PROGRAM INFORMATION DOCUMENT (PID)
APPRAISAL STAGE

December 12, 2012
Report No.: AB7203

Operation Name	Economic Management and Competitiveness Credit 1
Region	EAST ASIA AND PACIFIC
Country	Vietnam
Sector	General finance sector (25%); General public administration sector (25%); General industry and trade sector (25%); Banking (25%)
Operation ID	P122793
Lending Instrument	Development Policy Lending
Borrower(s)	THE SOCIALIST REPUBLIC OF VIET NAM
Implementing Agency	
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Estimated Date of Appraisal	December 17, 2012
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Corporate Review Decision	Following the corporate review, the decision was taken to proceed with the appraisal of the operation.

I. Country and Sector Background

Vietnam has achieved impressive records on economic growth and poverty reduction in the past twenty five years. Economic reforms launched in 1986 have transformed Vietnam from one of the poorest countries in the world, with per capita income (PCI) under $100, to a lower middle-income country with 2011 PCI of $1,374. Based on a 1998 'basic needs' poverty line, the poverty headcount fell from 58 percent in the 1990s to 14.5 percent in 2008, and is estimated to have fallen further by 2010. The country has attained five of its ten original millennium development goal targets. Reforms in the early 1990s contributed to major competitiveness gains, enabling a structural shift from agriculture to higher productivity manufacturing. Investments in physical capital and human resources led to increased capital and labor productivity. ASEAN and WTO membership in 1995 and 2007 respectively, and a series of bilateral trade agreements, promoted further reforms, leading to higher private and public investments.

There is growing recognition however that reforms now need to promote more efficient use of factor endowments and increase productivity across the economy. Productivity and growth since

the 1990s have been driven mostly by factor accumulation, and in particular capital deepening. But capital and labor productivity has declined. While the relative contribution of capital accumulation has increased in the last five years, its marginal productivity has declined, as has labor productivity growth due to a skills deficit. Recent assessments and surveys indicate that constraints to competitiveness stem largely from a number of policy and institutional weaknesses. Vietnam is running into competitiveness bottlenecks, which need to be addressed to avert a middle-income trap. The government is embarking on a new wave of policy reforms to address competitiveness challenges. These reforms are part of its Socio-Economic Development Plan 2011-2015 (SEDP 2011-15), and its restructuring plans focused on state owned enterprises, public investment, and the banking sector.

II. Operation Objectives

The EMCC intends to support the ambition of the SEDP 2011-2015 to strive for a new economic growth model, which targets competitiveness and the quality of growth. It will contribute to a range of outcomes including: (i) macroeconomic stability through: enhanced financial sector stability; and maintenance of fiscal discipline; (ii) a transparent, efficient and accountable public sector through: improved public administration and accountability; strengthened state enterprise management; and enhanced public investment management; (iii) an enabling business environment through: a more efficient business environment; and greater transparency and equity of the business environment. The operation will also look at two cross-cutting themes: (i) protecting the poor from adverse effects of Vietnam's economic transition and competitiveness-related reforms; and (ii) promoting greater data and policy-making transparency. Analytical work and policy dialogue will aim to ensure that these cross-cutting issues are appropriately taken into account in the reforms supported under the operation.

The EMCC will have the following prior actions:

Prior Action 1.1: Adoption of a comprehensive Credit Institutions restructuring plan and provide direction on related policy actions, including enhancing role of foreign participation in domestic commercial banks, incentives for consolidation of banks (especially weak banks) and plan to deal with non-performing loan. The Decision sets out a comprehensive policy framework to deal with weak banks, improve regulation, and avert systemic risk.

Prior Action 1.2: Issuance of a Circular to strengthen regulations on loan classification, and provisioning for and writing off of bad debts. The Circular adopts the following policies: (i) wider scope of application; (ii) more quantitative, stricter criteria for loan classification; (iii) commercial banks to adopt international standards for credit ratings; (iv) closer monitoring of transfer of bad assets to subsidiary organizations; and (v) closer monitoring of loans in category 2/5 (3-5 are NPLs).

Prior Action 2.1: Adoption of a Prime Ministerial Decision to strengthen the institutional framework for debt management and establish prudential fiscal targets and thresholds for medium-term sustainability. The Decision sets out a long-term strategy (2011-2020) for public debt management, consolidating for the first time external, domestic, sub-national, off-budget, and SOE debt and adopts the following policies: (i) medium to long-term deficit targets and borrowing limits; (ii) changing the composition of the debt portfolio to increase share and

maturity of domestic debt; and (iii) medium to long-term thresholds for public debt stock and debt servicing.

Prior Action 3.1: Revisions to the 2005 Anti-Corruption Law to enforce stricter transparency guidelines in areas and sectors most vulnerable to corruption (Law on Anti-Corruption).

Prior Action 3.2: Amendment of the Tax Administration Law, addressing three main groups of reforms: (i) simplification of administrative procedures to lighten the burden on private businesses; (ii) modernization of tax administration and moving towards international standards; and (iii) improving the efficiency and effectiveness of tax administration.

Prior Action 4.1: Adoption of a Prime Ministerial Decision to restructure State Economic Groups (SEGs) and General Corporations (GCs). The Decision adopts a policy on the level of state ownership in SEGs and GCs operating in different sectors.

Prior Action 5.1: Adoption of a Medium-Term Investment Plan for the period 2013-2015 to set medium-term capital expenditure priorities in the State Budget and through off-budget bond financing, allowing the government for the first time to move from a policy of annual capital budgets to a policy of public investments within a medium-term framework.

Prior Action 6.1: Adoption of a Prime Ministerial Decision for ministries and provincial authorities to review on an ongoing basis the impact of Administration Procedures (APs) on the business environment, and recommend actions to streamline procedures, avoid duplication, and reduce regulatory burden on the private sector. The Administrative Procedure Control Agency (APCA) is responsible for managing this process and the inter-ministerial coordination.

Prior Action 6.2: Adoption of rules and regulation to enable private businesses to register online. This will enable the government to adopt a policy, which private enterprises which to register their business using e-signature.

III. Rationale for Bank Involvement

The World Bank is supporting Vietnam in its new phase of development with the EMCC series. The EMCC is directly aligned to the objectives under the first pillar of the Country Partnership Strategy (CPS), which focuses on improving national competitiveness. More specifically, it will support measures to strengthen CPS Outcome 1.1: Improved Economic Management and Business Environment. This includes reforms to strengthen Vietnam's macroeconomic policy framework, public financial management (PFM), the financial sector, and market-based regulations. The EMCC will also contribute to the three cross-cutting themes of the CPS: (i) strengthening governance is one of the central objectives of policy and institutional reforms aimed at promoting competitiveness; (ii) analyzing the gender impact of competitiveness reforms, and measures to improve gender equity, which can lead to important gains in productivity; and (iii) strengthening resilience is also front and center of the competitiveness agenda, as Vietnam's transition will lead to major structural shifts in the economy, which will require measures to protect vulnerable groups.

The EMCC will continue to seek development partners' active participation in policy dialogue and analytical work as under the Poverty Reduction Support Credit series (PRSCs). The role of co-financiers under the PRSC evolved over time from co-financiers to active partners in the preparation of the operations and the policy dialogue with the government. This coordination has reduced the transaction costs for the government ministries and agencies. One of the new features under the EMCC is to have dedicated resources from development partners for analytical work and short-term technical assistance.

The International Monetary Fund (IMF) and the World Bank have had a close working relationship in Vietnam on the PRSC, which will continue with the EMCC. The IMF has not had a program in Vietnam since the Poverty Reduction and Growth Facility expired in April 2004. But it maintains a regular policy dialogue through Article IV consultations, staff visits, and its resident representative office in Hanoi, and technical assistance. The Bank and the International Finance Corporation (IFC) are already collaborating on a number of competitiveness-related reforms. These include strengthening financial sector soundness, improving state enterprise management, and increased energy and public investment efficiency. Under the EMCC, the Bank and the IFC are working together in the areas of Administrative Procedure simplification and revision of the Laws on Corporate Income Tax and Value Added Tax.

IV. Tentative financing

Source:		($m.)
BORROWER/RECIPIENT		0
International Development Association (IDA)		250
Borrower/Recipient		
IBRD		
Others (specify)		
	Total	250

V. Institutional and Implementation Arrangements

The EMCC will have a three-tiered governance structure. First, a Steering Committee chaired by the Deputy Prime Minister would review and endorse the proposed areas of focus for operation. Second, a Technical Working Group (TWG) would lead technical discussions and analyses for triggers and policy actions. The TWG would help oversee the preparation of the operation, discuss the technical elements of policy actions, decide on analytical work, and brief the Steering Committee and development partners. This should help build greater ownership for the EMCC among the lead technical staff both in government and among development partners. The State Bank of Vietnam (SBV) will be responsible for overall coordination of the program. Third, the EMCC Coordination which includes the following activities and institutions: Trust Funds to assist with coordination and analytical work; three technical missions including appraisal for preparation, and the SBV which will serve as the implementing agency.

Monitoring and evaluation of the program will also take place through three main channels. The first channel is monitoring progress against the results indicators agreed in the policy matrix.

These include indicators that have been drawn directly from the government's own strategies, and independent sources and surveys (e.g., Provincial Competitiveness Index and Provincial Governance and Public Administration Index). The second channel is monitoring specific follow-up activities to prior actions, and milestones for future triggers. These will be identified on a regular basis and updated. This responds to earlier concerns that whilst policies may have been adopted, implementation does not follow suit. The third channel will be in-depth analytical work on specific policy actions. This will help to identify more precisely ex-ante specific issues to monitor during implementation of prior actions.

A combination of these channels should help to build a better picture of how the EMCC is contributing to the overall objective of competitiveness and productivity. The operation will aim to consolidate these and report on an annual basis to ensure that there is regular consolidated information on implementation and results of the program. In addition, the government and development partners could carry out an independent mid-term and end-of-program review.

VI. Risks and Risk Mitigation

Vietnam faces important short-term domestic macroeconomic management challenges. Whilst foreign exchange reserves have more than doubled in 2012, it is low by international standards. The ongoing domestic credit bust could further worsen both growth prospects and asset quality. Another risk is the authorities' departure from fiscal and monetary discipline prompting inflation resurgence. This could unravel gains already made and further weaken confidence. A similar outcome, but where potential growth is compromised, could arise from delayed and poor implementation of structural reforms including the resolution of bad debts in banks and state-owned enterprises (SOEs). Vietnam is also vulnerable to the effects of a prolonged global economic slowdown, which could adversely affect exports, remittances, foreign investment, and possibly aid. Although it has managed to navigate the 2008/09 crisis reasonably well through implementation of a large stimulus package, fiscal space is now limited because of high levels of public debt and large contingent liabilities from a weak banking sector and poorly managed SOEs.

Mitigation measures include closer monitoring of macroeconomic developments, and increased dialogue with the authorities in collaboration with the IMF to ensure steadfast implementation of reforms already announced and to prepare for new ones. The ongoing work on a Financial Sector Assessment Program (FSAP) by the World Bank and IMF is expected to provide a comprehensive roadmap for financial sector reform and accelerate implementation. EMCC series itself can be considered as part of a risk mitigation strategy as it underscores the need to reform, builds consensus around challenging issues and helps design appropriate responses.

A potential lack of leadership and ownership over the EMCC program could ultimately affect its end results. This could be due to lack of incentives to pursue large reforms through EMCC in light of its multi-agency design. The EMCC has developed new governance arrangements to help strengthen Government ownership and coordination of the program. A more focused agenda, and dedicated resources to help bring in high quality analytical input should also help to mitigate some of the above risks. But there are also important political economy challenges. Strong political commitment is needed to drive much needed reforms, which can lead to short-term

losses to important interest groups. The latter can lead to powerful opposition to tightening of fiscal and monetary policies, but also any change to the status quo the management of SOEs, the banking sector and management of public investments.

Finally, whilst the need for reform may be strong, it will be important to adopt policies and institutions that are consistent with implementation capacity. Sophisticated standards will not serve their purpose if there is limited capacity to implement them. The program will maintain a very close dialogue to ensure appropriate sequencing and prioritization of reforms.

VII. Poverty and Social Impacts and Environment Aspects

Poverty and Social Impacts

Despite remarkable progress, the task of poverty reduction is not yet complete, and in some respects has become more difficult. Although tens of millions of Vietnamese households have risen out of poverty over the past decade, many still have incomes very near the poverty line and remain vulnerable to falling back into poverty as a result of idiosyncratic shocks or related economy-wide shocks, which have tended to become larger, more frequent, and lengthier. Vietnam's success has created new challenges. The remaining poor are harder to reach; they face difficult challenges – isolation, limited assets, low levels of education, poor health status – and poverty reduction has become less responsive to economic growth. Ethnic minority poverty is a particular concern. Although Vietnam's 53 ethnic minority groups make up less than 15 percent of the population, they accounted for 47 percent of the poor in 2010, compared to 29 percent at the end of 1990s.

Vulnerability is increasing and new forms of poverty may arise as a result of rapid economic transformation and global integration. The global crisis has exposed Vietnam's vulnerability to external shocks at both the macroeconomic and household level. Unemployment has risen and there are widespread reports of wage cuts and reduced working hours. These events have brought considerable challenges for urban residents, which have been documented in a number of studies and rapid assessments.

The reforms supported by EMCC are expected to improve productivity across key sectors of the economy. The proposed reforms are likely to have an overall positive effect on poverty and employment in the long-run due to improved competitiveness and productivity and better economic integration. There may be short-run costs associated with structural reforms. These will be analyzed as part of the EMCC to inform appropriate responses to protect the poor and vulnerable from macroeconomic shocks.

Environment Aspects

The EMCC operation is not likely to have significant negative effects on environment, natural resources, and forestry. Rather, as the operation supports measures that contribute to a shift towards macroeconomic stability; transparency, efficiency, and accountability of the public sector; and business enabling framework, it may contribute indirectly to positive environmental

externalities. The government's promotion of strategic environmental assessment (SEA) in development planning and a number of regulatory reforms and capacity building initiatives in the area of environment impact assessment (EIA) and SEA will serve as good mechanisms to address environmental aspects that could arise through the policy actions supported by EMCC.

VIII. Contact point

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