

CHAPTER II

VIETNAM'S ECONOMY

In this chapter, we present the Vietnamese economy. Furthermore, this chapter outlines the economic development of Vietnam before and after the reformation of doi moi, as well as the economic development of Vietnam in 2018 and 2019. For this reason, the author divides the exposure of this chapter into several sections with the intention of making it easier to understand the economic development of Vietnam the substance of which is presented in the description below.

A. Doi-Moi Reforms

1. Vietnam's pre-Doi-Moi economic conditions

After the Vietnam War ended in 1975, the reunification of North and South Vietnam was successful. But this unification was not followed by real success in the economic field (Porter, 1993). Deteriorating economic conditions forced the Vietnamese Communist Party (VCP) to make changes aimed at improving people's welfare. New generation party elites tended to think more pragmatically in viewing the international world and its impact on the domestic situation. In line with the development of this new thinking at the sixth party congress in 1986, the general secretary of the communist party Truong Chinh delivered an agenda of economic improvement which came to be known as Doi-moi (Asyathri, 2011).

The Doi-Moi Agenda itself was subject to debate before it was ratified as a national policy. The constellation of debates takes place within the internal party but does not result in conflict that results in division within the party. The party elite debate revolves around the positive and negative impacts of Doi-Moi on society related to a centralized planning system and large-scale agricultural production (Van Arkadie, 2000). The main priority to be resolved is the identification of problems caused by conservative

bureaucracy, and the overly rigid orthodox model of socialism that was previously applied to the source of economic development problems which also impact on the declining level of public trust in the government, and this endangers the legitimacy of the government under the socialist regime. At the end of the debate, it was agreed that renewal was still needed as an effort to strengthen socialism in Vietnam (Asyathri, 2011).

Doi Moi which in Vietnamese means renovation, was initiated by the communist party. This agenda then allowed foreign private corporations to participate in managing the agricultural industry which was originally under the authority of the Communist Party (Gates, 1995). Doi Moi is carried out through three strategies, namely: the stage of international economic integration, the stage of internal reform through traditional sector, and finally the stage of economic equality and change in institutions (Dewi, 2018).

The Doi Moi policy came into being after Vietnam faced an economic crisis which resulted in its inflation rate going up to 700 percent (The ASEAN Post Team, 2018). Furthermore, at the time, Vietnam was staunchly communist in an era where Cold War politics was at its height. Vietnam was facing embargoes and had difficulty carrying out trade. The country was also still recovering from its war with Cambodia in 1975 and the war with the United States (US) before that. The aim of Doi Moi was to establish a “socialist-oriented market economy”. With Doi Moi in place, Vietnam saw reforms that encouraged privately owned enterprises. The Communist Party also overturned its policy on collective farming and recognized private land use rights. Prior to Doi Moi, there was no private sector in the country, but today it has become a crucial component in Vietnam’s growth (The ASEAN Post Team, 2018).

Doi-moi during the transition period is still weak, especially in its mechanism (Asyathri, 2011). There is no time limit in the overall planning and implementation of the Doi-Moi policy, all of which proceed without a five-year plan like the general economic plan of the country. Vietnam's policies without planning can be said to be haphazard and risky. Doi-Moi is carried out without any other alternative policy if it fails in its realization. But on the other hand, these actions can also be said to be very brave in a positive sense, because the reform policy can be considered a colossal experiment for Vietnam. Even though the risk faced is very large, it is quite satisfying to see the results obtained after the reform.

2. Vietnam's economy post-Doi-Moi

Doi Moi (Economic Reform) which began in 1986, now continues to deliver Vietnam to the global trade ladder in the new century. Its trading partners cover 170 countries and territories (Kompas.com, 2008). Vietnam with "Doi Moi" since 33 years ago changed its direction from a centralized socialist economy to an open market oriented socialist. Foreign investors were given a tax write-off for a certain period, and a 75-year of build right. The revolution in the peaceful era was followed by joining ASEAN (1998), becoming a member of the Asia Pacific Economic Cooperation (APEC, 1998), realizing the full ASEAN Free Trade Agreement (AFTA, 2006) and in the same year became a member of the World Trade Organization (WTO) (Kompas.com, 2008).

The results of economic development planning are marked by increasing GDP of Vietnam. 2001 was an important year, as the start of the five-year plan and social development strategy (Kompas.com, 2008). Based on the results of the five-year socio-economic plan, the 1995-2000 five-year strategy shows economic improvement.

Economic growth that occurs in a linear fashion with the level of people's welfare. The problem of the gap can not

be avoided, but how small the gap between urban and rural countries can be reduced based on economic policies made. Doi-moi with decentralization is able to be optimized by urban and rural areas.

These positive results show how Doi-Moi, especially the decentralization policy, provided space for the community to participate in economic participation, as well as increasing channels for aspirations and advocacy on public issues with an increasing number of NGOs and voluntary association is an indication of the movement towards democracy. "Doi Moi" has gradually attracted foreign investment companies (PMAs) in industrial estates, and since the beginning of the 21st century has shown amazing numbers. PMA actors are treated with ease of licensing, namely the issuance is sufficient at the local governor's level, not necessarily to the national capital (Asyathri, 2011).

However, on a quarterly basis, there was a slowdown in this industry growth since 4Q 2017 due to the deceleration of electronic devices manufacturing industry. Improvement was seen in construction industry this year, especially in 3Q and 4Q (due to the acceleration in disbursement of public investment capital), the total growth of the whole year was 9.16% YoY (8.70% in 2017). Mining industry recorded a negative growth (-3.11% YoY), but less severe than the figure in the same period in 2017 (-7.1%). The production of crude oil decreased by 11.3% to 12 million of tons, the lowest in many years. Compensating for the decline of crude oil, coal and aluminum mining and liquefied gas witnessed positive growth (reached 9.1%; 23.3%; 29.8% respectively).

The benefits of Vietnam's reforms are also enjoyed by its people. In the World Bank's latest report titled "Climbing the Ladder: Poverty Reduction and Shared Prosperity in Vietnam," Vietnam has successfully reduced its rate of poverty by 13 percent last year. However, while many are out of poverty, income inequality is now on the rise in Vietnam.

According to global aid and development charity organization Oxfam in 2017, the yearly earnings of Vietnam's 210 richest people is enough to lift 3.2 million people out of poverty and end extreme poverty in the country (The ASEAN Post Team, 2018).

B. Vietnam's Economy in 2018

33 years on and the spirit of Doi Moi still lives on. The economic reforms carried out by the Communist Party has made Vietnam one of the region's fastest growing economies. The World Bank has also pointed out in its Global Economic Prospects report that Vietnam is one of six countries in East Asia with real GDP growth of more than six percent (The ASEAN Post Team, 2018).

According to estimates by the Asian Development Bank in the 2018 Asian Development Update Report, the Vietnamese economy will grow 6.9% in 2018 (Medcom.id, 2018). Vietnam's economy scored fantastic growth in the first quarter of 2018 (January-March) after growing 7.38% compared to the same period last year. The growth was faster than the first quarter of 2017 which grew 5%. In addition, the realization also exceeded the target set by the government at 6.7 percent. Reported by AFP, the growth is the fastest in the last 10 years. Vietnam last scored the highest growth in 2008 when the economy grew 7.4% (Fiansyah, 2018).

Economic growth in early 2018 was triggered by an increase in exports of the manufacturing industry, especially in the electronics sector. Analysts assess the increase in exports shows that Vietnam is not affected by the protectionist agenda of the President of the United States (US) Donald Trump. The agricultural sector and the large and retail trade sectors continued to grow strongly while the manufacturing sector which was the main engine of economic growth in Vietnam grew more than 13% (Medcom.id, 2018).

Vietnam has been one of the favorite destinations for manufacturing investment in Asia, especially electronics. A number of leading companies, such as Samsung, LG Electronics, and Canon have factories in the country because of low labor costs and open economic policies, including export and import trade. In the first quarter of 2017, Vietnam's economic growth was depressed after Samsung, which has its products having an export share of about 25% of Vietnam's total exports, announced the recall of Galaxy Note 7 phones due to battery problems. But in early 2018, Vietnam's export value rose and touched 54 billion US dollars, up 22%. In other words, Vietnam is able to export goods abroad an average of 18 billion US dollars every month (Medcom.id, 2018).

However, one might be missing the big picture if one only thinks Vietnam is only an outsourcing hub for manufacturing. In the past decades, Vietnam has quietly carved for itself a strong foothold in the ICT sector. The growth of Vietnam's Internet economy covering online travel, e-commerce, online-media and ride hailing is a clear indicator, with a compound annual growth rate (CAGR) of 38% between 2015 and 2018 (Mack, Oon, & Vu, 2019).

Vietnam's GDP grew 6.9% yoy in the 3rd Quarter of 2018, from 6.8% in the 2nd Quarter of 2018, the highest in ASEAN-5, as a solid performance in the industrial and construction sectors (8.9% yoy) and the sector services (6.8%). The manufacturing sector grew 12.1% driven by increased export demand due to positive spillover from the US-China tariff war. The construction sector grew 9.2% in line with infrastructure development, especially toll roads and urban transportation networks (railroads) to support logistics activities for industry. The service sector also continued to grow solidly (6.8%) triggered by the financial, banking and insurance subsectors (8.1%) as startup activities increased. There are currently around 3000 startup companies in Vietnam engaged in fintech, food tech, health, and e-commerce (Bank Indonesia, 2018).

According to KBSV research by KB securities, Vietnam PMI experienced positive moves in 2018, reaching the highest level in the past 7 years in November. PMI stayed above 50 points in the last 37 months, contrary to the downtrend of PMI in countries in the region (the average PMI of Asian emerging countries in November tumbled to the lowest in 24 months). Service sector in 2018 saw a fairly good growth as consumption increased, grew by 7.03%, lower than 7.44% in 2017, but higher than that in 2012-2016. Within sectors, wholesale and retail growth rate increased by 8.51% YoY, which was the highest growth in this region. Agriculture, forestry, fishing growth had its best performance since 2012, reaching 3.76% YoY thanks to expanding export markets and favorable weather conditions in 2018. Particularly, the agriculture sector rebounded and increased by 2.89%, fishing significantly rose by 6.46%, forestry climbed by 6.01% (KBSV Research, 2019).

Vietnam's exports grew 14.3% yoy (from 9% in the second quarter of 2018), contributed by cellphone and footwear components, mainly to the US and China. Vietnam has a positive spillover from the application of US-China import tariffs, as indicated in Vietnam's increasing share among US import partners. Referring to UNComtrade data, Vietnam's average share in US import partners during June-August 2018 was 2.0%, an increase from 1.8% in March-April 2018. Imports also accelerated (14.3% from 5.3%) especially machinery, communication equipment, computers and automobiles. Vehicle imports increased rapidly (26.9%) after contracting in the 2nd Quarter 2018 (-32.0%) due to tightening vehicle import requirements (Bank Indonesia, 2018). The government tightened vehicle import regulations by requiring exporters and car companies to have a Vehicle Type Approval (VTA) certificate before exporting vehicles to Vietnam.

The government of Vietnam has announced further reforms to their economy this year. In an effort to make

Vietnam more regionally competitive, Prime Minister Nguyen Xuan Phuc revealed that the country will cut corporate income tax rates from between 20 to 22% to 15 to 17% (The ASEAN Post Team, 2018). Furthermore, in March, the Ministry of Transport proposed to enhance services in maritime areas and multi-modal transportation by easing business conditions and regulations. If their ministry's proposal goes through, 314 out of the current 500 regulations will be cut.

Another notable step, Vietnam has taken to open up its economy by signing the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), which the World Bank has estimated will increase Vietnam's GDP by 3.5 percent. Despite rising trade tensions and volatility in emerging economies throughout 2018, Vietnam's economy saw broad-based growth and low inflation. Government spending and debt remained in check and bank capital rules were strengthened. Current economic risks relate to geopolitics, trade policy uncertainty, and domestic reform implementation. Looking ahead to the longer term, Vietnam will face risks related to aging, climate change, and digitalization.

Extensive market-oriented and outward-looking economic policies have helped Vietnam achieve sustained and inclusive economic growth. To maintain growth and raise its quality, Vietnam needs to modernize economic institutions, especially in terms of fiscal and monetary management, and continue with market-oriented and outward-looking reforms. In practice, continued tightening of credit policies, developing capital markets, and building a modern market infrastructure with adequate tools for financial system supervisors and regulators would help enhance the financial sector's ability to support sustainable growth.

In recent years, Vietnam has managed to halt the increase in public debt and create some fiscal space. The more favorable fiscal position provides the authorities with the

means to step in should downside risks materialize. Conversely, if growth surprises on the upside, existing debt could be paid down at a faster pace. Recapitalization of Vietnam's state-owned commercial banks should also be a priority, and the country's ongoing efforts to tackle corruption provide an opportunity to strengthen the rule of law.

Economic and political reforms under Doi Moi, launched in 1986, have spurred rapid economic growth, transforming what was then one of the world's poorest nations into a lower middle-income country. Between 2002 and 2018, more than 45 million people were lifted out of poverty. Poverty rates declined sharply from over 70% to below 6% (US\$3.2/day PPP).

C. Vietnam's Economy in 2019

One does not usually think of Vietnam as an economic power. Yet, over the past decade, Vietnam's annual GDP growth rate has been on the rise. Vietnam confirmed the best economic growth among ASEAN countries. With economic growth reaching 6.76 percent in the first semester of 2019, Vietnam became the country with the largest economic growth in ASEAN (Putra, 2019). Local gross domestic product (GDP) climbed nearly 7 per cent in the first three quarters of 2019, reaching its highest level for the last nine years.

According to the GSO, Vietnam's economic growth was at 6.79% (yoy) in Q1/2019, proving that the growth momentum has decreased slightly in the beginning of 2019. The service sector grew at 6.5% (yoy) in Q1/2019, which was lower than that in Q1/2018 at 6.7%. Wholesale and retail segments increased to 7.82% (yoy), contributing mostly to the overall growth. Accommodation and catering services was up to 7.60% (yoy). Finance, banking and insurance activities grew to 6.22%(yoy) and real estate business increased to 4.75% (yoy). The number of international visitors to Vietnam also increased significantly with over 4.5 millions of visitors,

around 7%(yoy). In particular, the leading markets experienced positive growth in tourist arrivals, including: Korea (24.1%), Japan (8.3%), Taiwan (26%) and Thailand (49.3%) on year on year basis. In the first quarter, the agriculture, forestry and fishery sector grew quite gloomy and only reached 2.68%(yoy) (VEPR Macroeconomic Research, 2019).

The rice prices went down due to the high market supply while livestock industry was affected by cholera outbreaks in most provinces. However, the fishery underwent highest increase in the past 9 years, reaching 5.1% (yoy) at Q1/2019. Thanks to the weather, stable costs and high market demand, production in fishery increased significantly. Meanwhile, the industry and construction sector grew at 8.63% (yoy), although it was lower than 10.08% of Q1/2018 but still contributed mostly to economic growth. Processing and manufacturing industry was the main growth driver in this sector with a high increase of 12.35%, which lower than Q1/2018 at 13.56%. At the same time, the mining industry grew at -2.2% (yoy). Indicators of industrial production imply the slow down in economic growth. Although industrial production index (IPI) increased to 9.2%(yoy), the consumption index in processing and manufacturing industry grew at 8% (yoy), but which are still lower than these in Q1/2018. Moreover, since the beginning of 2019, the indexes related to production and consumption declined considerably, while inventory index rose sharply. This is likely to lead to temporarily suspend production (VEPR Macroeconomic Research, 2019).

Today, Vietnam has become one of the darlings of global manufacturing supply chains, capable of competing with China with its high quality of manufacturing output in selected products while providing lower production costs. Many international firms have situated their factories in Vietnam, from electronics producers such as Samsung and LG, to automobile manufacturers such as Mercedes-Benz.

Director General of the General Statistics Office (GSO) Nguyen Bich Lam told a press conference that amid declining global economic growth, Vietnam still witnessed growth of 6.98 % in the first nine months of the year. The major contributors were industry, construction and services. Specifically, industry and construction increased by 9.36%, contributing 52.6% to GDP, while services increased by 6.85%, contributing 42.6% (Vietnam news, 2019).

The processing and manufacturing sector remained the pillar of growth, with a rate of 11.37%, followed by the service industry which included wholesale and retail sales, financial activities, banking and insurance, transportation and warehouses. Agriculture, forestry and fishery increased by 2.02%, lower than the growth in the same period last year, because they faced formidable challenges as the prolonged heatwave decreased productivity while African swine fever outbreaks had threatened the livestock sector's health. However, Lam announced those factors were declining. Lam also announced that in the first nine months this year, there was a record of newly established enterprises, reaching nearly 102,300. They also had the highest level of capital in recent years, reaching an average of VNĐ12.6 billion (US\$543,217) each (Vietnam news, 2019).

According to the latest business survey, 43.3 per cent of businesses rated their business performance in the period as "better than before", 18.3% said it was "difficult" and 38.4% rated the period as "stable." Investment capital in the first nine months reached a decent growth rate of 10.3%, higher than the same period in 2018, of which the non-state economic sector reached VNĐ624.6 trillion (\$26.93 billion), accounting for the largest proportion of 43.5% and the growth rate of 16.9%, while the investment capital of the state sector was VNĐ426.6 trillion (\$18.3 billion), accounting for 33% of the growth rate of 3%. The FDI sector reached VNĐ327.1 trillion (\$14.1 billion) accounting for 23.7% at a growth rate of 8.4%. It is noteworthy that investment capital from the State budget has

not improved much, continuing to reach the lowest growth rate in the years 2015-2019. Lam said that the total import and export turnover was estimated at \$382.72 billion, of which exports reached \$194.3 billion, up 8.2 per cent over the same period last year. Trade balance of goods in 9 months was estimated at \$5.9 billion, said Lam. GSO disclosed the consumer price index (CPI) in the period grew at the slowest pace over the past three years at 2.5% (Vietnam news, 2019).