



# TAKING STOCK

AN UPDATE ON VIETNAM'S  
RECENT ECONOMIC DEVELOPMENTS

Special Focus: Promoting Healthy  
and Productive Aging in Vietnam

July 2016

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**THE WORLD BANK**  
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# ACKNOWLEDGEMENT

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# ACRONYMS AND ABBREVIATIONS

<b>AEC</b>	Association of Southeast Asian Nations' Economic Community
<b>CDS</b>	Credit Default Swap
<b>CIT</b>	Corporate Income Tax
<b>CPI</b>	Consumer Price Index
<b>EAP</b>	East Asia and Pacific
<b>EU</b>	European Union
<b>FDI</b>	Foreign Direct Investment
<b>GDP</b>	Gross Domestic Product
<b>GDC</b>	General Department of Customs
<b>GSO</b>	General Statistics Office
<b>IMF</b>	International Monetary Fund
<b>MOF</b>	Ministry of Finance
<b>MOLISA</b>	Ministry of Labor, Invalids and Social Affairs
<b>MPI</b>	Ministry of Planning and Investment
<b>ODA</b>	Official Development Assistance
<b>OOG</b>	Office of Government
<b>PIM</b>	Public Investment Management
<b>PIT</b>	Personal Income Tax
<b>PMI</b>	Purchasing Manager Index
<b>PPP</b>	Purchasing Power Parity
<b>SBV</b>	State Bank of Vietnam
<b>SEDP</b>	Social Economic Development Plan
<b>SOEs</b>	State-Owned Enterprises
<b>SWI</b>	Saltwater Intrusion
<b>TPP</b>	Trans Pacific Partnership
<b>VAMC</b>	Vietnam Asset Management Company
<b>VAT</b>	Value Added Tax
<b>VHLSS</b>	Vietnam Household Living Standards Survey
<b>WB</b>	World Bank

**OFFICIAL INTERBANK EXCHANGE RATE: US\$ = VND 21,880**

Government Fiscal Year: January 1 to December 31



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# OVERVIEW

## *Recent Economic Developments*

**Global economic activity is showing little sign of improvement in 2016, but growth in the emerging East Asia and the Pacific remains resilient.** The latest World Bank Global Economic Prospects, released in June, projects global growth for 2016 at 2.4 percent. Growth prospects have weakened throughout the world economy, including major emerging and high income economies. Despite the prolonged weakness of the global economy, growth in developing East Asia and Pacific (EAP) is expected to ease only modestly to 6.3 percent in 2016 and 6.2 percent in 2017-18, mainly due to slower growth in China. Amidst lackluster growth prospects, global trade slowed further in 2016 with global merchandise trade growth declining to about 3 percent.

**In Vietnam economic activity moderated in the first half of 2016, mainly due to the impact of a severe drought on agricultural production and slower industrial growth.** After accelerating strongly last year, GDP growth slowed to 5.5 percent during the first half of 2016 (compared to 6.3 percent growth in the first half of 2015). The deceleration is largely due to a severe drought and saltwater intrusion across key agricultural regions which caused agriculture output to contract by 0.2 percent. In contrast, growth picked up further in the construction sector, driven by buoyant credit growth and a recovery in the real estate sector. The service sector also accelerated, driven in particular by retail trade growth which benefited from sustained strength of domestic consumption.

**Monetary policy continues to balance growth and stability objectives.** Driven by rising food and administrative prices, headline CPI inflation inched up moderately to 2.4 percent (year-on-year) in June. Meanwhile, credit growth continued to expand at an average of about 18 percent year-on-year (about three times nominal GDP growth) since the beginning of the year. To address rising concerns about adverse impacts of rapid credit growth on lending quality, the SBV adopted tighter prudential regulations which are expected to mitigate potential asset-liability mismatches and moderate credit growth. At the same time, the credit growth target for the year remains about 18 percent, suggesting that providing liquidity to the real sector remains a policy focus that may compel the authorities to ease the policy stance if needed.

**Banking sector stability has been maintained but lingering asset quality problems remain largely unresolved.** System-wide nonperforming loans (NPLs) are reported to have declined to about 3 percent of total loans, but this is likely to understate the true level of problem loans. Part of the reduction in reported NPLs is due to transfers of NPLs (equal to about 3.8 percent of gross loans) to the Vietnam Asset Management Company (VAMC). While Banks are required to gradually provision against assets transferred to VAMC, the underlying credit and associated capital impairment risks have not been fully eliminated, especially since less than 5 percent of the transferred bad debts have been resolved.

**At the beginning of the year, the SBV moved towards more market driven management of the exchange rate – a key step to enhance responsiveness to external volatility.** While maintaining a crawling exchange rate peg, the SBV moved to setting a daily reference

exchange rate in line with the market, instead of periodic one-off devaluations as applied in the past. As a result the dong depreciated slightly by just about 1 percent since the beginning of the year while foreign reserves started to recover – albeit very gradual - to about 2.5 months of imports by the end Q1-2016 from 2 months in 2015.

**Accumulated fiscal imbalances remain a cause of concern.** Overall fiscal deficit (including off-budget items) is estimated to have widened to about 6.5 percent of GDP in 2015 from 6.2 percent in 2014. As a result, Vietnam’s total outstanding public debt (government, publicly-guaranteed and local government) was estimated at 62.2 percent of GDP, nearly 11 percentage points higher than the level in 2010 and inching quickly toward the legally-mandated ceiling of 65 percent of GDP. Fiscal outturns in the first months of 2016 suggest that budget pressures persist.

**The drought and contraction in agriculture pose risks to livelihoods, in particular among poor and vulnerable households.** There are over 1.0 million poor households and over 1.0 million nearly poor households (about 8.1 million people) in the three most severely affected regions (Central Highlands, Mekong River Delta and the South Central). About 75.7% percent of these households have at least one household member working in agriculture and are thus vulnerable to income shocks associated with the drought. Simulations suggest that a 10% reduction in agricultural income could increase the poverty rate by 2.6 percentage points in the Central Highlands and by 1.9 percentage points in both the Mekong River Delta and the South Central.

#### Vietnam’s Macroeconomic Outlook

	2013	2014/e	2015/e	2016/f	2017/f
GDP growth (%)	5.4	6.0	6.7	6.0	6.3
CPI (annual average, %)	6.6	4.1	0.6	4.0	4.5
Current account balance (% GDP)	4.5	5.1	0.5	0.1	0.2
Fiscal balance (% GDP)	-7.4	-6.2	-6.5	-5.9	-5.7
Public debt (% GDP) - MOF definition	54.5	59.6	62.2	64.1	64.8

Source: GSO, MOF, SBV và WB

**Vietnam’s medium term outlook remains positive, but subject to risks.** GDP is projected to grow by 6 percent in 2016 with inflationary pressures contained and the current account in balance. The fiscal deficit is projected to remain high this year but then tighten over the medium term, reflecting the government’s fiscal consolidation plans. The baseline outlook is subject to external and domestic risks. A further weakening in the US and EU economies (especially following the BREXIT vote) and a sharper slowdown in China could dim Vietnam’s growth prospects. On the domestic front, slow progress in implementing structural reforms to boost productivity in both the state owned and private sector pose risks to medium-term growth prospects, while delays in addressing lingering NPL problems in banking sector and fiscal consolidation could pose a risk to future macroeconomic stability and growth.

## *Special focus: Promoting Healthy and Productive Aging in Vietnam*

**Vietnam is projected to begin aging at a very rapid pace.** As of 2016, around 7 percent of the Vietnamese population, or around six and a half million people, are 65 years old or older, and over 10 percent are 60 and older. By 2040, the number of people 65 and older is projected to almost triple to 18.4 million, and to account for 17 percent of the population (UN 2015). Put another way, the elderly dependency ratio in Vietnam (the percentage of people 65+ relative to the working age population) is expected to almost triple from around 10 percent presently to 26 percent by 2040. The speed of aging in Vietnam is among the fastest seen globally to date, and is happening at much lower income levels than currently old countries.

**An important consequence of these trends is the impact on the labor force.** The working age population of Vietnam is expected to shrink by around 5 percent as a share of total population between now and the early 2040s, though the absolute number of working age population will not peak until around 2038 at just over 72 million (from the current 66 million) before declining steadily. The demographic picture is therefore complex. Rapid aging becomes a reality in the very near future, but there is also a demographic window for Vietnam to accommodate. The demographic tailwind which Vietnam has benefited from since doi moi (more than doubling of working age population) is weakening and will reverse by the late 2030s.

**The speed of demographic transition in Vietnam poses new challenges for policymakers, employers and citizens, some of them urgent.** Rapid aging will require policy action and behavioral change in a number of areas:

- In labor markets, the challenge is to prepare for the structural decline in working age population and to enhance labor productivity of the shrinking labor force. First, this will require increasing female labor force participation, especially among urban professional women who often retire very early, and supported by enhanced state financial support for childcare and eldercare. A second measure would be moving away from seniority-based wage setting mechanisms, which make older workers less attractive and are not linked to worker productivity. A third area is promoting flexible work arrangements such as part-time, flexi-work and job-sharing, measures which are attractive to older workers and employers, and promote a “glide” into retirement rather than an abrupt withdrawal. A third cost-effective intervention is adjustments in the workplace to make them more suited to the physical capacity of older workers. Apart from enhancing the quantity of future workers, Vietnam should continue to improve worker quality, through strengthened quality of tertiary, vocational and technical education, development of life-long learning channels to facilitate continuous skill upgrading across the life cycle, and supportive reforms in labor regulation and policies such as ho khau to encourage movement of workers from lower to higher productivity sectors and from informal to formal sector jobs.
- In fiscal terms, the biggest risk will be financial sustainability of the pension system and its current low coverage. Despite sensible reforms in 2014, the formal sector pension system remains financially unsustainable and in need of deeper reform. A key measure

will be gradually raising official retirement ages, and eventually equalizing them for men and women, as well as ensuring that penalties for early retirement are actuarially fair. Other measures likely to be needed are downward adjustments in accrual rates to align with regional and global comparators, accompanied by widening the base for social contributions to include the full salary, allowances and bonuses. Better financial balance can also be achieved through disciplined application of pension indexation based on consumer price movements, and gradual reduction of the number of professions with preferential retirement conditions. If these important reforms of the formal sector pension scheme can be achieved, it will create fiscal space to expand coverage of pensions in line with the Government's ambitious targets. Global experience suggests that major expansion in coverage through purely contributory means is very challenging to achieve. In this context, more promising options include gradually lowering the eligibility age for the generalized social pensions from 80 years old toward 70 years over time. Expansion of subsidized contributory pensions for the informal sector should also be considered.

- There are also significant challenges for healthcare and aged/long-term care systems. The health delivery system will require a fundamental reorientation towards more emphasis on primary care and reduced reliance on hospital care in order to manage the increase in non-communicable diseases exacerbated by aging. There will need to be reforms of human resource policies and programs for the health sector, requiring new graduate and post-graduate training programs for general practitioners, as well as re-training of existing cadres. Reorientation to primary care and case management will also benefit from reforms in provider payment mechanisms for health services, strengthened gate-keeping modalities to control unnecessary hospital usage and admissions, and improved coordination of care across levels of the health system. There will also be a need for efficiency improvements in areas such as pharmaceutical procurement and prescription practices, as well as greater focus on managing conditions of age such as dementia. Growing demand for aged care will also require proactive public policy, with an emphasis on home- and community-based care and defining of appropriate roles for the state, the private sector, communities and households.



# SECTION I: RECENT ECONOMIC DEVELOPMENTS

## I.1: External Economic Environment

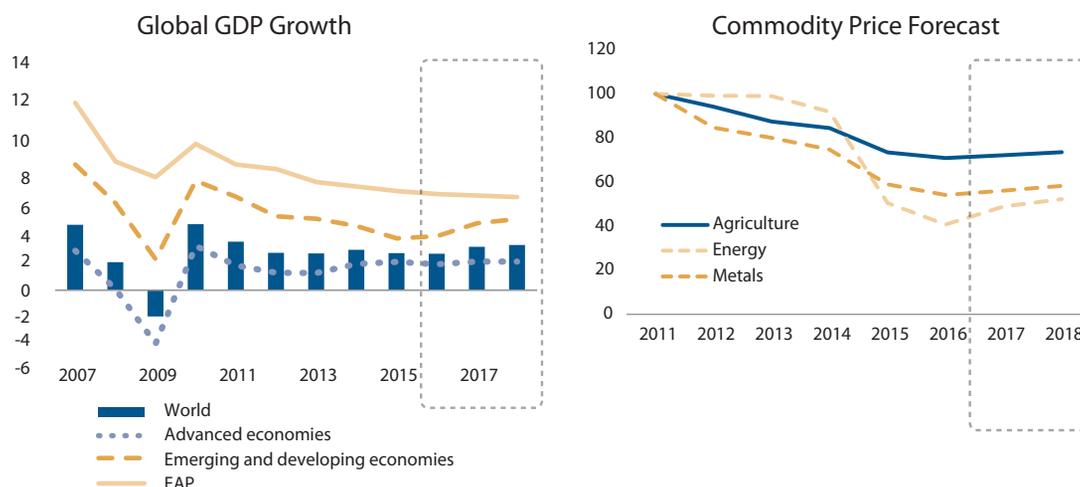
### *Global growth remains sluggish*

**1. Global economic activity is showing little sign of improvement in 2016.** Growth prospects have weakened throughout the world economy, including major emerging and high income economies (Figure 1.1). The latest World Bank Global Economic Prospects, released in June, projects global growth for 2016 at 2.4 percent, unchanged from the disappointing pace of 2015 and 0.5 percentage points below the January forecast. Further commodity price declines have worsened the prospects for commodity exporting emerging and developing economies. Meanwhile, growth in advanced economies remains disappointing despite lower energy prices and the ongoing improvement in labor markets. Amidst lackluster growth prospects, global trade slowed further in 2016. Global merchandise trade growth declined to about 3 percent, largely reflecting a marked deceleration in import demand from commodity exporters and slowing activity and economic rebalancing in China.<sup>1</sup>

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<sup>1</sup> World Bank, Global Economic Prospects, June 2016

**Figure 1.1: The global recovery remains subdued**



Source: World Bank

**2. Despite the persistent weakness of the global economy, growth in developing East Asia and Pacific (EAP) has remained relatively resilient and is expected to ease only modestly during 2016-18.** Growth of the developing EAP is forecasted to ease slightly to 6.3 percent in 2016 and 6.2 percent in 2017-18. The economic slowdown in EAP region largely reflects China’s gradual shift to slower, more sustainable growth and the weaker outlook of several commodity exporters (Table 1).<sup>2</sup>

**Table 1: East Asia and Pacific GDP Growth**

	2014	2015/e	2016/f	2017/f
Developing East Asia and Pacific	6.8	6.5	6.3	6.2
China	7.4	6.9	6.7	6.5
Indonesia	5.0	4.8	5.1	5.3
Malaysia	6.0	5.0	4.4	4.5
Philippines	6.1	5.8	6.4	6.2
Thailand	0.8	2.8	2.5	2.6
Vietnam	6.0	6.7	6.2	6.3
Cambodia	7.1	7.0	6.9	6.8
Lao PDR	7.5	7.0	7.0	7.0
Myanmar	8.5	7.0	7.8	8.4
Mongolia	7.9	2.3	0.7	2.7
Memo: Developing East Asia excl. China	4.6	4.7	4.8	4.9
Memo: ASEAN	4.4	4.4	4.6	4.8

Source: World Bank

<sup>2</sup> World Bank, East Asia and Pacific Economic Update, April 2016

**3. Global risks remain skewed to the downside.** Downside risks dominate the global outlook and include slow growth in high-income countries, a broad slowdown across emerging markets, weak global trade, persistently low commodity prices, and increasingly volatile global financial markets. The potential further weakening of the EU recovery following the BREXIT vote, the gradual slowdown and rebalancing in China and widespread weakness across other BRICS, could have substantial spillovers on other emerging and developing economies. Financial market turbulence—triggered, for instance, by spikes in borrowing costs during the U.S. monetary tightening cycle or by rising risk aversion—could significantly impact capital flows to the more vulnerable emerging economies.

**4. Looking ahead, Vietnam’s economy is facing stronger global headwinds.** Strong trade linkages expose Vietnam’s economy to weakening external demand, especially in the United States and EU (following the BREXIT vote, see also Box 1)—its main export markets. As a net importer of oil products low commodity prices will strengthen Vietnam’s external position, but at the same time exacerbate existing fiscal pressures due to declining oil revenues. While balance of payment risks are contained by resilient FDI, relatively limited exposure to volatile capital flows and recent steps by the authorities to enhance exchange rate flexibility, heightened financial volatility poses some risk against the backdrop of Vietnam’s weakening current account and low external reserve coverage. In addition, the anticipated policy rate liftoff in the United States is expected to cause sovereign spreads to rise in the international capital market. This could be a concern for Vietnam, given its large gross public financing needs, which are expected to be partially met by international bond issuances.

**Box 1: Vietnam’s exposure to BREXIT impacts**

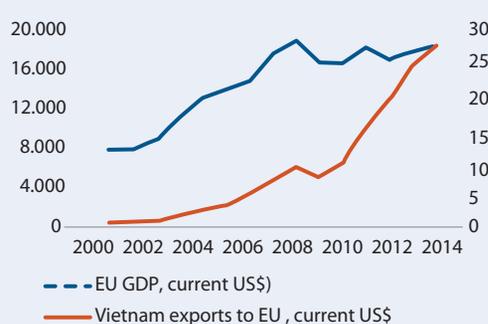
**The BREXIT vote adds considerable uncertainty to an already fragile global environment.**

On June 23, 2016, the U.K. held a referendum on its membership in the European Union, which resulted in a narrow victory for the “leave” campaign. In the short run, the BREXIT vote exacerbated volatility in global financial markets, although global markets have bounced back since then. In the longer run, it may further weaken the growth outlook in the UK and EU with knock on effects on global growth, trade and investment.

**Table 1 Exposure to BREXIT**

Transmission channel	Vietnam’s Exposure	
	EU/Vietnam Total	UK/Vietnam Total
Cross-border lending		2.3%
FDI	<8%	<2%
Exports	18.9%	2.9%
Tourist arrivals	12%	2%

**Vietnam’s exports and EU GDP**



**While Vietnam may be affected by these developments through financial market, trade and investment channels, exposure to potential first round effects is relatively limited** (table 1).

✓ **Financial markets:** The reaction of the Vietnamese markets has been in line with global markets. The Vietnam stock index was down 1.8% initially, but has since made up almost all losses. Equally, the Vietnam dong initially depreciated by 0.13% against US dollar, but has since

bounced back. More volatile global financial conditions and a sustained surge in the US\$ could reignite capital outflows and put pressure on the exchange rate and domestic interest rates. However, compared to more financially integrated economies, these risks are relatively contained in Vietnam, given its limited reliance on portfolio inflows (including cross-border interbank lending). Since part of Vietnam's public debt is denominated in US\$ and Yen, a sustained strengthening could in turn amplify pressures on the public debt stock, although associated liquidity and debt service risks are limited due to concessional and long term nature of this debt.

✓ **Trade and tourism:** BREXIT could further weaken the already frail growth prospects of the EU economy which would in turn dampen demand for imports, including from Vietnam. Being the second largest export destination, the EU market accounts for 19.5% of Vietnam's exports with the UK accounting for about 3 percent of Vietnam's exports. Exports to the EU are dominated by consumer goods, including garment, footwear, phones, and computers as well as selected food items, including seafood which together account for nearly 70% of Vietnam's exports to EU. In recent years, Vietnam's exports to the EU have been quiet resilient and not very sensitive to changes GDP growth in the EU. This suggest the effect of a potential slowdown in the EU may be dampened. Finally, visitors from the EU and the UK account for about 12% and 2% of all tourist arrivals, respectively. While a slowdown in the EU and UK could reduce travel demand, the magnitude of the impact is expected to be too small to affect the Vietnamese economy.

✓ **Foreign Direct Investment:** The impact of Brexit on FDI is also expected to be marginal. At the end of 2015, total cumulative FDI commitments of EU countries to Vietnam are around 25 billion, which is equivalent to about 8% of total – relatively small compared to top investors such as Korea, Japan, Singapore and Taiwan (China). FDI commitments by UK are less than 2 percent of the total.

**Despite the limited direct exposure, heightened global risks reinforce the focus on solidifying macroeconomic stability to strengthen Vietnam's resilience to cope with potential external volatility.** The current policy mix of continued exchange rate flexibility, a gradual build-up of foreign exchange reserves and fiscal consolidation (to stabilize debt and restore fiscal buffers) is appropriate in this context.

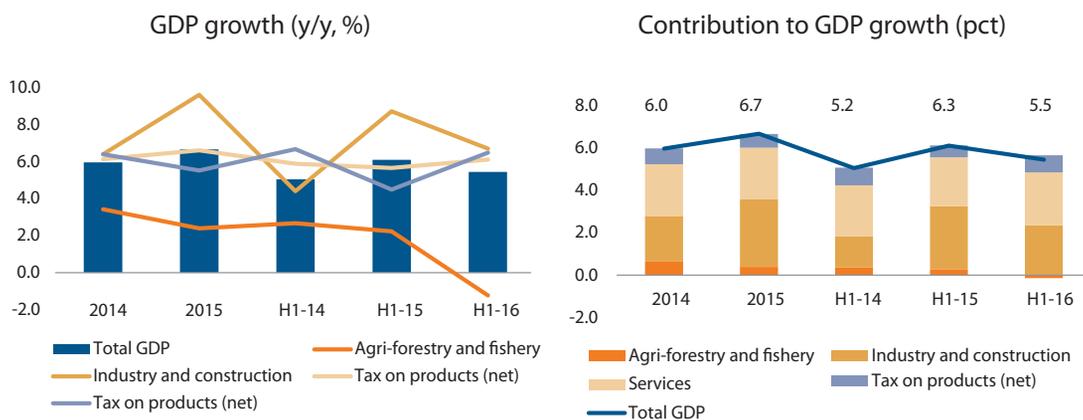
*Source:* WB staff estimates

## 1.2: Recent Economic Developments in Vietnam

### *Growth moderated due to the impact of a severe drought*

**5. Economic activity has moderated in the first half of 2016.** Driven by strong export-oriented manufacturing and buoyant domestic demand, growth accelerated to 6.7 percent in 2015 – the fastest growth rate in 7 years. Following this strong performance the first half of this year saw GDP growth (y/y) slowing to 5.5 percent, compared to 6.3 percent growth during the same period in 2015 (Figure 1.2). The deceleration is largely due to a severe drought and saltwater intrusion across key agricultural regions. Agriculture, forestry and fishery output contracted by -0.2 percent (compared to 2.2 percent increase during H1-2015). The output of mining sector continued contracted resulting from subdued oil price. In contrast, growth picked up further in the construction sector, driven by buoyant credit growth and a recovery in the real estate sector. The service sector also accelerated, driven in particular by retail trade growth which benefited from sustained strength of domestic consumption.

**Figure 1.2: Moderating growth**



Source: GSO

**6. A severe drought caused agricultural output to contract in Q1-2016.** Since the end of 2015, warmer than average temperatures and lack of rainfall—partially attributed to El Niño— have led to the most severe drought in Vietnam in 90 years. The situation has been worsened by salinity intrusion in the South Central Coast and Mekong Delta regions due to the decrease in freshwater from rainfall, reduced upstream river flows, and falling groundwater levels. It is estimated that the combined effect of the drought and salinity intrusion have affected about 360 thousand ha of agricultural land and 26 thousand ha have not been planted at all. According to the U.N. Food and Agriculture Organization (FAO) the drought is expected to continue to affect parts of the country until September 2016, likely placing over 600 thousand ha of rice at risk. As a result rice production fell by 6.4 percent in winter-spring harvest of 2016 leading to an overall year on year contraction of 0.7 percent in agricultural output during the first half of 2016. In April, an Emergency Response Plan was launched by the Government and the United Nations to address immediate life-saving and livelihood-protection interventions for the next three to five months and to identify longer term actions to bolster resilience (Box 2).

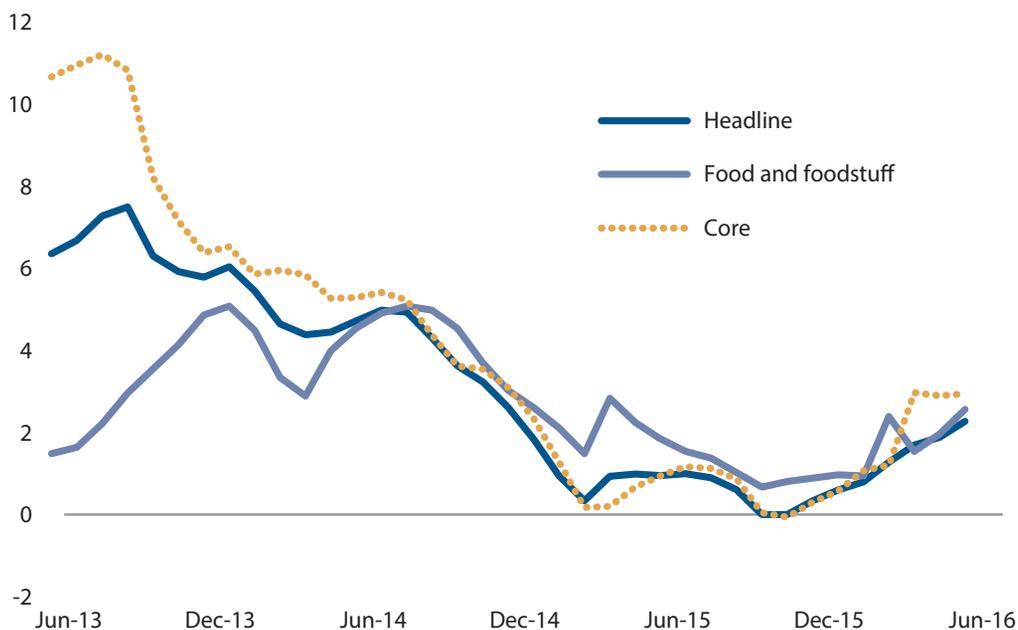
## Box 2: Drought and Saltwater Intrusion (SWI) in 2015-16

- As of April 2016, 22 out of 63 provinces have been affected by the current drought and saltwater intrusion. The affected provinces requested financial support from the central government, and 18 provinces have declared state of emergencies.
- Nearly 2.3 million people across the Mekong Delta, South Central, and the Central Highlands regions have had their access to livelihoods and basic services disrupted. The drought and its impacts are threatening agricultural production, limiting access to safe water for 400,000 households, and significantly disrupting access to social infrastructure (health care, education). Around 150 schools and 150 health centers in the affected provinces are estimated to have poor water and sanitation services as a result of the drought.
- Over 1.75 million people are estimated to have lost their livelihoods due to the impact of drought and SWI on the agriculture sector. Varying degrees of productivity loss have affected about 360 thousand ha of crops; and 26 thousand ha have not been planted at all. The current water shortage combined with loss of income could drive many farmers into poverty in the next few months. Many households are already in debt due to previous crop losses and do not have resources to stabilize their livelihoods in the coming months by restoring their farmland or aquaculture plots.
- The drought and contraction in agriculture poses a risk to livelihoods, in particular among poor and vulnerable households. There are over 1.0 million poor households and over 1.0 million nearly poor households (about 8.1 million people) in the three most severely affected regions. About 75.7% percent of these households have at least one household member working in agriculture and are thus vulnerable to income shocks associated with the drought. Simulations suggest that a 10% reduction in agricultural income could increase the poverty rate by 2.6 percentage points in the Central Highlands and by 1.9 percentage points in both the Mekong River Delta and the South Central. In other words, nearly 760 thousand people in these regions are at risk of falling into poverty.
- Almost 2.0 million ethnic minorities (EM) in Central Highlands, specifically, are expected to be vulnerable to the current drought as 93% of the currently working EM people are engaged in farm work while the mean share of income from agriculture among EM households is very high, at 82%.
- *Mekong Delta Region:* Saltwater intrusion is a cyclical natural phenomenon in the Mekong Delta, but provinces in the region are now facing the most extensive SWI in 90 years. In 2016, SWI started two months earlier than is typical, and extended inland an average of 50–60 km further than is usual, contaminating land an average 20–30 km further inland than normal. By the end of April, approximately 40–50 percent of arable land in the Mekong Delta was affected by SWI. As a result of SWI, rice cultivation area in this region declined by 16.7 percent between mid-March 2015 and mid-March 2016. The province most impacted is Ca Mau, with more than 49 thousand ha of paddy crops affected. As of April 2016, 11 of 13 provinces in the Mekong Delta had been seriously impacted by SWI, and salinization continues to increase. The highest increases have been recorded at the Ben Tre and Tien Giang stations. In the upcoming dry season, SWI is expected to encroach even further inland.
- *Central Highlands and South Central Regions:* In the Central Highlands and South Central regions, the drought has impacted nearly 70 percent of cultivated area. Local authorities estimate that about 40 thousand ha of paddy rice in three South Central region provinces (Khanh Hoa, Ninh Thuan, and Binh Thuan) are likely to remain unirrigated, and almost 31 thousand households lack access to safe water to meet daily needs. Estimates for the Central Highlands indicate that in Dak Lak, Lam Dong, Dak Nong, and Kon Tum about 150 thousand ha of agricultural lands (in addition to 10 thousand ha used for coffee cultivation) are likely to remain unirrigated. The forest fire warning in this area has also been raised to level IV, the highest level possible.

- The drought is expected to continue to affect parts of the country until September 2016, likely placing over 600 thousand ha of rice at risk, according to the U.N. Food and Agriculture Organization (FAO). Most affected households expect drastically lower rice yields in damaged fields in the coming months, with yield losses in excess of 70 percent. The Department of Crop Production estimated that it would cost approximately VND 34 trillion (US\$ 1.5 billion) to address the damages caused by drought and SWI. The impact figures are likely to grow, as the Ministry of Agriculture and Rural Development (MARD) expects salinity in the Mekong Delta to reach its highest level in a century.
- The drought is expected to have significant adverse economic repercussions for Vietnam's agricultural output and exports. MARD estimated the rice output could fall by 1.5 percent to 44.5 million tones this year. The ongoing drought has not only affected Vietnam's rice production, it has also limited its ability to export rice. Vietnam's rice exports are expected to fall about 10 percent to below 6 million tons—an eight-year low. Similarly, due to drought effects (and lower yields from old trees), coffee exports could fall 25 percent in 2016, to their lowest in a decade at 1 million tons.

Source: Strategy Note on Integrated Risk Management for Drought and Saltwater Intrusion in Vietnam, World Bank Draft, May 2016, forthcoming.

**Figure 1.3: Consumer Price Index (% , y/y)**



Source: GSO

***Amidst moderate inflation, monetary policy continues to balance growth and stability***

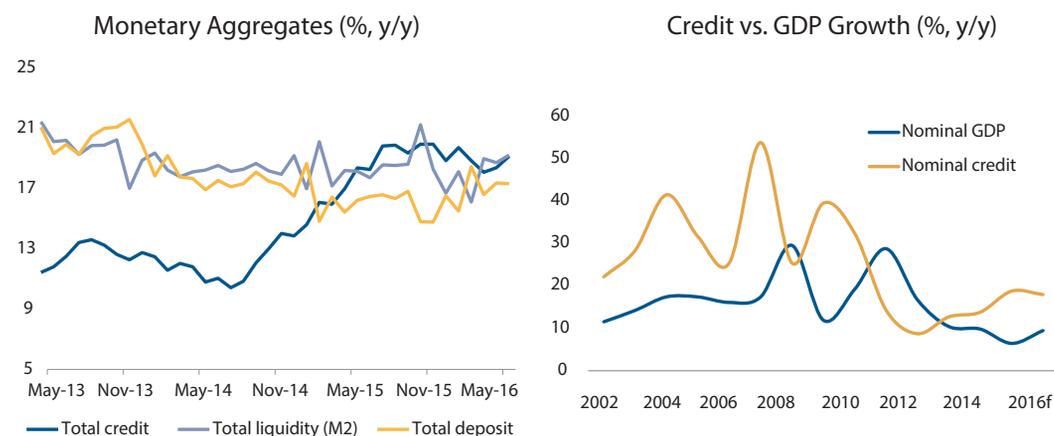
**7. Despite a recent uptick, price pressures remain subdued.** Driven by rising food and administrative prices, Vietnam's consumer price index has been ticking up slightly in the first months of 2016. Headline CPI rose by 0.46 percent month-on-month in June, bringing the year-on-year CPI increase to 2.4 percent, up from 0.6 percent in December 2015 (Figure 1.3). The drought induced contraction in agricultural output is putting upward pressure on

food prices which increased by 2.6 percent year-on-year during the first half of the year. Core inflation also picked up due in part to adjustment in health care fees and education services. This recent acceleration in inflation, notwithstanding, CPI inflation is expected to remain moderate mainly due to soft commodity prices and stay well below the 5 percent mark the authorities are aiming for this year.

**8. Monetary policy continues to balance growth and stability objectives.** The targets for monetary policy for 2016 embody SBV's dual focus on ensuring stability while boosting growth. The targets include achieving economic growth of 6.7 percent, maintaining CPI below 5 percent, reaching a credit growth rate of 18-20 percent, accelerating M2 growth rate to 16-18 percent and ensuring NPLs remain below 3 percent of total banking sector assets.

**9. Credit growth remained elevated during the first few months of this year – continuing to expand at roughly three times the pace of nominal GDP growth** (Figure 1.4). Despite an overall benign inflationary environment, the SBV has refrained from cuts in policy interest rates since late 2014. Nevertheless, several banks lowered lending rates and credit accelerated 18.8 percent in 2015. Credit continued to surge during the first months of 2016, expanding at an average of about 6 percent since the beginning of the year – equivalent to roughly 18 percent year-on-year.

**Figure 1.4: Strong Credit Growth**



Source: SBV

Source: GSO and SBV

**10. To address rising concerns about adverse impacts of rapid credit growth on lending quality, the SBV adopted tighter prudential regulations in April 2016** (Circular 06/2016). The measures which will be phased in over time include lowering the cap on short-term funds used for medium- and long- term loans and raising the credit risk weight for real estate lending. In addition, Circular 06/2016 also raised the limit for using short-term capital to purchase T-bonds from 15 percent to 25 percent (for state-owned commercial banks) and to 35 percent (for joint-stock and foreign banks). These steps are expected to encourage more prudent lending standards, mitigate potential asset-liability mismatches and potentially moderate credit growth. At the same time, the overall credit growth target for the year remains 18 -20 percent, suggesting that bolstering the real sector remains a policy focus that may compel the authorities to ease the policy stance if needed.

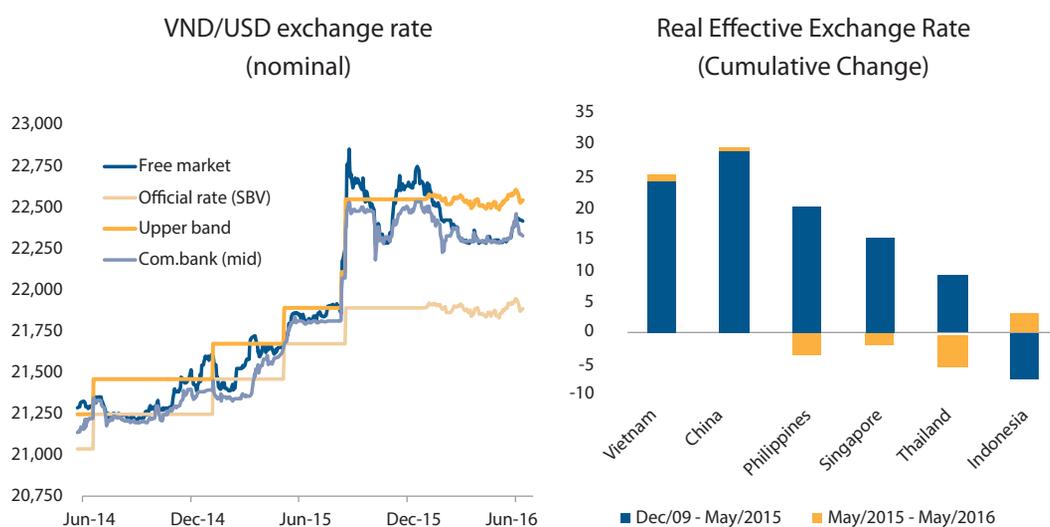
### 11. Meanwhile, lingering asset quality problems still pose a risk to the banking sector.

A major step in resolving the NPLs in the banking system was the establishment of the VAMC, which, since its establishment in July 2013, has absorbed more than \$8.5 billion in bad assets in exchange for zero interest bonds. Although this mechanism has reduced the NPLs reported by the banks, the relief provided to them is only temporary, while requiring them to provision against the transferred NPLs over an agreed period of time (recently increased from 5 to 10 years). Although NPLs in the banking system formed 2.9 percent of total banking assets by December 31, 2015, this only partly reflects the asset quality problem in the banking system, as it does not include the non-performing assets held by the VAMC. Including the NPLs held by the VAMC, total non-performing assets in the banking system exceed 7 percent. In February, SBV issued the draft Circular to amend the circular No. 19 on selling and settlement of bad debts at the VAMC and allows VAMC to buy and sell assets at market value and allowing more flexibility in dealing with NPLs.

### 12. Since the beginning of 2016, the SBV moved towards more market driven management of the exchange rate – a key step to enhance responsiveness to external volatility.

While maintaining a crawling exchange rate peg, the SBV moved to setting a daily reference rate of the dong versus the dollar in line with the market, instead of one-off devaluations as applied in the past. These steps reflect the longer term objective of the SBV to move away from using the exchange rate as the nominal anchor and to introduce inflation targeting. In the short run, they should prevent pressures from building up, especially in the context of volatility in currency markets across the region. As a result the dong depreciated slightly by 1 percent since the beginning of the year while foreign reserves started to recover– to about 2.5 months of imports by the end Q1-2016 from 2 months in 2015 (Figures 1.5). Due to the more limited nominal depreciation of the dong (relative to currencies of trading partner) the real effective exchange rate continues to appreciate.

**Figure 1.5: Relatively Stable Exchange Rate, but Real Appreciation**



## Slowing Trade

**13. While Vietnam’s trade performance remains exceptionally strong, it has not been completely insulated from the weak global environment.** Over the first five months of 2016, Vietnamese exports slowed to 6.2 percent (year-on-year) which is still far above global trade growth but lower than last year and the year before. This is mainly due to a combination of declining oil exports and slower growth of manufacturing export. After a strong year in 2015, export growth in the foreign invested sector –the main driver of higher value manufacturing exports slowed markedly to 7.2 percent from 13 percent last year, likely reflecting a combination of high base effects and subdued external demand. Oil exports on the other hand have been adversely impacted by the low oil price causing its share to fall to record low, accounting for only 1.4 percent of total exports (Table 2).

**Table 2: Export Performance**

	Share of total (%)			Growth (% ,yoy)		
	2014	2015	5T-2016	2014	2015	5T-2016
Total export value	100.0	100.0	100.0	13.8	7.9	6.2
Crude oil	4.8	2.3	1.4	-0.2	-48.5	-47.2
Non-oil	95.2	97.7	98.6	14.6	10.8	7.7
Agriculture and fishery products	14.7	12.7	12.8	12.1	-6.9	7.0
Rice	2.0	1.7	1.6	0.4	-4.5	0.3
Fishery products	5.2	4.1	3.7	16.9	-16.0	4.4
Manufacturing	49.4	49.2	48.4	17.2	7.6	6.6
Garment	13.9	14.1	12.8	16.6	9.1	6.4
Footwear	6.9	7.4	7.5	22.9	16.3	8.0
Technology manufacturing	24.8	30.1	32.0	11.3	31.0	12.1
Phones and parts	15.7	18.6	21.1	11.1	27.9	19.1
Computer and electronics	7.6	9.6	9.5	7.9	36.5	6.0
Other	6.3	5.6	5.4	13.7	-2.8	-4.0
Domestic sector	32.6	29.5	28.8	11.8	-2.5	3.8
Foreign invested sector	67.4	70.5	71.2	14.8	13.0	7.2
Foreign invested sector (excl. oil and phones)	46.8	49.6	48.8	17.9	14.3	5.7

Source: Vietnam Department of Customs

**14. Imports contracted by 1.7 percent in the first five months of 2016, reflecting the low oil price and a slowdown in imports of investment and intermediate goods.** Imports of machinery and equipment by foreign firms in the first five months of 2016 remained subdued—declining by 7.2 percent compared to the same period last year (Table 3). Imports of raw materials and intermediate goods have also moderated, as result of falling import prices and slowing exports (given the high import content of Vietnam manufacturing exports, there is a strong link between export and import performance).

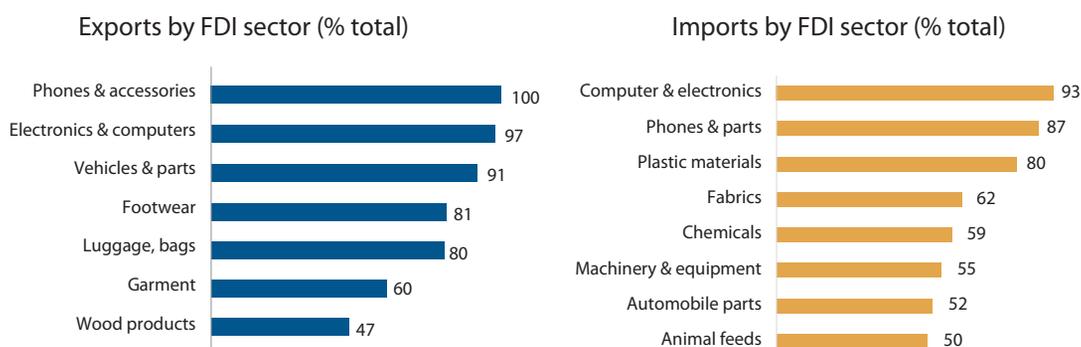
**Table 3: Import Performance**

	Share of total (%)			Growth (% , yoy)		
	2014	2015	5T-2016	2014	2015	5T-2016
Total import value	100.0	100.0	100.0	12.0	12.0	-1.7
Petroleum	6.3	4.2	3.7	9.8	-26.2	-22.9
Machinery and equipment	15.2	16.7	16.1	20.0	23.1	-7.2
Materials and intermediate goods	65.3	65.2	65.5	9.2	11.9	-0.3
Animal feed	2.2	2.0	1.8	5.7	4.2	-17.6
Fabrics	6.4	6.1	6.3	13.0	7.8	2.2
Metal	10.6	9.9	9.4	13.9	4.7	-5.2
Plastic material	4.3	3.6	3.5	10.5	-5.7	0.1
Consumer products	8.3	9.0	9.6	19.6	21.3	8.2
Other	4.9	5.0	5.1	17.4	13.4	2.6
<i>Domestic sector</i>	<i>43.0</i>	<i>41.3</i>	<i>41.0</i>	<i>10.5</i>	<i>7.5</i>	<i>-0.1</i>
<i>Foreign invested sector</i>	<i>57.0</i>	<i>58.7</i>	<i>59.0</i>	<i>13.1</i>	<i>15.5</i>	<i>-2.8</i>

Source: Vietnam Department of Customs

**15. The foreign invested sector continues to lead Vietnam’s trade activities.** The foreign-invested sector accounts for 71 percent of exports and 59 percent of imports, dominating key manufacturing exports of Vietnam (Figure 1.6). Hence, despite Vietnam’s overall strong trade performance, enhancing participation of domestic firms in trade remains a challenge, especially in the context of upcoming trade agreements, such as the Transpacific Partnership, the ASEAN Economic Community (AEC), EU Free Trade Agreement which will provide further opportunities for export growth. As wages will inevitably rise Vietnam’s current comparative advantage in low skill, low cost labor intensive manufacturing will dissipate. For Vietnam to remain competitive it will need to move up the value chain and enhance domestic value addition (Box 3).

**Figure 1.6: The Engine of Vietnam’s Export and Import Activities**

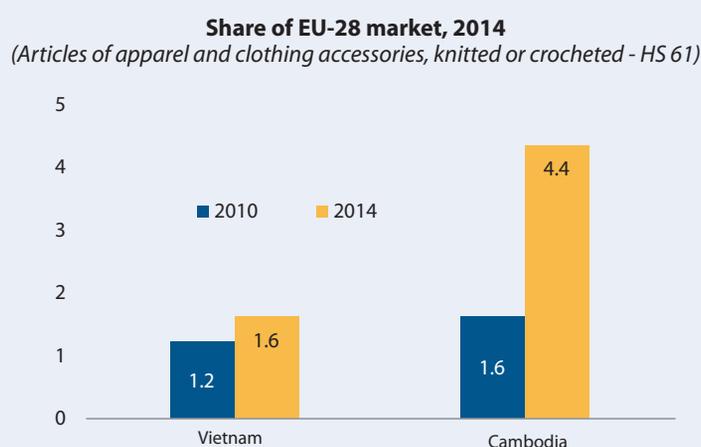


Source: Vietnam Department of Customs

### Box 3: Regional Competitors – Cambodia and Vietnam’s Textile Exports to EU

Both Cambodia and Vietnam are exporters of textiles and garments. At present, exports of garments account for about 70 and 16 percent of total merchandise exports of Cambodia and Vietnam, respectively. The industry has created about 700 thousand jobs for Cambodians (or 35 percent of employments in the industry sector) and nearly 1.2 million jobs in Vietnam (10 percent of employment in Vietnam’s corporate sector).

A comparison of the two country’ export performance shows the Cambodia has been successful in growing its market share in some specific export market. As ASEAN members, both countries signed trade agreements with the EU and enjoy the same market access. Cambodia more than doubled its market share in knitted and crocheted apparel in the EU over the past four years. In nominal terms, Cambodia exported nearly US\$ 2.2 billion of knitted apparel to EU countries in 2014 – almost three times larger than that of Vietnam. This shows that Vietnam is facing competition from other countries, especially in traditional labor-intensive low skill manufacturing exports.

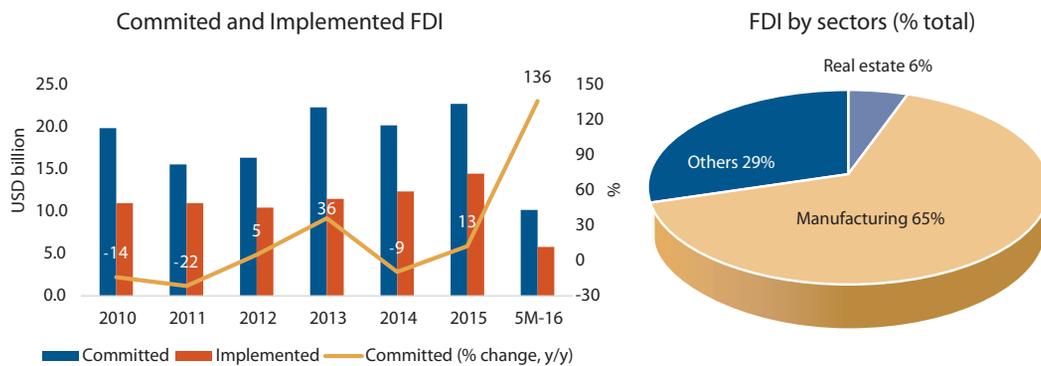


Source: Cambodia Authorities, Vietnam Department of Customs, UN Comtrade and World Bank WITS

### ***Bullish Foreign Direct Investment***

**16. Foreign direct investment has accelerated in recent months, reflecting positive investor sentiment about Vietnam’s deeper economic integration.** In the first six months of 2016, foreign investors committed US\$ 11.3 billion to Vietnam – a 105 percent increase compared to the same period last year. At the same time, foreign-invested firms disbursed US\$ 7.3 billion – an increase of 15 percent in nominal terms over the previous year (Figure 1.7). By end-June 2016, Vietnam had investments from more than 100 countries and territories, with total accumulated FDI commitments of around US\$ 290 billion in a broad and diversified range of investment activities. The foreign-invested sector contributes about 18 percent of Vietnam’s GDP, nearly a quarter of total investment, two thirds of total exports and millions of direct and indirect jobs.

**Figure 1.7: Foreign Direct Investment Continues Strong**

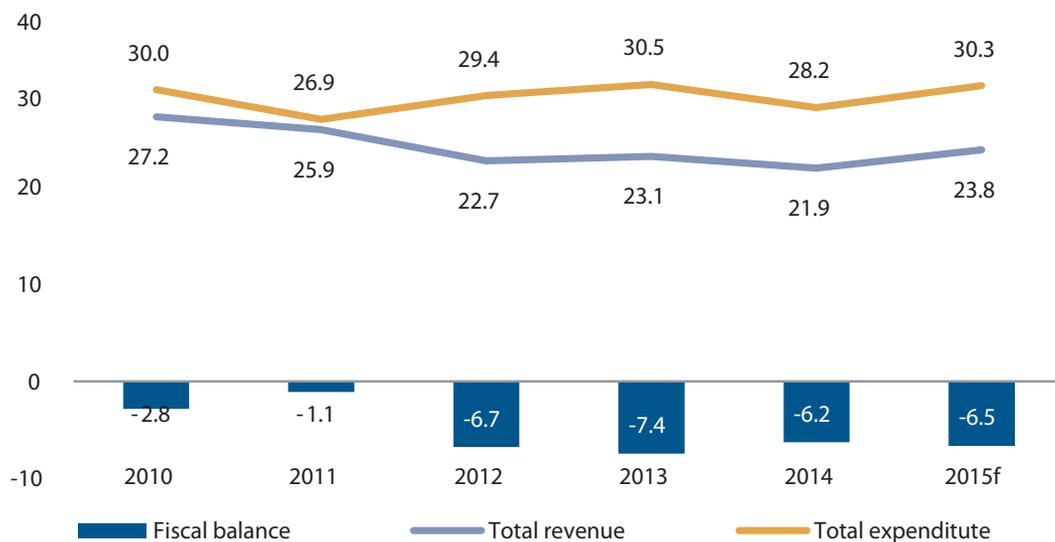


Source: MPI

**Fiscal Pressures Remains Acute**

**17. Despite strong revenue performance, rapid expenditure growth further widened the fiscal deficit in 2015.** The overall fiscal deficit (including off-budget items) is estimated to have widened to about 6.5 percent of GDP in 2015 from 6.2 percent in 2014. Preliminary figures show that budget revenues increased to the equivalent of 23.8 percent of GDP in 2015 – an increase of nearly 2 percentage points compared to 2014, but expenditures rose quickly to 30.3 percent of GDP, mostly a result of expansion of capital spending (Figure 1.8).

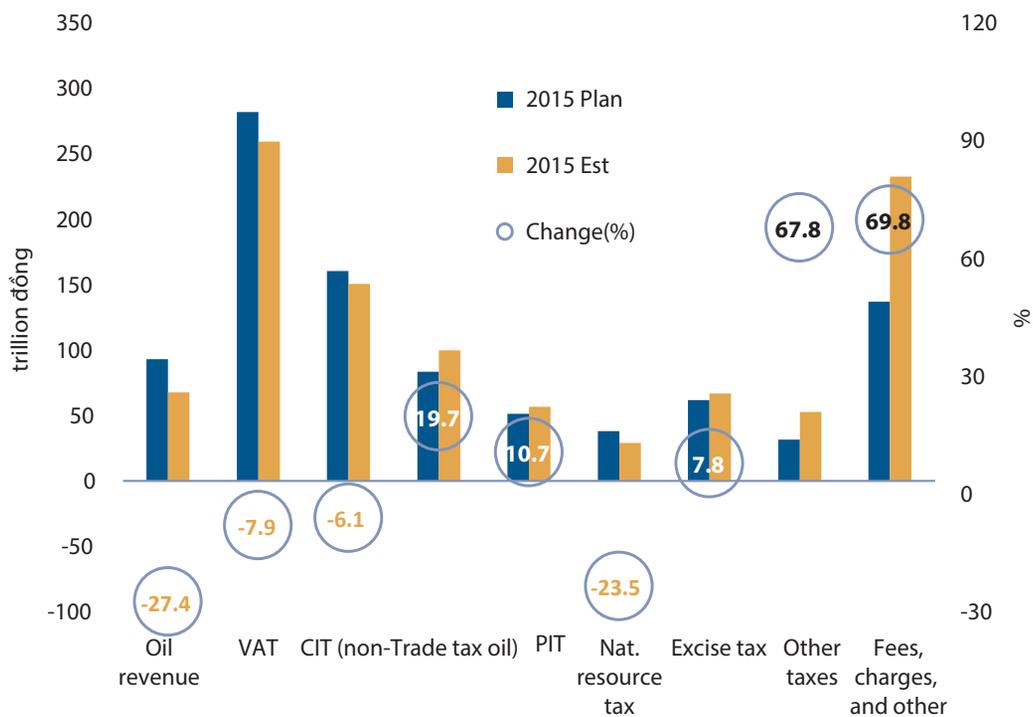
**Figure 1.8: Persistent Fiscal Imbalance (Fiscal Balance, % of GDP)**



Source: MOF

**18. Revenue collection in 2015 exceeded the initial budget plan, but mainly as a result of higher collection of non-tax revenue.** The latest estimate of the Ministry of Finance (MOF) shows that actual budget revenues exceed the initial revenue target by 9.4 percent in 2015. However, despite this overall strong revenue performance, collections from major taxes underperformed. The collection of value-added tax (VAT) and corporate income tax (CIT, excluding oil) which together account for a half of total tax revenue came in 7.9 percent and 6.1 percent below the initial target, respectively. Persistent weakness in the oil price also put pressure on oil related revenue which stayed 27 percent below the budget target. Weak collection on domestic tax was partially offset by rising trade taxes which -boosted by strong import growth- exceeded the initial budget target by 20 percent. Most importantly, non-tax revenue (fees, charges, capital revenue and collection of dividend from state capital) performed strongly, exceeding the initial budget target by almost 70 percent and more than compensating for the shortfall in tax collections. While non-tax revenues contained revenue shortfalls in 2015, some of the increase was based on one-off effects. For example, proceeds from sales form state assets and collection of land-use rights rose nearly 75 percent over the plan to VND 69 trillion (US\$ 3.1 billion), accounting for roughly one third of non-tax revenue. Since these do not present recurrent revenue sources, there are concerns about whether the recent increases are sustainable.

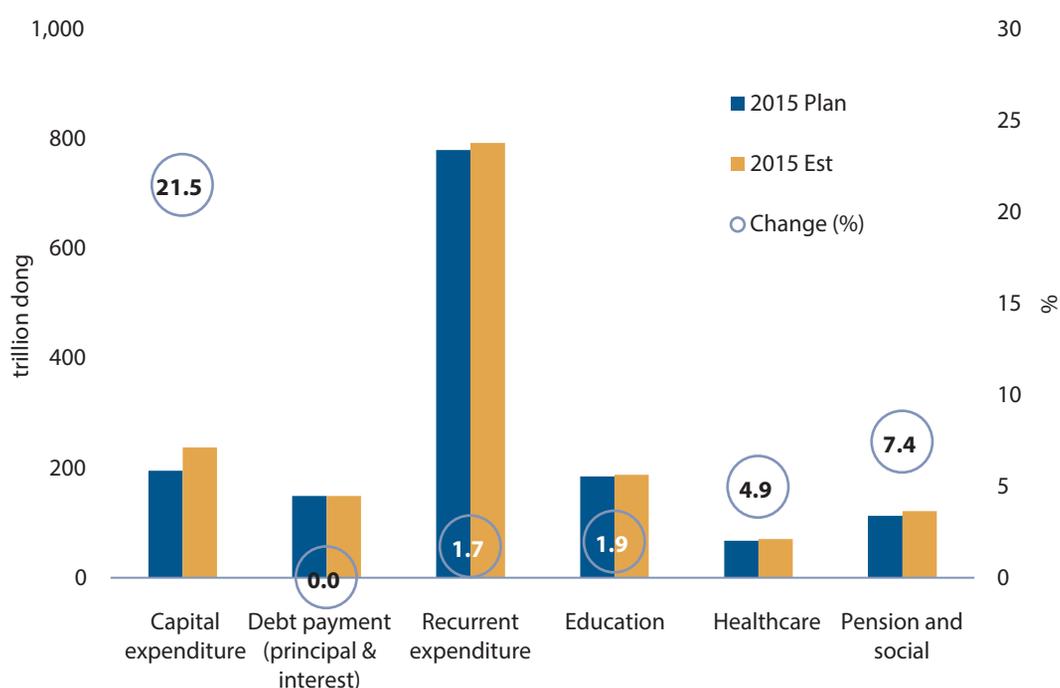
**Figure 1.9: Strong revenue collection, driven by non-tax revenue**  
*State budget revenues*



Source: MOF

**19. Public expenditure continued its expansionary trend mainly on the back of rising investment.** Total public expenditure increased by 18.3 percent in nominal terms compared to 2014, exceeding 2015 budget plan by 10.3 percent. While recurrent expenditure rose by 7.9 percent, capital spending increased 21.6 percent on the account of large public investment projects. Debt service payments also continued to rise in 2015 and now account for nearly 15 percent of total revenue. It is commendable that Vietnam continued to manage the expansion of the expenditure on social development areas such as education, training and healthcare given the increasing budgetary pressures.

**Figure 1.10: Expansionary Public Spending**  
*State budget expenditures*

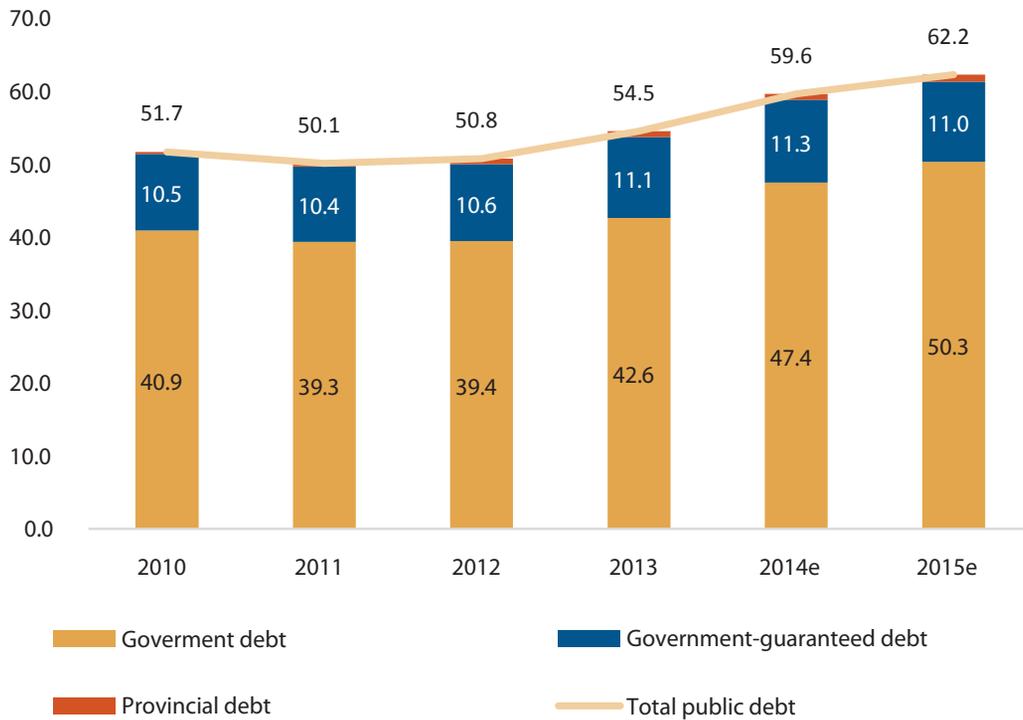


Source: MOF

**20. Fiscal outturns in the first months of 2016 continued to show persistent budget pressures.** According to the Ministry of Finance, estimated budget revenues through May 2016 stood at 39 percent of the annual plan. Revenue from crude oil declined by 48 percent (y/y), while collection from import and export tax declined by nearly 11 percent because of weakening import growth. During the same period, total expenditures reached VND 466 trillion (US\$ 20.7 billion), up 4.7 percent compared to the same period last year and accounted for 36.6 percent of the annual plan. Current expenditures were up 5.1 percent, and investment expenditures rose by 4.2 percent. As a result the budget deficit reached VND 70 trillion (US\$ 3.1 billion) - approximately almost 28 percent of annual target approved by the National Assembly. In the first five months of 2016, the MOF issued VND 147 trillion of domestic bonds to finance the deficit and infrastructure investment.

**21. Vietnam’s total public debt has been rising rapidly in recent years.** The Ministry of Finance reported that, by the end of 2015, Vietnam’s total outstanding public debt (government, publicly-guaranteed and local government) was estimated at 62.2 percent of GDP, nearly 11 percentage points higher than the level in 2010 and inching quickly toward the legally-mandated ceiling of 65 percent of GDP (Figure 1.11). The main driver of the rise in public debt appears to be large and persistent fiscal deficit with most of the additional financing needs being met by domestic debt.

**Figure 1.11: Rising Public Debt**  
Public debt (% of GDP)



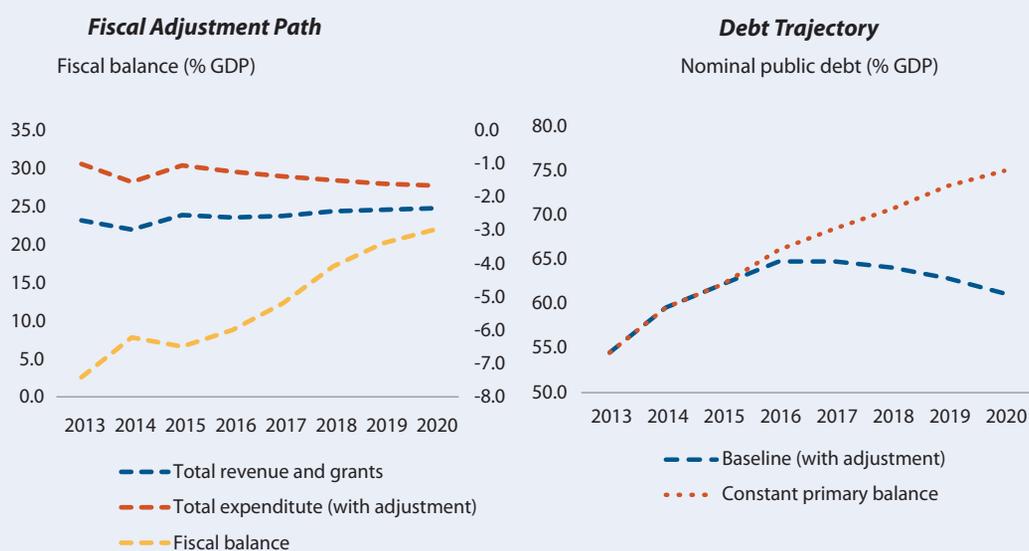
Source: MOF

**22. The government has made a commitment to fiscal consolidation to ensure public debt sustainability and rebuild fiscal buffers.** Even though the risk of acute debt distress remains limited (due to Vietnam’s largely concessional external debt), public debt has risen fast and with strengthening of domestic demand the rationale for countercyclical expansionary fiscal policy is diminishing. Moreover, medium term fiscal financing needs –including for the redemption of short term domestic debt—are substantial and interest expenditure is on the rise. At the same time, access to concessional external financing will naturally continue to tighten as Vietnam solidifies its middle income status and becomes more reliant on international and external capital markets as a source of governance financing. In this context a credible fiscal consolidation plan would not only lower overall financing needs but also reduce the cost of commercial borrowing by bolstering investor confidence and improving Vietnam’s creditworthiness in capital markets. The Government’s commitment to strengthen budget discipline, however, will have to be balanced with reforms

that create fiscal space to maintain critical investments in infrastructure and spending on essential public services. The quality of the adjustment, including a balanced combination of revenue and expenditure measures and a strong focus on spending efficiency gains, as opposed to across-the-board curtailment of discretionary spending and investment is therefore important (Box 4).

#### Box 4: Fiscal Consolidation And Debt Sustainability

Stabilizing debt levels will require a gradual fiscal adjustment path. The SEDP 2016-20 envisages that headline budget deficit would be reduced to 3 percent of GDP by 2020. Debt sustainability analysis suggest that achieving this deficit target –especially if combined with steps to slow down the issuance of guarantees– would indeed contain further increases in public and publicly guaranteed debt, allowing the public debt to remain below the 65 percent of GDP threshold by 2020. Under baseline scenario the revenue to GDP ratio would have to increase by about 1 percentage points to 24.7 percent of GDP by 2020. Moderation of expenditure growth (to less than nominal GDP growth) would contribute another percentage point of GDP to the adjustment. As the result, the overall deficit would decline from 6.5 percent in 2015 to about 3 percent by 2020. This baseline assessment is subject to considerable risk, including in particular delays in fiscal consolidation and persistent primary deficits exceeding the debt stabilizing level as well as growth and exchange rate shocks.



Source: Data from 2016 onward is projection. World Bank staff estimates.

### I.3. Gradual Structural Reform Progress

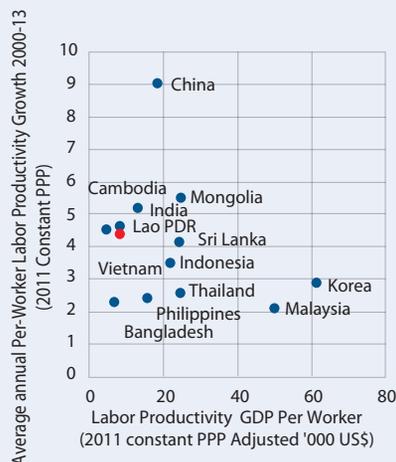
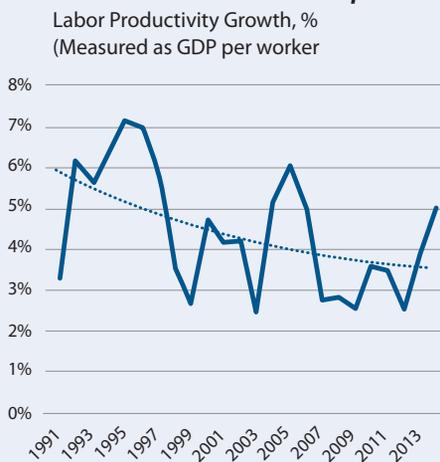
**23. Over the longer term, achieving higher rates of economic growth depends on Vietnam’s ability to continue and deepen structural reforms.** Having been a major driver of GDP growth in the early years of Vietnam’s transition, the contribution from productivity growth declined drastically over the past decade. Especially labor productivity growth has stagnated. There is also evidence that the rates of return to investments have deteriorated, partly reflecting diminishing returns, but also pointing to inefficiencies in the allocation of capital. Structural transformation—a major source of productivity growth in earlier years—

has slowed over the last few years. Meanwhile, within sector and firm productivity growth is dampened by a combination of incomplete restructuring of state owned enterprises and a still infant domestic private sector, dominated by small firms that simply lack the scale, access to technology and competitive pressure needed to boost productivity. Moreover, as wages inevitably rise, Vietnam's current comparative advantage in low skill, labor intensive industries will start to dissipate. Strengthening linkages to global value chains and diversifying into higher productivity and value added activities will become critical to sustain growth and job creation and make most of the opportunities offered by deepening global and regional integration.

### Box 5: Demographic Dividend, Labor Productivity And Growth

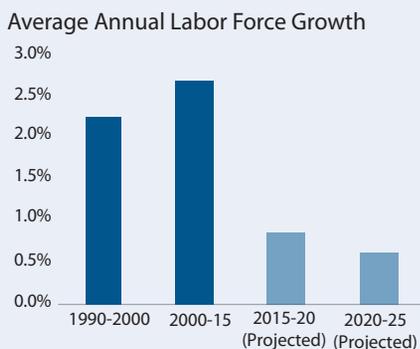
**Vietnam's demographic dividend is starting to dissipate.** In recent decades Vietnam reaped a significant demographic dividend. Since 1990 almost 25 million Vietnamese have come of working age. This greater labor supply translated into average annual labor force growth of about 2.5 percent, almost doubling Vietnam's work force between 1990 and 2013. Indeed, about one third of Vietnam's historical average GDP growth rate (6.7 percent) can be attributed to the expanding work force while two-thirds traditionally came from labor productivity growth. However, looking ahead, this demographic dividend will start to dissipate and potential employment growth is expected to decline due to demographic factors (the broader implications of population aging are discussed in this edition's special topic note). In coming decades Vietnam will become one of the fastest ageing societies in the world with significant implications for the labor market, fiscal policies, public services and growth. While the working age population and labor force will continue to expand for another two decades, the rate of increase will be markedly lower--about half of the recent historical average. In fact the working age population is already in decline as a share of the population. Furthermore, the already quite high labor force participation rate (around 77 percent) implies limited reserves to boost aggregate labor supply.

#### Vietnam's labor productivity growth has stagnated

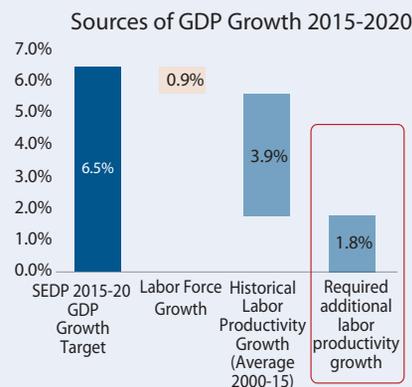


This means Vietnam will need to boost labor productivity to sustain high growth. GDP per employed person more almost tripled between 1990 and 2015—reflecting a combination of improved agricultural efficiency and a rapid shift of employment out of low productivity agriculture into higher productivity non-farm jobs. However, following a bout of labor productivity growth after the initial liberalization of the economy, Vietnam’s labor productivity growth has levelled off just shy of 4 percent over the past decade. While this is close to other emerging economies in Asia at Vietnam’s current productivity level (and high by comparison with emerging economies in other parts of the world), it is less than half of China’s labor productivity growth. Against the backdrop of slowing labor force growth, the current rate of labor productivity growth would not be sufficient to lift Vietnam’s potential growth rate to the levels targeted in the SEDP. This is putting renewed focus on structural reforms to boost efficiency in allocation of resources in the economy, productivity growth and competitiveness.

**A lower demographic dividend...**



**...requires productivity gains to sustain growth**



Source: WB staff estimates based on official data

**24. These challenges are reflected in the government’s new five year socioeconomic development plan (SEDP 2016-20).** The draft of the new SEDP 2016-20 reinforces the focus on productivity-growth enhancing structural reforms. The overall objective is to maintain macro-economic stability while striving for higher economic growth than previous years. The government targets average GDP growth over the next five years of 6.5-7 per cent per year. In terms of priorities, the plan continues to give attention to banking sector, SOE, public investment management and business regulation reforms to provide an environment conducive to private sector-led growth.

**25. Vietnam is making steady, but gradual progress in implementing SOEs reforms.** In the first four month of 2016, additional 34 SOEs were equitized. However, the majority of transactions only involves minority shares which may dampen the intended impact of private ownership on firm performance, in terms of enhanced management, technology transfer and market access. SOE corporate governance has also been strengthened. Pursuant to the Decree 87/2015/ND-CP on financial supervision, performance assessment and financial disclosure, all SOEs are obliged to send their financial reports to the corporate finance department of the Ministry of Finance to enable preparation of consolidated information on the financial performance of SOEs as basis for fiscal risk monitoring and management.

**26. Finally, on May 16, 2016 the Government issued Resolution No. 35/2016/NQ-CP on supporting and developing private sector enterprises and in particular SME over the next five years 2016-2020. The Resolution sets ambitious targets including doubling the number of private sector enterprises to at least one million enterprises by 2020.** The Resolution reiterates the principle that the State will protect citizens’ and

businesses' lawful property rights and right to freedom of enterprise. Enterprises may do business in all sectors and trades which are not banned by law. The State will pursue the policy of serving enterprises and creating favorable conditions for their investment and business activities in the formulation, issuance and implementation of laws and regulations concerning enterprises. The State will guarantee the stability, consistency and predictability of its policies, stabilize the macro-economy and build a favorable, safe and friendly business environment. At the same time, it will ensure equal access to funding sources, land and natural resources among enterprises, regardless of enterprise ownership. Particularly, it will adopt policies to back small- and medium-sized enterprises (SMEs), startups and creative and high potential businesses. In order to attain the intended policy targets, the Resolution assigns specific tasks to cabinet agencies and local administrations, focusing on administrative reform, support for startups, creation of a level playing field for enterprises of all economic sectors, and reduction of taxes, charges and fees imposed on enterprises.

#### I.4. Medium-Term Economic Outlook and Risks

**27. While growth is expected to moderate somewhat this year, Vietnam's medium term outlook remains positive.** GDP is projected to grow by 6 percent in 2016, underpinned by robust domestic demand, in turn reflecting strong private consumption and investment growth. Medium-term growth prospects are enhanced by TPP and other trade agreements which would give Vietnam greater access to large consumer markets while encouraging foreign direct investment. Despite soft global energy and food prices inflation is expected to pick up, albeit from a low level, on the back of stronger domestic demand, lower agricultural production in agriculture and adjustments in administrative prices. The current account balance is projected to remain in narrow surplus, although at lower level than last year, mainly due rising repatriation of investment income by FDI sector. The fiscal deficit is projected to remain high at about 6 percent of GDP this year bringing the public debt-to-GDP ratio closer to the statutory limit of 65 percent of GDP. Over the medium term, the fiscal position is set to tighten reflecting the Government's fiscal consolidation plans.

**Table 4: Vietnam key short-term indicators**

	2013	2014/e	2015/e	2016/f	2017/f
GDP growth (%)	5.4	6.0	6.7	6.0	6.3
CPI (annual average, %)	6.6	4.1	0.6	4.0	4.5
Current account balance (% GDP)	4.5	5.1	0.5	0.1	0.2
Fiscal balance (% GDP)	-7.4	-6.2	-6.5	-5.9	-5.7
Public debt (% GDP) - MOF definition	54.5	59.6	62.2	64.1	64.8

Source: GSO, MOF, SBV and WB

**28. Risks to the macroeconomic outlook remain skewed to the downside.** A further weakening of the economic recovery in the US and EU and a sharper slowdown in China could dampen growth due to Vietnam's high export orientation. In addition, El Niño weather patterns developing across provinces of Vietnam year present a risk to the outlook. Extended dry weather could amplify existing drought conditions that have damaged agricultural production and, if prolonged, could further decelerate growth in agriculture sector while pushing up food prices medium term. On the domestic front, slow structural reform progress also poses risks to medium-term growth prospects, as structural reforms remain critical for Vietnam's competitiveness. Delays in implementing fiscal consolidation could pose a risk to debt sustainability and future stability and growth.



## SECTION II. PROMOTING HEALTHY AND PRODUCTIVE AGING IN VIETNAM<sup>3</sup>

### A. The demographic transition

**Vietnam is about to start aging at an unprecedented pace.** As of 2016, around 7 percent of the Vietnamese population, or around six and a half million people, are 65 years old or older, and over 10 percent are 60 and older. By 2040, the number of people 65 and older is projected to almost triple to 18.4 million, and to account for 17 percent of the population.<sup>4</sup> Put another way, the elderly dependency ratio in Vietnam (the percentage of people 65+ relative to the working age population) is expected to almost triple from around 10 percent presently to 26 percent by 2040 (Figures 1 (a) and (b)). The speed of aging in Vietnam is among the fastest seen globally to date.

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3 This section was prepared by Philip O’Keefe (Lead Economist). It draws on analysis from a World Bank report: *Live Long and Prosper, Aging in East Asia and Pacific* (World Bank, 2016), and feedback from Gabriel Demombynes (Senior Economist), Kari Hurt (Senior Health Operations Officer) and Huong Lan Dao (Senior Health Specialist).

4 UN 2015 Population Projections Revision, using the medium fertility rate scenario for various projections quoted. Using age 60 as the cut-off, around 30 percent of the population will be elderly by 2050 (HelpAge International, 2015).

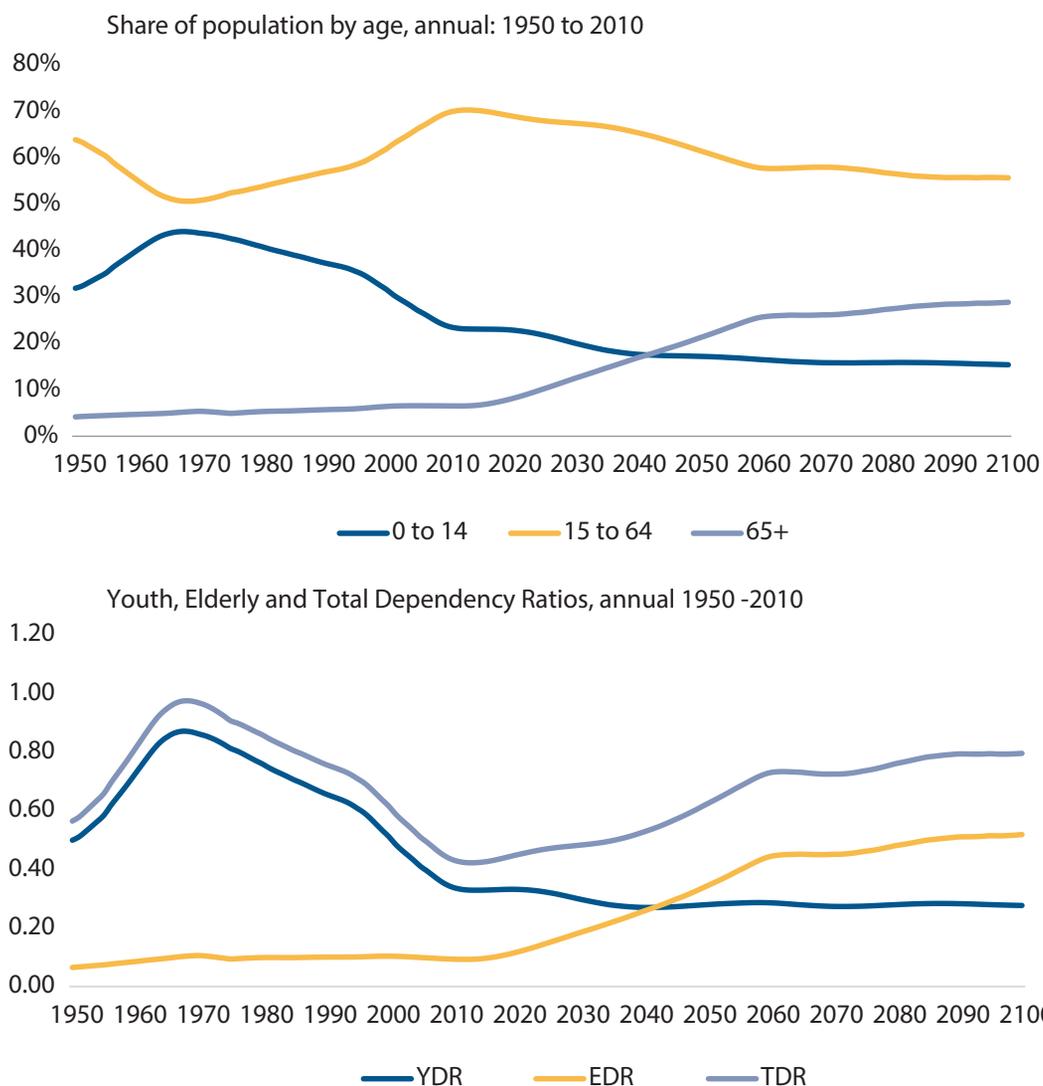
**The primary driver of rapid aging has been the steep decline in fertility rates**, with the total fertility rate per woman falling from over 6 in the mid-1970s to between 1.95 and 2.09 in 2015 as a result of rising income and educational levels and the introduction of an one-or-two child policy informally from the early 1980s and formally from 1993.<sup>5</sup> In the same period, life expectancy rose from just over 60 years old to 76 years old in 2014. This compares to a global average life expectancy for lower-middle income countries of 67 years old (WDI, 2016).

**An important consequence of these trends is the impact on the size and share of working age population.** Using the ILO definition of 15-64 years old, the working age population of Vietnam is expected to shrink by around 5 percent as a share of the total population between now and the early 2040s, though the absolute number of working age population will not peak until around 2038 at just over 72 million (from the current 66 million) before declining steadily from that point onwards. The demographic picture is therefore complex. Rapid aging becomes a reality in the very near future, but there is also a demographic window for Vietnam to accommodate it. At the same time, while there is no immediate decline in the absolute size of working age population (in contrast to neighbors such as Thailand or China), the “demographic tailwind” which Vietnam has strongly benefited from since doi moi (more than doubling of the working age population) is weakening already and will reverse by the late 2030s. As a result, Vietnam’s capacity to rely on an ever-increasing labor force as a strong driver of growth is close to exhausted and future gains will be much more reliant on human capital and productivity gains.

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5 The lower number is the UN estimate and higher number the GoV estimate of TFR. The population policy was relaxed in 2003 but re-imposed from 2009. In discussions of the draft Population Bill, there has been much debate about moving away from the two child guidance. See for example: <http://www.thanhniennews.com/society/vietnam-rethinks-twochild-policy-amid-declining-birth-rate-46409.html>. For an analysis of Vietnam’s population policy, see Pham, Hill, Hall and Rao (2012).

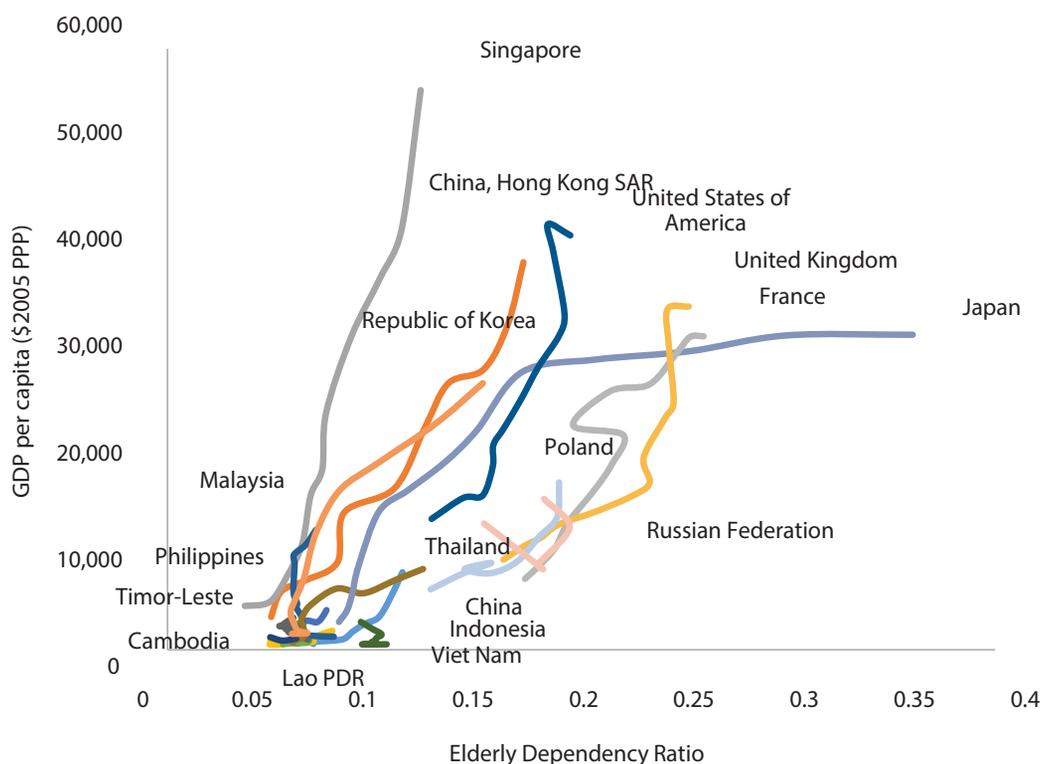
**Figures 2.1 (a) and (b): Vietnam's share of elderly population is rising sharply, resulting in steep increase in elderly dependency ratio (share of population by age and dependency ratios, 1950-2100)**



Source: UN Population projections, 2015 revision.

**The other notable feature which Vietnam shares with a number of its developing Asian neighbors is that it is aging rapidly at a relatively low level of GDP per capita.** Compared to rich East Asian countries and those of the OECD, it is aging at a much lower income level, suggesting that fiscal and administrative capacity to address aging is likely to be constrained (Figure 2.2). Even with sustained solid growth, the pace of ageing in Vietnam will mean that the country gets old before getting rich.

**Figure 2.2: Vietnam is aging at much lower income levels than OECD and its older neighbors (GDP per capita 2005 PPP and elderly dependency ratio)**



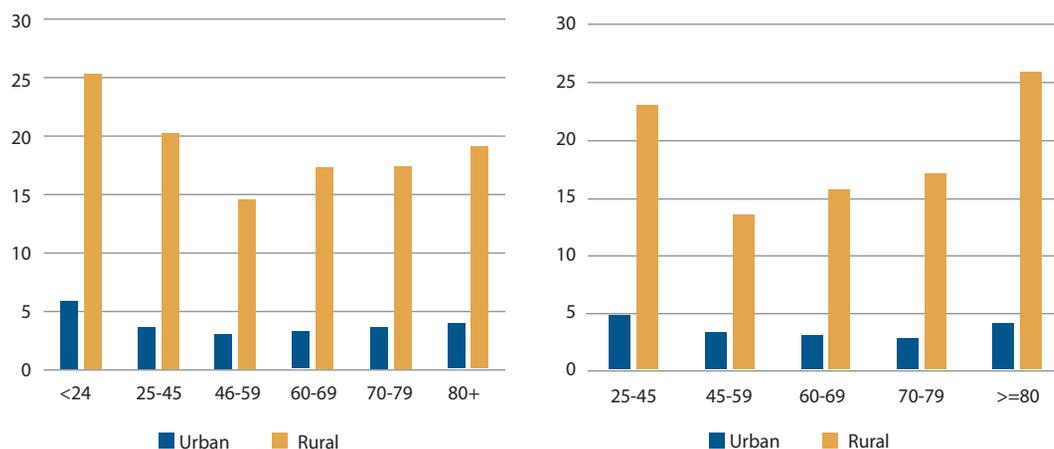
Source: World Bank (2016)

**The speed of demographic transition in Vietnam poses new challenges for policymakers, employers and citizens, some of them urgent and others with time to make necessary adjustments.** Aging will require policy action and behavioral change in a number of areas. In labor markets, the challenge is to prepare for the structural decline in working age population and to enhance labor productivity of the shrinking labor force. In fiscal terms, the biggest and most immediate risk will be financial sustainability of the pension system (and its current low coverage), but there are significant challenges also for healthcare and aged/long-term care systems. The following sections discuss the living situation of older people in Vietnam and then the key policy challenges presented by aging and policy recommendations.

## B. The living situation of elderly Vietnamese people

**Poverty rates by age in Vietnam have clear patterns in rural areas but tend to be low and fairly flat across the age cycle in urban areas.** Figures 2.3a and 2.3b show poverty rates by share of individuals living in poor households by age and poverty rates by age of household head. From either perspective, poverty exhibits somewhat of a “U” shape by age in Vietnam in rural areas, with poverty rates high among children and adults up to their 40s, before declining and then rising again in old age, particularly over age 80.

**Figures 2.3a and 2.3b: Poverty rates of individuals by age (left hand side) and poverty rates by age of household head (right hand side)**



Source: VHLSS 2014, Bank staff estimates

**Another angle on elderly poverty and vulnerability is self-reporting among elderly people on adequacy of their incomes.** Results from the Vietnam Ageing Survey (VAS) 2011 indicate that around 18 percent of urban elderly people and 30 percent rural elderly people report that their income is never or rarely enough to support their needs, with a further third of urban and 38 percent of rural elderly people reporting that their income was sometimes not enough. In addition, in the same survey, around 90 of elderly people reported having no significant savings, and significant shares had debt, primarily on business-related investment, housing, and health and daily expenses (Giang, 2012).

**While many older Vietnamese people continue to co-reside with their adult children, the share is falling and there is variation between urban and rural elderly.** Globally, there is a pattern of falling co-residence rates as countries become wealthier, and this is the case in Vietnam, where co-residence of people 60 and over with adult children has fallen from around 80 percent as recently as 1993 to around 50 percent for rural people 55-70 and 60-70 percent for urban people in the same age group.<sup>6</sup> The lower co-residence rate of elderly in rural areas is likely due to the increase in migration, and also the higher cost of housing in urban areas. Also reflecting the migration pattern, the incidence of elderly living in “skipped generation” households with their grandchildren but no adult children had risen to around 7 percent of households with elderly by 2010-11.<sup>7</sup>

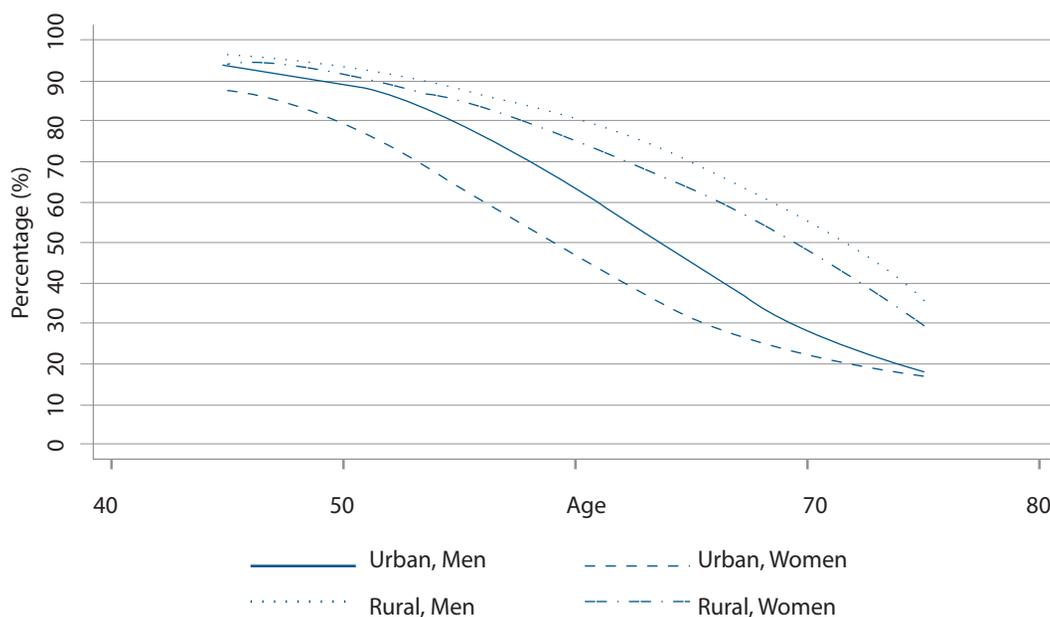
**Elderly people in Vietnam – especially rural elderly – tend to work till advanced ages, but there are significant variations by location and gender** (Figure 2.4). Overall a considerable share of Vietnamese elderly work beyond the global definition of “working age” (ages 15-64). However, the variations across categories of elderly are notable. Rural

6 See Evans and Palacios (2015) re global patterns in developing countries, World Bank (2016) for comparative EAP co-residence patterns and trends, and UNFPA 2011 on Vietnam decline.

7 6.8 percent in 2010 VHLSS and 7.1 percent in 2011 VAS. See Giang, op.cit.

people of both genders are considerably more likely to work well into old age than urban elderly, a pattern which is common across EAP.<sup>8</sup> As a result, those with higher levels of education are more likely to withdraw from work earlier, a concern as Vietnam seeks to enhance labor productivity. In both rural and urban areas, men have somewhat higher participation rates than women, though the difference in rural areas in particular is not very pronounced compared to regions such as South Asia, or countries within EAP such as Philippines, Indonesia and Korea. At age 65, around 70 percent of rural men are still working, often in agricultural activities, while less than one third of urban women are working at the same age. More strikingly, almost 40 percent of rural men are still working at age 75, suggesting that a significant share of elderly “work till they drop” (Giles and Huang, 2015).

**Figure 2. 4: Many Vietnamese have long working lives, especially in rural areas and among men (share of people working by age, gender and location, 2012)**



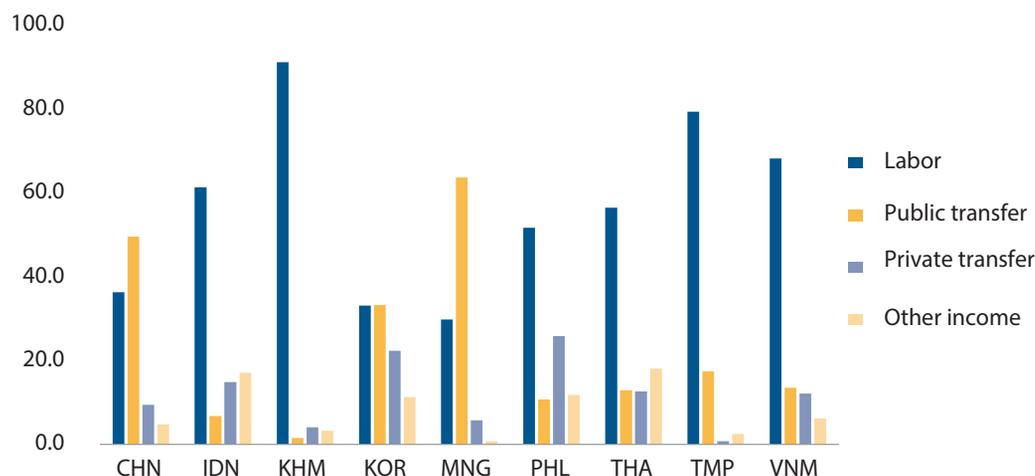
Source: Giles et al for World Bank (2015).

**The importance of own labor for elderly Vietnamese is confirmed by the share of people relying on different income sources for their primary source of support** (Figure 2.5). Around two thirds of people over 60 years old report own labor as their primary source of support. In contrast, only around 10-12 percent of older Vietnamese report public transfers as their primary source of support, reflecting the low coverage of pensions and limited social pensions. More surprisingly, the share of elderly reporting private transfers as their primary source of financial support is not much higher. At the same time, there are differences in sources of income among elderly sub-groups. VASS 2011 found a low share of 60-69 year olds relying primarily on transfers from children (around 13 percent), but also that financial support from children is much more significant for those 80 and over (with around two thirds reporting financial support from children as their primary source of income).<sup>9</sup>

8 See World Bank (2016) and Giles and Huang (2015).

9 See Giang (2012) which provides a comprehensive summary of results from the survey.

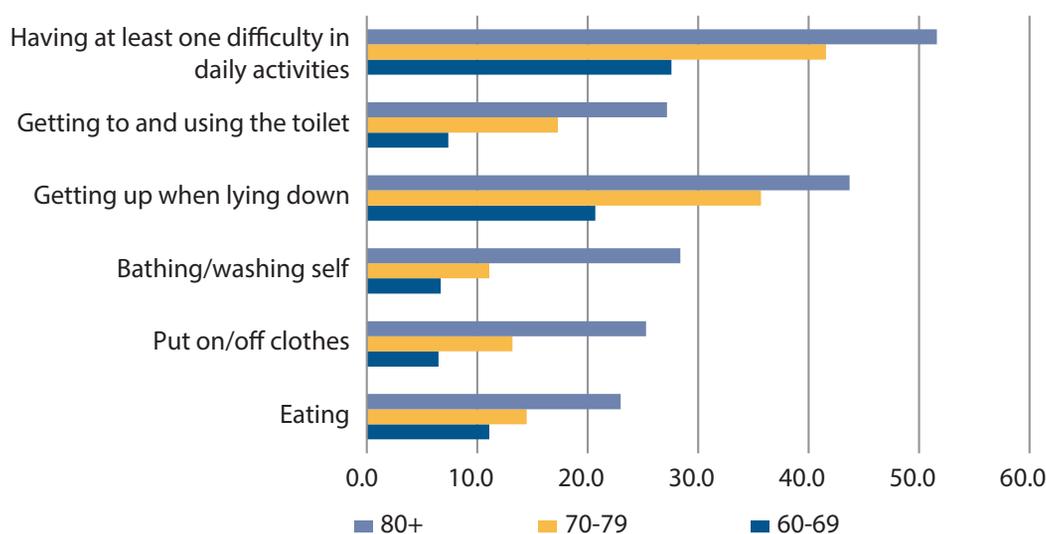
**Figure 2.5: As in much of developing Asia, most older Vietnamese rely on their own labor as their primary source of support (Primary source of support for people 60 years+. Rural top panel; urban bottom)**



Source: Giles et al, 2015 for World Bank based on VHLSS 2012 for Vietnam.

**While healthy years of life expectancy have increased for older Vietnamese people in recent decades, functional limitations increase with age.** This is a common pattern across EAP (World Bank, 2016). In Vietnam, the share of older people having at least one difficulty in activities of daily living increases from around 28 percent among those 60-69 to over 50 percent for those 80 and older, with somewhat higher incidence of difficulties among women (Figure 2.6). Among those who reported a need for support to perform their daily activities, over a quarter reported not receiving the needed support, with the unsupported population much higher among women and in urban areas (Giang, 2012) and other research indicating that the care gap was higher also among disadvantaged groups (Hoi et al, 2011).

**Figure 2.6: Share of older people by age with difficulties performing daily activities**

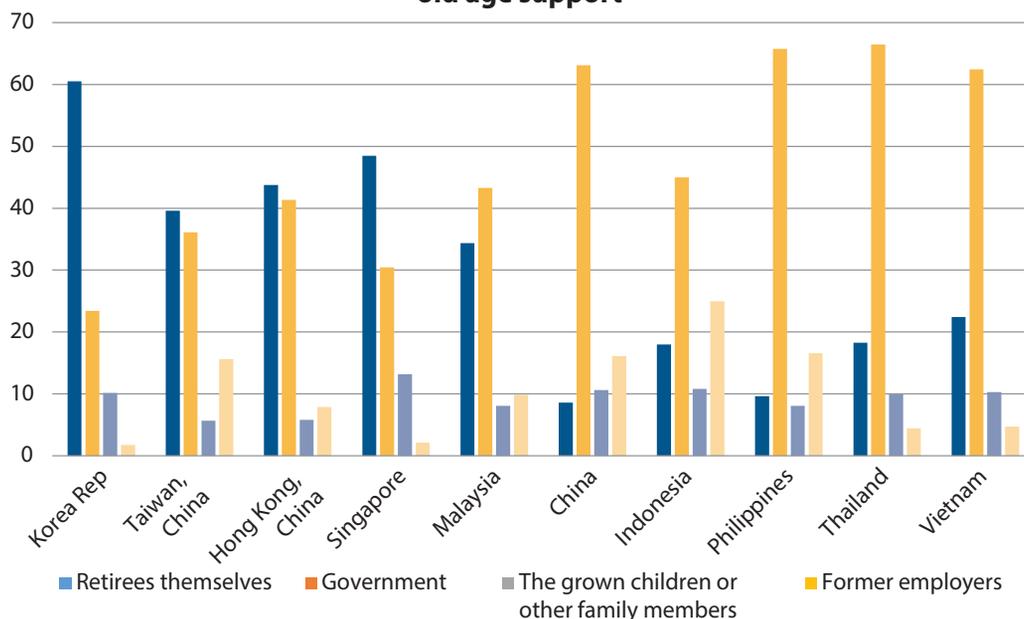


Source: VAS 2011 in Giang 2012.

**A final dimension of aging in Vietnam is expectations on sources of support in old age.**

In a recent survey that asked who *ideally* should be the primary source of support on old age, over 60 percent of adult Vietnamese answer “government”. (Figure 2.7). In contrast, they would prefer to rely less on children and friends. There is thus a major mismatch between preferred sources of support in old age and current realities.

**Figure 2.7: Vietnamese would prefer the state to play a bigger role in old age support in future Percentage by source of who should ideally be primary source of old age support**



Source: Jackson and Peters, 2015. Question: In your opinion, who, ideally, should be mostly responsible for providing income to retired people?

### C. Responding to rapid aging in Vietnam

**The rapidly changing demographics of Vietnam pose a number of challenges for policymakers and society.** At the macro level, there are concerns about possible impact of aging on future economic growth. There are also fiscal risks that accompany rapid aging, with rising pressures on the pension system, impacts on health spending, and emerging needs for a public sector role in aged and long-term care. A key insight from countries in Asia and beyond is that the risks to growth and fiscal positions from aging are real, but that policy choices and behavioral responses by employers, households and individuals play a crucial role in navigating these risks. This section discusses the policy options available to Vietnam.

*(i) Policy and institutional framework:*

**Vietnam has a high level institutional and policy framework on aging, and also an impressive grassroots organization of older people.** At the national level, Vietnam has a National Committee on Ageing, which is chaired by a Deputy PM and with representation of key government agencies and mass organizations. This is supported at grassroots level by the Vietnam Association of the Elderly, which has around 8.3 million members and 11,122

Older People's Associations with almost 100,000 branches. Some of these have evolved into Inter-Generational Self-Help Clubs (ISHC) which include programs for microcredit, livelihoods, health promotion, and elderly rights.<sup>10</sup> At the policy level, the 2009/10 Law on Elderly provides the legal umbrella for policies on older people, with elaboration in circulars and decrees on sectoral areas such as aged care, health care and pensions. The policy directions of the Law are elaborated in the National Action Plan for Older People, 2012-20, and supported by provisions in the Constitution about older people.

**Potential impacts of aging on the macroeconomy: At a macroeconomic level, predicting the impacts of aging on growth is difficult, as behavior and policies change in aging societies.** Estimates by ADB using a growth accounting model predict that aging in Vietnam does not weigh on growth in the current decade, but that it will have a modest negative impact on economic growth during the 2020s and will increase in the following decades. Estimates by Vietnamese researchers have suggested that aging may have a negative impact on growth from as early as 2017 if labor productivity remains unchanged.<sup>11</sup>

**However, much is dependent on assumptions about labor force participation and labor productivity, and how savings behavior and total factor productivity (TFP) evolve in response to aging.**<sup>12</sup> If, for example, formal sector retirement ages are delayed, the labor force effect of aging may be diluted. Equally, a given level of capital investment with a smaller workforce should result in higher productivity per worker. Finally, evidence from other parts of Asia suggest that the negative compositional effect on the savings rate from an older population may be more than offset by positive behavioral impacts as people save more during their working lives in anticipation of longer old age.

**Responding to aging in the labor market: Looking at the labor market, there are a range of policy measures and behavioral responses which can help to prepare Vietnam for the structural decline in working age population.** These include measures to impact total size of the labor force and the *quality* of future workers. A key insight from global experience is that labor market policies to address rapid aging are not just about old people, but require policy interventions across the life cycle. More specifically, measures which Vietnam could focus on would include the following:

**First, the potential for increasing female labor force participation is significant.** While the gender gap in labor force participation is considerably lower in Vietnam than EAP countries such as the Philippines and Indonesia, women in urban areas in particular remain notably less likely to be in paid work outside the home (World Bank, 2014). Gradually closing this gap would be the single most effective measure to offset the structural decline in working age population. However, progress is challenging. Apart from direct efforts in the labor market, such as efforts to close the gender pay gap, it will be vital to improve

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10 HelpAge International, Policy Mapping on Ageing in Asia and the Pacific Analytical Report, 2015.

11 Park and Shin, ADB, 2011. See Vietnam Institute for Development Strategies (VIDS). [web.unfpa.org/webdav/.../vietnam/.../NTA%20Executive%20Summary\\_ENG\\_FINAL](http://web.unfpa.org/webdav/.../vietnam/.../NTA%20Executive%20Summary_ENG_FINAL). Also Minh (2008). [veam.org/papers2008/03%20Nguyen%20Thi%20Minh.pdf](http://veam.org/papers2008/03%20Nguyen%20Thi%20Minh.pdf). National Transfer Accounts Bulletin (November 2015).

12 See Lee (2016) for a useful discussion of the potential channels through which aging may affect growth and the mitigating factors. Also Kinugasa and Mason (2007) for discussion of aging and savings in Asia.

the functioning of childcare and eldercare services, both of which have significant effects on female labor force participation (Thevenon, 2013). With respect to childcare, public investments are likely to be necessary, whether directly into subsidizing childcare services or through other channels such as extended-day kindergarten and primary school services (as Vietnam is already doing in extending the kindergarten day).

**A second area for potential policy reform and behavioral change by firms is extending productive working lives for those in the formal sector in urban areas. The primary focus for extending working lives should be the urban formal sector.** A key measure in this regard is gradual increase in official retirement age, which is 55 for women and 60 for men. Due to generous early retirement provisions, those in the social security system typically retire 3-4 years before the official retirement age. Official retirement ages have not been adjusted even as life expectancy has increased notably, with life expectancy at 60 for men around 20 years and at age 55 for women approaching 30 years (World Bank, 2016). Regression analysis indicates that availability of a formal sector pension is significantly correlated with withdrawal from the labor force across East Asia (Giles and Huang, 2015). While such reforms are politically challenging, they only become more so if delayed and eventually have to be done more rapidly.

**Apart from retirement age, there is a range of measures at firm level that can help to extend productive working lives and make older workers more appealing to employers.** One is reduction in seniority-based wage setting mechanisms, which make older workers less attractive and are typically not linked to worker productivity. A second area is promoting flexible work arrangements such as part-time, flexi-work and job-sharing, measures which are attractive to both older workers and employers and promote a “glide” into retirement rather than an abrupt withdrawal. A third, and very cost-effective, intervention is adjustments in the workplace to make them more suited to the physical capacity of older workers. Experience in countries such as Germany and Japan suggests that simple workplace modifications such as lowering work benches and improving access pay for themselves quickly.

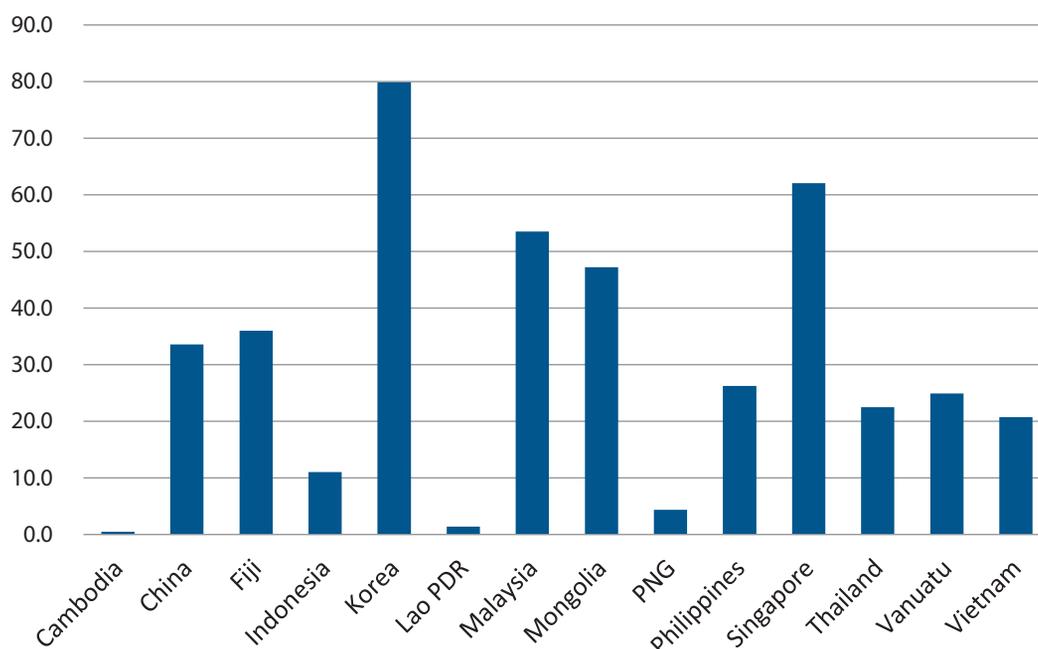
**A final area where Vietnam has significant potential to address a declining working age population is sustaining improvements in human capital acquisition and labor productivity.** Vietnam has already made major strides in improving educational attainment in recent decades, with its share of population aged 20-64 with secondary education or higher rising from 24 percent in 1990 to a projected half by 2030 (World Bank, 2016). Vietnam has also done remarkably well in terms of improving educational outcomes, as reflected in PISA scores which are above those of many OECD countries and MICs (Vietnam 2035). In terms of future labor productivity, an equally important channel could be increasing formalization of the labor market (due to higher productivity in the formal sector), which remains slower than might be expected. But there remains considerable scope to improve worker quality and productivity, through strengthened quality of tertiary, vocational and technical education, development of life-long learning channels to facilitate continuous skill upgrading across the life cycle, and supportive reforms in labor regulation and policies such as *ho khau* to encourage movement of workers from lower to higher productivity sectors and from informal to formal sector jobs.

(ii) *Pensions:*

**Vietnam's pension system faces a stark combination of challenges.** First, coverage of the system remains low at only around 22 percent of the labor force, with the large majority only entitled to a very modest social pension at age 80. Second, the formal sector pension system is financially unsustainable, despite reforms in 2014. Third, despite its financial unsustainability, the formal pension schemes provides pensions that are low in absolute terms. The three challenges are discussed in turn below.

**Vietnam has an ambitious goal of reaching 50 percent coverage of its formal pension scheme by 2020, but is likely to struggle to realize the goal without greater policy innovation and public spending.** The current coverage of around 22 percent of the labor force broadly matches the share of formal sector wage employment, though is well below the 38 percent share with wage employment of some form in 2014 (World Bank, forthcoming). This confirms the challenge of expanding social security participation to the large informal sector, a challenge shared globally by developing countries (Figure 2.8). Virtually no country has expanded coverage to the informal sector through a pure contributory route, and Vietnam is unlikely to be an exception. The 2014 Social Insurance Law amendments allow for a matching contributing approach for informal sector workers to incentivize their participation in social security. This is a worthwhile approach, but it is too early to say whether this will significantly expand coverage. The second strategy would be gradually lowering age for social pension eligibility from the current very high 80 years old. This has already been proposed but not yet financed.

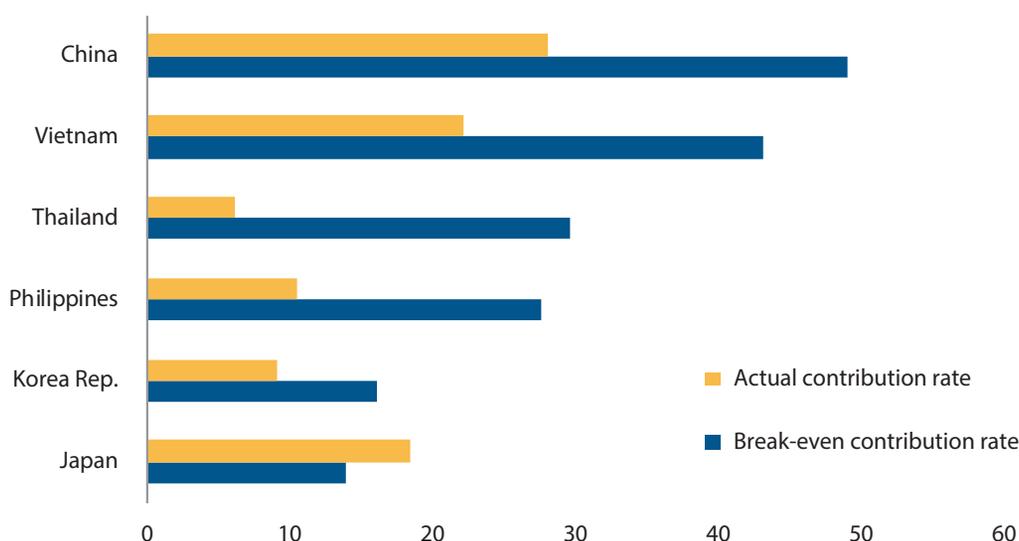
**Figure 2.8: Coverage of Vietnam's formal sector pension schemes remains low**  
**Active contributors to contributory pension schemes as % of labor force, early 2010s**



Source: WB pension database, accessed March 2016.

**The formal pension system faces major sustainability challenges which will grow rapidly as ageing accelerates.** While Vietnam undertook sensible reforms of its Social Insurance Law in 2014, the measures do not go far enough or fast enough to bring the pension system into financial balance. Actuarial projections prior to the amendments showed the pension fund starting cash flow deficits from the early 2020s and exhausting all accumulations by the mid-2030s and then requiring rising subsidies from the budget.<sup>13</sup> While the financial position of the pension fund has improved somewhat with the amendments, updated projections are not available. However, in the 2014 reforms, key drivers of financial imbalance were either not changed at all (e.g. retirement ages) or adjusted insufficiently to make the fund sustainable (e.g. accrual rates and early retirement rules). As a result, the pension fund is still likely to enter cash flow deficit in the 2020s. This can be seen from Figure 2.9, which shows the break-even contribution rate that would be needed to make the pension scheme sustainable. Clearly this is well above what would be desirable from a labor market viewpoint, suggesting that deeper reform will be necessary.

**Figure 2.9: Vietnam’s formal schemes will face significant sustainability issues as they mature**  
**Actual contribution rate and “break-even” contribution needed to sustain financial balance**



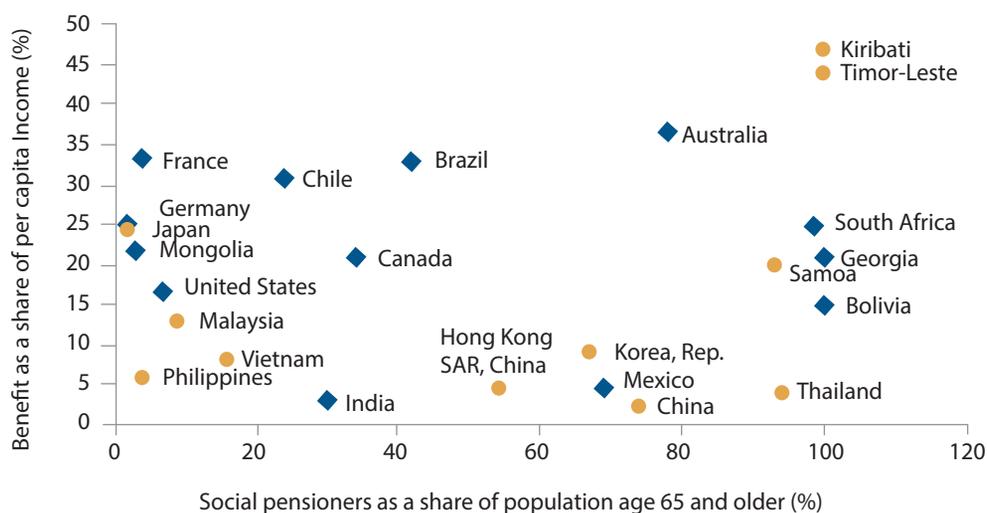
Source: OECD (2013) and Palacios (2015) for breakeven contribution rates. Japanese rate refers to 2017.

**The third major challenge for Vietnam’s pension system is adequacy of benefits.** In the case of those receiving social pensions, benefits are very modest, at under 10 percent of per capita income and with low coverage of those 65-79 due to tight targeting until age 80 (Figure 2.10). The situation of the formal scheme is more complicated. In terms of financial balance, benefits are very generous, with a 3 percent annual accrual rate for women and an average of 2.25 percent for men. These are very high by global standards and financially unsustainable. However, despite the high accrual rates, the absolute level of pension benefits remains low, as

<sup>13</sup> The budget has also borrowed significantly from the pension fund in recent years, totaling over 6 percent of GDP. This funding source would gradually shrink from early next decade in the absence of further reforms.

most people have contributed against basic salary and often minimum wage. Without fixing this issue, it will be difficult to continue the downward adjustments in accrual rates needed to bring the system into financial balance. The 2014 reforms to expand the base for contributions from basic salary to include allowances, bonuses and other compensation are a welcome step to address this problem.

**Figure 2. 10: Social pensions in Vietnam are both modest and tightly rationed by age and means**  
**Social pension coverage of 65 and over and benefit as share of pc income, latest available year**



Source: World Bank (2016).

**Looking ahead, some policy recommendations for Vietnam’s pension system are:**

**Vietnam should consider lowering the eligibility age for social pension gradually from 80 years old to around 70 years old over time.** Even if lowered to 70, this would be still above a number of other countries in the region (e.g. Pacific Island countries; Thailand; China; India). Nepal is an example of an evolving approach to elderly social pensions, introducing a universal social pension at aged 75, and over time lowering the threshold to 70 years and as low as 60 years old for specific groups. A key consideration with social pensions will be fiscal affordability. Projections suggest that a pension-tested elderly social pension at level of the poverty line for people 65+ would cost around 0.7 percent of GDP for the remainder of the decade (Giang, 2011), rising from 2020 as the number of elderly rises sharply.

**In order to expand participation in contributory pensions among informal sector workers, expansion of the current subsidized scheme should be considered.** The coverage expansion targets that Vietnam has set are ambitious and public subsidies will almost certainly be necessary to induce informal sector workers to join contributory schemes voluntarily (as has been seen with health insurance contributions). Mandating their participation will most likely not work. Such Matching Defined Contribution (MDC) schemes require a contribution from the worker but with a match from the government to create an incentive to join the scheme. They have been used in countries such as China,

Colombia, India, Korea, and Thailand, typically targeted to informal sector workers and farmers.<sup>14</sup> The match varies across countries, ranging from around 20 percent of worker contribution to 100 percent (i.e. 1 to 1 match). The example of Korea is notable one, with coverage more than doubling between 1995 and 1999 after introduction of matching contributions for farmers and fishermen. The global experience suggests that keeping MDC design fairly simple and easy to explain to informal workers is important, with flat or simple tiered contributions, flexible payment periodicity, and simple pension benefit structures.<sup>15</sup> There is, however, likely to be a fiscal trade-off between expanding social pensions and subsidies for an MDC scheme.

**If Vietnam is serious about coverage expansion of its pension system, it will also require deeper parametric reforms of the existing pension system to make it affordable.** In the medium term, the country cannot afford both the current system without further reforms and expanding coverage relying on general revenue subsidies (in form of social pensions and/or MDC). The need for another round of reforms of the formal pension scheme is pressing. The key measures to be considered, and which have been implemented in many countries reforming their pension systems in recent years, include:

- *Actuarial modeling of current pension system finances should be carried out at least every 2-3 years.* Simulations should also be done of key parametric reforms to enhance financial sustainability.
- *Phased increases in official retirement ages for men and women, with a target retirement age of 65 years old for both genders.* This would take time to phase in, but a pace of around 4-6 months per year seems appropriate. Once the target age is reached, further adjustments in retirement age should be automatically linked to increased life expectancy at retirement. In addition, the reduction in pension for each year of early retirement prior to the official retirement age should be increased from 2 percent reduction to 4-5 percent annual reduction to remove financial incentives to retire early.
- *The expansion in the contribution base outlined in the GoV roadmap should be followed closely and investments made to support VSS in ensuring compliance with the expanded contribution base.*
- *The pension accrual rate should be further adjusted, initially to no more than 2 percent annual for both men and women.* Over time, a further reduction in annual accrual rate should be considered, targeting a replacement rate of 40-50 percent over an average career.
- *Indexation should be based on CPI and become strictly rules-based and not subject to an annually negotiated approach.*
- *Over time, the list of special occupations subject to special retirement and pension benefit rules should be reduced, and ideally discontinued for new entrants to most listed professions.*

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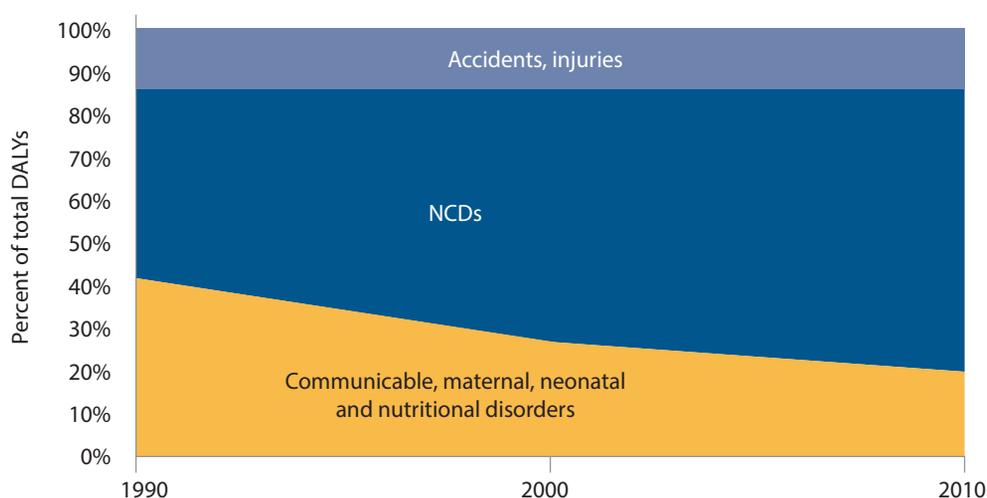
14 The Chinese scheme for rural and urban informal workers is innovative, combining a low matched contribution to an individual account with a “basic pension” which is paid for life from age 60. The total public subsidy comes to around 80-85 percent of the benefit stream after retirement, combining features of MDC and social pension.

15 See Hinz, Holzmann, Tuesta and Takayama (eds), 2013. Matching Contributions for Pensions: A Review of International Experience, World Bank, and Dorfman et al (2013) in that collection for details of the China scheme.

(iii) **Health and aged/long-term care:**

**While aging is not the sole cause, it is a significant contributing factor to the explosion of non-communicable diseases (NCD) in Vietnam in recent years.** As Figure 2.11 shows, NCD account for a rapidly growing share of the burden of disease. Aging is a significant contributor to this trend, as the incidence of non-communicable conditions, and often multiple chronic conditions, in older people is significantly higher than the general population. NCD requires a quite different health system response from the communicable and acute conditions which have characterized the burden of disease in Vietnam in the past. Up to 80 percent of NCD patients need low-level care and this can and should be provided by a strong primary care system. Only about 5 percent of patients with NCDs require complex case management delivered by specialized or hospital-based care (Vietnam 2035).

**Figure 2.11: NCD are exploding in Vietnam and aging is a significant contributing factor**



Source: Global Burden of Disease Study 2010, Institute for Health Metrics and Evaluation (IHME), 2013.

**Despite the rapid expansion of health insurance coverage in Vietnam in recent years, health care costs still impose significant financial pressure on older people.** In 2012, around 30 percent of households with mean age over 50 years old experienced catastrophic health spending, having to spend more than 25 percent of total non-food expenditure (Somanathan, 2015). Among the very elderly (household with mean age 80 and over), the share of households with such very high spending on healthcare approached 40 percent, and over 50 percent in urban areas.

**There are several features of the Vietnamese healthcare system which make it poorly prepared for rapid ageing and the continued expansion of NCD. They include:<sup>16</sup>**

- ***The health service delivery challenge is rooted in two interrelated problems: hospitals are doing too much and grassroots primary care is doing too little.*** Most NCD conditions – which are more prevalent among older people - require basic case management (e.g. provision of blood pressure and cholesterol medication) which is best managed from the primary care level. However, in Vietnam most people seek care either through private pharmacies or at the hospital level. Vietnam has a hospital-centric system in which referrals and self-referrals to overcrowded hospitals are largely a result of low public confidence in the quality of the grassroots health systems. The primary care system is fragmented and ill-prepared to address the challenge of NCD and an aging population. This over-reliance on hospitals and under-utilization of primary care is a product of several factors. The first is weak gatekeeping at primary care level. In most hospitals, well over half of patients come without any referral from a lower-level facility, and at least one-fifth of inpatient admissions should have been handled in an outpatient setting (Vietnam 2035). There are other factors though, including the incentives to hospitals to maximize revenues under socialization policies, the low quality of primary care providers (e.g., at commune health facilities, doctors and assistance doctors responded incorrectly to more than 50 percent of questions on cardiovascular and internal disease – Somanathan, 2015), under-development of general practice medicine, and fee-for-service provider payment mechanisms which encourage over-servicing. As aging progresses, these inefficiencies will become more and more costly to the system if unaddressed.
- ***Poor pharmaceutical procurement and prescription practices.*** Older people consume more drugs typically, and thus inefficient pharmaceutical practices become more costly as populations age. Vietnam’s current pharmaceutical procurement system is highly decentralized and complex. It results in wide differentials in prices of medicines across facilities and areas of the country. There are also irregularities in procurement. As a result, the budget and Vietnamese people pay too much for medication. For example, in Hanoi, an audit found that the prices of winning bids were 130 to 245 percent higher than prices of imported medicines (Somanathan et al, 2014). In addition, prescription practices remain overly-liberal, with regular unnecessary medication for conditions not requiring drugs.
- ***Policies to encourage healthy lifestyles remain weak.*** The best way to minimize the burden of NCD is to delay or prevent their onset. Vietnam does not yet exploit a number of proven policies for promoting healthier lifestyles, with tobacco and alcohol taxation very low, and a relatively modest emphasis on preventive and health promotion programs. In addition, screening programs for early detection of conditions such as breast cancer and diabetes are under-developed. This contributes to a gradually widening gap between health years of life expectancy and total years of life expectancy.

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16 See the health sector discussion in Vietnam 2035, Inclusion Pillar report (forthcoming) for more details.

- **The healthcare system is not yet prepared for the rapid rise in age-related conditions such as dementia and Parkinson's disease.** The number of people in Asia-Pacific region with dementia is expected to triple by 2050, creating new demands on health systems and potentially large economic costs if not well-managed.<sup>17</sup> There are also treatments that are disproportionately consumed by the elderly and for which demand is likely to rise sharply in coming years, including knee and hip replacements, hemodialysis, and certain cancer treatments. Like many developing countries, Vietnam does not have well-developed public health policies for dementia and other conditions of old age.

**In order to manage rapid aging and the generalized expansion of NCD, there are several reform directions for Vietnam's health system for which countries in the region and beyond offer useful lessons.** Encouragingly, GoV has chosen healthy aging as the topic of its Joint Annual Health Review for 2016, and it is hoped that this is a vehicle for better understanding the impacts of aging on health systems and approaches to managing them effectively. Focus areas for the future include:<sup>18</sup>

**First and foremost, the delivery system will have to be transformed away from the current hospital-centric approach to a model centered on good quality primary care, with grassroots providers at the center of an integrated system of care.** This will allow patients, and in particular older people, to be managed at the most appropriate level of care and in the most cost-effective manner. This will require a range of measures which will take a generation to mature, but which are important to initiate as soon as possible. There will need to be reforms of human resource policies and programs, resource allocation including provider payment mechanisms, gate-keeping modalities, and coordination of care. New graduate and post-graduate training programs will have to be launched, as well as re-training of existing cadres. While this is a challenging set of reforms which is likely to encounter resistance, there are good examples in the region such as Thailand which offer lessons for Vietnam.

**Reforming pharmaceutical procurement and prescription practices will be essential to controlling costs and promoting appropriate treatment, a need made more acute by rapid aging.** Higher level procurement should help realize opportunities for volume discounts on tenders. Beyond that, global experience shows the potential of strategies such as sole-source tendering in which the winning bidder is the sole supplier for a fixed term, therapeutic reference pricing which sets prices relative to a base drug in that therapeutic class, and a more disciplined process for including drugs in the social health insurance package. Neighboring countries which are good models include Thailand, Sri Lanka and Korea.<sup>19</sup>

**Reducing exposure to NCD-related risks will be increasingly important as aging progresses.** Measures to consider are: (i) significant increases in taxes on tobacco, which remains very cheap in Vietnam and is a key risk factor in cardiovascular disease, lung cancer and other conditions. The recent experience of countries such as Philippines and Tonga

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17 See Alzheimer's Disease international (2014) for prevalence and economic cost estimates.

18 These are discussed in more detail in World Bank (2016) and WHO World Report on Ageing and Health (2015).

19 See Somanathan (2015), Mandeville and Sinnott (2014) and World Bank (2016).

provides useful lessons. Increased taxes are also likely to be appropriate for unhealthy foods and alcohol; (ii) promotion of physical activity and dietary quality to promote better health and control obesity; (iii) expansion of screening and management of high blood pressure and cholesterol, and screening for cancer risk and early diagnosis and treatment; (iv) focus on early child nutrition, which has been shown globally to have a strong bearing on health in later life; and (v) more emphasis on self-management of health conditions and better medication adherence for NCD management.

**There is a need to prepare the health delivery system and communities to manage the expansion of age-related conditions such as dementia in ways which are cost-effective, humane and consistent with human resource capacity.** The first step is to raise awareness of the emerging scale of the challenge, and initiate training of service providers and families. Second, there will be a need to assess the medical priority of treatments for age-related conditions, their relative cost-effectiveness, and their affordability. This will involve difficult trade-offs given the financing constraints on the health insurance system. In this process, it will be important to put a strong emphasis on community-based care, which is more cost-effective and responsive to the desires of older people. In addition to financing, there is a large gap on the provider side. Vietnam has no formal training for geriatric specialists beyond short courses, and significant shortages of nurse aides and caring professionals. Realistically, there will never be enough specialized geriatric care providers, and familiarizing general practitioners with basic geriatric diagnosis and care will be vital, as well as preparing carers, social workers and others to manage care in the community.

**There is a growing demand for aged care and a significant deficit in care provision, but Vietnam to date lacks an elaborated strategy for aged and long-term care.** While spouses and families continue to be the primary source of care support for frail elderly (Giang, 2012), informal support is increasingly stretched. However, policy development is lagging. What is needed is a strategy which spells out the respective roles of the state, non-state providers (for profit and not-for profit), communities and households, and outlines a sustainable financing strategy. Aged care will most likely be an area where financing is mixed, where provision is often outside the public sector, and where clear policy is vital to avoid the problem of over-reliance on institutional care, which is costly and generally not preferred by older people. A key decision in the process of strategy formulation will be who is prioritized for public subsidies. While the poor elderly should be a priority, it is important also to prioritize on the basis of degree of disability.

**As in neighboring countries, it will be vital for reasons of both sustainability and quality of life to take the approach of “aging in place”, where aged care is provided as far as possible in home- or community-based settings.** An interesting example is China, with a national policy of 90 percent of aged care in the home, 7 percent in the community, and 2 percent in institutional care. In terms of community and home-based care, Older People’s Association branches and ISHC can be valuable assets in Vietnam. There are already many examples of ISHC providing community-based homecare and facilitating

health check-ups, exercise groups and other preventive measures for older people.<sup>20</sup> There are also interesting examples such as Thailand's "Friends Help Friends" Initiative, in which older people's groups receive public funding to train volunteers to provide support for frail elderly people, with volunteers often from among the "younger elderly".<sup>21</sup> China also has many pilots at subnational level and innovations such as "time banks" where the younger elderly provide care to older elderly, and the time provided is "banked" and they have a credit for future care to be provided when they are older elderly.

## D. Conclusion

**While aging poses real challenges for Vietnam, it is important to realize that policy and behavioral responses to promote health and productive aging are available.**

Undoubtedly aging poses new challenges for Vietnam in sustaining growth, managing public finances, and supporting living standards. The reform agenda related to aging may seem daunting, but there is considerable global and regional experience from which to learn. In terms of prioritizing aging reforms in Vietnam, a few areas stand out:

- a first is stimulating female labor force participation, particularly among urban women, through attitudinal and policy change in the labor market but also increased public support for childcare and eldercare to help balance work and family life and also help to stem declining fertility rates.
- a second is to continue reforms of formal sector pension schemes to make them more financially sustainable and, in doing so, create fiscal space for deeper policy efforts to expand coverage of the pension system through lowering the social pension eligibility age and potentially expanding subsidies to matching contributory schemes for informal sector workers.
- a third area is fundamental reform of the health delivery system to prepare it for the continued expansion in NCDs which will be exacerbated by rapid aging.
- a fourth area is developing a sustainable financing model for aged care which leverages informal care networks and promotes a model of care built around home- and community-based provision.

**None of the priorities above are intended to detract from the need for continued comprehensive efforts,** including in areas not covered in this note such as promoting age-friendly cities, expanded research on the situation and potential of older people, and other measures. Vietnam's government, employers and workers, and families have the opportunity to take a comprehensive approach to managing rapid aging and achieve healthy and productive aging.

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20 See [http://www.ngocentre.org.vn/webfm\\_send/4707](http://www.ngocentre.org.vn/webfm_send/4707) and HelpAge International, [www.helpage.org](http://www.helpage.org).

21 HelpAge International (2015) is a useful brief on community-based social care in East and South-East Asia.

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