The Insight Bureau

From the Desk of...

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August 2007: Vietnam's miracle economy is attracting foreign investment interest. Chris Bruton reviews Vietnam's economy and its prospects.

Vietnam today: Vietnam may be socialist in name, but its economy is now irrevocably capitalist. Yet the Communist Party still basks in the glory of having gained independence by defeating France, the US and even China. Given the somewhat factional and anti-central government nature of Vietnamese society, the government still believes that preservation of Party control is still the best way to maintain law and order, stability and its impressive economic progress. Admittedly there are more vocal challenges from dissidents who reject party ideology and control but these do not yet attract a popular following. Religious groups have also become increasingly assertive, including even the Catholic Church, long characterised and criticised for its docile co-existence with the Communist hierarchy.

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So are there risks to Vietnam's stability? Well, factors certainly exist that could acerbate popular dissent in the future. Over 50% of the population is under the age of 25, who never knew war, nor the hard times that followed it, having grown up during the increasingly comfortable times of "doi moi" reforms of the late 1980's and 1990's. The increasing inward flood of Overseas Vietnamese -- bringing with them welcomed investment capital and skills -- has also meant a spread of dissenting ideologies, learned in their countries of adoption. Already these factors have resulted in more assertive attitudes in National and Local Assemblies and People's Committees. For the time being, at least, all "sing the same tune with many differing voices and tones". As we see in other developing economies, individual economic advancement takes precedence over political challenge, at least for now.

Forces driving economic transformation: In 1986, eleven years after the traumatic 1975 reunification, GDP growth was at best 3%, matched by inflation at 400%. Then the new "doi moi" policy of economic renovation opened up domestic trade, gave greater autonomy to state-owned enterprises, passed a new foreign investment law, and granted land-use rights to local people as well as to foreign investors. Market reforms eased controls on prices, currency exchange, banking, private enterprise and land tenure.

Vietnam has embraced globalisation through its membership of AFTA (1995), APEC (1998), the US Bilateral Trade Agreement (2001) and now (finally) WTO this year (2007). Over the past six years, we have seen GDP growth rates improve progressively, reaching over 8.0% by 2005 and bouncing upwards year-by-year thereafter. Inflation has soared too, between 7.5-8.5%, but nowhere near the astronomical levels of earlier times. Such economic growth is nothing short of spectacular, even by Asian standards. Vietnam's GDP has been exceeded only by China and Cambodia during the past five years. However there is still a long way to go. Put into perspective, Vietnam's GDP is estimated at US$70 billion – that is barely 2.5% of the size of China or only 30% of the size of Thailand. Per capita GDP is presently around US$750 p.a. or only 37% of the level of China's or 22% of Thailand's. The appeal, of course, is growth.

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Can such growth be sustained? However, continued long-term growth requires savings to be ploughed-back into investment. A developing country needs plenty of young workers and a low dependency ratio. It also needs sound macro-economic policies that favour dynamic market development and attracting foreign direct investment. Vietnam's savings rate has already spiraled seven-fold, from only 5% in 1990 to over 35% today. Rather than hide savings away in the form of gold bullion or foreign currency notes, the Vietnamese are now investing in new businesses, often alongside Overseas Vietnamese relatives returning home with their own amassed external savings. Vietnam's demographic profile is also strong; a population of 85 million and a labour force of over 45 million which is growing annually by 2.5%. Its population under 25 years now represents 50% of the total, with 30% being under 15. Just as China's new entrant workforce availability is set to decline, so Vietnam's increases! Ten years ago, Vietnam's manufacturing wage cost represented 95% of that of China's. Today, that figure is about 60%, as growth has forced Chinese wages up. Certainly there remains an abundant labour pool in the rural Vietnamese agricultural sector. This used to make up 90% of all employment in 1990 and still represented 57% of total workforce in 2005. But it is also the quality and skills of the Vietnamese workforce that is attracting foreign investors. Granted, there are still severe skill shortages, but significantly, 83% of higher education graduates have achieved science-based qualifications, with a stock of over 80,000 IT graduates, growing at 10% per year.

Vietnam is increasingly reputed for market-friendly policies -- at a time when some other regional countries are retreating into protectionism. While the country will remain classified as a "non-market economy" for twelve years, quota-free access to world markets is now guaranteed by its WTO status. International investors will increasingly gain access to domestic markets, including banking and service operations. The new investment and enterprise laws also represent a massive leap forward; foreigners and locals are promised to be treated equally, with simpler investment procedures, no more stipulations about export of production and a level playing field in terms of resource-pricing. But the key question remains; will Vietnam live up to its commitments, fall behind or renege altogether?

Constraints to development: A big issue remains the future of Vietnam's state enterprises. Down from a previous 12,000, 2,200 mainly larger state-owned enterprises survive, representing 31% of Vietnam's GDP. Of these, a quarter will be retained with no intention of being turned over to private ownership. State sector priorities for financing and other privileges remain a cloud on the horizon. In particular, state bank reform is a problem, as they control of 70% of all lending (and all state enterprise lending). Gradual transformation of state bank equity down to 49% non-state by 2010 was announced, but it is frankly questionable as to how this will be achieved. The chaotic growth of the Vietnam Stock Market is another issue that could threaten the stability of the whole financial system, although belated measures curbing bank lending for stock market speculation have recently been introduced.

Infrastructure development may be a road-block to progress. The government has committed 9-10% of annual GDP to infrastructure, but is even this enough to meet requirements? Among the various sectors, telecommunications enjoy the best advantages. There is keen competition and market penetration is expected to reach high levels, even saturation point, by 2010. Electricity demand growth per year is exceeding 15%, requiring investment of US$3-4 billion per year. With 56% of supply dependent on hydropower, the main emphasis will be on thermal sources. The main reliance will henceforth be on private, independent power producers. Transport is also critical, with only one third of Vietnam's 130,000 km roads being paved. The key north-south highway is now under construction but a massive secondary road system will be necessary to reach all parts of the country. The rail system also requires extensive expansion and rehabilitation. Inevitably there will be external financing constraints on development, even though trade and current account deficits are modest, and external debt is manageable, owed mainly to sympathetic multilateral lending institutions.

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The land of opportunity? Vietnam has seen a remarkable turnaround from 20 years ago, even 10 years ago. Foreign investors will, no doubt, continue to be attracted as Vietnam catches up fast. Foreign-invested enterprise is responsible for over half of Vietnam's exports and will continue to play a decisive role. Generally, it seems that investors are happy with their experience in Vietnam, despite its low ratings on the "transparency" or "ease of doing business" league tables. Whether they turn out to be lucky stakeholders in the next gold rush or lemmings falling over a cliff, it remains to be seen; ample rewards may await those investors who have judged the right timing for market entry and have the appetite for the downside risks that could be involved.

About Christopher Bruton
Mr. Bruton is the founder of Dataconsult and has been based in Thailand for over 35 years. He is highly respected for his understanding of Thailand, Vietnam and the Indochina sub-region, providing advice to MNC and Asian businesses on their business strategies. He is a seasoned, insightful presenter who has briefed CEOs and board members of many MNC organisations. Dataconsult runs a Bangkok-based executive programme, *The Thailand Regional Forum* as well as business conferences in Vietnam, Cambodia and Thailand.

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