KfW Research
Emerging Markets Spotlight

Vietnam – vocational training: key building block of development strategy

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Economic situation

- Real growth
- Private consumption (yoy)
- Inflation rate

Impressive growth despite relatively high inflation

Vietnam's GDP has increased more than fivefold in real terms since 1990. The country has thus achieved emerging market status. The industrial sector has experienced particularly high growth. Private consumption is an economic mainstay. Inflation is currently low but was often high in the past years – a similar problem as in other emerging markets.

Growth financing

- Budget balance / GDP
- Current account balance / GDP
- Forex reserves

Fiscal indicators weak, foreign trade mostly unproblematic

The relatively high budget deficit of the past years (some 7 %/GDP) is not an expression of growth-promoting fiscal policy but highlights weaknesses on the revenue side of the national budget. The continuous rise in exports helped Vietnam achieve a high current account surplus up to 2014 which, however, has since moved in the direction of a – manageable – deficit (owing to increased imports of services, inputs and capital goods). Forex reserves as a liquidity buffer in external transactions should be increased.

Growth resources

- Investment ratio
- Years of school
- Labour market participation

Investment is sound basis of boom, use of human resources highly effective

The investment ratio has recently dropped and is only average compared with other countries. Nevertheless, investments are a key driver of the economic boom. In the use of its human resources Vietnam performs on a similarly high level as other emerging markets (school education) and even has outstanding labour market participation in excess of 80 %. Deficits remain in vocational training, however.

Economic relations with Germany

- Germany's share of exports
- Germany's share of imports
- FDI inflows from Germany

Trade and investment is growing, but on a low level

Bilateral trade with Germany is increasing in absolute terms but is of little significance for both countries. Germany imports mainly electronics and textiles from Vietnam and exports mostly machinery and chemical products to Vietnam. German direct investment in Vietnam is modest in the regional context of Asia as well, with a value of EUR 636 million (2014).

Legend (see p. 5 for detailed explanation of methodology) very good good neutral poor very poor

Investment climate – assessment by our local experts

A sustained economic boom period has elevated Vietnam to the status of emerging market economy. At political level the Communist Party is holding onto its monopoly of power, but in economic terms the government has been on a path of market-oriented reform for the past 30 years. The boom is mainly driven by the growth of industry which benefits from low wages and open borders (free trade agreements with the EU, ASEAN, etc.). But Vietnam is not only a success story. Rather low governance indicators point to very challenging conditions for private investors, for whom the continuing privileges of state-owned enterprises (SOEs) making life difficult as well. Deficits in the banking sector and fiscal policy also pose significant barriers to growth. If it makes progress in these areas Vietnam has good potential to achieve further economic growth.

Continued on p. 2

Focus: Deficits in vocational training hamper further economic growth

The industrial sector recently saw particularly strong growth, which led to an impressive expansion of exports, among other developments. But the majority of these exports are still labour-intensive products with little added value. Vietnam's goal of achieving sustained high economic growth requires higher labour productivity and greater production depth. A serious obstacle on this path is the lack of skilled workers. Existing vocational training opportunities are inadequate. The government intends to change this, but increasing international competitiveness requires further comprehensive economic reforms.

Continued on p. 2

Investment climate – assessment by our local experts

As recently as in the early 1990s, Vietnam had enormous developmental deficits as a result of the disastrous Vietnam War and many years of socialist, centrally planned economic policies, with half the population living below the poverty line. Since that time, comprehensive economic reforms towards a more market-oriented system have led to a five-fold increase in real GDP. The poverty rate dropped to 3 % in 2012 and Vietnam is today classified as a lower middle income country. Industry saw particularly strong growth (see also “Focus” below). Nevertheless, Vietnam’s constitution still defines the country as a socialist republic and confers a monopoly of power on the Communist Party. As an investment location and sales market, including for German enterprises, its major strengths are sustained growth, more attractive investment conditions than neighbouring countries (low wage level and strong external trade) and a large domestic market with demand backed by high purchasing power. The construction and consumer goods industries and, generally, manufacturing are currently experiencing particularly strong growth which will probably continue in the foreseeable future. The government is seeking to attract more high-tech investors with tax incentives and other benefits.

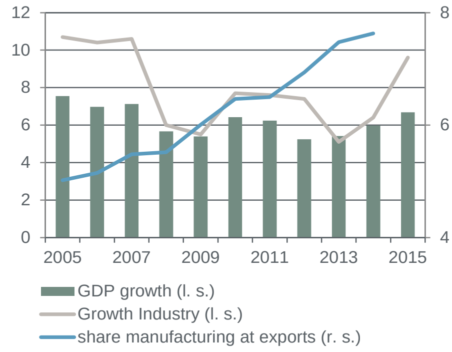
Still, Vietnam is far from being a clear-cut economic success story. The reality of its “socialist market economy” is anything but easy for private enterprises. Vietnam’s rather poor scores on governance indicators such as Doing Business and Corruption Perception speak for themselves. Vietnam also ranks lower in these areas than neighbouring countries such as Thailand or China.

Fiscal policy, state-owned enterprises (SOEs) and the banking sector are areas that require urgent economic policy intervention. The national budget deficit has been too high for a long time, at 6-7 % of GDP, which is mainly an expression of neglect on the revenue side. Land ownership, investment income and other items are still not subject to taxation, and the tax administration is weak.

A considerable problem is that state-owned enterprises (SOEs) continue to generate one third of GDP despite the economic reforms of the past 30 years. Politics strongly intervenes in the concerns of industrial SOEs, which have severe business management deficits as a result. Moreover, SOEs hardly innovate. This setting ultimately provides a breeding ground for corruption. The banking sector is dominated by state institutions, which also have major weaknesses in corporate and risk management. They also achieve low returns and are undercapitalised. Private commercial enterprises - especially small and medium-sized ones - have inadequate access to banking services. Although the government is generally concerned about privatisation, it remains to be seen whether it will actually take determined action to tackle the issue.

Based on an interview conducted with Dr Herbert Baumgartner (DEG Bangkok Office Director) on 12 September 2016. ■

Figure 1: Growth of GDP and industrial sector (in real terms in per cent), export share of manufacturing (in per cent)

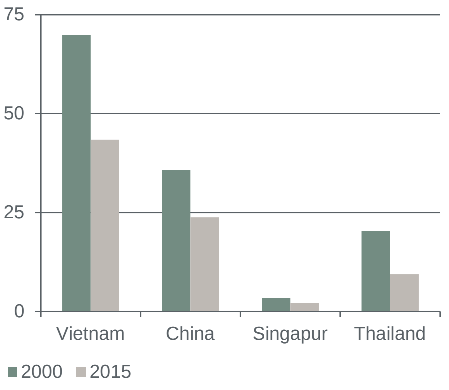


Sources: IMF, World Bank, EIU

Focus: Vocational training is an important factor for Vietnam to become a high-income country

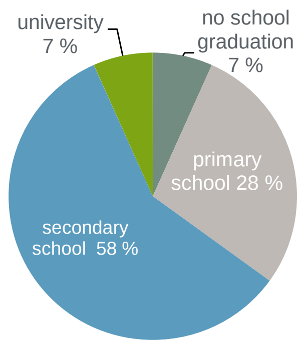
Industrialisation with basic technologies: Vietnam owes its transition to the status of emerging market economy in large part to the development of its industrial sector (Figure 1), which has consistently grown more strongly than total GDP since 2005. This sector has many foreign investors that produce goods for the world market. The share of manufactured goods in Vietnam’s total exports has risen continuously and is now a high 76 % (Figure 1). An analysis of the “technological content” of exported manufactured goods (Figure 2) yields valuable insights. In the year 2000, 70 % of these Vietnamese exports consisted of labour-intensive, or in other words, rather unsophisticated goods. That proportion then tended to drop significantly but was still 43 % in 2015. Exports of manufactured goods from Vietnam are therefore still dominated by a production that mostly relies on low value-added unskilled labour. A look at the neighbouring countries China, Thailand and Singapore is worthwhile in order to put this finding into perspective (Figure 2). These countries initially show a similar trend as in Vietnam: the proportion of labour-intensive exported goods has dropped. However, in 2015 that proportion was down to 24 % in China, 9 % in Thailand and only 2 % in Singapore, much lower than in Vietnam. This shows that Vietnam’s neighbours have already been much more successful in advancing to higher value added chains.

Figure 2: Share of labour-intensive products in manufactured goods exports (per cent), country comparison



Source: UNCTAD, own calculation

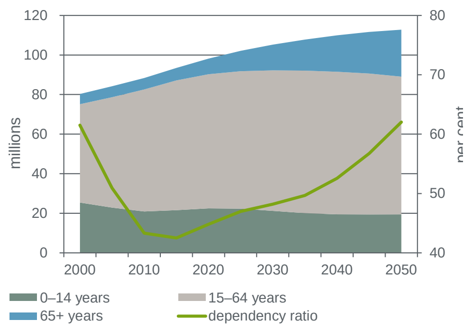
Figure 3: Vietnam, adult education level (age 25+) in 2009a)



a) latest available data

Source: UNESCO, own calculation

Figure 4: Population of Vietnam and dependency ratio



Source: United Nations, Population Division

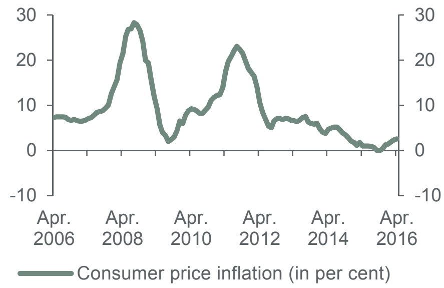
Vietnam wants to become an advanced economy and grow its economy with higher value added activities, so vocational training is gaining importance. The government has set itself ambitious goals: sustained high growth with higher value added, improved international competitiveness, higher labour productivity and production depth, more environmental protection etc. Human resources development therefore has high priority in its development strategy. Availability of labour generally is not an issue. The official unemployment rate is in fact a very low 2 %. But that does not say much and a tight labour market is certainly not the case. Unemployment and underemployment are still widespread, with 1.4 million new job seekers entering the labour market each year. Thanks to targeted efforts in the past years, Vietnam is generally doing well in the area of general education. Nearly 60 % of adults in Vietnam have completed secondary education and 7 % have a university degree (Figure 3). But there are still considerable deficits on the labour market. More than half of the employees are unskilled workers and companies lack qualified specialists and technicians in particular. Available vocational training opportunities are generally inadequate and regarded as too theoretical, that is, the subject matter does not meet employers' requirements. Many companies are attempting to solve the problem by providing on-the-job training which is not very efficient, however, and quickly reaches its limits. The government has recognised the problem and is working towards improving vocational training, including with the support of donor organisations. Initial progress is already apparent. But since both the state and businesses are entering uncharted territory in education policy, they will need patience and stamina. Unfortunately, observers deplore inconsistency in some areas of education policy, including the fact that the government has lowered the bar for entry to university, encouraging secondary school graduates to enrol in degree courses rather than vocational training.

In order to achieve the targets of its development strategy, however, Vietnam also must tackle mega-issues such as privatisation and demographics. The political focus on human resources development has been placed correctly. Nevertheless, the competitiveness of the industrial sector also depends on fundamental industrial-policy conditions. As mentioned above, the proportion of state-owned enterprises in manufacturing and banking remains high and privatisation is a politically sensitive issue.

The demographic trend demands urgent measures that cannot be deferred. As a result of declining birth rates and rising life expectancy, Vietnam is heading towards an ageing society. The dependency ratio (defined as the cumulative percentage of young and old people in relation to the number of available workers) has just reached its minimum and will soon rise sharply (Figure 4). That makes it all the more important to gainfully employ the available workers in general and with rising degrees of productivity in order to increase the production and consumption opportunities of future generations that will live in demographically more challenging times. The decline in the group of under 15-year-olds by 1.3 million in the past ten years should have freed up resources in the educational system that should now be used to expand vocational training. ■

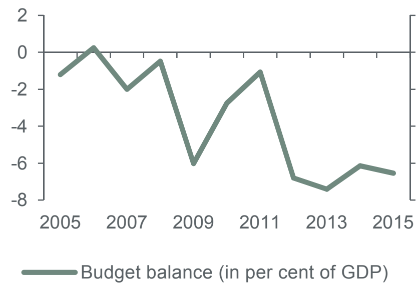
Overview of figures

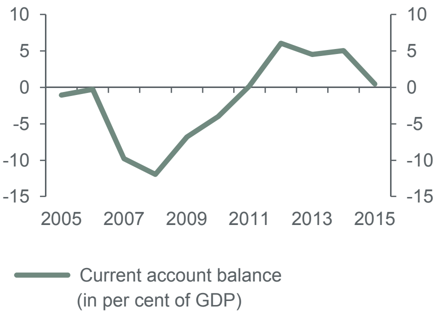
Economic situation



Source: Thomson Reuters Datastream; IMF; World Bank; General Statistics Office of Vietnam; own calculations

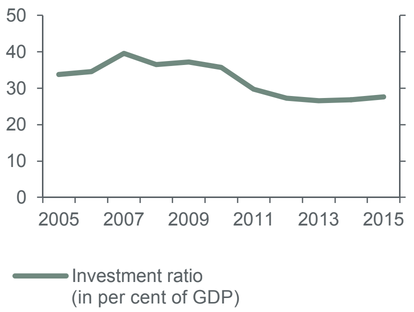
Growth financing

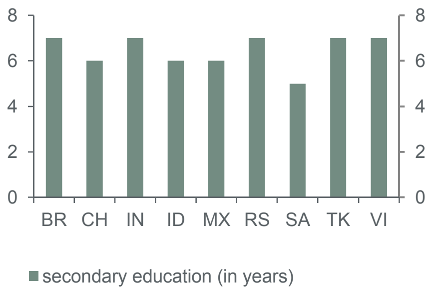




Source: Thomson Reuters Datastream; IMF, World Bank, own calcualtions

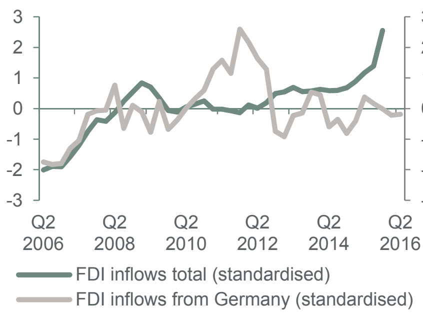
Growth resources





Source: Thomson Reuters Datastream; IMF, World Bank

Economic relations to Germany



Source: Deutsche Bundesbank; Thomson Reuters Datastream; IMF; UNCTAD; own calculations

Methodology

In the Emerging Markets Spotlight, a selected country is analysed based on various macroeconomic indicators. These indicators are grouped into four categories: economic situation, growth financing, growth resources and economic relations with Germany.

- Quintile 1
- Quintile 2
- Quintile 3
- Quintile 4
- Quintile 5

The indicators are used to compare the country's situation with its peers. The group comprises Brazil, China, India, Indonesia, Mexico, Russia, South Africa and Turkey. The comparison is based on a quintile ranking in five categories, which are labelled in different colours (see chart):

The country is assigned to a quintile of the country group for each indicator analysed. The best quintile may be different for each indicator. For example, higher growth rates are better, so here the upper quintile is coloured dark green, but higher debt rates are a negative factor, so here the upper quintile is coloured dark red.

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