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Vietnam and the Middle-Income Trap in Development

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Abstract: This article covers the general issues of the Middle-income trap, thereby identifying the risk of falling into Vietnam's middle-income trap, the reasons and proposing some solutions for Vietnam to overcome the middle-income trap and enter the league of high-income countries in 2045. The comments and analysis are based on the World Bank's criteria for classifying groups of countries, updated to July 2022.

Key words: middle-income trap, growth rate, development, MIT, MICs
JEL code: O110

1. Introduction

In 2009, Vietnam officially became a low-middle income country. The next goal is Vietnam will become a high-income country by 2045. Can it be achieved when in fact, Vietnam's growth trend is gradually decreasing, many new barriers appear, such as vulnerability due to the pandemic, difficulties in adapting to the industrial revolution 4.0, etc.? Is Vietnam at risk of falling into the middle-income trap (MIT)?

2. Literature Review and Previous Research Studies

As soon as Vietnam officially exits the group of low-income countries, economists also warned of the risk of a middle-income trap (MIT) waiting for Vietnam. Looking at the experience of neighboring countries such as Thailand, and Malaysia - countries that are said to have spent many years unable to escape beyond the Middle-income group, and join the high-income countries, Vietnam's leaders have been very serious, trying to run the

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economy with the aim that, Vietnam does not fall into the middle-income trap.

There are quite a lot of research, international as well as domestic conferences, which have been conducted around the topic of the middle-income trap. Some notable studies include:

ADB, 2017, “Middle-income trap: review of the conceptual framework”[1]. The aim of this study is to develop a conceptual framework for the Middle-income trap. Accordingly, the research presented an extensive literature review of what the Middle-income trap concept is, why economies become “stuck” in the Middle-income trap, and how the idea is criticized. At the same time, the research put together a list of countries stuck in the Middle-income trap according to different definitions. It also proposed a framework for assessing exposure to the Middle-income trap based on the following factors: i) unfavorable demographics, ii) low level of economic diversification, iii) inefficient financial market, iv) insufficiently advanced infrastructure, v) low level of innovation, vi) weak institutions, vii) inefficient labor market.

Kenichi Ohno, “Avoiding the Middle Income Trap: Renovating Industrial Policy Formulation in Vietnam” — Vietnam Development Forum (VDF), Hanoi national Graduate Institute for Policy Studies, Tokyo, Feb 26th, 2010 (Kenichi Ohno, 2010). The research confirmed that Vietnam’s growth in the last one-and-a-half decades was very remarkable. And now, in order to make processes of systemic transition and global integration deeper, Vietnam needs to create internal value to continue to grow and avoid the *“Middle-income trap”*. Vietnam has reached the point where growth towards higher income cannot be secured unless policy-making is renovated significantly to activate the country’s full potential. This research also recommended Vietnam should create industrial strategies, and concrete action plans and strengthen the strategic alliances with international partners, which are considered keys points for the renovation of Vietnam’s industrial policy formulation.

Paus, Eve - ADB, March 2017, “Escaping the Middle-Income Trap: Innovate or Perish”, had analyzed the reasons for the middle-income trap in Latin America, where countries have been at the Middle-income level for decades, and drew out lessons for Asia. This research supposed insufficient development of domestic innovation capabilities is at the heart of the middle-income trap. Especially, globalization brings many challenges for middle-income countries to narrow the capabilities gap, because there are more and more barriers for them in the context of technological innovation changing faster. This research proposed a comprehensive innovation-focused strategy with strategic active policies, making an innovation ecosystem are the only way to escape the middle-income trap.

Son D. K. (2021), *Renovation of Economic Growth Model* — the National Political Publishing House. This monograph commended the Middle-income trap is also an issue, demonstrating the need to renew the economic growth model in Vietnam in the coming time.

In addition, there have been quite a lot of seminars conducted in the country since 2009, all around the issue of the Middle-income trap and recommendations for Vietnam to avoid it.

All these researches are putting Vietnam in a normal development context, with the operation of the economy, as well as the world economy being stable in the new development trend. However, the Covid-19 pandemic that occurred and spread globally since the end of 2019, the war between Russia and Ukraine in early 2022 has turned upside down and really become a major barrier in the growth process of many countries including Vietnam. In April 2022, the World Bank lowered the growth forecast of most countries, with Vietnam being one of the most adjusted countries[2].

1 Available online at: https://www.adb.org/sites/default/files/publication/329201/adbi-wp760.pdf.
2 Available online at: https://moit.gov.vn/tin-tuc/hoat-dong/wb-ha-du-bao-tang-truong-kinh-te-toan-cau-nam-2022.html.

This once again warns of the risk of being trapped in Vietnam's Middle-income trap.

3. Research Results:

3.1 Middle-Income Trap and Classification of the World's Nations

The term "Middle-income trap" was indirectly introduced by Garret (2004), who observed that the growth rates of Middle-income countries had been in stagnation since the 1980s. This term was defined for the first time by Indermit Gill and Homi Kharas (2007) – two economists working at the World Bank. Accordingly, the "Middle-income trap" refers to the status of a country that, despite being lifted out of poverty and joining the group of Middle-income countries took decades to become a high-income country[3].

It is necessary to explore how to classify the world's nations before making clearer about Middle-income trap

The World Bank, an international organization dedicated to helping countries overcome poverty, has historically classified every economy as low, middle, or high income[4]. It now further sorts each of the world's nations into one of four categories: high-income, upper-middle-income, lower-middle-income, and low-income. Upper-middle-income countries and lower-middle-income countries are known collectively as Middle-income countries (MICs). In response to shifts in the global economy, the World Bank adjusts the boundary lines between the categories each July. This organization uses GNI per capita, in current US dollars converted by the Atlas method of a three-year moving average of exchange rates, as the basis for this classification. It views GNI as a broad measure and the single best indicator of economic capacity and progress.

Table 1 Classification of the World's Nations Based on Income

Categories	GNI/capita (Unit: USD)	
	2020-2021	2021-2022
Low-income countries	<= 1.035	<= 1.045
Lower-middle income countries	1.036-4.045	1.046-4.095
Upper-middle income countries	4.046-12.535	4.096-12.695
High-income countries	>= 12.536	>= 12.696

Source: World Bank[5].

According to this classification, for the 2022 financial year, the World Bank placed 80 countries in the high-income category. Many of these countries, such as the United States, Canada … have consistently ranked in this category since the 1980s[6]. Besides, there are a number of countries, such as Russia, Venezuela and the latest are Mauritius, Panama, and Romania which are countries that slipped to middle income, and have yet to regain the high-income classification.

In terms of Middle income, there are more than half of the world's countries (109 countries in 2020-2021 and 110 ones in 2021-2022) are Middle-income countries. Many MICs face similar challenges, which often include population growth that outpaces the development of infrastructure, a lack of investment capital and skilled workers,

3 Available online at: https://www.adb.org/sites/default/files/publication/329201/adbi-wp760.pdf.
4 Available online at: https://www.worldbank.org/en/country/mic/overview#1.
5 Available online at: https://www.worldbank.org/en/country/mic/overview#1.
6 Available online at: https://worldpopulationreview.com/country-rankings/high-income-countries.

and government corruption and/or instability[7][8].

Come back with the term "Middle-income trap". In fact, many Low-income countries have successfully made the transition to Middle-income status, thanks to rapid economic growth. However, they had stayed in this group for a long time, and still have not achieved the High-income status which is GNI per capita of above US $12,696 (according to the newest classification), like some countries in Latin America as well as Thailand, Malaysia… in Asia. It is said that, those countries have got stuck in a Middle-income trap. Today, the term is constantly gaining popularity. More and more countries are identified as potential victims of the Middle- income trap. It is becoming an important as well as worrying issue for many countries in the world.

3.2 Identification of Risk of Falling Into Vietnam's Middle-income Trap and Reasons

Vietnam has been ranked among Lower-middle income economies since 2009 when its GNI per capita reached the US $1,010. Since then, Vietnam's GNI/capita has increased annually, of which GNI in 2020 is US $2,660 per person (according to the WB), equivalent to a GDP per capita is the US $ 2,779 per person.

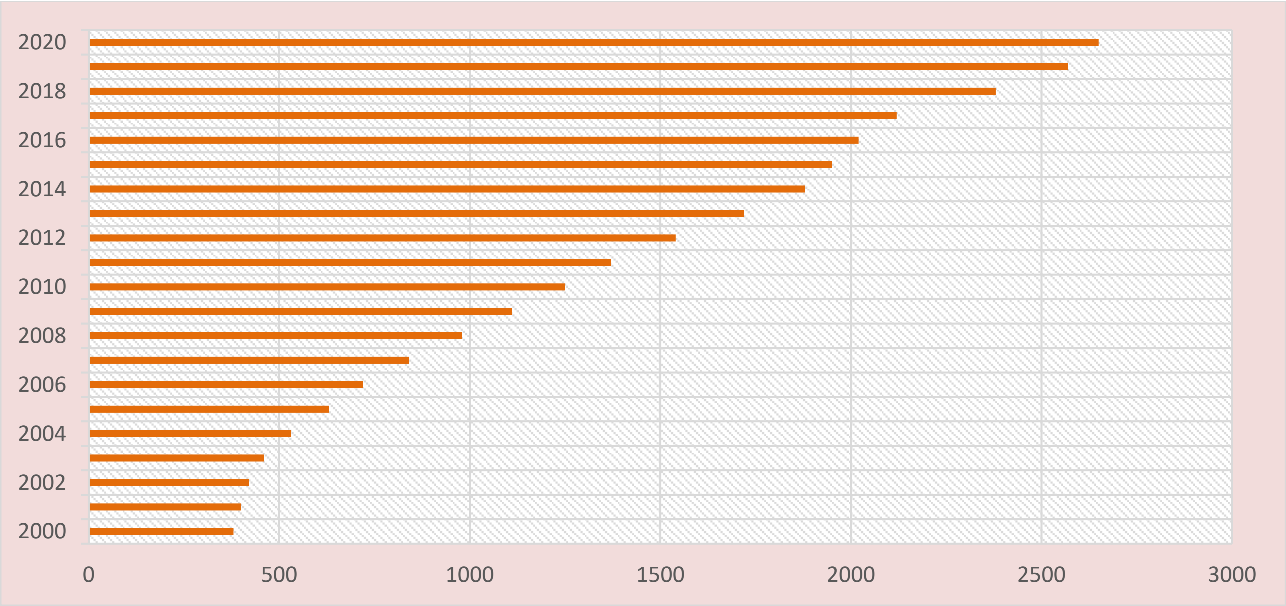

Figure 1 GNI per Capita (USD) in VN

Source: data.worldbank.org

Thus, Vietnam's GNI/capita has more than tripled after 13 years of escaping from the group of Low-income countries[9]. It is a really impressive result, and it is also the basis for Vietnam to aim to become a High-income country by 2045. This goal is completely grounded because according to a study by the Asian Development Bank (ADB) — in 2018, the average time a country needs to go from a Lower-income to a High-income status is from 30 to 40 years. This is the "golden period", because if it finishes without increase income, it will be officially seen as falling into the Middle-income trap. Vietnam has run nearly a half of way. And there are a lot of things Vietnam has to do to get the ambitious goal of becoming a high-income country by 2045.

[7] Available online at: https://www.investopedia.com/terms/m/middle-income-countries.asp#:~:text=There%20are%2053%20lower%2Dmiddle,of%20them%20are%20quite%20different

[8] Available online at: https://worldpopulationreview.com/country-rankings/middle-income-countries.

[9] Available online at: https://www.worldbank.org/vi/country/vietnam/overview#1.

To get this target, VN has set the plan for socio-economic development for the next stage with a growth rate in 2021-2025 is from 6.5% to 7.0% to become an Upper-middle income nation with GDP/capita reach from the US $4,700 to the US $5,000. And then, it will try to remains a growth rate annually at 7% or higher in the next following 20 years (2026-2045) to get opportunity to enter the league of high-income countries in 2045[10].

However, the growth of Vietnam's economy is tending to slow down when the growth rate in 2021 is only 2.58% (compared to the target of 6.5%) [14]. Thus, high growth pressure (remains at 7.5%) will be concentrated in the period of 2022-2025 and 2026-2045. It is really difficult when the most optimistic forecast for 2022 is only 6.6%[11].

The above analysis shows that Vietnam has not been stuck in the Middle-income trap, however, the risk is clear. There are many reasons given, however, the author wants to highlight the 3 key reasons:

Firstly, the damage caused by the Covid-19 pandemic is too great. The Covid-19 pandemic has had a profound and comprehensive impact on all sectors of the economy. Although Vietnam still achieves positive economic growth rates in 2020 and 2021 at 2.9% and 2.58% respectively — this is the lowest growth rate in the past 30 years. Production and business activities in Vietnam in these years were only at the level of maintaining operations. And perhaps Vietnam will need more time to recover its economy, then break through strong growth.

Secondly, Vietnam's growth still depends too much on the increase in capital rather than on the efficiency of using human resources and the application of technological advances.

Figure 2 shows that the contribution of TFP has increased over the years however, the contribution of capital in growth is almost constant and always remains at over 50%. This means that Vietnam's economic growth depends greatly on capital. However, the efficiency of capital use is not high when the ICOR coefficient is always maintained at 6.

Unit: %

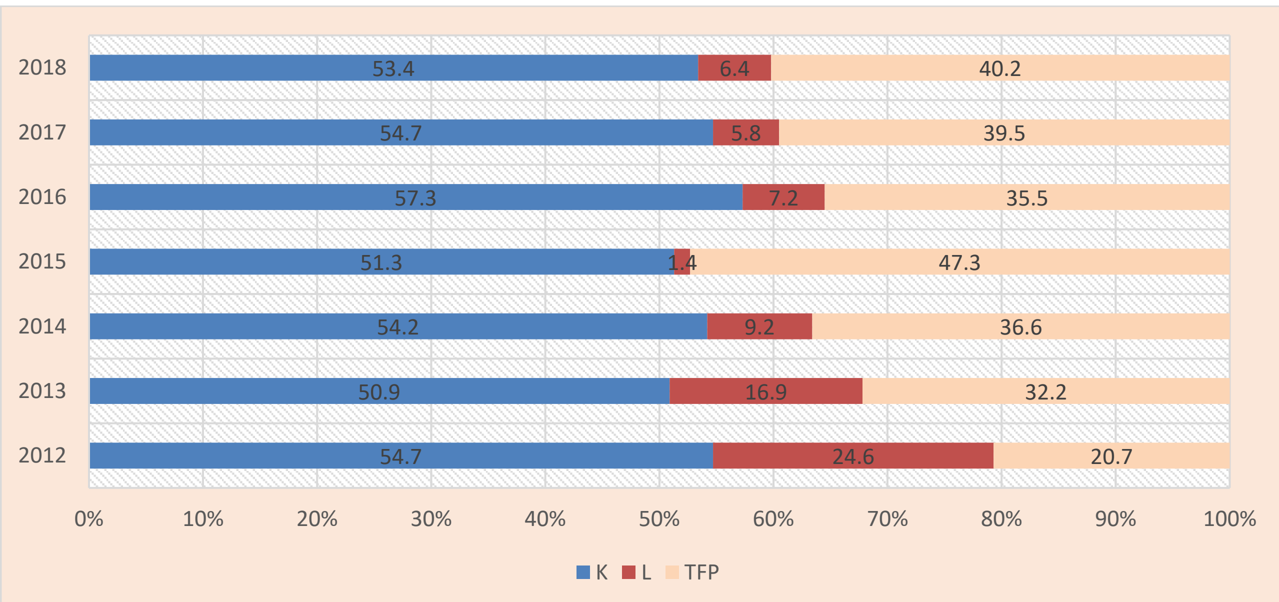

Figure 2 Contribution of TFP Factor in Vietnam's Economic Growth

Source: Son D. K. (2021)

[10] Available online at: https://daihoi13.dangcongsan.vn/tin-moi/thu-tuong-phan-dau-muc-tieu-som-tro-thanh-nuoc-thu-nhap-trung-binh-cao-5283

[11] Available online at: https://vietnamnet.vn/nguy-co-loay-hoay-trong-bay-thu-nhap-trung-binh-2011060.html.

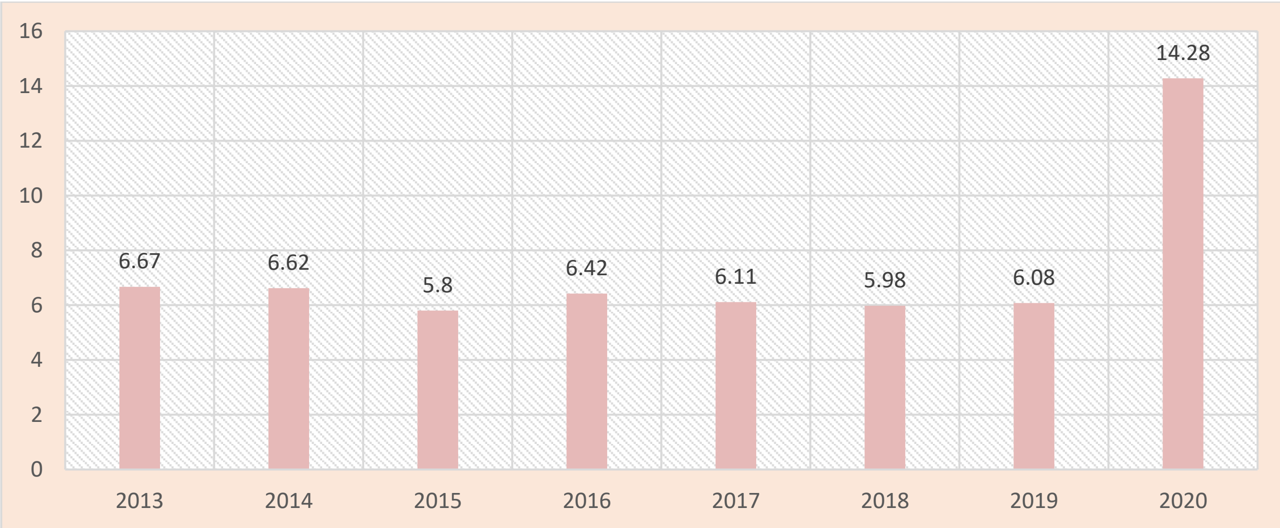

Figure 3 The ICOR Index in Vietnam

Source: https://www.gso.gov.vn.

Thirdly, the quality of human resources and scientific and technological capacity is still limited, not meeting the requirements of economic development. These two factors have a bonding relationship and motivate each other. Also, the low quality of human resources hindered the economy's ability to apply technological research results as well as absorb innovative technologies. It is worth mentioning that these are factors associated with the 4.0 Industrial Revolution to promote and create opportunities for Vietnam to shorten the development gap with previous countries.

All of these increase Vietnam's risk of getting stuck in the middle-income trap. The Figure 5 shows that in 1990, when both China and Vietnam were still Low-income countries, Malaysia was already in the group of Middle-income countries. However, by 2020 (means after 30 years), Malaysia is still stuck in the Middle income group. Meanwhile, China has made a dramatic change with its GNI/capita growing vertically. As a result, in 2020, China has caught up with Malaysia. If China maintains its the current growth rate of GNI per capita, China will officially join the group of high-income countries in 2023 or 2024.

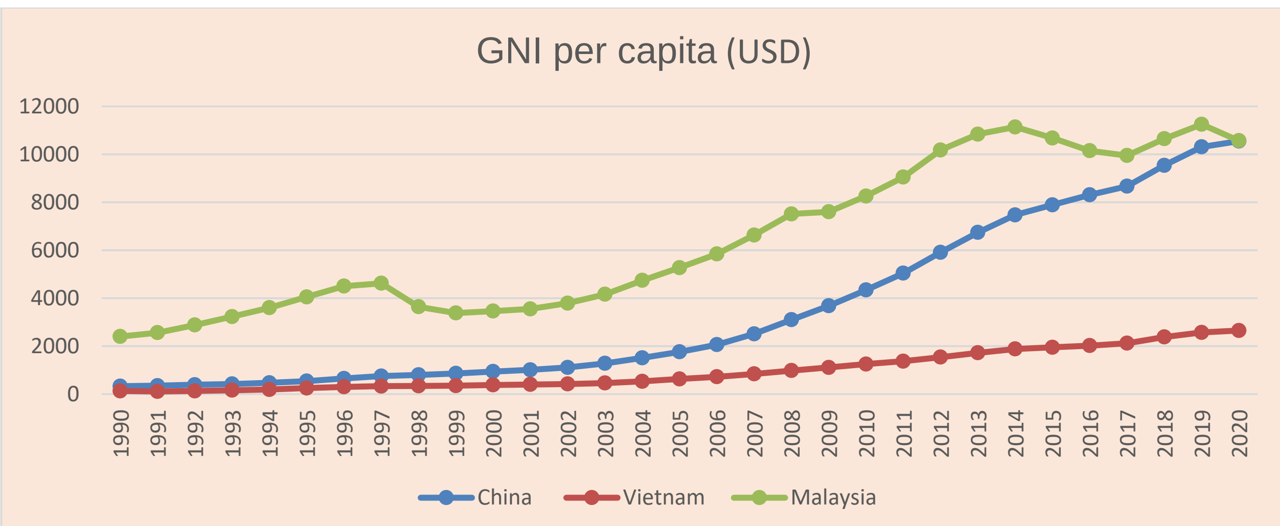

Figure 5 Comparison GNI Per Capita of Vietnam, China and Malaysia

Source: data.worldbank.org.

Looking back at Vietnam and comparing the growth trend, it can be seen that Vietnam must put a lot of effort in the next 20 years to achieve its goal of becoming a high-income country by 2045.

3.3 Solutions

The first, transforming the growth model associated with scientific and technological progress and high-quality human resources. The economic growth model that Vietnam has been applying is clearly no longer suitable, even a factor hindering growth. Transforming the growth model will bring a better quality of growth, more efficiency in using resources of the economy as well as the ability to adapt to new development requirements and conditions. Only in this way, Vietnam can improve productivity in manufacturing industries, increase competitiveness, create higher and higher value as well as create breakthroughs in growth. Because it is increased productivity that is the key to escaping the middle-income trap. Transforming the growth model is also very meaningful when many of the drivers that propelled the country’s growth in the past will diminish over the next decade, like a large number of workers, abundant resources...; At the same time, it is also an effective way to protect the environment, towards the goal of net-zero emissions as committed by Prime Minister Pham Minh Chinh at COP26.

Second, Vietnam should and needs to take advantage of the opportunities brought by the Industrial Revolution 4.0 to break through in growth. Because if Vietnam can not catch up or fails to adapt, it might face the risk of falling behind and getting stuck in the Middle-income trap. Therefore, Vietnam needs to be flexible and adaptive to make the best use of opportunities in the technology age, and that is also a way to limit the risk of falling behind. Accordingly, Vietnam needs to strongly promote digital transformation in sectors ranging from manufacturing to service activities, strengthening the application of AI technology in operation, processing, and organization.

Third, it is necessary for Vietnam to improve investment efficiency. As mentioned above, the contribution of capital to growth in Vietnam accounts for a high proportion of low-efficiency use. Therefore, the construction of an effective financial system is essential, thereby helping to allocate investment capital to the right places as well as areas to invest in, like investing into the infrastructure sector, for example. At the same time, Vietnam needs to remove barriers away private investment sector, and strongly promote the role of the private sector in promoting dynamic economic development. Green investment is also a common and effective trend, because it pays off in the long run as it spurs innovation, promotes efficient solutions, and helps Vietnam complete its middle-income transitions.

Fourth, Vietnam needs to develop its labor force in the direction of enhancing skills and applicability to new conditions in the digital era. Sharing Malaysia’s experience in workforce development, Mr. Yogeevaran — Former Ministry of Crop Industry and Commodities Malaysia emphasized focusing more on vocational training. Human capital, expressed in the abundant workforce in quantity, high quality, and skilled, will be a factor promoting the efficiency of using other sources of the economy. Moreover, in the context of integration and globalization, high-quality human resources can provide outsourcing services, thereby, bringing a source of high income for themselves and for the country. To do so, Vietnam needs to invest in transforming its education system, and in particular needs a major reform pushes to build inclusive and competitive vocational trainning systems. This gives workers many job opportunities as well as the opportunity to become global citizens.

And the last, Vietnam needs to establish an effective government by improving the Government index and the Global governance index under specific activities such as: implementing accountability, information transparency, strengthening digital government, improving the quality of public services... This is necessary to create an effective functioning institution, reduce bureaucracy and corruption, increase credibility as well as make the most of the support in many aspects of countries around the world in the development process. At the same time, building an effective government will not only form a dynamic, creative, and modern management apparatus but also help with the formulation and implementation of policies to promote knowledge and innovation.

4. Conclusion

Although it has not been confirmed that Vietnam is in the Middle-income trap, the risk is there and clear. With practical data, the article has shown the current state of Vietnam's economy showing the risk of falling into the Middle-income trap, explaining the causes and proposing some solutions. Vietnam needs to act thoroughly and synchronously with a range of solutions in order to have the opportunity to make a breakthrough in growth and not be caught in the Middle-income trap.

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