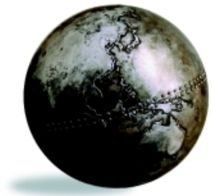


Viet Nam

With the loss of reform momentum and the economic slowdown over the last two years, the sustainability of past gains on poverty reduction is at stake. Carrying the process of poverty reduction forward in the coming years will require embarking on a second set of reform measures, one focused on diversifying rural livelihoods.

RECENT TRENDS AND PROSPECTS

In 1999, real GDP growth was estimated at 4.4 percent. This was half the average growth rate during the six-year period from 1992 to the onset of the regional crisis in 1997, an era of high growth driven by first-generation reforms (*doi moi*), booming private consumption, and foreign direct investment (FDI) inflows. The slowdown in growth during 1998-1999 resulted from the impact of the regional crisis, stagnating domestic demand, and loss of reform momentum.

Performance of various sectors in 1999 was mixed. Agriculture sector growth increased to 5 percent from 3 percent the previous year, with a bumper rice crop and growth in fisheries and livestock. The industry and service sectors continued to lag in 1999, with inventory buildup in key manufacturing industries, including cement, steel, coal, and fertilizers. Decreasing domestic demand and eroding competitiveness in vital subsectors slowed industrial growth. The deceleration in the service sector resulted from a slowdown in tourism, real estate services, and transportation, areas that were hit particularly hard by the economic slowdown. Two years of slow growth led to rising unemployment, particularly in the urban areas, and reached an estimated 7.4 percent in 1999.

Investment as a share of GDP has fallen during the last two years, from an estimated 29 percent of GDP in 1998 to 27.2 percent in 1999. This stemmed from lower private investment, less investment by state-owned enterprises (SOEs), and slower FDI inflows. The budgeted increase in public invesment in 1999 to stimulate demand did not materialize. To revive private investment, the government set up a Development Assistance Fund to provide medium- and long-term loans and credit guarantees for investing in productive ventures. FDI declined for the second year in a row, and estimates of the 1999 inflows range from $600 million to $1.4 billion. Before the crisis, two thirds of FDI inflows originated in Asia and hence were vulnerable to weaker regional GDP growth. The decline in FDI continued as investor sentiment remained lukewarm because of uncertainties about the direction and pace of reforms.

The fiscal deficit was about 2 percent of GDP in 1999. The budget deficit was maintained at moderate levels, despite falling revenues, because current expenditures were reduced. The banking system absorbed the bulk of the Treasury bill issuance that accounted for 51 percent of total financing in 1999.

The end-of-year growth rate of retail prices for 1999 was estimated at 0.1 percent compared with 9.2 percent in 1998. A fall in the food price index, weak domestic demand, and a relatively stable exchange rate contributed to price stability. Interest rate ceilings were reduced gradually from around 1.2 percent per month to 0.85 percent. Credit to the government and SOE sector was more restricted than in previous years, while credit to the smaller nonstate sector grew faster. The State Bank of Viet Nam estimated that money supply (M2) grew by 39.1 percent in 1999 compared with 26 percent in 1998, due largely to increased foreign currency deposits from inward remittances. These funds were re-deposited in overseas banks and did not translate into accelerated domestic credit growth. This partly explains why the money supply grew so rapidly in a year of record low inflation.

Exports grew slowly in early 1999 but perked up toward the end of the year, largely because of crude oil and rice exports. Textiles, garments, footwear, and marine products also registered stronger growth than in previous years. Crude oil was exported mainly to the People's Republic of China and Australia, marine products to Japan and other countries in the region, and most of the footwear exports to Europe. A higher volume of exports accounted for most of the increase in export earnings, rather than increased export price.

Overall export growth was 22.3 percent, up from only 1 percent in 1998. Imports showed only a small increase from the previous year, with fewer machinery and consumer goods and more petroleum products, fertilizers, steel, and synthetic fibers. With lower import levels and a resurgence of exports, the current account registered a substantial surplus, in contrast to a large deficit in 1998. Debt remained within manageable limits.

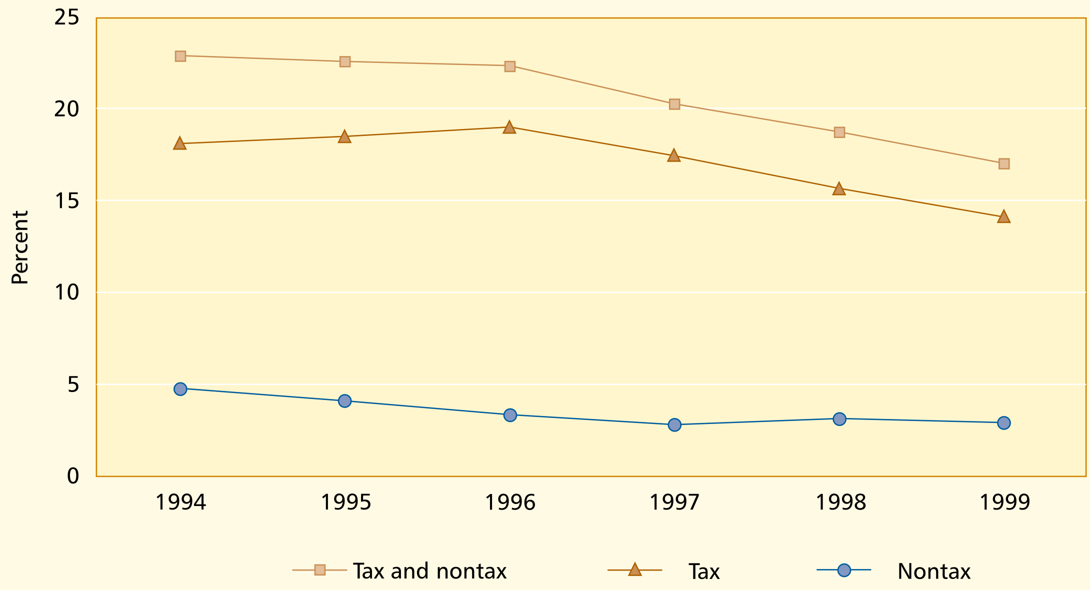
Table 2.13 Major Economic Indicators, Viet Nam, 1997-2001
(percent)

Item	1997	1998	1999	2000	2001
GDP growth	8.2	4.4	4.4	5.0	6.0
Gross domestic investment/GDP	28.3	25.5	19.7	20.8	21.9
Gross savings/GDP	21.8	21.1	22.0	21.6	20.5
Inflation rate (consumer price index)[a]	3.6	9.2	0.1	6.0	7.0
Money supply (M2) growth[b]	25.4	24.6	40.0	25.0	24.0
Fiscal balance/GDP[c]	-1.7	-1.6	-2.0	-1.7	-1.5
Merchandise exports growth	26.5	1.0	22.3	10.0	10.0
Merchandise imports growth	0.8	-2.1	1.2	16.0	17.0
Current account balance/GDP[d]	-6.5	-4.4	2.3	0.8	-1.4
Debt service/exports[e]	11.4	13.2	11.1	12.0	10.9

a. End of period; 1997 data based on retail price index, but since 1998 the CPI has replaced the RPI for estimating inflation.
b. Since 1996 the monetary survey has included 36 nongovernment banks.
c. On cash basis; excludes interest arrears, grants, and onlending.
d. Excludes official transfers.
e. Debt service on debt due/exports of goods and nonfactor services.

Sources: General Statistical Office; Ministry of Finance; State Bank of Viet Nam; staff estimates.

Figure 2.13 Government Revenue as Ratio of GDP, Viet Nam, 1994-1999



Source: Ministry of Finance (2000).

GDP growth is expected to be 5 percent in 2000 and 6 percent in 2001, as the industry and service sectors recover after two years of relatively low growth. Inflation is projected to be 6-7 percent in 2000 and 2001 because of an anticipated increase in prices of agricultural products that reflects the crop destruction caused by floods in 1999, higher prices for petroleum products, and stronger domestic demand. Export growth over the next two years is likely to be around 10 percent, and after a two-year slump, imports should recover in 2000 and grow at 16-17 percent. The current account surplus will probably narrow in 2000 and become a deficit the following year.

ISSUES IN ECONOMIC MANAGEMENT

The downward trend of revenue as a share of GDP over the last few years is a crucial concern (see figure 2.13). The drop largely results from a decline in tax revenue, particularly of corporate income tax and international trade tax. Corporate tax revenues declined due to the weak performance of state enterprises and the difficulties the private sector faced in the wake of the Asian crisis and weak domestic demand. Trade tax collections fell because the composition of imports changed, and more recently, the share of imports in GDP fell. The value-added tax, which took effect 1 January 1999, accounted for around 4 percent of GDP in 1999. As in the past few years, the government set lower budgetary targets for revenue as a share of GDP for 2000. To compensate for falling revenues, the government cut back on expenditures, specifically nonwage current expenditures. Considering the budget constraints on necessary nonwage public expenditure, this trend should be reversed.

Opaqueness of budgetary information makes it difficult to assess the fallout in terms of loss in productivity and growth. This has been aggravated by including a budget allocation for contingency to meet revenue shortfalls and other adverse developments.

To improve revenue performance and ensure that priority spending can be maintained without jeopardizing macroeconomic stability, the government must set and achieve revenue targets aligned to its macroeconomic projections. Problems in the design and administration of taxes will have to be addressed with a view to terminating discretionary rates and exemptions. Budgetary information also needs to be made more transparent so that revenue shortfalls can be monitored in terms of productive and nonproductive expenditures. Further, the practice of including a significant allocation for contingency must be reviewed, as it weakens the link between the budget and actual spending.

POLICY AND DEVELOPMENT ISSUES

Rapid economic growth from the early 1990s until the onset of the crisis had a significant impact in reducing poverty. It has also been associated with an increase in inequality, particularly a widening of rural-urban gaps, though Viet Nam has been and remains a relatively egalitarian society. The incidence of poverty, as measured by the headcount ratio, dropped from 58 to 37 percent between 1993 and 1998. During the same period, the depth of poverty measured by the poverty gap declined from 18.5 to 9.5 percent. The incidence of poverty in rural areas is 45 percent compared with 10-15 percent for urban areas, and 90 percent of the poor live in rural areas. In 1993, many people below the poverty line were able to improve their situations enough to cross the line and are now clustered just above it. Therefore, while gains in poverty reduction have been made, they remain quite fragile.

Indicators of inequality for 1993-1998 increased marginally, with the Gini coefficient (a measure of inequality) rising from 0.33 to 0.35. An estimated 96 percent of the increase resulted from widening rural-urban gaps, with differences in growth rates between regions also contributing to the disparity.

Poverty incidence during 1984-1994 declined as a result of high GDP growth rates. In the future, however, GDP growth alone may not suffice to reduce poverty levels. Measures will be needed to improve income distribution, particularly the differentials in the rural-urban income levels. Because most of the poor live in rural areas, it is critical to identify the factors associated with rural poverty, which include geographical factors and household characteristics. The Northern Uplands, Central Highlands, and North Central Coast are the most impoverished regions, with limited natural resources and low agricultural productivity. These three regions have 51 percent of the country's poor, although they contain only 26.8 percent of the population. Poverty among ethnic minorities living in the upland areas is also high.

Rural poverty bears most heavily on those farm households that

- Have small landholdings, often of low quality
- Rely on informal credit with high interest rates
- Have limited access to markets for farm goods
- Lack off-farm employment.

Providing off-farm employment is particularly relevant. This will involve moving away from the capital-intensive pattern of development with limited linkages to the rest of the economy that offers limited employment opportunities. This pattern of development has been perpetuated by a policy of resuscitating SOEs through preferential treatment. The government needs to move decisively to remove both explicit and implicit biases that favor SOEs and discriminate against nonstate enterprises. To make progress in reducing poverty, these distortions must be corrected and policymakers must articulate a time-bound strategy—*doi moi* phase two—for promoting labor-intensive growth.