The Pathfinder Economic Alert

Jump - Starting Growth: What Can We Learn from Vietnam and Malaysia?

I. Our Targets

The President Mahinda Rajapakse as the Minister of Finance has once again reiterated in the Budget of 2012, the Government's commitment to a sustainable growth target of 8% - 10%. A key objective of achieving this growth is to double per capita GDP to over $4,000 by 2016. The recent experiences of Vietnam and Malaysia provide important insights for developing a road map for achieving these goals.

II. Vietnam: New Reform Agenda for Rejuvenating the Ailing New Asian Tiger.

a) Doi Moi (Renovation)

In the mid-1980's, Vietnam's post-war economy was moribund. The liberalization package, Doi Moi (Renovation), introduced at that time unleashed the energy, discipline and hard work of individuals and enterprises. Vietnam became a star performer – a new Asian Tiger - in the firmament of the economies of the world. It experienced rapid growth and the living standards of its people improved significantly. In order to achieve this rapid growth and development Vietnam introduced **partial liberalization** to open up almost all the sectors of the economy to foreign private investment. Foreign investors from all destinations, including historical foes, such as America and China, were welcomed and provided with incentives to invest in Vietnam.

b) Loss of Growth Momentum.

However, as in the case of many countries which have done reforms half way, there is now a consensus that Vietnam is at a cross-roads. Inflation has been in excess of 20% in two of the past three years; foreign exchange reserves have slumped; the debt to GDP ratio has risen above those of its peers; and foreign direct investment has fallen. All three major rating agencies (S&P, Moody's & Fitch) have downgraded the economy.

The rapid growth since the Doi Moi has been driven by increasing capital investment and relatively cheap labour supply. Less attention has been paid to improving the quality of investment and total factor productivity. There is increasing recognition within Vietnam that the growth model needs to be "renovated". It has been argued that a major cause of Vietnam's problems has been the **lack of further economic reforms** and **excessive investment in inefficient state-owned enterprises (SOEs)** which have sucked up a great deal of capital and used it inefficiently. They have been permitted by the government to diversify into areas, such as property and stocks, which are outside their core competencies. The state sector has been shrinking and now accounts for about 40% of GDP. However, it continues to absorb a disproportionate share of the investment pie. **The Pathfinder Foundation invites the concerned parties to draw parallels in the Sri Lankan situation in formulating economic action plans**.

c) Reinventing Growth Through a New Cycle of Reform

Three priority areas have been identified for restructuring the economy: public investment, SOE's and the financial sector. The SOE's have already been directed to drastically reduce their investment in non-core activities to 10% from up to 30%. There is also a greater focus on increasing efficiency and total factor productivity, with SOEs being instructed to establish clear criteria for productivity and technology advancement rather than merely investment and revenue. The authorities have also signaled that the long-clogged pipe-line of IPOs to sell major chunks of SOEs will be reinvigorated, though poor market conditions are hampering this. In addition, the Government is selling SOEs in industries where private businesses are performing well.

The Pathfinder Foundation is pleased to note that in the 2012 Budget Proposals, the Government has proposed to introduce amendments to the Finance Act to improve the efficiency of the SOEs. However, the outcome depends on the specific restructuring measures and the Government's willingness to proceed, in appropriate cases in partnership with the private sector.

The State Bank of Vietnam (the Central Bank) has been requested to restructure the commercial banking system by orchestrating the consolidation of an over-crowded sector. Such activism, on the part of the monetary authorities, has been successful in other countries, notably Singapore.

The Government has also requested the Ministry of Planning and Investment to separate ownership and management in the largest SOEs (eg: Petrovietnam). SOEs are also being directed to pursue “OECD standards of corporate governance”. Isn’t this an option for major loss-making enterprises in Sri Lanka?

d) Managing Reforms

There is increasing recognition, even at the highest levels of the Vietnamese Government, that a major reform package is necessary. However, there is still concern whether policy-makers can fend off the resistance to major reforms from SOEs and private conglomerates, whose influence has increased sharply. Hence, the big question is how far the leadership will go in implementing major structural changes. The optimists contend that the 14-person Politbureau, which has been re-elected recently, now has the time and political space to act decisively. Others fear that the leadership may not be united on reform and that a rift could emerge between the Government and the Party, if reforms are pursued too aggressively.

Without reforms, Vietnam is likely to lose its remarkable growth momentum of the past 25 years. This, in turn, could undermine the compact that has existed between the Party and the people.

III. Jump- Starting Growth: Malaysian Mechanism

a) Middle – income Country Trap.

Despite its impressive performance over three decades, Malaysia has been struggling recently in achieving its aspiration of becoming a high-income country by 2020. In 1991, Dr. Mahathir Mohamad released ‘Vision 2020’ as the aspirational document for Malaysia’s long-term future. In recent years, it has become apparent that Malaysia was not going to meet the targets set out in the document. The realization also dawned among the current leadership that fundamental change was required to achieve “big results fast,” if Malaysia was to avoid the “Middle-income Country Trap” (very few middle-income countries have succeeded in achieving high-income status).

The Government has recently announced two major reform programmes to jump-start the fundamental change that is necessary. The Economic Transformation Programme (ETP) was launched in October 2010. It sets out a road map to lead the country to high-income status by 2020. The ETP targets annual growth of 6% and a doubling of per capita Gross National Income (GNI) to $15,000 (the World Bank’s threshold for high-income country status). The Government

Transformation Programme (GTP) is designed to deliver a large impact rapidly in those public services that are most important to the people.

Prime Minster Dato Sri Najib Tun Razak appointed Ibrahim Jala as the CEO of the newly constituted Performance Management Delivery Unit (PEMANDO). Mr. Jala has brought to the Government private sector turnaround skills honed at Malaysian Airlines and Shell. PEMANDO, in Bahasa Malaysia, means "Driver". It comprises 127 people (chosen on merit alone from 5,000 applicants), half each from the public and private sectors. PEMANDO acts as the architect and catalyst of the country's transformation programme. The public service is co-opted in the development of solutions and is responsible for implementation.

b) **Economic Transformation Programme (ETP) -** on liberalization, human capital development, public service transformation…….

The ETP has three objectives: transformation of the economy to achieve high-income status; inclusiveness; and sustainability over time. It focuses on 12 sub-sectors (eg: palm oil, health care and tourism). The ETP is also designed to undertake fundamental reforms to improve the competitiveness of the economy by focusing on liberalization, human capital development, public service transformation, strengthening delivery systems and meeting international standards. "The Economic Transformation Road Map" serves as the equivalent of a company prospectus. It has identified 133 specific entry points, which have the potential for transformative impact; as well as targets, milestones and accountability. The road map was developed jointly by 350 private sector representatives and 150 public servants who came together for 8 weeks in intense "Labs". 92% of the $444 billion investment projected over the next decade is expected to come from the private sector.

Some painful and unpopular measures, including subsidy rationalization, had to be introduced to fund the ETP. This has placed a very high premium on delivering and demonstrating positive results early. In the first of eight months of implementation, the ETP has achieved Ringgit 170 billion in committed investments with a projected GNI impact of Ringgit 220 billion as well as 362,396 new jobs. This constitutes 12%, 13% and 11% respectively of the ETP's 10-year targets.

The Pathfinder Foundation proposes the setting up of a mechanism such as a Task Force for implementation of reforms as identified in the Government's own policy documents and recent budget proposals (2010-2012) consisting of private, public as well as other civil society representatives.

(c) The Governments Transformation Programme (GTP) - crime, corruption, rural infrastructure……

The key focus areas of the GTP were identified through widespread consultation. These included crime, corruption, rural infrastructure, urban public transport, education and basic services for low-income households. In the first 12 months of its operation, the GTP has achieved 112% of the key performance indicators with only 79% of the budget. Crime has been reduced by 15%; 2400 corruption cases have been investigated with 540 persons being charged and 131 convicted. In addition a Whistle-blower Protection Act has been introduced. The literacy and numeracy targets have been met in education. The use of public transport has increased from 12% - 15% at a time when recourse to private transportation has been increasing in the Asian region. Two million lives have been impacted through the rural infrastructure programme, which has had 775 km of new rural roads and clean water for 35,000 households. One must reiterate that all this was achieved in a year.

The methodology adopted in implementing the GTP has been based on the following six specific techniques.

- Areas of focus are determined through public consultation.
- An intense problem-solving approach is adopted through the use of “Labs”. These labs involve inter-ministerial/agency teams and last 6-8 weeks of intensive analysis and problem-solving. The output is a detailed action programme for each of area of focus.
- Town Hall sessions (open days) are held to engage with the public on the action programmes developed through the “Labs”. Feedback has been received from 8,500 citizens.
- “A Government Transformation Programme Road Map” has been published so that the promises made by the Government are available for scrutiny by the public.
- There is strong leadership intervention through steering committees, weekly reports and daily interactions.
- An Annual Report is to be produced setting out both what has been and, more importantly, what has NOT been achieved.

The results of the different components of the GTP are being independently validated by international accountancy firms and/or multilateral institutions.

IV Conclusion

As we is very apparent, these experiences in Vietnam and Malaysia provide important insights for post-conflict Sri Lanka. The end of the conflict has undoubtedly improved the development prospects of the country dramatically. However, in itself that is insufficient to transform the future prospects of the people of Sri Lanka. This has been demonstrated by the relatively low levels of private domestic and foreign investment in the economy. The Government's target of 8% growth over a longer period of time cannot be met without investment of about $17 billion per annum, out of which –up to $14 billion has to be private investment, domestic and foreign (public investment has been capped at $3 billion - $3.5 billion). This substantial increase in foreign direct investment cannot be achieved without the benefits of peace being supplemented by a package of reforms that consolidate macroeconomic stability, improve the investment climate, strengthen the skill base, promote entrepreneurship/innovation and take advantage of Sri Lanka's economic geography (particularly the proximity to India).

With regard to the unequivocal importance being attached to the foreign investment in Vietnam, it is pertinent here to take note of the statement made by President Truong Tan Sang, ***"our foreign policy is such that Vietnam wants to be a reliable partner to all countries in the world. Our policy is that foreign investors, regardless of their country of origin, are an integral part of the Vietnamese economy".***

This is the Eighteenth in the series of Economic Alerts issued by the Pathfinder Foundation.

Readers' comments via email to pm@pathfinderfoundation.org are welcome.