STRUCTURAL POLICY COUNTRY NOTES

Viet Nam

This Country Note is an extract from the *Economic Outlook for Southeast Asia, China and India 2014: Beyond the Middle-Income Trap*, http://dx.doi.org/10.1787/saeo-2014-en.

Viet Nam

A. Medium-term economic outlook (Forecast, 2014-18 average)

GDP growth (percentage change):	5.4
Current account balance (% of GDP):	4.5
Fiscal balance:	-3.9

B. Medium-term plan

Period: 2011-20

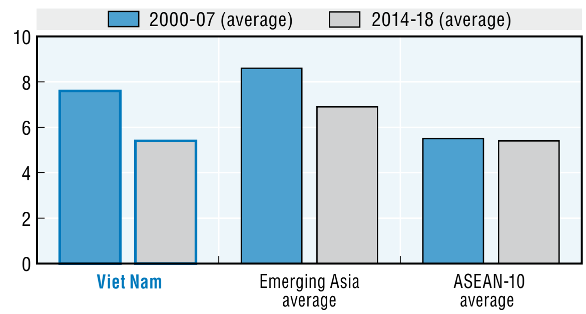
Theme: A modern, industrialised country by 2020

C. Basic data (in 2012)

Total population:	90 million*
GDP per capita at PPP:	3 547 (current USD)**

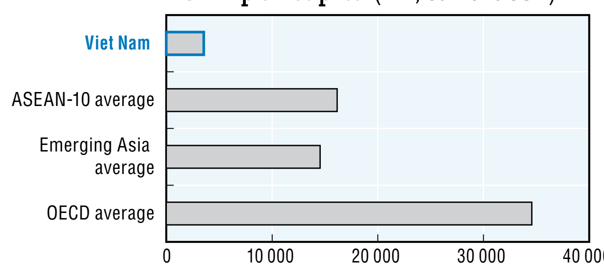
Note: * Total population data for 2012 are estimates.
** IMF estimate
Sources: OECD Development Centre, national sources and IMF.

GDP growth rates (Percentage change)



Source: OECD Development Centre, MPF-2014.

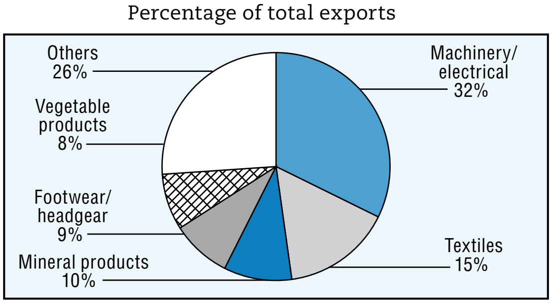
GDP per capita (PPP, current USD)



Source: IMF and national sources.

Composition of exports, 2012

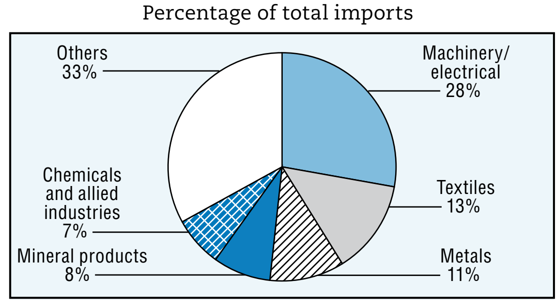
Percentage of total exports



Source: Trademap.

Composition of imports, 2012

Percentage of total imports



Source: Trademap.

Since Viet Nam initiated its *Doi Moi* Policy of economic reform in 1986, it has successfully modernised its economy and produced impressive growth and poverty reduction. However, economic growth has slowed in the last five years.

Continuing economic development requires new skills and labour structure. Viet Nam urgently needs to improve schooling and technical and vocational education and training (TVET) if it is to rectify the mismatch between skills supply and demand.

Viet Nam's private sector is crucial to its economic growth. Non-state enterprises (NSEs) account for more than 50% of gross domestic product (GDP) and create 60% of all new jobs. Yet they do not compete on an equal footing with state-owned enterprises. Viet Nam needs to foster an equitable, stable business environment, reduce transportation costs for NSEs, and afford them equal access to credit. Only then will it be able to harness NSEs' valuable, growing economic input.

Viet Nam needs to revisit its monetary policy. The country's priority today is to ensure macroeconomic stability and its monetary policy needs to meet that priority effectively. In the medium and long term Viet Nam should build a framework within which monetary policy is geared to controlling inflation and macroeconomic fluctuations.

Viet Nam's medium-term policy challenges and responses

- Increase access to education and strengthen TVET to improve the quality of human capital
- Ease access to credit and lower transport costs to develop the private sector
- Restructure the financial system to enhance the effectiveness of monetary policy

POLICY FOCUS

Increase access to education and strengthen TVET to improve the quality of human capital

Although Viet Nam enjoys relatively favourable population structure in which the working age population is nearly double the dependent population, labour productivity is low. According to the Asian Productivity Organisation (APO, 2012), Viet Nam's labour productivity in 2010 was 23.3% of Malaysia's and 37% of Thailand's. Not only does it lag behind its regional neighbours, its annual productivity growth rate fell from 5% during the period 2002-06 to 3.4% in 2007-11 according to the Ministry of Planning and Development.

Weak labour productivity and labour market outcomes are often attributed to inadequate human capital or workers having limited training opportunities to enhance their skills and productivity. It is a challenge to which Viet Nam must rise in its efforts to become more competitive in the global economy. It has therefore made education and training a priority area for development intervention.

Improve access to education

Successful economic reform in Viet Nam during the period 1990-2012 resulted in an impressive human capital development performance. Life expectancy rose by nearly ten years; the average number of years spent in schooling by people aged 25 and older lengthened by 1.5 years; gross national income (GNI) in constant USD 2005 purchasing power parity (PPP) increased more than 3.5 times; and Viet Nam's human development index (HDI) value increased 40.55%, the highest rise within ASEAN-5 (Indonesia, Malaysia, the Philippines, Thailand and Viet Nam).

Despite its dramatic improvement Viet Nam's HDI value is still very low. In 2012, Viet Nam ranked 127th out of 187 countries. It was in fact the last of the ASEAN-5 countries (Table 2.10.1), although Inequality Adjusted HDI (IHDI)[1] puts it above Indonesia and the Philippines. The inference is that, while Viet Nam's potential HDI is the lowest within ASEAN-5, its actual human development is better than some within the group.

Table 2.10.1. **Human Development Index in Viet Nam and other Southeast Asian countries, 2012**

	Human Development Index (HDI)	Inequality adjusted HDI	Life expectancy at birth (years)	Expected years of schooling	Mean years of schooling	Growth HDI 1990-2012 (%)	Rank out of 187 countries
Indonesia	0.63	0.51	69.8	12.9	5.8	31.32	121
Thailand	0.69	0.54	74.3	12.3	6.6	21.27	103
Philippines	0.65	0.52	69.0	11.7	8.9	12.56	114
Malaysia	0.77	n.a.	74.5	12.6	9.5	21.10	64
Viet Nam	0.62	0.53	75.4	11.9	5.5	40.55	127

Note: Expected years of schooling for children of school-entrance age, which is the total number of years of schooling a child of school-entrance age can expect to receive if prevailing patterns of age-specific enrolment rates stay the same throughout the child's life.

Source: UNDP (2013), *Human Development Report 2013 – The Rise of the South: Human Progress in a Diverse World*, United Nations Development Programme, New York, http://hdr.undp.org/en/reports/global/hdr2013/.

Significantly, average schooling in Viet Nam – as measured by mean years of schooling (MYS) – is the lowest in ASEAN-5 and school enrolment rates over the last three years have remained almost unchanged. As a consequence, the gap between its MYS and those of the other ASEAN-5 countries has widened and there has been no improvement in the country's expected years of schooling (EYS).[2]

In order to improve access to education, Viet Nam is implementing a four-pronged strategy:

1. expand schooling and training systems by concentrating on infrastructure and teachers to cover all education needs;

2. improve the standard of schooling and training to help more young people into higher education;

3. subsidise education in remote areas and for the disadvantaged (the poor, the disabled, ethnic minorities, etc.);

4. widen distance education to all areas of the country.

The plan is that by 2020 the enrolment rate should be 99% in primary schools, 95% at lower secondary level, 80% in higher secondary schools, and that 70% of disabled children should be schooled.

More vocational education and training to enhance labour force quality

The structure of the labour market in Viet Nam changed rapidly after its accession to the World Trade Organization (WTO) in 2007. For example, the proportion of unskilled jobs – described as "elementary occupations" in Table 2.10.2 – dropped sharply from 61.7% in 2007 to 39.98% in 2012. While demand for unskilled labour has declined quickly, it has risen for all other kinds of occupations. The numbers of workers with basic and medium skills ("service workers and shop and market sales workers"), skilled agricultural and fishery workers, and plant and machine operators and assemblers have grown at much faster rates than occupations that require higher skills.

Table 2.10.2. **Structure of labour market in Viet Nam, by type of occupation, 2007-12**
Percentage

	2007	2010	2011	2012
Legislators, senior officials and managers	0.60	0.90	1.10	1.05
Professionals	4.50	5.10	5.30	5.52
Technicians and associate professionals	2.90	3.70	3.60	3.48
Clerks	1.20	1.40	1.50	1.67
Service workers and shop and market sales workers	7.30	14.60	14.90	16.07
Skilled agricultural and fishery workers	5.70	15.50	13.90	12.74
Craft and related trade workers	12.50	12.60	12.10	11.96
Plant and machine operators and assemblers	3.30	7.10	7.00	7.27
Elementary occupations	61.70	39.10	40.40	39.98

Source: GSO (2011, 2012, 2013), *Reports on the 2010, 2011, and 2012, Viet Nam Labour Force Surveys*, General Statistics Office of Viet Nam, Ministry of Planning and Investment, Hanoi.

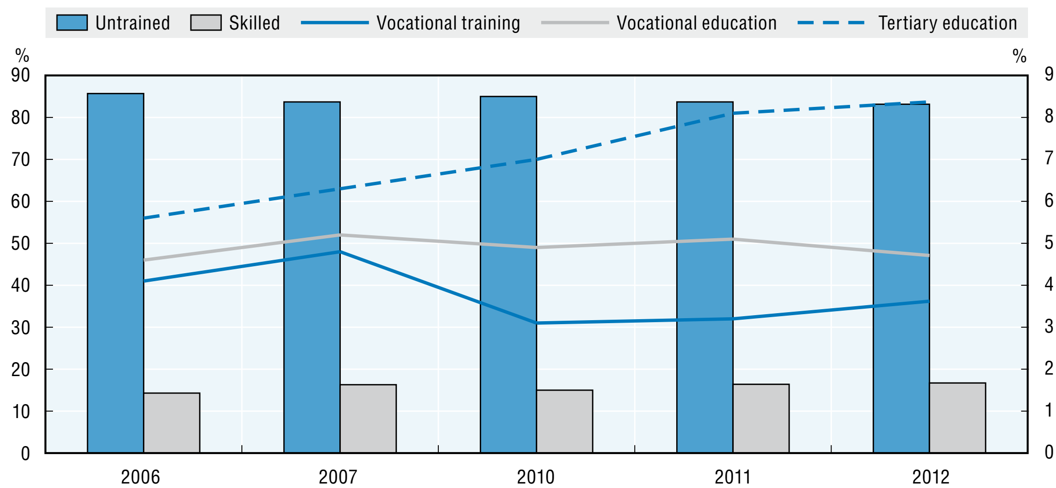
However, the rapid change in demand for skilled labour is not being met by the market supply. During the 2007-12 period, the proportion of untrained workers hardly changed from 83.7% to 83.15% (Figure 2.10.1). The apparent contradiction with the change in the structure of occupation in Table 2.10.2 can be explained by the fact that a high proportion (30.7%) of unskilled workers are trained at work by employers themselves. The inference is that official education and training institutions have not been producing workers who meet the requirements of employers. In other words, they have had to recruit unskilled workers and then train them at work themselves.

However, employers can provide only training that builds simple skills, is short-term in nature, and can be carried out cheaply and on a large scale. They are not willing to provide training in complex skills that requires comprehensive syllabuses, costly facilities and customised learning situations. The reason for their reluctance is the high cost of such training and the risk of learners quitting their jobs on completion of training. The failure to supply medium-level skills by formal education and training institutions may be an obstacle to Viet Nam achieving its economic growth goals.

The unchanged numbers of workers completing vocational training courses[3] and graduating from vocational education[4] institutions also supports the argument set out above (Figure 2.10.1). The share of workers who have certified training qualifications has not increased since 2007. Fortunately, however, this trend is offset by the rise in the proportion of workers with tertiary education qualifications. They have steadily increased to fill the growing demand for professional workers, legislators, senior officials and managers, technicians, etc.

Figure 2.10.1. **Structure of labour force in Viet Nam, by skill, 2006-12**

Percentage of total labour force



Source: GSO (2011, 2012, 2013), *Reports on the 2010, 2011, and 2012, Viet Nam Labour Force Surveys*, General Statistics Office of Viet Nam, Ministry of Planning and Investment, Hanoi

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The results of the Viet Nam STEP Employers Survey[5] – conducted in 2012 by Viet Nam's Central Institute for Economic Management (CIEM) with the support of the World Bank – point to mismatches between supply and demand of skills. Around 47% of firms claimed that the education system failed to meet the skill needs of the workplace. Of international firms, 66% stated there was a mismatch, while 36% of local firms made the same claim. The survey also reveals that well educated and highly trained workers and white-collar workers are more likely to think that their education is useful for their jobs. Indeed, a general finding is that the higher the level of education, the more relevant to the workplace it is seen to be. However, since more than 83% of workers in Viet Nam are still untrained, very few of them believe that education is useful.

To increase its TVET provision, the Vietnamese government has stepped up investment in public education and training institutions. It is also offering such generous incentives as low-cost land, credit subsidies, and tax holidays to encourage domestic and foreign private sector investment in TVET, while subsidising firms that provide inhouse training.

Increase and improve job-related and cognitive skills

Employers highly appreciate job-specific, problem-solving and leadership skills among white-collar workers. Such skills scored more than 2.5 out of 5 in the 2012 CIEM-World Bank STEP Survey. Nearly 87% of professional respondents stated that they had to interact with people from outside their company, 79% have to make presentations at work, and 72% have to supervise others. The figures for technicians are 84.6%, 66.7% and 53% respectively. Such abilities require high cognitive and inter-personal skills, a trend underlined by studies into the demand for managers, professionals, technicians and other skilled personnel in Viet Nam's labour market. Such a demand can only grow over time.

Theoretically, technical skills are imparted by TVET and higher education establishments or, in part, by on-the-job training. Cognitive abilities – such as leadership, problem-solving and communication – are acquired at primary and secondary education levels. To narrow the mismatch between skills supply and demand, Viet Nam needs to focus on improving TVET and higher education establishments and enhancing the teaching of cognitive abilities in secondary and primary schools.

TVET establishments have failed to meet the growing demand from employers for job-related skills. Viet Nam needs to raise their awareness and understanding of the skills the market requires. They need to work closely with firms to continuously update new skills and increase their capacity to meet demand. Similarly, it is important to help workers understand that skills pay off in order to persuade them to take up technical and vocational education and training.

Furthermore, to enable TVET education and training institutions to meet the fast-changing market demand for skills, they should enjoy greater freedom in determining syllabuses, recruiting personnel, and setting fees. The authorities should not interfere, but supervise quality and support learners with financial assistance.

In short, Viet Nam's successful policy reforms have effectively built human resources. However, the country started from a low base, and its human capital now urgently needs to be further upgraded and updated. Current education and training institutions and facilities fail to meet the requirements of the labour market and enterprises bear the burden of training workers. But relying on employers to train employees will not, in the long run, help Viet Nam to make the transition to a competitive, productive economy. It needs to comprehensively improve its education and vocational training system to rectify the mismatch between labour supply and demand and deliver the job-related and cognitive skills the market requires.

POLICY FOCUS

Ease access to credit and lower transport costs to develop the private sector

The private sector was officially acknowledged as an economic force in 1986 when, at its Sixth National Congress, the Communist Party of Viet Nam asserted: "[F]rom now on, [private capitalists] are allowed to use capital, technical and managerial knowledge for doing businesses in some industries."

Since then, legal frameworks and institutions have been put in place to enable the private sector to develop. In 1990, the Private Enterprises Law established a legal basis for sole proprietorships while the 1991 Company Law ushered in limited liability and joint-stock companies. However, private ownership – the fundamental prerequisite for a private sector to operate – was officially recognised and enshrined in the Constitution only in 1992 and not incorporated in the Civil Code until 1995. This tardy recognition echoes the trial and error approach of the *Doi Moi* economic reform policy. In other words, private ownership was recognised only once it had proved that it was necessary to the economy. However, even today the private sector still plays second fiddle to state-owned enterprises (SOEs) which have been assigned the lead role in the economic development of Viet Nam.

In parallel to its removal of trade barriers in the domestic market, Viet Nam has progressively opened up to the international market by signing bilateral and multilateral agreements that have helped NSEs[6] to develop rapidly. An important turning point came in late 2000 when the Enterprise Law significantly simplified business registration. In the same year, Viet Nam also signed a bilateral trade agreement with the United States, so securing its exports access to the world's largest market. These moves prompted a dramatic increase in the number of registered private enterprises in subsequent years.

In 2005, to prepare for WTO accession, Viet Nam substantially modified its legal framework to make it compliant with international rules and provisions. Of particular significance was the passing of the 2005 Enterprise Law which unified the previously fragmented and discriminatory legal framework that governed business. Up to 2005, the Law on Enterprise (1999) governed non-state enterprises, the Law on State-Owned Enterprises (2003) regulated SOEs, and the Law on Foreign Investment in Viet Nam (1996) governed the business of foreign-invested enterprises (FIEs).

To further support the private sector, Viet Nam has gradually developed its two-tier banking sector and monetary, capital, labour, land and services markets. It has also passed laws to regulate those markets and their institutions.

Steady increase in private sector's economic contribution

Improvements to the legal and institutional system have helped the private sector in Viet Nam to develop rapidly. From to 2000 to 2011, SOEs' contribution to GDP steadily shrank from 38.52% to 33.03%, while the private sector's steadily grew.

Private enterprises have demonstrated their entrepreneurship by rapidly growing in number. Since 2000, they have expanded nationwide, although they are concentrated in Ho Chi Minh City and Hanoi. In 2011 the number of NSEs doing business was nine times higher than in 2000. They account for over 61% of the total workforce in all types of enterprises – a share that has more than doubled since 2000. And they are playing an increasingly important role in accumulating capital: their share of the total capital of enterprises of all types rose from 35% in 2000 to more than 50% in 2011. In fact, they are growing in size and number faster than any other kind of firm. In 2007 there were only 103 among Viet Nam's 500 biggest enterprises (which include FIEs). By 2012 there were 225.

Changes in business structure beneficial to NSEs

The development of private businesses in Viet Nam is reflected in changes in types of enterprises. In their initial stages of development – between 1990 and 2000 – most NSEs were small or micro enterprises concentrated mainly in the southern part of the country and chiefly producing consumption goods such as food, garments, detergent and other staples. They were primarily family-owned and control stayed within the family. Indeed, relatives and personal acquaintances were their lenders as they were denied access to bank credit.

Modern structures, more attuned to modern business, have replaced the simple, traditional, and increasingly obsolescent ones. In 2002 "private enterprise"[7] was the most widespread structure and accounted for 39.41% of all registered companies. By 2011 only 14.3% of business entities were "private enterprises". In contrast, limited liability companies expanded sharply from 37.33% of firms to 57.22% by 2011. The growth of the joint stock structure was even more spectacular – from 4.5% to 20.1% over the same period. And with the rapid emergence of joint stock commercial banks, NSEs have gained greater access to loans and are more easily able to expand their business.

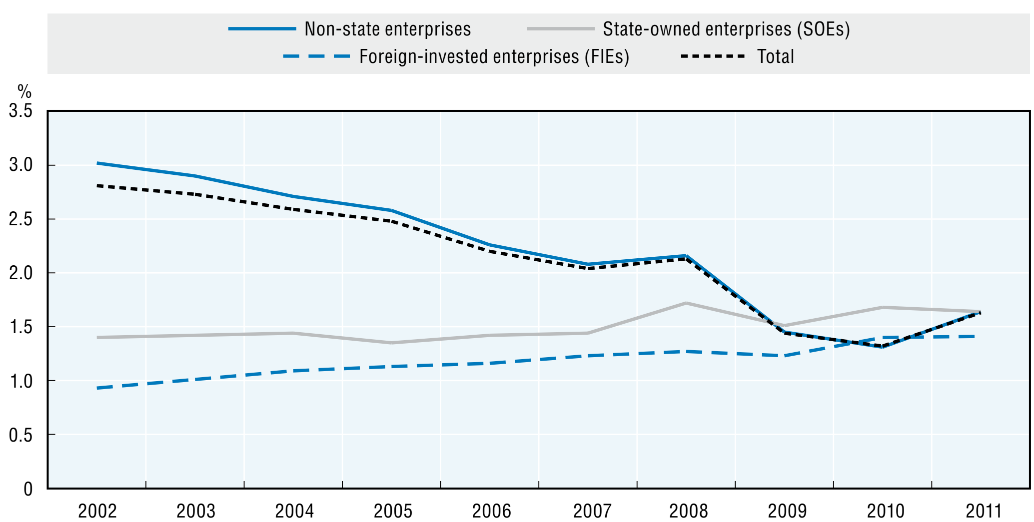
Non-state enterprises more capital-intensive than labour-intensive

As NSEs multiplied and grew between 2001 and 2011, they also became gradually more capital-intensive. By 2011 their average capital was over ten times higher than in 2000, while average workforce numbers had fallen by more than nine employees. Clearly, NSEs are gradually moving into more capital-intensive fields. The increasingly low volatility of capital supports this argument.

At the beginning of the new millennium, NSEs generally operated in labour-intensive fields, which made their capital volatility much higher than in SOEs and FIEs. As they got involved in projects that required more capital, their investment horizons grew longer and their capital volatility dropped. Recent data show that the volatility of capital in NSEs steadily converged towards the volatility levels of capital in SOEs and even FIEs (Figure 2.10.2). This suggests that NSEs are increasingly investing in long-term projects which are generally more capital- and technology-intensive.

Figure 2.10.2. **Capital volatility of enterprises in Viet Nam, 2002-11**

Ratio of total revenue to total capital



Source: OECD calcuation based on General Statistics Office of Viet Nam (GSO), *Enterprise Surveys*, 2001 to 2011.

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Access to credit has increased but still lags behind that of SOEs

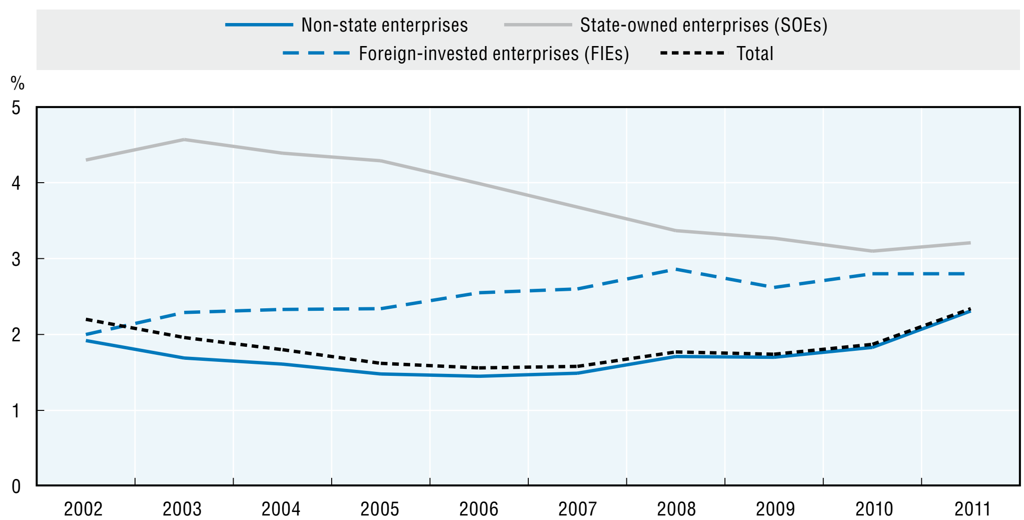
Credit accessibility may be measured by the debt index – a ratio of total debt over total owner's capital. The higher the ratio is, the better credit accessibility is. Figure 2.10.3 shows that SOEs' debt index, though gradually declining, remained much higher than NSEs and FIEs' indices from 2002 to 2011. Nevertheless, the tendency suggests that, while SOEs still enjoy easier access to loans than NSEs, their favoured status is gradually dwindling.

There are two clear trends in NSE debt indices: downward from 2002 to 2006 and steadily upward from 2006 to 2011. During the downward period, the banking sector was dominated by state-owned commercial banks which have long had a close relationship with SOEs. These banks tend to lend to familiar clients and are reluctant to grant loans to NSEs which are short on historical credibility.[8] NSEs survived on their own capital or on personal loans from relatives and friends.

From 2006, ahead of Viet Nam's WTO accession, it passed and amended numerous laws. From the new legislation joint stock commercial banks emerged. They supplied the missing channel of credit to the private sector and, as a result, the NSE debt index has risen steadily and businesses have expanded.

Figure 2.10.3. **Debt index of enterprises in Viet Nam, 2002-11**

Ratio of total debt to total capital



Source: OECD calculation based on General Statistics Office of Viet Nam (GSO), *Enterprise Surveys*, 2001 to 2011.

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NSEs an engine of growth, but persistent constraints are poor access to credit and high transaction costs

In 2012, the General Statistics Office (GSO) conducted a survey into business environment factors that impact negatively on company performance. It identified six factors:

1. high lending rates
2. high inflation with uncertain fluctuation
3. difficulty of access to credit
4. high cost of transportation
5. uncertain supply of electric power
6. unstable policies.

The government has made these concerns part of its economic policy and has gone some way towards mitigating them. Since early 2011, it has consistently applied policies to stabilise macroeconomic fluctuations. Indeed, stability has been its highest priority. Inflation has slowed and is under control and the exchange rate has been almost unchanged since March 2011. The trade balance and balance of payments have strongly improved with significant increases in foreign reserves,[9] while the lending rate fell from around 14% at the end of 2012 to 10.5% in July 2013.

The most problematic issues for NSEs, however, remain poor access to credit and transport costs. The high cost of transport is a result of Viet Nam's sorely inadequate transport infrastructure and fragmented logistics sector. It is an issue that can be addressed only by a long-term plan and will take time to improve.

Difficulty in accessing bank loans is a direct consequence of high non-performing loans in the banking sector. Although the advent of joint stock commercial banks has made it easier for NSEs to access credit, Viet Nam needs to take swift, radical action to ease this persistent strain on the private sector which plays such an increasingly crucial part in national economic development.

Private companies now contribute more than 50% of GDP and create over 60% of all new jobs. They are quite simply crucial to the economy. In last 11 years their number and their quality have development rapidly. Even though times are hard, there were twice as many NSEs in Viet Nam's 500 biggest enterprises in 2012 as in 2007 – figures that attest their vitality.

If Viet Nam maintains its efforts to stabilise the business environment and level the playing field so that NSEs can compete on equal terms, the could soon be playing the lead role in Viet Nam's economic development.

POLICY FOCUS

Restructure the financial system to enhance the effectiveness of monetary policy

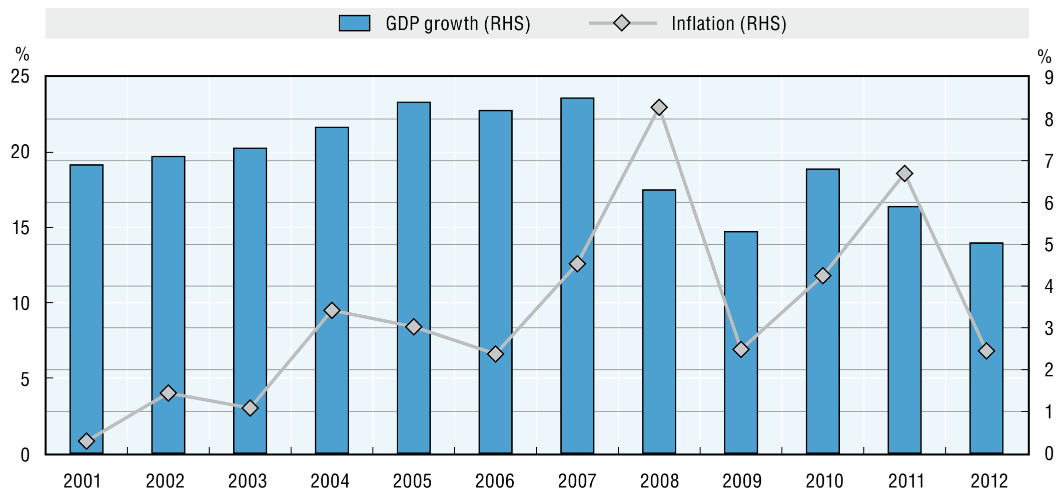
Monetary policy's broad mandate

Viet Nam's monetary policy seeks to facilitate fast growth, create jobs, reduce unemployment and improve living standards for all citizens. It also aims to control prices and inflation, stabilise the value of money, and ensure the sound development of the banking system and financial institutions. However, because monetary policy's mandate is so broad, it tends to be inconsistent over time and may contribute to macroeconomic instability.

Inflation control and economic growth

The Law on the State Bank of Viet Nam does not clearly define the prime objective of monetary policy. As one of the government's most important economic and financial management instruments, monetary policy targets both intermediate goals (the interest rate and exchange rates) and final objectives (the control of inflation and economic growth). As a consequence, there are times when the trade-off between inflation control and economic growth becomes a significant challenge. Indeed, since 2007 Viet Nam has had to contend with high inflation, the devaluation of the domestic currency, and the economic downturn. Recently, however, monetary policy management has actually improved and been relatively effective in controlling inflation and maintaining economic growth, although it still falls short of expectations. Figure 2.10.4 shows that the government did not pursue the objective of inflation control decisively enough.

Figure 2.10.4. **Inflation rate and GDP growth in Viet Nam, 2001-12**



Source: General Statistics Office of Viet Nam (GSO) and annual resolution of the National Assembly on socio-development.

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Developments in monetary policy in recent years

Viet Nam's monetary policy framework is not mature. From 2006 to 2011, the State Bank of Viet Nam (SBV) conducted monetary policy in a passive manner, keeping only loose control of the money supply as it had not caused high inflation. However, when headline inflation affected people's income, the SBV did an about-turn and tightened monetary policy. The result was macroeconomic instability (Table 2.10.3).

In early 2011, Viet Nam recognised that macroeconomic instability harmed the business environment, encouraged speculation in real estate and other non-productive sectors, and seriously discouraged long-term investments in the real economy. Macroeconomic indicators were bad and getting worse: soaring inflation, severe balance of payment and budget deficits, an escalating interest rate, dwindling foreign reserves, and bad loans piling up fast in the banks. In order to avert even worse damage, Viet Nam applied policies to tighten the money supply: it raised the lending rate to 18%, slashed public investment, and froze foreign exchange and gold markets.

The government has used these consistently and firmly since 2011 and they have helped to stabilise the economy. The most recent tightening of monetary policy reflected the government's determination to deal with high inflation. However, it also led to economic growth falling well short of official targets – 5.9% vs. 7.5% in 2011 and 5.03% vs. 6.5% in 2011 and 2012.

Table 2.10.3. **Overview of the developments of monetary policy in recent years in Viet Nam**

	Economic conditions	Monetary policy
2004-mid 2007	Mild inflation, high economic growth	Loosening monetary policy and expanding fiscal policy
	Officially entering WTO 2007, a large amount of foreign exchange flew in	Absorbing capital inflows without sterilising, hence boosting credits and money supply to record level
Mid 2007-mid 2008	High inflation	Open market operations (OMO) to withdraw money from circulation
	Sharply increasing interest rate	Interest rates (i.e. policy rate, rediscount rate and refinancing rate) adjusted upwards
	Increasing dollarisation	Implementation of a floating but controllable foreign exchange rate regime to prevent the appreciation of VND and restricting the fluctuation range of VND/USD exchange rate
	Slowing down economic growth	Selling compulsory SBV's promissory notes to commercial banks
		Consecutively increase required reserve ratio (RRR)
Second half of 2008-09	Global financial crisis and economic recession	Interest rates adjusted to create more favourable conditions for financial institutions to lower lending rate
	Easing pressure from inflation	Consecutively reducing RRR
	Capital started flowing out, FDI and capital inflow declining	Trading band of VND/USD exchange rate continuously expanded, and interbank exchange rate followed the upward trend.
	Economic growth slow down further	OMO and refinancing operations applied to control money supply in order to secure the payment system and stabilise monetary market
		Buying in SBV's compulsory promissory notes
		Subsidising 4% of interest rate on loans made in VND
First half 2010	High inflation and dollarisation	Tightening monetary policy to target of lowering inflation
Second half 2010	Easing pressure of inflation	Loosening monetary policy again
	Economic growth was under expectation	Credit and real money balance in second half increased almost twice the level in first half
2011	High inflation again	Interest rates (i.e. policy rate, rediscount rate and refinancing rate) adjusted upwards to help banks solve shortage of liquidity
	Sluggish economic growth	Overshooting devaluation to break circle of foreign exchange speculation
	Severe deficit in balance of payment and budget	Suppressing parallel foreign exchange market and gold market
	Escalating interest rate	Hard restriction on credit for real estate and stock investment
	High pressure for devaluation of foreign exchange	Tightening supervision on commercial banks' operations
	Exhausting foreign reserves	Setting ceiling for growth of credit and money supply for all banks
	Bad loans building up quickly in banking sector	Stabilising exchange rate
	Increasingly high inventory	
2012 to present	Inflation gradually declined to normal level	Keep on cautionary manner in managing monetary policy with highest priority of maintaining macroeconomic stability.
	Improved balance of payment and trade balance	Gradually removing ceiling on growth of credit
	Building up foreign reserves to more than 12 weeks	Consecutively cutting down interest rates (deposit rate, basic rate, refinancing rate, discount rate…) to level that is lower than those in good period of 2004-06.
	Declining interest rate	Conducting restructure of commercial banking sectors.
	Bad loans stopped increasing	Keep on stabilising exchange rate
	Sluggish growth of credit	
	Economic growth declined under expectation	
	Capital inflow has not improved yet	

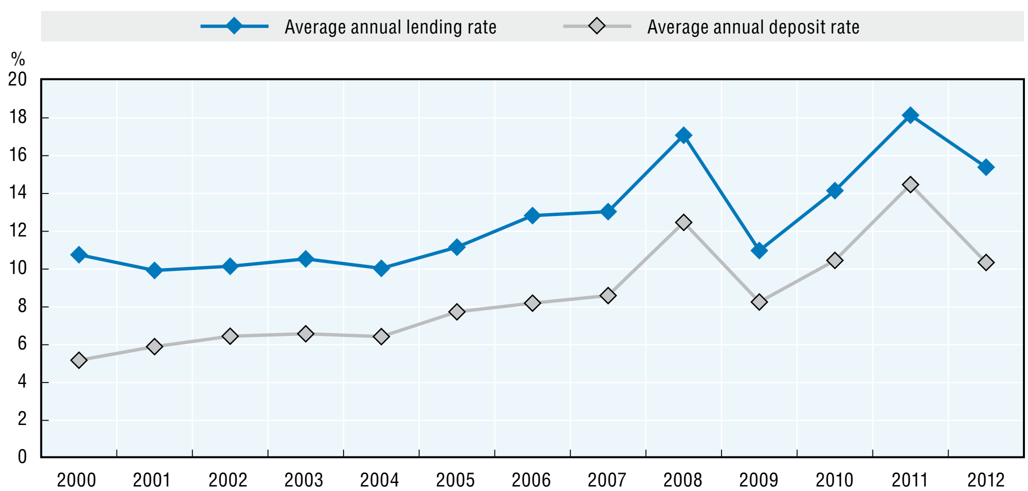
Source: Authors' compilation.

In summary, monetary policy has become gradually more effective and lends significant support to the attainment of targeted objectives. Policy implementation has gradually shifted to instruments such as the reserve requirement ratio (RRR), open market operations (OMOs), rediscount loans, refinancing, etc.

Credit restriction measures to avoid a real estate bubble

The SBV has intervened on policy interest rates (basic rate, rediscount rate, refinancing rate), and adjusted lending and deposit rates accordingly (Figure 2.10.5). Annual average deposit and lending rates increased steadily in the 2000-08 period, but fluctuated dramatically between 2009 and 2012.

Figure 2.10.5. **Average annual lending and deposit interest rates in Viet Nam, 2000-12**



Source: State Bank of Viet Nam (SBV).

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In the mid-2000s, the government took measures – including monetary policy to keep loans under strict control – to regulate the real estate market and prevent a real estate bubble from forming. Consequently, after an overlong period of prosperity, the market slipped into stagnancy in 2008 and remained that way.

In 2011, in a context of high inflation, the government promulgated Resolution No. 11/NQ-CP of 24/2/2011 on inflation control and macro stabilisation. It capped credit growth at under 20% and limited loans for non-productive activities to 16% to the end of 2011. As a result, the real estate market froze. In 2012, there was a 65% slump in new apartments for sale (equivalent to over 8 600 apartments) against the previous year and 28 000 apartments in the Ho Chi Minh City found no buyer.

In early 2013, the government approved an economic stimulus package of VND 30 000 billion (Viet Nam dong) to revive the real estate market. Although it is viewed as an optimistic signal, its implementation will face many challenges.

The effectiveness of monetary policy is also affected by the fact that Viet Nam's financial market is underdeveloped. The result is that stakeholders tend to over react in response to adjustments in the monetary policy – clearly reflected in the interest rate race among commercial banks when the SBV tightened monetary policy in 2008 and 2011, which in turn led to liquidity unrest in the market. Moreover, restrictions on financial instruments also affect the capacity to raise capital for the state budget as well as for businesses. That in turn affects Viet Nam's economic growth, since it depends heavily on bank lending.[10] The banking system is thus under constant pressure to provide capital for the economy even in the context of tight monetary policy aimed at controlling inflation. And as short-term deposits still dominate, Viet Nam's banking system is always faced with the risk of maturity mismatches, a problem that may be mitigated only if the capital market is improved.

Measures to enhance monetary policy

Maintaining macroeconomic stability must be the highest priority and monetary policy should be conducted to that end. In the medium and long terms, Viet Nam should conduct its monetary policy within an inflation-targeting framework in order to anchor macroeconomic fluctuations. To further enhance the effectiveness of monetary policy, it needs to rid the economy of dollarisation and make the Vietnamese dong the only currency in use.

Because Viet Nam is a bank-based economy, the effectiveness of monetary policy depends closely on the quality and development of the banking system. Successfully restructuring it so that it is modern and internationally compatible is essential to enhancing effective monetary policy. The government should go about restructuring cautiously but in a timely manner, too, as the longer the process is the costlier it will be to the economy.

Finally, the SBV and the government need to win public confidence in their policies and statements by keeping their promises and maintaining credible policies.

Policy makers need to strengthen their ability to stress test financial risks and their likely impacts on the financial and monetary situation and the economy. To that end, a valuable tool would be an improved database of serial macroeconomic and monetary variables. It would enable comprehensive research into and analysis of how these variables interact and affect the economy as a whole.

Notes

1. IHDI takes into account inequality in all three dimensions of the human development index (HDI) by "discounting" each dimension's average value according to its level of inequality. The HDI can be viewed as an index of "potential" human development and the IHDI as an index of actual human development.
2. Expected years of schooling for children of school-entrance age, which is the total number of years of schooling a child of school-entrance age can expect to receive if prevailing patterns of age-specific enrolment rates stay the same throughout the child's life.
3. Under the management of the Ministry of Labour, Invalids and Social Affairs.
4. Under the management of the Ministry of Education and Training.
5. STEP stands for Skills Toward Employment and Productivity. STEP studies measure skills demanded by the labour market.
6. The private sector in Viet Nam includes individual farming businesses and private economic units. Private economic units encompass NSEs, non-farming individual business, and co-operatives. On 31 July 2012 there were 4 971 206 private economic units out of a total of 4 983 979 economic units in total – a proportion of 99.74%. NSEs account for only 6.61% the number of private economic units but 45.66% in terms of employment. This report focuses mainly on NSEs when discussing the private sector.
7. Private enterprise is a firm owned by an individual who is its legal representative. The owner has total discretion in making business decisions, and is liable for its operations to the extent of all his or her assets.
8. It should be noted that, in 1997, Tang Minh Phung, the owner of a private company in Ho Chi Minh City together with numerous senior managers of the Vietcombanks and the Viet Nam Industry and Commerce bank were arrested on defrauding charges. Six people were sentenced to death (some were executed in 2003) while others received long jail terms. The case has a powerful impact on banks and private owners. Banks were reluctant to do business with private enterprises and loans to private enterprises were always carefully scrutinised.
9. Foreign reserves increased from around 4 weeks of imports at the beginning of 2011 to more than 12 weeks' imports in June 2013.
10. By the end 2012 total banks credit was more than 110% of GDP

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