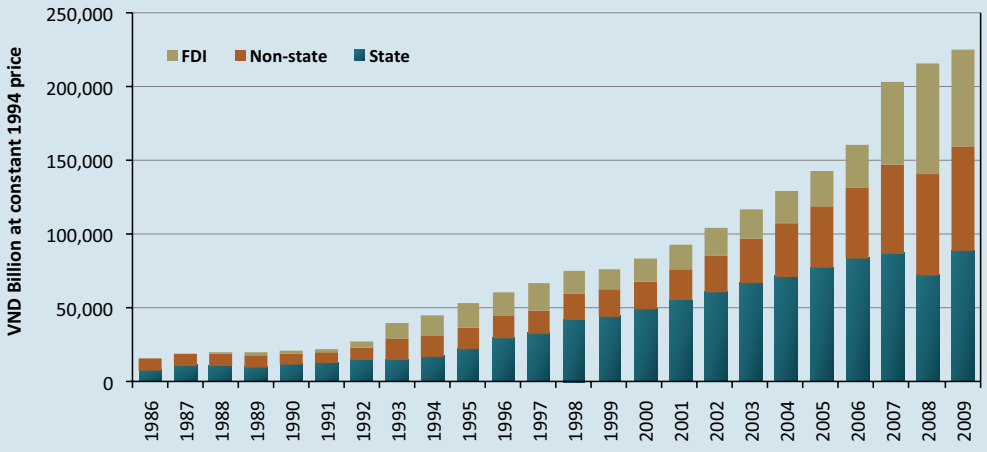
Foreign Direct Investment

Overall FDI Performance

- *Robust FDI inflows result in a high share of FDI to GDP*

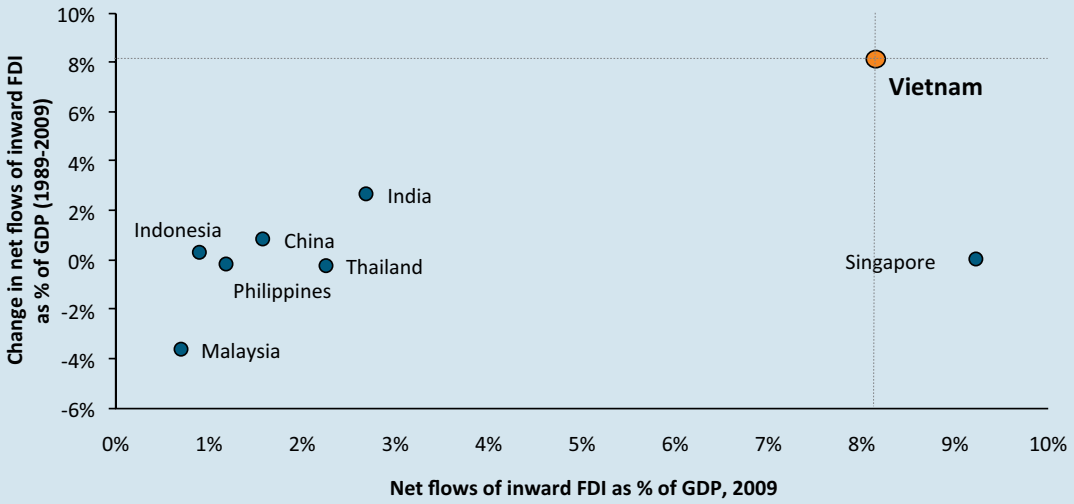
In Vietnam, FDI represents an important source of capital. According to data published by UNCTAD, the share of FDI in total gross fixed capital formation in Vietnam increased from 12 percent in 2006 to 25.5 percent in 2007 and 24.1 percent in 2008. The FDI stock relative to GDP increased from 25.5 percent in 1990 to 66.1 percent in 2000. By 2008, the total registered FDI amounted to USD 164 billion with almost 11,000 projects, but the FDI stock had dropped to 53.8 percent of GDP.

FIGURE 2.18: GROSS FIXED CAPITAL FORMATION BY OWNERSHIP, 1986-2009



Source: General Statistics Office of Vietnam.

FIGURE 2.19: OPENNESS TO FOREIGN INVESTMENT



Source: Economist Intelligence Unit 2010; calculations by ACI.

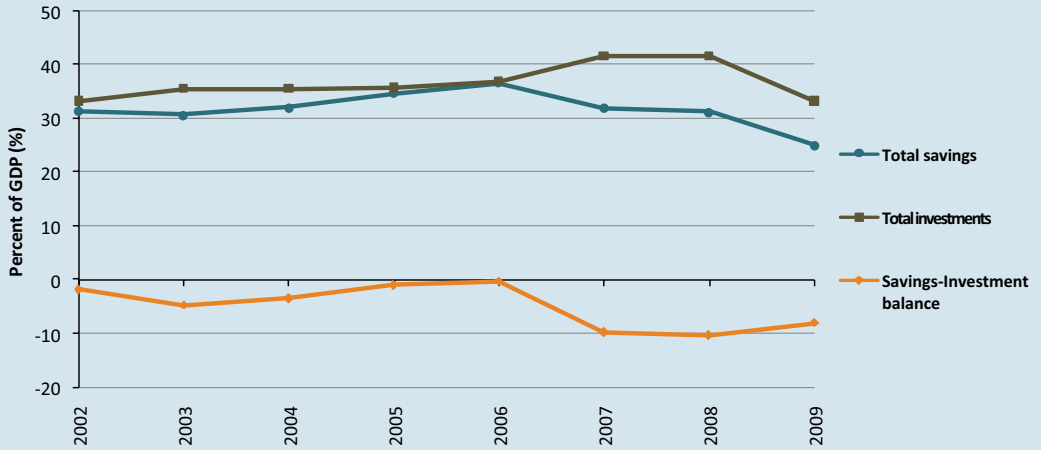
Domestic savings have not been sufficient to finance investment. The economy therefore depends increasingly on foreign resources and FDI has increasingly become an important source to compensate the saving and investment gap that has widened in the past three years.

FDI Implementation Rate

- *A widening gap between announced and realized FDI*

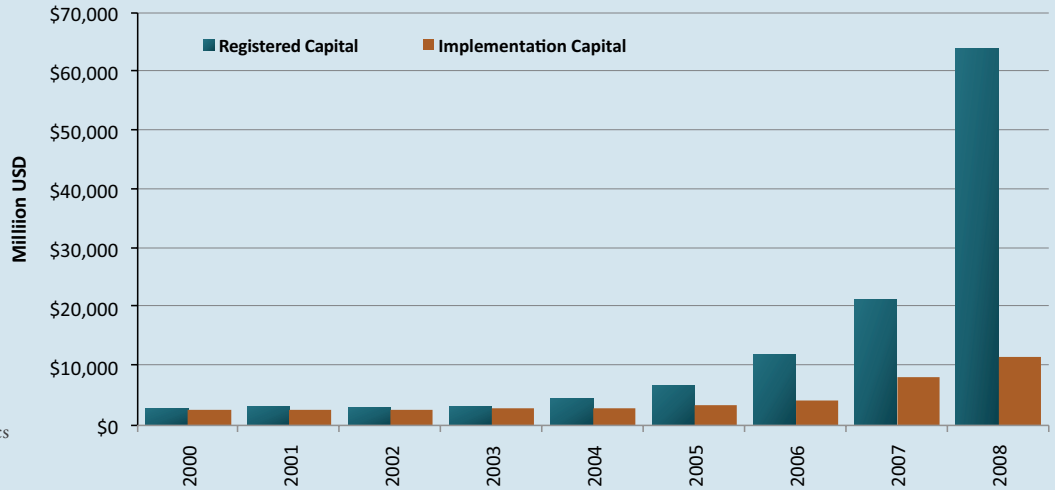
While the announced foreign direct investment projects continue to be strong, there is an increasing gap between announcements of foreign investment projects and actual investments made. The disbursement rate, actual vs. announced, was highest during 1997 – 2004 (73.5 percent) but has dropped dramatically to 40.1 percent during 2006 – 2008. Part of the growing gap might be explained by the FDI attraction race at the regional level that provides an incentive to "over-report" FDI commitments. But part of it is likely to be driven by increasing problems in implementing FDI projects in line with initial plans, or speculative behaviors of some investors who register projects to "reserve a seat" and resell their licenses for profit.

FIGURE 2.20: THE SAVINGS-INVESTMENT GAP, 2002-2009



Source: General Statistics Office of Vietnam.

FIGURE 2.21: ANNOUNCED VS. REALIZED FDI, 2000-2008



Source: General Statistics Office of Vietnam.

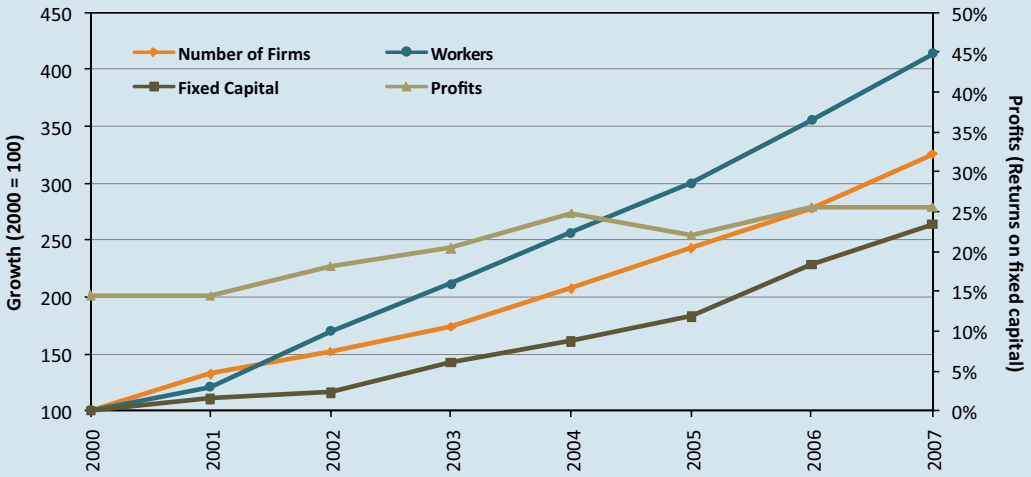
Targets of FDI

- *FDI is increasingly shifting to real estate and labor-intensive industries*

In the early years, FDI inflows were concentrated in import substitution and non-tradable industries (such as oil, construction, transportation, or communications) to serve the temporarily protected domestic market (STAR 2003). However, over the last five years, FDI inflows have shifted to more export-oriented and labor-intensive industries and to the real estate sector. Figure 2.22 shows that the number of workers in the FDI sector grew faster than the number of firms and fixed capital, reflecting a rapid shift towards labor-intensive industries. This trend is a response to the removal of industrial protection measures and also to the prevailing low-wage labor advantages. In 2009, the number of FDI projects investing in real estate and leasing business accounted for 21 percent of the total projects and the amount of invested capital was equivalent to 33 percent of total registered capital (GSO 2009).

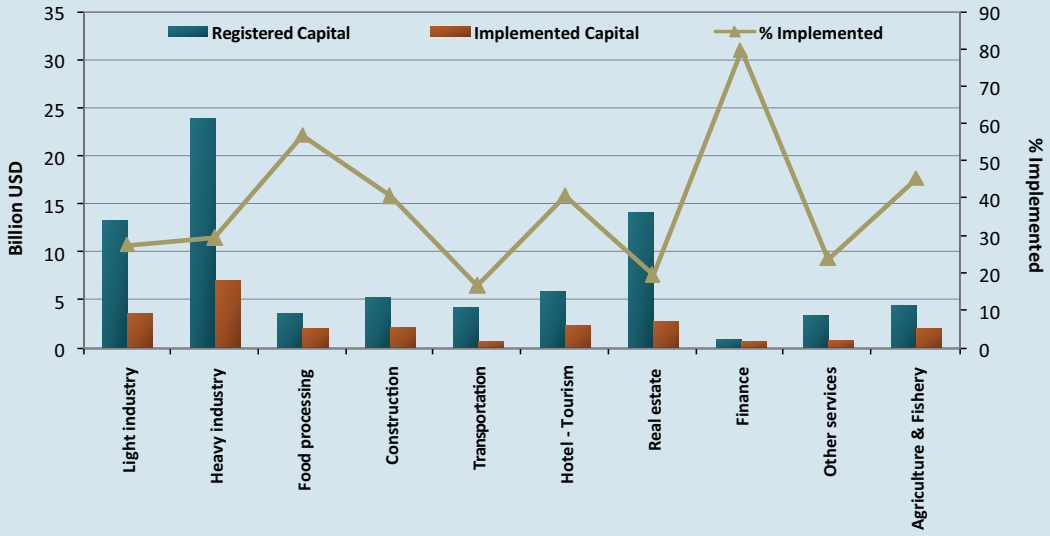
Although the manufacturing sector still accounts for the largest share in total registered capital, actual disbursement level in this sector have been especially low, representing only 30 percent of the total implemented capital during 1988-2007. This may reflect more difficulties and lower returns in investing in the manufacturing sector compared to the services and real estate sectors. It therefore requires reconsideration in policy and provision of incentives to encourage more FDI into the sectors that can boost up productivity and create more spillover values for the economy.

FIGURE 2.22: PERFORMANCE OF THE FOREIGN INVESTED SECTOR



Source: General Statistics Office of Vietnam.

FIGURE 2.23: CUMULATIVE FDI DISBURSEMENT RATIOS BY SECTOR, 1988-2007



Source: FIA's Report on Vietnam's 20-year FDI Development.

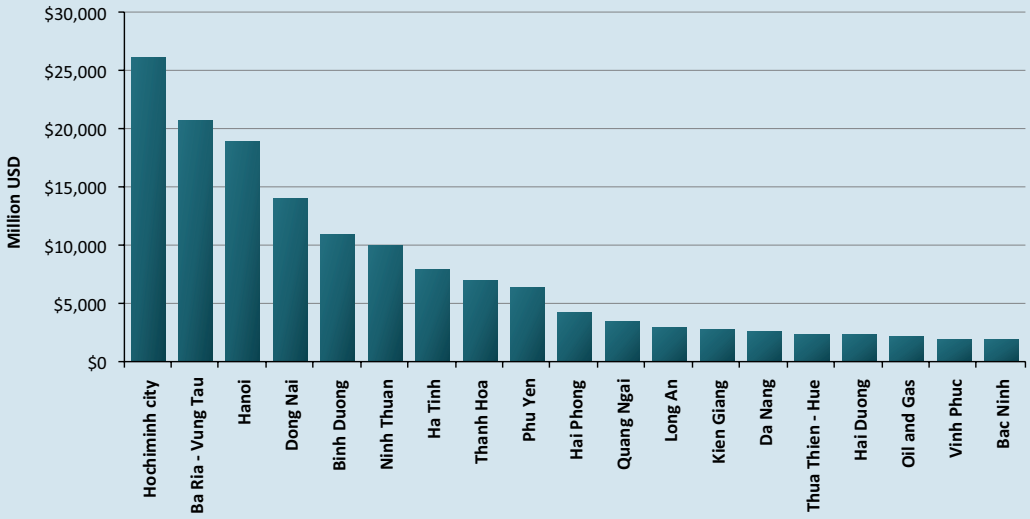
Policy decisions by the government of Vietnam in relation to the sectoral composition of FDI may also have an impact. There has been a call for a re-thinking of priorities for FDI. Investments in real estate projects have been criticized for various reasons, ranging from loss of land for agriculture to land price bubbles and increasing asset inequality between urban and rural areas. There is widespread discussion about focusing on projects with high domestic value-added or a high technological component. For instance, Ho Chi Minh City is now reluctant to grant FDI licenses to low-skilled labor-intensive projects. At the same time, the relocation of FDI manufacturing projects from China to Vietnam would continue. For instance, at present many South Korean businesses are seeking more competitive locations to replace some of their Chinese operations, and ASEAN countries are favoured because of their location and culture. Thus, Vietnam could be among the countries to benefit the most from this trend.

Regional FDI concentration

- *FDI is highly concentrated in a few geographic centers, but is moving slowly to the next layer of provinces*

In 2009, the top provinces attracting FDI in Vietnam are Baria-Vung Tau (USD 6.73 billion out of the total USD 21.48 billion), Quang Nam (USD 4.174 billion) and Binh Duong (USD 2.502 billion). Ho Chi Minh City and Hanoi were ranked 7th and 8th, respectively. There were 537 projects licensed in the three major economic centers of the country, accounting for 64 percent of the total new licenses granted countrywide. Cumulatively by the end of 2008, Ho Chi Minh City, Ba Ria Vung Tau and Hanoi were the top three destinations for FDI.

FIGURE 2.24: TOP DESTINATIONS FOR FDI (CUMULATIVE) AS OF DECEMBER 31, 2008



Note: FDI data are cumulative and cover the periods when Vietnam started to attract FDI until December 31, 2008.

Source: FIA.

BOX 2.2:
TECHNOLOGY LEVEL OF FIES IN HCM CITY

As of December 31, 2008, HCM city has three export processing zones and twelve industrial zones with a total of 1,143 active projects, whose registered capital stood at USD 4.36 billion and with approximately 250,000 employees. However, there are only three qualified high-tech enterprises: Nidec Tosok, Mtex, and Renesas. In 2005, exports of high-tech products from these three enterprises alone made up almost 22 percent of total export turnover of all operating industrial zones (IZs), amounting to USD 300 million. Overall, the technological content of industrial products remains low.

According to the recent 2008 survey conducted by HCM city's Department of Science and Technology, out of a total of 429 enterprises operating in industrial and export processing zones (EPZs), only one percent of all enterprises attained a high-technology level, 4 percent nearly high-technology, 8 percent slightly above average, 36 percent average and up to 51 percent, a below-average technology level. The technology level is measured in terms of sophistication in the following factors: machinery and equipment; information technology; human resources; and business operation methodologies. Tan Thuan EPZ is fully utilized, mostly by FIEs. However, a sizable number of its enterprises still have low technology levels.

Source: CIEM

Impact of FDI

- *FDI has limited spillover effects and few linkages with the local economy*

The increasing volume of FDI has been characterized by a relatively low technological content. Policies to attract high-tech investments from FDI have been strengthened since 2005 with the adoption of the Investment Law and the Law on Technology Transfer in 2006. The government also paid more attention to attract FDI with high technological content via the establishment of high-tech industrial parks such as Hoa Lac High-Tech Zone[9]. However, there are only 28 licensed investment projects in these parks at present, some of which are foreign invested, with registered capital totaling less than USD 1 billion and still in the "warm-up" phase. Low labor skills, low technological capability of domestic enterprises and weak forward and backward linkages between foreign-invested enterprises (FIEs) and domestic enterprises have hindered effective technology transfer (Tue Anh N.T. 2009).

According to the 2009 Provincial Competitiveness Index (PCI) Survey, among nearly 10,000 local private enterprises surveyed, only 6.9 percent reported FIEs as their main clients. Of the remainder, 15 percent cited SOEs and 58 percent mentioned other local private companies as their main clients.

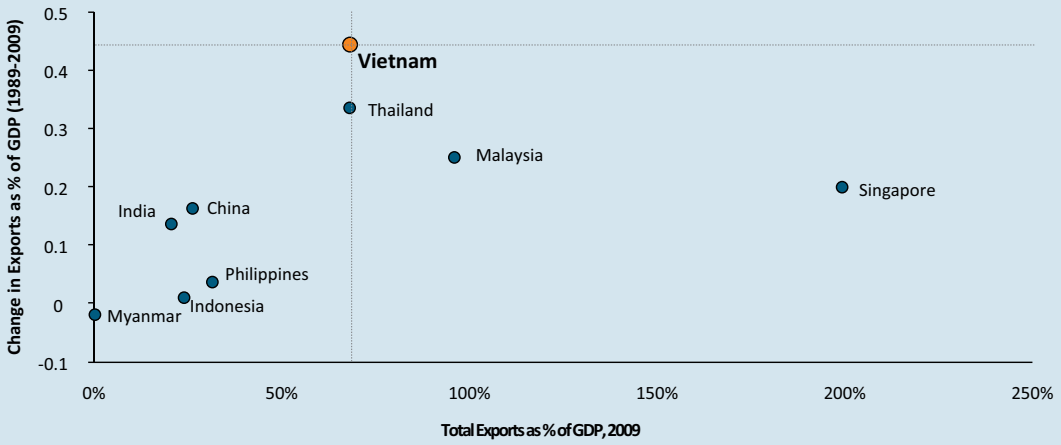
A recent CIEM survey of 100 percent foreign-invested companies in the garment and electronics industries in Hung Yen, Hai Duong, Vung Tau, Binh Duong and Dong Nai provinces revealed that the companies carry out only the simplest activities in their production line in Vietnam, while design and other more sophisticated details are decided by the parent company overseas. The parent company also supplies inputs and handles distribution and sales of final products. This is a typical model of a simple processing industry competing primarily on price, which requires cheap labor, high consumption of electric power, and good transportation and logistical infrastructure. With this model, it is very difficult to generate positive technology spillovers from the FDI sector. Recent policy measures and efforts to create a more enabling and less costly environment for enterprises, particularly for FDI, are important but not necessarily sufficient to generate FDI spillovers and contribute to productivity upgrading.

What Attracts FDI?

According to a recent JETRO's annual survey of Japanese-affiliated firms operating in Asia, political stability (61.1 percent of respondents), low wage labor (38.9 percent) and market size (38 percent) are Vietnam's strengths as an investment location.

In summary, FDI has increased in terms of volume, but the lack of incentives to increase quality, efficiency and competitiveness of industries in particular and the economy in general, has limited its contribution to upgrading competitiveness. Better incentives are needed to encourage high technology-intensive activities, accelerated technology transfer, introduction of technologies with less environmental pollution and a continuous skills transfer

FIGURE 2.25: LEVEL AND GROWTH OF EXPORTS



Source: Economist Intelligence Unit 2010.

Trade[10]

Trade contributes to prosperity in many ways and it enables specialization where an economy has comparative or competitive advantages. As a two-way street, trade exposes local producers to competition and it also offers access to knowledge in global markets.

Exports

Export Patterns

- *The level of exports to GDP is high, but Vietnam accounts for a relatively small share of the global market*

Available trade data vividly demonstrate the rapid integration of Vietnam into the world economy, especially after the conclusion of the Bilateral Trade Agreement with the US in 2001. Exports of goods and services soared more than four times between 2000 – 2008, from USD 17.2 billion to USD 69.8 billion in 2008, before contracting to USD 62.8 billion in 2009 in the aftermath of the global financial crisis. With this level, Vietnam's ratio of exports to GDP in 2009 was almost 68 percent, only behind Singapore and Malaysia, and at par with Thailand and higher than most of other countries in the region.

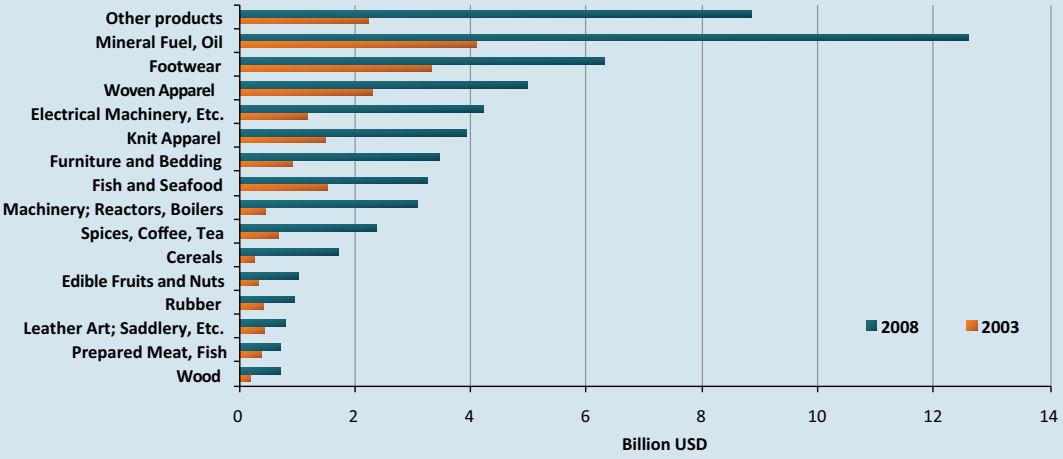
Table 2.5 below shows additional performance indicators of trade. Vietnam's export growth lags only behind that of China, but its global market share is relatively small. This is in part a reflection of the size of the economy.

TABLE 2.5: TRADE PERFORMANCE INDEX (TPI) IN 2006

Source: Trade Performance HS: Exports and Imports of all industries (2006), Trade Competitiveness Map, International Trade Centre (ITC).

Country	Global market share (%)	Growth of export value (%)	Growth of export volume (%)	Number of big exports with turnover of USD 100,000
China	8.1	31	21	4,644
Malaysia	1.3	14	2	3,397
Thailand	1.1	18	8	3,281
Indonesia	0.8	15	2	2,941
Vietnam	**0.4**	**26**	**9**	**2,107**

FIGURE 2.26: COMPOSITION OF VIETNAM'S EXPORTS BY MAJOR PRODUCT CATEGORY 2003 AND 2008



Note: Export products are classified according to the Harmonized System (HS).

Source: Global Trade Atlas.

Composition of Exports

- *Strong specialization in labor-intensive low-tech and agribusiness products*

Besides crude oil which accounts for a share of roughly one-fifth of all exports, key export products remain largely labor-intensive or agricultural activities, such as footwear, apparel (both woven and knit), and electrical machinery.

For the 15 top product categories shown in Figure 2.26, the relative increase between 2003 and 2009 varies considerably. The slower-growing product groups include footwear (average annual rate of increase of 13.8 percent), woven apparel (16.7 percent), fish and seafood (16.4 percent), rubber (18 percent), leather art & saddlery (13.2 percent), and prepared meat & fish (14.1 percent). The fast-growing product groups include electrical machinery (29 percent), furniture and bedding (30.7 percent), machinery, reactors and boilers (47.6 percent) and cereals (46.5 percent). As a group, the top 15 product categories increased by 22.9 percent per year, another indicator of Vietnam's growing export diversification. Exports in all other product categories (not shown in Figure 2.26) increased by 31.7 percent per year during the period 2003 to 2008.

TABLE 2.6: MANUFACTURED EXPORTS, 2000-2008

Country	Value of manufactured exports (billion USD)			World market share			Annual growth rate		
	2000	2005	2008	2000	2005	2008	2000-2005	2005-2008	2000-2008
Cambodia	1.1	3	4.6	0.02%	0.03%	0.03%	22.2%	15.4%	19.6%
China	228.4	722.6	1,370.1	3.79%	7.44%	9.51%	25.9%	23.8%	25.1%
Hong Kong	22.1	16.5	10.7	0.37%	0.17%	0.07%	-5.7%	-13.6%	-8.7%
Indonesia	42.9	55	82.4	0.71%	0.57%	0.57%	5.1%	14.4%	8.5%
South Korea	166.5	277.7	409.4	2.76%	2.86%	2.84%	10.8%	13.8%	11.9%
Malaysia	87.5	120.4	140.1	1.45%	1.24%	0.97%	6.6%	5.2%	6.1%
Philippines	36.6	39.4	45.2	0.61%	0.41%	0.31%	1.5%	4.6%	2.7%
Singapore	129.6	215.4	303.7	2.15%	2.22%	2.11%	10.7%	12.1%	11.2%
Taiwan	144.5	183.1	223.9	2.39%	1.89%	1.55%	4.9%	6.9%	5.6%
Thailand	58.7	95.9	149.1	0.97%	0.99%	1.04%	10.3%	15.9%	12.4%
Vietnam	**6.8**	**17.5**	**41.2**	**0.11%**	**0.18%**	**0.29%**	**21%**	**33%**	**25.4%**

Note: Mirror data is used for Vietnam and Cambodia in 2008.

Source: UN Comtrade.

FIGURE 2.27: MARKET SHARES IN WORLD'S 20 MOST DYNAMIC MANUFACTURED EXPORTS, 2000 AND 2008

Note: Most dynamic manufactured exports are products of which total global trade values are above USD 20 billion between 2000 and 2008.

Source: UN Comtrade.

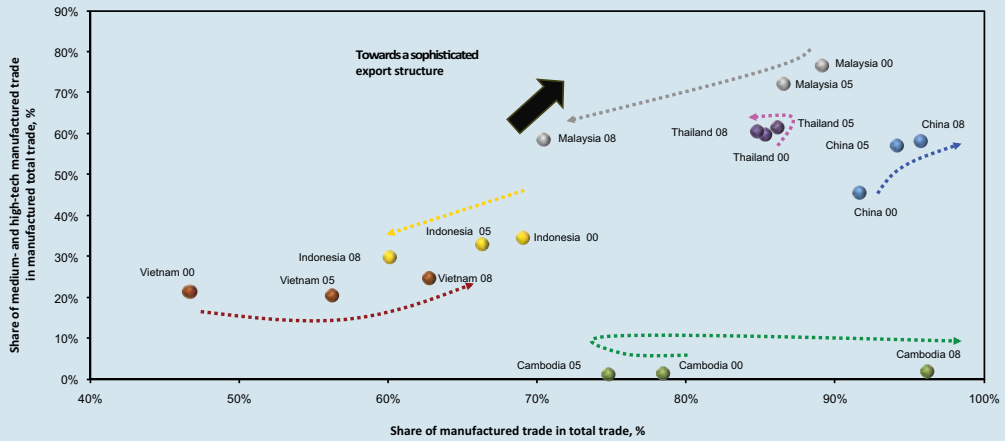
Vietnam may have specialized in industrial sectors facing sluggish demand growth and saturated markets. For instance, between 2000 and 2008 global trade of woven clothing for men and women grew at 4.3 percent and 7.1 percent respectively. These figures were well below the world trade average of 11.5 percent for the period.

Figure 2.28 sums up the evolution of Vietnam's export structure towards more sophisticated products. In general, Vietnam is moving in the right direction. However, the real challenge for Vietnam entails improvement in the technological sophistication of its industry.

- *Low level of value added in manufactured exports*

Compared to other countries in the region, Vietnam's industrial structure is technologically unsophisticated—the share of medium- and high-tech sectors in total manufacturing value added remains just above 20 percent, and it has been unchanged over the last few years. Labor-intensive low-tech industries, mainly the fashion cluster, account for more than 70 percent of Vietnam's manufacturing value added.

FIGURE 2.28: EVOLUTION OF EXPORT STRUCTURE TOWARD MANUFACTURED AND TECHNOLOGY-INTENSIVE EXPORTS, 2000-2008



Source: UN Comtrade .

TABLE 2.7: EXPORT TECHNOLOGY INTENSITY, 2000 AND 2008

Country	2000				2008			
	High tech	Medium tech	Low tech	Resource based	High tech	Medium tech	Low tech	Resource based
Cambodia	0.1%	1.2%	93%	5.7%	0.1%	1.8%	96.7%	1.4%
China	21.2%	24.3%	45.4%	9.1%	29.9%	28.3%	33.3%	8.5%
Hong Kong	25.8%	11.3%	58.5%	4.4%	20.5%	17.9%	47.1%	14.5%
Indonesia	14.9%	19.6%	31.9%	33.6%	6.4%	23.3%	22.7%	47.6%
South Korea	35.1%	35.3%	17.9%	11.7%	28.4%	44.3%	11.6%	15.7%
Malaysia	55.2%	21.4%	9.8%	13.7%	34.3%	24%	13%	28.6%
Philippines	69%	12.4%	11.9%	6.6%	62.1%	15.5%	8.1%	14.4%
Singapore	59.4%	20.9%	6.9%	12.7%	44.8%	22%	6.7%	26.6%
Taiwan	43.2%	28.2%	24.3%	4.3%	35.8%	32.5%	18.5%	13.2%
Thailand	32.4%	27.2%	21.9%	18.5%	22.7%	37.7%	16.1%	23.5%
Vietnam	**11.1%**	**10.3%**	**64.7%**	**13.8%**	**10.1%**	**14.5%**	**67.1%**	**8.2%**

Source: UN Comtrade .

Export Diversification

- *Market diversification is high, while the relatively low product diversification is improving*

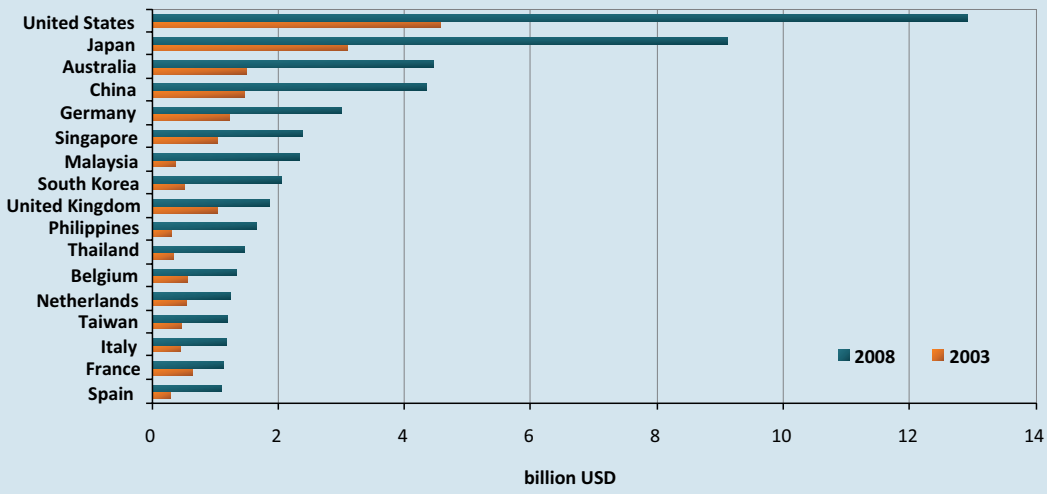
Vietnam's manufactured trade is far from concentrated. Vietnam ranks second in the region in market diversification just shy of China, and ahead of South Korea, Indonesia and Thailand (see Table 2.9). Vietnam's market diversification protects it from the stronger presence of key competitors in large markets. In terms of manufactured exports, the top five export categories accounted for over 50 percent in 2000, but dropped to slightly over 40 percent in 2008 (Figure 2.30) — evidence of increasing diversification.

Export Trading Partners

- *Focus on advanced markets in North America, Europe and Asia*

The US remains Vietnam's most important export market, as shown in Figure 2.29. It is followed by Japan, Australia, China and Germany. The top five export markets account for the majority of all exports from Vietnam, albeit their combined share has declined from 57.2 percent in 2003 to 55.4 percent in 2008. For the 17 major trading partners, the average annual growth rate of total exports was 23.5 percent. The slower-growing countries in that group included the EU countries and Singapore. The overall pattern shows a growing concentration of exports in the region and in Australia with 26.3 percent average annual growth of exports in the latter.

FIGURE 2.29: VIETNAM'S EXPORTS BY MAJOR TRADING PARTNER, 2003 AND 2008



Source: Global Trade Atlas

TABLE 2.8: EXPORTS OF MAIN PRODUCT CATEGORIES BY MARKETS, 2008-2009

Markets	2008		2009		Share of Vietnam's total exports (%)	
	Key Products	Value (billion USD)	Key products	Value (billion USD)	2008	2009
EU	Footwear	2.51	Footwear	1.71	17.3%	15.1%
	Garment	1.7	Garment	1.44		
	Seafood	1.15	Seafood	0.96		
	Crude oil	2.82	Crude oil	2.21		
ASEAN	Rice	1.52	Rice	1.23	16.3%	13.6%
	Computers	0.73	Computers	0.59		
	Garment	5.1	Garment	4.99		
US	Footwear	1.07	Furniture	1.1	18.9%	19.9%
	Furniture	1.06	Footwear	1.04		
	Crude oil	2.18	Garment	0.95		
Japan	Seafood	0.83	Seafood	0.76	**13.6%**	**11%**
	Garment	0.82	Electric cable	0.64		
	Rubber	1.06	Coal	0.94		
China	Coal	0.74	Rubber	0.86	**7.2%**	**10.7%**
	Crude oil	0.6	Cassava	0.5		

Source: DEPOCEN's Export Promotion Report 2009 – 2010.

Imports

Import Patterns

- *Imports are high and growing, leading to widening and persistent trade deficit*

Since 2006, imports have risen quickly, surpassing the growth of exports. During 2006–2008, the average annual growth of imports was 30.2 percent. This has led to a rapidly widening trade deficit, from 4.5 percent of GDP in 2006 to 16.8 percent in 2008. In 2009, imports contracted to USD 68.8 billion (equivalent to 62.5 percent of GDP) – a fall of 14.7 percent as compared to 2008. The contraction in imports in 2009 was caused by the sluggish domestic production as a consequence of the global recession. In addition, import prices also dropped due to the contraction in global demand.

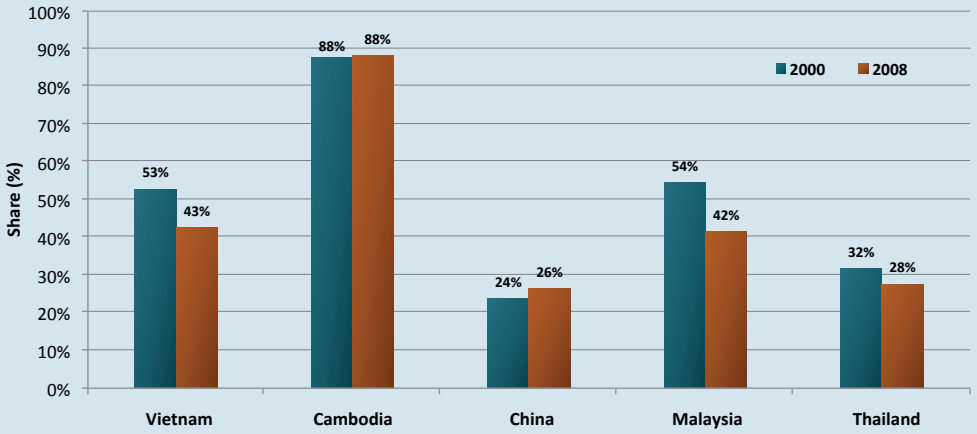
Figure 2.31 illustrates the trend in Vietnam's trade balance and its comparator countries over the period 1990 - 2008. The three comparison countries follow a similar pattern—roughly balanced until 1998, followed by a significant trade surplus in that year, primarily as a result of cutbacks in imports. Vietnam, however, has had a negative trade balance throughout the entire period, slightly less in the years

TABLE 2.9: MARKET DIVERSIFICATION INDEX, 2000 AND 2008

Country	Ranking		Index value	
	2000	2008	2000	2008
China	3	1	1.0	1.0
Vietnam	**1**	**2**	**1.0**	**0.9**
Korea	4	3	1.0	0.8
Indonesia	2	4	1.0	0.7
Thailand	5	5	0.9	0.7
Philippines	7	6	0.8	0.7
Malaysia	8	7	0.8	0.7
Taiwan	6	8	0.8	0.6
Hong Kong	10	9	0.4	0.4
Singapore	9	10	0.6	0.4
Cambodia	11	11	0	0

Source: UN Comtrade .

FIGURE 2.30: SHARES OF TOP FIVE MANUFACTURED EXPORTS IN TOTAL MANUFACTURED EXPORTS, 2000 AND 2008



Source: UN Comtrade.

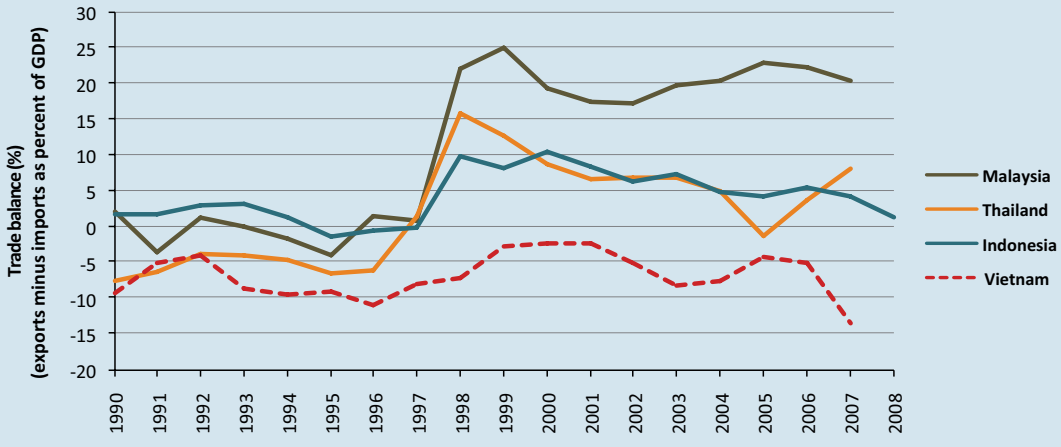
following the financial crisis, but widening substantially again afterwards. In 2009, imports exceeded exports by 20 percent, equivalent to 11.9 percent of GDP. The negative trade balance has affected the overall balance of payments; however, remittances from Vietnamese overseas, FDI and portfolio capital inflows, the balance of payments remains positive.

Import Composition

- *Imports of capital goods dominate, but the share of consumption goods is increasing*

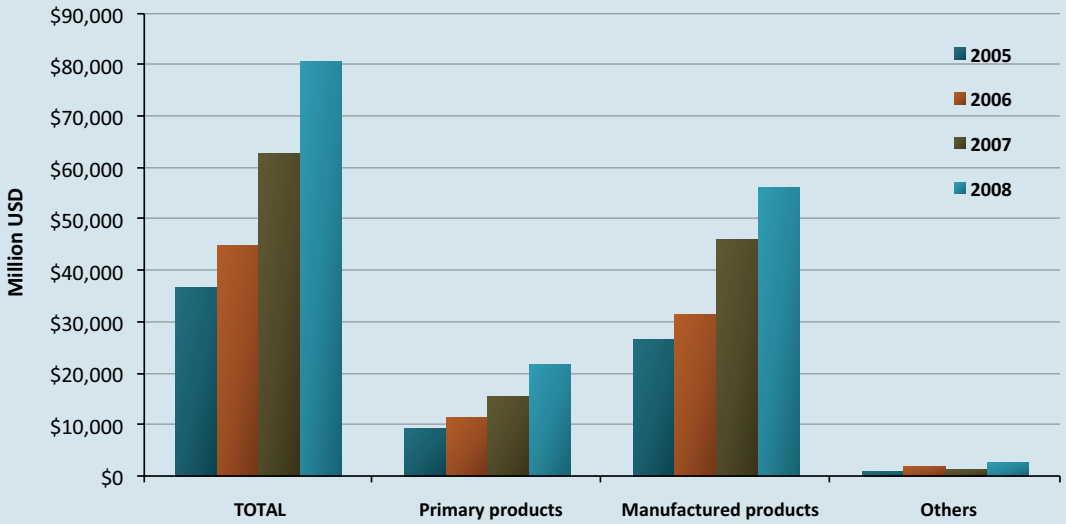
When classified by the Standard International Trade Classification (SITC), the share of manufactured products in total imports has been increasing rapidly at an average rate of 28.8 percent during 2006–2008, and these accounted for 69.7 percent of the total imports in 2008. Among the imported primary products, fuel accounted for the biggest share of 56.6 percent. Among the imported manufactured products, equipment, machinery and input materials accounted for the biggest share of 75.7 percent. This reflects Vietnam's heavy dependence on imported materials and equipment to serve the manufacturing sector.

FIGURE 2.31: TRADE BALANCE, 1990-2008



Source: World Development Indicators

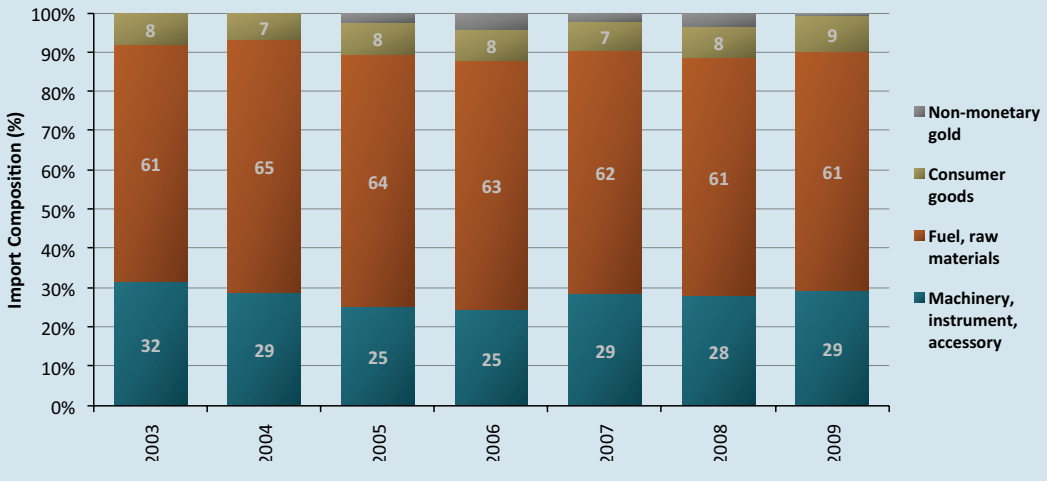
FIGURE 2.32: COMPOSITION OF VIETNAM'S IMPORTS, 2005-2008



Source: General Statistics Office of Vietnam.

In terms of commodity groups, 90 percent of total imports in 2009 comprised capital goods—fuel and raw materials accounted for 60 percent, while machinery and equipment comprised 30 percent of the total imports. Consumption goods accounted for a relatively small, but increasing, share in total imports—from 6 percent in 2000 to almost 10 percent in 2009. This reflects the "typical" structure of the Vietnamese economy which is dominated by low value-added processing industries and higher living standards which encourage consumption. It is more worrisome that imports of cars, motorbikes and other luxury goods for consumption are increasing rapidly while the overall living standards are still relatively low. In 2009, imports of cars and luxury goods accounted for almost 50 percent of the total imports of consumption goods. These trends are adding pressures on the trade balance and foreign reserves as such consumption goods are not used to serve export-oriented production and to create foreign exchange revenues.

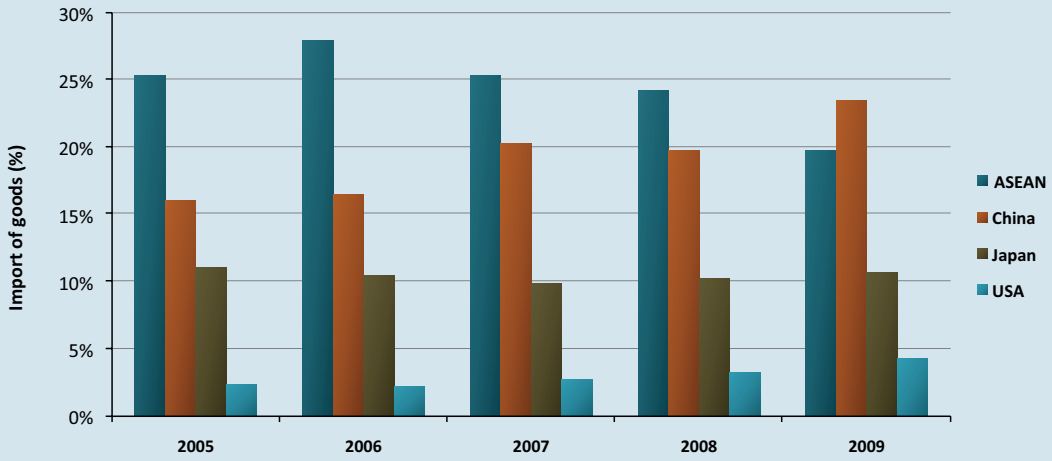
FIGURE 2.33: COMPOSITION OF VIETNAM'S IMPORTS BY COMMODITY GROUP, 2005-2009



Note: In 2003 and 2004 non-monetary gold is included in fuels & raw materials.

Source: General Statistics Office of Vietnam.

FIGURE 2.34: VIETNAM'S IMPORTS BY COUNTRY OF ORIGIN, 2005-2009



Source: General Statistics Office of Vietnam.

Import Trading Partners

- *Neighboring countries (ASEAN, China, East Asia) represent the main sources of imports; the trade deficit with China in particular is widening dramatically*

Vietnam's trading partners focus on some key countries and regions, including ASEAN (20 percent of total imports in 2009), China (23 percent), Japan (10 percent), Korea (10 percent), EU (8.3 percent) and USA (4 percent). These markets alone account for over three quarters of Vietnam's total imports.

Vietnam's imports from ASEAN are decreasing in relative terms while imports from China are increasing rapidly, from 15 percent in 2005 to 23 percent in 2009. This is partly explained by China's import products that tend to be cheaper than those imported from more advanced markets, and partly because Vietnam has not been able to take advantage of geographical proximity and the sizable, less-demanding Chinese market to boost up its exports to China. These trends are raising questions about strengthening the dynamism of intra-regional trade among ASEAN members.

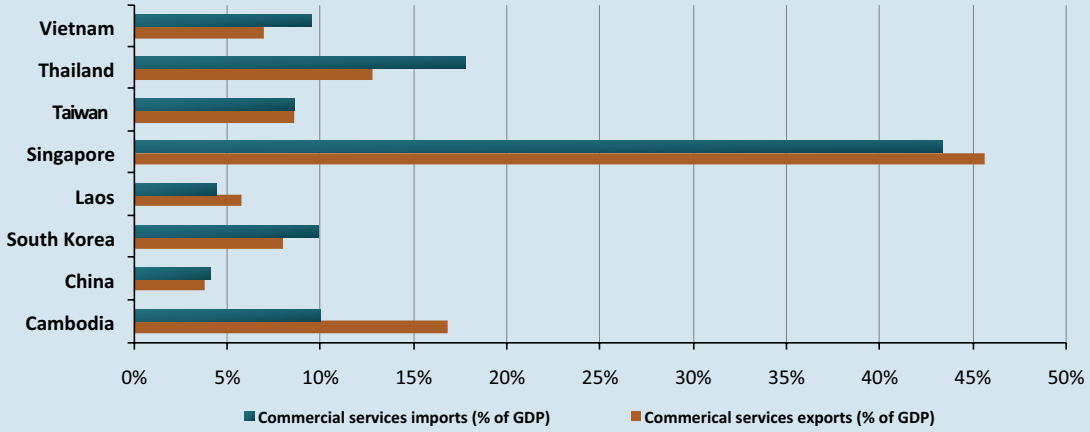
Trade in Services

- *A relatively small share of trade in services in total trade, and an increasing deficit in trade in services*

The value of services exports in 2009 reached USD 5.77 million. Tourism exports still dominate services exports and are estimated at USD 3.05 million; falling 22.4 percent compared to 2008. Next in importance are transportation services with an export value of USD 2.06 million, dropping 12.5 percent compared to that in 2008. Despite decreasing export values, tourism and transportation still accounted for 91.3 percent of Vietnam's total services export volume. Since these two sectors were primarily affected by the 2008 financial crisis, Vietnam's services export volume in 2009 fell 18.1 percent compared to that in 2008.

In a similar fashion, services imports also suffered from the global financial crisis. In 2009, import of services attained USD 6.9 billion, dropping 1.4 percent compared to that in 2008. Although their import values decreased, tourism, insurance and transportation services saw an increasing share in total services import, reaching 83 percent. All services, apart from government- and telecommunications-related ones, had lower import value in 2009 than in 2008.

FIGURE 2.35: SERVICES EXPORTS AND IMPORTS IN 2008



Source: World Development Indicators.

Figure 2.35 shows a regional comparison of patterns in trade in services. The pattern for Vietnam closely resembles that of South Korea, showing an increasing deficit in trade in services. The deficit in 2008 amounted to USD 819 million, while the deficit stood at USD 716 million in 2007.

Entrepreneurship

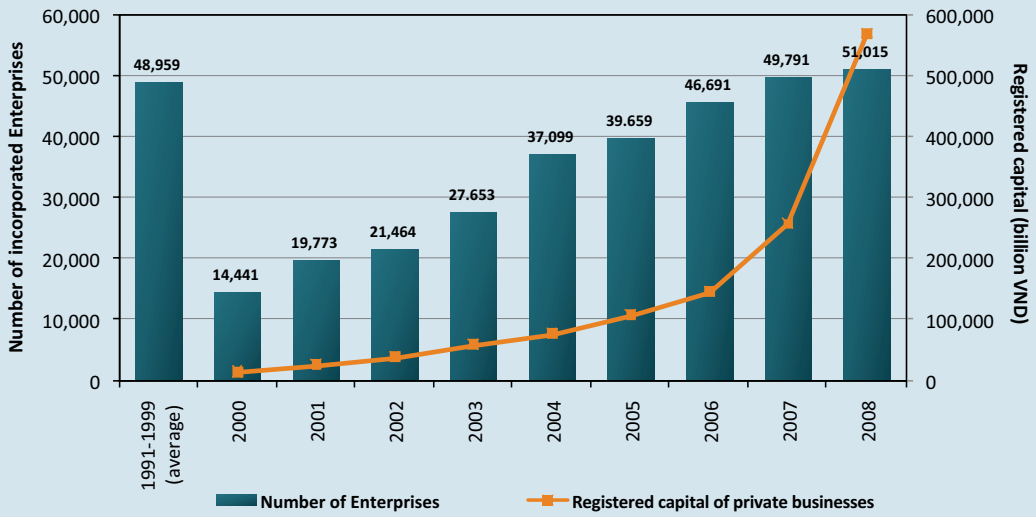
Enterprise Creation

- *The Enterprise Law (2000) triggered a rapid growth in the number and size of private enterprises*

The Enterprise Law adopted in 2000 eased restrictions and conditions in formal market entry. Since then, the number of enterprises has increased rapidly. The total number of business registration in the three years 2000-2002 surpassed the total number of the previous decade. Even when growth slowed in 2008 due to inflation and the global financial crisis, new enterprise registrations (over 51,000) still surpassed those from the year before. According to the data supplied by the Enterprise Development Agency, there were about 355,000 private firms registered in the whole country in 2009, with about 272,680 in operation that are paying taxes.

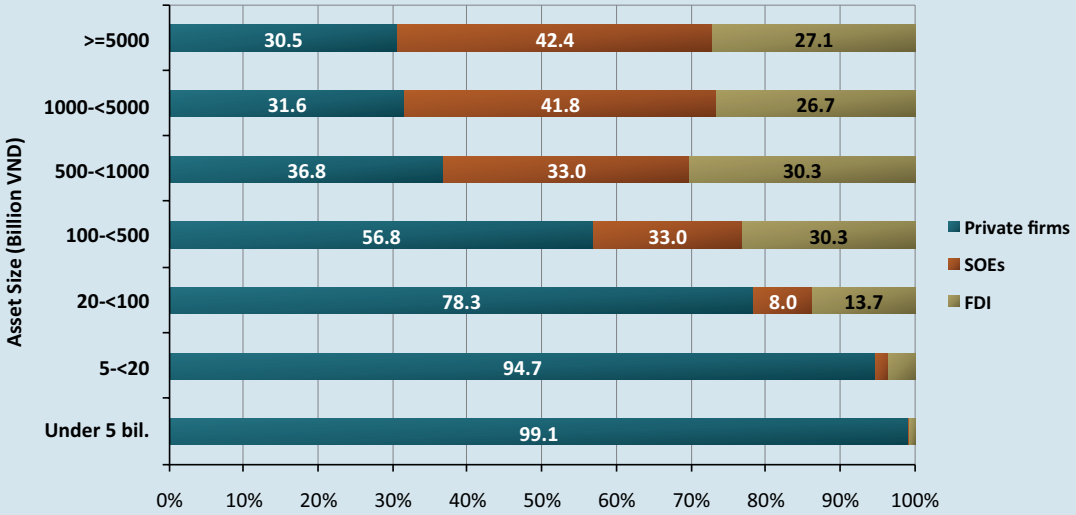
As shown in Figure 2.36, the average investment capital also increased sharply, especially after the Enterprise Law was adjusted in 2005 to simplify the business registration procedures and to allow companies of all sectors to operate in the same forms of governance. The average capital of one start-up in 2001 was VND 1.29 billion and this increased to VND 3.17 billion in 2006, and to VND 11.6 billion in 2008.[11]

FIGURE 2.36: NEWLY INCORPORATED PRIVATE ENTERPRISES IN VIETNAM, 1991-2008



Source: Enterprise Development Agency, MPI

FIGURE 2.37: SIZE DISTRIBUTION OF FIRMS BY OWNERSHIP, 2008



Source: General Statistics Office of Vietnam; Calculations by CIEM

Business Capacity

- *Private sector development needs to be fostered*

While the Enterprise Law triggered a boom in new and increasingly well capitalized enterprise registrations, there have been few further reforms to encourage intensive growth of the private business sector.

The private business sector in Vietnam lacks both the intellectual foundations and adequate capital to keep up with the demands of today's global economy. Small and medium enterprises (SMEs) make up 98.4 percent of the private firms. The lack of education and training for business management and capital accumulation has clearly hindered their capability to contribute to the move from factor-driven to knowledge-driven, or from labour-intensive to capital- driven economic models. Lack of adequate capital has also prevented private companies from investing in and upgrading their technology.

The development of the business sector also faces a major challenge related to the distortion of the market. Land and real estate speculation is usually far more profitable than investment in upgrading technology, developing new products, or improving worker skills. As a result, this problem has severely diverted efforts of many enterprises from activities that increase productivity and enhance competitiveness, which are critical for avoiding the middle income trap.

TABLE 2.10: NUMBER OF PROTECTED TITLES GRANTED

Year	Invention protection	Utility solution protection	Industrial design protection	Trademark protection
2001	783	26	376	3,639
2002	743	47	377	5,200
2003	774	55	468	7,150
2004	698	69	647	7,600
2005	668	74	726	9,760
2006	669	70	1,175	8,840
2007	725	85	1,370	15,860
2009	706	64	1,238	22,730

Source: National Office of Intellectual Property (NOIP).

Technology and Innovation

Development of Intellectual Property

- *Low level of protected intellectual property titles*

Although inventions and utility solutions are central to technology transfer transactions, there have been only few technology sales and purchases associated with patents. Among all protected titles, trademark protection in Vietnam has accounted for the highest proportion and also the fastest increase in number for the past 10 years.

The low number of protected titles indicates that technology goods have yet to develop in Vietnam. This is due to the lack of cooperation between inventors and firms, onerous protection registration procedures and low effectiveness of patent protection regulations.

Quality Infrastructure

- *Weak application and enforcement of quality standards among enterprises*

Much remains to be done with respect to upgrading the quality standards of the manufacturing and service operations in the country. Vietnam is lagging behind the region in terms of the percentage of firms with internationally recognized quality certifications. According to the World Bank's Enterprise Surveys, only 11.4 percent of the firms met this criterion, versus 22.4 percent for the region (2005).

Assessment

Vietnam's economic development pattern reflects the standard profile of a transitional economy on the catch-up path. It has been successful in achieving vigorous growth over the last two decades but the dynamism for further sustainable growth is declining as cost pressures rise, while new competitive advantages have yet to be created.

Vietnam's performance on intermediate indicators reflects current strengths which are unsustainable and will contribute little to creating future competitive advantages:

1. Capital deepening appears natural for a labor-intensive economy. The marginal productivity of capital should be much higher in a developing country like Vietnam where capital is scarce. However, in reality, capital has created growth but has failed to improve overall productivity. Decreasing efficiency of investment indicates that few new capabilities are emerging.

2. Low value added in exports dominated by labor-intensive goods is a sign that few if any additional capabilities are emerging. Linkages between the export sector and the local economy are undeveloped.

3. High diversification of markets but low diversification of products suggests that Vietnam has some generic advantages, such as low labor costs, but lacks strong market positions to capture value. The Vietnamese economy does not yet participate effectively in the world's most dynamic export markets.

4. Dependence on foreign investment is higher than that of other countries at the same stage of development, but the foreign sector has shallow roots in the local economy. Lack of entry by growth-oriented private companies and low level of innovation in SOEs suggest that few, if any, domestic growth drivers are emerging.

5. Market distortions and resources misallocation are among the major causes of Vietnam's slow pace of moving up the technological ladder and low efficiency in capital investment.

Endnotes

[1]Poverty rate based on poverty line of GSO and WB with monthly average expenditure per capita of 216 thousand VND.

[2]The Government set the poverty line for 2006-2010 to be VND 200,000 of monthly expenditure per capita for rural areas and VND 220,000 for urban areas.

[3]Industrial centres in Cau River Valley including Thai Nguyen, Bac Giang, Bac Ninh, Hai Duong, and Vinh Phuc Province.

[4]In economics, total-factor productivity (TFP) is a variable which accounts for effects in total output not caused by the growth in traditional inputs, labor and capital. TFP comprises a range of factors, but the predominant driver is technological progress.

[5]Preliminary population survey results in 2009.

[6]The comparable data for later years are not available.

[7]"The other" investment comes mostly from government bonds and accounted as off-budget expenditure.

[8]In 2008, total social investment increased at 10.2 percent while state investment reduced by 15.7 percent compared to that in 2007, mainly due to the measures adopted to control the inflation.

[9]The zone has been facing a delay in land clearance, construction of infrastructure and policy incentives.

[10]This section used some analytical input and data provided by Dr. Manuel Albaladejo (UNIDO). See Albaladejo, M. 2010. 'Benchmarking Vietnam's Industrial Competitive Performance', background paper prepared by UNIDO for the Vietnam Competitiveness Report 2010, Vienna, Austria.

[11]These figures should be interpreted with caution because they are used only for registration.

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