UNDP

ECONOMIC COMMITTEE
OF THE NATIONAL ASSEMBLY

VIETNAM ACADEMY
OF SOCIAL SCIENCES

RECOMMENDATIONS OF THE SCIENTIFIC WORKSHOP

ENSURING MACROECONOMIC STABILITY, SUSTAINING GROWTH MOMENTUM

Vietnam's economy 2010, Prospects for 2011

(Reference)

Hanoi, October 2010

"Ensuring Macroeconomic Stability, Sustaining Growth Momentum: Vietnam's Economy in 2010, Prospects for 2011"

After the global financial crisis and economic recession in 2008- 2009, the world's economy has switched to the beginning stage of growth recovery at a positive level in some countries, especially the emerging ones. However, since the second half of 2010, the recovery process seems to be slowed down and unstable. In addition, the public debt crisis in a few South European countries deepens the global financial instability and fuels new risks of a "double- dip crisis" at the end of this year or the beginning of next year. This development has substantially affected many economies in the world, including Vietnam.

While the world's economy is still encountering many difficulties, Vietnam is one of the few countries that have achieved considerable economic recovery and stable growth. The growth rate in the first nine months has continuously risen, one quarter after another[1], and the growth rate for the whole year could reach 6.7%, surpassing the 6.5% target set by the

[1] The economic growth of the first quarter was 5.8%, second quarter: 6.4% and third quarter: 7.16%

National Assembly. Social security issues were well- resolved. Nevertheless, Vietnam is currently facing challenges of choosing a growth model, of restructuring the economy and its institution, and also of encountering significant imbalances and prolonged macroeconomic instability.

In preparation for the Socio - Economic report to be presented at the 8th session of the 12th National Assembly, and in the framework of the UNDP-funded Project "Support for enhancing capacity in advising, examining and overseeing macroeconomic policies", the Economic Committee of the National Assembly in cooperation with the Vietnam Academy of Social Sciences have organized a Workshop on "Ensuring Macroeconomic Stability, Sustaining Growth momentum: Vietnam's Economy 2010, Prospects for 2011" in Ho Chi Minh city on 21st and 22nd September, 2010[2].

The goal of the workshop is to focus on evaluating basic economic issues of 2010 and forecasting the trend for 2011, identify and analyze existing problems in the short term as well as those in the medium and long term, when Vietnam is about to enter into a new stage of development. The workshop touched upon the following core issues: (i) The general issues of Vietnam's economy in 2010 and 2011, including the economic overview and macroeconomic

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[2] This workshop was a follow-up on the previous workshop: "Overcome crisis challenges: Vietnam's economy 2009 and prospects for 2010" in April 2010 and the workshop on "Vietnam's economic growth model: The current situation and options for the period of 2011- 2020" held in June 2010.

policies; (ii) Sectoral and specific economic issues; and (iii) Social security and Employment.

H.E Mr. Ha Van Hien, Member of the Central Party Committee, Member of the Standing Committee of the National Assembly, Chairman of the Economic Committee; Prof., Dr. Do Hoai Nam, Member of the Party Central Committee, Chairman of the Vietnam Academy of Social Sciences; and Mr. John Hendra, Resident Coordinator of the United Nations in Vietnam, co- chaired the workshop. Participants at the workshop included Dr. Nguyen Van Thuan, Member of the Standing Committee of the National Assembly, Chairman of the Committee on Law of the National Assembly; National Assembly deputies who are members of the Economic Committee, representatives from the Committees on Social Affairs and Science, Technology and Environment; representatives from the Central Party Office, relevant ministries and agencies; the Standing Office of the People's Council, People's Committee and the National Assembly delegations in Ho Chi Minh city; representatives of the National Assembly delegations in the South; representatives from IMF, WB, UNDP and Star Vietnam Project; representatives from economic associations and businesses; economists, scientists from the Vietnam Academy of Social Science as well as research institutes, universities, and the Fulbright Economic Teaching Program.

The workshop received over 20 written discussion papers and over 40 on- spot presentations and comments. The presentations and comments were well- prepared with significant academic and practical substance. The workshop highly acknowledged the accomplishments of Vietnam's socio-economic developments in 2010 as well as in the past five years (2006- 2010), while simultaneously proposing suggestions for the year 2011 and beyond. The detailed contents are presented in the workshop proceedings. In this publication, we only summarize workshop recommendations for the National Assembly deputies and relevant agencies for reference. The recommendations are as follows:

Recommendation 1: To continue prioritizing macroeconomic stability as the top priority to facilitate a firm economic growth.

Although the economic growth may reach 6.7% in 2010, surpassing the target set by the National Assembly, the economy still faces with many imbalances and significant risks:

First, due to high level of trade deficit[3], the balance of payments was minus USD 2.84 billion in the first six months of 2010, while the foreign reserves of Vietnam was as low as approximately USD 14 billion[4]. In 2010, the trade deficit is expected to be USD 14 billion and balance of payments deficit could reach USD 4 billion, creating huge pressure on the exchange rate and liquidity of the economy.

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[3] See Figures 1 and 2- appendix

[4] See Figure 3- appendix

Second, budget deficit in 2010 is predicted to be 5.95% GDP[5], making public debt go up (56.7% GDP), and foreign debt be at the highest level (since 2005)of 38.8% GDP as of December 31st 2009. Foreign debt is forecast to be 42.2% GDP in 2010.

Third, the investment - savings gap has been projected to increase to 13.6% in 2010, with declined savings and increased investment.

Fourth, after the slower increase in the second quarter, inflation has shown signs of speeding up since August, with a 0.23% rise in August and a 1.31% increase in September. The consumer price index in September 2010 rose to 6.46% compared to that of December 2009, while inflation pressure always rises in the last months of the year. So, inflation in Vietnam has not yet been under control, and the inflation target of 7-8% seems unfeasible.

Fifth, savings and lending interest rates remain high, resulting in many consequences (respectively 11.2% and 14% on average in September), regardless of Government's measures to lower the market interest rates[6].

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[5] See Figure 4- appendix

[6] Government's efforts to reduce interest rates were unsuccessful because:

- The credit market was abnormally distorted, contrary to common economic laws with such signals as: (i) Short- term interest rates were on par with long- term ones; (ii) Long- term deposits could be switched to short- term ones and vice versa; (iii) Demand deposits can be turned into timed deposits; (iv) Bonus and surcharge were added to mobilized interest rates; (v) Use of short- term capital for long- term loans and (vi) The credit market was dominated by administrative regulations.

Sixth, the USD interest rate in Vietnam is currently higher than that in international markets, thus investment trust inflows were pouring into Vietnam in search for profits through interest rates differences. However, if the changing conditions of the economy cannot generate profits for the capital inflows and leads to capital withdrawal, the economy could be troubled.

The macroeconomic instability is large and severe, illustrated through factors such as: huge budget deficits, high trade deficits, pressurized exchange rate, increasing inflation possibilities, high interest rates, etc., which can negatively affect the economy in both the short and long run. Meanwhile, the world's economy in 2011 is forecast to recover slowly and unpredictably, with many risks and instabilities[7]. Thus, it is essential to continue to keep macroeconomic stability as the fundamental priority in 2011, creating solid grounds for economic growth.

Recommendation 2: To change the growth model in order to enhance the quality of growth

Vietnam has long expanded the economic growth model in the horizontal way, mainly depending on increased

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- The interest rate of government's bond remained high, while the key buyers are commercial banks who later used these bonds to discount back at the State Bank of Vietnam (SBV), leading to the fact that strong increased credit flows only move back and forth between commercial banks and the SBV without flowing into production and/or cooling down the market interest rates.
- The administrative regulations like Circular 13 have substantially limited the percentage of mobilized capital that can be available for loan by commercial banks, creating pressures on interest rate increase.

[7] One typical example was the public debt crisis in Europe

investment[8], especially public investment; cheap and low-skilled labor; raw material exploitation and exportation and low-value processing exports, which altogether always put the economy at risks of severe macro imbalances. Moreover, the quality of economic growth is still low (with poor quality and low competitiveness), unsustainable (with large consumption of energy and resources, environmental pollution, etc.), and lack of innovation (i.e. lack of advanced technologies platform); national production resources are scattered, conflicts of interests among provinces and sectors are destroying the economy's general equilibrium.

The above-mentioned model has resulted in poor investment efficiencies, low ratio of added value to production value, the export structure mainly relies on medium and low technologies[9] and the total factor productivity (TFP) is weak, the technology level is 3-4 generations behind that of developed countries[10], the competitiveness of the economy is lagging far behind the rest of the world[11]. Despite the fact that Vietnam has become a middle-income country, the growth is losing its momentum and there are new challenges of economic management, risks

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8 Total social investment in the first 6 months of 2010 was 45.5% GDP, and is projected to be 41% GDP for the entire year

9 Vietnam's high- tech exports only accounted for 8.2% of total export turnover, compared to 33% (in the case of the Philippines), 39% (in China), 49% (in Thailand) and 67% (in Malaysia) (See the Workshop Proceedings for more information)

10 According to WEF, Vietnam's technology level is ranked 92 over 117 investigated countries (See the Workshop Proceedings)

11 Vietnam is currently among the 30% least competitive countries in the world (see the Workshop Proceedings)

of falling back to poverty, increasing inequality, and the "middle income trap" that may realize in the next decade.

Therefore, one of the key focuses of the 2011- 2015 plan is to enhance the *quality of growth*, and in 2011, it is necessary to *restructure the economy* and *select an appropriate growth model*. To this end, it is essential to give priorities to the following issues:

- **A growth uses the private sector as an engine and respects principles of the market economy:** It is important to establish a favorable, equal, transparent and non- discriminative investment and business environment for economic sectors, thus strongly boost the growth of the private sector as the engine of economic development. State owned enterprises (SOEs) only hold a few crucial economic areas that the private sector either cannot or refuses to do.
- **Restructuring public investment to enhance its quality.** That public investment accounts for a high percentage of the total social investment[12], plus the insufficiently calculated opportunity costs and the

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[12] According to the General Statistic Office, the total social investment in real price implemented in the first nine months of 2010 is estimated to be VND 602.8 billion, increased by 19.8% compared to that of the same period in 2009, in which, the State sector accounted for 37.6% of total capital, increased by 30.2%; the non-State sector accounted for 36.8% , increased by 17%; and the FDI sector accounted for 25.6% , increased by 10.7%

prolonged and ineffective investment process, escalated the ICOR[13] coefficient. A large volume of assets placed into the SOEs sector have not produced corresponding values, thus slowing down the money circulation and causing macro instabilities. Public investment through SOEs is one of the reasons for the imbalances in the economy such as budget and trade deficits. Hence, restructuring public investment in terms of internal relations and in correlation with total social investments, of the prioritized objectives, allocation of capital among areas, sectors, of its implementation, etc., is an urgent resolution to boost the quality of growth. Reducing public investment in the total social investment structure is of no less important. It is essential to use the indicator of public investment/GDP ratio for monitoring, rather than generally talking about the reduction of investment in total GDP.

- **Removing bottlenecks of the economy:** In the next few years, three bottlenecks of the economy that need to be resolved completely in order to make use of the potential resources and contribute to stable growth, include: (i) infrastructure

[13] According to the research result of Professor Kenichi Ohno, Vietnam's ICOR in 2009 was 8.0. (For additional information, see Table 1 - Appendix)

(highway, railway, port, electricity, etc.); (ii) human resources (human skill development, productivity enhancement); and (iii) institution (creation of a level playing field, law compliance).

- **Economic policies need to follow long term goals, creating market confidence:** the process of macroeconomic policy planning and implementation need to follow this direction. If macroeconomic policies continuously changing and inconsistent as shown in the past two years, investors will lose confidence and it will be difficult to attract long term investments. Macroeconomic policies should require a long term vision, so as to gain confidence from the investors and the market.

Recommendation 3: To enhance the macroeconomic regulation quality, strengthening the effectiveness of the coordination between fiscal and monetary policies.

For many years, the coordination between monetary and fiscal policies was not highly effective and did not truly inter-link, while implementing the objectives set. Despite the prolonged budget deficit and increased public debt and foreign debt, budget spending remained “as usual” when the economy encountered capital difficulties, thus forcing the monetary policies struggle to curb inflation and provide capital for the economy. In the short run, monetary policies often have “lonely deal with” macroeconomic matters such as inflation, interest rates, exchange rates, etc., without material support from fiscal policies, i.e. the role of fiscal policies in the economy remains vague[14]. Therefore, in economic management, especially between fiscal and monetary policies, should be strictly and effectively coordinated in order to share the responsibilities of policies, to ensure the achievement of economic goals.

Additionally, in 2011, as there is not much room left for monetary and fiscal policy adjustments, thus it is necessary to have flexibilities in macro management, simultaneously closely following global, regional, and domestic economic developments while predicting possible impacts of policies on macro variables. The use of regulatory tools should not imply "confusing" messages that may lead to the loss of market confidence and capability of macroeconomic stabilization. Also, it is also important to decide on the prioritized objectives suitable with each the policy period, without expecting too much from one policy being implemented.

Recommendation 4: To further use interest rate policy as the fundamental instrument of the monetary policy, while simultaneously ensure the consistency of policy objectives

[14] It is opined that Vietnam has not exercised instruments of fiscal policies but has only used the budget revenue and budget expenditure policies independently, with no correlation and even isolated from the domestic and international macroeconomic situations, to make impacts on the macro variables from the fiscal policy. Both budget revenues and expenditure of a certain year was always higher than the previous one.

The use of monetary policies in the past year has been inconsistent, even contradicted at times, causing psychological uncertainties in the market. For instance, while credits rose slowly, interest rates remained high with no signs of cooling, the State Bank requested commercial banks to increase legal capital and raise the capital adequacy ratio from 8% to 9% and did not allow the inclusion of demand deposits into lending capital of commercial banks. The policy inconsistency was also shown in policy announcements leading to "mixed messages": ***ensure macroeconomic stability while at the same time implement loose policies for the sake of growth***. Thus, monetary policy management needs to guarantee the consistency, not causing "noises" in the market.

Today, interest rate as the key instrument[15] of monetary policy has a very limited effect in the monetary and credit markets. In theory, long- term interest rates is extremely important to the economy, since it affects asset values and decisions on consumption, savings and investment of businesses and citizens. However, long- term interest rate

[15] To manage the monetary policy, the Central Banks in many countries have used various instruments, including interest rates to meet two goals: (i) To inform whether the current monetary policy is tightened or loosened one; and (ii) To resolve the real lending-borrowing relationship between the Central Bank and commercial banks. These countries called this primary interest rate (e.g the primary interest rate by the Federal Reserves Board or FED in the U.S, the one-day Repo interest rate in Thailand). Vietnam applies the basic interest rates but with a very insignificant meaning. Some other types of interest rates, including recapitalization rate, discount rate and rediscount rate, or open- market rate, etc., can also be used as the primary interest rate.

is a function of the expected short- term interest rates levels. Thus, if the State Bank of Vietnam (SBV) can influence the short- term interest rate expectations, it can also affect economic growth. In practice, the SBV is currently using various instruments such as: the required reserve ratio, prescribed credit growth limit, regulations on system security and other administrative regulations to influence interest rate expectations, but the effectiveness of these instruments was not up to our expectations (excessive fluctuations and instabilities in the financial system, high transaction costs, wrong credit allocation , poor transparency and lowered confidence in the macroeconomic management).

Thus, the monetary policy needs to use the prime interest rate tool in a more efficient manner with the following conditions: (i) The SBV has to be given more power to flexibly manage primary interest rates; (ii) Establish a framework to strengthen the management of short - term policy interest rates; and (iii) Further develop the inter-banking market with higher liquidity, as well as strengthen the institutional capacity of the State Bank to manage the liquidity of this market.

Recommendation 5: To create a framework to adjust exchange rates more flexibly and expand the exchange rate band

The fact that the SBV raised the inter- banking exchange rate between the VND and the USD three times within ten months[16] in 2010 in order to reduce trade deficit are “on again off again” and unpredictable moves, causing not only increased inflation expectations but also an abnormal phenomenon in the foreign exchange market: creating the “ceased”[17] transaction before adjustments and “rocketed” exchange rate after adjustments[18]. Many businesses who deal with import and export or had to import inputs for production and make payments in USD with no contingencies for increased exchange rates in business plan and contracts had to face exchange rate risks. These one - way policy adjustments have raised the VND depreciation expectations, increased transaction costs and uncertainties in the business environment, eroded the confidence in the domestic currency and resulted in adverse effects on FDI.

To increase exchange rate flexibility is a necessary and normal move in the market economy to cope with continuous changes in terms of comparative currency value relations and the demand- supply relations in the monetary market. In that line of reasoning, it is essential to adjust the exchange rate according to signals and principles of the market. It is

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[16] The rate has been “dumped” 3 times (5.5%, 3.5% and 2.1%) in the last 10 months (respectively in November 2009, February 2010 and August 2010). The VND has been devalued over 10% (See Table 6- Appendix).

[17] The buying and selling rates are equal

[18] In recent years, the foreign exchange market has experienced 2 unusual periods: the official exchange rate was higher than in the free market rate in March of 2008 when foreign currency supply increased dramatically; and in the second quarter of 2010, when the virtual supply of the foreign currency rose sharply due to increased foreign credit as the difference between domestic interest rate and foreign interest rate grew.

essential to avoid speculation expectations based on one- way exchange rate increase and/or narrow, sudden and sharp increase after prolonged fixed exchange rate periods. In other words, it is necessary to create a framework for more flexible exchange rate adjustment and a wider transaction band, etc., to circumvent exchange rate shocks.

Recommendation 6: To restructure budget revenues and expenditures to reduce budget deficit

The State revenue growth during the period of 2006-2010 was relatively high and the total revenue always exceeded estimates[19]. The actual revenues of 2007 and 2009 declined compared to those in the previous years, while the economic developments in these two years were opposite to each other[20]. Thus, the State budget revenue at times was not correlated with economic growth; State budget revenue was estimated too far from reality due to the lack of solid economic and financial foundations and loose State budget revenue disciplinary.

Similar to budget revenues, budget expenditures always exceeded the estimation during the period of 2006-2010. It is noteworthy that the over-spending was not clearly

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[19] The actual revenue rose 30% compared to the original estimation, and this figure in 2008 was 33.3% (see State budget Settlement report 2008 and the Workshop Proceedings)

[20] Economic growth was 8.48% in 2007, and only 5.3% in 2009 due to the impacts of the global economic crisis, while the budget revenue growth minus the GDP growth estimated in 2007 was -21.55% and implemented in 2009 was -26.21% (See the Workshop Proceedings).

correlated with economic management either[21]. It was also due to budget overspending that the total annual actual budget expenditures during the period of 2006- 2010 were frequently over 35% GDP. The average development investment expenditure accounted for 25% of total budget expenditure, but could not meet the investment demand in the context of exceptionally increasing total social investment. To compensate for the overspending amount, Vietnam had to borrow domestically and internationally. Since the debt was used for non- profit purposes, the original debt repayment had to rely on the issuance of new debts, creating a debt "spiral" with growing scale of government debt.

Since the budget expenditures have been at significantly high level, despite budget revenues being reasonably high, State budget deficit has not come down. In order to achieve State budget balance, reduce State budget deficit and decrease public debt, it is impractical to continue raising revenues with respect to GDP as it is already high (implementation from 2006- 2010 was approximately 28% GDP). Revenues from crude oil have also fallen drastically[22]. Hence, the only solution is to restructure the revenues and reduce expenditures, especially the development investment

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[21] 2008 experienced a normal growth rate, inflation was high but expenditure was up 37% compared to the original estimation; while inflation in 2009 was low and there was increasing need to boost expenditure to stimulate growth but budget spending was only up 19% compared to the original estimation

[22] The State budget revenue from crude oil fell drastically from 25% to 13-14% of total revenue in the period of 2006- 2010 (See Table 5 - Appendix).

expenditure from the State budget, and replace it with non-State investments. Moreover, State budget expenditure disciplines also need to be strengthened to put an end to over-spending even though the estimated spending amount already contains contingencies and financial reserves.

Recommendation 7: To solve the prolonged trade deficits by reducing preferences and favors for SOEs, speed up the development of supporting industries and gradually adjust exchange rate in a more flexible manner

Despite being an export- oriented economy, after 25 years, Vietnam is still a stressful importing nation, negatively affecting the balance of payments and other important balances of the economy. Trade deficit of the first nine months of 2010 was USD 8.6 billion, up 19.8% compared to that of the same period of 2009 and making up 16.7% of total turnover. If the gold exports and gold products were counted out, the trade deficits of the nine - month period would be USD 11.4 billion, up 15.7% compared to that of the same period of 2009 and making up 23.3% of total turnover, surpassing the target by 20%.

The primary causes of the trade deficit can be summarized as follows: (i) a long period of economic growth mainly based on investment, especially through capital injection into SOEs while the export capacity in this sector was weak with a strong import "capacity"; (ii) lack of supporting industries with sufficient capacity to meet demands for production of exporting goods, thus the economy's exports largely depend on imports (components, raw materials, etc.) and (iii) the financial crisis and economic recession in recent years have drastically lowered prices of Vietnam's export items[23].

In order to solve this deficit issue, the following measures should be taken:

- Balance public investments, especially investments to SOEs, reduce preferences and treat SOEs on an equal footing with other businesses
- Develop supporting industries with a clear, comprehensive and specific strategy[24]
- Further adjust the exchange rate more flexibly in order to enhance the competitiveness of Vietnamese products, while simultaneously avoid risks from monetary speculation due to massive imports and depletion of foreign reserves[25]

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[23] The international export price index in 2009 (based on export ratio) declined 19%, the prices of many of Vietnam's key products also fell drastically (See the Workshop Proceedings).

[24] There was a view that the vertical development of supporting industries (industrial support for textiles, footwear, car and motor production and assembly, etc.) is not the right issue to tackle. The general supporting industries are divided into four groups: (i) Detailed mechanical production and detailed production; (ii) Plastic components; (iii) Electronics; and (iv) Chemical products. Businesses in these four groups can provide supporting industrial products for most of the final products.

[25] Evidence from many monetary crises shows that an economy with a fixed exchange rate and a large and prolonged trade deficit can face a danger of becoming a target of speculations, resulting in a monetary crisis if there is an additional deteriorated foreign reserve (the 1997 Asian financial crisis is an example).

Recommendation 8: Not to attract FDI at all costs, increase the quality of FDI and create a stronger spillover effect in the economy

In the first nine months, the country has attracted 720 new licensed projects with total registered capital of USD 11.4 billion, up 37.3% compared to that in the same period of 2009. The total capital implemented in the first nine months of 2010 was USD 8.05 billion, up 4.8% compared to that of the same period last year (total implemented value in 2009 was USD 10 billion), proving that foreign investors are still interested in the Vietnamese market. Total export value of the FDI sector continued to grow considerably, estimated to reach USD 27.3 billion (including crude oil), up 26.5% compared to that of the same period last year.

However, the quality of FDI inflows to Vietnam remains low compared to that in other countries, mainly concentrated in "processing" projects, thus, while producing 45% of industrial outputs, it only contributed 40% of the added industrial value [26]. Meanwhile, technological transfers and management skills remains modest, labor training is still limited, primarily using cheap and low- skilled workers, many businesses create pollution and wastefully exploit natural resources. Many FDI businesses also contribute to the increased import of raw materials and semi- finished products, high "processing" level, and low "domestic

[26] See the Workshop Proceedings.

content". Furthermore, 50% of businesses continuously reported losses, and most ventures have switched to the 100% foreign capital type of investment, showing the possible issue of "price transfer"[27].

Therefore, it is essential to pay more attention to the quality of FDI, eliminate inefficient or seriously delayed projects. Moreover, it is important to gradually get rid of the FDI attraction at all costs and create a wide and positive spillover effect of FDI in the economy, especially through capacity building, technology transfer, market expansion, environment protection, etc. Simultaneously, improve State management, especially central management, in order to fix the state of separation and decentralization of power in FDI management, and thus enhance the quality of FDI investments towards sustainable development.

Recommendation 9: To change the way of thinking about SOEs, speed up the reform and restructuring of SOEs, especially the State-run economic conglomerates in a more thorough and aggressive manner.

In a socialist-oriented market economy, the orthodox view is to consider the State-run economic sector as the mainstream, in which the SOEs play a crucial part of the State-run economic sector. However, in the perception and attitude of a few managers and researchers, the concept of and distinction between State-run economy and SOEs are still vague.

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[27] See the Workshop Proceedings.

Today SOEs enjoy many privileges; most of the natural resources are put under the management of SOES, especially the economic conglomerates or large corporations. Many SOEs, for a long time, have not had to face both domestic and international competitive pressures; the large economic conglomerates have a big say and an important position in building the State's strategies, policies and investment programs.

The State – run economic sector accounts for over 40% of total social investment[28], and SOEs hold over 50% of total business capital in the economy[29]. Nonetheless, the State - run economic sector contributes only 37%- 39% of total GDP. If their contributions in other types such as State management, security and defense, education and training, healthcare, relief programs, sports and culture, etc. were excluded, then SOEs would merely contributed 27% GDP in 2008. GDP and industrial output growth of the State –run economic sector in general and of SOEs in particular are constantly lower than other economic sectors. The ICOR coefficient of SOEs is also higher than the private sector and FDI[30]. Meanwhile, SOEs create only 4.4% total employment of the economy. Additionally, SOEs are substantially

[28] See Figure 7- Appendix
[29] See Figure 8- Appendix
[30] See Table 1 - Appendix

contributing to the current account and budget deficits on a large scale[31]. Issues arising from the VINASHIN incident have clearly proved key weaknesses of SOEs when receiving significant privileges from the State.

It can be said that SOEs reform to date has been less successful than reforms in other sectors, due to the following reasons: (i) The institution and instruments to perform State ownership are inadequate; (ii) Despite the fact that the national economy has switched to the market economy, SOEs are not fully operating under the market mechanism; (iii) Though the national economy has integrated into the world economy, SOEs have not entirely integrated and have lacked global vision and thinking, especially in corporate governance.

With the objective of enhancing the quality of growth and ensuring growth sustainability, it is necessary to promote SOEs reform and restructuring measures as follows:

- Separate the "leading" role of the State – run economic sector with the "core" role of SOEs. Treat SOEs as an economic sector that operates on

[31] Direct contribution of SOEs only accounted for 20% budget revenue (excluding crude oil), and is declining, while large investments of SOEs in particular and of the State economic sector in general are creating budget deficits on a large scale. Regarding exports, exclusive of crude oil, charcoal, other minerals, SOEs only produced 15- 20% total export turnover. Meanwhile, with large sums of capital as well as big investment projects, splurging huge foreign currencies and imported goods, SOEs' import turnovers were also substantial (See the Workshop Proceedings)

an equal and competitive footing with other economic sectors[32].

- Work out a clear strategy of SOEs development under the principle of focusing on only essential sectors and projects of the economy
- Work out a clear roadmap to resolutely reform SOEs (through equitization, rearrangement and reform of remaining SOEs according to new standards).
- Strictly apply the "hard budget" principle to SOEs, i.e.to remove all forms of lending and credit provision upon administrative orders as well as "debt frozen and debt extension" for SOEs, to deny to repay and settle debts of SOEs, and to request SOEs to reimburse full costs at market prices.
- Redefine SOEs' privileges in access to natural resources, land, information, etc.
- Establish an information system and business M&E institution; to ensure open and transparent information disclosure over SOEs.

[32] This also suggests that SOEs are not an instrument to stabilize the macro-economy, to regulate the market, and carry out other social tasks. The above- mentioned responsibilities of SOEs are generally in compliance with legal regulations and similar to those of other economic sectors. However, there are some opinions that if SOEs do not play such roles, it is necessary to clarify rationales of the existence of SOEs in the economy.

In addition, as a latecomer to industrialization, the State-run economic conglomerates in the country have to clearly define their role as the "core" of the economy for the State to implement the industry policy, specifically the structural policy[33]. To enhance the effectiveness of the State-run economic conglomerates, it is important to manage them according to following guidelines:

- To redefine objectives of State-run economic conglomerate establishment and investment regulations: the business operations of these conglomerates should have two goals, namely (i) to implement structural policy[34] and (ii) to maximize profits. Economic conglomerates need to focus more on the first objective, while the second one can be given to the State Capital Investment Corporation
- To place State-run economic conglomerates in an international competitive environment
- To strictly control natural monopoly: All resources invested by the State in these conglomerates have to link with the achieved results to implement the structural policy and enhance the competitiveness based on a determined roadmap

[33] South Korea and China have successfully used economic conglomerates to implement their industry policies

[34] Investing in key business areas, creating a long-term development trend for the entire economy, and creating strong spillover effect to other industries.

- To disseminate and disclose business performance of State-run economic conglomerates based on compulsory audit provisions and to report their results to the National Assembly.
- To improve the management structure, accounting regimes, and corporate governance of State-run economic conglomerates, particularly through the development of a set of performance indicators for each State-run economic conglomerate according to long- term goals of supporting the Government structural policy and enhancing the competitiveness of conglomerates

Recommendation 10: To strengthen social security and promote it publicity, and enhance its efficiency and effectiveness of social security

In the last ten years, our nation has witnessed many significant achievements in implementing social security policies; the capacity to carry out these policies has been enhanced thanks to the economic growth[35]; the scope and participating subjects have also expanded[36]; the quality of

[35] Currently, the expenditure ratio of the State budget for social policies accounts for over 26%.

[36] The number of people participating in compulsory social insurance was 9.4 million in 2009, accounting for 18% of the labor force. It is projected that in 2010, 5.8 million people will participate in voluntary insurance. The subjects of healthcare insurance have also increased rapidly (both voluntary and compulsory), from 13.4% of the population in 2000 to 62% in 2010. The State budget has also paid VND 19,000 billion in 2010 for over 1.4 million people regarded as revolution contributors (See the Workshop Proceedings).

social security services has gradually improved. Nonetheless, the policies remain fragmented, asynchronous, overlapped and lack of correlations, and unable to attract the attention and active participation of the public. Financial resources to implement these social security policies are rather limited compared to their demand, and mainly depend on the State budget. The coverage and benefit levels have not yet been able to satisfy basic needs of people. The implementing mechanism is fragmented and uncorrelated among components. There is still lack of separation between State management and service supply in policy implementation[37].

Compared to other components of social security, social insurance is the most crucial pillar. The most pressing issue of social insurance in the first nine months of 2010 is outstanding debt of social insurance. While in 2009, the total amount of unpaid and delayed premium payment of compulsory social insurance was VND 2,000 billion, such debts amounted to VND 4,800 billion merely in the first six months of 2010. Debts outstanding for less than twelve months accounted for 65% of this total amount. Throughout the country, there are 5,325 businesses owing social insurance premium for over 12 months (including 2,217 enterprises in Ho Chi Minh City, 1,150 in Hanoi, 204 in Ba Ria- Vung Tau, 151 in Da Nang, and 114 in Binh Duong).

The outstanding social insurance debt, in substance, is to expropriate money of employees and more severely, of

[37] See the Workshop Proceedings for further details

State's financial fund. As the Social Insurance Law stipulates that any businesses late in payment have to pay only interests on the outstanding debt, many businesses tend to delay their payment for social insurance premium. Currently, the social insurance system lacks an active, positive and sustainable mechanism. Social insurance agencies should not just wait for insurance premium payment, but more importantly, focus on promoting the propaganda, enhance the efficiency and effectiveness of social insurance in the coming years.

To improve social security and social welfare is a key content of the Socio - Economic Development Strategy of Vietnam in the period of 2011 - 2020. The measures needed to be taken include: (i) To continue implementing socio - economic development programs linked with job creation; (ii) To synchronously and diversely develop and improve the quality of the insurance system, while simultaneously providing an appropriate policy to encourage active public participation; (iii) To profoundly carry out the transfer policy for people with honored contributions and social support policies for the subjects of social protection; (iv) The State should invest more resources in this field and actively play its crucial role in enhancing social welfare and developing a diversified system of basic social services; (v) To mobilize the entire society to improve social security; and (vi) To improve the legal system on social security.

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The Vietnam's economy has been entering the end 2010 period with many remarkable achievements, but simultaneously faced with many challenges regarding the growth model, quality of growth, economic imbalances, macroeconomic instability, weak macroeconomic policy management, problematic SOEs sector, social security, etc. To identify the issues of 2010 and forecast trends of 2011 and beyond, specific recommendations mentioned above have been synthesized and drawn from high-quality reports, presentations and comments from managers, the National Assembly deputies, scientists and economists. It is hoped that they will make certain contributions to the preparation of the Socio - Economic Development Plan for 2011, the Socio - Economic Development Plan for the period of 2011- 2015 and the Socio - Economic Development Strategy for the period of 2011- 2020./.

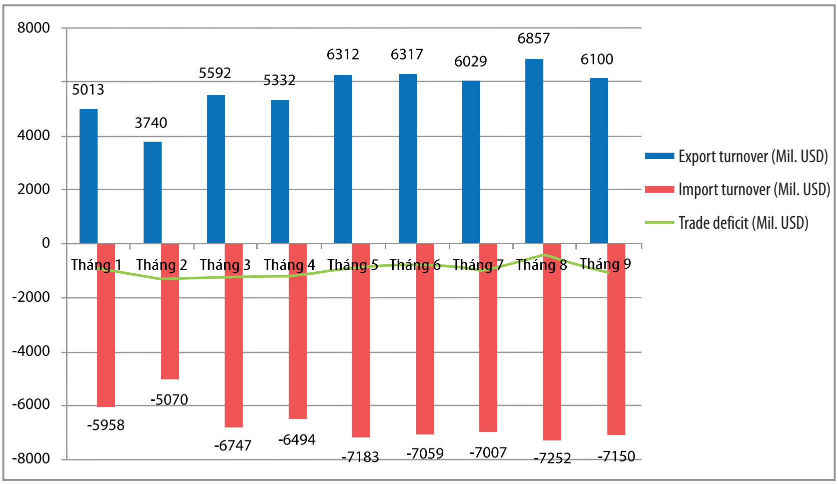
APPENDIX

Table 1: ***ICOR (incremental capital output ratio) coefficient by ownership***

	1996	2001	2007
Vietnam	3.44	5.14	5.38
State Enterprises	3.5	7.42	8.28
Private Enterprises	2.31	2.63	3.74
FDI (Foreign Direct Investment) Enterprises	5.82	6.29	4.99

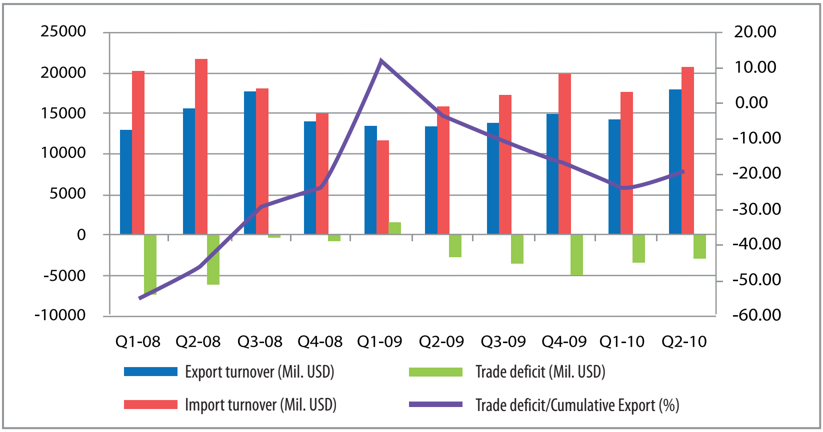
Source: GFCF Data – EIU (2010) and GDP Growth – WDI.

Figure 1: ***Exports, Imports and Trade Deficit in the first nine months of 2010 (Mil. USD)***



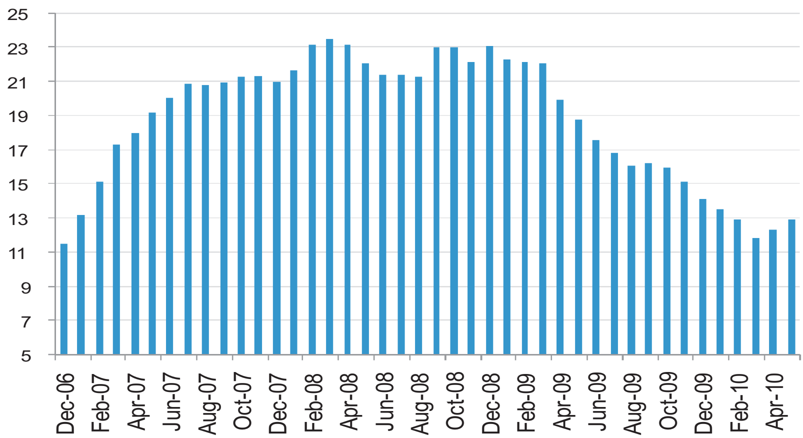
Source: General Statistical Office (GSO) of Vietnam.

Figure 2: ***Exports, Imports and Trade Deficit from the first to the third quarter of 2010***



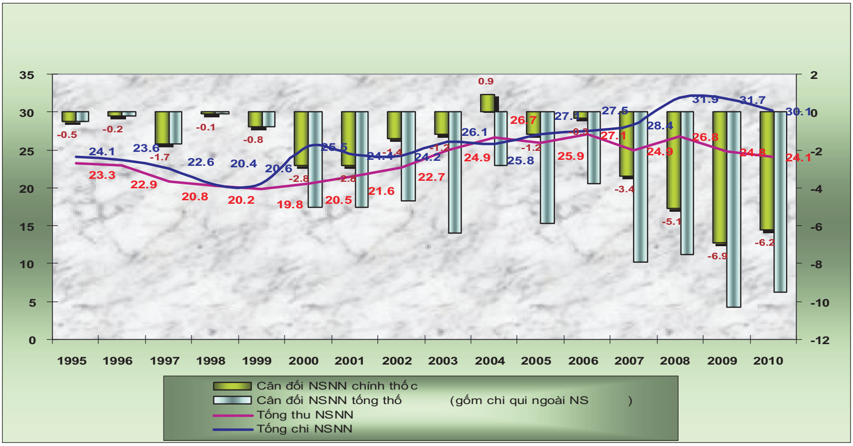
Source: General Statistical Office (GSO) of Vietnam

Figure 3: ***Foreign Exchange Reserve of Vietnam (Bill. USD)***



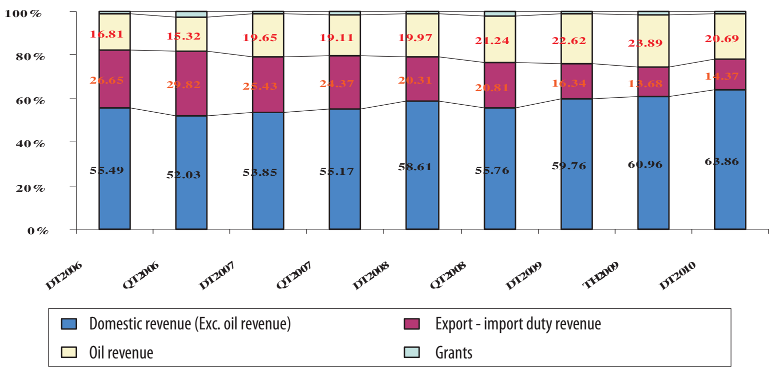
Source: International Monetary Fund (IMF).

Figure 4: State budget (1995-2010, % GDP)



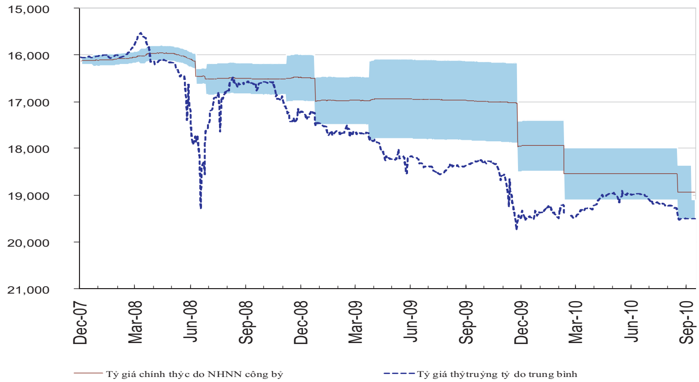
Source: International Monetary Fund (IMF) and Ministry of Finance (MOF).

Figure 5: Structure of state budget revenue (2006-2010)



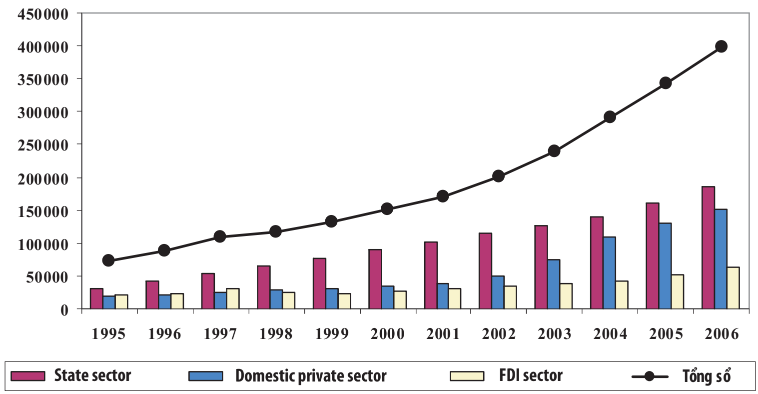
Source: Calculated based on data of Ministry of Finance (MOF).

Figure 6: Official and Free Market exchange rate (2007-2010)



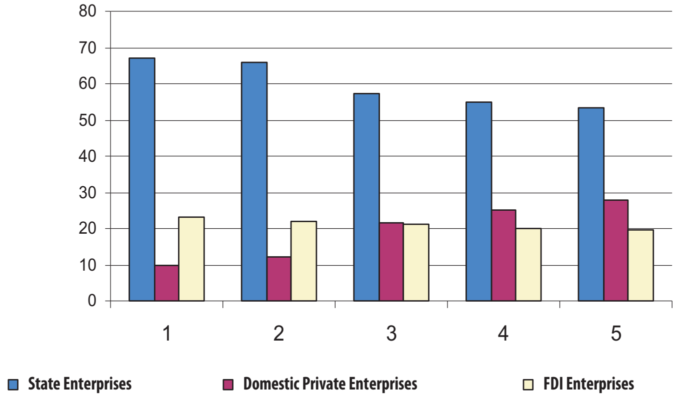
Source: International Monetary Fund (IMF) and Ministry of Finance (MOF).

Figure 7: *The social development investment capital by ownership (Bill. VND)*



Source: National Center for Socio - Economic Information and Forecast, Ministry of Planning and Investment (MPI).

Figure 8: ***Capital Structure of enterprises by Ownership (2000-2006)***



Source: Central Institute for Economic Management CIEM's report.

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