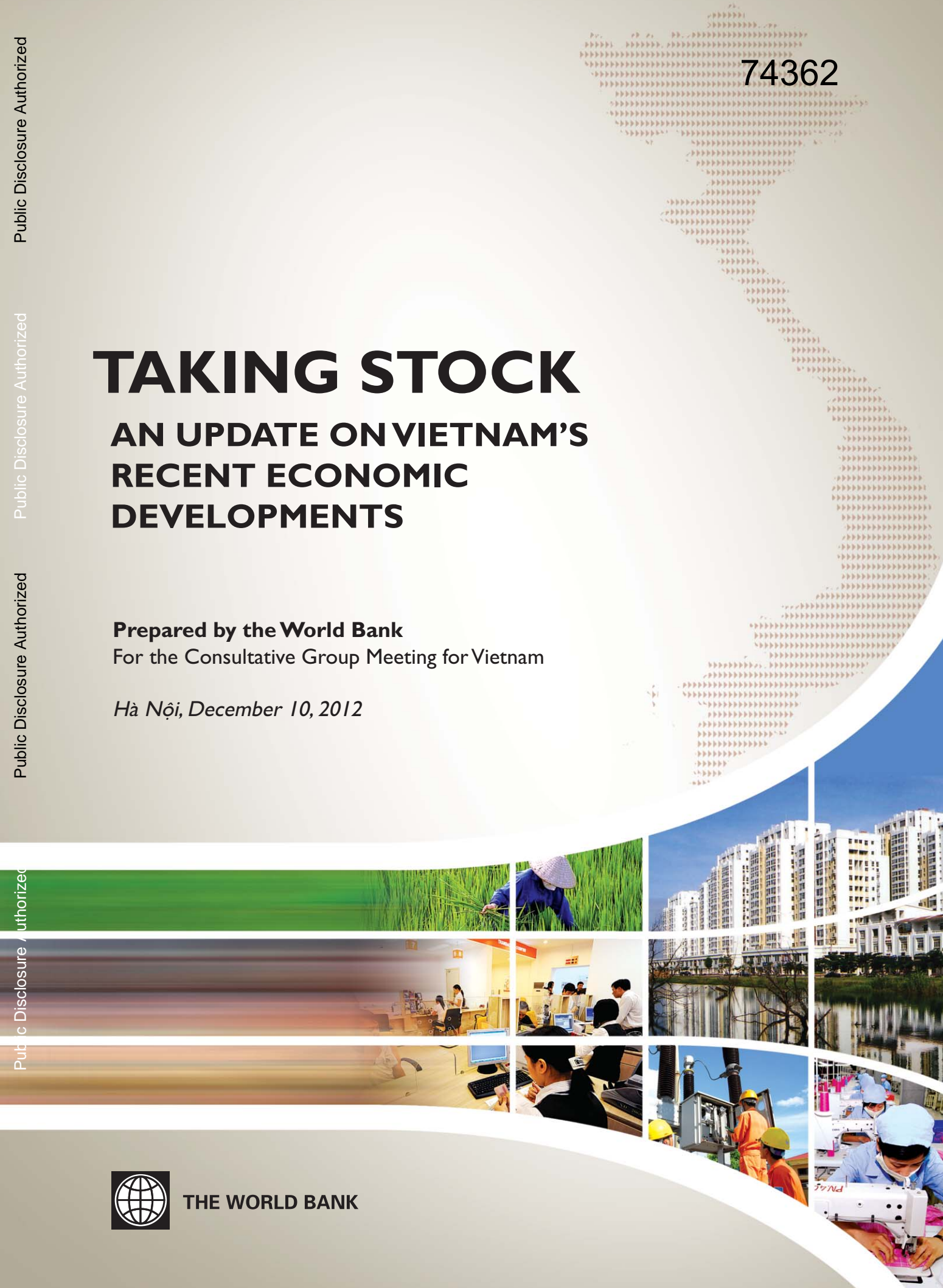


TAKING STOCK

AN UPDATE ON VIETNAM'S RECENT ECONOMIC DEVELOPMENTS

Prepared by the World Bank
For the Consultative Group Meeting for Vietnam

Hà Nội, December 10, 2012



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ACRONYMS AND ABBREVIATIONS

ASEAN	Association of Southeast Asian Nations
CDS	Credit Default Swap
CPV	Communist Party of Vietnam
EAP	East Asia and Pacific
ECB	European Central Bank
EU	European Union
FAI	Fix Asset Investment
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GSO	General Statistics Office
HUD	Housing and Urban Development Corporation
IMF	International Monetary Fund
MDG	Millennium Development Goals
M&E	Monitoring and Evaluation
MOF	Ministry of Finance
MOC	Ministry of Construction
MOLISA	Ministry of Labor, Invalids and Social Affairs
MPI	Ministry of Planning and Investment
NSCERD	National Steering Committee for Enterprise Restructuring and Development
ODA	Official Development Assistance
OOG	Office of Government
PMI	Purchasing Manager Indices
PPC	Provincial People's Committee
PPP	Purchasing Power Parity
SBV	State Bank of Vietnam
SOEs	State-owned Enterprises
SEGs	State Economic Groups
SGC	State General Corporations
VAMC	Vietnam Asset Management Company
VASS	Vietnam Academy of Social Sciences
VAT	Value Added Tax
VHLSS	Vietnam Household Living Standards Survey
VNCI	Vietnam Construction Industry
WB	World Bank

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PART I

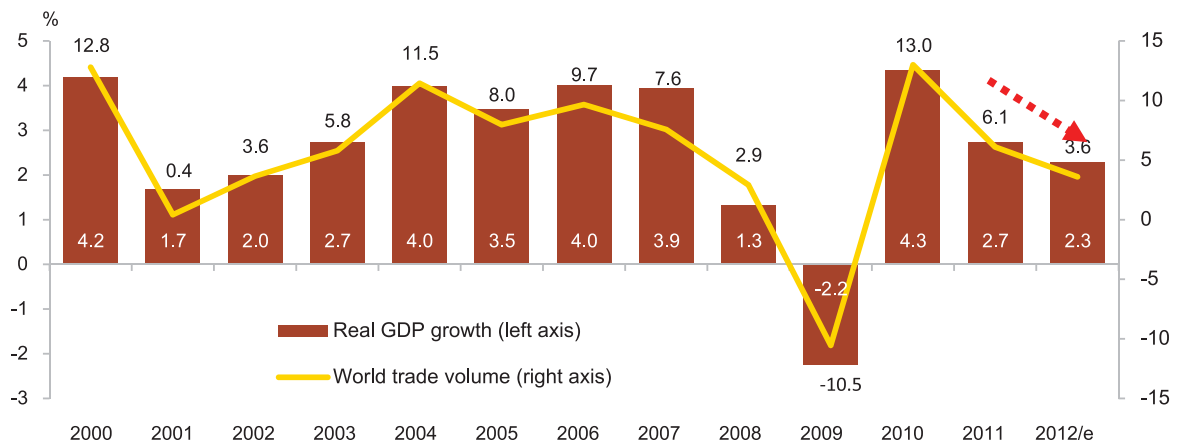


EXTERNAL ECONOMIC ENVIRONMENT

A. GLOBAL ENVIRONMENT ¹

1. In 2012 the global economy is expected to grow at its slowest pace in a decade excluding the crisis years of 2008 and 2009. Global economic activities strengthened during the first quarter, weakened in the second quarter and slowly picked up pace during the third quarter of 2012—reflecting the fragile and faltering nature of the recovery process. Overall, global growth is expected to be at around 2.3 percent in 2012, with high income countries growing at 1.3 percent and developing countries at 5.2 percent (3.4 percent if China and India are excluded). Correspondingly, the volume of world trade is expected to increase by only 3.6 percent in 2012 compared with a pre-crisis average of 7.3 percent (see figure 1).

Figure 1: Global recovery remains weak



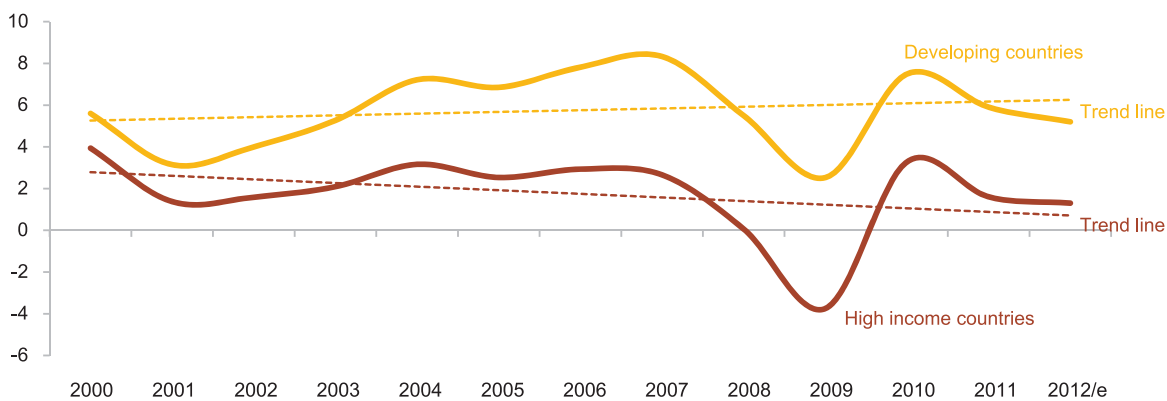
Source: World Bank Data and Staff Estimates

¹ This Section draws on several World Bank publications including Weekly Global Economic Briefs available at www.worldbank.org/prospects.

2. The weak recovery in high income countries is largely policy induced as investors and households remain unconvinced that policymakers will be able to take bold and decisive actions required for a stronger and more stable growth path. In the United States, labor and housing markets appear to be recovering—good news for countries like Vietnam that export mostly consumer products to the United States. However, investment and industrial activities in the United States show unusual weakness, perhaps due to concerns about the impending fiscal cliff². Activities in Europe have ceased to contract at an alarming rate, but growth remains weak as the likelihood of a serious crisis of confidence in the Euro Area remains non-trivial. In Japan the economy appears to be contracting in part because of economic fall-outs from territorial disputes with China over the sovereignty of several islands and the expiration of auto-purchase incentives.

3. Developing countries have succeeded in offsetting some of the effects of the weak external environment through stronger domestic demand. Despite a mid-year slowdown in the growth of exports and imports, developing countries remain a major source of global growth, with their imports expected to expand at an estimated 5.9 percent in 2012. Similarly, their retail sales grew at an annualized pace of 13.9 percent and industrial production at 5.6 percent during the third quarter of 2012. This relatively strong performance in developing countries has helped to mitigate recessionary conditions in the Euro Area and other high-income countries. Indeed, since 2011, developing countries have been responsible for two-thirds of the increase in extra-EU exports of French and German firms. At the same time, given the increased South-South interconnectedness, more than half of developing countries' exports since 2010 are going to other developing countries, gradually decoupling their long-term economic performance from that of high income countries.

Figure 2: Real GDP growth rate (in %) among high-income and developing countries



Source: World Bank Data and Staff Estimates

4. The easing of conditions in the global financial markets has lowered the price of risk and contributed to more relaxed financial conditions in developing countries. Market sentiments have improved because of the decision by the Central Banks of the United States, the Euro area and Japan to engage in a further series of quantitative easing, substantial progress in recapitalization of banks in both the United States and Europe, and agree on creating a pan-European banking-supervision authority. All this backed by a decision by the ECB to do whatever is necessary to support economies in difficulty. These actions have lowered the price of risk worldwide including in developing countries as can be seen from the following:

- Bond yield spreads for developing country debt are nearly 170 basis points lower than their average level during the 2000-10 period. Vietnam's five year credit default swap rates are close to a three-year low.

² Fiscal cliff refers to a number of mandatory tax increases and spending cuts that will come into effect in the United States on January 1, 2013 unless the legislators approve and the President signs a new deficit reduction plan before it.

- There has been a surge in new sovereign borrowers entering bond markets including countries such as Zambia and Bolivia and others such as Kenya, Paraguay, Rwanda, Tanzania and Uganda are preparing to issue foreign currency bonds for the first time.
- FDI inflows to developing countries have rebounded during 2012Q3 and expected to end the year at \$591 billion, considerably higher than in 2009 and 2010.
- At the same time, capital inflows from developing countries to the rest of the world will be at an all time high of \$406 billion in 2012, reflecting the growing confidence and capability of investors from emerging market in acquiring and managing assets globally.

5. Several factors point to a strengthening of growth and modest acceleration in 2013 through 2015. In the United States the restructuring in the housing market appears to have reached a turning point and is expected to contribute positively to growth in the coming years. In the Euro Area, the extent of fiscal consolidation will diminish and as a result its negative impact on growth should decline—contributing to a modest acceleration in 2013. Overall, global growth is expected to be around 2.6 percent in 2013, gradually strengthening to just below 3.5 percent in 2015 (see table 1). Growth in developing countries is projected to be around 5.6 percent in 2013, rising gradually to 5.9 percent by 2015. In contrast, GDP in High Income Countries is projected to expand at a mediocre 1.5 percent in 2013, increasing to 2.4 percent by 2015.

Table 1: Global Outlook
(Percentage change from previous year, except interest rates and oil price)

	2010	2011	2012e	2013f	2014f	2015f
World Trade Volume (GNFS)	12.8	6.1	3.6	6.0	6.7	7.0
Commodity Prices (USD terms)						
Non-oil commodities	22.5	20.7	-9.1	-3.1	-2.6	-1.9
Oil Price (US\$ per barrel) /1	79.0	104.0	105.6	105.8	106.5	106.9
Interest Rates						
\$, 6-month (percent)	0.5	0.5	0.7	0.8	1.1	-
Real GDP growth /2						
World	3.9	2.7	2.3	2.6	3.2	3.4
High income	2.8	1.6	1.3	1.5	2.2	2.4
Euro Area	1.9	1.5	-0.3	0.4	1.1	1.4
Japan	4.5	-0.7	1.9	1.2	1.4	1.5
United States	2.4	1.8	2.1	1.9	2.8	3.0
Developing countries	7.3	5.9	5.2	5.6	5.8	5.9
East Asia and Pacific	9.7	8.3	7.4	7.8	7.6	7.5

Source: World Bank Data and Staff Estimates; Notes: e = estimate; f = forecast

1. Simple average of Dubai, Brent and West Texas Intermediate

2. Aggregate growth rates calculated using constant 2005 dollars GDP weights.

B. REGIONAL ENVIRONMENT ³

6. With weak external demand, countries in the East Asia and Pacific (EAP) region are increasingly relying on domestic demand to boost growth. Trade performance has been mixed in the EAP region with Indonesia, Malaysia and Thailand seeing their trade accounts decline in the first three quarters of 2012 compared to the same period last year. China and Vietnam on the other hand saw their trade accounts rise. At the same time, among the large ASEAN countries, domestic demand grew at 9.4 percent in Q2 2012, boosting the overall growth rate. The underlying reasons

for booming investment spending are however mostly local: election-related spending in Malaysia, spending on reconstruction after last year's floods in Thailand and a large spurt in FDI in Indonesia. In contrast to the regional trend, investment rates in Vietnam fell as part of its anti-inflationary drive.

7. Growth will moderate in 2012 as rebalancing will lead to gradual but modest structural slowdown in some of the largest economies in the EAP region. GDP is projected to slow to 7.4 percent in 2012 – largely on account of weak external demand and policy actions in China directed towards moderating domestic demand and controlling inflation. Going forward, GDP growth in the region is projected to accelerate to 7.9 percent in 2013 before stabilizing at 7.6 percent in 2014-2015 – mirroring a modest acceleration in China in 2013 followed by growth stabilization through to 2015. GDP growth in the remaining countries in the region is forecast to average 5.8 per-cent over 2013-2015 underpinned by accelerating global trade and a rebalancing of regional demand towards consumption. Disposable income in the region is forecast to benefit from appreciating (real) exchange rates, rapid growth in wages in China and ASEAN-4 (Indonesia, Thailand, Philippines, Malaysia) and an accommodative monetary policy stance in the context of low inflation across the region.

Table 2: Regional Growth Outlook
(Real GDP in Local Currency Unit; Percentage change from previous year)

	2009	2010	2011	2012/e	2013/f	2014/f
East Asia	4.9	9.3	7.1	5.8	6.6	6.7
Developing East Asia	7.5	9.7	8.3	7.4	7.9	7.6
China	9.2	10.4	9.3	7.9	8.4	8.0
Indonesia	4.6	6.2	6.5	6.1	6.3	6.6
Malaysia	-1.6	7.2	5.1	5.1	5.0	5.1
Philippines	1.1	7.6	3.9	6.0	6.2	6.4
Thailand	-2.3	7.8	0.1	4.7	5.0	4.5
Vietnam	5.3	6.8	5.9	5.2	5.5	5.7
Developing EAP excluding China	1.5	7.0	4.4	5.6	5.7	5.8

Source: World Bank Data and Staff Estimates

8. The Chinese economy is showing signs of bottoming out, which will help commodity exporters in the region. The growth rate of China's economy in the third quarter was 7.4 percent (yoy), below its historic trend and the lowest in the past 14 quarters. However, data on industrial production, fixed asset investments (FAI) and exports suggest that China's economy is bottoming out. Quarter on quarter growth (saar) picked up from 8.2 percent in the second quarter to 9.1 percent in third quarter. The negative contribution of net exports to GDP growth also narrowed from -7.1 percent in the first half to -5.5 percent in the first three quarters of 2012. Light manufactured goods—a sector in which China and Vietnam sometimes compete for the same market—contributed the most to export growth, while Asia excluding Japan, was the destination which saw the fastest export growth. The uptick in growth in China will positively affect the commodity exporters in the region such as Mongolia, Laos, Fiji and Papua New Guinea, as China is their major export destination.

9. In most EAP countries policies have shifted to a more accommodative stance. Most major central banks in the region lowered their policy rates in 2012, and some, like China's People's Bank reduced the level of reserves that banks need to hold against deposits, and introduced other measures to increase liquidity. Ample liquidity has been feeding buoyant credit growth in the Philippines and Indonesia and has reignited credit growth in China in recent months. In the Philippines, the acceleration of government infrastructure spending has contributed to the strong growth performance in the first half of 2012, which together with tax administration reforms, has supported domestic revenue growth. In China, several local governments have started their own fiscal stimulus programs focused on infrastructure, despite concerns over local government debt.

This showed up in the sharp rebound in infrastructure investment, which had started to fall at a rate of 20 percent (yoy) in end-2011, but grew again by 15 percent by mid-2012. In Indonesia, the budget deficit is likely to come in at just above 2.2 percent of GDP, 0.7 percentage point higher than originally planned, but in line with the revised budget. In Malaysia, the budget deficit widened to 3 percent of GDP in the first half of 2012, up from 1 percent in the same period in 2011, and is expected to reach 4.5 percent of GDP, as budgeted.

C. RISKS

10. The modest acceleration of growth projected for 2013 is subject to significant downside risks. Although the likelihood of a Euro Area wide economic crisis has declined significantly, it could still happen—potentially subtracting 4.0 percent or more from developing country GDP. Second, if the US goes through the fiscal cliff, the extent of fiscal contraction could be as large as 4.6 percent of GDP. In such an event, the US economy will likely fall into recession and cause output in developing countries to decline (relative to baseline) by between 0.2 and 0.8 percentage points depending on the trade ties of the individual countries with the United States. Finally, there is a risk that fixed investment spending in China could slow significantly over the short-term, with important domestic growth implications and potentially adverse global outcomes—with global growth falling by as much as 0.6 percent.

11. Policy makers in EAP region should prepare for an external environment that will remain volatile and deliver only lackluster growth over the medium-term. Continued crisis preparedness remains a priority, while any resurgence in capital flows needs to be addressed with appropriate macroeconomic policies so as to avoid excessive risks building up domestically. Countries that have experienced high credit growth should be particularly alert, while commodity exporters should continue to build the institutions that help deal with commodity price shocks and reduce over-reliance on commodity revenues. The subdued outlook for advanced economies continues to put a premium on domestic demand, and thus rebalancing remains important for most countries in the region.

12. Over the medium-term, increased productivity in East Asia and the Pacific, which is increasingly becoming a middle income region, will drive growth. Continued structural reforms in product and goods markets, further regional integration, improvements in the business climate and investment in infrastructure and education systems will therefore become more important for growth. In the process of structural transformation, EAP will rapidly urbanize, while rising income inequalities and environmental pressures are likely to become more prominent. As short-term concerns continue to loom large on the policy agenda, policymakers should keep focus on this important structural agenda.

PART 2

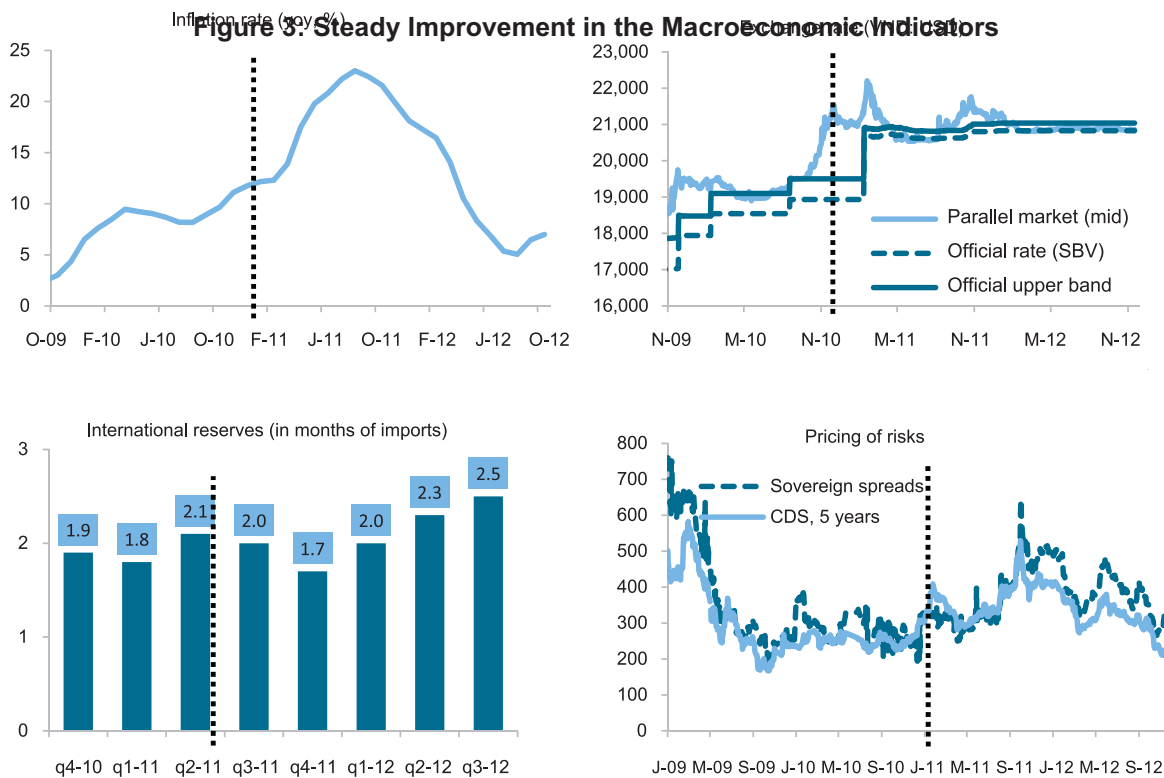


RECENT ECONOMIC DEVELOPMENTS IN VIETNAM

A. A RELATIVELY STABLE MACROECONOMIC SITUATION

13. Vietnam is enjoying a second consecutive year of relatively stable macroeconomic conditions. The country entered 2011 in a phase of heightened macroeconomic vulnerabilities. But the stabilization measures (Resolution 11) implemented over the course of 2011 have helped to steadily stabilize the economy. Inflation (y/y) has fallen from a peak of 23 percent in August 2011 to 7 percent in October 2012. The unofficial exchange rate has traded within the ± 1 percent band around the official exchange rate for most of the year. The increased supply of US dollars in the market has enabled the State Bank of Vietnam (SBV) to replenish foreign exchange reserves, which are now close to more than two months of imports. Vietnam's sovereign bond traded at a premium of less than 300 basis points in early November compared to a peak of 600 basis points at the end of 2011. Since the start of the boom and bust cycle in 2007, this is the first time that Vietnam has maintained macroeconomic stability for a period of 18 months or longer—one of its few achievements in recent years.

14. The improved situation has been made possible by good domestic policies and a favorable external environment. The depreciation of the currency, lowering of credit growth targets, keeping real interest rates positive and trimming of some of the wasteful public investments are clear demonstration of the Government's commitment to come to grips with its macroeconomic vulnerabilities. Equally important is the continuous assurance provided by the Government and the Party that macroeconomic stability remains one of its most important economic goals. These actions and pronouncements have helped to calm jittery investors and revived confidence in the dong as seen by robust growth in deposits and the increasing share of dong deposits in the banking system. The developments in the domestic economy have been complemented by improved confidence in the global financial markets and lower price of risks as seen by record low sovereign spreads and greater flow of portfolio investment into Vietnam. Given the stop-go policy culture of the not so distant past, the authorities' determination to maintain appropriate macroeconomic policies for two consecutive years is a welcome change and will certainly help Vietnam to gradually rebuild its track record as a country with sound macroeconomic management (box 1).



Source: SBV, GSO, IMF and The World Bank

15. Vietnam's gains on the macroeconomic front are, however, still fragile and face several downside risks. First, core inflation—which is calculated after excluding some of the more volatile components of the CPI basket such as food and fuel prices—is still very high at 11 percent. Second, while the level of foreign exchange reserves has risen in recent years, it is considerably low by international standards and especially so for a country like Vietnam whose trade to GDP ratio and M2 to reserves ratio are one of the highest in the East Asia and Pacific region. Third, the country remains susceptible to premature loosening of policies that could lead to resurgence of inflation. Fourth, the quality of assets in its credit institutions are worsening and its current level of public debt could rise sharply if some of the contingent liabilities in the banking sector and SOEs are realized. Finally, the delayed and inadequate implementation of structural reforms including the triple restructuring—of banks, SOEs and public investment—are starting to affect investors' confidence and could spill over to affect macroeconomic conditions.

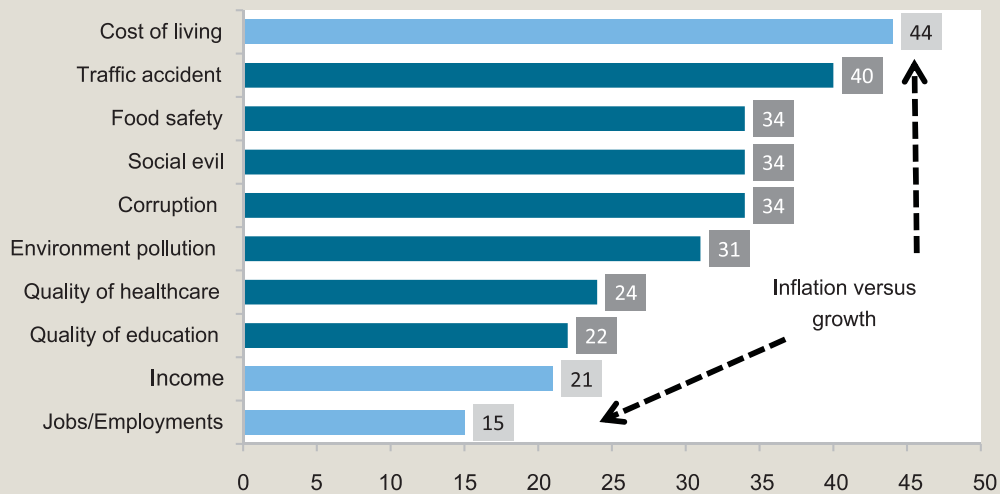
B. GROWTH AT RECORD LOW

16. In 2012 the Vietnamese economy is expected to record its slowest growth performance in since 1999. The fragile global economic recovery coupled with the domestic stabilization policy and slower than expected progress on structural reforms have led to a significant slowdown in economic activities in 2012 (figure 3a). The impact was severe in the first quarter of 2012, when GDP increased by only 4 percent compared to the same period in 2011. The performance has steadily improved since then, partly reflecting the Government's efforts to support economic activity and partly the result of seasonality in Vietnam's GDP data (see box 2). In May 2012, the Government adopted Resolution 13 that included a range of measures from tax breaks to additional capital spending to boost the slowing economy. It was complemented by aggressive reduction in policy rates by SBV amounting to 500 basis points during the first half of 2012. The economy responded to these

Box 1: Growth versus Inflation: A Citizen's Perspective

It is widely believed that the Vietnamese authorities tend to put relatively higher weight on growth than on inflation, as jobs and higher living standards are considered important determinants of political and social stability. This is why, some analysts believe, Vietnam has often opted for more accommodative monetary and fiscal policies and tolerated higher inflation than can be otherwise explained. But how do Vietnamese citizens see the trade-off between growth and inflation?

A recent survey covering ten districts and more than 2,600 citizens provides an answer to the above question. The survey was undertaken by the Government Inspectorate and the World Bank as part of an anti-corruption diagnostic study. When asked to identify the three most serious issues for Vietnam at present (the survey was undertaken in February-March 2012), 44 percent of total responses selected cost of living while 21 percent chose income and, even lower, 15 percent chose jobs (see below)



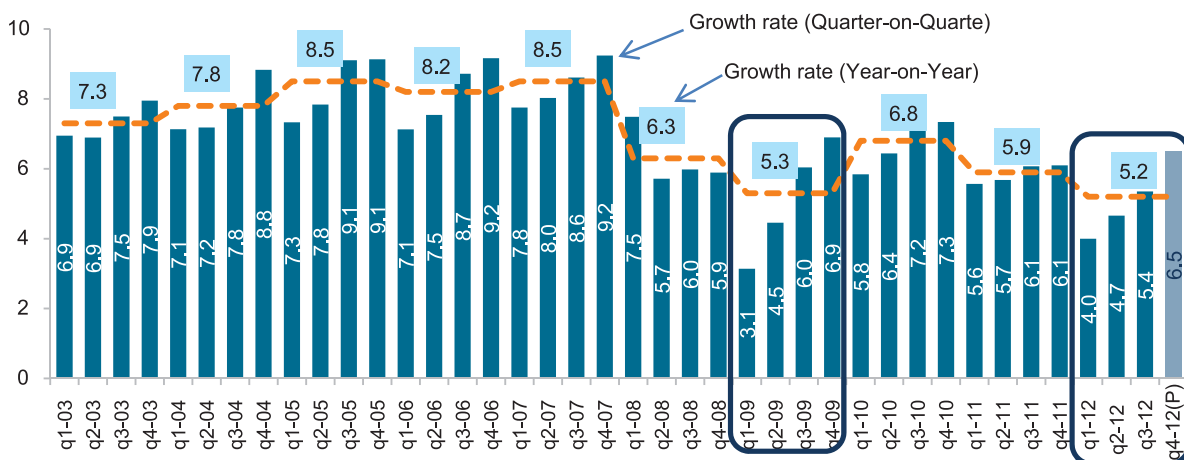
Source: *Corruption from the Perspective of Citizens, Firms and Public Enterprises*, GI, World Bank and others (2012)

There are good reasons to believe that Vietnamese citizens are increasingly worried about the quality of growth and not just its quantity. With the country achieving a lower middle income status and per capita income nearing US\$1,300, citizens are less worried their basic needs and increasingly looking for a better quality of life—good housing, better quality of education and healthcare services, improved urban amenities, a healthier environment, higher food safety standards and less corruption.

initiatives, with growth reaching 4.7 and 5.4 percent in the second and third quarter, raising the overall growth to 4.7 percent for the first three quarters of the year. With last quarter performance expected to be good, Vietnam is likely to post 5.2 percent growth rate in 2012.

17. The slowdown has been felt most acutely in the construction and manufacturing sectors. Construction activities have been affected significantly by stagnation in the real estate sector and slower growth in investment spending. At the same time in the manufacturing sector, especially for state and non-state domestic enterprises, growth has been adversely affected by weak domestic demand, high levels of inventory, limited access to bank lending and high cost of capital. The purchasing managers' index (PMI), which was below 50 (implying a contraction in output) over a seven-month period since March 2012, crossed the 50 mark in November 2012. The non-state enterprises have been particularly hard hit as nearly 42,000 SMEs have either closed, been liquidated, or temporarily suspended operations during the first ten months of 2012—a 6.7 percent increase compared to the same period in 2011. Weak domestic consumption has played an important role to slowing retail sales, which increased by an estimated 6.8 percent in real terms during January-October from a year earlier.

Figure 3a: A steadily falling growth rate (in %, Q1:2003-Q4:2012(P))



Source: General Statistics Office and The World Bank

18. The slowdown in the manufacturing sector is a matter of great concern. Vietnam's development success story has been written on the back of a rapidly growing and competitive manufacturing sector that employs around than 7 million people or one seventh of the country's labor force. Whilst the sector has been buffeted in recent years by cyclical factors such as weak global demand and high real interest rates, more alarmingly, its performance has been hamstrung by structural weakness in the economy such as high logistics costs, poor and unreliable infrastructure and lack of skilled labor. As figure 4 shows the trend growth rate of the manufacturing sector is not only negative, it is also slowing down faster than the rest of the economy. Accelerating structural reforms, some of which are discussed in part III of this report, could reverse the downward trend one sees in the manufacturing sector⁴.

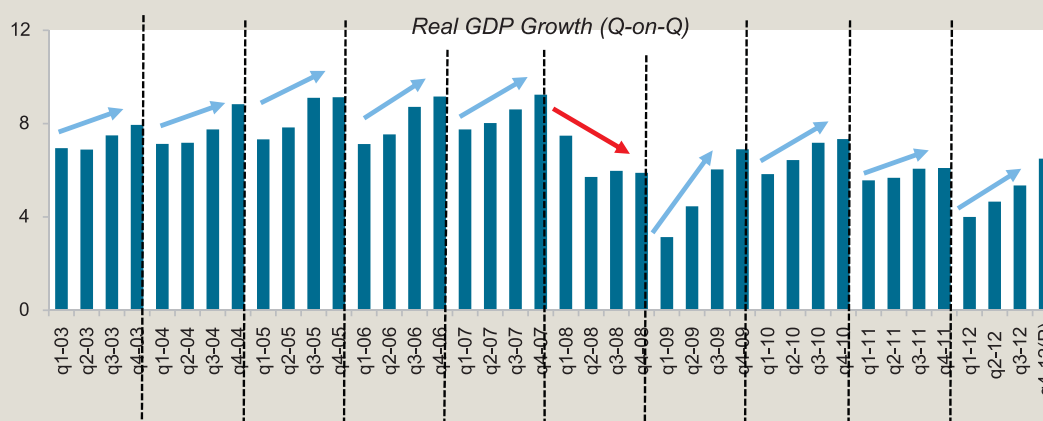
⁴ Also see Vietnam Development Report (2013) (forthcoming) for a detail discussion on how to upgrade and augment the skilled labor force in the country.

Box 2: Seasonality in GDP data

Like most countries, Vietnam's macroeconomic data are affected by seasonality. For example, the lunar new year, Tet, falls in the first quarter (Q1), which is also the time when work in most enterprises and government agencies come to a standstill resulting in a sharp drop in output for that quarter. Similarly the last quarter (Q4) tends to be the busiest period of the year when most enterprises are busy churning out goods for Christmas and Tet and so output picks up in this quarter. In fact if one examines the quarterly growth rate of the last ten years, it is easy to notice the following seasonal pattern in the growth rate (see figure):

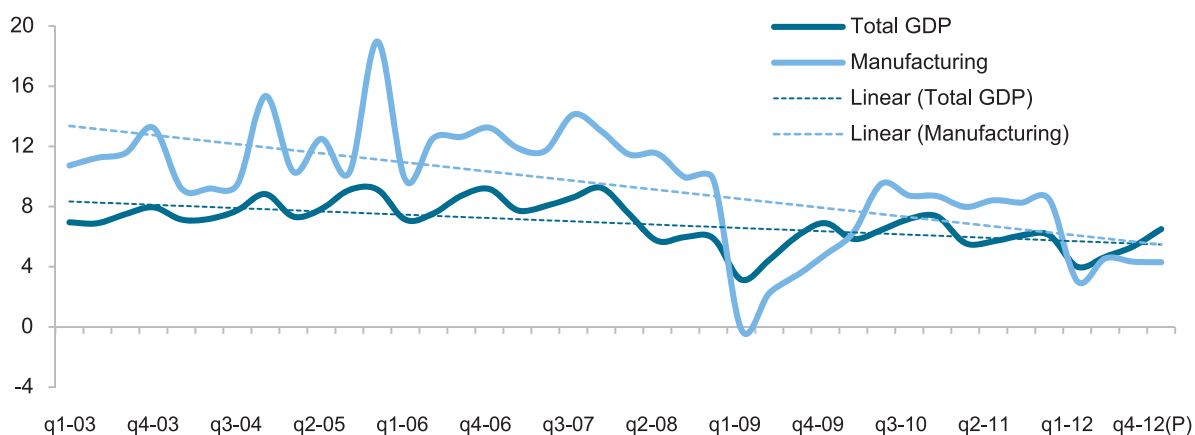
$$Q1 (\text{growth}) \leq Q2 (\text{growth}) \leq Q3 (\text{growth}) \leq Q4 (\text{growth})$$

When GDP data exhibits such strong seasonal patterns, it is important for GSO to publish data after correcting for the seasonal bias. It is also important for users of national accounts statistics to interpret the data correctly. For example, in 2012, when the first and second quarter growth rates were reported to be 4 and 4.7 percent respectively, many analysts called SBV to sharply reduce interest rates. But if they had taken into account the seasonal pattern in GDP growth, they may have been more restrained in their demand for interest rate cuts.



Source: General Statistics Office and World Bank.

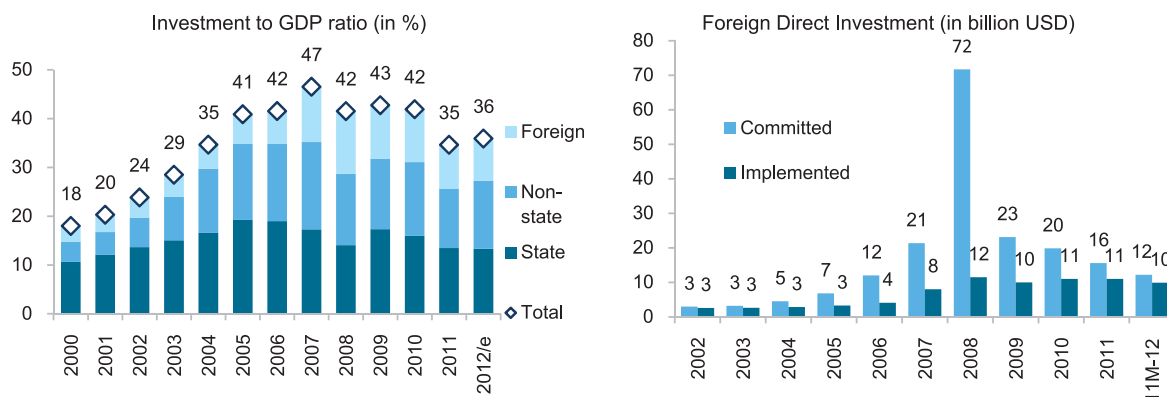
Figure 4: Long-term growth trends are in downward direction (%)



Source: General Statistical Office and The World Bank

19. A major source of recent growth deceleration is also due to slow growth in public and private investment. With slowing credit growth and efforts to restructure public investment, total investment has fallen sharply—from 41.9 percent of GDP in 2010 to 34.6 percent in 2011 and to a projected to be around 35 percent in 2012⁵. The decline has been uniformly spread across the state budget, state-owned enterprises and the private sector. Within the private sector, whilst domestic private enterprises have scaled back their investment plans, investments from foreign firms have not slowed down significantly in absolute terms. During the 10 months of 2012, foreign invested enterprises have disbursed \$9 billion, nearly the same amount for the same period last year. However, the overall commitment of foreign investors has continued to decline in recent years. Also the source of foreign direct investment (FDI) has become more concentrated, with a growing share coming from only a handful of countries such as Japan. Year to date, foreign investors committed \$10.5 billion, equal to two thirds of the previous year's figure.

Figure 5: Falling investment rate is a matter of concern

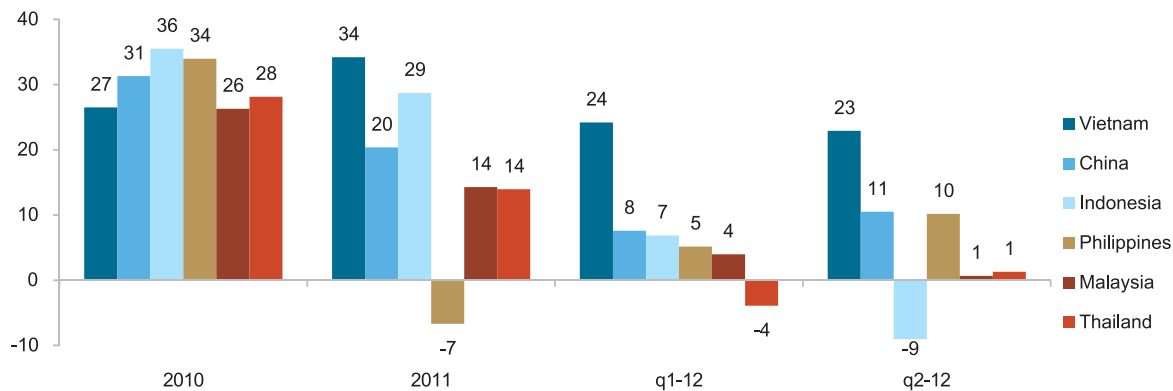


Source: General Statistics Office and The World Bank

C. BOOMING EXPORTS DESPITE A SLOWING ECONOMY

20. Vietnam's impressive export performance stands not only in sharp contrast to the lackluster growth performance but also with respect to the export performance of its regional competitors. As shown in figure 6, at 34 percent, Vietnam recorded the highest rate of export growth in developing East Asia in 2011, with Indonesia second and China coming third. This pattern has continued through the first two quarters of 2012. The bulk of these exports are originating in the foreign invested sector (including crude oil), which contributed 63 percent of total exports and grew at 32 percent in the first ten months of 2012. In 2012, Vietnam surpassed Brazil to become the largest coffee exporter in the world and overtook Thailand to be the largest rice exporter, though the earnings from commodity exports have declined slightly due to lower unit price⁶.

Figure 6: Vietnam export growth relative to selected Asian countries (%)



Source: The World Bank

⁵ Based on the first nine months of 2012 estimate.

⁶ The decline of rice exports from Thailand is however a result of domestic policies and not because of sharp improvements by Vietnam.

21. Vietnam's total export turnover between January and October 2012 is estimated at \$93.5 billion, rising 18.4 percent from the same period last year. Oil exports increased 16 percent thanks to higher volume and better prices. Non-oil exports continue to grow robustly thanks to strong performance of manufacturing exports, especially in the high-tech categories such as electronics, computers, cell phones and their accessories. Exports of rice, while increasing in volume—expected to reach 7.5-7.7 million tons in 2012— have not been particularly profitable for farmers. In fact much of the increased exports revenue from agricultural commodities is coming through higher volume and not higher prices. This is also a sector dominated by state-owned trading firms and enterprises. Key labor-intensive, manufacturing exports like garments, footwear, and wood products continue to do well. There are however concerns that the share of imported inputs in these products continues to be relatively high, with limited technological spillover from foreign to domestic enterprises and the inability of domestic manufacturers to move along the supply chain to capture higher value.

Table 3: Vietnam Merchandise Exports

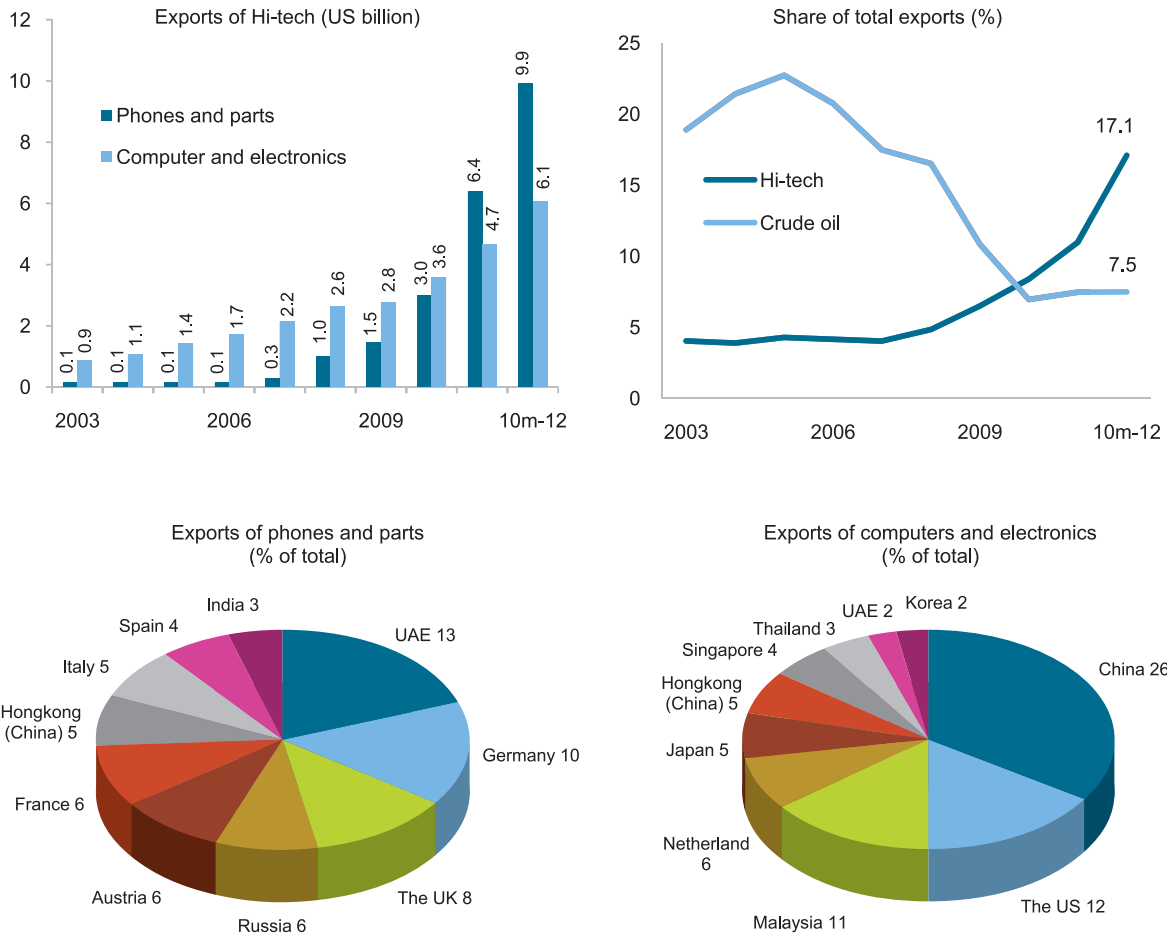
	Value (\$bn, 10M-2012)	Value change in %		
		2010	2011	10M-12
Total export value	93.5	26.4	34.2	18.4
Crude oil	7.0	-20.0	45.5	15.6
Non-oil	86.4	32.0	33.4	18.6
Agriculture				
Rice	3.1	21.9	12.6	-3.9
Other agricultural commodities	8.1	35.1	39.9	9.9
Seafood	5.0	18.0	21.9	1.4
Low cost manufacturing				
Garment	12.5	23.7	25.3	8.2
Footwear	5.7	26.0	27.9	10.5
Wood products	3.8	32.3	13.7	19.1
Hi-tech				
Electronics and computers	6.1	29.9	30.1	69.3
Cell phones and accessories	9.9	138.7	98.4	107.6
Other	32.2	33.2	35.6	10.9
Domestic sector	34.9	15.5	28.7	0.8
Foreign sector (including oil)	58.6	41.2	40.3	32.2

Source: General Statistics Office

22. The two-track nature of the export performance between the sluggish domestic enterprise sector and robust foreign invested sector can largely be explained by three factors. First, stabilization policies including the hike in interest rates, lower credit growth, and smaller budget deficits, have affected domestic enterprises considerably more than their foreign counterparts. Second, exports have been particularly buoyant as production capacity in a number of foreign enterprises (particularly in the electronic sector) has come on stream in recent years. Finally, domestic enterprises, particularly SOEs, which are known to be less efficient than their foreign competitors, have lost market share. This process has accelerated in recent years as the economy tries to rid itself of inefficient enterprises and the structural constraints to competitiveness remain unaddressed.

23. The dramatic growth in higher value manufacturing exports from Vietnam is one of the success stories of recent years. These items now account for more than 17 percent of Vietnam's merchandise export value and have much potential to accelerate in the future. Exports of mobile phones and spare-parts topped US\$9.9 billion in the first ten months, a 108 per cent increase year-on-year, placing the industry in second place after garments and textiles and on course to become the single biggest export item in 2013. This feat has been largely attributed to the exports of the Vietnam division of Korean giant Samsung, which last year accounted for more than 70 per cent of mobile phone exports from Vietnam, totaling \$6 billion. This year they have been exporting nearly \$1 billion worth of goods a month. At the same times, exports of computers, electronics items and spare parts stood at \$6.1 billion, an increase of 69 per cent over the same period last year.

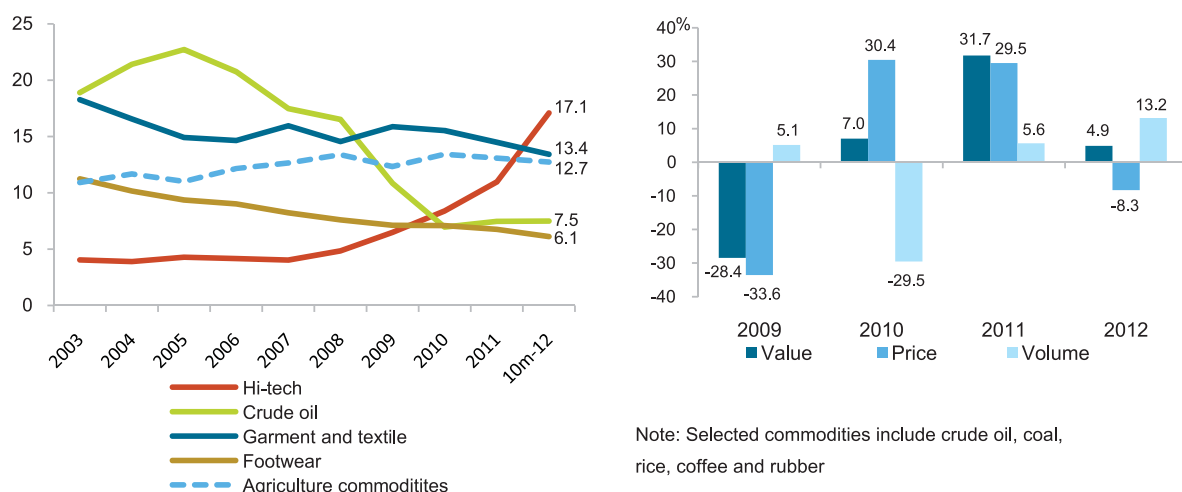
Figure 7: Vietnam's hi-tech exports: value and destinations



Source: General Department of Customs

24. Vietnam's exports are growing at both ends of the value spectrum: high-tech and agricultural commodities, with share of all other sectors in total exports experiencing modest to large declines. Oil exports have fallen significantly in the last decade—from nearly 20 percent of the total exports to around 8 percent (figure 8). High-tech exports have seen a sharp rise in their share from below 4 percent in 2003 to nearly 18 percent by 2012, the share of agriculture commodities have seen a modest increase. Ironically, the labor-intensive manufacturing sector has lost ground, with the shares of footwear, garments and textiles falling over time. But it is important to note that with aggregate exports growing at an annual rate of 20-22 percent, almost all sectors are posting positive growth. The growing share of agricultural commodity is also largely due to global commodity price boom and volume increase in recent years, and less to do with increased value addition.

Figure 8: Changing composition and unit price of selected export items



Source: General Statistics Office and The World Bank

25. Import growth has slowed down significantly in line with falling growth. Import spending in the year to October is estimated at \$93.8 billion, up 6.8 percent compared to 26 percent in the same period of 2011. Imports by foreign invested enterprises remained strong—growing by 23.9 percent. However imports by domestic enterprises decreased by 7.3 percent, reflecting a difficult operating and financial environment. Imports of raw materials and intermediate goods (fertilizer, animal feed, cotton, fiber, fabrics) have also been sluggish reflecting falling domestic demand and growing inventory.

Table 4: Vietnam Merchandise Imports

	Value (\$bn, 10M-2012)	Value change in %		
		2010	2011	10M-12
Total import value	93.8	21.2	25.8	6.8
Petrol and gasoline	7.9	-2.8	61.6	-6.3
Machinery and equipment	13.4	8.0	13.0	5.0
Garment and leather materials	2.6	35.7	12.5	3.4
Computer and electronics	10.7	31.7	53.1	77.5
Steel	5.1	14.8	4.5	-4.3
Fertilizer	1.3	-13.9	46.1	-9.9
Plastics	3.9	34.2	26.1	1.3
Fabrics	5.7	26.9	25.5	1.5
Chemicals	2.3	30.4	27.2	4.9
Chemical products	2.0	30.0	16.6	2.8
Pharmacy	1.5	13.3	19.3	19.8
Fibers and weaving yarns	1.1	45.1	30.4	-12.1
Pesticides	0.6	12.4	16.6	7.6
Cotton	0.7	71.9	56.1	-20.6
Paper	0.9	20.1	15.4	8.9
Automobiles	1.7	-5.2	6.8	-34.1
Other	31.9	35.1	26.6	5.1
Domestic sector	47.8	9.0	20.9	-7.3
Foreign sector	37.0	41.8	32.1	23.9

Source: General Statistics Office

D. SHARP TURNAROUND IN EXTERNAL ACCOUNTS

26. In 2012, Vietnam is expected to post its largest ever trade and current account surpluses. Not long ago large trade and current account deficits were considered a key source of macroeconomic vulnerability for Vietnam. Not anymore. The trade deficit (based on BOP definition) was only 0.4 percent of GDP in 2011 and is expected to yield a record surplus of 4.7 percent of GDP in 2012 (figure 9). Similarly, the current account balance has turned from a huge deficit of 11.9 percent of GDP in 2008 to a minor surplus of 0.2 percent of GDP in 2011 and is projected to report a record surplus of 2.7 percent in 2012. Strong performance in exports, slower growth in imports and continued robust flow of remittances have helped Vietnam to turnaround its external sector. This in turn has contributed to improve its balance of payments situation, augmented its stock of foreign exchange reserves and helped to reduce the pressure on the exchange rate. However, this performance may not last forever as imports are expected to pick up once the economy regains strength.

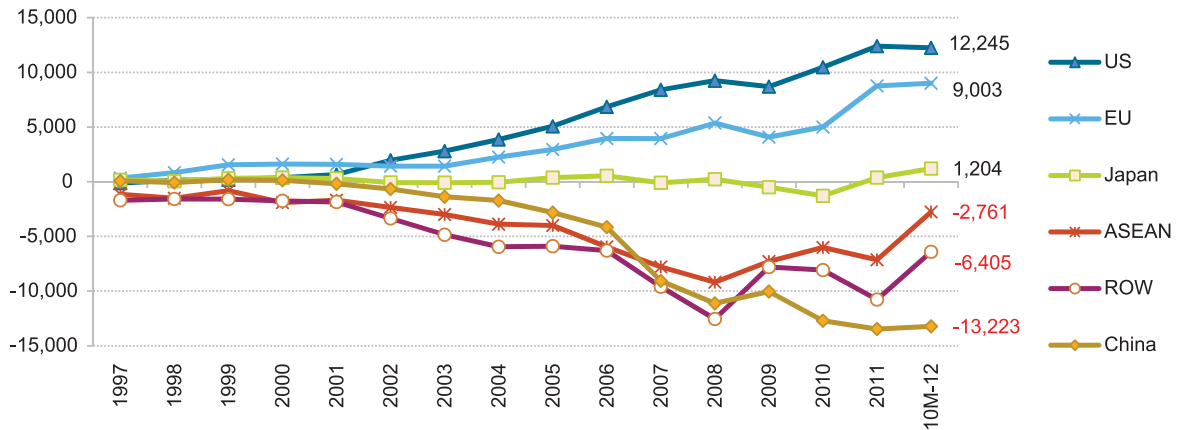
Figure 9: Trade and Current Account Deficits (% of GDP)



Source: General Department of Customs

27. Vietnam's trade balance by destination reflects its gradual evolution as a global supply chain, linking investors from the region to consumers in the West. As seen in figure 10, Vietnam has been running large trade deficits with its neighbors in ASEAN, which are also its main source of raw materials and intermediate inputs. These inputs are used as factors of production by the foreign invested enterprises, most of which are owned by investors from Japan, South Korea, Singapore, Taiwan etc., to produce globally competitive products that are then exported to the United States and Europe. Vietnam, with its low wages and large and young labor force, has been able to capture some of the global supply chains, albeit at a much smaller scale than what China has managed to achieve. In recent years, with western economies slowing down, Vietnam has begun to diversify its exports to its neighbors as well as to the rest of the World, which is also the reason for its improved trade balance position in recent years. It has cut down its trade deficit with ASEAN countries from more than US\$ 9 billion in 2008 to around US\$ 2.7 billion in 2012. It has made similar gains against the Rest of the World.

Figure 10: Trade balance by origins (in million USD)

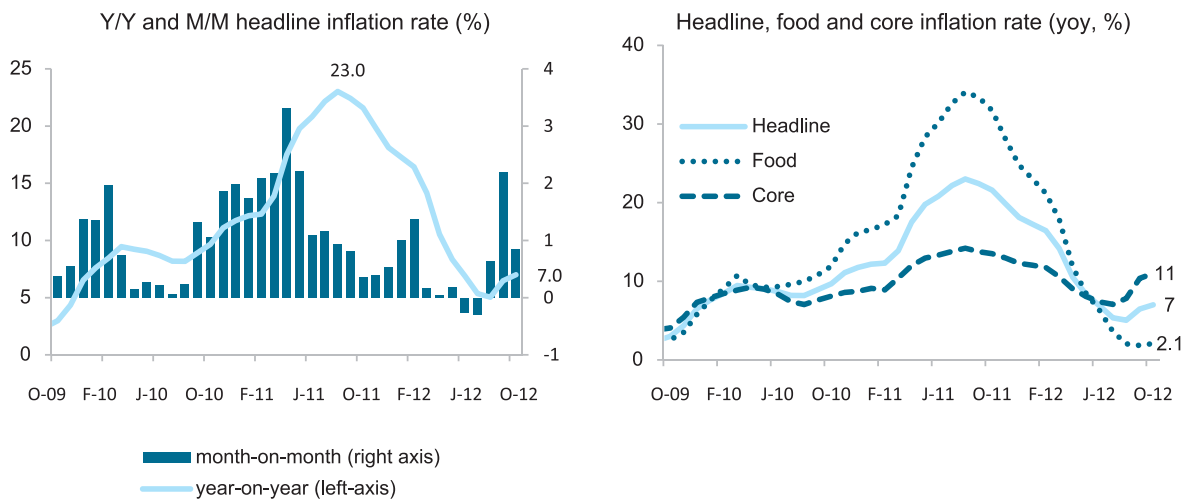


Source: General Department of Customs
 Note: ROW refers to Rest of the World.

E. INFLATION DYNAMICS

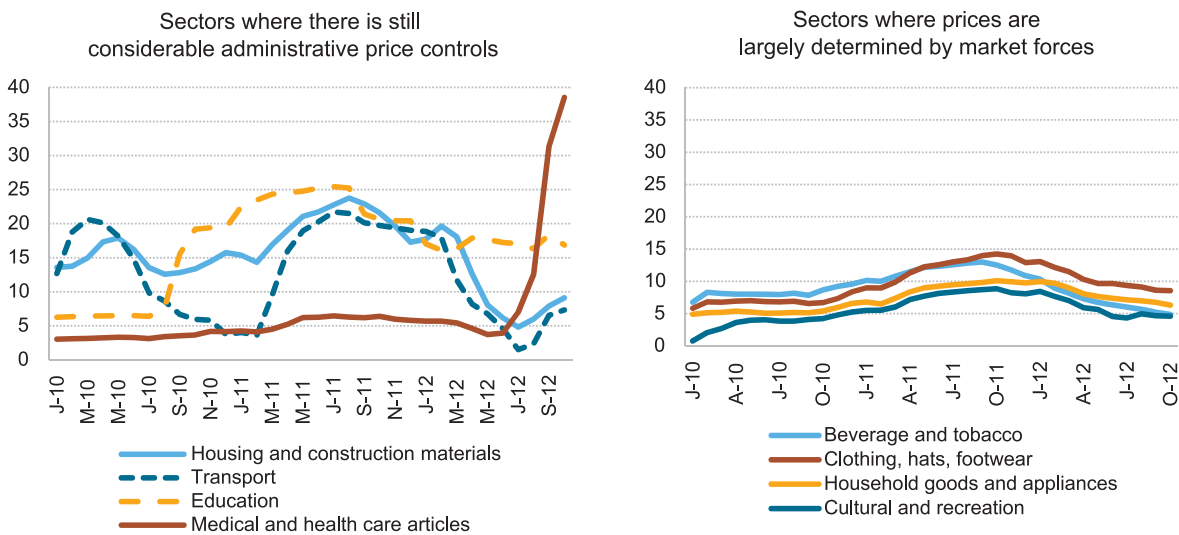
28. Inflation fell steadily through the first-half of the year bottoming out in August and then slowly rising through the second half of the year. The swift and unrelenting fall of inflation from its peak rate of 23 percent in August 2011 to 5 percent in a matter of twelve months took most observers by surprise (figure 11). The biggest driver of this change was the sharp reduction in food price inflation, which tumbled from 34 percent to 2 percent during the same time period. Much of this decline occurred largely on the back of good domestic harvests and stagnant or depressing global commodity prices especially for rice. However, core inflation—calculated by stripping inflation of volatile components such as food and fuel from headline inflation—remained sticky and has in the past few months started to increase rapidly. The month-to-month inflation, which is tracked closely by policymakers and media, dipped below zero for two consecutive months in June and July, leading to persistent calls by some analysts to relax monetary policy. However, given the seasonal bias in inflation data (as discussed in box 2), it was only a matter of time before inflation started to pick again and the calls for interest rate cuts faded away. Inflation is expected to creep up during the next three months on account of increased seasonal activities, lagged effect of earlier interest rate cuts and a series of administrative price hikes that have already occurred or are planned in sectors such as healthcare, energy and education.

Figure 11: The rapid rise and fall of inflation (in %)



29. Sectors where prices are largely determined by market forces tend to experience lower and more stable inflation rates than sectors where prices are administratively controlled. A brief analysis of inflation data shows that sectors producing goods and services such as education, healthcare, transport and housing, where prices are fully or partially controlled by administrative measures, tend to experience higher and more volatile inflation than those sectors where prices are determined mostly by market forces (figure 12). For example, medical and healthcare articles experienced very low inflation for a long period of time, giving a false sense of hope to authorities that they can achieve macroeconomic stability by administratively controlling prices. But then they are forced to raise prices by massive amounts after a lag. Therefore from an inter-temporal perspective, inflation for administratively controlled goods and services tend to be as high or even higher than goods and services whose prices are determined by market forces.

Figure 12: Inflation rate across different goods and services (in %)

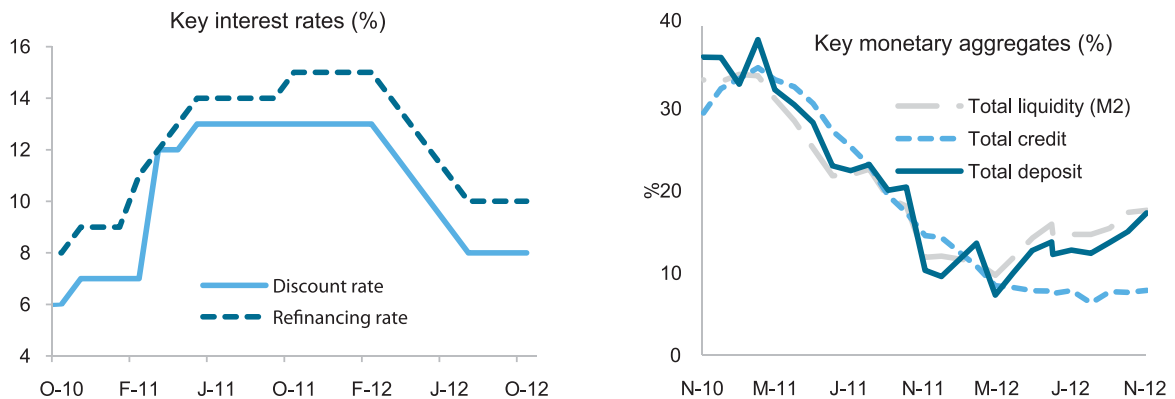


Source: General Statistics Office and The World Bank

F. MONETARY POLICY

30. Responding to a slowing economy and falling inflation, SBV aggressively reduced interest rates during the first part of 2012. Key policy rates were cut by 500 basis points between March and July 2012 (figure 13). The cap for dong deposit was also reduced from 14 percent to 11 percent. The rules on lending to real estate and for private consumption were also relaxed. SBV has been encouraging commercial banks to lower lending rates and promote credit for production, agriculture and rural development, exports, and small and medium enterprises. SBV has lowered the foreign exchange position limit (ratio of total foreign exchange to the institutions' equity capital for the previous month) of credit institutions and branches of foreign banks by day-end to 20 percent, from the current level of 30 percent. But many of these policies have not produced the desired results because banks have impaired balance sheets, and have become extremely cautious in extending new loans.

Figure 13: Monetary policy instruments



Source: State Bank of Vietnam

31. Consequently, as of mid-October, total credit has grown by only 2.8 percent since the beginning of the year, significantly lower than the 15 percent target for 2012. Total deposits, on the other hand rose by 14 percent during the first ten months of the year. While the banking system as a whole has enough liquidity, weak banks are continuing to struggle to get new liquidity or borrow from the inter-bank market. At the same time, the rate cuts have helped to alleviate the problems of those who can obtain credit, while most of the SMEs and consumers have not benefited much. This is partly because both individuals and firms are already highly leveraged, and there are uncertainties over future economic prospects, which has contributed to a more cautious attitude. The enterprises are unwilling to take out loans, or unable to do so due to lack of collateral.

G. FISCAL POLICY

32. A combination of economic slowdown and tax relief for enterprises has contributed to lower than expected domestic revenues in the first nine months of 2012. Revenue collection in the first three quarters declined by 0.6 percent in nominal terms compared to the same period last year. Outturn in the first nine months of 2012 was 67 percent of budget compared to 84 percent over the same period in the preceding two years (Figure 14a). VAT, which makes up around a third of total revenue, declined from 5.4 percent of GDP in the first three quarters of 2011 to 4.8 percent in the first three quarters of 2012. This is in part due to tax relief measures introduced in May this year (Resolution 13), allowing SMEs to delay VAT payments. VAT payments by foreign invested enterprises and domestic enterprises have fallen by 8 percent and 3 percent respectively over the same period last year, reflecting lower domestic consumption. VAT on imports and customs receipts have also declined, both due to lower volume of imports but also because of a shift in the composition of imports away from higher margin dutiable goods like cars. Corporate income tax payments by foreign invested enterprises has remained relatively strong (17 percent increase between Q3 2011 and Q3 2012), particularly compared to private domestic firms, thanks to buoyant exports.

Fig. 14a: Budget Revenues 9m-2012 (VND bn)

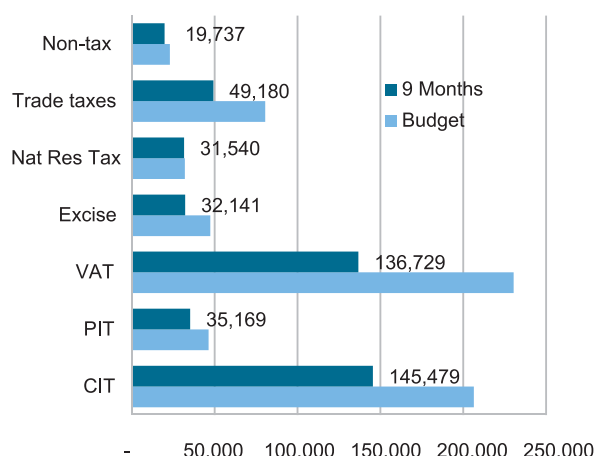
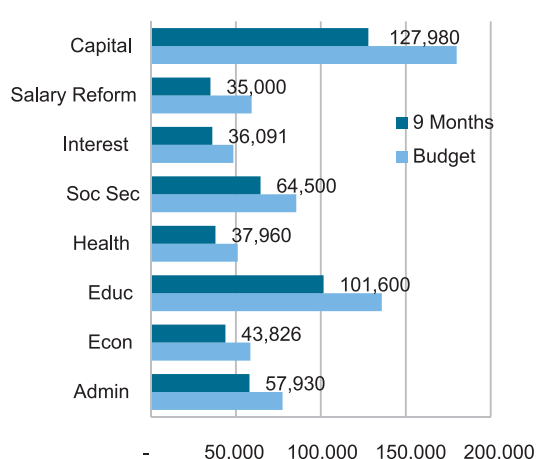


Fig. 14b: Government Expenditure 9m-2012 (VND bn)



Source: Ministry of Finance, WB Staff Estimates

33. Government expenditure in the first nine months of 2012 has remained on track. Outturn across major spending categories has been around 75 percent of budgeted expenditure (Figure 14b). There are also indications that the government has maintained discipline over capital expenditure, a major policy commitment in the 2012 State Budget amid growing concerns over inefficient public investments. By Q3 2012, the government had spent 71 percent of its VND 180 trillion capital budget. The ratio of capital to recurrent expenditure (on-budget only) was at around 27 percent in the first nine months of 2012 compared to an average of 29.5 percent over the same period in 2010-2011, showing some signs of adjustment. The Ministry of Finance has reported that 67 percent of VND 60 trillion planned capital spending through off-budget bonds was also executed in the first nine months of 2012. These projects make up nearly a quarter of total capital spending. The government has adopted a policy to cap capital expenditure through off-budget bonds to VND 225 trillion between 2011 and 2015, averaging at VND 45 trillion per year. The National Assembly has already indicated that up to VND 60 trillion could be raised through off-budget bonds in 2013. Part of the reason for frontloading is to enable the government to provide advances for important capital projects that are finding it increasingly difficult to borrow on the market. However this also means that the government will need to limit off-budget bond financed capital projects to a total of VND 45 trillion in 2014 and 2015.

34. The impact of slower revenue collection on the government's 2012 fiscal deficit target is still uncertain. In the first nine months of 2012, the fiscal deficit stood at 5.4 percent of GDP compared to a budget estimate of 5.2 percent for the entire year.⁷ The former however excludes off-budget capital spending, which means that the deficit in the first nine months could in reality be higher, unless repayments of these debts have accelerated.⁸ Slower revenue collection has also contributed to a current fiscal deficit of 0.5 percent of GDP, meaning that domestic revenues in the first three quarters of the year were insufficient to cover recurrent expenditure. These developments may be offset in part by higher than budgeted oil revenue. The projected price of oil in the 2012 State Budget was \$85 per barrel, whereas average price in the year to October 2012 was around \$106 per barrel.⁹ Earnings from crude oil were reportedly already at 104 percent of budget by mid-October. Other revenue will likely pick up as growth starts to gather pace in the last quarter of the year. The government could therefore meet its revenue target, which it tends to overshoot due to consistent underestimation in the annual State Budget.

⁷ WB staff estimates based on data published on MOF website.

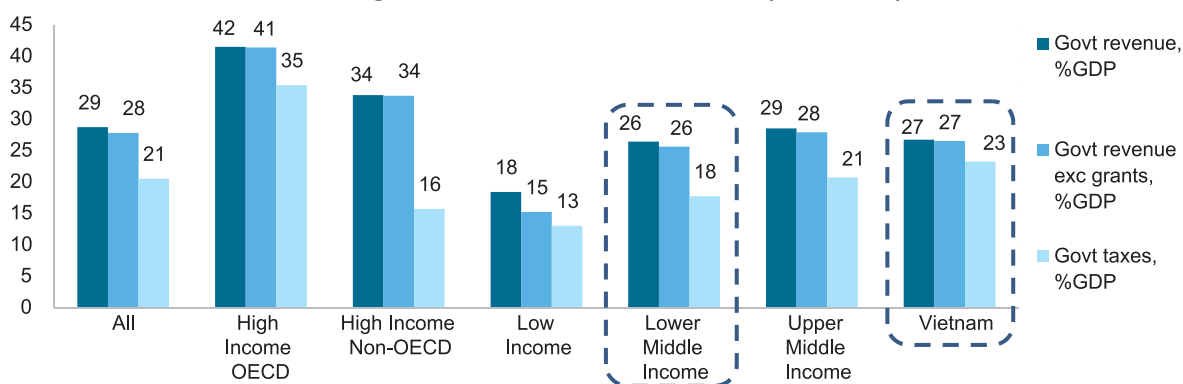
⁸ Government excludes off-budget capital expenditure from its official estimate of the budget balance.

⁹ <http://www.worldbank.org/prospects/commodities>

35. Some concerns were expressed by the National Assembly earlier this year regarding tax rates and tax levels in Vietnam relative to other countries at a similar stage of development. However, Vietnam has lower total tax rates compared to the average in other countries in the Asia Pacific Region. Revenue as a share of GDP is also comparable to other Lower and Upper Middle Income Countries (Figure 15). Whilst the level of tax to GDP is a little higher, this is in part due to strong growth and tax administration reforms in recent years. It is also due to taxes on oil, which constitute more than 25 percent of corporate income tax payments. This will decline as production starts to fall over time. Customs revenues have also started to decline because of tariff cuts. Therefore maintaining a strong revenue base is critical for fiscal sustainability. Efforts should be focused on ensuring that the tax system is efficient and equitable, for example by rationalizing and ensuring consistency and transparency in tax incentives.

36. In this regard, the government is looking at several tax policy reforms over the coming years. Most recently, the National Assembly approved an amendment to the Personal Income Tax Law raising the tax threshold from VND 4 million per month to VND 9 million per month. This will lead to a drop in the number of individual tax payers from close to 4 million people to around 1 million. But it will enable the government's Tax Department to focus its attention more on the large taxpayers, and potentially increase the efficiency of the system. The government is also reviewing the Laws on Corporate Income Tax and Value Added Tax to help simplify the tax structure, introduce thresholds where needed to relieve SMEs from tax obligations and revisit tax rates.

Figure 15: Government Revenue (% of GDP)



Source: IMF, "Revenue Mobilization in Developing Countries," March 2011

37. Tax administration reforms are progressing to improve the efficiency and transparency of tax administration and the business environment. According to the most recent Doing Business report of the World Bank,¹⁰ Vietnam's ranking on time needed for private businesses to comply with tax obligations had improved from 151 to 138 out of 185 countries. The number of hours that businesses require to comply with tax obligations has fallen but it remains close to nine hundred hours. Moreover, according to the most recent Paying Taxes report published jointly by PriceWaterhouse Coopers and the International Finance Corporation, Vietnam has the second costliest VAT payment system (320 hours after 480 hours in Pakistan) and the second costliest CIT payment system (217 hours after 250 hours in Bhutan).¹¹ The amendments to the Tax Administration Law, recently approved by the National Assembly, adopt measures to: (i) simplify tax administration and reduce burden of compliance in particular for SMEs; (ii) adopt modern practices of risk-based audits and Advance Pricing Mechanisms to deal with transfer pricing issues; and (iii) improve the efficiency and effectiveness of tax administration.

¹⁰ <http://www.doingbusiness.org/>

¹¹ <http://www.pwc.com/gx/en/paying-taxes/assets/pwc-paying-taxes-2013-full-report.pdf>

38. The Government has maintained public debt at sustainable levels though risks from contingent liabilities are likely to be significant. End 2011 figures show that public debt stock is at around 53 percent of GDP, approximately 60 percent of which is external and 40 percent domestic debt. Short-term borrowing is likely to have increased in 2012 in light of slower revenue collection, but there is little publicly available information on this.¹² Over eighty percent of the public external debt is borrowed on concessional terms. Vietnam is at low risk of external debt distress according to the IMF and World Bank's latest Debt Sustainability Analysis. Sources of concessional finance are gradually declining.

39. Risks from contingent liabilities are likely to be high even though the full extent is not known. The government is stepping up efforts to collect reliable and up-to-date information on contingent liabilities in the SOE sector and to monitor and manage potential fiscal risks associated with borrowing by SOEs. SOEs are highly leveraged – between 2007 and 2009, debt to equity ratio averaged 307 percent relative to 183 percent for non-state firms and 145 percent for foreign firms. The SOEs also had the highest debt-to-asset ratio among the three groups. Therefore economic slowdown, affecting SOEs could further fuel a banking sector crisis, which would have a negative economy-wide impact.

40. The Prime Minister issued a Decision in July this year to strengthen the institutional framework for debt management and establish prudential fiscal targets and thresholds for medium-term sustainability (PM Decision 958/QD-TTg). The Decision sets out a long-term strategy (2011-2020) for public debt management, consolidating for the first time external, domestic, sub-national, off-budget, and SOE debt. It includes adoption of the following policies: (i) medium to long-term deficit targets and borrowing limits; (ii) changing the composition of the debt portfolio to increase the share and maturity of domestic debt; (iii) medium to long-term thresholds for public debt stock and debt servicing. These are summarized in table 5 below.

41. All of the prudential targets and thresholds in Decision 958 are above current deficit and debt levels, and there are no formal penalties in case these are breached. This in part reflects medium-term expenditure needs (ref fiscal deficit target in table 5) and the reduction in concessional financing (ref targets on composition of debt portfolio in table 5). The lack of formal penalties is not a problem, because the targets and thresholds help improve transparency of fiscal policy. But it is important to communicate regularly on developments against the thresholds and targets through reports on the State Budget and the government's bi-annual Debt Bulletin. Much of the information in table 5 below is already available in the public domain – others, such as domestic debt information should be available soon. Some information however, on foreign exchange reserves for example, is not easily available in the public domain.

¹² One media report by STOXPPLUS "Vietnam's Public Debts Increase Sharply" estimates that debt could rise to 58 percent of GDP by end 2012.

Table 5: Summary of Selected Policies Adopted Under PM Decision 958

Indicator	Latest Estimates	2011-2015	2016-2020
Deficit targets and borrowing limits			
Fiscal deficit (inc. off-budget)	3.2% of GDP (2011)	< 4.5% of GDP	Around 4% of GDP
Bond-financed infrastructure	VND 120 trillion (2011 and 2012)	< VND 225 trillion	< VND 500 trillion (70% for re-financing)
Supplemental borrowing for infrastructure	-	< VND 55 trillion per year	
Composition of debt portfolio			
Government External Debt	60%		< 50% of Total Public Debt
ODA Debt	84% (end 2010)		> 60% of Total External Debt
Maturity of Domestic Government Bonds	-	Increase on average by 4-6 years	Increase on average by 6-8 years
Thresholds for debt stock and debt servicing			
Total Public and Publicly Guaranteed Debt	53% (2011)	< 65% by 2020	
Total debt service obligation	15% (2010)	< 25% of annual Government revenue	
External debt service obligation	3.5% (2010)	< 25% of annual export revenue	
Foreign Reserves (% of short-term debt)	-	> 200% per year	

42. The National Assembly in mid-November approved the 2013 State Budget estimates.

Government revenue is estimated to increase by 10 percent compared to the 2012 Budget to VND 816 trillion, and expenditure will also rise by 10 percent to VND 987 trillion. The overall budget deficit comes to 4.8 percent of GDP, based on government estimates. A priority for the government is salary adjustments for public servants. The 2012 State Budget raised the base salary from VND 830,000 per month to VND 1,050,000 per month. The total cost came to around 2 percent of GDP. Starting May 2013, the government plans to increase this by a further 14 percent to VND 1,300,000 per month. The Ministry of Finance in press reports has indicated that this would cost close to VND 60 trillion, around 6 percent of Government expenditure.¹³ On the other hand, the government has proposed a nominal cut to capital expenditure from VND 180 trillion in the 2012 Budget, to VND 170 trillion in the 2013 Budget.¹⁴ Notwithstanding higher off-budget spending as noted above, this would constitute the first nominal cut in the capital budget, certainly since 2006 though most likely going further back. The Ministry of Planning and Investment has indicated that it may be cut even further if revenue from land taxes and transactions fall short of the 2013 target.

¹³ Media Report¹⁴ Media Report "Reducing Public Investment to Increase Salary Level," Vietnam Business Forum (November 22, 2012)

43. A recent review of fiscal transparency by the World Bank highlights progress, but finds that there is much room for improvement including in areas such as the wage bill and capital expenditure. The review includes a survey of major stakeholders, canvassing views on priorities for reforms. The survey highlights strong demand for fiscal information in government, the National Assembly, the media, the private sector, civil society and Development Partners. Issues highlighted as priorities for improving disclosure include results from public spending, government debt and guarantees, and links between the budget and state enterprises. The media is the primary source of fiscal information for most stakeholders, rather than official budget documents, but the media itself has difficulty in interpreting primary Budget reports.

44. Stakeholder feedback suggests that there is much scope for improvement in the coverage, comprehensiveness and presentation of State Budget reports. This feedback can be explained by several factors. Firstly, there is a lack of information in public reports on the economic breakdown of spending (e.g. wages and salaries, goods and services, transfers) by administrative units. Disclosure of the economic breakdown would provide a more informative and analytical view of the Budget. It would for example help to better understand the salary reforms discussed above in the context of the overall government wage bill. Secondly, information on capital allocations in public documents is limited. With some exception, there is no information on capital spending by functions of Government or across all administrative units. As a result, it is not possible to get from the Budget document total spending in any one sector. Finally, Vietnam has a complex system of expenditure and revenue carry-over practices, which impacts negatively on credibility and transparency of the Budget. For expenditure that is carried over, there is no economic or functional breakdown, which suggests that budget execution may be under-reported. The government is looking at addressing some these issues as part of its review of the State Budget Law.

H. NEAR-TERM OUTLOOK

45. With the restructuring agenda gaining momentum, we expect some important progress in 2013. Efforts to divest non-core assets and equitize a large number of SOEs could send a positive signal to investors about government's commitment to this agenda. It could also involve some pains in terms of retrenchment of labor and restructuring of bad debts. We also expect some efforts to resolve the bad debt problem, though given the complexity of the issues involved, it is likely to be a much more drawn-out process. Many of these actions would involve costs and it is unclear how these will be met. If the costs are paid by allowing foreign or domestic private enterprises and banks to invest in the weak banks, it will certainly help to keep the fiscal situation under control and boost investor's confidence. Given the low price of risk in global capital markets, Vietnam has a unique opportunity to clean up a part of its bad debt problem by accessing external capital at a much lower cost than would have been otherwise possible.

46. Vietnam's economy is expected to grow at a moderate pace of around 5.5 percent during 2013. In our base case scenario, assuming the continuation of the good spell of macroeconomic stability and reasonable export growth, we do not expect any strong headwinds that could destabilize the economy in 2013. We expect the trade and current accounts to remain in surplus in 2013 though by a smaller amount than in 2012. We also expect some consolidation of the fiscal accounts and inflation remaining in the high single digit.

47. There are however several downside risks to our projections. First, on the external side we expect a weak global recovery but no big negative shocks from the United States, Euro Area or Japan. Therefore Vietnam's exports, FDI and remittances should continue to do as well as in 2012 or better. We also assume oil prices to remain relatively high (around US\$ 105 per barrel) but non-oil commodity prices to gradually fall—which should help keep a lid on domestic inflation. We also assume that more progress will be made on the restructuring agenda in 2013 compared to 2012.

Table 6: Vietnam Key Economic Indicators

	2009	2010	2011e	2012p	2013f
Real GDP (% change, y-y)	5.3	6.8	5.9	5.2	5.5
Consumer price index (% change, period average)	6.7	9.2	18.6	9.2	8.0
Government revenues (% GDP)	27.3	29.6	27.7	26.1	25.4
Government expenditures (% GDP)	34.5	32.7	30.9	31.3	29.2
Fiscal balance, official (% GDP)/1	-3.9	-0.7	-1.5	-3.7	-2.3
Fiscal balance, general (% GDP)/2	-7.2	-3.1	-3.2	-5.2	-3.8
Public sector debt (% GDP)/3	51.2	54.0	55.4	53.7	53.3
Trade balance (billions US\$, BOP definition)	-8.3	-5.1	-0.5	6.4	5.8
Current account balance (billions US\$)	-6.1	-4.3	0.2	3.7	1.9
Foreign direct investment (net, billions US\$)	6.9	7.1	7.1	7.2	7.3
External debt (billions US\$)/4	38.7	45.4	50.1	54.7	59.8
Foreign exchange reserves, gross (months of imports)	2.4	1.8	1.5	2.3	..
Domestic credit (% change y-y)	39.6	32.4	14.3	6.0	12.0
<i>Memo: Nominal GDP (billions US\$)</i>	93.2	103.6	122.7	135.9	150.0

e = estimate, f = forecast

1/ Excludes off-budgetary items

2/ Includes off-budgetary items

3/Public and publicly-guaranteed debt

4/Public and publicly-guaranteed debt. Forecast by Debt Sustainability Analysis 2012

Source: IMF and The World Bank.



PART 3



STRUCTURAL AND SOCIAL ISSUES

A. CONTEXT

48. Vietnam's economy, historically known for its stellar growth and poverty reduction performance, seems mired in difficulties: a steadily slowing economy, rising inequality and emergence of new sources of vulnerabilities. After a torrid growth rate of 8.3 percent per year during the 2003-07 period, the economy seems exhausted, with growth falling to below 6 percent for the 2008-11 period and further down to 5.2 percent in 2012—the lowest level reported in the past fourteen years. No one including the Government is expecting the economy to return to 6 percent plus growth rate any time soon. At the same time, poverty reduction has become less responsive to economic growth. Most of the remaining poor live in more isolated regions, work in agriculture and lack the education and job skills relevant for the modern economy. Among the tens of millions of Vietnamese households who have risen out of poverty over the past decade, many have incomes very near the poverty line and remain vulnerable to falling back into poverty as a result of idiosyncratic shocks or related economy-wide shocks. Inequality in income and opportunity between the rural and urban areas and between the rich and poor households is widely seen as rising.

49. Vietnam's slower growth in recent years can be attributed to falling productivity and reduced competitiveness. The contribution of productivity to growth has fallen to below 0.5 percent since 2007 (see VDR, 2012). The country's rankings on several cross-country competitiveness assessments have declined. Vietnam fell sixteen places in the last two years to 75th out of 144 countries assessed as part of the World Economic Forum's Global Competitiveness Index. Its overall ranking in the Doing Business survey fell between 2012 and 2013. In 2013 it ranked 99th out of 185 countries, falling from 90th position in 2011 and 98th position in 2012, and still below the East Asia Pacific average of 89th position. Similarly in the World Bank's Logistics Performance Index, which looks at trade facilitation issues, Vietnam has consistently ranked around the 65th percentile, whereas other countries like Sri Lanka and Philippines have now overtaken Vietnam.

50. Its problems stem largely from a lack of structural reforms in recent years, which is being reversed by 'restructuring' the key parts of its economy. Inefficiencies in SOEs, banks, and public investments have become a drag on Vietnam's long-term growth potential. The government has prioritized reforms in these areas and progress is being gradually made. Below we provide a brief discussion of the initiatives underway in restructuring the SOEs, developments in the banking sector and a short discussion on the trends and challenges of poverty reduction in Vietnam.

B. RESTRUCTURING OF STATE-OWNED ENTERPRISES

51. The long-awaited action plan for the implementation of SOE restructuring came out officially in mid-2012 with the issuance of two Prime Ministerial Decisions. Decision 704 targets strengthening corporate governance of SOEs while Decision 929 provides a framework for the restructuring of state economic groups and state general corporations for the period 2011-15. There are two major components to the action plan. The first component deals with improvements in the legal framework for the governance and operations of state enterprises, and the second involves the actual restructuring of SOEs. As per these Decisions, the National Steering Committee for Enterprise Reform and Development (NSCERD) has been assigned as the coordinating agency that assists the Prime Minister in the implementation of the actions in Decisions 704 and 929.

52. Decision 704 specifically aims to improve the transparency of SOE operations. It instructs the Ministry of Planning and Investment (MPI) to formulate a regulatory framework for information disclosure of single member limited liability SOEs, including the mother companies of state economic groups and state general corporations. These SOEs will have to follow similar information disclosure requirements as listed enterprises. These include the publication of annual reports and quarterly financial reports. The Ministry of Finance (MOF) is assigned with the annual disclosure on its website of aggregate information on SOE performance annually. It also will take the lead in drafting the SOE Annual Report presented to the National Assembly, which will be disclosed to public from 2013.

53. The SOE restructuring framework in Decision 929 lists five groups of tasks to be implemented. The first group deals with the classification of SOEs based on the nature of their activities, their role in the economy, which in turn will determine the desired level of state ownership. This will provide the basis for further equitization of SOEs as well as for rationalization of the sectoral structure of the state sector. The decisive factor for the classification will be the role that the state is expected to play in the economy, and identifying those sectors and areas where it will reduce or withdraw its presence. The remaining four groups of tasks are: (i) divestment of non-core businesses using market mechanisms; (ii) giving initial restructuring priority to enterprises in commerce, construction, lottery, telecom, water supply, urban sanitation, irrigation, maintenance of roads and railways; (iii) comprehensive restructuring of the state economic groups (SEGs) and general corporations (SGCs) including management, human resources, product lines, and development and marketing strategy; and (iv) further improving the legal framework within which SOEs are governed and operate.

54. Recent developments indicate a rearrangement and tightening of the state management of SEGs. In early October 2012, the government decided to disband two construction economic groups, the Vietnam Industry Construction Group (VNIC) and the Housing Urban Development Group (HUD) after less than three years of pilot. Their member SGCs, which had been merged to form the SEGs, have now been transferred back to the Ministry of Construction (MOC). In a recent press conference, the Chairman of the Office of the Government (OOG) announced that the government plans to reduce the number of SEGs to 5-7, and less than 10 SEGs and SGCs will be under the management of the Prime Minister instead of about 20 as of now. In addition, the governance of operation of the SEGs will be further tightened by newly issued legal documents including a Decree on the Exercise of Owner's Rights, a Decree on Management of SEGs and Special SGCs, and Regulation on Information Disclosure.

B.1 Need For A Results-Oriented Restructuring Effort

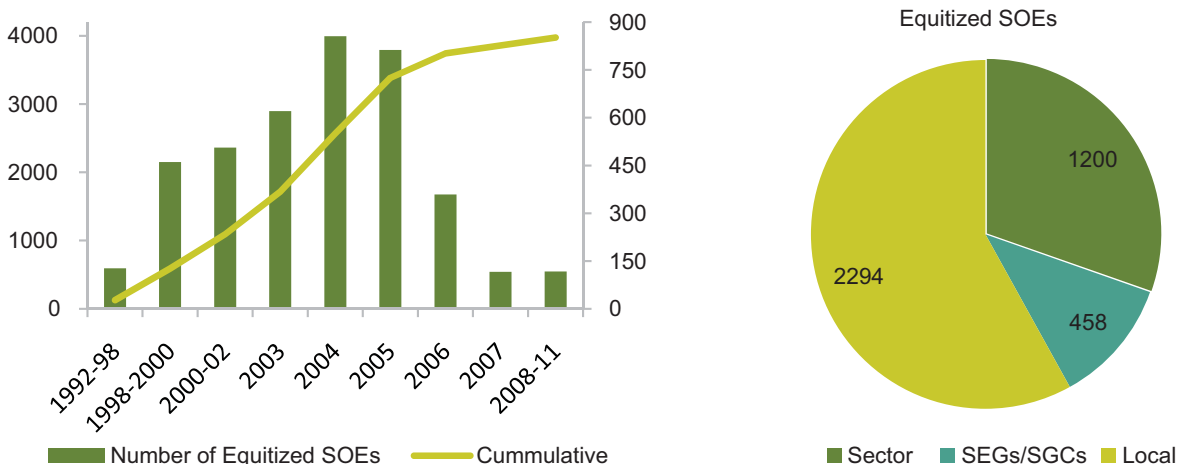
55. Limited progress has been made on the core restructuring agenda that involves sectoral consolidation and individual restructuring of SOEs. The foundation for these actions is a sound classification of SOEs according to strategic importance of the sectors. Decision 14/2011 is the present legal framework for SOE classification and is expected to be revised based on the experiences and lessons from the current restructuring efforts. Decision 14 provides a list of sectors classified by state ownership level. To date, there has been no credible action plan for

implementation of Decision 14, even though it came into force in April 2011. The current restructuring approach appears to be an individual-led process, and inadequate attention is paid on issues for the SOE sector as a whole such as the sectoral consolidation, divesture from non-core businesses, non-performing loans within the SOEs and the link with the banking sector restructuring effort.

56. Equitization—the main vehicle used to restructure SOEs in the past—has experienced slower progress in recent years. At the end of 2011, almost 4,000 SOEs were equitized, which were mostly managed by local government (figure 16). As a result, there were only 117 cases of completed equitization cases between 2008 and 2011. Commonly cited reasons for slow progress on equitization include an underperforming stock market, the global slowdown, and the impediments within the current legal framework. Decree 59 was issued at the end of 2011 to fix the latter and two more Circulars were issued in the beginning of 2012, but such regulatory changes alone cannot accelerate the equitization process. Much more needs to be done in order to achieve the ambitious equitization targets of more than 600 SOEs wholly owned by the state by 2015. Even the modest equitization target of 93 SOEs in 2012, many of which are small and medium-sized SOEs, is unlikely to be realized.

57. Decision 929 and Decision 704 set a number of ambitious deadlines for the preparation of key legal documents, some of which have already been missed. For example, by Q3 of 2012, all SEGs and SGCs have to submit their own restructuring plans to their respective state agencies. Investments in non-core businesses must be brought to an end by 2015. These are clearly very ambitious targets given how complex the process is. According to the MOF, as of the August 2012, 53 SEGs and SGCs have finalized their restructuring plans. However, many of these restructuring plans have not been developed by restructuring experts or professionals. MOF has committed to disclose on a quarterly basis information on progress with the restructuring agenda, though there is little information available to date. There is also no well-defined mechanism for M&E to regularly monitor implementation and make adjustments when needed.

Figure 16: Slow progress on equitizing SOEs



Source: MOF, Presentation at SOE Reform Workshop, February 2012 and NSCERD Report

58. Progress on the formulation of the legal documents required by Decisions 704 and 929 appears to be slow. According to these Decisions, more than 30 legal documents related to SOE governance and operations were scheduled to be developed and submitted to the Government by the end of 2012. This is obviously a very ambitious goal given the typical time-consuming process for the formulation of legal documents, particularly when these are cross-sectoral in nature. In addition, the inter-dependent nature of the policies embedded in these documents requires proper sequencing and consequently, more time is likely to be needed. As of mid-November 2012, only one document, namely Decree 99 on the allocation of the exercise of state rights as owner in SOEs, was actually issued.

59. The implementation arrangements of Decisions 704 and 929 involve simultaneous actions of state agencies on the one hand preparing the regulatory framework, and individual SOEs on the other formulating their own restructuring plans. The combination of such a top-down and bottom-up approach raises concerns about potential inconsistencies between restructuring plans prepared by the SOEs and the evolving regulatory framework for SOEs and their restructuring. To some extent, the potential mismatch is being addressed during the appraisal process when individual restructuring plans are reviewed and endorsed by state agencies. But the absence of well-defined guidance for the preparation of the restructuring plans of individual SOE is likely to make it a time-consuming process for both enterprises and state agencies. Decisions on restructuring may be postponed until there is clear agreement over regulatory provisions. In addition, there will be different agencies involved in endorsing the restructuring plans (the Prime Minister for the SEGs and SGCs type 91, sectoral ministries and provincial PPCs for other SOEs). As a result, a strong inter-agency coordination mechanism is needed to avoid potential inconsistencies.

60. SOE reform is one of the main issues discussed in the 6th Plenum of the Central Committee of the Communist Party of Vietnam, which concluded in mid-October 2012. The concluding remark of the Plenum requests a rapid divestiture of non-core business and full divestiture of existing SOEs with less than 50 percent of state equity. The remark also states that the leading role of the SOEs will be confined to four areas: defense, natural monopoly, essential public utilities and some strategic high-tech industries with large spill-over effects. For these industries, the SOEs need to be present only in key segments of the supply chain. Another important indication of fundamental changes is the request to adopt a market-based contracting scheme for SOEs in fulfilling their functions as a tool for macroeconomic management and social duties.

C. BANKING SECTOR DEVELOPMENT

61. The health of the banking sector continues to be a growing concern given recent news on the deteriorating asset quality of banks and slow progress of banking restructuring. Given rapid credit expansion, developing risk management systems, limited corporate governance coupled with a relatively weak regulatory and supervisory framework, the problems in the banking system have been building up for sometime (e.g., real estate and SOE sector developments). The NPLs reported by banks to SBV stood at 4.93 percent at end of September 2012. However, SBV has reported that its own estimate of NPLs is 8.82 percent. Several independent analysts and academics—some of them using international accounting standards—have come up with their own estimates for NPL, which are significantly higher than the SBV's estimate¹⁵. A gap in reported and estimated NPLs may imply banks may be under provisioning and this would imply weaker capital position of the banks than what is reported. The recent arrests of individuals associated with one of the Joint Stock Commercial bank has also brought attention the issues of cross ownership between financial institutions and potential impact on financial health of the related institution and the system as a whole. All this adds to uncertainty about the extent of the problems and has raised concerns about the overall health of the banking sector.

62. The authorities have tried to seek viable solutions to the problem of rising NPL, from both short and long-term perspectives, but progress and demonstrated actions have been limited. As a short-term response, SBV issued document 2871/NHNN-TD in May 2012 guiding Decision 59/2006/QD-NHNN promulgated in 2006 allowing 14 banks to trade in bad debts, so that banks with stronger capacity and capital base can acquire bad debts in weaker banks after paying a reasonable premium. Thus far, the solution does not seem to have brought results. SBV plans to issue a Circular replacing Decision 493 with stricter loan classification and provisioning requirements. Its implementation over time would allow more accurate classification and reporting on NPLs and

¹⁵ It is reported that the accumulated provisioning in the system reached VND75 trillion in the Q3, after the banks had written off VND12 trillion bad debts. Such provisioning is still far from the publicly announced bad debts of more than VND200 trillion which is by itself an underestimate by international standards.

adequate provisioning to better capture system-wide risks. SBV is also working on plan to address NPLs and is expected to submit it for Government review soon. It is reported that setting up of a public Asset Management Company (AMC) may be one of the options for addressing the bad debt problems. A couple of issues under discussion relating the AMC are sources of funding for this vehicle, asset transfer pricing principles and the process for ensuring appropriate accountability and liability of borrowers in the process (particularly as the current insolvency system does not provide an effective framework for the resolution of distress assets and has had limited implementation record).

63. Banks have been cautious in extending further credit to the economy given the developments in the real sector and growing stress on their balance sheets. For the first time in recent history, monthly credit growth was negative in Q1 of 2012. As of September 20, 2012 total credit growth in the system reached 2.35 percent despite continuous key rate cuts during the year by SBV. Lending rates have gone down to as low as 9-10 percent for selected loan programs in several banks, compared to the exorbitant lending range of 18-25 in the early months of the year. In order to infuse more credit into the system (in response to a slowing economy), SBV relaxed the credit growth limit assigned to each bank (the banks were classified into 4 groups, with Group 1 being top-rated and being granted the credit limit of 17 percent, and Group 4 consisting of problem banks with zero credit growth). Notwithstanding these efforts, the revised credit growth target of 8-10 percent for 2012 will be difficult to achieve (the initial target was 15-17 percent)¹⁶.

Figure 17: Growth rate credit and liquidity has changed considerably in the last two years

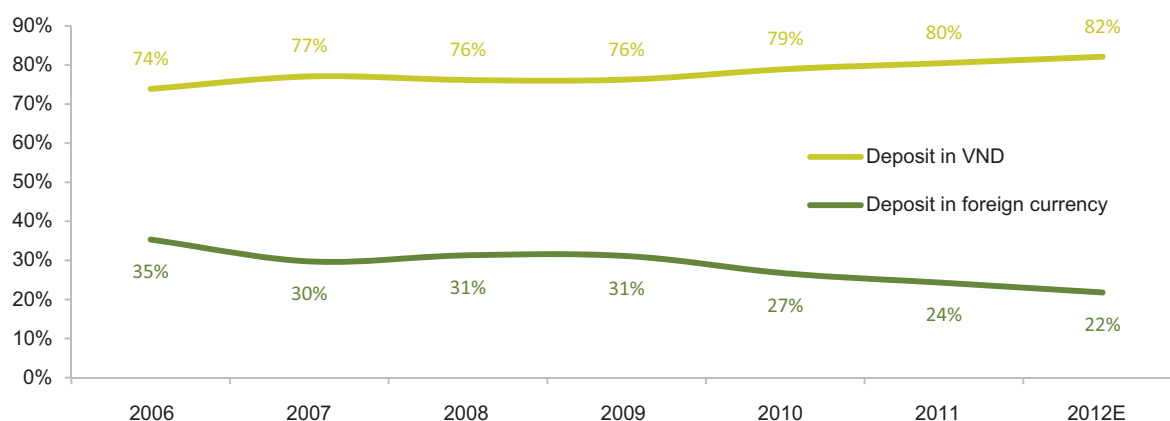


Source: State Bank of Vietnam

64. Despite the concerns about the sector, banks have been receiving ample deposits and liquidity of the whole system has been enhanced. During the first ten months, total liquidity in the system (M2) increased by 10.37 percent and total deposit growth reached 11.23 percent. Corporate deposits turned positive in July 2012 after serious negative growths in previous months (e.g. -0.46 percent in June, 3.58 percent in May and 5.6 percent in April), showing signs of recovery in the real sector. Deposits continued to grow despite SBV's decision to reduce the cap on short-term deposit rates (i.e. less than 12 months) to 9 percent in June 2012 (while the caps on medium and long-term deposit rates were officially removed in order to support the banks in coping with the maturity mismatch problem). The cap on USD deposit rates has been kept unchanged at 2 percent per annum. While depositors exude confidence in the domestic currency, they have become increasingly sensitive to the soundness of each bank and policy action by the regulators.

¹⁶ In November SBV started including the banks' investments in Government bonds as part of its credit growth calculation. In the first 10 months credit institutions have bought VND183 trillion of Government bonds, equivalent to approximately 5 percent overall credit outstanding. With the inclusion of government bonds the overall credit growth target may be achieved, but the year-on-year comparison of credit growth will be misleading.

Figure 18: Composition of deposits in local and foreign currencies



Source: State Bank of Vietnam

65. Banks have been cautious with the use of excess liquidity, as witnessed by the increasing amount of Government bonds being bought. Fund flow efficiency among banks has been quite low, and smaller banks still find it difficult to get needed liquidity in the inter-bank market, especially with the promulgation of Circular 21 in August 2012 by the SBV that strictly regulate lending and deposit activities among banks. Inter-bank trades were cut by half within the first week of implementation of the Circular and recovered slowly thereafter. The loan-to-deposit ratio of the banking system has noticeably improved in recent months. For example, the ratio was in the range of 100-120 percent in the period of 2009-2011 but reduced to below 90 percent in July 2012, indicating a flight to safety (corresponding numbers are: Thailand (95.8 percent), Malaysia (79.3 percent) and Indonesia (75.5 percent)).

66. The Government is participating in the joint WB-IMF Financial Sector Assessment Program (FSAP)¹⁷ to comprehensively assess the issues. FSAP will be an opportunity for the Government to comprehensively assess the stability and development issues in the financial sector and further strengthen the reforms agenda and its implementation. It can help to strengthen financial oversight, identify gaps in framework compared to international standards and provide recommendations to strengthen institutional capacity.

D. POVERTY REDUCTION¹⁸

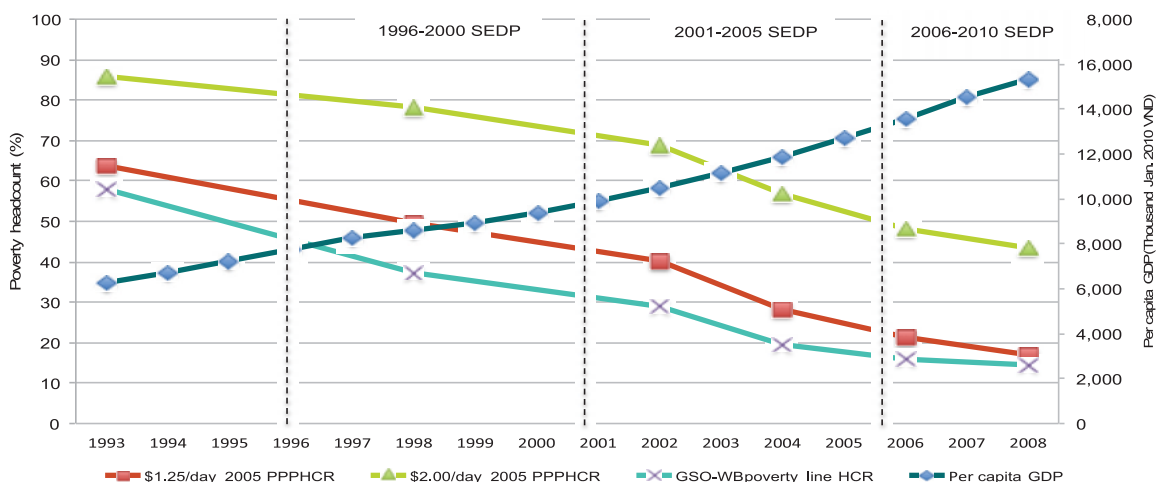
67. Although Vietnam has made remarkable progress in reducing poverty and promoting prosperity, it still faces considerable challenges. Vietnam's historical growth patterns have been remarkably pro-poor: growth in per-capita GDP averaged 6.1 percent a year between 1993 and 2008, and poverty fell by an average of 2.9 percentage points a year (figure 19). Using a 'basic needs' poverty line¹⁹ agreed in the early 1990s, the poverty headcount fell from 58 percent in 1993 to only 14.5 percent by 2008.

¹⁷ FSAP has been completed in nearly 150 countries.

¹⁸ This Section draws on the recently concluded report "Well Begun, Not Yet Done: Vietnam's Remarkable Progress on Poverty Reduction and the Emerging Challenges," Report No.70798-VN, The World Bank.

¹⁹ Vietnam's original 'basic needs' poverty line national poverty set in the mid-1990s is equivalent to \$1.10 person/day, below the \$1.25 person/day (PPP 2005) global standard.

Figure 19: Economic Growth and Poverty Reduction in Vietnam: Two Decades of Progress



Source: World Bank Poverty Assessment Report “Well-Begun, Not Yet Done: Vietnam’s Remarkable Progress on Poverty Reduction and Emerging Challenges”, 2012.
HCR is the head-count rate, or percent of population below the poverty line

68. Progress has also been substantial in other dimensions of well-being. Vietnamese today are healthier, better educated, and live longer lives. In 1998, one-quarter of all persons in the 15-24 year age group had not completed primary school. By 2010, only 12 years later, the percentage had fallen to a scant 4 percent, and upper secondary enrollments had nearly doubled (60 percent for girls, 54 percent for boys). Infant mortality has fallen to 14 deaths per 1000 live births, which is impressive even by middle income standards, and life expectancy has risen to 75 years. Access to infrastructure also improved dramatically: the number of households connected to the electricity grid increased from 77 percent in 1998 to nearly universal coverage (98 percent) by 2010. Vietnam has achieved most and in some cases surpassed many of the MDG goals. However some important challenges remain: stunting (low height for age) remains a concern in some regions of the country and among minority populations, and an estimated 40 percent of rural households still do not have access to clean water²⁰ or sanitary latrines.

69. Despite progress, the task of poverty reduction is not complete, and in important respects has become more difficult. As discussed in Part II, economic growth has slowed, and Vietnam has struggled with periods of macroeconomic instability and high inflation. Vietnam’s ‘basic needs’ poverty line (equivalent to \$1.10 person/day 2005 PPP) is low by international standards and the methods used to monitor poverty since the early 1990s are outdated. The standards that applied to low-income Vietnam in the 1990s are no longer relevant to modern day, rising middle-income Vietnam. Moreover, although tens of millions of Vietnamese households have risen out of ‘basic needs’ poverty over the past decade, many have incomes very near the poverty line and remain vulnerable to falling back into poverty as a result of idiosyncratic shocks (such as job loss, accidents, death or illness of a household member), or related economy-wide shocks, (such as the effects of climate change on rainfall and temperatures, human and animal influenza pandemics, and impacts of the recent global financial crisis).

²⁰ Clean water includes piped water, bottled water, water from deep wells with pumps, and rain water.

D.1 New Poverty Line

70. An updated poverty line was calculated for 2010 that better reflects living conditions of the poor a; based on this updated methodology the national poverty rate in 2010 is 20.7 percent²¹. The updated GSO-WB poverty line is equal to VND 653,000 person/month (\$2.25/person/day, PPP 2005), which is higher than the official MOLISA urban and rural poverty lines (VND 500,000 person/month and VND 400,000 person/month, respectively). Poverty rates using the GSO-WB poverty line are substantially higher than MOLISA's poverty estimates for rural areas (27 percent compared to 17.4 percent) but very similar in urban areas (6 percent compared to 6.9 percent) (see table 7). Despite an initial effort to bring the GSO-WB and official poverty lines together, there is now widespread agreement in Vietnam that it is more appropriate to use two poverty lines: the official lines (referred to as targeting lines) are used to determine eligibility for a number of social programs. The definition of the official lines is affected by the availability of public resources, and they are well suited for reaching the poorest and most vulnerable households. In contrast, the GSO-WB poverty line was defined independently of resource availability and is primarily intended for poverty measurement and monitoring over time.

Table 7: National and Regional Poverty Rates in 2010:
GSO-WB and official poverty lines

	GSO-WB Poverty Rate		Official Poverty Rate	
	Incidence (%)	Contribution to total (%)	Incidence (%)	Contribution to total (%)
All Vietnam (national)	20.7	100	14.2	100
Urban	6	9	6.9	14
Rural	27	91	17.4	86
Red River Delta (Hanoi)	11.4	12	8.4	13
East Northern Moutains	37.7	21	24.2	20
West Northern Mountains	60.1	9	39.4	9
North Central Coast	28.4	16	24	20
South Central Coast	18.1	7	16.9	10
Central Highlands	32.8	10	22.2	9
Southeast (HCMC)	8.6	7	3.4	4
Mekong Delta	18.7	17	12.6	17

Source: World Bank, 2012

D.2 Pockets of poverty or pockets of affluence?

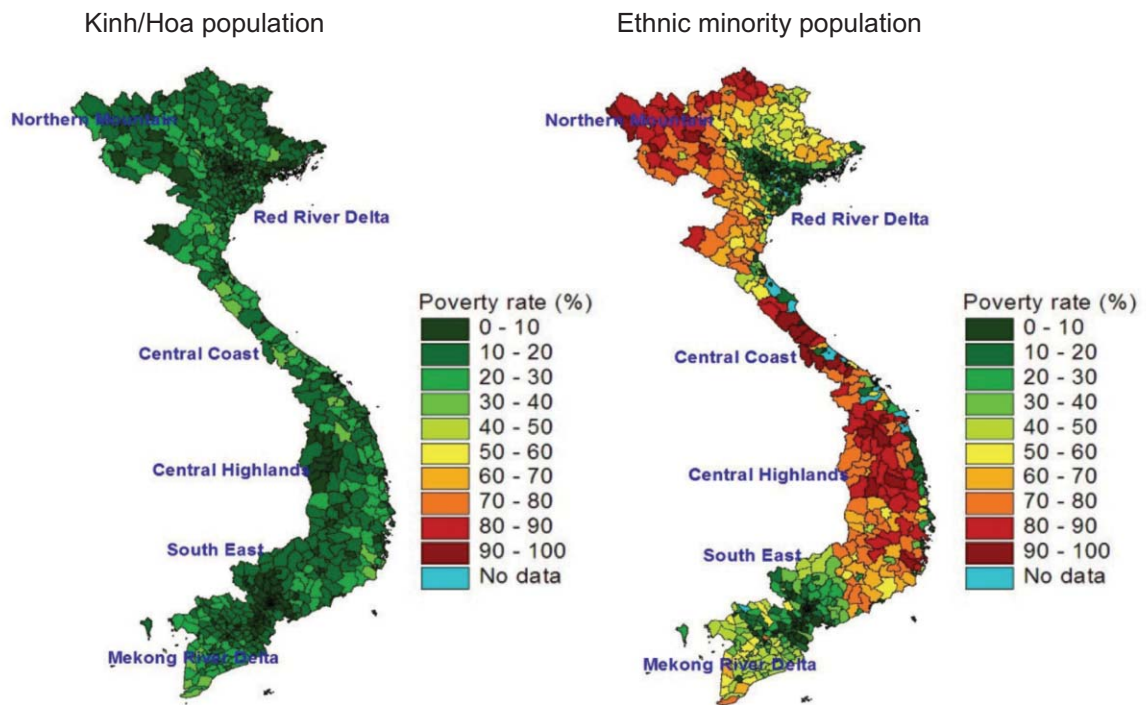
71. Is Vietnam a low income country with pockets of affluence or a rising middle-income country with some remaining pockets of poverty? National averages mask substantial differences in poverty rates across regions and populations. Poverty is primarily a rural phenomenon in Vietnam and it has become increasingly concentrated in upland regions of the country, including

²⁰ A team of local and international experts worked in collaboration with the General Statistics Office (GSO) and Vietnam Academy of Social Sciences (VASS) to update Vietnam's poverty monitoring system beginning in 2010. The design of the 2010 VHLSS was improved and a new sample frame developed on the basis of the 2009 Housing and Population Census. Welfare aggregates (per-capita consumption) were revised to develop a more comprehensive measure of well-being, and new spatial cost of living indices (SCOLIs) were developed on the basis of an innovative consumer price survey in 1,500 communes carried out in collaboration with GSO

the North East (37.3 percent poor) and North West Mountains (60.1 percent poverty), and also parts of the Central Highlands (32.8 percent poverty). In contrast, household wealth is heavily concentrated in the Red River Delta (near Hanoi) and Southeast (near HCMC) as well in urban centers along the coast.

72. The remaining poor are harder to reach; they face difficult challenges – of isolation, limited assets, low levels of education, poor health status – and poverty reduction has become less responsive to economic growth. Ethnic minority poverty is a persistent concern; the gap between minorities and Kinh majorities continues to rise. Although Vietnam’s 53 ethnic minority groups make up less than 15 percent of the population, they now account for 47 percent of the poor, compared to only 29 percent at the end of the 1990s. Two-thirds of ethnic minorities still lived below the poverty line in 2010, compared to only 12.9 percent of the Kinh, and minorities reside in more isolated and less productive upland regions of the country. Three-quarter of their total income comes from agriculture and allied activities. In contrast, poor Kinh have more diversified labor and earnings portfolios and live in more the more fertile coastal and delta regions. Those Kinh who do live in upland regions e.g. North East, North West Mountains, and Central Highlands are substantially less poor on average than minorities in the regions (figure 20).

Figure 20: 2010 poverty rate for Kinh/Hoa and ethnic minority people



Source: Estimation from the 2009 Housing and Population Census and the 2010 VHLSS (World Bank, 2012).

D.3 Rising inequality has created additional pressures

73. Rapid structural transformation and the ongoing transition to a market economy have created additional challenges for poverty reduction. Inequality in incomes and opportunities are rising, underpinned by continuing disparities in human development between urban and rural areas as well as widening disparities within rural areas and across socio-economic groups. Inequality is particularly high in the mountainous regions in the north of Vietnam, also the Central Highlands, all areas with substantial ethnic minority population. The rise in income inequality is partly a reflection of growth processes which have altered the relative returns to assets such as education and productive capital in the economy. Growth has interacted with existing inequalities in opportunities – inequalities in education, access to good jobs, patterns of social exclusion, geographic disparities – to increase income inequality and the welfare gap between rich and poor households. In addition, a recent study of ‘perceptions of inequality’ (World Bank, 2012) highlights growing concerns about inequalities linked to power, influence and lack of voice and participation.

D.4 New forms of poverty and vulnerability are developing in urban areas

74. Although income poverty rates are low in urban areas, urban residents struggle to cope with the rising cost of living (including increases in electricity and water tariffs, rising fuel prices) and many work in the informal sector without social insurance or employment benefits. Urbanization is accelerating and rural workers are moving to the cities in growing numbers to work in private industry and services. Many of these jobs are informal and lack the benefits historically provided by the public sector and SOEs. Remittances from urban migrants to their rural sending communities contribute substantially to rural poverty reduction; however instability of employment coupled with the rising cost of living in urban areas may reduce further remittances. Urban poverty is most prevalent in Vietnam’s small cities and towns, which lag substantially behind Vietnam’s larger cities in terms of infrastructure, urban amenities, and coverage of basic services.

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