Economic Security during Vietnam's Process of International Integration

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Abstract: During its integration, Vietnam's economy has undergone macroeconomic instability which negatively affected the economic growth and limited the benefits derived from integration. Due to macroeconomic instability caused by the lack of efficiency in managing foreign capital flows, foreign trade imbalance resulting from prolonged import surplus, mainly from the Chinese market, and the budget deficit from domestic and foreign debts, it is more challenging to ensure economic security.

Keywords: Economic security, integration, macroeconomic instability, import surplus, budget deficit.

1. Introduction

Vietnam is entering a phase of deep and extensive international integration with 11 signed Free Trade Agreements (FTA) and a new-generation FTA to be approved, namely the EU-Vietnam Free Trade Agreement (EVFTA). The integration process of Vietnam has had certain influences on its economic security and economic growth. Integration has exerted positive impacts on the economy such as expanding the export market, creating competition pressure to allocate resources with greater efficiency, and attracting foreign direct investment. However, integration has also had negative impacts on the economy and economic security.

Economic security can be understood on two levels. At the macro level, it is related to activities which can influence the economy as a whole, for example, macroeconomic instabilities such as inflation, local currencies depreciation, budget deficit, public debt, foreign debts, import surplus, etc. On the micro level are environmental pollution that causes impacts on a local and regional level, network security that causes impacts on enterprises or multi-level marketing businesses and online gambling which cause impacts on the people.

This article discusses issues of economic security on the macro level. The problems are currently serious for Vietnam and will become challenges in the coming phase of integration if focus cannot be directed at solving them from core. On that basis, this article provides suggestions of policies for Vietnam in the context of increasingly deep and extensive integration into the regional and global economy.

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2. Macro instability under the impact of foreign capital

Integration has provided opportunities for developing countries to have access to foreign capital under different forms such as foreign direct investment (FDI), foreign indirect investment (FII), commercial loans and official development assistance (ODA). However, financial crises which happened in the world (e.g. the Latin American debt crisis in the 1980s, the Asian financial crisis in 1997-1998 …) have shown that foreign capital flows can also carry crises if the recipient country does not possess enough capacity to absorb the capital, or doesn't have good adapting strategies to make use of the capital and fails to control its negative impacts.

In the first years after joining the World Trade Organization (WTO), Vietnam was going through "painful" experiences when the inflow capital rose strongly from 3.1 billion USD in 2006 to 17.7 billion USD in 2007, most of which was the FDI, that was raised by 2.5 times, from 2.5 billion USD in 2006 to 6.5 billion USD in 2007; and the FII capital flow, that was increased by about 5.5 times, from 1.1 billion USD in 2006 to 6.2 billion USD in 2007. This sudden increase of capital flows caused the local currency – the Vietnamese dong (VND) to appreciate and the State Bank of Vietnam (SBV) to intervene to stabilize the VND/USD exchange rate by spending a large amount of money to buy the US dollars. However, after the SBV's usage of the open market operations to stabilize the exchange rate, inflation rose to 23% in 2008 (Figure 1), which was the second highest level in the world, ranking only after Venezuela (40%). After 2008, Vietnam entered an unstable phase with the continual changes of the monetary policy from being expansionary to contractionary and from contractionary to expansionary. These changes created macro instability and caused decline in economic growth up until recent years. This has shown that Vietnam was not able to take full advantage of the opportunities brought about by integration and has not yet fully absorbed experiences and lessons from previous crises (Figure 2). The coming integration phase with the implementation of the new-generation FTA(s) and the increasingly higher level of liberalization requires Vietnam to learn profoundly from the experiences of the "rehearsal" it conducted immediately after the WTO accession.

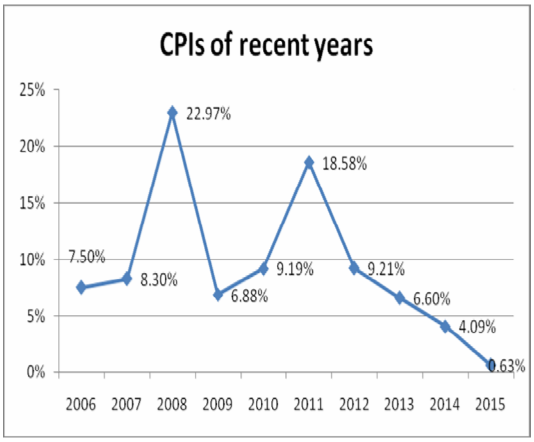

Figure 1: CPI of Vietnam, 2006-2015 [4]

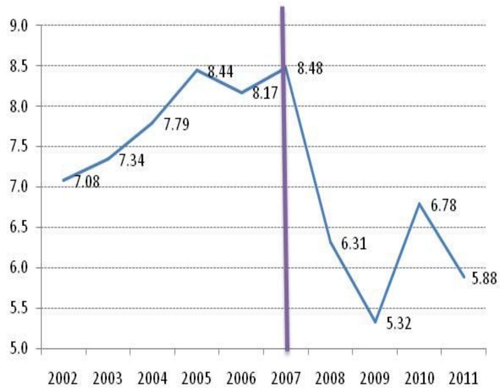

Figure 2: Growth of Vietnam, 2002-2011 [4]

3. Ensuring macro balances

Macro balances include internal balances such as the budget revenue - spending, savings – investment balances, and external balances such as the balance of payment. In this part we are to assess the balance between the budget revenue and the spending because the budget revenue – spending imbalance is related to public debt, inflation and the imbalance between savings and investment. Apart from that, we would also take into consideration the trade balance, one of the important components of the current balance of the balance of payment. The imbalance of trade can cause an impact on foreign debts, exchange rate and the liquidity of the economy.

Ensuring the budget revenue - spending and export - import balances is crucial to economic security. Here, economic security can include a very wide spectrum of issues such as bad debts, public debt and the liquidity of the financial system… However, in this paper, our analysis is limited to only the two issues of trade balance and budget balance.

3.1. Trade balance

3.1.1. Ensuring avoidance of large and prolonged trade deficits

During the period of 2001-2015, the trade balance was mainly a deficit. The deficit was the largest in the period of 2007-2011, when the economic growth rate was relatively high and Vietnam had just joined the WTO.

With the Vietnamese contemporary production and trade structures, a faster acceleration of growth rate equals a higher import surplus as the supporting industries of the economy are both insufficient and weak. When the economy expanded in terms of production, this resulted in imports of input materials from external sources, which was mainly China, followed by the Republic of Korea (South Korea).

In the three years of 2012-2014, the economic growth rate declined and the trade balance was a mild surplus. However, this was not due to better trade policies or the fact that the economic structure had changed for the better, but due to a decline in the economy with a rate of import lower than export. In 2015, when the economy regained its momentum, the trade balance became a deficit though at a small degree (Figure 3).

A trade balance with prolonged deficit and becoming a surplus only when there was a decline in the growth of the economy, presents many problems of the economy. Figure 4 below partly shows the biggest problem of the economy.

Throughout many consecutive years, the trade balance in the domain of domestic enterprises and that of the foreign-invested companies have had opposite directions of developments. While the trade balance of the latter was continuously in surplus, that of the former was continuously in deficit. As the foreign investment sector was in the global value chain and had a closer and stronger connection with the world, it enjoyed a higher proportion of export turnover.

On the contrary, the domain of domestic enterprises suffered from a trade deficit for an extended period of time. The sector had a large import surplus. Thanks to the export surplus of the foreign investment sector there was, on the whole, the lessening in the economy’s import surplus.

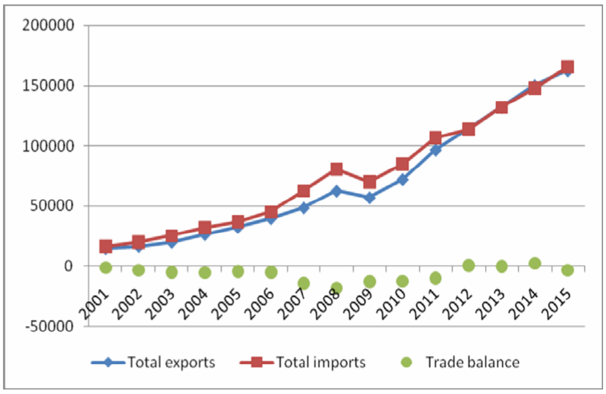

Figure 3: Trade Balance in the Period of 2001-2015, USD million [4]

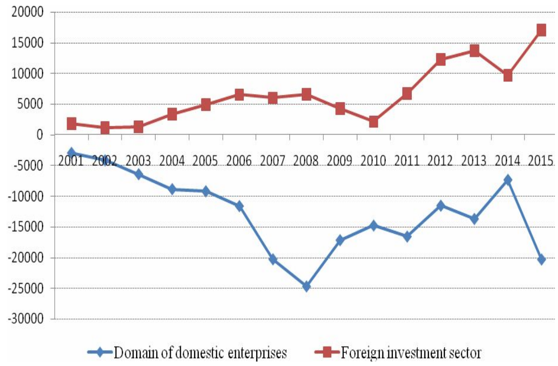

Figure 4: Trade Balance of Local Economy Sector and Foreign Investment Sector, USD million [4]

For a long period, the trade balance was a deficit. Only in the three years of 2012-2014, it was a mild surplus. However, this status was attained because the gross domestic product (GDP) of the economy declined, leading to a decline of import being stronger than that of export, causing a surplus in the trade balance. The condition was no longer maintained in 2015 when the economy accelerated, with the GDP rising by 6.68%, as compared with a lower growth rate of previous years.

The performances, which are toward two opposite directions, between the trade balance and economic growth, showed that the economy's instability was always included in its growth. That is, policies which promoted economic growth gave rise to trade balance deficits, creating exchange rate risks and foreign debts.

The export structure of our economy focused on the export of outsourced products such as labor-intensive footwear and textile, assembled products and the groups of products from agriculture, forestry, seafood and minerals. Vietnam's exports brought about a low added value, and had a low effect on the development of other sectors of the economy.

Major imports, mainly from China, were intermediate products and input materials for domestic production.

By sector, the foreign investment economic sector always had an export surplus and, the import surplus of the sector of domestic enterprises was high. Although the export surplus of the former made up for the latter to a certain extent, the economy as a whole still suffered from an import surplus because of the high import surplus of the local enterprises.

Evidently, the problem to be solved by Vietnamese policymakers is how to boost the growth of the domestic enterprises without causing a trade balance deficit. The country's policies to stimulate the economy seem to include the 2 following steps: Firstly, stimulating packages going into the domestic enterprises' sector, and, secondly, the local economy sector importing input materials, which are mainly from China.

3.1.2. Ensuring avoidance of supply shocks and market shocks

Currently, inputs and outputs, especially the import of inputs for the production in Vietnam, depend very strongly on China. Imports from China are mainly intermediate products and means of production used for domestic production and export. Many export products like agricultural products and raw materials are also dependent on the Chinese market (Figure 5).

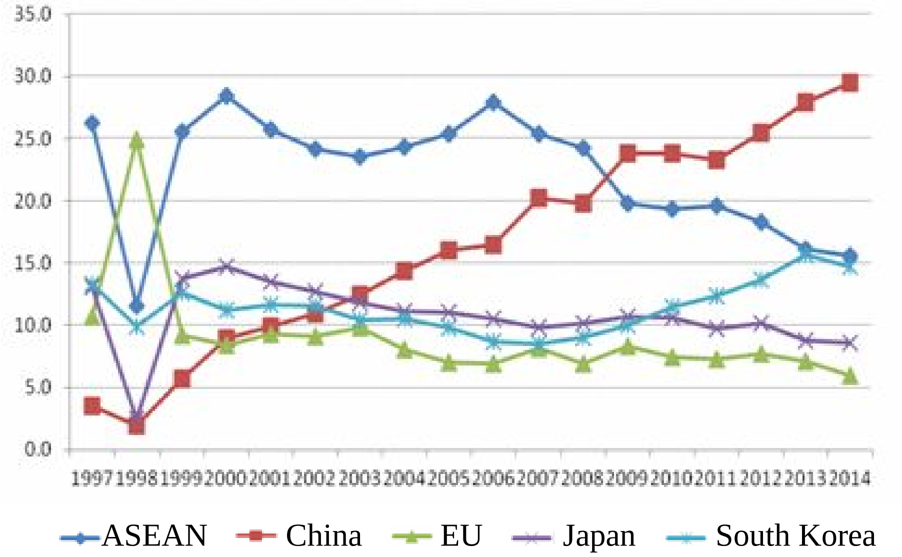

Figure 5: Proportion of Import from Several Major Partners (% Total Import) [1]

There are many explanations for the dependence of the Vietnamese economy on the Chinese economy. Firstly, China is a neighboring country which has a large economy providing many inputs that can meet the demand of Vietnam's domestic production. Hence, Vietnam becomes a large importer of China. Secondly, China is a large market where the huge demand for food products and input materials makes it a large importer of Vietnam as well. Although the proportion of import from Vietnam is small compared to China's total import, the value of exports from the former to the latter is still high since China is a large market and the scale of the Vietnamese economy is small.

In normal economic relations, enterprises trade with enterprises from other countries on the basis of profit maximization. However, put in the political and social context, the overly dependence on another country can create risks. In other words, to ensure economic security in the current context, Vietnam needs to diversify the markets for its import and export of goods. Through integration, Vietnam has gained many opportunities for market diversification and hence the economic security is more strongly strengthened.

3.2. Balance of state budget revenue- spending

The budget revenue is just enough for recurrent expenditures and hence spending on investment and development depends completely on borrowing. Thus, the budget deficit, which is prolonged and getting increasingly more severe, has caused the public debt to rise and affected the sustainability of public debt, especially foreign debt.

Figure 6 shows budget deficits from 2008 to 2015. The deficit has been on a rising trend in terms of the absolute value from VND 68 trillion in 2008 to VND 112 trillion in 2011, to VND 195 trillion in 2013 and to VND 226 trillion in 2015. In terms of the structure of the budget revenue, for example, in 2015 (the preceding years did not have changes which were large enough to change the main remarks), domestic revenue had the largest proportion, accounting for 70% of the total budget revenue. Ranking second was the revenue from export-import that accounted for 19%, revenue from crude oil-accounted for 10.2% and domestic revenue-accounted for 0.5% (Figure 7). A noteworthy point in Vietnam's budget revenue is that revenues from crude oil and export-import are on a declining trend under the impact of free trade agreements. The decrease in the budget revenue from export-import and crude oil will pose a challenge and requirements for increasing the budget collection from other sources. In collecting for the budget revenue by tax categories, revenues from the value added tax and corporate income tax make the largest contributions. These two taxes are levied on consumers and corporates. Hence, with the increase of value added tax or corporate income tax to compensate for the decrease of revenues from crude oil and export-import activities, the economy will undergo considerable impacts.

The personal income tax and royalties contribute the lowest amounts of revenues to the budget. These two taxes are potential sources of revenue for the budge because the collection of the personal income tax is currently lower than its potential, with the number of high income earners who are not yet covered being still high, while the royalties can be increased to both raise the budget revenue and contribute to the protection of natural resources, given the fact that losses of the royalties can be very large if illegal exploitation of natural resources and smuggling occur on a large scale.

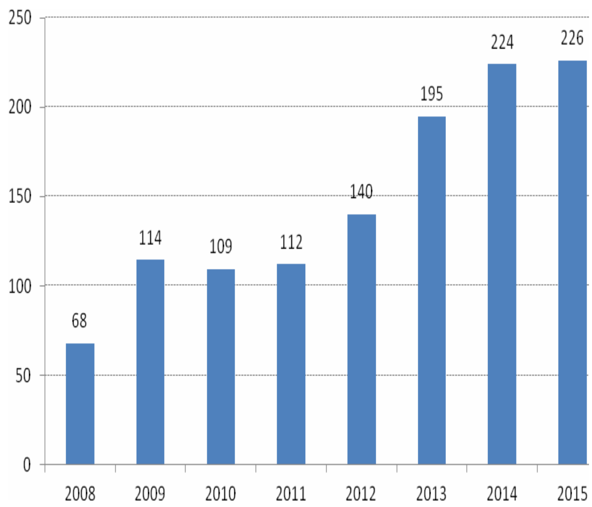

Figure 6: Budget Deficit through the Years, VND trillion [3]

Figure 8 shows the structure of state budget spending in 2015, in which the recurrent expenditure accounted for the controlling proportion (67.7% of total the total State budget spending), followed by spending on investment and development (accounting for 17%), debt and aids repayment (accounting for 13%). So, recurrent expenditure accounted for the largest proportion in the total budget spending, while spending on investment and development, especially spending on building infrastructures, accounted for a far lower proportion. It is worthy to note the figure of 13% which is for the repayment for debts and aids. That proportion is approaching the ratios of investment and development against the total. Borrowings over the many years have accumulated into a large debt. Of the recurrent expenditures, spending on education and training accounted for the largest proportion; followed by spending on social security and administrative management. These expenses are usually spent on people and hence it is very difficult to cut the budget spending via cutting recurrent expenditures. In the medium and long term, reduction of the recurrent expenditure shall be linked to the reform of the state management and public administration apparatuses, cutting down on staff, rearrangement of the roles and functions of agencies and sectors to avoid overlapping in order to create an apparatus which is both compact and efficient.

Although in 2015 the Ministry of Finance implemented many solutions to manage the state budget in a more tightened, economical and efficient manner, including the restructuring of the budget spending, increasing the proportion of investment and development, maximizing the saving in the recurrent expenditures, and ensuring the implementation of social security policies, issues in budget spending still persist.

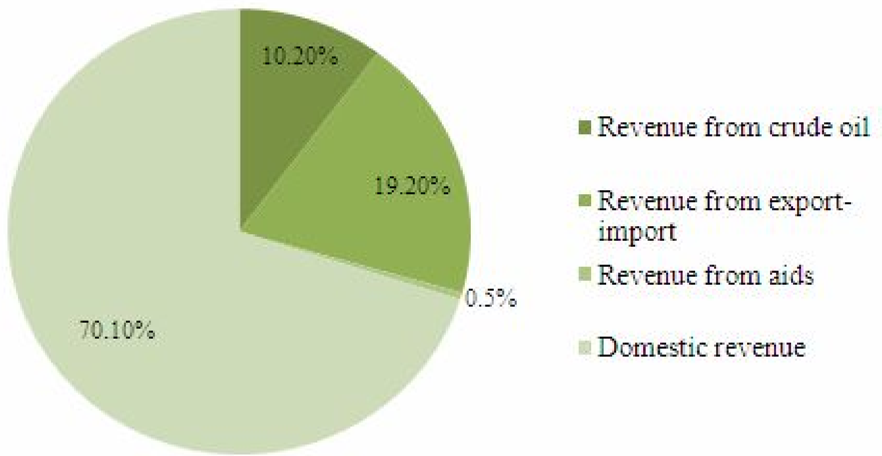

Figure 7: Structure of State Budget Revenue in 2015 (%) [3]

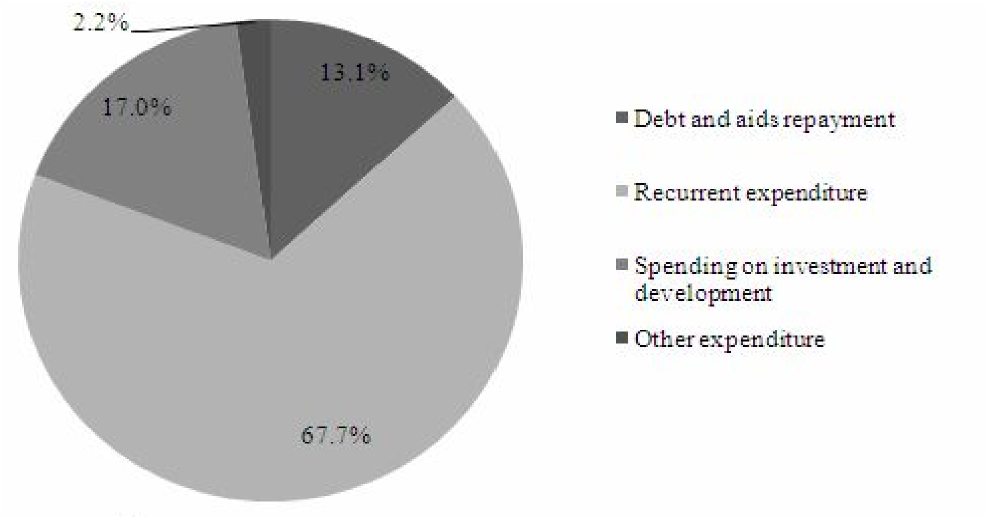

Figure 8: Structure of State Budget Spending in 2015 (%) [3]

A prolonged budget deficit has created accumulated public debts, including foreign debts. According to the data of the Ministry of Finance, in 2015, the ratio of public debt/GDP was around 62.2%, government debt/GDP was 50.3%, against the goal of 50%, and foreign debt/GDP was around 43.1%. The continuance of the current rate of budget overspending and the cap for government guarantees will cause the ratio of public debt against the GDP to surpass the ceiling (allowed) rate in the years of 2016-2017.

4. Policy choices for Vietnam

Given the issues of economic security of Vietnam, and opportunities and challenges from the new-generation FTA(s) in the upcoming future, Vietnam needs to put into consideration the following policies to resolve the existing problems at the core.

Firstly, to efficiently manage the foreign capital flow into Vietnam.

The "costly" lessons from the experiences of the Latin American debt crisis and the Asian financial crisis have suggested that Vietnam carefully consider the roadmap for the capital account liberalization in line with its capabilities. A step-by-step approach of opening is probably a suitable choice for Vietnam. Specifically, liberalization shall start with the FDI capital flow into Vietnam, its own direct investments overseas and indirect investments into the country, which are areas whereby Vietnam has liberalized at a certain level. Only after that, once the domestic financial system has become strong enough and is managed efficiently by a capable financial supervisory body, will attention be given to the liberalization of short-term lending funds and a mechanism of the free conversion of foreign and local currencies.

With the increasing financial integration, Vietnam needs to enhance the capacity of the domestic financial system, including the banking, securities and insurance systems so that they would be healthy enough against the shocks in the international financial system. Presently, the country's financial system still has many shortcomings in relation to the non-performing loans of the banking system, the lack of transparency and the small scale of the stock market, and an insurance market dominated by foreign insurance groups.

Vietnam also needs to enhance the efficiency of financial supervisory bodies, including: the National Financial Supervisory Commission, the State Bank of Vietnam, the Ministry of Finance, the State Securities Commission, in order to deal with sudden reversals of the capital flows, directing the flows toward efficient industries and controlling those flowing into highly speculative sectors, e.g. real estate and securities. At the moment, when the level of financial liberalization of Vietnam is still low, the financial supervisory capacity has still not yet been able to meet the demand. So, in the future, when commitments on financial liberalization have been considerably heightened, this weakness must be fundamentally resolved.

Secondly, to reduce budget deficit, control public debt, foreign debt

At present, the overspending has reached an alarming rate, leading to an accumulation of public debt and foreign debt at a high level. Vietnam must take drastic measures to tighten public investment and public spending to attain the following goals: increasing the efficiency of investment and development projects; controlling the public procurement; continuing the acceleration of the equitization of state-owned enterprises (SOEs), and the Government will not guarantee the loans of commercial projects by SOEs; with the State apparatus streamlined for the state budget savings.

In terms of revenue, under the trend of reduction of revenue from export-import and oil, Vietnam needs to enhance the efficiency of the domestic tax collecting system by expanding the collection of the personal income tax and property transaction tax, which are the sources of revenue not yet handled efficiently.

Thirdly, to reduce import surplus and dependence on supply from China

The lack of supporting industries is the core reason of import surplus and dependence on supplies from China, which has been occurring for many years in Vietnam. Hence, developing supporting industries is a priority policy in the upcoming future. However, it is a fact that domestic enterprises, with their current financial and technological capacities, would find it difficult to shoulder the role of guiding the development of the industries. Thus, Vietnam needs to take advantage of opportunities from new-generation FTA(s) to attract FDI investors to develop supporting industries in Vietnam, making use of the Rule of Origin.

Additionally, Vietnam needs to enhance the competitiveness of the export sector via solutions such as technological innovations, enhancement of the technological content, and improvement of added values of its exports.

5. Conclusion

Assessment of the economic security issues on the macro level during the past integration period has pointed out the most important macroeconomic challenges, including the macro instability under the impact of foreign capital flows and macro imbalances in trade and budget revenue – spending. The choices of policy for the coming integration period are suggested based on the analysis of the basic reasons of the above macro challenges which are related to the capacity to manage the foreign capital flows, the capacity of the supporting industries and that of the export sector.

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