Strengthening the Role of Government in Accelerating Economic Growth, 2021-2025

Jonathan Pincus

UNDP Viet Nam

Lessons from East Asia's Economic Transformation

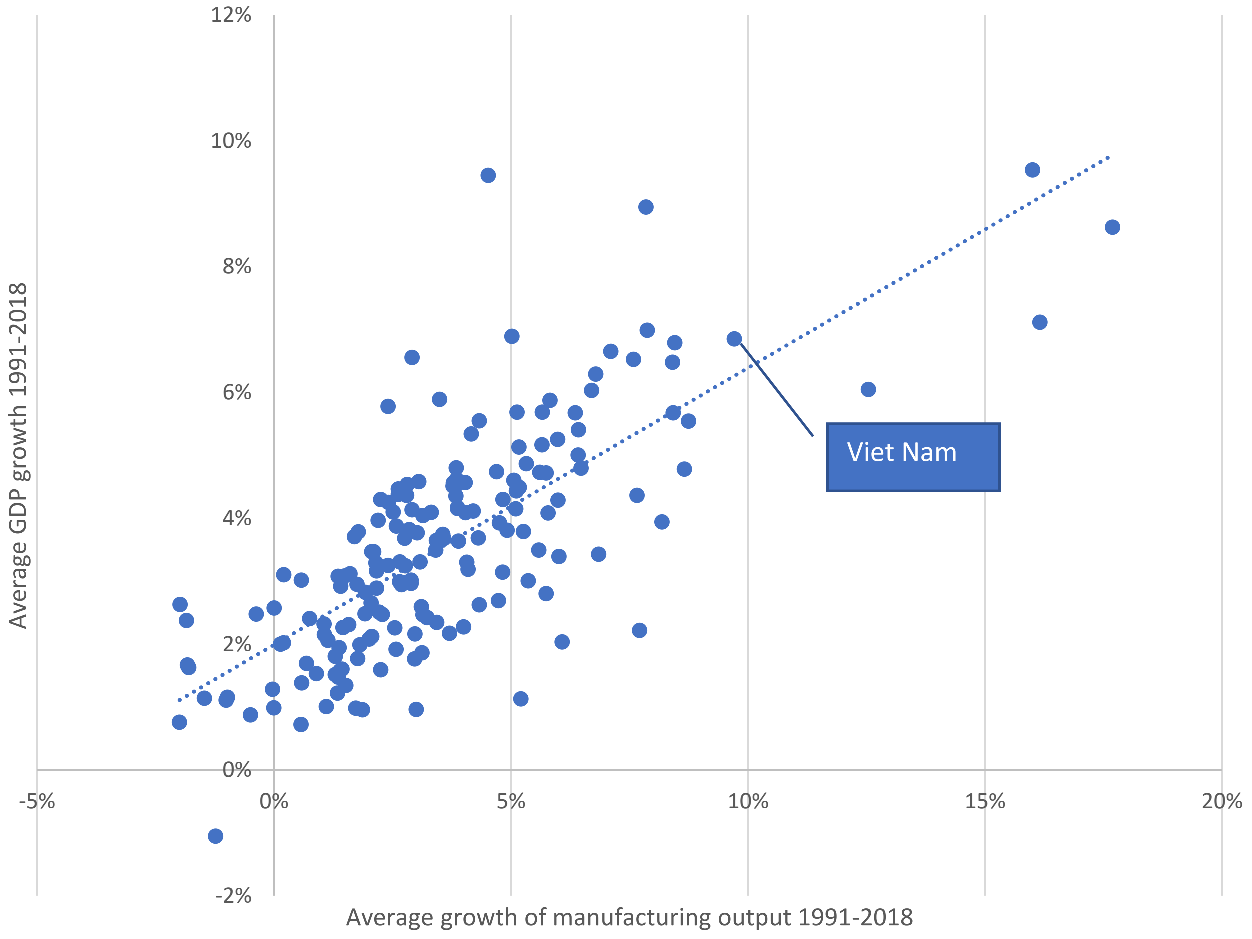
1. The fast pace of growth of manufactured exports was the main impetus for sustained productivity (and income) growth
2. Importance of sustaining a high rate of *productive* investment (public and private)
3. Strong support for research and development especially for technology adoption and penetration
4. Avoid over-reliance on foreign capital flows

Turing the Covid "rebound" into the post-Covid recovery

- A scatter gun policy targeting *all* industries and firms will not succeed
- Two indicators should guide post-Covid economic policy:
  - Exports: Support for domestic companies with a demonstrated capacity to compete on global markets
  - Productivity: Support for domestic companies with a demonstrated capacity to boost labor productivity, create jobs, pay better wages and that offer more training to workers
- Support should be tied to performance and withdrawn if targets are not met.
- Develop an index of "good" FDI projects that
  - Rely on local suppliers for a inputs
  - Create jobs, pay higher wages and offer more training
  - Conduct research and development activities in Viet Nam
  - Have achieved rapid growth of exports

Increase domestic content in manufactured exports

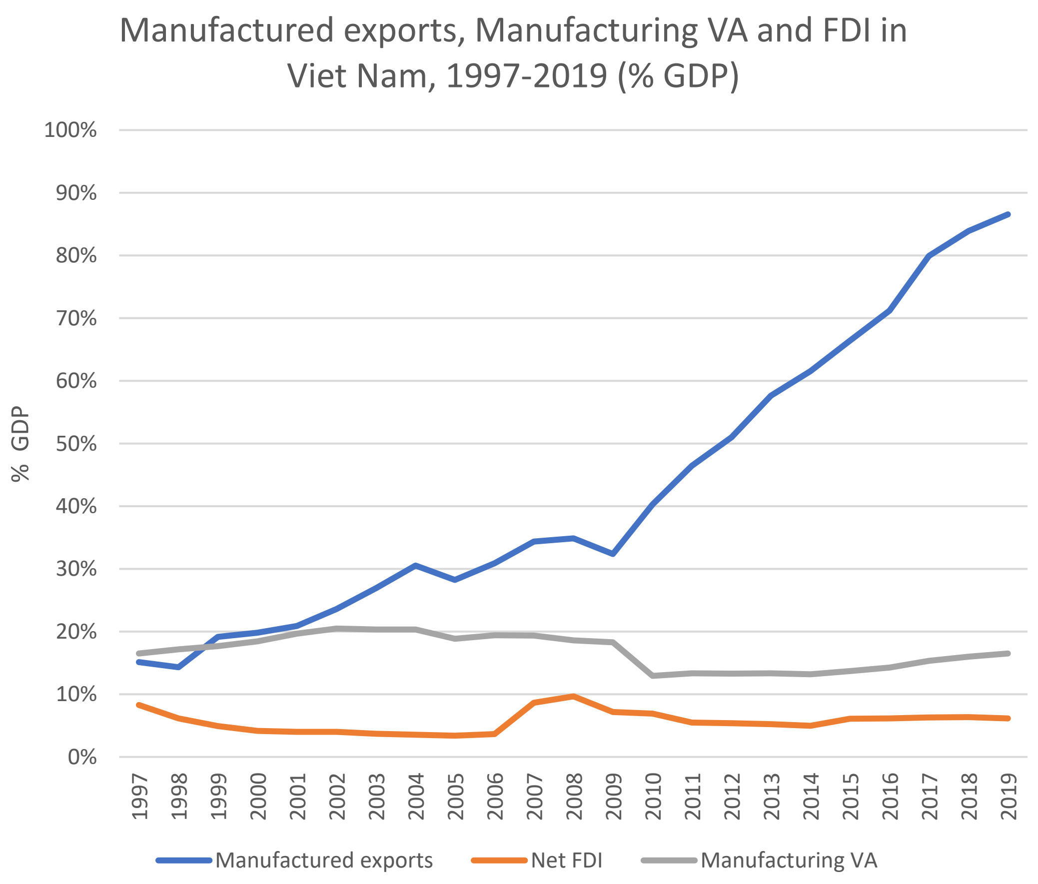
Close relationship between growth of GDP and manufactured exports



- Not just growth but the *rate of growth* of manufactures is key (Verdoorn's Law)
- Development of technological and managerial capabilities
- Economies of scale
- "Learning by doing"

Manufactured exports are soaring, but manufacturing value added is not

- Value added embodied in assembly operations is limited
- Job creation is rapid (good) but technological deepening is slow
- Vertical technology transfer within global value chains is limited
- Viet Nam is gaining valuable experience in various subsectors
- But assembly operations are not a viable long-term growth model



mtrade

Extraordinary growth rate of manufactured exports – But linkage effects still limited

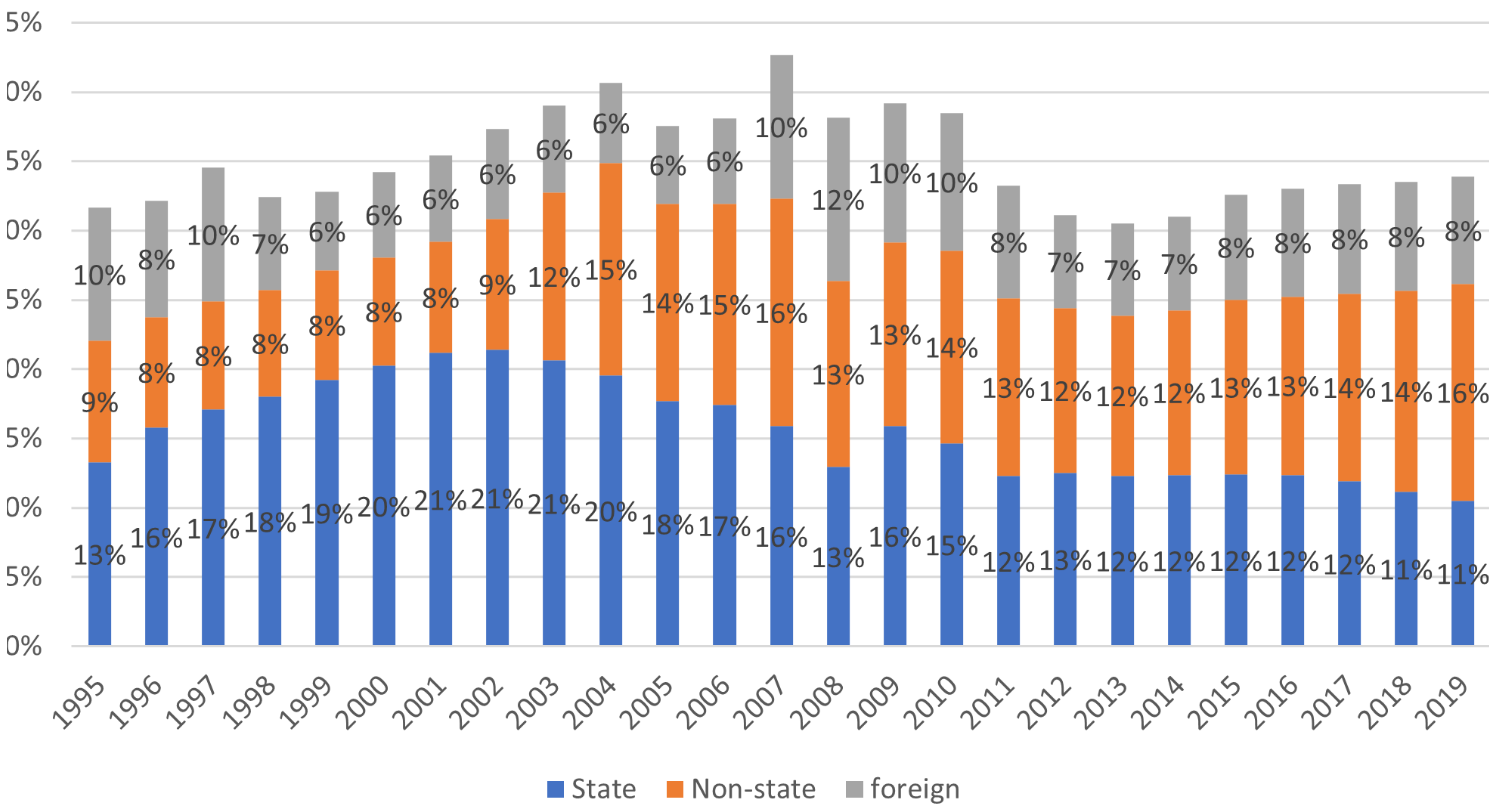
Commodity	2000 (constant USD billions)	2019 (constant USD, billions)	Annual growth
Transmission equipment	5.8	37,402.5	55%
Garments	2,198.1	25,703.1	13%
Footwear	1,811.7	16,249.2	12%
Telephones	20.3	15,165.8	39%
Integrated circuits	4.7	13,002.6	49%
Furniture	285.5	7,688.1	18%
Computers	598.5	6,964.3	13%
Iron and steel	75.3	5,894.4	24%
Televisions	39.6	5,279.6	28%
Electrical machinery	124.8	4,601.2	20%
Fabric	84.2	4,514.5	22%
Optical cable	159.3	4,029.0	18%
Audio equipment	23.2	2,716.2	27%
Auto and motorcycle parts	12.8	1,693.3	28%
Photographic equipment	22.1	1,652.8	24%
Yarn	138.8	1,556.7	13%
Liquid crystal displays	0	1,241.2	
Jewelry	0.8	1,215.9	44%
Aluminum	10.9	1,087.4	26%
Copper	4.2	1,040.7	32%

Source: UN Comtrade

- Need to identify opportunities for import substitution in export industries
- Government support in form of training, technology, credit, infrastructure tied to performance
- Incentives to FDI firms that procure from domestic suppliers

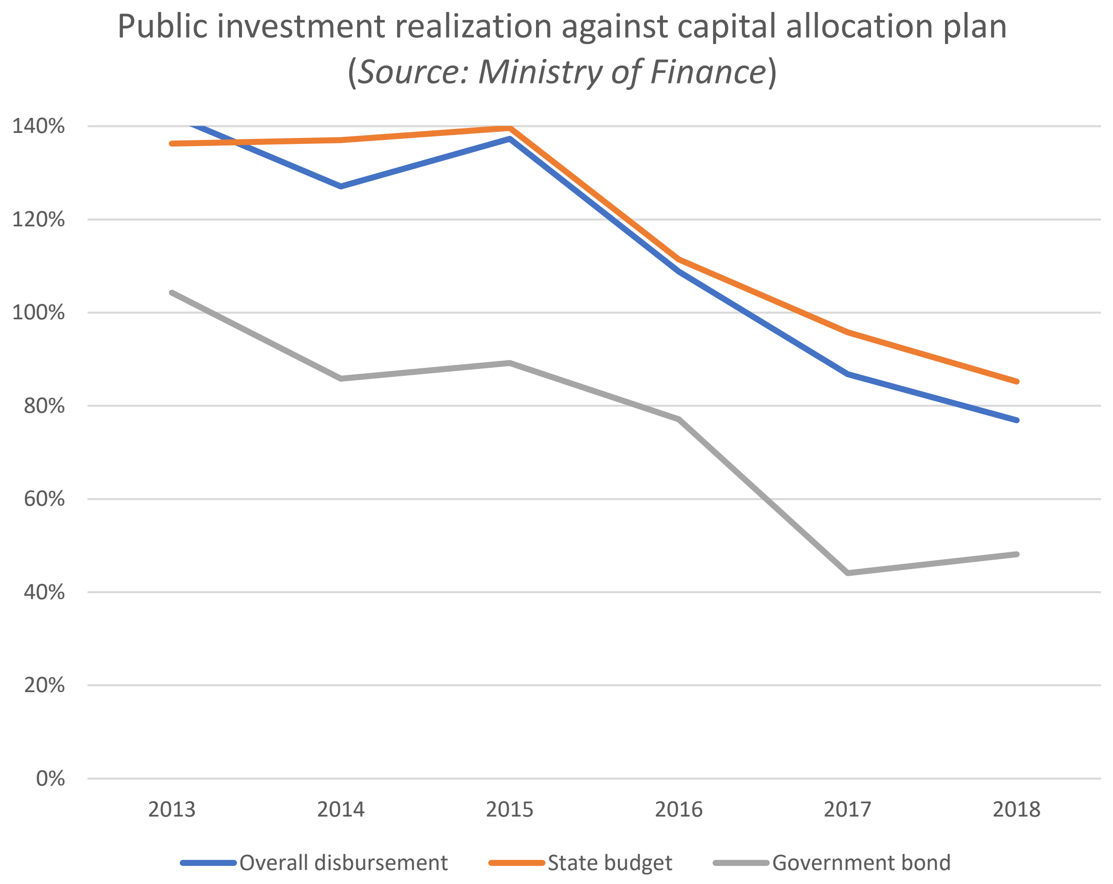
Sustain a high rate of *productive* investment

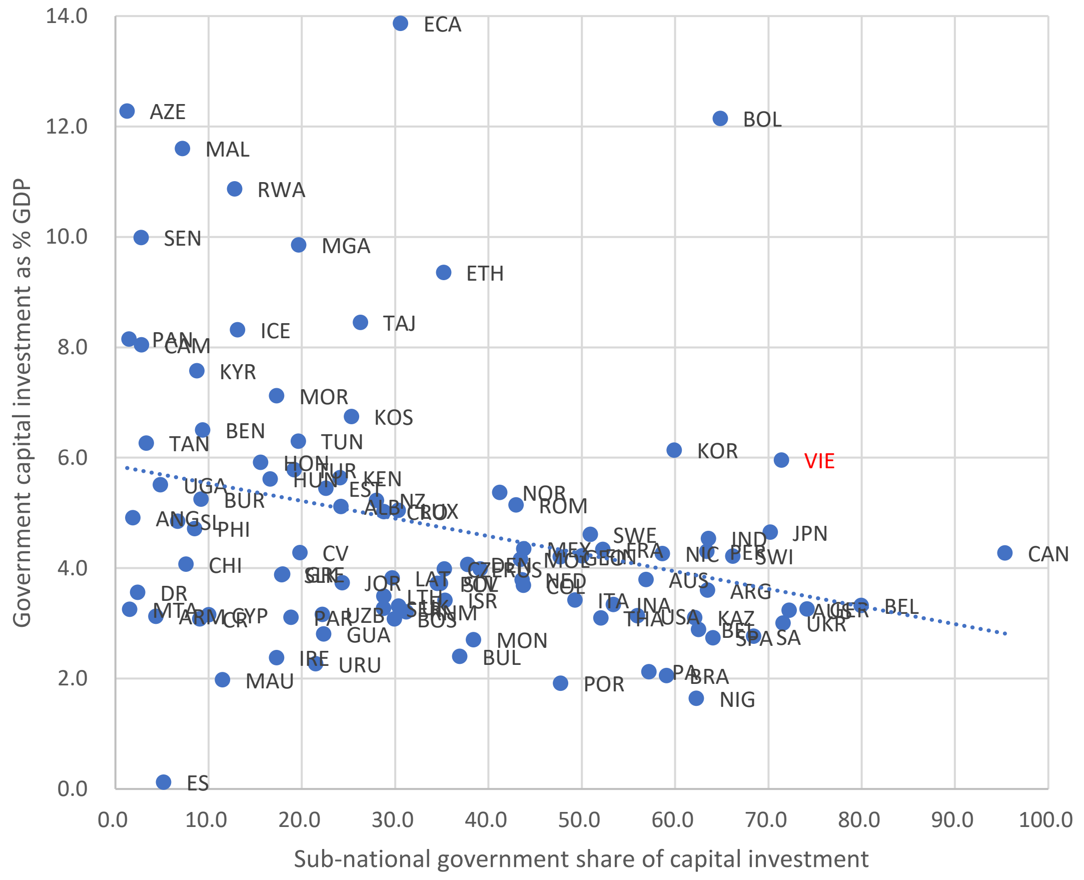
Dramatic fall in public investment since 2002



- FDI is relatively constant
- Share of private investment has doubled but public investment falls as % GDP
- Fiscal rules and slow disbursement of public investment funds
- Growing infrastructure backlog

Viet Nam radically decentralized public investment, slowing completion rates



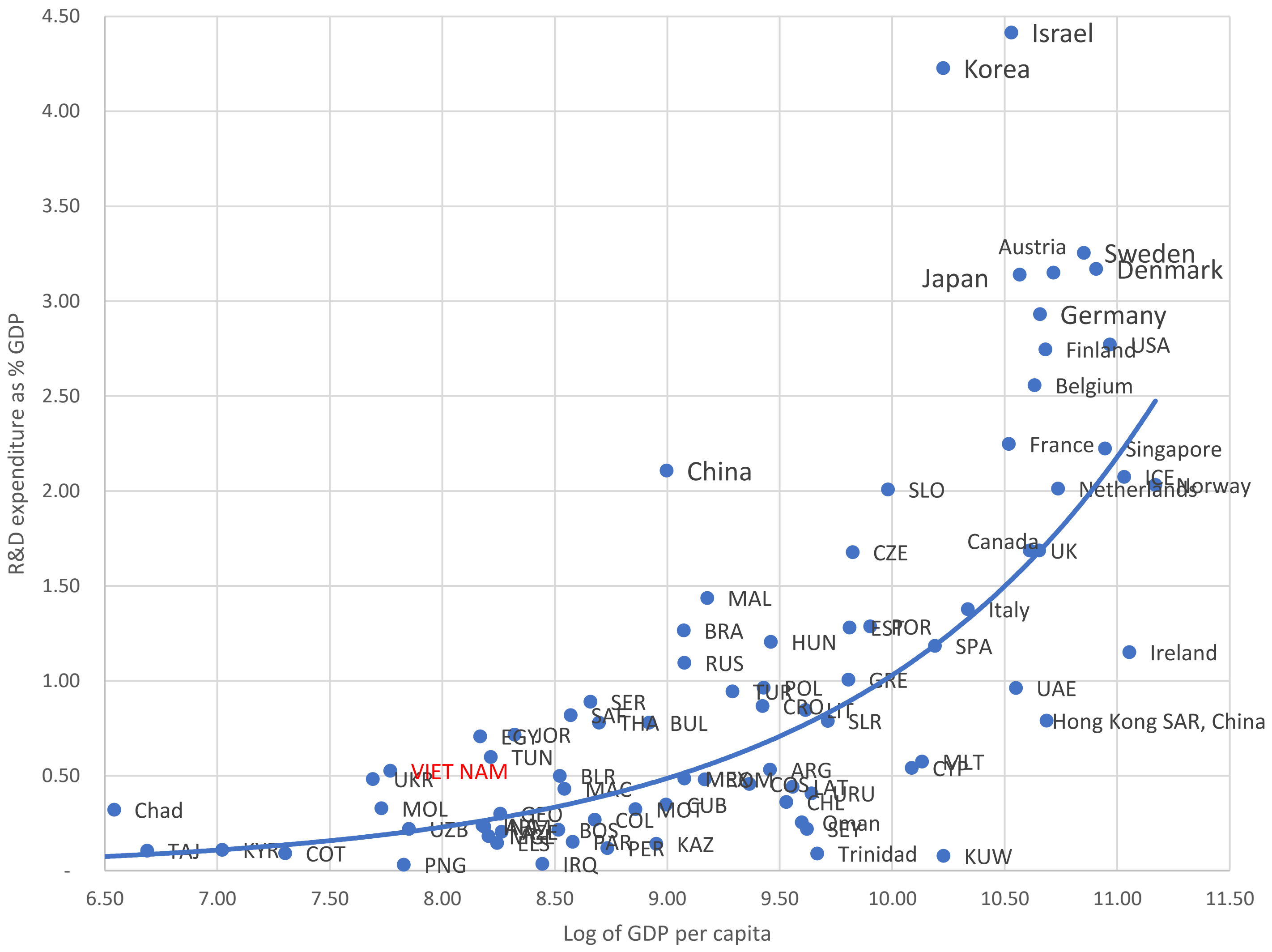


Increasing *productive* investment

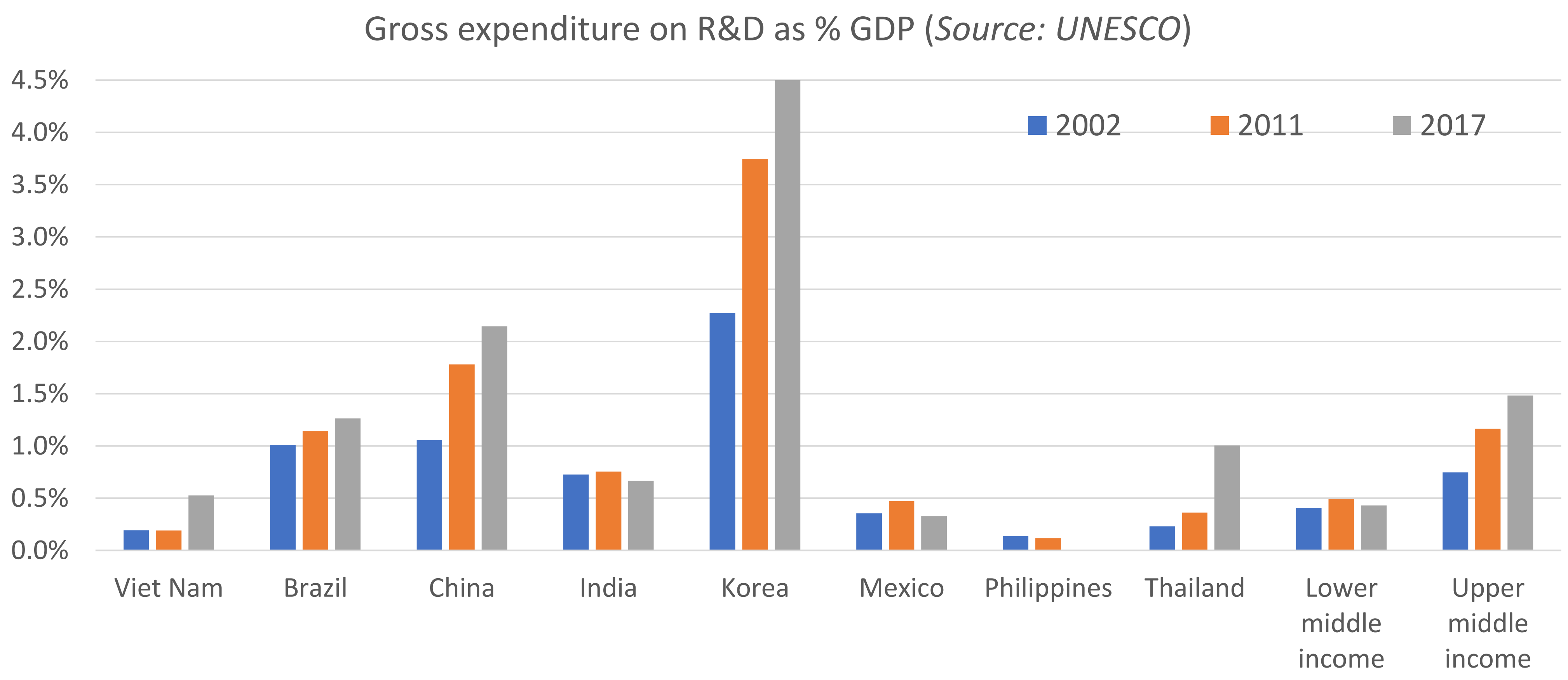
- Central government plays a larger role in prioritizing public investment projects → linked to exports and industrial clusters
- Regional public investment coordination: Reduce fragmentation (hundreds of small ports)
- Use tax policy to
  - increase the rate of return on investments in industry, agriculture and modern services
  - Reduce the rate of return on investments in rentier activities (property development, speculation, financial engineering, natural resource exploitation
- Support for companies that achieve export and productivity growth

Increase R&D effort

R&D spending as share of GDP and GDP per capita, 2016



R&D effort



Gross expenditure on R&D as % GDP (*Source: UNESCO*)
4.5%
4.0%
3.5%
3.0%
2.5%
2.0%
1.5%
1.0%
0.5%
0.0%
2002
2011
2017
Viet Nam
Brazil
China
India
Korea
Mexico
Philippines
Thailand
Lower middle income
Upper middle income

Entrepreneurial state supports technological transformation

- Goal is technological adoption and penetration by VIETNAMESE FIRMS -- support for commercialization of new technologies
- Reduce risks for private firms that already have capabilities but lack resources for sustained research effort
- Public finance for cooperation between public research institutions (including universities) and private firms
- Prioritize short cycle technologies (emerging products and components not based on existing patents)
- Linkages between public R&D and national defense: invest in cybersecurity (including theoretical and applied research)
- Subsidize R&D effort of domestic firms that have shown capacity to export

Over-reliance on foreign capital flows has slowed development of domestic capital markets

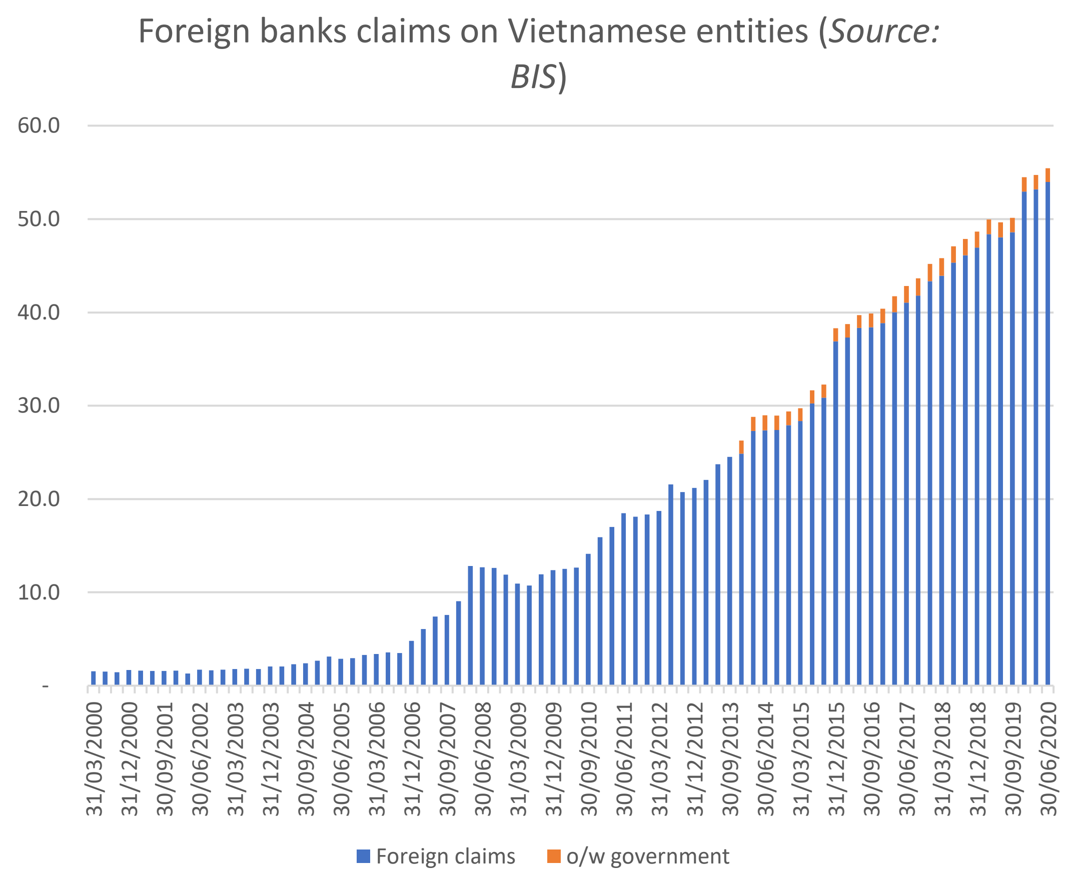
Disadvantages of foreign financing

- Foreign exchange risk: Foreign lenders will generally not offer VND loans, which means the borrower assumes all of the foreign exchange risk
- Currency mismatch: For government and companies that receive revenues in VND, dollar liabilities can result in large and sudden balance sheet effects
- Foreign exchange liabilities: Foreign borrowing and FDI create foreign currency liabilities that can force a slowdown in economic growth during recessions
- High cost: Foreign capital is expensive given exchange rate risk

Easy access to foreign capital flows will continue…

- …which has reduced pressure for reform and development of of domestic capital markets, which is the long-term goal
- Central banks injected trillions of dollars of liquidity into financial markets during the Covid-19 pandemic, on top of the trillions released during the GFC
- Excess liquidity will find its way to developing countries, where yields are potentially higher
- Can lead to asset bubbles and financial volatility (as in 2007-2008)
- Priority must be to develop infrastructure and regulatory basis for domestic capital markets: corporate bonds, securitization, insurance, leasing, etc.

Rising levels of foreign debt in East Asia and Viet Nam



Develop domestic capital markets

- Restrictions on foreign borrowing must remain in place or should be strengthened
- Meanwhile domestic capital markets should be strengthened
  - Develop market infrastructure: credit ratings agencies, asset registries, electronic transactions
  - Streamline bankruptcy and foreclosure procedures
  - Clarify and simplify legal and regulatory framework for banking, domestic corporate bonds, insurance and leasing
- Modernize Viet Nam Development Bank to introduce new lending mechanisms, increase transparency and efficiency

Thank you