



## PROBLEMS TO THE VIETNAMESE ECONOMY IN 2010 ARISING FROM EFFECTS OF THE GLOBAL FINANCIAL CRISIS AND RECESSION

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### 1. An outline of the world financial crisis

#### a. Developments:

The fifteenth of September, 2008 marks the worst crisis ever seen in the last 80 years after the Great Depression 1929-33. In fact, the crisis took place earlier, in the summer of 2007, but in that day, declaration of Lehman Brothers Bank bankruptcy shocked the world financial system. Many American and European corporations, such as Bear Stearns, Merrill Lynch, City Group, Morgan Stanley, or AIG, etc. went bankrupt or were on the brink of ruin if they were not acquired, merged or supported by central banks. The NYSE and a series of European and Asian stock exchanges wavered. Since the summer of 2007, some US\$35,000 billion have vanished into thin air. Up till now, governments have taken joint actions to rescue the world economy. We have never seen the fact that leaders of the G20, the group of the world leading economies and emerging ones, held three meetings within 10 months to work out measures to rescue the world economy from its crisis. The G20 has replaced the G8 in making the policy on the world economic development. Over US\$15,000 billion have been spent rescuing the economy so far.

#### b. Causes of the crisis:

There are numerous ways of explaining the causes of the crisis. C. Powell, former US Secretary of State argues that the crisis comes from un-

even development of the two major economies – Chinese and American ones. While Americans spend more and save less, the Chinese people are quite the opposite (China is holding over US\$2,000 billion in its reserves and the biggest creditor of the U.S.).

Some Chinese authors maintain that the crisis originated in the real economy where housing bubbles affected the monetary economy, and fluctuations in the monetary economy impacted on the real one. Regarding direction of the crisis, this argument has its own logic. The crisis started up in collapses in the American realty market (the real economy) and led to collapses in the banking system (the financial market).

Most experts, however, agreed that the crisis came from the financial and affected industries (that is, the real economy). The main cause was the fact that low interest rates encouraged the public to use bank loans to buy real estate, which lead to bubbles in the markets for real estates and investments. Banking institutions divided mortgages into small packages and sold them on the stock exchanges. Investors bought these packages in hope that the price would keep increasing in the realty market. When the inflation and interest rates rose, house buyers couldn't repay debts, housing prices fell drastically, and mortgages lose their values, which brought banks to the brink of bankruptcy. Because the globalization is associ-

ated with the liberation of capital accounts and increases in the volume of derivatives were too high, the finance market expanded beyond control, and its crisis not only ruined the American finance market but also shook the global finance one.

In the 1980s, the size of the monetary market equaled that of the real market. In the 1990s, the monetary market separated from the commodity market, became an independent sector with high growth rates based on new commodities. In 2007, the size of the finance market was four times bigger than the global GDP equaling some US\$230,000 billion. Fast development of the finance market was not well managed and supervised, and it lacked precautionary measures to ensure safety. And as a result, the financial crisis impacted on industries driving the global economy to a serious recession.

Some Marxist economists considered it as a periodical crisis of the capitalism.

Author of this article thinks that the crisis is something more than a periodical one. To make a long story short, there are three causes of the crisis: (1) government's failure to control the economy; (2) Greed of financial institutions; and (3) Market controlling institutions are careless and unable to cope with far-reaching globalization, increasingly complicated economic relationships and increasingly interdependence of economies.

#### c. Impacts of the global financial crisis:

The crisis impacted greatly on the economic growth. Because of fast and unpredictable developments, and effects of stimulus packages introduced by governments, experts have had to adjust their predictions. According to an IMF estimate publicized in early October 2009, the world GDP might rise by minus 1.1% while economies rise by minus 3.4%. The world trade in 2009 would fall by 11.9% as compared with 2008 in which the fall in commodities trade accounts for 13% and import by developed countries (Vietnam's main export markets) by some 15%.

#### d. Prospects:

Up till now, researchers agree that the global crisis reached its bottom, its recession rate started reducing, and some economies gained positive growth rates. Asians economies, especially Chinese and Korean ones obtained the fastest recovery. With a stimulus package of US\$600 billion,

China gained a growth rate of 7.9% in the second quarter of 2009 and a higher one in the third quarter. Its growth rate in 2009 is estimated at 8.5% and in 2010: 10%. The South Korean recovery rate is also high. Japan in the second and third quarters of 2009 gained positive growth rates after a rate of minus 3.8% in the first one. However, the yen still rose against the US dollar and the deflation was high, which made its prospects for recovery faint and both good and bad signs made their appearance.

In Europe, France and Germany enjoyed the most positive changes while England still faced some difficulties. In the U.S., although the crisis has passed its worst and the growth rate in the third quarter of 2009 was estimated at 2.8% - the highest one in the past two years - the unemployment rate was still high, varying from 9.7% in August 2009 to 10.2% in October and 10% in November. Many experts predict that this rate may stay high for some time before falling to an acceptable level (hopefully the first half of 2010). Some banks and companies have made some profit and become solvent but this was mainly due to downsizing while other banks still faced financial difficulties. Meanwhile, budget deficit and public debt were on the increase and topped the 12,000-billion mark for the first time in its history. The Global Confidence Index in November fell drastically. That is why President Obama had to maintain the stimulus package and the FED kept the interest rate low. The IMF in October 2009 also predicted that the 2010 global GDP would increase by 3.1%; developed economies 1.3% while developing and emerging ones 5.1%. The international commodity trade would rise by 2.7% and demand for imports by developed economies rise by 1.5% only.

## **2. Impacts of the global financial crisis on the Vietnamese economy**

Due to a low degree of financial liberation, the Vietnamese financial system is not directly affected by bankruptcies of American and European banks. An economy with high openness, the Vietnamese growth rate depends a lot on external factors, and therefore the global crisis affected greatly the economy, reduced the growth rate and threatened the macroeconomic stability.

Foreign investment fell strongly: in 11 months

of 2009, the registered capital reached US\$14.66 billion equaling 22.4% of the volume of the same period in 2008. Export also decreased. The export value in the 11 months of 2009 is estimated at US\$51 billion decreasing by 11.6% over the same period last year. This fall happened in all export markets although it was of different degrees because of different structure of exports: earnings from Asian markets fell by 18.7% making the Asian share in the Vietnam's export value fall from 44.7% in 2008 to 38.8% in 2009 in which the ASEAN share fell by 11.8% (from 16.8% to 15.9%); Japanese share by 37.4% (from 14.3% to 9.6%); and South Korea 11.3%. The EU share fell by 11.4% from 16% to 15.2%. Falls in Chinese and American shares were the smallest: China by 9.75% and the U.S. by 6.2%. Thus, the U.S., ASEAN, EU, and Japan are still Vietnam's major export markets and their places didn't change in 2009. Other sources of foreign exchange (such as tourism, indirect investment, and immigrant remittance, etc.) were all on the decrease.

Due to falls in export and investment, the 2009 growth rate is expected to reach 5.2%. This is a high level compared with regional countries but much lower than the average of previous years. What is worth worrying is the fact that the balance of payments in 2009 was in deficit for the first time although the foreign exchange reserve is still big as compared with previous years.

### **3. Problems arising after the global financial crisis**

In this period, there are three major trends that affect development of countries:

(1) Fast development of sciences and technologies, especially information and biological technologies and new materials: This is the strongest dynamic the produce enormous quantities of commodities.

(2) Economic globalization and trade liberalization, fast development of services and investment in terms of size and forms.

(3) Peace and cooperation is still a major trend but regional conflicts over power and influences, especially islands and water territories associated with natural resources are threatening global stability and development.

In fact, the three trends have come into being and developed strongly since the last decades of

the twentieth century. They affect and integrate into one another to produce intertwined opportunities and challenges, which makes uncertainty and risks increase. These trends constitute a coordinate system for development of this era and each country should find a place for itself in this system.

After the global financial crisis and economic recession in the face of natural disasters caused partly by the human race, these trends reveal new signs and their most noticeable features are:

- The first axis: The economic restructuring process will take place remarkably in many countries with appearance of new materials and sources of energy, and new energy-saving technologies in order to deal with exhaustion of non-renewable resources and climate changes.

- The second axis: Reforms in institutions for controlling the globalization, especially in mechanisms for managing the finance market should be carried out to prevent danger of crisis caused by uncontrolled globalization. Relationship between government and market will be adjusted with a view to beefing up the government's role macro-economic management and economic development. In some countries, adjustment of the capital accumulation – spending relationship will be realized while the protectionism tends to expand.

- The third axis: Alliances will be beefed up to deal with dangers to the humankind, such as development of nuclear weapons, international terrorism, climate change, higher sea level, cross-border plagues and pollution, and crises, etc. Noticeable characteristics of changes in this axis are transfer of power from the U.S. to Asia with rises of China and India, change from a uni-polar world to a multi-polar one, and establishment of a strategic forum between the U.S. and China (some researchers start mentioning a G2). The rise of China will change the politico-geographical map, and international power balance and development. The greatest effect on Vietnam will be from this factor that provides it with intertwined challenges and opportunities.

### **4. An overview on Vietnamese economic development since 2001**

In the years 2001 -09, Vietnam carried out its socioeconomic development plan for 2001 -2010 with the following main features:



**Firstly**, the Companies Law was passed in 2000 and effective as from 2001, which opened a new era for the private sector – an important dynamic of the economic growth.

**Secondly**, Vietnam carried out ASEAN and ASEAN- Plus Free Trade Agreements and got accession to the WTO – a landmark of its international integration – representing great opportunities and challenges. The most remarkable opportunity is possible increases in foreign investment and export, and the biggest challenge is the increasingly keen competition at all three levels.

As a WTO member, Vietnam should adjust its laws to the WTO rules based on equal market access and treatment and it promulgated companies and investment laws applied to all sectors. Such efforts created a new business climate in which its economic strength is measured.

**Thirdly**, Vietnam suffered from negative effects of the world financial crisis. After the Asian financial crisis 1997-99, it took Vietnam five years, up to 2005, to regain the growth rate of 1996. And in 2008-09 it was affected by the world financial crisis and recession. This crisis is also a measure of its ability to deal with external shocks. Generally, after nine years carrying out its socio-economic development plan, Vietnam gained a rather high growth rate – about 7.3%; the GNP in 2008 based on comparative price equaled 179% of the 2000 one (and 200% in 2010 as estimated). In 2008, the GDP was worth US\$90.7 billion and the per capita GDP was US\$1,047 (these figure are expected to rise to US\$100 billion and 1,220 respectively by 2010), which brings Vietnam away from the list of low-come countries.

There are positive changes in the structure of industry. The share of the agriculture fell from 23.2% in 2001 to 21.7% in 2009, manufacturing and construction rose from 38.1% to 40%, while the service sector made good progress in the last five years and gained growth rates that were higher than the ones found in other sectors.

The export value rose from US\$14.49 billion in 2000 to 68.69 billion in 2008 making an increase of 430%. The gross investment equaled 41% of the GDP and 30% of which was from foreign sources. The macroeconomic situation is stable: budget deficit and public debt are within safety limit.

In spite of these achievements, the Vietnamese reveals many defects and shortcomings:

- The economic growth depends too much on external factors (investment and export market). The share of foreign sector in the GDP rose from 13.8% in 2000 to 18.68% in 2008; in industrial output: from 21% to 40%; and in export value: from 47% to 55.5%. Total export and import value was about 160% of the GDP (export 70% and import 90%).

- Productivity, quality and competitiveness of local sectors and products are still poor. The economic growth mainly comes from increases in inputs (increasing the investment and exporting natural resources), the ICOR index is higher and higher. Shares of total productivity factors in the economic growth are small. The trade gap is increasingly high while the labor productivity stays low and macroeconomic balances are not firm enough. Vietnam not only faces danger of a medium-level development trap, but also falls far behind neighboring countries although they haven't escaped the medium income trap (Viet-





nam's 2007 per capita income equaled 42% of Indonesian, 33% of Chinese, 20% of Thai, and 11% of Malaysia ones).

## 5. Tasks for Vietnam in 2010

a. Enhancing the macroeconomic stability by improving efficiency of the use of regulatory instruments and policy response:

The macroeconomic stability is a decisive precondition for business development and social stability. Most difficulties and challenges Vietnam faced in the past two years comes from the outside, but there are causes from an inadequate macroeconomic management. The high inflation rate in 2007-08 caused by fast increases in the world prices led to increases in Vietnam's import. If Vietnam had employed more effectively instruments of the monetary policy and controlled the total liquidity (M2) and bank lending better in 2007, the inflation wouldn't have been so high. In early 2008 when the inflation rate had been at a high level, if fiscal policy and monetary one had been in harmony with each other, disorder of liquidity in the banking system wouldn't have taken place. If changes in the exchange rate in late 2009 had been handled sooner, effects would have been better and cost lower.

Danger of high inflation in 2010 comes from not only increases in the world prices but also macroeconomic instability in Vietnam if policy responses are not reasonable enough. On the world market at present, besides steady increases in the oil price because of short-term falls in the US dollar, not of rises in the market demand, prices of food show a seemingly long-lasting upward tendency, but Vietnam has enough resource and ability to control this commodity while demand for other commodities doesn't change. This means that, besides keeping a close watch on changes in the world market, Vietnam should beef up its macroeconomic stability.

The basic principle of the macroeconomic management is to observe laws of the market economy, and at the same time, pay full attention to regulatory role and development function of the government. Governmental regulations and interventions must aim at ensuring economic laws operate according to preset targets and not deviate from the track of the market. Employment of instruments of the monetary policy should be asso-

ciated with the relationship between the fiscal and monetary policies, and the ones between themselves. This direction is very important in 2010 when options open to policy makers, especially the monetary policy ones, are limited. Full attention must be paid to degree and time of adjustment. Right degree of adjustment and right timing can ensure a high efficiency and a low cost.

b. Restructuring the economy and changing the development model:

Process of restructuring the economy is related not only to economic cycle, but also strong development of sciences and technologies and increasingly keen competition. Recently, the restructuring of the economy and change in the development model have been mentioned many times at economic forums and by the mass media. Are they two different or similar problems? Restructuring the economy doesn't identical to changing the development model. Although the latter is the core of the former, the former is much broader.

Restructure the economy requires the following premises and conditions:

- + Transparency of mechanisms and socioeconomic policies and successful struggle against corruption: There is no sustainable development without success in the struggle against the corruption. It should be considered as an ethical matter and a category of development as well.

- + Developing all components of the market economy, especially the market for technologies, creating a level playing field for all sectors, eliminating monopolies and controlling natural monopolies: This effort will force companies to make the best use of their existing comparative advantages and develop the new ones in order to enhance their competitiveness.

- + Developing a human resource in terms of technical expertise and foreign languages: This should be seen as a long-term competitive advantage and permanent requirement in a globalized and changing world.

- + Developing the infrastructure, especially communication systems and urban infrastructure with a view to reducing transport costs thereby enhancing the competitiveness of local enterprises.

These premises and conditions have taken

shape by degrees and they should be perfected and beefed up in the coming years.

Examining the situation and identifying the premises and conditions allow us to clarify contents of the restructuring of the economy. Main directions are as follows:

- + Restructuring the companies with a view to developing private enterprises and rearranging and privatizing state-owned companies: The most important issue is to the restructuring in each company according to a new model of organization and management in order to apply and make the best use of technological equipment and changes in productive forces and the market.

- + Restructuring the industries: This process aims at moving from doing subcontracts producing goods of low added value to making commodities with high local contents and added value and profitable in the global value chain by applying new technical advances and improving quality of human resource and managerial skills (TFP). This is also the principal content of the change in the development model from extensive to intensive growth based on total factor productivity. It's necessary to see that the said two contents of restructuring aim at increasing the local value and developing the force of national industries – an important requirement in enhancing the comprehensive national power and building the independent economy.

- + Restructuring the banking system in order to improving its performance and ensuring the safety for the whole system.

- + Increasing quickly the shares of manufacturing and service sectors to change radically the structure of industry: Fast development of sciences and technologies and economic globalization make labor division and specialization more intensive, therefore economic relations and co-operations become more complicated and market demands more diverse. This situation requires a fast development of the manufacturing and service sectors. One of principal directions of industrial development is to develop strongly supporting industries for groups of products with close links among themselves and with the manufacturing industry as their center. In recent years, the service sector has gained high and stable growth rates. In 2009 alone, its growth rate was higher than the ones gained by the manufacturing sector, which creates

a good market for services.

- + Adjusting the strategy for market development: Vietnam should keep expanding its export markets by diversifying and multi-lateralizing them, and exploiting markets within free trade agreements Vietnam has taken part in (ASEAN and ASEAN Plus), and the Vietnam- Japan EPA, and at the same time, paying full attention to the domestic market comprising some 87 million persons with retail sales in 2009 amounting to some US\$65 billion and a growth rate of over 10% - higher than the economic growth rate.

In carrying out the restructuring process according to the above-mentioned directions, the companies have a decisive role. They are subjects of the restructuring process and change in the development model. The government only creates favorable premises and conditions for these processes.

The restructuring is a process that takes years to complete, is associated with capital and resource accumulation. This process may be carried out as a progression, and may take a short cut in fields where Vietnam has good conditions and technical advances are good. In this process, human resource is the core of the total factor productivity because it's human beings who invent and employ technologies, and manage the whole process. That is why fast development of the human resource in each company and the whole society is a matter of urgency■