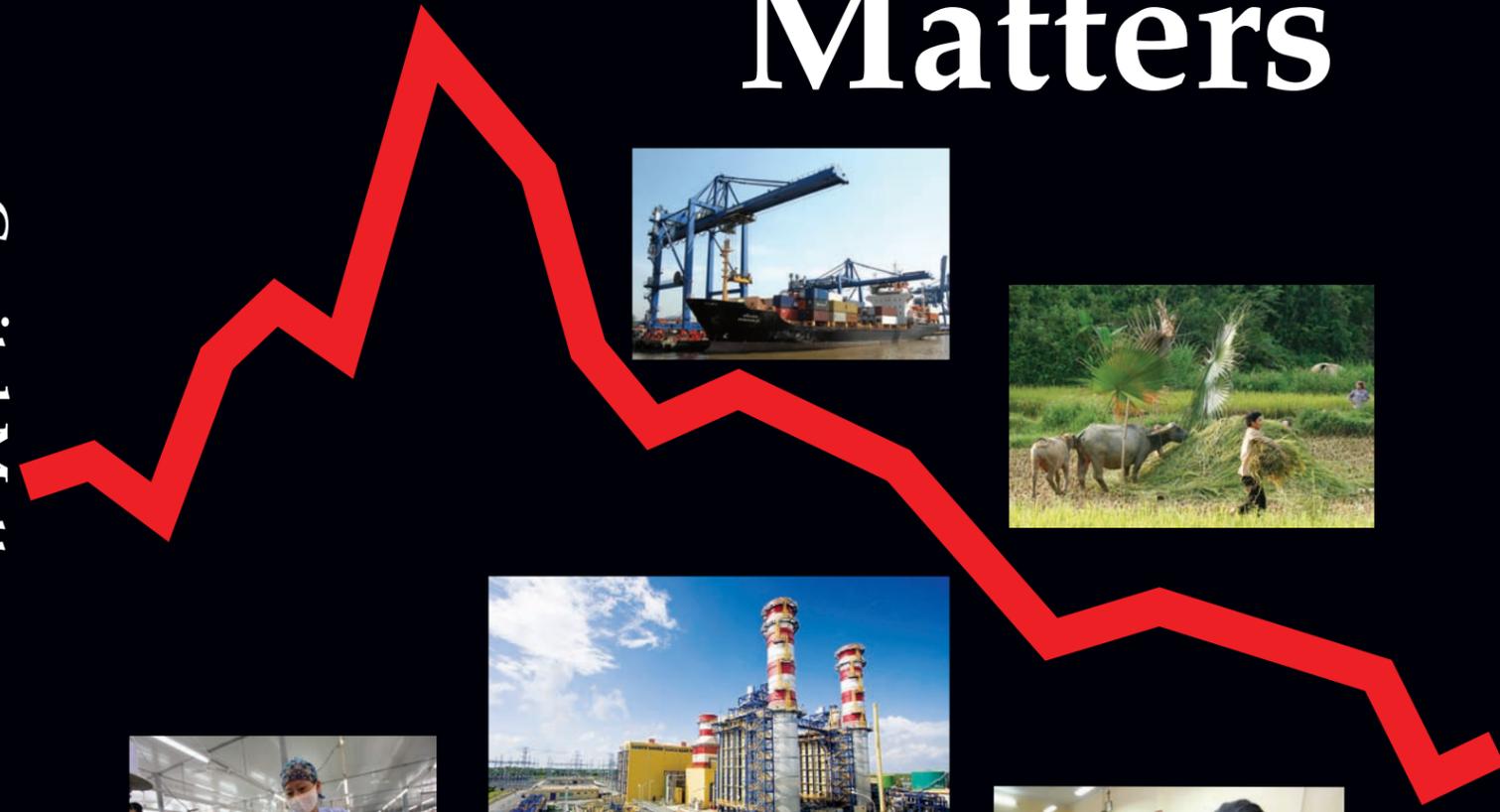


Capital Matters

Vietnam Development Report 2009

Capital Matters



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World Bank Report to the Vietnam Consultative Group Meeting
Hanoi, December 4-5, 2008

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CURRENCY EQUIVALENTS

CURRENCY UNIT = DONG
US\$ = 16,500
GOVERNMENT FISCAL YEAR
January 1 to December 31

ACRONYMS AND ABBREVIATIONS

ACB	Asia Commercial Bank
ADB	Asian Development Bank
AFTA	ASEAN Free Trade Area
BIDV	Bank for Investment and Development of Vietnam
BOT	Build-Operate-Transfer
BTO	Build-Transfer-Operate
CDS	Credit Default Swap
DAD	Development Assistance Database
DFID	Department for International Development of the United Kingdom
DRG	Diagnostic Related Group
DRS	Debtor Reporting System
EC	European Commission
Eximbank	Vietnam Import Export Bank
EIT	Enterprise Income Tax
EVN	Electricity of Vietnam
FDI	Foreign Direct Investment
GAC	Governance and Anti-corruption
GDP	Gross Domestic Product
GDT	General Department of Taxation
GNI	Gross National Income
GSO	General Statistics Office
HaSTC	Hanoi Stock Trading Center
HCMC	Ho Chi Minh City
HIFU	Ho Chi Minh City Investment Fund for Urban Development
HOSE	Ho Chi Minh City Stock Exchange
HSBC	Hong Kong and Shanghai Banking Corporation
IBRD	International Bank for Reconstruction and Development
ICOR	Incremental Capital-Output Ratio
IDA	International Development Agency
IFC	International Finance Corporation
IMF	International Monetary Fund
IPO	Initial Public Offering
IT	Information Technology
JICA	Japan International Cooperation Agency
JSB	Joint Stock Bank
JSC	Joint Stock Company
LDIF	Local Development Investment Fund

MHB	Mekong Housing Bank
MOF	Ministry of Finance
MPI	Ministry of Planning and Investment
MTEF	Medium-Term Expenditure Framework
NDF	Non-Deliverable Forward
NGO	Non-Governmental Organization
NPL	Non-Performing Loan
NPV	Net Present Value
OCBC	Overseas Chinese Banking Corporation
OECD	Organization for Economic Co-operation and Development
OTC	Over-the-Counter
P/E	Price-to-Earnings
PIT	Personal Income Tax
PPP	Purchasing Power Parity
PPP	Public Private Partnerships
PRSC	Poverty Reduction Support Credit
Sacombank	Sai Gon Thuong Tin Commercial Joint Stock Bank
SAE	Small-Area Estimates
SASAC	State-owned Assets Supervision and Administration Commission
SBV	State Bank of Vietnam
SCIC	State Capital Investment Corporation
SEDP	Socio-Economic Development Plan
SMBC	Sumitomo Mitsui Banking Corporation
SOCB	State-Owned Commercial Bank
SOE	State-Owned Enterprise
SRO	Self-Regulatory Organization
SSC	State Securities Commission
SSI	Saigon Securities Inc.
Techcombank	Vietnam Technology and Commercial Joint Stock Bank
UNCTAD	United Nations Conference on Trade and Development
USBTA	US-Vietnam Bilateral Trade Agreement
VAT	Value Added Tax
VBARD	Vietnam Bank for Agriculture and Rural Development
VBSP	Vietnam Bank for Social Policies
VDB	Vietnam Development Bank
Vietcombank	Vietnam Foreign Commercial Joint Stock Bank
Vietinbank	Vietnam Bank for Industry and Trade
VMBA	Vietnam Bond Market Association
VSD	Vietnam Securities Depository
VSS	Vietnam Social Insurance
VPBank	Vietnam Commercial Bank for Private Enterprises
VPSSC	Vietnam Postal Savings Service Company
WTO	World Trade Organization

ACKNOWLEDGMENTS

This report was prepared by the World Bank for the Consultative Group meeting of December 4-5, 2008. The outline and content of the report were discussed with donors, both virtually and at a workshop held in Hanoi on March 28. Comments and suggestions by Laurie Barnier (European Commission, EC), Bridget Crumpton (Department for International Development of the United Kingdom, DFID), Elke Foerster (on behalf of the Like-Minded Donor Group), Bahodir Ganiev (Asian Development Bank), Daniel Lenggenhager (Swiss Development Cooperation), Yasuhisa Ojima (Japan International Cooperation Agency, JICA) and Huong Thuy Vu (Embassy of Ireland) are gratefully acknowledged. The report also builds on various studies conducted or funded by donors in areas related to the content of the report over the months and years preceding its writing. Such studies, listed in the bibliography section, were prepared as part of each donor's own country program.

The preparation of the report involved consultations with Vietnamese researchers and practitioners who participated on a personal capacity. Their inputs and feedback were coordinated through a Reviewing Committee comprising Mr. Ha Bui (Ministry of Planning and Investment), Dr. Doanh Dang Le (Institute of Development Studies), Mr. Nghia Xuan Le (State Bank of Vietnam), Mme. Tam Thi Bang Le (advisor), Mme. Cuc Thi Nguyen (General Department of Taxation), Mr. Do Thanh Nguyen (Ministry of Finance), Mr. Huy Quang Nguyen (State Bank of Vietnam), Mme. Yen Thi Hoang Nguyen (Ministry of Finance), Mme. Lan Chi Pham (Institute of Development Studies), Dr. Thanh Tri Vo (Central Institute for Economic Management), and Mr. Bang Vu (State Securities Commission).

The team in charge of formally writing the report was led by Martin Rama. Viet Tuan Dinh and Keiko Kubota contributed to the entire report. Noritaka Akamatsu, James Anderson, Quang Hong Doan, Tuan Minh Le, Lasse Melgaard, Dzung The Nguyen, Nga Nguyet Nguyen, Duc Minh Pham, Kalpana Seethepalli, Susan Shen, Viet Quoc Trieu and Quyen Hoang Vu contributed inputs for specific chapters. The writing team built on a range of studies prepared by colleagues in the World Bank. It also benefited from substantive contributions by partners outside the World Bank. Special thanks go to Daniel Alvarez (Duke University), Michael Engelschalk (consultant), Cuong Viet Nguyen (National Economics University), GP Shukla (Duke University), and Roy Van Der Weide (consultant).

Nha Thi Vu (Vietnam Development Information Center - VDIC) was in charge of bibliographical research and referencing. The processing of the document was done by a World Bank team including Dung Thi Ngoc Tran on editing, Chi Kim Tran on publishing, and Phuong Minh Le on administrative Support.

Overall guidance was provided by Vikram Nehru, from the World Bank. Homi Kharas (Brookings Institution) and Luiz Pereira Da Silva (World Bank) served as peer reviewers. The report was discussed with the International Monetary Fund (IMF). Comments and suggestions by numerous colleagues are gratefully acknowledged.

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EXECUTIVE SUMMARY

Now, more than ever, it matters how Vietnam raises and uses capital.

In 2007 the world experienced unprecedented economic growth. There was abundant capital seeking profitable investments in emerging countries, and country risk premiums were low. Vietnam's accession to the World Trade Organization (WTO) was interpreted as a sign that its government was serious about economic reform. Given its hardworking population and excellent location, market sentiment was strong. Many saw Vietnam as a new economic tiger in the making, the "+1" country in a "China+1" investment strategy. Resources flowed in under many forms, from remittances to foreign direct investment (FDI) to portfolio investments. Capital inflows were four times higher relative to GDP than anything China had experienced since the beginning of its own reform process.

In 2008 the world economy went into a tail spin. What started as financial difficulties in a risky segment of the mortgage market in the United States grew into a global financial crisis of unprecedented proportions. Fear paralyzed economic activity, bringing credit to a halt and pushing many who had invested in emerging countries to sell their assets to raise liquidity.

What the next few years will bring is uncertain. What is certain, however, is that

2009 will be a difficult year. The downturn in industrial countries will lead to a decline in developing country exports. FDI projects under implementation may be delayed, or cancelled altogether. New FDI will decline, perhaps dramatically. Portfolio investment will become rare and even remittances could suffer, as those who send money home may see their jobs disappear and their earnings dwindle. In the year 2009, mobilizing capital for development will be very difficult indeed. Using it efficiently will be imperative.

* * *

Vietnam's balance of payments offers both the prospect of faster growth and the risk of greater turbulence. In late 2007, the abundance of capital inflows created strong pressure for the dong to appreciate, affecting export competitiveness. Resisting that pressure meant injecting massive amounts of liquidity into the economy. The result was a boom in banking credit, rising inflation, and an asset price bubble. In late 2008 and early 2009, export growth is bound to slow, capital inflows will decline, and the investment rate will fall. As economic activity slows and jobs are lost, real income growth will weaken, and the poor are likely to suffer the most.

The shifts in market sentiment that drive external capital flows are one of the main

risks faced by the Vietnamese economy. But the package of macroeconomic policies at present available to the government may be insufficient to mitigate the impact of those shifts. Another risk stems the possibility for enterprises and banks, both state-owned and private, to contract more debt than they should, running up implicit claims on the government. This risk has not materialized yet, and current circumstances make it unlikely in the short term. But in a financially open economy, this is more than just a theoretical possibility.

Disengagement from world markets is not the answer, however. Global integration has been the country's ticket to prosperity. Linking domestic prices to international markets allowed farmers to get better returns for their products and emerge from poverty. FDI inflows resulted in the creation of wage employment, making it possible for Vietnam to absorb millions of entrants into its labor market. Exports have been the main driver of economic growth, as domestic enterprises connected increasingly to international markets. Opening the services sector to new entry brought competition into activities previously dominated by large state-owned enterprises (SOEs) and state-owned commercial banks (SOCBs), resulting in substantial efficiency gains.

As Vietnam reaches middle-income status it will need to engage more deeply with private capital markets, including the global financial market. Without this, Vietnam's investment rate will be constrained by its domestic savings rate, which hovers around 30 percent of GDP. That may be high by international standards, but it is not high enough to support Vietnam's ambition to become an industrial country in one

generation. To bridge the difference and realize this ambition, Vietnam will have to embrace international capital, but with an adequate policy and institutional framework.

Global integration may hold the key to prosperity, but it also confronts the country with new challenges, especially in the area of economic management. Financial crises are a hazard of life in middle-income countries. Such crises can be costly, economically and socially, and set back economic growth. When capital market conditions change and lenders stop providing finance, long-gestation projects can be left incomplete, new ones are not constructed, real wages and asset prices fall, and the real exchange rate depreciates, spreading turmoil through the rest of the economy.

Managing risk requires decisive policy action. Limited reliance on short-term debt and a safe level of international reserves are critical, but may not be sufficient. Also needed are appropriate monetary policy, a sound banking system with the capacity to assess credit risks well, and solid financial sector supervision.

* * *

To ensure stability, Vietnam will need to reconcile its financing needs with a prudent reliance on foreign capital. A sudden surge in inflows as occurred in 2007 can lead to exchange rate appreciation, making borrowing in foreign currency more attractive and encouraging further short-term inflows. A flexible exchange rate can help deal with such a situation, and Vietnam's move in this direction is welcome. But excessive exchange rate variability can also hurt export

competitiveness and the business climate and affect balance sheets in enterprises and banks. Exchange rate flexibility may also accentuate instability in the presence of large short-term capital inflows or outflows.

Given these constraints, exchange rate policy alone will not be sufficient. Reconciling financing needs with macroeconomic stability will require a more comprehensive policy framework across all the major policy instruments: exchange rate policy, monetary policy, and fiscal policy. But for this framework to be effective, all three instruments will need to be brought up to speed, and the coordination between them will have to be improved.

Monetary policy can be effective in the absence of short-term capital movements, as had been the case until 2006. But monetary policy became less independent in the presence of large capital movements, as in late 2007 and early 2008, when the authorities basically lost control of credit growth and could not prevent significant demand pressures in the economy, resulting in rising inflation, a current account deficit, and asset price bubbles.

Effective fiscal policy requires good information on government revenue and expenditures, and strong control over public investments. Vietnam faces shortcomings in all three fronts. Its measure of the budget balance differs from standard international practice. The treatment of amortization, off-budget accounts, and revenue carry-overs substantially distort the budget position of the government. Information is particularly weak for budget-funded investment projects, which account for 30 percent of total capital accumulation in Vietnam. Just as it did in late

2007 and early 2008 in responding to overheating, the government should more systematically stop or delay projects with weak justification, insufficient funding or poor performance.

* * *

Investing efficiently should be a top priority of the government, regardless of the level of capital inflows. Capital efficiency is probably low, and may have deteriorated in late 2007 and 2008. During this period, state-owned Economic Groups and large State corporations relied on their deep pockets to diversify into sectors far removed from their core business, such as real estate, financial investments and the establishment of new banks. Real estate investments might have looked highly profitable as long as the asset price bubble was growing, but their actual returns were punctured when the bubble burst.

Economic Groups and large corporations investing in finance pose a potential threat to macroeconomic stability. Efforts to reform the state sector in Vietnam have relied on increased competition and harder budget constraints. If Economic Groups and large State corporations can raise funds directly from the public through deposit taking institutions, scrutiny over the bankability of their investment projects will inevitably deteriorate. Poor investment decisions could be pursued for longer than they should. Fortunately, in Vietnam the asset price bubble was short-lived, so that many of these investments did not have time to materialize. But looking forward this is an area where caution is warranted.

The usual evidence provided to claim that investment efficiency is low in Vietnam is its

growing Incremental Capital-Output Ratio (ICOR). But this can be misleading. In 2007, for example, the most dramatic increase has been for the foreign-invested sector, not because it is the most inefficient, but because it has grown the fastest.

Since ICORs are not necessarily helpful in assessing Vietnam's investment efficiency, this report analyzes in some depth how financial resources are raised, allocated and channeled to specific projects. The approach examines the sources and uses of funds, quantifies the gaps between investment and savings for each of the main economic agents, and highlights the mechanisms through which the agents that save channel resources to those that invest. The report then explores in more detail the efficiency of each of these mechanisms, including the raising of tax revenues by government, the issuance of debt, the allocation of resources through the budget, the targeting of social policy lending, the mobilization of banking credit, the raising of equity finance, the participation of the private sector in infrastructure projects, and the mobilization of donor support.

* * *

The main challenges revealed by this analysis are the shortage of long-term finance and the institutional constraints to develop private-public partnerships in infrastructure. Investment projects with potentially high returns may never be implemented due to the lack of funding. The bond market is still thin, and will probably remain that way unless there is more progress in consolidating the large number of outstanding series of government bonds and bills, thus supporting the emergence of a

reliable yield curve. The main obstacle to private-public partnerships is the absence of a specialized agency with the capacity to foster competition and with the ability to identify the financial support needed where there is a perceived funding gap.

Other sources of investment finance are functioning better, but improvements are possible in their case too. For example, much progress has been made in relation to the tax system. But the lack of a genuine property tax and the variability of the effective tax burden across enterprises with different ownership suggest that more could be done to improve efficiency and equity. In the banking system, there is need for stronger credit risk rating to rapidly identify borrowers under stress and weak loan portfolios. In the stock market several improvements can be made at the level of the trading platforms. In the medium term, its dynamism would be boosted by a faster (but still transparent) equitization of large SOEs and SOCBs.

The selection of public investment projects and their implementation are two areas where large improvements can be made in the use of public resources. Decentralization has brought key decisions closer to beneficiaries, and this should in principle improve project selection. But it has also led to weaker project appraisal and implementation processes. Cost-benefit analyses are not always undertaken, and the monitoring of project execution is not strong enough to avoid substantial delays and cost overruns. A Law on Public Investment is needed to identify the steps that line ministries and local governments need to take to prepare, appraise and implement projects. The Ministry of Planning and

Investment (MPI) also needs the capacity to review feasibility studies and monitor implementation. The Law should also provide clarity on the powers of the central government to suspend or stop investment projects, especially because the ability to adjust investment volumes rapidly may hold the key to macroeconomic stability in an increasingly uncertain world.

* * *

Vietnam has made important progress in establishing well-functioning capital markets

as the infrastructure to ensure its industrialization and modernization. But it has not fully succeeded yet. Investment rates have been high. But domestic savings have not always being mobilized efficiently, and foreign savings cannot always be relied upon. Meanwhile, investment decisions do not always channel resources to the right sectors and activities. And some of them could increase the vulnerability of the Vietnamese economy to shifts in market sentiment. In this context, the system for mobilizing and using capital matters.

PART I: NEEDS AND IMPACTS

1. FINANCING GROWTH

Vietnam has been one of the fastest growing countries in the world, with rapid output gains being sustained (among others) on massive capital accumulation. Reassuringly, the share of investments undertaken by the private sector, and especially by the domestic private sector, has grown steadily. By now, the state sector accounts for roughly 40 percent of the total, compared to 60 percent at the beginning of the decade. But with the investment rate exceeding 45 percent of the Gross Domestic Product (GDP) in 2007, questions remain regarding the efficiency and the affordability of this massive accumulation effort. Attempts to assess the efficiency of investment have so far relied on macroeconomic data, which is questionable on methodological grounds and leads to non-conclusive results anyway. On the other hand, some macroeconomic analyses are well suited to assess the affordability of the accumulation effort. The engineering approach to investment “needs” does not fall in this category, as it tends to focus on a few (mainly infrastructure) sectors, assuming that all master plans have to be implemented and all government targets attained. Moreover, the engineering approach remains silent on who (of the private sector or the state) should undertake the investments. But the economic approach gives a sense of magnitude of the investment effort needed to attain different growth

targets, and shows how large the current account deficit of the balance of payments can be when those targets are ambitious. And the financial approach highlights how the main stakeholders raise and channel resources for investments of various sorts. An assessment of debt sustainability suggests that Vietnam can afford a relatively high level of capital accumulation. But a rigorous analysis of the efficiency of capital accumulation in Vietnam needs to dig into each of the main sources and uses of funds identified by the financial approach.

Massive accumulation

Over the present decade, and especially after the acceleration of economic reforms that followed the 9th Party Congress, in 2001, Vietnam has experienced high rates of economic growth. Its GDP per person, measured at constant prices, increased on average by 6.5 percent per year. Admittedly, China has grown faster, as have also done a few other countries (many of them small, relying on natural resource booms or emerging from conflict). But when the period 2001-2007 as a whole is considered, Vietnam ranks 24 among 139 countries in terms of the growth of its GDP per person measured at constant prices (the ranking excludes countries and territories with a GDP of less than 2 billion dollars in 2007).

Another common way to measure progress is in current dollar terms. From this perspective, Vietnam climbed from a GDP per person of 413 dollars in 2001 to 836 in 2007, and will most likely surpass the 1000 milestone in 2008, a couple of years ahead of the target set by the Socio-Economic Development Plan (SEDP) 2006-2010. At 12.5 percent, the annual growth rate of GDP per person over the period 2001-2007 is much higher than when measured at constant prices. This is not surprising, given the gradual loss in the value of the dollar. Figures measured in current dollars are also more subject to fluctuations due to short-term movements in exchange rates.

However, there is more than inflation and short-term turbulence in the gap between measures at constant prices and in current dollar terms, and the implications will be discussed recurrently in this report. Beyond which GDP measure is used, it is clear that Vietnam has grown fast. Such rapid growth has been one of the main drivers of poverty reduction, another area where Vietnam has done remarkably well, regardless of the measure used.

Rapid economic growth has been partly sustained on massive capital accumulation

(Table 1.1). By 2007, Vietnam was investing 521.7 trillion dong per year, almost exactly three times as much as in 2001, when economic reforms accelerated. Only a fraction of this increase can be attributed to capital goods being more expensive.

The growth in investment has been faster in the private sector than in the state sector, with the strongest performance (both in absolute and in relative terms) corresponding to the domestic private sector. As a result, the fraction of total investment contributed by different stakeholders has changed dramatically since the acceleration of economic reforms. In 2001, the state sector accounted for almost 60 percent of total capital accumulation in Vietnam, with the rest divided roughly equally between foreign invested companies and the domestic private sector. By 2007, it was the private sector which accounted for 60 percent, with more than half of the amount contributed by domestic enterprises (Figure 1.1, left panel).

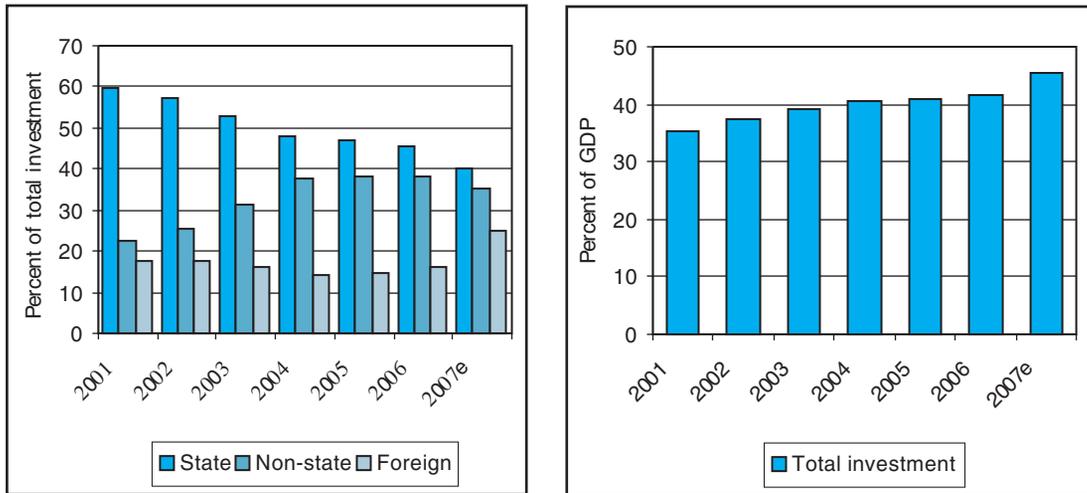
Investment has grown much faster than GDP. The share of total output dedicated to gross capital accumulation has increased from 35.4 percent in 2001 to an astounding 45.6 percent in 2007 (Figure 1.1, right

Table 1.1: Total Investment at Current Prices

	2001	2002	2003	2004	2005	2006	2007e	2008p
State	102.0	114.7	126.6	139.8	161.6	185.1	208.1	236.0
Private domestic	38.5	50.6	74.4	109.8	130.4	154.6	184.3	190.0
Foreign	30.0	34.8	38.3	41.3	51.1	65.6	129.3	153.0
Total	170.5	200.1	239.2	290.9	343.1	404.7	521.7	579.0

Source: General Statistics Office (GSO). Figures are in trillion dong. The state sector includes SOEs.

Figure 1.1: Key Investment Ratios



Source: Based on data from GSO.

panel). Not all of this effort translates into net capital accumulation, as some of the investment simply compensates the depreciation of existing capital. Based on national accounts, over the period 2001-2007, capital depreciation has accounted for roughly 4.5 percent of GDP, measured at current prices. But regardless of which measure of capital accumulation is considered, it is clear that Vietnam currently has one of the highest investment ratios in the world. For instance, on the gross accumulation measure only 12 out of the 139 countries considered had a higher ratio than Vietnam in 2007.

Efficient accumulation?

When a country is devoting such a massive amount of resources to capital accumulation, an obvious question is whether those resources are being invested efficiently. There is evidence, from studies using individual records from the enterprise survey of GSO that total factor productivity at the enterprise level is increasing rapidly. This

means that not all economic growth in Vietnam comes from increases in the volume of capital or the size of labor force. But regardless of the magnitude of total factor productivity gains, the question is whether the additional capital is being allocated to the “right” sectors, activities, and projects.

Because market mechanisms are still being developed in Vietnam, and public investment processes are only partially modernized, this is not just a hypothetical concern. Much of the economic policy debate in recent years, and especially around the 10th Party Congress, in 2006, was on the distinction between “quantity” and “quality” of growth. By now there is no doubt that Vietnam is delivering on the “quantity” dimension. Whether it does so on the “quality” dimension is much less clear.

However, providing an answer to this question is less straightforward than many commentators suggest. The usual commentary uses the ICOR as proof. On the surface, this is a sensible approach. The

ICOR measures how many units of capital are associated with every additional unit of output. So, in principle at least, the higher the ICOR the less efficient investment is (because more units of capital are needed to generate one additional unit of output).

A cursory look at the data suggests that the ICOR has indeed increased substantially in Vietnam in recent years. Using the standard measure, at constant prices, it went from 4.5 in 2001 to 6.6 in 2007. Some increase in the ICOR can be expected as the capital stock of the economy expands and the most urgent gaps are addressed. The first, critically important investments in basic infrastructure should do more to expand GDP than subsequent projects with lower priority. But a 48 percent increase in just six years seems too high to be due to the mere effect of a relative abundance of capital; especially because infrastructure gaps remain severe in Vietnam.

An important assumption underlying the interpretation of the ICOR as an efficiency indicator is that capital accumulation will result in a higher GDP within one year. While this might be plausible in the case of small commercial investments, it may be only partially true in the case of major industrial undertakings and it is most certainly wrong in the case of large infrastructure projects. It follows that the ICOR should increase when growth accelerates due to surge in investment, and decrease when investment decelerates.

Some would even question that the ICOR should be at all used to assess the efficiency of investment (Box 1.1). But even if the standard measure of the ICOR at constant prices was retained, most of the surge

observed in 2007 would be driven by foreign-invested companies (Figure 1.2). Admittedly, some relatively heroic assumptions are needed to disaggregate total output by institutional sector. It is also clear that an upward trend is noticeable in the case of the state sector and the domestic private sector, perhaps reflecting decreasing returns to capital as the most urgent investment gaps are addressed. But something radically different happened in relation to foreign investment in 2007, something that helps explain the macroeconomic turbulence of that year, and understand the unprecedented challenges faced by policy makers in their quest for stability.

Investment “needs”

While macroeconomic data is not adequate to evaluate the efficiency of investment, it is well-suited to assess its affordability. The capacity of Vietnam to sustain an investment ratio as high as in 2007 is questionable. Over time, various analyses have been proposed to determine the investment level Vietnam should aim for.

The simplest and intuitively most appealing approach focuses on investment “needs”. One popular variant of this approach, favored by those dealing with infrastructure, uses sectoral targets and master plans as its starting point. Through its development strategies and socio-economic plans, Vietnam has set ambitious objectives and targets across a range of areas. Some of those objectives and targets are related to outcome indicators, such as the proportion of the population having access to specific services. Others are spelled out in output terms, such as kilometers of highways or passenger airport capacity. Meeting these

Box 1.1: What Does an ICOR Tell about Efficiency?

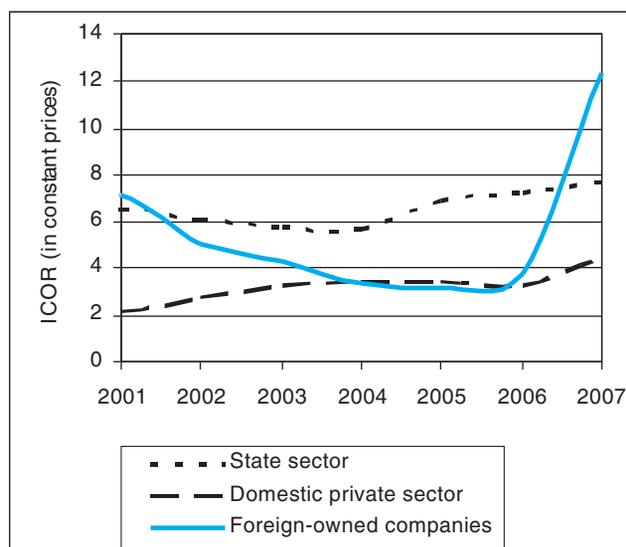
The concept of ICOR is intuitively appealing, but its mechanical application may lead to unwarranted conclusions. Implicit in it is the notion of productivity. The intuition is as follows: a country with a high ICOR derives relatively little additional output from its investments, which suggests that capital is not very productive. Conversely, small investments can go a long way in a country with a low ICOR. However, this intuition ignores the way in which capital is combined with other factors of production, such as labor.

To illustrate the point, instead of two countries consider two sectors, such as SOEs and private enterprises. And start by the levels of capital and output, instead of their increments. In 2006, Vietnamese SOEs accounted for 51.9 percent of all capital in the Enterprise Survey of GSO, but they only generated 35.8 percent of the total turnover. It would be tempting to conclude that investments are considerably more productive in the private sector, and society as a whole would gain from reallocating capital away from SOEs. The same Enterprise Survey shows that Vietnamese SOEs employed only 28.3 percent of total labor. However, it does not follow that labor is considerably more productive in SOEs than in the private sector, and society as a whole would gain from reallocating labor towards SOEs. This time the conclusion is certainly wrong, even if the reasoning is basically the same.

How to reconcile the apparent logic of the reasoning in relation to capital with the patent absurdity of the conclusion in relation to labor? The difference between the concepts of average productivity and marginal productivity is useful in this respect. The reasoning in the previous paragraphs is based on average productivity (of capital and labor respectively) in the two sectors of the economy. But what matters for efficiency is marginal productivity. To know whether reallocation of resources should go in one direction or the other, it is indeed more useful to think about the effect of reallocating one worker, or one unit of capital, from one sector to the other.

A critically important strength of a market economy is that it takes care of this reallocation on its own. If a worker is more productive in one sector, employers in that sector should be able to pay a higher salary, and poach him or her from the lower productivity sector. The same happens with capital: a sector with more profitable investment projects should be better able to attract credit from banks. The problem is then whether market mechanisms are operating efficiently or not.

If SOEs have easier access to credit than private enterprises do, then indeed they may have too much capital compared to what is socially optimal, and the ICOR will be high. Similarly, if their personnel policies are influenced by non-commercial objectives, then they may be over-staffed compared to private enterprises with a similar amount of capital, and the ICOR will be low. This is why a microeconomic analysis focusing on the distortions in the allocation of resources, all the way from the mechanisms through which funding is raised to the way in which investment projects are implemented, may be more revealing than an ICOR calculation.

Figure 1.2: The Incremental Capital-Output Ratio

Source: Based on data from GSO.

objectives and targets, in turn, requires implementing a range of investment projects.

Going from these diverse objectives and potential projects to concrete investment figures per sector is not straightforward. For instance, no readily-available estimates could be found in the case of irrigation. And for other sectors, compiling the various available estimates in a coherent way is a daunting task. However, the picture that emerges from this exercise is one where capital accumulation needs remain massive over the next few years (Table 1.2). Based on this “engineering” approach, the government would need to invest around 11.5 billion dollars per year. This is the equivalent of more than 16 percent of Vietnam’s GDP in 2007.

However, no matter how impressive the total figure, this approach to assessing investment needs has important limitations

that reduce its usefulness. First, as the case of irrigation shows, there is always a risk of omitting important sectors, activities or projects. Second, the engineering approach does not say much about who should undertake which investments. Most of the effort goes into quantifying the cost of publicly funded infrastructure development. But it is clear that some of the effort could be undertaken by the private sector (electricity, oil and gas, and telecommunications are obvious examples). Third, and related to the previous point, the engineering approach remains silent on investment needs in commercially-oriented sectors, such as manufacturing, real estate or tourism. Last but not least, it assumes that all development objectives are attained and all master plans implemented, while this may not be feasible (or may not be the best choice) under all circumstances.

Another frequently used approach to assess investment “needs”, more economic in

nature, relies on the ICOR. As discussed above, the ICOR captures the relationship between incremental capital on the one hand and additional output on the other. Dividing both terms by GDP, the relationship becomes one between the net investment rate (incremental capital over GDP) and the growth rate of the economy (additional output over GDP). Adding the depreciation rate to the investment rate, one obtains the gross investment rate.

The economic approach has the merit of its simplicity, although the question remains whether the standard ICOR is the relevant indicator for this calculation. To illustrate how the economic approach works, assume that the ICOR is equal to 5, which is a rough average of the last few years in Vietnam. Assume also a depreciation rate equivalent to 4.5 percent of GDP, which is again the

average for Vietnam in recent years, based on national accounts. Under these assumptions, a GDP growth rate of 8.4 percent per year is associated with investment “needs” amounting to 46.5 percent of GDP ($= 8.4 \times 5 + 4.5$). If the growth rate fell to 6 percent instead, investment needs would drop to 34.5 percent of GDP ($= 6 \times 5 + 4.5$).

The economic approach also provides a straightforward assessment of the way investment needs can be funded. This is usually done by assuming a constant domestic savings rate. The difference between investment needs and the savings rate needs to be financed by the rest of the world. By definition, this difference is the deficit of the current account of the balance of payments. Put differently, if the country invests more than it saves someone else has

Table 1.2: The Engineering Approach to Investment

Sector	Billion dollars per year	Forecast period
I. Economic development		
Transport	2.8	n.a.
Electricity	4.0	Until 2010
Oil and gas	0.9	Imputed from 2008
Telecommunications	0.7	Until 2010
Urban development	0.7	Until 2010
Water and sanitation (rural)	0.1	Until 2020
Environmental protection	0.3	Until 2011
Agriculture	n.a.	
II. Social development		
Education	1.2	Imputed from 2008
Health	0.7	Imputed from 2008
Total investment needs (I + II)	11.5	

Source: Based on estimates by the World Bank, the International Monetary Fund (IMF), the Ministry of Finance (MOF), and various line ministries.

to fill the gap. In countries with low savings rates, the current account deficit is mainly due to large imports of consumer goods, in excess of total exports. In countries with high investment rates, like Vietnam, large imports of capital goods tend to drive the deficit.

Again, to illustrate how this approach works, assume a domestic savings rate equal to 30 percent of GDP, close to the Vietnamese average in recent years. With a growth rate of 8.4 percent per year, the current account deficit amounts to 16.5 percent of GDP (= 46.5 – 30). This is a remarkably large figure, one that would raise concerns among credit rating agencies. But the current account deficit would drop by more than two thirds, to a much more palatable 4.5 percent of GDP (= 34.5 – 30), if the growth rate fell to 6 percent (Figure 1.3). Modulating the growth rate of the economy is thus a way to control the magnitude of the current account deficit. Much of the recent macroeconomic debate

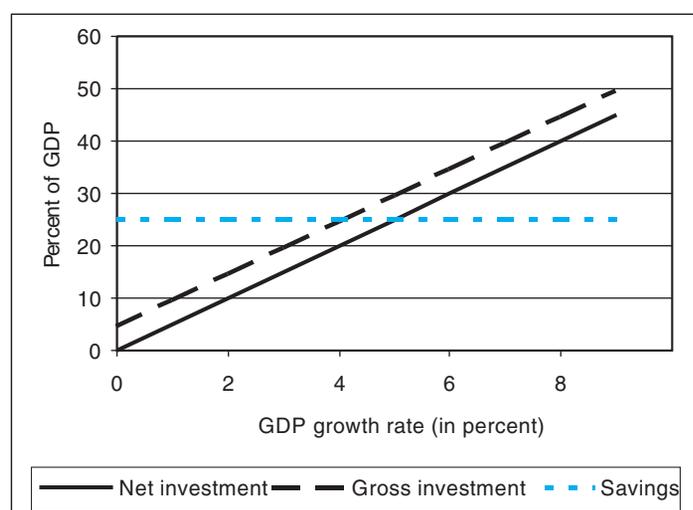
in Vietnam has implicitly relied on this type of analysis.

Investment funding

A less mechanical way to analyze the provenance and use of resources is the flow-of-funds analysis (Table 1.3). The most recent year for which this snapshot analysis can be conducted is 2007. Ideally, the exercise should be conducted annually, to introduce a time-series dimension, in addition to the snapshot. Moreover, the macroeconomic situation is changing quite dramatically as a result of the global financial crisis, so that the analysis for 2008 could be quite different. And the quality of available data leaves something to be desired, so the results should be interpreted with caution. Nevertheless, this snapshot gives interesting insights.

Following a standard practice, the economy is divided into government, the private sector, government, the banking sector, and the rest of the world. The government sector

Figure 1.3: The Economic Approach to Investment



Source: Own estimates.

includes on-budget capital expenditure and “off-budget” investment expenditure (mainly infrastructure bonds). A more difficult decision concerns the classification of on-lending of ODA and other resources. Much of the on-lending goes to lower levels of government, but large SOEs such as Electricity of Vietnam have benefitted from it as well. The balance is probably tilted in the opposite direction in the case of lending by the Vietnam Development Bank (VDB), which has a strong customer base among SOEs. Short of classifying on a loan-by-loan basis, the most defensible rule is to classify VDB loans as finance for SOEs and the rest of on-lending as budgetary resources for lower levels of government. Following standard practice, SOEs are counted as part of the private sector. An effort to treat them separately required too many assumptions to be credible.

The main sources of information to conduct the flow-of-funds analysis are the budget in the case of the government, the monetary survey in the case of the banking sector, and the balance of payments in the case of the rest of the world. Private sector data is compiled from the other sources, using the double entry principle, and balancing the account through the estimate of value added from domestic sales (a variable that can only be measured with a considerable margin of error). In principle, the accounts for the other three sectors should balance, in the sense that financing should match the difference between expenditures and income, if there is any. Unfortunately, budget sector data in Vietnam do not meet this requirement. The budget deficit is much higher when it is measured as the difference between expenditures and income (the standard definition) than when it is

calculated as the sum of all financial resources mobilized (such as domestic debt and foreign debt). The difference between the two measures is due to revenue carryovers, which are treated here as other government income.

This snapshot analysis reveals some clear patterns. A few of them are clearly visible in more standard presentations of the same data; others less so. Among the relatively obvious patterns is the breakdown of investment by sector. The government accounts for roughly 30 percent of total capital accumulation, whereas the private sector and SOEs contribute 70 percent of it, with roughly 10 percentage points invested by SOEs. This pattern was already clear in the gross investment data discussed earlier.

Both government and the business sector invested more than they saved, implying that they both needed to resort to finance. On the surface, they did it to similar extents. The financing gap for the private sector and SOEs was 58.7 trillion dong, equivalent to 3.6 percent of their total income and 18.0 percent of total capital accumulation. In the case of government, the gap amounted to 26.2 trillion dong, and the corresponding ratios were 7.6 and 18.6 percent respectively. However, this is because carryovers are being treated as revenue. If they were classified as finance, then the ratios for government would climb to 17.1 and 38.4 percent respectively. It follows that in 2007 the government was less thrifty than the private sector and SOEs. The main provider of financial resources was the rest of the world, with the current account deficit representing roughly 18.2 percent of total capital accumulation in Vietnam.

Table 1.3: The Financial Approach to Investment

	Government		
	Source	Use	Items included
1. Receipts			
Exports			
Transfers	4.3		ODA grants
Taxes	265.9		Taxes and oil-related revenue
Other income	73.4		Non-tax revenue + carryovers
2. Current Expenditure			
Consumption		157.3	Non-salary expenditure
Imports		4.7	Gasoline subsidy
Transfers		67.3	Salaries
Taxes			
Other			
3. Investment expenditure		140.5	Includes off budget but no VDB
4. Saving (=1- 2)	114.3		
5. Net financing (=6+7+8+9)	26.2		
6. To/from government			
7. To/from private sector	15.8		Bonds and VDB borrowing
8. To/from financial sector		7.4	Change in deposits - loans
9. To/from rest of the world	17.8		Change in foreign public debt
	Private sector and SOEs		
	Source	Use	Items included
1. Receipts			
Exports	878.5		Exports of goods and services
Transfers	108.2		Remittances + gasoline subsidy
Taxes			
Other income	660.2		Domestic value added (residual)
2. Current Expenditure			
Consumption			
Imports		1032.2	Imports of goods and services
Transfers			
Taxes		265.9	Taxes and oil-related revenue
Other		80.5	FDI profits + non-tax revenue
3. Investment expenditure		327.0	Total - government investment
4. Saving (=1- 2)	268.3		
5. Net financing (=6+7+8+9)	58.7		
6. To/from government		15.8	Bonds and VDB borrowing
7. To/from private sector			
8. To/from financial sector		115.1	Change in deposits + liquidity
9. To/from rest of the world	189.6		FDI + portfolio + loans

(continued)

Table 1.3: The Financial Approach to Investment (Continued)

	Financial sector		
	Source	Use	Items included
1. Receipts Exports Transfers Taxes Other income			
2. Current Expenditure Consumption Imports Transfers Taxes Other			
3. Investment expenditure			
4. Saving (=1- 2)			
5. Net financing (=6+7+8+9)			
6. To/from government	7.4		Change in deposits - loans
7. To/from private sector	115.1		Change in deposits + liquidity
8. To/from financial sector			
9. To/from rest of the world		122.5	Change in bank's foreign assets
	Rest of the world		
	Source	Use	Items included
1. Receipts Exports Transfers Taxes Other income	1032.2 34.7		Imports of goods and services FDI profits
2. Current Expenditure Consumption Imports Transfers Taxes Other		878.5 103.5	Exports of goods and services Remittances
3. Investment expenditure			
4. Saving (=1- 2)			
5. Net financing (=6+7+8+9)		84.9	
6. To/from government		17.8	Change in foreign public debt
7. To/from private sector		189.6	FDI + portfolio + loans
8. To/from financial sector	122.5		Change in bank's foreign assets
9. To/from rest of the world			

Source: Own calculations based on data from CSO, IMF and SBV. Figures are in trillion dong.

(Flow-of-fund analyses are built on the assumption that the financial sector is a pure intermediary, neither saving nor investing).

A closer look at the government account shows the importance of taxes as the main source of revenue, and the relatively even split of finance between domestic borrowing and external borrowing. It also appears that the government used some of these resources to increase its financial assets, under the form of an additional 7.4 trillion dong in deposits in commercial banks. This may not be a good choice from an economic point of view, and may simply reflect weaknesses in cash management.

In the case of the business sector, exports account for 53.3 percent of total income, which shows how open the Vietnamese economy is by now. And an additional 6.3 percent of income is under the form of remittances from abroad. The role of global integration is even more striking when looking at the financing side of the equation. An astounding 189.6 trillion dong, the equivalent of 58 percent of total capital accumulation by the private sector and SOEs, was received under the form of FDI, portfolio investment or lending from abroad. It is also striking to see the large fraction of business resources devoted to financial investments in 2007. Changes in banking deposits (net of loans) and government bonds (directly or through social security contributions) were equivalent to roughly 40 percent of capital accumulation. This is an indication of financial deepening, but such a rapid pace is a matter for concern.

Sustainable accumulation?

With Vietnam investing considerably more

than it saves, the question is whether this massive accumulation effort is sustainable over time. For the country as a whole, the financing gap is the same as the current account deficit of the balance of payments. In 2007, this deficit almost reached 10 percent of GDP, which is usually considered a warning threshold. However, comparing the current account deficit to the country's GDP is a rudimentary approach to assess whether it is too large or of adequate size.

Vietnam's external debt position has historically been robust. Most of its debt is concessional, enjoying a low average, fixed interest rate, long maturities, and no bunching of repayments. With support from a variety of multilateral and bilateral creditors, it also has a fairly diversified currency composition. It has access to strong private remittances, which help finance its trade deficit, and strong FDI inflows which provide significant non-debt creating financing. Moreover, the government has been prudent in external borrowing. The sovereign external market was only accessed once, for a ten-year maturity 750 million dollar bond. External debt is estimated to total 29.7 percent of GDP, and 21.6 percent in the case of the public sector.

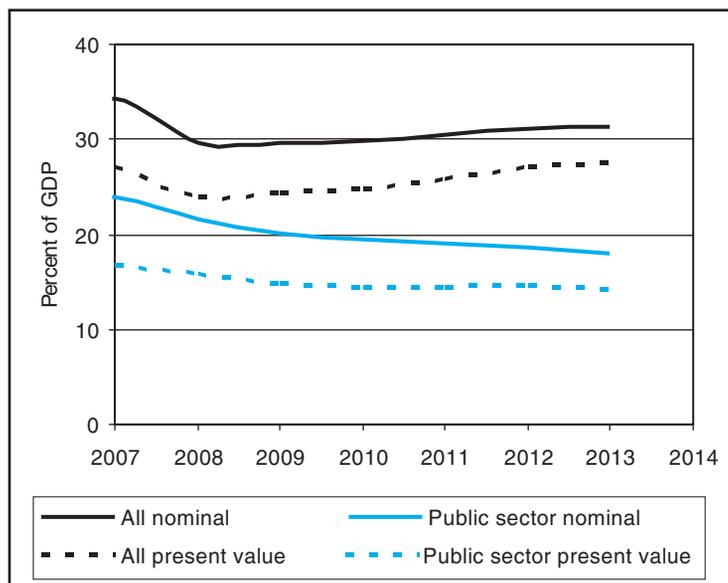
In terms of liquidity, in 2007 the service of external debt amounted to 6.2 percent of exports whereas the service of public external debt represented 11.9 percent of government revenues. These ratios remain manageable, well within the thresholds jointly established by the World Bank and the IMF. And they are expected to decline further in 2008, to 3.2 and 4.2 percent respectively. Although the current account deficit increased markedly in 2007,

financing from FDI and portfolio inflows also rose considerably. The rapid growth of exports and FDI inflows, buoyant government revenue and the appreciation of the dong underlie the expected reduction in these ratios in 2008.

Vietnam's debt situation has remained relatively favorable despite the significant macroeconomic imbalances that emerged in 2007. The much larger current account deficit was partly financed by much higher FDI and portfolio inflows. The latter declined in 2008,

but the former increased. Looking forward, under plausible macroeconomic assumptions, the present value of external debt is projected to decline consistently in relation to GDP, exports, and revenue (Figure 1.4). Stress tests indicate that the present value of debt to GDP ratio is most sensitive to an increase in other debt creating flows, and to a lower primary fiscal balance. A one-time 30 percent depreciation would have less impact on the present value of debt. But even the most extreme negative shock would not destabilize key ratios over the longer term.

Figure 1.4: A Robust External Debt Position



Source: Joint IMF-World Bank debt sustainability assessment (IMF, 2008).

2. TRANSFORMATION AND TURBULENCE

The analysis of economic growth is usually dissociated from that of macroeconomic stabilization. This is because the time spans involved are different, and also because growth is perceived as dealing with quantities, whereas stabilization has to do with prices. However, in an economy accumulating resources as massively as Vietnam, the connection between growth and stability cannot be ignored. There are two mechanisms connecting large investments with prices. One of them is relatively benign, the other more worrisome. On the benign side, some goods and services become more expensive as countries grow richer. These are basically goods and services that cannot be easily traded with the rest of the world. Housing and personal services are obvious examples. The result is that richer countries tend to be more expensive, and the same pattern can be observed across provinces within Vietnam. The implication is that rapid growth is associated with real exchange rate appreciation. In a country growing rapidly, appreciation happens at a non-trivial speed. The more worrisome mechanism is related to the balance of payments. Unless the domestic savings rate increases substantially, accumulating capital in the scale Vietnam did in recent years is bound to require large foreign savings. However, capital inflows tend to be volatile, as they

are affected by market sentiment. Investors' perceptions can switch from exuberance to fear in no time, for reasons that may have little to do with Vietnam's actual performance. Sudden capital outflows are obviously dangerous for economic stability, but surges in capital inflows are dangerous too, as they can result in asset price bubbles. These more dramatic swings in relative prices typically result in inefficiencies in the allocation of capital and may eventually lead to costly financial crises. Massive capital accumulation may thus hold the key to rapid economic growth, but it also confronts policy makers with unusual challenges.

Prices and quantities

Massive capital accumulation is associated with a greater availability of goods and services, but also with changes in the relative prices of those goods and services. The first dimension (quantities) is emphasized in most analyses about economic growth, but the second one (prices) is quite often ignored. Or, more accurately, variation in relative prices is analyzed from a cross-country perspective, for instance in the context of purchasing power parity analyses, but not from a time perspective.

Dissociating quantities from prices is understandable when long-term growth of

GDP per person is in the order of 1 or 2 percent per year, as was the case for most of the Western countries which are developed by now. At that pace, changes in relative prices are bound to take place over long periods of time. So long that they become irrelevant from the point of view of macroeconomic policy. But several East Asian countries have experienced much faster growth, crossing in one or two generations the income range that industrial countries spanned over one or two centuries. As Vietnam stands a chance to do the same, it is useful to understand how rapid growth may affect relative prices in the short term.

Purchasing power parity analyses provide a useful starting point. These analyses compare the price, in dollar terms, of a common set of goods and services across countries. The simplest version focuses on just one homogeneous product which is supposed to be made to the same specifications and delivered in the same manner all around the world, namely McDonald's Big Mac hamburger. In spite of the homogeneity of the product, the price of a Big Mac varies from 1.8 dollars in China to 3.6 dollars in the United States to 7.9 dollars in Norway. More refined analyses consider a broader basket of goods and services, with the assessment becoming increasingly complicated when items such as health care or education are considered.

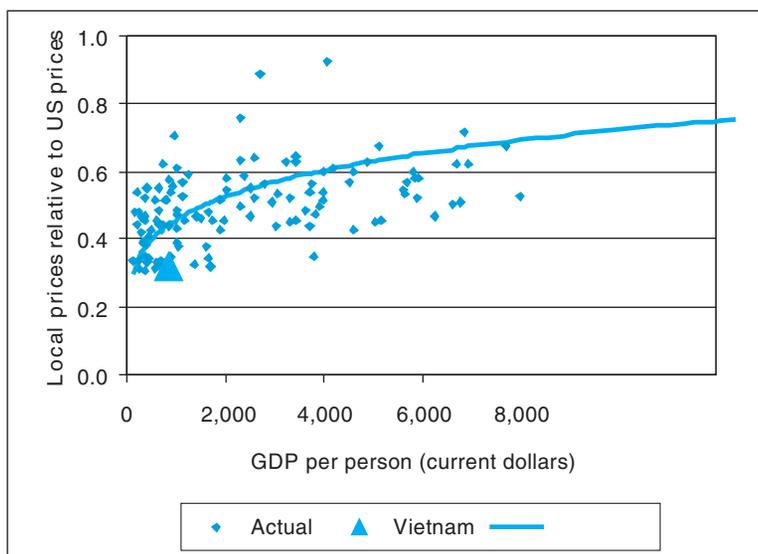
Whatever the definition of the basket and the methodological choices made for measurement, the ratio between the cost of the basket in a specific country and the same basket in the United States indicates how many cents of a dollar are needed in that country to enjoy the same purchasing power one dollar has in the United States.

As an illustration, PPP correction factors have played an important role in the measurement of world poverty, which usually involves counting which fraction of the population lives on less than "one dollar a day". In this context, "one dollar" means one dollar with United States purchasing power. In developing countries, that is actually much less than one dollar. For instance, in the case of Vietnam the most recent PPP correction factor is 0.322, which means that 32.2 cents buy the same in Vietnam as one dollar does in the United States.

As a general rule, adjustments for purchasing power parity are larger in poorer countries, which is another way to say that those countries are cheaper (Figure 2.1). While there is considerable dispersion across countries, the overall pattern is clear. A regression analysis involving the 169 countries for which data are available shows that an increase of 1 percent in GDP per person (measured in dollar terms) is associated with a 0.2 percent increase in prices (measured in dollar terms too). If the same relationship applied to individual countries over time, a growth rate of GDP per capita of 12.5 percent (the rough figure for Vietnam in 2001-2007) would be associated with an annual appreciation in the order of 2.5 percent.

Exchange rate appreciation

There are reasons to suspect that the pace of appreciation could be even faster in the case of Vietnam. To begin with, Vietnam remains considerably cheaper than other countries at a similar development level. While its PPP conversion factor is 0.322, the predicted value (given by the estimated line in Figure

Figure 2.1: Richer Countries Are more Expensive

Source: Own calculations using data from the World Bank.

2.1) is 0.441. Just catching up to the predicted value would require a 37 percent increase in domestic prices, in dollar terms. Admittedly, the development level is not the only good predictor of PPP conversion factors. But increased international integration, especially after the WTO accession, can be expected to lead to a more accelerated convergence of Vietnam to global norms and patterns across a range of dimensions. Similarity of prices could be one of them.

Price disparities across provinces also hint at the possibility of rapid appreciation. The standard analyses of PPP correction factors across countries can indeed be reproduced using Vietnamese provinces as the unit of observation (Figure 2.2). In this case, rather than a given basket, a set of individual goods and services such as rice, labor and housing can be considered. In terms of the scope to trade these goods and services across

provinces, they range from the fully mobile (rice) to the partially mobile (labor) to the fully immobile (housing).

In line with the pattern uncovered by cross-country analyses, goods and services are more expensive in richer provinces. And not surprisingly, the relationship is steeper the less mobile the good or service is. An increase of one percent in expenditure per person is associated with a 0.11 percent increase in the average price of rice (per kilo), a 0.83 percent increase in the average wage level (per hour), and a 1.63 percent increase in the average housing price (per square meter). Admittedly, housing and workers are less homogeneous across provinces than rice, which implies that some of the estimated gap in prices may simply reflect differences in quality. But the potential for appreciation implied by the estimated relationships seems considerable.

To illustrate the point, consider the

average growth rate of Vietnam's GDP per person during the period 2001-2007, measured in dollars. This rate was about 12.5 percent, so that the growth rate of expenditures per person must have been similar. If quality effects are ignored, a 12.5 percent increase in average expenditures per person, measured in dollars, would be associated with a 1.4 percent increase in the price of rice, a 10.4 percent increase in labor earnings and a 20.4 percent increase in the cost of housing. These increases are measured in dollar terms too. And while they suffer from measurement problems, related to the different quality of labor and housing across provinces, they are plausible. For instance, based on household survey data, labor earnings grew by a cumulative 12.5 percent per year between 1998 and 2006, at a time when the exchange rate was stable. A weighted average of these figures reflecting the relative importance of mobile, partially mobile and less mobile items in a hypothetical basket of goods and services is bound to yield a large price increase associated with growth, possibly much larger than cross-country analyses suggest.

Last but not least, time trends in the adjustment for purchasing power parity also point in the direction of rapid appreciation. Between 2001 and 2007, the ratio of domestic prices to United States prices grew by 3 percent per year in the case of Vietnam, half a percentage point faster than the cross-country comparison would suggest, and half a percentage point faster than China too. This does not appear to be a statistical artifact, given that the trend is almost the same when a longer period is considered.

For instance, between 1991 and 2007, the ratio of domestic prices to United States prices increased by 2.9 percent per year, compared to 1.5 percent in the case of China.

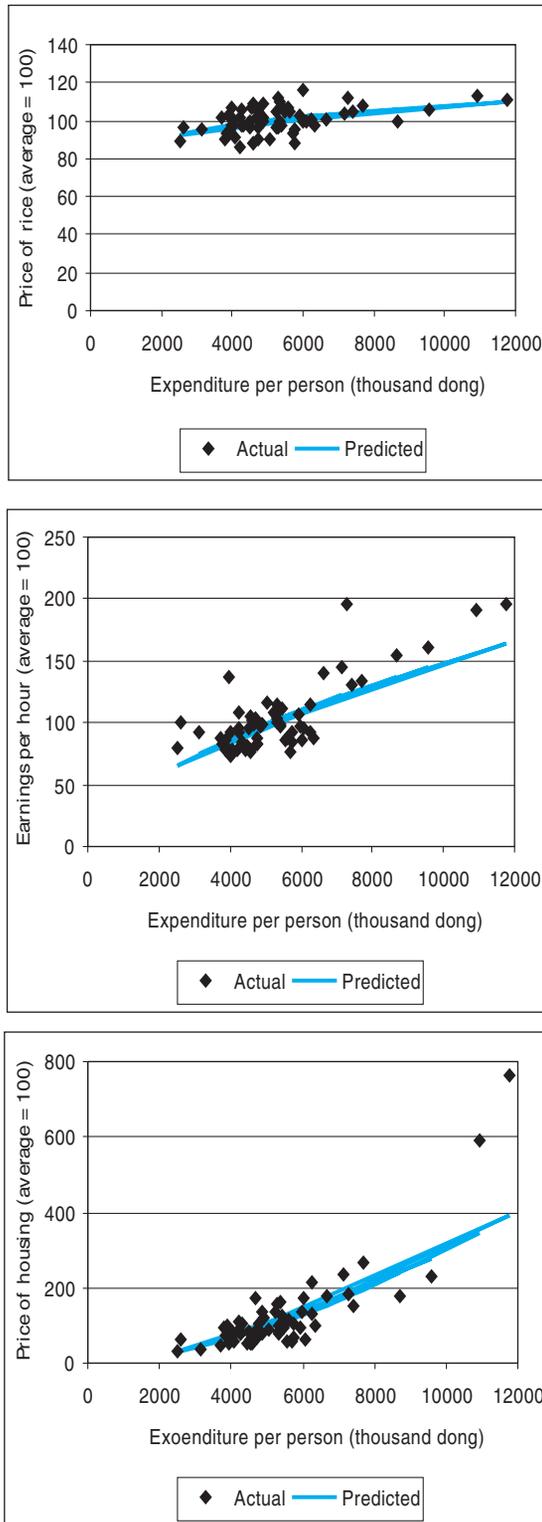
Capital inflows and prices

The acceleration of capital accumulation experienced by Vietnam in recent years was accompanied by a dramatic change in the composition of the balance of payments. Between 2005 and 2007 the investment ratio increased from 40.9 to 45.6 of GDP. Over the same period, the current account deficit increased from 0.9 to 9.8 percent of GDP. The capital account surplus increased even faster, from 4.8 to 24.6 percent of GDP.

This trend is now being reversed, due to the turbulence in international financial markets, and the reversal could be dramatic. However, beyond the shifts in market sentiment, it is clear that attempts to grow rapidly are bound to lead to current account deficits if they are not accompanied by an increase in the domestic savings rate. Large current account deficits need to be matched by similarly large capital inflows. And this, in turn, may create considerable pressure on domestic demand and prices.

In 2007 alone, 17.5 billion dollars in FDI, portfolio investments, banking credit and Official Development Assistance (ODA) entered the country. If remittances are added (they are usually counted as part of the current account) total inflows reached 24 billion dollars (Figure 2.3). This is the equivalent of 33.7 percent of GDP. To give a sense of perspective, in none of the years for which data are available did the capital account balance of China exceed 5 percent of GDP. Out of 129 countries for which data

**Figure 2.2:
Richer Provinces Are more Expensive**



Source: Own calculations using data from GSO.

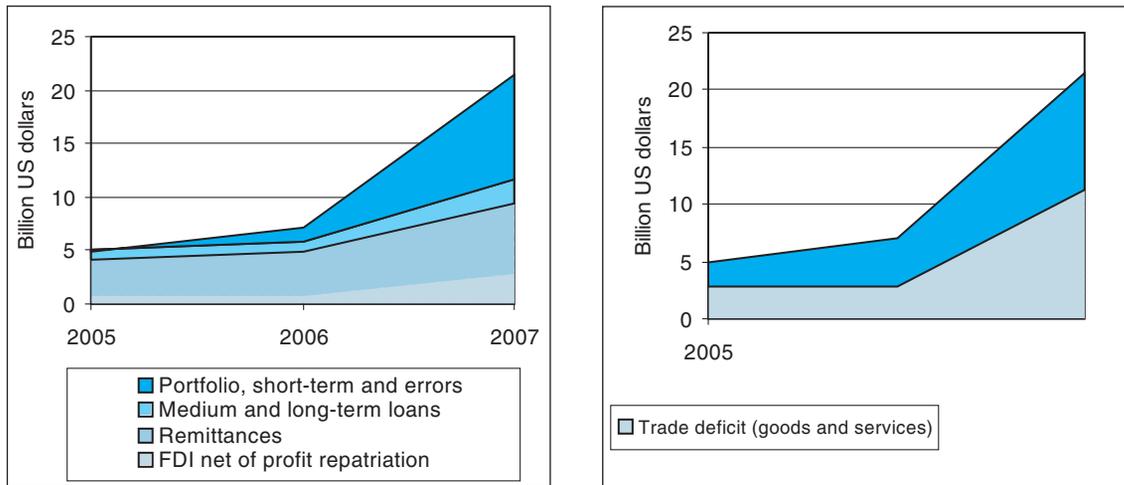
are available in 2007, only 13 had larger capital account balances than Vietnam.

Absorbing such large capital inflows would be difficult for an industrial country with mature financial institutions. It is enormously challenging for a country that is still in the process of establishing a modern central bank. To be clear, a large capital account balance is the flip side of massive capital accumulation. As shown by the economic approach to financing needs, an investment ratio in excess of the domestic savings rate is bound to lead to a current account deficit. But in the case of Vietnam, the hype associated with WTO accession resulted in capital inflows far exceeding the current account deficit.

This confronted the government with the “impossible trinity” of having capital mobility a fixed exchange rate and an independent monetary policy.

Massive capital inflows needed to be converted into dong to support the purchase of goods, services and financial instruments in Vietnam. In the absence of government intervention, this would have resulted in a more expensive dong or, equivalently, a cheaper dollar. Most mature economies would have allowed this nominal exchange rate appreciation as a way to absorb the shock. But the government preferred to prevent this appreciation, mainly to avoid a loss of competitiveness. There was a fear that nominal exchange rate appreciation would punish exporters and eventually undermine the appetite of foreign investors to bring capital to Vietnam.

In practice, there is an additional reason why a prudent approach to exchange rate flexibility might have been warranted, and that is the risk of affecting the liquidity, or

Figure 2.3: A Changing Balance of Payments

Source: Own estimates based on data from State Bank of Vietnam (SBV) and GSO.

even the solvency, of commercial enterprises and financial institutions. Balance sheet effects of this sort were one of the main reasons why the East Asian crisis of 1997 was so severe.

Currency mismatches are still common in Vietnam, and hedging against exchange risk is not developed. Accounting standards do not reveal which fraction of assets and liabilities is denominated in dong and which fraction in foreign currency, making it difficult to tell who is exposed and who is not. Moreover, after many years with the dong unofficially pegged to the dollar, the very notion of exchange rate risk sounded hypothetical to many.

Regardless of whether the decision to stabilize the exchange rate market was justified or not, it certainly led to a substantial increase in the liquidity of the economy. When SBV purchases the capital inflow to prevent the currency from appreciating, it injects dong in the economy. This additional liquidity can in turn be

“mopped up” by selling bonds, but in 2007 the SBV almost run out of government securities to sell. Money supply can also be tightened by selling SBV bills, but the interest rate offered was not attractive enough. As a result, banking credit was growing by more than 63 percent by March 2008, fueling consumer prices, imports, and a real estate bubble.

Asset price bubbles

There is an inherent instability in the “impossible trinity”. Once the macroeconomic situation runs out of control, it can rapidly drift in the direction of financial instability. Towards the end of 2007, the government started facing failure after failure in its attempts to sell securities in order to mop up liquidity. The interest rate needed to make bonds and securities attractive appeared to be too high, hence to costly to either the budget or SBV. Sterilization did not catch up with capital inflows, liquidity expanded and the banking system recycled it into loans. This in turn

resulted in additional demand for mostly everything. In the case of mobile goods and services, such as cars or cosmetics, additional demand translated into a surge in imports. In the case of less mobile goods and services, such as land, housing or office space, it led to a surge in prices.

Land and housing prices were already on an upward trend, due to rapid urbanization, the development of industrial parks and the construction of hotels and other tourist amenities (Figure 2.4). But the abundance of credit was such that by the end of 2007 land prices were doubling every few months. Confronted with the apparent prospect of doubling any investment over a short period of time, no interest rate of government bonds or SBV bills could look attractive. At that point, the control of the macroeconomic situation was lost, and a more radical approach to stabilization was needed.

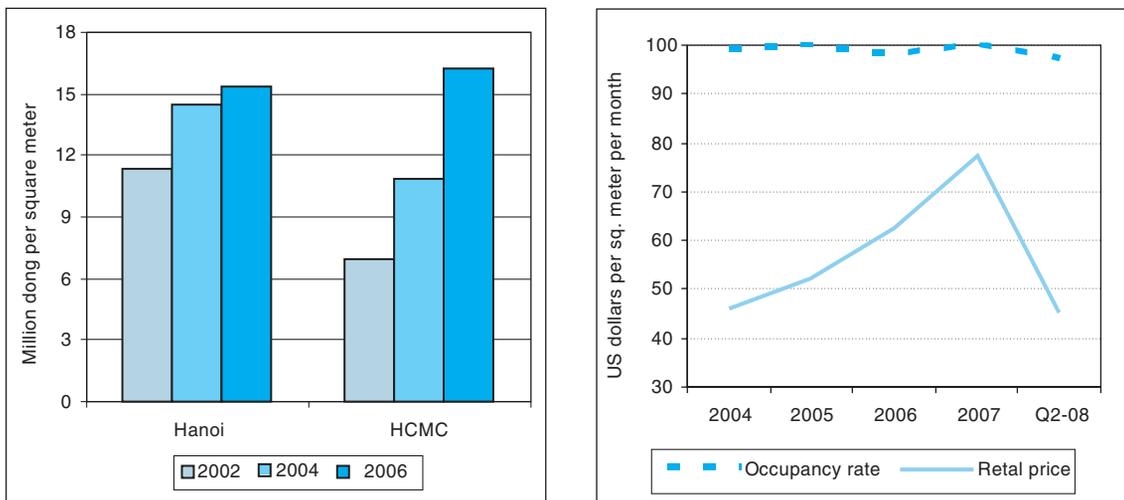
Interestingly, no similar bubble took place in the stock market despite the fact that the

number of shares available was roughly stable, much the same as the number of plots of land or office buildings. By mid-February 2008, before radical stabilization measures were taken, the VN Index was about 687, compared to 1,171 at the peak, in March 2007. This shows the importance of prudent financial sector regulation. In May 2007, concerned about a possible stock market bubble, the government had capped the share of banking credit that could support the purchase of stocks at not over 3 percent of a bank’s total lending. Subsequently, in February 2008, the cap was redefined at 20 times the bank’s legal capital. Similar ceilings were introduced for lending for real estate only in March 2008, after radical stabilization measures had led to the bursting of the real estate bubble.

What are the main risks?

The connection between rapid capital accumulation and changes in relative prices has several important implications for

Figure 2.4: The Rise and Fall of Real Estate Prices



Source: Own estimates based on data from GSO and Savills.

policy making in Vietnam. On the benign side, the prospects for Vietnam to become an industrial country within one generation are brighter than calculations “at constant prices” suggest. Economic growth results in more goods and services been produced, but it also leads to a sustained increase in the price of some of those goods and

services, including real estate, housing and labor. These price effects will lead to increased wealth by many, if not most, Vietnamese families. The consequences are far from trivial, as shown by some simple arithmetic on how long it would take for the country to catch up with its neighbors (Box 2.1).

Box 2.1: How many Years to Catch Up?

Forecasting long-term growth trends is a task economists do not excel at. For instance, there was a time when discussing how many years it would take for the Soviet Union to catch up with the United States seemed to make sense, in the understanding that the answer was: “not many”. In the early 1970s, even the famous economics textbook by Nobel Prize laureate Paul Samuelson devoted an entire section to this discussion. In all fairness, the Soviet Union’s military prowess and its remarkable space program gave some plausibility to the hypothesis of a quick catch up. And yet, forecasts ignored the fundamental weaknesses of the central planning model, making the entire discussion meaningless less than two decades later. Conversely, in 1977 Nobel Prize laureate James Meade also announced that Mauritius was a hopeless case in economic development. But Mauritius turned out to be one of the greatest success stories in economic development ever.

With the poor track record of the profession in mind, forecasting how long it would take to Vietnam to catch up with its neighbors is a risky undertaking. But it is interesting to see how sensitive the (hypothetical) answer is to real exchange rate appreciation trend.

In 2007, income per person attained 836 dollars in Vietnam, 1,918 in Indonesia, 3,850 in Thailand and 35,163 in Singapore. Over period 2001-2007, growth rates of income per person (measured at constant prices) were 6.5, 4.8, 4.8 and 4.0 percent per year respectively. If these rates are considered, then indeed it takes a very long time for Vietnam to catch up: 51 years with Indonesia, 95 with Thailand and 158 with Singapore. However, growth rates of income per person measured in dollar terms were 12.5, 6.4, 4.9 and 6.0 percent per year respectively. Using them instead, the time needed for Vietnam to catch up is 15, 22 and 63 years respectively. This shows the potentially far-reaching implications of changes in relative prices for a fast-growing country.

All of this is, of course, purely hypothetical. Nobody can tell whether Vietnam will go the way of the Soviet Union or be a success story like Mauritius. Although the latter seems more likely, it will all depend on economic policy decisions that will be made over the coming years. But if Vietnam was to keep growing at its current pace, the prospect of catching up with its neighbors in one generation would not be unrealistic.

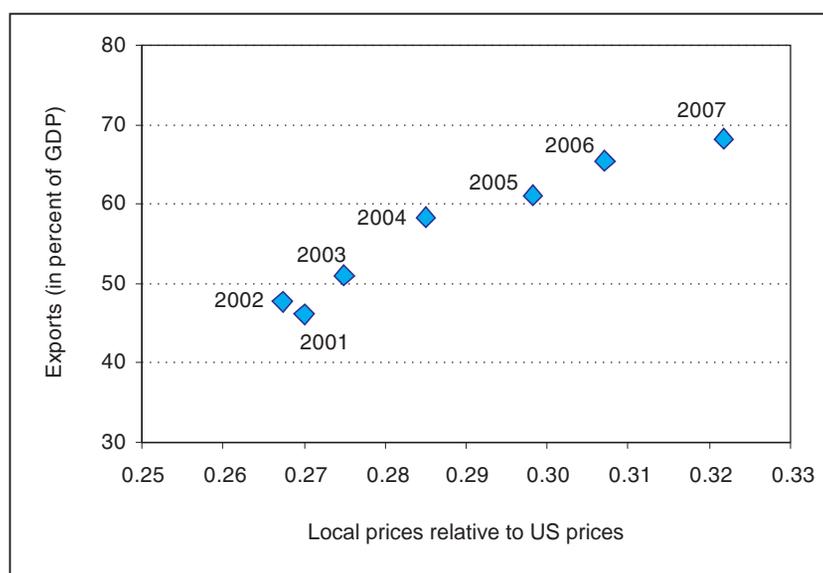
Also on the benign side, Vietnam will need to accept a gradual but steady real appreciation over time. The magnitude is bound to be small on an annual basis, but certainly not nil; perhaps a few percentage points per year. With the current exchange rate policy, which implicitly pegs the dong to the dollar, real exchange rate appreciation will happen through domestic inflation. It could also happen through nominal exchange rate appreciation if the authorities were to allow it. In any event, the fear of losing competitiveness would be misplaced in relation to this trend. The real exchange rate appreciation trend comes from the very fact that Vietnam is growing rapidly, hence becoming more productive. In fact, a look back shows that the trend has not conflicted with sustained penetration of Vietnamese exports in international markets so far (Figure 2.5).

On the more worrisome side, the variability

of capital inflows may confront Vietnam with sudden outbursts of real exchange rate volatility, as the experience of late 2007 and early 2008 showed. Ideally, the current account deficit of the balance of payments should be roughly equal to the inflow of long-term capital to the country, in which case SBV should be able to retain control of the money supply. But capital inflows are more volatile than the current account deficit, and there may be times when the gap will put pressure on macroeconomic management.

The experience of 2008 is revealing in this respect. While the final figures for the year are not known yet, most likely Vietnam will have experienced a real exchange rate appreciation in the double digits. On the benign side, this implies that GDP per person measured in dollar terms has grown faster than expected. The goal of the SEDP was to cross the 1,000 dollar benchmark

Figure 2.5: The Real Exchange Rate and Export Performance



Source: Own estimates based on data from GSO and World Bank.

some time in 2011, towards the end of the five-year planning cycle. Chances are Vietnam will have reached this milestone three years earlier than planned. In a way, substantial exchange rate appreciation could be expected as a result of WTO accession.

But it may be difficult for government to determine how substantial the appreciation should be, and whether the double-digit jump of 2008 is something that needs to be corrected in the coming years, or rather one more step in a longer-term process.

PART II: SOURCES AND USES

3. TAX REVENUE

Assessing the efficiency of capital accumulation requires analyzing one by one a series of steps, from the channels through which resources are raised to the mechanisms through which they are allocated to projects to the ways in which those projects are implemented and monitored. There is a similarity between this deconstruction of investment processes and a value-chain analysis in the case of production processes. In both cases, the goal is to identify concrete inefficiencies more than to make sweeping claims based on aggregate indicators. With government-funded investments accounting for roughly one third of capital accumulation in Vietnam, especial attention should go to taxation. Taxes and fees are the main source of government revenue, hence a key determinant of government savings. But they also affect the incentives faced by enterprises and households, and entail administrative costs. All of this results in a burden for society, potentially affecting the savings capacity of other stakeholders. Vietnam has undertaken two major reforms of its tax system, and is now in the process of implementing a third one. The objectives this time are to cope with the expected decline in trade-related revenue as the economy integrates with the rest of the world, and to adjust to the surge in the number of potential taxpayers as market mechanisms develop. The tax system has

been coping well so far, ensuring stable revenue for government and a good performance of its main tax instruments. But there are still important design gaps. If they remain unaddressed, they could result in an encouragement of informality, the mismanagement of natural resources, and the widening of inequality. Existing tax instruments can also be simplified to minimize waste. Tax administration processes need to be revamped to match the transformation of the taxpayer base.

A system in transition

Rapid global integration and the development of market mechanisms will transform Vietnam's tax base in the coming years. Previous milestones in the trade integration process were the membership of Vietnam in the ASEAN Free Trade Area (AFTA) and the bilateral trade agreement with the United States (USBTA). But the most important step was becoming a member of the WTO in early 2007. As a result of this process, and beyond the specific milestones, the trade policy regime has undergone significant changes mainly in three directions. Restrictions on the right to import and export have been relaxed, tariff rates have been reduced, and non-tariff measures have been slackened.

Import and export duties still accounted for

3.6 percent of GDP in 2001, when the reform process accelerated. By 2007, they were down to 2.1 percent. So far, this decline in tax revenue has been more than compensated by the good performance of other tax instruments (Table 3.1). Also, increasing global integration is leading to a higher ratio of imports to GDP, so that the reduction in tariff rates is partly offset by the increase in the tax base. But Vietnam needs to prepare for the gradual disappearance of trade-related revenue.

Meanwhile, the emergence of a vibrant private sector is changing the potential number and composition of taxpayers. For a country with a population of 86 million, Vietnam still has relatively few of them. At present, some 270,000 enterprises and organizations, and 1.62 million business households are registered for tax purposes. But these numbers are bound to increase rapidly. In 2007 alone, 63,655 new

businesses registered under the Enterprise Law. Many of them are small, falling somewhere in between the myriad household businesses of Vietnam and the much bigger SOEs and foreign-invested companies. An in-depth analysis of enterprise transitions (from one size to another, or to exit) suggested that the “missing middle” of the size distribution could be filled quite rapidly. The expectation is that the number of enterprises will increase by close to 50 percent within five years. The number of small taxpayers could reach at least 2.3 million by 2012.

The institutional nature of taxpayers matters too. Tax collection from SOEs still constitutes the major source of revenue government, accounting for 54 percent of all Enterprise Income Tax (EIT) proceeds and 42 percent of Value Added Tax (VAT) proceeds from domestic production. With the move to a market economy, the importance of SOEs in

Table 3.1: Composition of Government Revenue

Percent of total revenue	2001	2002	2003	2004	2005	2006	2007e
Tax revenue	78.5	80.2	74.8	69.6	71.4	79.6	77.9
Value added tax (VAT)	18.6	21.3	21.0	19.5	19.2	20.7	22.1
Excise tax	6.0	6.0	5.6	6.4	6.6	6.5	5.5
Enterprise income tax (EIT)	32.1	30.3	30.0	28.7	31.8	38.2	32.6
Personal income tax (PIT)	2.0	1.9	1.9	1.8	1.8	2.0	2.3
Import and export duties	16.8	18.0	14.2	10.9	9.9	10.0	12.2
Land and housing tax	0.3	0.3	0.2	0.2	0.2	0.2	0.2
Licence tax	0.4	0.3	0.5	0.3	0.3	0.3	0.3
Tax on transfer of properties	1.1	1.1	1.1	1.3	1.2	1.3	1.8
Levies on land use rights	0.3	0.3	0.3	0.3	0.4	0.5	0.7
Agricultural land-use tax	0.8	0.6	0.1	0.1	0.1	0.0	0.0
Other taxes	0.2	0.1	0.0	0.0	0.0	0.0	0.0
Non-tax revenue	19.6	18.0	23.3	29.0	27.0	19.0	20.8
Grants	1.9	1.8	1.9	1.4	1.6	1.4	1.3
Total revenue	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: MOF. Figures for 2007 are budget estimates.

the economy has been decreasing steadily, and the trend is bound to continue. But taxing a much larger number of smaller domestic private enterprises is bound to be challenging.

With these challenges in mind, an ambitious reform program was spelled out in the SEDP 2006-2010. The SEDP envisions tax administration playing an increasingly important role in mobilizing domestic resources and creating a dynamic investment environment. Objectives spelled out in the SEDP include developing a modern, fair and transparent revenue collection system, promoting voluntary compliance through a balance between high-quality taxpayer services and effective enforcement; and enhancing revenue collection with a final target of achieving a tax-to-GDP ratio of 21 percent (Box 3.1).

Coping well so far

A straightforward way to judge the performance of the Vietnamese tax system in the current transition is to assess its capacity to deliver a sustained flow of resources for the government to operate. From this point of view, the system has been doing well so far. In spite of the decline in trade-related proceeds, total revenue has fluctuated between 24.9 and 27.1 percent of GDP. This compares favourably with other countries in the region. Performance has been strong enough for government to consistently underestimate tax revenue. However, the underestimation could also reflect poor forecasting capacity, unforeseen economic developments, or a deliberate attempt to impose discipline on spending units.

Admittedly, buoyant revenue is partly due to high prices of oil in international markets.

But this is not the only reason. The decrease in trade-related revenues has been compensated primarily by the operation of an extremely efficient VAT. Tax “productivity”, defined as percentage points of GDP in revenue divided by percentage points of the basic tax rate, is a standard performance indicator. Vietnam’s VAT productivity is close to 0.6, which exceeds the average for industrial countries. Some cascading-inducing features of the Vietnamese VAT may contribute to this exceptional performance. But there is more than cascading involved, which explains why VAT has become one of the workhorses of the Vietnamese tax system.

The other workhorse of the system is EIT. Together with VAT, this has been a dominant source of revenue, with each of the two instruments contributing slightly less than 6 percent of GDP. The good performance of EIT is partly due to the high compliance among SOEs (Table 3.2). Much lower compliance among the domestic private sector is a matter for concern. Compliance rates with EIT are bound to improve when the Personal Income Tax (PIT) comes into effect, in January 2009. At that point, some 1.62 million business households will switch from EIT to PIT. But this will shift the enforcement problem elsewhere.

The Vietnamese tax system also does well in terms of equity. A study conducted using household survey data from 2006 shows that more affluent population groups, whether measured by income per person or by expenditure per person, face a proportionately higher tax burden (Figure 3.1). Comparing with a similar study for 1998, the tax burden is now heavier, and it is

Box 3.1: The Tax Reform Program

The tax system in Vietnam has undergone three phases of reform over the past two decades. The elements of a modern system were put in place in the early 1990s. A large number of laws were enacted or revised at that point, including for taxes on Turnover, Special Consumption (Excise), Imports and Exports, Profits, Natural Resources, Agricultural Land, Transfer of Land-Use Rights, and High-Income Earners. The second phase of reforms took place during the late 1990s and early 2000s, and focused on the removal of discriminatory treatment within the tax system. The third and current phase is more ambitious in scope, as it includes the reform of virtually all tax instruments and a modernization of tax collection processes, supported by a Tax Administration Law which became effective in 2007.

This third phase of reforms was adopted by the Politburo of the Party in 2004 and its implementation is being led by a Steering Committee under MOF. A special reform department was created in the General Department of Taxation (GDT). The program has a five-year implementation time frame, and includes ten major initiatives:

1. Institutional reform: reform of each of the substantive tax laws and enactment of a consolidated law on tax administration.
2. Taxpayer services: development of high quality taxpayer services to enhance voluntary tax compliance.
3. Reform and modernization of tax audit: development of a comprehensive audit program, including a national tax audit plan, an audit selection system, and new audit procedures.
4. Reform and modernization of tax collection: development of programs to deal with tax debtors, including annual arrears collection plan and efficient collection enforcement methods.
5. Reform and modernization of the taxpayer database: development of a database to support tax administration operations, revenue analysis, revenue forecasting, and risk management.
6. Information technology: development and implementation of an advanced Information Technology (IT) system to support tax administration reform.
7. Organizational restructuring: design and implementation of a function-based organizational structure at all levels of tax administration.
8. Capacity building of tax officials: training and development of tax administration staff to meet the requirements of a modern tax administration.
9. Modernization of tax office accommodation and equipment: substantial improvement of GDT's facilities and equipment across the country.
10. Management of the reform process: establishment of a proper management and governance framework for implementing the reform plan.

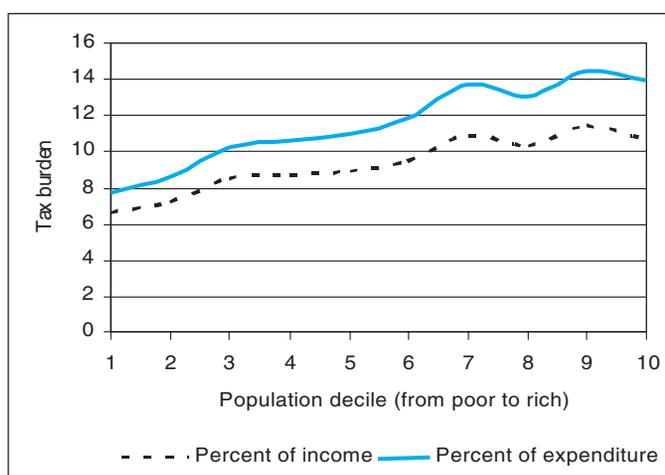
Key milestones so far have been the piloting of functional reorganization of tax offices and the introduction of self-assessment, for VAT and EIT in 2004, and for all taxes from 2007 onwards.

Table 3.2: The Revenue Gap on EIT

Sector	Operating surplus (billion dong) A	Average effective tax rate (percent) B	Potential revenue (billion dong) C = Ax B	Actual revenue (billion dong) D	Tax compliance (percent) E = D/C	Revenue gap (billion dong) F = C - D
SOEs	103,299	17	17,561	15,572	88.6	1,989
Domestic private	122,713	24	29,451	7,920	26.8	21,531

Source: Own calculations, based on data from MOF. Figures are for 2007.

Figure 3.1: A Progressive Tax Burden



Source: Jonathan Haughton (2008).

more progressive. The earlier study found that taxes represented about 8 percent of expenditures for all but the top quintile, where they stood at just over 10 percent. The figures for 2006 show a tax burden of about 8 percent only for the bottom two population deciles, rising steadily to reach a plateau of about 14 percent in the four top deciles.

This higher, more progressive, tax structure is due in large part to the introduction of the VAT in 1999, when it replaced a complex

system of turnover taxes. VAT is not progressive in every country. But in Vietnam poor people provide for many of their own needs rather than purchasing them, which in turn reduces the VAT they have to pay. Over time this will change, as home production becomes less important, making the tax system gradually less progressive.

Missing instruments

Despite its overall good performance, the Vietnamese tax system is still unbalanced.

Revenue from some tax instruments is almost negligible, standing at less than 1 percent of total revenue. Tax instruments with a strong potential to influence the allocation of resources and reduce waste are missing. And the main instrument being introduced at present will not yield high revenue for some time, but could distort incentives if it is not phased in carefully.

Current efforts to modernize the tax system are very much focused on the introduction of a broader PIT, extending beyond high-income earners to the population at large. With a potential 4 million taxpayers, ten times the current figure, enforcing the new PIT is bound to be challenging. International experience shows that PIT compliance is typically low in developing countries. In fact, the only large source of personal income that is relatively easy to monitor for a country at Vietnam's development level is the wages and salaries paid by formal sector employers. Growing wage employment and the gradual expansion of the formal labor market have been among the key drivers of poverty reduction in Vietnam. An attempt to expand the tax base too rapidly could penalize the formalization of employment, thus hindering modernization and job creation. It would be preferable if PIT remained for now tax on high-income earners only with its expansion to lower income groups taking place gradually.

With the current focus on taxing income, the taxation of assets has been somewhat neglected. And yet, taxing natural resources and land bear the potential to increase economic efficiency, reduce environmental damage and improve equity.

At present, natural resources may be placed

in four categories for the purpose of taxation. Minerals are only subject to royalty. Natural forest products are also subject to royalty, although rates are quite high in their case (up to 40 percent). While high rates aim to protect forest resources, they may also encourage the exploitation of high value natural wealth and create an incentive for evasion, thus negating their purpose. Natural aquatic resources and natural water are subject to a combination of EIT and a low rate of royalty. Most items in this category are taxed at 0-4 percent, except for pearls and sea-slug at 10 percent. A similar combination applies to oil and natural gas, although in this case EIT rates vary (from 6 to 25 percent) depending on the amount and depth of extraction.

The combination of EIT and royalty is a sensible model, and it should be generalized to all types of natural resources. The introduction of EIT in the case of minerals, and especially of natural forest products, should allow reducing royalty rates. While the aim of such high rates is to protect natural resources such as forests, in practice they tend to promote the exploitation of high-value natural wealth and foster tax evasion. Royalty rates should be reduced in number and should not be kept at an abnormally high level. This would also help reduce administrative and compliance costs. On the other hand, the EIT rate should not be reduced below 20 or 25 percent, not even in the case of the oil and natural gas sectors.

Property tax is another somewhat neglected instrument in the current system of Vietnam. In 2007, the associated revenue was less than 0.5 percent of GDP, whereas a ratio of up to 2 percent could be expected. Further,

two thirds of the actual revenue came from land-use right allocation levies, a hardly sustainable source.

Several features make property tax especially attractive. The tax falls on an unmovable base and is quite likely borne by residents in the jurisdiction where the services financed by its proceeds are provided. For this reason, one variation of this instrument is under the form of “betterment levies” or lump-sum payments exacted up front from the beneficiaries of public service improvements, such as road paving, drain infrastructure, sidewalks or street lights, which all have a visible benefit on property values. Property tax (or betterment levies) can thus be useful in providing sub-national governments with resources to invest in local infrastructure. By not taxing the income derived from the property, this instrument can also lead to significant improvements in the quality of land use. To avoid discouraging such improvements, some countries tax land more heavily than the premises built on it. Property tax can also make speculation on land less attractive, and help avoid (or at least contain) the asset price bubbles that could characterize this turbulent phase in the development of Vietnam.

Other desirable features of property tax are related to equity. In a developing country, the ability to redistribute resources through PIT may be limited, as only formal sector labor earnings are easy to track. Profits from investments and capital gains on assets are much more difficult to monitor. In fact, capital gains or urban land have been at the root of many of the recent (some times spectacular) fortunes amassed in Vietnam. Property tax is one of the few instruments

available to bring this newly amassed wealth into the country’s tax base.

When policy makers consider taxing property, they sometimes worry that poor people may be unable to pay. This concern may be divided into two parts: poor people with land of little value and poor people with valuable land. Exempting subsistence farms from property tax and introducing a minimum imposable threshold are obvious solutions to the first concern. The problem of poor people with land of significant value (particularly in cities) is that they may be reluctant to move to cheaper land for understandable social reasons, especially in the case of the elderly. A possible way to address this concern is to allow any poor person to defer his or her taxes (plus interest) until death, and then recover the debt out of the value of the property.

Another concern regarding property tax is its possibly complex administration, which can make it costly compared to its revenue potential. One difficulty in this respect is the need for property revaluation on a regular basis. However, systematic assessments conducted by area can bring the cost down. The self-assessment of property prices is another practical solution. Avoidance risks can be mitigated through the provision that the self-assessed value is what will be paid as compensation by government if the property is reclaimed for the purpose of infrastructure development. A more serious difficulty in a country like Vietnam concerns the still partial issuance of land-use right certificates, especially in urban areas (Box 3.2). Combined with limited local capacity, this calls for a step-by-step approach in introducing this new instrument.

Box 3.2: Land Administration Reform and Property Tax

An effective land administration represents not only a pre-requisite for the successful introduction of modern property tax but also an essential institutional arrangement for sustainable economic and social development. The allocation of agricultural land to households and individuals and the recognition of their land-use rights were among the initial steps of the doi moi process, enormously contributing to economic growth and poverty reduction. The promulgation of the 2003 Land Law laid out a comprehensive legal framework for further land administration reform. However, weaknesses in the existing land administration system represent a fundamental challenge to meeting the requirements of the Land Law and the expectations of the population.

The main problem at present is the incomplete issuance of land-use right certificates, especially in urban and upland areas. Household survey data from 2006 suggests that only 76 percent of agricultural land parcels, 68 percent of urban land parcels and 34 percent of forest land parcels have been granted land-use right certificates. In practice, this means that about two thirds of the total parcels of Vietnam still lack a certificate.

Underlying the incomplete issuance of land-use right certificates is the shortage of basic infrastructure for an effective operation of land administration, including cadastral mapping, transaction registrations and record management to the provision of land administration services. Problems are compounded by lack of public awareness and the limited capacity of land administration staff, especially at the commune and district levels. The system itself is cumbersome, not transparent and inefficient and does not provide the quality services that end users can rely on. As a result, land administration is generally recognized as one of the most severe constraints to business development and transparent governance in Vietnam.

There are also a number of significant land policy improvements pending. They range from the expansion of agricultural land use rights and land valuation to the reconciliation of the gap between the Land Law and the Housing Law on the registration of land use rights and the ownership of buildings.

The Ministry of Natural Resources and Environment has outlined a comprehensive program for the development and modernization of land administration. One of its objectives is to establish a digital cadastral land record system. Based on it, a land information system will be set up, to collect and update land information, establish a nation-wide unified land database, and develop a system for accessing, retrieving and distributing land information nationwide.

Further simplification

Even for existing tax instruments, relatively straightforward changes could result in increased economic efficiency. In the case of VAT, reducing the number of tax rate

levels (three at present) would be a step in the right direction. The lower tax rate of 5 percent could be eliminated, leading to a simplified structure, with either a zero or a 10 percent rate applying. While the current rate differentiation may generate modest

equity gains, if any, it creates distortions and opportunities for misclassification of items. A single positive rate lowers the cost of compliance by reducing the requirements of keeping records and invoices and simplifying tax forms.

Similarly, a large number of exemptions (29 at present) create administrative and compliance problems for traders who sell both taxed and exempt items. More critically, exemption breaks the VAT chain and may lead to cascading, as in the case of a turnover tax. The current set of exemptions should be scrutinized and, ideally, only a few of them should be retained.

Other simplifications may be considered in the case of VAT. The current practice of having a zero threshold of exempting small traders does not follow international good practice. A suitable threshold could be put in place based on the tradeoff between the cost of administration and revenue implications. This would help the administration focus on big taxpayers, while applying a simplified tax regime to traders below the threshold. For the latter, the subtraction method could be abolished, and replaced by the credit method. This would improve tax compliance since it leaves a trail of invoices that may be audited and used for verification.

There is also scope for simplification in the case of EIT. The four tax rate levels currently in force (28, 20, 15 and 10 percent) are being replaced by a single tax rate, at 25 percent. In contrast with this welcome development, the current EIT regime includes complex depreciation rules, involving 48 types of assets and three possible schedules. To implement the

current regime, each fixed asset is required to be classified and maintained in a separate file and also recorded in an assets record book, numbered and assigned a separate card with relevant statistics. A better approach would be to place all assets in four or five broad categories and then to depreciate the pool using a declining balance method. When an asset is added, the pool becomes larger; when an asset is sold, the pool becomes smaller.

The incentive regime embedded in the Vietnamese EIT is also complex and may not achieve its intended objectives. The regime is aimed to encourage capital accumulation in technologically dynamic sectors, in labor-intensive activities, and in poorer regions. These are legitimate development objectives, and more can be done to foster them under the current regime. For instance, deductions could be allowed for non-wage benefits for the personnel. But the current regime should also be rationalized.

At present, there are three major types of incentives: access to preferential or reduced rates, outright tax exemption or tax holiday for a prescribed period of time, and accelerated depreciation. Over 300 rules define eligibility and terms of application. But many of those rules overlap and some are contradictory. The system is also partially effective only, with business surveys revealing that a majority of beneficiary firms would have proceeded with their investments in the same form and location had the incentives not existed.

However, these incentives do have a cost in terms of foregone tax revenue. A simulation conducted using data from the most recent

enterprise surveys by GSO is revealing in this respect. The simulation assumed that enterprises eligible for EIT incentives, based on their location, had benefitted from them. It then inflated the amount of tax collected from them by bringing them from their eligible level to the general EIT rate of 28 percent. With this assumption, revenue from EIT would have been 7 percent higher in 2004 and 6.3 percent higher in 2005. Of course, this is only an indicative order of magnitude. Not all eligible enterprises may have accessed the incentives, for instance. But on the other hand, the simulation only considered incentives based on location, while there are others in force. Therefore, it is not by all means clear that these figures underestimate the loss.

The new PIT could benefit from simplification as well. At present, seven income brackets exist, when four (as in the old regime) would probably be sufficient. International experience suggests that having too many brackets complicates administration and encourages tax evasion, while doing little to promote equity. Importantly, these brackets are not indexed for inflation, which may result in an unplanned increase in the already high number of potential taxpayers. Given that business households will be migrating from EIT to PIT, the highest tax rate for the latter should be similar to the EIT tax rate. At 35 percent, it is currently much higher.

Tax administration reform

With almost 40,000 staff in its payroll, GDT is one of the largest public sector institutions in Vietnam. It is organized at three levels with the tax administration headquarters in Hanoi, 63 tax offices at the provincial level

and 674 tax offices at the district level. GDT is charged with collecting all major domestic taxes, in particular VAT, EIT, Excise Taxes, and natural resource taxes, which together account for more than two thirds of total domestic revenue collection. GDT is also responsible for the collection of a relatively large number of minor taxes, such as the tax on transfer of land-use rights, land and housing tax, and small business tax.

The tax reform program adopted by the government confronts GDT with a series of new challenges. Shifting collection priorities from the border to the domestic market, reducing dependence on oil revenues, focusing more on private sector enterprises and less on SOEs and foreign invested companies, adjusting to self-assessments as opposed to inspections, introducing modern taxpayer service processes, and adapting to the electronic formats increasingly used by taxpayers to keep their records are among them.

The new Tax Administration Law that became effective in July 2007 was an important step to address these challenges. The new law provides a foundation to ensure transparency and integrity in all tax administration operations. In addition, it eliminates gray areas potentially fostering noncompliance by taxpayers and abuse by tax administration officials. Among several important innovations, the new law introduces a unique Taxpayer Identification Number and stipulates that third party information can be acquired from various agencies for effective audit and enforcement, while safeguarding its confidentiality. But there are some weaknesses too. While the new law stipulates the general rights and responsibilities of tax administration agency and other related sub-

national organizations, it does not include provisions on the division of responsibilities between various levels of tax administration nor on the division of responsibilities between tax administration agency and People's Councils and People's Committees at various sub-national levels.

A taxpayer baseline survey conducted in 2007 and 2008 provides some information on how GDT is doing so far. On the positive side, it can be noted that 61.3 percent the interviewed taxpayers consider that the services to the public provided by tax offices are above average. However, only 3.9 percent of them rate these services as very good, suggesting that there is scope for improvement. The taxpayer baseline survey also reveals that taxpayers struggle to understand major components of the EIT legislation, such as preferential regimes or the determination of deductible expenses. Less than 40 percent of respondents found the VAT refund system easy to understand and implement. And more than 60 percent reported finding out about changes in the laws and procedures less than a month prior to entry in force. All of which suggests the need to improve on taxpayer information and communication.

Filing compliance provides another, complementary perspective on the strengths and weaknesses of tax administration in Vietnam (Table 3.3). Compliance is high in the case of VAT, and acceptable in the case of excise taxes, but it is low in the case of natural resource taxation, and dismal in the case of PIT. Electronic filing could help improve this mixed record. By reducing processing costs and minimizing the risk of corruption, an increased use of electronic filing is in the interest of GDT. It is hoped that by 2012 some 30 percent of taxpayers will be filing electronically. While this is still a much lower percentage compared to countries with a well advanced electronic tax administration system, such as Chile or Singapore, attaining this level would represent a major progress on the interaction with taxpayers.

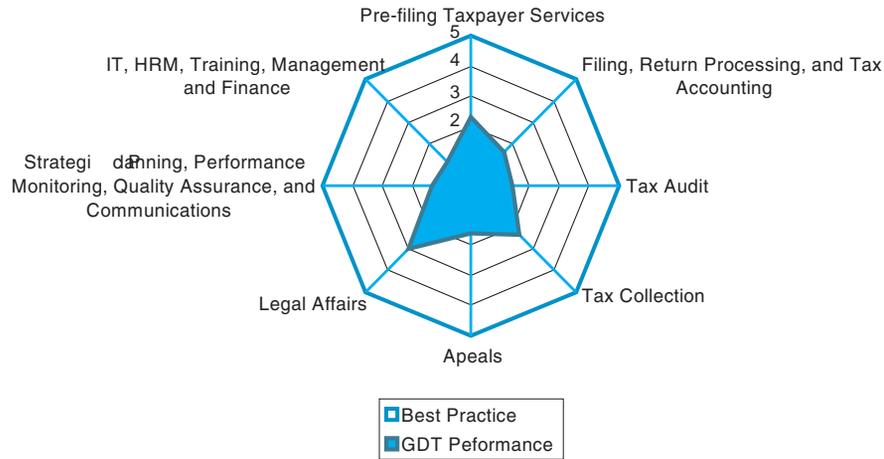
An assessment of GDT's operational processes was conducted by reviewing 15 functional aspects of the tax administration performance (Figure 3.2). Among them, the legal affairs function turned out to be the area with the most advanced processes in place. Provisions for the counseling and advising of GDT staff on legal issues exist, so that at least basic support for tax administration staff to

Table 3.3: Partial Tax Filing Compliance

Tax instrument	Filing among registered taxpayers	Filing on time among taxpayers having filed	Composite filing compliance index
EIT	82	78	64
VAT	92	91	84
Excise Duty	79	82	65
PIT	34	83	28
Tax on Natural Resources	60	81	49

Source: Own estimates, based on data from GDT.

Figure 3.2: Gaps in Operational Processes



Source: Based on Booz Allen Hamilton (2007). The outer line in the spider-web diagram indicates best practice performance.

deal with more complex legal matters is available. The legal support is not comprehensive yet, however, and additional processes to perform critical legal tasks, such as creating the capacity to issue private letter rulings to taxpayers, will still have to be developed. Existing processes are less satisfactory in most other areas, with the tax audit function being an area of concern. Procedures and methodologies for a risk-based audit selection have not yet been developed, and auditor discretion in the selection of cases for a desk or field audit is substantial. In addition, existing processes for the conduct of an audit provide substantial discretion to the audit team, and the overall audit planning and supervision process does

not yet include a systematic ongoing monitoring of audit efficiency.

Another area for improvement concerns revenue forecasting, which is the starting point in the preparation of the budget. Presently, GDT conducts revenue forecasting exercises for total tax revenues, VAT, excises, EIT, PIT, and natural resource taxes (including oil revenues). Projections for the following year are primarily based on the growth rate of revenues during the current year, adjusted after consultations with line ministries and GDT field offices. No econometric or micro-simulation modeling tools are used, and the quality of the data is poor.

4. DEBT AND LIABILITIES

The issuance of bonds is a potentially important mechanism to raise resources for investment, both in the public and in the private sector. Few enterprises (most of them large SOEs) have issued corporate debt in Vietnam. Government debt, on the other hand, is more developed. Roughly half of it is with the rest of the world; most of it is in concessional terms. The rest is under the form of a large number of relatively small series of domestic bonds. The overall indebtedness of the government is within prudent limits, which is reassuring given that debt management is still weak. Important progress has been made in the management of external debt, but it still needs to be integrated with that of domestic debt, as well as with the cash management function of the government. In part as a result of the weak management of domestic debt, the bond market in Vietnam is in a fledging state. In spite of rapid growth in recent years, the market is still relatively small. The very large number of small issuances of government bonds has made it difficult for a yield curve to emerge. Limited liquidity, in turn, has led to recurrent failure when issuing new series. Several efforts are underway to improve the efficiency of the bond market, but market consolidation should be the biggest priority. Open market operations and the management of the social security reserves

could be used to speed up the process. A remaining question is whether the government faces other, implicit obligations. A reliable estimate of contingent liabilities from infrastructure projects, borrowing by entities affiliated with provincial governments and large SOEs is unavailable. But even under pessimistic assumptions, the total amounts at stake seem manageable.

Prudent indebtedness

With only 24.1 trillion dong (less than 2 percent of GDP) in outstanding corporate bonds, issuance of debt by the private sector is still in incipient stages in Vietnam. In one way or another, most debt is from the government. Some of it is with external creditors, mainly with bilateral agencies and multinational organizations which provide development assistance in more or less concessional terms, including the World Bank. Another part is under the form of a large number of series of domestic bonds and bills, some issued by the State Treasury, some by SBV, and a few by sub-national levels of government and large SOEs.

What exactly should be considered as government debt is not free of controversy (Box 4.1). In the case of Vietnam, the concept is not defined in any legal document. For instance, should the debt of

Box 4.1: Defining Government Debt

A collective effort to define government debt was undertaken by the Bank for International Settlements, the Commonwealth Secretariat, Eurostat, the IMF, the Organization for Economic Co-operation and Development (OECD), the Paris Club Secretariat, the United Nations Conference on Trade and Development (UNCTAD) and the World Bank. The agreed definition should be seen as the official position of all the major international financial institutions. The External Debt Statistics Guide for Compilers and Users (or the Guide, for short), published by the IMF in 2003, brought together this collective effort, defining the public sector as follows:

“The public sector includes the general government, monetary authorities, and those entities in the banking and other sectors that are public corporations. A public corporation is defined as a nonfinancial or financial corporation that is subject to control by government units, with control over a corporation defined as the ability to determine general corporate policy by choosing appropriate directors, if necessary. Control can be established through government ownership of more than half of the voting shares or otherwise controlling more than half of the shareholder voting power (including through ownership of a second public corporation that in turn has a majority of the voting shares). In addition, it may be possible to exercise control through special legislation, decree, or regulation that empowers the government to determine corporate policy or to appoint directors. Any domestic institutional unit not meeting the definition of public sector is to be classified as private sector”. (The Guide, section 5.5, pages 39 and 40).

The Guide also refers to the World Bank’s Debtor Reporting System Manual (or DRS Manual), published in 2000, for more details. In its section on “General Definitions and Procedures” (page 4), the DRS Manual specifies that the public sector consists of the following types of institutions: (a) central governments and their departments, (b) political subdivisions such as states, provinces and municipalities, (c) central banks and (d) autonomous institutions including financial and non-financial corporations, commercial and development banks, railways and utilities. These autonomous institutions are counted as part of the public sector provided that their budget is subject to government approval, or the government owns more than half of the voting stock, or more than half of the members of the board of directors are government representatives, or the government is liable for the debt of the institution in case of default.

Source: IMF (2003) and World Bank (2000).

“off-budget” entities such as the VDB or the Vietnam Bank for Social Policies (VBSP) be counted as government debt? In principle, the answer would be yes. But then, when computing total government debt it would be important to net out any cross lending. For instance, some of the

debt of the two policy banks is with Vietnam Social Security (VSS), another “off-budget” entity.

The government of Vietnam has traditionally been prudent in its borrowing. Total public debt by end of 2007 amounted

to 42.3 percent of GDP, with 23.7 percentage points denominated in foreign currency. A significant reduction in the overall government deficit in 2008, together with considerable real exchange rate appreciation, should bring those figures down. With a significant portion of the foreign-currency debt being in concessional terms, ratios are even lower when the present value of the debt (as opposed to its nominal value) is considered. On that basis, the corresponding figures for 2008 are 32.7 and 15.8 percent. Lower expected deficits in the near future and a higher GDP should lead to further declines in these ratios, at least until 2010.

Weak management

It is reassuring that debt levels are moderate in Vietnam, because debt management is still weak. International standards provide a useful benchmark in this respect. The minimum requirement for sound debt management is that primary legislation provides clear authorization to the executive to approve borrowings and loan guarantees on behalf of the central government, whereas secondary legislation provides clear authorization to the implementing entities to undertake borrowing and debt-related transactions and to issue loan guarantees on behalf of the central government. Good practices include primary legislation specifying borrowing purposes, a debt management strategy, mandatory annual reporting to the National Assembly, and external audit of debt management activities.

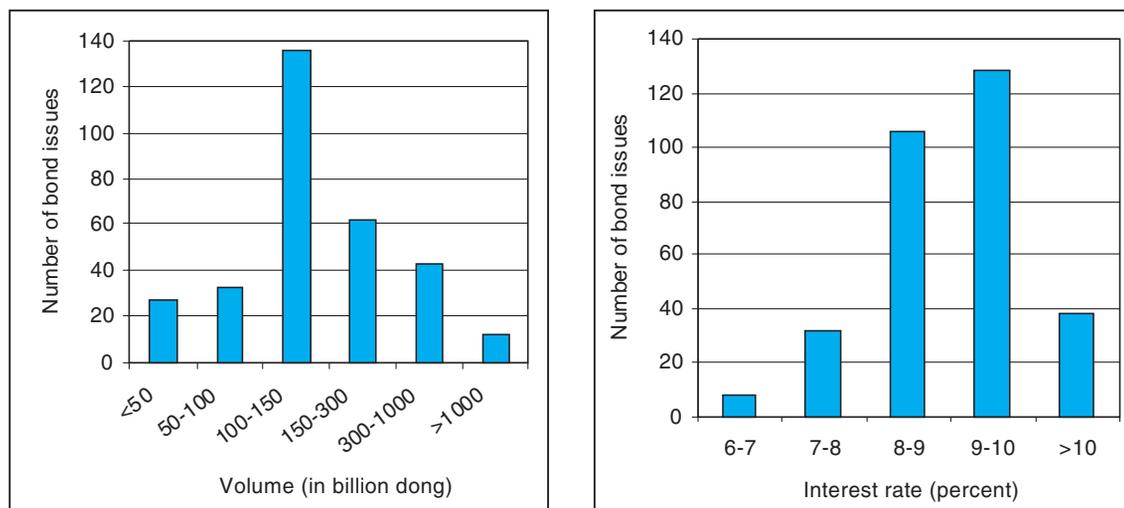
In some cases, there are also ceilings on the annual fiscal deficit and the overall debt level, as in the Stability and Growth Pact of

the European Union, or in the so-called fiscal responsibility laws of many countries. Other countries have a public debt committee to decide on the debt strategy, delegate its execution and monitor its performance. Debt committees are typically chaired by a minister or a very senior official. They ensure that relevant interests and expertise are consulted, and can assist co-ordination among key players.

Vietnam has made important progress on debt management in recent years. The legal framework has been gradually reformed and unified in the case of external debt, with definitions and concepts now close to international standards. The recently published External Debt Bulletin is another major step forward. In relation to domestic debt, regulations have been approved concerning the issuance of government bonds, of government guaranteed bonds, and of local government bonds. There is now scope to issue large volume bonds, in contrast with a tradition of multiple small issues (Figure 4.1).

Significant weaknesses remain, however. There is no unified and comprehensive legal framework for general debt management, and no high-level legal document regulating all activities related to debt borrowing and repayment. External debt management and domestic debt management are still separate, with the risk that inconsistent decisions may be taken about the structure of liabilities. The dispersion of responsibilities also leads to insufficient coordination in policy making, management and monitoring. The lack of a specialized debt management function spreads scarce skills and inhibits professionalism.

These problems are being addressed through

Figure 4.1: A Multiplicity of Small Bond Series

Source: Own calculations, based on data from MOF, for bonds issued until 2007.

the preparation of a Public Debt Law. Whether the debt of SOEs falls under this law would have important implications for debt management. Meanwhile, a government decree is expected to appoint MOF as focal point for debt management, and an MOF decision is expected to establish a single department for debt management and external finance, which should lead in assisting government on the management of public sector debt.

Another important weakness concerns the coordination between debt management and cash management. In Vietnam, decisions related to deficit financing take little account of the government's substantial cash surpluses. This carries a cost, given the interest rate differential between borrowing and lending rates. Due to the lack of a single account bringing together all cash balances held within the central government, the State Treasury does not have the capability to forecast future cash flows, hence to minimize the volume of idle government liquidity. Volatility in government cash

flows has its mirror image in volatility in banking sector liquidity, complicating monetary policy operations.

Better cash management would also require the use of State Treasury bills with shorter maturities. At present those bills are for 364 days, and any changes would require amending the State Budget Law, something that will not happen immediately. SBV serves as the fiscal agent for the State Treasury, but in practice its own liquidity bills compete with Treasury bills. For this reason, coordination with SBV is fundamental for effective cash management. Coordination would also allow bringing in the market knowledge of SBV, and avoid sending potentially confusing signals to investors.

Some times the question has been asked whether government should also try to manage private sector debt. In principle, it would be possible to limit or control private sector debt through measures such as the approval of all external borrowing. In

practice, this is difficult (if not impossible) to do once the capital account is liberalized. There may be no other option than to let the market determine the level of private debt, with lenders undertaking the necessary credit assessments of the borrowers. But to rely on market mechanisms it is necessary to have in place a good credit rating system covering the whole country, so that credit checks can be made before a decision is taken to lend. Letting the market determine private debt levels also requires appropriate governance, disclosure and risk management policies. This is necessary for the regulatory authorities to monitor lending activities, balance sheets and other disclosure requirements. Early warning systems to alert government about risks to economic stability, or to the level of reserves, may be considered as well.

A fledging market

The Vietnamese bond market grew substantially in recent times. Transactions increased by 98.1 percent in 2007, compared to an East Asian average of 21.1 percent. And they expanded by an additional 21 percent in the first nine months of 2008. Growth was even stronger in the case of corporate bonds, reaching 306 percent in 2006 and 251 percent in 2007. Macroeconomic turbulence, first in Vietnam and then in world markets, also prompted a flurry of transactions. Trading values of about 500 billion dong per session were not uncommon in late 2008.

These growth figures are impressive, but they convey a misguidedly upbeat assessment of the depth and efficiency of the bond market in Vietnam. In fact, its overall size represents only 13.7 percent of GDP, compared to an East Asian average of 63.1

percent. The trading value on government bonds has been growing together with their outstanding amount, but the average number of daily trades in 2007 was still estimated at three or less. Corporate bonds have been gaining ground, and account by now for about 15 percent of the total bond market value, but this is about half the average ratio in East Asian countries. Interbank deposit transactions conducted on a clean basis (this is, without using securities as collateral) dominate the money market. Repo transactions (the sale of securities with a commitment to repurchase them) are rare; those with maturities of less than two weeks hardly take place. Bond issuances have been partially successful at best, with more than 30 of them failing since March 2008.

Bond fragmentation is the main reason for this fledging state of the bond market in Vietnam. With 68 tender members and 46 issue underwriters, there is no shortage on the supply side. But there are currently 450 series of bonds with different maturities and no standard coupon rate for bonds in the market. As a result, a reliable benchmark yield curve has yet to develop and liquidity is low. If anything, the uncertainty brought in by macroeconomic turbulence has reduced liquidity even further, especially for long-term maturities. As foreign investors sell out their bond holdings and get some cash to repatriate, local investors (mainly banks) have been purchasing actively. But this is mainly on short-term maturities. In spite of reasonably high yields, over the entire year 2008 there were only a few small transactions involving bonds with terms over 10 years. If anything, corporate bonds find it harder to attract buyers than government bonds. This is partly due to the priority given

by SBV to bonds issued by the State Treasury when conducting open market operations. As a result of it, government bonds are more bankable than corporate bonds.

Developing the domestic bond market is a stated objective of the government. Reducing the cost of bond issuances should make it easier to raise resources for both government and the private sector. An efficient bond market would also provide more liquidity to enterprises and facilitate the conduit of macroeconomic policy. At the same time, this is a difficult policy area to manage. Several agencies are involved, including MOF, the State Securities Commission (SSC), GDT and SBV. They interact with a multiplicity of exchange and infrastructure providers, as well as with commercial institutions. In this institutionally fragmented context, there is merit in allocating the responsibility for issues related to the government bond market to the managers of government debt (presumably, the newly established department within MOF). This is because debt managers usually have both a good knowledge of the day-to-day operation of the market and a strong incentive to make it work. But decisions need to be coherent with those made by other key players, and they should avoid penalizing the corporate bond market, as current open market operations by SBV do.

The key priority is to consolidate bond series, so as to allow the emergence of a yield curve. A fund has been established to this effect. Combined with the newly approved regulations authorizing the issuance of large volume bonds, there is now scope to improve the size and liquidity of domestic issues. A more aggressive stance

in this respect would involve using current bond transactions to support this process. Both SBV (in the context of open market operations) and VSS (in its management of the reserves of the social security fund) are important buyers and sellers of bonds, and both have deep pockets. Their actions could be coordinated with those of the State Treasury to speed up the consolidation process.

For now, however, most of the action has focused on the nuts and bolts of bond market operation. Technology solutions are being implemented to provide traders and investors with online information on bond transactions. While certainly important, this will not solve the liquidity issues faced by the market. A tender program for government bond issuances has been published as well. But it contains limited information on the debt strategy or on management objectives. And it does not appear that the program was based on an active dialogue with investors and rating agencies.

Other efforts to increase the efficiency of the bond market have originated in the private sector. In September 2006, a group of commercial banks, securities firms, investment funds and insurance companies created a forum to facilitate debt securities trading by disseminating market information and standardizing practices. With support from MOF, SSC and SBV, this forum is now in the process of transforming itself into an occupational association, to enhance its legal and financial capacity for addressing operational as well as policy issues. The new Vietnam Bond Market Association (VMBA) expects to have a membership of 100 or more.

A potential player?

There are several public financial funds in Vietnam. Some of them operate at the central level only, while others are established at the provincial level. In most cases their operations are partially covered by budget transfers. Other sources of their revenue come from contributions by citizens and institutions. A few of these funds have accounts with the State Treasury, but the majority does not. Although, the government has issued a regulation with regard to financial disclosure on the operations of these funds, at present there is little information readily available on their financial positions.

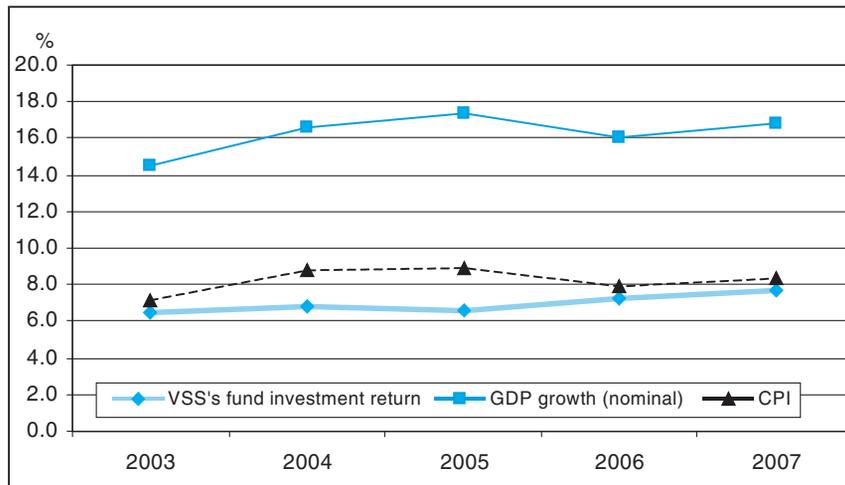
Most of these public financial funds are small; for instance, the Veterans' Legacy Fund, the Vietnam Children' Sponsors Fund, the Legal Assistance Fund, the Local Housing Development Fund, the Flood and Storm Prevention Fund, the Security Fund, the National Fund for Employment, Vietnam Environmental Protection Fund, the Fund for Vietnamese Overseas, the Training Credit Fund, the Prevention and Anti-drug Fund, the Dioxin Victims Fund or the Public Telecommunication Services Fund. Others are bigger if measured by the size of the flows they manage, but they do not have large reserves. Among them are the Health Care Fund for the Poor, Fund for Proceeds of Privatizing SOEs, the Health Insurance Fund or the many Local Development Investment Funds (LDIFs).

On the other hand, two of the public financial funds of Vietnam hold a substantial volume of assets. These are the Foreign Exchange Reserve Fund, currently totaling about 21.9 billion dollars in foreign currency, and the

Social Insurance Fund, with reserves amounting to 4.3 billion dollars. While the latter is smaller, it is growing rapidly due to the young average age of the Vietnamese population and the rapid formalization of the labor market. And this fund is to a potentially important player in the bond market.

The Social Insurance Fund is managed in a prudent and conservative manner, with safety as its predominant objective. Its assets are invested exclusively in domestic fixed-income instruments of one form or the other, all issued by public sector entities. At the end of 2007, 49 percent of the portfolio was in deposits with SOCBs, 31 percent in government bonds, 11 percent in loans to the policy banks, and 9 percent in loans to the state budget. The bulk of the current investments are in the form of privately negotiated loans rather than in publicly traded marketable securities as such. The investment portfolio is managed in-house by Vietnam Social Insurance (VSS). All investments are held until their respective final maturities, with no trading in or out in the meantime.

This approach to portfolio management is not conducive to the timely adoption of modern investment management practices including robust portfolio valuation, and risk measurement and control techniques, among others. In the case of VSS, the bulk of the portfolio is not even revalued periodically based on updated prices but carried instead at historical cost. The absence of modern management practices has resulted in low returns over the last five years (Figure 4.3). Returns are even lower from the point of view of contributors to the social insurance system, as VSS allocates about one third of

Figure 4.3: Will Future Pensions Be Affordable?

Source: Own calculations based on data from GSO and VSS.

the gross returns to supporting its own operational cost.

Over time, VSS will face a growing need to expand its investments in marketable and publicly traded securities, to diversify into asset classes other than domestic fixed-income securities, and to transition into traded sub-portfolios that have to be actively managed. This can only be accomplished successfully with a significant upgrading and revamping of the overall investment management infrastructure including the creation of a dedicated investment management unit with skilled professionals and a significant reinforcement of staff resources, both in terms of numbers and skills mix.

In doing so, VSS may contribute to the development of the bond market, and assist MOF in the consolidation of government bond series. However, the transition towards a more active management stance will need to be done cautiously. As the assets Social

Insurance Fund already account for more than 5 percent of the market it invests in, there is a risk of distorting prices and affecting liquidity. This problem is bound to become more serious is the fund outgrows the domestic market, in which case it may be imperative to consider investments in overseas assets. These challenges underline the importance of diversifying the fund's investments into new asset classes and potentially new markets globally, and managing its investment operations in a manner that combines a focus on prudent risk management with an optimization of investment returns.

VSS does not have any risk management infrastructure as such at the present time. To develop its capacity, a first step would be to conduct a periodic market value assessment of its portfolio. While the importance of knowing the updated value of the portfolio may not seem readily apparent when assets are held to maturity, this will be necessary to gradually move towards more active trading.

VSS should also report regularly on investment management and performance to its Governing Board, including details on portfolio composition, maturity profile and interest rate structure of the outstanding portfolio. Calculating investment performance by investment type, ideally against established benchmarks, would provide information on the relative efficiency of different types of investments and help ongoing decision-making.

Contingent liabilities

While the level of explicit government debt is within prudent limits in Vietnam, concerns have been raised about the level of implicit debts. These are obligations which will need to be honored only under specific circumstances. Government guarantees are a case in point. If an investor building an expressway is promised some minimum revenue from toll fee collections, but in the end vehicle traffic is insufficient to generate such revenue, the budget will have to pay for the difference. Other implicit debts are not recognized on paper, but are likely to be honored by the government in specific circumstances, and especially if the explicit debtors are under serious stress. A banking sector crisis is the obvious example. Governments may threaten not to bail out banks in the event of a crisis, but the social cost of not intervening could actually be much higher than that of recapitalizing the banks. Similarly, if a provincial government or a large SOE defaults on its obligations, there may be a need for the government to jump in.

These implicit obligations are known as contingent liabilities, as they may or may not materialize. Moreover, the probability that they will do, much the same as their

magnitude, is not really known, which makes their valuation particularly difficult.

Guarantees have been uncommon in Vietnam, except in electricity. Electricity of Vietnam (EVN) has offered investors a fixed purchase price for all the electricity they generate until the introduction of the competitive generation market in 2009, and for 90 percent of it afterwards. The government provided guarantees for the Phu My 2.2 and Phu My 3 Build Operate and Transfer (BOT) power plants, and the Nam Con Son pipeline bringing gas ashore. The guarantee package in this case includes the purchase price as well as access and availability of foreign exchange, water use rights, the performance of the gas supplier and the like. No contingent valuation has been carried out yet. But the purchase price was set at a level that is low enough, and the growth rate in the demand for electricity is high enough, for the exercise of these guarantees to be unlikely.

Sub-national debt is another potential source of liabilities for the central government (although not for the consolidated public sector). So far, only Hanoi and Ho Chi Minh City (HCMC) have issued provincial debt. But the process has been tightly controlled by MOF, which not only has to approve the issuance of debt but also intervenes in setting its modalities. Given the amounts involved and the tightness of the authorization process, again, it is safe to assume that risks are limited.

There may be some more concern in relation to debts issued not by the provincial governments themselves but by entities reporting to them. Several provincial governments have contributed equity to

LDIFs with the objective of speeding up the implementation of infrastructure projects, by raising resources from banks and bypassing the cumbersome administrative procedures of the public sector. The best-known example of a LDIF is the HCMC Investment Fund for Urban Development (HIFU), which has a capital of 1.49 trillion dong provided by the provincial government and 1.65 trillion dong in debt, mainly with banks. There are by now another 16 LDIFs in Vietnam, but they tend to be much smaller than HIFU. They are all regulated by a decree issued in 2007, which makes it clear that there is no formal government guarantee in their case. However, there is arguably a contingent liability in their case, no matter how modest it is for now.

Bond issuance by SOEs is a potentially important concern. Indeed, some of the large Economic Groups and State Corporations

have been among the main issuers of corporate debt. At around 30 trillion dong for now, their total debt is not too large (Table 4.1). However, in September 2008 Vinashin was authorized by MOF to issue 3 trillion dong in bonds, to borrow 10 trillion dong from domestic banks and to borrow 400 million dollars from external sources. This is to provide working capital for an enterprise with a robust series of shipbuilding contracts spanning many years, so that its solvency may not be at stake. However, if this trend were to continue, an important contingent liability could be building up.

On the surface, the contingent liabilities associated with SOEs are much larger than their bond issuances suggest, because they are all indebted with commercial banks. If SOEs were unable or unwilling to repay their loans, commercial banks could need to be bailed out. On closer

Table 4.1: Debt Issuance by SOCBs and Large SOEs

	2005	2006	2007
Vietcombank	1,375		
Bank for Investment and Development of Vietnam (BIDV)		4,252	3,000
Agribank		3,000	
Mekong Housing Bank (MHB)			1,000
PVFC		368	1,000
EVN		3,000	
Song Da Corp.		260	
Lilama			2,000
Electricity Construction Corporation (VNECO)			500
Vinacomin			1,500
Vinasin			7,000
Vinaconex			1,000
Vinasteel			400
CII		132	500
Total	1,375	11,012	17,900

Source: Own calculations, based on data from SSC. Figures are in billion dong.

inspection, however, this reasoning amounts to double counting. If the government needed (and wanted) to step in, it would need to bail out either the SOEs or the banks, but there is no good reason to bail out both sides. Moreover, SOEs are not the only creditors who could

run into difficulties. For instance, real estate developers could also be affected by the recent macroeconomic turbulence and lack the resources to service their debts. For this reason, it is preferably to treat the contingent liabilities from the banking system separately.

5. STATE CAPITAL

In spite of its declining share of investment, state capital still accounts for nearly 40 percent of total capital accumulation in Vietnam. Roughly half of this investment is implemented by the government, for non commercial purposes such as infrastructure development, whereas the other half is managed by increasingly profit-oriented SOEs. Given the sheer volume of resources devoted to capital accumulation by the government and by SOEs, legitimate questions about efficiency and accountability arise. Much progress has been made on the management and oversight of budget resources, including public investment. There is also a better integration of planning and budgeting processes, but the separate preparation of the budgets for capital and recurrent expenditures remains a weakness of the current system. An even bigger weakness concerns the management of public investment projects. The authority to approve such projects has been increasingly delegated to local levels of government. But no mechanism is in place to screen projects on a cost-benefit basis, to oversee their implementation, and to discontinue those with poor performance. The recent need to adjust government expenditures down, in response to the overheating of the economy, showed how important those mechanisms can be. Investments by SOEs are often

criticized as ineffective, but this may be a simplification as their rate of return compares favorably to that of other enterprises. However, high returns may result from the economies of scale characterizing the sectors many SOEs operate in, and from the market power they often enjoy, rather than from their internal efficiency. Therefore, reforming the state sector remains a priority and the question is how to do it right. Much has been accomplished through the introduction of private capital and the adoption of the corporate governance models of the private sector. More recently, rights over SOEs are being transferred out of line ministries and provincial government to address the conflict of interest between ownership and regulation. But the introduction of strategic investors into large SOEs is progressing too slowly, requiring a reconsideration of the equitization mechanisms used at present. And a strong management structure, separate from regulators, is still absent in the case of Economic Groups and large State Corporations.

Budget resources

As part of its renovation process, Vietnam has adopted an increasingly comprehensive legal framework for the management and oversight of budget resources, including public investments. Key milestones in this

process include the State Budget Law passed in 2002, the Law on Construction passed in 2003, the Law on International Treaties passed in 2004, and the Law on Investment, the Enterprise Law and the Procurement Law passed in 2005. In addition, important regulations on budget decentralization, project appraisal and monitoring and evaluation have been approved.

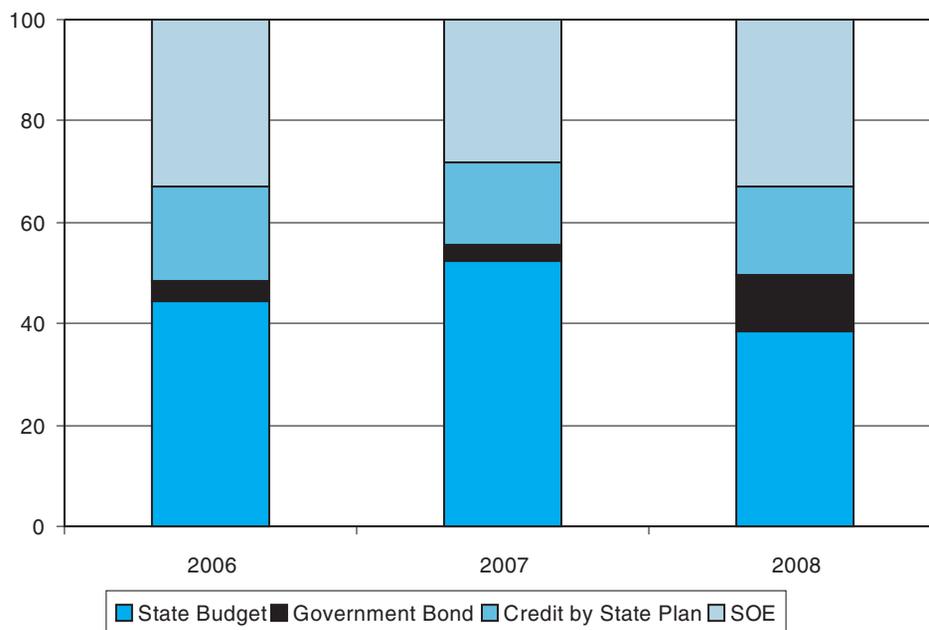
A forward-looking approach is gradually been adopted to guide public expenditure decisions. Budgets continue to be prepared on annual basis, but within a three-year stability framework. Budget allocation norms for both recurrent and capital expenditures, based on explicit formulas, give predictability to the flow of resources provinces can expect from the central government. Progress has also been made in linking planning and budgeting, with Medium-Term Expenditure Frameworks (MTEF) being successfully piloted in four sectors and four provinces. The MTEF approach is expected to be scaled up, and then mainstreamed into the budget process through the revision of the State Budget Law scheduled for 2009.

The integration of capital and recurrent expenditures into a single budget, one of the main weaknesses of Vietnamese public financial management, has gradually improved. These two components of the budget are prepared by MPI and MOF at the central level, and by the corresponding departments at the provincial level. Collaboration between the two sides has been facilitated by the introduction of the three-year stability period. The adoption of budget allocation norms for both capital and recurrent expenditures has also led to

greater coherence. But the separate preparation of the two components still hampers the effective management of resources and the composition of public expenditure remains unbalanced in some cases.

In practice, capital for public investments may come from three different sources. The state budget is used for investments with low potential for cost recovery in economic and social infrastructure, human resource development and environmental protection. It is also used for the maintenance of public works. For projects that can generate revenue but are unlikely to achieve full cost recovery, the stage budget only finances part of the investment. The second source is state credit, provided in concessional terms out of government's own funds or from ODA resources. State credit is used for priority projects across a range of sectors. The borrowing government agency is the owner of the investment but has responsibility to pay back interest and principal. Third is the capital used by SOEs, which comes from retained depreciation, after-tax profits, unused land and buildings, funds mobilized for business development, equity in joint ventures, and partnerships with domestic and foreign entities.

From a presentational perspective a fourth source is considered in Vietnam, namely off-budget government funds. Infrastructure or education bonds fall in this category. Although their spending is subject to the same public financial management regulations as the rest of the state budget, these funds are mapped to specific investments and reported separately from the main budget (Figure 5.1).

Figure 5.1: Funding Sources for Public Investments

Source: MPI. Data for 2008 are based on plans, not actuals.

Public projects

As for the way these resources are allocated, two breakdowns may be considered. One is according to the level of government that undertakes the investments. In this respect, the trend towards decentralization is quite remarkable. In 2001, some 50 percent of investments were undertaken by local governments. By 2007, the share had increased to 61.8 percent in which provincial governments and lower levels of government were in charge of 48.8 and 13 percent respectively. The share directly controlled by the central government is expected to decline even further in 2008, from 38.2 percent to a mere 33 percent. The other breakdown is by sector (Table 5.1). From this perspective, the importance of infrastructure investments is very clear.

Whether these projects actually serve their

purpose very much depends on the way they are identified, designed, appraised, approved and implemented. Since the issuance of the Law on Construction and the Common Investment Law an increasingly stronger foundation for the management of state capital is in place. The duties and authority of relevant government agencies have been clarified, and a process has been set up for projects of different importance. But there are important limitations as well.

In line with the decentralization process, public projects of national importance have to be submitted by the government to the National Assembly. The criteria to determine whether a project falls in this category include its size, its potential environmental impact and its requirements in terms of population resettlement. Projects related to security, defense or historic and cultural heritage also

Table 5.1: Public Investments by Sector of Activity

Sector	2001	2002	2003	2004	2005	2006	2007e
Agriculture, forestry and fishery	9.0	8.2	8.7	7.0	7.2	6.8	6.7
Industry, mining and energy	42.9	40.7	39.1	36.2	35.9	34.5	32.9
Construction	3.5	5.1	5.1	4.6	4.6	4.8	4.6
Trade	2.0	4.6	3.2	2.0	1.7	1.7	1.6
Hotels, restaurants and tourism	0.6	0.8	1.3	0.4	0.4	0.4	0.4
Transportation and communications	20.9	22.5	20.8	22.4	23.5	22.9	20.8
Finance and credit	0.5	0.2	0.9	0.5	0.5	0.5	0.5
Science and technology	1.9	0.3	0.7	1.0	0.9	1.4	1.5
Real estate, renting and consulting	0.6	0.8	0.9	1.5	1.3	1.5	1.8
State management and defense	3.6	2.7	3.5	5.9	6.0	6.4	6.4
Education and training	5.3	3.8	4.4	5.9	5.4	5.4	5.2
Healthcare and social relief	2.3	2.1	2.5	3.9	3.4	3.2	3.0
Culture, recreation and sport	1.6	2.2	2.8	2.7	2.5	2.5	2.4
Party and mass organization	0.3	0.3	0.2	0.4	0.4	0.4	0.4
Individual and community services	5.0	5.7	6.0	5.7	6.3	7.8	12.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Based on data from GSO. Figures are in percent of total public investment.

fall in this group. Projects of national importance are appraised and implemented by MPI in coordination with the relevant line ministries and local governments. Public projects of lesser importance are classified in categories A, B and C, depending on their characteristics, with requirements decreasing accordingly.

One importance difference is the extent to which cost-benefit analysis is used to appraise the projects. For those of national importance, the Prime Minister can set up an inter-agency appraisal panel. For instance, in the case of the Son La hydropower plant, the panel included researchers and associations, and gathered feedback on issues such as construction safety, environmental impact and population resettlement. However, this feedback is

more in the spirit of consultation than on project appraisal or impact assessment.

Public projects in category A, typically approved by line ministries and provincial governments and listed in the annual budget allocation plan, are subject to Net Present Value (NPV) calculation. However, the calculation is often based on partial information and is seldom updated to reflect changing circumstances, such as the surge in the cost of construction materials that occurred in early 2008. In principle, smaller projects in categories B and C are also subject to cost-effectiveness analysis, but the approach tends to be more cursory in their case. In the end, project selection remains largely qualitative, based on compliance with master plans, with limited importance attached to quantitative indicators.

One problem in this respect is the declining role of MPI as an investment appraisal agency, at a time when local authorities still lack the relevant expertise. As part of the drive towards decentralization, MPI is increasingly confined to a stewardship role, not intervening anymore in project appraisal and implementation. As a result, there is no agency in government with the capacity and the authority to review public projects prepared by lower levels of government and recommend changes (including their postponement or cancellation) when they do not meet minimum cost-effectiveness standards.

There are also important weaknesses in the implementation of public investment projects. While projects in category C should be completed within two years, delays are common due to insufficient funding. Also, the amendment of approved projects is a common practice, often resulting in substantial increases of the amount of resources spent.

The National Assembly can conduct on-site evaluation of project performance. In recent years, it has also taken a number of steps to strengthen the management of public projects. For instance, in 2006, although on-budget investment had increased by 23.6 percent, the total number of projects was brought below 13,000. As a result, the average capital per project became larger, monitoring was facilitated, and implementation delays were reduced.

In the end, one of the biggest difficulties is to postpone or cancel a poorly performing project. Until recently, this was only done on an exceptional basis, due to the potential clash with the local government or agency in

charge. A large pulp project in Gia Lai was one of very few large projects that were ever rejected, and this was only after protracted discussions. However, the macroeconomic turbulence of late 2007 and early 2008 required more decisive action to contain public expenditure. This was done under Prime Minister Decision 390, issued in April 2008. By then, MPI had already introduced standardized templates for the monitoring of public investment projects. Subsequently, with the authority provided by Decision 390, it requested line ministries and provinces to compile a list of all their ongoing projects having lost their relevance, being poorly implemented or lacking appropriate funding. On the basis of this information, MPI adjusted, downscaled or stopped 1,145 public projects with a total value of more than 30 trillion dong, accounting for 12.7 per cent of planned investment.

For how long these cuts will hold remains to be seen. But Decision 390 represented a critical step in the direction of bringing coherence to an increasingly decentralized public investment program. While a number of legal documents have been adopted in line with international practices, Vietnam has yet to develop a Public Investment Law to govern projects financed by public resources. This would have the potential to increase the efficiency in the use of state capital. As a Public Investment Law is prepared, the lessons from early 2008 should be taken into consideration. The delegation of decisions related to public investment projects is not incompatible with their screening on economic and social grounds, with the monitoring of their implementation, and with their adjustment when circumstances require.

SOE investments

At 85 trillion dong, or roughly 7.5 percent of GDP, the book value of the capital supposedly held by SOEs in 2008 was not commensurate with their importance in the Vietnamese economy. Just to give a sense of magnitude, investment by SOEs accounted for about 11.5 percent of GDP. This implausible gap between capital and investment probably reflects inadequate valuation, not capturing appreciation gains as the economy developed. Regardless of its true market value, this capital is their “own”. As such it is not subject to direct control by government authorities, even if new mechanisms are being put in place to this effect. And while those mechanisms develop, the relevant question is how effective this investment is.

A frequent claim, a highly plausible one, is that SOEs are less efficient than their private sector counterparts. However, this claim does not get straightforward support from available data in Vietnam, and it is important to understand why.

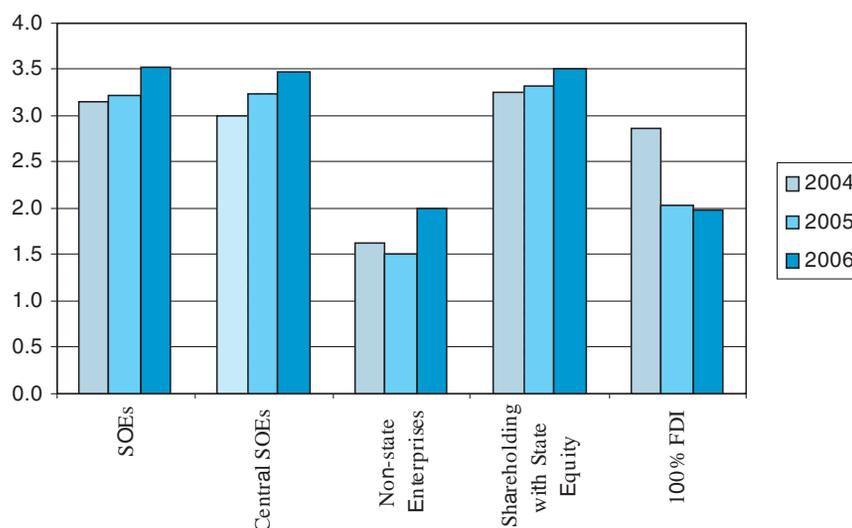
One readily available indicator of performance is the rate of return on assets. Asset valuation is problematic. While it should be similar for all enterprises, regardless of ownership, land-use rights tend to be seriously underestimated in the case of SOEs, which means that their assets are underestimated too, and their rate of return is overestimated. But due to their historically better access to credit, SOEs tend to have higher leverage than their private sector counterparts. This means that the same rate of return on assets is associated with a higher rate of return on capital in the case of SOEs. Overall, then, the rate of return on assets may be an imprecise indicator of

performance, but whether it has a net upward or downward bias is unclear. For what it is worth, the rate of return on assets is higher for SOEs than it is for private enterprises, regardless of whether they are domestic or foreign-owned (Figure 5.2).

Apart from measurement error (a distinct possibility), there are defensible explanations for this puzzling outcome. One of them is market power. While SOEs are increasingly subject to competition in product markets, several of them operate in legal or natural monopolies. Oil and gas production, mining and to a lesser extent power generation and telecommunications fall in this category. In this case, higher returns may to some extent result from natural resource rents or from more or less captive customers.

Another explanation has to do with the different room SOEs and private firms have in practice to under-report their profits. The analysis of patterns in tax revenue, discussed before, revealed a much higher EIT gap for domestic private enterprises than for SOEs. Avoidance and evasion are probably easier in their case than they are for entities whose managers are directly appointed by government. And profit figures reported to the GSO enterprise survey can be expected to be aligned with those reported to the tax administration agency. So, it is almost certain that private enterprises are more efficient in reality than they seem to be from a statistical point of view.

Last but not least, due to differences in their size and also to the different nature of the sectors they operate in, SOEs may benefit from economies of scale to a larger extent than private enterprises. Capital intensive

Figure 5.2: Rate of Return on Assets by Enterprise Ownership

Source: Based on Enterprise Survey from GSO. Figures are in percent.

activities such as mining or naval construction have very high fix costs, which means that their average cost per unit declines as the production volume increases. If so, inefficiencies in the internal management of SOEs could be more than offset by scale effects playing to their advantage.

Regardless of the explanation for this apparent anomaly, economic analyses that simply take for granted the inefficiency of SOEs may be too simplistic to be useful. Vietnam does not seem to have the rust belt of poorly performing SOEs which characterized the former Soviet block and even some regions of China. This is not to say that SOEs are at the efficiency frontier; almost certainly they are not. Moreover, large SOEs may pose risks to economic stability when they expand into financial sector activities, as will be discussed later. Therefore, reforming the state sector and bringing in private capital, if done right, should result in higher overall economic efficiency. The relevant question, from a

policy perspective, is how to do it right.

Divesting capital

Until recently, efforts to increase the efficiency of SOEs in Vietnam had combined three basic elements: enhancing autonomy from government administration for day-to-day management decisions, bringing in private investors through the equitization of capital, and adopting the corporate governance models of the private sector.

The first one of these elements was introduced in earlier stages of the reform program. Equitization had been piloted early on too, but only gained speed after 2001. By now some 3,800 SOEs have sold some or all of their capital to outsiders. Equitization also required taking SOEs out of the regulatory framework provided by the SOE Law and bringing them under the umbrella of the Enterprise Law. One further step in this process was the adoption of the unified Enterprise Law in 2005. This law provided a common set of corporate governance

framework for all enterprises, regardless of ownership. The unified Enterprise Law is being used to convert SOEs into either joint-stock companies or single-member limited liability companies.

There have been several studies to assess whether this combination of managerial autonomy, private ownership and corporate governance has improved the efficiency of SOEs. Some of those studies have compared the performance of enterprises before and after equitization, based on a range of indicators such as capital, turnover, profits and salaries. Others have compared total factor productivity gains across enterprises with different ownership structures. All of these studies show equitization under a positive light.

Now that the process is reaching large SOEs, new issues emerge. As the amount of capital at stake is sizeable, valuation becomes more sensitive. In the initial stages of equitization, which concerned small SOEs, few outsiders would have dared to buy shares. Selling them at book value (in fact, at a discount) to directors and employees was probably the only workable approach. As bigger SOEs came in line for equitization, public auctions started to be used. Having a “price discovery” mechanism of this sort in place became essential, given how murky the valuation of land and intangible assets would otherwise be.

The risk with selling at book value was to see large capital gains being made by investors shortly after equitization. While probably irrelevant in terms of economic efficiency, this windfall would have made the government vulnerable to the accusation of having handed over state assets at a

bargain price. The associated corruption risks and the global notoriety of “oligarchs” having made their fortunes in botched privatization episodes elsewhere, made it critically important to ensure some form of competition in the divestiture of state assets.

The emphasis on competition was pushed even further as the largest SOEs and SOCBs came in line for equitization. In their case, and after failed attempts to do strategic placement, the government decided that a public auction would be conducted using the stock exchange as a platform. While not necessarily involving a stock exchange listing, this approach was aimed at ensuring transparent price discovery. Only subsequently could direct negotiations be engaged with strategic investors, but the share price could be no less than the Initial Public Offering (IPO) price. While this approach had the merit of its transparency, its implementation ended up being more complicated than expected (Box 5.1).

By now, it seems clear that the mechanisms to equitize large SOEs need to be re-considered. Having a credible price discovery mechanism remains crucially important. Unfortunately, valuations by independent advisors may not have sufficient credibility in this respect. Thorough valuations can only be undertaken for very large SOEs, and even in their case the experience so far is that IPOs may yield substantially different share prices. This is not to say that the IPO prices are in any way reasonable. But the very fact that huge gaps are common undermines the credibility of the valuation, while at the same time creating serious governance risks. If a transparent competition mechanism is used for price discovery, equitization could come

Box 5.1: Equitization Methods: Competition versus Direct Sale

The equitization method based on conducting an IPO on a small share of the capital through public auction in the stock market was tried four times between 2006 and 2008. These four episodes concerned two leading insurance companies (PetroVietnam Insurance and Bao Viet), one large beer brewery (Habeco), and one of the biggest SOCBs (Vietcombank).

PetroVietnam Insurance did its IPO in December 2006, when the market was about to enter a period of bubble. The exuberant mindset of the time was reflected in an auction winning price of 160,250 dong per share, against the starting price of 11,500 dong. In June 2007, additional shares were sold by auction and rights issue, yielding a winning price of 75,500 dong. Even at that lower price, PetroVietnam Insurance could not find a strategic investor for a while. Then, in April 2008, when the stock market was reaching bottom in the aftermath of the stabilization program, a deal was reached with Temasia Capital of Hong Kong, China.

Bao Viet went through IPO in May 2007, when the stock market was hottest, and offered an 8.7 percent stake through public auction. The bid was strong, driving up the winning price per share to nearly 74,000 dong, compared to a starting price of 30,500 dong. Due to the very high price, however, the actual subscription reached only 74 percent of the amount won. Subsequently, Bao Viet attempted to sell part of its capital to strategic investors, but by then the share price had been diluted by new share issues to employees at a heavily discounted price. Given that the transaction could not be conducted below the IPO price, the expectation was that the transaction would fail. Then, in September 2007 Bao Viet managed to sell a 10 percent stake to HSBC and an additional 3.5 percent to Vinashin.

Habeco conducted its IPO in March 2008, when the stock market was already low. It only managed to sell 4.4 million shares, out of the 35 million offered. At 50,015 dong per share, the winning price was barely above the 50,000 dong starting price. Carlsberg from Denmark had a 10 percent stake in Habeco's capital from earlier on. After the IPO it acquired an additional 5.77 percent.

These three cases can be considered successful, in the sense that a strategic investor was attracted, or increased its stake in the company. This is despite the fact that two of them had IPO prices which were multiples of the starting price. However, the fourth case is still pending, and is seen as a failure.

Vietcombank had its IPO in December 2007, when the stock market was still high. This was after months of protracted negotiations with three potential strategic investors. Although the terms of these negotiations remain confidential, it is generally believed that prices being discussed were around 60,000 dong per share. With the stock market still riding high, the IPO resulted in shares being sold at 108,000 dong. But the stock market plunged by one third in the months following the adoption of the stabilization package. With shares trading in the informal market at a fraction of the IPO price, attracting a strategic investor will be challenging.

to be seen with suspicion, and eventually the credibility of the SOE reform program would be at risk. For this reason, proposals to proceed with direct sales of state capital to

strategic investors, while obviously favored by potential investors and financial intermediaries, should not be embraced lightheartedly.

Minor changes to the current approach could actually address some of its shortcomings. IPOs processed through the stock market provide an easily observable price discovery mechanism, but not necessarily one that is conducive to finding the fundamental price of the assets being sold. Equitization IPOs are not governed by the Securities Law, which means that full disclosure is not required. Because a small stake is offered to the market, the auction attracts mainly retail investors who have little understanding of the fundamental value of the assets offered. The risk is that the IPO price could be too high. This may happen when the price is driven up by unsophisticated domestic investors or when the entire market is driven up by market sentiment or expansionary macroeconomic policy. In this case, the alternative is to use the subsequent market price of the share sold through the IPO as the floor price for the sale to strategic investors.

In the case of small SOEs, competitive bidding provides a simple mechanism for price discovery. Financial statements independently audited could be made public, and prospective bidders be invited to submit sealed offers, as they would do for a tender. If no applications are received, then a direct sale can be considered. Having given the opportunity for everyone to compete for the capital stake being sold should help dispel any suspicions that the direct sale involved favoritism.

Managing capital

The SOE reform process entered a new phase in 2005, with the establishment of the State Capital Investment Corporation (SCIC). The SCIC is a for-profit organization mandated to exercise ownership rights in SOEs on behalf of

the state. In order to do so, it has to first receive those rights from the relevant line ministries and provincial governments. As of September 2008, the SCIC had received ownership rights in 882 SOEs, with a book value of 7.6 trillion dong. These SOEs operate in various sectors such as financial services, energy, manufacturing, telecommunications, construction, transportation, consumer products, health care, and information technology (IT).

The transfer of SOE ownership rights to the SCIC is aimed at solving a conflict of interest, whereby those in charge of adopting or implementing policies and regulations are also in charge of enterprises subject to those policies and regulations. The SCIC can probably do very little to improve the internal efficiency of the SOEs, and it probably should not even try. But its creation has the potential to strengthen the incentives faced by line ministries and provincial governments to adopt policies and regulations which are in the public interest, and to implement them without favoritism.

The SCIC is also charged with the task of fully divesting SOEs which are not of strategic importance. Enterprises targeted for full divestiture include those having a state share of capital below 30 percent, a total chartered capital of less than 20 billion dong and a rate of return on equity lower than 15 percent. In addition, these enterprises must operate in sectors not considered as a priority by government. The other SOEs under SCIC are considered as either strategic investments or flexible investments. These other SOEs are to be listed in the stock market, so as provide the SCIC with an easily observable performance indicator, facilitating its task as portfolio

manager on behalf of the state. The SCIC is also supposed to assist its affiliated companies to list overseas and to raise funds through other means.

Of the 882 SOEs the SCIC had received by September 2008, 40 had already been divested, and another 754 were expected to follow suit. The same classification and treatment will apply to the roughly 1,200 additional SOEs the SCIC should receive from line ministries and provincial governments in the coming time.

It is less clear that the SCIC will be in charge of exercising ownership rights on behalf of the state in the case of Economic Groups and large State Corporations. These are still, for the foreseeable future, under the direct authority of the Prime Minister, with any transfer of ownership to be decided on a case-by-case basis. There are also uncertainties regarding SOCBs, which report to SBV. For now, the transfer of ownership rights to the SCIC has been approved in the case of three SOCBs (Vietcombank, MHB and Vietinbank) and three large General Corporations (Vinaconex, Constrexim and VEIC).

In this respect, the Vietnamese approach to managing SOEs has both similarities and differences with the Chinese approach (Box 5.2). Like the Chinese State-owned Assets Supervision and Administration Commission (SASAC), the SCIC effectively addresses the conflict of interest between regulation and management, because it is managed for

profit and has no regulatory authority. But the Chinese SASAC was focused on the largest SOEs, which were seen as those with the highest potential to benefit from economies of scale and become global players over a short period of time. On the other hand, their Vietnamese equivalents, namely the Economic Groups and large State Corporations, are still firmly anchored under government. Also, the Chinese SASAC did not combine commercial and financial interests under the same roof, whereas the Vietnamese SCIC will exercise ownership rights in both commercial enterprises and very large banks.

From this perspective, it may be worth reconsidering some of the features of the new phase of the SOE reform process initiated in 2005. The way in which Economic Groups and large State Corporations diversified into financial sector activities during the asset price bubble of late 2007 and early 2008 raises concerns about economic efficiency and macroeconomic stability. While those concerns are discussed in more detail later in this report, stronger state management mechanisms may be required in their case. And the fact that Economic Groups remain under the direct oversight of appointed line ministries and government agencies means that conflict of interest between regulation and ownership still needs to be addressed. As Vietnam derives the lessons from the recent macroeconomic turbulence, this would certainly be an area deserving attention.

Box 5.2: China's Approach to the Management of State Ownership Rights

A centerpiece of China's SOE reform strategy has come to be known as "grasping the large and letting go of the small" (zhua da fang xiao). This strategy involves turning the more productive large and medium-sized SOEs into independent corporate entities and supporting the formation of large enterprise groups, or conglomerates, able to compete with foreign multinationals.

Among thousands of large enterprise groups organized around a state-owned "mother company", 113 were selected between 1991 and 1997 to become what is collectively known as "the national team". In an attempt to develop economies of scale, these groups were especially well implanted in sectors such as automotives, construction, electronics, machinery, petrochemicals, and steel. Groups in the national team expanded extremely quickly over the period 1997-2003, with growth rates of assets and turnover exceeding 20 percent per year. Following the national team example, over 2,300 provincially owned and managed groups have also emerged. The "grasp the large" strategy has also been adopted at lower levels.

Both SOE reform and the reform of the financial system took on greater urgency in the face of WTO accession commitments. In the case of the financial sector reform process, 2003 saw the formation of the China Banking Regulatory Commission in April to oversee the reform agenda for the banking system, replacing the People's Bank of China as the regulator of the banks. The year 2003 also saw the creation of SASAC to push forward the reform and restructuring of SOEs and overcome the fragmentation of state ownership arrangements.

SASAC is now the organization authorized by the State Council to perform the responsibilities as the "investor" of state-owned assets on behalf of the central government, taking over this role from some other state bodies. As such, SASAC is a special ministerial level institution directly under the State Council, but different from the government administrative organizations of public management for social enterprises and different from ordinary enterprise and business units. From a property rights perspective, SASAC's relationship with an SOE is akin to that of investor and business entity. SASAC acts as investor, enjoys an owner's equity rights, and assumes legal liabilities under Corporate Law but does not intervene directly in enterprise operations.

In 2003, when SASAC was established, its affiliated enterprises earned an estimated 2.2 percent of the Chinese GDP in profits. By 2007 they earned over 4 percent. For comparison, this is about as much as all oil companies in the United States made in 2007, and while Exxon's record profit of that year was the largest ever recorded, it represented only 0.3 percent of the United States' GDP. But disposition of these profits has been a vexatious issue since the beginning of economic reform. In 1994, as part of the tax reform program, the central government had made the rather casual decision that SOEs would no longer remit after-tax profits to the government. In the subsequent 13 years, they never did. Only in 2007 was this issue resolved, with the State Council finally approving detailed regulations for the remittance of a share of profits to the government.

Source: Becky Chiu and Mervyn K. Lewis (2006), Barry Naughton (2008), and Dylan Sutherland (2007).

6. POLICY LENDING

In the transition from plan to market, policy lending was separated from commercial lending and regrouped in specialized institutions explicitly benefitting from budget support to finance their operations. At present, there are two such institutions, namely VDB, which lends for large priority projects, especially in infrastructure, and VBSP, which provides targeted support for the poor and other disadvantaged groups. In terms of their outstanding portfolio, VDB is five times as large as VBSP. But in a way, the operation of VDB can be considered as an integral part of state capital management. The operation of VBSP raises different issues, mainly related to access to finance among poor households. Like many microfinance institutions around the world, lending relies on Savings and Credit Groups, whose participants are held collectively accountable for loan repayment. But unlike standard microfinance institutions, VBSP works closely with mass organizations and local authorities, which are in charge of recruiting borrowers, but also of verifying that they are eligible for subsidized credit. The overall number of borrowers is quite large, representing roughly a quarter of the number of households in the country. And the targeting is satisfactory as well. The proportion of borrowing households is much larger among those below the poverty line (and even among the food poverty line) than

it is among the near poor and the better-off. And VBSP loans represent a large fraction of household expenditures among the poor than among the better-off. Leakage is considerable mainly because there are many more better-off households in Vietnam than there are poor households. The impact of VBSP lending on household living standards appears to be positive, but relatively modest. With roughly half of VBSP borrowers being non-poor, the question is whether subsidization is warranted. The case of Cambodia, where microfinance is organized on a for-profit basis and has been thriving, is at times shown as an example that other approaches can be implemented, without tilting the playing field. The strategy of the VBSP is to move in the direction of more commercially-oriented microfinance in the future, but this may be a gradual process.

Social policy

VBSP was established in 2002 to take over the small-scale policy and directed lending programs previously administered by SOCBs and other government entities, including the Vietnam Bank for the Poor. Its institutional arrangements envision a non-profit bank that offers a full range of financial products and services at subsidized rates. In particular, VBSP is supposed to provide micro-credit at low interest rates without collateral. To target

the poor, it works extensively with mass organizations.

VBSP is exempt from many of the regulatory provisions that govern the operation of SOCBs and it is not covered by the regulatory framework for microfinance institutions either. With headquarters in Hanoi, it has 64 branches, 600 sub-branches and 8000 outlets, with more than 7,000 staff. Its management board is chaired by the Governor of the SBV and the other members of the board are from other government ministries or are directly appointed by the Prime Minister. MPI guides its operational policies, whereas MOF oversees its financial management. People's Committees are primarily responsible for the establishment and regulation of local savings and capital borrowing groups.

The VBSP has a charter capital of 8 trillion dong and an entrusted capital of 5.5 trillion from the state budget. These funding sources are complemented by mandatory contributions of 2 percent of total dong deposits by the SOCBs. The rates paid to the SOCBs are negotiable. Capital is also complemented with resources from Official Development Assistance (ODA) on-lending, deposits, and borrowing from various sources, including the Vietnam Postal Savings Service Company, the Social Insurance Fund and the SBV.

Under current arrangements, VBSP is not a solvent institution. As of 2008, outstanding loans by the VBSP totaled 30 trillion dong. A third of this amount was funded by deposits from the public, a quarter by deposits from SOCBs, a fifth through state budget grants, 16 percent by borrowing from SBV and 6 percent by borrowing from the State Treasury. Another way to break down

outstanding borrowing is based on its terms. As of 2008, VBSP had borrowed 17.1 trillion dong in concessional terms, and 13.3 trillion in market terms. The state budget covers the cost of subsidized lending and the losses VBSP may incur, as long as they are reasonable.

The target population of VBSP is quite broad. It includes households classified as poor, which are allowed to borrow for productive business, safe water, electricity, housing and schooling. VBSP also finances scholarships for disadvantaged students at universities, colleges and vocational training schools. A so-called job creation program targets small businesses, cooperatives, farms, business units for the disabled, socio-labor education centers, and business households. The households of migrant workers going abroad under the labor exports program are entitled to borrow as well. In addition, there are programs for safe water supply and rural sanitation, for production units employing former drug addicts, and for especially disadvantaged ethnic minority households.

Two main lending methods are used. For business households and production units, disbursement is made directly to the borrower, with VBSP in charge of all lending procedures, as well as controlling, supervising and collecting. For poor households and beneficiaries of social policies, on the other hand, lending is implemented through the establishment of Savings and Credit Groups. At present, VBSP has trust contracts with four mass organizations to set up these groups. These are the Vietnam Women's Union, Vietnam Farmers' Association, Vietnam Union and Vietnam Youth Union.

While group lending is organized along standard micro-finance principles, the close working relationship between mass organizations, local government officials and VBSP is a distinctive feature of Vietnam. Typically, local officials or representatives of mass organizations introduce the lending products of VBSP to their constituencies. Households are invited to create Savings and Credit Groups. To be eligible, they have to be residents of the same village or cluster of households, and they must range from 30 to 50. The list needs to be approved by the local People's Committee before being sent to VBSP, to certify that member households are classified as poor or are indeed eligible for support.

Data from the outstanding loan portfolio of VBSP suggest that it has been quite successful (Table 10.1). Its 6.3 million active loans are equivalent to slightly more

than a quarter of the total number of households in Vietnam. At 7.5 million dong, the average loan size is definitely modest. Financial charges on loans are modest. According to the household expenditure survey of 2006, the average monthly interest paid on VBSP loans was 0.36 percent per month, or around 4.3 percent per year. Only for the small and medium enterprises program is the average loan size important, but this line of business has a different status, as it is run in partnership with KFW. All of this suggests that VBSP is reaching beneficiaries of modest means. Whether they are the most modest, and what impact does subsidized lending have on their livelihoods, are different issues.

Poverty impact

The same household expenditure surveys used to measure poverty can be counted upon to assess how well targeted VBSP

Table 6.1: Beneficiaries from Social Policy Lending

Program	Outstanding loans (billion dong)	Number of beneficiaries	Average loan size (thousand dong)
Poor households	26,776	3,917,793	6,834
Safe water supply and rural sanitation	3,181	757,698	4,198
Disadvantaged students	6,061	731,224	8,289
Especially disadvantaged communes	5,839	353,572	16,514
Job creation	3,278	305,422	10,733
Housing in the Mekong Delta area	541	65,642	8,242
Temporary migrants abroad	730	44,846	16,278
Ethnic minority households	162	34,095	4,751
Forestry development by households	108	6,646	16,250
Small and medium enterprises	134	440	304,545
Others	245	53,250	4,601
Total	47,055	6,270,628	7,504

Source: VBSP. Data are as of September, 2008. The small and medium enterprises component is implemented as part of a partnership program with KFW.

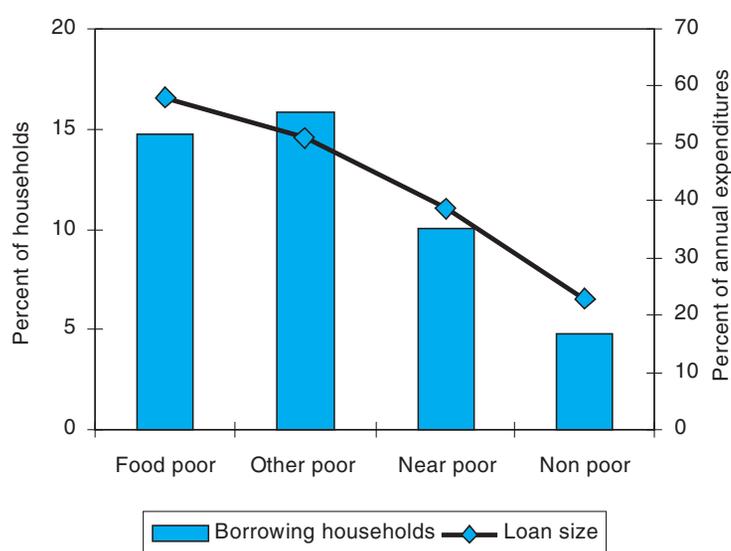
lending programs are. Given that those programs are subsidized, there is little justification to channel the resources to households which are not really in need. However, there are some grounds to be concerned about the selection of beneficiaries at local levels. For instance, Savings and Credit Groups are said to be reluctant to include very poor households in the borrowing lists, out of concerns about their low repayment capacity. Even beyond deliberate decisions by authorities, there could be a selection bias at play. The poor often lack the education to identify or exploit investment opportunities, which could make them less prone to ask for loans.

Household data for 2006 indicate a relatively better targeting than could be anticipated (Figure 6.1). The highest participation rates, around 15 to 16 percent, can be found among households in the two poorest groups of the population. The participation rate remains relatively high among the near poor, at

around 10 percent, but it falls below 5 percent of all households for the better-off. Borrowing amounts also display a clear progressivity, if not in absolute terms at least relative to household expenditures. The typical loan of a household living below the food poverty line accounts for 58 percent of its annual expenditures. The proportion declines steadily, to reach 23 percent in the case of better-off households.

This said, a majority of the Vietnamese population can currently be classified as better-off. This means that in spite of a lower participation rate, this group accounts for a large share of beneficiaries and absorbs a large proportion of resources. Almost 47 percent of the borrowing households can be considered better off, and they receive almost half of social policy lending. From this perspective, VBSP faces a considerable extent of leakage. Some of it is by design. For instance, its water supply and sanitation program is targeted to rural areas, but not

Figure 6.1: Is Social Policy Lending Well Targeted?



Source: Based on Cuong Viet Nguyen (2008). Data are for 2006.

exclusively to the poor. But in most cases, leakage is more of an unintended consequence, calling for a strengthening of targeting mechanisms

An altogether different question is whether social policy lending has a substantial impact on living standards. If it does, then some of the previous discussion about targeting is potentially misleading. Indeed, if VBSP loans were very successful at lifting households out of poverty, few of the borrowers would be poor. Success in poverty reduction could thus be misinterpreted as inadequate targeting. And there is some evidence that VBSP lending makes a difference. However, it may not be that substantial.

The assessment in this case relies on the comparison of pairs of households which are similar in all respects, except that one received a loan and the other did not. The comparison relies on statistical methods which allow determining when two households can indeed be considered “similar in all respects”. The analysis suggests that the borrowing households see their expenditures increase by around 5 percent, and their income by up to 9 percent.

The gap between the estimated impact on expenditures and income implies that borrowing households save more. This in turn is consistent with a mobilization of own resources (in addition to the borrowed resources) for investment purposes. Reassuringly, the percentage of overdue loans among Credit and Savings Groups stood below 1.5 percent in 2008. This is also consistent with relatively successful investments by borrowing households.

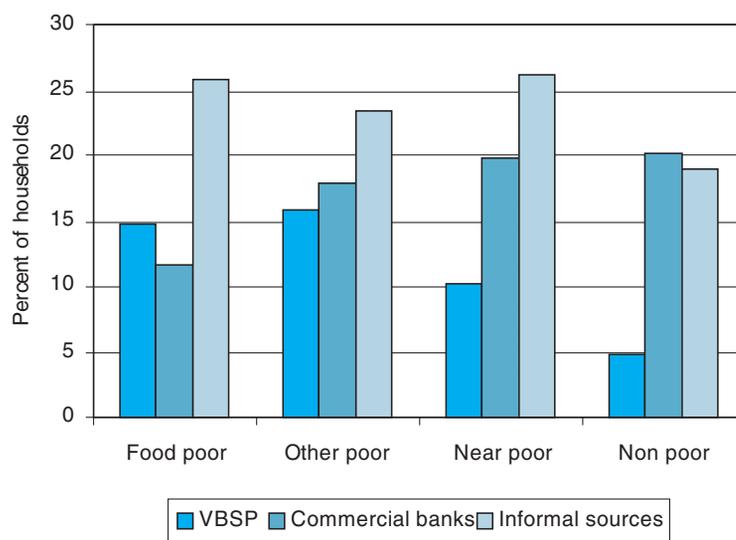
Unfair competition?

With a borrower base that extends well beyond the poor, VBSP certainly competes with other money lenders, formal and informal. The most obvious competitor is the Vietnam Bank for Agriculture and Rural Development (VBARD), which has a very broad reach too, but lends in commercial terms and requires collateral on most loans.

Even among the poor, who often have little to offer in terms of collateral, there are other sources of finance available. Informal rotating savings and credit groups are one of them. These groups include individuals who know and trust each other well enough to formulate together a saving and borrowing process. Shopkeepers are another source of informal credit in rural Vietnam. They sell on credit agricultural inputs such as pesticides, fertilizers and seeds, and collect payments after the harvest. There are moneylenders too. These are usually wealthy families living in the same communities or villages, who can rely on their good knowledge of customers to decide whether any collateral is needed. Their loans are in cash or in kind, typically for a short duration and at very high interest rates.

Household survey data reveal that VBSP is an important competitor for commercial banks and commercial money lenders among the poor and the near poor (Figure 6.2). Only among the better-off does it become a relatively marginal player. Conversely among households below the food poverty line is VBSP a more important source of finance than commercial banks. And even among that extremely deprived group, the difference is not large.

Because subsidized lending represents a

Figure 6.2: One among Several Sources of Finance

Source: Based on Cuong Viet Nguyen (2008). Data are for 2006.

form of unfair competition for those lending on a commercial basis, the question is whether it is justified from a policy point of view (Box 6.1). Given the rapid expansion of its network, VBSP is poised to take a dominant market position for the provision of microfinance in Vietnam. A dominant market position represents a disincentive for commercial banks and micro-finance institutions to operate in the rural and microfinance markets. And this in turn potentially reduces the overall efficiency of financial intermediation among the population groups that need it most.

VBSP management has actually indicated its intention to become a financially sustainable institution for micro and small enterprise financing. The strategy is influenced in part by the experiences of Bank Rakyat Indonesia. In the first stage of its transformation, VBSP will focus on reaching poor populations. To transition its operations towards non-subsidized lending,

a change in regulations and bank operation will be needed. The second phase is seen as one where VBSP still offers subsidized loans to target groups, but also begins market rate-based lending for some groups, such as migrant workers. The goal, perhaps somewhat optimistic, is to move from a subsidy-dependent bank to an operationally sustainable bank in seven years.

However, the Vietnamese approach to social policy lending is consistent with a broader objective, namely helping the poor (and some times the near poor) become part of the mainstream economy. In other areas, such as education and health, this objective is achieved through a combination of universal programs, government subsidies and targeting mechanisms. It is in this spirit that the budget picks up the payment of the health insurance premium for poor household members, or the financing gap resulting from their exemption from education fees.

Box 6.1: Microcredit in Cambodia and Vietnam

Cambodia has a thriving microfinance sector, not subject to government intervention. Services are provided by a commercial bank, 17 privately-owned microfinance institutions, and 26 regulated non-governmental organizations (NGOs). These altogether have over one million clients or about 7.5 percent of the population. Microfinance institutions have a strong profit orientation. Many of them have foreign investors as shareholders. Most of them are expanding rapidly and several are now taking deposits from the general public for an even stronger growth.

Among the key reasons that private sector microfinance operations have developed so far in Cambodia is the importance given to a for-profit ownership structure. Some consider that the extent of transparency, market-based management, and equal treatment of foreign and local participants make the case of Cambodia exemplary. In their view, this shows that a country can build a well-functioning and sustainable microfinance sector in a short time with clear and proper regulatory role of the government and vibrant private sector participation in the provision of products and services.

More generally, the Cambodian approach is seen as different from that of Vietnam on several important principles. Among them are the following:

- Microfinance is a business. In Vietnam microfinance is widely perceived as an activity to be financed and carried out by the government and NGOs, for social reasons more than as a business. But the subsidization of lending terms deters participation by profit-oriented organizations.
- Microfinance is independent from local authorities. In Vietnam, microfinance institutions are required to involve mass organizations among their owners, but the latter are so large that there is a risk of undermining competition. The participation of the same mass organization in several microfinance institutions could actually result in a potential conflict of interest.

Source: Binh T. Nguyen and Robert C. Vogel (2008).

In the case of credit, VBSP allows poor households to access credit despite them not having any collateral.

The relevant questions in Vietnam's case concern the quality of the targeting method but also the mechanism used to channel the

subsidy. Greater reliance on market principles would involve transferring the subsidy to other microfinance institutions (operating for a profit, but also NGOs) when they effectively provide credit to the targeted populations.

7. BANKING CREDIT

Credit from commercial banks has been one of the main sources of finance in Vietnam, and the transition to a market economy has been associated with a sustained increase in its volume, relative to GDP. However, the period following accession to the WTO was characterized by an unsustainable acceleration in the rate of credit growth, followed by a sudden contraction as government priorities shifted to stabilization. This macroeconomic turbulence accelerated what was an ongoing transformation of the banking sector, but it also amplified systemic risks. The ongoing transformation concerned, among others, the ownership structure of banking institutions. An ambitious reform roadmap adopted in 2005 envisioned bringing in strategic investors to all SOCBs. In spite of delays, several of them have made progress in this direction. Meanwhile strategic foreign investors have acquired increasingly larger stakes in an increasingly large number of Joint Stock Banks (JSBs). The period of dramatic credit growth was seized by JSBs as an opportunity to gain market share, especially given the restrained lending stance of SOCBs as they tried to clean their portfolios in preparation for equitization. The risks are mainly related to the quality of lending. The asset price bubble associated with rapid credit growth attracted investments in the financial sector by Economic Groups and large State

Corporations, which had deep pockets and saw the opportunity for quick gains. However, investments in lending institutions by large SOEs raise concerns about related party transactions. The possibility for these large SOEs to raise deposits from the public could loosen the screening of their investment projects and undo long-term efforts to improve the efficiency of the state sector. The asset price bubble also resulted in massive lending for real estate. Which fraction of those loans will be serviced remains an open question. An assessment of the risks faced by the banking system suggests that a financial crisis is unlikely. But the quality of loan portfolios will deteriorate given the bursting of the real estate bubble and the economic slowdown, at a time when Vietnam still lacks appropriate instruments to assess developments on a bank-by-bank basis and to react timely when needed.

Rapid growth

As part of the transition to a market economy there has been considerable financial deepening in Vietnam in recent years. Broad money (M2) accounted for only 58.1 percent of GDP in 2001, when reforms accelerated, and banking credit for 39.3 percent. At that point, there were barely 200,000 private bank accounts in the entire country. Credit cards were uncommon and ATM machines were

unheard of. Since then, there has been a steady increase in the use of financial instruments. At present, there are more than 10 million ATM accounts in Vietnam, approximately half a million credit cards, and approximately 5,000 ATMs in service. Between 2001 and 2006, banking credit grew at an average rate of 28.5 percent, but the demand for money was growing rapidly as well, as shown by the moderate rate of inflation over this period (5.45 percent per year on average). By the end of the previous five-year cycle, in 2006, broad money already represented 94.8 percent of GDP, and banking credit 71.3 percent.

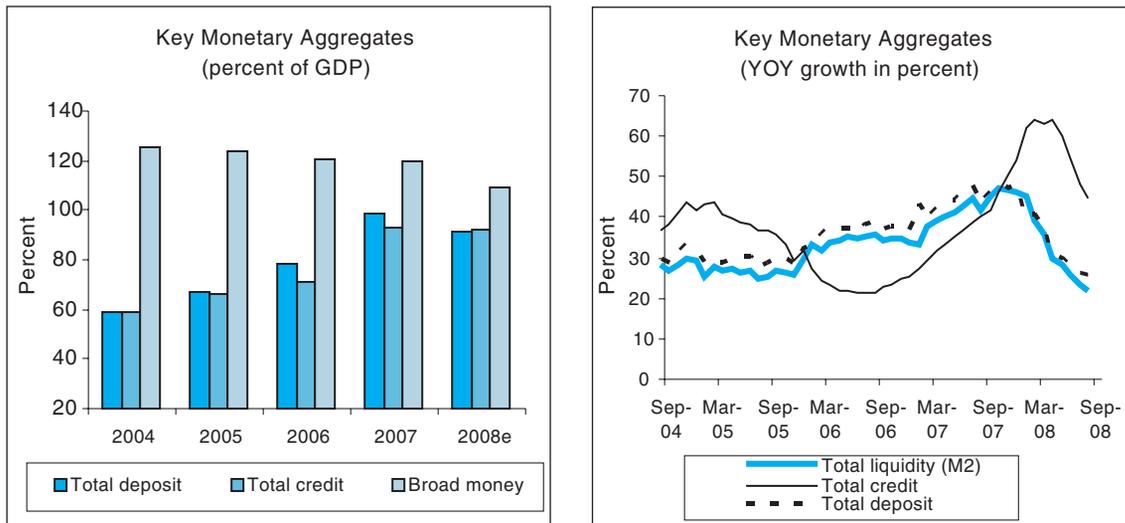
A considerable acceleration occurred from 2007 onwards, in fact so large that it represented a departure from the previous trend. When Vietnam's WTO accession was being finalized, capital inflows started accelerating in the form of both FDI and portfolio investments. Confronted with massive inflows, and concerned about the possible appreciation of the Vietnamese dong, the authorities intervened in the foreign exchange market. As a result, the dong not only failed to appreciate in nominal terms, but actually depreciated by 0.14 percent against the dollar in 2007. And this was at a time when the dollar was losing value against other international currencies. The flip side is that Vietnam's foreign reserves increased by 10.1 billion dollars in just one year, reaching 21.6 billion dollars by the end of 2007.

Massive purchases of foreign exchange to prevent the appreciation of the dong had the unwanted side effect of increasing liquidity. Until the last quarter of 2007, SBV was relatively successful at mopping up some of this additional liquidity by mobilizing various

monetary policy instruments. Among them were sales of government securities and SBV bills, increases in banking reserve requirements and higher policy interest rates. Yet, selling securities proved increasingly difficult as the interest rate offered became unattractive compared to the returns expected in a booming real estate market. The result was a ballooning of banking credit, peaking at 63.2 percent per year in March 2008 (Figure 7.1).

In response to the over-heating of the economy the central bank took contractionary measures leading to a sudden shortage in liquidity. Initially, the SBV stopped purchases of foreign currency. Subsequently, it did not renew a large reverse repo (a purchase of securities with a commitment to sell them back) and placed an even larger compulsory bill with commercial banks. A more comprehensive policy package was adopted in March 2008, reflecting a switch in government priorities from rapid growth to economic stability.

The stabilization package was no doubt successful. Inflation rates remained high during several months, but this was mainly due to the surge in the international prices of food products (especially rice) and oil. With a pegged exchange rate, the impact of food and oil inflation was transmitted to the domestic market to a larger extent than in other countries in the region, where some currency appreciation had taken place. However, "core" measures of inflation (excluding food, foodstuff and transportation from the consumer price index) showed a clearly decelerating trend. Government expenditures declined substantially, as did the value of imports. Credit growth fell even below the official 30 percent target.

Figure 7.1: Financial Deepening or Monetary Turbulence?

Source: Based on data from SBV and GSO.

Changing ownership

This surge and subsequent contraction in credit growth took place at a time when the structure of the banking sector in Vietnam was being fundamentally transformed. In fact, monetary turbulence had the positive effect of speeding up some of the ongoing banking sector developments. But it also had the negative effect of amplifying systemic risks.

One of the driving forces behind the transformation of the banking sector is the reform roadmap approved by the Politburo in August 2005, and converted into policy by the government in May 2006. At the risk of simplifying, this roadmap has two main building blocks: the creation of a modern central bank, with the capacity to conduct monetary policy and supervise the financial sector, and the introduction of a strong commercial orientation in SOCBs, by bringing strategic investors into all of them.

Since the approval of the banking reform roadmap, several SOCBs have made progress in their equitization plans. The most advanced is Vietcombank, which completed an IPO for a marginal share of its capital in late 2007 and held its first shareholders' general meeting in April 2008. As part of its equitization plan, Vietcombank was authorized to sell to strategic investors up to 20 percent of its capital. However, those investors are not allowed to buy shares below the IPO price, despite the fact that the stock market slump associated with macroeconomic stabilization has brought share prices substantially down. A waiver from the Prime Minister would be needed to go below the IPO price, and this is provided that the technical and financial assistance offered by the potential investor is considered valuable.

Some progress has been made by other SOCBs as well. MHB had its equitization plan approved in March, 2008. It includes

the sale of 15 percent of the capital to strategic investors with the accompanying requirement of long-term investment. Although this small SOCB has a relatively clean balance sheet, and Deutsche Bank AG Singapore was contracted to provide consulting services for its equitization, the transaction has still been stagnant due to unfavorable market conditions. The same applies to the cases of Vietinbank BIDV although they are in different stages of equitization process. In September 2008, Vietinbank's equitization plan was officially approved by the government. The bank can conduct the IPO for maximum 20 percent of its charter capital of which a maximum of 10 percent can be reserved for foreign strategic investors. In the long run, foreign strategic investors shall not own more than 20 percent of the bank's charter capital. Vietinbank contracted JP Morgan for equitization consulting services. BIDV's equitization plan has not been approved by the government, but the bank has chosen Morgan Stanley for the consulting services. The biggest and most complex SOCB, Agribank has also embarked on its way to equitization. However, it is widely anticipated that Agribank may take much longer than the rest four SOCBs due to its vast, weakly-connected banking network and the daunting task of cleaning up its balance sheet.

Meanwhile, foreign strategic investors have been acquiring stakes in JSBs. This trend has continued steadily in spite of macroeconomic turbulence. Although JSBs are smaller than SOCBs, they offer advantages compared to the opening of fully-owned foreign subsidiaries. Those advantages include a branch network and an

established customer base, providing a quick entry point into a rapidly growing market. Fully-owned bank subsidiaries have been opened so far by Standard Chartered and the Hong Kong - Shanghai Banking Corporation (HSBC). But these two banks have also acquired strategic stakes in existing JSBs, as also have done other reputable foreign investors (Box 7.1).

In addition to the large SOCBs scheduled for equitization, to the JSBs increasingly attracting strategic investors, and to the new fully-owned bank subsidiaries, the banking system of Vietnam also comprises a series of smaller institutions. These had originally been established as rural banks but have in most cases been upgraded to urban banks. Among them are Western Bank (previously Co Do Rural JSB), Saigon-Hanoi Bank (previously Nhon Ai Rural JSB), Kien Long Bank, Dong Thap Muoi Bank, Ocean Bank, and Dai A Bank.

Related parties

A less expected development was the venturing of Economic Groups and large State Corporations into non-core business areas such as banking, insurance, securities and real estate. This happened during the asset price bubble of late 2007 and early 2008, when it was expected that anyone mobilizing resources could quickly make substantial gains. Licenses to create new banks were granted to LienViet, TienPhong and BaoViet; applications are still pending in the cases of Vietnam Postal Savings Service Co (VPSC), and several others. As for Economic Groups and large State Corporations, 13 of them established securities investment funds, for a total of 1 trillion dong; 19 invested in banks, for 4.4

Box 7.1: Strategic Investments in the Banking Sector

Five out of the 10 largest JSBs, jointly accounting for 13 percent of the total assets of the Vietnamese banking system, have by now a foreign strategic investor.

HSBC acquired a 10 percent stake in Techcombank in December 2005, and increased it to 15 percent in July 2007. Techcombank is one of the largest JSBs in Vietnam, with total assets of 40 trillion dong at the end of 2007. HSBC became the first foreign bank to hold a 20 percent stake in a Vietnamese bank after the government allowed Techcombank to sell another 5 percent stake on July 30. Besides its Techcombank investment, HSBC is also holding a 10 percent stake in Vietnam's leading insurer Bao Viet Group.

The Overseas Chinese Banking Corporation (OCBC), the third largest financial group in Singapore, became a strategic partner of the Vietnam Commercial Bank for Private Enterprises (VPBank) in March 2006. VPBank has a registered capital of 2 trillion dong, a network of 140 branches and transaction offices throughout the country. The agreement included a commitment by OCBC to spend 8.2 million dollars over three years training VPBank personnel. In August 2008, VPBank was allowed to sell an additional 5 percent stake to OCBC, bringing its total stake to 15 of the capital.

The International Finance Corporation (IFC) of the World Bank, ANZ Bank and Dragon Financial Holdings (which owns the biggest investment fund in Vietnam) jointly hold the maximum allowable 30 percent of Sai Gon Thuong Tin Comercial JSB (Sacombank), the biggest JSB in terms of charter capital. In late 2007, IFC reduced its ownership in Sacombank by 2 percent, but the shares offered were quickly bought up by ANZ, so that the 30 percent threshold has been fully kept.

In a similar fashion, Standard Chartered, IFC, Jardines and Dragon Capital jointly hold 30 percent of Asia Commercial bank (ACB), the largest JSB in Vietnam in terms of assets. The bank has benefited from the foreign strategic partners in strengthening its corporate governance, capital base and management to make itself the leading JSB in Vietnam. In July 2008, Standard Chartered bought IFC's shares in ACB to increase its ownership from 8.84 percent to the maximum allowable 15 percent for a single foreign strategic partner in a local bank.

The most noticeable investment by a foreign bank in local bank took place in July 2007 when Sumitomo Mitsui Banking Corporation (SMBC) purchased of 15 percent of Vietnam Import Export Bank (Eximbank) for an amount of 225 million dollars. SMBC committed to supporting Eximbank in its retail banking, export finance, corporate governance and risk management.

Because most of these partnerships with reputable foreign investors started before the macroeconomic turbulence of 2007, JSBs should be in a relatively strong position. It is likely that the credit culture of these entities was reinforced, credit risk assessment improved and internal controls strengthened. Also, according to unconfirmed reports, the capital-adequacy ratios of some of the bigger JSBs could be unusually large, in the range of 15 to 30 percent.

trillion dong; and 13 invested in securities companies, for 420 billion dong (Table 7.1).

This is a worrying trend, as it risks undoing protracted efforts to harden the budget constraint on SOEs. In the planning period, credit was directly allocated to SOEs by SOCBs specialized in one particular sector (agriculture, industry, trade...). In the late 1990s, directed lending of this sort was taken out of the commercial banking sector. At present, only the VDB and the VBSP are supposed to provide subsidized credit to selected projects or households. Curtailing policy lending is a way to force enterprises to have bankable projects, of the kind a commercial bank with a strong profit orientation would be willing to finance. The suppression of explicit subsidies, the subsequent tightening of eligibility rules for policy lending, and the banking reform map itself were further steps towards levelling the playing field for all businesses,

regardless of their ownership. Together with increased competition in product markets, the sale of capital to private investors, and the adoption of the corporate governance models of the private sector, these steps were aimed at increasing the efficiency of SOEs in Vietnam.

If Economic Groups and large State Corporations were to control banks, or to raise deposits directly from the public, the pressure for them to have good projects would be loosened again. The separation of commercial and financial interests means that every investment project is subject to double scrutiny: once by the business entity which wants to undertake the project and a second time by the financial entity which decides to advance resources for it. Lack of separation implies that those who consider a project worth undertaking will be supporting it from both the borrowing end and the lending end. Under these circumstances, a

Table 7.1: Financial Investments by Large SOEs

	Number of SOEs involved	VND trillion
Total non-core investments		23,300
Financial investments to		13,888
Banks	19	4,426
Investment funds	13	1,061
Securities companies	13	420
Real estate	18	1,463
Finance and insurance	12	6,518
Other non-core investments		9,412
Total investments to other entities		164,637
Total debt		514,465
Owner's equity		377,081
Debt to Equity ratio		1.36

Source: NSCERD and MOF (2008), based on data from 76 Economic Groups and General Corporations..

dubious investment decision can be pursued for very long, with additional funding being provided to cover losses even if the chances to ever recover the investment are thin. The longer it takes for a poor investment decision to be exposed, and stopped, the more costly it becomes to fix it later on (for instance, through the recapitalization of the bank which lent in its support).

The combination of commercial and financial interests under the same roof, and the related-party transactions it supports, has been repeatedly associated with economic crises in middle-income countries. Chile in 1982-83 and several East Asian countries in 1997 illustrate the risks involved. Those crises involved excessively large investments in sectors going through unsustainable bubbles. It is also worth pointing out that the risk exists regardless of whether the commercial interests are owned by the private or the public sector. The economic groups of Chile were fully private. In East Asia, they used to fall in a gray area, combining private interests with cozy relations with government.

Fortunately, the stabilization package adopted in March 2008 resulted in the bursting of the asset price bubble, dramatically reducing the short-term profits that could be made in real estate and finance. As a result, several plans to expand in these directions were put on hold by Economic Groups and large State Corporations. And government became more cautious in its granting of banking licenses.

A diverse profile

There are 83 commercial banks in Vietnam, but in spite of the large number of participants the banking system remains

dominated by two main groups of entities. SOCBs account for approximately 48 percent of assets in the system and JSBs for an additional 28 percent. Fully-foreign subsidiaries, banks created by Economic Groups and large General Corporations and the former rural banks may be numerous, but their combined share of assets is small for now. Trends in banking credit are therefore heavily influenced by SOCBs and JSBs. However, these two groups of entities are different in several important respects, and they also behaved differently during the recent macroeconomic turbulence.

SOCBs are not numerous but they are big. On average, the assets of the largest four amounted to 13.4 billion dollars in 2007 (Table 7.2). The corresponding figures for JSBs are only a fraction of this. Even if only the four biggest JSBs are considered, average assets per bank reached 3.6 billion dollars (Table 7.3). The gap is smaller in relation to equity, with the average being 756 million dollars in the case of SOCBs, compared to 303 million for JSBs. The difference in the equity-to-assets ratio explains why their returns on equity are similar, at 22.3 and 28.6 percent respectively, in spite of large gap in their returns on assets. In the case of JSBs, the return on assets (2.3 percent) is close to the net interest margin (2.6 percentage points). But in the case of SOCBs it is much smaller (a meager 1.1 percent, compared to a 3 percent margin).

SOCBs expanded their portfolio much more slowly than JSBs during the period of rapid credit growth. Combined lending by SOCBs grew by only 25 percent during 2007. This

does not reflect a lack of liquidity, as these banks were flooded by cash much the same as JSBs were. The restrained lending stance of SOCBs was rather due to their efforts to improve the overall quality of their portfolio in preparation for equitization. Prudent lending is reflected in their low loans-to-deposits ratio. The excess liquidity enjoyed by SOCBs during this period was lent to JSBs through the interbank market. A deliberate clean up of bad loans in preparation for equitization may also explain their low return on assets, although higher operational costs are almost certainly part of the explanation too.

Combined lending by JSBs, on the other hand, grew by an astounding 95 percent. The rate of growth was much higher for some individual banks. This reflected an aggressive attempt to gain market share. By the time the stabilization package was adopted, in March 2008, the share of JSBs in

total banking credit was estimated to be close to 30 percent, up from roughly 12 percent in 2001, when reforms accelerated. This amounts to a fundamental transformation of the banking system in Vietnam. But it also raises questions regarding the quality of lending, hence the potential vulnerability of JSBs and, by extension, of the banking system as a whole.

Main creditors

In the initial stages of Vietnam's transition to a market economy, most banking credit went to SOEs. But their share has been declining steadily, to account for 31.1 percent of total outstanding loans in March 2008, when the stabilization package was adopted (Figure 7.2). There have been repeated claims that reckless borrowing by SOEs was one of main driving forces behind the rapid credit expansion of late 2007 and early 2008. However, in 2007 bank lending to SOEs grew by 52.9 percent, compared to 54.3

Table 7.2: Key Financial Ratios for SOCBs

	Vietcombank		BIDV		VietinBank		VBARD	
	2006	2007	2006	2007	2006	2007	2006	2007
Assets (million dollars)	10,443	12,274	9,852	12,518	8,432	10,660	15,704	18,090
Equity (million dollars)	625	698	276	543	349	682	698	1,099
Return on average equity	25.7	20.6	14.2	24.4	10.8	14.1	11.8	30.2
Return on average assets	1.5	1.2	0.4	0.9	0.5	0.8	0.5	1.6
Net interest margin	2.31	2.35	2.43	2.70	3.20	3.43	4.06	3.41
Equity/assets	6.0	5.7	2.8	4.3	4.1	6.4	4.4	6.1
Equity/loans	15.3	11.9	4.7	7.0	7.0	11.0	5.9	8.5
Loans/deposits	41	48	71	79	76	82	97	87
Loan growth	10	44	18	34	8	25	18	12
Fitch rating				D		D		D

Source: Financial statements reclassified by Fitch. All figures are in percent, except when otherwise indicated. Figures for VBARD in 2007 are for the first nine months of the year.

Table 7.3: Key Financial Ratios for JSBs

	ACB		Sacombank		Techcombank		VIB Bank	
	2006	2007	2006	2007	2006	2007	2006	2007
Assets (million dollars)	2,781	5,308	1,543	4,014	1,072	2,457	1,029	2,443
Equity (million dollars)	106	389	179	457	105	230	74	136
Return on average equity	33.9	44.3	19.8	27.4	15.3	24.4	16.4	18.3
Return on average assets	1.5	2.7	2.4	3.1	1.5	2.3	1.2	1.1
Net interest margin	2.38	2.02	3.47	2.58	3.29	3.26	3.05	2.54
Equity/assets	3.8	7.3	11.6	11.4	9.8	9.4	7.2	5.6
Equity/loans	10.0	19.8	20.1	20.9	19.5	18.7	13.1	13.1
Loans/deposits	45	45	68	65	59	60	61	56
Loan growth	81	87	71	146	64	130	73	82
Fitch rating		D		D				

Source: Financial statements reclassified by Fitch. All figures are in percent, except when otherwise indicated. Figures for ACB in 2007 are for the first nine months of the year.

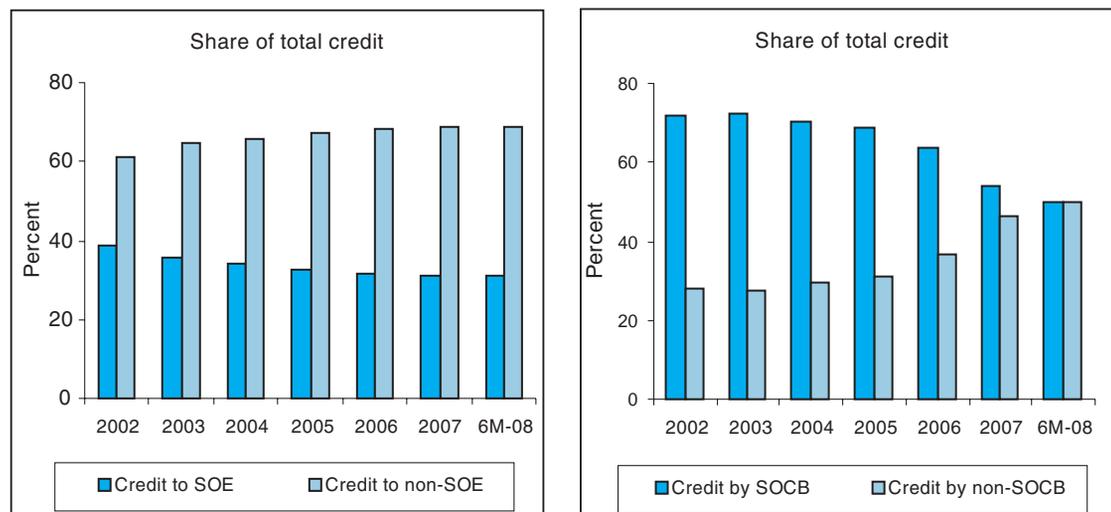
percent for credit to other sectors. In reality, the distinctive feature of this period is that for the first time in years the share of SOEs in banking credit remained roughly stable, instead of declining.

Interestingly, this relatively strong borrowing by SOEs is not so much associated to SOCBs as it is to JSBs. This is a new development, as JSBs had hardly lent to SOEs prior to 2007. But with the expansion of Economic Groups and large State Corporations into booming areas, such as finance and real estate, lending to large SOEs seemed both profitable and safe. And it provided an easy way for JSBs to recycle their excess liquidity.

Direct lending to purchase shares was much more subdued. In this respect, Vietnam benefited considerably from the restrictive regulations imposed in early 2007 to address what was then a worrisome increase in stock market prices.

The stock market boom of early 2007 was the first manifestation of the asset price bubble that was about to come. While the VN Index was around 315 in November 2005, by March 2007 it had reached 1,171. Over that short period of time, stock market capitalization skyrocketed from 2 percent of GDP to over 40 percent. The average price-to-earnings (P/E) ratio at the peak was about 37, roughly three times higher than the usual rule of thumb. Fearing the ensuing burst, in May 2007 the government capped lending for securities at 3 percent of total lending for each bank, which took effect by year end. The cap was reset at 20 percent of the chartered capital of each bank in February 2008. Because of this cap, rapid credit growth did not directly fuel the stock market. By February 2008, right before the stabilization package was adopted the VN Index was trailing at around 700.

There were no similar, restraining mechanisms

Figure 7.2: How Much Borrowing by SOEs?

Source: Based on data from SBV.

in place in relation to property, and as a result lending for real estate investments soared. Those investments are relatively heterogeneous, as they include anything from housing developments to industrial parks to hotels and golf courses. In light of this heterogeneity, various measures of the share of lending going into real estate could be produced. By some accounts, about half of all loans currently have property as collateral. However, direct lending to real estate investments peaked at around 10 percent of outstanding credit in early 2008, compared to 3 percent at the beginning of 2007. This is not a trivial increase. Given the expansion in the overall volume of credit, it means that some 80 trillion dong, or 7 percent of GDP, were channeled to the real estate sector in just a few months.

How vulnerable?

The tight monetary stance adopted as part of the stabilization package in March 2008 led to a sharp increase in interest rates and the bursting of the real estate price bubble.

Lending rates reached 21 percent per year, and that is without counting disguised fees. Combined with fiscal adjustment and a slowdown in industrial countries, economic activity decelerated. Borrower stress can therefore be anticipated, and it could lead to an overall deterioration of bank assets, especially as credits coming due need to be renewed and their interest rate adjusted. A few of the smaller, formerly rural JSBs were already facing difficulties around May 2008. Although the SBV supported them out of its refinancing window, the overall deterioration of loan quality is a matter of concern. However, it is not bad enough to bring sizeable banks down or trigger a confidence crisis among depositors.

The rapid deceleration of credit growth is certainly depriving businesses from access to working capital and dissuading them from undertaking new investments. But high lending rates did not have an immediate impact on outstanding loans. Common maturities in Vietnam are six and twelve

months, and roughly six months after the stabilization package was adopted interest rates were easing again. More importantly, there is a cap on the penalties that apply for repayment delays, at 150 percent of the interest rate of the loan. This means that for a loan contracted before the stabilization package was adopted, say at a 12 percent interest rate, the maximum charge applying on rollovers is 18 percent, less than the highest lending rate so far.

Another reason why a massive increase in the share of bad loans is unlikely is the relatively low leverage of business in Vietnam. In 2007, the average debt-to-equity ratio of the 48 largest companies listed in the stock market was about 0.6, much smaller than in industrial countries. Admittedly, the higher-end tail of the ratio matters more than the average, so that the economic slowdown could still affect businesses and contribute to a deterioration of loan quality. However, the slowdown is relative in the case of Vietnam, as GDP growth is likely to remain strong in the coming years, even amidst the global financial crisis.

Leverage is higher in the state sector, given that SOEs traditionally had better access to credit. For Economic Groups and large State Corporations, the average debt-to-equity ratio stood at 1.36 at the end of 2007. In this case, the high-end tail includes some cases with very sizeable leverage, such as Vinashin, Lilama and Cienco 5. It can be argued that these SOEs have a secure revenue stream, and if they were to confront liquidity problems they would be unlikely to default, given their strategic importance for the government. Therefore, the impact of poor performance by these

large SOEs is better seen as a contingent liability for the government budget, rather than a direct risk for the banking system. But attention is needed in their case.

The drop in asset prices is another area of concern. The VN Index declined steadily as a result of the stabilization package first and the global financial crisis subsequently. Bond prices declined heavily when interest rates skyrocketed. Vietnamese accounting standards do not require mark-to-market, so that investment losses are not reflected in financial statements. This calls into question the profit figures reported by many banks in 2008. Due to the cap on lending to buy shares, the exposure of the banking system as a whole to stock market fluctuations is limited. Exposure was higher in the case of bonds. Among the 11 JSBs for which data are available, government bond holdings accounted for 6.5 percent of total assets by the time the stabilization package. But with interest rates sharply down, the losses of the banks which kept their holdings should be limited.

The main concern is, no doubt, the slump in real estate prices. Unfortunately, there is not enough data to assess how large it has been. Based on piecemeal evidence, prime office space, tourist resorts, industrial parks and residences for expatriates are holding well. Strong FDI sustains the demand pressure in this segment. On the other hand, declines of 30 percent and more in the residential property market for local residents in urban areas seem common. This segment was heavily influenced by speculators, many of whom have left the market by now. However, restrictive lending regulations may play a mitigating role in this case. Indeed, Vietnamese banks were not allowed

Box 7.2: Assessing the Quality of Bank Lending

Credit risk assessment is regulated in Vietnam by Decision 493, issued by SBV in April 2005. In its article 6, consistent with Basel I principles, this Decision instructs all banks to classify each loan in five categories, from performing to total loss, based on quantitative performance indicators such as the number of days overdue and whether or not there was a rollover. According to article 7, in line with the Basel II agreement, credit risk needs to be assessed based on the expected financial situation of each customer.

Based on article 6, the share of non-performing loans (NPLs) of the entire banking system stood at 1.46 percent as of March 2008. It is widely accepted that this is an under-estimate, but there is less consensus as to how large the real figure is. Previous assessments conducted for the four largest SOCBs around 2004-2005, using the Basel II approach, suggested that the real NPL figure could be around three times higher than the figure based on loan servicing. It is also understood that loans approved during the period of rapid credit growth could be of a lower average quality.

A credible analysis of loan quality based on article 7 is available in the case of BIDV. In preparation for equitization, BIDV hired international consultants to classify loans based on Basel II criteria, using a set of 42 indicators. This exercise put the share of NPLs at 3.7 percent, compared to 2.8 percent based on article 6. A recent Fitch report cited a NPL share of 14.4 percent in the case of Vietcombank. However, the reliability of this estimate is not guaranteed.

Assessments of credit risk could also be accessed in the case of three of the five largest JSBs. In their case, the application of article 7 actually results in a lower share of NPLs than implied by article 6. This is because credit rollover automatically makes a loan non-performing under article 6, even if the borrower is solvent. Rollover is common in Vietnam due to the obligation for banks to match the maturity of their loans to that of their deposits, which are mainly short term. Based on article 6 the share of NPLs in these three banks had increased from 2.5 percent at the end of 2007 to 2.9 percent in the first quarter of 2008.

If these numbers are actually correct, the quality of banking sector assets is manageable though not impressive. However, a rapid credit growth temporarily brings down the share of NPLs by inflating the denominator. With the extraordinary credit growth in 2007, financial soundness depends very much on how the new credits extended will perform. Until more time elapses, the quality of those new credits may not be fully revealed by a conventional audit process. Forward-looking stress tests are more reliable tool to assess credit risk in the current environment.

to lend for property beyond 50 percent of its value, and the latter was set at 70 percent of the market reference point. With loans not exceeding 35 percent of the initial value of

the collateral (= 0.5×0.7) there is room to absorb a large decline in property prices, probably larger than anything Vietnam has experienced so far.

If the risk of a banking crisis seems low, a decline in the overall quality of the lending portfolio is almost certain. Unfortunately, credit risk assessment remains rudimentary in Vietnam, making it difficult for the authorities to monitor the situation of individual banks and to adopt timely corrective measures (Box 7.2). Credit performance is still evaluated on a loan-by-loan basis, using quantitative backward-looking indicators. All commercial banks

were supposed to have established their own internal credit risk rating systems by May 2008, and SBV was supposed to certify the soundness of those systems. However, by end 2008, only two out of 83 commercial banks had completed the process. Pending this very important change, and given the relative ignorance regarding the quality of the lending portfolio, it would be prudent to increase capital adequacy ratios.

8. EQUITY INVESTMENT

While offering opportunities for investors, the stock market helps mobilize risk capital for businesses. This capital is precious because it enables to raise a much greater amount of debt finances by leveraging. The stock market also provides a mechanism of corporate governance, a critical determinant of business success. Building on the equitization process and the hundreds of thousands of shareholders it created, a vibrant stock market developed in Vietnam. In the initial stages, most transactions took place in the informal market. But since end-2006 the number of stock listed and the number of market participants ballooned. Stock market capitalization has grown in a less steady way, alternating between boom and slump. The stabilization package adopted in early 2008 and the subsequent global financial crisis have brought share prices down, dramatically. But the overall development remains impressive, with one of the main strengths of the Vietnamese stock market being its ability to mobilize new capital, rather than just serve as support for secondary trading. The equitization of large SOEs and SOCBs should support a continued dynamism in the coming years. Looking forward, the Vietnamese equity market would benefit from the integration of its two stock exchanges into one, and the consolidation of relatively small securities companies into bigger entities, capable of

underwriting major public offers. There is also a scarcity of institutional investors, although the SCIC is bound to become an integral part of market development. For now, improvements are needed in the infrastructure of the stock exchanges, so as to cope with larger trading volumes and handle remote access. Importantly, increased transparency would strengthen the corporate governance role of the equity market. There is also some evidence that listing has been associated with better management in equitized SOEs, but more is needed in terms of compliance with disclosure requirements. Looking forward, the emergence of self-regulatory organizations should be encouraged. Self-regulation would be particularly important in the case of the informal stock market.

Ups and downs

The combined market capitalization of the Ho Chi Minh Stock Exchange (HOSE) and the Hanoi Stock Trading Center (HaSTC) grew dramatically between December 2005, when it accounted for roughly 2 percent of GDP, and March 2007, when it peaked at 43 percent. By way of comparison, the target set in February 2006 by the government was to reach a stock market capitalization of 15 percent of GDP by 2010. In light of these developments, the 2010 target was revised up to 50 percent in August 2007.

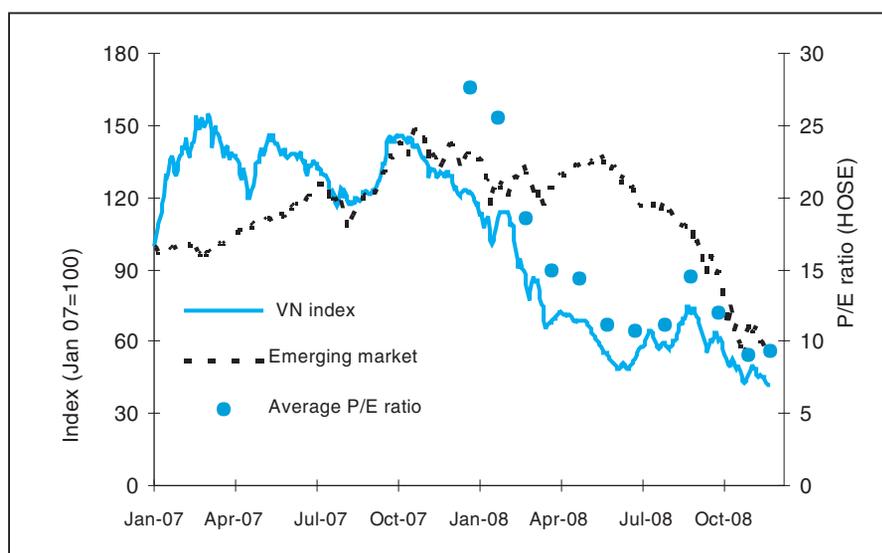
Share prices declined subsequently. Concerned about a possible bubble, the government imposed a cap on bank lending to purchase securities, at 3 percent of outstanding loans first and 20 percent of chartered capital later. Then, the stabilization package adopted in March 2008 constrained liquidity even further. More recently, the global financial crisis has prompted foreign investors to sell shares and repatriate their proceeds. As a result of all these developments, stock market capitalization had declined to 15 percent of GDP by end-2008 (Figure 8.1).

The decline in share prices should not be interpreted as a set back, or even as a major slowdown, in the development of the equity market in Vietnam. The number of listed companies has increased by fivefold to reach 329 by the end of November, 2008. Out of them, 167 are with HOSE and 162 with HaSTC. The number of licensed securities companies has also increased, to 98; the

number of investment management companies to 42, and the number of custodians to seven. In addition to the HOSE and HaSTC, there is a so-called over-the-counter (OTC) market, operating mainly with non-listed shares of equitized SOEs.

It is legitimate to ask whether a market of Vietnam's size needs two stock exchanges, especially because role sharing between the two markets is not very clearly established. In principle, companies listed in HaSTC are smaller, as the market operates on less stringent listing requirements. In practice, however, HaSTC lists businesses of quite significant size so that it effectively competes with HOSE. A stock market benefits greatly from liquidity, and higher liquidity is achieved by concentrating trading activities. A liquid market tends to attract more issuers and more investors. Most emerging market economies, except for very large economies like China's or India's, have only one, centralized exchange.

Figure 8.1: Stock Market Trends and Fundamentals



Source: SSC and SSI.

Today, exchanges compete across the national boarder to attract issuers and investors. Thus, the benefit of having competition within a country is becoming less obvious. In light of all this, the possibility of consolidating or integrating the two exchanges should be considered.

Main stocks

The initial development of the stock market was closely linked to the equitization process. Since the beginning of this process until October 2008 some 3,800 SOEs were equitized. While many of them are relatively small, by some estimates the process created more than 300,000 small shareholders. Anecdotal evidence suggests that a substantial amount of consolidation occurred through the informal market which, by some accounts, was about five times bigger than the official stock market by 2005. In fact, some of the boom in stock market capitalization observed since the end of 2006 is related to the migration of stocks from the informal stock market to the HOSE and HaSTC trading platforms.

Equitized SOEs will continue to be the backbone of the Vietnamese stock market in the near future. As of June 2008, 1,824 SOEs were still fully in the hands of the state, and they were the largest. Of those, 554 are bound to remain fully owned by the state, but the remaining 1,270 are to be equitized. A total of 189 large SOEs (including local giants such as Mobifone) are scheduled for divestiture before 2010. This is certainly bound to invigorate the stock market.

The number of listed companies which do not have state capital is growing steadily as well. Under the Enterprise Law of 2000

first, and subsequently under the Unified Enterprise Law of 2005, joint stock companies (JSCs) have mushroomed, with 270,000 of them registered by November 2008. About 3,700 are public, which in the Vietnamese context involves having at least 100 shareholders. Of these, some 1,066 have registered with HaSTC for disclosure and 328 are listed with HOSE or HaSTC (Table 8.1).

There has also been active issuance of equity and subordinate debt by banks. An important driver for this development has been the need for banks to strengthen their capital adequacy, which is measured against the amount of risky assets they hold. Banks with strong capital adequacy can extend a greater amount of loans.

Equity investment can take different forms. Initial investment to establish a business by founders, strategic participation in an existing business and the acquisition of a significant stake are all direct investments. The acquisition of a minority stake in an existing business, on the other hand, is considered a portfolio investment. When a stake in an existing business is acquired from a new issue in the primary market, it enables the business to mobilize new capital. When it is done in the secondary market, on the other hand, it does not raise new capital regardless of whether it is a direct investment or a portfolio investment, and regardless of whether it is a minority stake or a strategic share.

A notable strength of Vietnam's stock market has been its ability to mobilize new capital. Many emerging stock markets function primarily as trading platforms. Family owners of businesses are often

Table 8.1: Joint Stock Companies: Public versus Listed

Public	Listed	Public companies registered with the SSC for disclosure and listed on the HOSE	167
		Of which, have some state ownership.	121
	Non-listed	Public companies registered with the SSC for disclosure and registered with on HaSTC.	161
		Of which, have some state ownership.	119
Non-public	Non-listed	Public companies that are registered with the SSC for disclosure but not registered with HaSTC for OTC trading.	1.066
		Public companies that are neither registered with the SSC for disclosure nor registered with HaSTC for OTC trading.	About 3.000
Non-public	Non-listed	Non-public companies.	267.000

Source: SSC, HOSE, and HaSTC.

unwilling to accept the influence of outsiders or even the disclosure of information. In Vietnam, because many companies started with state ownership and came to the market through the equitization process, they are not constrained by a similar lack of motivation to go public. On the contrary, additional share offerings and new listings continue even when the market is down. Although many of additional share offerings are made as rights issues and stock dividends to existing shareholders, new IPOs and new listings continue as well.

Market participants

Vietnam's investor base is still small. There are 450,000 securities accounts in the country. Of those, 12,535 are held by foreigners including both individuals and institutions. The relatively large number of foreign individuals directly holding investment accounts is another characteristic of Vietnam's stock market. Each investor is allowed to have only one account so far.

Therefore, the number of accounts represents that of investors in the market. This "one-account rule" creates significant inflexibility and inconvenience for large institutional investors who wish to disguise their identity when buying or selling particular securities in order to avoid having an impact on the share price.

There are 21 investment funds managed by 42 investment management companies. About one quarter of their portfolio is in listed equity and the rest in OTC stocks. About 80 percent of the foreign portfolio investors are closed end funds, with a horizon of five to ten years. Closed end funds issue fund certificates only once to the public and they are not allowed to buy back shares from investors or issue additional units. Investors trade shares on the secondary market without affecting the fund's capital source. The total capital of these funds is always stable and unchanged throughout the operation time. Closed end funds thus provide a stable source of capital.

However, a small number of open funds were established in 2007.

By November 2008, the stock trading code had been granted to 858 foreign finance institutions, a five-fold increase from June 2006. About 30 percent of them have actually invested in the Vietnamese stock market so far. They include well-known groups such as Citigroup, Deutsche Bank, Credit Suisse, and JP Morgan. The remaining institutions are still studying the process or are only investing in JSCs in the banking and telecommunication sectors. While portfolio inflows were substantial in 2007, the subsequent decline in share prices and the sales prompted by the global financial crisis have brought their equity holdings to around 3 billion dollars only.

There are 98 licensed securities companies in Vietnam today. Many of them are members of both exchanges but some participate in only one of them. Many leading securities companies are owned by banks and insurance companies. A few, including the leading Saigon Securities Inc., have foreign partners. A couple of them are owned by the governments of Hanoi and HCMC. Yet, many Vietnamese securities companies are small and not capable of underwriting a large public offer by a major enterprise. There would be merit in promoting the consolidation of securities companies into a smaller number of larger firms.

Securities companies are not allowed to provide margin accounts for investors. Instead, banks have been providing credit against securities as collateral, though limited in volume by regulation. Securities lending, borrowing and short-selling are also prohibited. Therefore, securities companies

are taking little liquidity risk. The weak settlement system requires investors to shoulder the cost of the inefficiency in the form of pre-payment and pre-delivery of securities ahead of trading. The practice, while helping to sustain reasonable systemic stability of the market, imposes high transaction cost and inconvenience on investors.

Institutional investors are still under-represented in the Vietnamese market. There are nine life insurers and 23 non-life insurers; altogether they managed 58 trillion dong in assets as of the end of 2007. Vietnam lacks private pension funds. As for the state-run VSS, it is unlikely to invest in equity in the near future. At only 13.9 percent of their assets are securities investments, equity is not central to the investment strategy of insurance companies either.

Integral to capital market development is the role of SCIC, the holding company responsible for managing the state shareholdings in equitized SOEs (Box 8.1). Its mandate is to enhance the value of the enterprises by restructuring them and enhancing their corporate governance and performance while divesting non-strategic ones and investing in infrastructures. The SCIC can contribute to capital market development, as a major supplier of shares to the market, but it also depends on an efficient stock market to assess the performance of the enterprises it owns and to manage its portfolio. Thus, its sound business practice will directly impact on the market price integrity and transparency.

Organization and supervision

The ups and downs of Vietnam's stock market highlight the importance of

Box 8.1: A Combination of Temasek and Treuhand

The SCIC is modeled after Temasek of Singapore and Khazanah of Malaysia, but it also shares some of the characteristics of privatization funds in the transition economies of Eastern Europe and the former Soviet states, such as the German Treuhand. It started operation in August 2006 and now holds over 800 enterprises with estimated market value of over 2 billion dollars. It expects to eventually receive about 1,400 enterprises, and the market value of the portfolio is expected to grow to 21.5 billion dollars by 2010, or roughly one fifth of the expected GDP then.

On the “Treuhand side” of its mandate, SCIC has to classify the companies in its portfolio into three Groups called A, B and C. It will fully divest from Group C and much of Group B while keeping strategic State stakes in Group A. On the “Temasek side”, SCIC can use the funds raised by divesting remaining state stakes in equitized SOEs to make equity investment in infrastructure projects of national interest. Such equity enables a project to raise a much greater amount of debt at lower cost, thus enhancing the project feasibility.

However, to effectively contribute to the restructuring and governance of the enterprises in its portfolio, the SCIC needs a sound database and effective management of insider information. To divest non-strategic enterprises without disrupting the market, SCIC has to be able to appropriately value its assets and time the divestment while coordinating with the SOE equitization. To meet this challenge, it also needs competent systems for investment management and associated skills and expertise as well as sound business procedures and professional ethics. In addition, because it holds a large number of enterprises not listed in the formal market, SCIC needs to build an information network to reach out securities companies and find out market prices for OTC-traded companies. Valuing them frequently is necessary to measure their portfolio performance and handle their divestiture. The network capacity in question can be conceptually similar to one required for HaSTC to monitor the OTC market. Thus, the SCIC and HaSTC should consult each other to avoid the duplication of investments.

improving its regulation, upgrading its infrastructure and strengthening its supervision. On the regulatory front, the Securities Law that came into effect in 2007 substantially broadened the scope of responsibility of the SSC and achieved a significant improvement in the overall legal framework for capital markets. Among other things, it required all public companies to disclose audited financial statements regardless of whether they are listed on an exchange. Given the large number of stocks

being traded unofficially, this is an important move in the direction of transparency. But limited supervision capacity will make enforcement difficult.

Progress has also been made on trading infrastructure. The HCMC Stock Trading Center was recently transformed into a formal stock exchange (HOSE) and is now implementing the upgrading of its trading system to cope with growing trading volumes and to handle remote access. It should also

build in a stock watch system and a circuit breaker to monitor abnormal price and volume movements and control market overheating. Meanwhile, market participants already started demanding for derivatives instruments such as options and futures in the stock indices, foreign exchange, interest rates and government bonds as well as some commodities. This situation requires Vietnam to start upgrading them today with an aim to develop a modern market infrastructure rather quickly but in steps.

On the other hand, HaSTC has yet to upgrade its trading system. It not only needs to accommodate the growing volume and diversity of stocks being traded but also is charged with a responsibility to monitor the large OTC market. In addition, it is expected to build a bond trading platform. Vietnam's corporate and municipal bond market picked up in recent years thanks to demand from foreign portfolio investors. An effort is now needed to establish benchmarks and extend to the secondary market. But a bond trading platform is substantially different in terms of its design (membership, accessibility, fee structures, trading algorithm...) from a stock market platform. This will require that HaSTC accommodates to a different institutional setup.

Vietnam Securities Depository (VSD) would also benefit from an upgrade. Its mandate is to safe-keep traded securities and to facilitate corporate actions by the issuing companies, such as proxy voting at general shareholders' meetings, dividend payouts and the like. But data input at VSD is still operated manually. Looking forward, the VSD system should be integrated with the central public company registry, so as to enhance the integrity of securities ownership, settlement finality and

market transparency. The VSD system should also be linked with the inter-bank payments system to ensure safe and efficient settlement of transactions, particularly, the delivery-versus-payments settlement. This link is critical because VSD houses government securities which generate large value transactions, requiring sound risk management and time-critical settlement. Currently, the settlement of exchange-listed securities is supported by BIDV. The arrangement is creating considerable risks to market participants as well as to BIDV itself, as the trading volume increases.

On the supervision side, the monetary authority needs to be able to monitor capital flows in and out of the country. But stock market data is aggregated, making it difficult to identify flows related to foreign indirect investment. To find out, a better coordination is needed between SSC and VSD. Foreign portfolio investors are supported by global custodians who in turn rely on local sub-custodians to effect settlement of trades. This is an inescapable arrangement for portfolio investors in Vietnam, where VSD does not accept direct participation by global custodians overseas. Local custodians (and there are seven of them licensed in Vietnam) have to provide essential services such as daily net asset value calculation on a daily basis. Based on this information, it would be possible to know which securities or assets a foreign investor is holding and how much they are worth.

Increasing transparency

Apart from mobilizing risk capital, the stock market provides a mechanism of corporate governance. For equitized SOEs, in particular, listing could represent an important additional

step in the quest for state sector efficiency. However, inadequate disclosure of information by public companies makes it difficult to assess the fundamentals of the underlying business and encourages speculation. Whether listing has an impact on the way a company is run remains is, in the end, an empirical question. In the case of Vietnam, there is some preliminary evidence

to suggest that it makes a difference (Box 8.2).

This said, a significant portion of the public companies traded outside the stock exchanges has yet to comply with the requirement to disclose audited financial statements. The auditing industry lacks a capacity and expertise to deal with this mounting task. The situation obscures the

Box 8.2: Does Listing Improve Performance?

Among the equitized SOEs traded in HOSE, several have disclosed audited financial statements both before listing and for the three subsequent years. For these SOEs, it is possible to compare performance before and after listing, along dimensions such as profitability, liquidity, working capital management, investment policy and cashflow. This can be done by averaging performance indicators for the year prior to listing and for each of the three subsequent years, irrespective of the actual calendar year of listing. This is not a rigorous impact evaluation, to the extent that it does not involve a matched comparison group (for instance, a set of equitized SOEs not listed, over a similar period of time). Yet, the exercise provides some interesting insights.

Applying this approach to a sample of 21 equitized SOEs, it appears that their profit margins declined after listing. The main driver seems to have come from the pricing side of the equation, with declines in prices not being offset by similar declines in costs. However, the results also suggest that these firms improved their working capital management practices after listing. This was due to a better receivables management, with average days receivable across the sample as a whole falling from approximately 100 days before listing to around 60 days by the third year.

While improvements to working capital management had a positive impact on the free cash flow position of the sample as a whole, this was offset by increased capital expenditures, particularly in the first and second year after listing. One possible explanation is that the capital stock of companies was close to the point of obsolescence. The increased managerial freedom and access to finance associated with listing may have provided managers with the capacity to rejuvenate their enterprises.

Consistent with the increase in capital expenditures, there is also a noticeable change in the financing strategies adopted by firms in the period after listing. The equitized SOEs in the sample did increase their reliance on debt capital, relative to equity capital. Much of the additional debt taken on by the firms in the sample was short term. This may simply reflect the difficulties faced by enterprises in the absence of deep and liquid debt capital markets.

Source: Cuong Duc Pham and Tyrone M. Carlin (2008).

judgment on the stock market valuation based on P/E ratio or any parameter based on accounting information.

Public companies could be supported by an e-disclosure system to facilitate their compliance with regulations. The SSC and institutional market participants should also consider adopting an e-registration system for licensed market professionals. Such a system should be linked with professional examination, certification and training documentation. This would help the supervisor in the monitoring of professional conducts and would also make it easier for securities companies and investors to conduct background checks.

At the same time, licensed market participants should be required to develop a strong compliance program and promote compliance culture. This would require an appropriate corporate governance mechanism within the licensed market participants. For instance, they could be requested to have an independent compliance unit reporting directly to the board of directors and accountable to the SSC. Such a governance mechanism and its effective operation should be made part of the licensing requirements not only at entry but also for continuous operation. The latter would in turn require the SSC to be able to periodically inspect its adequacy. A code of good corporate governance for listed companies should also be developed in consultation with the stakeholders.

Looking forward, there are second-

generational issues already emerging in relation to self-regulatory organizations (SROs). The concept of self-regulation and the role of SROs are not well defined in Vietnam, probably due to the fact that the exchanges and the central depository started as a government agency. But self-regulation is a serious business. An entity must satisfy appropriate institutional conditions and capacity requirements in order to qualify as an SRO. The plan to corporatize the exchanges into for-profit business entities will likely complicate the extent to which they can play the role although corporatization may generate more overall benefits than costs.

Self-regulation would be particularly important in the case of the informal market. Indeed, there is no effectively enforceable regulation nor code in place with respect of unlisted stock issuers. But the unlisted stock market is bound to stay alive, and will likely grow. Some issuers prefer to stay unlisted but see benefits in liquidity of their stocks. Their investors always look for some liquidity, which could be much less than that of listed stocks. Some brokers are slated to expand intermediation of unlisted stocks. Nonetheless, investors of unlisted stocks do not have easy remedy for damage caused for lack of disclosure. Streamlining the unlisted stock market through licensed brokers could be practical under the current circumstances. The brokerage community should impose rules on themselves to govern their operations in unlisted stocks to respect the investor's interest.

9. PRIVATE PARTNERSHIPS

Public Private Partnerships (PPPs) in infrastructure are a promising avenue to finance infrastructure development and increase efficiency in the delivery of infrastructure services. But so far, with the exception of a few projects in the energy sector, PPPs are not taking off in Vietnam. To date, very few projects have involved a competitive selection of investors, and there is a noticeable absence of private foreign investors in projects that have been financed or are currently under preparation. Yet, there is clearly a financing gap that the private sector could help fill in. Assessments based on a rudimentary engineering approach suggest a financing gap in the order of 2 to 3 percent of GDP. A financial approach, taking into account the change in the global economic environment, would yield more ambitious targets. One of the main obstacles for the development of PPPs is the viability gap between the economic returns to a project as perceived by the government, and the financial returns as assessed by the prospective investor. A different perspective on risk and the limited capacity to impose full cost recovery on end-users often imply that the deal needs to be “sweetened” by government in one way or another. The issue is how to do so without incurring an excessive cost for the budget, without accepting large contingent liabilities and without distorting the incentives faced

by the investor. Two main mechanisms can be considered: guarantees and subsidies. Critical to their design is the way risks are allocated between government, the investor and end-users. Good mechanism design and proper costing will be important for the success of any PPP program. But they will not be sufficient. It will also be important to establish an appropriate policy framework, with clear allocation of responsibilities to prepare feasibility studies potentially involving government support, to appraise those studies and to monitor the projects operating under PPP arrangements. For now, the closer Vietnam has to this model is the LDIF model. However, for the PPP program to take off the establishment of a specialized government agency or department under MPI and the involvement of MOF will be needed.

What is a PPP?

By one relatively general definition, a PPP is the transfer to the private sector of investment projects that traditionally have been executed or financed by the public sector. This definition emphasizes the investment dimension of PPPs, but there are at least two other dimensions to consider. First, the private investor often gets the responsibility for the provision of a service through the project; and second, some of the risk associated with the project is transferred

from the government to the private sector. However, PPPs are different from the divestiture of state assets or the contracting out of services. This is because they involve cooperation between the government and the private sector, more in the spirit of a joint venture. There are several arrangements which are able to deliver this sort of cooperation (Box 9.1).

Much of the case for PPPs rests on the relative efficiency of the private sector, but efficiency depends on the degree of competition involved. Unfortunately, the scope for competition is limited in infrastructure, where sunk costs are network externalities tend to create natural monopolies. This is why attempts to bring

the private sector into PPPs often involve the “unbundling” of infrastructure services, so as to focus on its most competitive segments. For instance, there may be little scope to build a second expressway after a first one is in place, but there can be competition for the construction of the first expressway, or for its operation and maintenance.

Some infrastructure services are better suited than others to be procured and provided in a market setting. For instance, power generation, highways, airports, ports, and urban infrastructure tend to have broad commercial appeal. This is not true in the case of services with low cost recovery, such as rural electrification, rural roads or sanitation. In the context of nascent

Box 9.1. PPP Schemes and Modalities

Schemes

Build-own-operate (BOO)
Build-develop-operate (BDO)
Design construct-manage-finance (DCMF)

Buy-build-operate (BBO)
Lease-develop-operate (LDO)
Wrap-around addition (WAA)

Build-operate-transfer (BOT)
Build-own-operate-transfer (BOOT)
Build-rent-own-transfer (BROT)
Build-lease-operate-transfer (BLOT)
Build-transfer-operate (BTO)

Modalities

The private sector designs, builds, owns, develops, operates and manages an asset with no obligation to transfer ownership to the government.

The private sector buys or leases an existing asset from the government, renovates, modernizes, and/or expands it, and then operates the asset, again with no obligation to transfer ownership back to the government.

The private sector designs and builds an asset, operates it, and then transfers it to the government when the operating contract ends, or at some other prespecified time. The private partner may subsequently rent or lease the asset from the government.

Source: IMF (2004).

infrastructure markets, therefore, it is prudent to initiate PPPs in sectors that stand some chance of attracting private investment. In practice, this means that infrastructure plans should consider which type of funding is more appropriate in each case.

However, it should not be taken for granted that PPPs are always more efficient than public investment and government supply of services. In particular, if they are not well designed they can simply be a source of liabilities for the government, so that the savings for the budget are only apparent. Monitoring service delivery under PPPs may also be challenging, which means that trade-offs exist. The issue for government is how to approach those trade-offs.

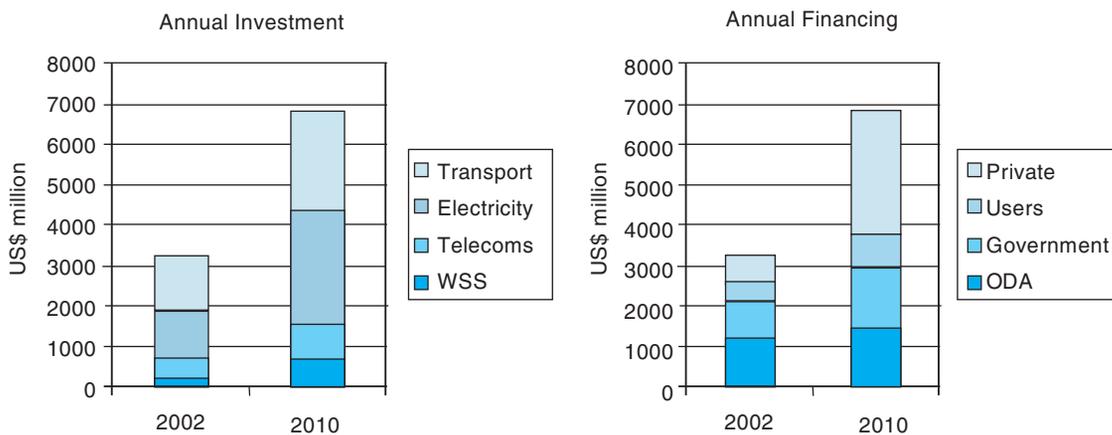
Two gaps

Discussions related to PPPs involve two different gaps. One of them, the financing gap, is the shortage of budget resources to undertake critically important infrastructure investments. The other, the viability gap, results from the difference between the returns associated with an infrastructure

project as seen by the government and as seen by the private sector. In the first case the issue is whether the government can invest on its own if needed. In the second case it is whether a private investor will want to invest if invited.

Discussions about PPPs in Vietnam tend to emphasize the financing gap. It is often said that the current profile of infrastructure funding is unsustainable. Currently, donors meet an estimated 33 percent of the ultimate burden of the investment program. As Vietnam enters the ranks of middle-income countries, its access to concessional finance will start to decline. Due to budget constraints, it is unlikely that the government will increase its funding for infrastructure by a substantial margin. Therefore, the argument goes, the private sector will have to pick up the part of the infrastructure program currently funded by donors. By one estimate, by 2010 the combination of government resources, user financing and ODA will fall short of the total “needs” by 3 billion dollars (Figure 9.1).

Figure 9.1: The Gap between Investment Plans and Available Financing



Source: World Bank (2006a).

This calculation, based on an engineering approach to investment needs, provides a strong motivation to mobilize sustainable magnitudes of private finance for infrastructure. A financing approach could be even more ambitious. The global financial crisis confronts Vietnam with the prospect of an economic slowdown. Supporting infrastructure development would be one way to sustain long-term growth. But the government will face constraints to expand its capital expenditures at a time when it also needs to ensure macroeconomic stability. An ambitious and effective PPP program could help reconcile infrastructure development with prudent fiscal policy.

A key issue is whether the private sector would be interested in filling this resource gap. There are several reasons why a project with high returns from a social point of view may not look profitable from a private point of view. A common way to describe this problem is in terms of a wedge between economic returns and financial returns.

An important reason why this difference in returns may arise is the difference between the government and the private sector in their approach to risk. The government can afford to be more patient than a private investor. When appraising infrastructure projects, governments typically consider a risk-free discount rate to compare future benefits to current costs. But a private investor will start from the interest rate, and add a risk premium. Another typical problem in developing countries is the limited scope for cost recovery. The limited ability of consumers to pay for the services rendered, and the weak capacity of the government to

force them to do so, may result in a diminished interest from private investors.

Given this viability gap, projects valued by government may not be undertaken by the private sector unless they are “sweetened” in one way or another. Some of the most complex issues with PPPs refer, precisely, to the sweetening component, and how to avoid it undermining the gains from bringing in the private sector. As tries to set up PPPs to support its infrastructure program, the government needs to establish a clear mechanism to determine whether public finance support is needed, and under which modalities it should be provided.

Subsidies and guarantees

Two main mechanisms can be considered to bridge the gap between economic and financial returns to infrastructure investments. One of them involves offering a guarantee to the private investor. In this case, the main issue is to identify what exactly needs to be guaranteed. For instance, in the case of an expressway it could be a minimum threshold for the revenue of the investor, or a minimum level of traffic, or a minimum rate of return on investment. And this still leaves the issue of valuing the guarantee, which represents a contingent liability for the government. The other mechanism is to provide a subsidy. In the expressway example, the subsidy could be determined as a certain amount per vehicle, or a certain amount per year.

These choices are not trivial, as they entail a different distribution of the risk between the government, the investor and end-users. A general principle is that risk should fall on the party that is more able to do something about it. For example, if the main risks are

associated with poor management of infrastructure services, shifting the risk to the investor could provide better incentives to make sure that the projects delivers. But this would not be accomplished if the government guarantees the revenue of the private investor (Box 9.2). If, on the other hand, the main risks are related to changes in policies, then the government should bear the risk. However, this is easier said than done. If the government is unreliable in relation to its policies, then it will also be unreliable in relation to the guarantees it offers. This is why policy risk is often mitigated through the use of foreign courts for the settlement of disputes.

Insolvency risk poses a different set of problems. If the investor goes bankrupt, there could be a disruption of service. But the response is not to guarantee the debts of the investor, as this would encourage excessively high leveraging of the project. If the government or end-users bear insolvency risk, then the government should set and enforce limits on the investors' indebtedness. Another important step is to make bankruptcy smoother. Mechanisms need to be in place to ensure that there is no service disruption in the event of a bankruptcy and assets can be rapidly transferred to the creditors or to new investors.

These complex issues can be addressed by establishing clear protocols for the granting of guarantees. For example, the line ministry or agency sponsoring the investment may be requested to demonstrate that the project cannot be undertaken under the PPP regime without a sweetener. An economic analysis may be requested to demonstrate that the project's cash flows are sufficient to cover repayment of the

guarantee. Project sponsors can be requested to supply a substantial portion of equity funds from their own resources.

While guarantees are complex to design and difficult to price, subsidies have the attractive of being relatively easy to auction. In this case, the government designs the subsidy and prospective investors compete on the amount of subsidy to be provided, with the PPP going to the one who asks for less support from the government. In countries where the PPP process is mature enough, the subsidy can be negative. This is what would happen if investors were willing to pay in order to operate the infrastructure services (say, a toll road).

A well-designed subsidy can unlock the impasse between governments seeking to realize efficiency gains in service provision through private participation, and private investors that are able but unwilling to finance projects that are not financially viable. In addition to aligning the interests of government and private investors, subsidies can be instrumental in supporting the principles of a market-oriented infrastructure finance system by generating competition (for the market) in investor selection and increasing transparency.

However, there are several issues to consider in designing the subsidy. The simplest design is under the form of a grant, but a relationship can also be established between the subsidy and the service being provided. For instance, the subsidy may be related to performance, with resources transferred in return for the operator providing, or the end-user purchasing, an infrastructure service. Output-based payments come in many varieties, including

Box 9.2: Successes and Failures in the Granting of Guarantees

The use of government guarantees to help persuade private investors to finance new infrastructure is appealing. It can allow the government to get the infrastructure built without paying anything immediately and to benefit from the skill and enterprise of private firms. But it can cause problems too.

In the 1990s, for example, the government of the Republic of Korea guaranteed 90 percent of a 20-year forecast of revenue for a privately financed road linking Seoul to a new airport at Incheon. The government did not have to pay anything up front and would get to keep any revenue exceeding 110 percent of the forecast. When the road opened in 2000, however, traffic revenue turned out to be less than half the forecast. As a result, the government has had to pay tens of millions of dollars every year. How much it will have to pay over the life of the guarantee is uncertain, but the present value of the liability could be in the order of 1.5 billion dollars.

The government's guarantee may not have been wrong, but it does raise questions. Should the government really have borne demand risk in the project? Could it have estimated the cost of its guarantee before granting the guarantee? If so, should it have disclosed an estimate of the cost in its accounts? More generally, could the government have built the road more cheaply using public finance? Or would it have been better to use private finance without a revenue guarantee, if necessary giving the firm a straightforward subsidy?

These questions are hard to answer even though governments have been using guarantees to help finance infrastructure since the construction of the bridge of Bordeaux in the early 19th century. Later in the same century, Argentina guaranteed railway investors returns of 6 or 7 percent on the capital they invested. The guarantees helped attract investment from foreign capital markets. Yet the government did not always have enough money to meet its commitments, in part because of the difficulty of accurately budgeting for claims and in part because the government usually had to make larger payments just when its tax revenue was low. In time, the guarantees contributed to a fiscal crisis.

It is difficult for governments to make good decisions about guarantees. To start with, there is no agreement among advisers about which risks governments should bear in privately financed projects. Second, government decisions would be difficult even in the absence of political pressures. Psychological research shows that people struggle to make accurate judgments about risks and then fail to make the best use of even their imperfect judgments. Most people, for example, are overconfident in their judgments and therefore think the world is more predictable than it is. Government decision makers may fall into the same trap, underestimating the risks to which they are exposing the public when they issue guarantees.

In sum, governments can easily make poor decisions about guarantees. There is no simple solution to this problem, but good decisions are more likely if three conditions are met. First, the government's advisers and decision makers have a framework for judging when a guarantee is likely to be justified. Second, the government's advisers know how to estimate the cost of a guarantee. And third, the government's decision makers follow rules that encourage careful consideration of a guarantee's costs and benefits.

Source: Timothy Irwin (2007).

consumption subsidies (water sector subsidies in Chile, and rural telecommunications in Chile and Peru), connection subsidies (rural electrification in Guatemala), shadow tolls (privately financed roads in Portugal and the UK). In some cases, both may be provided.

It is also important to determine beforehand the maximum amount of resources to be provided to the investor by the government. Indeed, the share of the subsidy in the total project cost should not be so high as to offset the benefits of additional financing, or the efficiency gains from private sector participation. For instance, the government of India sets the cap at 20 percent of the project cost.

The timing of the subsidy is an important tool for risk transfer, and for ensuring that investors are sufficiently vested in the project. To use India's example again, capital grants are provided at the stage of project construction, disbursements begin only after the private sector company has expended the equity contribution required for the project, and the grant is released in proportion to debt repayments remaining to be disbursed thereafter. Such a disbursement schedule shields the government from making a large unilateral capital contribution into a project before any private financing is spent; it also ensures that having disbursed their share of project capital, the equity providers, seeking to realize returns on their investment, will work to complete the project and claim their profit.

Institutional arrangements

While good economic analysis will be needed to decide whether a viability gap exists between economic and social returns,

and which support instrument would be needed to fill that gap, the success of PPPs will critically depend on the institutional arrangements in place to support them. Without a clear policy framework, an appropriate allocation of responsibilities and resources, and sufficient transparency of the decision-making process, it will be difficult for a PPP program to take off in any significant scale.

The government needs to develop its own technical expertise to manage PPP programs, conduct thorough project appraisal and prioritization, and ensure that PPPs are consistent with broader economic policy objectives. At present, the closer to such institutional framework in Vietnam is the LDIF model (Box 9.3). However, in spite being both expeditious and effective, the LDIF model falls short of the needs of a large-scale PPP program.

There is a need for a comprehensive, multi-sector system to determine when, in what form and to what magnitude, the government should provide support to specific PPP projects. For this to happen, there needs to be a specialized government agency, or a department within MPI, able to provide consistency in approaches across projects. The focus should be on developing a financing framework, and clarifying the elements that are common to all sectors, leaving this agency or department the necessary flexibility to fulfill their responsibilities. The framework should establish simple qualification criteria for government financial support to a project and should provide incentives for the agency or department in charge to gradually develop the process of preparing and bidding out projects for private sector investments. The

Box 9.3: Local Development Investment Funds

LDIFs are special investment institutions designed to provide provincial governments with an operational and legal structure for infrastructure development. They have the legal status of a State Financial Institution of the sub national government, with charter capital and balance sheets of their own. Their mandate is to mobilize medium- and long-term capital from local and foreign institutions and individuals, to make equity investments, to provide loans for investment, to contribute capital to set up enterprises in socio-economic infrastructure development, to handle investment loan provisions and debt recovery, and to act as a trusted institution that manages investment capital. LDIFs are also authorized to issue sub-national government bonds to mobilize capital for local budgets for the provinces and cities.

LDIF investments can include all forms of BOT, BTO and BT. They are able to develop projects and lend money to those projects developed by the private sector. The provincial People's Committee responsible for each LDIF has oversight over the investment policies, particularly where the scale of the investment is above a threshold, relative to the charter capital of that LDIF (usually 10 to 15 percent). Lending terms are a maximum of 15 years, except under special circumstances.

Reliance on such sub-national government investment funds has required considerable oversight, coordination and leadership from MOF. The first law governing LDIFs was promulgated in December 2001. It was followed by significant amounts of assistance to the established funds, culminating in Decree 138 on the Organization and Operation of the LDIFs, issued in August 2007. MOF has established a Project Management Office to support the LDIFs implement these policies and has set qualifying criteria for LDIFs to receive technical assistance and capital funding.

HIFU has been the pilot LDIF in terms of both its investment portfolio and its implementation of the good practice that is now part of Decree 138. HIFU commenced with the implementation of project preparation and private sector participant selection procedures on several pilot projects in the City. These include solid waste recycling, water treatment and urban transport projects. It is envisaged that, with the appropriate MOF oversight and support, the LDIFs will operate in accordance with common rules of engagement with the private sector with respect to the selection of private sector partners by LDIFs and to the concessions and authority granted by the provincial government to the LDIF-funded companies.

Source: World Bank (2008h).

specific contractual obligations to be eligible for guarantees (for instance, minimum revenues) should be identified at the feasibility study stage.

The design and implementation of support mechanisms for PPPs should be undertaken in concert with fiscal risk management considerations. Good fiscal risk management

requires that government make sensible financial commitments to PPP projects, as well as monitor and report their status through the project cycle. To the extent that subsidies and guarantees are part of the government's financial commitments to a PPP project, it is essential for them to be reported, monitored and tracked along with others in a comprehensive manner. Being explicit about the support provided has the benefit of revealing the true cost to government of individual infrastructure PPPs, and instituting early-warning signs of overexposure to fiscal risk.

Feasibility studies for PPP projects involving subsidies or guarantees should therefore be submitted to MOF for approval. The selection of the investor to implement the project, ideally through competitive bidding, should only happen after this approval has been secured. MOF should also be in charge of monitoring the fiscal impacts and contingent liabilities stemming from the PPP

program. One important issue concerns the role of SOEs in infrastructure finance, particularly in projects where private investment is being sought. In this respect, there is a need to differentiate between the role of SOEs as project implementers from their possible role as investors in infrastructure projects. SOEs should not play both roles in the same project.

One particularly critical issue is the establishment of infrastructure finance model that can allow the government to combine public funds, private capital and donor support in one project. Currently, infrastructure projects in Vietnam are financed in these three separate silos, and there are implementation issues in relation to all three. A well-designed policy and institutional framework for PPPs offers the opportunity to leverage and combine all three sources of financing and expertise, without crowding out private investment.

10. DONOR SUPPORT

The amount of resources committed by the donor community has increased steadily. But disbursement rates are low, reflecting the cumbersome procedures that need to be followed to meet both Vietnamese regulations and donor requirements. In addition, in spite of the progress made in harmonization, the fragmentation of donor assistance puts a strain on the government's capacity to handle it efficiently. Assessing the impact of donor support is actually difficult. No obvious counterfactual can be used for operations involving a dialogue over policy reforms, although a series of evaluations related to general budget support operations in Vietnam suggest that they have had a satisfactory impact. For more focused interventions, the available evidence indicates that donor resources are to some extent fungible, at least within the same sector. This means that in spite of meeting donor requirements, they end up supporting other activities because they free resources that the government would have used anyway. As Vietnam enters the group of middle income countries, the volume, composition and terms of donor support are bound to change. The volume of grants will remain roughly stable, whereas the volume of loans will probably increase, before returning to its current level in the first half of the next decade. But the gradual move to less concessional terms as Vietnam enters

the middle-income country group may make it more difficult to provide continued support in non-infrastructure areas. To maintain donor engagement on poverty reduction and the business climate, Vietnam could consider using non-concessional resources for general or sectoral budget support, especially if they can be combined with grants in the context of a harmonized policy dialogue. The other obvious response is to strengthen country systems, so as to reduce the cumbersome duplication of processes. This will require strategic clarity, to focus on the most important gaps with international practice.

Growing but cumbersome

Projects funded through official development assistance (ODA), including loans and grants, are equivalent to roughly 16 percent of total investment in Vietnam, or 33 percent of public sector investments. Not all ODA resources go to capital accumulation, and only 10 percent of the capital for on-budget investments comes from donor-funded projects. However, these figures show that ODA makes a relevant contribution to capital accumulation, in spite of Vietnam not being an aid-dependent country.

The amount of resources contributed by the donor community has increased steadily in the 15 years elapsed since the first

Consultative Group meeting, in 1993. For 2008, donors had jointly pledged the equivalent of 5.4 billion dollars. On average, around three quarters of the pledges materialize under the form of commitments. ODA disbursement, on the other hand, is lower (Figure 10.1). A gap is understandable in a young and growing program, as most projects span several years. But the gap is large in Vietnam, reflecting the cumbersome procedures that need to be followed to meet both Vietnamese regulations and donor requirements.

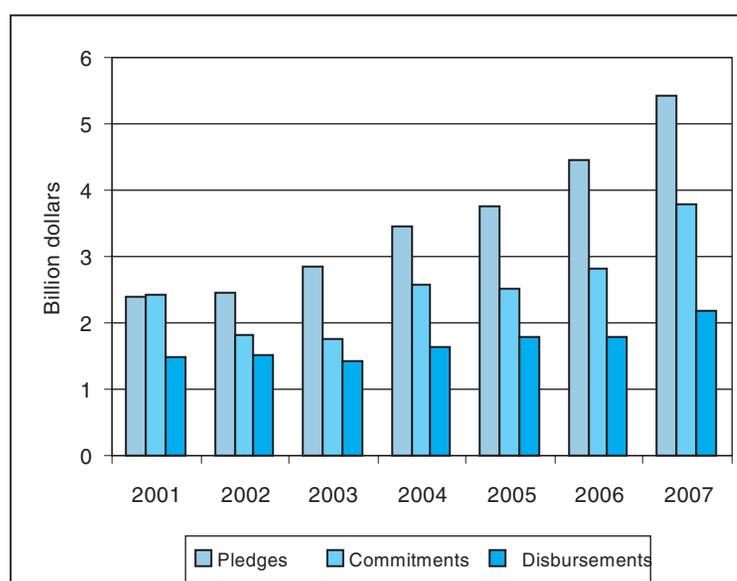
Following a series of reforms introduced between 2004 and 2006, the legal framework for ODA management in Vietnam is relatively comprehensive. It covers planning, budgeting, funds withdrawals, accounting, implementation, disbursement and reporting. A key regulation is Decree 131, issued in November 2006, which provides for the decentralization of ODA investment

ownership, with more discretion delegated to implementing agencies and strengthened oversight by line ministries and provincial governments.

Vietnam has probably gone further than most developing countries in articulating principles, commitments and targets for the coordination of donor support. The Hanoi Core Statement, issued in September 2005, established ambitious objectives in terms of ownership, alignment, harmonization, managing for results and mutual accountability, to be attained by the year 2010. This coordination effort, led by the government, has earned Vietnam an increasing recognition in the international arena.

Despite these clear objectives, the fragmentation of donor assistance still puts a strain on the government's capacity to handle it efficiently. For instance, in agriculture and rural development alone there are as many as

Figure 10.1: Donor Support Looking Backward



Source: MPI.

200 ongoing projects, with some 40 to 50 additional ones agreed every year. While this sector represents an extreme, it is by no means unique. In the health sector, for instance, there are around 75 ongoing projects, mostly below 500 thousand dollars in size, and with 98 percent of them funded by a single donor.

The processes to channel donor resources are cumbersome as well. As ODA constitutes part of the state budget, donor-funded projects must follow the same planning, discussion and decision-making steps as government-funded projects. But ODA projects also have their own, separate appraisal by the corresponding donor. There has been considerable progress in harmonizing the templates for feasibility studies among donors, especially among the development banks providing large loans. But the appraisal processes of donors and government remain on parallel tracks.

Aid effectiveness

Assessing the actual effectiveness of donor support to Vietnam is difficult. Any rigorous assessment requires a counterfactual or, put differently, some credible way to measure what would have happened in the absence of such support. However, in most cases the counterfactual is not observable. Just comparing the situation before and after a donor-funded initiative is undertaken is clearly not sufficient when other changes are happening at the same time, as is often the case in Vietnam. The problem is compounded in the case of initiatives entailing a range of economic changes, as opposed to a narrow, measurable intervention.

Evaluation is particularly difficult in the case of program-based approaches, combining a

policy dialogue with budget support, at either general or sectoral level. Consider Poverty Reduction Support Credits (PRSCs), the annual operations disbursing resources directly to the budget of the government of Vietnam in recognition for progress in policy reform. The preparation of these operations involves year-long technical discussions between participating donors and government on a dozen of key policy triggers (or actions of strategic importance) and an additional three dozen policy benchmarks (or actions of lesser importance, but still capable of making a major difference in economic outcomes). Triggers and actions are spread across all pillars of the SEDP 2006-2010, namely economic development, social inclusion, natural resource management and modern governance. On the resources side, since their inception in 2001 PRSCs have contributed around 1.8 billion dollars to the budget of Vietnam. The most recent operation in the series mobilized around 362 million dollars from a dozen donors, equivalent to one fifth of annual ODA disbursements.

Assessing the impact of PRSCs is difficult for two reasons. First, resources disbursed to the budget are indistinguishable from government revenue from other sources (such as taxes), and are subject to the same appropriation mechanisms as them, so that it is technically not possible to trace them to specific uses. Second, it is not clear how different the policy actions undertaken by the government would have been in the absence of the year-long dialogue between participating donors and government. In some areas, engagement results in important technical improvements; in other, characterized by limited political will,

conflicting institutional responsibilities or insufficient analytical work, the impact is more limited.

Several independent evaluations of the PRSC process in Vietnam have been conducted so far and they have been positive. A review by the Independent Evaluation Group (IEG) rated the outcome of the first series of five PRSCs as satisfactory. Another assessment was conducted after PRSC 4, as part of a broader evaluation of general budget support commissioned by 24 donors for seven countries. This assessment showcased Vietnam as a successful example of government-donor collaboration, with a strong impact on policies. An update conducted one year later by the same team but for Vietnam only concluded that PRSCs were effective at supporting policy reforms, at linking policy and budgets, at strengthening financial management and at helping donor harmonization. At the same time, PRSC operations were judged less effective at supporting policy breakthroughs and at helping policy implementation. They were seen as unable to overcome donor fragmentation in areas like public administration reform.

Assessing the actual effectiveness of donor support to Vietnam is easier in the case of more focused interventions, such as programs targeted to specific programs or to specific communes. In this case, the situation of similar geographic areas not benefitting from those interventions provides an appealing counterfactual. The relevant comparison is then not just between before and after the intervention in targeted areas, but rather between the gains made by areas targeted by the intervention and the gains made by similar, non-targeted areas (in

statistical jargon, impact assessment can be conducted through differences-in-differences methods).

Two recent evaluations of World Bank support to Vietnam, one for the transport sector and one for the health sector, use this approach (Box 10.1). Both conclude that resources were to a large extent fungible, meaning that their availability for targeted provinces and areas allowed government to redirect its own resources to non-targeted provinces and areas. Aid fungibility complicates the assessment of aid effectiveness. If non-targeted areas also benefit from more resources thanks to a donor project, the cleanness of the counterfactual is undermined, and the impact of donor support is underestimated.

Reassuringly, both evaluations conclude that the projects had a positive impact in the sectors they targeted (transport and health respectively). But they also imply that some of the ODA resources were actually channeled through government systems. Indeed, if one additional dollar of donor funding for a specific activity allows government to free X cents to spend elsewhere, then it is as if 100-X cents were processed through donor systems and X cents through country systems. The stronger a country's ownership of its development program, the more likely it is that final resource allocations will be independent of donor preferences. This, in turn, suggests that country ownership and the use of government systems go together.

Towards middle income

As Vietnam joins the group of middle-income countries, there has been speculation regarding the volume and nature of donor

Box 10.1: Aid Fungibility in the Transport and Health Sectors

The first World Bank-financed Rural Transport Project, launched in 1997, aimed at rehabilitating 5,000 kilometers of district and commune level roads in 18 provinces. An evaluation based on independent administrative data shows that the project was implemented as planned, with an average of 4.6 kilometers of roads per participating commune rehabilitated under the project.

However, a simple comparison between participating and non-participating communes shows that the average difference between them is only 2.5 kilometers. It also appears that project communes built more kilometers of new roads than did the non-project communes. This is despite the fact that the project did not finance new roads.

A more rigorous evaluation uses a panel data set of communes and households within project and non-project areas. The dataset comprises a baseline and follow-up data, including information on relevant characteristics of project and comparison areas. The results confirm that resources stayed within the transport sector, but were diverted from rehabilitation to the building of new roads. The results also show that the quality of rehabilitated roads improved in the project communes thanks to a switch away from the donors preferred technology, namely earth road rehabilitation.

Patterns are similar in the health sector. The World Bank's Population and Family Health Project and National Health Support Project were approved in 1996. Around half of the budget of each was directed to 37 of Vietnam's provinces, with the overall objective of improving primary care (especially maternal and childcare) in commune and district health centers. The measures implemented to achieve this goal included the upgrading of facilities, the purchase of equipment, the provision of essential drugs, in-service training and outreach services.

The outcome examined to assess the impact of these projects is infant mortality (deaths among children in the first year of life). Data are from the 1997 and 2003 Demographic Health Surveys, which were fielded at the inception of the projects and at their original closing date. The assessment compares gains in infant mortality between participating and non-participating provinces. However, to account for the possible fungibility of donor resources, an underlying function linking infant mortality to government spending and other determinants is estimated.

The results suggest that the government responded to the World Bank projects by scaling back its planned increase in spending in the project provinces, relying largely on the Bank to finance extra spending (compared to the initial level) in these areas. The projects thus allowed the government to achieve higher levels of spending (gross of World Bank-provided funds) in both project and non-project provinces. But while aid is fungible across provinces within the health sector, there is no evidence of fungibility between the health sector and other sectors in the economy.

Source: Based on Dominique van de Walle and Ren Mu (2007) and Adam Wagstaff (2008).

support it may receive. A standard classification between low- and middle-income countries relies on their Gross National Income (GNI) per person. As of 2007, countries with a GNI of up to 935 dollars were counted as part of the low-income group, and countries with a GNI of 936 to 3,705 dollars as part of the lower middle-income group. A GNI of 11,456 dollars or more was needed to be part of the high-income group. These thresholds are revised annually. Based on their current levels, Vietnam could enter the middle-income group in 2008. This is because in spite of a lower GDP growth in real terms, it experienced a substantial real exchange rate appreciation.

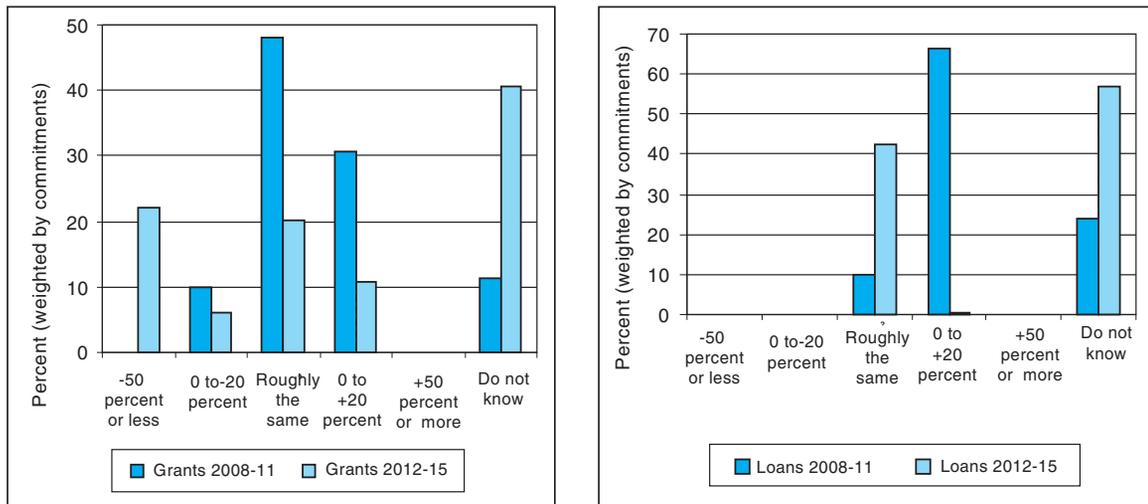
Joining the middle-income group may affect the volume of donor support in two ways. Donors providing grants tend to favor the poorest countries, and allocate fewer resources to middle-income countries. Some of them use the World Bank GNI thresholds as the basis for their own aid allocation rules. As for donors providing loans, they tend to gradually shift to less concessional terms as borrowing countries grow richer.

In the case of the World Bank, countries with a GNI of less than 1,095 dollars per person can borrow from the International Development Agency (IDA), with a 40-year maturity, a 10-year grace period and no interest charge. Countries considered creditworthy can access resources from the International Bank for Reconstruction and Development (IBRD), in terms comparable to those faced by high-income countries. A handful of low-income countries are considered creditworthy, and since 2008 Vietnam is one of them. IBRD loans are more flexible in their terms, depending on

the borrower's needs. They can have a maturity of up to 30 years, their interest rate is very close to LIBOR and their front-end fee is 0.25 percent. IBRD terms are thus more favorable than those usually faced by developing countries, especially at a time when risk premiums are very high. But they are less favorable than IDA terms. From the point of view of the World Bank, Vietnam is now entering a "blend" situation, where IDA and IBRD resources can be combined. After several years with a GNI above the IDA threshold, Vietnam will not be eligible for IDA support anymore. Other development banks have similar rules. The Asian Development Bank (ADB) is currently more advanced in its blending of resources for Vietnam than the World Bank.

In spite of Vietnam's access to middle-income status, donor support may still increase in the coming years. Intentions were assessed through a survey circulated among all the donors who are active in Vietnam. The survey was answered by 15 of them, jointly accounting for more than 4 billion dollars in commitments every year. The results suggest that the volume of grants will remain stable in the foreseeable future, but the volume of loans may increase, before returning to its current level in the first half of the next decade (Figure 10.2).

The survey of donor intentions also revealed some clear patterns in relation to aid instruments, aid modalities and lending terms. Respondents do not anticipate major changes in the volume of resources they devote to technical assistance. There is more dispersion in relation to investment credits, with some donors planning an increase in their volume and others a decrease. There is a clearly stated willingness to provide more

Figure 10.2: Donor Support Looking Forward

Source: Own calculations, based on an informal survey of donor intentions.

sectoral budget support, along the lines of current program-based approaches on Education for All, or on targeted transfers to disadvantaged communes under Program 135 Phase II. But there is considerable uncertainty regarding general budget support. This is probably due to the unclear status of the PRSC series beyond the end of its current five-year cycle. Respondents also anticipate an increase in the volume of resources they channel through non-government counterparts. The expected increase is modest in the case of civil society organizations, but more substantive in the case of the private sector. Those providing loans expect the terms of their combined support to shift to less concessional terms, with two thirds of resources channeled at close-to-market terms after 2012.

Priority areas

The survey of donor intentions does not suggest any strong sectoral orientation for future ODA support. But a recent survey of World Bank counterparts (the so-called

Global Poll) sheds some light on the areas Vietnam wants donors to help with (Table 10.1). The survey had 2,611 respondents from government, the media, academic centers, the private sector and civil society in 42 countries, including 57 participants from Vietnam. The results of the Global Poll need to be interpreted with caution, as country samples are small and questions have different formats (some are open-ended while others offer a multiple choice). Yet they provide some useful insights.

Interestingly, the areas favored by respondents to the Global Poll are not necessarily those considered most important from the point of view of economic development, but rather those in which donors may have the highest potential to make a difference. For instance, Vietnamese respondents see education as the main contributor to rapid economic growth, even to a larger extent than other East Asian respondents. But they do not think that education should be the most important

Table 10.1: What are the Main Priorities?

	Which areas contribute the most to faster growth in your country?		What should the main objectives of the World Bank be in your country?	
	East Asia	Vietnam	East Asia	Vietnam
Poverty reduction	-	-	52	37
Environmental protection	-	-	23	15
Improving education	23	35	12	12
Business climate	33	30	33	24
Improving governance	23	30	10	10
Reducing corruption	21	26	6	10
Infrastructure development	27	18	20	58
Agriculture and rural development	26	16	11	10
Employment/income generation	17	14	4	6

Source: Adapted from World Bank (2008g).

sectoral focus of the World Bank program. A similar gap can be seen in relation to the fight against corruption.

More generally, the Global Poll indicates that Vietnamese respondents see education, the business climate and improved governance as the main avenues to prosperity. But they expect the World Bank to help on infrastructure development, poverty reduction and the business climate. Only the business climate can be found in both top-three lists.

Supporting these priority areas will be more challenging as Vietnam enters the ranks of middle-income countries. The experience of China at a similar stage in its development process is revealing in this respect (Box 10.2). It suggests that maintaining policy lending and support for the social sectors as active areas for donor engagement as Vietnam becomes a middle-income country

will require a deliberate government choice. Absent that choice, there is a risk of seeing donor support gradually drifting away from more direct contributions to poverty reduction and the investment climate. Infrastructure finance would still contribute to capital mobilization. It would also help introduce better practices in project preparation and implementation, from planning to financial management to environmental and social safeguards, allowing the Vietnamese government to scale up what works, as the Chinese government has been doing consistently. But an early disengagement from the social sectors and from policy reforms related to the business climate could amount to a missed opportunity.

The cumbersome procedures for the disbursement of investment credits, together with the experience accumulated with PRSCs, indicate a possible way to maintain

Box 10.2: China's Graduation from Concessional Lending

While China was still a low-income country, the World Bank's strategy differed from that for other countries in two important respects.

First, it consistently emphasized lending for infrastructure. This was at a time when such lending was falling worldwide, due to excessive optimism regarding private sector participation in infrastructure and enormous caution in relation to the environmental and social impacts of large infrastructure projects. Second, budget support was not an important instrument. China was actually reluctant to accept any form of conditionality, and over the entire history of World Bank support to the country there was only one adjustment loan involving policy conditionality, for the rural sector. On the first dimension, there is a clear similarity between China and Vietnam; on the second one, there is an obvious difference.

As China approached middle-income levels, World Bank support was affected by two negative developments.

First, IBRD exposure ceilings on the share of the portfolio allocated to a single country constrained the World Bank's ability to lend. The volume of resources provided to China had never been large relative to the size of the country. In 1994, at its height, it reached 3.3 billion dollars, or 0.6 percent of GDP. But IBRD ceilings brought that volume down to less than 1 billion by 2001.

Second, the World Bank stopped providing IDA support to China from 2000 onwards. Although plans to switch from blend to all-IBRD lending had been considered earlier, the loss of IDA resources was a disappointment to the government and placed strains on the World Bank's relationship with China. IDA donors decided that China was sufficiently creditworthy to dispense with IDA funding. The government thought this unfair because per capita GDP was still below the cutoff line at that time and because there were still some 200 million people in China with consumption below a dollar per day. The government also felt that Bank senior management could have fought harder to retain China's access to IDA.

The shift to all-IBRD terms, more than the overall reduction in lending, complicated the World Bank strategy in China. Beneficiaries right down to the village or individual farmer level are responsible for loan repayment. With the loss of IDA, the World Bank is constrained from shifting its lending to lagging regions and from maintaining the level, or even the share, of lending to agriculture, the social sectors and poverty projects. This is because of the difficulties these regions and sectors would have in repaying IBRD. An innovative arrangement, in which DFID blends grants with IBRD loans to simulate IDA terms, offers an opportunity for the Bank (jointly with DFID) to remain engaged in social sectors and poverty projects. By also maintaining a relatively high level of lending for infrastructure, the Bank aims to increase the share of lending to poorer, inland provinces.

Source: Adapted from World Bank (2005).

donor engagement in non-infrastructure areas. This is to use non-concessional resources for general and sectoral budget support operations. By disbursing through country systems, budget support reduces some of the transaction costs associated with investment credits. Because it is associated with policy reforms, it may also contribute to poverty reduction and the improvement of the business climate. And given the extent of donor coordination attained in Vietnam, support in non-concessional terms by some donors can be blended with grant support by others to deliver overall terms close to those IDA can offer at present.

Country systems

Using country systems involves including ODA resources in national or provincial budgets, reporting on their use through the government's accounting system, and having the expenditures audited by or in cooperation with the State Audit of Vietnam. To qualify as using country systems, at least half of the resources contributed by a donor need to meet these standards. Currently, it is claimed that 12 percent of aid flows and 42 percent of the donors are using the national budgeting, financial reporting and auditing systems. However, these figures may suffer from inconsistent self-reporting by donors.

However, increasing the use of the government's systems and procedures in procurement, financial management and social safeguards remains a challenge. Apart from general budget support and sectoral budget support, most donors have to comply with practices and standards that are not compatible with those of the government of Vietnam. There is some tension between the understandable fiduciary concerns of

taxpayers in donor countries and their willingness to improve the capacity of recipient countries and entrust them to deliver on aid programs. The tension is exacerbated every time a corruption scandal arises, regardless of whether the scandal is an indication of corruption getting worse or rather proof that the government is serious about fighting it. In those tense times, additional transparency initiatives and control layers tend to be added by donors. While it is not evident that such initiatives effectively mitigate fiduciary risk, they often make the use of ODA more cumbersome, potentially resulting in even lower disbursement rates. Reaching the right balance between fiduciary controls and governance improvements will not happen in the absence of a clear strategy (Box 10.3).

Considerable effort has been devoted to the harmonization of feasibility studies between the government and the development banks operating in Vietnam. Guidelines have been issued specifying the objective of harmonizing procedures and policies of project preparation, appraisal and evaluation. For instance, feasibility studies are supposed to indicate the medium- and long-term results expected from projects, including their possible impact on the poor, ethnic minorities and local people. If the projects involve resettlement, then the compensation mechanism for the affected population needs to be specified.

Reforms of financial management in recent years have also enhanced the effective use and management of ODA. The implementation of a modern Treasury Management and Budget Information System (TABMIS), together with a unified and updated Chart of Accounts, will mark

Box 10.3: The Governance and Anticorruption Strategy

By the late 1990s, corruption had come to be recognized as a scourge for development. An expanding body of research provided evidence of the negative effects of corruption on investment and growth, on the ability of the state to deliver quality services to poor people, and on the effectiveness of international aid. Corruption, once viewed as a localized political issue, came to be viewed as a fundamental problem of economic development.

At the same time, it became clear that controlling corruption could not be accomplished through a purely enforcement-oriented approach. The underlying weaknesses in the system of governance open up the channels through which corruption operates, and addressing those governance weaknesses would be necessary to control corruption, and to support governments to become more effective. During the first decade of open discussion about corruption, the World Bank's emphasis on governance issues expanded and strategies for helping countries reduce corruption and improve governance were developed.

Following a large international consultation with representatives from governments, donors, civil society, parliaments, private sector, academia, and other stakeholders in 35 developing and 12 donor countries, a new strategy was adopted in 2007. Drawing upon the views expressed during the consultation, the Governance and Anticorruption (GAC) Strategy rested upon seven principles:

- The focus on governance and anticorruption is consistent with the mandate to reduce poverty.
- The country has primary responsibility for improving governance.
- Remain engaged even in poorly-governed countries (“don't make the poor pay twice”).
- There is no “one-size-fits-all” approach to governance and anticorruption issues.
- Engage with multiple government, business, and civil society stakeholders in operational work.
- Strengthen, rather than bypass, country systems.
- Work with others toward a harmonized approach.

The strategy itself consists of three main pillars: (i) supporting country efforts to strengthen governance and reduce corruption, (ii) addressing corruption in World Bank operations, and (iii) strengthening global partnerships. The strategy also emphasized that monitoring is key to accountability.

significant improvements. However, government systems are not currently able to adequately budget, account and report for donor-financed projects separately from other funds and expenditures, and as a result a parallel set of financial management

accounting systems is used. To allow confidence in reliance on country systems, weaknesses in the government internal controls, internal auditing, reporting and oversight procedures and mechanism would need to be addressed.

Table 10.2: Main Gaps in Procurement

Item	Donor requirements	Vietnamese regulations	Reference	
			Law	Decree 58
Eligible bidders	<p>Bidding is open to eligible bidders from all eligible countries.</p> <p>Bidders affiliated with the preparation consultants are disqualified from downstream bidding.</p> <p>SOEs may participate only if they operate under commercial law and are not dependent of the procuring entity.</p>	<p>National bidding restricted to domestic bidders only.</p> <p>Equitized SOEs affiliated with the preparation consultants may participate if the parties hold less than 30 percent of capital of each other.</p> <p>An equitized SOE is not considered as dependent if the procurement entity holds less than 50 percent of its capital.</p>	Article 4. para. 5	<p>Decree 58</p> <p>Article 3 para. 2(b)</p> <p>Article 3 para. 3(a)</p>
Opening of bids	<p>All bids received before bid submission deadline shall be opened.</p> <p>Deadline for submission of bids can be extended only prior to the original deadline for bid submission.</p>	<p>Only bids from bidders who bought bidding documents shall be opened.</p> <p>If less than three bids are submitted, they are not opened and the issue is referred to a higher authority for advice.</p>	Article 20 para. 1dd	<p>Article 28 para. 3b</p> <p>Article 70 para. 3</p>
Evaluation criteria	<p>For procurement of goods and works, quantification of factors must be in monetary terms</p> <p>Merit points system allowed for special cases, such as procurement of IT systems or textbooks and reading material.</p>	<p>Use of merit points system is allowed without limitation.</p> <p>Inadequate distinction between evaluation factors and qualification criteria such as financial capacity.</p>		<p>Articles 24 and 25</p> <p>Article 25 para. 2c and 2g</p>
Contract negotiation	<p>For procurement of goods, works and non-consulting services routine negotiations not allowed with any bidder. Negotiations only allowed in exceptional circumstances.</p>	<p>Contract negotiations for goods and works procurement are routine.</p>		<p>Article 31 para. 2a and 2b.</p> <p>Article 41 para. 6.</p>
Sole source	<p>Only under exceptional circumstances such as in response to natural disasters, can equipment or services be obtained from only one source.</p>	<p>Can be used for goods and works contracts costing less than 1 billion dong or consulting services costing less than 500 million dong.</p>		<p>Articles 40, 41 and 42.</p>

Source: Adapted from ADB and others (2008). The table is not exhaustive.

Some of the largest gaps between Vietnamese regulations and international good practice refer to procurement (Table 10.2). Those gaps provide a good illustration of the problems inherent in systems that are not harmonized. Both the Vietnam Procurement Law and the policies of the development banks stipulate that in the event of an inconsistency in the provisions, the banks' guidelines prevail. But in practice project officials often tend to "play it safe" by

trying first to apply the local rules. This is because the consequences of flouting the local regulations are severe and more direct. This has at times led to mistakes and delays in the implementation of projects financed by the development banks.

Recent months have witnessed large fluctuations in commodity prices, a global financial crisis, and a recession in industrial countries. This turbulence unfolded when

PART III: A POLICY AGENDA

11. ENSURING STABILITY

Vietnam was barely emerging from the overheating caused by its own success at attracting capital in massive amounts. While the government reacted swiftly, macroeconomic instability could undermine the efforts to increase the efficiency of capital accumulation. For now, the most likely scenario is one in which capital inflows decline substantially, bringing Vietnam back to a pre-WTO environment. But this is not the only possible scenario. Given the uncertainty, the immediate priority is to be ready to cushion the shocks stemming from the balance of payments. The standard prescription in this respect is to let the exchange rate fluctuate freely, and Vietnam is moving in that direction. However, getting there may take some time and meanwhile, the effectiveness of other policy tools, from monetary policy to fiscal policy, is limited. This suggests that the government should prepare to face more turbulence in the near future. Containing risk requires decisive action in the financial sector. Creating a modern central bank empowered to adopt appropriate monetary policy, building the institutional capacity to implement such policy, upgrading the ability of the banking system to assess credit risk, and improving the quality of financial sector supervision, will be critical to make Vietnam less vulnerable. There is also a need to improve communication with market

participants and the public at large. Progress has been made in relation to financial sector indicators. But better and more current data is also needed in relation to government revenue and expenditures, including public investments. Last but not least, ensuring stability has a social dimension. Rapid inflation and the deceleration of growth affect jobs and purchasing power. In a time of possible hardship it is crucial to ensure that resources can be channeled to those who need them most.

An uncertain world

At a time when Vietnam is consolidating its global integration, the world economy has turned much more unpredictable. The protracted negotiations that led to WTO accession had been conducted during a period of remarkable stability and sustained growth. International trade volumes were increasing steadily and country risk premiums had fallen. At the culmination of this process, in 2007, Vietnam was mainly suffering from its own success. Accession to the WTO was seen as a clear indication that the government was serious about economic reform and the reliance on market mechanisms. In a world of abundant capital and growing trade, capital flowed in, under the form of FDI, portfolio investments and remittances by the overseas Vietnamese community. Volumes were so large that

they would have been difficult to manage even for a seasoned central bank. Vietnam did not have one at the time.

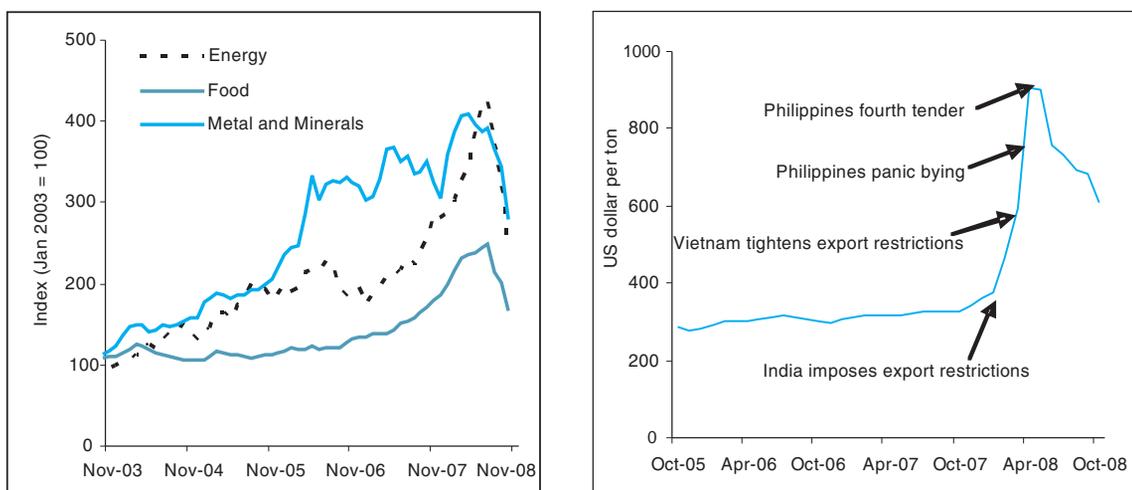
In the fall of 2008, difficulties got compounded by turbulence in the world economy. A financial crisis of unprecedented proportions led to a collapse in credit, in spite of abundant liquidity. Starting with a relatively narrow segment of the mortgage market in the United States, the financial crisis spread from one class of assets to another, forcing the adoption of massive bailout packages all over the world. Economic activity was hit to a larger extent than anticipated, with major industrial countries going into recession, and international trade slowing down. After trending upwards for several years, and experiencing a surge in late 2007, commodity prices fell sharply in 2008 (Figure 11.1).

This unprecedented global turbulence takes place at a time when Vietnam has become a much more open economy. The ratio of

international trade to GDP increased from 46 percent in 2001, when reforms accelerated, to an estimated 72 percent in 2008. International commitments made to accede to the WTO resulted in higher international capital mobility. While the dong is not convertible, foreigners face almost no restriction to purchase bonds and stocks in the domestic market, nor to sell them and repatriate the proceeds if they wish to do so. It is very difficult to achieve economic and financial integration without being susceptible to contagious effects. Sudden global turbulence is thus combined with increased Vietnamese exposure.

With the balance of payments as the main source of instability in the near future, cushioning the impact of its fluctuations on the domestic economy is a priority. Slower export growth and a slowdown in inflows would constraint the pace of capital accumulation, and some depreciation of the dong would take place. But Vietnam could also hold well in its export markets, FDI

Figure 11.1: Dramatic Fluctuations in Commodity Prices



Source: World Bank (2008e).

disbursements could continue in spite of a lower implementation rate (simply due to the sheer volume of approvals) and remittances may not fall by a large margin. While the first scenario is the most plausible, the second one is not totally unrealistic. Forecasting the balance of payments is therefore difficult. Rather than preparing for just one scenario, the government needs to be ready to respond.

Macroeconomics first

The economic reforms needed to improve the efficiency of capital mobilization in Vietnam are microeconomic in nature. However, microeconomic reforms alone will fail to deliver if the economy is subject to macroeconomic instability.

The experience of Vietnam in late 2007 and early 2008 is telling in this respect. Having lost control of credit growth, asset prices surged and investments followed the price signals. The rapid diversification of Economic Groups and large State Corporations diversified in the direction of real estate and financial investments actually showed that they had a strong profit drive. The problem was not so much their response, but rather the wrong economic signals they were responding to. Wrong market signals, especially when they last for long, create systemic risk (Box 11.1). And policy makers are not well equipped to deal with it. A stable macroeconomic context is thus a pre-condition for efficient capital mobilization.

In light of the uncertainties associated with international trade and capital movements, the government should try to steer the economy along a steady growth path in the medium term, while building in strong

stabilizing mechanisms to cope with short-term fluctuations.

A steady growth path, one that is not associated with major changes in the external debt position, requires a trade deficit that is commensurate with both the investment needs of Vietnam and availability of long-term capital. In recent debates, capital inflows have been blamed for the large trade deficit. But as long as those inflows are being invested, and especially invested well, the trade deficit should not be a matter of concern. Efficient investment should sooner or later translate into a higher supply of goods and services, hence into more exports and less imports. Trying to suppress the trade deficit, as some claim Vietnam should do, is the same as trying to reduce domestic consumption and investment. This would not be the right choice for a country that is not yet rich and needs to grow.

As for short-term stabilization mechanisms, the standard recommendation is to let the nominal exchange rate fluctuate. Vietnam is moving in the direction of increased flexibility, by gradually widening the fluctuation band around the rate set by SBV. However, whether the ultimate objective of the government is a fully flexible exchange rate is unclear at this point. And even if it were, there are understandable reasons why the transition may take some time.

In an economy not yet used to exchange rate risk, and with limited hedging instruments available, there could still be sizeable currency mismatches in enterprises and banks. Large fluctuations in the nominal exchange rate could then result in important balance-sheet effects, possibly leading to

Box 11.1: Systemic Risk in East Asian Economic Crises

The crises that shook East Asia over the last two decades had all a systemic element embedded. This is why they were so difficult to stop and eventually so costly. The way they unfolded provides useful insights for Vietnam.

The common cause of the crises in Thailand, Indonesia and South Korea, in 1997, was the mismatch between the composition of assets and liabilities in terms of their tenure and currency. In varying degree, banks and enterprises in the three countries were borrowing short-term credits in foreign currencies (mainly dollars) from abroad and financing long-term investments in domestic currencies. This mismatch resulted in large un-hedged foreign currency liabilities. When foreign investors and lenders stopped refinancing their credits, out of their concern about the borrowers' financial health, enterprises had to liquidate assets to repay their short-term credits. This pushed asset prices down, complicating further the already vulnerable situation of enterprises. Meanwhile, these countries' international reserves were not sufficient to counter the reversal of short-term capital flows. The result was a massive depreciation of local currencies. Lower asset prices and more expensive debt burdens brought many of those enterprises into bankruptcy, creating major recessions.

The root causes of Japan's decade-long economic stagnation were the protracted stock and property market bubbles of the late 1980s. It is often difficult to distinguish a bubble from a boom sustained on strong fundamentals. And it is tempting to misconstrue bubbles as a signal of the skills of policy makers, the vibrancy of the investment climate or the greatness of the nation. In the case of the stock market, the P/E ratio can be used as a starting point to assess those claims. A market-wide P/E ratio is measured as the ratio between total market capitalization and the total earnings of all companies traded in the market. The measure varies depending on whether past earnings or forecasted earnings are used in the calculation. Before the specifics, a very general rule of thumb is that a market-wide PER higher than 20 is a sign of overheating. A higher P/E ratio can be justified for rapidly growing economies such as China, India or Vietnam. Just before Japan's stock market collapsed in 1990, Tokyo's market-wide P/E ratio was registering over 60, while the total market capitalization surpassed 160 percent of GDP. Prolonged loose monetary policy is generally recognized as the primary cause of this bubble. Given how large the departure from economic fundamentals was, when the bubble burst debtors became insolvent and banks portfolios deteriorated sharply. A general reluctance to lend followed, and economic activity suffered.

Source: Noritaka Akamatsu (2008).

bankruptcies. For instance, an enterprise which sells to the domestic market but is indebted in dollars would suffer from the depreciation of the dong. Large exchange rate fluctuations may also affect

competitiveness in the short term, and create uncertainty among investors who see Vietnam as an export platform. And exchange rate movements also create a wedge between interest rates in domestic

and foreign currency, which may amplify short-term capital movements and lead to instability. For example, with a flexible exchange rate, a sudden capital inflow would lead to the appreciation of the dong, making interest rates in dong more attractive than interest rates in foreign currency. This could in turn attract more short-term capital (under the form of carry trade), pushing the dong even higher up.

If not all the burden of adjustment can fall on the nominal exchange rate, at least in the short term, then other stabilizing mechanisms are needed. Monetary policy is an obvious candidate, but its effectiveness is reduced in a context of international capital mobility if the exchange rate is rigid. And there are other shortcomings resulting from the fact that Vietnam has not completed the reform of its financial sector yet. That leaves fiscal policy as one of the main macroeconomic tools available to government. But institutional shortcomings in public financial management, especially in relation to public investment, reduce the effectiveness of this tool as well. Additional stabilizers can be considered in relation to trade and to short-term capital flows, but their merits are more questionable. All of this suggests that even if priority is given to macroeconomic stability, Vietnam could face considerable turbulence in the near future.

Containing risk

The overheating of the Vietnamese economy was fortunately brief. While the first signs were apparent in September 2007, a strong stabilization package was adopted in March 2008, barely six months later. By international standards, this is a remarkably swift response. But the ensuing decline in

asset prices, combined with the surge in interest rates and the tightening of banking credit, has resulted in increased levels of stress for borrowers. The extent to which real estate investors and urban developers will be able to service their debts is unclear. Growing difficulties to sell abroad could also create stress for manufacturing enterprises. The resulting increase in the share of bad loans is bound to affect commercial banks, especially those who lent more recklessly in support of formerly booming sectors.

Accelerating financial sector reform may hold the key to preventing this combination of stress and uncertainty to drift into systemic risk. At the risk of simplifying, four elements need to be combined. First, authorities have to be empowered to adopt the appropriate monetary policy, reacting quickly to market signals and avoiding the development of asset price bubbles like the one that affected Vietnam in late 2007. Second, the authorities also need to build the capacity to implement the chosen monetary policy without creating unnecessary hiccups along the way. Third, commercial banks need to upgrade their ability to assess borrower risk and allocate credit accordingly. And fourth, the authorities need to be able to quickly identify sources of borrower stress and weak bank portfolios, so as to intervene effectively.

Implementing the banking reform agenda approved in 2005 would help on several of these fronts. One of the building blocks of the agenda is the creation of a modern central bank, taking out of SBV the exercise of ownership rights on SOCBs, focusing its mandate on price and financial sector stability, and giving it the technical and operational autonomy to conduct its own

analyses, make recommendations to the government and implement monetary policies. This should help overcome the fragmentation in responsibilities for monetary policy, currently scattered across four SBV departments. Passing a new Law on the SBV is critical to accomplish these goals.

The smooth implementation of monetary policies requires the development of the money market, eventually leading to the emergence of a Vietnam Inter-Bank Offer Rate (VNIBOR). To do so, it is crucial to minimize volatility in the level of excess reserves in the banking system. But the stabilization of reserves is made difficult by the lack of reliable information on government cash flows. Indeed, the government itself creates large demand for bank notes, but estimating how this demand will evolve is challenging. The budget execution process makes it difficult to forecast future expenditures, whereas large inflows such as petroleum income create uncertainty on the revenue side. As spending authorities, line ministries have deposit accounts with SOCBs, but they move deposits from SBV to those accounts rather unexpectedly. State Treasury deposits at the central and provincial levels stay within the SBV system, but those at the district level and below are made to commercial banks, often without prior notice to SBV. On the funding side, better coordination is needed on the issuance of government securities. While a significant volume of government bonds is sold by SBV on behalf of MOF, an equally significant volume is issued in the form of retail bonds through MOF's own outlets. Other government bonds are auctioned at the stock trading centers. It is

not clear that SBV is well informed in advance of those other funding activities.

Strengthening the credit culture of commercial banks to assess credit risks requires bringing in strategic investors, with recognized management capacity and technical skills. This is already happening in the case of JSBs; it is one of the building blocks of the banking reform agenda in the case of SOCBs. Unfortunately, the stock market slump prompted by the stabilization package adopted in March 2008 has resulted in understandable delays in the equitization of SOCBs. There is agreement that maximizing efficiency should be the main objective, rather than maximizing government revenue. But there is a concern that selling state assets at this point would amount to handing them over at bargain prices to investors who would subsequently make handsome capital gains. And this could result in criticism and suspicion, potentially undermining the state reform process. However, as the economy stabilizes, the government should try to put SOCB equitization back on track.

Last but not least, authorities need to be able to quickly identify borrower stress and weak bank portfolios so as to intervene and avoid affecting market sentiment. In this respect, Vietnam is seriously lagging behind in the implementation of its credit rating system. As part of the banking reform roadmap, in 2005 it was decided that banks had to classify all their loans based on a series of quantitative performance indicators, including the number of days a loan was overdue and whether it had been rolled over. This was in line with the Basel I agreement. Banks were also instructed, within three years, to adopt a credit rating system well

suited to their customer base. The three years elapsed in May 2008, but only a couple of commercial banks have abided. Setting up these qualitative credit rating systems, having them certified, and linking them to SBV, so as to have a real time picture of the stress faced by the banking system, is an urgent priority.

Improvements in accounting standards are needed as well. Two kinds of systemic risk remain hidden under Vietnamese standards. Currently, assets and liabilities in foreign currency need to be converted into dong, but they do not need to be identified separately. Based on financial reports, it is therefore impossible to tell whether an enterprise or a bank is exposed to exchange rate risk. Or, put differently, whether it would suffer from an appreciation or a depreciation of the dong. Second, Vietnamese standards do not require “marking to market”. This means that the value of assets is recorder at face value, or at purchase price, not at market price. For example, if a commercial bank holds government bonds and these are trading substantially below par, marking to market would reveal a loss. But under Vietnamese standards the bank could still look very profitable. Marking to market is difficult in the case of property, but feasible in the case of financial assets.

Better credit rating systems and improved accounting standards should help identify which individual banks are facing difficulties, but they are less well-suited to assess systemic risk. Consider, for instance, the quality of lending for real estate and urban development in the midst of a real estate bubble. As long as property prices keep going up, the level of credit risk will

look tolerable. If anything, marking to market will increase the fraction of loans being classified as safe. However, credit risk could increase dramatically if the bubble was to burst. Assessing this kind of risk requires a different approach, known as stress test. In this case, an apparently healthy bank portfolio is subject to hypothetical shocks (a collapse in property prices, an increase in interest rates) to assess which fraction of outstanding credit would be at risk. In a context of increased turbulence, SBV should conduct stress tests as part of its supervision tasks.

Communicating well

In times of financial turbulence, when market sentiment is an important determinant of financial decisions, adopting the right policies may not be enough. It is also necessary to make sure that market players understand both the situation and the policies adopted, so as to avoid panic reactions and dangerous herd behavior. Market sentiment is particularly important in the case of Vietnam, a country which not yet perceived by everybody as a market economy. Historic reasons, influencing the way in which government decisions are made and communicated, may easily result in misunderstandings. And unwarranted perceptions may easily become true, simply because financial markets are vulnerable to self-fulfilling prophecies.

Vietnam was perhaps close to one of those self-fulfilling prophecies around end-May 2008. Despite the fact that a contractionary policy had been put in place by end-February, and a comprehensive stabilization package had been announced by end-March, there was considerable uncertainty

regarding their effectiveness at containing the surge in inflation and reducing a ballooning trade deficit. The country risk premium, measured through the price of five-year Credit Default Swaps (CDS) was increasing steadily. A large devaluation of the dong was also expected, according to the one-year Non-Deliverable Forward (NDF) exchange rate. And none of the important policy measures announced by the government seemed to be able to make a dent in these trends (Figure 11.2). The volume of transactions on these two instruments may not have been large, and many of those involved were probably foreign holders of Vietnamese bonds. But the message was unambiguous.

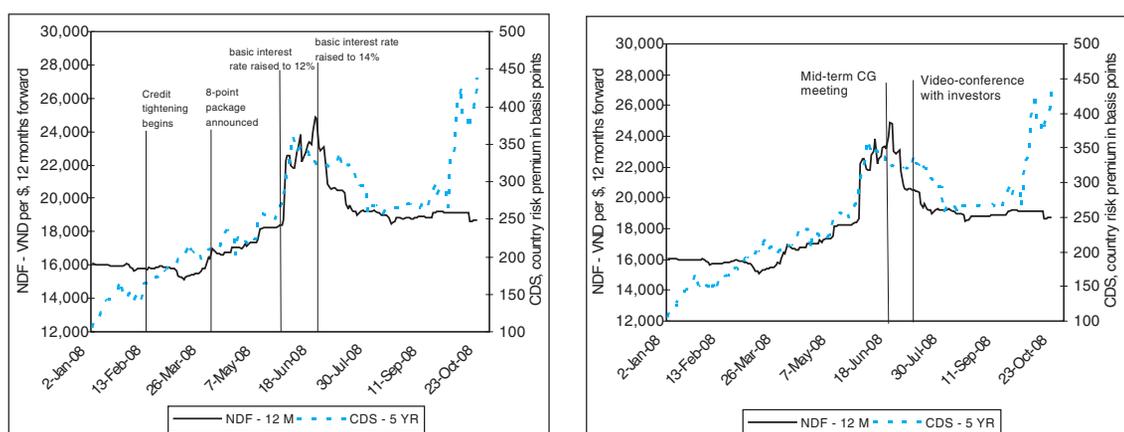
On the other hand, these trends ended up being sensitive to more “sensational” news. On May 29, 2008, a note by the research unit of an investment bank claimed that Vietnam was heading towards a currency crisis. This sent the NDF skyrocketing, to 22,500 dong per dollar, against the official 16,069 dong exchange rate. In early June, consensus by

participants at the highly visible mid-year CG meeting that the stabilization package was working marked a turning point for CDS. A few days later, on June 28, at a video-conference with investors from around the world, the government explained its policy stance and for the first time ever publicly announced the level of its international reserves. This was formally in violation of the Law on State Secrets, but the impact justified such a bold step, as the NDF plummeted.

Since then, the global financial crisis has exacerbated perceptions about risk, pushing the CDS up considerably. But it is encouraging that the government has taken other important steps to increase policy transparency and improve communication with markets and with the public at large. In particular, Vietnam is by now current in its data reporting for the IMF’s *International Financial Statistics*. And the level of international reserves is not treated as a secret anymore.

However, communication is an area where there is still room for improvement. Much of

Figure 11.2: Good policies are not enough



Source: World Bank.

the communication effort still relies on the announcement of a growth target for GDP. This is certainly a succinct way for outsiders to assess whether the priority of the government is to stabilize the economy or to support economic growth. But a target is not the same as a forecast. More importantly, a target is not particularly informative about the concrete policies the government plans to adopt to reach it.

There is of course the expectation that low growth targets will be associated with less ambitious investment plans, and therefore with a more cautious fiscal policy stance. But in this respect, a much more effective of communicating would be to produce timely and reliable budget data. At present, as was discussed earlier in this report, it is difficult to tell what the actual level of the budget deficit is. This is partly due to discrepancies from international practice especially in the way amortization of debt is treated (it is counted as expenditure in Vietnam and as a financing item in the rest of the world). But the most important shortcomings are related to the carryover of both revenue and expenditure from one year to the next.

Consider, for instance, the situation in 2007. Even after computing the amortization of debt according to international practice, the level of the budget deficit appeared to be quite high, at 5.6 percent of GDP. However, if the deficit is measured through the financial resources that had to be mobilized to bridge it (domestic and foreign debt, plus banking credit) it appears to be much more modest, probably in the order of 2.2 percent of GDP. The difference between these two figures is mainly due to revenue carryover. In other words, in 2006 the government ended up spending less than it had planned

(for instance, due to poor project implementation) and resources stood idle in a Treasury account. The carryover could be particularly important in 2008, a year when many contractors for public investment projects walked away due to the high cost of cement and other construction materials.

If the government of Vietnam wants to improve the communication of its policies and avoid potentially costly misunderstandings with market participants, it should do for budget statistics what it recently did for financial sector statistics. Namely, it should produce them and release them in a timely fashion, according to accepted international standards. Doing so will be more difficult than in the case of financial statistics, due to the poor monitoring of the implementation of public investment projects. This is an area where short term macroeconomic policy meets medium-term economic reform.

Social impacts

Stability has a social dimension as well. The surge in food and oil prices since late 2007, and the acceleration of inflation more broadly, had an impact on the wellbeing of many Vietnamese households. Vietnam is a net exporter of food, and its foreign sales of crude oil roughly match its foreign purchases of gasoline, implying that at an aggregate level the country gained from high food prices and was not adversely affected by high fuel prices. Households producing food for the market were clearly better off. But a majority of households do not produce food and all of them are buyers when it comes to gasoline. Microeconomic simulations using individual records from the 2006 VHLSS suggest that 51 percent of all households and 86 percent of urban households are worse off

when the price of rice increases. On the other hand, the deceleration of growth associated with the stabilization policy first, and with the global financial turbulence later, could result in jobs being lost or not being created rapidly enough to absorb the large number of entrants into the labor market.

Ensuring stability involves addressing these hardships. Failure to do so would not only be questionable on ethical grounds: it could also undermine popular support for critically important policy choices. But effectively mitigating the losses experienced by affected households is difficult in practice.

The standard economic response is to provide cash transfers which are commensurate with the losses, at least in the case of poorer households. More recently, it has become common to condition those transfers on the beneficiary households taking actions which are considered socially desirable, such as keeping their children in school. However, poverty reduction in Vietnam has not relied to any large extent on cash transfers, conditional or not. Cash transfers at the individual or the household are seen as potentially undermining the sense of self-reliance, if not directly the work ethic. Large redistribution mechanisms are in place, but the beneficiaries are lower levels of government, from poorer provinces to disadvantaged communes. Budget allocation norms and Program 135 Phase II are clear examples of this approach. Support to poor households takes a different form, namely ensuring their capacity to be part of the mainstream

economy. Poor households get free insurance cards, are exempted from paying school fees for their children, and can borrow without using collateral, among others.

A Vietnamese response to the hardships created by macroeconomic turbulence would thus require that two conditions be met. First, the targeting of households facing hardship should be reliable (Box 11.2). And second, a sufficient amount of resources should be available to ensure that those households effectively have access to the benefits they are entitled to.

Other possible measures to address hardship concern wage setting mechanisms. In 2008, high inflation has eroded the purchasing power of wages in urban areas, especially affecting the many migrants who work in industrial zones and live barely above the poverty line. The current collective bargaining and dispute resolution mechanisms are too rigid to process requests for wage adjustments. This has resulted in either long delays between price increases and wage increases or socially costly wildcat strikes. More flexible mechanisms for workers to appoint their representatives, and swifter conciliation in the event of disagreements, would contribute to more stable real earnings and more peaceful industrial relations at the enterprise level. A better functioning collective bargaining system should also help cushion adverse demand shocks, when wage moderation may be needed to preserve jobs.

With the world being more uncertain and the

Box 11.2: Identifying Poor and Vulnerable Households

Local authorities are requested to classify all households in their jurisdiction into a few broad categories, typically including: hungry, poor, near poor and well-off. Households in the “poor list” (the first two groups) are then entitled to a series of benefits. The classification is conducted at the lowest levels of government and updated once a year. Supposedly, it is guided by objective measures including the level of monthly income per person. In practice, subjective considerations by local officials and the views of the community also play a role. This subjective or social element results in a lack of consistency regarding what it is to be “poor” in different parts of the country. For this reason, the poverty rates produced by aggregating “poor household lists” tend to be unreliable. But the actual ranking of households within a community, and even within a similar area, is much more reliable.

At present, the quality of targeting by local authorities is hampered on three fronts:

- **Unknown households.** This is a serious issue in rapidly urbanizing areas, which are home to many migrants not even know to the police. These households do not show up in poverty counts, are not included in surveys, and can not be reached to channel benefits to them. In Vietnam, these unregistered households do not cluster in specific locations, but instead are spread out over urban areas that are often densely populated. In urban areas, local officials have limited knowledge of households residing in their localities, as opposed to rural areas, where mostly everybody knows each other. The number of unknown households is probably increasing in urban areas.
- **Households moving in and out of poverty.** These often define an entire “grey area” in between the poor and near-poor categories. Households in this “grey area” may be non-poor in one period but then see their income fall below the poverty line in the next. Macroeconomic instability most probably exacerbates those movements. But the annual household classification exercise may fail to capture them.
- **“Undeserving” households.** Local officials in Vietnam are found to exclude people from the “poor household list” because of what they consider socially reprehensible behaviour, such as drinking, gambling or commercial sex, even when these households would be poor by objective criteria, such as their monthly income per person.

By excluding people from the “poor household list”, authorities not only curtail their access to benefits, they also distort poverty counts. This may not be the only source of bias though. Local authorities may be tempted to overestimate the number of poor, in the hope to attract more resources. There is also anecdotal evidence of local officials underestimating the number of poor to demonstrate good performance.

These biases may be resolved by anchoring district-level aggregates of the “poor household list” to small-area estimates (SAE) of poverty. SAEs, also known as poverty maps, could be used to determine the budget allocation across provinces and districts, while “poor household lists” would determine how district budgets are distributed further down, to communes, villages and households.

The use of poverty maps, however, would not resolve the three forms of exclusion listed above. Perhaps a way to address them is to give households the opportunity to request a re-assessment of their poverty status, in between scheduled assessments, if they consider themselves poor but for any reason they have not been classified as such.

12. SUSTAINING GROWTH

Vietnamese economy being more exposed to it, the risk of facing macroeconomic instability is higher. This may result in a questioning of the merits of global integration, which would be a mistake. Global integration has been one of the main forces behind poverty reduction and a driver of economic reforms across a range of sectors. Importantly, given the level of the domestic savings rate, capital from abroad will be needed for Vietnam to sustain rapid economic and become an industrial country within one generation. Finding acceptable ways to mitigate the impact of fluctuations in world prices, and monitoring capital inflows in terms of their objective and time horizon, are defensible moves. But going beyond that point could hamper Vietnam's ability to attract the long-term capital it so much needs. To ensure macroeconomic stability, an investment program reconciling Vietnam's needs with the availability of long-term resources is needed. In the short term, the reconciliation will have to rely on macroeconomic policy tools. Fiscal policy is one of them. In this respect, the successful experience with adjustment in 2008, when a number of poorly performing projects were delayed or stopped, opens the door for a better management of state-funded investments. However, investment efficiency depends on microeconomic policies much more than on macroeconomic rules. A

review of the investment cycle, from funding to implementation, suggests several areas for improvement. The shortage of long-term finance and the lack of a proper institutional framework for private participation in infrastructure are the main shortcomings on the funding side. Weakness in the preparation, appraisal and monitoring of budget-funded projects, and the possibility for Economic Groups and large State Corporations to control financial institutions, are the main shortcomings on the implementation side.

Preserving integration

With the balance of payments as the main source of instability for the Vietnamese economy, the temptation to reconsider global integration may arise. Massive capital inflows were at the root of overheating in late 2007. The surge in the international price for rice fanned the flames of an already high inflation in early 2008. Since then, market sentiment has been volatile and the global financial crisis is putting new strains on the Vietnamese economy. In light of these developments, and aware of the continued global turbulence ahead, some may wonder whether the benefits from global integration outweigh its costs.

Backtracking on international integration would be a mistake, however. Becoming a full member of the global economy has

enormously contributed to economic growth and job creation in Vietnam. From the increasing commercialization of agricultural production to the development of labor-intensive manufacturing, participating in world markets has helped reduce poverty rapidly. Commitments made to accede to the WTO have exposed sectors previously dominated by large State Corporations to healthy competition. International agreements also served to “lock in” economic reforms and induce policy improvements across the economy. FDI would not have grown as fast as it did since 2006 had it not been for the signal that accession to the WTO sent to the world, regarding the commitment of the government to economic reform. Even the surge in the international price of rice, certainly detrimental to urban population groups, was beneficial to rural households in the deltas, many of whom are still poor.

The way in which the surge in the international price of rice was handled by several Asian countries is telling in this respect. Out of an understandable concern for food security, India, Vietnam and the Philippines took measures to increase the supply of rice available for the domestic market. But these restrictive measures compounded the problem. With only a fraction of the global supply of rice traded internationally, attempts to redirect the supply towards the domestic market sharply curtailed the volume of rice available in the already thin international market. In this context, food security for one country becomes food insecurity for another.

In Vietnam, an export quota of 4 million tons was set up in March 2008 out of concern for food security. Later in the month the

Vietnam's Food Association issued a series of regulations on compulsory registration of rice export contracts. Each exporter was allowed to register first-6-month exports totaling no more than half of its average total rice exports in 2006 and 2007. In April, a ban on new rice export contracts was imposed until June, in the anticipation of possible losses of spring crop in the North. By May, the domestic price of rice topped 588 dollars per ton, an increase of 73 percent over March prices. The fever was most notable in the South - the major rice production and export region. Internal preparation and consultation on a National Food Security Strategy was launched. In June, the international price started to decline, and so did the domestic prices. In July, the rice export quota was raised to 4.5 million tons, and the ban on the new rice export contract was removed. The decision was made to apply an absolute value tax instead of a tax on export values. Later, it was announced that the tax would be suspended if the international price of rice went below 600 dollars per ton.

Price-based mechanisms of this sort usually create fewer distortions than quantity-based interventions, like the original export quota. If designed well, an export tax can smooth fluctuations in international prices without preventing the operation of markets. Other countries have designed relatively sophisticated mechanisms to stabilize their export earnings. It does not necessarily follow that Vietnam should go in the same direction as those countries. But it would be important that any effort to mitigate the potentially adverse impacts of global integration be conducted in accordance with international agreements, so that it is not

perceived as an attempt to backtrack on global integration.

Perceptions matter even more in the case of capital flows than they do in the case of trade in goods and services. The capital account is the potentially most volatile part of the balance of payments, with surges in inflows leading to overheating and sudden outflows threatening financial stability. Yet, attempts to control inflows and outflows would seriously affect market sentiment and could thus undermine Vietnam's efforts to attract more capital to speed up its economic growth.

Monitoring inflows

While attempts to manage capital flows could backfire, there is certainly scope to monitor them better. A mechanism is in place to screen FDI applications, and it might have influenced the volume of approvals, or at least its distribution over time. Indeed, MPI was slower at processing applications in late 2007, when the Vietnamese economy was facing overheating, and faster during 2008, when there were concerns about the balance of payments. This might have been a deliberate attempt to smooth inflows, or it might have occurred just by chance. However, there are more efficient ways to handle the FDI flow of applications than to just speed up or slow down the administrative process.

While some FDI projects are clearly beneficial to Vietnam, others have been more controversial. One recent example is the hotly debated Van Phong Port, which involved disagreements between the Korean firm Posco and Vinalines. Other projects have raised environmental concerns, especially in relation to their management of

dangerous waste in the vicinity of residential areas. Concerns have also been flagged on the large number of FDI projects approved for golf courses, as they compete with agriculture for land and water, at a time when food security has been at stake.

In the drive towards decentralization, the authority to approve a majority of FDI projects now rests with provincial governments. But given the size of a typical province, some of the adverse impacts from those projects may be felt elsewhere. For instance, a deep sea port in one province may reduce shipment volumes in the deep sea ports of neighboring provinces. And water discharges from industrial parks may affect downstream locations in other provinces as well. Keeping the FDI approval process decentralized encourages healthy competition among provinces, with each of them trying to improve its investment climate in order to attract more capital. But it is also important to avoid drifting into what some commentators see as a race to the bottom. This calls for a stronger oversight of FDI approvals by MPI, with a focus on compliance with regional development plans and environmental impact assessments.

There is also room for improvement in the monitoring of short-term inflows. The experience of neighboring countries in the late 1990s shows that currency mismatches can result in systemic risk. As exchange rate flexibility increases, un-hedged currency mismatches in enterprises can result in substantial losses, raising doubts about their ability to service their obligations. Such doubts can make banks more cautious in their lending, potentially triggering dangerous cycles of credit contraction, bankruptcies and capital outflows. To

minimize the risk of this happening in Vietnam, authorities should more systematically check which banks and businesses are carrying unhedged foreign exchange liabilities, particularly short-term ones, while having long-term assets.

Portfolio inflows should be monitored not only in relation to their volume, but also to their tenure, invested assets and type of end-borrowers. For example, to the extent that the foreign portfolio investment is channeled into short-term assets such as bank deposits or money market instruments, the country's international reserves should be built up to fully and readily counter their possible reversals. On the other hand, short-term foreign currency borrowing by FDI firms guaranteed by their parent companies overseas should cause less worry. Foreign capital invested in illiquid, non-standardized assets including stocks in the informal stock market should also be less dangerous because a panicked exit from such an investment, even if possible, would cause substantial losses to the investor. The losses or the difficulty to exit would be greater, the larger the investor. Foreigners investing in such assets knowingly of the risk tend to be long-term oriented.

To monitor portfolio inflows as they are channeled through the financial sector, SBV, SSC and the Insurance Department of MOF would need to regularly exchange information and coordinate their actions closely. In this regard, the establishment of a high level committee to monitor financial flows and ensure the stability of the financial system and the economy is a welcome action by the Government.

Identifying the characteristics of the end

investors behind an investment manager, broker or nominee would also help understand the nature of the inflows. So far, a significant part of the foreign portfolio investments in Vietnam's stock market has been long-term oriented. Yet, some hedge funds have participated in the market, and this needs to be watched closely. It is not easy to identify end investors when the source of money is overseas (and, therefore, outside the jurisdiction of Vietnam). However, the SSC's tightening of registration and reporting requirements for representative offices of foreign investment managers was a good start. A strong anti-money laundering (AML) regime should also help.

Investment volume

The domestic savings rate has been in the order of 30 percent of GDP over the last few years. Even if those savings were invested in a very efficient way, they would probably not be sufficient for Vietnam to become an industrial country within one generation, as it aspires to. An alternative would be to increase the domestic savings rate. But this would be equivalent to decreasing domestic consumption, which may not be the preferred choice for a country that is barely entering the middle-income group. And in any event, there is relatively little that policy makers can do to influence the savings rate; the age composition of the population and subjective preferences play a much more important role in this respect.

The only viable alternative to sustain rapid growth is therefore to mobilize capital from abroad. However, in seeking external finance Vietnam should also take a cautious stance, so as to avoid increasing its external

debt beyond prudent levels, or becoming vulnerable to sudden reversals in capital flows. This requires a well-considered investment program that matches Vietnam's needs with the availability of long-term finance.

Forecasting long-term capital inflows is difficult, especially at a time of global turbulence. But some components are driven by relatively steady, structural trends. For instance, a significant portion of remittances goes into long-term investments, mainly in real estate but also in small businesses. The community of overseas Vietnamese who left in the aftermath of reunification is ageing, is prosperous, is increasingly confident in the policies adopted by the government, and is gradually renewing ties with relatives and with the country more broadly. Many members of this community are investing in Vietnam for their retirement. These long-term inflows, which may account for a third of total remittances or more, can be expected to continue on a slightly upward trend despite the global turbulence.

A better monitoring of capital inflows should also help refine forecasts in relation to FDI and portfolio investments. In the case of FDI, actual inflows are dominated by the implementation of previously approved projects, not by the flow of new approvals. And some large projects account for a large share of the total. Adequate oversight in their case should be informative of what can be expected overall. In the case of portfolio investments, it is important to identify those which are more prone to sudden reversal.

In practice, the reconciliation of total investment and savings (both domestic and

external) is achieved, in one way or another, through macroeconomic policies. The most straightforward way is through a flexible exchange rate. By not intervening in the foreign exchange market, the authorities force the current account deficit to be equal to the net capital inflow. However, the reconciliation is done in this case with the entire net inflow, including both long-term and short-term capital. Therefore, with a flexible exchange rate investment is higher in periods with large short-term inflows and lower in periods with capital outflows. In developing countries, where short-term inflows and outflows may represent a large share of GDP, this results in a higher volatility of investment.

Regardless of the merits and demerits of full exchange rate flexibility, Vietnam may not get there in the short term, or perhaps not even in the medium term. This means that other policy instruments will have to be used to reconcile the level of investment with the availability of long-term capital from abroad. Monetary policy is an obvious candidate, but its effectiveness is still limited in Vietnam's case. This is partly because a modern central bank is yet to be established, and the mechanisms for it to intervene in the money market still need to be strengthened. But in addition, with a relatively rigid exchange rate it is difficult to control money supply, because sharp fluctuations in capital movements have an impact on liquidity.

That leaves fiscal policy as an important tool for macroeconomic policy in the near future. And to some extent fiscal policy means public investment policy. This is because trying to adjust to a change in capital inflows mainly through recurrent expenditures could be both difficult and inefficient. There are obvious

institutional rigidities on government employment and salaries. And even if they could be overcome, just freezing salaries or downsizing personnel based on the availability of short-term resources would be bad development policy, as it would undermine long-term efforts to improve human resource management in the civil service. Also, there is only so much that can be accomplished by canceling seminars or reducing the use of official cars. Cuts across the board would lead to inefficiency and waste; reallocation of resources across units takes time.

A promising way to increase flexibility in public investment policy is to build on the experience of 2008, when the need to stabilize the economy required large cuts in public investment projects. In April, the government instructed all state units to review, reduce or postpone slow and inefficient projects. The relevance of the investment objectives, the availability of funding and the track record on performance were identified as the basic criteria to guide the review. Less than two months later, 28 line ministries and central agencies, 43 provincial governments and eight Economic Groups and large State Corporations had reported back on the projects to be postponed or cancelled. There were 995 of them, accounting for roughly 4 trillion dong, or the equivalent of 7.8 percent of total investments from the state budget. In addition, the issuance of off-budget funds for investment purposes was cut by 9 trillion dong, equivalent to one quarter of the annual plan. On the other hand, disbursements were allowed for projects completed ahead of time, and additional funding was made available for highly effective projects in key socio-economic areas.

This effective response could be easily embedded into the routine management of public investment projects. For instance, a three-tier system to monitor project performance could be established. Barring exceptional circumstances, public investment projects that address urgent socio-economic needs and are implemented according to schedule would not be subjects to cuts in funding or delays. At the other extreme, projects whose relevance is questionable or whose track record on implementation is weak would be subject to in-depth review, restructuring or cancellation, regardless of the availability of resources. In between these two, there would be a range of projects that would be allowed to continue in good times, but could be delayed in times of fiscal adjustment.

Investment efficiency

The volume of investment is determined at the macroeconomic level, but its efficiency depends on a number of decisions which are microeconomic in nature. The value chain analogy is useful to link those decisions and understand where the largest efficiency gains can be made. Value chain analyses trace the price of a product through various stages in its production process (say, from the farm gate to the consumer table) identifying the segments where a jump in prices occurs, and assessing whether the jump reflects genuine value added or rather limited competition. In the same spirit, the more detailed analyses presented earlier in this report allow to decompose the investment process into a series of stages, including the raising of resources, the selection of investment projects and the management of their implementation. At one end of this chain lie the cost of

investment and at the other its returns. The issue is then to identify what prevents high returns from materializing.

In raising resources for investment, the main inefficiencies seem related to the shortage of long-term finance and the institutional constraints to develop PPPs in infrastructure. This means that investment projects with potentially high returns may never see the light simply due to the lack of funding.

The bond market is still thin, and will probably remain that way in the absence of a reliable yield curve. For the latter to emerge, more progress is needed in consolidating the large number of outstanding series of government bonds and bills, each with limited trading. The main obstacle in relation to private partnerships is the absence of a specialized agency with the capacity to foster competition around investment projects, and to identify the financial support needed for those projects to be attractive when there is a perceived viability gap.

Other sources of funding for investment are in relatively better shape, but efficiency gains are possible in their case too.

The tax system, which remains the main source of funding for public sector investments, has seen considerable improvements but could still do better in terms of efficiency and equity. Its workhorses, VAT and EIT already have a good design, although both would benefit from further simplification. But modern natural resource taxation and a genuine property tax are still missing, and the tax burden remains unevenly distributed between large taxpayers and the emerging domestic private sector.

Banking credit has expanded remarkably

and its composition has changed substantially in recent years, with both the lending share of SOCBs and the borrowing share of SOEs declining over time. The necessary improvement in this case has to do with the monitoring of credit risk, so as to rapidly identify borrowers under stress and weak lending portfolios.

The stock market has also shown enormous dynamism in recent years, and the accomplishments should not be overshadowed by the slump associated with the stabilization package first and the global financial crisis later. But several improvements can be made at the level of the trading platforms. Perhaps the biggest contribution to a renewed vibrancy of the stock market in the medium term would come from a faster (but still transparent) equitization of large SOEs and SOCBs.

While much can be done to increase efficiency in the raising of resources for investment, the biggest weaknesses in the Vietnamese value chain seem to lie in its last two stages, namely the selection of investment projects and the management of their implementation. The concern is not related to private investment projects, including those of SOEs operating in a competitive environment, because in their case the market punishes bad choices and poor execution. The main concern is with public investment, because relying on markets as a correcting device is not always possible in their case. In this respect, it is important to distinguish between budget-funded projects and projects by Economic Groups and large State Corporations.

In relation to budget-funded projects, decentralization has brought the key

decisions closer to the beneficiaries, which in principle should result in more relevant projects being selected. But decentralization has also led to weaker project appraisal and implementation processes. Cost-benefit analyses are not always undertaken, and the monitoring of project execution is not strong enough to avoid substantial delays and cost overruns.

Two important measures can be adopted to remedy these shortcomings. First, a Public Investment Law could spell out more specifically the steps through which line ministries and local governments need to go as they prepare, appraise and implement projects. And second, MPI should develop the capacity to review feasibility studies and monitor implementation. This second step is particularly important at a time when the ability to adjust investment volumes rapidly may hold the key to macroeconomic

stability in an increasingly uncertain world.

Investments by Economic Groups and large State Corporations may not be as inefficient as they are often portrayed. But this may owe much to the economies of scale characterizing the sectors they operate in. Also, the venturing of these groups into finance and real estate during the overheating period of late 2007 and early 2008 is to some extent a reflection of wrong market signals coming from an inappropriate monetary policy. However, their initiatives to establish their own banks and deposit-taking institutions are a source of concern. Control over financial institutions would reduce the need for them to develop genuinely bankable projects, and would allow poor investment decisions to be pursued way beyond what is reasonable. Preventing this development is thus a priority from the point of view of investment efficiency.

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STATISTICAL APPENDIX

STATISTICAL APPENDIX

Population and Employment

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Table 1.1: POPULATION

(Thousand persons)

Year	Population (mid-year)	Growth Rate	By sex		By area	
			Male	Female	Urban	Rural
1976	49,160	2.35	23,597	25,563	10,127	39,033
1977	50,237	2.19	24,197	26,039	10,116	40,114
1978	51,337	2.19	24,813	26,524	10,105	41,226
1979	52,462	2.19	25,444	27,018	10,094	42,368
1980	53,630	2.23	26,047	27,583	10,295	43,335
1981	54,824	2.23	26,665	28,159	10,499	44,324
1982	56,045	2.23	27,297	28,747	10,708	45,336
1983	57,292	2.23	27,944	29,348	10,921	46,371
1984	58,568	2.23	28,607	29,961	11,138	47,429
1985	59,872	2.23	29,285	30,587	11,360	48,512
1986	61,109	2.07	29,912	31,197	11,817	49,292
1987	62,452	2.20	30,611	31,841	12,271	50,181
1988	63,727	2.04	31,450	32,277	12,662	51,065
1989	64,774	1.64	31,589	33,185	12,919	50,801
1990	66,017	1.92	32,203	33,814	12,880	53,136
1991	67,242	1.86	32,814	34,428	13,228	54,015
1992	68,450	1.80	33,242	35,208	13,588	54,863
1993	69,645	1.74	34,028	35,616	13,961	55,683
1994	70,825	1.69	34,633	36,191	14,426	56,399
1995	71,996	1.65	35,237	36,758	16,938	55,057
1996	73,157	1.61	35,857	37,299	15,420	57,737
1997	74,037	1.20	36,473	37,564	16,835	57,202
1998	75,456	1.92	37,090	38,367	17,465	57,992
1999	76,597	1.51	37,662	38,935	18,082	58,515
2000	77,635	1.36	38,166	39,469	18,805	58,830
2001	78,686	1.35	38,684	40,002	19,481	59,205
2002	79,727	1.32	39,197	40,530	20,004	59,723
2003	80,902	1.47	39,755	41,147	20,870	60,033
2004	82,032	1.40	40,311	41,721	21,737	60,295
2005	83,106	1.31	40,846	42,260	22,337	60,770
2006 rev	84,137	1.24	41,355	42,782	22,793	61,344
2007 est	85,155	1.21	41,855	43,300	23,370	61,785

Note: Population by sex and by area may not add to the total due to the possible exclusion of the armed force and migrant workers.

Source: GSO (2008)

Table 1.2: POPULATION BY LOCALITY

(Thousand persons)

Provinces/ Cities	Total	By sex		By locality	
		Male	Female	Urban	Rural
Ha Noi	3,289	1,652	1,638	2,182	1,108
Hai Phong	1,828	882	946	741	1,087
Ha Giang	694	344	351	76	618
Tuyen Quang	738	366	372	70	668
Cao Bang	523	257	266	83	440
Lang Son	752	375	377	152	600
Lai Chau	331	166	165	54	277
Dien bien	468	235	233	77	391
Lao Cai	590	294	295	123	467
Yen Bai	749	371	378	147	602
Bac Can	306	154	152	46	260
Thai nguyen	1,138	578	560	274	864
Son La	1,022	515	507	116	906
Hoa Binh	830	414	416	126	703
Vinh Phuc	1,190	578	613	205	985
Phu Tho	1,349	663	686	214	1,135
Bac ninh	1,029	502	527	136	893
Bac Giang	1,609	795	813	149	1,460
Quang Ninh	1,098	553	545	490	608
Ha Tay	2,561	1,254	1,307	269	2,292
Hai Duong	1,733	842	891	270	1,463
Hung Yen	1,157	557	599	128	1,028
Thai Binh	1,869	899	970	139	1,730
Nam Dinh	1,991	973	1,018	323	1,668
Ha Nam	825	400	425	81	744
Ninh Binh	929	453	475	148	781
Thanh Hoa	3,697	1,813	1,885	362	3,335
Nghe An	3,103	1,520	1,584	343	2,760
Ha Tinh	1,290	644	646	142	1,148
Quang Binh	855	423	432	123	732
Quang Tri	623	310	314	154	469
Thua Thien - Hue	1,151	566	585	364	787
Quang Nam	1,484	719	766	256	1,228
Da Nang	805	384	422	698	107
Quang Ngai	1,289	626	663	185	1,104
Binh Dinh	1,579	768	811	415	1,164
Phu Yen	881	438	443	179	702
Khanh Hoa	1,147	570	577	467	681
Ninh Thuan	575	285	290	186	389
Binh Thuan	1,171	585	586	439	732
Gia Lai	1,166	608	558	335	831
Kon Tum	390	196	194	136	254
Dac Lac	1,759	874	885	390	1,369
Dac Nong	422	202	219	60	361
Lam Dong	1,199	600	599	450	749
Ho Chi Minh City	6,374	3,053	3,321	5,426	949
Binh Duong	1,023	494	529	288	735
Tay Ninh	1,054	521	533	181	873
Binh Phuoc	824	420	404	126	698
Dong Nai	2,253	1,120	1,134	712	1,541
Baria - Vung Tau	947	476	472	419	528
Long An	1,431	705	726	238	1,193
Dong Thap	1,673	818	855	289	1,384
An Giang	2,231	1,099	1,132	634	1,597
Tien Giang	1,725	839	886	259	1,466
Ben Tre	1,354	659	695	132	1,222
Vinh Long	1,063	518	545	160	903
Tra Vinh	1,046	511	535	152	894
Can Tho	1,155	569	586	583	572
Hau giang	799	394	405	133	666
Soc Trang	1,284	626	658	237	1,047
Kien Giang	1,705	839	866	443	1,262
Bac Lieu	819	395	424	208	611
Ca Mau	1,241	612	629	250	991

Note: Population by sex and by area may not add to the total due to the possible exclusion of the armed force and migrant workers.

Source: GSO (2008)

Table 1.3: TOTAL EMPLOYMENT BY SECTOR

(Thousand persons)

	2001	2002	2003	2004	2005	rev 2006	est 2007
Total Employment	38,563	39,508	40,574	41,586	42,527	43,339	44,172
State	3,604	3,751	4,035	4,142	4,039	3,949	3,975
Non-state	34,959	35,757	36,538	37,445	38,488	39,390	40,197
State Sector Employment	3,604	3,751	4,035	4,142	4,039	3,949	3,975
Central	1,499	1,569	1,628	1,678	1,613	1,573	1,573
Local	2,105	2,181	2,407	2,464	2,426	2,376	2,402
Employment by Sector							
Agriculture, forestry and fisheries	24,468	24,456	24,443	24,431	24,342	23,995	23,811
Industry and Construction	5,552	6,085	6,671	7,217	7,782	8,336	8,825
Services	8,542	8,967	9,460	9,939	10,402	11,008	11,536
<i>Note:</i> Figures are rounded							
<i>Source:</i> GSO (2008)	63.5	61.9	60.2	58.7	57.2	55.4	53.9

Table 2.1: GDP BY INDUSTRIAL ORIGIN AND BY ECONOMIC SECTOR

(VND billion at current prices)

	2001	2002	2003	2004	2005	rev 2006	est 2007
Total	481,295	535,762	613,443	715,307	839,211	974,266	1,144,014
State	184,836	205,652	239,736	279,704	322,241	364,250	416,794
Non-State	296,459	330,110	373,707	435,603	516,970	610,016	727,220
Agriculture, Forestry and Fisheries	111,858	123,383	138,285	155,993	175,984	198,798	232,188
Agriculture	87,861	96,543	106,385	119,107	132,985	149,660	174,076
Forestry	6,093	6,500	7,775	9,412	10,052	10,802	12,067
Fisheries	17,904	20,340	24,125	27,474	32,947	38,335	46,045
Industry and Construction	183,515	206,197	242,126	287,616	344,224	404,697	475,680
Mining	44,345	46,153	57,326	72,492	88,897	99,702	111,664
Manufacturing	95,211	110,285	125,476	145,475	173,122	207,027	244,537
Electricity and Water	16,028	18,201	22,224	25,091	28,929	33,464	39,862
Construction	27,931	31,558	37,100	44,558	53,276	64,503	79,617
Services	185,922	206,182	233,032	271,698	319,003	370,771	436,146
Trade	67,788	75,617	83,297	96,995	113,768	132,794	156,286
Hotel and Restaurant	15,412	17,154	18,472	22,529	29,329	35,861	44,953
Transportation and Telecom	19,431	21,095	24,725	30,402	36,629	43,825	50,769
Finance, Banking and Insurance	8,762	9,763	10,858	12,737	15,072	17,607	20,752
Science and Technology	2,646	3,009	3,694	4,315	5,247	6,059	7,063
Real Estate and Renting	21,589	24,452	27,287	31,304	33,635	36,814	43,509
Public Administration	12,784	13,816	16,676	19,061	23,037	26,737	31,335
Education and Training	16,245	18,071	21,403	23,335	26,948	30,718	34,821
Healthcare and Social Welfare	6,417	7,057	8,865	10,851	12,412	14,093	16,151
Culture and Recreation	2,800	2,987	3,376	3,693	4,158	4,617	5,195
Party and Association	651	712	774	885	1,054	1,217	1,425
Community and Social Service	10,412	11,412	12,497	14,354	16,293	18,789	21,960
Private Household Employment	985	1,037	1,108	1,237	1,421	1,640	1,927

Source: GSO (2008)

Table 2.2A: GDP BY INDUSTRIAL ORIGIN AND BY ECONOMIC SECTOR

(VND billion at constant 1994 prices)

	2001	2002	2003	2004	2005	rev 2006	est 2007
Total	292,535	313,247	336,242	362,435	393,031	425,372	461,443
State	119,824	128,343	138,160	148,865	159,836	169,696	179,908
Non-State	172,711	184,904	198,082	213,570	233,195	255,676	281,535
Agriculture, Forestry and Fisheries	65,618	68,352	70,827	73,917	76,888	79,722	82,436
Agriculture	55,613	57,912	59,761	62,107	64,072	66,080	67,625
Forestry	2,556	2,568	2,589	2,610	2,635	2,670	2,700
Fisheries	7,449	7,872	8,477	9,200	10,181	10,972	12,111
Industry and Construction	106,986	117,126	129,399	142,621	157,867	174,259	192,734
Mining	19,185	19,396	20,611	22,437	22,854	22,987	22,520
Manufacturing	57,335	63,983	71,363	79,116	89,338	100,436	113,282
Electricity and Water	7,173	7,992	8,944	10,015	11,247	12,604	14,108
Construction	23,293	25,755	28,481	31,053	34,428	38,232	42,824
Services	119,931	127,769	136,016	145,897	158,276	171,391	186,273
Trade	47,779	51,245	54,747	59,027	63,950	69,418	75,437
Hotel and Restaurant	9,458	10,125	10,646	11,511	13,472	15,145	17,071
Transportation and Telecom	11,441	12,252	12,925	13,975	15,318	16,870	18,628
Finance, Banking and Insurance	6,005	6,424	6,935	7,495	8,197	8,867	9,649
Science and Technology	1,749	1,909	2,044	2,196	2,368	2,543	2,738
Real Estate and Renting	12,631	13,106	13,796	14,396	14,816	15,252	15,872
Public Administration	8,439	8,768	9,228	9,773	10,477	11,270	12,196
Education and Training	9,687	10,475	11,260	12,125	13,127	14,231	15,467
Healthcare and Social Welfare	4,151	4,464	4,853	5,234	5,640	6,082	6,568
Culture and Recreation	1,648	1,706	1,857	1,997	2,163	2,329	2,515
Party and Association	334	353	372	395	423	454	491
Community and Social Service	6,026	6,353	6,743	7,141	7,655	8,210	8,860
Private Household Employment	583	589	610	632	670	720	781

Source: GSO (2008)

Table 2.2B: GDP BY INDUSTRIAL ORIGIN -- GROWTH RATE

(Percent)

	2001	2002	2003	2004	2005	rev 2006	est 2007
Total	6.9	7.1	7.3	7.8	8.4	8.2	8.5
State	7.4	7.1	7.6	7.7	7.4	6.2	6.0
Non-State	6.5	7.1	7.1	7.8	9.2	9.6	10.1
Agriculture, Forestry and Fisheries	3.0	4.2	3.6	4.4	4.0	3.7	3.4
Agriculture	2.1	4.1	3.2	3.9	3.2	3.1	2.3
Forestry	0.5	0.5	0.8	0.8	1.0	1.3	1.1
Fisheries	11.5	5.7	7.7	8.5	10.7	7.8	10.4
Industry and Construction	10.4	9.5	10.5	10.2	10.7	10.4	10.6
Mining	4.1	1.1	6.3	8.9	1.9	0.6	-2.0
Manufacturing	11.3	11.6	11.5	10.9	12.9	12.4	12.8
Electricity and Water	13.2	11.4	11.9	12.0	12.3	12.1	11.9
Construction	12.8	10.6	10.6	9.0	10.9	11.0	12.0
Services	6.1	6.5	6.5	7.3	8.5	8.3	8.7
Trade	7.0	7.3	6.8	7.8	8.3	8.6	8.7
Hotel and Restaurant	6.7	7.1	5.1	8.1	17.0	12.4	12.7
Transportation and Telecom	6.6	7.1	5.5	8.1	9.6	10.1	10.4
Finance, Banking and Insurance	6.3	7.0	8.0	8.1	9.4	8.2	8.8
Science and Technology	11.3	9.1	7.1	7.4	7.8	7.4	7.7
Real Estate and Renting	3.3	3.8	5.3	4.3	2.9	2.9	4.1
Public Administration	5.2	3.9	5.2	5.9	7.2	7.6	8.2
Education and Training	5.7	8.1	7.5	7.7	8.3	8.4	8.7
Healthcare and Social Welfare	5.2	7.5	8.7	7.9	7.8	7.8	8.0
Culture and Recreation	2.9	3.5	8.9	7.5	8.3	7.7	8.0
Party and Association	5.4	5.7	5.4	6.2	7.1	7.3	8.1
Community and Social Service	5.1	5.4	6.1	5.9	7.2	7.3	7.9
Private Household Employment	2.8	1.0	3.6	3.6	6.0	7.5	8.5

Source: GSO (2008)

Table 2.3A: GDP DEFLATOR

(Percent)

	2001	2002	2003	2004	2005	rev 2006	est 2007
Total	1.6	1.7	1.8	2.0	2.1	2.3	2.5
State	1.5	1.6	1.7	1.9	2.0	2.1	2.3
Non-State	1.7	1.8	1.9	2.0	2.2	2.4	2.6
Agriculture, Forestry and Fisheries	1.7	1.8	2.0	2.1	2.3	2.5	2.8
Agriculture	1.6	1.7	1.8	1.9	2.1	2.3	2.6
Forestry	2.4	2.5	3.0	3.6	3.8	4.0	4.5
Fisheries	2.4	2.6	2.8	3.0	3.2	3.5	3.8
Industry and Construction	1.7	1.8	1.9	2.0	2.2	2.3	2.5
Mining	2.3	2.4	2.8	3.2	3.9	4.3	5.0
Manufacturing	1.7	1.7	1.8	1.8	1.9	2.1	2.2
Electricity and Water	2.2	2.3	2.5	2.5	2.6	2.7	2.8
Construction	1.2	1.2	1.3	1.4	1.5	1.7	1.9
Services	1.6	1.6	1.7	1.9	2.0	2.0	2.0
Trade	1.4	1.5	1.5	1.6	1.8	1.9	2.1
Hotel and Restaurant	1.6	1.7	1.7	2.0	2.2	2.4	2.6
Transportation and Telecom	1.7	1.7	1.9	2.2	2.4	2.6	2.7
Finance, Banking and Insurance	1.5	1.5	1.6	1.7	1.8	2.0	2.2
Science and Technology	1.5	1.6	1.8	2.0	2.2	2.4	2.6
Real Estate and Renting	1.7	1.9	2.0	2.2	2.3	2.4	2.7
Public Administration	1.5	1.6	1.8	2.0	2.2	2.4	2.6
Education and Training	1.7	1.7	1.9	1.9	2.1	2.2	2.3
Healthcare and Social Welfare	1.5	1.6	1.8	2.1	2.2	2.3	2.5
Culture and Recreation	1.7	1.8	1.8	1.8	1.9	2.0	2.1
Party and Association	1.9	2.0	2.1	2.2	2.5	2.7	2.9
Community and Social Service	1.7	1.8	1.9	2.0	2.1	2.3	2.5
Private Household Employment	1.7	1.8	1.8	2.0	2.1	2.3	2.5

Source: GSO (2008)

Table 2.3B: CHANGE IN GDP DEFLATOR

(Percent)

	2001	2002	2003	2004	2005	rev 2006	est 2007
Total	1.9	4.0	6.7	8.2	8.2	7.3	8.2
State	1.1	3.9	8.3	8.3	7.3	6.5	7.9
Non-State	2.5	4.0	5.7	8.1	8.7	7.6	8.3
Agriculture, Forestry and Fisheries	0.2	5.9	8.2	8.1	8.5	8.9	13.0
Agriculture	-1.7	5.5	6.8	7.7	8.2	9.1	13.7
Forestry	2.6	6.2	18.6	20.1	5.8	6.1	10.5
Fisheries							
Industry and Construction	2.5	2.6	6.3	7.8	8.1	6.5	6.3
Mining	0.0	2.9	16.9	16.2	20.4	11.5	14.3
Manufacturing	4.3	3.8	2.0	4.6	5.4	6.4	4.7
Electricity and Water	1.2	1.9	9.1	0.8	2.7	3.2	6.4
Construction	4.8	2.2	6.3	10.2	7.8	9.0	10.2
Services	2.4	4.1	6.2	8.7	7.4	0.0	0.0
Trade	0.8	4.0	3.1	8.0	8.3	7.5	8.3
Hotel and Restaurant	0.7	4.0	2.4	12.8	11.2	8.8	11.2
Transportation and Telecom	5.1	1.4	11.1	13.7	9.9	8.6	4.9
Finance, Banking and Insurance	1.2	4.2	3.0	8.5	8.2	8.0	8.3
Science and Technology	1.4	4.2	14.7	8.7	12.8	7.5	8.3
Real Estate and Renting	9.0	9.2	6.0	9.9	4.4	6.3	13.6
Public Administration	0.7	4.0	14.7	7.9	12.7	7.9	8.3
Education and Training	3.5	2.9	10.2	1.2	6.7	5.1	4.3
Healthcare and Social Welfare	1.7	2.3	15.6	13.5	6.2	5.3	6.1
Culture and Recreation	6.3	3.1	3.8	1.7	4.0	3.1	4.2
Party and Association	0.6	3.5	3.2	7.7	11.2	7.6	8.3
Community and Social Service	0.6	4.0	3.2	8.5	5.9	7.5	8.3
Private Household Employment	0.5	4.2	3.2	7.8	8.4	7.4	8.3

Source: GSO (2008)

Table 2.4A: NATIONAL ACCOUNTS: SOURCES AND USES

(VND billion at current prices)

	2001	2002	2003	2004	2005	rev 2006	est 2007
Sources	492,277	563,446	664,671	769,307	874,299	1,023,441	1,297,699
GDP	481,295	535,762	613,443	715,307	839,211	974,266	1,144,015
Trade Balance	10,982	27,684	51,228	54,000	35,088	49,175	153,684
Uses	492,277	563,446	664,731	769,307	874,299	1,023,441	1,297,699
Total Consumption	342,607	382,137	445,221	511,221	584,793	675,916	811,321
Gross Capital Formation	150,033	177,983	217,434	253,686	298,543	358,629	476,450
Statistical Discrepancy	-363	3,326	2,076	4,400	-9,037	-11,104	9,928

Source : GSO (2008)

Table 2.4B: NATIONAL ACCOUNTS: SOURCES AND USES

(VND billion at constant 1994 prices)

	2001	2002	2003	2004	2005	rev 2006	est 2007
Sources	304,230	334,640	367,691	392,558	417,469	455,924	540,572
GDP	292,535	313,247	336,243	362,435	393,031	425,373	461,443
Trade Balance	11,695	21,393	31,448	30,123	24,438	30,551	79,129
Uses	304,232	334,640	367,691	392,558	417,469	455,924	540,572
Total Consumption	210,029	225,610	243,515	260,940	280,104	303,520	332,456
Gross Capital Formation	92,487	104,256	116,623	128,916	143,291	160,247	199,011
Statistical Discrepancy	1,716	4,774	7,553	2,702	-5,926	-7,843	9,105

Source : GSO (2008)

Table 3.1: BALANCE OF PAYMENTS

(US\$ million, unless otherwise indicated)

	2001	2002	2003	2004	2005	rev 2006	est 2007
Current Account Balance	682	-604	-1,931	-1,591	-561	-163	-6,992
Trade Balance	481	-1,054	-2,581	-3,854	-2,439	-2,776	-10,360
Exports, f.o.b.	15,027	16,706	20,149	26,485	32,447	39,826	48,561
Imports, f.o.b.	14,546	17,760	22,730	30,339	34,886	42,602	58,921
Non-Factor Services (net)	-572	-750	-778	61	-296	-8	-894
Receipts	2,810	2,948	3,272	3,867	4,176	5,100	6,030
Payments	3,382	3,698	4,050	3,806	4,472	5,108	6,924
Investment Income (net)	-477	-721	-811	-891	-1,206	-1,429	-2,168
Receipts	318	167	125	188	364	668	1,093
Payments	795	888	936	1,079	1,570	2,097	3,261
Transfers (net)	1,250	1,921	2,239	3,093	3,380	4,050	6,430
Private	1,112	1,790	2,100	2,919	3,150	3,800	6,180
Official	138	131	139	174	230	250	250
Financial Account Balance	371	2,090	3,305	2,753	3,083	2,987	17,541
Net FDI Inflows	1,300	1,400	1,450	1,610	1,889	2,315	6,550
Medium and Long-Term Loans (net)	268	66	457	1,162	921	1,025	2,045
Disbursements	0	1,102	1,540	2,047	2,031	2,260	3,397
Amortization	0	1,036	1,083	885	1,110	1,235	1,352
Portfolio Investment	0	0	0	0	861	1,313	6,243
Short-Term Capital (net)	-1,197	624	1,398	-19	-588	-1,666	2,703
NFA of Commercial Banks	-1,197	624	1,372	35	-634	-1,636	2,624
Errors and Omissions	-847	-1,038	777	-279	-391	1,398	-381
Overall Balance	206	448	2,151	883	2,131	4,222	10,168
Financing	-206	-448	-2,151	-883	-2,131	-4,322	-10,168
Change in SBV's NFA (-, increase)	-194	-464	-2,151	-883	-2,131	-4,322	-10,168
Memorandum Items:							
Current Account Deficit (percent of GDP)	2.1	-1.7	-4.9	-3.5	-1.1	-0.3	-9.8

Source: SBV, IMF, and World Bank

Table 3.2: MERCHANDISE EXPORTS BY COMMODITIES

(US\$ million)

	2001	2002	2003	2004	2005	rev 2006	est 2007
Total Exports	15,027	16,706	20,176	26,485	32,442	39,826	48,561
Rice	625	726	721	950	1,047	1,276	1,490
Quantity (000 tons)	3,729	3,241	3,813	4,060	5,250	4,643	4,558
Average Unit Value (US\$/ton)	168	224	189	234	199	275	327
Crude oil	3,126	3,270	3,812	5,671	7,373	8,265	8,488
Quantity (000 tons)	16,732	16,879	17,143	19,501	17,967	16,419	15,062
Average Unit Value (US\$/ton)	187	194	222	291	410	503	564
Coal	113	156	184	355	669	915	1,000
Quantity (000 tons)	4,290	6,049	7,246	11,624	17,986	29,307	31,948
Average Unit Value (US\$/ton)	26	26	25	31	37	31	31
Rubber	166	268	378	641	804	1,286	1,393
Quantity (000 tons)	308	449	433	975	587	708	715
Average Unit Value (US\$/ton)	539	597	872	658	1,370	1,817	1,948
Tea	78	83	60	96	97	110	131
Quantity (000 tons)	68	75	60	99	88	106	114
Average Unit Value (US\$/ton)	1,150	1,103	1,002	961	1,103	1,045	1,143
Coffee	391	322	505	641	735	1,217	1,911
Quantity (000 tons)	931	719	749	975	892	981	715
Average Unit Value (US\$/ton)	420	449	674	658	824	1,241	2,674
Cashew Nut	152	209	284	436	502	504	654
Quantity (000 tons)	44	62	84	105	109	127	153
Average Unit Value (US\$/ton)	3,474	3,358	3,390	4,150	4,610	3,973	4,287
Black Pepper	91	107	105	152	150	190	271
Quantity (000 tons)	57	77	74	112	109	117	83
Average Unit Value (US\$/ton)	1,601	1,399	1,416	1,362	1,381	1,632	3,269
Marine Products	1,778	2,023	2,200	2,401	2,739	3,358	3,763
Vegetable & Fruits	330	201	151	179	235	259	306
Textiles and Garments	1,975	2,752	3,687	4,386	4,838	5,834	7,750
Footwear	1,559	1,867	2,268	2,692	3,040	3,592	3,994
Handicraft	235	331	367	426	569	630	825
Wood Products	335	435	567	1,139	1,563	1,933	2,404
Electronic and Computer Parts	709	605	855	1,075	1,427	1,708	2,154
Electric Cables and Wires	154	188	292	389	523	705	883
Plastic Products	134	153	154	261	350	480	711

Source: GSO (2008)

Table 3.3: MERCHANDISE IMPORTS BY COMMODITIES

(US\$ million)

	2001	2002	2003	2004	2005	rev 2006	prel 2007
Total Imports	16,162	19,733	25,227	31,954	36,978	44,891	62,682
Petroleum Products	1,828	2,017	2,433	3,574	5,024	5,970	7,710
Quantity (000 tons)	8,998	9,966	9,995	11,050	11,478	11,213	12,850
Average Unit Value (US\$/ton)	203	202	243	323	438	532	600
Fertilizers	404	477	628	824	641	687	1,000
Quantity (000 tons)	3,189	3,824	4,119	4,079	2,877	3,189	3,792
Average Unit Value (US\$/ton)	127	125	152	202	223	216	264
Steel and Irons	965	1,334	1,657	2,573	2,931	2,936	5,112
Quantity (000 tons)	3,938	4,951	4,574	5,186	5,524	5,707	8,027
Average Unit Value (US\$/ton)	245	269	362	496	531	515	637
Others							
Machinery and Equipment	2,741	3,793	5,359	5,249	5,281	6,628	11,123
Textile Fiber and Yarn	247	314	298	339	340	544	741
Cotton	132	97	106	190	167	219	267
Material for Garment & Footwear	1,590	1,711	2,034	2,253	2,282	1,951	2,152
Motor Vehicles and Parts	433	604	834	904	1,193	672	1,881
Motorbikes	670	422	329	452	541	557	725
Pharmaceutical Materials	69	83	76	100	116	133	158
Medicine	296	320	374	410	502	548	703
Paper of All Kinds	159	193	230	248	362	475	600
Chemicals	352	406	510	683	865	1,042	1,466
Chemical Products	361	482	582	706	841	1,007	1,285
Plastic Materials	495	617	785	1,191	1,456	1,866	2,057
Computer and Electronic Components	666	664	975	1,342	1,706	2,048	2,958
Wood - Sawn and Log	163	179	274	539	651	775	1,016
Milk and Dairy Products	247	122	164	206	311	321	462
Animal Feed and Materials	179	234	421	475	594	737	1,181

Source: GSO (2008)

Table 4.1: MONETARY SURVEY

	2001	2002	2003	2004	2005	rev 2006	prel 2007
(in VND trillion, end of period)							
Net Foreign Assets	117.6	117.4	131.4	145.8	191.1	287.9	410.4
Foreign Assets	135.9	135.9	150.5	172.3	220.5	327.0	472.3
Foreign Liabilities	-18.3	-18.4	-19.1	-26.4	-29.4	-39.1	-61.9
Net Domestic Assets	162.2	211.7	279.8	390.3	499.6	634.7	908.8
Domestic Credit	191.2	239.9	316.9	435.2	585.6	730.3	1,067.7
Net Claims on Government	2.1	8.8	20.1	14.9	32.5	36.5	0.0
Credit to the Economy	189.1	231.1	296.7	420.3	553.1	693.8	1,067.7
Claims on SOEs	79.7	89.5	105.4	142.9	181.3	218.5	334.2
Claims on Other Sectors	109.4	141.6	191.3	277.4	371.8	475.3	733.5
Other Items (net)	-29.0	-28.2	-37.0	-44.9	-86.0	-95.6	-159.0
Total Liquidity (M2)	279.8	329.1	411.2	536.2	690.7	922.7	1,348.2
of Which: Total Deposit	213.5	254.9	320.6	427.1	559.5	763.9	1,127.7
Dong Liquidity	191.1	235.5	314.1	408.1	531.5	723.2	1,089.6
Currency outside Banks	66.3	74.3	90.6	109.1	131.2	158.8	220.5
Deposits	124.8	161.2	223.6	299.0	400.3	564.4	869.1
Foreign Currency Deposits	88.7	93.6	97.1	128.1	159.2	199.5	258.6
(Annual change in percent)							
Net Foreign Assets	22.9	-0.2	11.9	11.0	31.0	50.7	42.6
Net Domestic Assets	27.5	30.5	32.2	39.5	28.0	27.0	43.2
Domestic Credit	23.2	25.5	32.1	37.4	34.5	24.7	46.2
Credit to the Economy	21.5	22.2	28.4	41.7	31.6	25.4	53.9
Claims on SOEs	14.0	12.3	17.8	35.6	26.9	20.5	53.0
Claims on Other Sectors	27.5	29.4	35.1	45.0	34.0	27.8	54.3
Total Liquidity (M2)	25.5	17.6	25.0	30.4	28.8	33.6	46.1
of Which: Total Deposit	25.1	19.4	25.8	33.2	31.0	36.5	47.6
Dong Liquidity	25.3	23.2	33.4	29.9	30.2	36.1	50.7
Currency outside Banks	27.0	12.0	22.0	20.4	20.2	21.1	38.9
Deposits	24.4	29.2	38.7	33.7	33.9	41.0	54.0
Foreign Currency Deposits	26.0	5.6	3.7	32.0	24.3	25.3	29.6

Note: Data from 1999 onwards comprise the SBV, six SOCBs and 83 non-state banks

Source: SBV and IMF

Table 5.1: STATE BUDGET REVENUES

(VND billion)

	2001	2002	final account 2003	2004	2005	rev 2006	est 2007
A Total Revenues and Grants	103,888	121,716	158,057	198,614	238,687	264,261	315,914
I Current Revenues	100,918	118,346	145,823	180,197	219,439	244,043	282,565
I.1 Taxes	91,688	106,154	127,948	155,579	191,725	230,565	265,862
1 Corporate Income Tax	33,298	36,826	47,410	56,987	75,847	100,820	103,054
2 Individual Income Tax	2,058	2,338	2,951	3,521	4,234	5,181	7,422
3 Land and Housing Tax	330	336	359	438	515	592	711
4 License Tax	400	407	778	657	726	794	881
5 Tax on the Transfer of Properties	1,191	1,332	1,817	2,607	2,797	3,363	5,690
6 Tax on Land Use Right Transfer	298	327	408	640	984	1,250	2,331
7 Value Added Tax	19,327	25,916	33,130	38,814	45,878	54,773	69,899
8 Special Consumption Tax	6,229	7,272	8,851	12,773	15,716	17,144	17,454
9 Natural Resources Tax	8,416	8,543	9,719	17,398	21,236	20,232	19,922
10 Agricultural Tax	814	772	151	130	132	120	113
11 Export & Import Tax	17,458	21,915	22,374	21,614	23,660	26,296	38,385
12 Other Taxes	158	170					
I.2 Fees, Charges and Non-Tax	9,230	12,192	17,875	24,618	27,714	13,478	16,703
13 Revenue from Discrepancy of Import Prices	116	168	133	40	0	0	0
14 Fees and Charges (Include Gasoline Fee)	5,120	6,016	6,483	7,765	8,135	8,008	8,516
15 Rental of Land	570	459	513	1,035	1,004	1,596	2,017
16 Others	3,424	5,549	10,746	15,778	18,575	3,874	6,170
II Capital Revenues	959	1,120	9,265	15,540	15,459	16,600	29,093
III Grants	2,011	2,250	2,969	2,877	3,789	3,618	4,256
B Carry-over	3,400	2,145	19,353	26,162	45,161	8,510	26,987

Source: MOF

Table 5.2: STATE BUDGET REVENUES

(Share of GDP)

	2001	2002	final account 2003	2004	2005	est 2006	est 2006
A Total Revenues and Grants	21.6	22.7	25.8	27.8	28.4	27.1	27.6
I Current Revenues	21.0	22.1	23.8	25.2	26.1	25.0	24.7
I.1 Taxes	19.1	19.8	20.9	21.7	22.8	23.7	23.2
1 Corporate Income Tax	6.9	6.9	7.7	8.0	9.0	10.3	9.0
2 Individual Income Tax	0.4	0.4	0.5	0.5	0.5	0.5	0.6
3 Land and Housing Tax	0.1	0.1	0.1	0.1	0.1	0.1	0.1
4 License Tax	0.1	0.1	0.1	0.1	0.1	0.1	0.1
5 Tax on the Transfer of Properties	0.2	0.2	0.3	0.4	0.3	0.3	0.5
6 Tax on Land Use Right Transfer	0.1	0.1	0.1	0.1	0.1	0.1	0.2
7 Value Added Tax	4.0	4.8	5.4	5.4	5.5	5.6	6.1
8 Special Consumption Tax	1.3	1.4	1.4	1.8	1.9	1.8	1.5
9 Natural Resources Tax	1.7	1.6	1.6	2.4	2.5	2.1	1.7
10 Agricultural Tax	0.2	0.1	0.0	0.0	0.0	0.0	0.0
11 Export & Import Tax	3.6	4.1	3.6	3.0	2.8	2.7	3.4
12 Other Taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0
I.2 Fees, Charges and Non-Tax	1.9	2.3	2.9	3.4	3.3	1.4	1.5
13 Revenue from Discrepancy of Import Prices	0.0	0.0	0.0	0.0	0.0	0.0	0.0
14 Fees and Charges (Include Gasoline Fee)	1.1	1.1	1.1	1.1	1.0	0.8	0.7
15 Rental of Land	0.1	0.1	0.1	0.1	0.1	0.2	0.2
16 Others	0.7	1.0	1.8	2.2	2.2	0.4	0.5
II Capital Revenues	0.2	0.2	1.5	2.2	1.8	1.7	2.5
III Grants	0.4	0.4	0.5	0.4	0.5	0.4	0.4
B Carry-over	0.7	0.4	3.2	3.7	5.4	0.9	2.4

Source: MOF

Table 5.3: STATE BUDGET EXPENDITURES

(VND billion)

	2001	final account			2005	rev	est
		2002	2003	2004		2006	2007
A Total Expenditures	117,285	129,434	162,150	187,353	229,092	267,575	341,418
I Current Expenditures	77,049	84,216	102,521	121,238	149,893	181,491	229,258
1 Administration Expenditure	8,734	8,599	11,359	15,901	18,761	18,994	29,214
2 Expenditure on Economic Affairs & Services	6,288	7,987	8,164	10,301	11,801	15,010	20,082
3 Social Expenditures	37,369	40,747	50,185	55,185	74,458	91,409	115,837
3.1 Education	12,006	13,758	17,390	20,401	22,031	33,822	43,396
3.2 Training	3,426	4,086	5,491	4,942	6,580	8,376	10,378
3.3 Health	4,211	4,656	5,372	6,009	7,608	12,685	16,426
3.4 Science, Technology & Environment	1,625	1,852	1,853	2,362	2,584	3,235	3,667
3.5 Culture	921	1,066	1,258	1,584	2,099	2,024	2,346
3.6 Radio and Television	838	681	1,056	1,325	1,464	1,140	1,410
3.7 Sports	483	586	648	883	879	943	1,005
3.8 Population and Family Planning	434	841	666	397	483	533	612
3.9 Social Subsidies	13,425	13,221	16,451	17,282	30,730	28,651	36,597
4 Interest Payment	4,485	5,330	6,395	7,217	6,621	8,913	11,100
5 Defence			13,058	14,409	16,278	22,892	28,922
6 Public Security			5,745	6,576	7,266	11,150	13,817
7 Others	20,173	21,553	7,615	11,649	14,708	13,123	10,286
II Investment Expenditure	40,236	45,218	59,629	66,115	79,199	86,084	112,160
1 Capital Expenditure	36,139	40,740	54,430	61,746	72,842	81,730	107,440
2 Others	4,097	4,478	5,199	4,369	6,357	4,354	4,720
B Carry-over	2,145	4,443	16,390	34,439	10,475	22,515	20,695

Source: MOF

Table 5.4: STATE BUDGET EXPENDITURES

(share of GDP)

	2001	final account		2004	2005	rev	est
		2002	2003			2006	2007
A Total Expenditures	24.4	24.2	26.4	26.2	27.3	27.5	29.8
I Current Expenditures	16.0	15.7	16.7	16.9	17.9	18.6	20.0
1 Administration Expenditure	1.8	1.6	1.9	2.2	2.2	1.9	2.6
2 Expenditure on Economic Affairs & Services	1.3	1.5	1.3	1.4	1.4	1.5	1.8
3 Social Expenditures	7.8	7.6	8.2	7.7	8.9	9.4	10.1
3.1 Education	2.5	2.6	2.8	2.9	2.6	3.5	3.8
3.2 Training	0.7	0.8	0.9	0.7	0.8	0.9	0.9
3.3 Health	0.9	0.9	0.9	0.8	0.9	1.3	1.4
3.4 Science, Technology & Environment	0.3	0.3	0.3	0.3	0.3	0.3	0.3
3.5 Culture	0.2	0.2	0.2	0.2	0.3	0.2	0.2
3.6 Radio and Television	0.2	0.1	0.2	0.2	0.2	0.1	0.1
3.7 Sports	0.1	0.1	0.1	0.1	0.1	0.1	0.1
3.8 Population and Family Planning	0.1	0.2	0.1	0.1	0.1	0.1	0.1
3.9 Social Subsidies	2.8	2.5	2.7	2.4	3.7	2.9	3.2
4 Interest Payment	0.9	1.0	1.0	1.0	0.8	0.9	1.0
5 Defence			2.1	2.0	1.9	2.3	2.5
6 Public Security			0.9	0.9	0.9	1.1	1.2
7 Others (Including Salary Increase in 2007)	4.2	4.0	1.2	1.6	1.8	1.3	0.9
II Investment Expenditure	8.4	8.4	9.7	9.2	9.4	8.8	9.8
1 Capital Expenditure	7.5	7.6	8.9	8.6	8.7	8.4	9.4
2 Others	0.9	0.8	0.8	0.6	0.8	0.4	0.4
B Carry-over	0.4	0.8	2.7	4.8	1.2	2.3	1.8

Source: MOF

Table 5.5: EXTERNAL DEBT

(US\$ million, unless otherwise indicated)

	2002	2003	2004	2005	rev 2006	est 2007
Public and Publicly Guaranteed	9,413	11,383	13,505	14,208	15,641	19,253
Official Creditors						
Multilaterals	3,256	4,510	5,323	5,540	6,149	9,032
Of Which IDA	1,100	1,476	1,744	1,780	2,010	2,422
Bilaterals	5,427	6,142	7,294	7,070	7,772	7,594
Private Creditors	730	731	888	1,598	1,721	2,626
Bonds	382	382	382	1,113	1,095	1,076
Commercial Banks	184	184	350	362	516	1,407
Other Private	165	165	156	122	110	144
Total Long-Term DOD	9,413	11,383	13,505	14,208	15,641	19,253
Disbursement	986	1,749	1,839	2,246	1,477	2,825
Payment (Debt Services)	849	776	612	698	765	886
Principal	642	573	327	435	436	505
Interest	207	202	285	263	329	381

Source: MOF (2008)

Table 6.1A: MONTHLY CHANGE IN CONSUMER PRICES
(Percent)

Month/ Year	2001	2002	2003	2004	2005	2006	est. 2007
January	0.3	1.1	0.9	1.1	1.1	1.2	1.2
February	0.4	2.2	2.2	3.0	2.5	2.1	2.2
March	-0.7	-0.8	-0.6	0.8	0.1	-0.5	-0.2
April	-0.5	0.0	0.0	0.5	0.6	0.2	0.5
May	-0.2	0.3	-0.1	0.9	0.5	0.6	0.8
June	0.0	0.1	-0.3	0.8	0.4	0.4	0.9
July	-0.2	-0.1	-0.3	0.5	0.4	0.4	0.9
August	0.0	0.0	-0.1	0.6	0.4	0.4	0.6
September	0.5	0.2	0.1	0.3	0.8	0.3	0.5
October	0.0	0.3	-0.2	0.0	0.4	0.2	0.7
November	0.2	0.3	0.6	0.2	0.4	0.6	1.2
December	1.0	0.3	0.8	0.6	0.8	0.5	2.9

Source: GSO (2008)

Table 6.1B: MONTHLY CONSUMER PRICE INDEX
(January 1995 = 100)

Month/ Year	2001	2002	2003	2004	2005	2006	est. 2007
January	128.3	130.4	135.3	139.6	152.9	153.0	166.0
February	128.8	133.2	138.2	143.8	156.7	156.2	169.6
March	127.9	132.2	137.4	144.9	156.8	155.5	169.2
April	127.3	132.2	137.4	145.6	157.7	155.7	170.1
May	127.0	132.6	137.2	146.9	158.5	156.7	171.4
June	127.0	132.7	136.8	148.1	159.1	157.4	172.8
July	126.8	132.6	136.4	148.8	159.8	158.0	174.5
August	126.8	132.6	136.3	149.6	160.3	158.6	175.4
September	127.4	132.8	136.4	150.1	161.5	159.1	176.3
October	127.4	133.2	136.1	150.1	162.2	159.4	177.6
November	127.7	133.7	137.0	150.4	162.7	160.3	179.7
December	129.0	134.1	138.0	151.2	164.0	161.0	184.9
Annual Index	127.6	132.7	136.9	147.4	159.3	157.6	174.0
Annual Growth Rate	(0.4)	4.0	3.2	7.7	8.1	6.9	9.2
Dec/ Dec Growth Rate	0.8	4.0	3.0	9.5	8.5	6.5	12.7

Source: GSO (2008)

Table 6.2A: CONSUMER PRICE BY COMMODITY GROUPS

(Monthly change in percent)

GOODS and SERVICES	Jan-07	Feb-07	Mar-07	Apr-07	May-07	Jun-07	Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07
General Index	1.1	2.2	-0.2	0.5	0.8	0.9	0.9	0.6	0.5	0.7	1.2	2.9
Food & Foodstuff	1.1	3.5	-0.4	0.5	1.0	1.0	1.6	0.9	1.0	1.1	2.1	4.2
of which: Food	1.8	2.8	-0.1	-0.1	0.6	0.4	0.5	0.9	0.9	1.1	2.7	3.0
Foodstuff	0.9	3.8	-0.6	0.7	1.0	1.4	2.3	0.9	1.3	1.2	2.0	4.7
Beverage & Tobacco	1.7	2.5	-0.7	-0.2	0.2	0.2	0.3	0.5	0.1	0.4	0.4	1.3
Garment, Hats, Footwear	1.0	1.3	-0.3	0.5	0.5	0.5	0.5	0.4	0.3	0.3	0.4	1.2
Housing & Construction Materials	3.1	1.9	-0.1	1.0	0.9	1.3	0.7	0.2	0.4	1.5	1.9	3.3
Household Appliances	0.5	1.1	0.1	0.4	0.6	0.4	0.5	0.3	0.3	0.2	0.2	0.5
Healthcare, Pharmaceutical Items	0.2	0.4	0.3	0.5	0.6	0.8	0.7	0.7	0.9	0.8	0.3	0.6
Transport & Telecommunication	0.0	0.1	0.6	1.1	0.6	0.9	0.2	0.2	-0.8	0.0	0.0	4.4
Educational Items	0.2	0.2	0.1	0.2	0.1	0.2	0.1	0.3	0.4	0.2	0.1	0.1
Cultural and Recreation Items	0.1	2.1	-1.2	0.0	0.4	1.3	0.3	0.2	-0.9	-0.7	-0.1	0.3
Goods and Other Services	0.9	2.3	-0.5	0.5	0.7	0.5	0.5	0.5	0.4	0.5	1.0	1.6
Gold	-0.1	2.1	2.6	1.1	2.3	-2.0	-0.6	1.5	1.9	6.0	8.9	2.1
US Dollar	-0.1	-0.2	-0.1	0.1	0.2	0.3	0.2	0.2	0.6	-0.6	-0.3	-0.2

Source: GSO (2008)

TABLE 6.2B: CONSUMER PRICE INDEX BY COMMODITY GROUPS

(December 2006 = 100)

GOODS and SERVICES	Jan-07	Feb-07	Mar-07	Apr-07	May-07	Jun-07	Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07
General Index	101.1	103.2	103.0	103.5	104.3	105.2	106.2	106.8	107.3	108.1	109.4	112.6
Food & Foodstuff	101.1	104.6	104.2	104.7	105.8	106.9	108.6	109.5	110.6	111.9	114.2	119.0
of which: Food	101.8	104.6	104.6	104.5	105.1	105.6	106.1	107.0	108.0	109.2	112.1	115.4
Foodstuff	100.9	104.7	104.1	104.8	105.8	107.3	109.8	110.8	112.2	113.5	115.7	121.2
Beverage & Tobacco	101.7	104.2	103.5	103.3	103.5	103.7	103.9	104.5	104.5	105.0	105.4	106.6
Garment, Hats, Footwear	101.0	102.3	102.0	102.5	103.0	103.5	104.0	104.4	104.8	105.1	105.5	108.9
Housing & Construction Materials	103.1	105.0	104.9	105.9	106.8	108.2	109.0	109.2	109.7	111.3	113.4	113.9
Household Appliances	100.5	101.6	101.7	102.1	102.8	103.2	103.7	104.0	104.2	104.5	104.7	105.3
Healthcare, Pharmaceutical Items	100.2	100.6	100.9	101.4	102.0	102.9	103.6	104.3	105.2	106.1	106.4	111.1
Transport & Telecommunication	100.1	100.1	100.7	101.7	102.3	103.3	103.4	103.6	102.7	102.8	102.8	102.9
Educational Items	100.2	100.4	100.5	100.6	100.7	100.9	100.9	101.2	101.6	101.8	101.9	102.2
Cultural and Recreation Items	100.1	102.2	101.0	101.0	101.5	102.7	103.0	103.2	102.2	101.5	101.4	103.0
Goods and Other Services	100.9	103.2	102.6	103.1	103.8	104.3	104.8	105.3	105.7	106.2	107.3	107.3
Gold	99.9	101.9	104.6	105.7	108.2	106.1	105.4	107.0	109.1	115.7	126.0	128.6
US Dollar	99.9	99.7	99.6	99.7	99.8	100.1	100.3	100.5	101.1	100.4	100.2	100.0

Source: GSO (2008)

Table 7.1: AGRICULTURE PRODUCTION IN CURRENT PRICE

(VND billion at current prices)

	2001	2002	2003	2004	2005	rev 2006	prel 2007
Gross Output	130,178	145,021	153,955	172,495	183,342	197,855	236,516
Crop Cultivation	101,403	111,172	116,066	131,552	134,755	145,808	174,389
Livestock	25,501	30,575	34,457	37,344	45,226	48,487	57,742
Services	3,273	3,275	3,433	3,599	3,362	3,560	4,386

Source: GSO (2008)

Table 7.2: AGRICULTURE PRODUCTION IN CONSTANT PRICE

(VND billion at constant 1994 prices)

	2001	2002	2003	2004	2005	rev 2006	prel 2007
Gross Output	118,990	122,150	127,628	132,888	137,112	142,711	146,811
Crop Cultivation	92,907	98,061	101,763	106,423	107,898	111,613	114,333
Food Crops	55,066	59,619	61,029	63,621	63,853	64,186	64,685
Industrial Crops	23,109	22,247	24,175	25,612	25,586	28,422	29,148
Livestock	19,283	21,200	22,907	23,439	26,108	27,907	29,201
Services	2,800	2,890	2,958	3,027	3,107	3,191	3,277
<i>Memorandum Items:</i>							
Paddy Output (000 tons)	32,108	34,447	34,569	36,149	35,833	35,850	35,868
Cultivated Area (000 ha)	7,493	7,504	7,452	7,445	7,329	7,325	7,201
Yield (ton/ ha)	4.29	4.59	4.64	4.86	4.89	4.89	4.98

Source: GSO (2008)

Table 7.3: INDUSTRIAL CROP PRODUCTION AND YIELDS

	2001	2002	2003	2004	2005	rev 2006	prel 2007
Production (000 metric tons)							
Cotton	34	40	35	28	34	29	16
Jute	15	20	12	13	13	11	31
Sedge	65	88	96	90	81	90	100
Sugar cane	14,657	17,120	16,855	15,649	14,949	16,720	17,379
Peanut	363	400	406	469	489	463	505
Soya-beans	174	206	220	246	293	258	276
Tobacco	32	33	32	23	26	42	32
Tea - raw and fresh	340	424	449	514	570	649	705
Coffee	841	700	794	836	752	985	961
Rubber	313	298	364	419	482	555	602
Black Pepper	44	47	69	73	80	79	90
Coconut	892	915	893	960	977	101	147
Area Cultivated (000 ha)							
Cotton	28	34	28	28	26	21	12
Jute	8	10	5	5	6	6	12
Sedge	10	12	14	13	13	12	14
Sugar cane	291	320	313	286	266	288	291
Peanut	245	247	244	264	270	247	255
Soya-beans	140	159	166	184	204	186	190
Tobacco	24	27	23	16	17	27	19
Tea	98	109	116	121	123	123	126
Coffee	565	522	510	497	497.4	497	506.4
Rubber	416	429	441	454	482.7	522.2	549.6
Black Pepper	36	48	51	51	49.1	48.5	47.9
Coconut	156	140	134	133	132	134	135
Average Yield (metric ton/ ha)							
Cotton	1.2	1.2	1.3	1.0	1.3	1.4	1.3
Jute	1.9	2.1	2.6	2.6	2.3	1.7	2.6
Sedge	6.6	7.2	6.8	6.9	6.4	7.3	7.2
Sugar cane	50.4	53.5	53.8	54.7	56.1	58.0	59.8
Peanut	1.5	1.6	1.7	1.8	1.8	1.9	2.0
Soya-beans	1.2	1.3	1.3	1.3	1.4	1.4	1.4
Tobacco	1.3	1.2	1.4	1.4	1.5	1.6	1.7
Tea - raw and fresh	3.5	3.9	3.9	4.3	4.7	5.3	5.6
Coffee	1.5	1.3	1.6	1.7	1.5	2.0	1.9
Rubber	0.8	0.7	0.8	0.9	1.0	1.1	1.1
Black Pepper	1.2	1.0	1.4	1.4	1.6	1.6	1.9
Coconut	5.7	6.5	6.7	7.2	7.4	0.8	1.1

Source: GSO (2008)

Table 8.1: INDUSTRIAL PRODUCTION OUTPUT

(VND billion at constant 1994 prices)

	2001	2002	2003	2004	2005	rev 2006	prel 2007
Gross Industrial Output	227,342	261,092	305,080	355,624	416,563	487,256	570,771
State Sector	93,434	105,119	117,637	131,655	141,117	149,951	158,341
Central	62,119	69,640	80,917	92,896	104,372	114,285	124,174
Local	31,316	35,479	36,720	38,759	36,745	35,666	34,167
Non-State Sector	53,647	63,474	78,292	95,785	120,127	151,102	190,457
Collectives	1,575	1,668	1,770	1,893	1,969	2,151	2,224
Private, Households and Mixed	52,072	61,807	76,522	93,892	118,158	148,950	188,233
Foreign-Invested Sector	80,261	92,499	109,152	128,184	155,319	186,203	221,973
Key Industries							
Coal	2,695	3,189	3,689	4,752	6,111	6,941	7,632
Oil and Gas	23,766	23,817	25,132	28,403	27,410	25,466	23,987
Mining and Metal Ores	239	281	344	467	476	622	557
Stones and Other Mining	2,398	3,039	3,597	3,842	4,354	4,775	4,728
Food and Beverage	50,373	56,061	64,585	74,694	84,482	103,079	123,494
Cigarettes and Tobacco	6,690	7,658	9,189	10,160	11,234	11,186	11,749
Textile Products	10,641	12,338	14,214	16,626	19,079	23,736	28,775
Garment - Apparel	6,862	8,182	10,466	12,792	15,304	19,166	23,840
Leather Tanning and Processing	9,529	11,096	13,535	16,018	18,920	22,496	27,218
Wood and Wood Products	3,903	4,488	5,485	6,570	8,120	8,765	9,720
Paper and Paper Products	4,562	4,877	5,655	7,140	8,311	9,419	10,664
Printing and Publishing	2,453	2,876	3,515	3,774	4,626	5,205	5,506
Chemicals	12,852	14,714	16,323	19,029	23,848	28,688	34,096
Rubber Products and Plastic	8,128	9,706	11,291	15,169	18,237	21,373	24,986
Non-Metallic Products	21,625	25,913	29,855	33,483	37,055	43,793	51,319
Metal Production	6,842	8,516	10,430	11,226	13,949	15,707	18,428
Metallic Products	7,063	8,506	10,646	12,963	17,595	22,836	27,186
Machinery and Equipment	3,421	3,711	4,612	5,371	5,495	5,561	5,847
Computer and Office Equipment	977	1,003	1,538	1,846	3,206	523	7,639
Electric and Electronic Equipments	5,172	6,520	7,462	9,050	11,992	15,841	20,553
Radio, TV and Telecom	5,407	6,169	7,162	7,956	9,137	9,138	9,207
Production & Repairing Motor Vehicles	4,265	5,774	8,306	8,692	9,753	9,344	11,714
Production & Repairing Other Transport Means	7,090	8,534	9,676	12,172	15,834	20,712	25,333
Furnitures	4,759	6,057	7,846	10,179	13,411	18,130	22,577
Recycled Products	151	174	204	261	267	321	387
Electricity and Gas	13,551	15,741	18,071	20,385	23,427	26,752	30,549
Water Supply	1,152	1,328	1,361	1,409	1,570	1,756	2,018

Source: GSO (2008)

Table 8.2: MAJOR INDUSTRIAL PRODUCTS

(VND billion at constant 1994 prices)

	Unit	2001	2002	2003	2004	2005	rev 2006	prel 2007
Assembled Automobiles	unit	20,526	29,536	47,701	50,954	59,152	47,576	72,710
Assembled Motorbikes	1,000	610	1,052	1,180	1,828	1,982	2,147	2,659
Assembled TV Sets	1,000	1,126	1,597	2,188	2,660	2,515	2,446	2,380
Beverage	mil. liters	971	940	1,119	1,343	1,461	1,547	1,845
Bicycle Tires	000 Pieces	21,656	22,778	26,686	26,008	20,387	22,832	24,432
Bicycle Tubes	000 pieces	22,997	24,032	36,083	32,386	26,848	28,964	30,200
Bricks	mil. pieces	9,811	11,365	12,810	14,661	16,530	18,005	19,822
Cement	000 tons	16,073	21,121	24,127	26,153	30,808	32,690	36,422
Chemical Fertilizers	000 tons	1,270	1,158	1,294	1,714	2,190	2,183	2,424
Cigarettes	mil. packs	3,075	3,375	3,871	4,192	4,485	3,941	4,298
Coal	mil. tons	13.4	16.4	19.3	27.3	34.1	38.8	43.2
Crude oil	mil. tons	16.8	16.9	17.7	20.1	18.5	16.8	15.9
Diesel Engines	000 pieces	18.7	32.6	184.4	182.4	201.6	170.0	109.9
Electric Engines	000 pieces	53.4	64.1	95.8	132.3	194.4	120.9	150.2
Electricity	mil. kWh.	30,673	35,888	40,546	46,202	52,078	59,013	66,838
Fabrics of All Kinds	mil. meters	410	470	496	502	561	570	611
Glass Products	000 tons	115	115	147	154	163	240	272
Insecticides	tons	20.0	20.7	40.9	54,523	45,877	53,113	59,151
Paper and Paper Products	000 tons	445	490	687	809	901	1,031	1,189
Porcelain	mil. pieces	314	284	524	404	514	407	458
Rice Mill Equipment	pieces	18,298	13,433	10,112	5,749	2,734	8,687	10,602
Salt	000 tons	699	974	909	906	898	842	920
Sawn Wood	000 m3	2,036	2,667	3,291	3,009	3,232	4,322	4,675
Soap and Detergent	000 tons	326	361	377	401	421	531	606
Steel	000 tons	1,914	2,503	2,954	3,280	3,403	3,837	4,227
Sugar (Refine)	000 tons	739	790	1,073	1,191	1,102	1,099	1,225
Tea	000 tons	82	100	85	122	127	124	128
Textile Yans	000 tons	162	227	235	241	259	269	275
Tin (Billet)	Tons	1,728	1,565	1,915	2,356	1,766	2,665	2,861
Transformers	pieces	15,664	18,633	33,364	50,146	45,540	28,149	32,941
Water Pumps for Agriculture	pieces	4,238	3,578	7,787	10,038	8,298	5,118	6,293

Source: GSO (2008)