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Volume 29 (4), 2020

## ECONOMIC INNOVATION IN VIETNAM IN THE PERIOD AFTER 1986<sup>5</sup>

*During the period from 1975 to 1986, Vietnam had to face a serious economic crisis. Difficulties and problems came from poverty, war consequences, unfavourable changes of the international situation and especially the outmodedness of the economic model of centralized bureaucratic planning. Therefore, Vietnam had to undertake a program of economic innovation, known as "Doi Moi" (Innovation) in 1986. Up to now, after 34 years, Economic Innovation has brought many achievements in terms of growth rate, the scale of the economy, the shifting of the economic structure toward modernization, institutional innovation and extended international integration... However, at the same time, there remain problematic issues such as quality of growth, productivity and sustainable development..., to be tackled with. In fact, this is the first economic innovation (1986-2019). These contents will be analyzed and evaluated by the article on the basis of the model of economic innovation through a process of change and continuity in the market economy thinking in Vietnam.*

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### 1. Introduction

Adam Smith's theory of economic development was first propounded (1776) which stated that the process of development, once having started to gather momentum and transform into a cumulative period, can exist by itself. This theory is continuously developed by K.

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<sup>5</sup> This research was funded by the Vietnam National Foundation for Science and Technology Development (NAFOSTED) under grant numbers: 502.02 – 2018.300 and 603.99-2018.301.

Marx and other economists to this day. K. Marx (1894) defined economic innovation through two stages: (i) technological innovation; (ii) expanded reproduction. Lenin's new economic policy (NEP) in 1921 was aimed at an integrated economic model consisting of the state economy, collective economy and private capitalist economy and emphasizing the role of the private capitalist economy. This was a prominent element in the new economic development policy implemented in Russia. This model was adopted by many socialist countries (before 1990) in their economic innovation programs. The development of the economic theory was marked by the birth of Joseph Schumpeter's innovative economics theory (1942), emphasizing the importance of institutional innovations, enterprises and technological innovation is the heart of the economy and the engine of growth.

By 1978, China had implemented an economic innovation program based on the socialist market economy model led by Deng Xiaoping (General Secretary of the Communist Party). In essence, this is an economic innovation model originated by innovating economic thought. Deng Xiaoping once said, "It doesn't matter whether it is a white cat or a black cat, as long as it can catch a mouse".<sup>6</sup> China implemented a mixed economic model, including the state economy, collective economy, private capitalist economy combined with mobilizing other resources in the entire society for economic development. Thus, by implementing this model, China abandoned the model of the planned and bureaucratic economy.

These theories are the basis for Vietnam to transform its thinking, to plan and carry out the economic renovation. Vietnam's economic innovation had been a gradual process with the landmark being the VI Congress of the Vietnamese Communist Party (1986). Since then, innovation policy officially became the long-term development direction of Vietnam. According to the Political Report of the Communist Party at the VI Congress mentioned above, economic innovation is defined as "the process of transforming the economy from a centralized and subsidized mechanism, based mainly on the system of mass and collective ownership to a multi-sector commodity economy, under the market mechanism with the regulation of the State, under the leadership of the Communist Party of Vietnam in the socialist orientation; step by step promoting industrialization and modernization; transforming the economy from a basically 'closed' economy to an 'open' economy in the region and the world, with a view to combine national strength with the global strength in economic development".

It must be emphasized that a market economy is a product of human civilization which is highly developed by capitalism, but the market economy by itself is not synonymous with capitalism. The socialist-oriented market economy in Vietnam is a mixed economy which

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<sup>6</sup> In order to convince Chinese leaders, Deng Xiaoping thought that a private capitalist economy (black cat) was needed, considering it a key source of Chinese economic development, complementary to the state economic sector (white cat) which was not effective. And so far the Chinese have been very successful in economic development.

is affected by economic rules, combined with the exploitation of the elements that ensure the socialist orientation.<sup>7</sup>

After 34 years of economic innovation, Vietnam has changed a lot. From a backward agricultural economy, Vietnam has been able to build technical and economic infrastructure to meet the demand of the process of modernization and industrialization; the quality of life of the majority of the people is improved; politics and society are largely stable; national security is maintained; international relations are expanded and Vietnam has increased its role and reputation in the international arena.

There have been extensive literature writings on Vietnam's Innovation since 1986. The book by Vuong Dinh Hue (2016) titled "Looking back 30 years of Innovation: Prominent Achievements in Economic Development" has given an overview of the significant achievements of Vietnam's Innovation in the past 30 years; Tran Dinh Thien (2015) on "Assessment of the achievements of 30 years of Innovation and positioning of Vietnam's economy"; Report by the General Department of Statistics in 2006 also analyzes the Innovation and Development of Vietnam in 20 years; Report by the Economic Committee of the Congress (2013) on Macro-economy – challenges ahead; The article on "Socialist-oriented economy through the documents of the Party during the Innovation period" by Nguyen Thanh Tuan... These writings provide certain information and understanding about 30 years of renovation in Vietnam. However, there is a need to systematize these materials to provide a more comprehensive picture of this important period in contemporary Vietnamese economic history. Jerry Couvisanos et al (2014) argued that innovation economics is defined as a body of economic theory that contends a priori that economic development is the result of appropriated knowledge, innovation and entrepreneurship operating within an institutional environment of systems of innovation.

## 2. Why did Vietnam Design Economic Innovation?

There are several major reasons why Vietnam had to innovate. *Firstly, it was due to the serious economic crisis.* After the reunification of the country in 1975, the Vietnamese took lots of pride in winning the war and thought that if we could overcome the hardships of war, there should be no difficulty in building the grand socialist economy after 15 or 20 years. It was no coincidence that during this time, in Nghe An, a central province of Vietnam, there was the slogan that "we need only a sheath of rice, a packet of egg-plants and a communist heart" to build socialism in our country. However, in reality, the enthusiasm and rationalist thinking did not help create "an economic miracle" as we desired.

Until Innovation, Vietnam's economy had fallen into a serious predicament. Industrial production was stagnated. Circulation and distribution of commodities were congested due to the shortage of goods and the policy of closed-door by the government. Prices of

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<sup>7</sup> Socialist orientation means the achievements of economic innovation must serve the interests of people of all strata, social welfare, poverty alleviation, etc. and create fairness and equality for the Vietnamese people.

commodities elevated. Inflation increased up to three digits. The life of government officials and employees and the urban population was in an extremely difficult situation. The life of rural people was even worse. Due to the implementation of the policy of planned agricultural development through the operation of a co-operative society, people develop a negative attitude of depending upon the collective. The result was that many people did not take much responsibility in work, agricultural products fell and the life of farmers became very difficult.

During the period 1976-1980, the GNP growth rate reached only 1.4%, while the population increased at 2.24%; In 1986, there was hyperinflation of 874.7% (General Department of Statistics, 2006).

*Secondly, the out-modedness of the bureaucratic and centralized economic planning model.* This was the Soviet Union style of economic and social development model. This model emphasized the role of economic planning, with the foundation being the state ownership. It did not acknowledge the commodity economy and market mechanisms. It did not acknowledge the multi-sector economy. It was to build a closed and inward-oriented economy. It gave priority to the development of the heavy industry. It was to implement the policy of equal distribution of goods. The widespread of the government's subsidy system generated a dependent attitude and eliminated the dynamics and activeness of the individuals. Besides, with limited financial resources, the state's subsidy policy became inefficient.

It is to be noted that, during the time of war, this centralized economic planning was effective, because it could centralize power and resources and direct everyone toward a cause, that is, to fight for the independence of the country. However, when the situation had changed, this model needed to be replaced. This was one of the urgent needs pushing Vietnam towards Innovation.

*Thirdly, it was poverty, war and the consequences of war.* As we may know that, the economy of Vietnam was mainly based on small manufacturing enterprises. The productive force was weak. In addition, it had to undergo years of war. Within only 4 decades (1945-1985), Vietnam had had to undergo four major wars, with France, the U.S., Cambodia and China. All wars left behind a heavy loss. Moreover, the frequency of natural disasters, especially storms (10 storms annually on average) made the poor Vietnam become poorer. At that time, Vietnam's per capita income was among the lowest in the world. Infrastructure and technologies were backwards and heavily damaged by wars. Labour was basically manual and thus, productivity was very low. Therefore, the life of the people was very difficult. In this context, Vietnam must find a way to get out of the crisis. People said that it was like to save them. In other words, this situation forced Vietnam to start Innovation.

*Fourthly, it was the unfavourable changes of the international situation.* It is important to note that, during the 2 wars against France and America, Vietnam had received enthusiastic support of socialist countries and many peace-loving people in the world. This showed that, Vietnam was well aware of the influence of external factors. The support of external factors contributed to the victory of Vietnam. After the country was unified (1975), large amounts of aid from allies were cut short due to various reasons. To make the situation worse, Vietnam got into 2 wars in the Southwest and the Northern borders. Investments in the

defence and security did adversely affect the social-economic development of the country. Meanwhile, the US and the West put an embargo on Vietnam, which lasted for several decades. This caused great loss to Vietnam in many ways, particularly in economic and diplomatic fields. "The Cambodia Question" made Vietnam's relations with many countries become worse. Vietnam was even isolated. In this situation, there was only one way for Vietnam to get out, that is to change its domestic and foreign policies. In other words, Vietnam must innovate. It was the only choice.

*And fifthly, it was the impact of various reforms and innovations taking place abroad.* Perhaps, the most direct impact came from the Soviet's programs of innovation. The socio-economic difficulties and inadequacies of Soviet socialist model were factors behind the process of innovation and reforms of the Soviet Union and socialist countries in Eastern Europe. In 1985, the 27<sup>th</sup> Congress of the Communist Party of the Soviet Union adopted a innovation policy with an impressive name, i.e., "Perestroika". However, the Soviet Union did not succeed in its reforms. As pointed out by some analysts, the Soviet Union failed because they started with "political innovation" and made lots of mistakes in policy-making and implementation measures. Yet, the reform policy of the Soviet Union had a great impact on the innovation process of Vietnam. During this time, Vietnam and the Soviet Union had a special friendship and every change in the Soviet Union had both a direct and indirect impact on Vietnam. It was quite obvious that the impact of the Soviet Union's reforms on Vietnam was greater than that of neighbouring countries such as China. During this time, Vietnam and China hardly had any interaction as a result of the border war in 1979. However, in East Asia, some "dragons" such as South Korea, Taiwan, and Singapore had made miraculous progress as a result of economic structural reforms and active foreign policy. This created a "domino" impact in the region, including Vietnam.

#### **Interview 1: Economic Innovation in Vietnam**

Vietnam is in the process of transitioning to a market economy and deeper and deeper integration into the world economy. The macroeconomic policies from 1986 up to now, in my opinion, have been on the right track, helping the economy to achieve certain results in economic growth and poverty reduction. The role of science and technology, and recently the role of innovation in economic growth have been reflected in the evolution of economic theories that govern our economic policy. Thus, it can be said that, Innovations in Vietnam was an inevitable outcome of a pro-long socio-economic process. The root cause of economic innovation in Vietnam was this social urge to make the entire society move in one direction. It was to seek a way out of a deadlock. The turning point was the policy of economic innovation, outlined in the 6th Congress of the Communist Party of Vietnam in 1986.

*(Interview with Professor, Dr. Nguyen Quang Thuan, Vice Chairman of the Central Theoretical Council of Vietnam Communist Party, Former President of Vietnam Academy of Social Sciences)*

As analyzed above, the combination of all these five kinds of elements forced Vietnam to innovate in order to survive. There was no other choice.

### **3. How has Vietnam Fostered Its Economic Innovation?**

The policy of Innovation has officially been implemented since the 6<sup>th</sup> Congress of the Communist Party of Vietnam in 1986. Economic innovation guidelines have gradually been completed during the implementation process. Today, economic innovation is thus defined by the State of Vietnam as follows: the process of transition from the bureaucratic centralized planning economy to multi-sector commodity economy, operating under market mechanism, with the management and regulation of the State, in accordance with socialist orientation (Nguyen Thanh Tuan, 2016). Innovation in Vietnam has some important characteristics:

*Firstly*, the State is to accept the equal and legitimate existence of many economic sectors (The 9<sup>th</sup> Congress of the Communist Party of Vietnam regulated 6 economic sectors: State-owned economy, collective economy, individual economy, private capitalist economy, State capitalist economy, foreign-invested economy), many forms of ownership (public ownership, collective ownership, private ownership, mixed ownership). However, the State economy plays a key role.

*Secondly*, the economic mechanism is the social market economy; a school of economics represented by Paul Samuelson – a Nobel Prize Economist in 1970 – with his theory on mixed economy. Its argument is that the market economy under the management of the State, so the economy is operated by two hands: market and State. This helps promote optimal allocation of social resources to maximize profits through competition. At the same time, the management of the State helps avoid the failures of the market, such as inflation, social disparity, economic crisis...

#### **Interview 2: market economy in Vietnam**

Due to the intense pressure of the domestic and international situation, we have no other way but to renew. The first activity in the process is the renovation of thinking in which economic thinking should be renewed first and foremost. In my opinion, the process of renewing the economic thinking from the local to the global level is completed step by step through every Party Congress. In particular, the 2006 Party Congress outlined the socialist orientation in the market economy in Vietnam towards a multi-sector economy. This economic model in Vietnam still obeys the rules of market economy. Up to now, Vietnam has acknowledged the practical existence of many forms of ownership, many economic sectors other than the state ownership and the state economy. On this basis, various proper guidelines and orientations has been brought out to promote a commodity economy with various forms of ownership and economic sectors; thereby all resources have been mobilized for building the national economy.

This is a breakthrough in changing economic thought, helping liberate the production force that was constrained in the previous centrally-planned economy.

*(Interview with Associate Professor, Dr. Hoang Van Hai, Director of Institute of Business Administration, School of Economics, Vietnam National University, Hanoi)*

*Thirdly*, the economy is oriented toward socialism. Before Innovation, the State of Vietnam was of the view that, the market economy is a capitalist economy and does not operate very well. After Innovation, the State of Vietnam has changed and is of the opinion that the market economy is the general achievement of humankind and is not contradictory to socialism. Socialist orientation is understood to mean that the State-owned sector continues to hold a key role in the economy, because according to Marxist socialism, all means of production are owned by the people and the socialist State is a representative State.

*And finally*, economic innovation has been a transition from a closed-door economy to an open and internationally integrated economy. An outstanding advantage in the economic innovation in Vietnam is its positive and proactive integration into the regional and global economy. The great expansion of international relations and international trade has created favorable conditions for Vietnam to promote its comparative advantage.

#### **4. Major Achievements of Vietnam's Economic Innovation**

It can be said that the most significant achievement of Vietnam's Innovation after 34 years has been its transition from a bureaucratic and central planning economy based on the agricultural economy to a market economy. Thereby, the country has been able to get rid of the outmoded method of development. This has become an irreversible trend. This is the result of the continuous development of innovation thinking. The major achievements can be seen in the high economic growth, the reduction of poverty rate, economic structure shifting towards a positive direction, development of foreign trade, attraction of more FDI and ODA, proactive and positive opening and integration into the world economy.

*Regarding the economic growth*, Vietnam's economy has achieved a growth rate much higher than that of the pre-innovative period. In the initial stage of the Innovation (1986-1990), the annual GDP growth rate was of only 4.4%. But since 1990, Vietnam's economy has gone through nearly 20 years of impressive growth. In the second phase of Innovation (1991-1995), the annual GDP growth rate was of 8.2%, almost doubled the previous 5 years. In the following 5 years (1996-2000), despite the adverse effect of the regional financial crisis (1997-1999), Vietnam could manage to maintain the annual GDP growth rate of 7.6%. In the period from 2001 to 2005, GDP increased at 7.34% per year. In the period from 2006 to 2010, due to the slowdown of the world economy, Vietnam's GDP growth rate also reduced, yet could maintain at 6.32% per year (Vuong Dinh Hue 2016). In the following years, Vietnam continued to be affected by the global financial crisis of 2008 and public debt crisis of 2010, however, the current GDP growth rate of Vietnam is considered a relatively high rate in the region and in the world (Vuong Dinh Hue, 2016), and by 2018, it reaches 7.08% (Statistical Book of Vietnam, 2018).

The highlight of Vietnam's Innovation is not only the high growth rate, but it is its inclusiveness. The poverty rate reduced from over 85% of the population (according to the poverty line USD 2/person per day) in 1993 to 13% in 2013; extreme poverty (according to the poverty line USD 1.25/person per day) almost disappeared, while inequality did not rise much and is still within the average rate of the world (World Bank, 2019).

*The scale of the economy has increased rapidly.* In 2003, after 16 years of Innovation, GDP per capita of Vietnam was USD 471/year (Tran Dinh Thien, 2015) but in 2018, per capita income was nearly USD 2,600 (Statistical Book of Vietnam (2018)). The productive forces have made progress both in terms of quantity and quality; the production technology has been improved. Macro-economy is largely stable; inflation is under control.

*The economic structure of Vietnam has started to shift towards modernity.* The composition of the economic structure has shifted in the direction that the agricultural sector is reduced; the industrial and service sectors are increased. The composition of the economy continues to shift toward promoting the potentials of all economic sectors and multiple forms of ownership.

The proportion of agricultural sector in GDP fell sharply, from 47% in 1988 to 18-20% in 2000 and has continued to fall until now. According to yearly Statistical Book of Vietnam, on the contrary, the proportion of industrial sector increased rapidly, from about 23% by the end of the 1980s to nearly 40% at present. The proportion of the service sector has also increased steadily and its contribution to the GDP structure has been quite stable, currently accounts for more than 40% (Statistical Book of Vietnam, 2018).

*Regarding labour structure,* agricultural labour force which accounted for more than 2/3 of the labor force in the period 1986-1990, has continuously reduced to about 6% in 2013 (Statistics of WDI). The industrial labour force increased proportionately: each year there is about 1% of workers moving out of the agricultural area and turned to the industrial area (Tran Dinh Thien, 2015).

Another point of achievement of Vietnam Innovation in economic growth is *FDI attraction*. FDI started to flow into Vietnam when the foreign investment law was enacted in 1987 and the market was opened. However, it was not until 1991 that FDI became a significant force. In 1994, the scale of FDI was equivalent to 10% of national GDP and made a significant contribution to the high growth rate of the country's economy in the years before the Asian financial crisis (Tran Dinh Thien, 2015). In the first wave of FDI, Vietnam reached a peak in FDI attraction in 1996, one year after Vietnam joined ASEAN. The same thing happened when Vietnam joined WTO in 2007 and FDI reached a peak in 2008.

By the mid-1990s, FDI enterprises contributed  $\frac{1}{4}$  of the total industrial production value and accounted for over 6% of GDP (Tran Dinh Thien, 2015). Ten years later, the shares were 43.8% and 15.99%, respectively (Tran Dinh Thien, 2015). FDI has risen above the domestic industrial production value since 2014, ahead of export turnover since 2004 (Tran Dinh Thien, 2015) and FDI enterprises currently contribute about 23.5% of total social investment (nearly 20% of GDP), accounting for over 70% of export turnover (Pham Thien Hoang, 2019).

*The structure of exports has improved significantly.* Export turnover regularly increases at a double-digit rate. Vietnam's exports have increased rapidly with a high growth rate of over 15% in the period from 2011 to 2019 and officially reached a turnover of USD 500 billion in mid-December 2019 (Song Ngu, 2019). In 2011, there were 21 items with export turnover of over 1 billion USD, accounting for 81% of total export, whereas by 2019 there



are 32 items. In which, there are 8 items exported over 5 billion USD and 6 items exported over 10 billion USD, accounting for 92.86% of the total export (Agency of Foreign Trade, 2019). Exports shifted towards increasing the proportion of industrial products and reducing the proportion of agricultural products. Key economic zones have been founded, which are to be the force for the growth of the regional and national economy. Economic and industrial zones have been developed in order to attract investment, at the same time to establish specialized regions of certain crops and livestock linked with the processing industry.

*Various sectors of the economy have witnessed rapid development.* The industrial and construction sectors have maintained a fairly continuous growth. Industrial products have become more diversified and its quality improved, thereby enhanced its competition capacity, ensured the supply and demand of the economy, maintained a stable domestic market and expanded export market; given priority in the development of several new and hi-tech industries. The agricultural sector has maintained a relatively stable development. Rural industrialization and modernization have made an important shift. From a malnourished country, Vietnam has become the 2<sup>nd</sup> largest exporter of rice in the world, contributing to the international food security. Vietnam has also exported a large quantity of coffee, rubber, cashew nuts, pepper and seafood. The service sector has become more diversified; better meet the demands of production and people's life: tourism and telecommunication develop at a rapid rate; bank and finance services, legal counselling have become more efficient. The exploitation and use of national resources associated with sustainable development has received attention. Socio-economic infrastructure has been improved, especially transport, electricity, communication, telecommunications, irrigation, urban infrastructure, education and health care. The application of science and technology, especially high technology, has created preconditions for the building of a knowledge economy.

After 34 years of Innovation, Vietnam has made important institutional developments, giving the shape to a socialist-oriented market economy. Under the leadership of the Communist Party, the ideology and policy of development of a socialist-oriented market economy has been institutionalized into laws, creating a legal framework for an efficient economic operation. In 34 years of Innovation, the Constitution has been amended 3 times, over 150 laws and 70 ordinances have been issued. Recently, the Congress has passed the 2013 Constitution, thereby created a legal basis and promoted the institutionalization of the socialist-oriented market economy. It is to affirm the principle of a multi-sector economy, with multiple forms of distribution. It is also to affirm the principle of a uniform development of market elements and the smooth operation of all market categories. The state management of the economy in accordance with the principles of the market economy has been affirmed. The principle of social justice and progress has been implemented to a certain extent. The principle of open door, integration into the regional and international economy is affirmed.

Thirty-fourth years of economic innovation has seen *the positive role of economic actors in the national economy, free trade and competition in accordance with the law*: state owned economy gradually asserts its leading role; state-owned enterprises are gradually restructured, equitized under the Enterprise Law and declined in number. The collective

economy is reformed. New forms of cooperation are founded to suit the market mechanism. Private economy increased rapidly, which help improve business efficiency, create new jobs, and make a significant contribution to GDP. FDI economy is encouraged, foreign-invested enterprises have contributed remarkably to the implementation of the socio-economic development goals, reduce unemployment and increase exports. Social organizations and trade unions have played a more important role in the economy. The socialist law-governed State, under the leadership of the Vietnam Communist Party is being finalized, state apparatus has been refined. Innovation is seen not only in thinking but also in implementation.

The process of Innovation has helped establish uniform market elements and all market categories which operates smoothly, and is well integrated with regional and international markets. The scale and commodity structure of the markets is improved. Trade infrastructure, services, management mechanism, competitiveness... are all better. Financial and monetary markets have seen a dynamic and strong development. Besides the capital mobilization through banking channel, the formation of stock markets helps to diversify investment sources. At the same time, the operation of the insurance market has made a positive contribution to the stabilization of production and people's life. Real estate market is developing rapidly. The labour market is formed on a national scale. Sciences and technology markets are in the process of formation. The number and value of the technological transaction have increased markedly in recent years. The market of some basic public services, especially health care and education, have made new developments, for example, the mobilization of non-state resources.

Besides, *economic growth is largely in harmony with cultural evolution, social and human progress, social justice, environmental and natural resource protection.* Previously, the State had taken charge of the subsidiary system and employment allocation. After Innovation, new mechanisms have been established and policies have been made in order to maximize the participation of various economic sectors and labours. Previously, the State had not encouraged people to do business for fear of social disparity between the rich and the poor. After Innovation, the State encouraged people to do business in accordance with laws, which helped in reducing poverty in the country. Social security is largely ensured. Synchronous development is made in social and welfare system, especially in poverty reduction, employment, social insurance system, preferential policies for the veterans, and health care policies for all. In the difficult situation of the economy, Vietnam has increased the government budget and mobilized resources to implement social policies. Vietnam has completed ahead of schedule many Millennium Development Goals of the United Nations.

Thirty-fourth years of Innovation has been a long way of *deep and extensive international economic integration at many levels*, according to the principles and standards of the global markets. Vietnam has been able to set up many strategic economic partnerships. It has also made a positive contribution to the establishment of ASEAN Community in 2015. Domestic markets are more fully developed according to WTO commitments. As of 2020, Vietnam has negotiated, signed, and implemented 16 free trade agreements (FTAs) with nearly 60 partners; of which 12 FTAs have been implemented, 1 FTA was signed but not yet in effect and 3 agreements are in the negotiation round (Bui Thanh Son, 2020). The participation of Vietnam in the negotiation of FTAs has made a positive contribution to the

economic development of the country. It helps improve the country's competitive capacity. This is especially meaningful as Vietnam have been involved in three value chains which play an increasingly important role in the global economy, i.e.: food and food security value chain; energy and energy security value chain (oil, gas and coal); and textile and footwear value chain (Vuong Dinh Hue, 2016). Currently, Vietnam has stepped up its participation and implementation of new-generation FTAs in which the Comprehensive and Progressive Agreement for Trans-Pacific Partnership officially came into effect on January 14, 2019 and the Vietnam-EU FTA (EVFTA) was signed on June 30, 2019. After Vietnam signed and participated in a series of free trade agreements (FTAs), it became a highly open economy (reaching over 200% of GDP in 2018) (Pham Thien Hoang, 2019).

### **Interview 3: FTA in Vietnam**

Joining new-generation FTAs is an opportunity for Vietnam to implement the policy of perfecting the socialist-oriented market economy institution, the legal system; improving the investment and business environment towards ventilation and transparency and international standards.

Besides great opportunities, Vietnam also faces many difficulties and challenges from implementing new-generation FTAs.

The implementation of the "new generation" agreements requires us to have a suitable roadmap and comprehensive solutions, i.e. to complete the institutional and legal system along with activities of information, propaganda, knowledge dissemination and capacity building for officials of ministries, departments and branches, localities and enterprises to ensure taking advantage as well as avoiding violations of CPTPP and EVFTA.

*(Interview with Professor, PhD, Do Duc Binh, National Economics University, Vietnam)*

## **5. Issues of Economic Innovation in Vietnam**

Besides the major achievements mentioned above, the process of Innovation in Vietnam has also faced many challenges and hindrances. It is not difficult to realize that the economic growth rate is not truly adequate with the potentials and opportunities of the country. Some limitations of the Innovation process are: the low quality of growth; the process of restructuring of the economy has not been as expected; issues of labour productivity and enterprises...

### *Firstly, low quality of growth*

The economic growth of Vietnam largely relies on the exploitation of resources, the increase of capital investment and cheap labour. Industries based on the exploitation and use of natural resources such as agriculture, forestry, fisheries, mining... always occupy a large proportion of GDP (about 30% during the period 1991-2009). The dynamics of growth and economic restructuring has been the processing and assembling industries which require high intermediate costs and are dependent on imports, often cause environmental pollution and have made no remarkable growth. Export turnover has

increased at a rapid rate, yet the export structure has changed slowly, focused mainly on exporting crude commodities and minerals. The competitiveness of exports is low.

*Secondly, low quality and inefficiency of investments*

The growth and restructuring of the economy have become more and more dependent on FDI. Yet, this capital source has not been allocated proportionately, is of low quality and has not contributed markedly to the quality of growth. The investment structure is not rational, use of capital investment, especially state investment, is not efficient. The efficiency of investment is expressed in the Incremental Capital – Output Ratio (ICOR) (capital investment/GDP ratio). According to the calculation of the General Department of Statistics, the period from 1991 to 1995, the ICOR was 3.5; the period (1996-2000) was 4.8; the period (2001-2005) was 5.1; it was 8 in 2008, 2009.<sup>8</sup> It is to be noted that in the area of public investment, especially state-owned enterprises, ICOR has been very high, which was 12 in 2009, while the general ICOR of the economy was 8. However, ICOR decreased in the period from 2016-2018, which were 6.42, 6.11 and 5.97 respectively. In recent years, investment efficiency and competitiveness have been improved by many new production capacities added to the economy but still far from ICOR at 3.0 to achieve investment efficiency and sustainable development (SBV 2019).

*Thirdly, the foundations for economic growth (macroeconomic stability, socio-economic institution, basic health care and education, infrastructure) are inadequate, competitive capacity is slow in improving.* Factors contributing to the quality of growth and competitiveness of the economy (quality of human resources, productive elements such as labour, land, technology, and innovative capacity) are weak and inadequate.

According to the Report of the World Economic Forum (WEF) as a result of a survey in 133 countries and territories, Vietnam has a very low index of infrastructural quality (111/133), quality of roads (120/133), quality of power supply (103/133), the cost of basic education (103/133), quality of training and management schools (11/133). According to the WEF Report on global competitiveness, the competitive capacity of Vietnam from 2001 up to now has hardly been improved. It has even been relegated in terms of competitiveness in recent years.

*Fourthly, in reality, there are no close links between economic growth and social progress.* High economic growth is not always accompanied with sustainable development and poverty reduction. Economic growth has also generated some urgent social issues: employment for workers, increasing gap between the rich and the poor, disparity in the level of development and income... among regions, environmental pollution and recession, increasing problematic social ills, especially drugs and prostitution.

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<sup>8</sup> The high ICOR (Incremental Capital – Output Ratio) means low investment efficiency and low competitiveness. According to the recommendation of WB, the ICOR at 3 shows an efficient investment and a stable and sustainable development of the economy in developing countries.

*The process of economic restructuring of the economy has not taken place as expected.*

The scale of the state-owned sector has not reduced. On the contrary, it has increased. Employees working in the public sector by the end of 2013 were over 5.33 million, a strong increase compared to 4.794 million by the end of 2009. This explains why regular expenditure in the state budget tends to increase day by day, reaching about 70% of the national budget at present. Equitization of State-Owned Enterprises (SOEs) is superficial, the proportion of state ownership is maintained "overwhelmingly" in order to keep "socialist orientation". But in fact, it is a hindrance to change in the governance structure. Thus, the goal of improving the efficiency of enterprises is not achieved. It gives chances to interest groups to steal profits. That explains why investment effectiveness and ICOR is hardly improved.

A similar situation happens to the restructuring of Credit Institutions (CIs). Solutions to bad debt currently aim at "cleaning up" the grounds, dismantling temporary barriers. It has not thoroughly solved the bad debt issue according to market principles. Governance structure and operation of credit institutions has not much changed.

Restructuring of public investments seems to have made some progress when the proportion of public investment/GDP tends to decrease in nearly one decade. But as mentioned above, this does not mean that the amount of capital investment of the public sector decreased, but it is because investment in private and FDI sectors has expanded significantly. State budget deficit has often been at a high level (almost always at 5% GDP). Regular expenditure constantly increases. These are evidences of the unsuccessful efforts at administrative and public sector reforms. Borrowing situation (through debenture issuing) to reconvert the old debt of the Government may lead to incalculable consequences in long-term growth, because this will further increase debts in the future.

*Domestic private enterprises have not had sustainable growth.*

In the last 3 years, the number of bankrupt or deactivated enterprises has increased. In 2010, 47,000 enterprises stopped functioning. In 2013, the number was 61,000. In the first half of 2014, it was 34,000 (World Bank, 2014). The causes behind these numbers are partly due to the domestic and external economies have not recovered. But the major cause is that enterprises are not able to find a market or to get access to loans. In addition, the input costs are rising. Nearly 95% of Vietnamese enterprises belonging to the category of "small and medium-sized enterprises (VCCI, 2014) [in reality, they are small and super small enterprises], and only about 15% of them have access to official credit. SMEs tend to find informal sources of credit rather than from the banks due to the constraints of collateral security. On average, each SME in Vietnam lacks of \$42,000 credits (Wignaraja and Jinjark, 2014 – ADB working paper).

On the other hand, the technological capacity of domestic enterprises is also a problematic issue. In 2011, only 0.005% of enterprises had scientific initiatives (VCCI, 2014). Report on the global competitiveness in 2012-2013 of the World Economic Forum (WEF, 2013) shows that the level of technological absorption of Vietnam is very low (98/133). Moreover, the size of enterprises tends to become smaller. In 2007, the proportion of super

small enterprises accounted for 61.4%. In 2012, it increased up to 66.8% (VCCI, 2014). Some enterprises have become larger not because of production development, but thanks to the process of property speculation and investment. This is most evident in the real estate industry. Vietnam has no industrial billionaires. Even some strong domestic brands have been lost to foreign investors. For example, Kinh Đô has sold 80% of its share to Mondelez International.

*Labor productivity is low and the growth of labor productivity tends to decrease.*

This is another challenge of long-term growth targets in Vietnam. In the 1990s, a high economic growth rate was accompanied by a rapid growth rate of labour productivity (World Bank, 2013), but thereafter, the growth rate of labour productivity declined sharply. During the period 2000-2006, labour productivity increased by nearly 6%/a year on average, which reduced to about 3%/ a year during the period 2007-2013 (CIEM, 2011). This shows that after more than 2 decades of Innovation, Vietnam's economy was not able to reach Lewis's turning point which means that the economy is still in the process of transition from the agricultural sector to industrial and service sectors. It has not achieved a high level of industrial accumulation. The shifting to an industrial and modernized economy seems not to have started. The target of reaching a per capita income of \$3,000 in 2020 (in the Socio-Economic Development Strategy 2011-2020) has become impractical, because this means that from 2015 onwards, Vietnam must have the growth rate of per capita income at least 10% per year.

Growth of labour productivity is closely linked with labour's skills. Employers in Vietnam are facing many difficulties in finding skilled workers, although they are willing to pay higher wages (World Bank, 2014). This situation is very paradoxical if we look at the PISA results of Vietnam. However, it indicates the fact that the educational system of Vietnam has been doing well in transmitting academic knowledge; it has not been successful in turning this knowledge into working skills.

*Numerous negative impacts come from environmental pollution, climate change and epidemics.*

For more than three decades, Vietnam has focused almost exclusively on economic innovation and neglected its environmental protection leading to environmental pollution of soil, water, air and noise. This phenomenon takes place in many industrial zones, big cities such as Hanoi, Hai Phong, Ho Chi Minh City and craft villages. To name a few, water pollution in the Thi Vai River, Dong Nai or the Formosa disaster in Ha Tinh have seriously affected coastal ecosystems in 6 provinces in Central Vietnam ...

Climate change is having adverse impacts on sustainable development in the Mekong Delta. For example, continuous drought occurs in the central provinces such as Binh Thuan, Ninh Thuan, and Central Highlands; Salt-water intrusion has been becoming more and more serious in the Mekong delta since 2018 reaching its peak in early 2020 when the saline water reaches 80 to 100 km in width in some main rivers.

The biggest challenge for economic innovation in Vietnam in the coming time is to handle the consequences of human and cattle diseases such as COVID-19 in humans and African swine fever in pigs, Bird flu H1-N1....

## Conclusion

In brief, thirty-fourth years of Innovation is a significant period in the history of Vietnam's development and modernization. The socialist market-oriented economy is gradually taking shape; institutions of the socialist market-oriented economy have been formed and improved. The investment environment is constantly improved. Position and strength of Vietnam in the international arena is enhanced. This helps promote industrialization and modernization and improve the quality of life of the people. At the same time, we are also aware of the remaining limitations and challenges of the economy. It is important to attend to these challenges if we are to aim at rapid and sustainable development. Naturally, dealing with these issues will take time. It is believed that, with the high political will of the leadership of Vietnam and the consensus of the majority of the people, the obstacles on the path of the Innovation will gradually be resolved. Also, we are to realize that, these limitations are inevitable consequences of the market economy mechanism and we have to learn to live with it and to implement specific measures to reduce its negative impact. The internal economic situation and the commitment to international integration require Vietnam to implement early fundamental and systemic institutional innovations rather than merely partial innovations. The second innovation is being demanded by reality (Le Dang Doanh, 2016).

It should be noted that, in order to deal well with the challenges or issues facing Vietnam as mentioned above, the second economic innovation suggested by many Vietnamese scholars needs to be fostered. In fact, Vietnam has been continuing to renovate its economy and during economic innovation period, however, in this second economic innovation, it is necessary to be institutionalized in official documents of the Communist Party and the Government of Vietnam. It should clearly define the goals and implications both in terms of the theoretical and practical models of the second economic innovation process. It should also state what contents it can inherit from the first economic innovation (since 1986) and what it should develop in the 2nd economic innovation.

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## APPENDIX

### Index of Vietnam Economic Growth during Inovation Period (1990-2018)

Indicator \ Year	1990	1995	2000	2005	2010	2015	2018
GDP per capita (current US\$) (billion USD)	98.03	288.02	433.33	699.50	1333.58	2107.01	2452.14
GDP growth (annual %)	5.101	9.540	6.787	7.547	6.423	6.679	7.076
Exports of goods and services (% of GDP)	36.039	32.813	49.966	63.699	72.002	89.779	102.475
Imports of goods and services (% of GDP)	45.277	41.908	53.278	67.015	80.215	88.988	105.832
Merchandise trade (% of GDP)	79.676	65.607	89.539	120.075	135.489	169.845	199.756
Inflation, GDP deflator: linked series (annual %)	42.095	17.040	11.594	9.204	12.074	-0.191	3.398

Source: *Tradingeconomic.com/World Bank*, <https://data.worldbank.org/country/vietnam>.