Public & Social Sector Practice

What will it take to achieve Vietnam's long-term growth aspirations?

COVID-19 has interrupted the country's journey to become a high-performing economy, but the right structural adjustments could help get it back on track.

by Bruce Delteil, Matthieu Francois, and Nga Nguyen

September 2020

This is the second of two articles in which McKinsey looks at COVID-19's immediate impact on Vietnam's economy and identifies the long-term challenges the country can address to realize its potential.

With relatively few recorded COVID-19 cases and fatalities to date, Vietnam now has an opportunity—and an imperative—to consider its longer-term economic aspirations, even as the country responds to a resurgence of the virus. Enduring success will require Vietnam's leaders to focus on issues and opportunities that long preceded the pandemic.

In the first piece of this two-part series on reimagining Vietnam, we outlined how the country could chart a short-term course out of the pandemic's immediate effects. In this article, we discuss how a rebound might be sustained over a longer time horizon to reach the country's stated goal of becoming a high-income nation by 2045. According to a 2019 joint report from the World Bank and the Vietnam Academy of Social Sciences, success would require annual growth of 7.0 to 7.5 percent from 2021 to 2030—a big step up from the 6.3 percent Vietnam averaged over the ten years before 2018.

In that year, McKinsey research identified Vietnam as one of 11 recent global outperformers, thanks to its GDP-per-capita growth of more than 5 percent annually for 20 years, in addition to its successful effort to lift a significant percentage of its people out of poverty. Vietnam has the elements in place to continue as an outperformer—for instance, growing disposable income, continued investment in infrastructure programs, and an attractive business environment. Adjustments in four broad areas could help the country get onto the required growth trajectory.

1. A position as a preeminent international destination

Vietnam was already attractive as a destination for offshore manufacturing and for tourism before COVID-19. Even as the country addresses the new virus strain, its low level of recorded cases and fatalities has shown that its systems can identify and manage the outbreak.

This may position Vietnam well as international tourism resumes. The country could then turn its attention to marketing itself as a destination in Asia, where the earliest arrivals may come from when countries open their borders. In the meantime, tourism and hospitality operators will need to use the opportunity to diversify both tourism products and market segments. Domestic tourism could be promoted to test the new offerings, but discounts may be needed because of the relatively lower local spending power.

Reattracting and accelerating foreign direct investment (FDI) in the manufacturing sector will also be vital to accelerate Vietnam's path to higher growth. In our earlier piece, we discussed how Vietnam is well-positioned to go on attracting FDI, especially as manufacturers seek to strengthen and diversify their supply chains in response to the frailties the pandemic exposed.

2. Investments in education and infrastructure to boost productivity

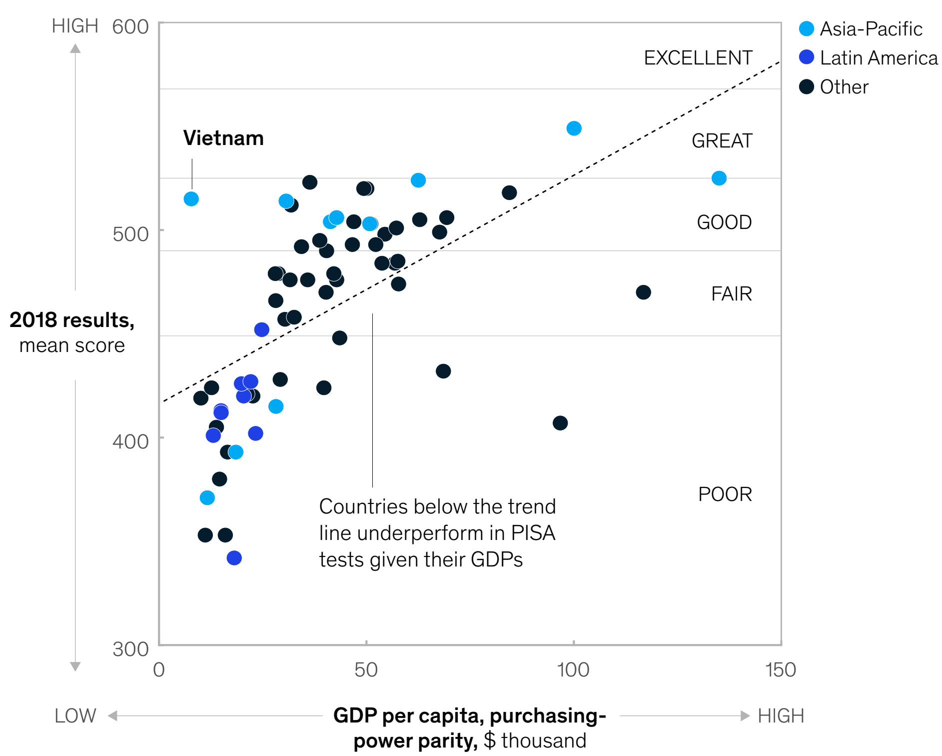
To sustain longer-term growth, a handful of structural changes could also be considered. Three enablers are essential: education, workforce productivity, and infrastructure. In education, Vietnam can leverage its clear strengths: a 2017 McKinsey study of the drivers of student performance identified it as one of Asia's high-performing countries (Exhibit 1). Vietnam, for example, has significantly increased school enrollment at all levels over the past 20 years. Primary-school enrollment is virtually universal, ranking only behind Japan's and higher than South Korea's and Hong Kong's, among other Asian high performers. Education initiatives could focus on developing cognitive, behavioral, and practical skills and on boosting vocational schools.

Investment in education could raise skill levels in the workforce as part of initiatives to increase productivity, which lags behind that of Vietnam's regional peers and has plateaued, despite positive economic growth (Exhibit 2) and ongoing competitiveness in labor costs. A higher-skilled workforce could attract manufacturers exploring Industry 4.0 technologies and help to move the country up the value chain into more productive and higher-earning areas. A recent McKinsey survey showed that Vietnamese companies are the most eager among their peers in the Association of Southeast Asian Nations to implement Industry 4.0, yet adoption remains low. A coordinated effort from public, private, and academic stakeholders would be required to translate intention into implementation.

Exhibit 1

Vietnam's academic performance is significantly above that of countries with the same level of GDP per capita.

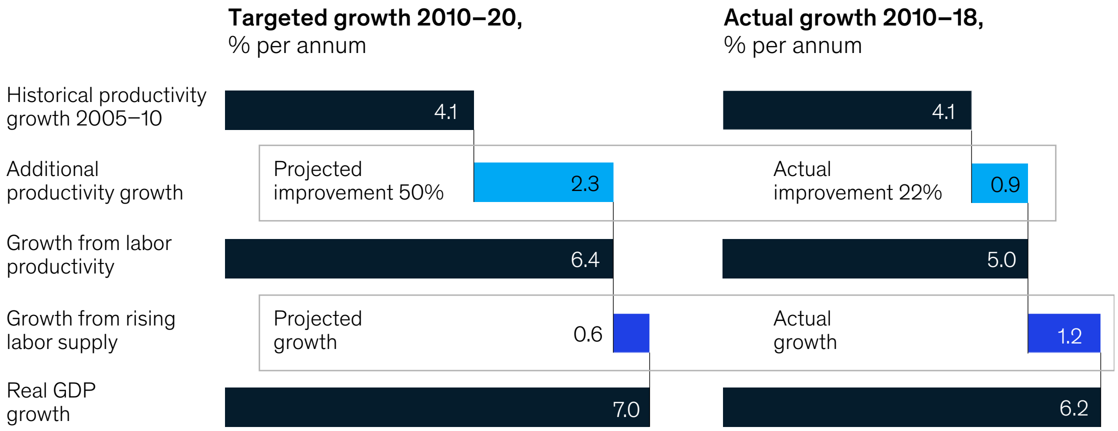
Programme for International Student Assessment (PISA) compared with GDP



Source: Programme for International Student Assessment

Exhibit 2

Vietnam's GDP has sustainably been above 6 percent, but productivity improvements have reached a plateau.



Source: Vietnam General Statistics Office 2018; McKinsey Global Institute analysis

As for infrastructure, investments to redevelop it could be scaled up. Ports are running at overcapacity. Ho Chi Minh City and Hanoi need significant investments in roads and airports. But public debt stands at around 60 percent of GDP—compared with 52 percent in Malaysia, 40 percent in the Philippines, and about 30 percent in Indonesia—and represents a potential hurdle to redevelopment. The framework for public–private partnerships was simplified in 2020, but continued efforts to execute will be needed to close the infrastructure gap.

3. A continued focus on small and medium-sized enterprises and the informal sector

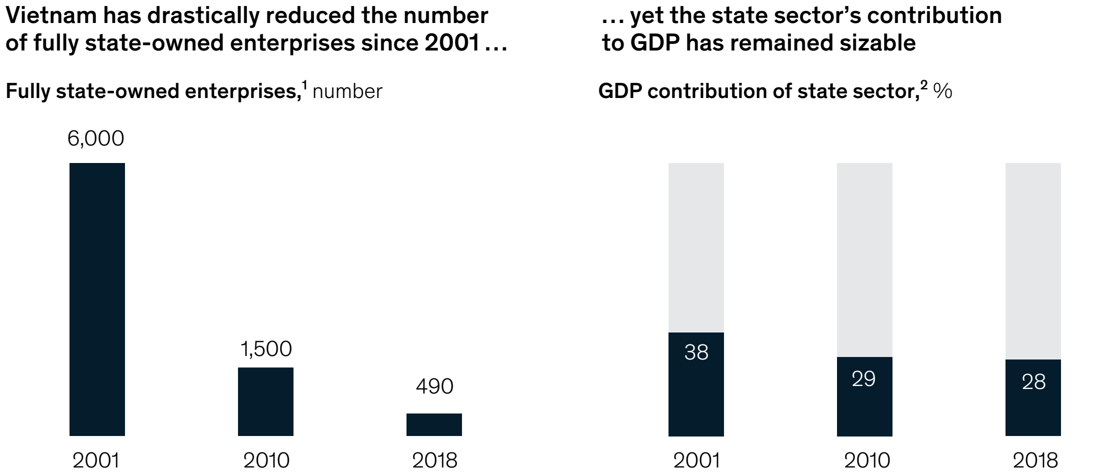
Beyond manufacturing and tourism, the country could focus on boosting the competitiveness of other strategic areas at home—including state-owned enterprises (SOEs), small and medium-sized enterprises (SMEs), and start-ups—to increase national resilience. SMEs and the informal sector collectively form a crucial domestic demand engine and will continue to need support, especially in the short term while growth and incomes remain depressed. Financial inclusion could be prioritized and the banking system strengthened, with a focus on making more banks Basel compliant.

The country also can't ignore a major underperforming engine of growth: SOEs account for one-third of GDP yet grow much more slowly than other companies do. While Vietnam has reduced its number of fully owned SOEs by more than 90 percent since 2001, its journey is far from complete because these efforts have yet to make the sector any leaner (Exhibit 3). Targeted equitizations, sustainable divestments, and transformation programs could be considered to make SOEs competitive at home and even more competitive on the global stage.

In addition, the country could tap the significant unrealized potential of its start-up ecosystem. In 2019, $741 million was invested in Vietnam's start-ups, compared with $2.38 billion in Indonesia's. It's little surprise that Vietnam has created only one unicorn, compared with six in Indonesia. A more holistic ecosystem effort could remove structural limits on private entrepreneurship, make financing available for high-potential projects, and provide fertile incubation structures for high-growth businesses.

Exhibit 3

Vietnam's privatization effort has cut the number of fully state-owned enterprises, but the state sector still represents a third of GDP.



[1]Companies fully owned by the state before any equitization.
[2]The state sector includes agencies and organizations the government has established or in which it has invested in facilities, provided all or part of the budget, directly managed, or participated in management.
Source: Ministry of Finance, General Statistics Office

4. Exploring renewable energy for less carbon-intensive growth

As a major driver of new energy demand and a country likely to be heavily affected by climate change, Vietnam could accelerate its journey toward a less carbon-intensive future. A new national plan signals a significant effort to energize this transition. Under the latest proposal, coal is expected to represent about 37 percent of energy generation by 2025, instead of half as previously planned. Renewables would grow to about 25 percent of the mix, from 13 percent in the previous version.

This proposal embodies a significant scaling back of plans to develop coal plants, which have come under pressure and faced challenges in financing over recent years. To understand exactly what it will take to integrate renewables, Vietnam could also look at opportunities to encourage significant new capital investment in them through strong incentives and conduct a detailed grid-capability assessment for a new generation of assets.

Looking ahead to the day when the pandemic stabilizes and global trade picks up, the suggested structural adjustments could reignite Vietnam's critical export sectors and put its transformation goal back within reach. With appropriate post-COVID-19 responses paving the way for economic recovery, such adjustments to Vietnam's economy could go a long way toward realizing a future as a high-performing nation.

Bruce Delteil is a partner in McKinsey's Hanoi office, where **Nga Nguyen** is a consultant. **Matthieu Francois** is an associate partner in the Ho Chi Minh City office.

The authors wish to thank Marco Breu and Thuy Tran for their contributions to this article.

Designed by McKinsey Global Publishing