

The Transition of Vietnam's Model of Economic Growth

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Abstract

Viet Nam communist party (VCP) VI Congress witnessed a change in economic thought that aimed at increasing the production. The Congress provided a guidance for an extensive model of economic growth. In fact, this model produced various positive results, mobilizing all possible resources for production and satisfying demands for food and employment. Prolonged dependence on this model, however, led to many shortcomings: unstable growth rate, waste of natural resources, environmental pollution, poor competitiveness and unstable balances of trade and payments. Seeking for and changing the model of economic growth, therefore, has become a matter of great urgency to Vietnam today.

Keywords: economic growth, model of economic growth

Introduction

Developing the economy at a high rate is desirable for all countries. The world today, however, is witnessing negative effects of fierce economic growth, such as damage to natural resources, worsening living conditions, and widening gaps between the rich and the poor. Seeking for and changing the model of economic growth, therefore, has become an urgent problem to many countries, including Vietnam.

The paper examines changes in Vietnam's model of economic growth and suggests preconditions needed for successful change in the model of economic growth for the coming years. The paper is based on qualitative methods with such devices as analyzing, comparing, contrasting and generalizing.

Theories of Model of Economic Growth

Economic growth and growth model have been discussed by economists for ages. Typical views are as follows:

First, the classical view developed by William Petty (1623-1687), Adam Smith (1723 - 1790) and David Ricardo (1772 - 1823) [Tran Tho Dat, 2005] maintains that agriculture is the most important and therefore basic factors of economic growth are land, labor and capital. Degree of combination of those factors varies over industries and technological levels. Of these factors, the land is the most important and acts as a limit on economic growth.

Second, Karl Marx adds technology to the aforementioned group of factors when he considers it as a directly productive force [K. Marx & F. Engels, 1993]. Marx argues that capital accumulation is a precondition for economic growth. In other words, part of surplus value should be turned into additional constant capital (c_1) and additional variable capital (v_1).

Third, neoclassical model of economic growth tries to explain origins of growth employing a production function that expresses relationship between increases in output and in factor inputs (capital, labor, natural resources and technology) [Vu Thi Ngoc Phung, 2005]

$$Y = f(K, L, R, T, \dots)$$

where Y denotes output (GDP, GNI); K capital, L labor, R natural resources and T technology.

Neoclassical economists point out that other factors besides the ones in the production function may exist in the producing process. Each factor has a certain effect on growth of output and these factors correlate. Of these factors, capital is considered as the most important because it is associated with technical and scientific advances while labor is seen as the most essential resource for economic growth.

Fourth, in his model of economic growth, Keynes suggests that the economy is affected by two factors: aggregate supply (total supply of goods and services of the economy), and aggregate demand (volume of goods and services demanded by the economy). It is the aggregate demand that determined output and employment of the economy while the aggregate supply plays a passive role and is affected by the aggregate demand. In the market, the aggregate demand usually increases slower than the aggregate supply, which may lead to reductions in investment and rises in unemployment. To deal with this situation, aggregate demand should be increased. When it is greater than the aggregate supply, investment, employment rate and income will all increase. [Mai Ngọc Cường, 2005]

In his analyses, Keynes maintains that governmental intervention that aims at increasing aggregate demand, employment and income is necessary when dealing with economic crisis and high unemployment. First of all, he suggests employing public expenditure to stimulate private investment and finance private enterprises. Raising profit and decreasing interest rate by increasing the money supply can encourage private investment. To achieve this goal, Keynes suggests allowing inflation to a certain extent.

He values the role of taxes and government bonds as additional sources of budget income. He suggests cutting interest rate in order to encourage investment and progressive income tax to make redistribution of income more even, thereby increasing disposable income. And he supports public investment in public works.

Fifth, Roy Harrod in England and Evsay Domar in the U.S. developed a new model of economic growth in the 1940s that considered increases in savings and decreases in ICOR are preconditions for economic growth [Trần Thọ Đạt, 2005].

In fact, however, economic growth does not necessarily comes from increases in investment; and ineffective investment produces no growth. When investment is effective, increases in savings can only create a short-term economic growth. These arguments help Robert Solow develop a new model of hisname in 1956 based on the neoclassical economic theory. While Harrod-Domar model pays attention to the role of capital in form of savings and investment in economic growth, the Solow model includes labor and technical advances in the function of economic growth. The latter is considered by Solow as decisive factor of both long- and short-term economic growth.

Sixth, modern economists emphasize economic equilibrium in Keynesian model. The equilibrium does not necessarily exist in the level of potential output but at a point lower than this level. Under normal conditions, unemployment and inflation may exist. Natural unemployment rate and acceptable inflation rate should be identified. The economic equilibrium is determined by balance between aggregate supply and demand.

Modern models of economic growth usually pay less and less attention to natural resources or land as variables of the function of economic growth. They consider land as a fixed factor while the role of natural resources becomes less important. Such factors as land or natural resources could be included in capital (K). Thus, three factors that affect directly the economic growth are capital, labor and TFP (Total Factor Productivity).

Capital and labor are considered as physical or extensive factors whose effects on economic growth can be quantified.

TFP reflects efficiency of technical, institutional, or cultural factors and is considered as quality of economic growth, or an intensive factor of growth.

Development of theories of models of economic growth shows that it is a process of changing from models of extensive growth based on natural resources and labor to intensive ones based on technical advances.

VCP Official View on Change in Economic Growth Model

Evolution of VCP Official View:

VCP official view on economic growth model has evolved over time.

VCP Congress VI in December 1986 introduced the economic reform. In this Congress, effort to face, evaluate and present clearly the status quo allows VCP to point out its mistakes that caused many difficulties for the country. The Congress VI accepted that “Rises in output are very slow compared with potentials and energy spent. Efficiency of investment and production is poor. Most factories can only run at half of their capacity. Labor productivity is falling. Natural resources are poorly tapped or wasted.

Distribution of goods is very poor and complicated. Supply cannot meet demand for food and consumer goods. Living standard of the public, especially civil servants, is low.” [VCP, 2008]

To overcome shortcomings of the centrally-planned mechanism, the Congress VI accepted the existence of a mixed market economy and diversification of ownership. The Congress stressed that “amending and introducing consistent policies on economic sectors. Fundamental rules should be made into laws to make the public feel sure and start their businesses. . . principle of equality should be observed. Persons who make useful goods and services, fulfill their obligations, and obey laws are respected and entitled to income corresponding to their labor and legal businesses.” [VCP, op. cit., pp. 47-48]

A series of resolutions by VCP Central Committee and Politburo on various fields were promulgated, such as Resolution 2 - NQ/TW (April 1987) by the Politburo of term VI on distribution and circulation of goods, four reductions and removal of barriers to free trade, Resolution 3 – NQ/TW (August 1987) on reform in state control over state-owned enterprises; and Resolution 10-NQ/TW dated April 5, 1988 by the Politburo on reform in agricultural production management.

Thus, the governing idea that infuses all resolutions of the Congress VI suggests emancipating all possible potentials for production, tapping all resources, encouraging all classes to engaging in business to meet urgent needs of the public during the crisis. There is no denying that the Congress VI provided an ideological basis for a model of extensive growth at that time.

The model of extensive growth produced many positive results, mobilized all productive forces for development and satisfied the market demand for food and employment. In 1986-1990, the average growth rate was 4.45% and goals set for three economic programs (increasing output of food, consumer goods and exports) were achieved. Food production made very good progress making Vietnam change from an importer of rice to an exporter as from 1990. Supply of consumer goods was abundant, distribution of goods was free from barriers and export earning started increasing.

Documents of VCP Congress VII in 1991 declared: “In the past four years, to meet demand by the public, we have mobilized and made the best use of potentials of the whole country for development, encouraged workers to increase their income and prosper legally, and accepted gaps in income caused by differences in labor productivity and efficiency.” [VCP, op. cit., p. 176]

After ten years following this model and obtaining many achievements, however, various shortcomings have become visible. The VCP Congress VIII in 1996 gave the following remark on implementation of the 5-year plan 1991-1995, “Quality and efficiency of development is poor, danger of falling behind regional economies still looms large. Productive forces are small while facilities, especially the infrastructure, are obsolete. Almost no technical advance is realized. Well-trained, competent and ambitious human resources are small and badly employed. Labor productivity increases slowly.” [VCP, op. cit., p. 393]

Congress IX in 2001 affirmed the direction for economic development in Vietnam is to “develop the economy in a fast, effective and sustainable manner along with ensuring social progress and equality, and environmental protection; mobilize all resources for fast and effectively development of industries and fields Vietnam enjoy some advantages to meet domestic market demand, promote export, and improve competitiveness at home and abroad; enhance labor productivity and quality of economic growth; practice thrift and fight against waste; and accelerate capital accumulation.” [VCP, op. cit., p. 508]

Regarding the socioeconomic development strategy, Congress IX affirms that “the industrialization and modernization in Vietnam should and could be made shorter; some leaps could be taken besides normal steps forward. All advantages and potentials should be tapped to achieve modern technologies, especially bio- and information technology, apply more and more technical advances, and develop the knowledge-based economy by degrees. Educational and techno-scientific development based on Vietnam spiritual and intelligent strengths should be considered as a basis and dynamic for industrialization and modernization.” [VCP, op. cit., pp. 465-466] Up to 2006, 20 years after the model of expensive growth was introduced, its shortcomings became more apparent as pointed out by Congress X in 2006. In its report on the 5-year plan 2001-2005, the Congress notes, the growth rate in the past five years is low in comparison with national potentials and foreign countries in their first stages of industrialization. Scope of production is still small and per capita income is low.

The economic growth is totally based on extensive factors, traditional products and industries that employ too much labor, capital and natural resource and many obsolete technologies. Labor productivity rose slowly and is very low compared with regional countries. The national competitiveness is very poor.” [VCP, op. cit., pp. 679-680]

In this Congress, the lesson of fast and sustainable development drawn from the implementation of the 5-year plan 2001-2005 is “fast growth should be associated with sustainable development. Interaction between those two aspects reflects at both macro and micro levels, and in both short and long term. Quantitative growth should be linked with quality, efficiency and competitiveness of the economy. When tapping factors of extensive growth, full attention should be paid to intensive ones. Economic growth should be associated with cultural and human development, social progress and equality, democracy, job creation, improvement in living standard, encouragement to efforts to prosper legally, and poverty alleviation. Gaps between provinces and zones should be bridged. Great effort should be made in all stages of development to protect and improve the environment [VCP, op. cit., p. 688]

Congress XI in 2010 called for “reforming the model of economic growth and restructuring the economy, accelerating industrialization and modernization, and ensuring fast and sustainable development.” Regarding the economic growth model, the Congress suggested moving from the extensive growth to a new model combining both extensive and intensive growth by expanding the scope of production and paying proper attention to quality, efficiency and sustainability of economic growth. [VCP, 2011, p. 191]

Thus, the VCP since 1986 has moved from supporting a model of extensive growth based on natural resources, labor and capital to a model of intensive growth based on TFP. In other words, the emphasis is on quality of economic growth instead of high growth rates.

Achievements and Shortcomings:

In implementing the model of extensive growth since 1986, Vietnam has obtained many encouraging achievements in the past 25 years, but the model has gradually revealed shortcomings.

- **Achievements:** Vietnam attained a pretty high growth rate, scope of production rose, and Vietnam escaped underdevelopment. Its real GDP in 2010 amounted to US\$101.6 billion; per capita GDP was US\$1,168 and export earnings reached US\$71.65 billion.

Most sectors and industries enjoyed pretty high growth rates. Agricultural sector ensured food security and an increasing volume of farm products for export. Living standard in rural areas was improved while poverty alleviating programs have attained impressive achievements.

Industrial production provided variety of goods with improved quality, which enhanced the competitiveness of the economy, satisfied the market demand, and gained footholds in foreign markets. Investment in high technologies and new industries started to increase.

The service sector attained a stable growth rate. The economic structure changed in the direction of industrialization. Up to 2010, the agricultural sector accounted for 20.6% of GDP and shares of manufacturing and service sectors were 41.1% and 38.3% respectively. Labor structure also changed positively: 48.2% of the working population work in agricultural sector, 22.4% in manufacturing sector and 29.4% in services sector.

Table 1: Vietnam’s Growth Rate in 1986-2010

Year	1986 - 1990	1991- 1995	1996- 2000	2001- 2005	2006 - 2010
Average growth rate	4.45%	8.2%	7.0%	7.51%	7.02%

Source: Author’s calculations based on Viet nam Statistical yearbook 2010

- **Shortcomings:** Extensive economic growth proved to be less sustainable. Macro balances were not stable. Quality, efficiency, and competitiveness of the economy were low in comparison with potentials. The economic growth depended mostly on increases in investment and exploitation of natural resources. Efficiency of employment of investment, especially the public one, is poor because of great loss and waste.

In the manufacturing sector, assembling and doing subcontracts still play important roles because modernization was carried out very slowly. Labor productivity was low in comparison with neighboring countries. Infrastructure was not uniformly and quickly developed and failed to support the economic growth.

Table 2: Some Macroeconomic Indicators in 2005-2010

Indicator	2005	2006	2007	2008	2009	2010
Growth rate (%)	8.44	8.23	8.46	6.31	5.32	6.78
CPI (%)	8.4	6.6	12.63	19.89	6.52	11.75
Public debt/GDP (%)	41.8	42.9	45.6	43.9	49.0	51.3
Trade balance (US\$ billion)	- 4.31	- 5.06	- 14.2	- 18.02	- 11.85	- 12.40
Balance of payments (US\$ billion)	- 0.3	-0.2	-7.0	-10.8	-7.4	-9.3

Source: Viet Nam Statistical yearbook 2010

Conclusion and policy implications

Changing from the extensive growth model to an intensive one is an urgent task and it is not easy. By examining experience of economic growth of high quality in Japan, South Korea and Singapore, and analyzing current conditions in Vietnam, I propose the following preconditions for a successful change in economic growth model for Vietnam.

Firstly, a labor force of high productivity and competence is a very important factor to the change in economic growth model. Education not only satisfies human demand for knowledge but also provides learners with ability to take part in economic activities. When competence is improved, labor productivity and personal income certainly increase accordingly. Investment in human resources not only supplies an important input but also helps reduce inequality when opportunities are open to everybody. This effort helps enhance the quality of economic growth.

To improve the quality of human resources, a comprehensive reform in teaching and learning programs and evaluating methods should be carried out in all levels of education that aims at enhancing learners' self-educating capacity, creativity, modern work style and sense of responsibility. Management of education service should aim at providing more autonomy for schools. Testing and evaluating schools should be publicized to force schools to enhance their sense of responsibility.

Vocational training could be introduced to high schools along with general education in order to help students identify their appropriate occupations after graduation. Institutes training educational service managers also need radical reforms. Employing effectively the trained human resources is also as important as development of education system to the change in economic growth model. To achieve this aim, salary scale and treatment to civil servants should be reformed. In recruiting and assessing competence of civil servants, attention should be paid to their expertise and skills instead of academic degrees or seniority. Preferential treatment will help experts feel sure and satisfied with their careers.

Secondly, effective use of capital is one of important conditions for change in the growth model. One of major lessons of improving the use of capital is make the process of using public funds transparent and open. The transparency will encourage competition and develop a proper market mechanism.

Developing the technical infrastructure is a key to a successful change in the growth model. Public investment should be concentrated on major infrastructure projects in key economic zones and high-tech parks instead of being divided among too many small-sized projects. There should be policies on preservation and protection for natural resources and ecosystem. Environment-related laws should be improved. Law enforcement should be strong enough to prevent violations.

Thirdly, macroeconomic policies should be transparent in order to distribute evenly benefits from economic growth. The government should avoid paying too much attention to growth rate and neglecting social progress, or giving top priority to certain industries or provinces and ignoring others, especially agriculture and rural areas. Poverty alleviation programs in depressed districts should be carried out effectively. Medical care and social security and relief should be strengthened in order to provide more protection for vulnerable and disadvantaged groups.

Fourthly, a strong government is a key to success of a development strategy. Such a government should be centralized and committed to long-term development policies. A precondition for a strong government is a team of competent and well-paid civil servants who are free from pressure of interest groups and allowed to carry out initiatives.

To build such government, the administrative machinery should be firm, clean, effective and neat. Democracy and rule of laws should be made into principles for the government. Administrative reform should be accelerated and all classes are allowed to supply public services. There should be programs to enhance the quality of civil servants in terms of expertise, skills, work ethics and leadership ability. Proper treatment and incentives should be offered to civil servants and incompetent officials should be fired. A reasonable salary scale and housing policies can also enhance sense of responsibility of civil servants and prevent corruption.

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