

TAKING STOCK

AN UPDATE ON VIETNAM'S RECENT ECONOMIC DEVELOPMENTS

Hanoi, December, 2013



THE WORLD BANK

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ACRONYMS AND ABBREVIATIONS

ASEAN	Association of Southeast Asian Nations
CDS	Credit Default Swap
CIT	Corporate Income Tax
CPI	Consumer Price Index
EAP	East Asia and Pacific
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GDC	General Department of Customs
GIC	Growth Incidence Curves
GSO	General Statistics Office
IMF	International Monetary Fund
MOF	Ministry of Finance
MOIT	Ministry of Industry and Trade
MOLISA	Ministry of Labor, Invalids and Social Affairs
MPI	Ministry of Planning and Investment
NSCERD	National Steering Committee of Enterprise Reform and Development
ODA	Official Development Assistance
OOG	Office of Government
PMI	Purchasing Manager Index
PPP	Purchasing Power Parity
SBV	State Bank of Vietnam
SOEs	State-owned Enterprises
SEGs	State Economic Groups
SGC	State General Corporations
TOT	Terms of Trade
TPP	Trans Pacific Partnership
VAMC	Vietnam Asset Management Company
VASS	Vietnam Academy of Social Sciences
VAT	Value Added Tax
VHLSS	Vietnam Household Living Standards Survey
WB	World Bank

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EXECUTIVE SUMMARY

Recent Economic Developments

External Economic Environment

Global growth, led by developments in high-income countries, has shown tentative signs of recovery in recent months. Leading indicators suggest that global production and trade cycles may have bottomed out in the second quarter of 2013, although the assessment is subject to a high degree of uncertainty. Developing country sovereign bond spreads, while elevated relative to the levels in the first half of 2013, have declined significantly since late August. Despite the improved economic outlook, global commodity markets, with the exception of energy prices, continue to soften. Food and metal commodity price declines are hurting incomes, exports, and fiscal revenues in resource-rich developing countries.

Developing East Asia is set to retain its status as the global growth leader, though with the balance of risks still on the downside. Developing East Asia will contribute nearly two-fifths of global growth and one-third of global trade—higher contributions than any other region. As the global growth cycle undergoes change, consolidation of fiscal and monetary policies may be warranted in many East Asian countries. The balance of risks to the base case regional forecasts lies on the downside; although upside risks have also recently emerged. The three immediate downside risks include: (i) a less orderly tapering of the U.S.'s unconventional monetary policies; (ii) prolonged fiscal deadlock in the U.S.; (iii) and a sharper-than-expected slowdown of investment in China. On the upside, particularly notable are the positive spillover effects of Japan's ongoing efforts to reflate its economy.

Recent Economic Developments in Vietnam

Macroeconomic stability in Vietnam continues to improve, underpinned by moderating inflation and strengthening external accounts. Headline CPI inflation has stabilized, aided by subdued credit growth and easing of food price increases. The decline in core inflation (excluding food and energy prices) has been more gradual. Pressure on the Vietnamese dong has also eased substantially. Stronger external trade and capital account balances have enabled foreign exchange reserves to build up to an import cover of about 3 months, up from 1.6 months in December of 2011. The sovereign risk on Vietnam's credit default swap (CDS) has fallen to levels seen just before the global financial crisis in 2009.

A sustained recovery in GDP growth remains hampered by slow-moving structural reforms and global uncertainty. Domestic demand in Vietnam remains weak on account of subdued private sector confidence, overleveraged SOE and banking sectors, and shrinking fiscal space. On the supply side, cross-country competitiveness assessments show that Vietnam is falling behind relative to comparator economies. Reenergizing medium-term growth will require renewed attention on a number of structural reforms – with emphasis on the country's state owned banks and enterprises.

With rising pressures on the budget, the government is faced with some crucial fiscal policy choices, as it seeks to balance the twin objectives of economic expansion and macroeconomic stability. On the one hand is the short term imperative of offsetting weak private sector demand, which has led to countercyclical fiscal measures, mainly in the form of tax breaks. On the other hand, with shrinking fiscal space and keenly aware of the need to restore fiscal sustainability, the government's attention is turning to fiscal consolidation. Attention is also needed on the changing composition of public debt. The share of concessional external debt in Vietnam's total public and publicly guaranteed external debt is expected to fall with its graduation to middle-income country status. This has important implications for long term fiscal sustainability, as domestic bonds carry considerably higher interest rates and are of much shorter maturity relative to concessional external debt.

Progress on SOE restructuring has been slower than expected. Progress has been hampered by a cumbersome regulatory framework and limited financial and operational analysis underlying the planned divestures. Decision 929 and the draft revision of Decision 14 provide an important opportunity to make progress in this regard. Disclosure of financial and non-financial information of SOEs has also been weak, partly on account of a fragmented regulatory setup. In addition, the current legislative framework provides little clarity on what should be publicly disclosed. Significant improvements to information disclosure are expected with the adoption of Decree 61, expected to be implemented from 2014. Nonetheless, more work is needed to ensure that the targets chosen are feasible; proper account is taken of the complexity of the issues and specificity of individual SOEs (especially where high levels of debt or complex cross ownership structures are involved); and, oversight and coordination mechanisms are strengthened, both in policy formulation and implementation.

While systemic liquidity concerns have dissipated for now, the root causes of the banking sector fragility have yet to be resolved. Non-performing loans (NPLs) in the banking sector remain a major concern, although poor quality and limited disclosure of data preclude accurate estimation. The size of NPLs may be estimated higher if international good practice is applied. In an important step, the government has adopted Prime Minister's Decision 843, which assigns the State Bank of Vietnam the responsibility of coordinating system-wide NPL resolution. Another important element of Decision 843 is the establishment of the Vietnam Asset Management Company (VAMC) with the purpose of buying bad debts from banks to provide more breathing room to restructure them. However, to be effective, the VAMC's organizational and financial capacity needs to be significantly reinforced and it needs to be empowered to take swift actions on the restructuring and sale of purchased debts. Due attention is also needed to issues of bankruptcy, insolvency and creditor rights which will facilitate corporate debt restructuring.

The medium-term macroeconomic outlook remains favorable on balance, albeit with considerable downside risks. GDP growth in the baseline scenario is expected to rise modestly, to 5.5 percent by 2015. This assumes macroeconomic prudence through continuation of monetary policy caution and a phased withdrawal of the fiscal stimulus, and a renewed focus on structural reforms (with particular attention on the SOE and banking sectors). The current account would remain in surplus, albeit by a much smaller amount as import growth picks up with expectations of accelerated recovery. Capital inflows are also expected to strengthen as investor confidence recovers, resulting in further reserve accumulation. However, the outlook for public sector debt contains growing risks, underscoring the need for fiscal consolidation.

Although macroeconomic stability has been largely restored, a few critical risks remain: (i) private sector demand remains sluggish and highly susceptible to any further negative news; (ii) although diminished, the risk remains that authorities could depart from fiscal and monetary discipline to offset weak private sector demand; (iii) the momentum on structural reforms could further slow down, putting GDP growth on a lower trajectory and undercutting fiscal sustainability; (iv) and, the banking sector remains subject to sudden shifts in depositor confidence and to further deterioration of balance sheets of the more fragile banks.

Special Topics

Trade facilitation, competitiveness and growth in Vietnam

Vietnam has made major headway in enhancing external integration and strongly leveraging its benefits. This is manifest in the fact that exports have remained strong in recent years despite a difficult external environment. This good news needs to be tempered, however, by the fact that Vietnam's exports remain dominated by less sophisticated products with low value added and embodying modest technology. An enhanced emphasis on competitiveness and greater value added will therefore

be essential: an objective that, among other things, will require strengthening the following three key pillars of trade facilitation:

- i. **Transport infrastructure and logistics:** There are significant gaps in Vietnam's infrastructure and transport links – including weak corridors connecting major growth poles to international gateways, high transport costs, and poor quality of transport and logistics services. Investment for trade logistics has not kept up. There is also over-reliance on public investment that tends to be inefficient and spatially fragmented.
- ii. **Regulatory procedures for trade:** Despite improvements in border management, many agencies still rely on outmoded, opaque and time-consuming procedures susceptible to corruption. Business processes remain complex and rely primarily on manual procedures with very little information technology. As a result, trade logistics costs are relatively high for Vietnam in a setback to its export competitiveness.
- iii. **Supply chain organization:** Key constraints facing manufacturing supply chains include reliance on imported input, which increases lead-time and lowers the flexibility to respond to global market conditions. The already crowded industrial zones near major cities are increasingly constrained in their ability to physically expand and access skilled labor. Agricultural supply chains are constrained by small farm sizes, dated farming methods, regulatory hurdles for large-scale agro-processing, dominance of government-to-government rice exports, and poor quality of exports.

A dual-track strategy is needed for Vietnam. In the long-term, it would need to move up the value chain by upgrading its technology. In the interim period, it should focus on capturing a greater part of the value chain in products it is already exporting. Some key policy recommendations are suggested in Part III.A of this report.

Corruption and economic growth in Vietnam

Corruption in Vietnam has long been recognized as a serious problem. Cross-country rankings show that Vietnam is assessed poorly on a number of institutional aspects that are important for controlling corruption, especially assessments of civil society, the media and access to information. Areas identified as high risk for corruption also have problematic business environments. While Vietnam's overall "ease of doing business" ranking is in the top half of countries assessed, the ranking for dealing with taxes is considerably worse. And among countries that have participated in the World Bank's Enterprise Surveys in the past five years, the percentage of firms reporting paying bribes when dealing with taxes is relatively high.

The pattern of negative correlation between corruption and growth found in most cross-national empirical studies likely also applies to Vietnam. A 2012 survey of 1,058 firms in 10 provinces suggests that firms that paid bribes were doing significantly worse than those that were not. The results also show, however, that many of the firms are not entirely blameless victims: most of the reported bribes were not directly suggested by officials, but were initiated by the firms in an expedient attempt get around their problems. It turns out that firms that routinely react to problems by presenting gifts or money to the in-charge officials are doing worse than their peers who seek other solutions. These findings of a negative correlation between firm-level growth and corruption echo earlier studies in Vietnam reaching similar conclusions.

Many policies would simultaneously reduce the bureaucratic problems that hinder firms and the opportunities for corruption that such hindrances create. The 2012 study by the World Bank and Government Inspectorate showed that provinces and districts with more progress on administrative reforms and transparency actually do have lower levels of corruption. At the same time, transparency has been shown to be associated with firm-level investment in its own right as it reduces uncertainties for investors. The fact that corruption is associated with slower growth merely strengthens the imperative to treat such reforms with urgency.

Poverty and inequality in Vietnam

The latest survey data show that growth over the 2010-2012 boosted the welfare of Vietnamese across the socioeconomic distribution. Analysis presented in Part III.C shows that over 2010-2012 consumption grew for the entire bottom 90 percent of the population, and showed no improvement for the richest 10 percent. This tells us that the welfare of most Vietnamese improved substantially over 2010-12, even while growth was more modest than previously. The analysis further indicates that expenditure levels in rural areas rose at every point on the economic spectrum, for both the rich and the poor. In urban areas, however, the welfare improved for the bottom 60 percent, while declining for the upper 40 percent. This pattern of broad-based growth generated a drop in the poverty rate, which was more pronounced in rural areas than urban, and also corresponds to a decrease in inequality.

Ethnic minority welfare has improved greatly over time, even though poverty remains concentrated among this group. In 2012, ethnic minorities comprised approximately 15 percent of the population, just over half (51 percent) of the poor, and three out of four of the extreme poor in Vietnam. It is important to recognize, however, that the welfare of ethnic minorities has improved substantially over time. Their per-capita consumption grew at an annual rate of 7.4 percent between 1998 and 2010, a remarkable rate of improvement which only seems slow when compared to the growth of 9.4 percent over the same period for the Kinh majority. Between 1993 and 2008, the poverty rate for ethnic minorities fell from nearly 90 percent to 50 percent. Poverty rates for ethnic minorities are currently much higher than for the Kinh majority because they started out much poorer and because their gains have lagged behind the spectacular gains in welfare in the country overall.

The situations of the 53 ethnic minority groups are diverse. Ethnic minorities are often discussed as if they were a single group, but in fact their situations are very diverse among many measures. They vary in the size of groups, with just five of the 53 groups having populations over 1 million, three with populations between 500 thousand and 1 million, and many with populations of less than 5,000. They are in a mix of locations—mostly the Northern Mountains and Central Highlands, but also in the Mekong River Delta and to a lesser extent other areas. Finally, while each individual group other than the Hoa has a higher poverty rate than the Kinh majority, poverty rates vary greatly between groups. Ethnic minority poverty has a complex mix of causes, as discussed in Part III.C.

Observed pathways out of poverty are similar to those for Kinh. Analysis by the World Bank shows that work is that while ethnic minorities often face particular challenges, the observed pathways out of poverty are not substantially different than those for those from the Kinh majority. To escape poverty in these conditions, ethnic minorities first shift from semi-subsistence agriculture to a market orientation, then make efforts to maintain their cultural identity while building financial and social capital. This process involves moving to cash crop production, then intensifying agricultural production, and then moving to agricultural diversification and/or trading and services, and then investing in education for their children.



PART I:

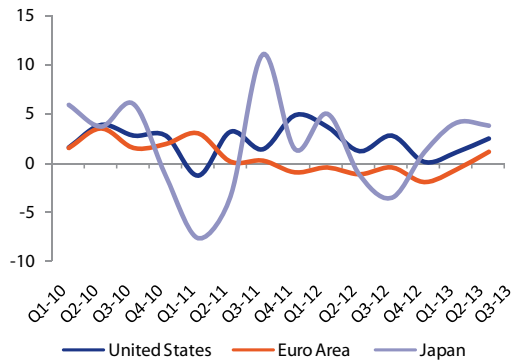
EXTERNAL ECONOMIC ENVIRONMENT

I.A High-Income Countries Lead Tentative Global Recovery

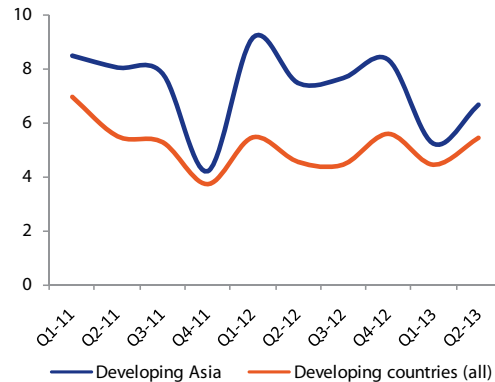
1. **Global growth, led by developments in high-income countries, has shown tentative signs of recovery in recent months.** The second quarter of 2013 marked the first time in 30 months that the economies of the Euro area, Japan, and the United States all posted positive growth (figure 1.1a). The growth momentum became more hesitant in the third quarter, however. Led by the private sector, recovery intensified in the United States, with its economy growing at 2.5 percent and 2.8 percent (quarter-on-quarter, annualized, in seasonally adjusted terms) during the second and third quarters of 2013. Japan's economy, propelled by its expansionary macroeconomic policies, grew by a solid 3.8 percent in the second quarter before slowing down to 1.9 percent growth in the third quarter. The Euro area exited its long recession in the second quarter, registering growth rates of 1.2 percent and 0.4 percent in the second and third quarters, respectively. More recently, growth has also picked up in several emerging markets (figure 1.1b) including Brazil, China, Malaysia, South Africa, and Turkey—although growth in each of these countries is well below the pre-crisis levels. Leading indicators of economic activities suggest that global production and trade cycles may have bottomed out in the second quarter, although this assessment remains subject to a heavy dose of uncertainty.

Figure 1.1: Global Growth Prospects

(a) Recovery in major advanced economies



(b) Rebound in developing countries



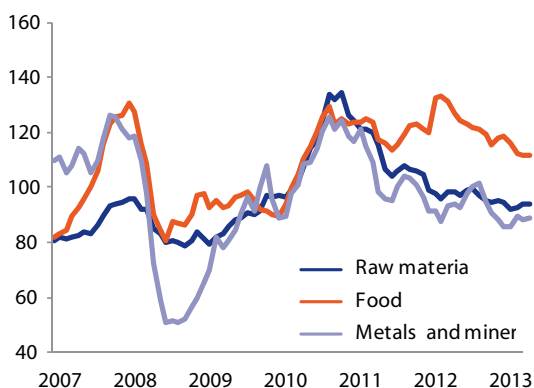
Source: World Bank

2. Despite the improved economic outlook, global commodity markets continue to soften.

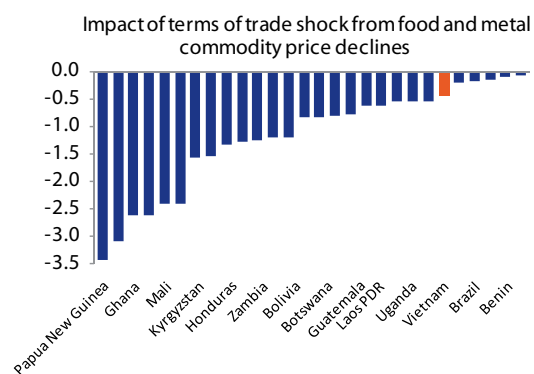
Raw material prices have declined by 30 percent from their post-crisis high in February 2011 (figure 1.2a). Food prices are down 14 percent while metal and mineral prices have declined by 29 percent. Food and metal commodity price declines are hurting incomes, exports, and fiscal revenues in resource-rich developing countries (figure 1.2b). Estimates at the World Bank of the impact of lower commodity prices on export earnings suggest that commodity producers in sub-Saharan Africa and Latin America have suffered (net) losses of over 1 percent of GDP and over 2.5 percent in some cases. Income declines in major middle-income commodity producers are smaller but not insignificant: about 0.4-0.6 percent of GDP in Indonesia, South Africa and Vietnam and nearly 0.2 percent in Brazil.

Figure 1.2: Decline of Global Commodity Prices

(a) Composite price index (2010 = 100)



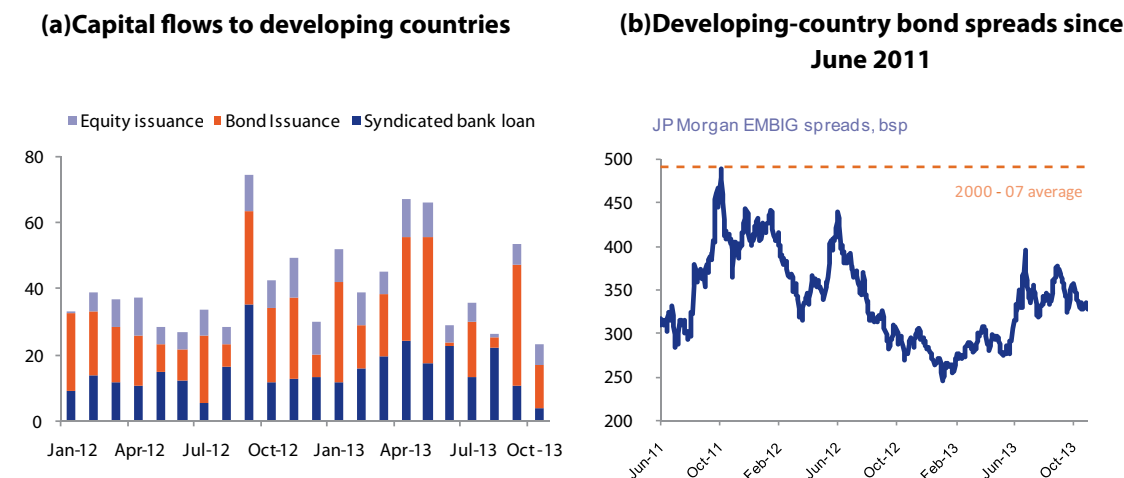
(b) Impact on Terms of Trade



Source: World Bank

3. **Gross capital flows to developing countries eased in October** (figure 1.3a). At just \$23 billion, gross capital flows in October were the lowest since December 2011. They were also lower in the June-August period when market concerns about possible tapering of US monetary stimulus pushed up long-term interest rates, weakening capital flows to developing countries as asset portfolios were readjusted towards high income economies. Although developing country sovereign bond spreads have declined significantly since late August, they remain elevated relative to the levels in the first half of 2013 (figure 1.3b). Higher-risk borrowers appear to be getting rationed out: only 16 percent of total bond issuance since September has been accounted for by non-investment grade borrowers, compared with an average of 48 percent between January and June.

Figure 1.3: Global capital market trends



Source: World Bank

I.B Developing East Asia Remains a Major Growth Engine

4. **Developing East Asia is projected to maintain growth rate in excess of 7 percent, retaining its status as the global growth leader.** Growth in China is expected to meet the official indicative target of 7.5 percent in 2013 – 0.8 percentage points lower than the World Bank’s projected rate in April 2013. Growth in developing East Asia excluding China is expected to decline from 6.2 percent in 2012 to 5.2 percent in 2013, before rebounding to 5.3 and 5.7 percent in 2014 and 2015, respectively (Table 1.1). Notwithstanding the decline in growth in 2013, developing East Asia will contribute nearly two-fifths of global growth and one-third of global trade –contributions that are higher than any other region.

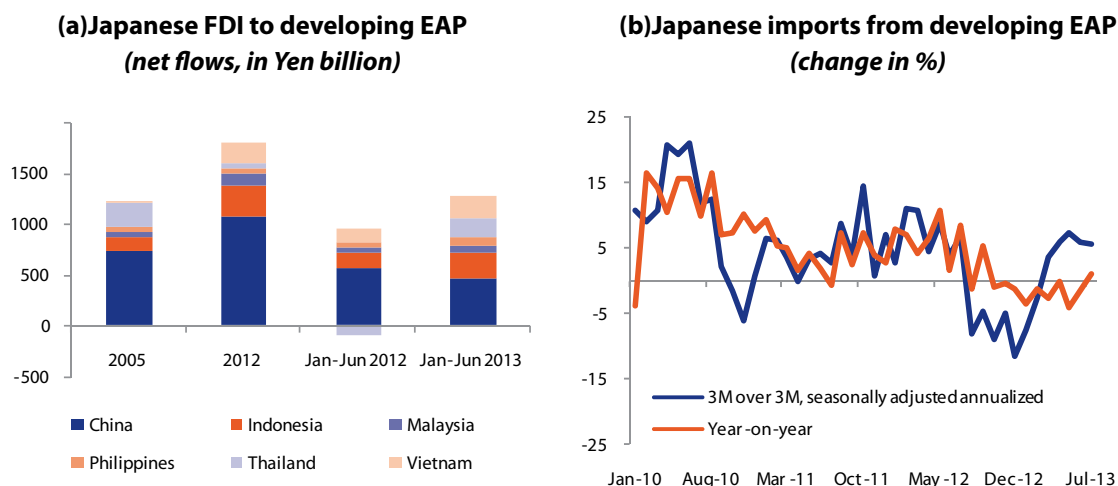
Table 1.1: East Asia Pacific: GDP Growth Projections

	2011	2012	2013f	2014f	2015f
East Asia	7.1	5.9	6.0	6.4	6.4
Developing East Asia	8.3	7.5	7.1	7.2	7.2
China	9.3	7.8	7.5	7.7	7.5
Indonesia	6.5	6.2	5.6	5.3	5.8
Malaysia	5.1	5.6	4.3	4.8	4.8
Philippines	3.6	6.8	7.0	6.7	6.8
Thailand	0.1	6.5	4.0	4.5	5.0
Vietnam	6.2	5.2	5.3	5.4	5.4
Memo: Developing East Asia exc. China	4.5	6.2	5.2	5.3	5.7
Memo: ASEAN	4.6	5.6	5.1	5.1	5.4
<i>Assumptions about the external environment:</i>					
World	3.1	2.5	2.3	3.1	3.4
High-income countries	1.8	1.6	1.3	2.1	2.3
Developing countries	6.3	4.7	4.8	5.3	5.6

Source: World Bank

5. **Japan's ongoing efforts to reflate its economy will have significant implications for the rest of the region.** Already, expansionary monetary and fiscal policies have helped strengthen domestic spending and lift growth in Japan, while causing the yen to weaken – by 20 percent in real effective terms since September 2012. Gains by Japanese exporters in third-country markets are expected to benefit East Asian suppliers of parts and components in regional production networks. Japanese FDI to the region has also picked up markedly, increasing by 49 percent from January to June 2013 over the same period of the previous year – in comparison, Japanese FDI was 47 percent higher in 2012 than in 2005 (figure 1.4a). Expectations of an even weaker yen is encouraging Japanese companies to invest more, which should have positive spillover effects on East Asian economies with strong trade and investment ties with Japan.

Figure 1.4: Japanese FDI and Imports from Developing EAP Countries



Source: World Bank

6. **As the global growth cycle undergoes change, adjustments to fiscal and monetary policies may be warranted in many EAP countries.** Most EAP countries have eschewed large fiscal stimuli to support growth this year, and some have started addressing fiscal sustainability issues related to past expansive policies. Credit growth has moderated in several of the region's large economies, though credit-to-GDP ratios remain elevated in most countries compared to the 2008 levels. The authorities are also employing macro-prudential measures to contain risks arising from recent credit expansion. At the same time, several EAP countries are trying to rationalize their subsidy regimes – including fuel subsidies in Indonesia and Malaysia and the rice subsidy in Thailand.

I.C Balance Risks For The Region Lies On The Downside

7. **The balance of risks to the base case regional forecast lies on the downside; although upside risks have also recently emerged.** The three immediate downside risks include: (i) a less orderly tapering of the U.S.'s unconventional monetary policies; (ii) prolonged fiscal deadlock in the U.S.; (iii) and a sharper-than-expected slowdown of investment in China. Additionally, the risk of Europe remaining in a prolonged slow crawl is a real one, especially as worries about the possibility of deflation in the EU region get firmer. However, not all risks are on the downside. Firstly, stronger global growth will provide considerable tailwinds to EAP countries through expansion of global trade. This will enable them to wind down stimulus measures without losing much growth. Second, Japan's efforts to exit deflation and revive growth could spill over to EAP countries through expanded bank lending, portfolio rebalancing, and increased outward foreign direct investment.

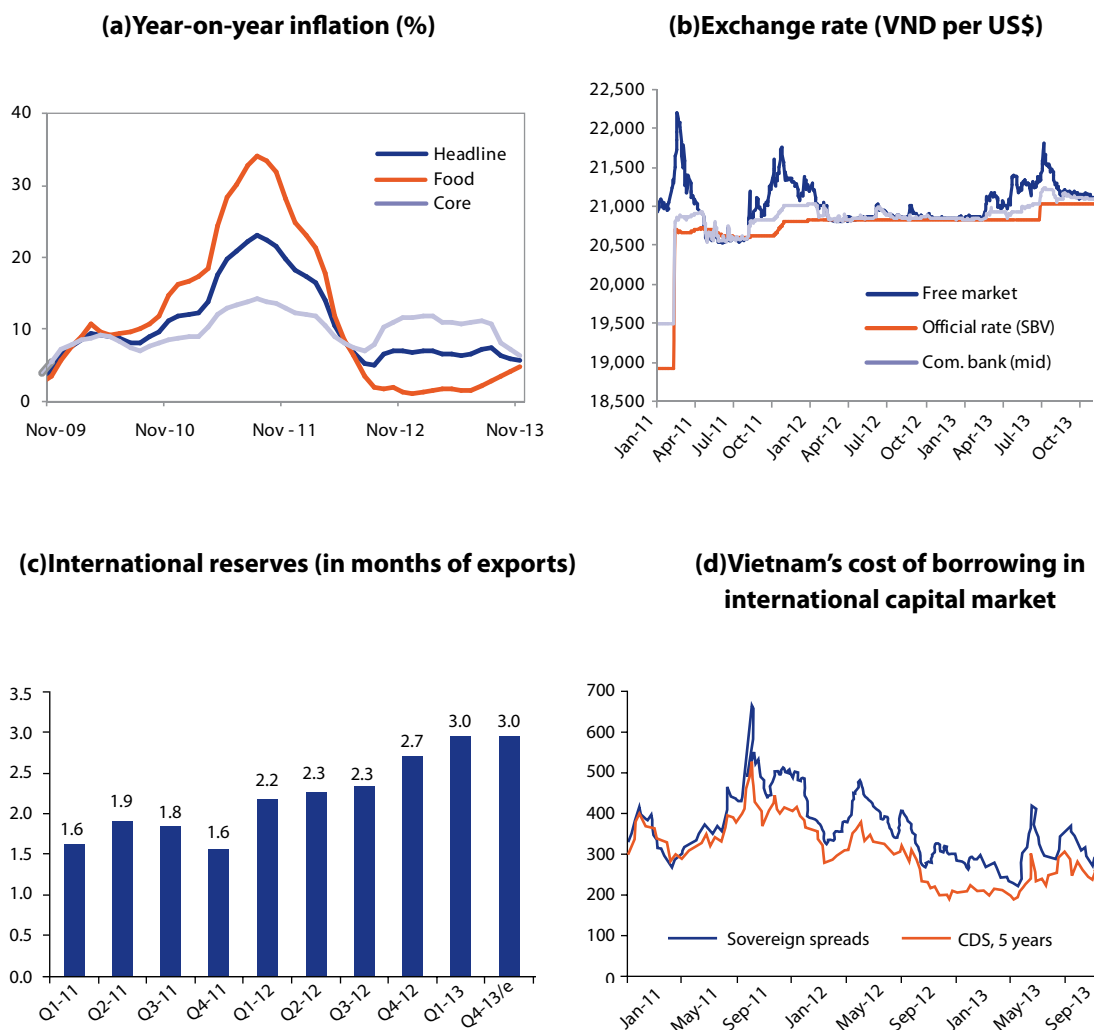


PART II: RECENT ECONOMIC DEVELOPMENTS IN VIETNAM

II.A. Macroeconomic Conditions Remain Stable

8. **Macroeconomic stability continues to improve, underpinned by moderating inflation and strengthening external accounts.** Headline CPI inflation has stabilized, averaging 6.7 percent over the past twelve months (figure 2.1a). Subdued credit growth and easing of food price increases contributed to this. Food prices – the principal driver of the trend inflation in recent years – grew by 4.9 percent (year-on-year) in November 2013, as supply of agricultural products proved adequate and household consumption growth remained moderate. The decline in core inflation (excluding food and energy prices) has been more gradual: year-to-date, core inflation has averaged 10 percent, reflecting a series of increases in administrative prices. Pressure on the Vietnamese dong has eased and the exchange rates in the official and unofficial markets have converged (figure 2.1.b), with concerns abating over tapering of monetary expansion in the US. Stronger external trade and capital account balances have enabled foreign exchange reserves to build up to an import cover of about 3 months, up from 1.6 months in December of 2011 (figure 2.1.c). Acknowledgement of these positive developments by financial markets has led to a decline in the sovereign risk on Vietnam's credit default swap (CDS) – to levels seen just before the global financial crisis in 2009 (figure 2.1.d).

Figure 2.1: Key short-term macroeconomic trends

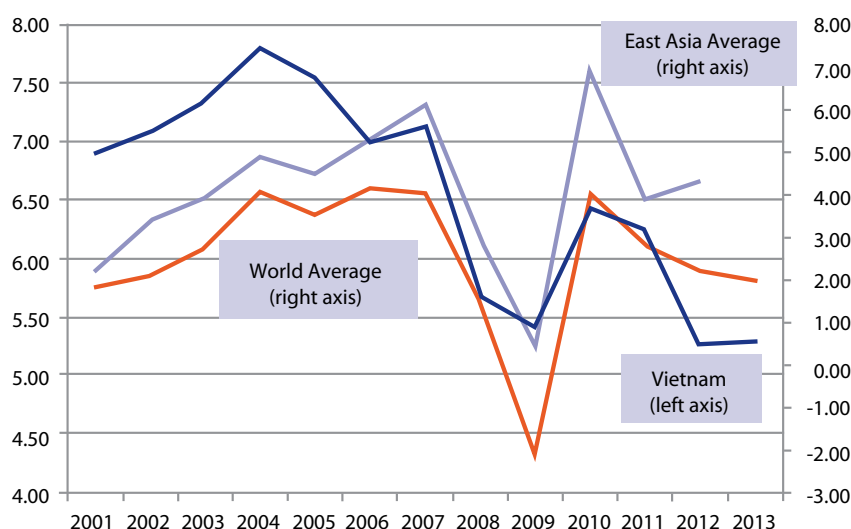


Source: GSO, SBV, IMF and WB

II.B. GDP Growth Stagnates at Modest Levels

9. **A sustained recovery in GDP growth remains hampered by slow-moving structural reforms and global uncertainty.** While the external sector has held up well despite the global situation, domestic demand remains weak on account of subdued private sector confidence, overleveraged SOE and (undercapitalized) banking sectors, and shrinking fiscal space. Reenergizing medium-term growth will require renewed attention on a number of structural reforms – with particular urgency on restructuring and addressing the financial frailties of the country's state owned banks and enterprises; a lumbering agenda that is widely acknowledged, including in the government's own 2011-2015 SEDP, but has seen slow policy action. In the short run, growth is likely to remain constrained by the uncertain global economic prospects. As one of the world's most open economies (measured with respect to its trade-to-GDP ratio), deeply plugged into the regional manufacturing supply chains, Vietnam's economy is heavily exposed to the global and regional economic developments. Its short-term growth performance accordingly mirrors those economic relationships (figure 2.2)

Figure 2.2: Vietnam's growth has closely tracked global and regional growth since 2001
(GDP growth, %)

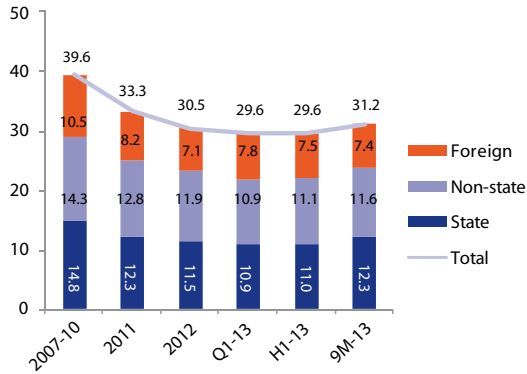


Source: GSO, WDI, and World Bank EAP Update October 2013

10. **Private sector expenditure continues to grow at a hesitant pace.** Total investment in the first nine months of 2013 was recorded at 31.2 percent of GDP, having picked up noticeably from 29.6 percent in the first six months on the back of a spurt in public investment spending and a slight uptick in private investment. This, however, is still 12 percentage points below the peak in 2007. Some moderation of state sector investment was expected. But the decline in the domestic private investment rate sector – from an average of around 15 percent of GDP in 2007-2010 to around 11.5 percent thus far in 2013 – is worrisome. In large part it reflects a major downward shift in investor confidence. The most recent Provincial Competitiveness Index (PCI) – a more accurate measure of investor confidence than it is of competitiveness – highlights the challenge: 43 out of the 63 provinces saw a decline in their PCI between 2009 and 2012. Moreover, compared to 2007, far fewer firms reported higher investments (6.5 percent in 2012 vs. 27.1 percent in 2007) or intentions to expand production (20 percent in 2012 vs. 74 percent in 2007).

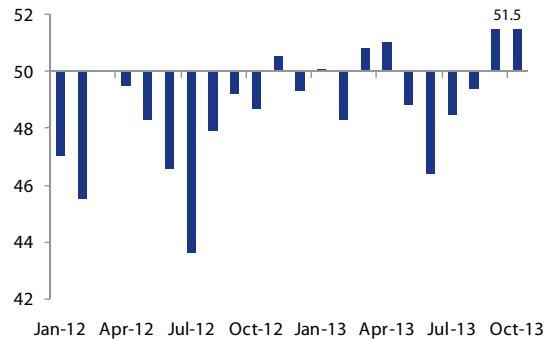
11. **There are some incipient signs of recovery in private investment that bode well.** As noted, non-state investment saw an uptick in 2013Q3 (figure 2.3). In addition, the HSBC Purchasing Managers' Index (PMI) rose back above the crucial the 50.0 mark (indicating expansion) in September-October (figure 2.4). Investor confidence among foreign investors has gradually picked up since early 2012, although it remains well below the levels in 2010-2011 (figure 2.5).

Figure 2.3: Investment (% of GDP)



Source: GSO

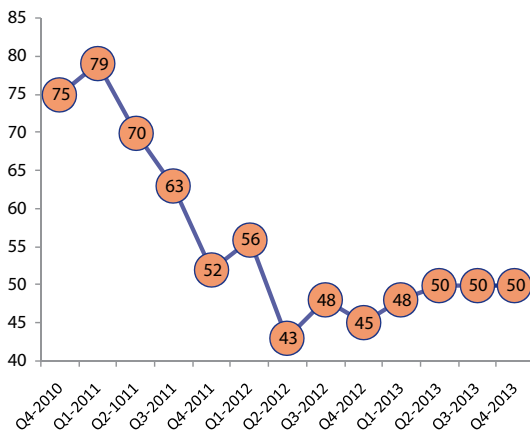
Figure 2.4: Manufacturing's PMI



Source: HSBC

12. **Household consumption, too, has been subdued since the onset of the global crisis,** recording an average growth rate of 5.1 percent during 2009-2012, compared to 8.9 percent average during the previous 4 years. The Nielsen Consumer Confidence Index indicates a recovery in consumer confidence in 2013 (figure 2.6), although that may not yet have translated into real spending -- retail and wholesale trade growth has moderated in 2013 relative to the previous year.

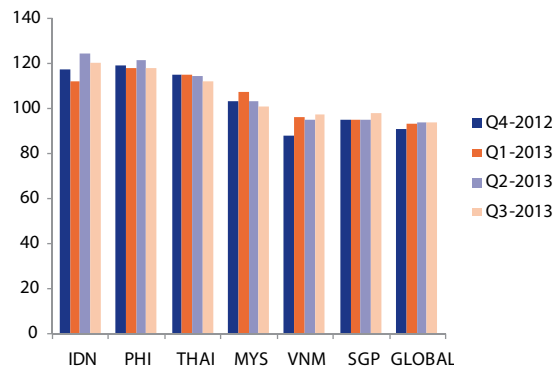
Figure 2.5: Vietnam Business Climate Index



Business Climate Index (BCI) is an indicator for economic activity in Vietnam prepared by the European Chamber of Commerce in Vietnam

Source: EuroCham

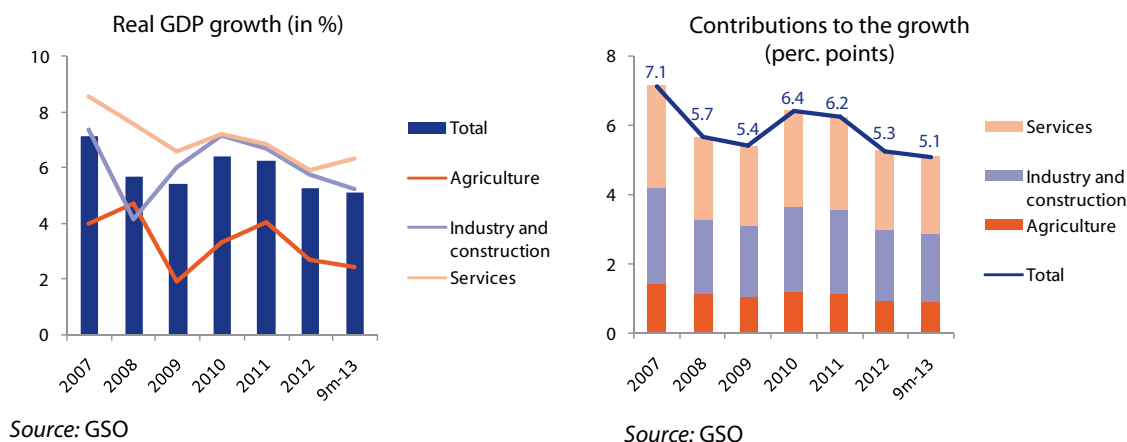
Figure 2.6: Consumer Confidence Index



Source: Nielsen

13. **On the production side, activity has been relatively slow in industry and construction due to weak domestic demand and previous stockpiling of factory inventories.** The problems facing the industrial sector seem to be coming largely from domestic enterprises catering to the domestic market. The slowdown in production is reflected quite clearly in the Index of Industrial Production (IIP), which grew at only 5.6 percent between January and November 2013 – a higher pace than the 5.4 percent increase in 2012 but much lower than the 7.3 percent increase in 2011. The services sector has fared slightly better thus far in 2013 (figure 2.7), despite a slight moderation of retail and wholesale sales. At the same time unfavorable weather conditions have contributed to muted growth in the agriculture sector.

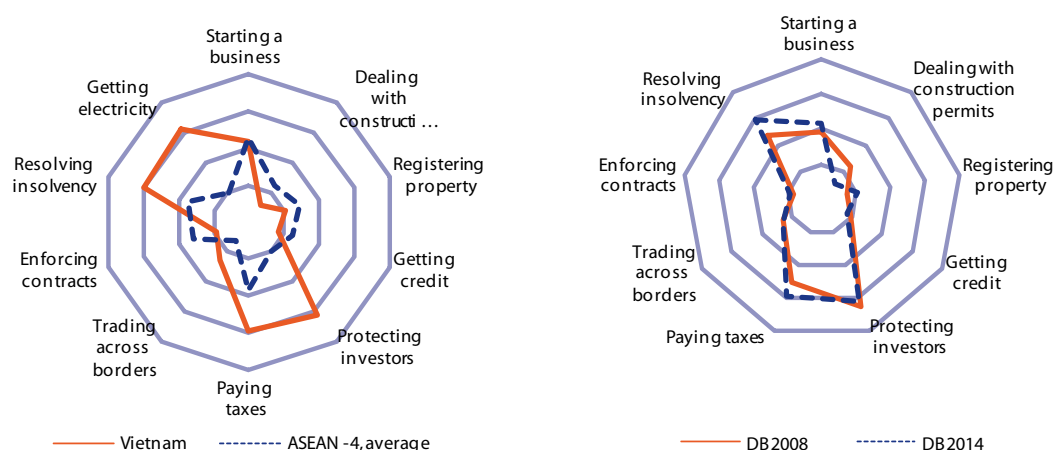
Figure 2.7: GDP - Sectoral Contributions to Growth



14. **In response to the persistent weak domestic demand, the government has phased in a number of stimulus measures to support businesses.** The Ministry of Finance introduced several fiscal measures including deferment of corporate income tax and value added tax for small and medium-sized enterprises (SMEs), as well as subsidies and tax breaks to stimulate the real estate sector (Box 2.1). It is too early to tell if any of these measures has been successful in their objectives.

15. **As the global economic conditions begin to ease and Vietnam looks to reposition itself on a higher growth trajectory, several important structural reforms will remain essential.** Cross-country competitiveness assessments show that Vietnam is falling behind relative to comparator economies. Vietnam's performance on structural policies in the Bank's Country Policy and Institutional Assessment is slightly below the average for all IDA countries, even though it performs better in other dimensions. Vietnam's ranking on the Doing Business survey has fallen from 90th position in 2011 to 99th, as business environment reforms progressed at a faster pace in other countries. Vietnam appears to be lagging in the particular doing business areas of protecting investors, paying taxes, resolving insolvency, and getting electricity (figure 2.8): it lags the ASEAN-4 countries (Indonesia, Malaysia, Philippines and Thailand) by a significant margin in these areas. While Vietnam has regained some ground in the World Economic Forum's Global Competitiveness Index on account of improved macroeconomic performance, its overall ranking fell from 59th position in 2011-12 to 70th in the 2013-14 assessment.

Figure 2.8: Vietnam's performance on doing business indicators has stagnated



Source: Doing Business Indicators, the World Bank

Box 2.1: Government's support to real estate sector

As part of Resolution 02 dated January 7, 2013, the Vietnamese government introduced, among other things, policies to assist a distressed real estate sector. Policies include:

Taxes

The Ministry of Finance has presented to the National Assembly a number of tax incentives including: From 1 July 2013, the rate of corporate income tax ("CIT") for enterprises investing in social residential projects will be 10 percent. Those enterprises will also be entitled to a reduction of 50 percent of input VAT for the period 1 July 2013 to 30 June 2014. For the same period, enterprises investing in low income residential projects (i.e., constructing apartments with an area of up to 70m² and a price of less than VND15 million/m²) will be entitled to a reduction of 30 percent of output VAT.

Enterprises investing in residential projects will also be given an extension of up to 6 months for payments of CIT due for the first quarter, and up to 3 months for payments of CIT due for the second and third quarter of 2013. Further, these enterprises will be entitled to an extension of up to 6 months for payment of VAT due for the first three months of 2013.

Land rental and land use fees

Enterprises, households and individuals renting land from the State, and for which the applicable land rental has doubled compared to the amount payable in 2010 (as a result of the new regulations under Decree 121/2010/ND-CP), will be entitled to a reduction of 50 percent on the land rental amount.

The payment of land use fees by enterprises facing financial difficulties can be scheduled alongside their sale progress within a maximum of 24 months from the date of receipt of the tax authorities' payment request.

Financial support

Under the Resolution, state commercial banks are instructed to lend at low interest to (i) low income earners and other selected beneficiaries for the lease/lease purchase of social housing and commercial housing with an area of up to 70m² and a price of less than VND15 million/m²; and (ii) enterprises investing in social residential housing.

Local authorities are also instructed to use their allocated budget to acquire commercial residential projects, which can be turned into resettlement and social residential projects benefiting low-income earners and other policy beneficiaries.

Licensing: To further support the implementation of real estate projects, especially those converted from commercial residential projects into social residential projects, the government also directs its licensing authorities to shorten the approval process.

Housing ownership for foreigners: Under the Resolution, it is directed that regulations relating to housing ownership for foreigners will be more open so that more foreigners will be entitled to own residential housing in Vietnam.

Source: Mayer Brown JSM

II.C. Rising Fiscal Pressures Require Decisive Government Action

16. **The government is faced with some crucial fiscal policy choices, as it seeks to balance the twin objectives of economic expansion and macroeconomic stability.** On the one hand is the short term imperative of offsetting weak private sector demand, which has led to countercyclical fiscal measures, mainly in the form of tax breaks. On the other hand, with shrinking fiscal space and keenly aware of the need to restore fiscal sustainability, the government's attention is also turning to fiscal consolidation; for example, it is looking at clearer requirements for SOEs to pay dividends to the State Budget as part of the new Law on State Capital Invested in Enterprises. Fiscal pressures could also be eased through the government's ongoing efforts to consolidate capital spending, which are discussed further below.

17. **Tightening fiscal conditions have led the government to revise up its fiscal deficit target for 2013, from 4.8 percent budgeted to 5.3 percent of GDP.** This excludes infrastructure projects financed through off-budget bonds. The State Budget ran a primary deficit of around 2.7 percent of GDP and a current deficit of 0.1 percent of GDP in the first nine months of the year. It is expected that by the end of 2013 the government will have a current surplus as revenue collection starts to pick up. This is important for fiscal sustainability and consistent with the provisions of the State Budget Law, which restricts debt financing to capital investments.

18. **The increase in the fiscal deficit target will put pressure on debt sustainability.** As reported in the July 2013 Taking Stock report, Vietnam is assessed at low risk of debt distress. The proposed increase to the 2013 deficit target will not change the overall rating of low level of debt distress. But even a small increase in the pace of spending growth can lead to a rapid deterioration in debt dynamics.

19. **On the positive side, a number of steps have been taken to better monitor and report on the prudential thresholds.** For example, the latest bi-annual Public Debt Bulletin (issued in July 2013) includes consolidated information on both external and domestic government debt and data till end 2012. Previously bulletins reported only public and publicly guaranteed external debt, with an eighteen-month delay. It now also includes a table on performance against a number of the prudential debt thresholds.

20. **Fiscal discipline needs to be stepped up to ensure consistency with the prudential deficit thresholds adopted by the government.** The long-term fiscal strategy, adopted through Prime Minister's Decision 958 (2012), aims to maintain the overall deficit below 4.5 percent of GDP between 2011 and 2015, with further consolidation expected between 2016 and 2020 with a deficit target of around 4 percent of GDP.

21. **Attention also needs to turn to the composition of public debt.** The changing composition of public debt poses a new set of challenges. Nearly 80 percent of Vietnam's public and publicly guaranteed external debt is concessional with long maturities, the share of which is falling with Vietnam's graduation to middle-income country status. At the same time, the share of domestic debt, including government guarantees, has increased – from 37 percent of total outstanding public debt stock in 2007 to around 44 percent in 2012. The changes in debt composition have important implications for long term fiscal sustainability. Interest rates on domestic bonds are still considerably higher than those on concessional external debt. Domestic debt maturity is also much shorter, which poses re-financing risks particularly as much of the borrowing is for longer-term investments.

22. **The adoption of the Medium-Term Debt Management Program (MTDMP, 2013-2015) is an important step forward in this regard.** Under the MTDMP (PM Decision No. 689/QĐ-TTg, May 4, 2013), the government for the first time has set medium-term targets across its entire debt portfolio including for public and publicly guaranteed external debt; domestic debt; domestic and external debt guarantees broken down by recipients; and off-budget bond issuances. These targets are based on a preliminary analysis of costs and risks of the current and future proposed composition of the debt portfolio, and are consistent with the debt thresholds adopted in PM Decision 958.

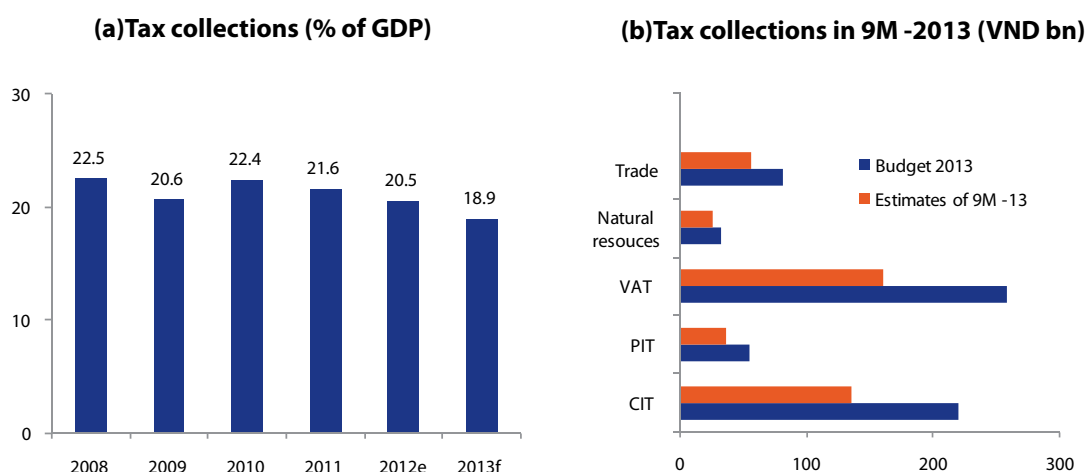
23. **Establishment of a Treasury Single Account is also important for strengthening fiscal discipline.** Despite progress to improve oversight and control over cash balances held by various spending units, the current arrangement falls short of a Treasury Single Account (TSA). Establishment of a TSA will reduce the level of idle cash balances, reduce debt servicing costs, potentially increase returns on any surplus cash, and improve liquidity for timely payment processing. In a potentially important move, the government is considering implementing the TSA in two state-owned commercial banks, with the intent to extend implementation to the remaining state-owned commercial banks by 2014.

Tax revenue collection has slowed down

24. **The growing fiscal deficit is driven in large part by slowing tax revenue collection** (figure 2.9a). This is due to a combination of slower economic growth and tax break stimuli to the private sector. Preliminary estimates of budget execution in the first nine months of 2013 show that revenue collection

was 67 percent of the budget compared to an average of around 80 percent over the same period in the past years. The shortage of total budget revenues is estimated at about VND 63 trillion (approximately USD 3 billion) or 7.7 percent of the annual plan. Corporate income tax (CIT) and value-added tax (VAT) which make up around 54 percent of total budget revenue, achieved just around 60 percent of the target (figure 2.9b). Corporate tax payments by state owned enterprises declined by 20 percent in nominal terms compared to the same period last year. VAT payments by SOEs have also declined around 6 percent in real terms compared to the same period last year. Although imports have recovered, the collections of trade taxes are at only 62 percent of the annual plan.

Figure 2.9: Tax Collections in State Budget



Source: MOF and WB estimates

25. **The government is likely to face continued challenges on the revenue front over the medium-term.** The recently amended Corporate Income Tax Law reduced the corporate tax rate from 25 percent to 22 percent.¹ This will be further reduced to 20 percent from January 1, 2016. In addition, smaller businesses will pay taxes at a lower rate of 20 percent. The government expects that this reduction should attract new investment as well as divert towards Vietnam some of the investments currently heading to lower tax jurisdictions. While the government's desire to make the tax regime attractive for investors is understandable, the short-to-medium-term benefits from further cuts are not clear at this point given that the corporate income tax rate is already at competitive levels (figure 2.10) compared to global peers. If anything, in the short-term the reduced rates are likely to lead to a further reduction in tax collections. Vietnam's standard 10 percent VAT slab is also fairly competitive relative to others (figure 2.11). However, the key issue that needs to be considered in the next round of VAT reforms is the potential unification of the tax rates into a single rate in addition to zero rating in order to promote efficiency.

¹ The revised CIT Law also increases the number of exemptions and the scope of preferential tax rates. Tax-exempt status is now given to incomes from the transfers of the Certificates of Emission Reduction (CERs), the State Development Bank of Vietnam (SBV), the Vietnam Social Policy Bank (VSPB), and to higher education institutions. The scope of preferential tax rates at 10 percent and 20 percent has also been broadened to include a larger list of industries. While the criteria for receiving tax incentives are outlined in detail in the law, however their multiplicity will likely create challenges. Together with other incentives in the form of tax holidays and tax exemptions, these amended provisions could potentially lead to a further loss in corporate tax revenues.

Figure 2.10: Corporate Income Tax Rates (%)

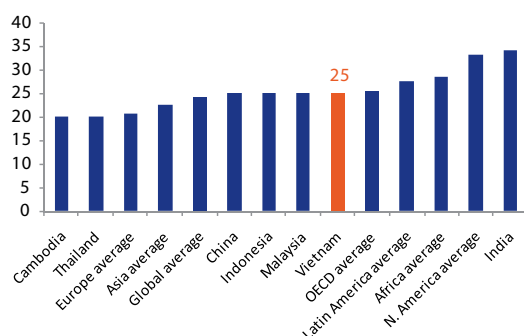
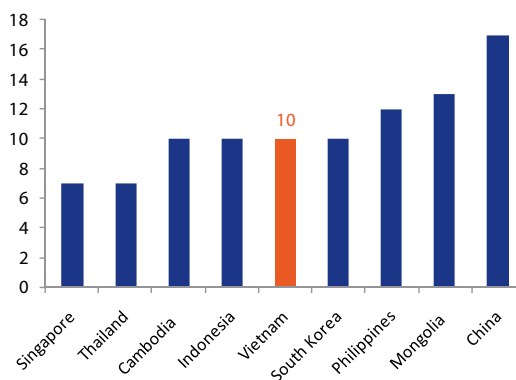


Figure 2.11: Standard VAT Rates (%)



Source: KPMG, IMF, World Economic Outlook, International VAT Monitor, Ernst and Young, VAT and Sales Tax Worldwide, 2008, 2009, IMF The Modern VAT, 2001

Consolidation of Capital Expenditures is Showing Early Results

26. **On the expenditure side, government efforts have focused mainly on consolidating capital spending.** In June 2013, the Prime Minister issued Directive 14 to tighten the requirements for capital budget allocations and thereby prioritize clearance of capital expenditure arrears to private contractors by 2015. Directive 14 requires implementing agencies to demonstrate that all efforts have been made to cut costs, and allows increased allocation only in exceptional cases arising from higher costs due to inflation or land acquisition difficulties. Directive 14 further requires all government agencies to clear their arrears before becoming eligible for getting any new project funded.

27. **These measures have started to show some results.** MPI has reported that the 2013 State Budget has allocations for just fewer than 6,000 projects, which are roughly 1,200 projects less than the 2012 State Budget. Table 2.1 below shows that total capital spending (including off-budget) is estimated to have fallen from around 11.6 percent of GDP in 2010 to 9.4 percent in 2011 and 7.8 percent in 2012. On-budget capital spending in 2013 is planned to decline compared to actual spending in 2012.

Table 2.1: State Budget Expenditure Estimates (% of GDP)

	2010 Actual	2011 1st Est	2012 1st Est	2013 Budget
Expenditure	27.2	25.5	26.0	24.3
Recurrent	18.7	19.3	20.3	19.5
Investment (on budget)	8.5	6.3	5.8	4.8
Investment (off budget)	3.1	2.2	2.0	2.4

Source: Staff estimates based on MOF published numbers

28. **Whilst the consolidation of capital spending is welcome, greater transparency is needed in the overall State Budget, including in the allocation of recurrent spending.** At the moment, basic information on the economic breakdown of recurrent spending is hard to get. For example, whilst the government publishes allocations for salary reforms, it does not publish the actual wage bill. Such information is critical to having a better understanding on the affordability and efficiency of recurrent spending, especially in light of the tightening fiscal situation in Vietnam.

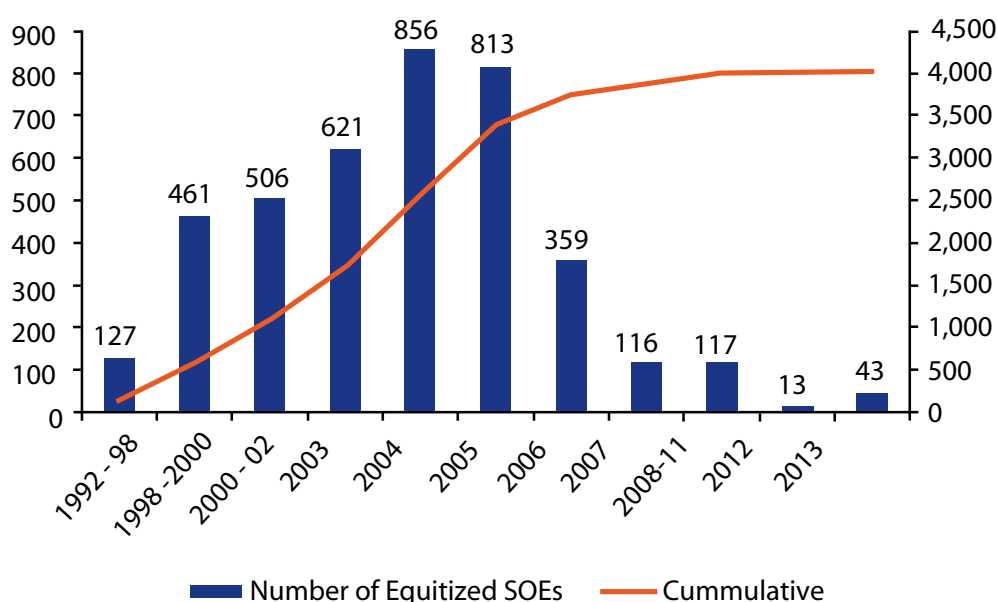
29. **The current process of reviewing the State Budget Law (2002) offers an important opportunity to address some of these critical fiscal transparency issues.** In addition, earlier public reporting on changes to budget assumptions and on budget proposals for the following fiscal year would significantly enhance transparency. It is therefore recommended to publish a comprehensive mid-year update on budget implementation and also the following year's budget proposal when it is submitted to the National Assembly.

II.D. Progress on SOE Reforms has been Slower than Anticipated

30. **Some important decisions have been taken by the government to restructure SOEs.** Over the past year, the government has developed and adopted a number of regulations to improve oversight and management of SOEs and has put forward plans to restructure the SOEs. Key measures have included: (i) Decree 71 on the management of state capital invested in enterprises; (ii) Decree 61 on the disclosure of SOE information; (iii) Decree 50 on the remuneration of SOE managers and linking this to performance. The amendment of Decree 59 on equitization is also nearly complete and is expected to remove important hurdles for equitization, including the requirement to have book value as floor prices for selling state equity.

31. **However, actual progress on restructuring has been slower than expected for SOEs in general (figure 2.12) and for State Enterprise Groups (SEGs) and General Corporations (GCs) in particular.** As of end September 2013, restructuring plans of about 55 percent of SEGs and GCs with targets on divestment and corporate governance reforms were approved. In addition to difficult market conditions and the complexity inherent in the restructuring process, progress has been hampered by a cumbersome regulatory framework as well as limited financial and operational analysis underlying the planned divestures. Furthermore, the cost of financial restructuring is likely to be large, which the government will need to take account of in its budget.

Figure 2.12: Progress of Equitization 1992-2013



Source: MOF, NSCERD and CIEM

Note: 2013 data are up to September

32. **The pace of reform actions to implement the SOE restructuring agenda needs to pick up pace.** Decision 929 provides an important opportunity in this regard. It assigns clear roles and responsibilities for the restructuring agenda, sets a deadline for preparing restructuring plans for GCs and SEGs and for initiating divestment of their non-core investments. Recognizing that the process requires further clarity, the government is finalizing a revision of Decision 14 to specify the level of participation the state will retain in enterprises in different sectors. To complement this, the recently issued Decree 71 requires all SEGs to divest from 5 high risk non-core activities (banking, insurance, real estate, securities trading, and investment funds) by 2015. This would be an important achievement and would help to reduce risks, including of fiscal bailout, emanating from opaque and unregulated activities.

33. **Disclosure of financial and non-financial information of SOEs has also been weak, partly on account of a weak and fragmented regulatory setup.** Current practices are generally insufficient in the quality, accuracy and timeliness of data, which constrains the government's ability to provide oversight. In a survey conducted in 2011 for the Vietnam Development Report (2012), respondents cited transparency as the top reform solution for SOEs in Vietnam together with accelerating equitization.² Information on SOEs was also ranked as the top area for improving disclosure in a survey conducted in April 2012 on the transparency of the State Budget in Vietnam.³ A recent review by the World Bank finds shortcomings in the existing stock of regulation for information disclosure.⁴ SOE reporting requirements have grown organically and involve disclosure of different types of information to many different agencies. Each of these agencies has different rights to SOE financial and non-financial information and many of them are overlapping. In addition, the current legislative framework provides little clarity on what should be publicly disclosed.

34. **Significant improvements to information disclosure are expected with the implementation of Decree 61.** The new decree – issued in June 2013 but expected to be implemented only from 2014 – reduces duplication in reporting requirements by building a standardized information disclosure system, thereby lowering the administrative burden of compliance. Under Decree 61 SOEs are required to report twice a year to their owners (quarterly for larger SOEs). SOEs also have to prepare an annual plan with clear objectives, and submit it to their owners. Their performance will be assessed against the plans, as opposed to previous year's performance as in past regulation. Annual financial statements audited by independent auditors must be submitted to the owners in March of each year. These then need to be submitted to Ministry of Finance who will prepare a synthesis analysis for the government and the National Assembly.

35. **Decree 61 also provides greater clarity on public disclosure of financial information.** Enterprises with state capital investment will now be required to disclose information on: (i) efficiency and preservation of state capital at the enterprise; (ii) business results of the enterprise; (iii) use of funds of the enterprise; (iv) contributions to the State Budget; (v) employee pay scales; (vi) corporate governance; (vii) annual salaries, remunerations, bonuses, and incomes of managers. Owners will

² World Bank, Vietnam Chamber of Commerce and Industry, Irish Aid (2012), 'Vietnam in Transition – Changing Attitudes Toward the Market and the State'.

³ World Bank, "Vietnam Fiscal Transparency Review: Analysis and Stakeholder Feedback on State Budget Information in the Public Domain," (March 2013) – See pages 30-31 and 39-40.

⁴ World Bank, "Transparency of State Owned Enterprises in Vietnam: Current status and ideas for reform," EMCC Policy Note (2013)

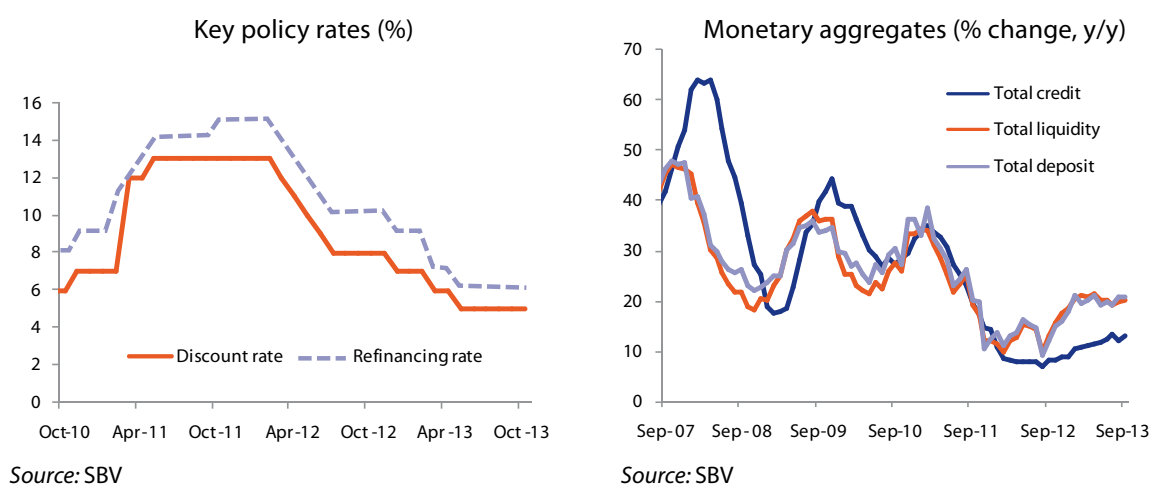
have to publicize: (i) the enterprises' financial status and performance classification and (ii) financial performance data of the enterprises including return on equity, ratio of debt to equity, and debt repayment capacity.

36. **The SOE restructuring process has room for improvement in some key areas.** Firstly, there has been a significant and persistent difference between planned targets and actual achievements, which raises questions about the feasibility of the targets. The current top-down approach appears to take little account of the risks associated with a changing external environment, or to the complexity of the issues and specificity of individual SOEs – compounded in cases in which the SOEs have high levels of debt or have complex cross ownership structures. Secondly, coordination mechanisms remain weak, both in policy formulation and implementation, leading to fragmentation of the reform program across line ministries, agencies and provinces. Successful SOE restructuring will require strong oversight and close inter-ministerial coordination.

II. E. Despite Monetary Policy Easing, Credit Growth Remains Slow

37. **The slowing pace of CPI inflation over the past eighteen months has provided the State Bank of Vietnam the space to ease policy interest rates in an attempt to boost private demand.** The SBV has slashed its key policy rates by 800 basis points and lowered the deposit rate cap on local currency accounts by 700 basis points since March 2012 (figure 2.13). Even so, with the inflation rate declining at an even faster pace, in real terms these interest rates remain higher than they were in early 2012. Money supply has risen at a rapid clip since early 2012, with broad money (total liquidity) rising at 20 percent (year-on-year) in September 2013.

Figure 2.13: Monetary Aggregates



38. **Despite substantial easing of monetary policy, credit growth is picking up only gradually.** Total credit to the economy from the banking system is estimated to have grown by about 7.5 percent (year-to-date) by November 2013 compared to the annual target of 12 percent. The interest rate cuts have yet to boost lending to the private sector or to the SMEs, partly due to difficulties of the corporate sector. Credit activity remains subdued as banks, with balance sheets saddled by high levels of NPLs, have seen heightened risk aversion and are looking to deleverage. Credit demand also remains weak, reflecting low business confidence among the private sector.

39. **Under such circumstances, any further monetary easing is likely to have only limited impact on growth, unless banking sector reforms pick up.** Under current conditions, further monetary easing will only add to concerns surrounding credit quality and macroeconomic stability. In order to restore the functions of the credit market and make monetary policy more effective, restructuring of the banking sector (and the associated restructuring of SOEs) continues to be an imperative.

II.F. Root Causes of Banking Sector Fragility Yet to be Resolved

40. **The banking sector presented a mixed picture in its performance in 2013.** A big priority for the State Bank of Vietnam (SBV) since 2012 has been to ensure adequate liquidity to ward off a systemic crisis. At the same time, strong growth in banking sector deposits has continued, but commercial banks have lately turned to government bonds for safe investment rather than supporting new lending. While systemic liquidity concerns seem to have dissipated for the time being, the root causes of financial system fragility have yet to be fully addressed.

41. **Important financial sector vulnerabilities remain, also acting as a drag on overall economic performance.** Serious concerns about the overall quality of the banking sector portfolio are still valid, and the policy response thus far to stem further deterioration of the sector financial health has yet to confirm its effectiveness. Non-Performing Loans (NPLs) in the banking sector continue to be a major concern. The SBV reported an NPL ratio of 4.65 percent as of August 2013. However the reliability of this number is difficult to ascertain given concern regarding quality of banking data (at both aggregate and bank level) and the limited disclosure of these statistics (by banks and SBV). The size of NPLs may be estimated higher if international good practice is applied.

42. **The government is now looking to further enhance foreign participation in domestic banks.** Foreign investment could play a critical role in satisfying the recapitalization needs of the banking sector and strengthen the ability of domestic banks to address problems. Additionally, capital injections are likely to come with improved corporate governance, and transfer of skills and technology. Around 11 leading Vietnamese banks currently have some form of foreign ownership. Four out of five State-Owned Commercial Banks, accounting for approximately half of the system, have been partially equitized within the current limits of the law and 2 of them now have had strategic investors in place.

43. **To accelerate the process, the government is finalizing an amendment to Decree 69 to enable increased foreign investment in domestic commercial banks.** The latest draft of the revised Decree continues to maintain the overall cap on foreign investment at 30 percent (consistent with Vietnam's WTO commitments) but introduces provisions which open the door for additional foreign investment, by allowing: (i) higher ownership in special cases (e.g. restructuring needs of weak banks) subject to Prime Ministerial approval; (ii) higher ownership sub-limits for different categories of investor groups – for example, single foreign strategic investors would be permitted up to 20 percent ownership (compared to the 15 percent limit, or 20 percent with Prime Minister's approval, under Decree 69); (iii) non-strategic foreign investors to own up to 15 percent, with a 20 percent limit applying collectively to each foreign investor together with its affiliates (compared to the 5 percent and 10 percent limits under Decree 69). Furthermore, the revised draft Decree broadens the definition

of foreign investor by including branches of foreign banks and closed-end funds, member funds and securities investment companies, that were established in Vietnam with more than 49 percent foreign ownership.⁵ The new Draft Decree also relaxes the requirement in Decree 69 that stipulates the transfer price of shares to be no less than the auction price in the case of equitized SOCBs. Finally, the revised draft Decree offers to reduce the number of transactions that are required to be registered and/or approved by the SBV, and to provide for a simpler and more transparent approval process

44. **To improve loan classification and provisioning, the SBV issued Circular 02 in early 2013.** Circular 02 requires banks to adopt policies that are closer to international best practice in calculation of NPLs. Implementation of Circular 02 has been put on hold until June 2014, however, given the banks' preoccupation with the immediate NPL and related problems and their lack of readiness to adopt the enhanced regulation. These policies are critical to address the problems of inaccurate and under-reporting of NPLs.

45. **The government has adopted Prime Minister's Decision 843, an important step toward addressing the problem of high NPLs across the banking sector.** Decision 843 assigns the SBV the responsibility of coordinating system wide NPL resolution and monitoring the compliance of banks and their Asset Management Companies with their NPL resolution plans and targets. Special provisions have been adopted for cases where banks conceal NPLs or fail to implement agreed NPL resolution plans. In particular, Decision 843 allows the SBV to carry out additional audits of the offending banks; restrict expansion of their business; limit the distribution of dividends and transfer of shares and assets; impose additional prudential requirements; require increased provisioning; and cap credit growth. This Decision has the potential to address NPLs in the economy if supporting regulations and other complementary reform measures get implemented effectively and without delay.

46. **Another important element of Decision 843 and resolution of NPLs is the establishment of the Vietnam Asset Management Company (VAMC) in July 2013.** The VAMC is expected to buy bad debts from banks at book value (after deduction of unused specific provisioning for the bad debts) through special zero interest, five year maturity bonds or at market price without the bonds. It aims to purchase VND30-35 trillion worth of bad debt by end of 2013 and reported to have purchased NPLs VND 18 trillion as of November 26, 2013. In order for VAMC to play its designated role in the resolution of NPLs, it would be important to improve its capacity and related regulatory framework appropriately. Reforms to the current related regulatory framework have started and should to empower VAMC to take swift actions on the restructuring and sale of purchased debts (e.g. ownership transfers of the underlying collateral, protection when dealing with commercial banks and borrowers, private sale).

47. **Due attention is also needed to issues or bankruptcy, insolvency and creditor rights which will facilitate corporate debt restructuring.** In this regard the revisions to the bankruptcy law, particularly the treatment of credit institutions, are of particular interest for resolution of the NPLs and related restructuring efforts. Attention is also needed on improving corporate governance in the banking sector and improving disclosure of financial data and statistics. Contingency planning framework and safety nets could further enhance the efficacy of the reform efforts and improve the Government's ability to cope with any future distress in the banking sector.

⁵ In the past, this issue has caused difficulties in negotiations between equitized SOCBs and foreign strategic investors.

II.G. Improved External Accounts Thanks to Strong Export and FDI Performances

48. **Vietnam's export performance continues to be relatively strong considering the dent in global demand.** Total exports were valued at nearly \$109 billion, rising 16 percent in the first ten months of 2013 compared to the same period last year (Table 2.2). Whilst the value commodity exports (crude oil and agriculture products) have decreased, non-oil exports have continued to grow robustly. The foreign-invested sector, contributing two third of Vietnam's overall export value, has performed especially well.

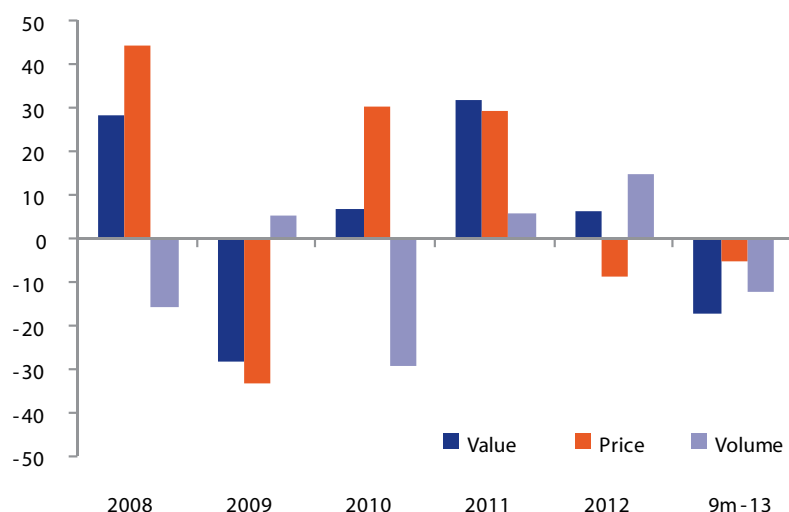
Table 2.2: Export Performance

	Share of total (%)			Growth (%)		
	2011	2012	10M-03	2011	2012	10M-13
Total export value	100.0	100.0	100.0	34.2	18.2	16.0
Crude oil	7.5	7.2	5.5	46.1	13.6	-13.5
Non-oil	92.5	92.8	94.5	33.3	18.6	18.4
Agriculture and fishery	20.1	18.0	13.5	27.7	5.5	-6.8
Rice	3.8	3.2	2.4	12.7	0.4	-17.9
Low cost manufacturing	24.5	23.6	23.8	20.0	13.9	17.2
Garment	13.6	13.2	13.6	17.9	14.2	18.5
Hi-tech	11.4	17.9	28.4	68.0	85.7	54.6
Phones and parts	6.6	11.1	16.5	113.4	98.8	78.3
Others	36.5	33.3	28.0	37.9	8.0	7.4
Domestic sector	43.1	36.9	33.1	26.3	1.1	3.5
Foreign invested sector (incl. oil)	56.9	63.1	66.9	40.8	31.1	23.4

Source: GDC

49. **The export share of crude oil and key commodities in total exports has decreased by nearly half in the last ten years, from 31 percent in 2003 to 16 percent as of October 2013.** This reflects a significant shift from raw and agricultural products toward manufacturing goods in Vietnam's exports. Export volume and price of key commodities have also fallen. Average export price of rubber in the first ten months of 2013 was down nearly 17 percent compared to the same period last year. Export price of coal and rice decreased by 15 percent and 3.2 percent respectively (Figure 2.14).

Figure 2.14: Vietnam's Key Commodity Exports



Note: Weighted change in export value, price and volume.
Key commodities include crude oil, coal, rice, coffee and rubber.
Source: GDC

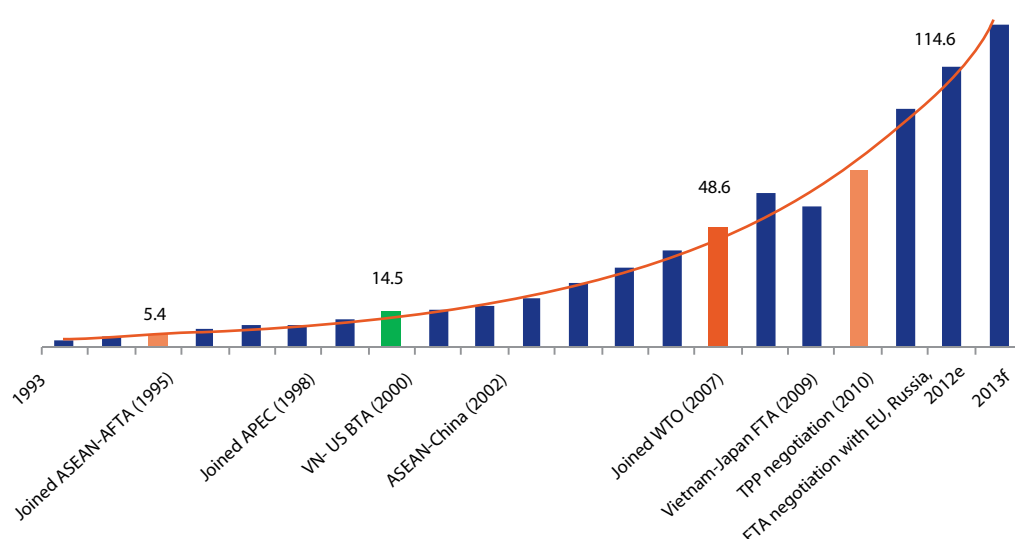
50. **Vietnam's export markets have remained relatively stable. ASEAN, the European Union, the US, and China account for about two thirds of Vietnam's total exports** (table 2.3). Vietnamese exporters have been trying to expand their business to new markets such as Africa, South Asia and Latin America but the share of new markets is still small. Vietnam is currently negotiating the Trans-Pacific Partnership (TPP) to build on earlier rounds of trade liberalization (figure 2.15) and provide a fresh impetus to Vietnamese exports, especially through access to new markets in Latin America. A more diversified market would help Vietnam to sustain gains from its exports and mitigate economic risks from the external economic environment.

Table 2.3: Vietnam's Export Markets

	Share of total (%)			Growth (%)		
	2011	2012	10M-13	2011	2012	10M-13
China	11.5	10.8	9.8	52.2	11.4	4.6
Japan	11.1	11.4	10.2	39.5	21.1	2.8
The US	17.5	17.2	17.9	18.9	16.2	20.1
EU	17.0	17.7	18.4	45.3	22.8	24.2
ASEAN	14.0	15.1	14.2	30.7	27.6	9.4
East Asia (excl. Japan)	9.0	9.9	9.6	46.1	29.7	14.5
<i>Others</i>	19.9	17.9	19.8	26.7	6.6	26.1
Total	100.0	100.0	100.0	34.2	18.2	16.0

Source: GDC

Figure 2.15: Vietnam External Trade Chronicles



Source: GDC, MOIT and World Bank

51. **Imports have picked up significantly in 2013 after sluggish growth in 2012.** Total import value in the year to October is estimated at US\$109 billion, up 15.9 percent compared to 6.6 percent in 2012 (table 2.4). Imports of the foreign-invested sector continue to grow solidly while imports of domestic companies, which were unusually weak last year, have gradually rebounded. Machinery, equipment, raw material and intermediate goods are among the biggest import items.

Table 2.4: Import Performance

	Share of total (%)			Growth (%)		
	2011	2012	10m-03	2011	2012	10M-13
Total import value	100.0	100.0	100.0	25.8	6.6	15.9
Machinery and equipment	14.4	14.1	13.9	12.1	4.5	13.3
Intermediate goods	12.7	18.7	22.9	23.0	57.7	44.5
Materials	27.1	25.2	25.2	20.4	-0.8	15.5
Products	18.7	15.7	12.8	34.8	-10.4	-8.1
Others	27.2	26.3	25.2	35.9	3.0	11.1
Domestic sector	54.3	47.3	43.1	21.0	-7.0	5.2
Foreign invested sector	45.7	52.7	56.9	32.1	22.7	25.6

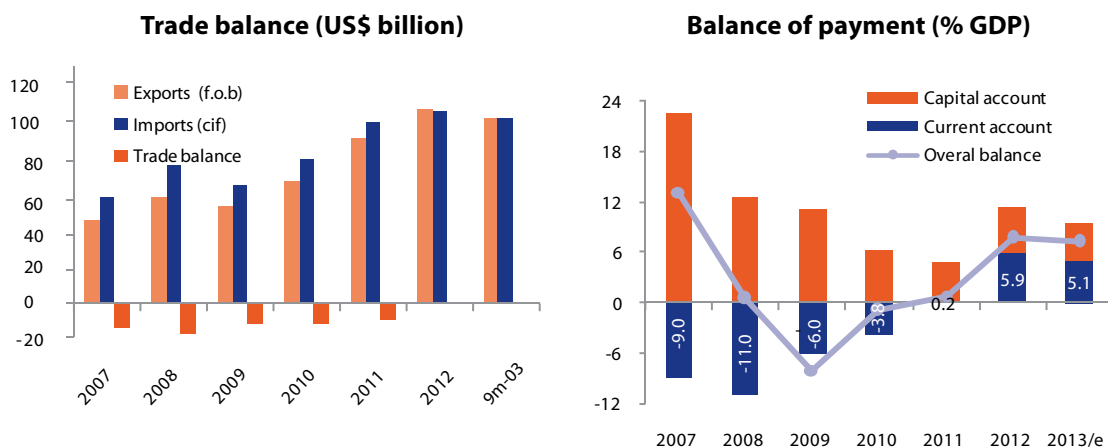
Source: GDC

52. **The share of the FDI sector in Vietnam's imports has increased substantially.** An important share of these imports is machinery and equipment, raw materials and intermediate goods of foreign-invested enterprises. FDI's share in Vietnam's total imports has increased substantially, rising from 18 percent in 1996 to 35 percent in 2003, to nearly 57 percent thus far in 2013.

53. **Despite the substantial rise in imports, the foreign-invested sector has recorded a significant trade surplus.** However, increasing share of imported intermediate inputs of FDI sector for export processing raises many questions on the value addition foreign invested firms' exports and the weaknesses of supporting industries in Vietnam. While exports can contribute to the general economic development through job creation and spillover effects in the rest of the economy, more effort is also need to ensure that the domestic value added embodied in Vietnam's exports of FDI sector is enhanced. Section III.A shed more light on this agenda.

54. **Strong export and FDI performances have contributed to another year of favorable external accounts** (figure 2.16). Despite significant recovery of imports, robust exports and resilient private remittance have contributed to a current account surplus for the third year in a row. Vietnam's current account was in surplus by 0.2 percent of GDP in 2011 to a record 5.9 percent in 2012 and an estimated 5.1 percent projected for 2013. The capital account surplus remains sizeable owing to consistent FDI inflows and Vietnam's continuing access to concessional financing.

Figure 2.16: Trade Balance and Balance of Payments

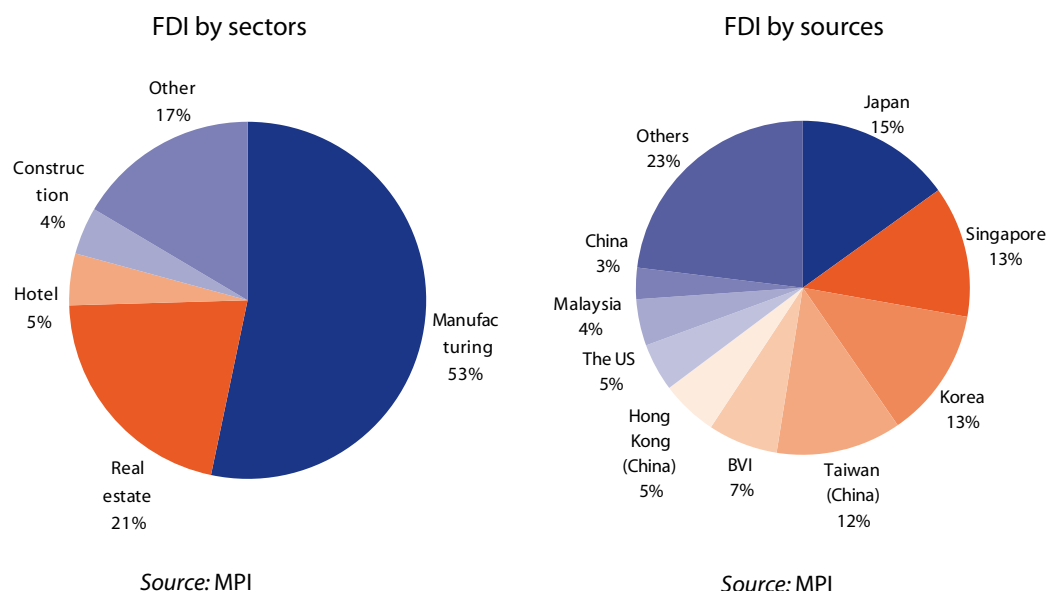


Source: GDC

Source: SBV and WB estimates

55. **There has been a visible shift in the composition of FDI, with a rise in investment in manufacturing, retail and technology.** FDI flows – accounting for 8.4 percent of GDP on average of 2010-12 – are also becoming less speculative in nature than in the past. Most of the FDI flowing into Vietnam originated from Asian countries (figure 2.17). Among the top ten foreign investors, seven are from Asia. As of end September, Japan was the largest foreign investor with total committed capital of \$33.4 billion (Box 2.2), followed by Singapore, Korea and Taiwan (China).

Figure 2.17: FDI Stock by Source and Sector



II.H. Medium-term Outlook Remains Favorable on Balance, Albeit with Significant Risks

56. **The medium-term outlook remains favorable on balance, albeit with considerable downside risks.** GDP growth in the baseline scenario is expected to rise modestly, to 5.5 percent by 2015 (table 2.5). This assumes macroeconomic prudence though continuation of monetary policy caution and a phased withdrawal of fiscal stimulus, and a renewed focus on structural reforms (with particular attention on the SOE and banking sectors). The current account would remain in surplus in the near term (albeit of a much smaller amount), as import growth picks up with expectations of accelerated recovery and the rapid expansion of exports from foreign-invested manufacturing companies is starting to moderate. Capital inflows are also expected to pick up as investor confidence recovers, resulting in continued reserve accumulation. However, the outlook for public sector debt contains growing risks, underscoring the need for fiscal consolidation to preserve debt sustainability in the medium term.

Table 2.5: Vietnam's Key Economic Indicators

	2010	2011	2012/e	2013/p	2014/p	2015/p
Real GDP (% change, y-y %) /1	6.4	6.2	5.2	5.3	5.4	5.5
Consumer price index (% annual average)	9.2	18.6	9.1	6.7	7.0	6.8
Current account balance (% of GDP)	-3.8	0.2	5.9	5.1	3.0	0.6
Government fiscal balance (% GDP) /2	-2.8	-2.9	-4.5	-5.2	-5.0	-4.5

1/ GDP based on 2010 price

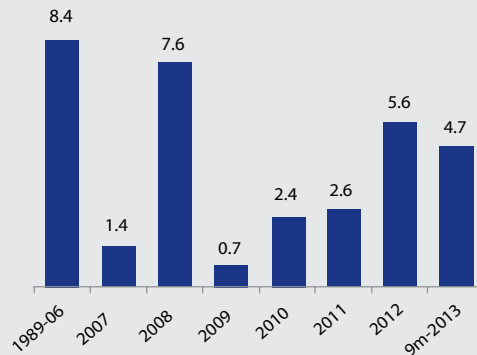
2/ by GFS definition

Source: GSO and WB estimates

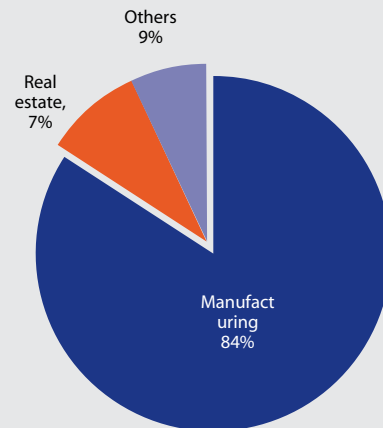
Box 2.2: Japanese FDI to Vietnam

First Japanese investors started their direct investment in Vietnam in 1989. By the end of September 2013, total FDI of Japan to Vietnam was approximately US\$ 33.4 billion, accounting for about 15 percent of total committed FDI in Vietnam. Currently, Japan takes the lead among over 100 countries and territories investing in Vietnam.

Japanese FDI to Vietnam (US\$ billion)



Japanese FDI by sectors



Most of Japanese FDI has focused in manufacturing sector (84 percent of total) and the the rest was invested in the real estate and the service sector. A half of investors set up their business in Vietnam as fully Japanese - owned, others chose to join hands with local partners.

Japan is currently helping Vietnam to build its strategy for industrialization and modernization by 2020. Both sides have identified 6 priority sectors for intensive cooperation, including: electrical, electronics; food processing; agricultural machinery; shipbuilding and repair; automobile and spare parts, environmental and energy efficiency technologies. Vietnam is also coordinating with Japanese International Cooperation Agency (JICA) and other authorities of Japan on feasibility study to set up two advanced industrial zones in Haiphong city and southern Baria -Vung Tau province to serve Japanese enterprises wishing to invest in Vietnam.

57. **Although macroeconomic stability has been largely restored through prudent adjustments in monetary and fiscal policies, a few critical risks remain:** (i) private sector demand remains sluggish and highly susceptible to any further adverse global economic events or negative news with respect to risks in the banking and SOE sectors; (ii) although diminished, the risk remains that authorities could depart from fiscal and monetary discipline to offset weak private sector demand, and thereby undercut hard-earned macroeconomic stability; (iii) there is a risk that the momentum on structural reforms could further slow down, putting GDP growth on a lower trajectory and further undercutting fiscal sustainability; (iv) finally, the banking sector, with its substantial NPL ratios and exposure to the fragile financial positions of the SOE sector, remains subject to sudden shifts in depositor confidence and to further deterioration of balance sheets of the more fragile banks.



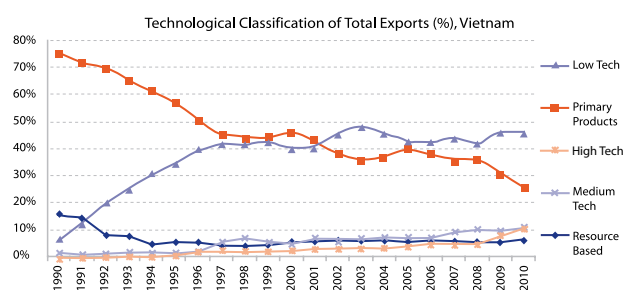
PART III.A:

TRADE FACILITATION, COMPETITIVENESS AND GROWTH IN VIETNAM

58. **Vietnam has made major headway in enhancing external integration and strongly leveraging its benefits.** This is manifest in the fact that export performance has remained strong in recent years despite a difficult external environment: exports rose 34 percent in 2011, 18 percent in 2012 and nearly 20 percent in the first three quarters of 2013. This good news needs to be tempered, however, by the fact that Vietnam's exports remain dominated by less sophisticated products with low value added and embodying modest technology (figure 3.A.1).

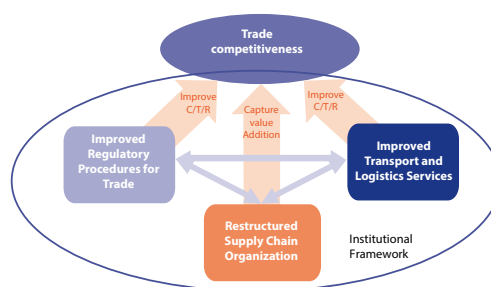
59. **An enhanced emphasis on competitiveness and greater value added will be essential to close the remaining gaps in the export sector:** an objective that, among other things, will require strengthening the three key pillar of trade facilitation (figure 3.A.2). These pillars function within an institutional framework to improve efficiency, reliability and capture higher value added.

**Figure 3.A.1: Improved Structure
But Low Tech**



Source: UN Comtrade

**Figure 3.A.2 Three Pillars of Trade
Competitiveness**



Source: Source: Authors. (C/T/R: Cost/
Time/Reliability).

60. **An assessment of Vietnam's performance on trade competitiveness presents a mixed picture.** While the country scores well overall on the World Bank's Logistics Performance Index (LPI), some sub-component of the LPI – infrastructure and customs – have deteriorated (table 3.A.1) significantly.⁶

Table 3.A. 1: Vietnam's Logistics Performance Indices, recent years

	2007	2010	2012
LPI	53	53	53
Customs	37	53	63
Infrastructure	60	66	72
Timeliness	65	76	38

Source: World Bank

61. Vietnam's performance on the three main pillars of trade facilitation may be summarized as follows:

i. **Transport infrastructure and logistics:** There are significant gaps in infrastructure and transport links in Vietnam (figure 3.A.3). Weak corridors connecting major growth poles to international gateways, high transport costs, and poor quality of transport and logistics services are some of the key impediments. Despite increased public investment, investment for trade logistics has not kept pace with the growth of exports. There is also over-reliance on public investment (World Bank's VDR 2012) that tends to be inefficient and fragmented across provinces.

⁶ This discussion summarized the key messages of a recently released World Bank report: Trade Facilitation, Value Creation and Competitiveness: Implications for Vietnam's Economic Growth, in May 2013.

Figure 3.A.3: Vietnam's infrastructure is below regional average

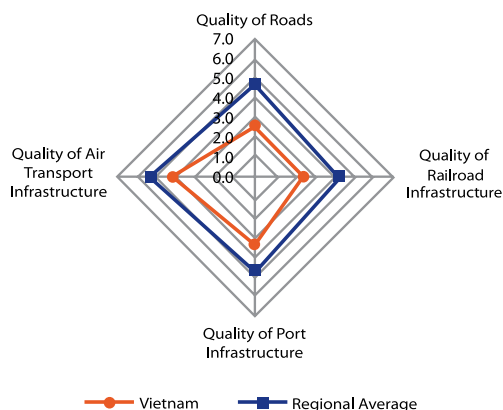


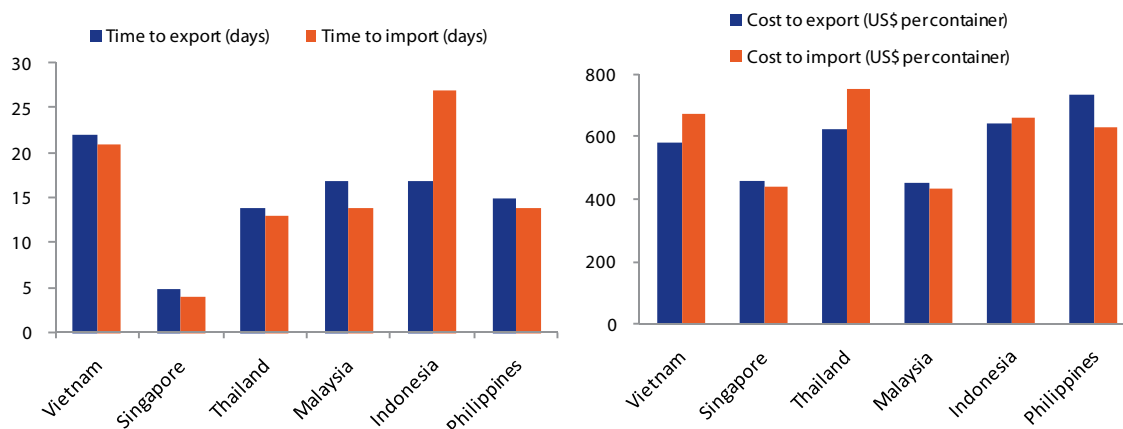
Figure 3.A.4: Weak infrastructure undermines growth



Source: World Economic Forum, 2011-12

ii. Regulatory procedures governing trade: While border management has been strengthened in a number of areas, many agencies continue to rely on outmoded, opaque and time-consuming procedures susceptible to corruption. Business processes likewise remain complex and rely primarily on manual procedures with very little information technology. As a result of the regulatory burdens, trade logistics costs are relatively high for Vietnam which sets its export competitiveness back (figure 3.A.5).

Figure 3.A.5: Comparative costs related to trade logistics



Source: World Bank Doing Business, 2012

iii. Supply chain reorganization: This third pillar involves the selection and sequencing of operational services for production and other activities from source to customer. Key constraints facing manufacturing supply chains include heavy dependence on imported materials and intermediaries both for sourcing and marketing. This negatively affects the ability to reduce lead-time and meet the flexibility of changes in global markets. The industrial zones/clusters located near major cities are crowded and face difficulties in expanding and gaining access to labor. Relocation will require easier access to land, efficient connectivity to the major seaports, and skilled labor. Agricultural supply chains are constrained by small farm sizes and backward farming methods. These chains also face regulatory constraints for large-scale agro-industrial development, dominance of government-to-government arrangements for rice exports and the poor and inconsistent quality of exports.

62. **A dual-track strategy is needed for Vietnam.** In the long-term, it would need to move up the value chain by upgrading its technology. In the interim period, it should focus on capturing a greater part of the value chain in products it is already exporting.

63. **A number of policy recommendations can be made to implement the mentioned strategy.**

- i. First, in order to overcome the mentioned infrastructure and logistics shortfalls, trade competitiveness should be made an explicit goal in key transport strategies. Vital transport corridors should be given priority in terms of adequate investment and greater management attention. It is time to develop and implement a national logistics action plan complemented by a legal framework conducive to PPP investment.
- ii. Second, trade regulatory procedures should be further simplified to reduce time and costs and improve the reliability of cross border trade. Modern customs procedures and IT application and risk-based management to reduce physical inspections are needed for this.
- iii. Third, an action plan is needed to convert general industrial parts and export-processing zones into industrial clusters so as to generate increasing returns to scale from agglomeration and promote domestic supporting industries. Global experience shows that industrial clustering generates local demand for inputs, gradually making input supply a profitable business in the clusters, whether through trade or local production. This has the potential to foster local entrepreneurship even where education or skill levels are low, as shown by studies for China, Ethiopia, and Vietnam. Success with industrial clustering also depends on having complementary policies in place and remaining compatible with market incentives.
- iv. Fourth, the desired advancement in agricultural supply chains will require a legal framework that enables scaling up of successful contract farming for large scale agro-industry development. Other policy measures include an increase in the proportion of B2B rice export sales of rice, more effective regulations of health and sanitary conditions from the fish farms to the markets, and development of spot and futures markets.

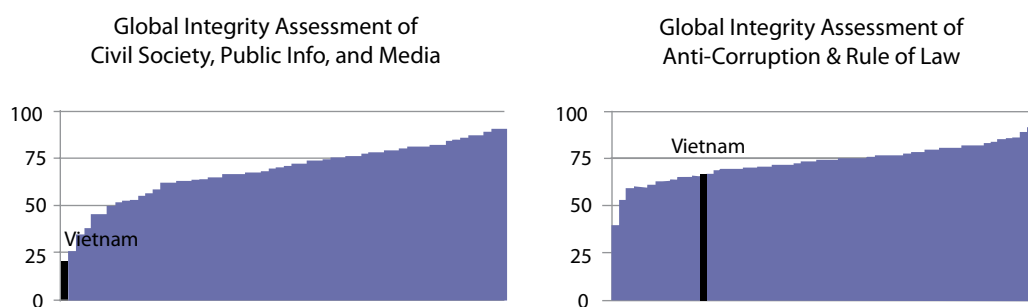
PART III.B:

CORRUPTION AND ECONOMIC GROWTH IN VIETNAM

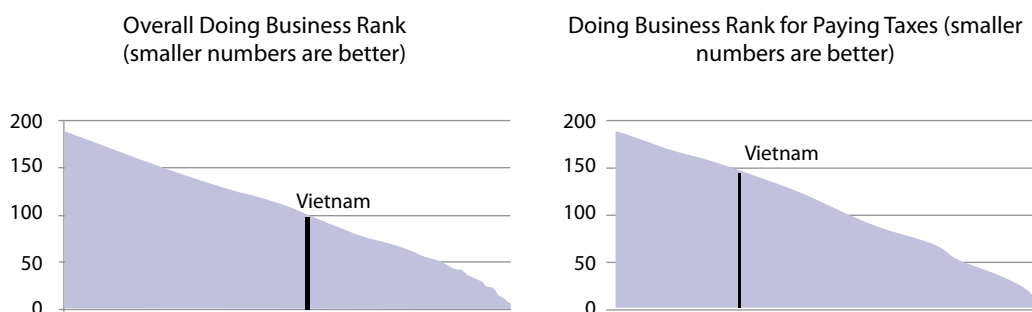
64. **Corruption in Vietnam has long been recognized by the leadership and the international community as a serious problem.** Cross-country rankings show that Vietnam is assessed poorly on a number of institutional aspects that are important for controlling corruption, especially assessments of civil society, the media and access to information (figure 3.B.1). While one may question some of the assessments—a rating of zero for access to information seems particularly unwarranted—the overall conclusion that these are areas of particular concern seems beyond debate. Assessments of the anticorruption legal framework and enforcement are relatively more positive, although still weak.

65. **Areas identified as high risk for corruption also have problematic business environments.** While Vietnam's overall "ease of doing business" ranking is in the top half of countries assessed, the ranking for dealing with taxes is considerably worse. And among countries that have participated in the World Bank's Enterprise Surveys in the past five years, the percentage of firms reporting paying bribes when dealing with taxes is relatively high. This finding mirrors the findings of corruption surveys carried out by the World Bank and the Government Inspectorate (see below), in which firms also reported a high prevalence of bribery for dealing with taxes. In general, a relatively large percentage of firms report paying bribes in Vietnam.

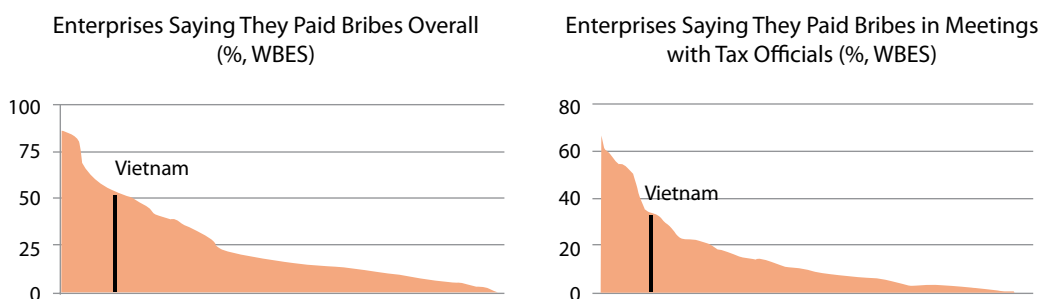
Fig 3.B.1: Vietnam ranks poorly in international rankings of the institutions for controlling corruption



Assessments of Vietnam's business environment vary



Vietnam's firms report relatively high levels of corruption, especially in areas with more problematic business environments



Notes: The top two figures are based on Global Integrity's assessments, where each country's score is the most recent from the last three rounds (2011 for Vietnam). The middle two figures depict the most recent rank from Doing Business (2013 for all countries). The bottom two figures depict assessments by firms in the World Bank Enterprise Surveys carried out between 2006-2013 (2009 for Vietnam). The countries included in the second and third panels are those for which data from both Doing Business and the World Bank Enterprise Surveys are available. The set of countries in the first panel is smaller, limited to those assessed by Global Integrity.

For all charts, the data are sorted so that placement further to the right is better.

66. **Vietnam's consistent record of growth and of attracting FDI may raise questions about the relationship between corruption and the country's economic growth.** Does the pattern found in most cross-national empirical studies (box 3.B.1), the negative correlation between corruption and growth, also apply to Vietnam? A 2012 survey of 1,058 firms in 10 provinces suggests that the answer is

likely to be “yes.” The survey, which was carried out by the World Bank and the Government Inspectorate of Vietnam, asked firms about their change in operational efficiency over the previous two years, and also about their experiences in dealing with 14 agencies and procedures. Indeed, the survey went farther than many similar surveys, exploring not only whether bribes were paid, but the impetus for the bribes, who initiated the bribes, and more generally how the firms react when they encounter bureaucratic difficulties.

Box 3.B.1: Impact of corruption on economic growth: what does global experience tell us?

Corruption is often portrayed as a symptom of underlying problems: bureaucracy and red tape, unaccountable officials, excessive discretion, lack of transparency, and so forth.

Few would doubt that corruption is harmful in and of itself, that it may dissuade investment and distort the incentive system. At the same time, the bureaucratic delays and hurdles that bribes are paid to circumvent may also be harmful. For decades, economists have debated the net effect: is corruption “grease” for the wheels of commerce, and therefore positively related to growth, or is it “sand” that impedes the functioning of the economy? Most empirical studies suggest the latter. A recent meta-analysis, examining 460 estimates from 41 different studies (Campos, Dimova, and Saleh, 2010) found that, on average, most studies find a negative association between economic growth and corruption.

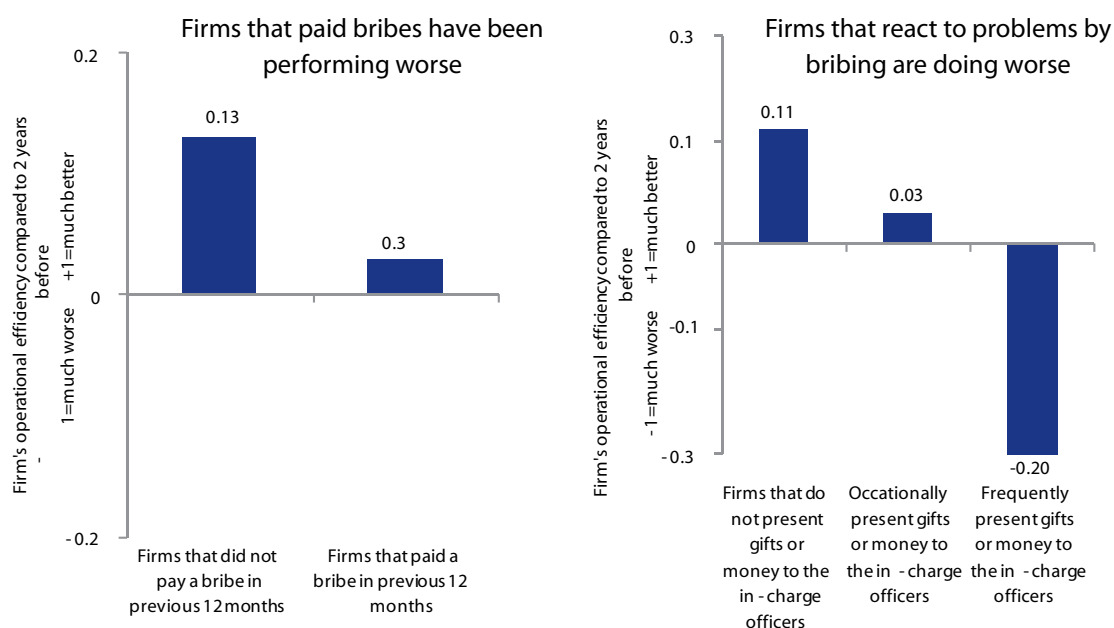
Even if the net effect of corruption is negative at the macro level, the effect that corruption has on individual firms—and the role that firms play in generating the corruption—is another matter. Empirically, as it turns out, the micro behavior does, in fact, mirror the macro results. Many (but not all) studies of data on individual firms relating their performance with the level of corruption they face find a negative association: firms that pay bribes, and firms in more corrupt environments, perform worse than firms that don’t pay bribes and firms in less corrupt environments. For example, a well known study in Uganda found that a one percentage point increase in the bribery rate was associated with a reduction in firm growth of three percentage points (Fisman and Svensson, 2007). Another study, using a large panel dataset of firms in 14 transition countries from 1997 to 2007, found that higher levels of bribery impeded the average firm’s growth of both real sales and labor productivity (Kochanova, 2012).

67. **On average, firms that paid bribes were doing significantly worse than those that were not paying bribes** (left-hand panel, Figure 3.B.1). The results also show, however, that many of the firms are not entirely blameless victims. Most of the bribes reported in the survey by the World Bank and the Government Inspectorate were not directly suggested by officials. Rather, firms offered the bribes to solve their problems or to avoid them altogether.⁷ While such firms seem to think that the benefits of speeding processes along exceed the costs of such bribes, it turns out that firms that routinely react to problems by presenting gifts or money to the in-charge officials are doing significantly worse than their peers who seek other solutions (right-hand panel, Figure 3.B.2). Both patterns remain statistically significant even after controlling for size, ownership, sector of the enterprise, and the province where

⁷ Examining a different survey of firms, DEPOCEN (2012) similarly found that 70% of enterprises agreed with the statement “In case of working with government offices, give money first, everything will be easy”. (p. 56).

the firm is located. The finding of a negative correlation between firm-level growth and corruption echoes earlier studies in Vietnam reaching similar conclusions.⁸

Figure 3.B.2: Bribery and Firm Performance



Source: World Bank and Government Inspectorate of Vietnam. (2012). Corruption from the Perspective of Citizens, Firms, and Public Officials—Results of Sociological Surveys. National Political Publishing House. Hanoi, Vietnam.

68. **There are many possible explanations for this pattern.** Less efficient firms may seek to bribe their way out of problems, while those who invest in learning the rules and defending their rights do better. In addition, in a dynamic setting where some places are undertaking administrative reforms and reducing the need to pay bribes, more backward firms that continue to rely on old habits would simply be wasting their money. Certainly, many firms pay bribes because they feel they have little choice, but it would nevertheless behoove firms to continuously explore options and push back against officials who create unnecessary hurdles for them, rather than resorting to bribery. Finally, as has been argued elsewhere, firms that are growing may actively seek out jurisdictions with lower levels of corruption.⁹

69. **Many policies would simultaneously reduce the bureaucratic problems that hinder firms and the opportunities for corruption that such hindrances create.** The study by the World Bank and Government Inspectorate showed that provinces and districts with more progress on administrative reforms and transparency actually do have lower levels of corruption. At the same time, transparency has been shown to be associated with firm-level investment in its own right as it reduces uncertainties for investors.¹⁰ The fact that corruption is associated with slower growth merely strengthens the imperative to treat such reforms with urgency.

⁸ Using data from the World Bank's survey of firms in 2005, Nguyen and van Dijk (2012) find that corruption hampered growth of private firms, but the opposite held for state-owned firms. Using data from a survey of SMEs in 2005 and 2007, Rand (2009) found that bribery hurt firm performance, and Rand and Tarp (2012) attribute this to the targeting of successful firms for their ability to pay. Reporting on the 2011 round of the same SME survey, CIEM et al (2012) report that bribe paying firms were not growing significantly faster or slower than others, but were significantly more likely to exit. A dissenting finding, in which firms that are growing were estimated to be more likely to pay bribes, can be found in Malesky (2013), although the methodology of that study does not permit a researcher to control for other factors. In another partially dissenting finding using yet another dataset, McCulloch, Malesky and Duc (2013) report that although transparency is associated with higher firm-level investment, informal payments have no discernible effect on firm-level investment.

⁹ Bai et al (2013).

¹⁰ McCulloch, Malesky and Duc (2013).

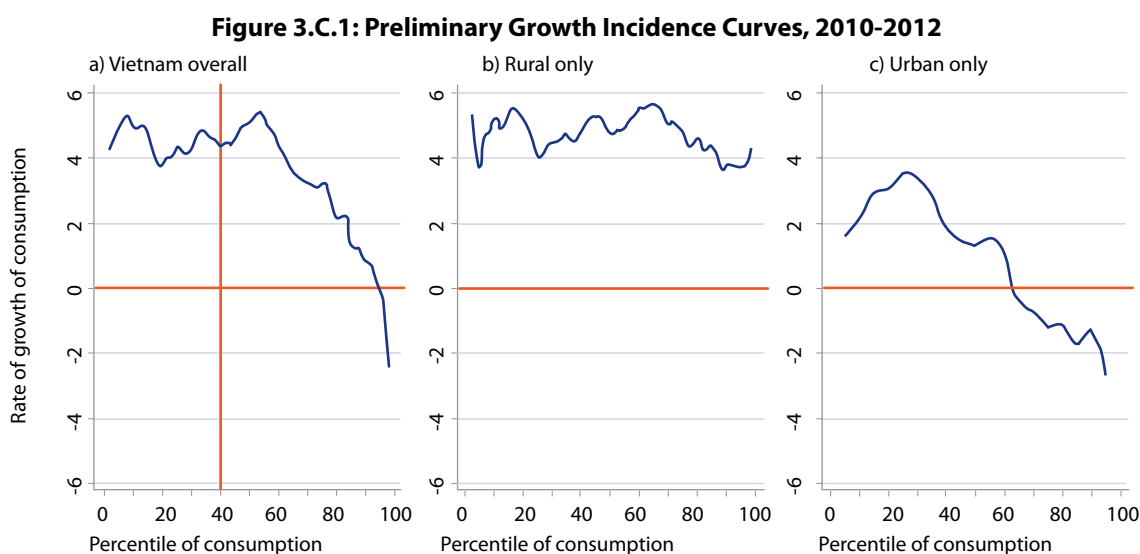
PART III.C:

POVERTY AND INEQUALITY IN VIETNAM

This section reviews two issues. First, it presents a brief overview of the most recent poverty and distributional trends based on a first analysis of the 2012 Vietnam Household Living Standards Survey. Second, it discusses the continuing challenge of ethnic minority poverty in Vietnam

III.C.1. Poverty Update

70. **Preliminary analysis based on the latest survey data shows that growth over the 2010-2012 boosted the welfare of Vietnamese across the socioeconomic distribution.** The following charts are called “Growth Incidence Curves” (GIC). Along the x-axis, they rank people from the poorest to the wealthiest, from left to right. Figure 3.C.1 shows the annualized growth rate of expenditures between 2010 and 2012 for every point along the distribution of consumption in 2010. Separate figures are shown for Vietnam overall, rural Vietnam, and urban Vietnam.¹¹



Source: Preliminary World Bank Analysis of Vietnam Household Living Standards Survey data

71. **Figure 3.C.1a shows that over 2010-2012 consumption grew for the entire bottom 90 percent of the population.** Only for the richest 10 percent does the curve show no improvement. This tells us that overall, the welfare of most Vietnamese improved substantially over 2010-12, even while growth overall has been more modest than previously. The continued improvement for most Vietnamese and the slower rate of increase at the top end corresponds to a decrease in inequality. The

¹¹ The underlying household survey data does not capture temporary migrants, and thus their experience is not reflected in the figures presented here. It is likely that they experienced more acutely the effects of the slowdown.

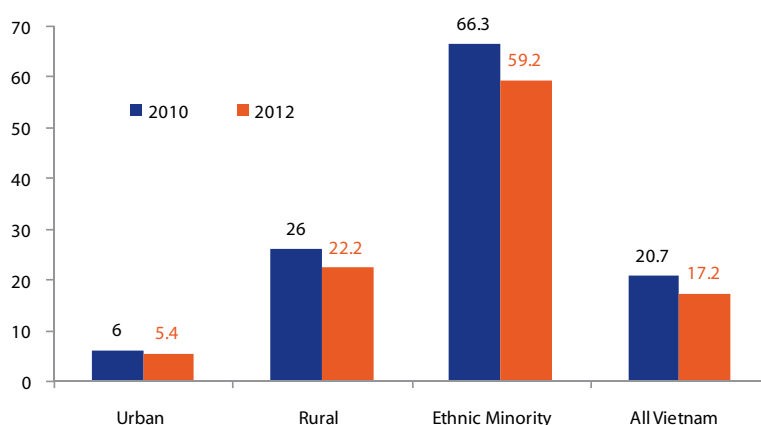
bottom 40 percent corresponds to the portion of the curve to the left of the vertical line. Overall for this group, expenditure per person grew by a substantial 4.4 percent per year in real term¹². Figures 3.C.1b and 3.C.1c present the separate rural and urban GICs. The rural GIC indicates that expenditure levels have risen in rural areas at every point on the economic spectrum, for both rich and poor. In urban areas, the GIC shows a very different pattern. The welfare of the bottom 60 percent of urban dwellers improved. However, there were declines in consumption levels for the upper two-fifths.

72. **This overall pattern is compatible with the broad macroeconomic story.** Private investment growth has slowed down and some firms have closed businesses or reduced production in the wake of the global crisis. The survey data show that these developments hit hardest on Vietnamese at the higher end – those who form the bulk of employees in formal, urban firms. What is both encouraging and somewhat surprising is that despite the overall slowdown, expenditure growth has continued for most Vietnamese households, including both rural households and poorer urban households. The full dynamics of this pattern are the subject of ongoing analytical work by the World Bank.

73. **The growth in consumption among poorer Vietnamese households has generated a continued drop in the poverty rate.** Using the GSO-WB poverty line, which is based on expenditure, the overall poverty rate fell from 20.7 percent to 17.2 percent in 2010-2012. The drop was most pronounced in rural areas – where it fell from 26 percent to 22.2 percent, and it also fell in urban areas, from 6.0 percent to 5.4 percent.

74. **Poverty continues to be markedly higher among ethnic minority Vietnamese.** The new VHLSS shows data that their overall poverty rate has declined sharply from 66.3 percent in 2010 to 59.2 percent in 2012 (figure 3.C.2). Nonetheless, the high poverty rate underscores the remaining challenge of addressing ethnic minority poverty. Ethnic minority poverty continues to decline but is less responsive to growth than is poverty overall. Over 2010-2012, poverty overall fell by 17 percent of its 2010 level, while the ethnic minority poverty rate fell by only 11 percent of its previous level. One way to measure the effect of growth on poverty is through the growth elasticity of poverty, which is the percentage decline in a poverty rate divided by the percentage change in GDP per capita. For poverty over 2010-2012, the elasticity was 1.55 overall but only 0.98 for ethnic minorities.

Figure 3.C.2: Poverty Rates in 2010 and 2012 for Vietnam
(Using GSO –WB Expenditure-Based Poverty Line)



Source: World Bank analysis of Vietnam Household Living Standards Survey data.
Estimates for 2012 are preliminary

¹² The World Bank has recently articulated twin worldwide goals of eliminating extreme poverty and boosting shared prosperity, measured as the welfare of the bottom 40 percent of the population.

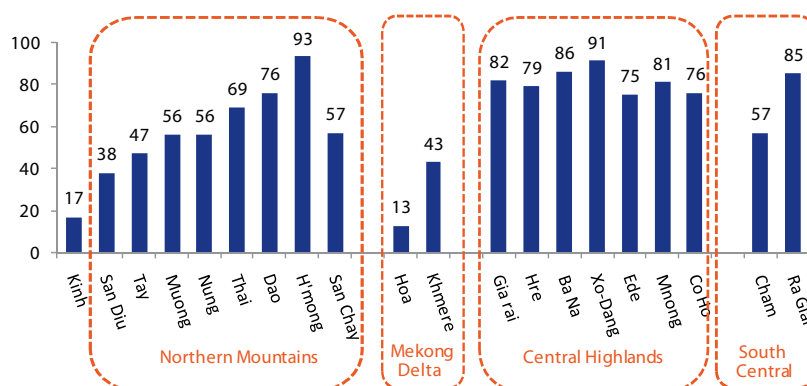
III.C.2. A Profile of Ethnic Minority Poverty

75. **Vietnam's poverty is now highly concentrated among minorities.** When Vietnam was a much poorer country in the early 1990s, ethnic minorities were poorer on average than the Kinh majority, but they made up just a small fraction of the poor. In 2012, ethnic minorities comprise approximately 15 percent of the population, just over half (51 percent) of the poor, and three out of four of the extreme poor in Vietnam.

76. **Ethnic minority welfare has improved greatly over time.** It is important to recognize that the welfare of ethnic minorities has improved substantially over time. Per-capita consumption grew at an annual rate of 7.4 percent for minorities between 1998 and 2010, a remarkable rate of improvement which only seems slow when compared to the growth of 9.4 percent over the same period for the Kinh majority. Between 1993 and 2008, the poverty rate for ethnic minorities fell from nearly 90 percent to 50 percent. (A new, higher poverty line was established in 2010, so pre-2010 poverty figures are not comparable the latest numbers.) Ethnic minority households have also become increasingly linked to the commercial market. Poverty rates for ethnic minorities are currently much higher than for the Kinh majority because they started out much poorer and because their gains have lagged behind the spectacular gains in welfare in the country overall. Nonetheless, the fact that ethnic minority is a remaining challenge should not obscure the fact that Vietnam's broad-based growth has benefitted ethnic minorities as well.

77. **The situations of the 53 ethnic minority groups are diverse.** Ethnic minorities are often discussed as if they were a single group, but in fact their situations are very diverse among many measures. They vary in the size of groups, with just five of the 53 groups having populations over 1 million (the Tay, Thai, Muon, Khmer, and H'mong), three with populations between 500 thousand and 1 million (the Nung, Dao, and Hoa), and many with populations of less than 5,000. They are in a mix of locations—mostly the Northern Mountains and Central Highlands, but also in the Mekong River Delta and to a lesser extent other areas. Finally, while each individual group other than the Hoa has a higher poverty rate than the Kinh majority, poverty rates vary greatly between groups (figure 3.C.3).

Figure 3.C.3: Poverty Rates among Ethnic Minorities in 2009
(Using GSO-WB Expenditure-Based Poverty Line)



Source: World Bank analysis of Vietnam Household Living Standards Survey data. Estimates for 2012 are preliminary

78. **Ethnic minority poverty has a complex mix of causes.** The causes of persistent ethnic minority poverty have been researched in depth. A partial list of prominent studies on the issue would include those by the Asian Development Bank (2003), DFID and UNDP (2003), Oxfam and ActionAid (2009), and the World Bank (2009 and 2012)¹³. All these studies agree that the persistence of ethnic minority poverty has a complex set of causes. One of many possible typologies of those causes is the following:

- *Ethnic minorities have less access to education, higher dropout rates, and later school enrolment.* There is lack of ethnic minority teachers and bilingual education for ethnic minorities. School fees also represent a burden for ethnic minorities.
- *Ethnic minorities have less mobility, with Kinh migrant households enjoying better benefits from government programs and their social networks.*
- *Ethnic minorities have less access to formal financial services.*
- *Ethnic minorities have less productive land.* They are more dependent on swidden agriculture and have less off-farm employment.
- *Ethnic minorities have lower market access and poorer returns from markets.* While this varies among ethnic groups, ethnic minorities engage in trading activities less than the Kinh group.
- *Ethnic minorities are subject to stereotyping and misconceptions,* not just among Kinh households but even among ethnic minorities themselves, which can much hinder participation by ethnic minorities in their own development.

79. **Observed pathways out of poverty are similar to those for Kinh.** Work by the World Bank has examined the profiles of ethnic minorities who have been successful in moving out of poverty. The general finding of that work is that while ethnic minorities often face particular challenges, the observed pathways out of poverty are not substantially different than those for those from the Kinh majority. To escape poverty in these conditions, ethnic minorities first shift from semi-subsistence agriculture to a market orientation, then make efforts to maintain their cultural identity while building financial and social capital. This process involves moving to cash crop production, then intensifying agricultural production, and then moving to agricultural diversification and/or trading and services, and then investing in education for their children.

¹³ A comparative global study (Hall and Patrinos 2012) which includes Vietnam finds similar profiles of indigenous/ethnic minorities around the world.

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