

# BUSINESS ENVIRONMENT IN 6 MONTHS 2015 AT VIETNAM THE "DARK SIDES" BEHIND THE GROWTH RATE OF 6,28%

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*According to the report by the General Statistic Office, Vietnam's GDP in the first half of 2015 has grown at the highest rate over the last five years, reaching 6.28%. This is a positive sign which predicts the possibility of attaining the fast growth rate of the 2001-2010 period. However, to turn this positive sign into reality, we need to (i) look into the "dark sides" which reflect the drawbacks behind the growth rate of 6.28%, then (ii) re-direct the growth process for sustainability, long-term and effective maintenance of the fast growth figures.*

### 1. Economic growth of Vietnam over the first 6 months of 2015

The growth achievements over the first 6 months of 2015 are shown in the table below:

**Table 1: GDP growth rate of the first 6 months during 2010-2015 (%)**

	Year 2010	Year 2011	Year 2012	Year 2013	Year 2014	Year 2015
GDP growth rate	6.22	5.92	4.93	4.9	5.22	6.28
Industry-Construction		6.63	5.59	4.97	5.12	9.09
Agriculture, Forestry, Fishery		3.9	2.88	2.06	2.9	2.36
Trading-Services		6.23	5.92	6.13	7.19	5.9
Manufacturing			5.96	5.61	6.61	9.58

Source: Vietnamese GSO

The Table 1 shows that:

(1) GDP growth rate over the first 6 months of 2015 is much higher than that of the same period in 2014 with a trend of growth rate in the second quarter being higher than that of the first quarter (6.08% in the first quarter, 6.44% in the second quarter). Such growth rate is the highest over the last five years, even higher than the growth rate of 2010 (6.22%). The figures reflect the obvious trend of economic recovery in our country. According to a survey by Bloomberg, these positive figures led their economists to forecast the growth rate of Vietnam's economy in 2015 to be in the third place after India (7.5%) and China (6.8%)

(2) The growth is seen in all the three sectors, with the highest rate in the Industry-Construction sector. The

growth rate of the first 6 months in this sector is estimated to be 9.09%, which is much higher than the rate of the same period in the previous years since 2010. The index of industrial production (IIP) in the first 6 months is estimated to increase by 9.6%, which is also higher than that of the same period of the previous years. The most noticeable point is the strong recovery of the manufacturing sector, which records the highest growth rate of 9.58%. The Industry sector contributes 2.98 percentage points to the 6.28 percentage points of growth, accounting for 47.5%. The Manufacturing sector alone contributes 80% to the growth rate of the whole industry sector.

The reasons for the outstanding growth of the Industry sector are listed as follows: Beside the factor of FDI enterprises remaining active, there is a fast increase in the number of new FDI projects in the Manufacturing sector, accounting for 75% of total FDI investment in the first 6 months of the year. It is worth noticing the recovery of local enterprises. During the first half of the year, there are fewer enterprises announcing bankrupted than those established. The newly established enterprises total at 45,406 with the total registered capital amounting to 282,396 billion VND, making an increase of 21.7% in terms of number of enterprises and 22.3% in terms of registered capital in comparison with the rates of same period of the previous year. Moreover, during the first 6 months of the year, there are 8,507 enterprises which previously stopped operation returning to work, making an increase by 2.2% over the same period of 2014. At the same time, the number of enterprises which completes the procedure of liquidation in the whole country is 4,708, decreasing by 0.9% over the same period of the last year. The number of enterprises in difficulty which must close down temporarily is over 27,000, making a decrease by 5.8% over the same period of the last year, of which 8,898 enterprises registered for discontinuing in a certain term and 18,153 enterprises are in temporary interruption in waiting for blocking their enterprise registration code.

## **2. The "dark sides" behind the 6.28% growth rate**

### **2.1 The contribution to industrial growth in particular and to the economy in general is mainly from outsourcing activities.**

Without the contribution by the construction sector, Vietnam' manufacturing sector contributes 52% in the overall growth and the growth of GDP in the industrial sector, according to the statistic reports. However, the portfolio of the manufacturing industry reveals that the most noticeable growth which drives the whole growth rate of this sector is seen in the outsourcing and assembling activities. The statistics shows that car assembling records a growth rate of 57%, mobile phone assembling 68%, TV assembling 40%, followed by shoes making 23%, and manufacturing of electronics, computers and optical products 21.1%. Meanwhile, local manufacturing records a growth rate below the average of the whole economy, for example textile manufacturing grows by 2.2%, cigarette production by 1.7%, fertilizer manufacturing by 2.5-3%, seafood production by 5.3%.

### **2.2 The growth relies mainly on FDI, whilst the growth of domestic sector is witnessing some of not very positive signs.**

- The growth in industrial sector is recorded mainly in FDI enterprises. The most outstanding records of growth (40-60%) are mostly found in FDI enterprises, mining industry including oil exploitation records a growth of 11% in FDI joint ventures, and even the growth of 11% in power production is also generated by the foreign

investors in the power industry. This situation goes in a contrary to the much lower than average growth rates recorded in production of foods, cigarettes, beer, garments, fertilizers, etc. by the local enterprises.

- The growth of exports is recorded also mainly in FDI enterprises (15,5%) while that of domestic enterprises is negative (decrease by around 3%), with the decrease being recorded in all high-value produce exports. The FDI enterprises are also leading the increase in import turnover (25%) with more than 70% account for the import of materials and spare parts. The highest ratio remains with imports from China (30% of total import turnover) with the growth rate recorded as 23.8%, which doubles those of the second country namely South Korea.

*The "problems" in 2.1 and 2.2 show that Vietnam is recording high economic growth, which mainly relies on outsourcing activities in FDI enterprises. The impacts of restructuring growth model are not significant enough; the program for developing supporting industries records no results yet due to the lack of connecting production activities between domestic and FDI enterprises. This leads to the situation whereby FDI enterprises keep doing assembling products from imported materials and parts whilst domestic enterprises have no work and laborers keep running to FDI enterprises to do assembling. Such situation might be the noticeable problem to be solved in short term.*

### **2.3 The service sector, especially high quality service, has not seen encouraging signs of growth**

- Statistics show that the service sector used to have the highest growth rate in previous periods, e.g. 7.64% in 2006-2010, 6.14% in 2011-2014. The above table also shows that the growth rate of the service sector in the first 6 months over the period of 2011-2014 always topped over other sectors. The recording high growth rate was 7.1% in the first 6 months of 2014, but that of 2015 fell to 5.9%, slowing the growth of the whole economy. With the growth rate of only 5.9%, the service sector contributes only 2.2 percentage point to the overall growth, accounting for 35% of the national economic growth. The down-going trend is witnessed in the recent years with contribution by 48% to the total economic growth in 2014, 52.58% in 2013, making a total contribution of only 45% in the period 2006-2010 (estimated by the authors from the available statistics).

- The slow growth in the service sector is reasoned by its dependence on the traditional activities with low added values such as trading including wholesaling and retailing (grows by 9.8%), passenger transporting (grows by 7%). In the contrary, all high quality services record low growth rates, such as real estate grows by 2.27%, which is lower than the rate of 2.51% of the first 6 months of 2014, catering by 2.9%, cargo and warehousing by 4.5%, which is lower than the rate of 5.2% of the first 6 months of 2014, and banking and finance by 5.8%. The low growth rates of the above service industries reflect the low domestic demand in both consumption and investment; the credit growth of over 6% just nearly reaches the rate of GDP growth; the lower growth compared with the same period of the last year is recorded in both capital mobilization and total transaction by the banks.

### **2.4 Agriculture-Forestry-Fishery industry are struggling to grow**

- The ratio of agriculture in the economic structure will decrease following the development trend. However, to reduce this ratio, in the mean time Vietnam's agriculture still needs fast growth to create motivation for other industrial and service sectors to develop, which will allow a safe decrease for agriculture itself. The fact is that during the first 6 months of 2015, agriculture has fallen into its own "lost crop". Agriculture's growth rate in this

period is 2.36%, the lowest rate in comparison with that in the previous years, when it was 3.52% in the period 2006-2010, 2.94% in the period 2011-2014 and 2.9% during the first 6 months of 2014. The slow growth results in the lowest contribution of 6.7% by agriculture to the overall growth, while its contribution was 8.7% in the period 2006-2010 and 9.7% in the period 2011-2014.

- The accumulative contribution by Agriculture, Forestry and Fishery to GDP is low because Agriculture takes the highest proportion, up to 75%, in the industry's GDP, but it has the lowest growth rate of 1.9%. Cultivation is the one with the lowest growth rate of 1.08% (during the first 6 months of 2014 this figure was 2.8%), but it accounts for the largest proportion in the industry, which is 50.7%. Therefore, the industry's overall growth rate is made lower accordingly.

- The reason for the slow growth of Agriculture, Forestry and Fishery over the first 6 months are explained with the factors such as weather and climate which are not favorable for production. In addition, other factors are named, including (i) substantial reduction in cultivating land areas and aqua production areas due to the failure of the policy of land accumulation; (ii) unreasonable policy of restructuring plantation; (iii) policy of produce purchase; and (iv) unfavorable fluctuation in the market and market prices of.

### 3. Forecast of 2015 growth

Using extrapolation for the correlation between the GDP growth rate of the first 6 month and that of the year over the previous years, if GDP growth rate of the first 6 months reaches 6.28%, the authors estimate that the annual GDP growth rate will be 6.5% - 6.6%, which means higher than the set target.

**Table 2: Estimated GDP growth rate in 2015**

	2010	2011	2012	2013	2014	2015
Growth rate of the first 3 months (%)	5.97	5.9	4.75	4.76	4.96	6.03
Growth rate of the first 6 months (%)	6.18	5.92	4.93	4.98	5.18	6.28
Annual growth rate (%)	6.78	5.8	5.25	5.42	5.98	
Growth coefficient of 6 month over annual growth	0.92	102	0.93	0.92	0.87	
Average growth coefficient	0.94					
Estimated annual GDP growth in 2015(%)	6.5-6.6					
Growth rate of the last 6 months (%)	6.7-6.8					

Source: Estimation by the authors

Following the trend, it is forecasted that it would not be difficult to achieve the target of 6.5-6.6% growth rate under the positive growth of the first 6 months. However, the direction for growth should be as follows to assure this and even higher growth rates in 2015 and the following years:

- Industry should maintain the current rate of growth while ensuring the efficiency and sustainability through improving growth capacity of domestic enterprises and reducing the volume of outsourcing activities as a source of growth.

- Agriculture's growth rate should be made to return to 3% -3.5%, which is higher than that of the same period of the last year.
- High quality trading and service sector, especially real estate, banking and finance, insurance, tourism should attain the growth rate of the previous period. The growth rate of exportation should be raised to 15%, which is just equal to the achievement in 2014.

#### **4. Some implications for assuring the estimated growth target:**

##### *(1) To be persistent and prioritize domestic investment in the policy of demand stimulation*

Stimulating domestic consumption and investment demand is a policy with "2 in 1" impacts. On the one hand, it can overcome some weaknesses of the domestic economy over the last few years when the domestic investment tends to decline. The proportion of 31.1% of investment over GDP during the first 6 months is not enough for better growth. If the proportion is increased to 33-35% (by around 2%), it is possible to get an increase of 0.4-0.5 percentage point of growth. On the other hand, the figures of the last 6 months show that the investment by enterprises, especially private ones, is still very low. Demand stimulation for domestic investment is a solution to overcome challenges and obstacles coming from the decline caused by the changes in economic relations between Vietnam and China.

Together with those action there should be flexible, cautious and effective monitoring of monetary policies to fit with macro economic development so as to boost the economic recovery, control inflation, and monitor the credit growth to suit the set target of around 15%. It also needs to effectively coordinate monetary policy, fiscal policy and price control on some commodities and services under the government regulations.

##### *(2) To keep FDI as a growth engine but need to develop some solutions for coordinating FDI enterprises with domestic ones.*

This recommendation covers two aspects:

*First*, to continue with FDI attraction policies. However, it is necessary to improve the quality of FDI capital flow, with special attention paid to the large investment FDI projects. The GSO reports that FDI over the first 6 months by 20th June 2015 includes 757 newly licensed projects with total registered capital of 3,839.2 million USD, making an increase of 15.4% in the number of projects and decrease of 21% in capital in comparison with the same period of 2014. Moreover, 281 previously licensed projects are fuelled with 1,654.2 million USD. This makes the total registered capital of new and adjusted projects come up to 5,493.4 million USD, in fact decreasing by 19.8% compared with the same period of the last year. This means a declining trend in the capital of FDI project, which is most noticeable in Chinese FDI projects with low technology, small size in the areas where Vietnamese enterprises are capable of implementing. Thus, there should be stricter control on Chinese FDI projects in order to increase quality of investment projects.

*Second*, to reduce obstacles for domestic economic sectors through the solutions of coordinating domestic and FDI enterprises. There should be discussion and negotiation with large FDI enterprises so as domestic enterprises can get involved in producing supporting parts for FDI enterprises in replacement of imports. This is another "2 in

1" solution as it reduces difficulties for domestic enterprises through production of parts and components together with FDI enterprises on the one hand and it supports the national project to develop the supporting industry using coordination with FDI enterprises on the other hand.

*(3) To restructure agriculture*

This is an effective solution to develop capacity of the domestic economy for the sake of growth. For this, it is necessary to identify featured products which suit the advantages of climate, natural conditions of each region and sub-region, then to develop production of specialties in those regions. It is also necessary to create competitive advantages for these specialties by investing to develop specialization in large scale; attract FDI to agriculture for agricultural commodities, organize production following the advanced models to create higher agricultural outputs, with high quality and economic value and lowered costs thanks to the economies of scale.

A bigger size of agricultural outputs will create favorable conditions for developing upward integrated industries which supply inputs for agriculture as well as downward integrated industries which carry on agricultural outputs such as trading and services. Following that development of value chain, the agriculture sector will be restructured in the direction of improving production efficiency and the absolute value of revenue from agriculture.

Another solution is to boost the exportation of agricultural merchandise, which is expected to push up the growth of agriculture in particular and that of the whole economy in general. For this, it is necessary to look into the factors which pose impacts on the decline in exporting aqua products over the last time, such as the markets, prices, exchange rates, supply, purchasing power, etc. The research will serve as a basis for directing and monitoring the production for exports of agricultural products.

*(4) To reduce the dependence on imports from China*

According to the Center for Industrial and Trading Information under the Ministry of Trade and Industry, during the first 6 months of 2015, Chinese imports to Vietnam keeps increasing sharply and maintaining at the highest level of 24.4 billion USD, increasing by 23.9% compared with the same period of 2014. It is well noted that many of their products fall into the strength of domestic producers, creating more competitive pressure for domestic enterprises, more obstacles for domestic production, especially in the sectors of agriculture, consumer goods production and inputs production for agriculture. Such condition to remain will set up high barriers for domestic production. Therefore, it is recommended to minimize imports of commodities in these categories from China via two directions:

(i) To continue promote free trade with international partners to escape from the Chinese imports. This can be done through Free Trade Agreement (FTA) between Vietnam and South Korea, EU and Trans-Pacific Partnership. Important partners with great interest in Vietnam are looking forward to negotiations and conclusion of economic partnership agreements with Vietnam. Therefore, we should have clearer direction toward this process of negotiation.

(ii) Vietnamese producers should try their best in localization of input materials to improve their role in controlling the supply chain and to reduce the dependence on Chinese materials. There should be research for

development of domestic production with emphasis on the products falling within the Vietnamese producers' capacity. While implementing localization strategy, when the domestic producers' capacity is not good yet, they should consider diversifying foreign investors including those from Japan, South Korea, etc. and work together with these investors to develop our supporting industry and get more deeply involved in the global supply chain as well as to limit import surplus.

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