Boosting productivity is key

Vietnam is striving to improve economic reforms in an attempt to prevent from falling into a middle-income trap. **Raymond Mallon**, senior economic advisor for the Australia-Vietnam economic reform programme, writes about the prospects for the domestic economy in 2019 and beyond.

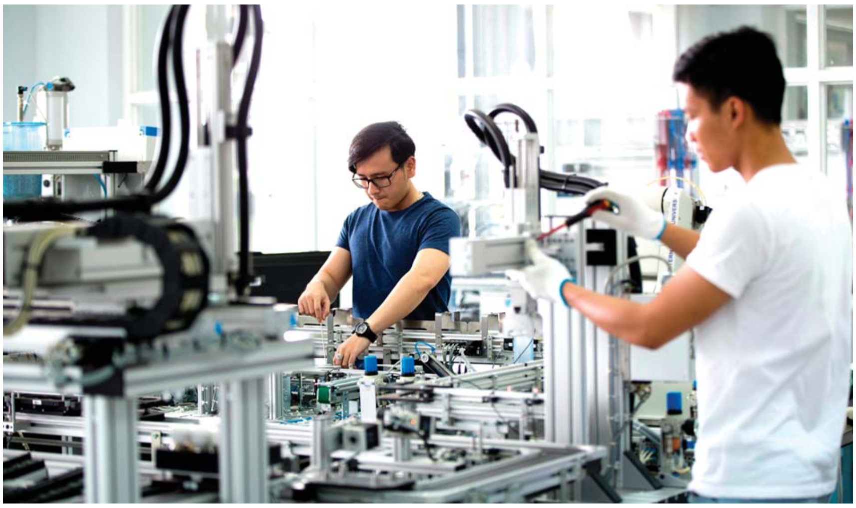

Photo: Le Toan

Reforms in areas such as skills development and retirement age could boost economic potential

The middle-income trap refers to a situation when a nation loses its competitive advantage at that level, and is unable to sustain the strong growth in productivity required to move up the economic ladder to high income status.

Countries caught in this trap typically feature low levels of investment, limited economic diversification, a slow pace of structural change, relatively high levels of inequality, and stagnant labour markets and living standards.

While the above are not currently characteristics of the Vietnamese economy, national policymakers still need to accelerate efforts to boost productivity growth. The more effectively an economy utilises capital and labour, the greater its prosperity. Or, as American economist Paul Krugman once famously stated, “Productivity isn’t everything, but in the long run it is almost everything. A country’s ability to improve the standard of living over time depends almost entirely on its ability to raise output per worker.”

During the early stages of *doi moi*, Vietnam was able to rely primarily on increased inputs of capital and higher workforce participation to achieve strong growth.

However, the potential to sustain growth via increased input diminishes with increased prosperity. For example, with already high levels of work-force participation and a slowing population growth rate, the opportunities to increase productivity through increased labour inputs are limited. As this diminishes, the focus needs to shift to using these inputs more effectively.

Vietnam now needs to identify and implement reforms that will support a transition from a resource/input driven growth model, to a model where more growth is generated from innovation and technology transfer that accelerates productivity growth.

Accelerating productivity growth

The government needs to sustain a strong focus on building market economic institutions and a policy and regulatory environment directly and clearly targeted at national interest considerations.

At the firm level, competition and innovation are critical to stimulating productivity growth. The government can help stimulate competition and innovation in several ways, such as improving skills and human development, improving infrastructure and facilitating sustainable urbanisation, and removing barriers to national and international economic integration and the flow of technology, ideas and skills.

Alongside this, competition and innovation can also be stimulated via removing barriers to the entry of new businesses, growth of existing businesses, and exit of businesses that are not performing efficiently in order to free resources for more efficient use.

In addition to effective management of natural resources and the environment, Vietnam also needs to improve management systems and corporate governance. This is required both to improve efficiency and to mobilise the capital needed to fund innovation and expansion.

From a structural perspective, the government can facilitate the movement of employment from low to high productivity. This implies a need for policies to facilitate a shift from low-value agriculture (for example lower quality rice) to higher value-added agriculture (for instance horticulture), and to industry and service sectors.

The development of effective and competitive markets for agriculture land use rights, and the removal of barriers to rural urban migration, could help accelerate such structural changes.

A shift is also needed from low productivity informal employment to higher productivity in the formal sector. This requires further administrative and regulatory reforms to simplify formal business entry, and the development of more effective market institutions.

State-owned enterprise (SOE) reform is also very necessary. Most SOEs are capital intensive, create very few jobs, and have low levels of total factor productivity. State resources should be moved out of non-strategic commercial businesses, and remaining SOEs should be subjected to stronger and more independent corporate governance.

Achieving sustained strong productivity growth requires effective state investments in infrastructure and education. A high-quality education system is a must to encourage creativity and support breakthroughs in science and technology.

Urbanisation and international trade and investment can also help enhance efficiency and productivity growth. Finally, economies need strong market institutions and a supportive business-enabling environment to encourage the emergence of creative and dynamic entrepreneurs.

There also remains some scope to make better use of labour resources. For example, labour force participation could be enhanced through skills development and improvements in healthcare, reducing barriers to women’s participation in the workforce, including adopting a uniform retirement age, increasing the retirement age, and lowering remaining barriers to labour mobility.

Caught in a middle-income trap?

The middle-income trap is not something that economic theory sees as inevitable. However, as economies develop, further progress tends to require more complex institutional reforms. Vested interests can be expected to resist such reforms if they lose privileged access to economic opportunities.

There is no easy answer to the political economic challenges, but it is important that reforms have a credible evidence base on the potential national benefits of reform. It is also important that reform efforts focus on developing institutions to hold policymakers accountable for making decisions in the national interest.

Reforms that can help include retaining a strong focus on combating corruption by reducing regulatory and administrative ambiguity, increasing public transparency in policymaking and implementation processes, and engaging with the media and public to hold officials accountable.

The government must improve regulatory and administrative quality, including requiring all agencies to provide clear arguments as to the national interest objectives of all policy measures.

It is necessary to establish independent policy/regulatory agencies drawing on international good practice, to ensure that regulators have no vested interests in commercial activities.

Prospects for Vietnam

Recent momentum with growth in investment and domestic demand all but assures strong economic outcomes for 2019. Medium to longer-term growth will require sustained efforts on the methods already outlined. Given that the government has already signalled its intention to move forward in most of these areas, the concrete actions already taken, and the dynamism of Vietnamese society, there should be optimism about Vietnam’s medium to long-term economic prospects.

I am particularly encouraged by recent efforts to reinvigorate efforts to strengthen skills development and university education and research. There is still much to be done, but the large numbers of Vietnamese students returning from studying at some of the best universities in the world, and the increased opportunities for overseas investment in the education sector are encouraging.

The moves to increase use of e-government in public service delivery offer great opportunities to reduce corruption and to hold officials more accountable to the public.

However, there are risks. Most importantly, the global economic environment is more uncertain than it has been in a long time. Vietnam is very heavily integrated into the international economy with close links to global production chains. Any sudden downturn will adversely impact on Vietnam’s economic prospects.

It is also important for the country to sustain its commitment to competition, transparency, and equality. Vietnam will only realise its full economic potential if everyone, regardless of their place of birth, gender and ethnicity, is given the opportunity to realise their full personal potential. There is also need to better enforce environmental and other social safeguards.

Preparations have begun on developing national development strategies and plans for the next decade. As foreshadowed in the Vietnam 2035 Report, new socio-economic development plans are expected to include an even stronger commitment to a well-regulated market-based economy with a strong focus on the public investments needed to help Vietnam succeed in moving up the economic ladder to high income status.■