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Vietnam
Sustaining Growth in Difficult Times

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Vietnam has achieved high rates of economic growth for a period of two decades. Growth slowed in 2008 as the government was forced to tighten credit in order to slow down price inflation. With the advent of the global recession, the government must now reverse course and find ways to support demand in the face of declining exports and foreign investment. However, as a small, open economy with a fixed exchange rate and large fiscal and trade deficits, Vietnam's options are limited. The most effective response would be to gradually depreciate the Vietnamese dong to slow the flood of imports and boost export prospects, while redirecting the public investment towards labour rather than import-intensive projects. The government must also find ways to impose discipline on the large state-owned enterprises and control their diversification into financial sector activities.

Keywords: Vietnam, macroeconomic policy, economic growth, state-owned enterprises.

I. Introduction

In its final press release of the year, Vietnam's General Statistics Office announced that in 2008 the country's gross domestic product (GDP) had crossed the symbolically important threshold of US$1,000 per capita.[1] Although still low by ASEAN and wider Asian standards, average incomes have risen nearly fourfold since 1989 at current exchange rates and three times at purchasing power parity exchange rates. According to official figures, the percentage of the population living on less than US$1 per day had fallen from more than 60 to less than 12 per cent over the same period.[2]

Despite the attainment of this important milestone, 2008 was a gloomy year for Vietnam's economy. Although output grew by a respectable 6.2 per cent, domestic commentators focused on the drop in performance relative to the 8.5 per cent rate recorded in 2007 and the failure to reach even the government's adjusted growth target of 6.7 per cent. Massive capital inflows in 2007 and early 2008 contributed to economic overheating, which was evident in high and rising inflation and a mounting current account deficit. Consumer price inflation peaked at 28 per cent in August, among the highest in the region, and the trade deficit ended the year at a remarkable US$17 billion or 19 per cent of GDP. The government was forced to rein in credit growth to slow down inflation and defend the Vietnam dong (VND), which effectively burst the stock market and land price

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bubbles. The Ho Chi Minh City Stock Exchange was one of the worst performers in the world in 2008, losing 66 per cent of its value. Prices for commercial and residential properties were also down by as much as half in the major urban markets. In a cruel twist of fate, the global credit crunch struck just as Vietnam appeared to be emerging from its domestically generated financial instability.

Growth is almost certain to slow further in 2009 as the global recession weakens export demand and inward investment, both of which are likely to contract in real terms. The government has attempted to stimulate the economy by lowering interest rates and injecting liquidity into the banking system, and also plans to increase public investment and provide loan guarantees for small- and medium-scale enterprises (SMEs). These remedies are unlikely to succeed in stimulating growth, and may in fact contribute to a renewed bout of price inflation and a widening of the trade deficit.

High-profile requests for assistance from large state-owned enterprises (SOEs) have focused attention on the government's state-led industrialization strategy.[3] The debate over the role of the conglomerates is likely to grow more intense over the coming year. While some influential leaders of the Communist Party see the conglomerates as a vital tool in the fight against inflation and in the provision of basic necessities like food and power, others argue that the SOEs have leveraged their privileged access to state credit and land to build corporate empires geared more to money making than social progress. Despite tight control over the media, the role of the state conglomerates is debated openly in the newspapers, on the Internet, and even on state-run television.

The main argument of this paper is that as a small, relatively open economy with a fixed exchange rate, Vietnam's options in the face of a global recession are rather limited. However, the government could ease the pain of the inevitable slowdown by redirecting public spending away from capital-intensive, import-using investments and towards labour-intensive projects that do not add to the trade deficit. The government will have to go beyond public investment in infrastructure and impose discipline on large SOEs if it is to achieve these objectives.

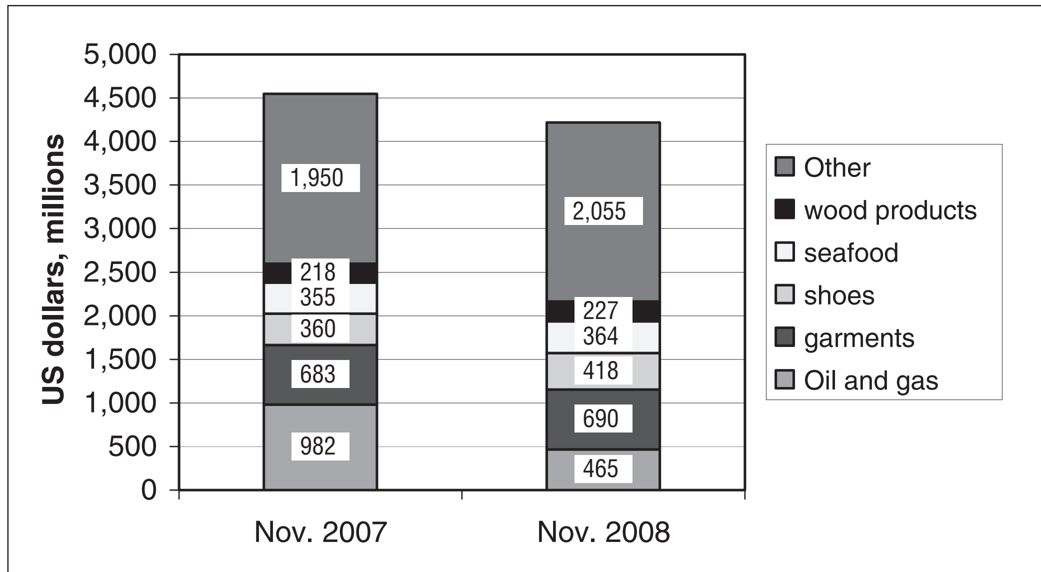
The rest of this paper consists of three sections. Section II reviews the likely impact of the global recession on Vietnam, and suggests a set of policies to reduce the negative effects of slower export growth, falling export prices and a reduction in foreign direct investment (FDI). The paper then turns to the specific problems facing the large SOEs, and argues that more rigorous disclosure requirements and separation between financial and industrial interests are needed to ensure that public investment is directed towards projects that create jobs, profits and foreign exchange. The final section concludes.

II. The Impact of Global Recession on Vietnam

It is now clear that the global credit crunch has developed into a recession that is likely to be, in the words of IMF Chief Economist Olivier Blanchard, "the worst crisis in sixty years."[4] As a small, export-oriented economy, Vietnamese growth will suffer from a recession that is occurring simultaneously in North America, Europe, and Japan.

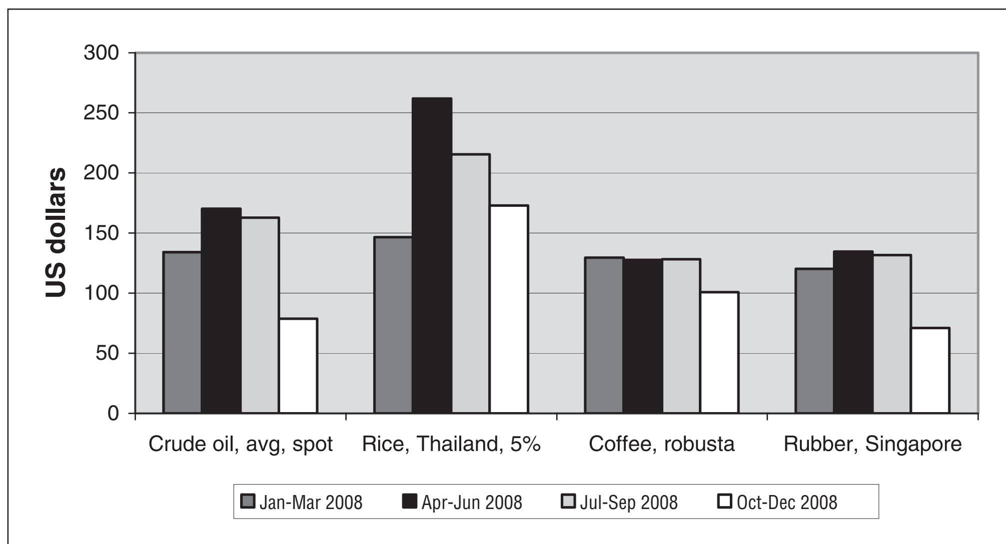
The global crisis will affect Vietnam's macroeconomy in five ways. First, demand for some Vietnamese exports will weaken. To date Vietnam's export performance has remained remarkably strong, but by the end of 2008 exports values had already begun to contract. As shown in Figure 1, Vietnamese trade data indicate that exports fell by 7 per cent in November, largely as a result of lower oil prices. Prices of other commodities produced in Vietnam are also falling (Figure 2). Anecdotal evidence suggests that orders for manufactured exports including garments, footwear, and furniture are dropping quickly, and seafood producers are also under pressure.[5] According to the Ho Chi Minh City branch of the Vietnam General Conferation of Labor, 30,000 jobs have already been lost in the city in these industries.[6] With exports equal to

FIGURE 1
Exports, November 2007, November 2008



SOURCE: General Statistics Office (GSO).

FIGURE 2
Commodity price trends (2007=100)



SOURCE: World Bank.

70 per cent of GDP, and more than half of export demand originating in the crisis-hit United States, Europe, and Japan, export contraction is likely.[7]

Second, foreign investment will fall over the short to medium term as investors face financing constraints and reassess earnings prospects in 2009 and 2010. According to the Ministry of Planning and Investment, foreign investors disbursed US$11.5 billion in 2008, up a remarkable 43 per cent from 2007. But the ministry expects this figure to decline in 2009 as investors lose access to financing and as global demand slumps.

Third, tourist arrivals are also likely to fall. Culture, Sport and Tourism Minister Hoang Tuan Anh said recently that Vietnam will miss its annual tourism target in 2008, the first time that this has happened since the Severe Acute Respiratory Syndrome (SARS) outbreak in 2003. Tourism is an important source of foreign exchange and employment in Vietnam. Vietnamese banks have lent billions of dollars for hotel and resort development, and cannot afford to see these investment projects fail. Fourth, remittances from overseas could fall. It is likely that overseas Vietnamese are subject to the same income-asset price-credit problems that have affected other residents of the United States and Europe.

Finally, the fall in commodity prices will result in a shortfall in government revenues. The government must now recalculate the central budget since the current version assumes an average oil price of US$100 per barrel in 2009. It is estimated that the budget will be reduced by US$2 billion if oil prices remain at current levels. Moreover, other sources of revenue, particularly trade taxes, will also fall. In 2007, for example, import taxes, VAT, and excise taxes on imported goods accounted for about 16 per cent of government revenues.

The combination of these factors has led most observers to reduce their growth forecasts for 2009. Only the government and the World Bank predict that growth will exceed 6 per cent next year, with a consensus view forming around the 5 per cent mark (Table 1). Forecasting growth is never an exact science, and it is made even more difficult in Vietnam by the absence of consistent and reliable data series.[8] Nevertheless, economists agree that 2009 will be a difficult year, and that the government should prioritize job creation and price stability to protect the most vulnerable people in Vietnam.

TABLE 1
Current GDP Growth and Growth Forecasts, December 2008

	2008	*2009*
Actual	6.23	n.a.
Government of Vietnam	6.7	6.5
International organizations		
World Bank	6.5	6.5
Asian Development Bank	6.3	5.0
IMF	6.25	5.0
Others		
BMI	6.0	5.0
Citigroup	6.3	5.2
CLSA	5.6	2.6
Deutsche Bank	6.1	4.1
Economist Intelligence Unit	6.1	4.3

The set of policy options available to Vietnam as the government seeks to limit the fallout from the global recession are much more limited than those of larger countries. China, for example, records a substantial trade surplus and massive levels of foreign exchange reserves. While China posted an estimated current account surplus of 11 per cent of GDP this year, Vietnam recorded a deficit of 12 per cent. The result is that China has added to reserves and exported capital while Vietnam must find foreign savings to finance its deficit. China has accumulated US$1,500 in foreign exchange reserves per capita, compared to Vietnam's US$250 per capita. This means Vietnam is more vulnerable to sudden shifts in capital flows. The rate of price inflation in China is also much lower than in Vietnam. Moreover, as a large country that meets most of its consumption requirements from domestic production, extra

demand in China is more likely to stay in the country.

Lowering interest rates and injecting liquidity into the banks makes sense in countries that meet the following critieria: (i) massive losses have forced banks to hoard cash, which has tightened conditions in credit markets, particularly interbank markets; (ii) exchange rates are flexible; (iii) the country is large enough that growth in the money supply will reduce the real interest rate *and* the real exchange rate (in small, open economies an increase in the supply of money will typically result in a real exchange rate depreciation but not a fall in real interest rates); and (iv) borrowing and lending take place for the most part in the domestic currency.

Vietnam does not meet any of these criteria. It is true that many banks in Vietnam are carrying too many non-performing loans, mostly due to overexposure to the property sector. But most Vietnamese banks are not short of liquidity and they are not hoarding cash. The interbank market is liquid and behaving normally. According to Vu Tien Loc, Chairman of the Vietnam Chamber of Commerce and Industry, the biggest problem is not the lending rate but rather that fact that that the banks cannot find enough viable borrowers.[9] The State Bank of Vietnam (SBV) does not need to pump money into the banks like the Federal Reserve, the Bank of England, or the European Central Bank.

Vietnam's exchange rate is fixed by the SBV. Therefore, following the standard logic of Mundell-Fleming, monetary policy has a limited effect on output. At the fixed rate, as real interest rates fall below the international rate, domestic residents switch to assets denominated in foreign currencies, and if these are not available they move into assets like gold and land. The monetary authorities buy the domestic currency to defend the exchange rate, and in doing so they reduce the money supply. If the central bank does not step in to defend the exchange rate, the result is inflation and the sort of panic buying of foreign currency that Vietnam experienced in July 2008. With over US$100 billion of broad money supply and less than US$25 billion of foreign exchange reserves, the SBV would find it difficult to defend the exchange rate at a time of rising unemployment, still-high inflation, and stagnant exports.

In other words, under fixed exchange rates monetary easing results in asset switching rather than more economic activity. This is clearly the case in Vietnam. Real interest rates are still broadly negative in Vietnam, and have been for most of the year. Negative real interest rates have not prevented economic growth from slowing down, but it has stoked inflation.

It is also important to remember that Vietnam is a small country that is very open to foreign trade. Large economies like the United States, the Eurozone and China take on some of the characteristics of closed economies because such a large proportion of transactions in goods and capital markets take place in the home market. The ratio of imports to GDP is much lower, meaning that increments to consumption are more likely to stay in the country. Monetary loosening is therefore a reasonably effective way for large economies to stimulate consumption and investment. Small countries, whether their exchange rates are flexible or fixed, do not really have this option. A small country that attempts to create a gap between domestic and international interest rates will simply be subject to destabilizing capital flows that will eventually force the monetary authorities back into line. If their foreign exchange reserves are small, their margin of error can be very small.

"Dollarization" is another reason that monetary loosening would not stimulate the economy in Vietnam. Lowering VND interest rates could persuade depositors holding VND savings accounts to switch to dollars or gold, which would have the effect of reducing demand for money. The imbalance between the supply and demand for VND generates inflation, and the increased demand for dollars puts downward pressure on the VND exchange rate. We know that about 25 per cent of bank loans in Vietnam are denominated in U.S. dollars rather than VND. A large and sudden depreciation of the VND relative to the dollar would make it difficult for many of these borrowers to pay back their loans. This could

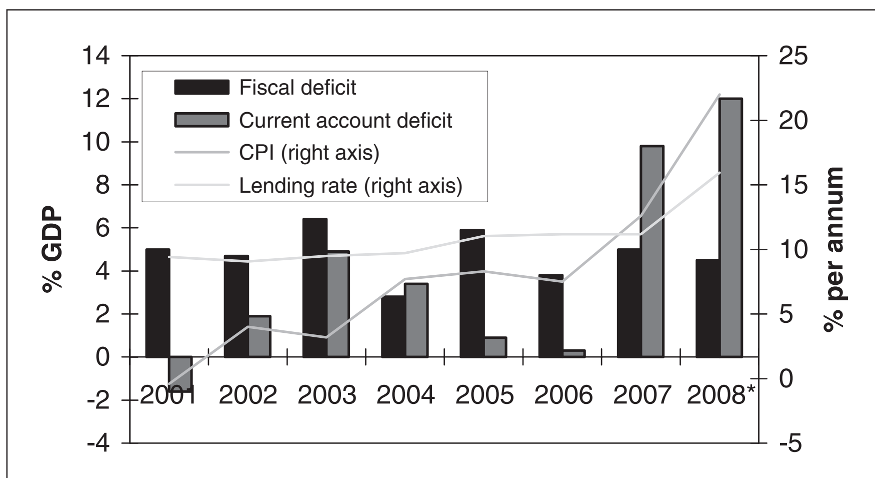
create problems for the banking system, which is already struggling with high rates of non-performing loans.

Under fixed exchange rates, fiscal policy normally has a greater impact on aggregate demand than monetary policy. When exchange rate are flexible, more government spending can increase demand but it is also likely to make the domestic currency appreciate, which acts to reduce domestic demand by reducing exports and drawing in imports. Under a fixed exchange rate, the fiscal stimulus attracts an inflow of foreign capital. To maintain the exchange rate, the central bank buys the foreign exchange and increases the money supply. So under fixed exchange rates a fiscal stimulus can increase output, but often at the cost of higher rates of inflation.

The problem that Vietnam faces is that the fiscal deficit is already large, and has been for some time. According to the IMF, the fiscal deficit including off-budget spending was 5 per cent of GDP in 2007 and 4.5 per cent last year. These are most likely underestimates. The government's large budget deficit has widened the trade gap and contributed to price inflation. Even if the government does not spend more money in 2009, the fiscal deficit is likely to widen as oil revenues and income from trade taxes fall. Further fiscal loosening could destabilize the macroeconomic situation, primarily because Vietnam would find it difficult under current conditions to finance a big trade deficit.

While expanding the fiscal deficit is too risky, the government can increase the growth-enhancing effects of existing spending. The main reason that the budget deficit is so large now is that spending is very inefficient. Too much money is spent on capital and import-intensive projects that do not contribute enough to economic growth, or on speculative ventures by large SOEs.[10] Spending on public infrastructure is not adequately prioritized. For example, Vietnam does not need all of the twenty deep-water ports that have already been approved by the central government. Indeed, two ports would be adequate to handle Vietnam's current and foreseeable trade

FIGURE 3
Vietnam's Macroeconomic Indicators



NOTE: *Figures for 2008 are estimates.
SOURCE: IMF; average lending rate for 2008 author's estimate.

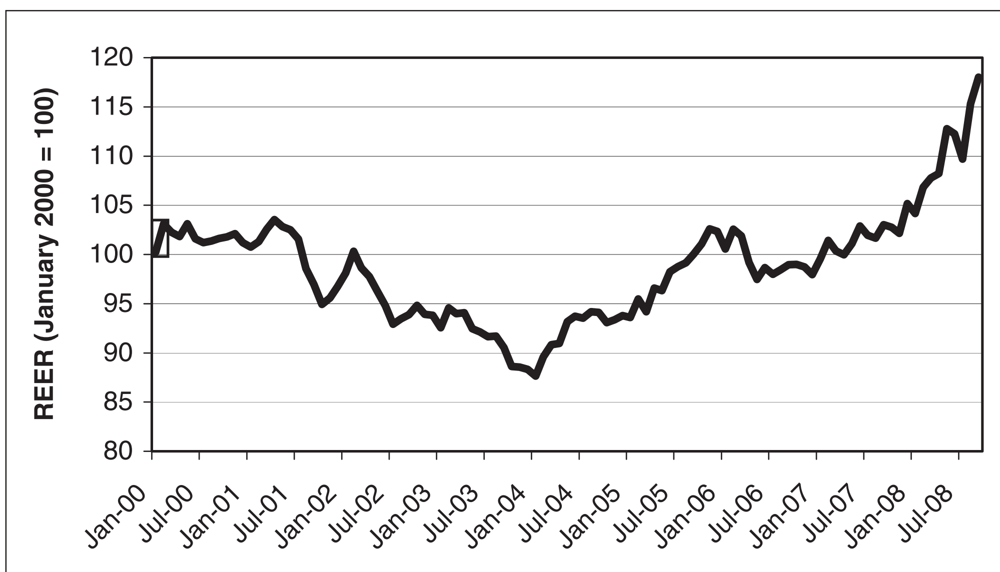
volumes. Similarly, in 2008 the government also signed a US$6 billion joint venture agreement to build a 200,000-barrel-per-day oil refinery with Japanese and Kuwaiti partners, even before the country's first refinery comes on stream. At the same time the government is holding talks with Venezuela's national oil company to build a third refinery.

Capital and import-intensive projects such as these represent a drain on government finances and scarce foreign exchange. An appropriate fiscal stimulus would begin with rescheduling these and other slow gestating projects in favour of labour-using projects like road building and irrigation maintenance. Total spending does not need to rise. The objective should be to use existing spending to create as many jobs as possible without adding unduly to the trade deficit.

Vietnam recorded large trade deficits in 2007 and 2008 as a result of extremely large capital inflows, the large fiscal deficit and economic overheating. Another reason for the trade gap is that the VND is too strong relative to the currencies of Vietnam's trading partners. Figure 4 shows the real effective exchange rate (REER) from January 2000 to September 2008. The REER tracks movements of the VND against the currencies of Vietnam's trading partners after adjusting for inflation.[11] As shown in the figure, the VND fell in real terms from 2000 to 2003, but began to appreciate after January 2004 as domestic inflation began to accelerate. By September 2008 the VND was 33 per cent above its real value in January 2004 and 20 per cent above that of January 2000. The trend has probably accelerated in the October–December period as the U.S. dollar has strengthened against the currencies of a number of Asian countries and against the euro.

As a country that relies heavily on export markets and is increasingly open to imports, Vietnam cannot afford to allow the real value of

FIGURE 4
Real Effective Exchange Rate, January 2000 to September 2008



SOURCE: GSO trade statistics, IMF International Financial Statistics, author's calculations.

VND to rise too high. This is particularly true in years of slow global economic growth like 2009. Moreover, Vietnam already has a large trade deficit. Simply increasing government spending while leaving the exchange rate unchanged will widen the trade deficit without doing much to increase domestic demand. Domestic producers are also at risk from competition from cheap imports.

The decision to devalue the currency by 3 per cent on 25 December 2008 was an appropriate move, and the initial market reaction has been positive. Non-deliverable forwards for the VND fell in the wake of the decision. But the fact that market rate immediately rose to the top of the trading band signals that further action is expected.

A managed depreciation of the VND is necessary but is not without risks. First, Vietnamese companies have borrowed in dollars from domestic and international banks. If they earn in VND and pay back their debts in dollars, a weaker VND would squeeze their profit margins and in some cases could increase the likelihood of default. Banks could accumulate more non-performing loans. For this reason, the adjustment must be gradual and must be signalled clearly by the SBV to give borrowers time to adapt.

The second risk is inflation. Depreciation of the domestic currency makes imports more expensive. When close substitutes are available in the home market, consumers and business switch from imports to domestically produced goods. But many things that households and companies buy in Vietnam are not produced domestically or at least at a price and quality comparable to imported goods. The result is that there is a good deal of "pass through" inflation when the VND depreciates. This is one reason why increasing the fiscal deficit now is very risky. If inflationary pressures are already strong, a depreciation of the currency could lead to a rapid upturn in prices.

Third, exchange rates sometimes overshoot when domestic residents and foreigners lose confidence in the capacity of the monetary authorities to manage the money supply. Households and businesses rush into safe currencies like dollars, or into assets like gold, when the domestic currency begins to lose value. In their desperation to preserve their wealth, they are willing to pay very high rates to acquire foreign currency, and no interest rate is high enough to entice them back into the domestic currency. For this reason, the government cannot cut interest rates and allow the currency to depreciate at the same time. Savers in VND must be able to make up through higher interest rates what they lose though currency devaluation. In other words, the annual rate of VND depreciation should reflect the difference between U.S. dollar and VND interest rates on savings.

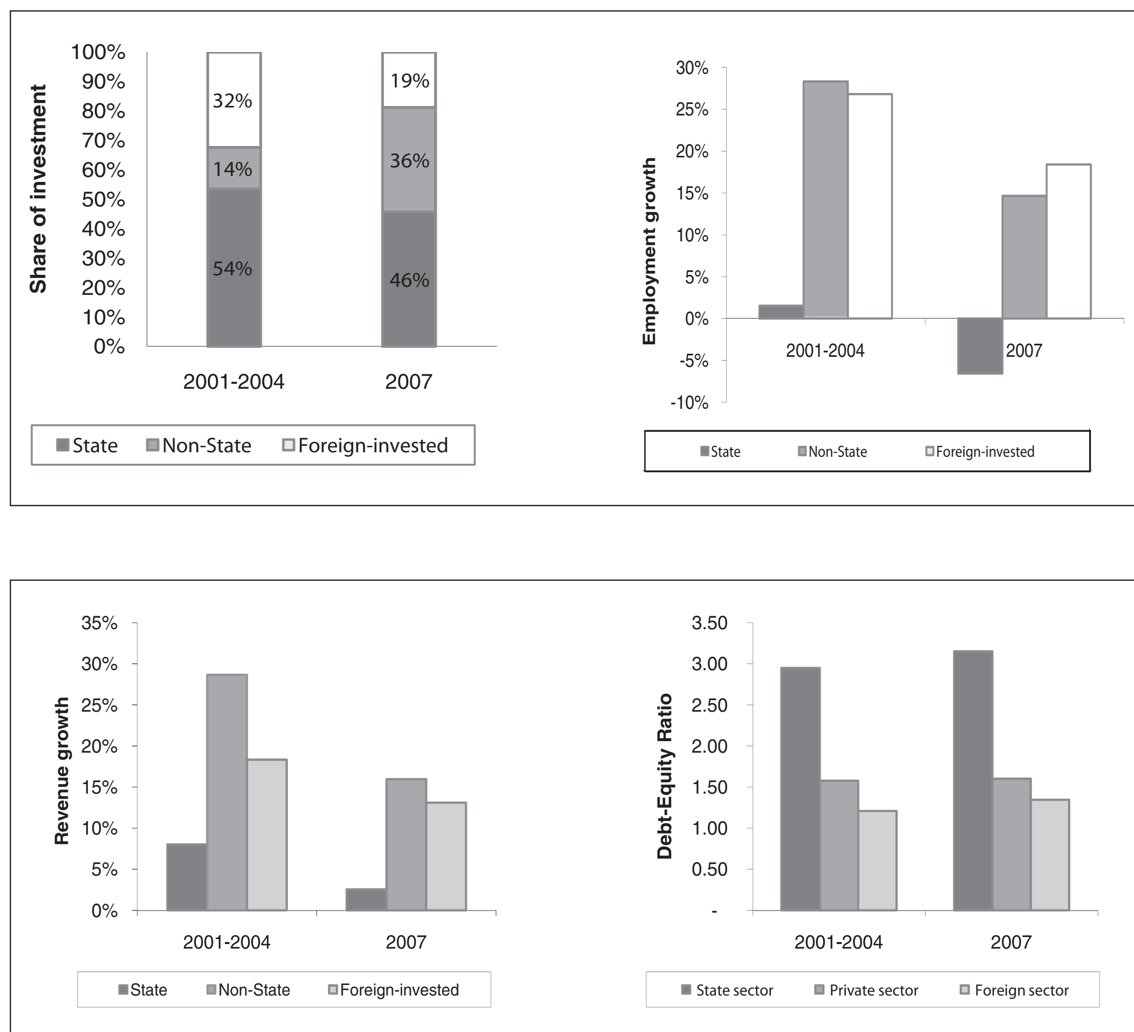
III. Reform of the Large State Enterprises

The previous section emphasized the importance of using capital more efficiently to promote job creation and reduce trade balance. In view of the difficult external environment, the government must prioritize employment growth and macroeconomic stability, including containment of trade and fiscal deficits. As noted above, a public investment programme guided by these objectives would shift resources away from capital and import-intensive projects and towards labour-intensive projects that use mostly domestic goods and services.

One of the most serious obstacles to achieving these aims is the high rate of investment and poor job creation record of state-owned corporations. Although the state sector lags non-state and foreign firms in job creation and productivity growth, it continues to absorb nearly half of investment. According to the most recent enterprise survey data, the sector actually reduced its workforce by 7 per cent in 2007 (Figure 5). SOEs are heavily indebted, as demonstrated by debt-equity ratios that are much higher than those recorded in the foreign-invested and domestic non-state sectors.

A particularly worrying trend is the movement of large state-owned conglomerates into financial activities. Large SOEs like Petro-Vietnam (oil and gas), EVN (electricity), Vinashin (shipbuilding), FPT (computers and computer software), Vinatex

FIGURE 5
Performance Comparison: State, Private, Foreign Enterprises



SOURCE: General Statistics Office, Enterprise Surveys, relevant years.

(garments and textiles), and Vinacomin (mining) have opened banks, finance companies, securities firms, leasing companies and insurers. According to press reports, twenty-eight of seventy "general corporations" have created subsidiaries in banking, securities and insurance, accounting for 20 per cent of total investment.[12] Petro-Vietnam, the state oil company, has six financial firms.[13] These ventures enable state business groups to leverage state assets and their privileged position in domestic markets. Allowing this trend to continue poses several immediate risks for the government. First, SBV will not be able to regain control over the money supply if industrial firms

are allowed to set up new vehicles to create credit for themselves. Second, intra-group lending is a notoriously risky practice that diverts credit away from sound businesses and towards less deserving projects. Bank insolvency at least partly related to intra-group lending has triggered financial crises in a number of developing countries in Asia and Latin America. Third, these financing vehicles create instruments that managers use to shift value from public companies to private entities, including joint stock companies that are child firms of SOEs.

Equitization, or the transformation of SOEs into joint stock or limited liability companies, is intended, or at least justified, as a means to induce SOEs to operate along commercial lines. The government may maintain a majority or minority stake, or even maintain 100 per cent ownership of the equitized firms (hence "equitization" rather than "privatization"). Typically the government retains complete ownership of parent corporations and equitizes their subsidiaries, allocating preferential shares to the employees of the equitized firms. New child companies created by state conglomerates are often equitized from the outset, although the parent company retains a majority or significant share.

There is little doubt that this system has created profit-seeking companies. However, in the absence of rigorous regulations to promote competition or public disclosure, equitization has created incentives for managers of SOEs to generate profits based on their monopoly or oligopoly position in domestic markets and their favoured access to state capital and land. Large state enterprises have leveraged access to state assets to enter into lucrative property and financial markets, contributing to the stock market and land booms of 2007 and 2008, and at the same time building interlocked corporate and financial empires that exercise significant political power at the local and national levels.

The case of Vietnam Airlines (VNA) illustrates the strategies that large state companies use to accumulate capital, market share, and political power. VNA dominates the domestic market for air travel and also controls almost every aspect of the industry. VNA subsidiaries include aviation fuel, airport services, airline catering, aircraft maintenance, and aviation import-export. Although VNA's refusal to sell fuel to Pacific Airways last year was rightly criticized and subsequently overturned, the incident exemplifies the inherent risk in concentrating so much market power in the hands of a single player.[14] The difficulties encountered by JetStar Pacific (formerly Pacific Airlines) in its effort to expand its position in the domestic and international markets suggests the complicity of regulatory authorities in maintaining an unequal playing field in the aviation industry. At the very least, comments by regulators reveal a bias against "foreign" firms that is not in the interests of the Vietnamese economy.

VNA is not a well-managed firm. The State Inspectorate has documented many examples of inefficiency and mismanagement in an audit the results of which were released in 2007.[15] Some findings raise serious questions about the company's competence in its core business, such as the well-documented case in which VNA purchased medium-range engines for long-range aircraft. Failed real estate investments have also been identified, for example, VNA's failure over a fourteen-year period to complete a hotel project in Ho Chi Minh City's District 1.[16]

Like the other state conglomerates, VNA has invested in numerous subsidiaries. In a particularly egregious example of rent-seeking behaviour, VNA announced that it will create an insurance company to insure its own aircraft. Aside from the basic problem that neither VNA nor any of its five partners (including the state mining company Vinacomin and the state machinery manufacturer Lilama) possesses any expertise or experience in the insurance business, the idea that an airline would attempt to insure itself is certainly a violation of the most basic principles of risk management.[17] VNA will no doubt purchase reinsurance, taking a healthy cut of the profits as a middleman. This is further evidence that the conglomerates have pursued diversification into finance as a means of leveraging their monopoly positions in Vietnam.

Again, little information on this venture has been made available to the public. VNA's other prominent venture into the financial markets is its stake in Techcombank, the CEO of which is a former VNA deputy general director.

Aside from insurance and resorts, VNA has diversified into a wide range of businesses through its numerous child companies, which have in turn created grandchild companies. Take for example Southern Airport Services Company (SASCO), the core business of which is to provide ground services at Tan Son Nhat airport in Ho Chi Minh City. SASCO is also active in resorts and hotels, cargo, taxi services, auto repair, import-export, agriculture, seafood and fish sauce production, precious stones, gasoline retailing, banking (as a shareholder in East Asia Bank) and trade promotion (in the form of Viethaus, a joint venture trade promotion and convention centre in Berlin), among other businesses. Like many other Vietnamese conglomerates, the predominant strategy is to diversify into numerous business lines on the basis of favoured access to state contracts, subsidized loans from state-owned commercial banks and government land. The end result is high rates of investment in numerous state-owned or state-related companies of unknown profitability.

Vinashin, the state-owned shipbuilding conglomerate, has launched 200 subsidiaries in a range of sectors including insurance, real estate, banking, securities, wholesale and retail trade and even beer manufacturing. The company reportedly carries debts in excess of US$2 billion, including the proceeds of US$750 million in sovereign bonds issued in 2006. In a rare moment of candour, General Director Pham Thanh Binh argued in early 2008 that since heavy industries are slow to turn a profit, Vinashin must make quick money in its subsidiary businesses to accumulate capital for investment in ships and steel.[18]

Petro-Vietnam, the state oil company, has created subsidiaries in banking, finance, insurance, securities, and real estate in addition to related investments in fertilizer production, power generation, oil services, and shipping. The company will soon start up the long-delayed Dung Quat refinery, first approved for construction in 1997. Yet even before this US$2.5 billion comes on stream, the government has approved three more refineries. No feasibility studies have been published to justify these ventures at a time when refinery margins are under pressure due to global overcapacity.

These and other examples illustrate the point that Vietnam's large SOEs are profit-seeking, but that their corporate strategies are heavily driven by the imperative to maintain investment and to diversify into a wide range of sectors and activities. Easy access to state capital provides the means for these companies to maintain high levels of investment. Control over government-owned land opens up investment opportunities that are closed off to most private firms because land is either too expensive or administratively difficult to obtain. Land also makes state corporations attractive joint venture partners for foreign companies. Control over domestic markets and natural resources like oil, minerals and agricultural land, or monopoly or oligopoly control over domestic markets, generates revenue flows to service debt.

The absence of rigorous reporting requirements facilitates the process. VNA, Petro-Vietnam and Vinashin, like most state corporations, do not regularly publish annual reports, balance sheets, or cash flow statements. Each year the State Audit reviews the performance of selected state companies, but these reports are not made available to the public. The government routinely admonishes the press to avoid negative reporting on the state conglomerates.

The dependence of large state companies on indebtedness, investment and diversification has resulted in a capital intensive growth pattern that has been relatively unsuccessful at creating jobs. Table 2 compares Vietnam's performance with that of other countries in the region. The periods selected represent the two decades in which each of these countries achieved its most rapid GDP growth rates. In other words, the table compares successful growth episodes rather than average performance. The table shows that although

TABLE 2
Comparisons of Growth Episodes, East and Southeast Asia

	% GDP growth	*ICOR*	*% Job growth*
Vietnam 1991–2007	7.6	3.5	2.4
Korea 1969–1988	8.4	2.8	3.2
Malaysia 1977–1996	7.4	4.9	3.5
Thailand 1976–1995	8.1	3.6	3.0
Taiwan 1963–1982	9.8	2.9	3.4
Indonesia 1977–1996	7.2	2.8	2.9
Philippines 1961–1980	5.4	2.3	3.3

NOTES: ICOR is the incremental capital output ratio.
All figures are average annual rates.
SOURCES: Calculated from World Bank World Development Indicators for all indicators except job growth (ADB) and IMF's International Financial Statistics (ICOR). CPI data for Vietnam published by GSO.

Vietnam has achieved high rates of growth, its growth has been more capital using than the comparator countries. More importantly, job growth during Vietnam's period of most rapid growth was inferior to all of the other countries, including the Philippines and Indonesia.

Vietnam cannot sustain growth in the face of a serious global recession if the country's largest enterprises continue to use capital inefficiently and fail to create jobs for the country's growing workforce. If, as expected, export earnings, foreign direct investment, and portfolio capital flows decline, Vietnam will face difficulties financing a large and increasing current account deficit. Heavy investment spending by state-owned corporations would increase imports without necessarily generating compensating exports. Moreover, high rates of investment financed by government borrowing run the risk of driving up the fiscal deficit, and therefore price inflation.

The economy's capacity to sustain incomes during the recession will depend largely on the balance between job creation and destruction. With the expected decline in export-oriented employment, incomes will suffer unless domestic investment is directed towards labour-using activities. Unfortunately, state-owned corporations have a poor track record when it comes to job creation, and it is unrealistic to expect these firms to change their strategies over the short period.

IV. Conclusion

Vietnam has enjoyed two decades of rapid economic growth, averaging 7.4 per cent per annum from 1989 to 2008. This is a remarkable achievement by any standard, and one that has transformed the lives of millions of Vietnamese people. Growth will slow in 2009 as the external environment deteriorates. Export growth will be difficult to sustain, and inward investment is likely to decline significantly.

As a small, relatively open economy with a fixed exchange rate and dollarized liabilities in the banking sector, Vietnam's policy options are limited. A unilateral monetary stimulus would increase the current account deficit, which is already running at unsustainable levels. Lowering VND interest rates too quickly could result in a run on the domestic currency, as savers abandon the dong in expectation that the difference

between dollar and dong interest rates does not cover the risk of dong depreciation. Adding to the fiscal deficit could once again ignite price inflation.

The most pragmatic response would be to gradually move the dong lower against the currencies of the Vietnam's main trading partners to reclaim some of the export competitiveness lost during the recent real appreciation of the VND. A weaker dong would also prove some protection from the flood of imports from China and other countries in the region attempting to cope with demand contraction in the United States and the euro zone. SBV needs to monitor interest rates spreads between dong and dollar deposits to ensure that savers still have an incentive to hold dong balances despite the gradual depreciation of the domestic currency.

On the fiscal side, the government can maximize the impact of existing spending levels by cancelling or postponing import and capital-intensive projects in favour of labour-intensive projects that rely on domestically produced inputs. The objective is to stimulate domestic demand and sustain incomes without increasing the trade deficit or resorting to inflationary deficits.

Reprogramming public investment in this way should include the large SOEs, which account for nearly half of all business investment in Vietnam but which use capital inefficiently and do not create many jobs. The government has announced its intention to provide interest rate subsidies to SMEs in an attempt to boost job growth.[19] But the proclivity of the state sector to produce child and grandchild firms, many of which are indeed small, and some of which are equitized, will complicate efforts to direct these subsidies to genuine SMEs. A more effective strategy would be to introduce greater transparency and accountability into the state sector, requiring SOEs to publish annual reports, quarterly cash flow statements and balance sheets, and full disclosure of investment plans, use of state assets and ownership of subsidiaries. Publication of state audit reports would also give managers of state corporations greater incentives to use public money more wisely.

NOTES

1. "Thu nhập bình quân trên 1.000 USD/người nhưng vẫn nghèo", *Tuổi Trẻ*, 1 January 2009. In fact, at the time of the announcement, average incomes had slipped below the US$1,000 mark owing to the depreciation of the Vietnam dong against the U.S. dollar. Vietnam's per capita GDP was about US$2,800 in purchasing power parity terms (that is, adjusting for differences in local prices) in 2008 according to the International Monetary Fund.
2. These figures are reported by the World Bank in the World Development Indicators <www.worldbank.org/data>.
3. James Hookway, "Vietnam's Stimulus Stirs Criticism as State Conglomerates Ask for Handouts", *Asian Wall Street Journal*, 29 December 2008.
4. Olivier Blanchard, "Cracks in the System: Repairing the Damaged Global Economy", *Finance and Development*, December 2008, p. 8.
5. "Seafood Industry Tangled in the Nets of Global Turmoil", *Thanh Nien Daily*, 8 December 2008, p. 6.
6. "Vietnam Says More Jobless in 2009", Deutsche Presse-Agentur, 23 December 2008.
7. In 2007, Vietnamese exports to the United States, EU, and Japan account for 26 per cent, 19 per cent, and 16 per cent of total exports respectively.
8. Although statistical sources have improved markedly in recent years, Vietnam still lacks a systematic labour force survey, complete disclosure of government finances, and a consistent series of national accounts.
9. "Kích cầu 1 tỉ USD: nên chi vào đâu?", *Tuổi Trẻ*, 11 December 2008.
10. See David Dapice et al., "Choosing Success: The Lessons of East and Southeast Asia and Vietnam's Future" (Cambridge, MA: Harvard Vietnam Program), January 2008, <http://ashinstitute.harvard.edu/asia/programs/vietnam/research>.
11. This calculation is based on VND exchange rates against the country's fifteen largest trading partners, which together account for more than 90 per cent of trade by value.
12. "Ổng lớn đầu tư hàng chục nghìn tỷ đồng bất ổn" posted on vneconomy website on 23 April 2008, downloadable at <http://vneconomy.vn/?home=detail&page=category&cat_name=06&id=c9663a1933d32b>.

Hoang Vu, "Siết chặt đầu tư tay trái" posted on the website on 5 June 2008 at <http://www.vneconomy.vn/?home=detail&page=category&cat_name=07&id=519a3dac2731a2>.
13. List of Petro-Vietnam financial firms.
14. See <http://www.laodong.com.vn/Home/Pacific-Airlines-bi-Vinapco-ngung-cap-nhien-lieu/20084/82830.laodong>.
15. See <http://vietnamnet.vn/kinhte/2007/08/735334/>.
16. "Đất công lãng phí nhiều năm, trách nhiệm ở đâu? Bài 3: "Xí" đất rồi bỏ hoang", *Sài Gòn Giải Phóng*, 2 December 2008.
17. See <http://www.vnexpress.net/GL/Kinh-doanh/Kinh-nghiem/2008/04/3BA01A2A/>.
18. "Renovation of State-Run Enterprises Needs a Breakthrough", Vietnamnet, 5 January 2008, <http://english.vietnamnet.vn/biz/2008/05/780952>.
19. "Government Approves One Billion Dollar Stimulus Package", Vietnamnet, January 16, 2009, <http://english.vietnamnet.vn/reports/2009/01/824282/>.

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