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*The 30 Years of Viet Nam's Catching-up Development*

Assessment of The 30 Years of Viet Nam's  
Catching-up Development and Policy  
Recommendations for Sustained Growth to High  
Income Country

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# Introduction

- The 30 Years of *doi moi* and catching-up development resulted in a considerable growth of Vietnam. Vietnam turned from a poor country to a lower middle income nation in 2008 and is now approaching the upper middle income level.
- In 2022 Vietnam's GNI per capita was 3,939 \$US. Vietnam may reach the upper middle-income level (more than 4,300 USD) in the mid-2020s.
- The problem is whether Vietnam will step up from the upper middle income stage to the high income status by 2045. What are the conditions for Vietnam to escape from the middle income trap and achieve the sustained growth in the next two decades?
- This lecture will address that issue by assessing the current pattern of industrialization and offering policy recommendations.

# Contents

- Analytical framework
- Current structure and problems of the Vietnamese economy
- Recommendations of strategies and policies for Vietnam to escape from the middle income trap and achieve the sustained growth to the high income level.

# Analytical framework

Three theoretical issues which are relevant to Vietnam:

## 1. **The input-driven growth vs TFP-led growth:**

So far this is the most important theoretical issue which has been widely discussed. Sometimes, the terms investment-driven growth vs innovation-driven growth were used alternatively. It has been argued that *a country falls into a middle income trap if it is not able to shift from input-driven growth to a TFP-led growth pattern*. This standing point has also been supported by most economists in Vietnam since the 2010s.

But I have a different view.

- The sources of TFP are not necessarily related only to innovation. Institutional reforms also have a role. Reforms on factor markets will contribute to efficient use of capital and other factors, and thus result in the rise of productivity.

- Capital and technology are difficult to be separated since in most cases, technology is embodied in capital. The Japanese experience in the 1955-73 high growth period showed that capital accumulation and innovation had been mutually stimulated.

The core point is the ***continued rise in the productivity***. In the process of middle income country growth to high income status, ***both accumulation and innovation are important***.

# Analytical framework (cont.)

## 2. **Structural transformation and the middle income trap:**

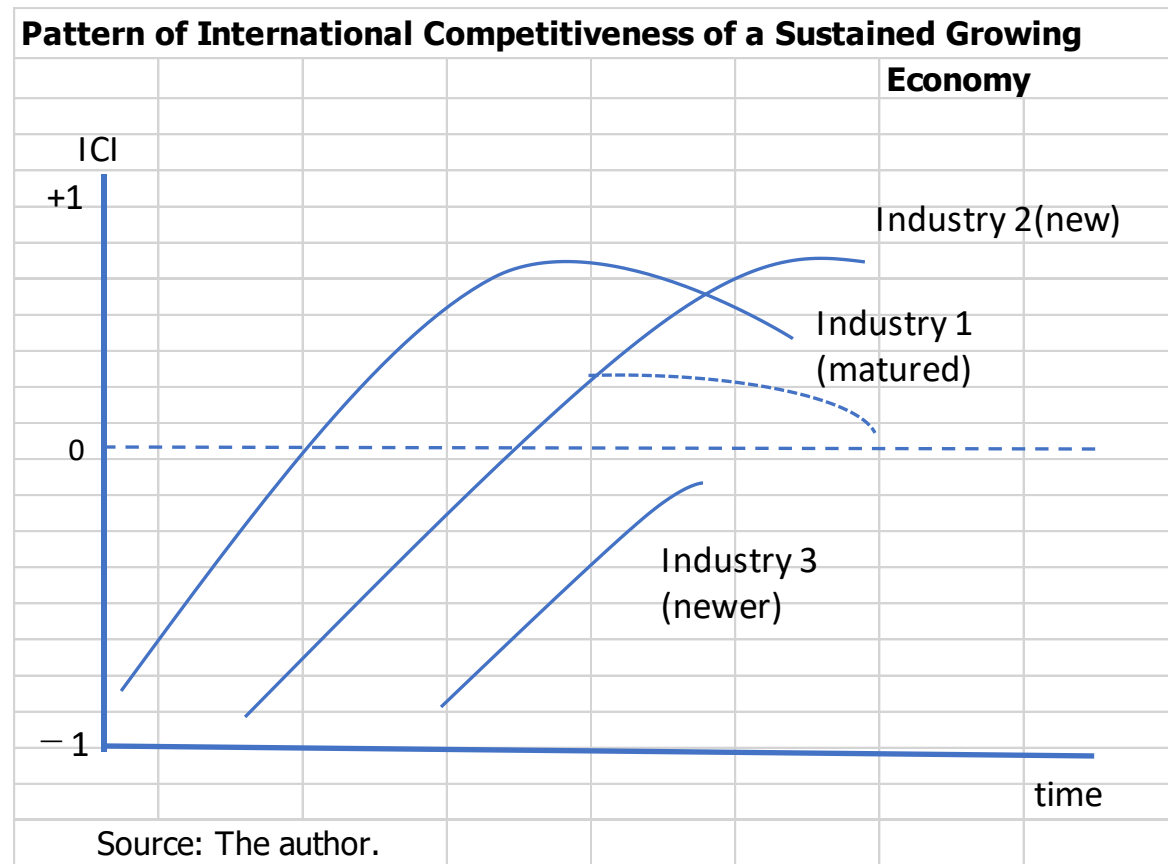
The second view is on the turning point in the industrialization. In the early phase, characterized as labor surplus, along with the move of low wage labor from agriculture to the manufacturing sector, the countries export labor-intensive products and can reach a middle income level.

At the turning point, no more cheap labor is available, the countries have to upgrade the industrial structure to higher value added products. Without such structural transformation from labor-intensive industries to capital, technology and skill intensive products, the countries may fall into a trap.

In the context of international specialization, such countries are in a position of a sandwich.

- This argument offers good and clear implications. For escaping from the middle income trap, the countries at the turning point should have industrial policies to promote and nourish firms to invest in higher value added sector, and make effort in educational training for skilled human resources.
- In the context of increasing presence of global value chains, the structural transformation is to upgrade to higher value added parts of the value chain and/or to higher chains.

ICI: International Competitiveness Index=  $(X-M)/(X+M)$ .  
Transformation from Industry 1 to 2 and then to 3 is essential for avoiding the sandwich position (escaping MIT)





# Analytical framework (cont.)

## 3. Increasing presence of global value/supply chains (GVCs, GSCs):

GVCs and GSCs play an increasingly important role in the economic development and international specialization. The developing countries may grow rapidly if succeeding in the participation in increasingly higher levels of GVCs and GSCs.

Continuing offer of good infrastructure, skilled labor and technological capabilities of local firms is essential for sustained growth. *Rapid changes in world technology and environment require **quick policy reactions**.* Without quick and appropriate policies, middle income countries may fall into trap.

# Analytical framework (Summary): 1

- The sustained growth of **productivity** is the key factor for escaping from the middle income trap.
- In the process of catching-up to high income countries, **structural transformation** (the shift of resources from low to high productive sectors) is the most important driving force to increase productivity and to maintain international competitiveness over time.
- In that process, **capital accumulation and technological progress** are both important.

## Analytical framework (Summary): 2

- Growth of productivity is also promoted by the creative destruction of the structure of firms and business units, which results in **expanding scale of firms** that can adopt technology and undertake efficient capital accumulation.
- Institutional reforms in the **factor markets** to enhance the efficient allocation of capital and labor, emphasis on the supply of **high skilled labor** and strengthening of **innovation capabilities** are essential for enabling the structural transformation process.

## Current structure and problems of the Vietnamese economy: (1) On the industrialization pattern

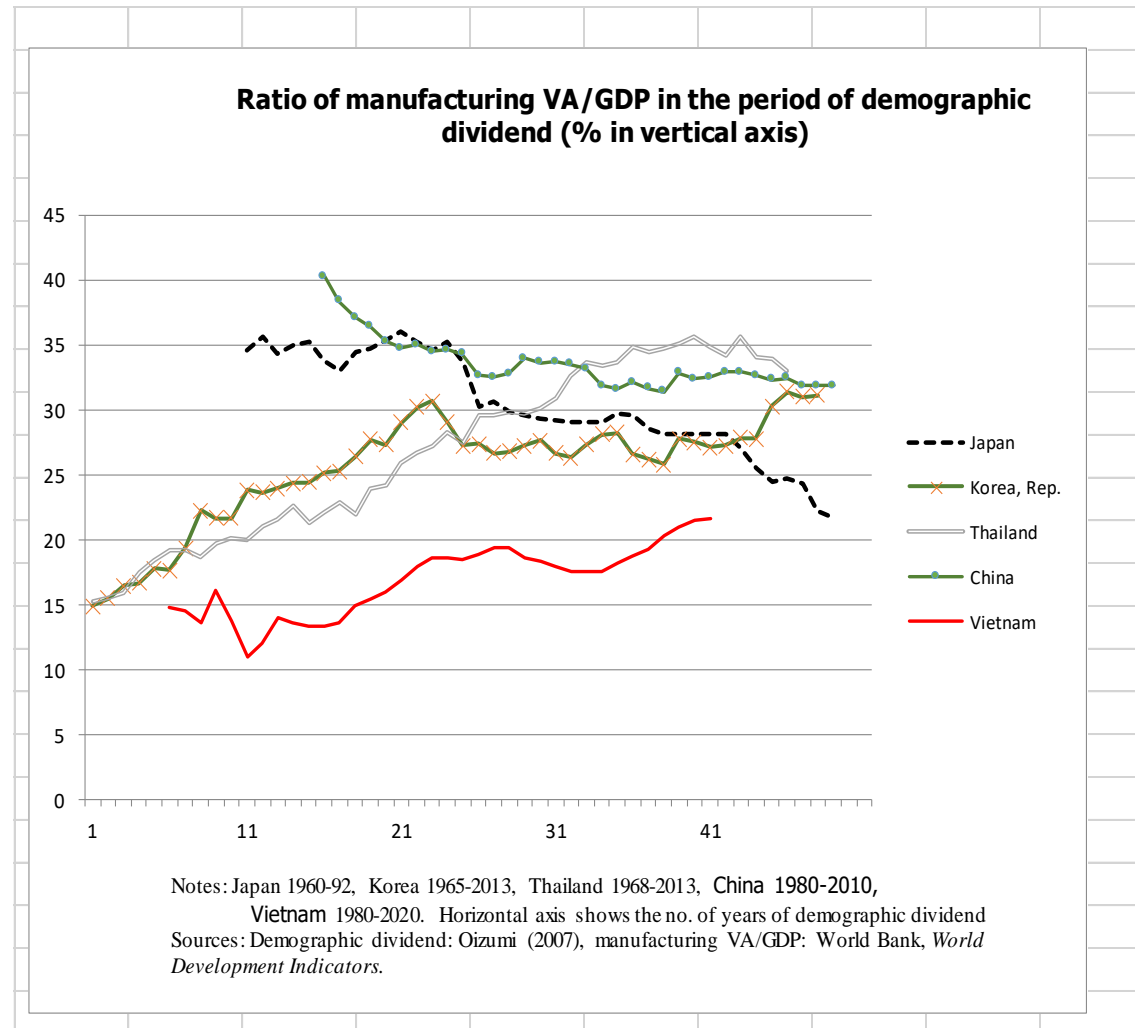
- Vietnam has shown a fairly good performance since the 1990s but the economy has not experienced *a high growth period* (an annual average growth of about 10% in a successive period of more than 10 years).
- The absence of such high growth has been mainly attributed to *the manufacturing sector*, which was not strong enough to trigger *a more dynamic transformation*.
- Contrast to the experience of successful East Asian economies.

# Problems of the manufacturing sector

- **Low level of industrialization** (compared with East Asian economies in the same period of demographic dividend). = >
- Vietnam's manufactured products have been increasingly knitted in the GSCs and GVCs. However the quality of Vietnam's participation in GSCs/GVCs has been low (high import contents/low local contents of export products, weak capability to supply VA to products made in foreign countries).

Increasing participation in GSCs/GVCs **as a simple assembly factory**. High dependence on imports of parts, components and semi-processed products from China and Korea.

# Vietnam's relative low level of industrialization during the period of demographic dividend



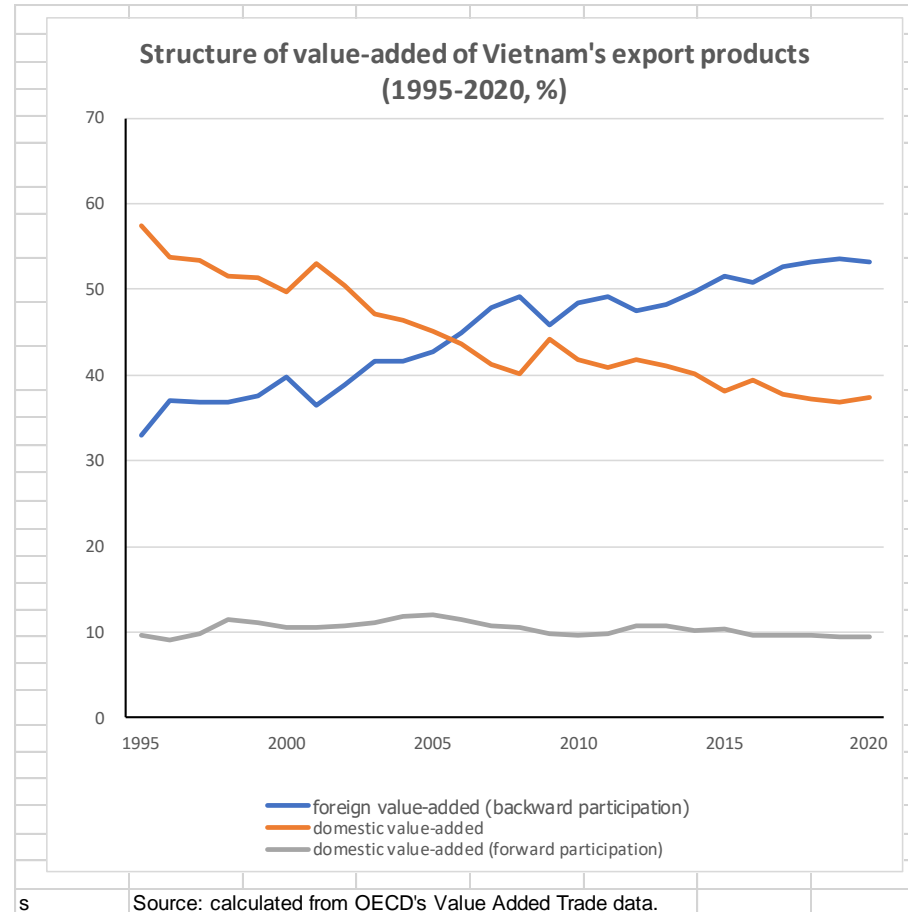
# Manufacturing VA per capita has expanded since the 1990s but currently still low

Per Capita Value-Added Manufactured Products in Selected Asian Countries						
						\$US
	1990	2000	2010	2015	2020	2021
Vietnam	12	73	171	286	465	
			288	544	859	925
Philippines	222	271	483	593	569	610
Indonesia	151	203	682	697	774	834
Thailand	434	569	1,545	1,563	1,782	1,909
China	103	305	1,439	2,321	2,736	3,445

The figures of Vietnam in the lower line are those after the revision of GDP in 2010.

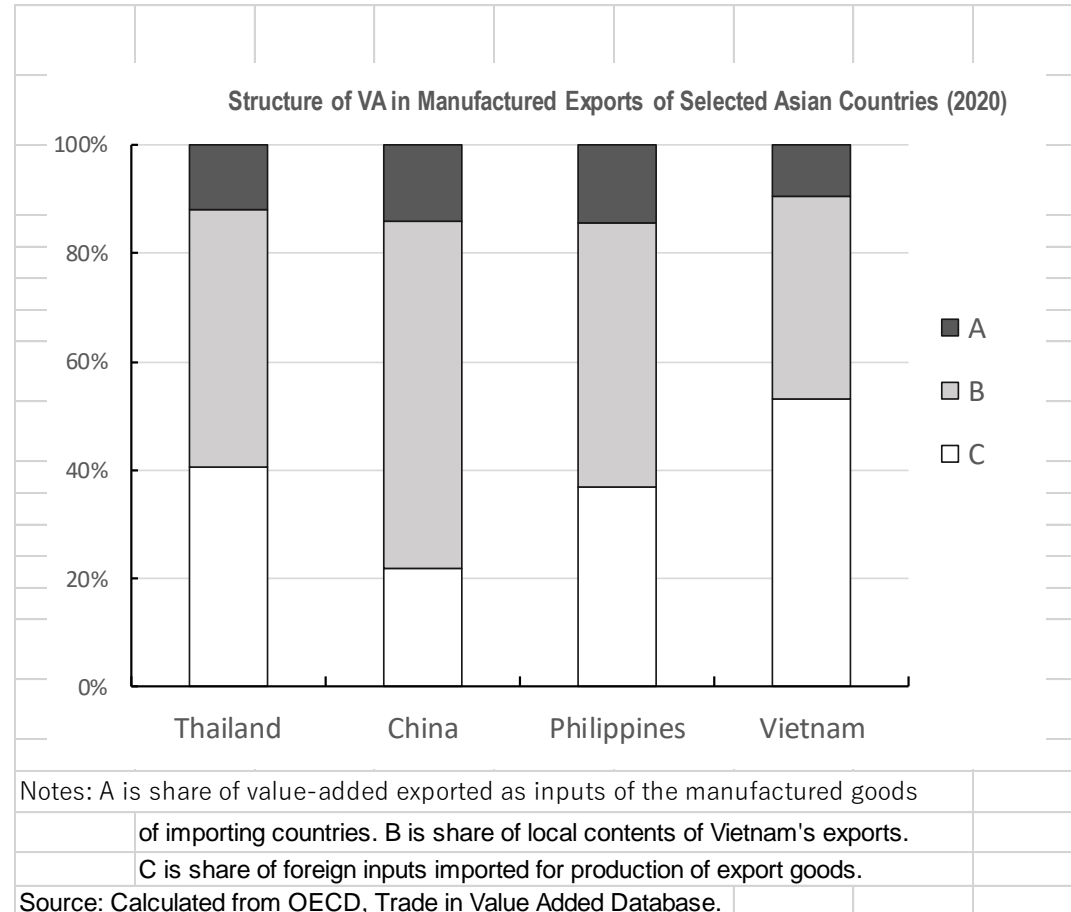
Source: Calculated from UNCTAD Data.

Backward participation in GVCs (% of intermediate imports embodied in Vietnam's total exports) rose steadily. Forward participation (% of domestic VA as inputs of Vietnam's importing countries) remains low.





Vietnam's exports depend largely on imports of inputs ( C ) and provide small VA to products of importing countries (A)



# Apparel, Vietnam's major export product, depends largely on imports of textiles.



# Vietnam's pattern of industrialization resulted in an instable Pacific Trade Triangle

Vietnam's Trade Balance by Types of Manufactures and by Major Partners				
			(US\$ Billion, 2022)	
	China	Korea	USA	World
Basic materials	2.1	0.7	▲ 3.2	▲ 23.6
Processed goods	Δ 36.8	▲ 10.2	6.8	▲ 56.1
Parts/Components	▲ 9.9	▲ 31.5	11.1	▲ 36.4
Capital goods	▲ 13.9	1.6	35.9	55.7
Consumer goods	0.0	1.8	46.1	77.1
Total	▲ 59.9	▲ 37.8	95.1	12.1
Source: Calculated from Data of <i>Global Trade Atlas</i> .				

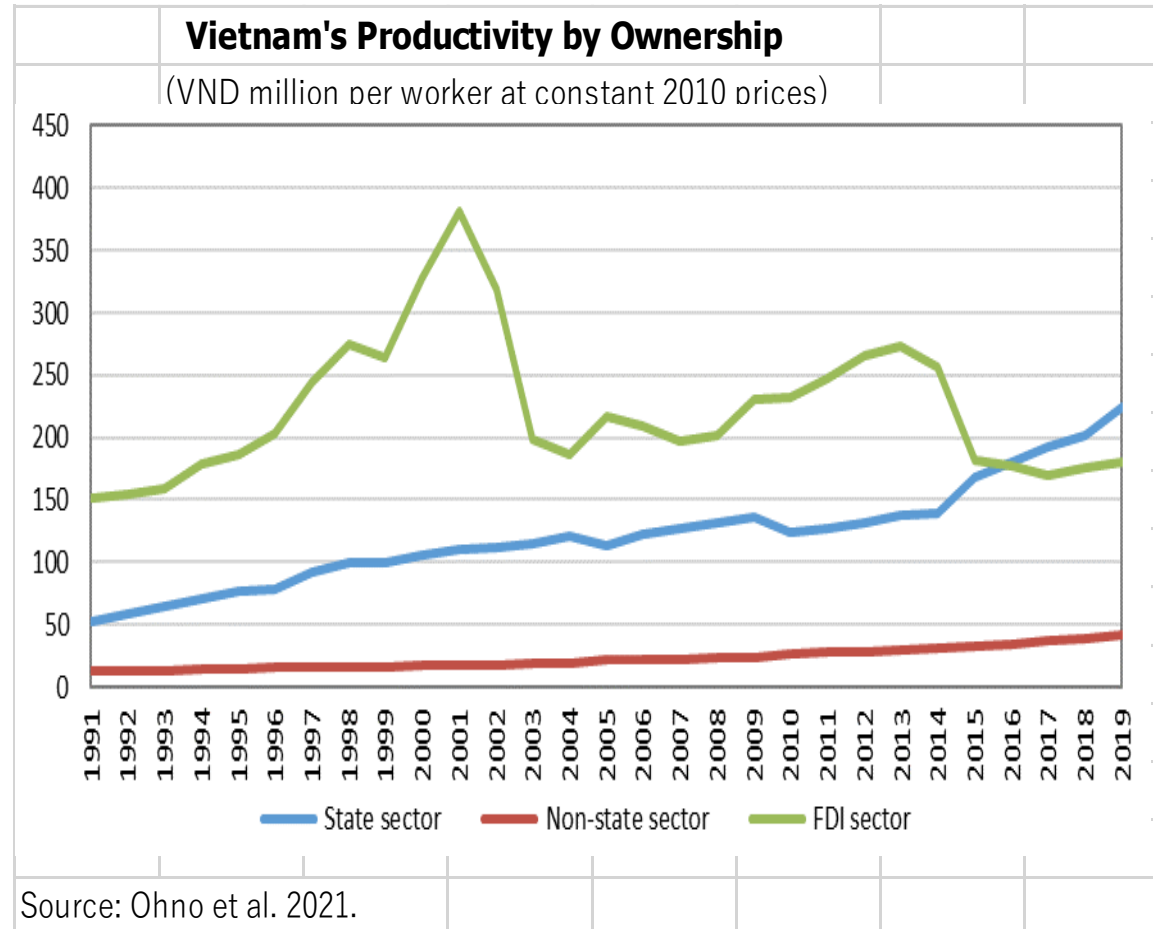
## Current structure and problems of the Vietnamese economy:(2) On the structure of firms

- The existence of **a large informal sector and a considerable number of micro and small firms.**
- Due to very small scale of operations, they are poor-endowed with capital, and consequently are not able to be equipped with modern machines which embody technology.
- According to our estimate, the non-agriculture informal sector accounts for nearly 30% of the workforce. Another sector which is also low productive is agriculture, accounting for 35% of the workforce. =>
- **The productivity of the non-state sector,** composed mainly of agriculture and informal sector, is therefore **extremely low.**

# The two low productive sectors (informal sector and agriculture) account for 63% of the workforce

Share in GDP (%)		Share in labor		1,000	Share (%)
		Total (T)	54,659		100
Agriculture (A)	14.1	Agriculture (A)	18,831		34.5
Industry/construction	34.5	Industry/construction	16,452		30.1
Services	41.6	Services	19,349		35.4
State sector	27.1	State sector (S)	4,226		7.7
Non-state sector	42.7	Non-State sector	45,664		83.5
(Collectives) (C)	3.6	FDI	4,768		8.7
(Private)	9.7				
(Household) (H)	29.4	Formal businesses (F)	15,152		27.7
FDI Firms	20.4	(State firms) (SF)	1,108		2
		(Non-state firms)	9,075		16.6
		(FDI firms)	4,969		9.1
Informal sector (I)	19	Informal sector (I)	16,450		28.1
$I = (H+C)-A$		$I = T-(A+S+F-SF)$			
Notes: Agriculture includes forestry and fishery. Informal sector excludes agriculture, forestry and fishery. See the text for more explanations.					
Another component of GDP is "product tax less subsidy", accounting for 9.9%.					
Sources: Estimates basing on the data of <i>Vietnam Statistics Yearbooks</i> and <i>The White Book on Vietnam Enterprises 2021</i> .					

The productivity of non-state sector, composed mainly of agriculture and informal sector, is very low



# Strategies and policies for sustained growth to high income

- Speed up **the structural transformation for raising productivity.**
- Formalize the informal sector and scale up the size of firms for promoting efficient capital accumulation and innovation.
- Reforms and development of factor markets for promoting efficient allocation of resources and facilitating structural transformation.
- Emphasis on supply of skilled labor and R&D activities for upgrading the industrial structure.
- Five concrete policies.

# Five policies: (1) Expanding, deepening and upgrading industrialization

- Adopt policy to facilitate the start-up of businesses so that local firms, including SMEs, can exploit opportunities of market and technology to invest in industrial production.
- Efforts in the substitution of imports from China and Korea.
- Adopt new FDI policy which has two elements:
  - (1) Encourage high quality projects which produce high skill, high technology intensive products for substitution of imports.
  - (2) Encourage vertical linkages with local firms, offer opportunities to local firms to participate in the GVCs/GSCs.



## Five policies: (2) Formalization of the informal sector and promotion of development of SMEs

- For raising the productivity of the economy as a whole it is essential to **transform the household-based units into formal enterprises** (simplifying administrative procedures, convincing household entrepreneurs on the advantage, effective policy to support SMEs as a demonstration effect).
- New SMEs will be emerged from the informal sector.
- Policies for supporting SMEs: Strengthening central and local governments in charge of SMEs (more active in guidance and support given to SMEs for access to capital, for linking with FDI; having research unit to publish an annual *White Paper for SMEs*, etc.)

Stronger SMEs will increasingly participate in the development of supporting industries. Only a small number at present

	Apparel and footwears	Plastics products	Machinery	Electronics	Total
State-owned firms	9	7	14	1	31
Non-state firms	729	124	2437	101	3391
FDI	347	91	576	404	1418
Total	1085	222	3027	506	4840
Source: Vietnam's Ministry of Industry and Trade (2022)					

## Five policies: (3) Improvement of the factor markets and business environment

- The concurrent existence of labor shortage in urban areas and labor surplus in rural areas must be solved by reforming the **labor market**: to change the household registration (*hộ khẩu*) and to improve the housing service for migrant workers, two factors which discourage rural labor to migrate to work in urban areas. Related policy: expanding supply of skilled labor.
- SMEs are in a disadvantageous position in the access to **capital**. Improving the asymmetric information between banks and borrowers, and raising the capacity of SMEs in the planning of investment projects are necessary (set up banks or funds specializing for SMEs, offer certificates for SME consultants who can advise SMEs to plan for investment projects, etc.)

## Five policies: (4) Expanding the supply of skilled labor

- **Shortage of skilled workers** is a serious problem. Workers having 9 years or less of education account for 61% of total workforce. Nearly 12% have not graduated from elementary school.
- Expansion of the supply of skilled labor in order to push the industrialization and upgrade the industrial structure is **an urgent task**. Policies on the expansion of vocational immediate course, specialized technical colleges,...must be quickly implemented.
- Connect Vietnamese **technical intern trainees** in Japan with FDI and local firms which have plans to invest in high VA products.

## Five policies:(5)

### Strengthening the innovation capability

- In the next one decade or so, expanding industrialization, upgrading industrial structure and institutional reforms for efficient allocation of resources are major sources of productivity growth. At the same time, Vietnam has **to prepare for an innovation-led growth** for the 2030s and beyond.
- Vietnam has recognized the importance of innovation for economic growth but so far the effort has not been sufficient.
- R&D/GDP, still 0.7%, should be raised. Incentives given to private sector and FDI to encourage R&D activities.
- Vietnam's ranking in Global Innovation Index (GII) has been improved in recent years but many components of GI have large room for improvement (tertiary education, infrastructure of ICT,...)

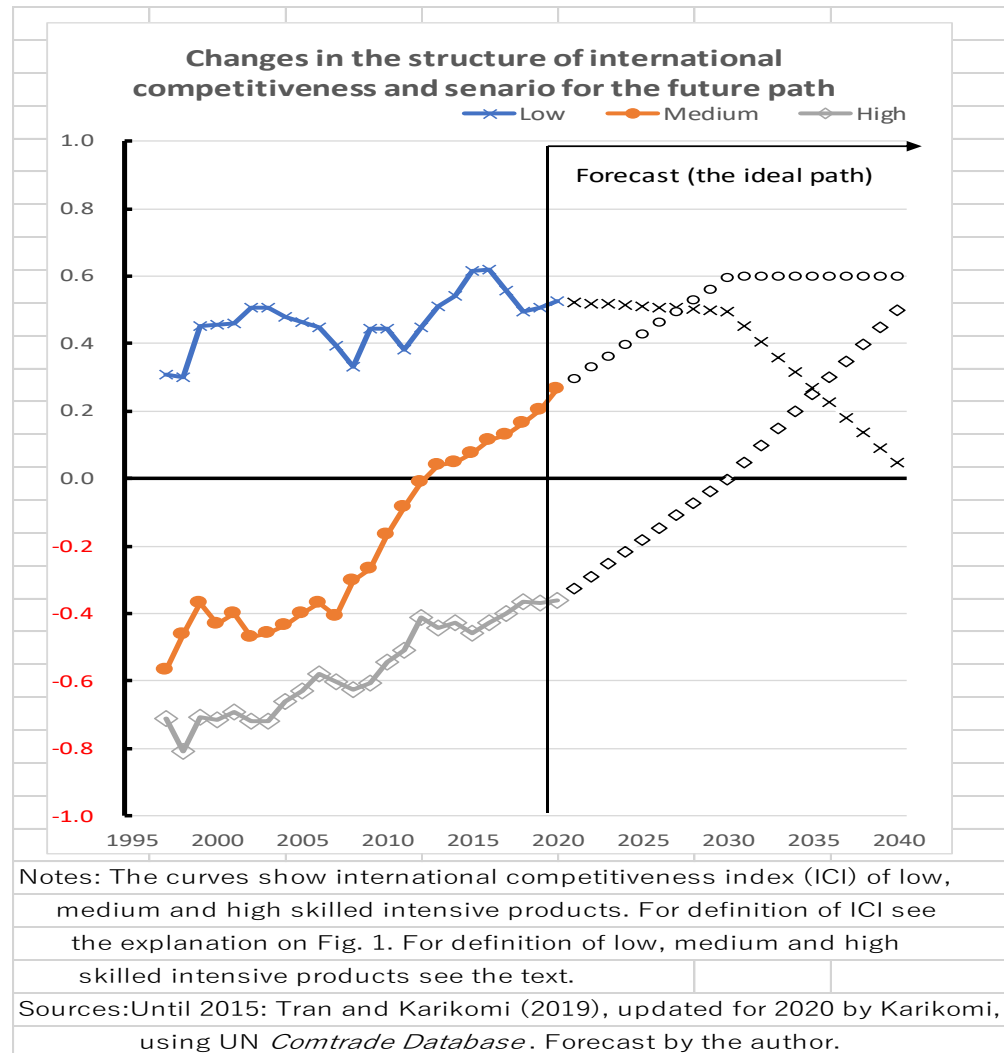
## Concluding remarks: (1) Rising productivity for sustained growth to high income

- If five policies are adopted and implemented, the transformation of the manufacturing sector, the formalization of the informal sector, the efficient allocation of capital and labor, the upgrade of the quality of labor, and the innovation capability will be progressed and strengthened. As a result, capital accumulation will be expanded in a more efficient direction, and will stimulate the adaptation of technology.
- Capital deepening and the efficiency created by structural transformation and by institutional reforms in the factor markets will result in **rising productivity, the condition for escaping from the middle income trap and continuing growth to high income.**

## Concluding remarks: (2) Escaping the middle income trap in a global perspective

- In the context of globalization, the structural transformation and sustained growth of productivity will keep Vietnam **competitive in international markets**. This is a condition for Vietnam to avoid the position of a sandwich where the country is unable to compete with low cost countries but yet is not able to compete with advanced countries.
- In other words, the ideal path for the future is **the continuing upgrade of the structure of comparative advantage**.

# Current structure of Vietnam's comparative advantage and the ideal path for the future





- Thank you