Inclusive and Sustainable Growth Assessment

Viet Nam
2016–2020

(Draft as of 22 August 2016)
CURRENCY EQUIVALENTS

(as of 22 August 2016)

Currency Unit   –   dong (d)
$1.00    =   $0.000046
$1.00    =   d21,830

ABBREVIATIONS

ADB    –    Asian Development Bank
ADF    –    Asian Development Fund
CPS    –    country partnership strategy
FDI    –    foreign direct investment
GDP    –    gross domestic product
PRC    –    People’s Republic of China
SOE    –    state-owned enterprise

NOTE

In this report, "$" refers to US dollars unless otherwise stated.
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VIET NAM: INCLUSIVE AND SUSTAINABLE GROWTH ASSESSMENT

I. RECENT GROWTH, POVERTY, INEQUALITY, AND ENVIRONMENTAL DYNAMICS

A. Economic performance

1. **Strong macroeconomic performance and structural transformation.** Following the gradual opening and liberalization of the economy in the early 1990s, Viet Nam has achieved sustained high economic growth. Per capita gross domestic product (GDP) growth has averaged 5.5% since 1990, yielding a three-and-a-half-fold increase in average income and lifting the country to lower-middle income status in 2010. In global terms, only the People’s Republic of China (PRC) has performed better. Growth has been driven by an expanding pool of young labor and a shift in the economy, away from agriculture towards higher value-added service and manufacturing industries. External trade has also been a major economic driver, along with over $250 million in foreign direct investment (FDI) from more than 100 countries. Through this process, Viet Nam has developed competitive niches in industries such as textiles, footwear, coffee, rice, and tourism. More recently, improvements in Viet Nam’s investment environment coupled with rising wage costs in regional competitors have encouraged new investment in communications and electronics.

2. **Balancing growth and stabilization.** Viet Nam experienced prolonged macroeconomic stability during 1991–2007, but the economy remained relatively closed, with links to the global economy limited largely to trade, official development assistance, and remittances. Various free trade agreements that culminated in accession to the World Trade Organization in 2007 triggered a sharp increase in FDI and portfolio capital flows. Massive capital inflows proved challenging for the authorities to manage, generating asset price inflation, particularly in real estate, and increasing Viet Nam’s exposure to global economic downturns. The subsequent global financial crisis in 2008 triggered a period of macroeconomic instability. Economic growth slowed, foreign reserves declined, inflation rose to double digits, and the trade deficit expanded. The government responded with high rates of public investment that widened fiscal and monetary imbalances and increased the ratio of public debt to GDP. Macroeconomic policies in place since 2011 have restored macroeconomic stability, with economic growth increasing to 6.7% and inflation falling to 0.6% in 2015. However, as Viet Nam further integrates with the global economy, maintaining stability and weathering external shocks will be an ongoing macroeconomic challenge.

3. **Remaining vulnerabilities.** Viet Nam’s productivity and innovation continue to be hampered by important factors. The government has yet to outline a clear strategy to resolve a large number of nonperforming loans dating back to 2005–2010, when many state-owned enterprises (SOEs) and banks channeled assets into high-risk property development. Another drag on the economy has been slow progress in finding buyers for SOEs, due to complex ownership structures and opaque accounting in many SOEs.

B. Labor market developments

4. **Rapidly changing employment landscape.** During the period of central planning, 1954 to 1986, SOEs and agricultural collectives dominated formal enterprise. This changed rapidly, however: the formal private sector provided just 40% of employment in 2000, but this increased to 85% in 2014, while the proportion of capital stock increased from 35% to 74% during the same period. A major driver has been the gradual shift of labor from agriculture to
manufacturing, services, non-agricultural household enterprises, and private firms. Agriculture’s share of the labor force has continued to drop over the last decade, at about 1.6% per year, and now comprises just over 40% of total employment. Workers have shifted into household enterprises, which now account for 21% of total employment, and wage employment, which accounts for 36% (Figure A.1, in Appendix 1). Labor productivity (output per worker) has been declining since the end of the 1990s, in industry, mining, finance, and real estate. In agriculture, however, labor productivity has grown robustly, but is still lower than in most middle-income countries in Southeast Asia. Almost half the workforce is still engaged in agriculture. Job creation in manufacturing has plateaued at a relatively low level, and the service industry is mostly informal.

C. Poverty and inequality trends

5. **Rapid nationwide poverty reduction.** Poverty in Viet Nam, however measured, has fallen rapidly since the early 1990s. The poverty rate based on a $1.90 per day purchasing power parity declined from 50% in the early 1990s to an estimated 3% in 2015 (Figure A.2, in Appendix 1), meaning that close to 50 million people have risen out of poverty. The food poverty rate fell from 24% in 1993 to 7% in 2008, while the poverty gap narrowed from 18.5% to 3.5%.Viet Nam has also achieved rapid growth with only modest increases in income inequality. During 1993–2012 the average income of the bottom 40% of the population grew at an annual rate of 9%, one of the highest rates globally. The Gini coefficient has increased only slightly, from 32.6 in 1993 to 34.8 in 2014.

6. **Structural transformation and inequality.** Despite the remarkable record of reducing poverty in absolute and nationwide terms, and the inclusiveness of growth, challenges remain. A large number of urban people remain near poor, and are vulnerable to significant economic and environmental shocks. Urban poverty is also likely to be undercounted because housing, water, and sanitation costs are left out of official consumption and income poverty estimates. Official surveys also likely miss urban migrants. This is a consequence of Viet Nam’s household registration (ho khau) system, which aims to restrict spontaneous migration, but is widely flaunted, especially in Ho Chi Minh City, Hanoi, Danang, and other industrializing areas. In 2009, the United Nations Development Programme’s urban poverty survey found that in Hanoi and Ho Chi Minh City, 17% of people were temporary or unregistered migrants; they usually have lower incomes, live in overcrowded conditions (with less than 7 square meters of living space per person), and lack a private water tap and social insurance.

7. **Pockets of poverty remain.** Reductions in the national poverty rate notwithstanding, poverty continues to be significantly higher in the Northern Mountains, North Central Coast, and Central Highlands, where ethnic minorities tend to live. Although they account for just 14.5% of the population, ethnic minorities make up more than half of the poor.

8. **Declining demographic dividend.** Viet Nam’s economic success has come in part as a demographic dividend of the large working-age population. The share of the population that is of working age peaked in 2013 and is now declining, while the actual size of the working-age population is projected to begin falling soon after 2035. Importantly, the population over 65 years old will rise from 6.7% in 2015 to 14.4% in 2035, transforming Viet Nam from a young to

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1 The poverty gap is the mean shortfall in income from the poverty line (counting the non-poor as having zero shortfall), expressed as a percentage of the poverty line. This measure reflects the depth of poverty as well as its incidence.

an aged society. The decline in the working-age population means that a key driver of Viet Nam’s rapid per capita growth is diminishing, making it crucial to continue improving human capital and other sources of productivity.

D. Gender equity

9. **Nationwide progress on gender equity.** Viet Nam has made considerable progress toward gender equality. The 2014 Human Development Report ranked Viet Nam 58th out of 154 countries on the Gender Inequality Index, while in 2014 the World Economic Forum ranked Viet Nam 76th out of 142 countries on its Gender Gap Index, an improvement from 2011, when it was 79th out of 135 countries.  

10. **Access to education and health care improving for females.** In 2013, 22.4% of males aged 5 and older completed primary education, while the rate for females was 22.6%. In the school year 2013–2014, 47.8% of primary students, 48.6% of lower secondary students and 52.8% of upper secondary students were female. For ethnic minorities, the gender gap in education has also narrowed. In 2008, the rate for ethnic minority children enrolled in primary and lower secondary schools was slightly higher for females (89%) than for males (87%), up from 83% for girls and 89% for boys in 2002. The adult literacy gap has narrowed as well, with the female-to-male ratio increasing from 0.93 in 2007 to 0.96 in 2012. Viet Nam has also significantly improved women’s access to health care during pregnancy and delivery, as well as family planning services. In 2008, an estimated 86.4% of pregnant women received more than three pre-natal checks at commune health clinics, a rise from 84.3% in 2005. In 2011, skilled health staff attended 93% of births compared to 88% in 2006. However, challenges in accessing maternal health services in the North West and Central Highland regions result in lower rates for prenatal checks and births attended by skilled health staff (around 70% in the North West, and 80% in the Central Highlands). The national maternal morbidity rate has dropped dramatically (from 233 per 100,000 live births in 1990 to 59 in 2011). During 2010–2015, Viet Nam’s adolescent (age 15–19 years) birth rate (38) was below the global average rate (47.4). The national total fertility rate dropped rapidly from 2.33 children per woman in 1999 to 1.7 children in 2013, with the urban total fertility rate even lower.  

11. **Growing labor force participation and gender wage gap.** The ratio of female to male labor force participation was 0.92 in 2010, well above countries of similar income status (0.64), and the global average (0.73). The 2009 World Bank Enterprise Survey found that Vietnamese firms employ proportionally more women and have more female top managers than most countries of a similar population size (3rd of 13) in the lower-middle income group, where it places 5th out of 26 overall. Furthermore, Vietnamese firms have a higher rate of female participation in ownership (59.2%) than the East Asia and Pacific region as a whole (54.3%),

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and low-income countries (29.8%). However, Viet Nam is among the few countries in the world where the gender pay gap has been widening.\(^\text{10}\) Female workers earn only 70%–80% as much as their male colleagues in all economic sectors—state, non-state, and foreign-invested. Women even earn less than men in female-dominated industries, such as healthcare, social work, and sales.

12. **Women remain excluded from leadership.** In business, government and political spheres, Vietnamese leadership remains overwhelmingly male. In the last 15 years, the share of women in the National Assembly has been declining and is now 24.4%, and there are few women serving as chairs of National Assembly committees. While women comprise 47% of the civil service,\(^\text{11}\) women hold only 9.1% of ministerial-level positions, and only 27% of directors and deputy-director generals are women.\(^\text{12}\) Women also constitute only 18.3% of Communist Party leadership in communes, 14.2% in districts, and 11.3% in provinces.

13. **Low female birth sex ratios.** Births of boys is much higher than that of girls because of sex-selective abortion, which is both gender discrimination and a threat to gender equity. The sex ratio at birth (number of male births per 100 female births) was in the normal range of 105–106 in 1979 and 1989, but since 2005 the ratio has risen rapidly, to nearly 114 in 2013, placing Viet Nam—with India and the PRC—among the countries with the highest sex ratio at birth. In about 20 years, Viet Nam will have a large surplus of men, which could increase antisocial behavior and violence.

E. **Progress towards achieving the Millennium Development Goals**

14. By the end of 2015, Viet Nam had formally achieved three of the Millennium Development Goals: (i) eradicating extreme poverty and hunger, (ii) achieving universal primary education, and (iii) promoting gender equality in education.\(^\text{13}\) Viet Nam also met the targets for a number of health-related indicators, such as reducing the maternal mortality ratio and the child mortality ratio. The country also achieved the targets for malaria and tuberculosis control, and for combating HIV/AIDS. Viet Nam is also close to reaching the targets for universal access to reproductive health services and improving maternal health.

15. **Additional effort needed.** Stronger efforts are needed to meet other targets, including Millennium Development Goal 7 (ensuring environmental sustainability). While the country has curtailed greenhouse gas emissions, and increased reforestation programs, Viet Nam still faces pressures associated with a rapidly developing economy and large population, including biodiversity loss, environmental pollution and violations, and an emphasis on economic growth over sustainability. Stronger effort is also required to fully realize targets such as ensuring debt sustainability, enhancing access to affordable essential drugs, and developing a non-discriminatory trading and financial system.

F. **Environment and climate change issues**

16. **Growing environmental pressures.** Urban expansion and infrastructure development, plus agricultural expansion, have contributed to a significant decline in natural forests. However,

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this has been partially offset by 20 years of increases in the area of forest plantations (from 9.4 million hectares in 1990 to 13.8 million hectares in 2010). The country’s water resources are under growing pressure from rising demand and greater pollution. Agriculture uses about 82% of available fresh water. Excessive use of agro-chemicals is a primary cause of water contamination, although urban and industrial discharges are also significant pollution sources. As 60% of Viet Nam’s rivers originate outside its borders, water security is a growing concern. Reduced flows from dams and water diversion in countries up river increase saline intrusion threatening agricultural areas such as the Mekong Delta.

17. **High risk of climate change impacts.** Viet Nam is exposed to high risks from climate change, as a result of its long coastline and large river deltas, which support large population concentrations, and from its economic dependence on agriculture. According to the global climate risk index, Viet Nam ranks 7th worldwide for climate risk exposure. Similarly, a 2012 report modeling climate change and sea level rise scenarios for Viet Nam showed that with a medium level of global emissions, by the end of the 21st century Viet Nam will face: (i) average annual temperatures increasing by 2°C to 3°C; (ii) the number of days with maximum temperature over 35°C rising from 15 at present to 30 over most of the country; (iii) rainfall decreasing in the dry season and increasing in the rainy season; and (iv) average sea levels rising 57–73 centimeters.

18. **Increasing carbon emissions and air pollution.** Rapid industrialization and urbanization over the last decade have increased air pollution. Carbon dioxide emissions have risen and are higher than in almost all other countries in the region. Energy use per unit of GDP is the highest in Southeast Asia and rising (Figure A.3, Appendix 1).

G. **Business environment and private sector development**

19. **Changes in the structure of the corporate sector.** Market and regulatory reforms introduced since the 1980s have considerably changed the structure of the corporate sector in Viet Nam. Agricultural collectivization policies were abolished and thousands of SOEs equitized. Meanwhile, the number of registered new enterprises has increased dramatically, reflecting both the formalization of existing household businesses as well as the creation of new enterprises, including large numbers of foreign owned firms. The cost of starting a business amounts to 4.9% of average annual per capita income, one of the lowest scores in Asia and the Pacific. By the end of 2014, over 400,000 registered private companies were operating in Viet Nam—a nearly 20-fold increase since 2000. Viet Nam has, however, made less progress on resolving insolvency (it was ranked 123rd out of 189 countries in 2015), protecting minority investors (122nd of 189) and paying taxes (168th of 189). Viet Nam’s overall ranking in the *Doing Business 2015* survey was 90th out of 189 countries.

20. **The private sector’s role in the economy is growing.** The formal private sector contributed 67% of GDP in 2013. In 2000, the formal private sector accounted for just 29% of capital, 39% of tax revenues, and 32% of jobs in the enterprise sector. Since then these

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14 The current estimate for agriculture sector water use is 80 cubic kilometers per year.
15 Sector Assessment (Summary): Water Supply and Other Urban Infrastructure and Services (accessible from the list of linked documents in Appendix 2 of the CPS).
numbers have increased, albeit at different rates. The sharpest increase has been in the formal private sector’s share of employment (76% in 2007, rising to 88% in 2014). This increase has resulted from the rapid growth of domestic and foreign private enterprises and equitization of labor-intensive SOEs. By 2014, the formal private sector contributed 78% of total capital investment and 55% of total tax revenues (the latter was a slight decrease from 61% in 2007). The private sector’s growing contribution to employment, capital investment, and tax revenue generation is shown in Figure A.4 (Appendix 1). Much of Viet Nam’s export growth has been generated by manufacturing investments by multinational companies. Annual FDI inflows averaged around $7.4 billion over 2007–2014. By 2014, Viet Nam’s trade-to-GDP ratio stood at 164% and its export-to-GDP ratio was 84%, significantly higher than other countries with a similar per capita income level.

H. Drivers of reform

21. Regional cooperation and global integration are driving structural reforms. World Trade Organization accession in 2007 and recent free trade agreements with partners such as the European Union and the Republic of Korea have resulted in reduced tariffs and duties, the ending of state monopolies, and opening of numerous sectors to foreign investment. Recent progress on the Trans-Pacific Partnership and ongoing Association of Southeast Asian Nations economic integration will maintain this momentum by enforcing requirements to: reduce state ownership in enterprises seeking to access foreign markets, enhance protection of intellectual property, introduce more stringent labor standards, and further remove tariff and non-tariff barriers to trade. Other significant agreements are the Free Trade Area of the Asia–Pacific and the Regional Comprehensive Economic Partnership, both of which are at a less advanced stage of negotiation than the Trans-Pacific Partnership. Top-down multilateral trade integration is also being complemented by important subregional collaboration, including within the Greater Mekong Subregion.

22. Emergence of new domestic drivers of reform. While the central government retains overall control by setting the direction and boundaries of reform, provincial governments have been given greater political and fiscal autonomy. In collaboration with the private sector, and especially foreign-owned enterprises, provincial governments are now driving crucial reforms. Rapid economic development means that policy makers face more diverse interests, including new domestic and foreign businesses, an increasingly vocal National Assembly, and greater pressure from civil society.

II. Key Impediments to Inclusive and Sustainable Growth

A. Low productivity and inefficient resource allocation

23. Viet Nam’s strong growth trajectory has enabled it to realize its comparative advantage of low labor costs. The declining trend in labor productivity, however, suggests the current development model may not be sustainable (Figure A.5, Appendix 1). Growth in labor productivity (output per worker) has been falling since the end of the 1990s in industrial subsectors where SOEs are dominant including public utilities, construction, and finance. In agriculture, which employs almost half the workforce, labor productivity has grown robustly, but it is still lower than in most middle-income countries in Southeast Asia.

24. State-owned enterprises contribute to stagnating productivity. The formal enterprise legal framework ensures equal treatment of all companies, regardless of ownership, but effective application lags behind. SOEs benefit from state monopolies and special
arrangements not available to privately owned companies, and receive special treatment from the government in many different forms, both explicit and implicit. These include access to subsidized credit, access to land on favorable terms, the ability to obtain government contracts through non-competitive bidding or insider information, and exemptions from prudential governance and financial management regulations. As a result of their favorable conditions, SOEs are a major drag on economic growth and productivity. In 2012, the average capital efficiency ratio for Vietnamese SOEs was 1.62—i.e., they needed $1.62 in capital to generate $1.00 of revenue. This compares with average ratios of 0.69 for multinational corporations (i.e., $0.69 in capital generates $1.00 in revenue) and 0.47 for private domestic companies. SOE productivity is particularly weak in the transportation, storage, and telecom industries, which are sectors that significantly impact economic efficiency, and serve to increase domestic production costs. SOEs are not unusual in many economies, especially in sectors that are natural monopolies (public utilities) or are capital intensive (large infrastructure). In Viet Nam, however, SOEs are present across almost the entire economy, including garment manufacturing, mobile telephone services, and banking—sectors where private companies can be more effective. Given the influence of SOEs in Viet Nam’s economy, reform of their ownership and incentives for privatization will be a vital step toward lifting long-term productivity and growth.

25. **Inefficient financial markets.** Despite rapid expansion since the early 1990s, the financial sector remains shallow and unsophisticated. The financial market is more diversified but still largely bank-based, while equity market capitalization has grown rapidly. Bond and insurance markets have developed but remain relatively small. The financial market mobilizes savings relatively well but falls short in allocating credit to its most productive uses and providing an inclusive payment system. Much of the lending, especially by state-owned banks, has gone to SOEs, or increasingly to private companies with political connections, often preventing lending to productive segments of the domestic private sector. Financial inclusion has increased since the early 1990s, but remains an issue for less well-off Vietnamese, especially in rural areas. Despite the prominence of banks in formal markets, they serve only about 10% of the population, with informal finance still playing a significant role in the economy. Nonperforming loans are believed to be under-reported, compared to middle-income peer countries in East Asia, with many nonperforming loans and restructured loans held by SOEs. Moreover, the ownership of private banks by other private banks and by enterprises (including SOEs) remains significant. Compliance with Basel Core Principles of financial accountability is improving, but still low, and many banks do not meet Basel II’s capital requirements for market and operational risks, even as the country moves toward Basel III. Onsite inspections, particularly of state-owned commercial banks, have been limited, and consolidated supervision of banks is lacking.

26. **Worsening productivity of domestic private enterprises.** Private firms in Viet Nam, on average, were using their capital more productively than their counterparts in the PRC in the early 2000s, but by 2014, the productivity of their assets had fallen to less than half that of their peers in the PRC. Vietnamese private firms are overwhelmingly small and informal, which prevents productivity gains through specialization and economies of scale. Also, with regard to both assets and labor productivity, the relatively few large domestic private firms (and especially those with more than 300 employees) tend to be even less productive than the smaller private firms. This trend in private sector productivity is worrying for future income growth, as the private

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sector was responsible for almost 90% of formal employment by the end of 2015, up from approximately 70% in 2002.

27. FDI exporters are driving strong near-term economic growth, but the low productivity of domestic private enterprises means Viet Nam is not fully participating in global value chains. A striking feature of export manufacturers is the relatively high value of their imported components—e.g., an estimated 50%–60% for garment and footwear exports. Most local firms, and particularly small- and medium-sized enterprises, serve the domestic market only, or export commodities with little value-added. They lack the capacity to export directly or service larger, export-focused foreign investors.

28. A modern service sector is a critical input for manufacturing, and especially for exporters, but Viet Nam lags behind its competitors. Lack of access to early stage financing limits the development of a dynamic environment for startups. Government business development support programs have generally been ineffective, and insurance, telecommunications, and transport and logistics are also inadequate. The impact of these weaknesses will become even more pronounced as Viet Nam participates in global value chains, and the value added in exports rises.

29. The agricultural sector is at a turning point. There are major opportunities in serving domestic, regional, and international markets, but the sector will no longer be able to compete on the basis of low-cost, labor-intensive natural resource use. Despite rapid gains since 1992, labor productivity remains much lower than in comparator countries. The sector also faces growing domestic competition for labor, land and water from cities, industry, and services. Change is also needed in the structural patterns of production and supply chain organization, which are highly fragmented, with limited collective action among farmers, and weak vertical coordination. This fragmentation has contributed to unnecessary transaction costs, unrealized economies of scale in certain functions, and poor incentives to produce and maintain quality. Future growth therefore depends on greater efficiency and innovation.

30. Shortages of skilled labor. Graduates often lack the skills demanded in the market. A survey conducted by the Viet Nam Student Association showed that 50% of graduates cannot find jobs in their field, and a significant number must be retrained. When Vietnamese executives were asked about their challenges, inadequately educated workers was the third most-frequently mentioned problem, while the seventh was the poor work ethic. While there has been a significant increase in the availability of training programs, quality remains variable. Government efforts to manage the education sector through entry barriers to foreign providers, and administrative control are hindering growth in the supply of skilled workers and firms. An inadequate focus on vocational training also contributes to the lack of skilled workers. Management of vocational training is fragmented across different government bodies and specialized agencies. Training facilities and teaching staff lack adequate funding, because society still undervalues vocational training and its graduates.

31. Inefficient investment in infrastructure. Viet Nam has invested over 10% of GDP in infrastructure between 2011 and 2015, more than Thailand and the PRC, which spent 7%–8%. However, the efficiency of this investment has been low and is deteriorating, and the infrastructure quality and impact are questionable. For example, according to the Provincial Competitiveness Index survey, over 70% of manufacturing firms report that their products are

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being damaged due to poor road quality. Infrastructure and utilities (electricity and water) are struggling to keep pace with growth and urbanization.\textsuperscript{23} Electricity demand has increased at an annual rate of almost 20\% since 2000, twice as fast as the growth rate of the economy. Domestic electricity capacity is inadequate to meet growing demand, leading to reliance on electricity imports from Lao PDR and the PRC. According to the Provincial Competitiveness Index survey, firms often face up to 50 hours of power outages per month. Water supply coverage for urban areas also remains low; about 70\%–80\% in first and second-tier cities; 50\%–55\% in third-tier cities; and only 15\%–20\% in fourth and fifth-tier cities.

B. Unequal access to economic opportunities and social services

32. While the pace of economic growth and poverty reduction in Viet Nam has been impressive, significant inequality remains across geographic areas and social groups. Key impediments to more equal access to economic opportunities and social services include unequal benefits of urbanization, limited livelihood opportunities for people in remote and rural areas, inequitable access to social services, and weaknesses in public financial management and accountability.

33. Unequal benefits of urbanization. Viet Nam’s economic transformation since the early 1990s is closely linked to urbanization, with urban areas now accounting for roughly 70\% of GDP. The urban population has grown from 12.8 million (19.5\% of the total) in 1990 to 31 million (34.5\%) in 2014.\textsuperscript{24} Urban residents experience the impacts of growing population density, weak urban transport, a lack of solid waste management, and unequal access to water and sanitation, and their increasing expectations regarding quality infrastructure and services are intensifying pressure on urban management. The urban population with access to improved water sources is officially 98\%, but only 61\% have a house connection. Less than 10\% of urban wastewater is centrally treated. Most households rely on septic tanks and only a few cities have a seepage management service. Recurrent urban flooding stems from poor management of storm water, which worsens as urbanization intensifies. Viet Nam has 3,000 kilometers of coastline, and many cities face increased flood intensity and frequency because of sea level rise and other climate change impacts. At the same time, strong growth in urban centers has increased pressure on transport systems, most of which is being met through a rapid expansion in the use of private vehicles. Bus systems are present only in large cities, and these have been serving a declining portion of total demand since 2000 because of road congestion. Private vehicles (mostly motorcycles) make up an abnormally high proportion (80\%–90\%) of total trips. The current road network is becoming severely congested during peak hours, and the increase in private car ownership will only exacerbate this problem.

34. Limited livelihood opportunities for remote and rural people. Although Viet Nam has made rapid progress in improving its water supply situation since 2005, further improvement is needed in many parts of the country—especially heavily populated areas with ethnic minority groups, and remote and poor communities. Progress in providing access to sanitation and hygiene has been especially slow. A recent survey revealed that 52\% of rural population has some sort of sanitation facilities, but only 18\% have access to latrines that meet the hygienic standard of the Ministry of Health. The same survey indicates that only 12\% of schools have hygienic sanitation facilities.\textsuperscript{25} Rural and remote communities also face substantial inequities in

\textsuperscript{23} Viet Nam Chamber of Commerce and Industry. 2015. \textit{Viet Nam Provincial Competitiveness Report}. Ha Noi.

\textsuperscript{24} Sector Assessment (Summary): Water Supply and Other Urban Infrastructure and Services (accessible from the list of linked documents in Appendix 2 of the CPS).

\textsuperscript{25} Government of Viet Nam. 2015. \textit{National Health Survey}. Ha Noi.
access to economic opportunities and employment, because of weak transport networks that make it difficult for residents to access markets, and the lower availability of electricity. More direct investment in rural areas to promote agriculture and facilitate private investment is likely to be needed, including support for farmer organizations to maintain rural infrastructure and other elements that influence farmer and agribusiness transaction costs, and coordinate their activities. The government’s rural electrification program, which is seeking to provide electricity services to all remaining rural households by 2025, will also have to be fully implemented, but faces a challenge in that most remaining areas that lack electricity access are very far from existing networks; further expansion is not feasible without augmentation of existing rural networks. Sustainable development of rural electricity networks is further constrained by the weak capacity of provincial electricity authorities.

35. **Inequitable access to social services.** Key issues in the health care sector include inequity in access to primary health care, hospital overcrowding, services that do not meet minimum quality standards, and escalating costs that exclude poorer families from accessing health care. Those with formal employment and the poor are typically able to obtain health insurance coverage; however, many workers in the informal sector (approximately 30% of the total) cannot afford coverage. More broad-based financing of health coverage, including non-contributory (general tax) sources as well as individual contributions are needed. Achieving financially sustainable universal health coverage will require shifting the focus of health care from hospitals to primary care providers. Improving the quality and governance of health service delivery is also a critical issue. Only about 40% of employees are covered by social insurance, and it is vital to increase mandatory coverage for waged workers (recently extended to include all workers with contracts of more than 1 month), followed by expansion of voluntary social insurance to the informal sector (where more choice and flexibility in schemes, including the ability to pay premiums by installments, is needed).

36. In the education sector, low quality, limited access, inequities, and ineffective governance remain significant challenges. While Viet Nam’s education sector is now better organized, more diversified, and better funded, all levels of education face issues that limit their capacity to respond to the needs of a growing economy. The government has continued efforts to increase access and retain in-school students from vulnerable groups (including ethnic minorities, the rural poor, domestic migrants, physically disabled, and females). However, these approaches have not been sufficiently inclusive to date, and additional innovations are needed. More than half of children with severe disabilities never attend school. Half of students living in poverty are from an ethnic minority, and most ethnic minority students live in remote rural areas. Poverty among ethnic minority groups is closely associated with low or limited access to educational and training opportunities.

37. Among ethnic minorities, the Kinh have the largest proportion of people completing higher levels of education, while the Hmong ethnic group lag far behind. In higher education, there is also evidence that minority ethnic groups, the disadvantaged, and those from some regions are not represented in proportion to their numbers in the population. This limits the capacity of the country to draw on the largest possible talent pool, with negative implications for both equity and provision of skills.

38. **Weaknesses in public financial management and accountability.** Significant progress has been made in improving the transparency and accountability of public service

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26 Sector Assessment (Summary): Health (accessible from the list of linked documents in Appendix 2 of the CPS).
27 Sector Assessment (Summary): Education (accessible from the list of linked documents in Appendix 2 of the CPS).
delivery since the late 1990s, when budget documents were still regarded as state secrets. At the same time, public sector management is becoming more complex, with a growing economy and the rise of new industries linked to global value chains contributing to a proliferation of regulations and policies. In this environment, implementation and enforcement challenges are limiting the impact of new public financial management laws and regulations on improving service delivery and the business environment. While further regulations are needed in some important areas (such as business licensing and customs administration), there is a need to focus on compliance and supporting the capacity of institutions charged with the administration of laws and regulations. The continued devolution of administrative and fiscal powers to provincial governments only adds to these challenges. The quality of governance among provinces varies considerably, as does how well they adhere to national policies. Stronger provincial institutions have generally done well in encouraging greater private sector development and enhanced service delivery. However, in provinces with weaker performance, entrepreneurs with a background in state employment often use their personal connections to access scarce business resources and to minimize government regulation of their operations. Limited public administrative capacity, especially among mid- and lower-level civil servants, also constrains the implementation and quality of public spending in some provinces.

C. Unsustainable resource utilization and climate change

39. Viet Nam’s rapid economic growth, high population density, and unique geography—with a long coastline and large river deltas—combined with the economic importance of agriculture, create significant environmental challenges. These challenges are being amplified by additional risks from climate change.

40. Unsustainable natural resource use. Viet Nam’s economy is more dependent on natural resource use than is the case for most countries in Southeast Asia. More than half the labor force depends on agriculture or other land use to some degree. In the mountainous northwest and central areas, poorly planned expansion of agriculture has removed biodiverse natural forests and caused soil erosion, which in turn contributed to more frequent and severe flooding of lower-altitude farms and human settlements. A significant portion of the protective mangrove forests has been destroyed, while overfishing has seriously depleted near shore fishery resources. Agricultural output has risen, but has increased land degradation through more intense land use and as a result of chemical fertilizers and pesticides. Energy use is growing faster than in any country in Southeast Asia, led by electric power. Reflecting current trends and policies, the share of power generated with coal will rise from 32% in 2014 to 54% by 2030 (footnote 24). Around 60% of the coal used for electrical generation will be imported. The intensity of energy consumption (the amount of energy used per unit of economic output) is also among the highest in the world, and inefficient energy use is a primary reason.

41. Viet Nam’s natural resources and environment will come under increasing pressure from rapid economic growth and the growing demands of an increasingly affluent society. Growing pressure on Viet Nam’s environment from urban expansion, infrastructure development, the expansion of agriculture, and unsustainable resource use (para. 16) are negatively impacting land, water, and air quality. Water pollution has reached serious levels around major urban cities. Air quality has also declined because of growth in fossil fuel use for power generation, industrial energy, and transport. In urban areas, environmental pollution from urban and

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industrial wastewater has resulted in toxic waterways, with impacts on economic production, and likely severe impacts on human health.

42. **Climate change vulnerabilities.** Viet Nam is among the countries most vulnerable to climate change as a result of its location, significant population living in low-lying deltas, and economic dependence on sectors that are vulnerable to climate change. Predicted changes in precipitation, temperature, and sea level (para. 17) all indicate substantial risks in high-density and economically important areas. In the lowlands, challenges include floods, droughts, and susceptibility to catastrophic weather events such as typhoons, while upland challenges include poor soils, difficult terrain and high levels of erosion. Specific vulnerabilities to climate change risks include: (i) in agriculture, (a) rice and livestock production will suffer the most from climate change, with spring and summer crop outputs both likely to decrease; (b) rising temperatures affect the metabolism, growth and seasonal reproduction of aquatic organisms increasing their vulnerability to diseases and toxins; and (c) floods and storms can destroy fish ponds, fish cages, and reduce estuarine water salinity, severely affecting aquaculture production; (ii) impacts to the energy sector will be significant as a result of rising temperatures, with energy consumption increasing as more power is needed for electric fans, air conditioners, industrial cooling processes, and agricultural irrigation and drainage pumps; (iii) transport infrastructure may be damaged or destroyed as storms and floods grow in both frequency and intensity; and (iv) groundwater tables may decrease significantly as a result of overexploitation and decreased groundwater recharge during the dry season, while sea-level rise will exacerbate saltwater intrusion in coastal zones.

### III. Government Aspiration, Strategies, National Targeted Programs

43. **Long-term strategy.** Viet Nam aspires to become a modern, industrialized economy that has successfully transformed itself into an upper middle-income economy by 2035 (footnote 24). To achieve this goal, the government’s socio-economic development strategy, 2011–2020 lays out a vision for environmentally sustainable and socially equitable economic development, highlighting the need for maintaining macroeconomic stability and deepening structural reforms.

It defines three "breakthrough areas": (i) promoting human resources and skills development, particularly for modern industry and innovation; (ii) improving market institutions; and (iii) infrastructure development. Looking forward to 2035, the government recognizes that: (i) rapid growth will only be sustained if it addresses the environmental degradation associated with unsustainable growth, and nurtures a creative and innovation-led economy, (ii) maintaining its record on equity and social inclusion will require assisting marginalized groups and delivering services to an aging, middle-class society; and (iii) fulfilling the country’s aspirations will require modern and transparent governance institutions that are fully rooted in the rule of law. Viet Nam has responded to the global sustainable development agenda, committing itself to localize and achieve the broad objectives of the United Nations Sustainable Development Goals by 2030, and making commitments to lower greenhouse gas emissions through the intended nationally determined contribution framework, as agreed in Paris at the 21st session of the Conference of the Parties to the United Nations Framework Convention on Climate Change.

44. **Medium-term development plan.** The government’s five-year socio-economic development plan, 2016–2020 elaborates the government’s objectives for the second 5 years of the socio-economic development strategy, and identifies the specific measures to achieve high quality and sustainable economic growth.

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plan include (i) supporting faster rates of private sector development, industrial restructuring, and service sector development; (ii) developing special economic zones and regions; (iii) developing integrated urban infrastructure, including improved urban planning, linking major urban centers; (iv) enhancing education and human resource quality with a focus on innovation and technology development; (v) mitigating and preventing the adverse impacts of climate change and environmental degradation; and (vi) increasing public sector efficiency and reducing corruption.

45. **Targeted anti-poverty programs.** Viet Nam has implemented 16 national targeted poverty reduction programs and 30 different state-funded projects since 2006, covering areas such as construction of new rural areas, employment and vocational training, sustainable poverty reduction, and child protection. The National Targeted Poverty Reduction Programs focused on poor communes in coastal, delta and midland areas, and targeted registered poor households with social assistance, free and subsidized health care, exemptions from school fees and subsidized credit; they also made some investments in commune infrastructure. The Program for Socio-Economic Development in Communes Facing Extreme Hardship in Ethnic Minority and Mountainous Areas (Program 135) is now in its third phase, and focuses on communes with large ethnic minority populations, high mountainous areas, and other remote areas (such as the offshore islands). It was approved in 2013 and will last for 10 years. The program is geographically targeted with a high share of its expenditure allocated to the provision of infrastructure (in particular, roads, schools, commune health centers and public markets), although it also contains a smaller livelihoods component. The Rapid and Sustainable Poverty Reduction Program (Program 30a) was initiated in 2009, and is targeting 62 districts with the highest proportions of poor and near-poor households.

IV. **Implications for ADB Country Engagement**

46. Viet Nam made impressive progress in terms of economic growth and poverty reduction during 1991–2015, but significant disparities remain. There is significant risk that structural transformation will increase inequality. Equality of opportunity is uneven, with a bias against women, ethnic minorities, people with disabilities, and unregistered domestic migrants. The country’s rapid economic growth has produced environmental degradation, with the poor particularly vulnerable to environmental degradation and climate change.

47. ADB support will be small compared to the massive scale of the government’s development plans. This implies that ADB must provide support that is focused, selective, and catalytic, and that combines financing with new knowledge and other sources of finance to maximize its contribution to the government’s development efforts. Ensuring that ADB support is knowledge-based, and draws together skills and talents from across the organization, can help Viet Nam identify and adapt good regional practices as it addresses its diverse development challenges.

48. To achieve this, ADB’s country strategy will need to sharpen its focus on achieving inclusive and sustainable growth. Lessons from ADB programs in Viet Nam indicate the need to (i) promote projects and programs that create economic opportunities, eliminate social exclusions and biases, improve access to opportunities, and protect vulnerable people and the
environment in a sustainable manner; and (ii) work with other development partners to ensure synergies and complementarities, and thereby maximize effectiveness.31

49. ADB must also leverage external and domestic forces that support reform. Regional cooperation and global integration are an impetus for deeper structural reforms. The ongoing process of free trade negotiations and Association of Southeast Asian Nations economic integration will maintain reform momentum, enforcing requirements to reduce state ownership in enterprises seeking to access foreign markets, enhancing protection of intellectual property, introducing more stringent labor standards, and further removing tariff and non-tariff barriers to trade. Domestically, the ongoing process of fiscal decentralization, emergence of new business interests, an increasingly vocal National Assembly, and a more diverse civil society are important factors that ADB must consider when engaging in policy dialogue with the government.

50. Given this context, the focus of the ADB country partnership strategy for Viet Nam should be to accelerate economic growth and poverty reduction, but with an enhanced focus on reducing unintended exclusion to the resulting economic opportunities. It should also seek to ensure sustainability of natural resources, and realization of intended development impacts. Achieving this will require targeted interventions that address all three of Viet Nam’s major development constraints (paras. 25-42). ADB will also seek to leverage the added impetus to structural reforms from regional cooperation and global integration. Specific priorities include:

(i) **Innovation, productivity and increased employment.** Developing a more innovative and productive economy that generates increased employment opportunities will require that ADB assist the government to meet the challenges and exploit the opportunities of its ongoing market-based economic reforms. Priorities include efforts to increase the pace and deepen the impact of structural reforms, particularly in relation to reforming SOEs. ADB should also help enhance the enabling environment for private sector development, particularly for job-creating small and medium-sized enterprises, and promote improved physical connectivity to develop supply chains, both within Viet Nam and for external trade. Investments in transport infrastructure should also be used to better connect the poor to markets and increase their access to basic productive assets and public services. ADB will need to engage with business associations, particularly young entrepreneurs, to equip firms with the skills and knowledge needed to advocate for better policies and access business opportunities related to global value chains.

(ii) **Enhanced, more inclusive infrastructure and service delivery.** To foster more inclusive economic growth ADB should support the creation of more diversified economic opportunities, and broader access to these opportunities and to essential social services. This support should target regions with disproportionately high numbers of poor, near-poor and other vulnerable groups and ethnic minorities. Support is also needed to make urbanization more inclusive by promoting equitable service delivery and ensuring an inclusive and productive labor market. ADB will also seek to promote more accountable and transparent public financial management, and promote gender equity in all its activities.

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(iii) Improved environmental sustainability and climate change response. It is critical to ensure Viet Nam’s natural resources and environment do not come under further pressure from rapid economic growth and the growing demands of an increasingly affluent society. ADB can help Viet Nam build climate resilience into economic planning, sectoral policies, and infrastructure investments to reduce the most severe risks posed by climate change. Sustainable economic growth will require more effective management of natural resources, and ensuring that resource use is responsive to the existing and potential future impacts of climate change. To this end, ADB support should target initiatives that support climate change mitigation and adaptation, as well as enhancing disaster risk preparedness.

(iv) Accelerate and maximize benefits of regional coordination and integration. ADB will enhance physical connectivity and facilitate trade between Viet Nam and its neighbors through the Greater Mekong Subregion Regional Investment Framework. ADB will also leverage reform momentum under the Association of South East Asian Nations integration process and various free trade agreements to spur reforms to SOEs, the financial sector, and business regulations. In addition to physical connectivity and structural reforms that accelerate economic integration, ADB will also facilitate dialogue and greater regional cooperation on energy security and environmental issues.

51. The changed circumstances facing Viet Nam will require an economy that is capable of rapidly adapting to change, and an economic development model that can deliver sustainable and equitable growth over the long term. This marks a major departure from the development model that has served Viet Nam well for almost three decades, with vital, complementary roles played by both the state and private sector. It is crucial that reforms and policy initiatives to enable this transition be carefully sequenced. The government cannot upgrade all areas in parallel, as this would overwhelm its ability to achieve change, and likely result in failure. The challenge is made more acute by Viet Nam’s need to transition to a new set of competitive economic advantages and policies. The impact of individual reforms often depends on other (prior or simultaneous) policy steps. Failure to properly sequence reforms will significantly delay results, while the political will to pursue reform may wane in the absence of some positive results. Establishing the correct reform sequence is thus a critical dimension of a sustainable, inclusive growth agenda.

52. Overcoming the key binding constraints to inclusive and sustainable economic growth over the next 5 years will require changes in both the macro- and microeconomic conditions driving productivity, which will in turn require continuing changes to institutions—economic, administrative, and those that deliver essential social services—throughout Viet Nam.
APPENDIX 1

Figure A.1: Employment by Type

Total Employment 52.6 million, 100%

- Family farming 22.5 million, 43%
- Wage work 18.7 million, 36%
- Non-farm household enterprise 11 million, 21%
  - Without contract 7.4 million, 14%
  - With contract 11.3 million, 22%
  - Government 4 million, 7.6%
  - State-Owned enterprise 1.4 million, 2.6%
  - Foreign private sector 2 million, 3.8%
  - Domestic private sector 3.9 million


Figure A.2: Poverty Headcount Indicators

Poverty headcount ratio at $1.90 a day (2011 PPP) (% of population)
Poverty headcount ratio at national poverty lines (% of population)

PPP = purchasing power parity
Figure A.3: Carbon Dioxide Intensity of Gross Domestic Production in Southeast Asian Countries, 2005–2013

Note: Figures are kilograms of carbon dioxide per $ of gross domestic product, in 2005 prices.

Figure A.4: Contribution of Firms to Enterprise Numbers, Employment, Capital and Tax Revenue by Corporate Ownership (% of total)

Figure A.5: Labor Productivity Growth (3-year Moving Average)

% growth in labor productivity (3-year moving average)