

Vietnam in 2016

Transition and Trepidation

ABSTRACT

The 12th party congress showed a preference for stability. Vietnam and the US grew closer over trade and China, but the US election results introduced uncertainty. The Vietnamese economy grew steadily despite drought and global economic weakness. Reform of state firms fell behind schedule, productivity growth lagged, and an environmental disaster sparked vigorous dissent.

KEYWORDS: Vietnam, drought, state-owned enterprise, TPP, Samsung, #ichoosefish

POLITICS AND INTERNATIONAL RELATIONS

The year 2016 opened with the 12th party congress, at which the general secretary of the Communist Party of Vietnam, Nguyen Phu Trong, won a second term in what was widely regarded as a victory for conservative leadership. The outcome was seen as a vote for stability in politics and economic policy, and the elevation of the central bank's governor and other senior economic officials to the Politburo underlined this.¹ The transition has provided no clear indication of the government's appetite for continuing economic reforms—in particular those affecting state-owned enterprises (SOEs) and the state banking system. SOEs dominate key industries such as energy, telecoms, and transport, and their privileged access to capital from the state banking system crowds out private investment. Their reform is the

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1. "Vietnam's New Leaders Grapple with Debt," *Financial Times*, May 19, 2016; see also J. London, "Where To from Here for Vietnam?" East Asia Forum, February 4, 2016, <<http://www.eastasiaforum.org/2016/02/04/where-to-from-here-for-vietnam/>>.

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most important remaining task in the pursuit of efficient and equitable growth, and the most difficult. The government itself admits that progress in these areas has consistently fallen short of targets.²

With the party congress having produced no new SOE reform measures, Hanoi has opted for the easier and less controversial step of promoting (or at least talking up) nonstate actors among the domestic business community. For example, in the wake of President Obama's May 2016 visit, which included a well-received and widely publicized session with young entrepreneurs in Ho Chi Minh City, the government announced plans for new laws and initiatives to support small and medium-sized enterprises, encourage competition, and promote startups. Of course, SOE reform would be one of the most economically effective ways to accomplish these and many more development goals, but the two agendas are not linked in public discussion.

In international relations, the year saw Vietnam and the US moving steadily closer to one another. Obama's visit was a marker of improved bilateral relations and a strong signal of the US administration's resolve to resist Chinese expansionism in the South China Sea. It included (among other things) an announcement that the US would end its embargo on weapons sales to Vietnam. The embargo was previously regarded as a human rights bargaining chip, but its abolition appears to have been decided without a rights quid pro quo. Vietnam followed up by expressing determination to see the Trans-Pacific Partnership (TPP), an American-led free trade agreement that excludes China, enter into force. As more than one observer has noted, pursuit of a TPP deal "crystallises how far Vietnam's leaders are willing to go to secure a deeper economic relationship with the US. No country had to do more to enter the TPP than Vietnam. Like the US, Vietnam sees the TPP as a strategic political instrument, not just a trade agreement."³

The TPP also promised a larger proportional gain to Vietnam than to any other treaty partner, even despite concerns about trade diversion due to rules of origin that would limit Vietnamese producers' ability to use Chinese inputs in goods for sale to TPP partners. US tariffs on many lines of Vietnamese exports, including seafood, apparel, and footwear, would have been

2. World Bank, "Overview," September 26, 2016, <<http://www.worldbank.org/en/country/vietnam/overview>>, accessed November 20, 2016.

3. Dien Luong, "A Window of Opportunity for Reforms in Vietnam," East Asia Forum, February 12, 2016, <<http://www.eastasiaforum.org/2016/02/12/a-window-of-opportunity-for-reforms-in-vietnam/>>.

greatly reduced. Vietnamese producers of livestock and some other farm goods would have suffered, but on many other TPP provisions—including, importantly, those covering state-controlled industries and activities—the country had negotiated for itself significant exemptions or delays. TPP implementation would have increased Vietnam’s exports by 30% in a decade, and GDP, wages, and capital returns by about 10%, relative to a no-TPP scenario.⁴

In the final three months of 2016, however, the bilateral bubble began to deflate. In September, the National Assembly delayed a vote to approve the TPP as the tone of the US election campaign made it increasingly clear that the US Congress would not ratify the treaty this year, if at all. Then in November, Donald Trump won the US presidency against all expectations. Whereas a victory by his Democratic rival Hillary Clinton had been expected to mean continuation of the Obama administration’s “pivot” to Asia, including ever-closer political and economic relations with Vietnam, the Trump campaign expressed ambivalence over US security commitments and hostility toward international trade agreements, including the TPP, and threatened to apply tariffs and other trade-restricting measures to exports from China.

At the close of 2016, when the president-elect had yet to make any major pronouncements on Asia-Pacific economic policy or security, it seemed that America’s influence in the region was set to wane.⁵ Absent decisive American moves on security, and with a new Philippine administration moving aggressively away from the US and toward bilateral deals with China on trade, aid, and access, Vietnam risks being left standing virtually alone in opposition to China’s maritime expansionism. And without the TPP, Vietnam’s economy will presumably become still more closely linked to that of China, the source of over 25% of its imports and the destination for an increasing share (currently 10%) of its exports. At a late-November Asia-Pacific Economic Cooperation meeting in Peru, the attention of Asia-Pacific countries was tangibly shifting toward the Regional Comprehensive Economic Partnership, a China-led free trade initiative that excludes the United States.

4. World Bank, “Global Economic Prospects: Potential Macroeconomic Implications of the Trans-Pacific Partnership,” 2016, <<http://pubdocs.worldbank.org/en/287761451945044333/Global-Economic-Prospects-January-2016-Highlights-Trans-Pacific-Partnership.pdf>>.

5. M. Noland, G. Hufbauer, S. Robinson and T. Moran, “Assessing Trade Agendas in the US Presidential Campaign,” Briefing No. 16–6, Peterson Institute for International Economics, September 2016, <<https://piie.com/system/files/documents/piie16-6.pdf>>.

The Asia-Pacific international trade situation remains fluid. Following the lead of its Southeast Asian neighbors, Vietnam's hopes for industrial upgrading (that is, moving beyond assembly of basic items) rest on its participation in rapidly expanding regional trade in electronic and mechanical parts and components. Currently, Southeast Asia's largest share of this trade is in sales of parts and components of electronic devices to Chinese firms for final assembly and export to the US and other rich-country markets. Higher US tariffs on Chinese exports would cascade back through the region, slowing industrial growth and job creation in all countries linked to this global production system. On the other hand, US trade policy that discriminates specifically against China might accelerate the movement of final assembly operations out of that country and into Vietnam, bringing increased foreign investment and blue-collar job creation.

ECONOMY AND ENVIRONMENT

Vietnam's economy expanded at 5.5% per year in the first half of 2016, 0.8 points slower than the corresponding period in 2015.⁶ Global economic growth remained slow in 2016, and global trade expansion has been unprecedentedly low since 2010, spelling lower growth for trade-dependent economies like Vietnam. The ongoing slowdown in China, a key trading partner, exacerbated these external forces.

Growth was also impacted by a severe El Niño drought in the first half of the year, with 52 out of 63 provinces affected; 18 were declared to be in a state of emergency by mid-year. The drought, as well as dam construction in China and Laos, lowered Mekong River water levels. Consequently, the Mekong Delta, source of over half of national rice production, was subject to saline water intrusion up to 90 km inland, far further than in past years. That region's winter/spring rice crop was down by 10% year on year, with the UN's Food and Agriculture Organization reporting that farms in the worst-affected areas lost 30%–70% of production. Other areas (especially the Central Highlands) and crops (especially farmed shrimp) were also badly affected.

Despite these headwinds, GDP growth for 2016 was still forecast to exceed 6%, about one point faster than the ASEAN average. However, a larger-than-usual fraction of recent growth is attributable to increasing public-sector

6. World Bank, "Vietnam's Growth Moderates amidst Severe Drought, Slow Industrial Growth," July 19, 2016, <<http://www.worldbank.org/en/news/press-release/2016/07/19/vietnams-growth-moderates-amidst-severe-drought-slow-industrial-growth>>.

spending. The public-sector deficit exceeded 5% of GDP in 2016, raising public debt almost to its legislated cap (65% of GDP). As in many transition economies, spending cuts are constrained, since much public expenditure is dedicated to nondiscretionary items such as civil-service salaries, pensions and transfer programs, and loan servicing. Slow progress on SOE reform exacerbates the fiscal deficit due to continuing inefficiencies in public spending and the need to cover nonperforming loans. Core inflation, however, remained low at under 2% per year.

The widening fiscal deficit and weak external demand have both been factors in reducing Vietnam's current-account balance from 5% of GDP (2014) to less than 0.5%. By contrast, capital inflows, especially foreign direct investment in labor-intensive industries, remained strong in 2016. A large share of new foreign direct investment is in electronics assembly; mobile phones and accessories are now the largest category of merchandise exports, and computers and parts rank third, after apparel.

Anemic global growth and domestic structural inefficiencies make productivity gains critical as a source of growth in Vietnam. However, there was no sign in 2016 that labor productivity growth had broken with its five-year declining trend. Foreign investment is viewed as a catalyst for productivity gain, but there was little foreign-led activity on two important productivity-growth margins: the acquisition of large technology-intensive SOEs, and greenfields investment in technology-intensive industries (as opposed to assembly of technology-intensive appliances). The initial public offering of shares in Mobifone, a state-owned telecoms company, was postponed in 2016, as it had been in 2015. The IPO for Vietnam Airlines (a small stake of which was earlier sold to Japan's ANA) was also once again postponed.

A number of other SOE IPOs were recorded, but few shares sold were subsequently listed on Vietnamese stock exchanges, a sign that sales were mainly to other state-owned or equitized public companies. Among greenfields investments, Samsung's US\$ 300 million commitment to build a technology R&D center in Hanoi made headlines in March 2016; however, according to Vietnam's Ministry for Planning and Investment this initiative is "an obligation" in return for incentives granted to other assembly plants planned by Samsung, which is by far Vietnam's largest single foreign investor.⁷

7. "Samsung to Build \$300 m Research Centre in Hanoi," *The Nation* [Bangkok], March 25, 2016, <<http://www.nationmultimedia.com/news/business/aec/30282483>>. Interestingly, the predicted

Poverty and Income Distribution

Progress on poverty alleviation continues; however, the country's poorest households remain dependent on farming and fishing and were clearly adversely affected by the drought. Vietnam's ethnic minority groups continue to fall behind in relative terms. Their predicament is clear: their reluctance to participate in (and/or exclusion from) urban-centered growth leaves them isolated from the primary driver of economic gain, the expansion of industrial jobs and jobs in peripheral services sectors, and the remittances from urban workers that spread such gains back to rural communities. Consequently, ethnic minorities, 15% of Vietnam's population, now make up 60% of those below the poverty line.⁸

Environmental Challenges

In coastal central Vietnam, a massive fish kill attributed to toxic materials released from the Taiwanese-owned Formosa Ha Tinh steel plant in Ha Tinh Province (the same plant that was the site of a violent protest in 2014 in which four Chinese construction workers were killed) disrupted fisheries, seafood sales and exports, and local tourism. Over 100 tonnes of dead fish washed up on beaches in four central provinces. Although the incident occurred on April 4, 2016 and a Formosa official (later fired) implicitly admitted responsibility on April 27, it was late June before the Vietnamese government acknowledged a link to the steel plant and ordered the company to pay compensation of US\$ 500 million. In the intervening and subsequent months, the government endured a storm of public protest (see below).

In the Mekong Delta, farmers butted heads with the government over land-use responses to drought and salinization. The farmers sought to switch land from rice to shrimp production, while the government continued to defend the minimum-rice-acreage rule enshrined in its Rice First policy. This is a long-standing set of inducements and regulations intended to maximize rice production, with historical roots in the country's food-security concerns

sectoral effects of the TPP in Vietnam are highly skewed toward labor-intensive industries, which are predicted to expand by 15% relative to baseline growth over a decade. Skill-intensive industries, by contrast, are predicted to decline by 3% relative to a no-TPP trend (see World Bank, "Potential Macroeconomic Implications," Figure 4.17).

8. World Bank and Ministry for Planning and Investment, *Vietnam 2035: Toward Prosperity, Creativity, Equity and Democracy* (Washington, DC: World Bank Group, 2016), p. 6.

but with contemporary support from state-owned rice export companies.⁹ In the face of the reality that rice planted in saline soils does not grow, the government retreated somewhat, allowing 400,000 hectares of salt-affected land to be planted to other crops so long as “conditions required for rice farming are conserved.”¹⁰

In cities, meanwhile, pollution and congestion continued to climb. Data from air pollution monitors established by the US Embassy in Hanoi (late 2015) and Ho Chi Minh City (early 2016) revealed peak air pollution in the capital to be as high as in the world’s most polluted cities.

The incipient impacts of global warming are potentially even more worrying. US President-elect Trump has threatened to withdraw from global climate deals. If he does, the likely loss of global momentum for reduced greenhouse gas emissions will further imperil Vietnam’s vulnerable coastal ecosystems and populations. Sea level rise (up to one meter by 2100) is already predicted to displace 3.5–5 million people (4%–6% of the country’s current population) from the Mekong Delta.¹¹ The costs of mitigation and/or adaptation will be huge.

HUMAN RIGHTS

Vietnam’s international scores on voice and accountability lag far behind other indicators of governance quality.¹² However, the use of social media is now ubiquitous and continues to undermine the state’s monopoly on information and interactions. Social media as a platform for protest and as a means for grassroots organization gained in prominence in 2016 after the Ha Tinh fish-kill incident. Clumsy attempts by Hanoi to manage and quiet public outrage withered as protesters, brought together by (among other things) the #ichoosfish hashtag, took control of the public debate. Even so, the government arrested a number of activists, harassed protesters, banned

9. “Against the Grain,” *The Economist*, January 18, 2014, <<http://www.economist.com/news/asia/21594338-vietnams-farmers-are-growing-crop-no-longer-pays-its-way-against-grain>>.

10. D. Brown, “Mother Nature and a Hydropower Onslaught Aren’t the Mekong Delta’s Only Problems,” Mongabay, October 2016, <<https://news.mongabay.com/2016/10/mother-nature-and-a-hydropower-onslaught-arent-the-mekong-deltas-only-problems>>.

11. D. Brown, “Will Climate Change Sink the Mekong Delta?” Mongabay, October 3, 2016, <<https://news.mongabay.com/2016/10/will-climate-change-sink-the-mekong-delta/>>.

12. World Bank and Ministry for Planning and Investment, *Vietnam 2035: Toward Prosperity, Creativity, Equity and Democracy* (Washington, DC: World Bank Group, 2016), Figure O.18.

some journalists, and blocked websites, Facebook, and Instagram in the weeks following the fish kill and around the time of President Obama's visit.¹³ As protests over and inspired by the fish kill continued throughout the year, writers and bloggers who kept up criticism of the government's handling of the issue continued to be targets of intimidation and arrest.¹⁴

13. Amnesty International, "Vietnam: Shameful Wave of Arrests of Activists as Obama Visits," May 23, 2016, <<https://www.amnesty.org/en/latest/news/2016/05/viet-nam-shameful-wave-of-arrests-of-activists-as-obama-visits/>>.

14. "Vietnam Arrests Mother Mushroom, a Top Blogger, for Criticizing Government," *New York Times*, October 11, 2016, <<http://www.nytimes.com/2016/10/12/world/asia/vietnam-arrest-blogger-mother-mushroom.html>>.