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Singapore | 5 January 2017

Reviewing Vietnam’s Economic Reforms since the CPV’s Twelfth Congress

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EXECUTIVE SUMMARY

- Since its inauguration in April 2016, Vietnam’s new government led by Prime Minister Nguyen Xuan Phuc has adopted various reforms to promote Vietnam’s economic growth.
- These reforms are primarily aimed at improving the country’s business environment and addressing economic woes left from the previous administration, such as the weak banking system, the underperforming and corruption-laden state-owned sector, and the burgeoning budget deficit.
- Such reforms have boosted the business community’s confidence in the new government’s reform agenda and resulted in positive changes that have won international recognition.
- However, the government’s reforms also face major challenges, especially the highly possible demise of the Trans-Pacific Partnership and the rising protectionism worldwide. These setbacks will tend to constrain Vietnam’s economic performance and slow its reform momentum in the coming years.
- As Vietnam’s new government has been in power for only more than six months, it is still too early to fathom the scope and substance of its reforms. How it pursues its reforms and navigates the country through 2017 will provide a better understanding of the Vietnamese economy’s future performance, as well as the political prospects of PM Phuc and his government.

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INTRODUCTION

Following the Communist Party of Vietnam's (CPV) Twelfth Congress in January 2016, Vietnam's National Assembly installed a new government led by Prime Minister Nguyen Xuan Phuc in April. His government will run the country at least until 2021 when a new government will be appointed after the CPV's Thirteenth Congress. One of the major mandates of Mr Phuc and his government until then is to strengthen Vietnam's economic performance, and to oversee its economic restructuring towards a more sustainable and innovative growth model.

This essay provides an initial assessment of the efforts by Vietnam's new government to fulfil such a mandate. It argues that contrary to the public's uncertainty about his policy inclinations before the CPV's Twelfth Congress, PM Phuc has proven to be an active, reform-minded, and business-friendly leader. Various measures to resolve legacy problems left by the previous administration and to improve the business environment have brought about positive changes. However, Mr Phuc's government is still struggling to address Vietnam's longstanding economic woes, such as the weak banking system, the underperforming state-owned sector, and the fast-expanding budget deficit. Despite some initial achievements, challenges for the government in the next four years remain substantial.

RESOLVING ECONOMIC LEGACY ISSUES

Under the stewardship of former Prime Minister Nguyen Tan Dung, Vietnam's economy attained certain achievements, but major problems also emerged. Specifically, Vietnam maintained an average GDP growth rate of 5.91 per cent between 2011 and 2015. By the end of 2015, Vietnam's GDP was \$193.4 billion, and per capita income reached \$2,109. Inflation was curbed, falling from 18.13 per cent in 2011 to 0.6 per cent in 2015. Meanwhile, a rather effective monetary policy also helped to stabilize macro conditions and stimulate growth. Interest rates were gradually cut, causing credit to re-expand and become more affordable to businesses.¹ Most notably, foreign trade grew substantially during this period as export turnover increased 18.5 per cent annually, reaching \$162 billion in 2015.²

On the other hand, under the previous government, Vietnam's banking system remained weak and fragile; the state-owned enterprises (SOEs) were still underperforming and infested with corruption; while the fiscal deficit and public debts kept ballooning. Without effectively addressing these issues, PM Phuc's government will unlikely be able to

¹ In 2015, for example, credits grew by 17.29 per cent, the highest in 5 years.

² Statistics in this paragraph are extracted from the government's report to the National Assembly, March 2016. Full text of the report is available at <http://baochinhphu.vn/Tin-noi-bat/Toan-van-Bao-cao-cua-Chinh-phu-tai-ky-hop-thu-11-Quoc-hoi-khoa-XIII/250204.vgp>, accessed 10 Dec 2016.

strengthen Vietnam's economic performance in a sustainable manner. At the same time, fixing these problems successfully will do credit to the new government and provide Mr Phuc with a strong political base ahead of the next Party congress. Therefore, conducting reforms to tackle these problems has become one of the top priorities for PM Phuc and his government.

Reforming the banking system

In 2015, the State Bank of Vietnam (SBV) took a number of bold steps to reform the banking system. Specifically, it oversaw five state-sponsored mergers between domestic banks, bringing the number of Vietnam's commercial banks from 42 down to 34.³ Three other banks that were technically bankrupt were also nationalized by the SBV.⁴ The SBV also attempted to reduce the bad debt in the whole system, which it announced to be 3.15 per cent in May 2015, mainly by transferring bad debts from commercial banks to the state-owned Vietnam Asset Management Company (VAMC).

Under the new Governor Le Minh Hung, the SBV plans further mergers to bring the number of domestic banks down to about 15 to 17 by 2020. However, so far, no new mergers have been approved, and the SBV has not released its plan for future ones yet. The process obvious takes time, and the SBV might also want to be cautious about future mergers so that the banking system will be strengthened, and not weakened in the process. For example, the merger between Sacombank and Southern Bank in 2015 has proven disastrous, at least for the former. Previously one of the best private commercial banks, the post-merger Sacombank is now struggling to absorb a huge amount of bad assets and non-performing loans inherited from Southern Bank.

At the same time, the SBV seems still unclear about how to clean up the remaining bad debts in the banking system, which analysts believe to be much higher than official accounts. Finding sufficient financial resources with the minimal political and economic risks is the key challenge. For example, after it decided to nationalize three private banks in 2015, law makers have questioned the legal basis of the decision as the arrangement effectively transferred the responsibility to solve these banks' bad debts from private bankers to the government. As a result, while some experts have called for the government to use state budget to bail out some troubled banks, Deputy Prime Minister Vuong Dinh Hue has made a bold statement that the government will consider "shutting down" some weak banks. In the same vein, PM Phuc revealed in December 2016 that the government was working with the Asian Development Bank (ADB) and a Vietnamese private company on a government plan to sell banks that it has nationalized to (possibly foreign)

³ These are between PGBank and VietinBank; Dai A and HDBank; MHB and BIDV; MDBank and Maritime Bank; and Southern Bank and Sacombank.

⁴ These are Vietnam Construction Bank, OceanBank, and GPBank.

investors.⁵ If implemented, such measures will reflect a fundamental change in the government's mindset and its regulatory framework regarding the banking industry.

Meanwhile, in early 2016, the SBV announced that it had selected 10 commercial banks⁶ to apply Basel II standards.⁷ These banks are requested to fully comply with Basel II by 2018, while the remaining banks will start applying Basel II from 2019. Stricter standards under Basel II are expected to help Vietnamese banks improve their risk management, thereby strengthening the whole banking system. At the same time, applying Basel II standards will pressure Vietnamese banks into increasing their capital. As such, they may be encouraged to negotiate more mergers among themselves, which may ultimately help to make the banking system leaner and healthier as the SBV expects.

Reforming SOEs

Reforming the inefficient and corruption-laden state-owned sector is yet another urgent task for the new government. One of the key measures was to equitize (i.e. partially privatize) non-essential SOEs and divest those that have been equitized.

In the first ten months of 2016, however, only 51 SOEs were approved for equitization. The total value of these 51 SOEs was VND32 trillion (\$1.4 billion), in which the state-owned equity was VND23.34 trillion (\$1.03 billion). During the same period, VND3,352 billion (\$148 million) of government's stake in equitized companies was sold for VND6,407 billion (\$282 million).⁸

The pace of the reform therefore fell short of the government's expectation. In June 2016, PM Phuc issued a decree urging relevant authorities to implement the 2011-2015 SOE reform program and prepare the blueprint for the 2016–2020 period. Apart from seeking to speed up the equitization process, the decree also emphasizes the need to divest non-essential businesses. The divestment became even more urgent as the government wants to finance parts of its fast expanding budget deficit through such divestments.

⁵ “Thủ tướng nêu 8 định hướng điều hành tại Diễn đàn VDF” [PM gives 8 governance direction at Vietnam Development Forum], *Government Portal*, 9 Dec 2016 (<http://baochinhphu.vn/Tin-noi-bat/Thu-tuong-neu-8-dinh-huong-dieu-hanh-tai-Dien-dan-VDF/293725.vgp>), accessed 6 December 2016.

⁶ These are BIDV, VietinBank, Vietcombank, Techcombank, ACB, VPBank, MB, Maritime Bank, Sacombank and VIB.

⁷ Basel II is the second of the Basel Accords published in June 2004. The Accord outlines international standards on three pillars: minimum capital requirements, supervisory review process, and market discipline. The Accord is designed to ensure that financial institutions have enough capital to meet obligations and absorb unexpected losses.

⁸ Report on Vietnam's restructuring of SOE in the 2011-2015 period, the first 10 months of 2016, and the directions for the 2016-2020 period, available at (<http://vietnamfinance.vn/ho-so-vnf/bao-cao-ve-tinh-hinh-tai-co-cau-doanh-nghiep-nha-nuoc-thang-102016-20161102153903121.htm>), accessed 5 December 2016.

For example, the government decided to sell all of its stakes in Habeco and Sabeco, two major breweries accounting for more than 60 per cent of Vietnam's beer market. The two companies were equitized in 2008 but their listing on stock exchanges was delayed and the government still owns a majority stake in both of them. To speed up the divestment, the government instructed the Ministry of Industry and Trade (MOIT) to have Habeco and Sabeco listed on stock exchanges as early as possible and conduct the divestment through public auctions in a transparent manner. By December 2016, the listing process of the two companies had been completed, and the divestment is expected to take place in 2017.

As a result, Vietnam's SOE reform will likely accelerate in the coming years. At the same time, the government has also conducted an anti-corruption campaign under the guidance of CPV General Secretary Nguyen Phu Trong. Targeting "interest groups" in SOEs, the campaign is expected to reduce resistance against the SOE reform and make the state-owned sector more transparent and efficient. So far, former Minister of Industry and Trade Vu Huy Hoang and some senior SOE executives have fallen victim to the campaign. There are signs that the campaign is expanding to target other senior officials and their circles, which may generate important political implications for the country ahead of the next Party congress.

Dealing with burgeoning budget deficit

Vietnam's nominal budget deficit has kept expanding over the past decade, reaching VND256 trillion (\$11.47 billion, or 6.1 per cent of GDP) in 2015.⁹ Considering the deficit as a major risk for the country's long-term economic stability, the new government has introduced a number of reforms to alleviate the problem.

On the one hand, the government has tried to cut down on non-essential expenditures, such as holding conferences, sending officials overseas on study tours, or acquiring new office equipment. It has also introduced mechanisms for ministerial level officials to get to work by taxi or private cars rather than official cars. At the same time, the government has also emphasized fiscal discipline by requiring ministries and local governments not to overspend their allocated budget. Large and economically unviable capital projects, such as the construction of two nuclear power plants in Ninh Thuan Province, have also been shelved.

There have also been efforts to trim the bureaucracy, and hence the government's payroll. In November 2016, for example, the MOIT announced that it would undertake a major restructuring program aimed at reducing the number of its agencies by eight.¹⁰

⁹ For more analysis of Vietnam's fiscal deficit, see Le Hong Hiep, "Growing Fiscal Deficit Presents a Major Risk for Vietnam", *ISEAS Perspective*, 7 July 2016.

¹⁰ "Bộ Công thương sẽ tái cơ cấu bộ máy tổ chức, giảm 7 đơn vị" [MOIT to restructure, scrapping 7 agencies], *Voice of Vietnam*, 22 November 2016, (<http://vov.vn/kinh-te/bo-cong-thuong-se-tai-co-cau-bo-may-to-chuc-giam-7-don-vi-571671.vov>) accessed 29 November 2016.

At the same time, the government has strived to maximize revenues by cracking down on tax evasion and other tax frauds. It also warned against the introduction of policies that may undermine revenue collection. To guide the government's fiscal consolidation, the National Assembly passed a resolution in November 2016 that requests the government to limit its 2017 budget deficit to 3.5 per cent of the GDP,¹¹ a significant reduction from 6.1 per cent in 2015.

To deal with the deficit, the government has mobilized various financial sources, especially from international financial institutions and the domestic bond market.¹² At the same time, as mentioned above, it has also tried to sell its stakes in equitized enterprises to partially finance the deficit. In the long run, however, improving the business environment and strengthening Vietnamese enterprises to sustain a broad and strong tax base will be essential to Vietnam's fiscal consolidation efforts. As such, implementing reforms to improve the business environment has also been a key task of the new government.

BUSINESS ENVIRONMENT REFORMS

Since coming to power, PM Phuc has demonstrated his commitment to deepening reforms. One of the first public meetings that he attended after his appointment was a dialogue with the business community on 29 April 2016. During the dialogue, Mr Phuc listened to complaints as well as proposals of businesses, and sent out a strong message about his government's commitment to better serve the business community. He promised to maintain consistent policies and create a favourable and level playing field for all businesses.¹³ One day before the dialogue, he signed off a resolution on tasks and solutions to improve the business environment and to enhance national competitiveness.¹⁴ Just two weeks later, on 16 May 2016, his government issued another resolution on developing Vietnamese enterprises by 2020.¹⁵ Setting the target of achieving 1 million enterprises by 2020, the resolution also aims to increase the private sector's share in the GDP to 48-49 per cent, and private investment's share in total social investment to 49 per cent. More importantly, it sets the target of having 30-35 per cent of Vietnamese enterprises engaging in innovative activities annually.

¹¹ "Dự toán bội chi ngân sách 2017 khoảng 3.5% GDP" [2017 budget deficit estimated to be about 3.5% of GDP], Vietstock, 18 October 2016, (<http://vietstock.vn/2016/10/du-toan-boi-chi-ngan-sach-2017-khoang-35-gdp-758-499968.htm>), accessed 30 October 2016.

¹² For example, by 7 December 2016, the government had issued domestic government bonds worth VND281 trillion (\$12.5 billion).

¹³ "Thủ tướng: Doanh nghiệp lớn mạnh thì đất nước hùng cường" [Strong companies make strong country: PM], *Government Portal*, 29 April 2016 (<http://thutuong.chinhphu.vn/Home/Thu-tuong-Doanh-nghiep-lon-manh-thi-dat-nuoc-hung-cuong/20164/24666.vgp>), accessed 1 December 2016.

¹⁴ Full text of the resolution is available at (<http://datafile.chinhphu.vn/file-remote-v2/DownloadServlet?filePath=vbpq/2016/04/19.signed.pdf>), accessed 9 Dec 2016.

¹⁵ Full text of the resolution is available at (<http://datafile.chinhphu.vn/file-remote-v2/DownloadServlet?filePath=vbpq/2016/05/35.signed.pdf>), accessed 9 Dec 2016.

The new government and its high-ranking officials have also frequently used the term “chính phủ kiến tạo” (literally “facilitating government”) as a guide for its reform agenda. Such rhetoric has been translated into certain concrete actions. For example, tax and customs regulations have continuously been streamlined. In November, the National Assembly passed a law to remove 41 businesses from the list of conditional ones. More laws and regulations will be revised to cut red tape and further reduce barriers to businesses. Specifically, PM Phuc has promised to abolish up to 3,500 business licenses.¹⁶ Such determination to improve the business conditions is well reflected in a statement by Minister, Chairman of Government Office Mai Tien Dung:

We are determined not to leave any holes in the legal system, cutting down on unjustifiable business conditions, scrapping business permits, and putting an end to interest groups.¹⁷

Such reform efforts have been acknowledged internationally. For example, Vietnam has climbed up nine spots in the World Bank Doing Business 2017 Report, which measures the ease of doing business in 190 countries worldwide.¹⁸ At the same time, customs and trade-related reforms have helped the country climb 14 ranks in the World Economic Forum’s 2016 Enabling Trade Index.¹⁹ If maintained, such reforms will contribute significantly to Vietnam’s growth momentum in the future.

CONCLUSION

Since its inauguration in April 2016, Vietnam’s new government led by PM Nguyen Xuan Phuc has adopted various reforms to strengthen the country’s economic performance. Such reforms have been focused on consolidating the banking system, improving the performance of the state-owned sector, reducing fiscal deficit, and improving the business environment. These efforts have been recognized internationally and brought about some initial positive outcomes. However, while the government’s commitment to reforms is obvious, whether such reforms will result in stronger and more sustainable economic growth for the country in the long term remains to be seen.

¹⁶ “Thủ tướng quyết bỏ 3.500 giấy phép con 'cởi trói' cho DN” [PM determined to scrap 3,500 licenses to free up businesses], *Zing News*, 24 June 2016, (<http://news.zing.vn/thu-tuong-quyet-bo-3500-giay-phep-con-coi-troi-cho-dn-post660400.html>), accessed 2 December 2016.

¹⁷ “Vietnam cuts through red tape in bid to unleash business spirit”, *VnExpress*, 1 July 2016, (<http://e.vnexpress.net/news/business/vietnam-cuts-through-red-tape-in-bid-to-unleash-business-spirit-3429130.html>), accessed 3 December 2016.

¹⁸ World Bank, *Ease of Doing Business in Vietnam*, undated, (<http://www.doingbusiness.org/data/exploreeconomies/vietnam/>), accessed 9 December 2016.

¹⁹ World Economic Forum, *Regional overview: East Asia and Pacific*, undated, (<http://reports.weforum.org/global-enabling-trade-report-2016/regional-overview-east-asia-and-pacific/>), accessed 9 December 2016.

An outstanding problem that may offset the effectiveness and momentum of such reforms is the increasingly adverse international economic environment, especially the return of protectionism as manifested in the likely collapse of the Trans-Pacific Partnership (TPP). As one of the most open economies in the region with the share of exports and imports to GDP reaching 160 per cent, Vietnam’s economic performance is highly reliant on foreign trade. Vietnam will have to turn to other trade partners and free trade agreements to compensate for the loss of the TPP. Yet, the widespread backlash against globalization in various countries means that the success of such efforts is not guaranteed.

More importantly, the collapse of the TPP may slow the reform momentum of Vietnam in the coming years. With its very high and comprehensive standards, the TPP has encouraged Vietnam to pursue not only economic but also legal, socio-political and institutional reforms. Although Vietnamese officials have repeatedly claimed that with or without the TPP, Vietnam will continue to further reforms, the extent and substance of such reforms are still open questions. At a panel discussion on 10 December 2016, for example, former Minister of Planning and Investment Bui Quang Vinh mentioned that due to the uncertain prospects of the TPP, the recent session of the National Assembly decided to shelve several draft laws that aim to introduce reforms to bring Vietnam into compliance with TPP standards.

As Vietnam’s new government has been in power for only a little more than six months, it may still be too early to draw any definitive conclusion about the scope and substance of its reforms, and whether it will be able to overcome mounting challenges. Perhaps, how the government pursues its reform agenda and navigates the country through the likely bumpy year of 2017 will provide us with more clues about the future performance of the Vietnamese economy, as well as the political prospects of PM Phuc and his government ahead of the next CPV Congress.

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