Board Meeting of September 22, 1998  
Statement by Michael Marek

Vietnam CAS

The World Bank's CAS provides a good analysis of the overall economic situation and the benefits of accelerated reform. However, we have a few concerns about the World Bank's strategy, especially regarding the pace of needed reforms and the downside risks/contingency plans.

Reform Direction and Urgency of Reform: The CAS states, "There is no evidence that the response to the Regional crisis will be to 'close the doors' as some observers had feared." (p.4) As the doors are barely open at present, our main worry is not so much that the Government of Vietnam (GVN) will backtrack on what little has been achieved, but that they will continue at the present slow pace of reform.

Vietnam's closed capital account sheltered it from the early impact of the crisis, and we are worried that one of the lessons that the GVN is taking away from the crisis is that reforms should progress slowly and with great caution. Yet, we see troubling times ahead if the GVN continues at its present pace of reform:

Vietnam has a large current account deficit, and this is a key source of vulnerability (9.6% of GDP in 1997). The current account was mainly financed by a combination of FDI and medium and long-term loans.

However, declining investment flows are now a threat to financing the current account. Two-thirds of FDI to Vietnam comes from the region, and FDI flows have fallen by 40% in the first half of 1998 and are likely to be down $1 billion for the year as a whole (4% of GDP). Even in the best case scenario of recovery in the region, these FDI flows are unlikely to strengthen for several years if Vietnam does not accelerate reform.

Two-thirds of Vietnam's exports have been to East Asia, and export growth has fallen from 30% to 10% in the first half of 1998.

Vietnamese banks are weak, with non-performing loans possibly around 15% due to poor lending to failing state-owned enterprises.
Reserve levels have fallen to low levels, budget revenues are down and the inflation rate has risen to 7% (highest in 2 years).

There is great urgency to speed up the pace of reform; otherwise, we could be looking at balance of payments and domestic financial difficulties. In short, continuing at the current slow pace of reform, even without a downturn in the external environment (gradual recovery scenario), is likely to have severe consequences.

**False Optimism about Pace of Needed Reforms:** Although the CAS does acknowledge that "differences with the Government lie mainly in the pace of reform and the urgency for action," the CAS seems overly optimistic about the Government of Vietnam's (GVN) willingness to engage in needed reforms. The GVN has made little progress in terms of financial, trade, and SOE reform in recent years, despite constant assurances about its desire to reform.

**More Analysis of Downside Risks Needed:** There is not enough attention devoted to the risks associated with a deterioration in external conditions or inadequate pace of structural reforms in the CAS. Again, the CAS does acknowledge the downside risks, but they should be emphasized more. These consequences of such a scenario are grave severe balance of payments and domestic financial difficulties - but they are not considered in depth, presumably due to assurances by GVN officials about their willingness to reform. Furthermore, the contingency plan would kick in if conditions did deteriorate thus providing little incentive to the GVN to speed up the pace of reforms.

**WB Assistance Despite Little Progress on Structural Reforms:** Vietnam’s last ESAF expired in November 1997, and has not been renewed due to a lack of significant commitment to structural reforms. However, the World Bank continues to provide the GVN with large IDA allocations. Even in a low case lending scenario - “unsatisfactory macroeconomic performance; little progress on structural reforms; targeting or public expenditures to the poor; transparency or decentralization’ - the World Bank is willing to provide $283 million per year to GVN. The low case, however, is again not considered as a serious option because “the government has stated firmly that it does not plan to be in the low case.” (p.21)

There are two other points we would like to raise:

**Public expenditure review:** It is our belief that the success of the CAS would depend on the willingness of the government of Vietnam to share budgetary information on public expenditure, as well as budget planning. It is our understanding that this is hard to do.

Yet, it is important to get a handle on budget priorities, such as a focus on development and poverty reduction programs, as opposed to unproductive expenditure, such as military spending.

We would appreciate comments from the staff on their view of the budgetary process and content. How, for example, Vietnam stacks up to IMF fiscal transparency good practices.

We understand that a public expenditure review is scheduled for the year 2000. Is there any way to accelerate this in order to factor this into the bank's work and the development process?
Core labor standards: The CAS recognizes that free markets are an important avenue to growth and poverty alleviation. Progress on core labor standards, particularly freedom of association and collective bargaining, contribute to market efficiency.

Among other things, we believe the CAS should recognize the importance of assisting the Ministry of Labor, Invalids, and Social Affairs (MOLISA), improve its capability to enforce Vietnam's basic labor laws. In addition, labor unions should be included in the Bank's commitment to seek greater participation by civil society and the development of independent NGOs.

Recent events in Asia demonstrated the importance of participation by key stakeholders and the public's belief that they have a voice and a sense of ownership in the reform process, if that process is to be sustainable. We view recognition and implementation of core labor standards as an important part of that process.