Vietnam: Country Assistance Strategy Progress Report

1. Vietnam is one of IDA’s largest borrowers and a few years ago appeared poised for a major breakthrough in both sustainable growth and poverty reduction. We very much welcome the analysis showing impressive reductions in poverty, but as noted in the progress report, these gains are fragile and poverty remains widespread and deep.

2. It is therefore disappointing to see the notable slowdown in the pace and scope of the reforms needed for Vietnam to better realize its considerable economic and social potential. The CAS Progress Report points out that there is a large unfinished agenda, particularly in trade reform, improving the investment climate, banking reform, and SOE reform. The slow pace of adopting policies conducive to private enterprise is of particular concern, given the important role the private sector must play if Vietnam is to effectively capitalize on favorable regional and growth trends. As things now stand, Vietnam appears poised to fall further behind many of its regional partners. We question whether current reform efforts and the uncertainties that underlie the extent of the government’s commitment to address the obvious constraints to growth are sufficient to justify even a low case IDA lending scenario.

3. We support the Bank’s strong focus on poverty alleviation and its efforts to strengthen participation in the comprehensive development framework (CDF). While we welcome the agreement at last December’s CG for the broader international development community to better coordinate development assistance, the effectiveness of these efforts in reducing poverty will depend heavily on a commensurate commitment by the government to move more forcefully to address economic weaknesses now constraining growth. As experience shows, economic growth will be the most important determinant of how successful Vietnam will be in raising incomes and reducing poverty. It
is crucial that macroeconomic policies, sound economic management, social development, and poverty reduction be mutually reinforcing.

4. We welcome the report (para 27) that "gender issues are receiving more priority..." This is critical in a country in which the link between gender inequity and poverty is clear, and trafficking in women provides grim evidence of lack of adequate social protections. We would welcome hearing more from staff about increasing attention to gender.

5. CDF and commitment to policy reforms: While welcoming the progress reported in application of the CDF, it is troubling to see the lack of impetus in the economic reform agenda. We would be interested in staff comment on whether there are ways in which the CDF could better support efforts to increase public and government understanding and action on Vietnam's economic reform program.

I would now like to address some specific areas crucial to Vietnam's future progress:

6. **Vietnam has made little progress on liberalizing trade, and prospects for a bilateral trade agreement with the U.S. remain unclear.** In an effort to note some action taken, the box on page 4 highlights “recent reforms” with respect to “opening up to foreign trade”. However, lowering the maximum import tariff to 50% and number of tariff-rates to 15 and reducing foreign exchange surrender requirements from 80% to 50% are very small steps toward trade liberalization. It is sobering to see no progress on the Bank’s call for a detailed timeline for trade policy reform. Trade liberalization, particularly reforms to promote exports, is fundamental to sustainable economic growth in Vietnam.

7. **We see little evidence to be optimistic on the prospects for real progress on creating a supportive environment for private investment.** We understand that the National Assembly approved twenty amendments and two new articles for the 1996 Foreign Investment law. While these changes may marginally improve the investment climate, we understand that stronger measures initially proposed were removed. **Have Bank discussions with the private sector in Vietnam provided any grounds for optimism that the government recognizes the crucial importance of building a policy and regulatory environment conducive to restored investment and employment creation?** We note that one of the principles for the Bank’s support for infrastructure is to catalyze private sector involvement. This is unlikely to occur without the creation of an enabling policy and regulatory environment. The IFC created a Private Sector Forum to help build momentum toward removing constraints to investment. **Can you comment on the work of this forum?**

8. **Vietnam should not substitute official development assistance (ODA) for private sector finance.** Net medium- and long-term lending to Vietnam is projected to increase more than seven-fold this year as net FDI turns negative. The Bank sees such lending outstripping FDI by a greater than 2:1 ratio in each of the next two years and a greater than 1:1 ratio in 2005. The Bank should encourage Vietnam to implement the necessary reforms to recapture the FDI inflows, which averaged more than $1.5 billion per year in the mid-1990's growth period -- far in excess of ODA inflows. It is critically important
that the Bank’s assistance helps build an enabling environment to catalyze -- not replace--private sector investment.

9. **Furthermore, Vietnam's capacity to effectively absorb new lending appears to be weakening.** As noted in the CAS progress report, there are serious capacity weaknesses and the disbursement ratio is projected to fall to 14% this year, down from 17% in FY99 and 22% in FY98. These figures suggest a need to re-examine further increases in the Bank's Vietnam portfolio.

10. We welcome plans noted in paragraph 30 to undertake a Public Expenditure Review and urge that priority be given to introducing greater transparency and accountability in the budget process. It is our understanding that a large share of the budget --- almost one-third in 1997 --- is not reported in the budget. Revenue sources are also not identified.

11. **On social equity,** we welcome the fact that donors have agreed to a division of labor in the education sector, and strongly endorse the major focus IDA is giving to primary education. We hope that similar arrangements will help advance the slower pace of health sector reform, including increased emphasis on vaccinations and combating infectious diseases. We also agree with the progress report (paragraph 27) that the issue of child labor still warrants attention. We also urge that Bank provide more meaningful support on core labor standards.

12. **Finally, a clear sense of the Bank’s strategy in the absence of credible action on reform is lacking.** We note the reference in paragraph 17 to possible consideration of alternative approaches to a SAC, such as a multi-year “floating tranche” operation. Two points on this: first, we question the appropriateness of a SAC unless there is clear and convincing evidence of commitment to reform; and, second, we would not recommend any alternatives that undermine conditionality or reduce incentives to implement reforms. As we repeatedly see, genuine borrower ownership of reform is crucial to its success.

13. **Potential issues for the next CAS:** we welcome this section. While all four areas cited are clearly linked to sustainable development, we think progress on fundamental economic reforms must be the core focus, and expansion into additional areas should depend on how Vietnam proceeds with this program.