COUNTRY ECONOMIC REVIEW

SOCIALIST REPUBLIC OF VIET NAM

November 2000

CURRENCY EQUIVALENTS
(as of 27 October 2000)

Currency Unit	–	Dong (D)
D1.00	=	$0.00007
$1.00	=	D14,352

ABBREVIATIONS

AFTA	–	ASEAN Free Trade Agreement
ASEAN	–	Association of Southeast Asian Nations
CPI	–	consumer price index
FCD	–	foreign currency deposit
FDI	–	foreign direct investment
GDP	–	gross domestic product
JSB	–	joint stock commercial bank
O&M	–	operation and maintenance
ODA	–	official development assistance
PER	–	Public Expenditure Review
SBV	–	State Bank of Viet Nam
SME	–	small and medium enterprise
SOCB	–	state-owned commercial bank
SOE	–	state-owned enterprise
VAT	–	value-added tax

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EXECUTIVE SUMMARY

The year 1999 witnessed a modest pickup in the performance of the economy of Vietnam. Gross Domestic Product (GDP) growth rose from 4.4 percent in 1998 to 4.7 percent in 1999. With domestic demand remaining sluggish, the major contribution to GDP growth came from export expansion. Investment as a share of GDP fell by almost 4 percentage points. Excepting for Government investment, the shares In GDP of all other subcategories of investment, i.e., foreign direct investment (FDI), State-owned enterprise (SOE) investment, and domestic private investment, shrank. The rise in government investment spending reflected the fiscal stimulus package that the Government introduced in mid-1999.

Good harvests boosted agricultural growth but sluggish domestic demand depressed activity in the rest of the economy in 1999. After a slowdown in 1998 due to drought, agricultural production picked up to 5.2 percent in 1999 with a bumper rice crop, as well as growth in the fisheries and livestock subsectors. The industry and construction sector registered a growth of 7.6 percent in 1999. The modest pickup in industrial growth reflected the strong performance of the mining and quarrying subsector led by higher crude oil production. Manufacturing growth, which had been the main driver of industrial sector expansion before the economic slowdown, decelerated further in 1999 due to sluggish domestic demand. The performance of the construction subsector improved marginally in 1999 after crashing to a -0.5 percent growth in 1998. The services sector performance deteriorated further from 3 percent in 1998 to 2.1 percent. The economic slowdown during 1998-1999 has resulted in an increase in unemployment from 6 percent in 1997 to 7.4 percent in 1999.

The actual fiscal deficit in 1999 (2.8 percent with onlending) was lower than the Government's earlier projections because of higher oil revenues and lower than budgeted expenditures, particularly capital expenditure and onlending. The share of revenue in GDP continued to fall, reflecting the declining share of tax revenues, particularly taxes on trade. As a result, nonwage current expenditure including social sector spending, and operation and maintenance (O&M) spending have been squeezed.

Monetary policy in 1999 was accommodative. Broad money grew by 39.3 percent, fueled by a rapid growth in foreign currency deposits (FCD). Domestic credit growth decelerated in 1999 due to (i) the cautious stance adopted by banks burdened with non-performing loans and undergoing restructuring, and (ii) lower demand for funds by SOEs in key industries that saw accumulating inventories. The State Bank of Viet Nam replaced the monthly ceiling rate on dong borrowings with a prime monthly rate of 0.75 percent, signaling a move toward market-determined interest rates. Despite the rapid growth in broad money, the inflation rate has been falling since the beginning of 1999. Underlying the falling price trend is the sharp decrease in food prices that has not been fully offset by higher non-food prices.

Viet Nam's overall balance of payments shifted into surplus in 1999 reaching $790 million. This development was mainly due to the current account, which moved from a deficit in 1998 (4.6 percent of GDP) to a surplus in 1999 (4.0 percent). The current account surplus reflected a strong surge in exports and continued import compression. Export growth picked up from a lackluster 2.4 percent in 1998 to 23.2 percent in 1999. Underpinning the strong export performance was the price-driven surge in the value of oil exports and fast-growing manufacturing exports led by garments and footwear. Volume effects dominated the higher export earnings of agricultural commodities. Import growth, which had plummeted in 1998 (-1.1 percent), picked up marginally to 1.1 percent in 1999. The weakness of imports for two successive years was due to sluggish domestic demand and falling investment that reduced the demand for imports of intermediate goods. The capital account, on the other hand, turned from a modest surplus in 1998 to a deficit in 1999, reflecting the slowdown in FDI and an outflow of short-term capital. FDI inflows, which were estimated to have declined to $1 billion in 1998, further declined to $961 million in 1999. The sizable current account surplus in 1999 helped raise gross international reserves to $2.9 billion or 12.5 weeks of imports.

Viet Nam's stock of medium- and long-term convertible currency debt at the end of 1999 was estimated at $10 billion equivalent to 35.6 percent of GDP, or 70.5 percent of exports of goods and nonfactor services. Total debt service as a percentage of exports of goods and services was 10.7 percent, of which service on public sector convertible debt amounted to 4.2 percent. In September 2000, Viet Nam secured a major write-down of its debt to Russia. Under the terms of the agreement, Viet Nam will repay $1.7 billion, 10 percent in cash, and 90 percent in goods, over 23 years. Viet Nam's external debt is assessed as sustainable over the medium and long term.

Since the adoption of the crawling peg in February 1999, the exchange rate has been relatively quiescent. Between February 1999 and June 2000, the nominal depreciation in the dong has been only 1.5 percent against the US dollar. Although the dong did not depreciate much in nominal terms over this period, with falling inflation, the real effective exchange rate (REER) depreciated by an estimated 6 percent. The REERs of Malaysia, Philippines, and Thailand however depreciated more steeply.

Structural reforms have been pursued with limited success, in large part because they have occurred in the context of slowdown in growth and falling investment. The Enterprise Law, which became effective on 1 January 2000, is intended to provide a strong basis for liberalizing private entry and unifying the legal framework for most enterprises. Since its passage, 5,000 new private companies have been registered of which over 1,000 are small and medium-size enterprises (SMEs). An overhaul of investment incentives designed to attract and facilitate FDI has yet to succeed in generating much international interest. The slowdown in FDI inflows is due to a variety of reasons including, inter alia, (i) the low starting base, (ii) the marked slowdown in disbursements from within the region following the crisis which has not been offset by increase in inflows from non-regional sources, and (iii) investors' perception that the cost of doing business in Viet Nam is high.

The US-Viet Nam Trade Agreement was signed on 13 July 2000. Until the signing of the agreement, Viet Nam was one of the few countries on which the US had imposed general tariffs that are generally much higher than the Normal Trading Status tariffs. According to a recent report, the agreement could almost double Viet Nam's annual exports to the US to $768 million over the next few years. Besides the direct trade effects, secondary effects are likely in terms of more FDI, technology transfer, and other business opportunities. Realizing the potential positive effects of the agreement, however, would depend on the Vietnamese exporters' ability to reduce costs, improve quality, and ensure stable supplies.

SOE and banking reform have moved slowly. Obstacles to speeding up the process of equitizing SOEs include (i) interenterprise debt, (ii) valuation of fixed assets, and (iii) the approach to dealing with labor redundancy. SOEs account for around 35 percent of the non-performing loans of the banking sector. Therefore, SOE reform is inextricably linked with banking reform. There has been some progress in restructuring joint-stock banks, but restructuring of State-owned commercial banks appears to be less advanced. The establishment of the National Development Assistance Fund (NDAF) effective 1 January 2000 is a step toward separating policy lending from commercial lending. The opening of the Ho Chi Minh City stock exchange in July 2000, is as yet an event of symbolic significance as only four local firms have officially registered to list on the bourse.

Viet Nam has made significant gains in poverty reduction. Comparative results of the 1993 and 1998 Viet Nam Living Standards Surveys show that the incidence of poverty, measured by the headcount index, dropped from 58.2 percent in 1992/93 to 37.4 percent in 1997/98. Poverty decomposition shows that poverty reduction between the period 1993-1998 was mainly the result of the strong growth rate rather than improved distribution. The data also show, however, that not all socio-economic groups have benefited to the same extent--agricultural workers, ethnic minorities, and those residing in poorer regions have progressed the least.

After two years of slowdown, the economy is showing signs of recovery. Real GDP grew by 6.2 percent in the first half of 2000 according to official estimates. GDP growth for the whole year is projected at 6.1 percent and for 2001 at 6.4 percent. Domestic demand is expected to pick up in 2000, supported by a modest recovery of investment. Agriculture is projected to grow by 3.6 percent for the whole year. Growth in the industrial sector is projected at 9.7 percent in 2000, assuming investment and imports continue to recover. Services sector growth is expected to improve to 4.4 percent.

The fiscal deficit is likely to widen to 3.2 percent in 2000 and further to 3.5 percent in 2001 as the costs of structural reforms weigh in. With the substantial monetary overhang resulting from rapid liquidity growth in 1999 and the first half of 2000, inflation is likely to pick up to 2.5 percent by the end of 2000 and rise to around 5 percent by the end of 2001.Exports, which continued to perform well in the first half of 2000, are projected to grow by 12.9 percent over the whole year while import growth is projected to recover to 17.3 percent. The current account surplus is likely to shrink to 2.3 percent in 2000. There are emerging sources of pressure on the dong that may require greater flexibility in exchange rate management.

The medium-term challenge lies in managing the transition from the dominance of the State sector in major spheres of economic activity to a more mature economic structure that relies on markets and incentives. To carry forward the gains in poverty reduction, both the pace and the quality of growth will be crucial. Indeed, to set in motion a virtuous cycle of growth and poverty reduction, it will be necessary to focus greater attention on linkages between economy/sector wide growth-oriented incentives, investments, and institutions on the one hand, and targeted interventions for the poor on the other.

The Government has announced a target annual GDP growth of at least 7 percent over the next few years. To achieve this objective, the investment rate will have to be raised above 30 percent. A significant proportion of increase will have to come from private investment. Private investment is linked to long-term development of the private sector. To finance the required magnitude of investment levels, it will be necessary to mobilize sufficient domestic resources, particularly private saving. This in turn will depend upon carrying forward banking sector reforms and developing long-term saving instruments. Key policy and performance indicators to watch include (i) stronger revenue mobilization effort, (ii) greater flexibility in exchange rate management, and (iii) progress on structural reforms in the SOE and financial sectors. With decisive action, Viet Nam can carve out a niche for itself in recovering Asia; without it, Viet Nam risks being left behind.

I. RECENT ECONOMIC DEVELOPMENTS

A. Growth, Employment, Saving, and Investment

1. Aggregate Growth

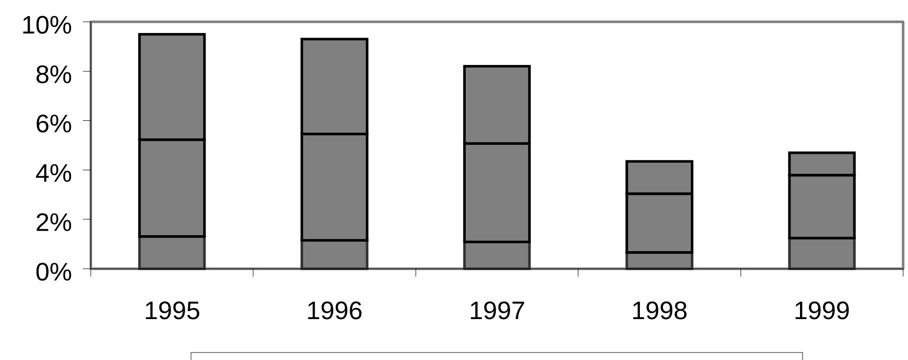
1. From 1992 to 1997, Viet Nam's gross domestic product (GDP) expanded at an annual average rate of 9 percent. In 1998, however, the growth rate decelerated to 4.4 percent (the official estimate is 5.8 percent), followed by a pickup to 4.7 percent in 1999 (Table 1). While Viet Nam's recent growth performance is well below the rates achieved in the high growth era, it compares favorably with the regional average for Southeast Asia (2.9 percent).[1] The modest recovery of growth in 1999 was led by net exports. Consumption spending was subdued and investment spending fell. On the supply side, in 1999, the agriculture sector performed well. However, the manufacturing and services sectors that had been the main drivers of rapid growth prior to 1997, slowed down in 1998 and decelerated further in 1999. The pace and direction of policy reforms in key areas such as the State enterprise and banking sectors have as yet to generate the momentum necessary to transform modest economic recovery to sustained high growth. Moreover, the impact of reforms has been limited because they have occurred in the context of two years of economic slowdown.

2. Sectoral Growth

a. Agriculture

2. Over the period 1993-1997, agriculture sector growth averaged 4 percent. Performance in 1998 (2.8 percent growth) was disappointing due to drought-affected low harvests. A bumper rice crop, as well as growth in fisheries and livestock in 1999, boosted agricultural growth to 5.2 percent. Its contribution to real GDP growth also increased markedly compared to the previous year (Figure 1). Agriculture's share in GDP declined from 26.2 percent of GDP in 1995 to 23.9 percent in 1999, but it still accounted for the largest share of employment (69 percent) and a significant share of exports (40 percent).

Figure 1: Sectoral Contribution to Real GDP Growth
(In percentage points of real GDP growth)



Source: General Statistical Office and staff estimates.

[1] Asian Development Bank (2000). *Asian Development Outlook 2000 Update.* Manila.

Table 1: Viet Nam: Gross Domestic Product, by Sector, in Constant Prices, 1995-1999

Economic Activity	1995	1996	1997	1998	1999
			Annual Percentage Change		
Agriculture, forestry, and fishery	4.8	4.4	4.3	2.8	5.2
Agriculture	4.3	4.6	5.0	2.7	5.5
Forestry	5.9	2.0	0.1	0.4	3.1
Fishery	8.2	4.1	1.0	4.3	3.8
Industry and Construction	13.6	14.5	12.6	7.3	7.6
Mining and quarrying	13.5	13.6	13.2	10.8	14.9
Manufacturing	13.5	13.6	12.8	9.2	7.4
Electricity, gas, and water supply	18.5	17.8	14.7	12.3	7.0
Construction	12.7	16.1	11.3	(0.5)	2.4
Services	9.8	8.8	7.1	3.0	2.1
Wholesale and retail trade	11.3	9.7	6.9	2.0	2.0
Hotels and restaurants	10.1	10.2	7.0	1.5	2.5
Transport, storage, and communication	9.7	7.4	8.9	1.0	4.6
Financial intermediation	14.2	11.4	4.3	2.0	3.4
Real estate services	6.6	6.2	7.1	2.0	4.8
State management	8.9	7.0	4.0	4.0	(5.5)
Education and training	7.3	8.0	7.1	6.8	2.3
Health and social work	9.1	7.0	4.0	6.5	4.0
Other services	8.9	10.2	12.5	7.7	1.9
Gross Domestic Product	9.5	9.3	8.2	4.4	4.7
			Percent of GDP		
Agriculture, forestry, and fishery	26.2	25.1	24.2	23.8	23.9
Agriculture	22.3	21.3	20.7	20.4	20.5
Forestry	1.2	1.1	1.1	1.0	1.0
Fishery	2.7	2.6	2.4	2.4	2.4
Industry and Construction	29.9	31.3	32.6	33.5	34.5
Mining and quarrying	5.3	5.5	5.8	6.1	6.7
Manufacturing	15.5	16.1	16.8	17.5	18.0
Electricity, gas, and water supply	1.7	1.9	2.0	2.1	2.2
Construction	7.5	7.9	8.2	7.8	7.6
Services	43.8	43.6	43.2	42.7	41.6
Wholesale and retail trade	17.2	17.2	17.0	16.7	16.2
Hotels and restaurants	3.4	3.5	3.4	3.3	3.3
Transport, storage, and communication	4.0	3.9	4.0	3.8	3.8
Financial intermediation	2.0	2.1	2.0	1.9	1.9
Real estate services	5.0	4.8	4.8	4.7	4.7
State management	3.6	3.5	3.4	3.4	3.1
Education and training	3.6	3.5	3.5	3.6	3.5
Health and social work	1.5	1.5	1.4	1.5	1.5
Other services	3.5	3.5	3.6	3.8	3.7
Gross Domestic Product	100.0	100.0	100.0	100.0	100.0

Source: 1999 General Statistical Office and staff estimates.

3. **Agricultural diversification.** The production structure of agriculture in Viet Nam is dominated by rice, which accounts for half the gross value of agricultural output. Rice production increased from 24.9 million tons in 1995 to an estimated 31.4 million tons in 1999, i.e. an increase of 26 percent. This reflects a combination of area and yield effects: the area under rice increased 13 percent during 1995-1999. The yield also increased, but at a declining rate. Falling world prices of rice since mid-1999 have pulled its domestic price down to the lowest level in a decade. The Government's response has been to instruct major exporters to stockpile rice.

4. While rice and other cereals remain the most important component of agricultural production, there has been some diversification to industrial crops in recent years. Their share in the gross value of agricultural production has gone up from 15.2 percent in 1995 to 16.9 percent in 1999. The area under perennial crops (including coffee, rubber, coconut, and tea) increased by 48.3 percent during 1995-1999, while the area under annual crops (including sugarcane) increased by 15 percent. Sugarcane, coffee, and rubber production recorded the fastest growth.

(i) Sugarcane production increased by an annual average of 19.6 percent during 1995-1999. However, yields were low and the cost of domestic processing was high. The subsector has been supported by indirect subsidization through local policies favoring conversion of land to sugarcane production. Many sugar refineries are located in areas where not enough sugar is being produced, resulting in underutilized capacity and higher transportation costs. Refined sugar is protected from cheaper imports through nontariff barriers. Despite such protection, many sugar companies are incurring losses. Recently, under Circular 81, the Government announced a 50 percent cut in the value-added tax (VAT) applied to loss-incurring sugar companies.

(ii) Coffee production more than doubled from 218,000 metric tons (t) in 1995 to 436,000 t in 1999. Viet Nam is the third largest coffee producer after Brazil and Colombia and the largest producer of robusta. Coffee is now Viet Nam's second highest agricultural export earner after rice, contributing around 6 percent of export revenues. A significant share of coffee production comes from independent households. Production increased after the allocation of land use rights to farmers. However, private sector participation in processing and marketing remains limited. Falling world prices of coffee in 1999 hurt coffee growers. Faced with a shortage of working capital and poor coffee preservation facilities, growers had little choice but to go to the market and accept low prices for their produce.

(iii) Rubber production increased 72 percent over the period 1995 to 1999, and accounts for the third largest share of Viet Nam's agricultural export earnings. Competition from Malaysian rubber exports has intensified with the depreciation of the ringgit.

The value of livestock production increased 27.2 percent over the period 1995 to 1999. However, its share in the gross value of agricultural production registered only a modest increase from 17.1 percent in 1995 to 17.3 percent in 1999. There has also been a slight decrease in the share of the forestry and fishery subsectors in the share of GDP during 1995-1999.

5. **Recent Reforms.** That progress, albeit limited, has been made towards agricultural diversification, is apparent. An important contributory factor has been the greater security in land access. Over the past two years, nearly 3 million farming families have received land use rights, which can, in principle, allow them to secure bank loans for investment and to lease and transfer plots. There is scope for further improving the functioning of land markets by easing restrictions on land use and extending the duration of land use rights. There has also been some liberalization in the inputs market. The Government recently lifted quotas and delicensed imported fertilizers that are cheaper than domestically produced fertilizers, thus benefiting poorer farmers.

6. **Future Directions.** Further progress in agricultural diversification depends on addressing existing constraints such as (i) overcoming farmers' lack of familiarity with modern production and marketing techniques through better agricultural extension and research both areas that are currently under-funded, (ii) reversing the deterioration in irrigation infrastructure through higher spending on operations and maintenance, and (iii) mobilizing rural saving and extending credit to rural enterprises based on sustainable interest rate structures.

b. Industry

7. **The Record Since 1993.** Industry's performance in the 1990s has been one of strong growth, followed by deceleration, and most recently, signs of recovery. During the strong growth phase (1993-97), the industry and construction sector (in constant prices) grew on average by 13.3 percent, and its share of GDP increased to 32.1 percent. Although industry accounts for more than one third of GDP, it accounts for only 12 percent of employment: Growth in industrial production was broad-based during this period. Then there was deceleration in 1998 and 1999, with the sector's (two year average) growth rate falling to 7.5 percent. During this time, except for mining which maintained its growth rate, the rate of expansion in the other subsectors slowed, with construction recording the steepest decline. The construction boom, which had been fueled by large projects, hotels, offices, and residential complexes, came to an abrupt halt as the regional crisis hit these activities. Within manufacturing, growth in gross value of production decelerated virtually across the board. Moreover, the fallout from the slump in construction activity could be seen in the fall in the production of construction materials including steel and cement.

8. **Performance of Selected Industrial State-owned Enterprises.** The performance of industrial State-owned enterprises (SOEs) deteriorated in 1998-1999 as many enterprises faced rising inventories, low financial reserves, and burdensome debt. The rate of growth of State sector industrial production, excluding oil and gas, recorded a negative growth (–0.1 percent) in 1999. The performance of the steel and cement subsectors in fact highlights the combined impact of shocks and structural weaknesses that have undermined industry's performance in the last two years. Steel stockpiles rose due to sluggish domestic demand, with Viet Nam Steel Corporation (VSC), which accounts for over a third of the domestic steel output, stockpiling 850,000 t. The problems faced by the domestic steel industry include cheap imports, high overhead costs due to obsolete technology, and in 1998-1999, a slump in the construction industry. Notwithstanding these problems, 14 projects with a total investment of $1.76 billion are planned for the subsector over the next five years. VSC is to give loans for development investments but will not form any new joint ventures—there are already 12 joint ventures under the umbrella of VSC.

9. The slump in construction also affected the domestic cement industry. Nearly 40,000 t of cement stocks accumulated in 1999 despite a ban on cement imports. To clear the stockpiles, the Government sought to reduce the ceiling price on cement, a move resisted by domestic producers who face high costs of production. Despite the oversupply of cement, the Viet Nam Cement Corporation plans to invest in 10 infrastructure projects with a combined capacity of 9.9 million t at an investment of $2.1 billion over 2000-2005. It hopes to find export markets in Cambodia and the People's Democratic Republic of Lao.

10. While growth in several industry subsectors contracted, the oil and gas subsector performed consistently. The Russian-backed VietSovPetro joint venture is the largest entity in the domestic oil and gas sector producing 82.2 percent of crude oil output. Petro Viet Nam is proposing to build a pipeline to bring gas from the Nam Con sea basin fields in partnership with the British American BP/Amoco, Norway's Statoil, and India's ONGC Videsh. Currently, Viet Nam imports all its refined oil products. However, preparatory work has begun for the $1.3 billion Dung Quat oil refinery project, Viet Nam's first oil refinery. The Russian-backed project should be able to refine around 6.5 million t of crude oil per year.

11. **Ownership Patterns.** The state subsector dominates industrial production although its share has been declining: from 50.3 percent of the total value of industrial production in 1995 to 43.5 percent in 1999. The involvement of SOEs in industry remains broad-based but they are particularly dominant in the capital-intensive industries, including oil and gas, electricity generation, metallurgy, and chemical products. SOEs are also a significant presence in electronic equipment, paper products, textiles, and printing.

12. The share of the domestic non-State sector also declined over 1995-1999 from 24.6 percent to 21.8 percent. Within the domestic non-State sector, households account for the largest share (14 percent) while the share of private enterprises remains stagnant at a mere 2.2 percent. Private registered companies are concentrated in garments and textiles, food and beverages, wood products, and leather products. The ratio of labor to fixed capital is significantly higher in the domestic non-State sector than in the industrial SOEs sector. The foreign-owned sector gained at the expense of the State and domestic non-State sectors. Its share of total value of industrial production increased from 25.1 percent in 1995 to 34.7 percent in 1999. Of industry's 12 percent share of employment, the State sector accounts for 3.1 percent, the domestic private sector for 6.9 percent, and the foreign-owned enterprise sector for 2 percent. Employment within private industry is dominated by household enterprises.

13. The Government has been promoting industrial zones (IZs), export processing zones (EPZs), and industrial parks as the means to fast-track industrial growth. Viet Nam now has 63 IZs, 3 EPZs, and one "hi-tech" park. Of the IZs and EPZs, 53 are run by domestic companies, while 14 are backed by foreign property developers. Domestic-owned IZs have received preferential loans for their construction. The impact of IZs and EPZs on industrial growth has so far been limited because of slow progress in infrastructure development. Only 12 IZs have managed to rent out over 50 percent of their area. Moreover, the contribution of IZs and EPZs to production is not geographically dispersed. IZs and EPZs in the south accounted for 90 percent of production and 91 percent of export turnover by IZs/EPZs in the country.

14. **Recent Reforms.** Recognizing the need to improve the business environment, the Government has been taking steps to strengthen the legal and regulatory framework. The new Enterprise Law, which came into effect on 1 January 2000, is intended to provide a strong basis for liberalizing private entry and unifying the legal framework for most enterprises. Since its passage, 5,000 new private companies have been registered, of which small and medium

enterprises (SMEs) number over 1,000. Most of the new enterprises are involved in industrial production. However, implementation of the law has not been easy. Business registration offices established by provincial and district committees do not have the capacity to cope with the large number of applicants. Also, the abrupt elimination of requirements for certain types of business permits led to problems and a recognition of the need for more careful assessment of the types of licenses that should be eliminated/retained.

15. SOE reform has progressed, but at a slower than targeted pace. The main driver of the Government's SOE reform process is its equitization program, which commenced in 1993. Of the 451 enterprises equitized so far, 80 percent have majority private ownership. A Restructuring Assistance Fund has been established to finance, among others, severance payments to redundant workers.

16. **Future Directions.** Prospective industrial policy is likely to continue to be based on the dominance of State enterprises, particularly in "strategic activities" while cautiously moving towards opening up the rest of the economy to domestic private firms and foreign-invested enterprises. Official policy statements have emphasized the importance of enhancing the competitiveness of domestic production. To pursue this strategy effectively, it is imperative that decisive action be taken toward fostering more efficient ownership of enterprises through deepening SOE reform and private sector development. It is also necessary to create a favorable investment climate that allows subsectors where Viet Nam has a comparative advantage to realize their full potential, particularly subsectors/products that are labor-intensive and that rely on agricultural resources.

c. Services

17. The services sector is the largest contributor to the Vietnamese economy, accounting for 41 percent of the GDP. Until recently, the dynamism of the services sector was a key factor in Viet Nam's growth performance. During 1994-1997, the services sector grew at an average rate of 8.8 percent. Employment growth in the services sector (5.6 percent) over this period outstripped that in agriculture (0.4 percent) and industry and construction (4.0 percent). As a result, while the share of agriculture in employment went down and that of industry remained roughly constant, that of the services sector increased. In 1998, the service sector's growth decelerated to 3.0 percent and the momentum in job creation slowed. The sector's disappointing performance (2.1 percent real growth) continued to exert a drag on the overall growth of the economy in 1999.

18. The services sector in Viet Nam is diverse, ranging from self-employment in microenterprises such as street food vending, small-scale trade, and transport (cyclos), to employment in the burgeoning number of luxury hotels. During the high growth period, fast-growing segments in the services sector included wholesale and retail trade, real estate services, financial intermediation services, and tourism-related activities such as hotels and restaurants. Foreign direct investment (FDI) inflows fueled growth in the real estate business, particularly office and apartments, and also tourism-related activities such as hotels and restaurants. These subsectors were hard hit by the regional crisis.

3. Employment and Wages

19. **Unemployment.** The effects of the economic slowdown in 1998 and 1999 were evident in the labor market. The urban unemployment rate rose from 6 percent in 1997 to 6.9 percent in 1998 and further to 7.4 percent in 1999. Layoffs by SOEs, the slowdown in construction, and

the negative growth in the services sector, hitherto the main labor-absorbing sector--were among the reasons for the rising unemployment rate. The proportion of migrants, many of them unregistered, who were unable to find work in the cities, is likely to have been much higher. Underemployment is pervasive in rural areas. It is estimated that on average, workers in rural areas were working to only about 70 percent of their potential.

20. **Structure of the Labor Market.** According to official estimates, 38.5 million people or 50.5 percent of the population were employed in 1999 (Table 2). Around 80 percent of the active labor force was self-employed, of whom over 60 percent were self-employed farmers. Household non-farm employment has grown quite rapidly (5.4 percent over the period 1993-1998) but household farm employment hardly risen (0.4 percent).[2] Wage employment, which grew by 3.5 percent per annum during 1993-1998, still accounted for only 20 percent of total employment. The State sector accounted for 40 percent of wage employment and 8.7 percent of total employment. State sector employment grew at an average annual rate of 3.7 percent over the period 1995 to 1998, declining slightly in 1999 (-0.4 percent). Non-State sector employment grew at annual average rate of 2.7 percent over the period 1995 to 1999.

Table 2: Employment by Sector

	Employment % of total		**Wage Employment** % of total	
Sector	**1995**	**1999**	**1992-93**	**1997-98**
Agriculture, fisheries and forestry	69.7	69.0	27.0	17.6
State	0.8	0.6		
Non-state	68.9	68.4		
Industry and construction	13.3	12.0	37.7	39.7
State	3.0	3.1		
Non-state	10.3	8.9		
Services	17.0	19.0	35.3	42.7
State	5.0	5.0		
Non-state	12.0	14.0		
Memo:				
Total employment as % of population	47.9	50.5		
Total wage employment as % of total employment			19.6	20.1

Source: General Statistical Office, Viet Nam Living Standards Survey 1992-1993/1997-1998.

21. **Government policies.** The National Program for Employment Generation established in 1992, has largely functioned as a safety net aiming to alleviate the negative impacts of SOE restructuring. It aims to directly promote employment opportunities through providing severance payments, subsidized credit, and training in new skills. However the program's annual budget is too small to make a dent on the rising unemployment figures.[3]

22. The official minimum wage rate is D144,000 per month ($10). The minimum wage for State employees, which had not been adjusted since 1993, has been raised by 2.5 percent with effect from 1 January 2000. The Government has been concerned about wage differentials for local staff working in foreign-owned enterprises, particularly about the salary gaps between

[2] World Bank estimates based on Viet Nam Living Standards Survey 1992-1993 and 1997-1998.

[3] *Viet Nam: Attacking Poverty.* Viet Nam Development Report 2000. Joint Report of the Government of Viet Nam-Donor-NGO Poverty Working Group. Hanoi.

Vietnamese and foreign employees who hold similar positions. The mandatory requirement of dollar-denominated wage for local staff, which had been a long-standing demand of foreign enterprises, has been eliminated. The Government is encouraging workers to seek overseas employment and has issued regulations to prevent exploitation of Vietnamese overseas workers by employment agencies.

23. Labor market outcomes can improve if domestic private investment, which has demonstrable job-creation potential, is encouraged. This requires an environment that is conducive to private sector development. Also, as Viet Nam lowers its trade barriers, job losses in inefficient industries may become inevitable. Delaying workers' move to more efficient industries, or hindering the development of new productive enterprises, would run counter to the Government's objective of creating new job opportunities. The vast majority of Viet Nam's poor live in rural areas. Hence, policies aimed at reducing the vulnerability and raising the productivity of rural workers will have a strong, positive impact on labor market outcomes.

4. Composition of Demand, Investment, and Saving

a. Composition of Demand

24. Private consumption and FDI were the main drivers of real GDP growth for much of the 1990s (Table 3). The private consumption boom ended in 1997 due to (i) lower consumer confidence, and (ii) weak performance of enterprises which limited the paychecks of employees and thereby affected their purchasing power. The contribution of investment to GDP growth has fallen even more dramatically than private consumption, led by a sharp drop in the contribution of FDI inflows. On the other hand, the contribution of net exports which had, in earlier years, been negative, increased sharply in 1999. The sizable contribution of the external sector in 1999 is due both to strong exports and compressed imports.

Table 3: Contribution to Real GDP Growth
(percentage points of real GDP growth)

Item	1995	1996	1997	1998	1999
Private Consumption	5.4	6.6	4.3	3.7	1.0
Gross Capital Formation	4.3	3.9	2.7	(2.7)	(3.1)
of which FDI	9.0	0.1	1.6	(2.7)	(2.0)
Net Exports	(0.6)	(1.2)	1.1	1.8	7.5

Source: Staff estimates.

b. Investment

25. A breakdown of investment into constituent components shows that in 1999, all categories of investment, except government investment, contracted (Table 4). The rise in government investment spending reflected the fiscal stimulus package introduced by the Government in mid-1999 to stimulate growth.

26. The declining contribution of the other investment components reflected a number of inter-related factors: (i) the slowdown in FDI inflows, triggered by the regional crisis and due to

investors' persisting reservations about the high cost of doing business in Viet Nam; (ii) over-investment in certain sectors such as real estate in previous years; (iii) compressed imports of capital goods and industrial raw materials, in part due to import restrictions; and (iv) unwillingness of banks to lend to enterprises because of rising non-performing loans (NPLs) and ongoing bank restructuring.

Table 4: Investment Shares, 1995-1999
(percent of GDP)

Item	1995	1996	1997	1998	1999
State sector	10.4	12.7	13.6	14.5	12.7
Government	6.6	8.8	7.1	7.8	8.4
SOE investment	3.8	3.9	6.5	6.7	4.3
Domestic non-state investment	8.0	7.4	5.8	5.4	4.0
Foreign investment	8.8	8.0	8.9	3.9	3.4
Total	**27.1**	**28.1**	**28.3**	**23.8**	**20.1**

Source: General Statistical Office and staff estimates.

27. Of concern is the declining share of private investment in GDP during 1995-1999. If this trend continues, it could slow potential growth of the economy. The reduction in the share of private investment seems to reflect several inter-related factors. First, the domestic private corporate sector in Viet Nam is very small, in part, because very few private firms grow to become medium and larger scale enterprises and private investment is thereby retarded.[4] This factor is in turn caused by the uneven playing field between SOEs and private enterprises. For example, the private sector is faced with constraints in meeting its requirements for medium- to long-term bank financing for investment. Unlike State enterprises, private enterprises are faced with stringent collateral requirements for obtaining medium term financing. The effect is to crowd out private investment. This is underscored by the fact that around 85 percent of the outstanding medium- and long-term loans of the Viet Nam Bank for Agricultural and Rural Development was given to SOEs and only 15 percent to non-SOEs.[5] Again, only 27.8 percent of the preferential loans provided by the National Development Support Fund has gone to the private sector. The rest have gone to the State sector.

28. Second, SOEs and government service agencies dominate all sectors of infrastructure in Viet Nam. However, their performance has not been up to the mark either in terms of physical or financial performance indicators.[6] Government forecasts indicate that to meet the country's infrastructure needs, investment of the order of 12 percent of GDP is required in the next three years. The Government's own investment in infrastructure is unlikely to exceed 3 percent of GDP while official development assistance (ODA) is unlikely to provide more than 2 percent of GDP. This means that the private sector, i.e. the foreign and domestic private sector, will have to fill the gap. Private sector participation in infrastructure investment would however need to be within a framework of public-private partnership appropriate to Viet Nam.

4 Programs Department West. (2000). *Viet Nam, Macroeconomic Policies, and Poverty.* Manila: Asian Development Bank.

5 Agriculture Department West (2000). *Viet Nam: Agriculture Sector Program Loan.* Manila: Asian Development Bank.

6 World Bank 1999. *Viet Nam. Private Solutions for Infrastructure: Opportunities for Viet Nam.* Country Framework Report on Private Participation in Infrastructure. Washington, D.C.

29. Third, available investment incentives are perhaps not attractive enough. For example, the Law on Encouraging Domestic Investment is restricted to providing incentives for new enterprises (Circular 146/1999TT-BTC), not to new projects of already established firms. Moreover, although the general business environment is improving, investment incentives have evoked limited response from private investors because the risk associated with capital investment projects remains high.

c. Saving

30. National saving rose from 13.6 percent of GDP in 1995 to 24.1 percent in 1999. Trends in the financing of domestic investment have been somewhat uneven over the last 5 years. In 1995, the financing was split more or less evenly between national saving and foreign saving. In 1996 and 1997, the national saving rate rose (Table 5) faster than the investment rate. Thus, financing the higher investment rate involved some substitution of national saving for foreign saving. In 1998, saving fell but investment fell even more. In 1999, the saving rate rose again.

31. Given the paucity of reliable information on trends in private savings and retained earnings by enterprises, only a partial explanation of saving behavior is possible. The increase in inward remittances and government saving have contributed to an increase in national saving.[7] It is estimated that about a quarter of private savings are outside the formal financial system.

Table 5: Investment and Saving
(percent of GDP)

Item	1995	1996	1997	1998	1999
Gross Domestic Investment	27.1	28.1	28.3	23.8	20.1
Gross National Saving	13.6	17.6	21.4	19.2	24.1
Saving-Investment Gap	**(13.5)**	**(10.5)**	**(6.9)**	**(4.6)**	**4.0**

Source: Staff estimates.

32. A key challenge facing policymakers is mobilizing sufficient domestic resources to finance investment levels that are consistent with the Government's growth targets and limiting recourse to foreign borrowing. Moreover, development of SMEs that are essential for job creation, depends upon raising the saving rate and allocating it through efficient resource transfer mechanisms. It is unlikely that Government saving and retained earnings by SOEs will increase significantly. Therefore, the burden of financing the higher level of investment required to meet growth objectives will fall on private saving.

33. While private saving may be expected to increase gradually over time with rising incomes and financial deepening, the rate of increase may not be sufficient to achieve growth

[7] Government saving, defined as revenue and grants less current expenditure averaged 5 percent of GDP over the last few years. The increase in government saving reflects the compression of current expenditure and not higher revenue mobilization. Official estimates of retained earnings by SOEs is unavailable. Unofficial estimates indicate that they are of the order of 4-5 percent of GDP. On this basis, public saving is estimated at 9-10 percent of GDP.

targets. There could be direct (e.g. special tax incentives, interest rates) and indirect approaches to raising private saving. Based on cross-country studies, there is little evidence that the former approach has been effective--the number of income tax payees in Viet Nam is very small and the responsiveness of private saving to higher interest rates on dong deposit seems to be low. Indirect approaches based on financial liberalization particularly the development of long-term saving instruments such as pensions, life insurance, and mutual funds are likely to be more effective. Incentives for raising saving need to be provided, inter alia, through lending-linked deposits, reduction in transactions costs for potential savers through branch expansion. It is also important to create a conducive institutional environment for small savers through better supervision of banks and deposit insurance.

B. Fiscal Developments

34. Underlying Viet Nam's moderate fiscal deficits in recent years are falling shares of revenue, with the brunt of fiscal adjustment borne by cuts in non-wage current expenditure. These trends are of concern because unless they are arrested and reversed, there is likely to be a fallout in terms of inadequate productive expenditures, loss in efficiency, and growth. Equally important, to the extent that public spending that benefits the poor could be affected by falling revenue shares, preserving and carrying forward the process of poverty reduction could be rendered more difficult.

35. The declining trend in revenue shares continued into 1999 with the revenue-to-GDP ratio falling from 19.9 percent in 1998 to 18.3 percent in 1999 (Table 6). Moreover, the fiscal stance was eased to stimulate demand. Consequently, the deficit widened from 2.6 percent of GDP in 1998 to 2.8 percent in 1999. As in the past, the deficit was financed without recourse to bank financing. Further, it was financed entirely from external sources. The actual deficit was lower than the Government's earlier projections because of higher oil revenues and lower than budgeted capital expenditure and onlending. Recent developments in major components of revenue and expenditure are discussed below.

1. Revenue Developments

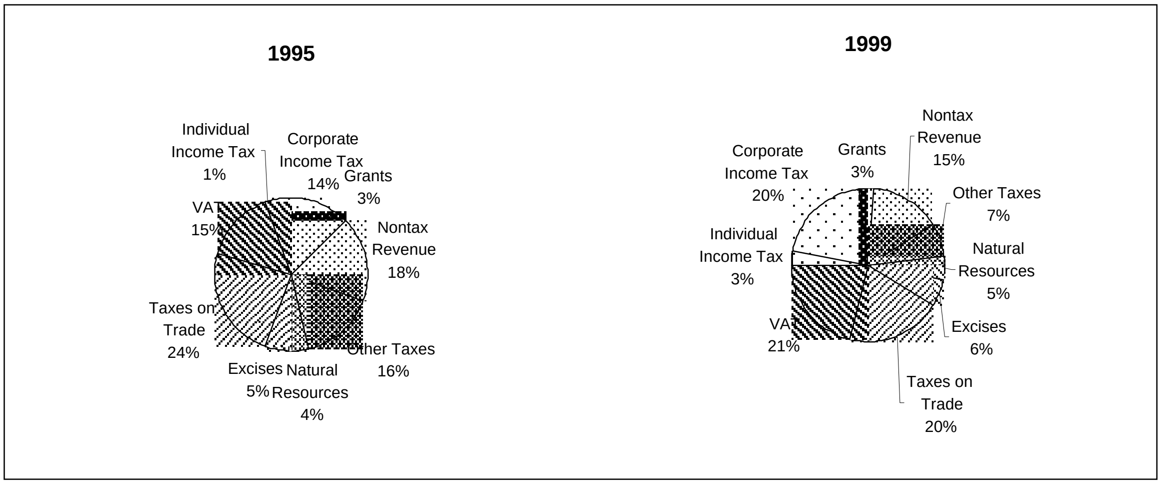
36. The changing structure of government revenues is presented in Figure 2. The share of tax revenues in total revenues (including grants) has gone up from 79.4 percent in 1995 to 83.3 percent in 1999, while the share of nontax revenues in total revenue has fallen. However, tax revenues as a share of GDP have been on a declining trend, falling from 18.5 percent in 1995 to 15.4 percent in 1999.

37. Three taxes (taxes on trade, corporate income tax, and value-added tax [VAT]) account for the bulk of total tax revenue (Table 6). Of these, the falling share of trade taxes have been a major contributory factor to the declining share of revenue. Their share fell steadily from 5.8 percent of GDP in 1995 to 3.7 percent in 1999. Foreign exchange and other import restrictions leading to lower imports, and therefore to lower import tax collections, have contributed to the decline. Tariff reductions have also been a factor. Collections from trade taxes are likely to decline further as Viet Nam implements its program of tariff reduction under the ASEAN Free Trade Agreement (AFTA).

38. Collections from corporate income tax, which had increased from 3.2 percent to 3.7 percent of GDP in 1998, declined slightly to 3.6 percent in 1999. The decline in the share of corporate tax revenue in 1999 was due to the weak performance of state enterprises, the more difficult environment faced by the private sector in the wake of the Asian crisis, and the slump in

domestic demand. As the economic recovery gains momentum, revenue performance from this source should increase. However, the full picture in regard to costs of SOE reform, particularly resolution of SOE debt problems, is still not clear. There is thus an element of uncertainty about the contribution to revenue-GDP ratios from this source.

Figure 2: Composition of Government Revenues



Source: Ministry of Finance

39. The standard rate for the enterprise income tax other than the oil sector, foreign enterprises, and joint ventures, is 32 percent; for the oil sector, it is 50 percent; for foreign investors and joint ventures, the standard rate is 25 percent. A number of tax incentives are being considered to attract FDI into oil and gas, including a reduction in the applicable tax rate from 50 percent to 32 percent, reduction in the level of tax imposed on natural resources, and the removal of export tariffs from oil and gas exports that have had natural resources tax already imposed on them. The tax system allows for exemption or reduced rates for certain types of investment projects, including afforestation, infrastructure, and export production. In addition, joint ventures and foreign enterprises that meet certain sectoral and geographical criteria are eligible for tax holidays. The criteria include projects in rural areas, infrastructure projects in mountainous or remote areas, and enterprises in IZs and EPZs. Cross-country studies do not indicate that the benefits of such tax incentives justify the associated revenue, administrative, and efficiency costs. Moreover, tax incentives may be less important in making the investment decision than assessments of the general business environment.

40. The share of VAT (formerly the turnover tax) increased from 3.4 percent of GDP to 3.8 percent in 1997, falling to 3.3 percent in 1998, before rising again to 3.8 percent in 1999. The standard rate is 10 percent. Following the introduction of VAT on 1 January 1999, a number of measures were issued, the most important of which was Decree 78/1999 effective 1 September 1999. The decree reduced tax rates by 50 percent—from 10 percent to 5 percent—for specific categories of goods and services: (i) provision of essential goods and services attracts a lower rate of 5 percent; (ii) tax reduction of 50 percent is permissible on machinery and engines; and (iii) VAT is not levied on exports. The decree also expanded the scope of deemed input VAT credits. The contribution of VAT to revenue can be further improved with the withdrawal of exemptions and discretionary reductions in rates that have been allowed in the administration of the VAT. The Government has indicated that further reforms to the VAT by end-2000 are under

Table 6: Government Finance

Item	1995	1996	1997	1998	1999
			Percent of GDP		
Total Revenue and Grants	23.3	22.9	20.9	20.5	18.8
Total Revenue	22.6	22.4	20.0	19.9	18.3
Tax Revenue	18.5	19.0	16.9	16.6	15.4
Nontax Revenue	4.1	3.3	3.1	3.3	2.9
Grants	0.7	0.6	0.8	0.6	0.5
Total Expenditure and Onlending	24.1	23.7	24.8	22.5	21.2
Current Expenditure	18.6	17.4	16.4	15.2	13.3
Capital Expenditure and Onlending	5.5	6.3	8.4	7.3	7.9
Overall Fiscal Deficit (cash basis) [a]					
Incl. onlending	(1.4)	(1.3)	(4.8)	(2.6)	(2.8)
Excl. onlending	(1.2)	(0.8)	(2.6)	(1.1)	(1.4)
			Percent of Tax Revenue		
Income Tax					
Corporate	17.5	18.5	21.8	22.2	22.6
Individual	1.2	2.7	2.8	3.1	3.0
Value-Added Tax (VAT)	18.4	19.5	22.2	20.0	24.3
Excises	5.9	6.2	8.7	9.5	7.1
Taxes on Trade	31.4	29.2	25.4	25.3	23.4
Other Taxes	25.7	23.9	19.0	20.0	18.0
			Percent of Expenditure		
Total Current Expenditure (cash basis)	77.1	73.6	66.1	67.6	62.6
General Administrative Services	10.3	10.0	9.1	8.4	7.0
Economic Services	7.3	6.5	5.8	6.0	6.2
Social Services	33.0	31.6	30.5	30.4	30.4
Education	8.5	8.6	9.3	9.6	9.6
Health	4.4	4.4	3.9	3.9	3.7
Social Subsidies	13.4	12.8	11.9	10.8	10.9
Other	6.9	6.1	5.5	6.2	6.2
Other Noninterest Expenditures	21.2	21.3	18.0	20.2	16.2
Interest Payments (paid)	5.3	4.2	2.4	2.6	3.0
Capital Spending and Onlending	22.9	26.6	34.0	32.3	37.4
of which onlending	0.9	2.2	8.9	6.7	6.8

[a] Excluding grants.
Source: Ministry of Finance and IMF.

consideration, which would reduce the number of rates, expand the scope of self-assessment, and simplify documentary requirements.[8]

41. The share of nontax revenues in GDP fell from 4.1 percent of GDP in 1995 to 2.9 percent in 1999 (Table 6). The main contributors to nontax revenues are fees and charges on government services and net profit after tax of enterprises. The declining trend in nontax revenues could be because (i) Central Government fees and user charges that account for a significant portion of non-tax revenues are increased only occasionally, and (ii) profitability of enterprises has weakened in recent years.

2. Expenditure Developments

42. The expenditure-to-GDP ratio fell from 24.1 percent of GDP in 1995 to 21.2 percent in 1999. There has been a shift in expenditure from the current to the capital side over this period. The share of current expenditure fell from 18.6 percent of GDP in 1995 to 13.3 percent in 1999, while the share of capital expenditure increased from 5.5 percent of GDP in 1995 to 7.9 percent in 1999. Within current spending, wages and salaries were on average slightly higher in 1999, indicating that it is the nonwage current expenditure items that are getting squeezed as a result of falling revenue shares.

43. Current spending on social services declined from 8.0 percent of GDP in 1995 to 6.4 percent in 1999. Within this category, the largest expenditure was on social subsidies followed by education and health. The share of social subsidies fell during 1995-1999. A significant number of social safety net programs are however off-budget. The share of current spending on health also fell during 1995-1999. The recent Public Expenditure Review[9] (PER) has noted that per capita spending on public health is less than one-half of the $12 recommended by the World Development Report 1993[10] as being needed to finance an essential package of health services. The share of current spending on education to GDP has remained about the same. The PER has recommended that given Viet Nam's already low level of salary and non-salary expenditures on education, public spending on education needs to be not only protected but increased as a share of GDP.

44. Spending on economic services (including agriculture, industry, and transportation) has declined during 1995-1999. The extent to which spending on operation and maintenance (O&M) was protected is not known because the budget does not present data on this item. However, the PER reported underfunding of the O&M budget in the transport and irrigation subsectors, and recommended that the imbalance between recurrent and capital spending in these sectors be redressed. Scheduled interest payments have remained under 5 percent of total expenditure since 1996.

45. Capital spending, mainly on rural projects to stimulate demand, increased in 1999 though not to the extent anticipated. The shortfall in capital spending reflected overly optimistic assessments of project implementation capacity. The five-year public investment program (PIP) for 1996-2000 was adjusted downward in a midperiod review. This implied a 15 percent cut in projected investment in agriculture, education, transportation, and health. Officials attributed the need for downward adjustment to capital shortage. To improve the PIP process, the

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8 International Monetary Fund (2000). *Vietnam—Staff Report for the 2000 Article IV Consultation.* Asia Pacific Department. Washington, DC.

9 Joint Report of the Government of Viet Nam-Donor Working Group on Public Expenditure Review (June 2000). *Viet Nam: Public Expenditure Review.* Hanoi.

10 World Bank (1993). World Development Report 1993. *Investing in Health.* Washington, DC.

Government is considering operating the PIP as a rolling expenditure plan, updated each year to reflect both past events and changes in future estimates.

46. **Issues in Fiscal Policy.** An overall assessment of fiscal developments would indicate that falling revenue-to-GDP ratios have squeezed nonwage current expenditure, including social spending and other productive expenditures such as O&M. It is imperative that deficits be contained primarily through increased revenues rather than reduced expenditures. Over the medium-term, the Government plans to raise revenue collections by broadening the tax base, removing discretionary exemptions and rates, and further strengthening tax administration. On the expenditure side, there is a need to protect expenditure on physical and human capital development to enhance efficiency, competitiveness, and poverty-reducing growth.

C. Monetary Developments and Prices

1. Monetary Developments

a. Monetary Growth

47. Broad money grew rapidly (39.3 percent) in 1999. The major counterpart of the increase was the accelerated growth in net foreign assets (NFA) (Figure 3).. The expansion in NFA stemmed from the balance of payments surplus. Net domestic asset (NDA) expansion slowed in 1999 with the deceleration in credit growth.

48. Regarding the components of broad money, foreign currency deposits (FCD) rose sharply in 1999, registering an annual percentage change of 54.4 percent (Table 7), while growth in dong deposits decelerated from 36 percent in 1998 to 24.4 percent in 1999. These trends reflect a portfolio reallocation from dong deposits to FCD consequent upon higher rates on US dollar deposits relative to rates on dong deposits. Other contributory factors include liberalization of regulations on inward remittances and on opening FCDs, and the perception that FCDs are a form of insurance against exchange rate uncertainty. The money multiplier went down owing to an increase in the currency-deposit ratio, perhaps due to falling dong deposit rates.

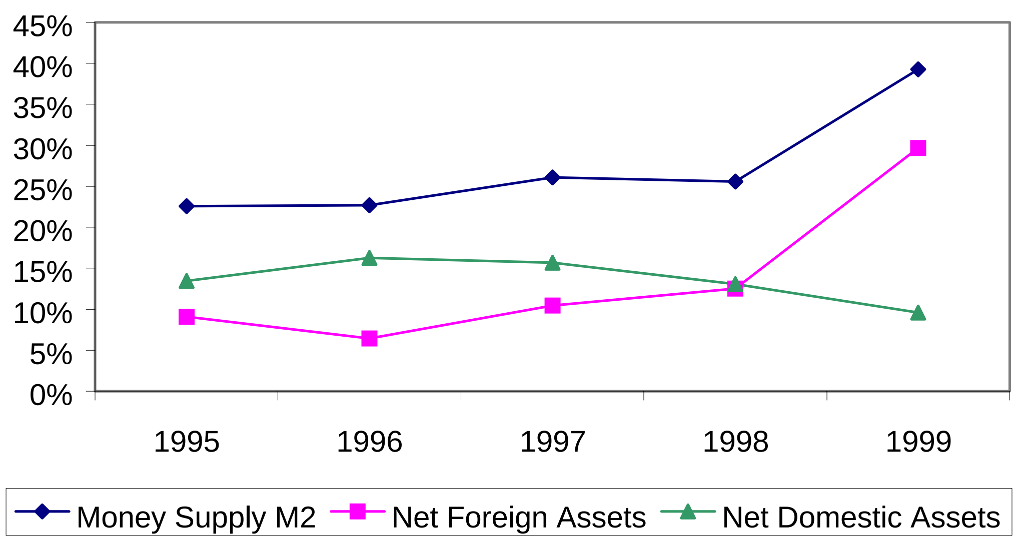
49. **Credit.** The deceleration in overall credit growthfrom 21.4 percent in 1998 to 10.5 percent in 1999 reflected the weak demand for funds for fixed investment in industry and construction enterprises. It also reflected the unwillingness of banks, burdened with rising NPLs and facing prospects of restructuring, to lend to distressed SOEs. Compared with that in previous years, credit to the SOEs was more restricted in 1999, while credit to the smaller non-State sector grew faster. Nevertheless, directed lending by State-owned commercial banks (SOCBs), particularly to SOEs, is still quite significant. Net credit to the Government fell in 1999. In fact, the Government sector repaid the banking system on a net basis in 1999.

50. The share of dong loans in total credit to the economy increased from 73.9 percent in 1998 to 79.1 percent in 1999, with a commensurate decline in the share of foreign currency loans. The imbalance between FCD growth and foreign currency loans was accentuated by the current practice of many Vietnamese banks of depositing their foreign currency funds with foreign banks.

b. Monetary Instruments

51. The monetary policy instruments used by the State Bank of Viet Nam (SBV) include (i) the interest rate, (ii) the discount rate, (iii) reserve requirements, and (iv) auctions of T-bills and T-bonds.

Figure 3: Contribution to Broad Money Growth, 1995-1999



Source: State Bank of Viet Nam.

52. **Interest Rates.** Interest rate policies in Viet Nam are gradually being liberalized. Individual banks have been permitted to determine their dong deposit rates since 1996. Demand deposit rates declined from 5.5 percent in the first quarter of 1999 to 1.7 percent by the end of the year, while three-month deposit rates declined from 9.4 percent to 4.0 percent. Generally, deposit rates offered by joint-stock commercial banks (JSBs) were higher than those of SOCBs. Also, US dollar deposit rates were more stable than the dong deposit rates.

53. The lending rate ceiling was gradually reduced over 1999 to stimulate credit growth and demand. Notwithstanding the cuts in interest rates, the falling consumer price index (CPI) implied, on an ex-post basis, some passive tightening of monetary conditions through increases in the real interest rates. In August 2000, the SBV replaced the monthly ceiling rate on Vietnamese dong borrowings with a prime monthly rate of 0.75 percent. The interest rate can now be adjusted within a trading band of 0.3 percent for short-term loans and 0.5 percent for medium- and long-term loans. The new policy is intended to move closer to market-determined interest rates.[11] Also, the ceiling interest rates for foreign currency lending was replaced with an interest rate based on Singapore's inter-bank market, with a trading band between 1 percent and 2.5 percent a year. The Government's intention is to enable the interest rate on foreign currency loans in Viet Nam to match the regional common rate and thus attract more foreign capital to Viet Nam.

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[11] SBV will set a ceiling level in the trading band but not a floor level. The SBV will use the lending interest rates that nine selected commercial banks apply to their "best" clients. After observing these banks' weekly information on interest rates, the SBV will announce the prime interest rate every month.

Table 7: Monetary Survey [a]

Item	1995	1996	1997	1998	1999
	Annual Percentage Change				
Net Foreign Assets	56.3	31.3	47.9	48.6	97.8
Net Domestic Assets	16.1	20.5	20.2	17.7	13.7
Domestic Credit	23.8	17.6	20.8	21.4	10.5
Government, net	1.8	(5.5)	0.0	90.9	(65.5)
State Enterprises	17.5	11.3	15.7	22.9	9.7
Non-State Sectors	41.8	31.7	30.3	10.2	29.8
Other Items, net	173.4	(5.8)	26.5	58.1	(13.3)
Money Supply (M2)	22.6	22.7	26.1	25.6	39.3
Dong Liquidity	24.3	23.7	22.1	24.6	34.4
Currency in Circulation	3.1	18.1	11.1	7.6	53.7
Deposits	50.9	28.4	30.8	36.0	24.3
Foreign Currency Deposits	16.8	18.9	41.7	28.9	54.4
	Contributions to Growth of Broad Money				
Net Foreign Assets	9.1	6.5	10.4	12.5	29.7
Net Domestic Assets	13.5	16.3	15.7	13.1	9.6
Domestic Credit	21.1	15.7	17.8	17.4	8.3
Government, net	0.2	(0.5)	0.0	4.9	(5.3)
State Enterprises	8.3	5.2	6.4	8.7	3.6
Non-State Sectors	12.5	11.0	11.4	3.9	10.1
Other Items, net	(7.7)	0.6	(2.1)	(4.4)	1.3
Money Supply (M2)	22.6	22.7	26.1	25.6	39.3
Dong Liquidity	18.9	18.7	17.5	19.0	26.5
Currency in Circulation	1.3	6.6	3.8	2.3	14.2
Deposits	17.6	12.1	13.7	16.7	12.2
Foreign Currency Deposits	3.6	4.0	8.6	6.6	12.8

[a] Based on the monetary survey of four State-owned commercial banks and 24 non-State-owned banks.
Sources: State Bank of Viet Nam and staff estimates.

54. SBV also conducted discount operations in 1999 to help deposit banks meet their working capital requirements. The discount rate on short-term commercial papers was set at 0.45 percent per month. Normally, the discount rate should be set above the deposit rates and the inter-bank rate to ensure discipline in liquidity management and to preserve the incentive of member banks to mobilize savings and to use the inter-bank market. The discount rate has generally been above the deposit rate.

55. **Required Reserves.** Under the regulation on required reserves,[12] bankers and creditors are required to maintain reserves equal to the balance of daily average mobilized deposits multiplied by a reserve requirement ratio (RRR) periodically stipulated by the SBV. In 1999, the SBV reduced the RRR to stimulate credit, reduce operational costs, and improve the profitability of credit institutions. The reduction was from 7 percent to 5 percent for SOCBs, urban joint-stock commercial banks, foreign banks' branches, joint-venture banks, and finance companies on deposits with maturity of less than 12 months. [13]

56. **T-bills and T-bonds.** Price-based monetary policy instruments in Viet Nam are mainly T-bills with maturity of less than 12 months and T-bonds with maturity of 12 months or longer. One objective of the T-bill/bond issuance is to finance the deficit. Another is to signal the target interest rate. A third is to pave the way for a securities market. So far, however, the Government has relied on the captive market of State enterprises and State-owned banks to buy the government securities. T-bill auctions were held throughout 1999, but T-bond auctions have been suspended since June 1999.

57. **Issues in Monetary Policy.** Although progress has been made in improving the effectiveness of monetary policy, a number of challenges remain. First, the prime rate, which has replaced the interest rate ceiling, is still short of a fully market-determined interest rate. The prime interest rate is normally formed in the inter-bank market, but in Viet Nam the inter-bank market is still quite thin. Second, the persisting practice of implicit subsidies to SOEs through loans at concessional interest rates crowds out credit to the private sector. Third, the use of market-based indirect methods of controlling money supply are hampered by the lack of a well developed capital market. Fourth, the dollarization of the economy reduces the SBV's margin for maneuver. It is also a potential source of instability in the banking system. Policy measures that discourage the use of foreign means of payment for domestic transactions and liberalization of interest rates can help dedollarize the economy.

2. Prices

58. It is striking that rapid monetary growth in 1999 occurred when prices were declining. The inflation rate has been falling since the beginning of 1999. The 12-month percentage change in the CPI fell from 9.2 percent in end-December 1998 to 0.1 percent in end-December 1999. Trends in food prices dictate the behavior of the CPI since staples (principally rice) and other food items make up 60.9 percent of the CPI basket. As can be seen from Figure 4 below, food price inflation led by the price of staples fell sharply between January 1999 and the end of the year.

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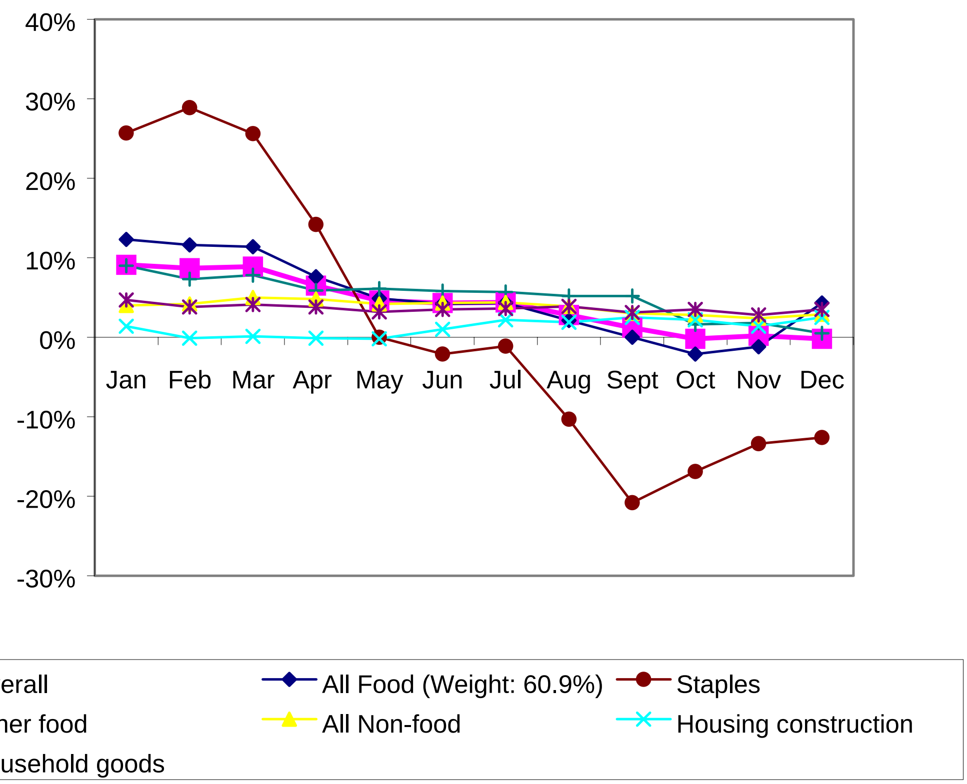
12 Regulation on Required Reserves for Bankers and Creditors came into force on 1 January 1998.

13 The RRR for the Viet Nam Bank for Agriculture and Rural Development was lowered to 3 percent. Rural joint-stock commercial banks, cooperative banks, central people's credit fund and local people's credit fund were brought under the RRR policy and the ratio applicable to them was set at 1 percent. The reserve requirements for dong and foreign currency deposits are similar except that the currency of denomination and the applicable exchange rate are to be announced by the SBV.

Figure 4: Consumer Prices, by Major Component, 1999

(% change year-on-year)



Source: General Statistical Office.

59. The volatility of food prices is mainly due to that of rice prices which were affected over the last two years, in succession, by domestic and external factors. Domestic rice prices soared in mid-1998 following an extended drought that affected the summer crop and that prompted the Government to impose a temporary ban on rice exports. This trend in rising prices reversed in early 1999 with the slump in world rice prices that dragged down the domestic price of rice.

60. Nonfood prices rose by 3 percent in 1999. Within the nonfood category, housing construction prices declined, reflecting the slump in the construction industry due to the economic slowdown. Prices of household goods however were steady. Thus, overall prices in Viet Nam declined because the decrease in food prices was not fully offset by higher nonfood prices.

61. Soaring world petroleum prices have so far had little impact on inflation. The Government has made some upward adjustments in the domestic price of imported oil products, but these are still below world prices. The Government has justified the partial pass-through on the ground that the surge in crude oil export earnings allows a cross-subsidization of imported petroleum product prices.

62. The monetary and price trends in 1999, i.e. (i) accelerating broad money growth, (ii) decelerating credit, and (iii) falling price levels, are because the banking system's excess

liquidity found its way to foreign banks rather than to more rapid domestic credit growth and higher prices. However, the effects of the substantial monetary overhang resulting from the liquidity growth are likely to be manifested in a build up of inflationary pressures.

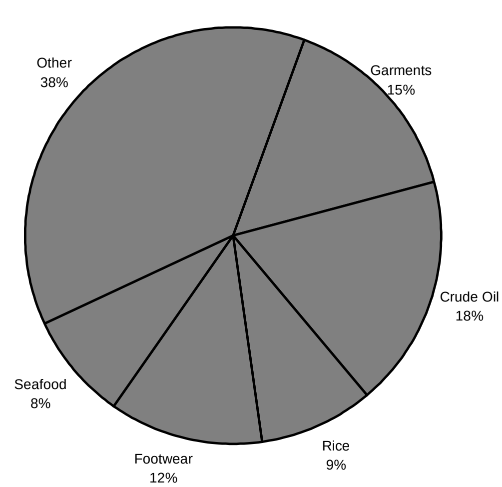
D. External Trade and Balance of Payments

63. Viet Nam's overall balance of payments shifted into surplus in 1999 reaching $790 million (Table 8). This development was due mainly to the current account, which moved from a deficit in 1998 (4.6 percent of GDP) to a surplus in 1999 (4.0 percent). The capital account, on the other hand, turned from a surplus in 1998 to a deficit in 1999. Since the adoption of the crawling peg in February 1999, the exchange rate has been relatively quiescent. The sizable current account surplus helped raise gross international reserves to $ 2.9 billion in 1999 or 12.5 weeks of imports.

1. Exports

64. Export growth picked up from a lackluster 2.4 percent in 1998 to 23.2 percent in 1999. Underpinning the strong export performance was the price-driven surge in the value of oil exports, and fast-growing manufacturing exports, led by garments and footwear. Crude oil contributed 9.2 percentage points of the 23.2 percent export growth and its share in total exports rose from 13.2 percent in 1998 to 18.1 percent in 1999 (Figure 5). Garments and footwear contributed 8.4 percentage points to export growth and their share in total exports rose from 21.1 percent in 1998 to 27.2 percent in 1999. On the other hand, because of the fall in world rice prices in 1999, rice contribution to the growth in value of exports was near zero despite the increase in the volume of exported rice. The share of rice exports in total exports went down from 10.9 percent in 1998 to 8.9 percent in 1999. With falling world coffee prices, the contribution of coffee exports to export growth was negative and their share in total exports declined from 6.3 percent to 5.1 percent.

Figure 5: Main Exports in 1999



Source: UNDP.

65. The growth in manufacturing exports was made possible by an improved environment for private sector exports. The fastest contribution was in fact, made by domestic private

companies. Diversification to European markets also contributed to the growth in manufacturing exports.

66. Japan remains Viet Nam's largest individual trading partner in terms of export turnover (17.6 percent of total exports). The share of the European Union has gone up significantly in the last two years, from 16.1 percent in 1997 to 30.9 percent in 1999. The share of the US (5.8 percent) has risen marginally, but is likely to increase significantly over the medium term with the signing of the bilateral trade agreement between the two countries. Exports to ASEAN countries have fallen from 23.8 percent of total exports in 1997 to 13.9 percent in 1998 and further down to 13.2 percent in 1999. The decline in 1999 was mainly due to a fall in rice imports by Indonesia and the Philippines.

67. While crude oil and agricultural exports still account for over 50 percent of exports, there is evidence of export diversification due to a vigorous growth of manufacturing exports. A recent study estimates that Viet Nam's untapped export potential could represent roughly 25 percent of its GDP and that up to 1.6 million jobs could be created in light manufacturing in the near future through labor-intensive exports.[14]

2. Imports

68. Import growth, which had fallen sharply in 1998 (-1.1 percent), picked up marginally to 1.1 percent in 1999. Weak imports for two successive years were due to sluggish domestic demand and falling investment. Intermediate goods, followed by machinery and equipment, have historically accounted for a significant share of imports. The economic slowdown and excess capacity in 1998 and 1999 led to falling imports of raw materials, machinery, and capital goods. This trend was further accentuated by the diminished inflow of foreign investment. FDI is typically accompanied by machinery imports. Due to concern about falling FDI, the authorities imposed import restrictions including restricted access to foreign exchange and credit that also dampened imports. The oil import bill and the share of petroleum products in total imports went up as oil prices rose. Cement imports were down as there was an oversupply of domestically produced cement and producers lobbied successfully to ban imports of cement.

69. As with exports, Japan accounts for the largest individual trading partner share of imports (14.1 percent). ASEAN countries account for 24.9 percent, a share that has remained relatively steady in recent years. The share of the European Union has also remained at around 10 percent.

3. Nontrade Current Account

70. The deficit on the balance of the nonfactor services account widened in 1999 with an increase in payments that more than offset the modest increase in receipts due to a recovery of the tourism industry in that year. The deficit on the balance of the investment income narrowed in 1999 due to an increase in receipts and decrease in payments. Receipts rose because of higher interest earnings on deposits of Vietnamese residents in foreign banks and the higher international reserves. Net transfers registered an increase in surplus because the rise in inward remittances by overseas Vietnamese more than offset the decline in official transfers.

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14 Belser, P. (1999). *Viet Nam: On the Road to Labor-Intensive Growth?* Background Paper for Viet Nam Development Report, 2000. Hanoi.

4. Capital Account.

71. The capital account is estimated to have swung from a significant surplus in 1997 to a deficit in 1999, reflecting the slowdown in FDI and an increase in the net outflow of short-term capital (Table 8). Medium- and long-term loan disbursements decreased from $1.1 billion in 1998 to $1 billion in 1999. There was an increase in official disbursements from $796 million in 1998 to $970 million in 1999. However, commercial loan disbursements declined.

72. Disbursements of ODA loans increased but at a decreasing rate in 1999, with the level of undisbursed commitments remaining high. The Government is mindful of the need to further improve ODA performance to compensate for the slowdown in FDI inflows. ODA implementation performance can be improved, inter alia, by strengthening public investment and planning procedures, developing the regulatory framework for ODA, and strengthening ODA management, monitoring and evaluation. To this end, the Government recently issued regulations linked to decree 87/CP to guide the management and utilization of ODA.

5. Foreign Direct Investment.

73. Starting from a low base, for much of the 1990s until 1997, FDI generally lived up to the expectation that it would play a key role in accelerating growth. FDI disbursements rose from an estimated $316 million (2.0 percent of GDP) in 1992 to peak at $2.3 billion (11.3 percent of GDP) in 1995. Since then, FDI inflows have slowed down: they were estimated at $961 million or 3.5 percent of GDP in 1999. A number of factors account for the slowdown in FDI inflows. First, before the crisis, the bulk of the FDI disbursements originated from within the region. In the aftermath, the marked slowdown in disbursements from within the region was not offset by increase in inflows from nonregional sources. Second, investors' perception is that the cost of doing business in Viet Nam is high. Third, the rapid growth in FDI for much of the 1990s was possible because the starting base was low; eventually a leveling off and a decline, although a gradual one, would have been expected. Also, the type of sectors that attracted FDI in the past, including heavy industry, real estate, and construction, have reached their saturation points. Fourth, foreign-owned enterprises have accounted for less than 10 percent of total exports in recent years. The EPZs which were expected to attract a significant share of FDI, accounted for a relatively small share of the FDI disbursements over the period 1995-1999. Fifth, two-thirds of the FDI inflows have been in the form of joint ventures with SOEs while 100 percent foreign-owned enterprises have accounted for around 20 percent of FDI. The investors' experience that SOEs are less flexible and the difficulties in entering into tie-ups with the domestic non-state enterprises may have caused them to reassess their investment decisions.

Table 8: Balance of Payments

Item	1995	1996	1997	1998	1999
			$ Million		
Current Account					
Trade Balance (net)	(3,155)	(3,142)	(1,315)	(980)	1,080
Exports (FOB)	5,198	7,338	9,145	9,366	11,540
Imports (FOB)	8,353	10,480	10,460	10,346	10,460
Services, net	159	(61)	(623)	(539)	(597)
Factor Incomes, net	(279)	(427)	(611)	(669)	(412)
Transfers, net	627	1,200	885	1,122	1,181
Of which: Official Transfer	153	150	175	172	131
Current Account Balance,					
Including Official Transfers	(2,648)	(2,430)	(1,664)	(1,066)	1,252
Excluding Official Transfers	(2,801)	(2,580)	(1,839)	(1,238)	1,121
Capital Account	2,326	2,079	1,663	457	(73)
Foreign Direct Investment (gross)	2276	1812	2074	1041	961
Foreign Direct Investment (net)	2268	1757	1900	669	358
Medium- and Long-Term Loans	(253)	98	375	432	605
Disbursements	443	772	1,007	1,122	1,036
Scheduled Amortization	696	674	632	690	431
Short-Term Capital, net	311	224	(612)	(644)	(1,036)
Errors and Omissions	299	71	(3)	275	(390)
Overall Balance	(23)	(281)	(4)	(334)	789
Financing	23	281	4	334	(789)
Of which					
Change in Net International Reserves	(390)	(190)	(214)	(137)	(952)
Change in Arrears	428	541	323	126	548
Debt Relief	0	0	0	413	0
			Annual Percentage Change		
Exports (FOB)	28.2	41.2	24.6	2.4	23.2
Imports (FOB)	59.3	25.5	(0.2)	(1.1)	1.1
Gross Foreign Direct Investment	117.2	(20.4)	14.5	(49.8)	(7.7)
			Percent of GDP		
Exports (FOB)	25.1	29.8	34.1	35.0	40.8
Imports (FOB)	40.3	42.5	39.0	38.6	37.0
Current Account Balance	(13.5)	(10.5)	(6.9)	(4.6)	4.0

Source: State Bank of Viet Nam and staff estimates.

74. Concerned about the slowdown in FDI inflows and recognizing that the Foreign Investment Law drafted in 1987 compared unfavorably with those of neighboring countries, the Government amended the law. Key provisions of the Foreign Investment Law that became effective on 1 July 2000 follow:

(i) Foreign banks can lend to foreign-owned enterprises that use property rights and land use rights as collateral.

(ii) More flexible banking arrangements were introduced to make it easier for foreign visitors to convert dong to dollars and remit profits abroad.

(iii) Royalty and corporate income tax payable by oil and gas companies operating in geologically difficult locations were reduced.

However, the business cooperation contract, which is regarded as unreasonably restrictive, has not been replaced.

6. External Debt.

75. Viet Nam's stock of medium- and long-term convertible currency debt at the end of 1999 was estimated at $10 billion, equivalent to 37.4 percent of GDP, or 70.5 percent of exports of goods and nonfactor services. The debt, which includes the loan component of FDI estimated at $3.6 billion, grew at an average rate of 12 percent over 1995-1999. About 60 percent of convertible currency debt is public, of which official bilateral creditors account for 70 percent and multilateral agencies for 7 percent. Total debt service amounted to 10.7 percent of exports of goods and non-factor services, of which 4.2 percent was public debt service. Because of Viet Nam's access to concessional external financing, the average grant element of the debt was about 55 percent.

76. In September 2000, Viet Nam secured a major write-down of its debt to Russia. Under the terms of the agreement, debt to Russia has been valued at one transferable ruble per US dollar. Russian claims on Viet Nam (TR 10.5 billion) would receive an up-front 70 percent discount. On the remainder ($3.15 billion), 50 percent would be written off and the balance of $1.7 billion would be repaid over 23 years, 10 percent in cash and 90 percent in goods. The interest rate applied will be 5 percent.

77. Private sector debt stock declined in 1999. In previous years, it had grown faster than overall debt due to FDI-related borrowings. The short-term debt stock in 1999 was estimated at $557 million or about 5.6 percent of the medium- and long-term debt, much of it in the form of interest arrears on medium- and long-term debt. Short-term debt has been decreasing since 1996. The amount of private nonguaranteed private sector debt is insignificant.

Table 9: Debt Stock and Debt Service

	1995	1996	1997	1998	1999
			$ Million		
Medium- and long-term debt					
Convertible currency	6,478	8,024	9,551	9,645	10,020
Public sector	4,524	5,081	5,557	5,424	6,083
Private sector	1,953	2,943	3,994	4,221	3,937
FDI-related	1,851	2,718	3,615	5,803	3,599
Other	102	225	379	418	337
	Percent of Exports of Goods and Non-factor Services				
Total debt service	12.1	9.8	11.1	13.2	10.7
Total convertible currency debt stock	85.2	79.9	81.8	86.2	70.5

Source: IMF.

78. Regarding the Heavily Indebted Poor Countries (HIPC) Debt Initiative, Viet Nam is expected to achieve debt sustainability after receiving debt relief provided under traditional mechanisms.[15] Countries that are assessed as having sustainable debt burdens have not been deemed to require assistance under the Initiative.

7. Exchange Rate Developments

79. The crawling peg system, introduced in February 1999, allowed the interbank exchange rate to depreciate by a maximum of 0.1 percent per day from the previous day's average interbank market rate. Between February 1999 and June 2000, the nominal depreciation of the dong has been only 1.5 percent against the US dollar. Although the dong did not depreciate much in nominal terms over this period, with falling inflation, the real effective exchange rate (REER) depreciated by an estimated 6 percent. The REERs of Malaysia, Philippines, and Thailand, however, depreciated more steeply.

80. A combination of policy, institutional, and other factors account for the relatively modest nominal depreciation of the dong in 1999. The band set for the crawling peg is narrow and, together with the rate of crawl, allows for only a gradual depreciation. The interbank market is thin and as yet functions under official guidance. Although there has been some liberalization, importers' access to foreign currency remains tightly controlled. The management of the exchange rate is in part, influenced by the fact that much of the external debt is owed by SOEs whose debt servicing costs would go up if there is a steep depreciation.

81. The pressure on the dong in 1999 was somewhat relieved by the operation of a number of exceptional factors: (i) a buildup in foreign exchange reserves owing to a current account surplus that was due in part to import compression, (ii) subdued credit growth, and (iii) a falling inflation rate. With the recovery of imports and acceleration of credit growth in 2000, pressures on the dong have reemerged. For effective management of the crawling peg, it may be necessary for the Vietnamese authorities to widen the band so as to respond in a timely manner to future external pressures. Also, the move toward market-based foreign exchange operations must be complemented with greater transparency in central bank operations in the foreign exchange market. A step in the direction of greater transparency would include, for example, timely release of and equal public access to information on the foreign reserves position.

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15 *Grouping of Heavily Indebted Poor Countries. Status as of October 17, 2000. World Bank.* http://www.worldbank.org/hipc

8. Trade Policy

82. Viet Nam has made progress in trade liberalization in recent years. The freeing up of trading rights has resulted in a quantum leap in the number of private trading enterprises. The number of items that require an import license has been reduced from 20 to 9, although import licenses are still required for products not included in an enterprises' business registration license. Quotas and targets on traded commodities including rice have been lifted. However, despite the easing of restrictions, some manufacturing industries benefit from very high tariff barriers: motorcycles (50 percent), nonalcoholic drinks (50 percent), bricks and tiles (48 percent), and sugar (32 percent) as well as motor vehicle assembly, steel, and cement. These industries also benefit from nontariff barriers.

83. Among its AFTA commitments, Viet Nam is to achieve a tariff range of between 0 and 5 percent by 2006 for goods imported from other ASEAN countries and to eliminate nontariff barriers. Most of the tariff-reducing efforts to date concern those with lower than 20 percent tariffs such as materials and fuel. From 2001, tariff reductions will be more intense and will be a real challenge to the economy. By 2003, the Government is expected to reduce most of the tariffs to at most 20 percent, and remove quotas except for a selected list of products.

84. The US-Viet Nam Trade Agreement, signed on 13 July 2000, has five major sections, including new market access for US agricultural and industrial goods, increased intellectual property rights protection, market access on various service sectors, provisions to protect US investments, and transparency measures in these areas. Until the signing of the agreement, Viet Nam was one of the few countries on which the US had imposed general tariffs that are generally much higher than the Normal Trading Status tariffs. After the agreement is ratified by the US Congress and Senate, Vietnamese exporters could benefit almost immediately, with tariff rates averaging 40 percent being cut to less than 3 percent. According to a recent World Bank study,[16] the agreement could almost double Viet Nam's annual exports to the US to $768 million in the next few years. Currently, the biggest export from Viet Nam to the United States is coffee, but exports of footwear and textiles are expected to climb rapidly. In addition, exporters of agro products, wood products, and other labor-intensive industries are likely to gain. Besides the direct trade effects, there are likely to be secondary effects: more FDI, technology transfer, and other business activities. The trade agreement would be a necessary, but not sufficient, condition to approach the export levels and patterns of Viet Nam's richer neighbors. Realizing the potential positive effects of the agreement would depend on the Vietnamese exporters' ability to reduce costs, improve quality, and ensure stable supplies.

85. **Issues in External Sector Account.** Notwithstanding favorable external prospects, Viet Nam's competitiveness needs to be strengthened. Its main competitors have undergone structural rehabilitation that has increased their external competitiveness. Viet Nam however continues to be perceived as a high cost economy and its labor cost advantage is being eroded. Policy reforms in key areas such as trade and tariffs, taxation, labor market, and exchange rate management, need to be applied in a consistent and sustained manner to improve Viet Nam's external competitiveness.

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[16] Fukase, E and W. Martin (1999). *The Effects of the United States Granting Most Favored Nation Status to Viet Nam.* World Bank Policy Research Paper 2219, Washington, DC.

E. Economic Policies and the Poor

1. Trends in Poverty and Inequality

86. Viet Nam's rapid economic growth from the early 1990s until the onset of the crisis had a significant impact in reducing poverty. It was associated with some increase in inequality, particularly a widening of rural-urban gaps, although Viet Nam has been and remains a relatively egalitarian society. The findings, based on comparative results of the 1993 and 1998 VLSS, show that the incidence of poverty, measured by the head count index, dropped from 58.2 percent in 1992-1993 to 37.4 percent in 1997-1998. During the same period, the depth of poverty measured by the poverty gap declined from 18.5 percent to 9.5 percent. The incidence of poverty in rural areas is 45 percent compared with 10-15 percent in urban areas. Further, 90 percent of the poor live in rural areas. Significantly, many individuals who were positioned just below the total poverty line in 1993 were able to improve their situations to cross the poverty line and are now clustered just above it. This is one indication that the gains in poverty reduction remain fragile. [17]

87. Indicators of inequality for 1993 and 1998 show an increase over the period, with the Gini coefficient rising from 0.33 in 1992-1993 to 0.35 in 1997-1998. Most of the increase came from the widening rural-urban gaps. Disparities in growth rates between regions were also a contributory factor. Around 96 percent of the increase in inequality over 1993-1998 can be attributed to an increase in inequality between rural and urban areas. Also poverty decomposition shows that poverty reduction between 1993 and 1998 was the result mainly of strong growth rather than improved distribution.[18]

88. The latest data shows that regardless of the poverty line chosen, the incidence of poverty declined but not all socioeconomic groups benefited to the same extent. Specifically, households that benefited most are the well educated, urban, white-collar households. Agricultural workers, ethnic minorities, and those residing in poorer regions progressed the least.[19]

2. Responsiveness of Public Policies to the Poor

89. A key question that needs to be addressed is the extent to which public policies have been pro-poor. Since the majority of Viet Nam's poor are in rural areas, there is a strong linkage between measures to promote rural development and poverty reduction. Some of the areas where the government can do more to promote agricultural diversification and more broadly rural development have been highlighted earlier (para. 6). These include ensuring adequate funding for research and extension activities, strengthening rural infrastructure, mobilizing rural saving, and extending credit to rural enterprises based on sustainable interest rate structures. These need to be complemented with efforts to enhance the quality of social services in rural areas.

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[17] Footnote 3, page 7.

[18] Footnote 3, page 7.

[19] Glewwe, Paul, Michele Gragnolati, and Hassan Zaman (2000). *Who gained from Viet Nam's boom in the 1990's? An Analysis of Poverty and Inequality Trends.* Policy Research Paper 2275. Washington, DC.

a. Fiscal Policies

90. Regarding fiscal policies and the poor, the burden of formal taxes, particularly consumption taxes such as VAT, on the poor may not be onerous as they tend to rely on goods and services produced by the informal sector that goes largely untaxed.[20] However, poor households pay disproportionately more of local fees and contributions as some of these charges are levied on a per capita basis. On the question of whether public spending has been pro-poor, the recent PER observed that the criteria used to make fiscal transfers to the provinces are not transparently pro-poor. It therefore recommended that to enhance the pro-poor bias of public spending, a formula-based system that relates transfers to provinces based on needs, should be adopted. The PER also noted that State investment has been concentrated around the areas of the Hanoi-Haiphong and Ho Chi Minh City. Consequently, the rural sector from which many of the poor derive their livelihoods were relatively underfunded in terms of government expenditure. The resources allocated to poverty-related programs such as the Hunger Eradication and Poverty Reduction (HEPR) Program remain small. The impact of these programs is further diminished by poor targeting.

b. Inflation Control and Credit Policies

91. The Government has been successful in keeping inflation, which can hurt the poor, under check. However, there is a positive correlation between credit growth and inflation in Viet Nam. Rapid credit growth can therefore work to the detriment of the poor, particularly since credit to SOEs has crowded out credit to the rest of the economy. Although subsidized credit to the poor is the largest share of the Government's HEPR program, there is insufficient evidence that such policies have been successful in reaching the poor.

c. Export Diversification

92. Export diversification, particularly in the direction of labor-intensive manufacturing exports, can create jobs and therefore benefit the poor. Diversification has taken place in recent years but Viet Nam continues to depend on oil and agricultural exports that are vulnerable to commodity price shocks. Currently, world oil prices are high while international rice prices are low. This has significant distributional implications because, arguably, the higher oil prices swell government revenues and help finance the disproportionately larger State investment expenditures on the urban growth centers. Poor rural households, on the other hand, suffer from low rice prices but do not benefit from the higher oil prices.[21] There is a related issue here of the policies in place to protect the poor from such commodity price shocks. The plight of growers hit by crashing coffee prices indicates that the Government should consider measures such as setting up a stabilization fund and facilitating the development of storage facilities for such eventualities. The overvaluation of the exchange rate relative to regional competitors also has distributional implications. Simplifying matters somewhat, overvaluation amounts to a tax on agricultural exporters and a subsidy on users of imported goods mainly residing in cities.

d. Trade Policy

93. Recent progress in trade policy, including the signing of the bilateral trade agreement with the US, is likely to have a net positive impact on the poor, as it will give impetus to the export sector, particularly labor-intensive, light manufacturing which generates employment. To

[20] Footnote 4, page 9.
[21] Footnote 4, page 9.

realize this potential, however, Vietnamese exporters should be able to reduce costs, improve quality, and ensure stable supplies. Trade liberalization could mean job losses in hitherto protected industries. To mitigate this, the Government will have to draw up plans for effective safety nets and relocation.

e. FDI

94. In the past, the direct impact of FDI on poverty reduction has been limited because such investment largely went to capital-intensive import substituting industries that had little impact on employment. Also, FDI has been largely concentrated in the Hanoi-Ho Chi Minh City area. It is possible to enhance the contribution of FDI to poverty reduction through mechanisms such as (i) tie-ups between foreign investors and SMEs, particularly in agroprocessing; (ii) skills transfer through training and education of employees; (iii) public-private partnerships in infrastructure investment, particularly in subsectors that cater to basic human needs such as water supply and sewerage; and (iv) encouraging FDI outside the urban growth centers.

f. The Strategy for Hunger Eradication and Poverty Reduction

95. The Government is currently finalizing the Strategy for Hunger Eradication and Poverty Reduction for 2001-2010. It is imperative that the strategy be coherent and holistic in its approach to carrying forward the gains in poverty reduction. Policies to lift the poor sustainably out of poverty should be complemented with policies that aim to reduce the costs of being poor, including better access to credit and social services.

II. POLICY ISSUES AND PROSPECTS

A. Policy Issues

96. After two years of economic slowdown in 1998 and 1999, there are now encouraging signs of economic recovery. A number of factors now provide a good opportunity for transforming the economic recovery to high growth: (i) the external sector is doing well with both oil and nonoil exports up; (ii) industrial sector growth has recovered; (iii) the fiscal stimulus appears to be working and domestic demand is rising; (iv) the bilateral trade agreement with the US has been signed; and (v) the long-standing issue of debt owed to Russia has been settled. Equally important, the Government is currently engaged in a medium-term and long-term planning exercise that will guide the country’s efforts to achieving poverty-reducing growth in the coming years. At this critical juncture, the Government and its development partners have a unique opportunity to establish priorities based on a strategic vision for Viet Nam’s long-term economic development.

97. Identifying priorities in macroeconomic management and structural policies that support poverty-reducing growth has in fact been a recurrent theme throughout this paper:

(i) Raising investment in infrastructure (para. 28), focusing on public-private partnerships in infrastructure development.

(ii) Raising private saving to finance higher investment (para. 32).

(iii) Strengthening the Government’s revenue mobilization effort to ensure that productive expenditures and spending on the poor are not squeezed (para. 46).

(iv) Moving more strongly towards market-determined interest rates and phasing out implicit subsidies to SOEs in the form of loans at concessional interest rates (para. 57).

(v) Managing the exchange rate to strengthen external competitiveness (para. 85) and to tap Viet Nam's considerable potential in labor-intensive manufacturing exports.

The common message running through the policy elements highlighted above is the realignment of the role of the public sector to allow private sector development and to rationalize SOEs sector. Also important will be financial sector reforms to provide resources to restructure the private sector and to limit the risk of macroeconomic instability. These structural policy issues are discussed next.

1. Private Sector Development

98. The domestic private sector's share of GDP has remained stagnant in recent years. However, its large share in employment and labor-intensive exports indicates that it has been outperforming other enterprise sectors in exploiting Viet Nam's comparative advantage in labor-intensive production. Indeed, private sector development in Viet Nam, through its effect on growth and employment, can have a significant impact on poverty reduction. However, the sector faces formidable barriers covering a broad range of policy, administrative, and institutional areas. Removing these barriers is a challenging task.

99. The Government's policy priorities for developing the non-State sector include creating an equal business environment for all enterprises and increasing transparency in investment-related policies and incentives. Effective implementation of private sector development will involve sets of interlocking reforms in a number of areas:

(i) **Graduation of household and micro enterprises to the formal sector.** In Viet Nam, there are a large number of household and micro enterprises, mainly in the informal sector at one end and a few large enterprises at the other end. The "middle", i.e. medium-size enterprises, is missing. Government interventions need to focus on helping the household and micro enterprises graduate to small and medium-scale enterprises in the formal sector.

(ii) **Increasing private sector access to finance.** Incentives in lending to domestic private firms relative to State enterprises are weak. For example, private enterprises face stringent collateral requirements. These constraints need to be addressed to increase private sector access to finance.

(iii) **Streamlining incentive packages for investment and reducing distortionary incentives.** Private enterprises perceive the Law on Encouraging Private Investment to be cumbersome and inconsistent with the related regulations. Incentive packages for investment need to be streamlined to allow private enterprises to avail of such incentives. The investment regime of the past was a factor in the proliferation of industries that were relatively intensive in the use of capital and imported inputs. Investment policy has to be re-geared so that the type of investment incentives offered are consistent with Viet Nam's comparative advantage in labor-intensive production.

(iv) **Removing constraints on physical inputs.** Although the import regime is gradually being liberalized, private enterprises continue to face difficulties in obtaining foreign exchange for imported inputs. Trade reform should include liberalizing access to imported inputs by private firms. Also, private enterprises face greater hurdles than State enterprises in gaining access to land, site development, and utility connections. Such constraints in gaining access to inputs and infrastructure need to be addressed.

(v) **Easing information, technical, and marketing constraints.** Business support services are relatively undeveloped in Viet Nam. As a result, there is little scope for outsourcing activities such as market research, computer services, and project development. Also, the public sector dominates the provision of business services. Policies to encourage business support services include regulatory changes to level the playing field between public and private service providers; encouraging the formation of service industry associations; and promoting initiatives to strengthen technical, marketing, and management skills of service providers.

(vi) **Removing second-tier barriers to SME investment.** The Enterprise Law became effective on 1 January 2000 but its implementation has not been smooth due to institutional limitations at second-tier and local administrative levels. There is a need to focus on capacity-building efforts together with bringing about attitudinal changes at different levels of Government toward the private sector.

2. SOE Reform

100. SOEs have been a dominant element in the Vietnamese economy in terms of share of GDP, share of fixed assets, and outstanding domestic bank credit. Although reliable data is scarce, indications are that the financial performance of SOEs has deteriorated in recent years as evidenced by unsold inventories, excess capacity, mounting debt, and redundant labor. The fallout on the rest of the economy has been considerable. The performance of the banking sector has been adversely affected by the high share of NPLs to SOEs. Also, preemption of credit by SOEs has deprived the domestic private sector of medium-term resources for investment.

101. The Government has reaffirmed its commitment to reform of SOEs for increased effectiveness and competitiveness. It has developed an SOE reform plan that includes (i) equitization/divestiture sale of 1,857 enterprises, (ii) restructuring/merger of 423 enterprises, and (iii) providing an adequate safety net for redundant workers. If fully implemented, the reform plan will cover one third of the SOE sector and one quarter of its employment.

102. Progress in equitization has been slow, with only 451 equitized enterprises to date, well below the target. Obstacles to speeding up equitization include (i) interenterprise debt, (ii) valuation of land, buildings, and equipment, (iii) the approach to dealing with labor redundancy, and (iv) management of equitized enterprises.

103. Deepening the SOE reform process will show the Government’s commitment and improve investor perceptions about the business environment in Viet Nam. Key SOE reform priorities include the following:

(i) Place State-owned firms on the same legal footing as private companies based on a transparent comprehensive legal framework and well-defined institutional responsibilities.

(ii) Ensure competitive tenders/auctions to get investors with financial muscle and to maximize government revenues.

(iii) Consider equitizing selected large financially sound enterprises, other than those deemed "strategic," through public offering on the new stock exchange to encourage capital market development.

(iv) Identify the terminally ill SOEs and take steps to liquidate them.

3. Financial Sector Reform

104. As of 31 December 1999, Viet Nam's banking sector comprised 4 SOCBs, the Bank for the Poor, the Housing Development Bank of the Mekong River Delta, 48 JSBs, 26 foreign bank branches, 5 financial companies, and 8 leasing companies. Total bank assets amounted to 40.4 percent of GDP, total loans to 22 percent, and total deposits to 26 percent at the end of 1999. Within the banking system, SOCBs accounted for over 80 percent of total bank assets.

105. NPLs of deposit money banks amounted to 13.2 percent of total loans, an underestimate of the actual percentage of NPLs, as the figure relates to 4 SOCBs and 24 non-State banks. The ratio of NPLs of the non-State banks was about twice that of the SOCBs. SOEs accounted for around 35 percent of the NPLs while the private sector accounted for 16.8 percent. The share of SOE indebtedness has risen because the burden of financing SOE investment has shifted from the budget to the banking system. The rapid proliferation of JSBs in the 1990s, many with nonviable small capital bases and poor supervision, has resulted in insolvencies.

106. There has been some progress in restructuring 14 weak JSBs with high risk of insolvency and low capital base: 3 JSBs were closed, 2 merged, and 10 were placed under SBV's special supervision/control. Obstacles to bank restructuring include the small capital base of these banks, lack of documents, the low value of the collateral, weak functioning of real estate markets, and problems in the legal environment. Progress in restructuring SOCBs appears to be less advanced. The establishment of the National Development Assistance Fund effective 1 January 2000 is a step in separating policy-based lending from commercial lending.

107. The Government's priorities for the banking sector include (i) strengthening the four SOCBs, (ii) restructuring the JSBs, (iii) separating policy-based and commercial lending, and (iv) streamlining the policy on collateral requirements. Restructuring SOCBs is necessary, but it has to be accompanied by complementary reforms including improving the governance of the SOCBs, removing their quasi-fiscal burden of financing SOE investment, further liberalizing interest rate policies, and encouraging SOCBs to make realistic loan loss provisioning. Overall, banking sector reform will have to be accelerated if the sector is to fulfill its crucial role of resource mobilization and intermediation.

108. Capital market development is still in its infancy in Viet Nam. The opening of a stock exchange in Ho Chi Minh City in July 2000 is as yet mainly of symbolic significance. To date only four local firms have officially registered to list on the bourse. It is essential that the

supporting legal and operational infrastructure be put in place and practical training imparted to stock exchange officials and staff.

B. Short- and Medium-Term Prospects

109. At this juncture in Viet Nam's economic development, there are a wide variety of policy initiatives that have a bearing on economic prospects. These range from an unchanged policy regime at one end through slow reform to accelerated reform at the other end. In addition, there are a number of factors beyond the control of the Government that can exert an influence on economic prospects. These include the impact of world commodity prices on export earnings and the extent to which investors are convinced that Viet Nam is not lagging behind its competitors in effectively completing the process of structural rehabilitation.

110. **The Government's macroeconomic targets and projections.** The Government's projected growth rate for 2000 is 6.7 percent. The medium-term macroeconomic framework for 2001-2003 has set a GDP growth target of 7-7.5 percent for 2001. The projected investment rate for 2000 is 29 percent and the target for 2001 is 29.5 percent. Export growth in 2000 is officially projected at 19.6 percent and between 13 and 16 percent thereafter. Inflation is officially projected at 4.6 percent in 2000, and is targeted to be contained at around 5 percent during 2001. The revenue-to-GDP ratio is projected to increase by only 0.45 percent in 2000.

111. **The global context.** The main impetus for this growth is likely to come from maintaining strong export performance and in the recovery of the industry and services sectors. The external environment is likely to improve in Viet Nam's favor. Recovery in Asia is expected to continue. The strong momentum in the US economy is expected to be maintained, a factor which has gained significance with the signing of the trade agreement between Viet Nam and the US.

112. **Growth, investment, and saving.** According to official estimates, real GDP grew by 6.2 percent in the first half of 2000. Bank staff projections for the whole year and for 2001 are somewhat more conservative than official figures. GDP growth for 2000 and 2001 is projected at 6.1 percent and 6.4 percent respectively (Table 10). Domestic demand is expected to pick up supported by a modest recovery of the investment rate to 22.7 percent of GDP in 2000 and its further improvement to 23.9 percent in 2001. The expansion in investment is expected to come mainly from domestic private investment, with Government, SOE, and foreign investment growing at lower rates. Most of the required increase in financing of investment is expected to come from private saving. Public saving, comprising government saving and retained earnings of SOEs, is projected to remain at around 10 percent of GDP.

113. **Sectoral growth rates.** Agriculture is estimated to have grown by 4 percent in the first half of 2000. It is likely that agricultural output could adjust to falling world prices of agricultural commodities in the second half of the year. Accordingly, agriculture is projected to grow by 3.6 percent for the whole year and, assuming that commodity prices eventually stabilize, by 4.2 percent in 2001 (assuming world prices of agricultural commodities recover by then). Industry and construction grew by over 9 percent in the first half of 2000. Growth in the industrial sector is projected at 9.7 percent for the whole year of 2000 assuming investment and imports continue to recover. The announcement of the SOE reform package under consideration of the Government and streamlining of the implementation of the Enterprise Law is also expected to contribute to resurgence of the industry and construction sector. Services sector growth is expected to recover to 4.4 percent in 2000 and increase moderately to 4.9 percent in 2001.

Table 10: Key Economic Indicators - Short-term Projections

Item	1998	1999	2000	2001
Output and Growth (constant 1994 prices, %)				
GDP Growth	4.4	4.7	6.1	6.4
Agriculture	2.8	5.2	3.6	4.2
Industry	7.3	7.6	9.7	9.6
Services	3.0	2.1	4.4	4.9
Saving and Investment (current prices, % of GDP)				
Gross National Saving	19.2	24.1	25.0	24.0
Gross Domestic Investment [a]	23.8	20.1	22.7	23.9
Money and Inflation (annual % change)				
Money Supply (M2)	25.6	39.3	25.0	18.9
Consumer Price Index (end of period))	9.2	0.1	2.5	5.0
Government Finance (% of GDP)				
Revenue and Grants	20.5	18.8	16.9	16.9
Expenditure and Onlending [b]	22.5	21.2	19.6	19.7
Overall Fiscal Surplus/Deficit(-)[c]	(2.6)	(2.8)	(3.2)	(3.5)
Balance of Payments				
Merchandise Trade Balance (% of GDP)	(3.7)	3.8	2.5	0.6
Current Account Balance (% of GDP) [d]	(4.6)	4.0	2.3	0.1
Exports (annual growth, %)	2.4	23.2	12.9	13.1
Imports (annual growth, %)	(1.1)	1.1	17.3	18.6
External Payments Indicators				
Gross Official Reserves($million)	1995	2947	3903	4664
(week of imports)	9.9	12.5	13.9	14.0
External Debt Service (% of exports of goods and services)	13.2	10.7	9.8	9.1
Total Convertible Currency External Debt Stock (% of GDP)	38.5	37.4	35.0	33.0
Memorandum Items				
GDP (current prices, D billion)	356,197	394,310	442,258	497,212
Average Exchange Rate (D/$)	13,297	13,944	14,362	14,793

[a] Gross domestic investment is gross fixed capital formation plus changes in stocks.
[b] Includes current and capital expenditure, including on lending.
[c] Includes on lending.
[d] Excluding official transfers.

Source: Vietnamese Authorities and ADB estimates and projections.

Return to the growth rates experienced in earlier years in the services sector is not expected as some of the FDI related service activities and real estate are showing signs of excess capacity.

114. **Revenue, expenditure, and fiscal deficit.** In the first half of 2000, fiscal developments were partially on track. Revenue collections were 41.2 percent of the Government's full year target. Total spending reached 35.5 percent of the annual target but capital spending was well below target. Prospective fiscal developments include a reduction in revenues from tariffs as Viet Nam proceeds to honor its commitments under AFTA for tariff reduction. Also, the budget will need to absorb the costs of wage increase. The wage bill is projected to increase by 25 percent (1 percent of GDP).[22] The fiscal costs of SOE and banking sector reform in the first phase are likely to involve around 3 percent of GDP, mainly for establishing an Asset Management Company, with current annual costs for associated interest payments and social safety nets estimated at 0.6 percent of GDP. These current costs are expected to be met out of the budget. The share of revenue to GDP is expected to fall further in 2000 but bottom out thereafter as measures are taken to strengthen revenue mobilization. The trend in falling share of expenditure is likely to be reversed as the cost of structural reforms particularly in the SOE and the banking sector begin to weigh in. The fiscal deficit is likely to widen to 3.2 percent in 2000 and further to 3.5 percent in 2001.

115. **Inflation and monetary policy.** During the 8 months of 1999, the year-on-year change in the CPI index was -2.4 percent. However, the inflation rate for the whole year is forecast to increase to 2.5 percent for the year 2000 as rapid credit growth and the monetary overhang from excess domestic liquidity are manifested in higher prices. The inflation rate is expected to accelerate to 5 percent in 2001.

116. In the first half of 2000, broad money grew by 14.3 percent, with FCD growing by 16.8 percent and dong deposits by 9.4 percent. Foreign currency lending remains low. Dong credit, which was sluggish in the first quarter of the year, recorded a 10.62 percent increase in the first five months of 2000 compared to 1.87 percent for the same period the previous year. Monetary growth for the whole year is projected at 25 percent, slowing further to 18.9 percent in 2001.

117. **The external sector.** Exports in the first six months of 2000 registered a growth of 26.2 percent over the same period the previous year, led by an increase in crude oil exports as world oil prices remained high. Despite higher volumes, export earnings from rice and coffee exports in the first half were substantially lower because of a decline in international prices. Garment and footwear exports also grew at a slower rate compared to the same period the previous year. Import growth which was sluggish in 1999, was 30 percent higher in the first five months of 2000 as compared to the same period the previous year. This partly reflects the increase in petroleum prices and higher imports of machinery and equipment critical for the utilization and expansion of productive capacity. With the recovery of imports in the first half of 2000, the trade balance swung into deficit.

118. Over the medium-term, the prospects for the external sector have improved with the signing of the trade agreement with the US. However, realizing the potential may not be immediate and will depend upon whether the competitiveness of Viet Nam's exports can be improved. In the meanwhile, export growth for the whole of 2000 is projected at 12.9 percent based on slower growth of non-oil export earnings. It is expected to pick up to 13.1 percent in 2001. Import growth for the whole of 2000 is projected at 17.3 percent and is expected to further accelerate to 18.6 percent in 2001 as investment, and, in turn, demand for capital goods imports

[22] Footnote 9, page 15.

expand. The current account surplus is expected to shrink in 2000 to 2.3 percent. On the capital account, FDI inflows are not expected to pick up significantly. The profile of future scheduled debt servicing obligations shows a declining trend. Viet Nam's current and projected debt service indicators are considered sustainable. The improved reserves position is expected to be maintained in the next two years.

119. Despite robust export earnings, a shortage of US dollars occurred in the first half of 2000 and the difference between the parallel market exchange rate and the official rate widened. Emerging sources of pressure on the dong include (i) widening of interest rate differentials between dollar and dong deposit rates as dollar deposit rates rise, (ii) recovery of imports and widening of the trade deficit, (iii) acceleration in credit growth, (iv) continued slowdown in capital inflows, (v) liberalization of the foreign exchange market, and (vi) liberalization of the import restrictions and surrender requirements. The dong is expected to be allowed to depreciate at an annual average rate of 3 percent over the next two years in line with the Vietnamese authorities' desire to limit the ballooning of the dong value of external debt.

C. Conclusion

120. After two years of slowdown, Viet Nam's economy is showing signs of recovery. There are however a number of macroeconomic vulnerabilities that can retard sustained growth, including declining revenue-to-GDP ratios, excessive monetary growth, and erosion of external competitiveness. The oversized heavily indebted SOE sector needs to be shrunk. The under-sized private sector needs to expand to become the driver of broad-based growth and employment.

121. Despite these handicaps, Viet Nam has made significant gains in poverty reduction over the past five years. Poverty decomposition shows that poverty reduction between the period 1993-1998 was mainly the result of strong growth rather than improved distribution. The data also show however that not all socio-economic groups have benefited to the same extent. Agricultural workers, ethnic minorities, and those residing in poorer regions have progressed the least. This suggests that there is scope for better targeting of poverty programs to reach these vulnerable groups.

122. A number of factors now provide a good opportunity for transforming economic recovery to sustained growth: (i) the external sector is doing well with both oil and non-oil exports up; (ii) industrial sector growth has recovered; (iii) the fiscal stimulus appears to be working and domestic demand is rising; (iv) the bilateral trade agreement with the US has been signed; and (v) the long-standing issue of debt owed to Russia has been settled. The chief risks for the next few years stem from the possibility of policy drift and insufficient investments to support projected growth rates.

123. Summing up, transforming Viet Nam's recovery to sustained poverty-reducing growth, requires continuation of prudent macroeconomic management and deeper structural reforms. The policy mix should aim to lift the poor sustainably out of poverty and to reduce the costs of being poor through providing better access to services. With decisive action, Viet Nam can carve out a niche for itself in recovering Asia; without it, Viet Nam risks being left behind.

APPENDIX

Appendix 1

Table A.1 Key Economic Indicators

Item	1995	1996	1997	1998	1999
Output and Growth (constant 1994 prices, %)					
GDP Growth	9.5	9.3	8.2	4.4	4.7
Agriculture	4.8	4.4	4.3	2.8	5.2
Industry	13.6	14.5	12.6	7.3	7.6
Services	9.8	8.8	7.1	3.0	2.1
Saving and Investment (current prices, % of GDP)					
Gross National Saving [a]	13.6	17.6	21.4	19.2	24.1
Gross Domestic Investment [b]	27.1	28.1	28.3	23.8	20.1
Money and Inflation (annual % change)					
Money Supply (M2)	22.6	22.5	26.1	25.6	39.3
Consumer Price Index (end of period)	12.9	4.4	3.6	9.2	0.1
Government Finance (% of GDP)					
Revenue and Grants	23.3	22.9	20.9	20.5	18.8
Expenditure [c]	24.1	23.7	24.8	22.5	21.2
Overall Fiscal Surplus/Deficit(-)[d]	(1.4)	(1.3)	(4.8)	(2.6)	(2.8)
Balance of Payments					
Merchandise Trade Balance (% of GDP)	(15.2)	(12.7)	(4.9)	(3.7)	3.8
Current Account Balance (% of GDP) [e]	(13.5)	(10.5)	(6.9)	(4.6)	4.0
Exports (annual growth, %)	28.2	41.2	24.6	2.4	23.2
Imports (annual growth, %)	59.3	25.5	(0.2)	(1.1)	1.1
External Payments Indicators					
Gross Official Reserves($ million)	1,323	1,673	1,858	1995	2947
(week of imports)	6.6	8.3	9.3	9.9	12.5
External Debt Service (% of exports of goods and services)	12.1	9.8	11.1	13.2	10.7
External Debt (% of GDP)	35.0	36.6	38.6	38.5	37.4
Memorandum Items					
GDP (current prices, D billion)	228,892	272,036	313,623	356,197	394,310
Average Exchange Rate (D/$)	11,038	11,033	11,706	13,297	13,944
GDP (current prices, $ million)	20,737	24,657	26,792	26,788	28,278
Population (million)	72.2	73.4	74.5	75.6	76.6
Per capita GDP (current prices, $)	287.2	335.9	359.6	354.3	369.2
Annual Population Growth (%)	1.7	1.6	1.5	1.5	1.4

[a] Derived as gross domestic investment plus current account balance converted into dong using average exchange rate.
[b] Gross domestic investment is gross fixed capital formation plus changes in stocks.
[c] Includes on lending.
[d] Excludes grants and includes on lending.
[e] Excluding official transfers

Source: Vietnamese Authorities and ADB estimates and projections.

Table A.2: Viet Nam: Gross Domestic Product by Economic Activity
(Current Prices, 1994-1999)

	1994	1995	1996	1997	1998	1999
			D Billion			
Agriculture, forestry, and fishery	48,968	51,319	53,577	55,895	57,433	60,434
Agriculture	41,839	43,658	45,652	47,915	49,206	51,911
Forestry	2,265	2,399	2,448	2,450	2,459	2,536
Fishery	4,864	5,262	5,477	5,530	5,768	5,987
Industry	51,540	58,550	67,016	75,474	80,960	87,098
Mining and quarrying	9,114	10,345	11,753	13,304	14,741	16,932
Manufacturing	26,624	30,231	34,339	38,743	42,321	45,457
Electricity, gas, and water supply	2,856	3,384	3,986	4,572	5,136	5,498
Construction	12,946	14,590	16,938	18,855	18,761	19,211
Services	78,026	85,698	93,240	99,895	102,938	105,128
Wholesale and retail trade	30,185	33,595	36,866	39,422	40,210	41,015
Hotels and restaurants	6,125	6,741	7,428	7,949	8,068	8,270
Transport, storage, and communication	7,154	7,851	8,429	9,178	9,270	9,696
Financial intermediation	3,450	3,940	4,388	4,578	4,670	4,827
Real estate services	9,135	9,738	10,337	11,071	11,292	11,834
State management	6,484	7,063	7,558	7,860	8,174	7,723
Education and training	6,496	6,968	7,526	8,062	8,614	8,809
Health and social work	2,757	3,009	3,220	3,348	3,566	3,707
Other services	6,240	6,793	7,488	8,427	9,074	9,247
Gross Domestic Product	178,534	195,567	213,833	231,264	241,331	252,660
			Percent of GDP			
Agriculture, forestry, and fishery	27.4	26.2	25.1	24.2	23.8	23.9
Agriculture	23.4	22.3	21.3	20.7	20.4	20.5
Forestry	1.3	1.2	1.1	1.1	1.0	1.0
Fishery	2.7	2.7	2.6	2.4	2.4	2.4
Industry	28.9	29.9	31.3	32.6	33.5	34.5
Mining and quarrying	5.1	5.3	5.5	5.8	6.1	6.7
Manufacturing	14.9	15.5	16.1	16.8	17.5	18.0
Electricity, gas, and water supply	1.6	1.7	1.9	2.0	2.1	2.2
Construction	7.3	7.5	7.9	8.2	7.8	7.6
Services	43.7	43.8	43.6	43.2	42.7	41.6
Wholesale and retail trade	16.9	17.2	17.2	17.0	16.7	16.2
Hotels and restaurants	3.4	3.4	3.5	3.4	3.3	3.3
Transport, storage, and communication	4.0	4.0	3.9	4.0	3.8	3.8
Financial intermediation	1.9	2.0	2.1	2.0	1.9	1.9
Real estate services	5.1	5.0	4.8	4.8	4.7	4.7
State management	3.6	3.6	3.5	3.4	3.4	3.1
Education and training	3.6	3.6	3.5	3.5	3.6	3.5
Health and social work	1.5	1.5	1.5	1.4	1.5	1.5
Other services	3.5	3.5	3.5	3.6	3.8	3.7
Gross Domestic Product	100.0	100.0	100.0	100.0	100.0	100.0

Source: General Statistics Office and staff estimates.

Table A.3: Gross Domestic Product by Expenditure Shares
(current prices)

Expenditure Item	1994	1995	1996	1997	1998	1999
			D Billion			
Final Consumption Expenditure	148,037	187,233	225,231	250,584	289,862	306,884
Household	133,299	168,492	202,509	225,084	258,607	273,760
Government	14,738	18,741	22,722	25,500	31,255	33,124
Gross Capital Formation	45,483	62,131	76,450	88,754	84,687	79,217
Gross Fixed Capital Formation	43,325	58,187	71,597	83,734	78,347	72,119
Increase in Stocks	2,158	3,944	4,853	5,020	6,340	7,098
Exports of Goods and Services	60,725	75,106	111,177	135,180	159,165	198,116
Less: Imports of Goods and Services	77,591	95,925	141,016	160,706	179,363	191,381
Net Exports	(16,866)	(20,819)	(29,839)	(25,526)	(20,197)	6,735
Statistical Discrepancy [a]	1,880	347	194	(189)	1,844	1,474
Expenditure on Gross Domestic Product	178,534	228,892	272,036	313,623	356,197	394,310
			Percent Distribution			
Final Consumption Expenditure	82.9	81.8	82.8	79.9	81.4	77.8
Household	74.7	73.6	74.4	71.8	72.6	69.4
Government	8.3	8.2	8.4	8.1	8.8	8.4
Gross Capital Formation	25.5	27.1	28.1	28.3	23.8	20.1
Gross Fixed Capital Formation	24.3	25.4	26.3	26.7	22.0	18.3
Increase in Stocks	1.2	1.7	1.8	1.6	1.8	1.8
Exports of Goods and Services	34.0	32.8	40.9	43.1	44.7	50.2
Less: Imports of Goods and Services	43.5	41.9	51.8	51.2	50.4	48.5
Net Exports	(9.4)	(9.1)	(11.0)	(8.1)	(5.7)	1.7
Statistical Discrepancy	1.1	0.2	0.1	(0.1)	0.4	-0.3
Expenditure on Gross Domestic Product	100.0	100.0	100.0	100.0	100.0	100.0

[a] Difference between production-based estimates of GDP (which are considered to be more accurate) and expenditure-based estimates.

Source: General Statistical Office and staff estimates.

Appendix 4

Table A.4: Inflation Rate
(end-of-period, in percent)

Item	1995	1996	1997	1998	1999
Consumer price index (1995=100)[a]	12.9	4.4	3.6	9.2	0.1
Food and food services	19.8	4.4	1.3	12.3	(1.9)
Beverages and cigarettes				5.3	2.6
Garments and footwear				2.3	1.9
Housing and building materials				1.7	2.5
Household equipment				2.5	3.5
Pharmaceutical products and medical services				8.7	4.1
Transport and postal services				3.0	1.6
Education				9.6	3.8
Culture sports and entertainment				1.3	1.9
Other goods and services				4.0	3.1

[a] Since January 1998, the CPI index has been calculated under a new methodology and with different weights for the components.

Source: General Statistical Office.

Appendix 5

Table A.5: Government Finance

Item	1995	1996	1997	1998	1999
			D Trillion		
Total Revenue and Grants	53.4	62.4	65.4	73.0	74.2
Total Revenue	51.8	60.8	62.8	70.9	72.3
Tax Revenue	42.4	51.8	53.1	59	61.8
Nontax Revenue	9.4	9.1	9.7	11.9	10.5
Grants	1.6	1.5	2.6	2.1	1.9
Total Expenditure					
Including onlending	55.1	64.3	77.7	80.2	83.5
Excluding onlending	54.6	62.9	70.7	74.8	77.8
Current Expenditure	42.5	47.3	51.3	54.3	52.3
of which interest payments paid	2.9	2.7	1.9	2.1	2.5
scheduled	4.1	4.1	3.9	2.1	2.5
Capital Expenditure and Onlending	12.6	17.1	26.4	25.9	31.2
of which onlending	0.5	1.4	6.9	5.4	5.7
Overall fiscal balance (incl. grants and onlending)	(1.7)	(1.9)	(12.3)	(7.2)	(9.3)
Financing	1.7	1.9	12.3	7.2	9.3
Domestic (net)	2.7	0.6	5.2	(0.2)	(1.2)
Banking system	(0.2)	(0.3)	0.0	1.6	(5.4)
Nonbanks	2.9	0.8	5.2	(1.8)	4.2
Foreign (net)	(1.0)	1.4	7.1	7.4	10.6
Disbursements	2.0	3.8	10.2	10.2	13.5
Amortization paid	3.0	2.5	3.2	2.8	3.0

Source: Ministry of Finance and IMF.

Appendix 6

Table A.6: Monetary Survey [a]

Item	1995	1996	1997	1998	1999
			D Trillion		
Net Foreign Assets	10.8	14.2	21.0	31.2	61.6
Net Domestic Assets	41.9	50.4	60.6	71.2	81.0
Domestic Credit	47.1	55.3	66.8	81.0	89.6
Government, net [b]	4.7	4.4	4.4	8.4	2.9
State Enterprises	24.1	26.8	31.0	38.1	41.8
Nonstate Sectors	18.3	24.1	31.4	34.6	44.9
Other Items, net	(5.2)	(4.9)	(6.2)	(9.8)	(8.5)
Money Supply (M2)	52.8	64.7	81.6	102.4	142.6
Dong Liquidity	41.7	51.5	62.9	78.3	105.4
Currency in Circulation	19.2	22.6	25.1	27.0	41.5
Deposits	22.5	28.9	37.8	51.4	63.9
Demand Deposits	7.4	10.8	14.9	20.2	25.6
Other Deposits	15.1	18.1	22.9	31.1	38.3
Foreign Currency Deposits	11.1	13.2	18.7	24.1	37.2

[a] Based on the monetary survey of four State-owned commercial banks (SOCBs) and 24 nonState banks.

[b] Includes D2.4 trillion recapitalization of SOCBs in October 1998, under which frozen loans of SOCBs were written off by the SBV on behalf of the Government and swapped for government equity in SOCBs; no loans were formally extended by the SBV to the Government for this operation.

Sources: State Bank of Viet Nam and staff estimates.