Report No. 13143-VN

Viet Nam
Public Sector Management and Private Sector Incentives
An Economic Report

September 26, 1994

Country Operations Division
Country Department I
East Asia and Pacific Region

Currency Equivalents

The Vietnamese currency is the dong (D).

Calendar 1993	August 1994
US$1.00 = D10,640	US$1.00 = D11,000
D 1,000 = US $0.09	D 1,000 = US$ 0.09

Fiscal Year

January 1 - December 31

Weights and Measures

Metric System

List of Acronyms

ADB	-	Asian Development Bank
ASEAN	-	Association of Southeast Asian Nations
BFT	-	Bank for Foreign Trade
BHS	-	Brussels Harmonized System
BID	-	Bank for Investment and Development
BOT	-	Build, Operate, and Transfer
BOO	-	Build, Own, and Operate
CMEA	-	Council of Mutual Economic Assistance
CPI	-	Consumer Price Index
DFI	-	Direct Foreign Investment
DGPT	-	Directorate General of Post and Telecommunication
EPR	-	Effective Protection Rate

List of Acronyms
(continued)

EPZ	-	Export Processing Zone
GDP	-	Gross Domestic Product
GNP	-	Gross National Product
HCMC	-	Ho Chi Minh City
ICB	-	Industrial and Commercial Bank
ICOR	-	Incremental Capital Output Ratio
IDA	-	International Development Association
ILO	-	International Labour Organization
IMF	-	International Monetary Fund
JV	-	Joint Venture
LSMS	-	Living Standards Measurement Survey
MIGA	-	Multilateral Investment Guarantee Agency
MOF	-	Ministry of Finance
NGO	-	Non-Governmental Organization
NIE	-	Newly Industrialized Economy
ODA	-	Official Development Assistance
OECD	-	Organization of Economic Cooperation and Development
OECF	-	Overseas Economic Cooperation Fund
PCF	-	Popular Credit Fund
PIP	-	Public Investment Program
QR	-	Quantitative Restriction
RSB	-	Rural Shareholding Bank
SBV	-	State Bank of Viet Nam
SCCI	-	State Committee for Cooperation and Investment
SIDA	-	Swedish International Development Authority
SOCB	-	State-Owned Commercial Bank
SOE	-	State-Owned Enterprise
SPC	-	State Planning Committee
UNDP	-	United Nations Development Programme
VBA	-	Viet Nam Bank of Agriculture
VNLSS	-	Viet Nam Living Standard Survey

VIET NAM

PUBLIC SECTOR MANAGEMENT AND PRIVATE SECTOR INCENTIVES

ECONOMIC REPORT

Table of Contents

This report was prepared on the basis of an economic mission that visited Viet Nam in March/April 1994. The report was written by a team led by David Dollar and including Reza Amin, Richard Bird, Gerry Caprio, Michael Finger, Pierre Guislain, Hendrik Koppen, Natalie Lichtenstein, Jennie Litvack, Ray Mallon, Glenn Pederson, Govinda Rao, and Thang Long Ton. The mission would like to express its gratitude to the State Bank of Viet Nam and to other ministries and agencies that assisted in the preparation of this report. The peer reviewers for the report were Daniela Gressani and Shanta Devarajan. The report was discussed with the Government of Viet Nam in September 1994 and revised and updated on the basis of those discussions.

TABLES, FIGURES AND STATISTICAL APPENDIX

TABLES

FIGURES

VIET NAM

PUBLIC SECTOR MANAGEMENT AND PRIVATE SECTOR INCENTIVES

SUMMARY

1. Viet Nam has been carrying out an ambitious adjustment and reform program since 1989 and is making a steady transition to a market economy. The country achieved some notable successes during the 1989-92 period, despite a lack of international financial support. Initial structural reforms included decollectivization of agriculture, price liberalization, unification and devaluation of the exchange rate, and hardening of the budget constraint for state enterprises. At the same time the fiscal deficit that was the root cause of inflation was reduced through a combination of tax reform, elimination of subsidies, and expenditure restraint. These reforms produced good results. Real GDP growth accelerated from 5-6% in 1990-91 to 8% in 1992-93. At the same time inflation was brought down from 68% in 1991 to 18% in 1992 and 5% in 1993.

2. While Viet Nam's achievements are impressive, there are weaknesses in both the economy and the reform program that should not be overlooked. The country remains one of the poorest in Asia, with per capita GNP below US$200 in 1993. Concerning the reform program, Viet Nam is moving from the relatively easy price liberalization measures to more difficult structural reforms, such as restructuring state-owned banks, privatizing public firms, and streamlining the trade regime. Furthermore, fiscal restraint during 1990-91 was to some extent the result of holding down all expenditures rather than making choices among public services. With improved revenue and greater access to international finance, all of these expenditure categories have grown, leading to a reemergence of fiscal problems. Both the fiscal and external deficits grew alarmingly in 1993. Tighter fiscal and monetary policies were introduced in 1994 to deal with the emerging macroeconomic problems, and these policies will need to be maintained in order to ensure that the economy remains on a stable growth path.

3. Viet Nam's macroeconomic management was good during a period of austerity. This belt tightening yielded results and put the country in a good position to shift from adjustment to growth. The country is fortunate to have a substantial volume of foreign resources -- both private investment and ODA -- available to support its development. These resources provide both an opportunity and a challenge to Viet Nam. The foreign resources have the potential to make the economy's development more rapid. Managing both the macroeconomic and microeconomic impact of these resources, however, will be a new challenge for the government, and for the larger society.

4. This economic report reviews developments with Viet Nam's economy and reform program during 1993-94 and assesses the economy's prospects for growth in the medium term. While foreign resources can assist the country's development, sustained growth will depend primarily on Viet Nam's own ability to generate savings to finance investment. Thus, the report focuses on a number of strategic choices that policy-makers face as they try to strengthen both public and private savings and to spur the economy's development. A unifying theme of the report is that many of these choices involve the issue of centralization versus decentralization. In many ways decision-making in Viet Nam remains highly centralized. This system is working fairly well at the moment. However, the economy right now is quite a simple one. There are only a few important imports, a small number of major foreign investment projects underway, and a handful of aid projects being implemented.

5. If Viet Nam makes full use of the domestic and foreign resources available for development, then the complexity of the economy will grow very rapidly. The number of important exports and imports will multiply, and hundreds of large investment projects could be implemented simultaneously. In this case, the current, highly centralized decision-making will inevitably become a severe bottleneck for development. Thus, the most important strategic choice that the government faces is whether to give up some control and to decentralize decision-making in return for a faster pace of development. Decentralization would have other benefits as well. The current system is not only a growing bottleneck, but also by extension a breeding ground for corruption, because corruption is one way to move decisions through the bureaucracy.

6. The general tension between centralization and decentralization can be seen in a number of specific areas:

- the respective roles of central and local authorities in raising revenue, planning public expenditure, and regulating the economy;
- ongoing efforts by the government to allocate credit through the commercial banks;
- the complex system for managing imports through permits, licenses, and tariffs; and
- cumbersome procedures for licensing foreign investment.

These are the main topics covered by the report. The conclusion of the analysis is that in each area Viet Nam would be well served by introducing greater decentralization. In the fiscal area, this means clearly assigning some revenues and expenditures to local levels. For the banking system and the regime for foreign trade and investment, this means accelerating the liberalization of the economy and shifting the government's focus from control to promotion. In other words, instead of trying to control all of the decisions, the government should concentrate on establishing an incentive regime that promotes efficient decisions by households and firms.

7. These ideas are not new in Viet Nam. The government is already moving in these policy areas. Nevertheless, the issues of decentralization and liberalization remain controversial, and progress is at best gradual. The main purpose of the report is to contribute to this policy dialogue in Viet Nam by analyzing the benefits that a strategic shift from control to promotion would yield, and by making specific recommendations for reforms that would realize these benefits.

8. One of the reasons why decentralization and liberalization remain controversial in Viet Nam is that the government is very concerned about regional inequalities. The report examines this issue in several ways. First, it reports major results from a representative household survey carried out by the government with technical assistance from the World Bank and financing from UNDP and SIDA. This survey yields up-to-date information on poverty and income distribution in Viet Nam. Second, the report analyzes how government expenditures and policies can be used to promote relatively balanced growth throughout the country, in order to bring about a more rapid reduction in poverty.

Macroeconomic Performance

9. On the surface Viet Nam's macroeconomic performance was good in 1993, with robust growth of 8.1% and a decline in consumer inflation to 5.2%. There were some underlying problems, however, that required corrective actions early in 1994. The fiscal deficit increased significantly, to 6.2% of GDP, a level that the government had difficulty financing. On the monetary side, domestic credit increased by nearly 60%. This rapid expansion of credit did not lead to immediate inflation because it financed a surge of imports. However, the level of the resulting trade deficit -- as well as the level of the fiscal deficit -- was not sustainable.

10. Viet Nam went through a period of austerity in 1990-91, during which time its current account deficit declined to virtually zero: in other words, no foreign resources were available to the country. The situation has changed dramatically in the past two years, and there are now large commitments for direct investment projects and for aid-financed infrastructure projects. Relatively little of this potential funding actually disbursed in 1993, however. Disbursements of concessional loans, for example, were less than US$250 million. The government in the meantime increased its expenditure, mostly on infrastructure and social spending, but did not have adequate financing for these expenses. A major part of its problem was that it misjudged the amount of aid money that would actually disburse, and then had to rely on commercial sources to fund its deficit. In the monetary area, the State Bank allowed rapid growth of credit to producers, who in turn purchased imports. There were not adequate external flows to cover the resulting deficit, however, with the result that it was paid for by a drawdown in gross reserves of the banking system -- something that can be done only once. Thus, the financing for both the fiscal deficit and the external deficit in 1993 was precarious.

11. Viet Nam can look ahead several years to a time when inflows of direct investment and ODA could contribute very substantial financing for development, provided the macroeconomy continues to be well managed. Through its fiscal and monetary policies, however, the government tried to push rapid expansion in advance of this financing. This expansionary policy threatened to reignite inflation. Early in 1994 the government moved to strengthen its macroeconomic policies. It restrained the growth of public expenditure and tailored its deficit to match the availability of concessional ODA; and it limited the expansion of domestic credit through bank-by-bank credit ceilings, higher interest rates on refinancing and on foreign currency loans, and stricter reserve requirements. This adjustment program yielded quick results. The fiscal deficit is projected to be sharply lower in 1994, less than 3% of GDP. Credit growth also decelerated. And the external deficit is projected to decline to about 5% of GDP, a level that can be sustained over the medium term. The sound macroeconomic policies created a favorable environment for growth, which accelerated to an 8.7% rate.

12. **Investment and savings**. One of the most positive macroeconomic developments for Viet Nam in 1993 was the large increase in investment, a growth of 41% in current prices and 32% in constant prices. As a result, the investment rate has increased from 15.1% of GDP in 1991 to 19.4% in 1993. The increased investment in 1993 came both from budgetary investment in infrastructure and from investment in commercial activities. The public investment program has rebounded from a low of 2.8% of GDP in 1991 to 7.0% in 1993. The other 12.4% of GDP in investment last year came from autonomous state enterprises, joint ventures between the public and private sectors, and private firms and households. The division between the public and private sectors in Viet Nam is not always clear, so that it is difficult to determine the extent of purely private investment in the economy.

13. While the increase in investment in 1993 was positive, developments in the area of savings were not encouraging. The increase in national savings has been one of the most important achievements during Viet Nam's reform program. In the revised national accounts, savings are estimated to have increased from 3.2% of GDP in 1989 to 16.3% in 1992. This development confirms that households have the same strong predilection to save that is observed throughout East Asia. Stabilization of the economy, strengthening of property rights, and improvements in the banking system combined to bring forth these savings and to channel them to productive uses. In 1993, however, national savings declined to 11.2% of GDP. Of this five point decline in the savings rate, about one-fourth can be attributed to a decline in government savings and three-fourths to a decline in savings outside of the government sector. Reversing this decline is an immediate and important task for economic policy that will require actions both on the government budget and on the incentives that encourage households and firms to save and invest. Strengthened fiscal and monetary policies in 1994 have already made a contribution, with domestic savings projected to rise to 15% of GDP for the year.

14. **Budget developments**. Viet Nam's budgetary situation in 1993 was characterized by sharp increases in both revenue and expenditure and by an expansion of the fiscal deficit. Revenue mobilization by the government has been a notable area of success during Viet Nam's adjustment program. Total revenue increased to 22.3% of GDP in 1993 and a projected 25.4% of GDP in 1994, up more than 10 points of GDP since 1991. Revenue increases of this magnitude are unusual. In fact, the experience of other countries shows that such large increases are often followed by some downward adjustment in future years. Hence, the government should be cautious in its fiscal planning and not assume that further large gains will be forthcoming.

15. While Viet Nam's tax reform has been successful in raising revenue, it has made less progress with other goals, in particular, reducing distortions. The focus of tax reform now needs to shift toward making the tax code more neutral in its effect on incentives. The turnover tax, for example, creates poor incentives because of its cascading effect on producers. The government is planning a comprehensive and phased reform of its overall tax system. It will first simplify the turnover tax by reducing the number of rates, and eventually replace it with the less distorting value added tax. As part of its tax reform the government will consider modifications to the profit tax as well. This tax is very high and is an impediment to firms reinvesting their earnings. The tariff code also needs to be reformed. It too has a wide range of rates, creating poor incentives and difficulties for administration.

16. Turning to the expenditure side of the budget, during 1990-91 the government reduced its spending as part of the campaign to halt high inflation. During this austerity period a number of adjustments were made that should help the long-term growth of the economy. The military was reduced in size, with about half a million soldiers demobilized. Subsidies to state enterprises were curtailed, which had a positive effect on their productivity. The austerity, however, also made it difficult for the government to supply a range of important services that are needed for the economy and the society to develop. Investment in infrastructure, for example, declined to a very low level, and there were problems with the delivery of social services as real civil service salaries declined in the face of inflation.

17. The government has moved in the past two years to turn this situation around and to increase its development expenditure. While these investments in infrastructure and human resources are necessary in the medium term, the rate of growth of government spending was too rapid in 1993. Real government spending essentially doubled between 1991 and 1993. That rate of growth threatened macroeconomic stability, and in 1994 the government had to modify its spending plans in order to bring

its deficit under control. Viet Nam is a poor country that clearly has a lot of needs, but they cannot all be met at once. One of the main messages of this report is that the government must carefully set priorities and manage its expenditures.

18. The fiscal deficit was a problem in 1993 because it was large relative to low-cost sources of financing. Reducing the fiscal deficit was at the heart of Viet Nam's disinflation program in 1990 and 1991, during which time the deficit was reduced to 3.8% of GDP. Starting from that point, it made sense for the government to allow the deficit to gradually expand as aid resources became available. The returns to public infrastructure projects in Viet Nam are very high, and deficit financing is a sensible strategy as long as the government controls its debt in light of its servicing capacity.

19. Expenditure increased too rapidly in 1993, however, opening up a deficit that the government had difficulty funding. The deficit was equivalent to about US$800 million. The net flow of concessional loans, on the other hand, was quite small, creating a serious financing problem for the government. To its credit, the government did not resort to inflationary sources of finance. It did, however, borrow significant amounts from domestic and international commercial sources at high interest rates. This high-cost borrowing will impose substantial interest costs on the budget in the future.

20. The initial 1994 budget had similar problems, projecting a large increase in expenditure and optimistic forecasts of ODA disbursements. During the year, however, the government adjusted the budget several times, as it became clear that the ODA inflow for the year would be quite low, including only about US$200 million in concessional loan disbursements. The government introduced tax and expenditure measures that resulted in a decline in the fiscal deficit to a projected 2.7% of GDP. As a result of these strong measures the government did not need to rely excessively on the domestic banking system or international commercial borrowing. To keep its fiscal house in order the government of Viet Nam needs to do a better job of managing its expenditures and controlling its deficit. The expanding ODA commitments from multilateral and bilateral donors should lead to growing concessional inflows. The government needs to plan carefully the priority projects to be financed from ODA and to move quickly to implement these projects. This strategy would allow the fiscal deficit to expand modestly as ODA disbursements increase. It is recommended that the government manage its deficit to match the financing available from concessional loans, plus a small amount of domestic borrowing. The government has begun selling treasury bills, which is useful for the development of domestic capital markets. It would be prudent, however, to rely to only a small extent on the issuance of T-bills for financing, as domestic interest rates remain quite high.

21. **Monetary developments**. Notwithstanding a surge in credit, which helped to underwrite the strong growth noted above, in 1993 Viet Nam achieved one of the best performances among transitional economies with respect to inflation reduction. An important task for the authorities is to consolidate these gains and to develop the monetary policy instruments that will permit effective control of inflationary forces. The sharp deceleration of inflation, to 5.2% in 1993, appears somewhat paradoxical in the face of the rapid growth of money and credit. Domestic credit rose 58.7%, led by a near tripling of credit to the non-state sector. Several factors appear to have helped reduce inflationary forces. First, the authorities liberalized imports, as witnessed by the running down of foreign exchange reserves, thereby providing increased competition and a safety valve for demand pressures. Second, with a large part of the population in agriculture, Viet Nam faces a more elastic supply of labor to the rest of the economy in comparison with other transition economies, where a larger percentage of workers are in heavily subsidized jobs in industry and hence have little desire to seek other employment.

22. The State Bank's tools for controlling inflation have been central bank refinancing, interest rates on refinancing and on deposits and loans, and reserve requirements. In early 1994 the State Bank moved to slow down the growth of credit, as some of the above factors cannot be depended on to continue to hold down inflation, and also as part of the program with the IMF. The State Bank put in place bank-by-bank credit ceilings as a temporary measure for achieving global credit targets. This tool is highly effective for implementing monetary policy in the short term, but ultimately leads to disintermediation of the formal financial sector if maintained too long. Within the next few years these individual bank credit ceilings should be replaced by auctions of refinancing lines and deposits at the central bank, and then by the use of repurchase agreements. Although the authorities are interested in developing primary and secondary treasury markets so as to permit open market operations, even most developed countries have markets of insufficient depth for this purpose and instead prefer the use of repurchase agreements. Before this development of instruments can be fully effective, however, the State Bank needs to move as rapidly as possible to improve the payments system and to encourage the greater use of dong-denominated payments instruments. Additionally, insuring the soundness of individual banks will increase their willingness to trade with one another, a prerequisite to indirect methods of monetary policy implementation.

23. **Balance of payments and the exchange rate.** Viet Nam's balance of payments situation in 1993 was characterized by an extraordinary surge in imports, which grew by 46.4% in constant prices. To some extent these imports were financed by the increasing flows of direct foreign investment and private remittances and should be viewed as a positive sign of improving confidence in the economic situation. The rapid growth in imports was also positive in that it reflected continued trade liberalization moves on the part of the government. The magnitude of the increase, however, was alarmingly high. This excessive growth of imports was fueled by the easy credit policies of the State Bank and by the increase in government expenditure, including capital projects financed by commercial overseas borrowing. As a result, the current account went from near balance in 1992 to a deficit of US$1.1 billion (8.3% of GDP) in 1993. The corrections in macroeconomic policies in early 1994 -- in the direction of tighter fiscal and monetary policies -- resulted in a slowdown in the growth rate of imports to 12.6%. At the same time, sound macroeconomic policies and strengthened incentives for exporters led to an acceleration of the growth rate of exports from 12.4% in 1993 to 23.3% in 1994. Thus, the external deficit is projected to decline to about 5% of GDP in 1994, a level that can be sustained over the medium term.

24. The government's exchange rate management has been fairly good. Producers can buy foreign exchange easily from commercial banks to finance current account transactions. The official rate is set through foreign exchange trading floors and deviates little from the parallel rate. The exchange rate has been remarkably stable for about two years now, in the range of 10,500-11,000 dong per U.S. dollar. The net interventions of the State Bank in the foreign exchange market have not been large. Nevertheless, in the second half of 1993 the State Bank sold foreign exchange to support the dong. This policy is not recommended for two reasons. First, official reserves are quite low, so that net selling cannot go very far before the government will run out of reserves. Second, given the moderate inflation of the past two years, intervention to stabilize the nominal exchange rate resulted in appreciation of the real exchange rate. This was probably one factor limiting the competitiveness of Viet Nam's exports in 1993. If there is pressure toward devaluation in the foreign exchange market, then the State Bank should allow this depreciation to occur, intervening only to smooth out movements. Stability in the exchange rate is desirable, but should be pursued through macroeconomic tools, not through intervention. In

particular, the growth rate of domestic credit will have to be controlled more carefully if stability of the exchange rate is to be achieved.

Growth Prospects and Financing Requirements

25. On the surface Viet Nam's macroeconomic performance was good in 1993. But, a look below the surface revealed a number of disturbing developments. Government expenditure rose at a rapid rate, and most of this was for recurrent items, not investment. As a result of the increase in spending, the government had a deficit that it had difficulty financing. There was also a large increase in the external deficit: some of this financed investment, but much of it financed consumption. The decline in national savings from 1992 to 1993 was a major concern for the government.

26. Viet Nam still has good growth prospects, but it needs to make some adjustments in its policies if it is to realize its potential. The fundamental problem is that the government is still trying to do too much. This can be seen at the macro level in excessive government expenditure that threatens macroeconomic stability; at the micro level the public sector is crowding the private sector out of a range of activities that the private sector could well undertake. For Viet Nam to grow successfully, the government will need to focus its activities more sharply and to give greater scope to the private sector to expand. The more prudent fiscal policies introduced in 1994 are an important step in the right direction, but they need to be complemented by further structural reforms to improve the incentives for saving and investment.

27. The government's medium-term target for growth is 8%. The government would like to see the economy grow even more rapidly, in the 9-10% range, if that can be achieved without sacrificing macroeconomic stability. These growth targets are ambitious and will be a challenge to achieve. Viet Nam has been able to grow at 8% for several years with only a moderate investment rate. There are three factors that can explain this outcome. First, some large, fixed investments of the mid-1980s, in oil and hydropower, came on line in the early 1990s, so that some of the increments to GDP were based on these earlier investments. Second, the initial response of the economy to the removal of distortions – especially in services and in agriculture – permitted large increases in output based on only minor additional investments. Third, labor-intensive manufactures have been a leading sector, particularly in 1993-94, and this exploitation of comparative advantage is an efficient development strategy that requires relatively little investment. The first two of these factors are clearly temporary; as their effects wear off, greater amounts of investment will be required to sustain the growth rate. The third factor – exploiting comparative advantage in labor-intensive industries – is more permanent. The experience of the successful East Asian Newly Industrialized Economies has shown that export-oriented industrialization is an efficient strategy that generates a relatively large amount of output from a given level of investment.

28. The report examines a number of growth scenarios for Viet Nam, assuming that the investment rate required to generate a given rate of growth gradually increases. To maintain growth in the 8% range, the investment rate in these projections rises from 20% of GDP in 1994 to 26% by 1999. To meet this goal would require a significant increase in domestic savings. The projections here hold the current account deficit to the 5-6% of GDP range, a level that can be financed from reliable sources, notably direct foreign investment and official development assistance. Given this inflow of foreign savings, sustained 8% growth would require an increase in the national savings rate from 15% of GDP in 1994 to 20% by 1999. A second scenario indicates the likely outcome if the savings rate does not rise so dramatically: in this case the growth rate of GDP decelerates to 6.0% by the end of the decade.

29. Thus, at the heart of a high-growth scenario for Viet Nam is the need for a significant expansion of domestic savings. The government can contribute to this directly by building up its own savings, which were less than 1% of GDP in 1993. Government revenue is already large relative to GDP. As high tax rates distort investment, production, and consumption decisions, further increases in revenue should be pursued cautiously. For this reason a strategy to improve government savings must include expenditure restraint. In order to meet its savings target the government will have to carefully set priorities and reallocate spending away from inefficient uses.

30. There is clearly great potential to increase the savings of households and firms. High private savings have been one of the keys to rapid growth throughout East Asia, and increasing private savings in Viet Nam will be necessary to sustain a high growth rate. Households have substantial liquid savings, but these funds are not channeled to a sufficient extent into productive investment. That the national savings rate declined during a year in which the economy was growing well is a disturbing sign, indicating that there are substantial problems with the incentive regime for savings and investment. Thus, the strengthening of incentives -- through further reforms of legal infrastructure, the financial system, and the regime for foreign trade and investment -- is another crucial part of the reform agenda.

31. **Financing requirements.** While increases in public and private savings in Viet Nam will be the primary sources of financing for new investment, the economy will also require greater inflows of foreign savings if high growth is to be sustained. Direct foreign investment could provide a growing source of financing, and measures to improve the environment for foreign investment are discussed below. Viet Nam also needs an expanding volume of aid flows to assist with financing economic and social infrastructure. Significant commitments have already been made, and the government should move quickly to implement these projects and to accelerate disbursements. The early experience with project implementation reveals that aid management procedures are cumbersome and need to be streamlined if a large investment program is to be realized. At the same time, there is a need for further commitments from donors, as well as for a better mix between quick-disbursing program loans and project commitments. The requirement for quick-disbursing support in 1995 is about US$400 million. IMF resources and an IDA structural adjustment credit should provide the bulk of the necessary financing. In addition to multilateral sources, about US$120 million of quick-disbursing financing from bilateral donors is required for 1995. The planned Consultative Group meeting in November 1994 will provide an opportunity to solicit these quick-disbursing funds to cover the gap in 1995. In addition, it will take new project commitments of around US$1.5 billion annually in order to gradually build up disbursements to levels that would meet Viet Nam's financing requirements for the medium term.

Public Sector Management

32. Viet Nam will grow more successfully if it can establish an efficient division of labor between the public and private sectors. The resources that the government has at its disposal are limited. Therefore, it must target its expenditures carefully to priority public services. The private sector can be counted on to invest and produce in a wide range of sectors, provided an appropriate incentive framework is in place. There are other services, however, that the private sector cannot or will not produce in adequate amounts. Development will be more rapid if the government focuses its expenditure on these services, most of which fall into the broad categories of infrastructure and human resource development, and leaves other activities to the private sector.

33. **Budget management.** A first important issue of public sector management in Viet Nam concerns the budget, specifically (1) the process of preparing and managing the budget, and (2) the current pattern of government expenditure. Studies of government expenditure in different sectors have revealed that efficiency of expenditure is currently low. In the transport sector, for example, the government is planning major new investments, while at the same time not providing adequate resources for operations and maintenance (O&M) of existing infrastructure. Infrastructure bottlenecks are universally acknowledged as a key problem holding back the development of the economy. Sufficient expenditure on O&M is more important than construction of new facilities for two reasons: (1) it is the only measure that would improve the infrastructure situation immediately and (2) without it, construction of new facilities will not be efficient, as they will not be properly utilized.

34. The imbalance between capital and O&M funding is just one example of inefficiency in public expenditure. In order to improve the effectiveness of government spending more broadly, Viet Nam needs to reform the institutions and procedures for preparing and managing the budget. In the process, it will be important to increase the transparency of the budget. It is difficult to make specific recommendations to improve the efficiency of expenditure because the budget lacks sufficient detail. The government needs to introduce a proper economic and functional classification of expenditures. This will set the stage for conducting a thorough Public Expenditure Review to analyze the effectiveness of different programs in meeting their objectives. On the basis of this review the government will be able to identify inefficient programs that can be cut.

35. An important factor contributing to inefficiency in public expenditure is that the fiscal system is overly centralized. The central government attempts to control the details of spending at all levels of government, which is neither practical nor efficient. The proposed enactment of an organic budget law next year provides the opportunity to introduce more efficient decentralization. It is recommended that responsibility for basic education and health be assigned to the local level. The central government can ensure that all provinces have sufficient resources for these expenditures through specific-purpose transfers. It is further recommended that local government be given more discretion over the expenditures assigned to them and a more stable revenue base to finance these expenditures. Tax-sharing rules should replace the current system of annual revenue negotiations with the center. In the longer term, Viet Nam should consider introducing even greater decentralization, allowing localities to raise some revenue through their own taxes. A system of general-purpose transfers can be used to ensure that poor provinces have adequate resources to meet their expenditure needs.

36. **Public investment program.** The increased level of domestic and external resources has enabled the government to expand its investment program, which is now targeted to economic and social infrastructure. An important reform in recent years has been to remove from the capital budget support for commercial firms in cement, power, and other sectors that can finance their investment through borrowing. While the general focus of the capital budget is appropriate, the system for preparing the investment budget needs to be improved. Criteria for project selection are not clear, planning is not done on a multi-year basis, and investments have been chosen without adequate concern for the related implications for the recurrent budget. To ensure that resources are allocated to priority investments, the government should prepare a multi-year public investment program (PIP) that looks beyond the annual budget horizon. The PIP should establish priorities among investment proposals by developing procedures and strict criteria for selecting projects. In general, efficient public investments are those that are complementary to private sector development and situated in a well-defined sectoral strategy. The sectoral strategies in turn should be developed primarily on the basis of the economic rates of return to

different potential investments. The PIP should be closely linked to the budget to ensure that it is realistic in terms of (1) domestic and external resources available for the investment budget and (2) the provision of funds in the recurrent budget to finance related operating and maintenance costs.

37. **State enterprise reform.** The effort to sharpen the focus of public expenditure needs to be complemented by a thorough program of state enterprise reform. A large number of state-owned firms produce goods and services that could be provided by the private sector. Public support for these enterprises is thus inefficient. The government should concentrate its financial support on a small number of strategic firms producing public services, such as power and water. It is recommended that the government plan to gradually divest the other, non-strategic enterprises.

38. The government has introduced an initial set of measures to harden budget constraints of public firms, including the elimination of subsidies from the budget, interest rate reforms that reduced implicit subsidies through the banking system, and the principle of equal taxation of state and private firms. These policies led to a rationalization of the sector, and several thousand loss-making firms were liquidated. Now that most loss-making firms have been closed, the immediate issue on the state enterprise reform agenda is to create a level playing field between public and private firms in the competitive sectors. This would set the stage for privatization of state firms. An important step toward creation of a level playing field was the passage of the bankruptcy law, applicable to both state and private firms.

39. For non-strategic firms, it is recommended that the company law be amended to enable state enterprises to reorganize as single shareholder companies, placing them under the same legal framework as private companies. The process of reorganizing non-strategic firms as companies should take about two years. To manage that process and to manage the government's shares in these companies, a ministry-level agency or holding company should be established. As a result of this change, the state's ownership in these firms would no longer be exercised by line ministries. These reforms would enable the government to accelerate the completion of its pilot program of "equitization," in which shares of enterprises are sold to workers and the general public, and to prepare a broader program of privatization.

40. Concerning strategic firms, the government plans to submit to the National Assembly during 1995 a state enterprise law to stipulate the management and operational structure of these firms and to specify how the government will exercise ownership rights in them. In the meantime the government should improve the accounting, auditing, and monitoring of these firms, concentrating initially on the largest firms, many of which will eventually be classified in the "strategic" category. The creation of a general department of state enterprises within the Ministry of Finance in early 1995 should facilitate this task.

41. The reform of the Public Investment Program can be an important support to these state enterprise reforms. Public investment in state enterprises, through the budget or through subsidized or guaranteed loans, should be restricted to firms providing important public services. The shareholding companies fully or partially owned by the government should find their own investment funds without government support or guarantees.

Incentives for Saving and Investment

42. Viet Nam is in transition from a system of central planning to a market economy. In a centrally planned system the government tries to manage all production and investment decisions. In a market economy, on the other hand, the role of the state is more focused. The government must provide a range of services that cannot be provided by private firms or that are not likely to be provided in adequate amount by private firms. Other goods and services can be produced by the private sector in a market economy. In these sectors, however, the state still has an indirect role, namely to provide an efficient overall incentive framework for saving, investment, and production by households and firms.

43. **Legal reform**. At the heart of the incentive regime is the legal system, which protects property rights and regulates commercial transactions. The government has recognized that a successful transition to a market economy requires the development of an appropriate legal framework, which will inevitably take some years to complete. The gradual process of putting into place the necessary elements of such a system has included a new constitution and the enactment of legislation in the areas of contract, company, land, and bankruptcy law. That process is now accelerating with the enactment in June 1994 of a labor code to protect employees and employers alike as the labor market develops and a domestic investment promotion law to provide incentives for the domestic private sector comparable to those for foreign investors. The legislative agenda for the 1995-96 period includes a basic civil code as the legal foundation for the system as whole and a commercial law to facilitate business activity, as well as the implementing legislation needed to give full play to the land and bankruptcy laws enacted in 1993. Amendments in the company law and the enactment of a state enterprise law as part of the State Enterprise Reform Program would strengthen the legal basis for competition between public and private firms.

44. Importantly, a major transformation is underway this year in the mechanism for the settlement of economic disputes, which is central to the effectiveness of the legal framework. The people's courts at the national and provincial levels established economic courts in July 1994 to adjudicate economic disputes and exercise functions under the bankruptcy law. These developments highlight the need for training of legal personnel to staff these new functions as well as for the strengthening of Viet Nam's growing legal profession. A number of technical assistance programs are starting up in Viet Nam which are intended to assist both in the preparation of legislation and in the training of legal professionals.

45. **Financial sector**. The financial sector can play a key role in spurring savings and investment, but the sector's ability to mobilize savings and finance investment is currently limited by several problems. These weaknesses include bad debts in the state-owned commercial banks that threaten the solvency of the system; poor accounting and management practices in these banks; and high taxation of intermediation which discourages expansion, especially of new banks. In addition, a poor check-clearing system and shortages of large denomination notes discourage use of domestic currency. As a result, "dollarization" of the economy is a problem.

46. The four state-owned commercial banks inherited a significant amount of bad debt when they were separated from the State Bank. More importantly, it is not clear what the quality of recent lending is as supervision of banks is weak. The capacity of both the central bank and the state-owned commercial banks is currently being strengthened through technical assistance from the Fund, the Bank, ADB, and bilateral donors. An important complement to this work is determining the exact scope of the non-performing loans in the banks' balance sheets, which would require independent portfolio audits. These

audits would set the stage for a program to clean up the bad debts and to ensure that banks are adequately capitalized. In order to minimize the fiscal cost of such a program and to increase competition in the sector, it is recommended that this program include at least partial privatization of the state-owned banks.

47. One of the most positive features of Viet Nam's financial sector reform has been the entry of about 60 new banks, mostly private, both domestic and foreign. This entry has the potential to create a vibrant banking sector. The expansion of these banks is hampered, however, by high taxation, especially the turnover tax assessed on banks' net interest income. This tax in practice discriminates against newly established banks because they have little deposit base and initially fund their lending primarily by equity. Thus, they have interest income but little interest cost, so that the effective tax rate is extremely high. This burden is passed on to borrowers in the form of high interest rates and discourages the expansion of the private banking sector. It is recommended that banks be exempt from the turnover tax in order to improve the incentives for commercial banks to expand their operations.

48. By reducing inflation the authorities have taken the hardest steps to encourage resource mobilization. They should now introduce other measures to encourage the use of domestic currency and deposits, specifically an increased supply of larger denomination notes -- of course draining an equal amount of smaller value notes -- and an improved check clearing system. The State Bank must make it attractive for firms and households to use dong-denominated instruments if "dollarization" is to be reduced.

49. **Foreign trade policy.** The experience of successful economies in the region has demonstrated the importance of openness to the international market in order to spur efficiency and growth. Liberalization of foreign trade is thus a key element of a successful program to strengthen incentives and to improve the enabling environment for the private sector. The government has removed nearly all quantitative restrictions and replaced them with tariffs. Furthermore, the system of export and import permits and licenses has been gradually liberalized, with the result that the private sector -- especially in manufacturing -- now has better access to foreign trade. A number of concrete liberalization measures were introduced in 1994, including elimination of shipment licenses for exports. The government is exploring the possibility of joining GATT and recognizes that remaining impediments to imports will have to be largely removed before it can do so. Thus, the program of reducing administrative barriers to trade will continue, with plans for phasing out shipment licenses for imports during 1995-96.

50. An important remaining barrier is the use of permits to manage imports of 15 major commodities. These permits are used to meet two objectives that could be better pursued through other instruments. In the case of key inputs such as fertilizer and cement, the permits are used flexibly with the objective of ensuring adequate supplies to the economy. It is recommended that these permits be replaced with a system of monitoring inflows and publishing timely information, so that trading companies can respond quickly and efficiently to incipient shortages. For consumer items such as refrigerators, the import permits are used to control consumption. It is recommended that these permits be replaced by special excise taxes. An import barrier is the wrong instrument here, as it encourages inefficient production.

51. In addition to administrative barriers, another significant trade distortion is the tariff code. Viet Nam's current code differs significantly from those in place in leading exporting countries. It is very complex, containing a large number of rates from 0% to 200%. Furthermore, rates have been

frequently changed. The tariff code should be revised as a matter of urgent priority. The objective in the medium term should be a tariff code with a small number of rates, and a maximum rate no higher than 30%. As an interim step the government may want to make a less drastic change. A realistic first step would be to lower the top rate to 60%. However, it is important to announce now that the ultimate goal is to reduce dispersion of effective protection to very low levels, so that producers will make efficient investment decisions.

52. **Foreign investment.** In the area of foreign investment, the government has likewise made substantial progress in liberalization, but significant impediments remain in place. Cumbersome procedures and bureaucratic requirements for the negotiation of contracts, issuance of related licenses, and implementation of projects are singled out by most investors as major problems in this area. The government has already taken some measures to reduce these bottlenecks. In addition, the following measures to streamline the investment process are recommended: (1) decentralization of issuance of licenses for small projects to provinces or regional SCCI offices; (2) reduction in the number of agencies and levels of government involved in the license approval process and in the issuance of other permits required to undertake the investment; and (3) elimination of the requirement for feasibility studies, at least for small projects.

53. Foreign investors face significant difficulties in securing land use rights and are further hampered by the inability to mortgage these rights. This situation would be improved by the organization of land use right auctions (open to foreign as well as domestic investors). In addition, regulations concerning foreigners' use of land are expected to be issued by end-1994, and it is important that these regulations allow foreigners to mortgage and transfer land use rights.

54. The government realizes that Viet Nam's continued growth will depend to a large extent on the development of supporting infrastructure. State enterprises in the power, telecommunication, and transport sectors have not been able to finance all of the infrastructure investment required to sustain the economy's robust growth. Thus, the government intends to invite the private sector, including foreign investors, to complement public investment in these critical sectors. The government is in the process of studying how some of these sectors or parts thereof could best be opened to competition.

Poverty Reduction

55. Viet Nam embarked on its economic reform program with the primary objective of raising general living standards. In order to pave the way for long-term gains in per capita incomes, the government initiated a thorough structural adjustment program. Unlike the populations of many other transition economies undergoing market reforms, the majority of the Vietnamese people benefited immediately from the change in policies: with 80% of households engaged in agricultural activities, decollectivization and price liberalization resulted in higher incomes and improved living standards for most of the population. Despite strong gains in per capita income in recent years, however, Viet Nam remains a very poor country.

56. **Poverty profile.** The recently completed Viet Nam Living Standards Survey (VNLSS) highlights three important features of poverty in Viet Nam:

- The overall incidence of poverty is extremely high; the consumption level of 51% of the population is below a widely used international poverty line. Even in the relatively

prosperous Mekong Delta, half the population survive at per capita consumption levels below this poverty line.

- There are significant regional disparities in living standards throughout the country. Poverty incidence ranges from 33% in the southeast to 71% on the north central coast.

- Rural areas throughout the country are much poorer than urban areas (i.e., 57% rural poverty incidence versus 26% urban). Rural poverty accounts for 90% of the poor. Poverty incidence figures are much higher in Viet Nam than in China (9%), Indonesia (15%), or Thailand (16%). Twenty or 30 years ago, these countries had poverty rates similar to Viet Nam's current level of about 50%. Several decades of rapid growth, however, have resulted in sharp declines in the proportion of their populations living below the poverty line.

57. Although Viet Nam's consumption based poverty rate is very high, other important welfare indicators such as education and health status are much better than in many other low-income countries. Viet Nam's literacy rate is a remarkable 88%, a rate comparable to countries with five times the per capita GNP of Viet Nam. Under five mortality is about one-third that of other low-income countries, and life expectancy is 67 years. Malnutrition rates, on the other hand, are very high with almost half the children under age five stunted; this is reflected in the consumption based measure used to form the poverty line.

58. Although Viet Nam has a high incidence of poverty, the distribution of income is relatively equitable. The gini coefficient, which measures the degree of income inequality, is 36%. This places Viet Nam among the more equitable of East Asian countries. Recent gini coefficients for other countries in the region, for example, are 33% in Indonesia, 36% in China, 41% in the Philippines, 43% in Thailand, and 48% in Malaysia. Inequality in countries in other regions of the world is even higher, with gini coefficients as high as 59% in some Latin American countries.

59. While Viet Nam began its transition to a market economy with a relatively equal distribution of income, a disturbing development in the past few years is that growth rates of different regions of the country have varied enormously. Furthermore, there is a clear pattern in which relatively poor areas are growing slowly. The two poorest regions, the north central coast and the north mountains, are growing at about 3% per year, whereas the prosperous southeast is expanding at the annual rate of 15%.

60. Results of simulations illustrate how growth will impact on poverty reduction in Viet Nam. If Viet Nam achieves its targeted 8% annual growth rate and if the unequal growth rates of different regions continue throughout this decade, the national incidence of poverty would decline to 29% by the year 2000. If growth were more balanced and reached 8% in each region of the country, on the other hand, then the poverty rate would decline more rapidly, to 23% by 2000. Of course, the extent of redistribution required to achieve 8% growth in all regions of the country could well result in a lower aggregate rate of growth. This trade-off between equity and growth is complicated, and ultimately decisions depend on social preferences and political pressures. Nevertheless, this simulation illustrates an important point about growth and poverty reduction in Viet Nam. The vastly different growth rates among regions result in significantly lower poverty reduction, than if growth were more evenly spread throughout the country. Poverty reduction will be quicker if regional growth is more evenly distributed. Finally, under a scenario in which the economy grows more slowly, at 6% per year, 35% of the

population would still be poor in the year 2000. Thus, the country's success in reducing poverty will depend on (1) the overall growth rate and (2) the extent to which growth is balanced among regions.

61. **Policies and programs to reduce poverty.** The government can have a strong impact on the extent to which poor households participate in growth through its expenditures and policies. A number of public services are strongly pro-poor in the sense that poor households benefit disproportionately from these services, which in turn enable households to increase their income and rise out of poverty. Primary education and preventative health services are pro-poor in this way.

62. The central government in Viet Nam takes responsibility for financing and delivering these services. The service delivery system does not work well in practice, however, and results in underfunding in poor areas. As noted in the earlier discussion of the fiscal system, it is recommended that provision of basic education and health services be assigned to the local level. The central government can ensure universal provision of these key services through specific-purpose transfers to finance education and health. These transfers could take the form of matching grants that are progressive (i.e. require a higher contribution from wealthier provinces).

63. There are other important services that the government provides that will influence poverty reduction. One of the interesting results of the VNLSS is the extent to which household income -- and hence the ability to rise out of poverty -- is related to the existence of key infrastructure such as rural roads, inland waterways, and irrigation. In general, people who live near such infrastructure have higher living standards and have been better able to take advantage of the market reforms than those who do not. For example, the data show that those people living in communities located near an all-weather road (i.e. passable year round) have significantly higher per capita income than those not living near such a road. They are significantly more likely to have a permanent market located in their village; to engage in more than one economic activity; to leave the village to seek work; to sell agricultural surplus; and to be served by public transport. The VNLSS data indicate that each of these factors is significantly and positively correlated with living standards.

64. The provision of infrastructure through the PIP is another part of the budget that is overly centralized. All investment projects have to be approved by the center. In practice, local governments have a better appreciation of the infrastructure needs in their areas and should be allowed more discretion in determining expenditure priorities. In general, the centrally managed PIP should cover large projects whose benefits are national or regional. The criteria for selecting such projects should focus primarily on economic rate of return. The central government can help promote more balanced growth by ensuring that provinces have adequate resources from which to finance small-scale infrastructure projects at the local level.

65. Local governments should be provided with adequate resources and sufficient flexibility to address local needs. If rehabilitation of key infrastructure is a priority, local governments should be able to reallocate resources from elsewhere in their budget to focus on the item of urgency. The central government can enable provinces (particularly poorer provinces) to support their own investments and maintenance by allocating resources for investment and recurrent costs via a general grant. This grant can be distributed to provinces based on criteria such as population, per capita income, cost of delivering services, and local tax effort. By devolving more autonomy to local governments to support the investment and operation of infrastructure of local priority, efficiency of public expenditures would rise. Appropriate local infrastructure would enable households in these areas to participate more effectively

in the market economy. The data suggest that all factors of production would be used more efficiently and would generate higher household earnings if accompanied by adequate infrastructure.

66. The government can influence poverty reduction through its policies as well as its expenditures. Development of the financial system is particularly important to spur poverty reduction. As Viet Nam's poverty profile clearly indicates, the incidence of poverty is much higher in rural than in urban areas. Access to credit is a constraint to rural poverty alleviation. Owing to inadequate collateral and high transaction costs, poor households have traditionally lacked access to formal credit and have consequently relied on costly informal credit. Even with the heavy reliance on the informal sector, the credit gap in the rural sector is large and will likely remain that way until fundamental constraints are removed, competition is enhanced, and public confidence in the banking system is restored.

67. A system of rural credit delivery is continuing to evolve in Viet Nam from the old state bank structure towards a more diverse set of rural financing institutions. The Bank for Agriculture continues to play a major role in this changing structure, though several alternative private financial institutions have begun to emerge in rural Viet Nam. The strategy of the State Bank is to license new institutions that will supplement the efforts of the state banks. Foremost has been the replacement of the former rural credit cooperatives with private, rural shareholding banks and Popular Credit Funds during 1992-93. These new institutions face significant challenges; nevertheless, their emphasis on rural savings mobilization, outreach, lower transaction costs, and access of the poorer households offers important lessons for rural financial development. The Popular Credit Funds are an innovation which should be expanded to other provinces according to the plan of the State Bank.

Conclusion

68. The key to sustaining a high growth rate in Viet Nam will be the expansion of domestic savings as a source of financing for growing investment. The government can contribute directly by carefully managing its expenditures so as to generate growing savings. The government has an important indirect role as well through its influence on the incentive regime for households and firms. Following up on the impressive reforms that have been implemented to date, further measures are required to develop legal infrastructure and the financial system and to liberalize foreign trade and investment. The rapid growth promoted by these reforms will result in a rapid increase in living standards and decline in poverty in Viet Nam, the ultimate objective of the renovation program. Poverty reduction can be accelerated through measures that encourage broad-based growth of rural and urban areas throughout the country. Fiscal reforms to ensure that important pro-poor services are well provided will be at the heart of an effective poverty alleviation strategy.

I. MACROECONOMIC DEVELOPMENTS

A. Introduction

1.1 Viet Nam has been carrying out an ambitious adjustment and reform program since 1989 and is making a steady transition to a market economy. The country achieved some notable successes during the 1989-92 period, despite a lack of international financial support. Initial structural reforms included decollectivization of agriculture, price liberalization, unification and devaluation of the exchange rate, and hardening of the budget constraint for state enterprises. At the same time the fiscal deficit that was the root cause of inflation was reduced through a combination of tax reform, elimination of subsidies, and expenditure restraint. These reforms produced good results. Real GDP growth accelerated from 5-6% in 1990-91 to 8% in 1992-93. At the same time inflation was brought down from 68% in 1991 to 18% in 1992 and 5% in 1993.

1.2 While Viet Nam's achievements are impressive, there are weaknesses in both the economy and the reform program that should not be overlooked. The country remains one of the poorest in Asia, with per capita GNP below US$200 in 1993. Concerning the reform program, Viet Nam is moving from the relatively easy price liberalization measures to more difficult structural reforms, such as restructuring state-owned banks, privatizing public firms, and streamlining the trade regime. Furthermore, fiscal restraint during 1990-91 was to some extent the result of holding down all expenditures rather than making choices among public services. With improved revenue and greater access to international finance, all of these expenditure categories have grown, leading to a reemergence of fiscal problems. Both the fiscal and external deficits grew alarmingly in 1993. Tighter fiscal and monetary policies were introduced in 1994 to deal with the emerging macroeconomic problems, and these policies will need to be maintained in order to ensure that the economy remains on a stable growth path.

1.3 Viet Nam's macroeconomic management was good during a period of austerity. This belt tightening yielded results and put the country in a good position to shift from adjustment to growth. The country is fortunate to have a substantial volume of foreign resources – both private investment and ODA – available to support its development. These resources provide both an opportunity and a challenge to Viet Nam. The foreign resources have the potential to make the economy's development more rapid. Managing both the macroeconomic and microeconomic impact of these resources, however, will be a new challenge for the government, and for the larger society.

1.4 This economic report reviews developments with Viet Nam's economy and reform program during 1993-94 and assesses the economy's prospects for growth in the medium term. While foreign resources can assist the country's development, sustained growth will depend primarily on Viet Nam's own ability to generate savings to finance investment. Thus, the report focuses on a number of strategic choices that policy-makers face as they try to strengthen both public and private savings and to spur the economy's development. A unifying theme of the report is that many of these choices involve the issue of centralization versus decentralization. In many ways decision-making in Viet Nam remains highly centralized. This system is working fairly well at the moment. However, the economy right now is quite a simple one. There are only a few important imports, a small number of major foreign investment projects underway, and a handful of aid projects being implemented.

1.5 If Viet Nam makes full use of the domestic and foreign resources available for development, then the complexity of the economy will grow very rapidly. The number of important exports and imports will multiply, and hundreds of large investment projects could be implemented simultaneously. In this case, the current, highly centralized decision-making will inevitably become a severe bottleneck for development. Thus, the most important strategic choice that the government faces is whether to give up some control and to decentralize decision-making in return for a faster pace of development. Decentralization would have other benefits as well. The current system is not only a growing bottleneck, but also by extension a breeding ground for corruption, because corruption is one way to move decisions through the bureaucracy.

1.6 The general tension between centralization and decentralization can be seen in a number of specific areas:

- the respective roles of central and local authorities in raising revenue, planning public expenditure, and regulating the economy;
- ongoing efforts by the government to allocate credit through the commercial banks;
- the complex system for managing imports through permits, licenses, and tariffs; and
- cumbersome procedures for licensing foreign investment.

These are the main topics covered by the report. The conclusion of the analysis is that in each area Viet Nam would be well served by introducing greater decentralization. In the fiscal area, this means clearly assigning some revenues and expenditures to local levels. For the banking system and the regime for foreign trade and investment, this means accelerating the liberalization of the economy and shifting the government's focus from control to promotion. In other words, instead of trying to control all of the decisions, the government should concentrate on establishing an incentive regime that promotes efficient decisions by households and firms.

1.7 These ideas are not new in Viet Nam. The government is already moving in these policy areas. Nevertheless, the issues of decentralization and liberalization remain controversial, and progress is at best gradual. The main purpose of the report is to contribute to this policy dialogue in Viet Nam by analyzing the benefits that a strategic shift from control to promotion would yield, and by making specific recommendations for reforms that would realize these benefits.

1.8 One of the reasons why decentralization and liberalization remain controversial in Viet Nam is that the government is very concerned about regional inequalities. The report examines this issue in several ways. First, it reports major results from a representative household survey carried out by the government with technical assistance from the World Bank and financing from UNDP and SIDA. This survey yields up-to-date information on poverty and income distribution in Viet Nam. Second, the report analyzes how government expenditures and policies can be used to promote relatively balanced growth throughout the country, in order to bring about a more rapid reduction in poverty.

1.9 One of the important conclusions of the report is that it is possible to combine elements of fiscal decentralization with centrally managed transfers that ensure that poor regions receive adequate public services. The report recommends this kind of system for Viet Nam. Such a system would

promote rapid growth -- which is the most effective method of reducing poverty in the long run -- while at the same time ensuring that there are also targeted programs to address the immediate problems of poverty in Viet Nam.

1.10 The report is organized as follows: The remainder of this chapter reviews recent economic developments and prospects for growth in the next few years. It provides the macroeconomic context in which to view the strategic issues taken up in subsequent chapters. Chapter 2 focuses on issues of public sector management, including the budget, the public investment program, and reform of state enterprises. The following chapter examines several issues that are at the heart of the incentive regime for producers: legal reform, the financial system, and the regime for foreign trade and investment. The final chapter presents a poverty profile for Viet Nam and information on income distribution and regional inequalities. It also reviews the system of inter-governmental transfers and their effectiveness in addressing issues of poverty.

B. Macroeconomic Performance

1.11 On the surface Viet Nam's macroeconomic performance was good in 1993, with robust growth of 8.1% and a decline in consumer inflation to 5.2%. There were some underlying problems, however, that required corrective actions early in 1994. The fiscal deficit increased significantly, to 6.2% of GDP, a level that the government had difficulty financing. On the monetary side, domestic credit increased by nearly 60%. This rapid expansion of credit did not lead to immediate inflation because it financed a surge of imports. However, the level of the resulting trade deficit -- as well as the level of the fiscal deficit -- was not sustainable.

1.12 Viet Nam went through a period of austerity in 1990-91, during which time its current account deficit declined to virtually zero: in other words, no foreign resources were available to the country. The situation has changed dramatically in the past two years, and there are now large commitments for direct investment projects and for aid-financed infrastructure projects. Relatively little of this potential funding actually disbursed in 1993, however. Disbursements of concessional loans, for example, were less than US$250 million. What happened in 1993 is that the government increased its expenditure, mostly on infrastructure and social spending, but did not have adequate financing for these expenses. A major part of its problem was that it misjudged the amount of aid money that would actually disburse, and then had to rely on commercial sources to fund its deficit.

1.13 In the monetary area, the State Bank allowed rapid growth of credit to producers, who in turn purchased imports. There were not adequate external flows to cover the resulting deficit, however, with the result that it was paid for by a drawdown in gross reserves of the banking system -- something that can be done only once. Thus, the financing for both the fiscal deficit and the external deficit in 1993 was precarious.

1.14 Viet Nam can look ahead several years to a time when inflows of direct investment and ODA could contribute very substantial financing for development, provided the macroeconomy continues to be well managed. Through its fiscal and monetary policies, however, the government tried to push rapid expansion in advance of this financing. This expansionary policy threatened to reignite inflation. Early in 1994 the government moved to strengthen its macroeconomic policies by:

- restraining the growth of public expenditure and tailoring its deficit to match the availability of concessional ODA; and

- limiting the expansion of domestic credit through bank-by-bank credit ceilings, higher interest rates on refinancing and on foreign currency loans, and stricter reserve requirements.

1.15 This adjustment program yielded quick results. The fiscal deficit is projected to be sharply lower in 1994, less than 3% of GDP. Credit growth also decelerated. And the external deficit is projected to decline to about 5% of GDP, a level that can be sustained over the medium term. The sound macroeconomic policies created a favorable environment for growth, which accelerated to an 8.7% rate.

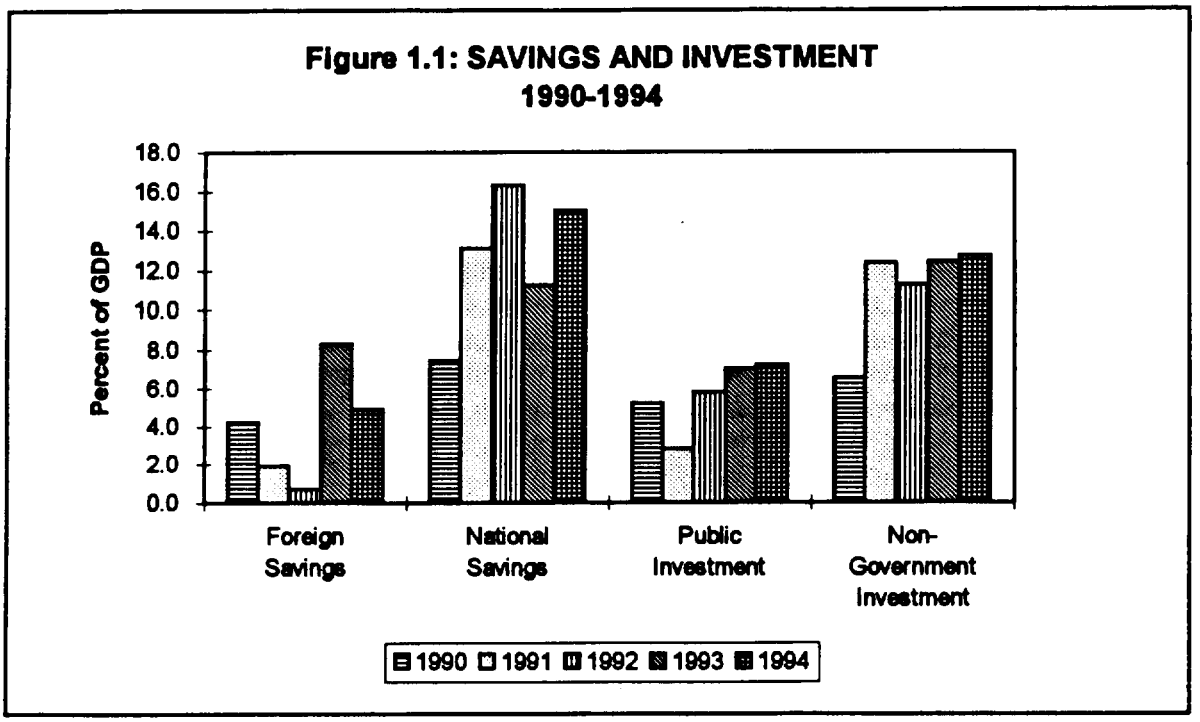
1.16 **GDP growth.** The economy's growth remained strong in 1993, with real GDP increasing 8.1% (Table 1.1). This result was a small decline from the 8.6% growth of 1992. Construction – which is visibly booming in urban areas – was the fastest growing sector (18.3%). Industry (12.1%) and services (9.4%) also continued to expand rapidly. Growth of agricultural production, on the other hand, was disappointing, up only 3.8% over 1992.

1.17 These sectoral results point up one of the important elements of Viet Nam's growth, that is, its sharp concentration in urban areas in general and in Ho Chi Minh City in particular. Economic results in Ho Chi Minh City were once again close to spectacular. The real GDP of the city increased 13.9%, with balanced expansion of manufacturing, services, and construction. The city's foreign trade expanded an even faster 18%. Nearly one-third of Viet Nam's increase in GDP in 1993 came from Ho Chi Minh City, which has 5% of the country's population.

Table 1.1: GROWTH RATES OF GDP AND MAJOR SECTORS 1990-94 (1989 Prices)

ITEM	1990	1991	1992	1993	1994 Est.
			(Percentage Change)		
GDP at Market Prices	5.0	6.0	8.6	8.1	8.7
Agriculture	1.5	2.2	7.2	3.8	5.5
Industry	2.5	9.9	14.6	12.1	12.1
Services	10.3	8.3	7.0	9.4	9.3
Construction	4.7	5.1	11.0	18.3	17.5

Source: General Statistical Office.



1.18 **Investment**. One of the most positive macroeconomic developments for Viet Nam in 1993 was the large increase in investment, a growth of 41% in current prices and 32% in constant prices. It should also be noted that the General Statistical Office has revised upward the investment figures for the period 1991-93. This correction is very welcome; last year's economic report remarked that an investment rate of 12% of GDP for an economy growing at a 7% annual rate was implausible. The revised series has the investment rate at 15.1% in 1991, rising to 17.0% in 1992 and 19.4% in 1993.

1.19 Even with this upward revision, the Incremental Capital Output Ratio (ICOR) was 2.2 in 1993, rather low in comparison to other developing countries. The State Planning Committee believes that official figures still understate total investment, so that in reality both the investment rate and the ICOR are higher than indicated by these figures. Even with further upward revision, however, the ICOR would still be below the level of 3-4 commonly found in other developing countries. There are three factors that can explain Viet Nam's low ICOR. First, some large, fixed investments of the mid-1980s, in oil and hydropower, came on line in the early 1990s, so that some of the increments to GDP were based on these earlier investments. Second, the initial response of the economy to the removal of distortions -- especially in services and in agriculture -- permitted large increases in output based on only minor additional investments. Third, labor-intensive manufactures have been a leading sector, particularly in 1993-94, and this exploitation of comparative advantage is an efficient develop strategy that tends to keep the ICOR low.

1.20 The first two of these factors are clearly temporary; as their effects wear off, the ICOR will rise, requiring greater amounts of investment in order to sustain the growth rate. The third factor -- exploiting comparative advantage in labor-intensive industries -- is more permanent. The experience of the successful East Asian Newly Industrialized Economies has shown that export-oriented industrialization is an efficient strategy that tends to keep the ICOR low, so that a relatively large amount of output is generated from a given level of investment.

1.21 The increased investment in 1993 and 1994 came both from budgetary investment in infrastructure and from investment in commercial activities (Figure 1.1). The public investment program has rebounded from a low of 2.8% of GDP in 1991 to around 7.0% in 1993-94. The other 12-13% of GDP in investment came from autonomous state enterprises, joint ventures between the public and private sectors, and private firms and households. The division between the public and private sectors in Viet Nam is not always clear, so that it is difficult to determine the extent of purely private investment in the economy.

1.22 **Savings.** While the increase in investment in 1993 was positive, developments in the area of savings were not encouraging. The increase in national savings has been one of the most important achievements during Viet Nam's reform program. In the revised national accounts, savings are estimated to have increased from 3.2% of GDP in 1989 to 16.3% in 1992 (Figure 1.1). This development confirms that households have the same strong predilection to save that is observed throughout East Asia. Stabilization of the economy, strengthening of property rights, and improvements in the banking system combined to bring forth these savings and to channel them to productive uses. This increase in savings more than made up for the decline in foreign financing available to Viet Nam, so that investment could increase quickly during a period in which the economy's utilization of foreign savings was in decline.

1.23 The use of foreign savings had dropped to nearly zero by 1992, as a result of the lack of foreign sources of financing. This situation changed dramatically at the end of 1992, and in 1993 the inflow of foreign savings grew to more than 8% of GDP. As discussed in more detail in Section D below, much of this came from unreliable sources of financing. This sudden inflow of foreign resources seems to have crowded out domestic savings. After several straight years of increases, national savings declined from 16.3% of GDP in 1992 to 11.2% in 1993. Of this five point decline in the savings rate, about one-fourth can be attributed to a decline in government savings and three-fourths to a decline in savings outside of the government sector. Reversing this decline is an immediate and important task for economic policy that will require actions both on the government budget and on the incentives that encourage households and firms to save and invest. Strengthened fiscal and monetary policies in 1994 have already made a contribution, with domestic savings projected to rise to 15% of GDP for the year.

C. Budget Developments

1.24 Viet Nam's budgetary situation in 1993 was characterized by sharp increases in both revenue and expenditure and by an expansion of the fiscal deficit (Table 1.2). Concessional flows to finance this deficit were minor, so that the government had to rely on expensive sources of finance, both domestic and foreign. In 1994 the government introduced tax and expenditure measures to reduce the deficit. The government will have to manage its deficit carefully in the next few years, controlling expenditures to match available sources of funding.

1.25 **Revenue.** Revenue mobilization by the government has been a notable area of success during Viet Nam's adjustment program. Total revenue increased to 22.3% of GDP in 1993 (of which 0.8 percentage points came from foreign grants). This collection was up from 19.0% of GDP in 1992 and 13.5% in 1991. Thus, over a two-year period the government increased its revenue by nearly 10 points of GDP. Revenue increases of this magnitude are unusual. In fact, the experience of other countries shows that such large increases are often followed by some downward adjustment in future years. Hence, the government should be cautious in its fiscal planning and not assume that further large gains will be forthcoming.

1.26 In addition to increasing its revenue, the government is also relying on a more diversified revenue base. Oil revenue barely increased in 1993, so that its share in total revenue declined to about one-sixth. For the first time, the profit tax overtook the turnover tax as the main domestic source of tax revenue. And import duties nearly tripled as a result of the surge in imports combined with more effective collection of tariffs (Appendix Table 5.2).

1.27 Several years ago it could be said that Viet Nam's tax collection was low, and that this was especially true for some types of taxes. Import tariffs, for example, were only 5% of the value of imports. This situation has been rectified in the past two years. In 1993 import duties amounted to 15.8% of the value of imports. The government now needs to be careful about further attempts to increase revenue. In the case of imports, the current average tariff collection is appropriate and additional increases are likely to hurt the economy by creating disincentives to export and import.

1.28 While Viet Nam has achieved more diversification in the types of taxes from which it obtains revenue, its tax base is still narrow in the sense that most revenue comes from state enterprises. Revenue from state enterprises is nearly three times higher than tax collections from private firms, even though more than half of GDP comes from the private sector.

1.29 While Viet Nam's tax reform has been successful in raising revenue, it has made less progress with other goals, in particular, reducing distortions. The focus of tax reform now needs to shift toward making the tax code more neutral in its effect on incentives. The turnover tax, for example, creates poor incentives because of its cascading effect on producers. In an attempt to minimize the distortions from cascading, Viet Nam's turnover tax is extremely complex with many different rates. This complexity creates problems for administration, and in fact the government is only successful at collecting the tax from the firms that it owns. Turnover tax collection from the private sector is minor.

1.30 The government is planning a comprehensive and phased reform of its overall tax system. It will first simplify the turnover tax by reducing the number of rates, and eventually replace it with the less distorting value added tax. As part of its tax reform the government will consider modifications to the profit tax as well. This tax is very high and is an impediment to firms reinvesting their earnings. The tariff code also needs to be reformed. It too has a wide range of rates, creating poor incentives and difficulties for administration. This reform is taken up in more detail in Chapter 3, under the discussion of foreign trade.

1.31 In summary, the tax system in Viet Nam now places a significant portion of GDP in the hands of the government, to fund its activities. Further large increases in revenue as a share of GDP are not likely to occur, and in fact would not be desirable. The government should concentrate now on reforming the tax system in order to create better incentives for production. This reform will spur the growth of the economy and ensure that revenue collections are robust as development proceeds.

Table 1.2: SUMMARY OF BUDGETARY OPERATIONS, 1990–94

	1990	1991	1992	1993	Budget 1994
			(Percent of GDP)		
Revenue (inc. Grants)	14.7	13.5	19.0	22.3	25.4
Tax Revenue (Private Sector)	2.3	2.6	3.5	4.1	..
Tax Revenue (State Enterprises)	8.7	7.7	10.3	11.5	12.3
External Trade Taxes	1.8	1.4	2.0	4.3	..
Other Non-Tax Revenue	2.0	1.8	3.3	2.5	1.5
Current Expenditure (exc. Interest)	14.7	11.4	14.0	18.8	18.8
Wages and Salaries	4.2	2.6	..	..	..
Other	10.5	8.8	..	..	..
Capital Expenditure	5.1	2.8	5.8	7.0	7.2
Overall Primary Balance	-5.1	-0.7	-0.8	-3.5	-0.6
Interest	3.0	3.0	2.9	2.7	2.1
Overall Balance (Accrual Basis)	-8.1	-3.8	-3.7	-6.2	-2.7
Overall Balance (Cash Basis)	-5.8	-1.5	-1.7	-4.7	-2.5
Financing	5.8	1.5	1.7	4.7	2.5
Foreign Loans and Grants (Net)	3.0	1.0	2.4	1.4	0.9
Domestic Loans (Net)	2.8	0.5	-0.7	3.4	1.5
State Bank (Net)	2.0	0.9	-2.0	1.5	..
Government Securities (Net)	0.8	-0.4	1.3	1.9	..

Source: Ministry of Finance.

1.32 **Expenditure.** Government expenditure has increased even more rapidly than revenue during the past two years. During the 1990-91 period the government reduced its spending as part of the campaign to halt high inflation. During this austerity period a number of adjustments were made that should help the long-term growth of the economy. The military was reduced in size, with about half a million soldiers demobilized. Subsidies to state enterprises were curtailed, which had a positive effect on their productivity. The austerity, however, also made it difficult for the government to supply a range of important services that are needed for the economy and the society to develop. Investment in infrastructure, for example, declined to a very low level, and there were problems with the delivery of social services as real civil service salaries declined in the face of inflation.

1.33 The government has moved in the past two years to turn this situation around and to increase its development expenditure. While these investments in infrastructure and human resources are necessary in the medium term, the rate of growth of government spending has been too rapid. Real government spending essentially doubled between 1991 and 1993. That rate of growth threatened macroeconomic stability, and in 1994 the government had to modify its spending plans in order to bring its deficit under control.

1.34 Viet Nam is a poor country that clearly has a lot of needs, but they cannot all be met at once. One of the main messages of this report is that the government must carefully set priorities and manage its expenditures. The increased tax revenue noted above and the growing flow of aid mean that the government has substantial resources at its disposal. These resources will not yield much benefit, however, if the government tries to do too many things at once. How well the economy develops in the next few years will depend to a large extent on how well the government sets priorities and manages its expenditure. This topic is taken up in detail in Chapter 2, which examines the budget system, the roles of local and central government, current expenditures, and public investment.

1.35 **Fiscal deficit and financing.** The fiscal deficit was a problem in 1993 because it was large relative to low-cost sources of financing. Reducing the fiscal deficit was at the heart of Viet Nam's disinflation program in 1990 and 1991, during which time the deficit was reduced to 3.8% of GDP. Starting from that point, it made sense for the government to allow the deficit to gradually expand as aid resources became available. The returns to public infrastructure projects in Viet Nam are very high, and deficit financing is a sensible strategy as long as the government controls its debt in light of its servicing capacity.

1.36 Expenditure increased too rapidly in 1993, however, opening up a deficit that the government had difficulty funding. The deficit was equivalent to about US$800 million. The net flow of concessional loans, on the other hand, was quite small, creating a serious financing problem for the government. To its credit, the government did not resort to inflationary sources of finance. It did, however, borrow the equivalent of US$400 million from domestic sources at high interest rates. It also resorted to about US$200 million of commercial international borrowing. This large amount of high-cost borrowing will impose substantial interest costs on the budget in the future.

1.37 The initial 1994 budget had similar problems, projecting a large increase in expenditure and optimistic forecasts of ODA disbursements. During the year, however, the government adjusted the budget several times, as it became clear that the ODA inflow for the year would be quite low, including only about US$200 million in concessional loan disbursements. The government introduced tax and

expenditure measures that resulted in a decline in the fiscal deficit to a projected 2.7% of GDP. As a result of these strong measures the government did not need to rely excessively on the domestic banking system or international commercial borrowing.

1.38 To keep its fiscal house in order the government of Viet Nam needs to do a better job of managing its expenditures and controlling its deficit. The aid commitments made at the Donor Conference of November 1993 should lead to growing concessional inflows. The government needs to plan carefully the priority projects to be financed from aid sources and to move quickly to implement these projects. This strategy would allow the fiscal deficit to expand modestly as ODA disbursements increased. It is recommended that the government manage its deficit to match the financing available from concessional loans, plus a small amount of domestic borrowing. The government has begun selling treasury bills, which is useful for the development of domestic capital markets. It would be prudent, however, to rely to only a small extent on the issuance of T-bills for financing, as domestic interest rates remain quite high.

D. Monetary Policy and Inflation Control

1.39 Notwithstanding a surge in credit, which helped to underwrite the strong growth noted above, in 1993 Viet Nam achieved one of the best performances among transitional economies with respect to inflation reduction. An important task for the authorities is to consolidate these gains and to develop the monetary policy instruments that will permit effective control of inflationary forces. This includes developing indicators and instruments, as well as skills in interpreting and utilizing them.

1.40 Although the sharp deceleration of inflation is clear, the exact measurement of this change varies significantly depending on the index used and the time period chosen. Inflation from the producers' view (measured by the GDP deflator) fell to 13.2% in 1993, from 73% and 35% in 1991 and 1992, respectively, while from consumers' perspective it was only 8.3% last year – and a mere 5.2% on a December/December basis, the lowest rate among transitional economies. A key factor accounting for the five percentage point gap between the two (annual average) indices reflects the stabilizing presence of imports in the CPI basket.

Table 1.3: CONSUMER PRICE INFLATION
(Percent Change)

Category	1992		1993	
Food	19.5	(7.8)	6.4	(6.9)
Non-Food Goods	38.0	(14.1)	6.1	(3.1)
Services	44.8	(41.0)	23.4	(18.9)
Overall CPI	37.7	(17.5)	8.3	(5.2)

Note: Annual averages, with December/December data in parentheses.

1.41 The slowdown in inflation was broadly based, as each major component of the CPI decelerated (Table 1.3). Output-based measures also reveal a widespread deceleration, with the largest increases last year in construction (29.8%) and the categories of finance, state management, tourism (all 24-25%), and the smallest rises in industry (9.4%) and agriculture (4%).

1.42 The sharp deceleration of inflation appears somewhat paradoxical in the face of the rapid growth of money and credit. Domestic credit rose 58.7%, led by a near tripling of credit to the non-state sector. M2 increased a more modest 19%, reflecting the running down of net foreign assets. Although financial depth declined slightly -- from 26.5% to 25.8% of GDP -- last year, dong M2, which excludes foreign currency deposits, rose from 18.5% to 20% of GDP, and broader measures of financial depth showed even larger gains (Chapter 3). This increase in the use of the dong is consistent with a fall in inflation expectations and the seemingly still high real interest rates available to depositors.

1.43 Several factors appear to have helped reduce inflationary forces. First, the authorities liberalized imports, as witnessed by the running down of foreign exchange reserves, thereby providing increased competition and a safety valve for demand pressures. Second, with a large part of the population in agriculture, Viet Nam faces a more elastic supply of labor to the rest of the economy in comparison with other transition economies, where a larger percentage of workers are in heavily subsidized jobs in industry and hence have little desire to seek other employment. Moreover, especially in view of the large part of credit growth (about one-fourth) accounted for by the Agriculture Bank, it is likely -- given the 4-5% per month interest rates in the informal sector -- that part of the rapid advance in credit represents a reallocation away from the informal sector.[1/] Thus this part of credit expansion is probably offset by an unrecorded fall in informal credit. Lastly, not all increases in output will have the same inflation impact: although real GDP has risen by 43% since 1989, gross capital formation has registered an impressive 141% jump, and anecdotal evidence suggests that most of this increase has been highly productive. It is therefore to be expected that capacity is rising faster than demand, putting downward pressure on inflation.

1.44 Part of the explanation for the surge in credit is that it reflected an easing up from the very tight conditions in 1992. Real interest rates have declined steadily, using a forward-looking measure of consumer prices (Figure 1.2), and were lower still -- with long-term rates under 10% by the end of 1993 -- if the GDP deflator is employed. The SBV both lowered nominal interest rates and eased up on reserve requirements. In 1992, the authorities had been "recommending" an added 20% in reserves, mostly held in settlement accounts at the SBV, beyond the 10% minimum required reserves. This moral suasion was eased during the year, and total reserves fell from 25.5% of deposits at the end of 1992 to 20.6% at the end of 1993, while refinancing from the central bank rose about 40%. With supply conditions easy and demand robust, a surge in credit was the result.

1.45 The SBV's tools for controlling inflation have been central bank refinancing, interest rates on refinancing and on both deposits and loans, and reserve requirements. In early 1994 the SBV moved to slow down the growth of credit, as some of the above factors cannot be depended on to continue to hold down inflation, and also as part of the program with the IMF. Although the SBV could raise reserve requirements, the financial sector already is heavily taxed (Chapter 3), and this tool is inefficient in that it forces banks to call in loans and thereby disrupt projects already underway. Indeed, consistent with the longer term development of the financial sector, the authorities moved in early 1994 to ease

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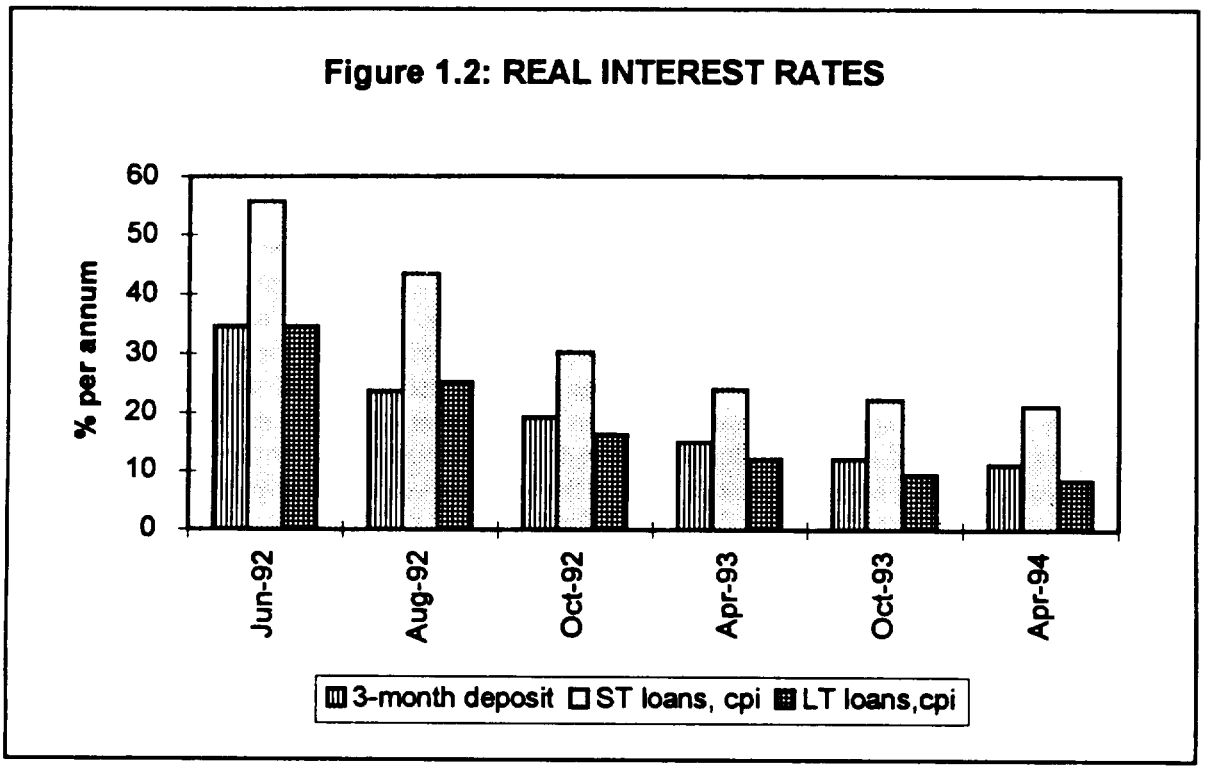
1/ Officials in the Agriculture Bank confirmed that many of their customers are replacing informal sector loans with credit from their bank.

further the pressure to hold excess reserves and made the 10% required ratio significantly less binding. In order to offset this expansionary move, the SBV put in place bank-by-bank credit ceilings as a temporary measure for achieving glocal credit targets. In the short term this tool usually is highly effective for implementing monetary policy but ultimately leads to disintermediation of the formal financial sector if maintained too long.



1.46 Within the next few years these individual bank ceilings can be replaced by auctions of refinancing lines and deposits at the SBV, and then by the use of repurchase agreements. Although the authorities are interested in developing primary and secondary treasury markets so as to permit open market operations, few countries in the OECD have markets of sufficient depth for this purpose and instead prefer the use of repurchase agreements (selling some underlying paper with the agreement to repurchase it a few days later at an agreed price) and reverses (buying with the agreement to re-sell). But before this development of instruments can be effected, the State Bank needs to move as rapidly as possible to improve the payments system and to allow for the greater use of dong-denominated payments instruments. Additionally, insuring the soundness of individual banks will increase their willingness to trade with one another, a prerequisite to indirect methods of monetary policy implementation.

1.47 In sum, the authorities have achieved commendable gains in reducing inflation. The rapid expansion of credit in 1993 threatened to reignite inflation, but the State Bank moved quickly to limit the growth of credit. The bank-by-bank credit ceilings give the SBV a credible and easily implemented tool to restrain credit growth should it appear to be surging above agreed targets. Over the medium term the State Bank needs to turn its attention to the development of indirect tools of monetary policy.

E. Balance of Payments and the Exchange Rate

1.48 Viet Nam's balance of payments situation in 1993 was characterized by an extraordinary surge in imports, which grew by 46.4% in constant prices. To some extent these imports were financed by the increasing flows of direct foreign investment and private remittances and should be viewed as a positive sign of improving confidence in the economic situation. The rapid growth in imports was also positive in that it reflected continued trade liberalization moves on the part of the government. The magnitude of the increase, however, was alarmingly high. This excessive growth of imports was fueled by the easy credit policies of the State Bank and by the increase in government expenditure, including capital projects financed by commercial overseas borrowing. The corrections in macroeconomic policies in early 1994 -- in the direction of tighter fiscal and monetary policies -- resulted in slower growth of imports and a decline in the external deficit.

1.49 **Exports**. The growth of exports, at 12.4% (constant prices) in 1993, was lower than in recent years. This development reflects the fact that two of the economy's major exports have reached plateaus: oil exports will not increase by much more until new fields are brought into production a year or two hence, while rice exports have probably achieved about their maximum penetration of a world market that is quite small. The need for Viet Nam to diversify its exports was highlighted in the previous economic report. Some progress in this area was made during 1993-94, with increased exports of rubber, tea, coffee, marine products, and light manufactured goods. The value of exports in each of these areas remains quite low, however. Exports of light manufactured goods increased by more than 100% in 1993, but still only accounted for US$350 million. Clearly the country has much greater potential in this sector. Two factors that likely retarded the development of non-traditional exports were the real appreciation of the exchange rate, discussed in more detail below, and the complex trade regime that continues to discriminate against exports (Chapter 3). The government did introduce some measures in 1993-94, however, to strengthen incentives for exporters, which have apparently had a quick impact: the growth rate of exports in 1994 will once again be above 20%.

1.50 **Imports**. The increase in imports was a positive development, though the rate of growth was somewhat too rapid in 1993. Viet Nam will need to use its macroeconomic tools to ensure that in the future the growth of imports is at a level that can be sustained. It is encouraging that most of the increase was accounted for by capital goods, with such imports rising by US$600 million. There were also increased imports of intermediate products. Thus, the surge in imports was fueled by the increase in overall investment, which in turn was spurred by the growing confidence in Viet Nam's economy, as well as by the relaxed monetary and fiscal policies.

1.51 **Balance of payments**. Viet Nam's current account went from near balance in 1992 to a deficit of US$1.1 billion (8.3% of GDP) in 1993. It is efficient for the economy to make use of foreign savings, given that the return to investment is high in Viet Nam. The problem, again, was that the change from one year to another was too extreme. Private investment and growing disbursements of ODA provided significant financing for the external deficit in 1993. In addition, the deficit was expanded further by the government's commercial borrowing and by loose monetary policies.

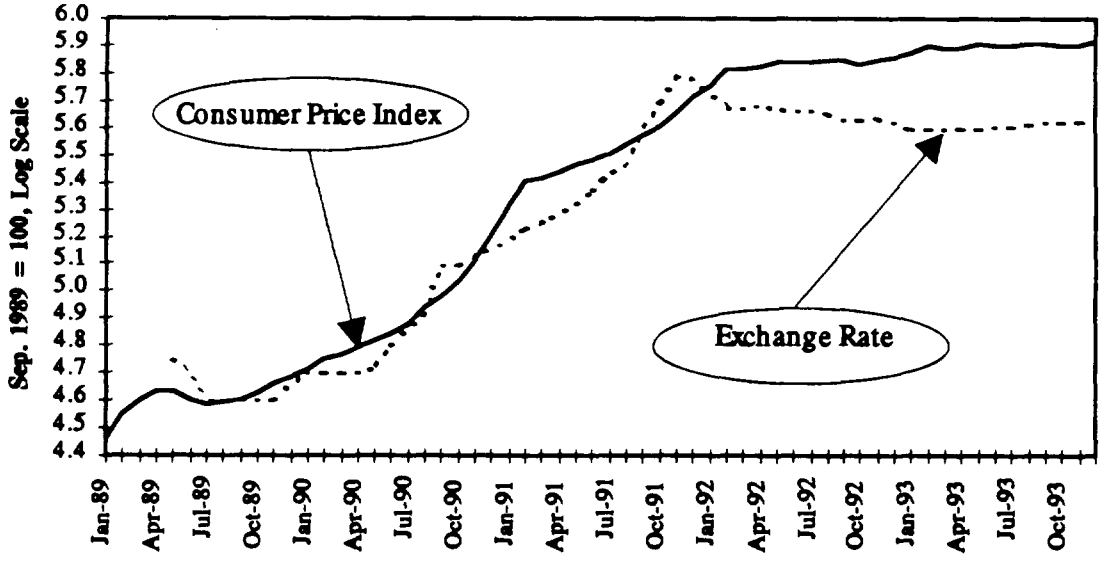
1.52 The link between monetary policy and the external deficit in Viet Nam is very direct because much of the country's money supply consists of foreign currency deposits. When the State Bank effectively reduced real interest rates and eased up on credit in 1993, much of the expanded lending by commercial banks was in foreign currency and went directly to purchase imports. One result of these

policies was that the gross foreign reserves of the banking system declined sharply. This cannot be repeated year after year, so that a tighter credit stance was necessary for 1994 and beyond.

1.53 Looking at the financing of the external deficit, about half of it was financed from ODA and private flows that should be reliable sources of financing. The other half of the deficit was financed by commercial international borrowing and a drawdown of gross reserves, which are not sustainable sources of financing for Viet Nam. Based on the significant aid commitments made at the November 1993 Donor Conference, disbursements from concessional loans will now be on the rise. The task for the government is to manage the external deficit so that it is at a level that can be funded from stable sources. The more prudent policies adopted in early 1994, aimed at restraining government borrowing and the growth of domestic credit, resulted in a reduction in the deficit to a projected 4.9% of GDP.

1.54 **Exchange rate developments**. Viet Nam's exchange rate management has been fairly good. Producers can buy foreign exchange easily from commercial banks to finance current account transactions. The official rate is set through foreign exchange trading floors and deviates little from the parallel rate. The exchange rate has been remarkably stable for about two years now, in the range of 10,500-11,000 (Figure 1.3). The net interventions of the State Bank in the foreign exchange market have not been large. Nevertheless, in the second half of 1993 the State Bank sold foreign exchange to support the dong. This policy is not recommended for two reasons. First, official reserves are quite low, so that net selling cannot go very far before the government will run out of reserves. Second, given the moderate inflation of the past two years, intervention to stabilize the nominal exchange rate resulted in appreciation of the real exchange rate. As noted above, this was probably one factor limiting the competitiveness of Viet Nam's exports in 1993.

Figure 1.3: EXCHANGE RATE AND INFLATION 1989-1993



1.55 If there is pressure toward devaluation in the foreign exchange market, then the State Bank should allow this depreciation to occur, intervening only to smooth out movements. Stability in the exchange rate is desirable, but it should be pursued through macroeconomic tools, not through intervention. In particular, the growth rate of domestic credit will have to be controlled more carefully if stability of the exchange rate is to be achieved.

F. Growth Prospects and Financing Requirements

1.56 On the surface Viet Nam's macroeconomic performance was good in 1993. But, a look below the surface revealed a number of disturbing developments. Government expenditure rose at a rapid rate, and most of this was for recurrent items, not investment. As a result of the increase in spending, the government had a deficit that it had difficulty financing. There was also a large increase in the external deficit: some of this financed investment, but much of it financed consumption. The decline in national savings from 1992 to 1993 was a major concern for the government.

1.57 Viet Nam still has good growth prospects, but it needs to make some adjustments in its policies if it is to realize its potential. The fundamental problem is that the government is still trying to do too much. This can be seen at the macro level in excessive government expenditure that threatens macroeconomic stability; at the micro level the public sector is crowding the private sector out of a range of activities that the private sector could well undertake. For Viet Nam to grow successfully, the government will need to focus its activities more sharply and to give greater scope to the private sector to expand. The more prudent fiscal policies introduced in 1994 are an important step in the right direction.

1.58 The government's own medium-term target for growth is 8%. This target is ambitious and will be a challenge to achieve. As noted in Section B, Viet Nam's ICOR has been low in recent years, and there are reasons to expect it to increase. Viet Nam's growth prospects are analyzed here in two different scenarios, in both of which it is assumed that the ICOR gradually increases to 3.4 by 1999. Furthermore, the projections hold the current account deficit to a level that can be financed from reliable sources, notably direct foreign investment and official development assistance. Specifically, the deficit declines from 8.3% of GDP in 1993 to around 5% sustained over the medium term.

1.59 The base case illustrates an 8% growth scenario, which is the government's medium-term target. To sustain this rate of growth, the investment rate would have to increase from 20% of GDP in 1994 to 26% by 1999 (Table 1.4). To finance this 8% growth scenario requires a large increase in domestic savings, from 15% of GDP in 1994 to 20% of GDP by the end of the decade. The moderate growth scenario indicates the likely outcome if domestic savings do not rise so rapidly. In this scenario, domestic savings only reach 16% by 1999 (Table 1.4). As a result, the growth rate gradually declines from the 8% level of recent years to around 6% by the end of the decade.

1.60 From a sectoral point of view, industry is projected to be the leading sector, as it has been during 1992-93. Starting from a low-base, industry has been growing rapidly, based on development of the energy sector and of labor-intensive manufacturing. The base projections show the expansion of industry slowing down a little from the 13% growth rate of recent years to about 11% sustained over the medium term. The growth rate of agriculture has jumped around in recent years, and the base projections have a conservative estimate of 3%-4% growth. Viet Nam is a densely populated country with limited potential for further expansion of agriculture. Rural development is obviously a high priority for the country, but increases in rural incomes in many cases will require diversification away from agriculture.

Table 1.4: MACROECONOMIC INDICATORS AND PROJECTIONS 1990–99

	Actual				Prel.	Projected				
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
						Base Scenario				
Growth Rate (%)										
GDP	5.0	6.0	8.6	8.1	8.7	8.0	8.0	8.0	8.0	8.0
Industry/Construction	3.0	8.6	13.3	12.9	12.6	11.5	10.9	10.5	10.2	10.2
Agriculture	1.5	2.2	7.2	3.8	5.5	3.5	3.5	3.5	3.5	3.3
Services	10.3	8.3	7.0	9.4	9.3	10.0	10.0	10.0	10.0	10.0
Export	35.9	23.9	31.2	12.4	23.3	10.0	6.9	6.5	7.3	7.7
Import	2.9	15.3	19.9	46.4	12.6	11.8	8.7	7.1	5.8	5.5
Share in GDP (%)										
Gross Investment	11.7	15.1	17.0	19.4	19.9	21.8	23.4	24.6	25.2	25.8
National Savings	7.4	13.1	16.3	11.2	15.0	16.2	17.1	18.0	19.0	19.9
Current Account	-4.2	-1.9	-0.7	-8.3	-4.9	-5.6	-6.2	-6.5	-6.3	-5.9
						Moderate Growth Scenario				
Growth Rate (%)										
GDP	5.0	6.0	8.6	8.1	8.7	7.4	6.9	6.6	6.3	6.0
Industry/Construction	3.0	8.6	13.3	12.9	12.6	9.8	8.8	8.3	7.8	7.2
Agriculture	1.5	2.2	7.2	3.8	5.5	3.0	3.0	2.9	2.9	2.5
Services	10.3	8.3	7.0	9.4	9.3	10.0	9.0	8.5	8.0	7.8
Export	35.9	23.9	31.2	12.4	23.3	8.0	6.0	6.2	6.5	6.5
Import	2.9	15.3	19.9	46.4	12.6	9.3	7.0	6.4	5.1	5.0
Share in GDP (%)										
Gross Investment	11.7	15.1	17.0	19.4	19.9	20.5	20.9	21.5	21.7	22.1
National Savings	7.4	13.1	16.3	11.2	15.0	15.3	15.0	15.3	15.6	16.3
Current Account	-4.2	-1.9	-0.7	-8.3	-4.9	-5.3	-5.8	-6.1	-5.9	

Source: Historical data: General Statistical Office; Projections: Bank staff estimates.

There is also good potential for diversification within agriculture, for example toward livestock, that would tend to increase the growth rate of the sector and hence the GDP growth rate.

1.61 Government policy will be one of the important factors determining whether Viet Nam can achieve the 8% sustained growth in the base scenario. As has been emphasized above, at the heart of a high-growth scenario for Viet Nam is the need for a significant expansion of domestic savings. The government can contribute to this directly by building up its own savings, which were less than 1% of GDP in 1993. Government revenue is already large relative to GDP. There may be some scope for increasing revenue as a share of GDP, through reform of tax rates and tax administration. It is not likely that the share would increase very much, however. Also, high tax rates distort investment, production, and consumption decisions, so that further increases in revenue should be pursued cautiously. For this reason a strategy to improve government savings should include expenditure restraint. The increase in recurrent expenditure between 1991 and 1993 was very large. The next chapter looks in detail at how the government budget is prepared and where the government spends its money. This analysis leads to specific recommendations for changes in how the budget is prepared and managed and in the composition of expenditure. In order to meet its savings target the government will have to carefully set priorities and reallocate spending away from inefficient uses.

1.62 Generating a greater amount of government savings will allow the public investment program to expand. In the projections it is shown to rise to 8.5% of GDP. This is not a large increase, as it already reached 7.0% of GDP in 1993. There are two problems with the current public investment program, however. First, the financing for the 1993 program was precarious, relying on high-cost domestic and foreign borrowing. The government needs to tailor the program to reliable sources of financing. It should focus on building up its own savings and on quickly implementing donor-financed projects. There is the potential for the government to have a large investment program with stable sources of financing within a few years. The second problem with the public investment program is that it is not well organized. There are a lot of infrastructure and social sector needs in Viet Nam, but they cannot all be addressed at once. The government needs to carefully set priorities and manage its investment program in light of the available resources. This issue is also examined in Chapter 2.

1.63 There is great potential to increase the savings of households and firms. High private savings have been one of the keys to rapid growth throughout East Asia, and increasing private savings in Viet Nam will be necessary to sustain a high growth rate. Households have substantial liquid savings, but these funds are not channeled to a sufficient extent into productive investment. That the national savings rate declined during a year in which the economy was growing well is a disturbing sign, indicating that there are substantial problems with the incentive regime for savings and investment.

1.64 Chapter 3 examines issues and problems of the incentive regime, including the major bottlenecks holding back expansion of private savings and investment. Legal infrastructure will need to be strengthened if the market economy is to develop successfully, and the government has concrete plans in this area. In addition, development of the financial system will be one of the crucial factors determining whether Viet Nam can sustain a high growth rate, as financial institutions play a critical role in mobilizing savings and allocating investment funds. A final important incentive issue is the regime for foreign trade and investment. Strong incentives for exporters and a receptiveness to foreign investment would also help the country achieve its investment and growth objectives. The government has made progress improving incentives in each of these areas, but there still remains a significant agenda for reform. As noted in the introduction, a common theme of the measures recommended for reform is decentralization and liberalization.

1.65 Thus, the main issues taken up in the report concern an efficient division of labor between the public and private sectors that will promote high savings and investment and hence rapid growth in Viet Nam. How the benefits of growth are distributed is also an important issue and is the focus of the final chapter of the report. The results of a first, nationally representative household survey reveal that Viet Nam remains a very poor country. Furthermore, poverty is particularly acute in rural areas and varies widely among the major regions of the country. Rapid growth will be necessary to reduce poverty in Viet Nam, and hence the analysis and recommendations of Chapters 2 and 3 will be part of an overall strategy for poverty alleviation. Chapter 4 considers the additional benefits that could come from targeted measures to address the problems of poor households and regions.

1.66 Financing Requirements. While increases in public and private savings in Viet Nam will be the primary sources of financing for new investment, the economy will also require large inflows of foreign savings if high growth is to be sustained. Direct foreign investment could provide a growing source of financing, and the measures discussed in Chapter 3 should help accelerate these flows. Viet Nam also needs an expanding volume of foreign aid to assist with financing economic and social infrastructure. Significant commitments have already been made, and the government should move quickly to implement these projects and to accelerate disbursements. The early experience with project implementation reveals that aid management procedures are cumbersome and need to be streamlined if a large investment program is to be realized.

1.67 Existing commitments of aid, combined with projected increases in direct foreign investment, will cover much of the external financing requirement for Viet Nam's development in the next few years (Table 1.5). There remains, however, a financing gap in the immediate future that will need to be filled with quick-disbursing resources. Viet Nam requires an estimated US$400 million to fill this gap in 1995. IMF resources and an IDA structural adjustment credit should provide the bulk of the necessary financing. In addition to multilateral sources, about US$120 million of quick-disbursing financing from bilateral donors is required for 1995. The planned Consultative Group meeting in November 1994 will provide an opportunity to solicit these quick-disbursing funds to cover the gap in 1995.

1.68 In addition to quick-disbursing funds for the next year, Viet Nam also needs further commitments of financing for projects in economic and social infrastructure. For many of these projects, it will take two years from the date of commitment to reach the point of substantial disbursements. Thus, project commitments are required now to provide the requisite financing for 1996 and beyond. If donors make significant new commitments, and the government moves quickly to implement the indicated projects, then the need for adjustment lending in future years will be reduced, and eventually eliminated. To build up to the required level of project disbursements by 1998-99 will require new commitments annually of about US$1.5 billion.

1.69 In summary, four integrated measures will be needed to meet the external financing requirements to sustain high growth in Viet Nam over the medium term. First, the government needs to continue to improve the environment for private foreign investment, so that these flows expand. Second, the government and donors must work together to improve aid management and project implementation, so existing commitments disburse as planned. Third, some quick-disbursing adjustment funding will be needed in the next few years to fill the remaining gap. Finally, significant new aid commitments to finance projects will be required on an annual basis.

Table 1.5: EXTERNAL FINANCING REQUIREMENTS, 1991-1999

(Base Scenario)

	Actual			Prel.	Projected				
	1991	1992	1993	1994	1995	1996	1997	1998	1999
				(US$ million)					
Financing Needs									
Current Account Deficit	188	75	1063	743	944	1174	1352	1443	1499
Official M&L Amortization	256	435	644	287	340	195	197	226	283
Others (Net) a/	-143	-8	76	-29	..	..	..	..	..
Reserve Requirements	276	463	-527	254	269	269	160	235	273
Total	577	965	1256	1255	1553	1638	1709	1904	2055
Financing Resources									
Official Grants	55	64	194	101	136	143	118	123	129
Long Term Borrowing	59	487	202	484	769	920	930	1020	1073
- Existing Commitments	..	..	..	..	370	521	380	..	..
- Required Financing	..	..	..	..	399	399	550	1020	1073
Direct Foreign Investment	220	260	300	435	501	575	661	761	853
Short-Term Capital (Net)	-89	-41	-58	-19	..	..	..	..	..
Arrears Accumulation (Net)	332	196	-266	-2459	..	..	..	..	..
Debt Rescheduling b/	..	..	883	2713	147	..	..	..	..
Total	577	965	1256	1255	1553	1638	1709	1904	2055

Note:

a/ Errors and omissions for 1991-1994.

b/ Based on the Paris Club negotiations.

Source:

Actual data: Vietnamese authorities and Bank and Fund staff estimates.

Projections: Bank staff estimates.

II. PUBLIC SECTOR MANAGEMENT

2.1 Viet Nam will grow more successfully if it can establish an efficient division of labor between the public and private sectors. The resources that the government has at its disposal are limited. Therefore, it must target its expenditures carefully to priority public services. The private sector can be counted on to invest and produce in a wide range of sectors, provided an appropriate incentive framework is in place. There are other services, however, that the private sector cannot or will not produce in adequate amounts. Development will be more rapid if the government focuses its expenditure on these services, most of which fall into the broad categories of infrastructure and human resource development, and leaves other activities to the private sector.

2.2 Viet Nam is fortunate that it began its transition to a market economy with a smaller public sector (and hence a larger non-state sector) than was typical of the planned economies. Nevertheless, the public sector is large in Viet Nam, producing about two-fifths of GDP. About one-third of that is accounted for by government services (i.e., defense, education, or health), while the other two-thirds is production from state enterprises in manufacturing, construction, and services. In the adjustment to a market system, Viet Nam needs to focus this public sector more sharply.

2.3 The first two parts of this chapter examine issues of Viet Nam's budget, specifically (1) the process of preparing and managing the budget, and (2) the current pattern of government expenditure. Efficiency of expenditure is currently low. In order to improve the effectiveness of government spending Viet Nam needs to reform the institutions and procedures for preparing and managing the budget. In the process, it is recommended that the government clarify the roles of different agencies, and also create a clear and efficient division of labor between central and local authorities. The budget system in Viet Nam has been completely centralized, and introduction of some decentralization should contribute to greater efficiency.

2.4 It will also be important to increase the transparency of the budget. It is difficult to make specific recommendations to improve the efficiency of expenditure because the budget lacks sufficient detail. The government needs to introduce a proper economic and functional classification of expenditures. This will set the stage for conducting a thorough Public Expenditure Review to analyze the effectiveness of different programs in meeting their objectives. On the basis of this review the government will be able to identify inefficient programs that can be cut.

2.5 While it is difficult to make specific recommendations about the allocation of expenditure, one problem that is clear is that the government is not spending enough to construct and maintain economic infrastructure. Infrastructure bottlenecks are universally acknowledged as a key problem holding back the development of the economy. The underfunding of operations and maintenance in the recurrent budget is a particularly acute problem that needs to be addressed immediately. Sufficient expenditure on O&M is more important than construction of new facilities for two reasons: (1) it is the only measure that would improve the infrastructure situation immediately and (2) without it, construction of new facilities will not be efficient, as they will not be utilized properly. Hence, this report recommends that the government move quickly to provide adequate resources in the recurrent budget for O&M of infrastructure. Looking toward the medium term, it will also be important to prepare an efficient public investment program on a three-year, rolling basis, to address longer term needs in infrastructure and human capital development.

2.6 The last part of the chapter examines developments with state enterprise reform. Some of Viet Nam's state enterprises provide important public services, and their expansion will be supported by the public investment program. The government has yet to define criteria for identifying these firms or to establish an effective mechanism for managing them. The vast majority of Viet Nam's 7,000 state enterprises do not fall into this category: rather, these firms produce the same kinds of goods and services produced by the private sector. For Viet Nam's long-term development, it will be important to transform these firms into companies that compete without explicit or implicit subsidies. The chapter makes practical recommendations for carrying out this transformation, which would lay the foundation for eventual privatization of non-strategic public firms.

A. Budget Management and Central-Local Relationships

2.7 In contrast to its limited function in a centrally planned system, fiscal policy plays a key role in economic management in market economies. Developing a fiscal system that would enable a government to formulate and implement an effective fiscal policy should thus be part of any program of reform underpinning the process of transition to a market-based economy. This involves fundamental fiscal reforms, including the creation of new institutions and the modernization of systems in areas such as taxation, budgeting, and accounting.

2.8 In the course of the comprehensive economic reform program it initiated in 1989, the government has already made significant progress in the fiscal area. It has started to modernize tax administration and the tax system, created a Treasury Department in the Ministry of Finance to strengthen budget execution, and taken some bold measures to restructure public expenditure. A new Budget Law regulating the budgetary process is expected to be considered in the National Assembly in fall 1994.

2.9 This section discusses first some aspects of budget management and execution that require further measures to complete the process of fiscal reform; second, the financial relationship between central and local government; and finally the preparation of a Public Investment Program.

Budget Management

2.10 Currently in Viet Nam, budget preparation involves a great deal of negotiation among government agencies. The proposed Budget Law would impose more discipline on the budgetary process by setting out the basic budgetary procedures (to be detailed in later decrees), the responsibilities of all agencies involved, and a timetable for budget preparation. The proposed Budget Law also sets out the main expenditure and revenue responsibilities of the various levels of government and defines the financial relationships between central and local governments.

2.11 Under the proposed law, the central position of the Ministry of Finance (MOF) would be clarified by giving MOF overall responsibility for the budget, including for capital expenditure. Putting MOF in charge of budget management will make it easier to conduct an effective fiscal policy. At present, the State Planning Committee (SPC) plays an important role in setting the financial framework of the budget and in drawing up the investment budget. Close cooperation in these two areas between MOF and SPC would be essential under the new arrangement, with SPC assuming more of an advisory role. SPC could make a useful contribution in particular through the preparation of (i) medium-term

macroeconomic projections, to be regularly updated, as a basis for revenue projections and to guide fiscal policy, and (ii) a three-year rolling Public Investment Program (PIP) which, by establishing investment priorities, would guide decisions on the investment budget. A number of specific recommendations to improve budget management are presented below.

2.12 **Budget formulation**. The move towards a market economy needs to be accompanied by major structural changes in the budget, on the revenue as well as expenditure side. At the same time, the government must keep tight control over the fiscal deficit and public sector borrowing in order to maintain a stable economic climate. Many budget decisions -- on investment, pensions, salaries, borrowing -- have longer term implications, but these cannot be taken into account within the framework of the annual budget.

2.13 The government needs to prepare medium-term targets for the fiscal deficit. This is the first step towards developing a medium-term financial plan that would go beyond projecting revenue and expenditure aggregates as well as borrowing needs. It could help those in charge of the budget to set priorities and consider trade-offs by looking at longer term implications of decisions within a coherent budget framework. Ongoing efforts to strengthen external debt management and prepare a three-year Public Investment Program (see below) would provide essential inputs for a medium-term financial plan.

2.14 **Budget nomenclature**. It is recommended that a new budget nomenclature, and associated expenditure coding system, be introduced based on the IMF's Government Finance Statistics methodology. This nomenclature classifies expenditures on the basis of their functional and economic characteristics as well as their administrative origin. By presenting a clearer picture of how public resources are used, it assists budget preparation and the analysis of how proposed policy measures would affect the budget.

Budget Execution and Financial Management

2.15 The **Treasury** plays a central part in the operations of MOF. Its responsibilities typically include the management of all government cash operations (receipts, making payments, managing the cash position), government accounting at all levels, debt management (borrowing policy, debt servicing), and reporting on government financial transactions. As the department was established only recently, it is not yet able to undertake all these tasks in an adequate manner. In a recent report, the IMF makes a number of recommendations on how to strengthen Treasury operations. These concern in particular ensuring that Treasury operations be comprehensive (e.g. Treasury, not the Investment Development Bank, should make payments relating to the investment budget), and that there be consistency in accounting and fiscal reporting, especially at local government level. The detailed project monitoring, in which the Treasury is currently engaged, is better left to the line ministries.

2.16 **Procurement**. Bidding procedures for public works construction have been issued, and regulations dealing with government procurement of goods and services are currently being drafted. It is important that these regulations establish uniform, clear, and explicit procedures for competitive bidding on government contracts. These should encourage a greater role for private firms in providing goods and services to the government.

2.17 **External debt management**. In view of the sizeable existing external debt burden of Viet Nam, the substantial commitments made at the recent aid conference in Paris, and the external borrowing

by SOEs which involves a potential liability for the government, it is essential that the authorities maintain tight control over their external debt. The External Finance and Foreign Exchange Department in MOF has recently been put in charge of external debt recording, but this does not cover SOE borrowing. There is no comprehensive data base on existing debt.

2.18 External debt management has several elements: (i) creation of a database that is comprehensive, and adoption of a computerized debt reporting system; (ii) development of a debt strategy that provides guidance on borrowing ceilings and terms consistent with the country's capacity to service the debt; (iii) debt servicing: ensuring that interest and principal payments are made on time; and (iv) debt negotiation, in particular when debt rescheduling options are discussed.

2.19 While debt servicing, and possibly also debt recording, might be considered Treasury functions, responsibility for development of a debt strategy and for debt negotiation might be given to MOF in collaboration with SBV and SPC. Whatever the institutional responsibilities, however, it is most important that a centralized and comprehensive debt recording and reporting system be established without delay.

2.20 **Aid coordination.** The broad purpose of aid coordination is to mobilize foreign assistance on the best possible terms to meet the development needs of the country. This can be a complex task, given the many types of aid (commodity aid, financial aid as grant or loan), the many donors (bilateral and multilateral) all offering aid on different terms and conditions, and the different purposes of aid (for projects, balance of payments support, technical assistance). Up until now, no agency has been in charge of overall aid coordination. The Foreign Aid Management and Reception Department (AIDRECEP) in MOF currently deals only with grants, while the External Finance and Foreign Currency Department in MOF is in charge of loan negotiations and the International Cooperation Department in SPC is involved in other aid related issues.

2.21 A recent government decree gives SPC responsibility for the coordination of all ODA. This includes elaborating an aid mobilization strategy and establishing priorities for the use of aid resources. Approval by the Prime Minister of all aid agreements is required by the decree as part of the negotiation process. While centralization of aid coordination is desirable, it would be preferable to separate the function of resource mobilization from that of establishing needs and setting priorities (e.g. as a PIP would do in the case of investment needs). These are quite different tasks requiring different skills. Close cooperation between the aid coordination agency and MOF must also be assured in order that conditions imposed by the government's borrowing strategy are observed and aid is fully accounted for in the budget.

Central-Local Government Financial Relations

2.22 The proposed Budget Law also addresses the issue of financial links between central and local authorities, specifically the assignment of responsibility for government expenditure and revenue. Chapter 4 contains a more specific description and analysis of the current system of intergovernmental fiscal relations. The proposed budget law provides only a broad framework for intergovernmental finances; subsequent implementing regulations will define the details. Thus, Chapter 4 assesses what changes in the design of intergovernmental finances would improve the delivery of local services throughout the country.

2.23 The present allocation of responsibilities between central and lower levels of government is not enshrined in law, but determined by convention, and is subject to changes from year to year. Provincial and district governments account for roughly a third of consolidated government expenditure. Expenditure on education (through secondary level), health care (for all except national facilities), operation and maintenance, and government administration account for the bulk of local spending.

Table 2.1: SHARE OF PROVINCIAL EXPENDITURES IN TOTAL, 1992

	Total Expenditure (Bn. Dong)	Provincial Expenditure (Bn. Dong)	Share of Provincial Expenditure in Total (%)
I. Current Expenditure			
1. General administrative services	2404.0	1076.7	43.1
2. Economic services	1490.0	1176.3	78.9
3. Social services	6245.0	2872.6	46.0
(i) Education	1495.0	1325.0	88.6
(ii) Health	1136.0	1000.3	88.1
(iii) Others	3614.0	547.2	15.1
4. Other expenditures	8532.0	1612.0	18.9
Total - Current Expenditure	18671.0	6697.5	35.9
II. Capital Expenditure	4955.8	1706.6	34.4
III. Total Expenditure	23626.8	8404.1	35.5

Source: Ministry of Finance

Provinces and districts have negligible "own" revenue sources. They share in centrally collected and administered taxes and can benefit from central government transfers. These are all subject to negotiation every year.

2.24 Total public expenditure (center plus provinces) in 1993 was 38,975 billion dong, of which 11,411 billion dong were for provincial expenditures. Provinces in 1993 thus accounted for less than a third of total expenditures (29%). This appears to be a decline since 1992 when provinces accounted for 35% of total expenditures. Table 2.1 provides a breakdown for provincial and total expenditures. This breakdown illustrates that the provincial role is especially important with respect to the provision of social services, particularly education and health. Moreover, although most capital expenditures are central, the provinces play a major role in maintaining public investments, as may be seen from the high proportion of current expenditure on economic services shown in the table.

2.25 The share of local government in total government expenditure in Viet Nam does not differ much from that in many other countries. However, the discretion they have in using resources within their area of responsibility is very limited. The strong guidance they receive from the central government has led to obvious inefficiencies. The central government in Viet Nam maintains close control over local spending by various means, such as budget formation and spending restrictions; specified transfers for a host of very minor programs; and centralized investment decisions.

2.26 First, the central government issues every year detailed norms for recurrent expenditure items (e.g. education, health, government administration, economic services) which are used as a basis for preparing draft provincial budgets. The norms inserted by the Ministry of Finance in the annual budget circular reflect to an extent the resource constraint on the budget and therefore do not represent an adequate level and quality of service delivery. However, during the subsequent process of budgetary negotiation between the center and the provinces, expenditure levels are usually set well below those indicated by the norms. A further weakness of the system of norms is that it does not sufficiently take differences in needs among provinces into account. For example, expenditure norms for education and health are currently based on population size, i.e. the number of official residents. This ignores the effect of the large flow of (illegal) migrants to the cities, particularly Hanoi and Ho Chi Minh City, which increases the number of people seeking education and health care. The result of the present system is a budget spread too thinly across a range of items that do not necessarily reflect local priorities. Resources might be used more efficiently if local authorities had greater flexibility in allocating them.

2.27 Second, provincial budgets are submitted to the central government for review and serve as a basis for setting the tax sharing ratios and transfers during the budget negotiations. This process gives the central government a strong voice in determining the level and composition of provincial spending. Third, at present the government also directs local spending through a host of specific programs financed centrally and delivered locally. These 32 programs, however, are very specific in nature, and funding for each program is extremely small (see Chapter 4). As a result, these programs have little impact. Finally, the center also controls local investment by requiring that all investments over a certain size receive central government approval. Nevertheless, local authorities enjoy a degree of budgetary discretion to the extent actual revenues exceed budgeted levels. They have some freedom in deciding how to use part of the excess revenue.

2.28 Local authorities have virtually no revenue powers, i.e. they have few "own" resources. Bases and rates of almost all taxes are determined by the central government. Tax collection, which before 1991 was the responsibility of the provinces, is now centralized. The establishment of a central tax department appears to have had a positive effect on tax collection. Tax evasion has been significantly reduced, in part by offering tax collectors a substantial performance related incentive. The gap between expenditures and "own" taxes at the local level is filled by a combination of shared central taxes and transfers from the center. While revenue from certain taxes goes entirely to local authorities (e.g. land use tax, agricultural tax), other taxes are shared (turnover tax). Share ratios and tax assignments are volatile, however: in 1993, HCMC received 100% of the profit tax, but will get only 50% in 1994. Revenue from income tax, which in 1993 went entirely to the center, will in 1994 go to the provinces. HCMC's share of the turnover tax will drop from 28% in 1993 to 7.5% in 1994 and a similar drop will occur in the case of Hanoi. The poorer provinces also benefit from a general transfer which is negotiated annually. As mentioned earlier, there are a number of small specific transfers as well.

2.29 The proposed Budget Law would introduce some important changes in the present system. These include notably the following:

(i) District budgets would be abolished and formal commune budgets introduced. There would thus be three budget levels: central, provincial, and commune.

(ii) Revenue and expenditure responsibilities of the three levels of government are set out in the Law in broad terms. They are summarized in Table 2.2 below.

(iii) Transfers from higher to lower level governments to finance current expenditures would be determined by a formula based on factors such as population, natural resources, and level of economic development in each of the regions. Transfers for capital expenditure would be made for approved projects.

2.30 The responsibilities of the various levels of government are outlined in general terms only. These will be elaborated in subsequent implementing decrees. In terms of expenditures, the proposed shift in responsibility for most education and health services from the provinces and districts to the central government would imply a much more limited role for local government. In education, provinces would remain responsible for pre-primary education only. On the other hand, the system of expenditure norms would be abolished, giving the local authorities discretion in the use of their resources, though in a more limited area.

2.31 It is not at all clear that such a centralization of the provision of education and health services would improve the efficiency in the delivery of these services, result in lower costs, or better take into account the differences in needs among provinces. While the center may well want to assure a minimum level of certain services, the current proposal does not give provinces the authority to provide additional services in response to local needs. Given the likely increase in mobility of the population as Viet Nam moves to a more market oriented economy, and the essential role of an educated and healthy population in attaining this goal without unduly exacerbating income inequalities, a better approach might be to continue local responsibility for service delivery coupled with a better designed system of local revenues, intergovernmental transfers, and central monitoring to ensure that all citizens receive at least a minimal standard of these key services.

2.32 The current system of annually negotiated transfers and tax shares would be replaced by (a) the assignment to local authorities of the revenue of certain minor taxes and fees, roughly as at present, (b) the sharing of revenue from the turnover tax, with the ratio to be fixed for each province for two to three years, and (c) a general transfer to each province on the basis of a formula that is still to be determined. In addition, the central government would provide specific transfers for local investment projects.

2.33 On balance the proposed new arrangements may offer a modest improvement in terms of meaningful decentralization. Even though local government functions are being curtailed, they provide for a degree of genuine local autonomy as regards part of the recurrent budget, which at the moment hardly exists. Nevertheless, the central government would remain very much in charge of overall government spending and revenue. Much of local investment would still be centrally controlled and decisions remain non-transparent. Local power over revenue will remain negligible. Yet, once the transfer formula and the turnover tax sharing is agreed upon, the provinces can look forward to a more

Table 2.2: DRAFT BUDGET LAW PROPOSALS ON ASSIGNMENT OF EXPENDITURE AND REVENUE RESPONSIBILITIES

LEVEL	EXPENDITURES	REVENUES
CENTRAL GOVERNMENT	State administration Defence Internal Security Price support Economic activities of central agencies Health National education Culture, sports Scientific research Social securities and insurance	External trade taxes Special consumption tax Personal income tax Oil and gas revenue Resources tax Mineral Revenue Profits tax on foreign enterprises Profits and retained income from SOEs Proceeds from sales of assets Fees and non-tax revenue as specifies by govt. Turnover tax (shared)
PROVINCIAL GOVERNMENT	Prov. activities of economic, social and culture nature Scientific research Sports Securities and social order in localities Investment (except central projects)	House and land tax (100% outside communes, 85% inside communes) Land use tax (80%) Natural resource tax (part) Turnover tax (shared) Land use transfer tax License tax Slaughter tax (outside communes) State economic activities as specified by govt. Fees and non tax revenue
COMMUNES	Investments in child care centers, nurseries	Land use tax (20%) House and land tax (15%) License tax Slaughter tax (in communes) Rent from public use land Fees and non-tax revenue

predictable revenue base. On the other hand, although the assignment of revenues to provinces would be laid down in the Law, tax rates will still be determined by the center and tax collection will also remain centralized.

2.34 **Suggestions for reform of intergovernmental finances.** A fiscal system corresponding to a market oriented growth strategy in general calls for a greater degree of effective decentralization than prevails in Viet Nam at present in order to achieve greater efficiency in spending and raising revenue.

An effective implementation of certain expenditure policies is likely to require a decentralization of expenditure decisions. Many allocative functions necessary for accelerating economic growth and alleviating poverty are best performed by local authorities. There is no hard and fast rule as to which services should be provided by central and local governments (or indeed by the private sector). Certain functions are likely to be shared between levels of government. In practice, the assignment of spending responsibilities differs a great deal across countries. A desirable assignment of responsibilities might not be too different from what is current practice in Viet Nam, with education (except higher education) and most health care services the responsibility of local government.

2.35 The government is concerned about providing certain basic services (e.g. primary education and basic health care) as well as a social safety net throughout the country, at least at a minimum level. Rather than centralizing the provision of such services, as proposed in the draft Law for education and health, or imposing a rigid budget system on the provinces as at present, a system of conditional grants could be used. Specific matching transfers, if used for appropriate expenditures, can be a useful way of ensuring that basic services of national importance are made widely available. To determine the resources needed to deliver these minimum services, detailed norms need to be developed that quantify the cost of delivering these services. The norms currently used for budget preparation (e.g. official population size in the case of education and health) should be adjusted to more accurately reflect local needs and costs. A variable matching rate would allow for differences in fiscal capacity between provinces.

2.36 It is critical to ensure that resources are provided to local authorities on terms that encourage both fiscal effort and efficient implementation, and at the same time take into account the considerable divergence between regions in the capacity to mobilize resources. This calls for a reallocation of taxing powers between the center and local government as well as a carefully designed system of intergovernmental transfers. If local government is given greater autonomy in spending decisions, it should also have more control over revenue. This would increase its accountability vis-a-vis the local population and hence the efficiency with which local goods and services are provided.

2.37 While the proposed Law lists a number of minor taxes and fees to be assigned to local governments, "assignment" relates to who receives the revenue, not to who sets the base and rates of the taxes, which is currently done by the center. At least for certain taxes, e.g. property tax, land use tax, slaughter tax, rates might be set locally, perhaps within a range established centrally. Giving local authorities power over certain taxes does not necessarily mean decentralizing tax collection. One potentially promising option to take advantage of current tax collection and to encourage tax effort is to enable provinces to apply supplementary rates to existing national taxes (piggy-backing).

2.38 In addition to local taxes and shared national taxes, local governments will need transfers from the center to bridge the remaining fiscal gap. The general transfer proposed in the Law, if carefully designed, would go a long way towards equalizing access to resources between provinces. While an appropriate formula would allocate the transfer between provinces, the size of the total transfer might be set in relation to total revenue or some other variable, in order to give provinces a more predictable income base.

2.39 The administrative and technical capacity to efficiently provide local services varies greatly among provinces. To decentralize the financing and provision of certain services may be efficient in the case of large cities such as Hanoi and HCMC, but certain other provinces may be unable to handle it. Instead of giving all provinces the same degree of autonomy at the same time, a phased approach might

be adopted whereby some provinces are allowed to assume full responsibility for certain services immediately whereas others would be granted this over time.

Investment programming and budgeting

2.40 The move to a market economy also has implications for the level and composition of public investment. As the government's role in the economy changes, responsibility for the financing of most investment should be transferred to the private sector and to financially independent state enterprises. Funding through the budget should be limited to areas for which alternative sources of finance are not (yet) available, notably economic and social infrastructure, including public utilities.

2.41 The government's policy since 1989 has been to move off-budget all investments by state enterprises that are supposed to operate along commercial lines. While this has reduced the pressure on the investment budget, there continues to be a need for a major investment effort by the government, in particular after capital spending was sharply cut back in 1991-92. The rapid rise in economic activity since 1989 is putting a heavy strain on existing infrastructure which, owing to long wars and inadequate maintenance, is generally in poor condition. A long list of priority investment needs was prepared for the 1993 Donor Conference in Paris. With the promise of substantial foreign aid, increased funding for investment will be available. Nevertheless, the size of the investment budget will still be constrained by the need to keep the fiscal deficit at a manageable level. Hence the importance of carefully setting priorities for investment.

2.42 The investment budget is part of the annual government budget. Primary responsibility for its preparation lies with SPC, which decides on investment priorities of the central government and reviews the larger investments proposed by the provinces. There is strong competition, from ongoing and new projects, for budgetary funding. SPC faces a number of difficulties in establishing priorities among the many competing claims:

- because of the one year time horizon of the budget it is impossible to look at the future demands a project will make on the budget both to complete the investment and in terms of operation and maintenance requirements, and thus at its financial sustainability.

- there is no comprehensive project database with information on total project costs and their phasing. Costs of ongoing projects have generally not been updated.

- the methodology for analyzing a project's costs and benefits, a standard procedure in project appraisal in market-oriented economies, is not yet well established, and the necessary skills are scarce. Similarly, strict selection criteria for including projects in the budget have not been elaborated.

- although an effort has been made to outline sectoral investment priorities as part of the preparation for the donor conference, more work is needed in formulating development strategies for the key sectors and in setting out how these are to be supported by specific investment projects.

2.43 Conscious of these weaknesses, SPC has started preparation of a three-year Public Investment Program (PIP). The PIP would set out medium-term financing requirements for priority investment projects within a realistic financing framework. Such a PIP serves two purposes: it is a guide to the preparation of the annual investment budget, and it is a useful tool for attracting foreign financing and directing it to priority areas. To assist SPC in this task, the following offers a brief discussion of the coverage and format of a PIP as well as of what is required to make it an effective instrument of financial management. It is based on the experience other countries have had in creating and managing a PIP.

2.44 **Coverage and format of a PIP**. There are no set rules as to what investments should be covered by a PIP. What matters is that the concept chosen should be practical from the point of view of data requirements and useful for policy purposes. In the case of Viet Nam, where budget management is highly centralized, the PIP could cover all investments funded through the budget (from domestic as well as foreign sources), including local government investments. Investments by state enterprises would be covered if at least part of their financing is through the budget.

2.45 In addition, it is recommended that the PIP include investments undertaken by state enterprises where the government has played an important role in securing the financing for the project. Thus, for example, if ODA funds are onlent to an SOE or the government guarantees the foreign borrowing of an SOE, the resulting projects should be included in the PIP. Similarly, projects financed from directed credits through the Bank for Investment and Development should be included in the PIP.

2.46 The PIP document should provide at least three kinds of information. First, it should discuss the macroeconomic setting for public investment, and show that the proposed investment program is consistent with macroeconomic projections and broad sectoral priorities and consistent in its assumptions about availability of resources. Second, a set of tables would summarize planned investment expenditures, by sector and project, over the three-year period. For each project it would show the total cost, amount already spent, expected outlays in each of the three years of the program, and the remaining costs of completing the project. To the extent possible, sources of financing would be identified. Contrary to projects included in the first year of the PIP, which normally have assured funding, projects in the later years will often still be in need of financing. One of the purposes of the PIP is to identify these needs as a basis for discussion with donors.

2.47 The third component of the PIP is a set of project summaries, preceded by a brief discussion of government involvement in the various sectors as well as of sectoral development objectives, strategies and investment priorities. Project summaries, preferably not longer than two pages, usually comprise: a succinct description of the project, a summary of project costs, status of the project, and financing. They need not be prepared for projects below a certain size.

2.48 **Project preparation and appraisal**. Responsibility for preparing and evaluating projects rests with line ministries and state enterprises. The quality of the investment program depends on the capacity of these agencies to process projects. Project preparation involves setting out what the project intends to achieve, the design of the project, cost estimates, and who will implement it. Cost data should include an estimate of what it will cost to run and maintain the project once it is completed. During

project evaluation an assessment is made of the project costs and benefits (rate of return), how the project supports the achievement of sector objectives, the financial sustainability of the project, implementation capacity and other factors. Guidelines on project preparation and evaluation should be issued to all spending agencies on the methodology to be used, on what the analysis should cover, and on the format for submission. Such manuals are readily available.

2.49 **Screening projects for the PIP**. As requests for investment financing invariably outstrip the funding that is likely to be available, a principal function of the PIP is to establish priorities. To qualify for inclusion in the PIP, projects must meet certain criteria. They need to have been well prepared and thoroughly appraised. Apart from being technically sound and economically viable, projects must fit in the development strategy for their sector, and there should be some assurance that future running costs of the project will be covered. Financing needs, especially domestic funding from the budget, will be taken into consideration as well. For the first PIP, all projects will have to be screened, including those already started. The latter, often conceived many years ago, have to be reviewed against the background of possibly revised sector objectives and changed priorities. For some of them there are no up-to-date estimates of the cost of completing the project.

2.50 **Integration of PIP into the budget**. If the PIP is well prepared and realistic, it will constitute the basis for drawing up the investment budget. The investment budget should be fully consistent with the first year of the PIP. The PIP is usually larger than the budget as it includes financing from other sources than the budget, e.g. domestic borrowing by enterprises and use of their own funds. For the PIP to be an effective planning instrument, it should be closely linked to the budget. This can be encouraged by

- requiring that the investment budget only finance projects that are included in the PIP;
- ensuring that the PIP use realistic assumptions with regard to available resources, especially domestic budgetary resources;
- linking the preparation of the PIP to the annual budget cycle.

2.51 If, as proposed in the draft Budget Law, MOF is to assume full responsibility for preparing the budget, it will be responsible for determining the resource envelope for investment. It will have to provide SPC with estimates of likely availability of both domestic budgetary resources and expected disbursements from external sources. Given the present involvement of SPC in making revenue projections and in aid coordination, close consultation between the two agencies is essential.

2.52 Another aspect of the link between PIP and budget relates to the recurrent costs of investment projects. If project submissions include estimates of future recurrent costs, these can feed into the preparation of the recurrent budget and contribute to establishing a realistic budgetary framework for the medium term.

B. Government Expenditure

2.53 Reviewing developments in the area of public finance over the period 1989-92, fiscal policy made an important contribution to the stabilization of Viet Nam's economy. The sharp reduction in the

fiscal deficit and the elimination of bank financing of the deficit were instrumental in bringing inflation under control. This was achieved through a combination of revenue and expenditure measures. While tax reform and windfall oil income provided a boost to revenue, total expenditure was cut by almost 9% of GDP over a period of two years through a number of drastic measures. These included substantial layoffs in the military, the elimination of subsidies to state enterprises, tight control over civil service pay which led to a sharp fall in real earnings, and a severe squeeze on public investment.

2.54 While reduction of the fiscal deficit was a commendable achievement, some aspects of the fiscal reform program were hard to sustain. Moreover, although fiscal policy measures resulted in a major shift in the composition of the current budget, notably by curtailing the reliance of state enterprises on the budget, resource allocation could still be improved in a number of ways, especially through a better balance between recurrent and capital expenditure, greater emphasis on budgetary provisions for operation and maintenance, and measures to increase the efficiency of expenditure on wages and salaries.

Government expenditure since 1992

2.55 Following the large fiscal contraction in 1990-91 and a recovery in 1992, the budget expanded at a rapid pace in 1993 and growth is expected to continue in 1994. A strong revenue performance has encouraged a steep rise in government expenditure, from 22.7% of GDP in 1992 to 28.5% in 1993.

2.56 An analysis of how these additional resources were used is hindered by a lack of detail and by inadequate classification of expenditures. In broad terms, economic services and, particularly, social services have been allocated the bulk of it. The share of general administration remained more or less constant. While this seems in line with overall development objectives and the changing role of government, most of the increase in social services is accounted for by "other" services, i.e. excluding education, health, pensions, and social relief. The precise nature of these expenditures is not clear.

2.57 The wagebill is budgeted to reach 7.6% of GDP in 1994, up from 2.6% in 1991 (Table 2.3). Much of this increase reflects the impact of the reform of civil service pay. The first phase of it was implemented in 1993, and the program will be completed in 1994. The reform program has two elements: monetization of the payments in kind, which until recently accounted for a significant part of total remuneration, and an increase in money wages. Altogether, the package was designed to partly compensate staff for the fall in real income during 1990-91. At this stage it is hard to assess the effect of these measures on real earnings, given also the effect on take home pay of measures such as the introduction of mandatory health insurance.

2.58 Parallel to the changes in pay the government is making an effort to reduce the civil service. Staff cuts were made starting in 1989, and in 1991 a policy of eliminating so-called "non-productive" jobs was adopted. Its objective was to reduce the number of government employees by 20% between 1991 and 1994. Limited data suggest that the actual reduction may be around 10%. If measures prior to 1991 are taken into account, the civil service appears to have shrunk by 20% between 1989 and the end of 1993.

Table 2.3: CONSOLIDATED GOVERNMENT EXPENDITURE, 1989-94

	1989	1990	1991	1992	1993	1994 (budget)
			(% of GDP)			
Total expenditure	24.1	22.8	17.3	22.7	28.5	28.5
Current expenditure	18.3	17.7	14.5	16.9	21.5	21.5
Wages	4.6	4.2	2.6	..	6.5	7.6
Subsidies	..	..	..	..	0.1	0.2
Interest	2.9	3.0	3.0	2.9	2.7	2.6
Other	10.8	10.5	8.8	..	12.2	6.3
of which:						
operation and maintenance	0.9	0.7	0.6	..	0.4	0.5
Capital expenditure	5.8	5.1	2.8	5.8	7.0	7.0
			(% of total)			
Total expenditure	100.0	100.0	100.0	100.0	100.0	100.0
Current expenditure	75.9	77.6	83.8	74.4	75.4	75.4
Wages	19.1	18.4	15.0	..	22.8	26.7
Subsidies	..	..	..	..	0.4	0.7
Interest	12.0	13.2	17.3	12.8	9.5	9.1
Other	44.8	46.1	50.9	..	42.8	22.1
of which:						
operation and maintenance	3.7	3.1	3.5	..	1.4	1.8
Capital expenditure	24.1	22.4	16.2	25.6	24.5	24.6

Source: Statistical Appendix Tables 5.4-5.5.

2.59 Having slashed **capital expenditure** in 1991 as an expedient way to contain the overall level of spending, the government has turned around and substantially raised budget allocations for investment in subsequent years. The 1994 investment budget amounts to 7.0% of GDP, a quarter of the total budget. Initially, the government financed some of the investment projects through external borrowing on commercial terms. Following the donor conference, substantial project funding on soft terms has been promised. Moreover, with the government having become a saver, domestic budgetary resources are also available to finance investment.

2.60 The investment budget contains a number of large energy projects conceived in the late 1980s (Table 2.4). Many of these suffered implementation delays as a result of the cutback in capital spending in 1990-91. In addition there are several large new projects that have attracted foreign financing, especially in the transport sector. An important reform of the capital budget has been to gradually remove support for commercial enterprises in sectors such as cement, steel, and even power. As seen in Table 2.4, the share of the capital budget allocated to power is on the decline, and will be close to zero in 1995. Thus, budget-financed investment will go to the infrastructure and social sectors. Commercial enterprises will have to find their investment resources elsewhere. This is a good policy that will make the best use of budget resources and ensure that commercial firms pay market rates for the use of investment funds.

2.61 Provinces and districts are accounting for an increasing share of the investment budget, around 30% in 1994. Almost all of this goes towards rehabilitation of infrastructure, in particular roads and bridges which have deteriorated as a result of a lack of maintenance. The central government often assumes responsibility for the original investment in infrastructure, leaving subsequent maintenance to local authorities who do not have the resources for it.

2.62 Budget allocations for operation and maintenance have been declining as a share of GDP. They account for a significant share of local budgets, about 25% in HCMC. HCMC People's Committee puts maintenance needs at roughly four times the budget allocation for 1994, and the situation in Hanoi is similar.

Table 2.4: GOVERNMENT INVESTMENT, 1993-94
(billions of dong)

	1993	1994 (budget)
Industry and energy	5,692	2,226
of which: 500 kv transmission line	3,000	1,500
Hydro power stations:	1,543	
Yaly	216	
Hoa Binh	360	170
Vinh Son	302	-
Thac Mo	650	-
Song Minh	15	-
Transportation	979	2,428
of which: Highway No.5	25	285
Highway No.1A	98	595
Highway No.80	20	35
Thang Long-Noi Bai road	70	58
Viet Tri bridge	40	50
Phu Luong bridge	10	46
Thong Nhat railway road	50	95
Tan Son Nhat airport	38	10
Waterways (incl. irrigation)	623	1,265
Agriculture	73	302
Forestry	194	210
Public service	338	290
Water supply	331	488
Education and training	261	410
Health care, sports	400	511
Culture, telecommunication	108	221
Government administration	151	242
Other	450	708
Subtotal	9,600	9,300
Counterpart funds		1,000
Reinvested depreciation by SOEs		700
Reinvested land use income by local auth.		500
Reforestation		300
Job creation		300
Total	9,600	12,100

Source: State Planning Committee.

Expenditure Issues

2.63 Having raised revenue to a respectable level of 22% of GDP, and with substantial external financing on affordable terms committed, mobilizing additional resources, as distinct from increasing the efficiency of resource mobilization, should no longer be the major concern of the government. Instead, the critical issue facing the government is how to get better value for its money.

2.64 The previous economic report identified three areas of concern, which remain valid: one relates to civil service pay and the wider question of government employment; a second concerns expenditures for operation and maintenance. The third concern – changing the balance between current and capital expenditure in favor of the latter – is also still valid even though allocations for investment were increased in 1993 and 1994. Here an additional issue is making sure that the right projects are being selected. Finally, a fourth area in which allocation issues are potentially important is the provision of social services. These absorb more than 40% of the recurrent budget in 1994, and their share has been growing rapidly.

2.65 **Government pay and employment**. Following the monetization of payments in kind, the wagebill can now be seen to account for 35% of the current budget. Management of the wagebill is thus an important tool in controlling the budget. Keeping nominal wages constant in the face of high inflation was one of the main methods by which the government reduced the level of public spending between 1989 and 1992. Government pay policy also affects the productivity of the civil service. Even after the recent adjustment, teachers' salaries, the largest component of the wagebill, are only back at what they were in 1985 in real terms. Low pay is a key factor accounting for the poor quality of teaching, and this applies to workers throughout the government. However, given the budget constraint, raising government pay levels will require further reductions in the size of the civil service. In addition to further reducing overstaffing, this may involve transferring responsibility for the provision of certain services to the private sector.

2.66 Salary levels in the government are well below those in the private sector, resulting in a flight of qualified staff. The competition from private firms for skilled staff will grow stronger as the private sector develops. A more differentiated pay structure may also be needed to retain particular skills. Following up on recent measures, further changes in government pay and employment policies must remain a focus of the government's reform program.

2.67 **Public investment**. Although capital expenditure has recovered from the deep cuts made in 1990-91, a further increase in the share of resources going to investment is recommended. The high growth scenario projects an increase in the investment budget to 8.5% of GDP. Public investment needs in the economy are large. A review of key sectors identified many projects in transport, irrigation, public utilities and the education and health sectors. Initially, most of these investments are likely to involve rehabilitation of existing facilities, to be followed by expansion of capacity. What appears to be a relatively high level of current expenditure suggests that domestic resources could be found to complement the promised external financing.

2.68 The proliferation of investment proposals from ministries, government agencies and donors, with financing needs in excess of available resources, demands that priorities are established through a systematic process of project analysis, selection and phasing. Financing needs for completing ongoing projects, providing their continued viability is assured, have to be determined and must be set against

those from new projects. The three-year rolling Public Investment Program that SPC has started to prepare will be an essential tool in this process. It would establish standards for project analysis, set up a screening mechanism for all new projects, and match investment needs with resources.

2.69 **Operation and maintenance costs.** Budgetary spending on operation and maintenance fell sharply, from 3.2% of GDP in 1986 to 0.4% in 1993. Inadequate maintenance has been a key factor behind the present large rehabilitation requirements. Timely maintenance outlays have a potentially high rate of return, and increasing the O&M budget is a high priority. Greater expenditure discretion at the local level, as proposed in the draft budget law, would encourage this by increasing the accountability of those responsible for maintenance. Maintenance budgets should be prepared on the basis of established needs and well prepared maintenance programs that should be economically justified.

2.70 Given that existing maintenance needs are significantly underfunded and that the proposed rise in the level of investment will generate further demands for O&M financing, the implications of new investments for the recurrent budget have to be taken into account in decisions on the investment budget. The PIP can play a useful role in this, given also its three-year time horizon, by requiring that project proposals contain estimates of future current costs and by giving this aspect sufficient weight when screening projects for the PIP.

2.71 **Expenditure on social services.** Transition economies typically experience a sharp increase in the demand for expenditure in the social sphere, in particular on account of payments for pensions, unemployment benefits, social welfare and poverty alleviation programs. At the same time, however, notably in the provision of health and education services, there are opportunities for recovering some of the cost of these services, and for shifting some of the burden of their provision to the private sector. The cost of these services dominates the budget and is rising rapidly. Efforts to control them and to ensure that resources are used efficiently is hindered by limited information on their structure and the factors that affect their growth. A review of these expenditures is urgently needed as part of an effort to strengthen budget management.

C. State Enterprise Reform

2.72 The state enterprise sector in Viet Nam, although not large compared to most socialist economies, plays a significant role in the economy. Recognizing that the reform of this sector is of central importance to maintaining macroeconomic stability and is fundamental to transforming the economy into a market system, the government has focused since 1988 on restructuring the state-owned enterprises (SOEs). The adopted measures which have resulted in the reduction of the number of SOEs and in their improved performance include elimination of operating subsidies, expanded enterprise autonomy, and exposure of SOEs to market forces in a competitive environment, including equal tax treatment for state and private firms. Despite the progress made, SOEs have not yet fully adjusted to the new economic conditions owing to a number of systemic and structural shortcomings. This section discusses these issues, examines the government's reform agenda, and suggests a set of medium-term policy measures that would facilitate the adjustment of the state enterprise sector to the market economy.

Role of the State Enterprise Sector

2.73 **Background.** The contribution of the whole state sector to GDP was 34% in 1990, with the state enterprise sector accounting for 71% of this contribution or about 24% of GDP (compared with 57% of GDP in China and well over 60% of GDP in former socialist economies). Agriculture, industry and commerce, with the respective GDP shares of about 34%, 21% and 10%, were the leading economic sectors. While SOEs' contribution to the agricultural sector's value added was insignificant (about 2%), their share in the industry and commerce sectors' GDP was close to half.

2.74 The number of SOEs in 1990 totaled approximately 12,000, of which about 3,000 large- and medium-scale enterprises were centrally controlled under the jurisdiction of the central government and 9,000 medium- and small-scale enterprises were locally controlled under the jurisdiction of district and provincial governments. About 20% of the centrally controlled and 60% of the locally controlled enterprises were loss-makers. With an employment of about 2.1 million people, SOEs accounted for about 7% of the country's employed workforce and 61% of employment in the state sector. About 3,600 SOEs in the industry sector accounted for approximately 40% of the employment in the enterprise sectors, making this the largest of SOE groups in terms of employment and contribution to GDP.

2.75 The reforms of 1990-93 have resulted in substantial changes in the enterprise sector. By the end of 1993, the number of SOEs had been reduced to 7,000 (through liquidation of 2,000 mostly locally controlled enterprises and the merger of 3,000 SOEs with other SOEs), profitability had improved (the number of loss-making enterprises had been decreased to approximately 20%), and employment in the state enterprise sector had dropped to about 1.7 million people. At the same time, SOEs in the industry sector had kept their dominant role, and the share of the enterprise sector in GDP has been roughly stable. Given the average GDP growth of 7% during this period, these data are indicative of a marked enhancement of SOEs' performance and productivity.

2.76 The contraction of the number SOEs is primarily attributed to: imposing hard budget constraints on SOEs; subjecting them to market forces in a liberalized and competitive economy; and allowing liquidation of enterprises. The adverse social effects of unemployment, resulting from labor reduction measures and liquidations, have not been much of a problem since an adequate social safety net has been provided, and Viet Nam's growing economy provides job opportunities for the unemployed in the non-state sector.

2.77 Three principal factors have influenced the growth of the enterprise sector. First, as SOEs had a low capacity utilization rate before the reform program was initiated, a major effect of the reforms was to cause SOEs to generate additional output from existing resources with only minor amounts of investment. Second, large investments made during the period of Soviet aid have reached the production stage, particularly in oil production from offshore rigs and in power generation from the Hoa Binh hydro-electric station. Third, Viet Nam's export-oriented strategy provided SOEs with expanded export markets and incentives to enter these markets.

Structure and Governance

2.78 SOEs, defined as enterprises with one or more units of production/service (generally located on the same site), form the core of the enterprise sector. Prior to initiation of a comprehensive economic reform program in early 1989, the state enterprise sector was structured to accommodate the objectives

of the, then prevailing, command economy. In the centrally controlled segment, the line ministries, the unions of enterprises and the SOEs were responsible for implementation of the central plans. For each branch of activity under a line ministry, an intermediary institution (a union of enterprises or a corporation)[1/] was established between the ministry and the branch enterprises. These intermediaries were literally in charge of enterprises under their purview and had the responsibility for: allocation of resources and quotas; procurement of inputs and distribution of outputs; and assurance of enterprise performance in accordance with the plan. For some SOEs, another intermediary tier had been established between the unions/corporations and enterprises, namely, the company. For example, even at present, the National Steel Corporation consists of two companies, one with seven and the other with four enterprises. Although the role of the unions has somewhat diminished, the structure remains intact in most sectors.

2.79 As of January 1992, there were about 2,600 centrally controlled enterprises and 113 unions/corporations spread across all ministries and central organizations, the only exception being SPC with no enterprises under its control. The Ministry of Defense was the largest controller of SOEs, followed closely by the Ministry of Agriculture and Food Industry. These two ministries controlled close to 40% of central SOEs. The other ministries with a relatively large portfolio (each with over 100 SOEs) were the Ministries of Transport, Commerce, Construction, Forestry, Light Industry, and Heavy Industry. As a result of re-registration (para. 2.92), by the end of 1993, the number of SOEs had been significantly reduced in the Ministry of Defense (by 50%) and in the Ministries of Transport and Forestry (by 20%).

2.80 At the local level a structure similar to that of the centrally controlled SOEs prevailed, i.e., the local unions acted as intermediaries between the People's Committees and SOEs. Under the government's reform program, SOEs were permitted to leave the union of enterprises. Subsequently, a vast majority of local unions were dissolved, and at present, local unions are active only in Hanoi, Ho Chi Minh City, and Hai Phong.

2.81 While SOEs are generally managed by directors, management boards have been established in a limited number of large-scale enterprises on an experimental basis. In the case of SOEs under the control of unions/corporations, managers are nominated by the intermediaries and then appointed by the supervising state bodies. In other cases, managers are directly appointed by the state bodies.

2.82 The 1989 reforms provided SOE managements with a broad scope of autonomy, including authorization to: adjust product mix; procure inputs and market outputs; introduce new technologies; borrow funds; invest own resources; acquire assets, lease assets and divest moveable assets; hire and fire employees; set wages, salaries and benefits in agreement with the Ministry of Labor; and allocate after-tax profits. SOEs, which had severed their ties with unions/corporations, took full advantage of these privileges and many of them were able to adjust to the changing economic environment, but those that remained under the control of the intermediaries were restricted in several areas. In this respect, monopolistic intermediaries (such as those engaged in cement and steel manufacturing) still set output prices and most intermediaries handle their enterprises' imports and exports.

1/ Neither one of these institutions was or is classified as an enterprise. The terms "corporation" and "company" used for the title of intermediaries are misnomers and should not be interpreted as commercial entities incorporated under the Law on Companies.

2.83 Viet Nam's multi-tier structure of the enterprise sector, created under its former command economy, is incompatible with the country's evolving market system. SOEs' superstructures (companies and unions/corporations), if maintained, would impose an unnecessary overhead on enterprises and impede SOEs' adjustment to the new conditions. Further, continuation of the current structure could result in the expansion of unwanted monopolies as long as Viet Nam remains without an anti-monopoly or a fair competition law. The government would be well advised to dismantle the existing structure.

Legal Status and Ownership Rights

2.84 The legal status and ownership structure of state enterprises is still evolving. Under existing State Enterprise Regulations, a state enterprise is a business institution established by the state, invested with state capital, and managed by the state as owner. A state enterprise is distinguishable from private businesses (sole proprietorships) as well as from limited liability companies and shareholding companies. The Company Law is effectively unavailable to state enterprises, as it requires at least two partners for the formation of the former and seven for the formation of the latter. Consequently, SOEs, private businesses, and companies function under different laws, decrees, and systems. This situation limits the government's flexibility in commercialization and privatization of SOEs. For example, an SOE cannot be converted into a single-owner company as a step toward commercialization. Nor can partial shares of SOEs be easily sold to the domestic or foreign private sector.

2.85 In order to facilitate commercialization, it is recommended that the Company Law be amended to allow for single-owner companies. Most of Viet Nam's state enterprises are small, and the government could convert the vast majority into companies within two years. The government should also consider amending the Company Law to permit foreigners to own shares of companies. This change would facilitate foreign participation in state companies, and open up a new vehicle for foreign investment into Viet Nam.

2.86 **Ownership rights.** The state's rights as owner in SOEs still lack the precise clarification that stake/share ownership under a company law would provide. A proposed state enterprise law would remove this deficiency. The main issue that needs to be addressed is which agency (or agencies) should exercise the ownership rights of the state in SOEs, particularly in the centrally controlled ones.

2.87 At present, line ministries exercise the state's ownership rights in the centrally controlled SOEs, and people's committees exercise these rights in locally controlled SOEs. In the case of centrally controlled SOEs, the government recognizes the inherent conflict of interest when the ownership rights of the state are accorded to a line ministry which at the same time is responsible for the development and execution of the government's policies and regulations for the sector. It is also aware that a line ministry, with vested interest as an owner, cannot support and regulate activities of all types of ownership equitably and without prejudice in Viet Nam, where the non-state sector accounts for 58% of the economy.[2/]

2/ In this context, governmental approvals are required for establishment (including limitations on fields of business) of private enterprises. Conflict of interest arises, for example, in the Ministries of Commerce and Forestry where both are owners of SOEs but, at the same time, the former is responsible for the allocation of textile export quotas (imposed by importing countries) and the latter has the regulatory responsibility of the forests.

2.88 Several options, including the establishment of an independent agency for the exercise of the state's ownership rights, are under consideration. The government is, however, concerned that the concentration of the state's ownership rights in a single agency might burden that agency with an unmanageable task. A solution to this dilemma is to transfer such rights in all SOEs which would be transformed into commercial companies to a single agency and to leave the ownership responsibility with line ministries for strategic enterprises that will continue to receive government support. Since the latter group is expected to be in the non-competitive sector of the economy, the issue of conflict of interest would not arise.

Recent Reform Initiatives

2.89 Notwithstanding the positive impact of enterprise autonomy on the economy, the lack of a system that would ensure SOE accountability resulted in the abuse of authority, particularly among locally controlled SOEs. Irresponsible behavior of some managers in the state enterprise sector, combined with the absence of accounting systems and financial control, prompted the government to adopt, in 1990, regulations for the establishment of new SOEs and the re-registration of all existing SOEs, plus unions and corporations. SPC was made responsible for evaluating the applications for re-registration, and a high level council was appointed to make final decisions on SPC's recommendations. The qualifying criteria for re-registration of a SOE included: existence of demand for its products or services; the ability to preserve its capital; the ability to repay its debts; the lack of adverse environmental impact; and the clarity of ownership of its assets, including land use rights. Specific criteria for re-registration of unions and corporations were not established until recently. The re-registration process started in 1991.

2.90 **Re-registration**. During the first phase of re-registration (November 1991-March 1993), the fate of some 11,000 SOEs out of the 12,000 SOEs existing in 1990 was determined. About 2,000 inefficient and chronic loss-making enterprises, mostly small-scale and accounting for about 4% of total state enterprise assets, were liquidated and their assets were generally sold to the highest bidder from either the private or the state sector. Another 3,000 poorly performing enterprises were merged with other SOEs. The remaining SOEs, comprising 1,861 centrally controlled and 4,190 locally controlled, were re-registered. With an employment level of less than 500 people in about 90% of the re-registered enterprises, the average size of SOEs remains small. Reportedly, about 300 medium- and large-scale well-run SOEs accounted for 80% of the total contribution of the state enterprise sector to the budget in 1993.

2.91 During the second phase of re-registration, which has already begun, decisions will be taken regarding the remaining 1,000 un-registered SOEs, as well as enterprise unions and corporations. The Prime Minister issued Decision 90 in March 1994 providing instructions on the second phase of re-registration, including the re-registration of enterprise unions, corporations and loss-making strategic enterprises. The decision requires completion of the process by the end of 1994.

2.92 The criteria set for re-registration of unions/corporations are that a union/corporation must have: at least five SOE members with technological and commercial linkages; a minimum legal capital of 500 billion dong (about US$46 million), except in "special" sectors where the minimum capital would be 100 billion dong; an integrated accounting system or a system for consolidating the members' financial statements; a supporting feasibility study to show the viability of the corporation; an organizational plan, including personnel requirements; and a set of operational and organizational regulations approved by the line ministries or provincial authorities. SPC is to classify all unions/corporations into three categories:

those that are viable; those that are non-viable, but important; and those that are primarily administrative. Corporations in the first category must be registered by September 30, 1994, those in the second category should be restructured and re-registered by December 31, 1994, and those in the third category should be liquidated or re-registered as an SOE or be merged with other corporations (or enterprises) by September 30, 1994. Failure to meet the deadlines set would lead towards cessation in the union/corporation's operation in any category.

2.93 The top-down approach evident in the Prime Minister's decision appears to ignore the choice of joining or not joining a corporation that SOEs should have. In that sense, the decision seems inconsistent with the government's decentralization policy. Further, the decision, if appropriately implemented, would probably formalize and, to a limited extent, rationalize the role of enterprise unions and corporations. Nevertheless, most of the issues raised in connection with enterprise unions and corporations would remain unresolved.

2.94 **Enterprise groups**. In March 1994, the Prime Minister also issued Decision 91 on a pilot program for the establishment of enterprise groups. The objectives in establishing enterprise groups are: to accelerate agglomeration and concentration of state enterprises; to raise the potential international competitiveness of the state enterprise sector; to gradually terminate the system of management and administration by line ministries; to eliminate the distinction between centrally and locally controlled enterprises; and to strengthen the role of state management of enterprises, thereby raising the effectiveness of the economy.

2.95 The decision calls for the establishment of several groups by the end of 1995, when the program will be assessed. An enterprise group can be national, regional or local and should: have at least seven enterprise members and a capital of 1,000 million dong (about US$92 million); and be sectoral or multi-sectoral, with the latter having a sector-specific orientation. Such a group will be governed by a board of management, comprising seven to nine members, appointed by the Prime Minister. In establishing enterprise groups, the development of monopolies that stifle internal competition should be avoided. The first enterprise groups will be proposed by line ministries and the People's Committee of Ho Chi Minh City.

2.96 The government's intention to reduce the number of enterprises and create business organizations of the size and diversity of international corporations is understandable. However, two major issues arise: the timing of the program; and an administrative approach to the development of internationally competitive organizations. Regarding the first issue, given the prevailing confusion about the role of unions/corporations and the solutions prescribed under Decision 90, some of the corporations that would evolve may have the size and characteristics of the enterprise groups envisaged under Decision 91. Starting a new experiment before the implementation of Decision 90 is imprudent and may result in the creation of "white elephants." Regarding the second issue, the government could better achieve its objectives if the necessary incentives were formulated and private and public enterprises were permitted to jointly or severally develop the desired organizations.

2.97 **Equitization**. The Pilot Equitization Program was launched in accordance with the Prime Minister's Decisions 202 (June 1992) and 84 (March 1993). The program calls for transformation of a limited number of medium-scale and non-strategic SOEs, which are either viable or potentially viable, into shareholding companies through acquisition of shares by enterprise employees (on preferential terms), domestic private and public investors, and foreign investors with the proviso that the latter group's

participation must be approved by the Prime Minister. The shareholding companies so created will be government by the Law on Companies. Although 19 SOEs have participated in the program do far, by March 1994, only two SOEs had been equitized and the transformation process was well under way in the case of two other SOEs.

2.98 **Enterprise supervision and restructuring.** The Government has undertaken a broad program to improve the financial management and supervision of state enterprises, including

- assessment of the financial and economic viability of SOEs with large overdue debt;
- establishment of a framework for restructuring and recapitalization of viable but technically insolvent large- and medium-scale SOEs;
- introduction of improved techniques and organization for the financial supervision of SOEs;
- strengthening of the accounting and auditing system of SOEs; and
- recommendation of measures for improving the internal management of SOEs.

The above-mentioned program was launched in January 1994 and no particular constraint is foreseen in its implementation.

Medium-Term Agenda for Reform

2.99 The government's reform program for state enterprises has to date largely been a pragmatic response to fiscal difficulties. Further reform is hampered by the lack of a clear vision of where the sector is headed. The government has indicated its plan to reduce the number of state firms to a relatively small number of "strategic" ones, but has yet to clearly define which sectors and firms fall into this category. The following excerpts from the Political Report of the Central Committee in January 1994 illustrate this lack of a clear policy direction for state enterprise reform:

> "Industrialization and modernization call for a great deal of capital from different sources as well as efficient use of capital... Domestic capital is of decisive significance; foreign capital is important... To maintain an average annual growth rate of no less than 8%, we must quickly raise our total investment capital to over 20% of the annual GDP in the next few years and even higher in succeeding years, coupled with efforts to increase efficiency... Intensive investment from the State Budget is of decisive significance for the growth of the whole economy... Capital allocated from the Budget should be invested mostly in the construction of socio-economic infrastructure, a number of new key industrial enterprises and a number of processing units for agricultural, forest and aquatic products and for export goods and services... The state will fund only those socio-economic infrastructure projects where no direct return on capital is possible. The remaining capital should be allocated in the form of Government credits to be repaid by the users."

2.100 This statement indicates, on the one hand, that the government intends to concentrate budget investment on infrastructure, which is a sensible strategy. On the other hand, it reveals a desire to continue to provide government support to firms in industry, including processing and exporting sectors. This latter policy is not recommended. The government is not going to have sufficient resources to

support all of this investment. Furthermore, investments in manufacturing can be undertaken more efficiently by the private sector. The government needs to make a clear decision about which sectors and firms are going to receive government support, and it should restrict this list to a small number of public utilities, such as power and water.

2.101 The other enterprises owned by the government should be transformed into commercial companies that compete with the private sector. As noted above, a practical way to accomplish this would be to amend the Company Law so that commercial state enterprises can be quickly converted into companies with the state initially as the sole shareholder. It is further recommended that the state's ownership in these firms be exercised by a central agency, not by line ministries that also have regulatory responsibilities in the sectors. These changes would facilitate privatization, which could be pursued initially on an experimental basis, and eventually on a broad scale. Thus, a medium-term enterprise reform program that would support rapid growth of Viet Nam's economy would include:

- A clear definition of strategic sectors, such as infrastructure and public services, in which state enterprises will continue to be active.

- Assessment of the potential private sector investment in the defined strategic sectors and estimation of the need for state investment in and credit to these sectors.

- Amendment of the Law on Companies to permit: formation of limited liability and shareholding companies solely owned by the state; and acquisition of shares in Vietnamese companies by foreign investors.

- Transformation of non-strategic enterprises into state-owned commercial companies under the amended Law on Companies, and establishment of an independent and commercially oriented agency to exercise the ownership rights of the state in these firms.

- Enactment of a state enterprise law that would govern the strategic enterprises that will continue to receive government support and assignment of line ministries and other central agencies to exercise ownership rights in these firms.

III. INCENTIVES FOR SAVINGS AND INVESTMENT

3.1 Viet Nam is in transition from a system of central planning to a market economy. In a centrally planned system the government tries to manage all production and investment decisions. In a market economy, on the other hand, the role of the state is more focused. The government must provide a range of services that cannot be provided by private firms or that are not likely to be provided in adequate amount by private firms. The previous chapter examined this issue in detail, reviewing the budget system and Viet Nam's public expenditure and making recommendations for improving the efficiency of this expenditure. This chapter examines a second important role of the state in a market economy, which is to provide the overall incentive framework for saving, investment, and production by households and firms.

3.2 Most goods and services are produced by the private sector in a market economy. Viet Nam's transition has progressed to the point that more than half of GDP is produced by the private sector. Also, as reviewed in the previous chapter, Viet Nam still has a significant number of state enterprises operating in the competitive sectors of the economy, and this report recommends that the government create a level playing field so that these firms and the private sector can compete, as a step toward eventual privatization. The private sector plus these commercial state firms form the heart of the economy, and the government clearly has an interest in spurring their expansion. The experience of successful economies in the region has shown that this can best be accomplished by establishing an efficient incentive regime and then relying on the decentralized decision-making of households and firms.

3.3 One of the key elements of the incentive regime is the overall macroeconomic environment, which was discussed in Chapter 1. In addition, the government plays a major role in establishing the legal, regulatory, and policy environment in which investment and production take place. This chapter examines major issues in these areas. The first section reviews recent developments concerning legal infrastructure and makes recommendations for further reform and institution-building in this area. The remainder of the chapter then examines some key aspects of the policy and regulatory framework, focusing on the financial sector, policy toward foreign trade, and the regime for foreign investment.

3.4 In a market economy the financial sector provides an essential range of services necessary for economic expansion. Given the need to increase savings to sustain high growth in Viet Nam, policies toward this sector are especially important. Currently, there are problems with the functioning of the financial system that result in unnecessarily high short-term interest rates and non-availability of other important services (i.e., efficient check clearing or term lending). Savings and investment in Viet Nam are hampered by the poor functioning of commercial banks, and rectifying this situation is a key component of improving the incentive regime.

3.5 The next issue taken up is policy toward foreign trade. One of the reasons why prices have become much more effective incentives in Viet Nam is that the government has pursued a good exchange rate policy and liberalized imports and exports. There remain, however, several major problems with the trade regime. These include a system of permits and licenses that could be used in a restrictive manner that would affect access to imports and distort prices. More importantly, the tariff code differs significantly from those in place in leading exporting countries and needs to be revised in order to strengthen the incentives for long-term investment and development.

3.6 The final issue addressed by the chapter is policy toward foreign investment. Viet Nam has created a separate legal framework for foreign investors, and in many cases they face prices different from those of domestic producers. For this reason the incentive regime for foreign investment must be taken up as a separate topic. The economy will develop more successfully if the incentive regime for foreign investment is brought more in line with that for domestic producers. Section D of the chapter makes specific recommendations for actions that would move in this direction.

3.7 The recommendations from this chapter, together, form a vision of an incentive regime that would spur long-term development in Viet Nam. While the government has made progress with improving the incentive regime, there remains a disturbing tendency for the government to try to micro-manage a range of decisions. This indicates that the government has not fully accepted the principle of decentralized decision-making by households and firms. It is true that in a market economy the government can influence decisions through incentive policies. However, in order for the incentive regime to be effective it needs to be relatively stable. Changes will inevitably have to be made at various points. But if changes are occurring constantly then firms will be reluctant to make long-term investments. Thus, Viet Nam needs to make some fundamental decisions about the incentive regime that it is putting into place, and then allow producers to operate without the frequent changes and interventions that now characterize the system.

A. Development of Legal Infrastructure

3.8 Viet Nam's economic reforms have been reflected in a transition in the legal framework. Moving from a socialist legal system comparable to those in pre-reform China and Russia, Viet Nam has begun a steady progression of changes in law and legal infrastructure to meet the new demands of the market economy. New laws enacted in specific areas in 1987-90, such as foreign investment, contracts, companies, and private enterprises, were followed by the new constitution in 1992 which clarified and protected the right of private ownership. Since then, other specialized laws have been enacted, such as land law, bankruptcy law, and environmental protection in 1993, and a labor code and domestic investment promotion law in 1994. Preparations continue for some basic building blocks of the legal system such as the civil code and commercial law, now expected in 1995. The legal infrastructure is also developing to meet the demands of economic reform, as can be seen in the establishment of economic courts in 1994 and the re-emergence of the legal profession.[1/]

3.9 Thus, the current legal system in Viet Nam already includes several important elements that support the incentive regime to promote increased economic activity. There are multiple vehicles now available for private investment. Private enterprises, which are essentially sole proprietorships, can be established by Vietnamese nationals. The company law permits only Vietnamese nationals to be shareholders in companies, whether in the form of limited liability companies (which do not issue shares) or shareholding companies (which can issue shares to the public). Under the foreign investment law, foreign nationals can join with either a Vietnamese individual, private enterprise, company, state enterprise or co-operative to establish a joint venture enterprise or enter into a business co-operation

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1/ For a fuller discussion of the legal framework, see Natalie G. Lichtenstein, "A Survey of Viet Nam's Legal Framework in Transition," World Bank Policy Research Working Paper No. 1291, April 1994.

contract, or they can establish a wholly foreign-owned enterprise. Moreover, under the domestic investment promotion law, Vietnamese investors will have access to a variety of incentives, including tax breaks and investment support funds, for investments in selected regions and sectors.

3.10 **Public investment** in new state enterprises is restricted under recent governmental decrees on state enterprise reform, as the legal regime for state enterprises is undergoing reform (para. 2.89). While state enterprises have been regulated in recent years by a complex and sometimes confusing patchwork of decrees, circulars and instructions, work continues on a more comprehensive state enterprise law which would regulate the establishment, management and operation of those enterprises in which the government elects to retain ownership. A draft state enterprise law was discussed, but not enacted, at the July 1993 session of the National Assembly, and a revised draft law is scheduled to be submitted for consideration in 1995. Interestingly, the forms of investment included under the domestic investment promotion law include the purchase of shares in enterprises, such as state enterprises diversifying their ownership.

3.11 Both **civil and economic contracts** are recognized and enforceable, under ordinances enacted in 1991 and 1989, respectively. Economic contracts form a subset of civil contracts, namely, those for specified types of economic transactions between two legal entities or a legal entity and an individual with business registration. However, there remain disputes over the distinctions between the two, and it is anticipated that the civil code, when enacted, will clarify these definitional conflicts. The contract ordinances are particularly important at this juncture in the area of mortgages, as they provide the legal basis for the mortgage contract. Greater clarity in the general contractual regime set forth in the civil code, including specific provisions related to mortgages, would have the advantage of clarifying the mortgage regime.

3.12 A key element of the incentive regime was strengthened with the enactment of a revised Land Law in 1993, after much discussion at the National Assembly and as many as 20 drafts. While land in Viet Nam remains the property of the people, under the exclusive administration of the State, **land use rights** are now available for different categories of land and different categories of land users. Under the law, the State allocates land to Vietnamese organizations, households and individuals for use and for rent, and protects their rights to exchange, assign, rent, inherit and mortgage land use rights; the State also is empowered to allocate land for rent by foreigners. Within this basic framework, the law sets out responsibilities for setting the rules to apply to the exercise of land use rights, and differentiates among six categories of land (agricultural land, forestry land, land for rural residential areas, urban land, specialized land and unused land). Thus, there are more than 10 different laws, ordinances and decisions contemplated for the implementation of the land law, including a law on tax on the transfer of land use rights (already enacted), three decrees already in place (on allocation of agricultural land, forestry land and minimum prices for transfer) and two framework ordinances in final preparation, on the rights and obligations of Vietnamese organizations granted land use rights by the State and the rights and obligations of foreigners leasing land. One of the major implementation issues needing further clarification is the procedure, and, in the case of foreigners, the right, to mortgage land use rights.

3.13 Another key element of the incentive regime was given a substantial foundation with the passage of the **Bankruptcy Law**, which took effect July 1, 1994. The new law offers for the first time in Viet Nam a comprehensive legal framework for the restructuring or liquidation of insolvent enterprises. Notably, it applies equally to all forms of enterprise operating in Viet Nam, including in its scope state enterprises as well as enterprises involving foreign individuals and organizations. Special rules will be

issued for its application to enterprises providing directly for national defense, security and important public services, and treaty obligations must be followed where foreign parties are involved. Bankruptcy procedures will be under the newly established economic courts at the Supreme People's Court and provincial people's courts, with the implementation of court decisions by appropriate execution offices of the Ministry of Justice and provincial departments of justice. The law provides preferential treatment for secured creditors and permits unsecured and partially secured creditors an opportunity to participate in the process.

3.14 A fair, credible means for **dispute resolution** is necessary for the incentive regime to function effectively. Changes in the range of avenues available for the resolution of disputes in Viet Nam are also underway. The system of courts for the handling of civil cases will be paralleled, beginning in 1994, by courts, at the national and provincial level, for the handling of economic cases. The previous system, under which the State Economic Arbitration system had exclusive jurisdiction for the settlement of disputes under economic contracts, is being replaced by the economic courts. As with specialized civil courts, the specialized economic courts will be part of the Supreme People's Court at the national level and the 53 provincial people's courts. Similar labor courts may also be established for the implementation of the Labor Code, which takes effect in 1995. In addition, the Vietnam International Arbitration Centre at the Chamber of Commerce and Industry has been established for the arbitration of disputes involving foreign parties, and both legislation and accession to international conventions are anticipated to provide for enforcement of arbitral awards. The setting up of non-governmental arbitration facilities for domestic disputes is also planned.

3.15 As might be expected where a wholesale transformation of the legal system is anticipated, there are also elements of the legal system supporting the incentive regime which are still under preparation. Work on the drafting of a **civil code** has been underway for many years, which is not uncommon among civil law jurisdictions. The draft civil code, now numbering nearly 600 articles, would be expected to lay down basic rules in numerous areas relevant to economic activity. The current legislative agenda calls for the civil code, which was discussed by the National Assembly in 1994, to be enacted in 1995. After the civil code is in place, changes to some of the laws noted above, such as the contract and company laws, will also be necessary. The lawmaking process so far in Viet Nam has seemed to accommodate such revisions, as the Foreign Investment Law has been amended twice, and the Land Law of 1987 completely revamped in 1993.

3.16 Another legal building block of some import for a transforming socialist economy, the **labor code**, was enacted in June 1994. Its objectives include protection of employer and employee rights and obligations, regulation of labor contracts, social insurance, providing the right to strike and setting up a labor arbitration mechanism independent from the government. Labor disputes which are not arbitrated would be under the jurisdiction of courts, possibly separate labor courts to be set up at the supreme and provincial people's courts.

3.17 To facilitate commercial activity, the civil code will be supplemented by a **commercial law**, which is expected to follow the civil code by about a year. The commercial law, which has been under preparation for some time, would be anticipated to provide rules for commercial transactions, and is currently thought to address such areas as the definition of "business person" and the business behavior to be regulated, the regulation of brokers and other intermediaries and the provisions of commercial contracts and handling of violations of their provisions.

3.18 The legislative agenda for 1994-95 includes several other laws and ordinances to be prepared by the government and submitted to the National Assembly (laws) and its Standing Committee (ordinances), such as the state enterprise law and revisions to the Company Law (paras. 2.85-2.86). In bringing that agenda to reality and designing future legislative agendas, there are two overall concerns about the transformation of the legal system to date which Viet Nam's policymakers and legislators would be well-advised to consider. These are: the high degree of differentiation of rules based on the origin of the capital of the enterprise, preventing the creation of a level playing field among economic actors; and the trend to general purpose laws which precede the implementing ordinances and regulations needed to complete the legal framework.

3.19 The seemingly excessive degree of differentiation can be seen in a few key examples. There are now at least ten different kinds of entities which are mentioned in economic legislation: individuals with business licenses, private enterprises, limited liability companies and shareholding companies under the company law, Vietnamese-foreign joint ventures as limited liability Vietnamese legal entities, wholly foreign-owned enterprises, state enterprises, unions/general companies, group companies and collectives. The choice of investment vehicle is further compounded by the different rights and obligations available to each type in different laws. For example, while the provisions of the land law offer mortgage of land use rights to Vietnamese entities, the rights of foreign organizations leasing land to enter into such mortgages are not explicitly mentioned in the Land Law. (They may later be permitted under the implementing ordinances.) However, both joint ventures and wholly foreign-owned enterprises are Vietnamese legal entities, so that they may be treated as domestic organizations for purposes of the land law. Thus, an investor must make a decision on the form of investment based on an analysis of complex rules which may not lead to the most efficient use of resources. And, certain anomalies are bound to result, such as the conundrum that an equity joint venture enterprise is treated as a limited liability company and Vietnamese legal person under the Foreign Investment Law, but, oddly, cannot be a limited liability company under the company law which does not allow foreign shareholders.

3.20 Having a limited number of forms of organization and equal treatment for all of them could be expected to lead to more effective competition among enterprises. Fewer, easier to follow rules would save legal and management resources not only for the enterprises which are competing, but also for the government agencies which retain certain regulatory functions under these laws and for judicial and arbitration personnel who must assist in the resolution of the disputes which inevitably arise under them. However, one can point to the new bankruptcy law as evidence of a positive trend, in that it applies to all enterprises in Viet Nam, without further differentiation. This, in turn, means that creditors need not undertake different analyses of bankruptcy protection for each type of debtor, but rather can make their lending decisions based on the economic viability of each debtor. That kind of loosening up of the legal framework would facilitate the incentive regime.

3.21 The second worrisome trend is the delayed issuance of the multiple layers of ordinances and decrees which provide the details for the implementation of generally worded laws. This division of function among legal instruments is a natural recognition of the respective political and legislative roles and staffing of the National Assembly, with its two semi-annual sessions; the Standing Committee, which meets monthly; and the Government, which is in continuous session, as it were, and the ease of subsequent amendment. Where the implementing legislation is not ready for issuance at the same time or shortly after the law, however, delay and potential confusion may result. Moreover, where sensitive issues such as mortgage rights for foreign investors are left vague in the law, it then falls on the ordinance or decree to resolve the issue as well as to provide for detailed implementation. This has a

tendency to add both complexity and delay, both at the initial stage of getting the regulations in place and during implementation, when numerous pieces of legislation (law, ordinance, decision, circular) are all relevant and must be consulted to ascertain legal rights and obligations.

3.22 A separate concern is to ensure that foreign technical assistance provided in the legal field fit Viet Nam's unique legal situation. Viet Nam's legal system blends together several important legacies: a centuries-old Vietnamese legal tradition, seventy years under French-influenced codes and forty years of socialist legislation, with a measure of U.S. common law influences in the pre-1975 period. Against this backdrop, Viet Nam's lawmakers, economists and lawyers alike, have been charged with creating a new legal framework for market transactions and forms of economic activity that are themselves new to the Socialist Republic of Viet Nam. Other countries in similar legal transitions have been faced with difficulties in reconciling legislative advice and training offered by legal experts from different legal traditions and jurisdictions, and it will be equally important for Viet Nam to choose among comparative legal experiences to find those most relevant to Viet Nam's own needs.

3.23 Looking to the future, greater attention to these three overarching themes in legal reform strategy--excessive differentiation of entities and rights, interrelationship of laws and implementing regulations, and developing the civil law tradition--would be the highest priority in enabling the legal system to give full support to the incentive regime. In implementing the legal reform strategy in the next two years, progress on the civil code and commercial law and development and nurturing of the new dispute resolution mechanisms, economic courts and arbitration bodies, would have the greatest impact. Moreover, given the complexity of the current legal framework and the additional elements expected to be added, development and regulation of the legal profession and more legal training to produce a sufficient number of well-trained lawyers, government legal officials, judges and arbitrators will also merit greater attention than in the pre-reform era.

B. Reform of the Financial System

3.24 The Vietnamese financial system has made continued progress toward that needed by a market-oriented economy. Clearly the most impressive achievements have been the reduction of inflation to a rate among the lowest in transitional economies and the maintenance of positive real interest rates. Banks have been given greater freedom to make their own lending decisions and, in fact, encouraged by the authorities, have substantially increased credit to the private sector to levels above that seen in other transition economies at comparable stages in the transition process. New payments instruments have encouraged less reliance on foreign exchange and gold as means of payment. And the taxation of financial intermediation, though still high, has lessened somewhat recently owing to reforms of reserve requirements.

3.25 That said, there are still serious weaknesses in the financial system, and improvements are required in a range of areas. Currency usage remains lower than might be expected owing to the continued shortage of larger denomination notes, albeit a problem that the SBV is in the process of resolving. The check clearance and interbank settlement systems remain inadequate to the needs of a modern financial system, and the level of human capital in the financial system, though somewhat improved by the establishment of foreign and joint venture banks, sorely needs further development. Most importantly, much of the banking sector remains in state hands, two-thirds of outstanding credit is to state enterprises, and government at different levels still interferes in the allocation process. Even if all loans on the state-owned commercial banks' balance sheets were performing, levels of capital in these banks would be generally inadequate. Bad and doubtful loans appear to be low in relation to other

transition economies, but still exceed capital in most if not all of the state-owned commercial banks (SOCBs). Moreover, the usage of a variety of modern techniques and management processes to understand and deal with the many risks confronting banks are rarely used today in Viet Nam.

3.26 This part of the chapter will review recent developments in the banking sector, highlighting the most pressing areas for reform. No attempt will be made to review thoroughly all aspects of finance, in view of the forthcoming financial sector review of Viet Nam. Rather, this section will review very recent developments in finance, taxation of commercial banks, and concerns about the safety and soundness of the financial sector. In order to achieve the government's stated objective of encouraging a more dynamic financial sector, a lessening of financial sector taxation, upgrading of the payments system, encouragement through tax deductibility of provisioning for bad and doubtful debts, and the undertaking of audits and risk asset reviews for the SOCBs are recommended. Although these measures are by no means free, the gains in seignorage associated with a deepening of the financial system and the savings in misallocated resources are likely to be greater than any short-run costs.

Recent Financial Sector Developments

3.27 The financial system's tasks during the transition are to raise and efficiently allocate resources, to make payments, to help finance the emerging private sector, to help insert a hard budget constraint on state enterprises, and to perform a corporate governance function, both in the public and private sectors. In Viet Nam banks are far and away the dominant force in finance, so this section will review banking sector developments related to these points. While a nonbanking sector is beginning to emerge, information markets – in particular accounting and auditing – and contract enforcement mechanisms have not developed to the point needed for arms-length, nonbank finance. Hence it is expected that relationship banking will continue to dominate the financial sector for the remainder of the decade.[2/]

3.28 Despite the reduction of inflation, overall monetary depth as measured by the ratio of M2/GDP declined slightly from 1992 to 1993, but has increased from the very low levels of the late 1980s. As seen in Figure 3.1, Viet Nam has avoided the disintermediation seen in those transition economies that have not had the same success in lowering inflation, such as Russia and Romania. Also, as noted in Chapter 1, the relatively flat profile of M2 in the 1990s masks an increase of dong M2, reflecting the public's increased confidence in the government's macro policies. Moreover, as a result of the government's program to sell treasury bills in small denominations to the public, a part of what might have been savings in the banking sector instead was held in this form. Thus M3, including both T-bills and gold certificates, reached 29% of GDP at the end of 1993, which is well above the average for low-income countries.[3/] However, it is also clear that financial depth has not increased as much

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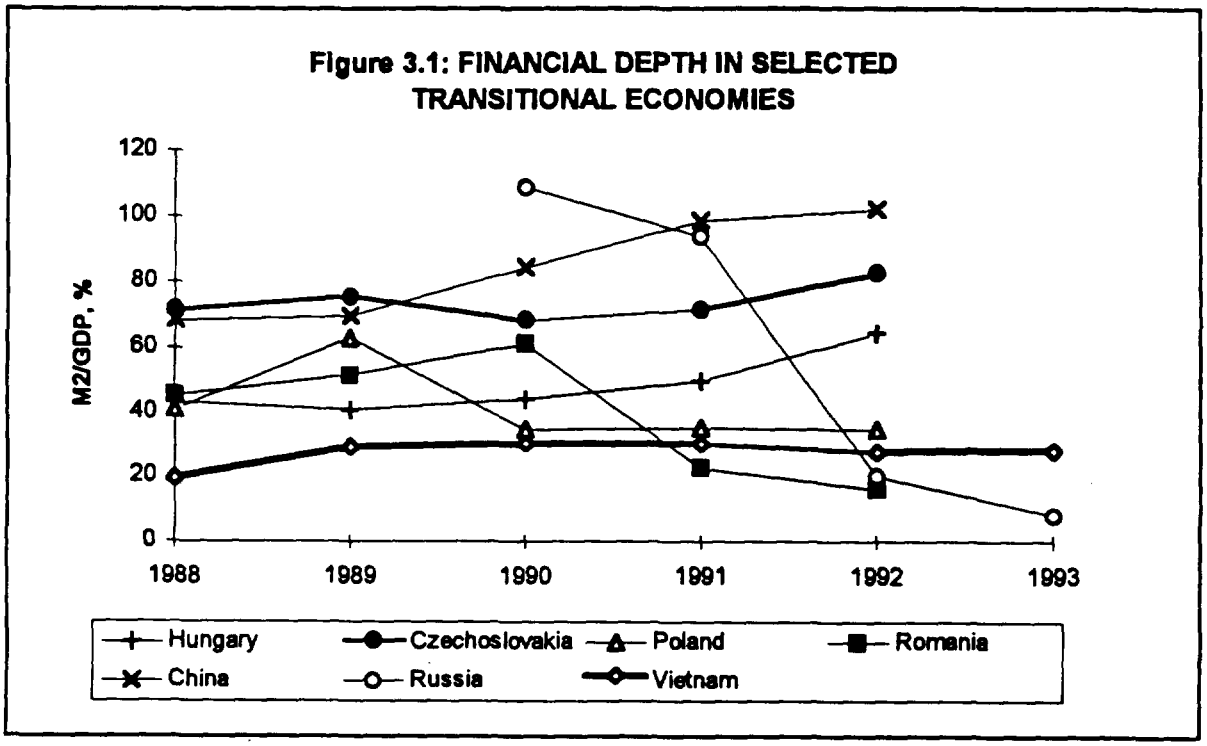
2/ This does not imply that, for example, efforts to develop equity markets are of no avail, but rather that the contributions of such markets likely will be limited and mostly indirect. For example, the development of equities will increase the demand for audited financial statements, and this increase in information will benefit banks and other segments of the economy.

3/ Since T-bills are tradable and reportedly being used in transactions, they actually could be included in M2. According to the 1989 World Development Report, the average M3/GDP figure for countries with less than US$450 per capita GNP was about 25%; the average M2 level likely was several percentage points less.

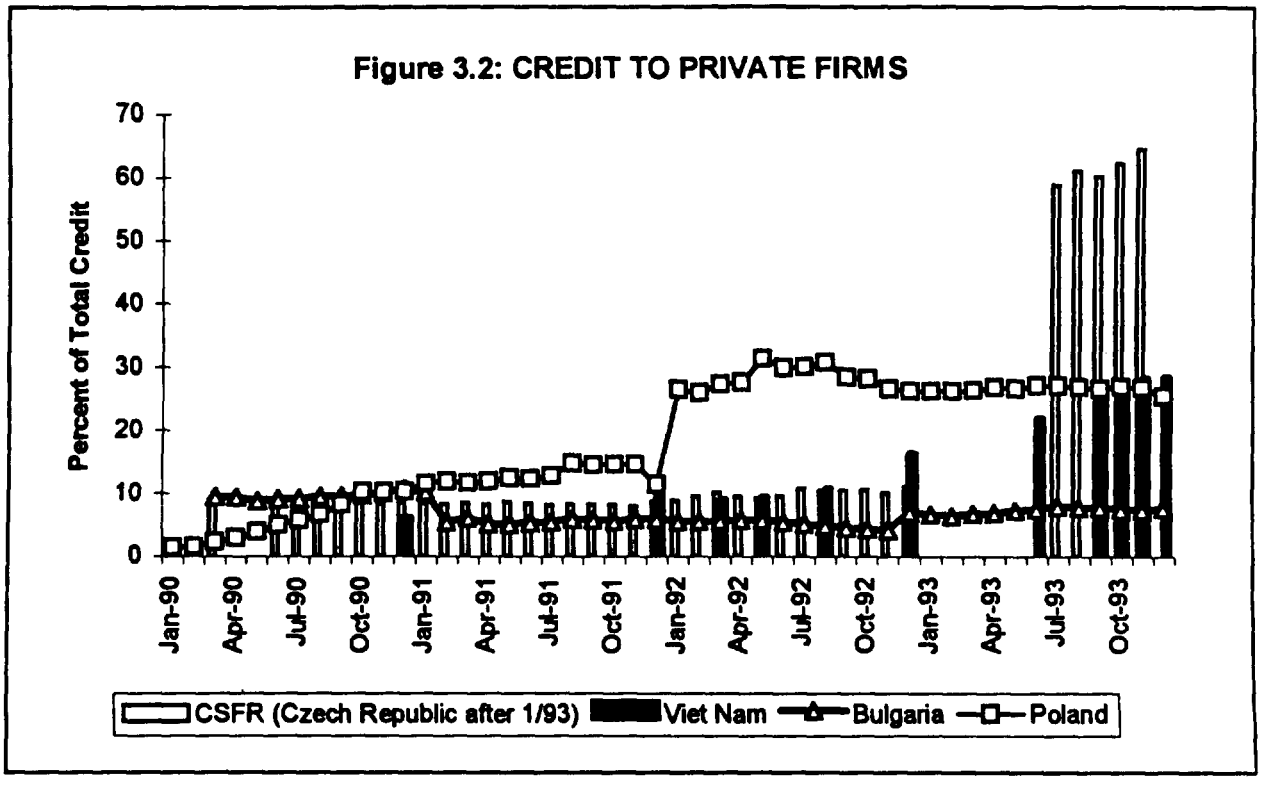
as might have been hoped given the impressive and sustained reduction in inflation; the high level of financial sector taxation (discussed below) likely was a prime factor in the sluggishness of financial deepening. Also, the practice of making currency available in limited amounts likely retarded its usage, at least until the end of 1993 when this policy appears to have ended. The government began to make available larger denomination notes in the first half of 1994, which should further boost the demand for dong.[4/]



3.29 The number of institutions in the banking sector has grown significantly. From 35 banks at the end of 1992, the total had risen to 60 by early 1994. The four SOCBs accounted for most of the deposits and 90% of total credit outstanding at the end of 1993, compared with 97% at the end of 1990. Foreign banks have been welcomed. Moreover, a number of foreign institutions have opened joint venture banks, both with the state banks as well as with private residents. These institutions are training local staff, making an important contribution to Viet Nam's longer term financial development. Sensing that the market might be getting crowded, both relative to profitable opportunities as well as in comparison to the authorities' ability to supervise, a temporary freeze on entry was introduced early in 1994.

4/ Gold and dollars continue to be used for many large transactions, in part because dong notes above the equivalent of US$1 are scarce. Also, the T-bills being sold to the public are available in large denominations and are tradable, so residents apparently are beginning to use these instruments for payments.

3.30 Notwithstanding the continued domination in deposit taking and lending by the state-owned banks, the banking system has responded rapidly to the demands of the growing private sector. As shown in Figure 3.2, Viet Nam ranks relatively high in furnishing credit to the private sector, especially as it began the transition process in earnest somewhat after the countries of Eastern Europe. In flow terms, credit to the private sector last year soared 178%,[5/] compared with a 24.7% increase to state enterprises. In part the government deserves some credit for the rapid response of the banks, as it established an informal target for credit to the private sector of 30% of total credit (in stock terms) in 1993 (and 40% in 1994). More importantly, authorities already had convinced the state banks of the need to lend for viable projects, so it is likely that much of this increase would have taken place without the target.



3.31 Owing to the absence of surveys, it is difficult to ascertain the extent to which banks are enforcing a hard budget constraint, especially on public enterprises. The above evidence on credit growth to public and private firms provides some indirect support for the banks' claims that they only lend to firms, public or private, that can repay, though it does not address whether good or bad firms are receiving credit. The likelihood that bankers are being tougher in Viet Nam is strengthened by the debt recovery process, described below, which is putting pressure on state enterprises to repay bad debts which existed prior to April 1992. This process, which has included the liquidation of numerous firms, might

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5/ Note that as is the case in most transitional economies, the definition of the private sector is somewhat vague, including both cooperatives but also some joint ventures between SOEs and foreign firms.

be expected to introduce some discipline into lending decisions. Bankers report few arrears on loans made subsequent to that date, suggesting a relatively hard budget constraint is in place, though local definitions of arrears vary from bank to bank, and perhaps among branches of the same bank. Also, the maintenance of positive real interest rates appears to be a significant ingredient in convincing firms that a reform program is credible and will not include bailouts. In sum, there are signs that budget constraints have hardened in Viet Nam. Lastly, evidence on corporate governance is scarcer still. Vietnamese banks appear to have been concentrating efforts on reforming their internal operations and making sound credit decisions rather than on exerting a corporate governance role for their clients. As the banks get their basic business processes in place, they appear determined to become more active in the decisions of their clients.

Taxation of Financial Intermediation

3.32 The level of financial sector taxation continues to be a problem that both is retarding the development of the financial sector in Viet Nam and reducing its safety and soundness. Three main types of taxes are imposed on banks: reserve requirements, the turnover tax, and the profits tax. In 1992 and most of 1993, banks were required to maintain 10% of deposits in a blocked account at the SBV, meaning that it not only could not be used for settlement, but also in effect that reserves had to be constituted each day. In March 1994 this system changed, as the central bank began to allow banks to average both for the purpose of constituting and maintaining reserves, and also changed the composition of reserves. Previously, reserves had to be held as deposits at the SBV. Now banks are required to hold at least 55% of minimum required reserves as deposits at the SBV, but can hold up to 15% as T-bills and up to 30% as vault cash. Instead of a uniform 10% reserve requirement, the authorities opted for a 13% ratio on sight deposits and 7% on time deposits.[9]

3.33 The SBV also reportedly has eased the moral suasion, applied in force in 1992, that banks hold an additional 20% of deposits for the purposes of settlement on deposit at SBV branches, and, as noted in Chapter 1, there are some signs that the banks have reduced these holdings. Still, given the sluggish payments system, underdeveloped money markets, and the artificial separation of reserve accounts -- one for required reserves, held at SBV headquarters, another for settlement held in the SBV branches -- banks are forced to tie up 10-15% of deposits to make settlements, whereas in developed economies they hold as little as 0.5% for such purposes.

3.34 This form of taxation is in addition to a turnover tax, applied to the gross interest margin (interest received less interest paid, without any deduction of operating expenses), of 15% to 30%, except for the Agriculture Bank, which pays a modest 2%. Viet Nam thus is one of the few countries not to exempt the banking system from such a burden. Exemption is the rule -- not just for turnover, but for

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[9] This might later complicate monetary control, as in Italy and other countries, as attempts to tighten can be offset by attracting more term assets. See Caprio and Honohan, Monetary Policy Instruments in Developing Countries, The World Bank, 1991.

sales and value added taxes as well -- because it is understood that the tax either will be passed on to borrowers and depositors, where interest rates can be determined by the banks, or will impose an added burden on banks and hence limit formal sector financial intermediation.

3.35 In Viet Nam, the combination of reserve requirements, turnover taxes, and profits taxes have combined to make it unprofitable to intermediate. Table 3.1 shows the profit from raising an additional 10,000 dong of deposits given interest rates in effect in April 1994 and assuming that the marginal operating costs of doing so are 4% of deposits mobilized.[7] In 1992, effectively 30% of deposits were immobilized in reserve accounts, while it is assumed that from April 1994 the banks hold reserves of only 20% -- 10% as required reserves and another 10% for settlement purposes. Thus in 1992 the intermediation margin was negative and presently it is estimated to be scarcely positive. For some banks, such as the Vietcombank, the turnover tax is higher -- double that assumed here -- so that profit from intermediation would again be negative. In view of the government's stated intent to make the banking sector more dynamic, the high level of financial sector taxation should be reduced. While a reexamination of the entire tax system may be appropriate -- most countries find it preferable to keep corporate taxes uniform across industries and at levels below 50% -- in the meantime exempting the banking system from turnover taxes would in this example double the profits from intermediation. Merging the two reserve accounts at the SBV and allowing the resultant account to be used for settlement would further slash the high taxes on banking and thus contribute to deposit mobilization.[8] With these changes and the maintenance of low inflation rates, an increase in financial depth and in the government's revenue from seignorage can be expected.

3.36 Finally, it should be noted that whereas the principal reason for exempting the banking sector from turnover taxes is to encourage the overall banking system, it would also create a more level playing field for new private banks, foreign banks, and the large SOCBs. At present, in calculating the base for the turnover tax, banks are allowed to deduct from their interest income only interest expenses on liabilities. However, new banks, including those from abroad, are mainly funded by equity, and might be expected to enter more slowly -- if at all -- the deposit market. Since these banks are not allowed to deduct any actual or imputed return on equity, they are automatically taxed at a very high rate. Indeed, it is straightforward to show that, in the above example, the net profit would be sharply negative today if a bank paid shareholders at the rate local banks are rewarding depositors. This distinctly uneven playing field will retard financial sector development unless it is changed.

7/ Low income countries usually have average operating costs of 4%-6% of assets, and it seemed reasonable to assume that marginal and average costs were equal to 4%.

8/ Concerns that banks would not meet their required holdings of reserves in the new arrangement could be met by using close of business balances for the computation of maintained reserves.

Table 3.1: TAXATION OF BANK INTERMEDIATION

	Post 4/1/94	1992
Annual interest income on 10000 dong	2832.43	3137.34
Less interest expense	2269.49	3202.82
Plus interest on excess reserves	15.08	104.57
Equals gross margin	578.02	39.10
Less turnover tax, 15%	86.70	2.35
Equals pre-tax interest margin	491.32	36.75
Less operating expenses	400.00	400.00
Less profits tax	45.66	0.00
Equals after-tax profit	45.66	-363.25

Safety and Soundness

3.37 Bankers in Viet Nam emphasize their independence in making credit decisions, except at the development bank, as well as their prudence in lending. However, there is so little verifiable information that it is difficult to take comfort in this assertion. In general the SOCBs do not employ any loan classification schemes, and it is unclear how they plan for the risks they face. Estimates of nonperforming loans consequently do not have as firm as basis as in other countries.

3.38 To be sure, Viet Nam was fortunate to have less government intervention, relative to other transitional economies, in credit decisions prior to the onset of the transition process, and in part as a result of a less industrial economy has a much smaller share of nonperforming loans to inefficient state enterprises in relation to GDP. Moreover, the Debt Resolution Committee and the Liquidation Committee have made progress in resolving the "old" debt problem -- for loans up to April 30, 1992 -- and have merged or closed about 1000 inefficient enterprises and auctioned off their assets. Creditors are allowed either to use the land of the defunct debtors or have the government find other tenants and pay the land use fee to the creditor. Where assets are insufficient to cover debts, the liability for the difference has been passed on to the Finance Ministry, though it is not clear at present how the government will deal with the problem. Liquidated state enterprises had approximately 1.7 trillion dong of net debts, of which 700 billion was to the state banks and another 900 billion was in the form of interfirm arrears to still open state enterprises. The latter owe the state banks 535 billion dong, and the total of nonperforming loans in the state banks from all sources was estimated at just less than 2 trillion dong up to April 30, 1992.

3.39 This estimate of the nonperforming loan portfolio assumes that all subsequent loans were good, a result that even in a sound macroeconomic environment is not likely. Efforts are underway to minimize bad loans. The SBV has put great efforts into developing its surveillance capacity, mainly

through an off-site supervisory system. However, since its on-site supervisory capacity is limited, the accuracy of this system is difficult to ascertain. Although some technical assistance has been received from the International Monetary Fund, the needs are great and additional technical assistance will be required.

3.40 Another mechanism to limit bad loans to state enterprises is the Finance Ministry's pressure on state-owned firms, as part of the government's ownership function. The new bankruptcy law will help with loan recovery, and short of this procedure, the MOF has issued instructions on financial management and rules of payment, in an attempt to prohibit arrears from arising. Non-creditworthy firms are instructed to pay cash, a ruling designed to prevent interfirm arrears in particular.

3.41 Whatever the bottom line on nonperforming loans, two characterizations are clear: first, loan losses will be much greater than the meager level of capital in the SOCBs, and second, these losses will be a small fraction of what has been seen in Eastern Europe and the former Soviet Union countries. It is of overwhelming importance that the government begin audits and portfolio reviews, as this process will not only help narrow down the range of estimates on loan losses but also provide technical assistance to banks, including for the establishment of loan classification systems. Moreover, the review will help the government address the longer term issue of what to do with the state banks, specifically clarifying which to recapitalize and which to close down. The government wants to keep all of the state-owned commercial banks open, but the wisdom of such a decision will only become clear after a closer look is taken at how these institutions operate and at the condition of their balance sheets.

Summary of Financial Sector Recommendations

3.42 The Vietnamese financial system has performed well given the limitations it has confronted. Its greatest needs, in addition to the measures to support monetary control (Chapter 1) at present are

- larger denomination currency notes and an improvement of the payments system to encourage greater usage of dong and dong-denominated deposits;
- an exemption of banking from the turnover tax and a lessening of the burden of holding excess reserves at the SBV to encourage expansion of banks; and
- audits and risk asset reviews of the state-owned commercial banks and a strengthening of the bank supervisory function to instill greater confidence in the banking system.

If these measures are adopted, Viet Nam can expect an increase in financial depth. With a large volume of resources flowing into the formal financial sector in the next few years, the emphasis of external donors should be on large-scale technical assistance to ensure that these resources will be productively invested, along with a strengthening of the regulatory environment. Special lines of credit would be unwarranted in view of the expected ample availability of domestic (and foreign) resources. Unless specific imperfections can be identified and a credible case can be made regarding the likelihood that such lines of credit would lessen them, it would be sensible to direct policies at the causes of the imperfections, such as inadequacies in the legal framework and the dearth of qualified auditors and accountants, and of accounting standards.

C. Foreign Trade Policy

3.43 International trade, for many developing countries, has been a major vehicle for expanding national output, employment and productivity. Export opportunities provide a lucrative incentive for enterprises to increase their output and to offer additional employment. The standards of quality and cost that must be achieved to be successful in international trade are an important stimulus to increased productivity. The end result of this increased employment and productivity, plus the price and cost discipline that international competition spurs among enterprises that produce for the domestic market, is an improved standard of living.

3.44 The trade policy reforms that Viet Nam has introduced have been, on the whole, well conceived and effective in providing an attractive environment for export-oriented enterprises. Exchange rate unification and devaluation in 1989 were key reforms. The government, since these reforms, has maintained a relatively stable real exchange rate (Chapter 1) and has permitted both Vietnamese citizens and foreigners to hold and to make purchases and sales in foreign currencies. The absence of exchange controls has been an important stimulus to the expansion of trade.

3.45 As noted in the World Bank's last economic report, through the mid-1980s Viet Nam's trade was primarily with CMEA countries. The dissolution of the Soviet Union and of the CMEA system brought to Viet Nam the necessity to redirect its trade to the market economies. At the time of the collapse of the CMEA system, two-thirds of Viet Nam's exports were basic commodities, and these could be redirected to international markets. But Viet Nam's manufactured exports to CMEA countries were low-quality products not easily marketed elsewhere. Manufactured goods still make up only about 20% of Viet Nam's total exports, but, as Table 3.2 documents, light manufactures have been the most rapidly expanding part of Viet Nam's exports. (About four-fifths of exports of light manufactures, estimates indicate, are garments.) From 1990 through 1993, the US dollar value of Viet Nam's exports of light manufactures and handicrafts grew by 160% per year, total exports by 32% per year. The government is concerned to further expand and to diversify these manufactured exports in the near future.

3.46 Available tabulations of Viet Nam's imports do not provide as clear a picture of what is imported. In 1993 imports of capital goods accounted for 15% of the value of imports (Appendix Table 3.3). Other major imports are refined petroleum products and intermediate inputs (especially fertilizer, steel, fabric, and cement). However, more than half of imports are classified in an "other" category, making it difficult to analyze the pattern of Viet Nam's trade.

Policies to Support Exporting

3.47 The government of Viet Nam has implemented important policy steps that are making Viet Nam an attractive location for export oriented enterprises. Duty drawback and duty exemption systems for inputs used to produce for export have been introduced. The duty exemption system was improved in 1994 so that an exporting firm need pay no import duty on imported inputs, provided that they are processed for export within three months. Field visits to exporting firms revealed that the system works well in practice.

Table 3.2: US DOLLAR VALUE OF VIETNAMESE EXPORTS TO CONVERTIBLE CURRENCY AREAS: SHARE AND GROWTH RATE OF SELECTED PRODUCTS

Product	Share 1993	Growth 1990-93
	(%)	(% annual rates)
All merchandise	100	32
Rice	12	8
Petroleum	29	29
Coal	2	23
Rubber	2	62
Coffee	4	61
Marine products	13	20
Agr. and forestry products	17	34
Light industrial goods and handicrafts	12	160
Other	9	52

Source: Ministry of Trade.

3.48 **Export processing zones.** The Vietnamese government has approved the construction of five export processing zones. As of April 1994, eight licenses had been granted for building factories in these zones. These licenses constitute a small fraction of the total of more than 800 licenses given for foreign investments in Viet Nam, these 800 licenses having a total registered capital of US$7.5 billion. Under regulations issued in October 1991 and amended in December 1992, export processing zones offer free trade conditions and a liberal regulatory environment to enterprises that locate within them. Fiscal incentives include a four-year tax holiday starting with the first profit-making year and a 10% tax on net profit thereafter, compared with the normal two-year tax holiday with an income tax rate of 15% to 25%.

3.49 The export processing zones also intend to provide expedited access to licensing and to other approval and regulatory processes. For example, the government of Ho Chi Minh City has created a management board to oversee the two export processing zones located in the city and to provide one agency through which investors may complete all the arrangements for a project, from application for an investment license through approval of factory design, issuance of permits for construction and for utilities hook-ups, and importation of machinery and equipment.

3.50 Export processing zones are in principle attractive because they will provide foreign exchange earnings, employment, backward linkage to local suppliers of inputs that initially will be imported, and transfer of technology through the skills learned by local workers employed in the zones. Export processing zones in other countries, however, have met with limited success. In other Asian

countries, export processing zones have generated minimal backward linkages. "Indirect exports" have evolved only as equal-footing policies have been extended throughout the economy.[9]

3.51 **Export permits and taxes.** The trading system in place in Viet Nam in the late 1980s provided four levels of control of exports:

(a) To engage in international trade, an enterprise had to have a government granted certificate to trade internationally.

(b) Discretionary exports permits were issued to enterprises holding such certificates. These permits specified quantities of a specific product that could be exported during a specified period of time.

(c) Each particular shipment required an export license, used primarily for record-keeping purposes -- to keep track of what had been exported.

(d) Some products were subject to export taxes or export quotas.

3.52 Year-by-year, the granting to enterprises of certificates -- the authority to export and to import -- has been liberalized. Previously, to be granted the authority to export and to import, an enterprise had to satisfy certain criteria, including a minimum size of invested capital and a minimum annual production. Under present policy, any enterprise with prospects for receiving an export order is granted the authority to export the products it produces, and likewise to import inputs that are needed for export production.

3.53 Similarly, export permit and shipment licensing requirements have been lifted for all items except oil, rice, and wood products. As of April 1994 no products were subject to export quota and, except on raw materials, export taxes have been eliminated or reduced to minimal levels. Manufactured goods carry no export duty, and rates on processed materials are generally lower than those on materials in crude form.

Policies Affecting Imports

3.54 Besides the customs tariff, there are three levels of control of goods imported into Viet Nam, "certificates," "permits," and "licenses."

3.55 **Certificates.** Before an enterprise can export or import, it must apply for and receive a certificate to engage in international trade -- a certification by the government that the enterprise is competent to do so. (Applications for trade certificates from enterprises not owned by the central government must first receive the approval of the local People's Committee.) These certificates are for

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[9] The successes and failures of export processing zones are reviewed in World Bank, Export Processing Zones, Policy and Research Series No. 20, Industry and Energy Department and Country Economics Department.

an indefinite length, the expectation being that if the enterprise is effective, it will continue to hold its certificate.

3.56 Before 1987 the foreign trade of Viet Nam was dominated by some 28 state-designated trading monopolies. Entry into the import-export business is still tightly controlled, and the export-import business is dominated by publicly owned companies. To receive a certificate as an export-import trading company, the company must have a certified working capital of at least US$200,000 and a minimum level of annual turnover, though smaller capitalization is accepted in certain regions. The certificate specifies the products in which the company is allowed to trade, but the government has not attempted to limit trade in each product to only one company. For example, while some 60% of imports of fertilizer are by a single, state-owned company, the remaining 40% is imported by 30 or more other companies.

3.57 As part of the government's program to boost exports, requirements for producing (as opposed to strictly trading) companies to obtain an import-export certificate have been significantly relaxed. At present, any enterprise, public or private, with reasonable prospects for exporting may obtain a certificate to export its output and to import inputs necessary for production. The capital and turnover requirements imposed on trading companies are not applied to such producing companies. Another liberalization is that the granting of a foreign investment or joint venture license is often accompanied by the granting of a certificate to export and to import. As a result of this liberalization, the number of firms certified to import and export has increased to more than 1,000, about 15% of which are private enterprises.

3.58 **Permits**. Until recently, permits were used to control virtually all imports into Viet Nam. An important reform in 1994 was the elimination of the requirement for a permit for all but 15 products (including refined petroleum, fertilizer, cement, and some consumer items such as refrigerators). For these items, the Ministry of Trade determines before the year begins the amount of imports that the economy will need. Import permits are then granted in accordance with these planned amounts. The planned amount carries the sense of an indicative amount, and might be changed if the ministry's assessment of market conditions changed. There are regular, monthly meetings to discuss the plan, in which permitted amounts might be changed. There could be ad hoc meetings in between, if the ministry judged it necessary.

3.59 **Import licenses**. The import license system is basically a record-keeping mechanism. A shipment-specific license is routinely granted if the appropriate permit is in order. The license is applied for after the goods are shipped, sometimes after they arrive in Viet Nam.

3.60 **Tariff code**. The current Vietnamese tariff is based on the tariff and revenue law passed by the National Assembly in 1991. This law was substantially amended in July 1993, the changes being, in the main, to add provisions for other than normal importation; e.g., for the treatment of goods in transit to another country, and for imports for humanitarian relief, for exhibitions, or for display in advertising or other sales efforts. For many goods, the law indicates an acceptable range for the tariff rate.

3.61 Until 1994, implementation of the tariff law was the responsibility of the Ministry of Finance. That ministry developed the decrees that established the actual rates. Beginning in 1994, the Ministry of Trade has responsibility to initiate changes of the tariff. These proposed changes are then taken to the Ministry of Finance for consultation; when the Trade and Finance Ministries agree to a

change, the Finance Ministry proposes the change to the government. If the government approves, tariff rate changes are enacted by signature of the Prime Minister, provided that they are within the ranges specified in the law.[10]

3.62 The government holds quarterly meetings to review all revenue sources, and at these meetings proposed changes of tariff rates are considered. Various considerations influence the decision to change a tariff rate, the general objective of import policy -- of the determination of tariff rates and of the issuance of import permits -- being to establish a balance among imports, domestic supply, and the country's needs. Government officials, on the one hand, seek to establish rates low enough so that importers may earn an appropriate profit; on the other hand, they recognize that another objective of tariff administration is to determine rates that are high enough to protect domestic producers. Also, a governmental decree issued on January 15, 1994, states that tariff management should encourage exports.

3.63 In this regard, government officials see the day-to-day monitoring of the Vietnamese market as a major input into the determination of appropriate tariff rates. In their view, timely revisions are needed, otherwise the purpose of the tariff -- to establish a balance among imports, domestic supply and national demand -- is defeated.

3.64 The end result is a tariff code that is complex, containing at least 20 different rates that range from 0% to 200%. The average rate (unweighted, as of January 1993) was about 11.9%, and almost four-fifths of all tariff lines carried rates of 20% or lower. Rates on consumer goods tend to be among the highest rates. Rates on processed food products are in the range of 25% to 45%, rates on clothing in the range of 50% to 100%. In August 1993, the rate on passenger cars and small motor-bicycles was increased from 60% to 150%.

3.65 The process of rate adjustments discussed above allows for quarterly changes of tariff rates, and changes are frequently made. For example, on August 15, 1993, some 500 new rates were put into effect. Of these new rates, only 50 were lower than the rates they replaced. The other changes were increases of various sorts: (a) across-the-board increases for some categories of products, (b) additional tariff escalation by introduction of proportionally higher rates on more highly processed products, and (c) additional dispersion of rates for similar products.

3.66 The rates reported in Table 3.3 illustrate changes of the first sort -- higher rates to replace lower ones. Many of the changes not only increased rates, they increased the degree of tariff escalation (with degree of processing) as well. For example, rates on both refined and non-refined vegetables oils had been 7%; after August 15, 1993, the rate on non-refined vegetable oils became 5%, the rate on refined oil, 25%.

3.67 Tariff escalation is further illustrated by the rates reported in Table 3.4. The tariff rate on a fully assembled car or motorcycle is 150%, but the more the imported kit of car or motorcycle parts leaves for domestic assembly, the lower is the duty rate on imported parts. At the extreme, if some domestic materials are used, the remaining parts are dutiable at only 5%. Rates on many electronic

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[10] Interested groups, both producers who compete with imports and importers, have the right to address the appropriate governmental authorities to propose changes and to comment on proposed changes of tariff rates.

products (television receivers, phonographs, radios, sound amplifiers, etc.) are similarly escalated, from 3% to 50%, the lowest rate applying if some domestic components are used.

3.68 In other instances, additional dispersion (some high rates, some low) was added to the tariff, but the rates do not appear to be correlated with degree of processing. For example, flat-rolled steel products carry a duty rate of 15%, but zinc-coated flat-rolled steel products carry a zero rate. Generally speaking, rates on steel products vary widely: the tariff rate on some gauges of construction rods is 20%, other gauges enter duty-free. Likewise for different sizes of various bars and shapes.

Table 3.3: TARIFF RATE INCREASES – AUGUST 15, 1993: SELECTED PRODUCTS

Product	Range of tariff rates (percentage, ad valorem)	
	Before	After
Fruits and melons	20-25	30-35
Meat and fisheries products	20-30	35-45
Alcoholic and nonalcoholic beverages	70-100	80-150
Clothing	40	50
Used clothing	70	100
Fabrics	20-30	35-45
Hides and skins	1	5
Electrical batteries	0-20	20-30
Metal ores and concentrates	0	1-5

Source: Viet Nam Trade Information Centre, Export and Import Tariff for Commercial Goods, (Hanoi, 1993).

Recommendation for Trade Reform

3.69 To succeed in international markets, an enterprise must meet world standards for quality and productivity. Jobs in exporting sectors will thus be high productivity, well-paying jobs, that contribute to a higher standard of living for the Vietnamese people. Vietnamese trade policy is very receptive to the needs of exporting enterprises. The duty drawback-exemption system for inputs incorporated into exported goods is designed to give Vietnamese exporters access to inputs of world-class quality at international prices – to put them on an equal footing with producers outside of Viet Nam in competing for export markets. As noted above, these policies have been well conceived and are being well executed.

3.70 But no more than one in five Vietnamese workers is employed in producing for export. Improving the standard of living of the other four-fifths of Viet Nam's workers will depend on improving productivity in those sectors of the economy that produce for domestic consumption. For workers employed in these sectors, the discipline spurred by import competition can likewise be an important source of productivity growth and higher incomes. In this regard, the pattern of tariff rates, especially the pattern of recent changes, is disturbing. This pattern suggests accommodation to domestic pressures for protection rather than to a well-conceived and rigorously implemented view of where Viet Nam's comparative advantage lies.

Table 3.4: TARIFF RATES ON IMPORTS OF SMALL PASSENGER CARS AND MOTORCYCLES

(as of April 1, 1993)

Category	Ad valorem rate
Completely assembled	150
Semi knocked down	120
Completely knocked down, form 1	40
Completely knocked down, form 2	30
Incomplete kits, using some domestic parts	5

Source: Viet Nam Trade Information Centre, Export and Import Tariff for Commercial Goods, (Hanoi, 1993) p. 309.

3.71 Attempting to maintain high rates of protection can lead to several sorts of inefficiencies and losses. For one, high rates, particularly high rates on popular consumer goods such as motorcycles and refrigerators, will lead to smuggling. Viet Nam has very long land and sea borders and the underdeveloped state of Viet Nam's transportation system means that there is little cost to importing through out-of-the-way entrance points rather than through major transportation arteries. At the present level of per capita income in Viet Nam, the duty on the television receivers a person can transport with a hand cart or bicycle is equal to several months' pay, hence a high duty will be a strong incentive for small-scale smuggling that will, in aggregate, seriously erode tariff revenues.

3.72 High rates of protection, particularly highly escalated rates, are an incentive against improved productivity. Take, for example the duty rates reported in Table 3.4. Suppose the motorcycle to which these rates applied sold in international markets for US$500, and that the entire kit of parts for the motorcycle sold for US$400. Suppose also that to qualify for the lowest rate on imported parts, the assembler incorporated a Vietnamese-made part, say, the muffler, that has a value at international prices

of US$50. How efficient at assembling the motorcycle and at producing mufflers would the Vietnamese assembler have to be in order to sell in the Vietnamese market in competition with imports?

3.73 A motorcycle, if imported would carry a duty of 150% and hence would sell in Viet Nam for US$1250. The incomplete kit of parts (everything but the muffler) can be imported for US$367.50 - - US$350 plus 5% customs duty. The Vietnamese assembler – muffler manufacturer will collect a markup of US$882.50, the difference between the price of an imported motorcycle and his US$367.50 outlay for imported parts.[11/] A producer outside of Viet Nam, one who bought and sold at international prices, would receive a markup of only US$150 for producing the muffler and assembling the vehicle. The ratio of US$882.50 to US$150 is 5.88, i.e., the Vietnamese producer need be only one-sixth as efficient as an international producer to profitably compete in the protected Vietnamese market. An escalated tariff structure thus is not an incentive to develop world-class domestic production, it is an incentive to remain inefficient. If industries that produce for the domestic market are to generate per capita earnings comparable to those earned in export industries, they must likewise approach international standards of efficiency.

3.74 The information above on the relative inefficiency that import restrictions protect can be viewed from another perspective, a perspective that helps one to judge when export promotion and import substitution are appropriately balanced in a development program. The logic of economics suggests that resources will be best used when export promotion and import substitution are each carried to the point at which the last unit of domestic resources yields the same return; i.e., when the cost to the Vietnamese economy to save a dollar of foreign exchange by not importing vehicle assembly and mufflers is the same as the cost to earn a dollar by exporting, say, garments. Garment production in Viet Nam is on a free-trade footing, i.e., imported inputs for export production are duty-free, and there is no export tax on the garments. Thus, in the example above the resources that would earn US$1.00 in the production of garments would, if used to assemble autos and produce mufflers, save the Vietnamese economy only 1/5.88 of US$1.00, about 17 cents.

3.75 The lesson of this exercise is that the present system of determining tariff rates and other import restrictions is not leading producers to the appropriate choices. Differentiated rates imply that the resource cost of saving a dollar of foreign exchange by producing more (importing less) of one product is not equal to the resource cost of saving a dollar by producing more of another – an obvious misallocation of resources. Likewise, high rates of protection imply that the resource cost of saving a dollar of foreign exchange in import-competing industries is considerably higher that the resource cost of earning a dollar in export industries – another indication of misallocated resources.

11/ The incentives implicit in the schedule suggest that the mufflers might not even be produced in Viet Nam. The escalated tariff has made them a very high value item, and smuggling in mufflers might be the best alternative for the assembler. Another possibility is that the assembler will import the mufflers legally, as spares. Even if spares are dutied at the rate on finished motorcycles, 150%, the assembler's cost for a complete kit of parts would be US$492.50; US$350 of inputs dutiable at 5% plus US$50 (the muffler) dutiable at 150%. That is less than the US$520 that a completely knocked down kit, form 2, would cost, i.e., less than US$400 plus 30% duty.

3.76 As prelude to a complete revision of the tariff, the Vietnamese government should complete an analysis of the effective protection rates implicit in the present tariff. Such an analysis would provide a clearer picture of the true cost of saving or of earning foreign exchange in various activities. Even before such a study is completed, however, the government could take a first step toward tariff reform by immediately reducing the number of rates, for example to 4-6 rates, and lowering the highest rate from 200% to the 50-60% range. The longer term objective should be to reduce the number of rates further and to set the highest rate in the 20-30% range. As noted, a good study of effective protection could help the government attain this longer term goal.

3.77 In summary, the present system of import regulation reflects a philosophy of central control of the economy. The government's objective should be to move away from a system in which the government regulates imports with a view to filling in on a short-term basis between the economy's "needs" and the output that the present pattern of resource allocation happens to deliver. The longer-term objective should be to create a policy and institutional environment in which decentralized market decisions will lead to an efficient allocation of Viet Nam's resources, with the pattern of exports and imports being a byproduct of those decisions.

3.78 Another objective over the longer term should be to provide a more stable as well as a more liberal trading environment. Exporter and importer confidence in the stability of trade policy could be enhanced by reducing the number of trade policy instruments. Improved customs administration and data collection processes should eliminate the need for import licenses, which are used largely for record-keeping.

3.79 The government should also plan to eliminate the import permits for the remaining 15 items for which they are required. The government is using these permits to meet objectives that could be better pursued through other instruments. In the case of key inputs such as fertilizer and cement, the permits are used flexibly with the objective of ensuring adequate supplies to the economy. It is recommended that these permits be replaced with a system of monitoring inflows and publishing timely information, so that trading companies can respond quickly and efficiently to incipient shortages. For consumer items such as refrigerators, the import permits are used to control consumption. It is recommended that these permits be replaced by special excise taxes. An import barrier is the wrong instrument here, as it encourages inefficient production.

D. Foreign Investment Regime

3.80 With the enactment in December 1987 of a foreign investment law, which was amended in June 1990 and December 1992, Viet Nam has given itself a rather liberal and generous regime for foreign investment in the country. This new regime, which is a core part of the government's overall economic reform and liberalization program, has met significant success. Overall commitments in foreign invested projects have jumped from US$366 million in 1988 (the first full year after enactment of the law) to US$2,777 million in 1993, which amounts to an average annual growth rate of 50%. All foreign

investment in Viet Nam to date has been foreign direct investment, as portfolio investment is not yet allowed.[12]

3.81 The law authorizes three main forms of foreign investment, namely joint ventures (JVs), 100% foreign owned enterprises, and business cooperation contracts (i.e. investments that do not entail the establishment of a new corporate entity); amendments to the law have introduced additional special regimes for BOT projects (para. 3.108) and export processing zones. A different package of incentives is linked to each of these forms of foreign investment.[13] The December 1992 amendments to the foreign investment law and the ensuing regulations of April 16, 1993, removed much of the discrimination in favor of joint ventures and against 100% foreign enterprises. Investors appear to have reacted quickly to these changes with joint ventures in total approvals dropping from an average of about 80% by number for the period of 1988-1992 to about 65% in 1993, replaced by growing numbers of 100% foreign-owned enterprises.

3.82 Care should be taken in interpreting these numbers, however, as they may give an overly positive picture. First, they include project equity as well as debt, with equity representing on average about 55% of total project capital and debt 45%. Second, they include the Vietnamese contribution to joint ventures, typically in the form of real estate contributed by state-owned enterprises. As joint ventures account for about 75% of projects and the local share averages about 25 to 30% of the equity, about 11-12% of these totals are in fact not foreign investment but domestic investment. Third, equity contributions are often inflated by the foreign as well as the domestic partners. Fourth, these numbers reflect approvals for licensed investments, of which some will never be formally committed, some will never be carried out, and others will be carried out on a smaller scale. As of mid-March 1994, over 130 projects worth about US$650 million had already been canceled by SCCI, i.e. their license had been revoked, most often for failure to implement the project.

3.83 Actual implementation, which includes investments in cash or kind, amounted to US$2.1 billion by end-1993, or about 28% of total project amount. Using a one year lag, the implementation rate by end-1993 would increase to 44% of the value of projects licensed by end-1992. If one considers that these amounts tend to include the full amount of the Vietnamese contribution to joint ventures, which is typically in the form of land and buildings, it becomes clear that project implementation rates are low.

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[12] Indeed, the foreign investment law and regulations do not allow the constitution of joint stock companies by foreigners or with foreign equity. Similarly, the company law prohibits any foreign ownership of shares in Vietnamese companies. Enterprises with foreign capital can thus only be established as limited liability companies under the foreign investment law, whose capital, unlike that of joint stock companies, is not divided into tradeable shares. A foreign investor can only sell his equity interest in a joint venture with the unanimous consent of the joint venture's board and with the approval of SCCI; SCCI approval is also required in the case of transfer by an investor of his interests in a business cooperation contract or a 100% foreign-owned company. Despite these strict restrictions on capital mobility, a number of close-ended investment funds have been established in recent years with the primary purpose of investing in Viet Nam. They invest in a range of foreign invested projects, typically as minority passive partners and are bound by the same restrictions on transfer of their interests.

[13] As mentioned below, these many different incentives are not always consistent and may conflict with each other.

It is interesting to note that these implementation rates are above average for oil and gas projects (at 57%, or twice the average, and representing one-third of project implementation) and finance projects (at 70%, but representing only 5% of total project implementation) and below average for tourism (16% rate, 12% of project implementation) and industry projects (25%, representing a bit less than one-third of total project implementation). One hypothesis to explain these sectoral differences is that joint venture projects and projects involving land acquisition and site clearance are more difficult to implement (for reasons detailed below). Excluding the oil and gas sector, the implementation rate would drop from 28 to 23%, and from 44 to 39% with a one-year lag.

3.84 Looking at the employment side, job creation from foreign invested projects has been very limited to date, at best. By end-1993, less than 46,000 jobs had been created. Assuming a one-year lag between implementation and job creation, this would imply an investment cost per job created of close to US$24,000; with a two-year lag the amount would still be close to US$14,000, which is still very high for a low-income country such as Viet Nam. The official emphasis and priority given by the government to the use of the latest technologies in foreign invested projects, as reflected in official government pronouncements and in screening criteria for foreign investments (see below), may account for some of this high cost.

3.85 Since 1988, a total of 45 provinces and cities (out of 53) have had licensed foreign investment projects. HCMC, Vung Tau and Hanoi have taken the lion's share. Foreign investment increased, however, significantly in the north of the country in 1993 and early 1994, partly as a result of greater efforts by local authorities to create an attractive environment for investment. The sources for investment in Viet Nam are quite diverse; investors from over 30 countries have obtained investment licenses. The year 1993 saw an increase in the share of Korean and Japanese investors, which can be in part attributed to the establishment of diplomatic relations with Korea and to the resumption of official Japanese aid and the end of the U.S. embargo. From a project and sector point of view, 1993 has seen a number of very large projects, including two cement plants (and a third in the first quarter of 1994), and large hotel and real estate projects.

3.86 Finally, to put foreign investment into Viet Nam in perspective, it is useful to make some comparison with other countries in the region. The net inflow of DFI into Viet Nam was US$300 million in 1993. This absolute amount is quite small, about 1% of all the foreign investment in East Asia. Net inflows (1992 data) into some of the other countries is the region were US$11.2 billion to China, US$4.1 billion to Malaysia, US$2.1 billion to Thailand, and US$1.8 billion to Indonesia. However, Viet Nam's economy is much smaller than these other economies, so that DFI relative to GDP is rather large in Viet Nam, at 2.3% in 1993. Figures for these other countries (1992 data) are 2.2% of GDP in China, 7.2% in Malaysia, 1.9% in Thailand, and 1.4% in Indonesia. Thus, foreign investment into Viet Nam has grown rapidly and is now significant relative to GDP; at the same time, the absolute level is small relative to total foreign investment in East Asia, and there is wide scope to increase foreign investment into Viet Nam.

Impediments to Foreign Investment

3.87 Despite these positive developments, significant impediments remain. If not removed or reduced in the coming years, these could become serious bottlenecks for sustained growth of foreign investment in the country. They are discussed below under the broad headings of problems in procedures and bureaucracy, property related issues, remaining problems in the legal and incentive framework for

foreign investment, and sector-specific issues related to foreign investment in the infrastructure sectors. In a sense, there is a danger that the relative success encountered in recent years may disguise the need for change. This section will discuss a few areas of concern and suggest ways to address these.

3.88 **Procedures and bureaucracy**. Cumbersome procedures and bureaucratic requirements for the negotiation of foreign investment contracts, the issuance of related licenses, and the implementation of projects are singled out by most investors and observers, as well as senior government officials, as one of the major problems in the area of foreign investment in Viet Nam.

3.89 These problems, which deal with the full range of licenses and permits required to implement projects, and are thus only in part related to SCCI, include:

- too many agencies and too many levels of government involved on the Vietnamese side; these typically include about eight central government agencies, the local government, the concerned union of enterprises and the concerned SOEs;
- too much information requested in the early stages of the approval process at a great cost to investors;
- much of the information requested and of the controls made by Vietnamese officials pertain to non-essential aspects of the transaction; projects need to meet too many criteria;
- Vietnamese officials do not always have the expertise or skills to evaluate projects;
- the evaluation process denotes a strong central planning approach, with Vietnamese officials determining whether specific investments are needed or not, based on their own analysis of demand and supply in the country or region and on their assessment of the capabilities of local enterprises; this tendency seems to have been reinforced by a recent practice to develop master plans for foreign investment by sector and geographic area;
- SCCI and other agencies have too much discretion in decision-making;
- the absence of uniform interpretation of foreign investment rules and regulations adds to the arbitrary nature of the process;
- foreign investors in practice must hire local consultants who may not always have the skills required to contribute to the substantive preparation of the project, but have access to key officials;
- in order to limit processing delays, foreign investors may have no choice but to enter into a joint venture with a well connected Vietnamese party (often an SOE);[14]

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[14] According to a survey of foreign-invested enterprises conducted by the Saigon Times (March 24-30, 1994, p. 21) it took 100% foreign-owned enterprises about two years, or twice as long as joint ventures, to receive the necessary licenses.

- corruption under various forms appears to be prevalent and increasing, as reported by foreign investors, the press, and senior government officials.

3.90 Many of these problems are bound to increase with the growth in the number and volume of foreign investment requests. A system that may have been suitable in the first wave of foreign investment (1988-1990), when annual foreign investment licenses issued over a three-year period amounted to 214 in number and US$1.5 billion in volume, is no longer suited when in a single year 268 projects have been approved for a total amount of US$2.7 billion, as was the case in 1993. Furthermore, the experience gained in these six years of implementing the foreign investment law should allow the government to relax the approval system.

3.91 To reduce these bottlenecks, the government has already taken some measures, which may not always be optimal, however. Even though, for example, the measures announced by a March 1994 joint communiqué of SCCI and the Hanoi People's Committee include some useful streamlining of the licensing and approval process for real estate and other investments in Hanoi, they also provide that small projects such as hotels with less than 50 rooms and office buildings of less than 3000 square meters or US$3 million in value will no longer be entertained. Although this will certainly reduce the work load and hence the delays in processing applications, it does not address the core of the problem and will preclude many projects that would have been of great benefit to the economy of Hanoi. One of the strengths of Viet Nam is its web of small and medium enterprises; hampering the development of such enterprises does not appear to be good policy. A better approach would have been to expedite and streamline the approval process for small projects that raise no important policy issues.

3.92 The regulations for export processing zones include a streamlined one-stop investment approval mechanism, which is said to function well at least in the two EPZs of HCMC (Tan Thuan and Linh Trung). It is too early to draw any conclusions from the short operational life of EPZs, but if this streamlined investment approval process indeed works well, it could be used as well for projects outside the EPZs.

3.93 Additional measures to streamline the investment process that the government may wish to consider are as follows:

- A distinction should be introduced between the award of a foreign investment license and the award of tax, customs and other benefits allowed under the foreign investment law. This could be done by establishing a two-track investment approval system. First, a fast track procedure would result in the automatic award of a license to investors who do not request special tax, customs or other incentives for their project. The only condition for the award of this type of license would be the observance of all legal conditions as set forth in the law and applicable regulations. Such projects would only need to be reviewed by SCCI and, in case of small projects, by local SCCI branches or local governments. Licenses would have to be issued in a short time frame (say one month) and could only be denied on the basis of the non-conformity of the project with criteria established in the law and regulations. Investors should be able to appeal a rejection to an economic court. The second track, to be followed by investors who wish to receive some or all of the benefits or incentives authorized by law, would consist of a streamlined version of the existing system. It may be restricted to specific sectors of the economy and/or regions of the country. Investors who want to invest in sectors where the government feels no additional

foreign investment is needed (e.g. restaurants, breweries) could do so at their own risks, without special incentives.[15] This dual system would focus the largesse of the government only on those sectors or areas where it feels that foreign investment is needed and would not take place (or not in sufficient volume) without such incentives.

- The number of agencies and levels of government involved in the license approval process and the issuance of other permits required to undertake the investment should be reduced.

- The issuance of licenses for small projects should be decentralized to provinces or regional SCCI offices; if the government is concerned about the consistency of license decisions, it could issue guidelines requiring the concerned authorities to license projects meeting specified criteria; licenses issued in violation of these criteria could be suspended by or at the initiative of the central government.

- Specific guidelines should be prepared detailing when the concerned authorities are bound to issue a license. The number of project evaluation criteria and the amount of information requested from potential investors should be reduced. In this context, the requirement of feasibility studies should also be abolished, at least for small projects; indeed, these are costly to prepare and rarely provide the type of information needed to assess a project. Where feasibility studies are still required, the information to be included in such studies should be limited to what is essential to decide on the issuance of a license.

3.94 **Role of various agencies.** As mentioned above, no fewer than eight agencies (and often more) are automatically involved in the screening of all foreign investment proposals. Previous Bank reports have already indicated that this is excessive, redundant and ineffective. It may be useful to mention the role of some of these agencies to illustrate how their intervention is no longer adapted to the needs of a market economy.

3.95 The Ministry of Science, Technology and the Environment is amongst these agencies. It is supposed to evaluate the technology offered by the foreign investor, as well as the environmental aspects of the proposed project. It is not clear why the proposed technology would need to be screened. An investor is normally better able to judge what equipment and technology best suit the needs of its company. This is certainly the case when the investment is in a 100% foreign owned company, but also when it is in a joint venture. Some argue that the ministry should check on the technology to make sure that the Vietnamese partner (usually a state enterprise) does not get cheated. One should, however, distinguish between the choice of the appropriate technology and the fair value of the concerned equipment. On the first question, one would imagine that the Vietnamese partner will in general be more familiar with the technology used in his sector than ministry of technology officials; on the second, it is

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[15] If the government insists on limiting foreign investment in certain (non-defense related) sectors, it would by far be preferable to auction off such licenses to the highest bidder rather than banning such investment altogether. Such bans are rarely effective, as foreign investors can easily enter into agreements with Vietnamese citizens to act as in-between (or front man) for them; this is already happening in a number of sectors where foreign investment is banned or discouraged.

difficult to imagine how the ministry could have good access to current market prices for a very broad range of equipment and technologies. A contract with an international company specialized in evaluation and control would be a better way to achieve this objective (the inspection or control fee could be borne by the importer).

3.96 Vietnamese officials seem overly concerned by the frequent import of second-hand equipment or equipment based on old technology and have made repeated statements about the need to import only state of the art technology. Although this may be an appropriate approach in a few cases, it may not be in many others and may result in the apparent capital-intensive bias of foreign investment noted above. Favoring high-technology investments in a country whose main competitive advantage is qualified and inexpensive labor may indeed be a misguided policy. Many foreign investments are further hampered by restrictive rules on licensing of technology, whose real effect seems to be to slow down the transfer of technology into the country, i.e. exactly the opposite of what was intended.

3.97 The State Planning Committee is another important agency for reviewing foreign investment decisions. In reviewing a foreign investment proposal, SPC will inter alia examine the demand and supply conditions prevailing in the concerned sector. If it considers that the existing and/or approved capacity levels are adequate to meet the anticipated demand, it will most likely oppose the project and cause its demise. But in a market economy, it is the investor who assesses demand and supply conditions and who takes the risk of insufficient markets for its products. One of the reasons for the demise of the command economies across the world was precisely the inability of the command mechanisms to accurately forecast and balance supply and demand. The most important role for the state in this context is to make information available to investors to help them make such assessments. In addition, as mentioned above, the state may choose to use its fiscal and other incentives to stimulate investments in specific sectors or regions.

3.98 The concerned sector ministry also gets to review the foreign investment applications. As this ministry is, however, also the supervising authority of state enterprises in its sector, it may try to block projects which threaten the viability of its enterprises by increasing competitive pressures. As a reviewer of foreign investment projects, the sector ministry has a serious conflict of interest between promoting the sector it is in charge of and defending the interests of the enterprises it owns or supervises. The proposals to separate supervision of state enterprises from line ministries (paras. 2.90-2.100) would eliminate this conflict of interest.

3.99 **Property issues.** Land-related issues are of major concern to many foreign investors. Foreigners have a difficult time acquiring land use rights and often have to rely on a Vietnamese partner for that purpose, even though the law was recently changed to allow them to acquire long term land use rights in their own right. The price of such land use rights has recently skyrocketed, and the cost and time required to acquire land has been mentioned as a major reason for not going ahead with some investment projects. Such costs often include compensation of displaced farmers or occupants (up to 50 times the annual value yielded by their crops in the case of projects with a duration of 50 years), relocation costs, site clearance costs, etc. Although this is normally the responsibility of the Vietnamese partner in joint ventures, the joint venture partners often end up sharing these costs. In addition, unclear zoning regulations in many areas (cities especially) and overlapping responsibilities for the award of building licenses add confusion to the process.

3.100 Weak mortgage and collateral mechanisms hamper all private investors, but foreign ones in particular. It appears that, as of this writing, foreigners can only get mortgages on land use rights in the context of BOT projects (in which they can obtain such land free of charge); as no such project has yet been licensed, it is not possible to assess whether this right to mortgage land use rights is effective and enforceable. The government is considering plans to issue regulations allowing the mortgaging of land use rights by foreign investors as part of the implementation of the new land law. In this context, foreigners should also be allowed to sell or transfer their land use rights. Problems also seem to be encountered with respect to the mortgaging of buildings, primarily with buildings contributed by the state or state enterprises as capital contribution to joint ventures. In order to make mortgages and other forms of collateral effective, institutional mechanisms will need to be put in place for their registration and enforcement.

3.101 Foreign and non-state domestic investors are currently at a disadvantage relative to SOEs and other government bodies in acquiring land use rights for the purposes of productive activities. The organization of auctions of land use rights (open to foreign as well as domestic investors) would be one way to improve access to needed real estate. The government may also wish to consider auctioning from time to time excess land and buildings owned by the state or SOEs that are presently not used to their full potential. Such auctions would help create a fair market for real estate and would provide additional revenues to the government while giving the private sector (domestic and foreign) better opportunities to acquire the real estate they need to carry out productive investments. In addition, in order to increase the liquidity of the real estate market, SOEs should be charged market prices for the use of the land they occupy.[16] This would encourage them to relinquish surplus land.

3.102 **Legal framework for foreign investment.** By and large, Viet Nam has a good legislative framework for foreign investment. Some problems remain, however, as well as areas for improvement. Of particular concern are the regular changes and amendments in laws, regulations, decisions, circulars or announcements applicable to foreign investors, which may affect the viability of a project. Moreover, these are often not announced publicly in advance of effectiveness, and investors have complained about the difficulty of finding out when relevant new rules are promulgated. Also, new rules are not always clear or consistent with other parts of the legal framework, nor are they consistently interpreted or applied. All this creates a high degree of uncertainty, which is detrimental to private investment. All new rules and regulations applicable to business activity should be broadly published prior to becoming effective. Enough time should be given to businessmen to familiarize themselves with these new rules and to adapt their business activities accordingly. In addition, in the case of rules applicable to foreign investors, a notice of their publication could be published in the English language press in Viet Nam; this is currently done in some but not all cases. The frequency of change in rules governing business activity (including changes in tax and customs schedules) should be reduced. Greater stability in these rules would allow enterprises to plan their activities without undue uncertainty and would hence encourage investment.

3.103 Current regulations applicable to joint ventures are unduly restrictive and are seen by many investors as a major problem in running joint ventures and as one of the key factors in decisions not to

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[16] In some instances, the government could also contribute the right to use the needed land as capital of the SOE.

invest in Viet Nam. The requirement of unanimity of the joint venture's board members for all major decisions affecting the organization and operation of the joint venture are mentioned by many investors as a major problem. It may indeed be very difficult to get agreement of all board members on all important decisions and this requirement often leads to the maintenance of the status quo. In fast changing times, as is clearly the case of Viet Nam during its transition to a market economy, but more generally also as a result of the globalization of the economy, companies need to be very flexible to adapt to changing market conditions and to seize opportunities without being limited by the least dynamic partner, who may in fact own only a small share of the joint venture's capital. Unanimity rules may prevent such flexibility and hence hurt the company's prospects.

3.104 In addition, joint ventures (and other forms of enterprises) should be allowed to create subsidiaries, which does not appear to be allowed at present. This could become a major step in the creation of Vietnamese conglomerates, which the government wants to promote (paras. 2.96-2.98). Allowing joint ventures to form subsidiaries (fully or partially owned) would also give the Vietnamese partners in such joint ventures the opportunity to learn how to manage company groups, before attempting to launch purely Vietnamese groups, which may not be very successful given the current state of development of Vietnamese business (state-owned as well as private). To facilitate the creation of such groups of enterprises, foreigners should also be allowed to buy shares in Vietnamese joint stock companies, something that is not allowed at present (para. 2.85).

3.105 Other areas in which the joint venture regime could be improved include:

- repealing or relaxing restrictions on sale or transfer of equity interest in joint ventures;
- using independent evaluators to determine the value of contributions to joint ventures made by foreign and local partners, especially for joint ventures with large capitalization; and
- developing mechanisms to match local and foreign investors; in this context, Vietnamese enterprises may need some assistance to assess the soundness of their proposed foreign partners, as a number of joint ventures have foundered due to the inability of a financially weak foreign partner to deliver on its commitments.

3.106 More generally, differences and artificial barriers between legal regimes applicable to different types of investment, based on the origin of the invested capital (private domestic, foreign and/or state), may have had their justification initially but have now outlived their usefulness and should be abolished in favor of a single set of rules and regulations applicable to all enterprises, irrespective of ownership (paras. 3.19-3.20). Laws, regulations and administrative practices governing business activity should be harmonized into a single system providing a level playing field for all investors. The current system of discrimination between enterprises is not even consistent, as each group has special benefits and special burdens, which encourages investors to choose a specific capital structure solely for the purposes of obtaining special advantages. It also creates unnecessary rigidity that prevents the growth and development of enterprises and may prevent the development of larger business groups in Viet Nam. The government is considering streamlining and leveling the current uneven playing field with a view to harmonize rules and incentives applicable to different categories of businesses and, eventually, to have a single framework applicable to all enterprises, irrespective of the source of their capital.

3.107 At present, there is no adequate dispute settlement mechanism in place in Viet Nam to deal with disputes between investors and the state (including ministries, local governments and state-owned enterprises). Viet Nam is planning to accede to the New York Convention on international arbitration and to the Washington Convention on settlement of investment disputes between a state and foreign investors. In addition, enactment of an ordinance on the recognition and enforcement in Viet Nam of foreign arbitral awards is high on the authorities' agenda.[17] Most issues involving foreign investors are currently settled through some form of negotiation between the investors and the concerned authorities. This ad hoc approach will become more and more difficult to pursue as the economy and the volume of investment grow and, with them, the occurrence of problems or disagreements. In view of the lack of a functioning enforcement and dispute settlement mechanism and of the absence of adequate exit mechanisms, most investors see their investment as a sunk cost which they may never be able to retrieve. As a result, they have to count on high profits to recover their initial investment plus a reasonable margin. The establishment of proper enforcement, recourse and dispute settlement mechanisms would reduce the cost of investing in Viet Nam and hence benefit the economy at large.

Foreign Investment in Infrastructure

3.108 Bottlenecks in infrastructure are unanimously described as the major obstacle to growth, private sector development and foreign investment, the main problem being the inadequate supply of infrastructure services (transport, telecommunications, power, gas, water), in terms of availability as well as quality. In this context, the December 1992 amendments to the foreign investment law included a new article introducing the concept of Build-Operate-and-Transfer (BOT) contracts for infrastructure projects. The enactment in November 1993 of special regulations for BOT projects is one of the more important innovations in the foreign investment regime during the past year, and deserves to be discussed in greater depth. A more detailed circular "guiding the implementation of the regulations on investments in the form of Build-Operate-Transfer contracts" was issued by SCCI in February 1994.

3.109 A BOT project is a "project approved by the government for the purpose of constructing and carrying on a business operating infrastructure projects"; "at the end of its term, the project shall be transferred to the Government of Viet Nam without compensation." The decree in effect establishes a special foreign investment regime for BOT projects, different from and more generous than that applicable to the three traditional forms of foreign direct investment. It includes generous tax and customs benefits, guarantees the convertibility of dong earned through operation of a BOT project into foreign currencies, authorizes the use of real estate (including buildings and land use rights) and other assets of the BOT company as collateral or mortgage, exempts the right to use land from the payment of rents, sets forth procedures for the tender, evaluation and selection of BOT contractors and negotiation of BOT contracts, stipulates what needs to be covered by BOT contracts, provides for arbitration based on the laws of the country chosen by the parties in case of disputes, and provides that SCCI will issue licenses for BOT projects upon approval of the Prime Minister. BOT contracts can be signed by the private BOT company with a ministry, general department, or People's Committee of a province or city.

17/ The government has recently decided to join the Multilateral Investment Guarantee Agency (MIGA). This should further improve the foreign investment climate and offer investors new options for insuring their investments.

3.110 No BOT project has yet been licensed as a BOT project, although some BOT-type projects have been approved prior to the issuance of the new BOT regulations. These include a BOO (Build-Own-Operate) power plant in Hiep Phuoc near HCMC and a BOT tollroad in the same area. These two projects support inter alia the Tan Thuan Export Processing Zone and are sponsored by the same Taiwanese investor, the first as a 100% foreign owned company (in association with other Asian investors) and the second in joint venture with a Vietnamese partner. In the telecommunications field, Telstra of Australia has entered into a business cooperation contract with DGPT that is in part similar to a BOT in that Telstra is responsible for building and financing specific telecommunications facilities whose property will revert to the government without compensation at the end of the ten-year contract; DGPT, however, is technically the operator of the equipment, rather than Telstra, which provides operational assistance to DGPT. Telstra shares international telecommunications revenues with DGPT. Other examples exist in the transport and telecommunications sectors of BOT-type arrangements that have been licensed on an other legal basis.

3.111 Even though it may be too early to assess these new BOT regulations, a few points can already be mentioned. The authorization to mortgage assets of the BOT company is an essential and very positive part of these new regulations. The circular, however, restricts the use of the mortgaged assets after they have been transferred to the mortgagee (typically a bank) to the continuation of the implementation of the project and seems to stipulate that in case the BOT company is liquidated the payment of salaries, insurance and taxes would have precedence over the payment of the loan secured by the mortgage. A secured creditor, however, should have priority over other creditors when it comes to allocating the right to the proceeds from the sale of the secured asset.

3.112 A potential problem in the implementation of BOT projects is the overlapping responsibilities of the different government bodies. Potential BOT investors have to negotiate in parallel with the government body that will enter into the BOT contract (e.g. the Ministry of Energy for a power plant) and SCCI which will be issuing the license. Furthermore, it is not entirely clear what the role of the concerned power company is with respect to the discussion of BOT projects; as it will most likely be signing the power purchase agreement, which constitutes the key agreement in a BOT package, its role should not be underestimated. Mechanisms will need to be set up to ensure better coordination among these different state bodies, for example by establishing for each major BOT project an ad hoc committee responsible for preparing, reviewing, negotiating and authorizing the contract on behalf of the state. The government should speak with one voice vis-a-vis investors.

3.113 From the experience gained so far, as well as from similar infrastructure projects carried out under the form of joint venture or business cooperation contracts, it appears that such projects are often not properly evaluated from an economic point of view. Contracts are signed and licenses issued on the basis of what is largely a short-term financial analysis, which typically indicates that the government will get a new or improved infrastructure at no or little immediate direct cost to the Treasury. Little or no attention is given to the assessment of various options for the private provision of such infrastructure services. The possibility and desirability of introducing competition in these sectors is, for example, rarely examined. This may not be so surprising in view of the agencies involved in screening and negotiating these projects. Indeed, the two most influential agencies tend to be the concerned sector ministry, which has a tendency to defend the current monopoly structure, and SCCI which has poor capacity to perform economic analysis and sees its role primarily as fostering foreign investment. In some cases, however, the country would be better served by abolishing existing monopolies and

promoting private competition against the incumbent state monopolies rather than by BOT-type contracts linking the private BOT company closely to the state monopoly.

3.114 As BOT projects are very complex in nature and in view of the lack of experience of government agencies in this area, the government would be well advised to appoint a team of international advisers to help in the preparation and negotiation of such deals. These advisors, who would typically include lawyers and financial and economic experts, would be paid by the government. The costs incurred in this way are minimal relative to the cost to the country and the budget of (i) choosing the wrong option for private delivery of infrastructure services; (ii) poorly negotiated deals, or (iii) protracted negotiations due to the novelty of this approach and the inexperience of civil servants. Such advisors should not only help the government in preparing and negotiating BOTs, but also other large contracts in the infrastructure area, including for example joint ventures and business cooperation contracts for roads, ports, power plants and telecommunications systems. To date, much of the advice given to the government on BOT issues was provided on a pro bono basis by law firms and other consulting firms. This ad hoc approach may have been appropriate to launch the process but can no longer satisfy the government's needs for expert and independent advice.

3.115 The government should seek long-term assistance from international experts in developing BOT and other schemes to promote private investment in infrastructure sectors. Such assistance could, for example, include an analysis and evaluation of options for private investment in sectors that have so far been managed by state enterprises or other public bodies, the design of sector reform programs, the identification of promising projects, the preparation of project-specific tender documents and contractual documents, assistance in negotiation of BOT and other private infrastructure schemes, preparation of promotional material to attract foreign investment in these sectors, and strengthening the Vietnamese institutions responsible for tendering, negotiating, supervising and regulating these projects.

3.116 **Foreign investment in mining**. There is very little foreign investment to date in the mining sector, primarily due to the absence of a mining law (many drafts have been prepared) and/or mechanisms guaranteeing that a company investing in exploration costs would also get the mining concession. Viet Nam has mineral resources which could attract a significant amount of foreign investment if the right conditions are put into place.

Summary of Recommendations

3.117 Viet Nam's performance in the field of foreign investment is strong but should not give the authorities any reason to rest on their laurels. Significant problem areas remain that need to be addressed. First, the rapid increase in the number of foreign investment applications and in the related volume of investment demand a revised, streamlined and simplified process for foreign investment project approval and implementation. This process should to the extent possible be automatic, transparent and predictable. The level of discretion given to government authorities needs to be reduced; a broad range of projects should be approved automatically without detailed government evaluation, which should be limited to very large projects and projects requiring major incentives or benefits; overlapping jurisdiction and unclear boundaries between government agencies, various levels of government, unions and enterprises need to be abolished in favor of a system with fewer actors, a clearer allocation of responsibilities and better coordination; reasonable efforts should be made to limit opportunities for corruption; and recourse or appeal mechanisms need to be established, as well as sanctions against officials who hinder the implementation of economic reform programs decided at the highest levels.

3.118 Second, a better functioning market for land use rights and improved mechanisms for collateral, including registration and enforcement, as well as removal of discrimination against foreign investors in these areas, would further help improve the overall environment for foreign investment in Viet Nam.

3.119 Third, with respect to foreign investment in the infrastructure areas, which may become increasingly critical to the success of the government's economic reform program, due attention will need to be given to the possibility of introducing competition in some of these infrastructure sectors, state monopolies may need to be dismembered, and contract and project award procedures will need to be streamlined and accelerated. Here again, technical assistance will be required.

3.120 In summary, Viet Nam has been very successful in attracting foreign investment. There are, however, a number of areas were progress is required to sustain this level of interest in the country. With some changes, Viet Nam should be able to increase the actual implementation rate and volume of foreign investment and to use such foreign inflows more efficiently. A significant share of new commitments could come from infrastructure projects which are much more complicated to develop, negotiate, and implement than industry or tourism projects, for example, and will require the development of new approaches and capabilities.

IV. POVERTY REDUCTION

4.1 Viet Nam embarked on its economic reform program in 1989 with the primary objective of raising general living standards. In order to pave the way to long term gains in living standards, the government implemented a thorough structural adjustment program. Unlike the populations of many other transition economies undergoing market reforms, the majority of the Vietnamese people benefited immediately from the change in policies: with 80% of households engaged in agricultural activities, land contracting and price liberalization resulted in higher incomes and improved living standards for most of the population, despite significant public sector layoffs. However, much of the success of the structural adjustment program was due to fiscal restraint which reduced public investment and expenditures on important services such as health and education.

4.2 Throughout this report two main areas for government focus have been stressed so that macroeconomic objectives can be achieved: (1) public sector management, and (2) the incentive structure for private savings and investment. This chapter examines the impact of the resulting macroeconomic growth on poverty and living standards in Viet Nam. Rapid growth by itself will have a strong impact on poverty reduction. There are also ways in which government expenditure and policies can accelerate the growth in incomes of the poorest households. The chapter makes recommendations aimed at strengthening the impact of growth on poverty reduction.

4.3 The chapter is divided into three parts. The first part examines the current poverty situation and the implications of economic growth on poverty reduction throughout this decade. It also looks at different aggregate growth scenarios. The second part of the chapter examines two essential topics related to public sector management: The first is the need to direct public expenditures to areas in which poverty is high and to devolve decision-making about local investments to local government. The second topic of importance is inter-governmental fiscal relations and the need to ensure adequate levels of financing at each level of government to enable the delivery of important "pro-poor" services throughout the country. The third section of this chapter concerns the development of a rural financial system which can effectively mobilize local savings and provide much needed credit to households and small enterprises.

A. Economic Growth and Poverty Reduction

4.4 The Viet Nam Living Standards Survey (VNLSS) highlights three important features of poverty in Viet Nam:

- The overall incidence of poverty is extremely high; the consumption level of 51% of the population is below a widely used international poverty line. Even in the relatively prosperous Mekong Delta, half the population survive at per capita consumption levels below this poverty line.

- There are significant regional disparities in living standards throughout the country. Poverty incidence ranges from 33% in the southeast to 71% on the north central coast.

- Rural areas throughout the country are much poorer than urban (i.e. 57% poverty incidence in rural areas versus 26% in urban areas). Rural poverty accounts for 90% of the poor (Table 4.1).

Table 4.1: INCIDENCE OF POVERTY
(Headcount measure, in percent)

REGION	RURAL	URBAN	TOTAL
N. Mountains	63	34	59
Red River Delta	55	15	49
N. Central Coast	74	42	71
Central Coast	54	36	49
Central Highlands	50	–	50
South East	45	17	33
Mekong Delta	52	28	48
AVERAGE	57	26	51

Note: Regions consist of the following provinces:
N. Mountains - Lao Cai, Yen Bai, Ha Giang, Tuyen Quang, Cao Bang, Lang Son, Bac Thai, Vinh Phu, Son La, Hoa Binh, Ha Bac, Quang Ninh;
Red River Delta - Ha Tay, Hanoi, Hai Phong, Hai Hung, Thai Binh, Ninh Binh, Nam Ha;
N. Central Coast - Thanh Hoa, Nghe An, Ha Tinh, Quang Binh, Quang Tri, Thua Thien;
Central Coast - Quang Nam, Quang Ngai, Binh Dinh, Phu Yen, Khanh Hoa, Ninh Thuan, Binh Thuan;
Central Highlands - Gia Lai, Dac Lac, Lam Dong;
South East - Song Be, Tay Ninh, Ho Chi Minh City, Dong Nai, Ba Ria;
Mekong Delta - Long An, Tien Giang, Ben Tre, Vinh Long, Tra Vinh, Dong Thap, An Giang, Kien Giang, Can Tho, Soc Trang, Minh Hai.

4.5 Average per capita annual expenditure in Viet Nam was found in the survey to be 1,373 thousand dong; yet those in the north central region spend less than a half (974 thousand dong) of what those in the southeast (2,008 thousand dong) spend. In addition to regional disparities, intra-regional differences in living standards, and specifically urban-rural differences, are very pronounced. Urban per capita expenditures are much higher than rural, on average 1,741 thousand dong for urban and 1,189 thousand dong for rural. Indeed, the urban areas in the poorest regions of Viet Nam are still more prosperous than the rural areas of the wealthier provinces (except for the southeast where the rural areas are thriving) (Table 4.2). It is important to note that in this analysis adjustments have been made for differences in regional price levels.

Table 4.2: REAL PER CAPITA EXPENDITURES BY REGIONS *
(Thousand dong)

REGION	RURAL	URBAN	AVERAGE
North Mountains	936	1,415	1,007
Red River Delta	1,151	2,457	1,349
North Coast	934	1,401	974
Central Coast	1,239	1,951	1,457
Central Highlands	1,159	—	1,159
South East	1,610	2,509	2,008
Mekong Delta	1,300	2,453	1,506
Weighted Average	**1,189**	**1,741**	**1,373 (US$129)**

Note: * Expenditures have been adjusted for regional price differences.

4.6 Over half of Viet Nam's population fall under a poverty line constructed on the basis of a basket of goods in which the food items reflect local consumption patterns and contain 2,100 calories per person per day and the non-food items reflect the cost of basic goods consumed by people who just reach the poverty line. How does this incidence of poverty compare to other countries?[1/] A comparison of poverty incidence indicates that poverty is much higher in Viet Nam (51% rural) than in China (9%), Indonesia (15%), the Philippines (21%), or Thailand (16%). While the poverty rate of Viet Nam is much higher than these other countries, it is important to note that all these countries had poverty rates similar to Viet Nam's only a few decades ago.

1/ It must be noted that cross-country comparisons -- even those based on identical methods -- are at best approximate since the basket of essential food and non-food items (determined by the food and non-food consumption patterns of those attaining 2,100 calories) is priced locally to determine the poverty line. Therefore, each country's poverty line involves a different basket of goods. Ideally, to make international comparisons, the basket of goods should be adjusted for content and converted via purchasing power parity exchange rates into measures which can be compared across countries. This information is unavailable at present for Viet Nam. Nevertheless, other country examples (using a poverty line based on 2,150 calories per person per day) are provided here to give a rough assessment of how Viet Nam compares to other East Asian countries.

4.7 Although Viet Nam's consumption based poverty rate is very high, other important welfare indicators such as education and health status are much better than in many other developing countries. Viet Nam's literacy rate is a remarkable 88%, a rate comparable to countries with five times the per capita GNP of Viet Nam. Under five mortality is about one-third that of other low-income countries. Immunization coverage rate is reported to be 88%, double the rate found in other comparable countries, and life expectancy is 67 years. Malnutrition rates, on the other hand, are very high with almost half the children under age five stunted; this is reflected in the consumption based measure used to form the poverty line.

4.8 Incidence of poverty is high, and average per capita expenditures are low. The distribution of consumption in Viet Nam, however, is relatively equitable, with a national gini coefficient of 36%. Gini coefficients in other developing countries range from 23% in Hungary, to 59% in Guatemala. Most East Asian countries are in the 33-45% range (e.g. Indonesia 33%, Malaysia 48%, the Philippines 41%, Thailand 43%). China, a country to which Viet Nam's development experience is often compared, had a gini of 33% in 1985, which climbed to 35.5% in 1990 after 5 years of rapid growth.

Prospects for Growth and Poverty Reduction

4.9 As Viet Nam continues to deepen its reform program, the government targets annual growth rates of about 8%. Given national population growth rate of 2%, this would mean an annual growth in per capita income of 6%. If Viet Nam does grow at this rate, what will be the implications for poverty reduction? This will depend on the extent to which the poor share in the growth process. It is possible to estimate the implications of different growth paths on poverty reduction in Viet Nam. This section reports the results of such an analysis and highlights the policy implications.[2/]

4.10 Results of simulations examining the impact of different growth scenarios are shown in Table 4.3. The base case scenario of 8% is contrasted to a high growth rate case of 10% and a lower growth case of 6%. This analysis illustrates the dramatic impact of aggregate growth on poverty reduction. If Viet Nam achieves its targeted 8% annual growth rate, and if the unequal growth rates of different regions continue throughout this decade, the national incidence of poverty would decline to 29% by the year 2000. This means that almost half of the poor in Viet Nam today would rise out of poverty by the decade's end. If the economy grows more rapidly at 10%, the incidence of poverty would decline to 25%. Under a scenario where the economy grows more slowly at 6% per year, 35% of the population would still be poor in the year 2000.

4.11 Two factors contribute to poverty reduction in any country. The first is the pace of economic growth -- the faster a country grows the quicker poverty reduction will come. The second is the distribution of household income (or consumption) -- the more equally distributed, the more likely the poor are to share in the growth process and rise out of poverty. In Viet Nam, regions generally are

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2/ The impact of growth on poverty alleviation is projected using the following data and specifications: (1) the distribution of household consumption data from the Viet Nam Living Standards Survey (a proxy for household income) and (2) regional poverty lines constructed using the "Cost of Basic Needs Methodology" (Ravallion, 1994). Furthermore, in these scenarios it is assumed that different regions of the country grow at different rates, reflecting the actual dispersion in regional growth rates observed in 1993.

Table 4.3: POVERTY UNDER DIFFERENT GROWTH SCENARIOS
(Headcount Incidence)

Region		1993 Regional Growth *	Growth in Per Capita Income	Gini	1993	2000 6% Growth	2000 8% Growth	2000 10% Growth
Northern Uplands	- Rural	3.08	1.80	24.5	62.8	56.9	50.8	45.0
	- Urban	*	*	25.2	34.3	27.8	23.8	20.3
Red River Delta	- Rural	4.60	2.60	26.3	55.0	43.8	36.2	29.0
	- Urban	*	*	30.8	15.4	11.2	8.2	5.7
North Central	- Rural	2.50	0.50	24.7	73.6	71.9	67.7	66.3
	- Urban	*	*	31.1	42.4	34.2	30.9	27.8
Central Coast	- Rural	6.28	4.28	30.7	54.0	32.9	28.3	20.9
	- Urban	*	*	31.3	36.0	19.1	14.5	10.6
Central Highlands	- Rural	11.34	9.34	29.5	50.1	15.1	9.6	6.0
Southeast	- Rural	14.30	12.30	36.7	45.2	4.5	1.4	0.6
	- Urban	16.15	14.15	33.1	17.1	1.4	0.5	0.2
Mekong Delta	- Rural	7.73	5.73	29.9	52.0	24.3	16.7	10.8
	- Urban	*	*	40.8	28.4	15.4	11.0	7.5
		7.5%	5.5%	36.4%	50.9%	35.0%	29.0%	25.0%

Note: * Regional growth rates are adjusted to reflect the different aggregate growth scenarios.

growing at vastly different paces (ranging from 2.5% per annum in the north central, to 15% in the southeast), and have disparate distributions of consumption (gini coefficients ranging from 25% to 42%). Those regions with the lowest incidence of poverty tend to have the most inequitable distribution of consumption and are also those growing most rapidly; conversely, those regions with the highest incidence of poverty currently have the most equal distribution and face the slowest pace of economic growth.

4.12 An examination of poverty measures in 1993 indicates that there are major differences in poverty (1) between regions, and (2) between rural and urban areas in all of Viet Nam's regions. While aggregate reductions in poverty would be large under any of the three growth scenarios above, regional poverty reduction will differ greatly due to the vastly disparate regional growth rates. By 2000, the regional differences remain stark, as do urban-rural differences; however the magnitude of poverty becomes much less severe in some areas. Indeed analysis illustrates clearly that poverty reduction will be very gradual in the slow growing regions, despite their more equal distribution, whereas it will be very quick in the fast growing areas, despite their more inequitable pattern of consumption.[3/] For example,

[3/] Annual GDP growth rates for 1993 in each region (aggregate growth of 7.5%) are scaled up proportionately to equal aggregate growth of 8% and are assumed to remain the same until 2000. Regional distributional data is disaggregated into rural and urban; however, for lack of more detailed data, region specific GDP growth rates are applied to both rural and urban areas (except in the case of the southeast region, where urban Ho Chi Minh City is separated from the rural areas).

while the distribution of per capita consumption in the north uplands is currently the most equitable in Viet Nam (gini coefficient of 25%), the rate of economic growth in this region is also relatively slow at 3.1% in 1993. If the growth rate does not accelerate and enable greater per capita consumption, 2000 51% of rural, and 24% of urban residents in the north uplands will still suffer from poverty. On the other hand, the southeast has the most inequitable distribution of consumption in rural Viet Nam (gini of 37%) and among the worst for urban areas (gini of 33%); but it is growing quickly at an average annual rate of 15%. If the same distribution and growth rates persist, poverty in this region could be almost eliminated by 2000.

4.13 If the economy were to grow at an aggregate annual rate of 8%, and each province were to continue to grow at the same rate it did in 1993, national poverty incidence would decline from 51% to 29%. If, however, all regions were to grow at the national average, 8%, poverty incidence would decline to 23%. Of course, the extent of redistribution required to achieve 8% growth in all regions of the country could well result in a lower aggregate rate of growth. This trade-off between equity and growth is complicated, and ultimately decisions depend on social preferences and political pressures. Nevertheless, this simulation illustrates an important point about growth and poverty reduction in Viet Nam. The vastly different growth rates between regions result in significantly lower poverty reduction, than if growth were more evenly spread throughout the country. Poverty reduction will be quicker if regional growth is more evenly distributed.

4.14 Viet Nam's poverty profile indicates clearly the large difference in poverty between rural and urban areas in every region of Viet Nam. While some regions will grow more rapidly than others, it will be important for the rural sector to participate in its region's growth in order to achieve the magnitude of poverty reduction reported here.

4.15 The above analysis highlights several important aspects of poverty in Viet Nam and has implications for poverty alleviation efforts. Poverty is extremely prevalent in Viet Nam, but is much more common in rural than urban areas. General rural development must be the first order of focus for poverty reduction efforts. Broad based economic growth will lead to major reductions in poverty. Indeed, projections estimate that poverty will almost be halved by the year 2000 under current growth rates. But the analysis also indicates that if the present pattern of regional growth and distribution remains unchanged, poverty will remain a very serious problem in some areas, whereas it will become much less serious in other areas. Thus, efforts targeted to these very poor, slow growing regions are also needed.

4.16 As suggested in Chapter 2, cost-benefit analysis should be the starting point for all economic investments in Viet Nam, and only those investments with a positive rate of return should be considered. However, given the vastly different regional growth rates and their implication for poverty reduction, viable investments in slower growing areas with high poverty incidence should also be considered. While the opportunity cost of selecting projects with lower (but positive) rates of return can be significant, poverty reduction should come much quicker if poorer areas share in growth.

4.17 Efforts should differ by region depending on the principal constraints faced in that area. For example, viable projects in the poorest region of Viet Nam, the north central coast, may involve investments in irrigation which would improve agricultural productivity greatly while reducing vulnerability to natural calamities. The second poorest region, the north mountains, also has land that is underutilized but for different reasons. Poor roads, inadequate agricultural extension, and lack of access to capital all limit the ability of farmers in the hilly areas to switch from annual crops to the more lucrative (and environmentally safe) perennial crops. Thus, improving the availability of these services should be the focus for this region. And in the Red River Delta, where agricultural land is used far more efficiently than anywhere else in Viet Nam, plots of land are so small that households would have to diversify their activities to rise out of poverty. They are currently constrained from doing so owing to a severe credit shortage in the rural areas. Financial policies that would encourage savings and enable medium and longer-term investments would permit households to engage in other activities and raise living standards.

4.18 Efforts at broad based economic growth and regional development are presently limited, however, by a Public Investment Program that does not focus sufficiently on rural areas; by a system of intergovernmental finances which limits the ability of local governments to implement the appropriate development strategy; and by a rural financial system which does not provide the right incentives for private sector growth. The first two subjects are taken up in Section B and the third is addressed in Section C.[4]

B. Public Expenditures and Poverty

Public Expenditures that Benefit the Poor

4.19 The VNLSS data clearly indicate a high prevalence of poverty throughout Viet Nam. The analysis in Section A indicates that if rural areas participate equally in regional growth, poverty reduction can be substantial in some regions. This indicates the need for (1) broad based rural development, and (2) targeted efforts (investment and/or assistance) for certain areas.

4.20 **Constraint to poverty reduction: rural infrastructure.** Areas with a high incidence of poverty are often constrained by the availability or quality of the factors of production: land, labor, and capital. The development of these factors is closely tied to the existence of key infrastructure such as rural roads, inland waterways, and irrigation. There are many indications that people who live near such infrastructure have higher living standards and have been better able to take advantage of the market reforms than those who do not. For example, the data show that those people living in communities located near an all-weather road (i.e. passable year round) have significantly higher average per capita expenditures than those not living near such a road (1,269 thousand dong compared to 1,010 thousand

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[4] For a more comprehensive discussion of (1) intergovernmental fiscal relations and (2) rural development (and the need to invest in physical infrastructure and human resources as well as target particularly pro-poor services and areas), see "Viet Nam: Poverty Assessment and Strategy Report", Fall 1994. For a more comprehensive discussion of financial issues, see "Viet Nam Financial Sector Study", Fall 1994.

dong). They are significantly more likely to have a permanent market located in their village; to engage in more than one economic activity; to leave the village to seek work; to sell agricultural surplus; and to be served by public transport. The VNLSS data indicate that each of these factors is significantly and positively correlated with living standards (at least at a 95% confidence level).

4.21 The existence of an all-weather road also appears to affect labor mobility, which is significantly related to economic status. On average, households in communities with labor mobility (i.e. which report to have residents that sometimes leave the village to seek work elsewhere) have per capita expenditures of 1,256 thousand dong compared with 975 thousand for communes without labor mobility. Again, we see that people in communities characterized by labor mobility, engage in more economic activities, and are more likely to have ready access to an all-weather road.

4.22 While one must be cautious not to draw causal relationships between any of these factors, the proximity of an all-weather road is associated with the existence of permanent markets, enterprises, economic diversification, labor mobility, and higher living standards. However, whether economic status preceded or succeeded the availability of infrastructure is unclear. Experience from other countries indicates that transportation is a prerequisite for increases in agricultural productivity and rural development more generally. Aggregate studies for groups of countries have confirmed the important positive impact of rural roads on crop and livestock output, crop area and yield and fertilizer demand. In the absence of good transportation, agricultural development is hindered in several ways: prices for inputs are higher and output lower; marketing of high value perishable products is impossible, and access to new technology and information is more limited. In Viet Nam, as elsewhere, the presence of all-weather roads seems to improve the flow of goods, services, and information. This leads to greater economic diversification, labor mobility (in and out of the household's home village), more productive use of farm land, and higher living standards. While the VNLSS data unfortunately do not include information on rural waterways, the latter serve a vital role for households in the two main deltas. As with rural roads in other areas, inland waterways serve as the vital channel for the flow of information, goods and services to rural households.

4.23 Irrigation is another key type of infrastructure which directly affects the household's use of land, and therefore agricultural productivity. Indeed, land and irrigation are by far the most important influences on farm production, according to econometric estimates of a paddy rice supply function using the VNLSS. Irrigation is found to add substantially to land value: the difference between zero and 100% irrigation amount to 645 kg/ha. Not surprisingly, access to irrigation is correlated positively with living standards. Yet, the provision of irrigation services has undergone a transition since the economic reforms were initiated and the role of the commune changed. Today, responsibility for providing irrigation services remains vague. Some districts appear to assume responsibility and fund district level irrigation systems. Smaller scale commune irrigation systems, however, appear largely unfunded. Potential for "micro" irrigation schemes appears great, particularly in some parts of the country. For example, micro irrigation schemes could improve the reliability of irrigated water supply significantly, enlarging the command area by 10-20%. With an effective extension service, appropriate varieties, good seed and access to inputs, production increases of 50% or more could be attained. However, improvements in local finance, including incentives to mobilize local resources, are needed to support such efforts.

4.24 **Implications for public expenditures**. The VNLSS data clearly indicate that access to infrastructure is associated with household economic status. Currently, investment projects (including cost-effective local rehabilitation projects) are all decided by the central government. The decision criteria used to select investment projects in the past has been vague. The central government should continue to manage carefully the public investment program for large projects (i.e. where benefits exceed the boundaries of one province); however, local governments should be assigned responsibility for local investments so that they can reflect local needs. Such decentralization should produce greater efficiency in decision-making and implementation.

4.25 Local governments should be provided with adequate resources and sufficient flexibility to address local needs. If rehabilitation of key infrastructure is a priority, local governments should be able to reallocate resources from elsewhere in their budget and focus on the item of urgency. The central government can enable provinces (particularly poorer provinces) to support their own investments and maintenance by allocating investment and recurrent cost resources as part of a general grant. The distribution formula for this grant should include basic indicators of provincial need; reflect different costs of delivering services through the country; and contain a component for fiscal effort to encourage local resource mobilization, where possible. By devolving more autonomy to local governments to support the investment and operation of infrastructure of local priority, efficiency of public expenditures would rise. Appropriate local infrastructure would enable households in these areas to participate more effectively in the market economy. The data suggest that all factors of production would be used more efficiently and would generate higher household earnings if accompanied by adequate infrastructure.

Intergovernmental Fiscal Relations: Funding "Pro-Poor" Services

4.26 Pro-poor services throughout Viet Nam are underfunded; this problem is particularly acute in the poorer areas. Improvements in the system of inter-governmental finances could help ensure that each level of government, even in the poorer provinces, is adequately funded -- and provided with sufficient expenditure and revenue raising autonomy -- to support local investments and their ongoing operation and maintenance. Since poor provinces are less able to mobilize additional local revenues to support services, well designed intergovernmental transfers are particularly important.

4.27 Two main categories of problems exist with the system of intergovernmental finances in Viet Nam: (1) the extent of centralization, and (2) the design of the system. First, the high degree of centralization in Viet Nam reduces both the efficiency of expenditures and the incentive for formal local resource mobilization. Second, regardless of centralization, weaknesses in the design of the system -- e.g. weak assessment of expenditure needs (i.e. expenditure norms unrelated to cost or local capacity); inaccurate estimates of revenues, and the resulting inadequate level of transfers -- leaves local governments underfunded; their ability to deliver important services depends on factors outside the formal system (i.e. community contributions). Ironically, the system designed to be highly centralized, is in fact quite decentralized since the ability to deliver many local services depends on local circumstances.

4.28 What is the role of sub-national governments in undertaking expenditure policies targeted to reduce poverty? Potential inter-provincial mobility of population can limit the efficacy of sub-national governments in undertaking redistributive policies. Nevertheless, sub-national authorities have a comparative advantage in identifying the poor; deciding which local investments and recurrent expenditures are most appropriate, given their limited resources; and delivering services to communities

within the province. They may also be more efficient providers both of social and community services such as health and water supply and economic services such as agricultural extension, irrigation, and roads. Local governments may thus play an important role in deciding and implementing expenditure policies, including those intended to alleviate poverty.

4.29 Concern is sometimes expressed about the possible effects of decentralizing public sector activities owing to the poor quality of local government administration in many developing countries. To a considerable extent, however, each country gets the local government it wants. In Viet Nam local government officials, like those anywhere, respond to the incentives with which they are faced. If those incentives discourage initiative and reward inefficiency, then it should come as no surprise to find inefficient local governments. The answer to this problem, if it is one, is to alter the incentive structure to make it possible and attractive for honest, well-trained people to make a career in local government. Similarly, one answer to local governments that make "wrong" decisions is to provide an incentive structure that leads them, in their own interests, to make the "right" decisions, that is, decisions that are both economically efficient and politically acceptable. The fiscal arrangements needed to achieve this result will promote accountability and provide incentives for the cost-effective provision of public services. To the extent local governments are best suited to providing the services needed to accelerate economic growth and reduce poverty, they should therefore have a greater role both in raising revenues and in allocating expenditure, subject to the provision of adequate incentives to ensure that they do so in a responsible and efficient way.

4.30 As discussed in Chapter 2, a proposed Organic Budget Law which addresses central and provincial responsibilities is expected to be discussed in the National Assembly in October 1994. If the National Assembly passes this law, the budget process will become more formal and transparent. This will facilitate and improve budget implementation and thus will be a significant achievement. However, the proposed law only provides for modest decentralization and, in fact, increases the centralization of health and education. The proposal only sets the broad outline for the budget process and subsequent implementing regulations will define the details of the system. Therefore, this is an opportune time to review the existing system of intergovernmental finances and examine how improvements in its design would facilitate the delivery of local services which are critical to the poor.

Design of Intergovernmental Finances

4.31 Resources provided to local governments should be on terms that encourage both local fiscal effort and efficient implementation, while at the same time recognizing adequately the considerable divergence in the capacities of governments in different regions of the country. This calls for reallocation of some spending and taxing powers between the center and provinces and a carefully designed system of intergovernmental transfers. This section discusses the issues which should be addressed in the design of an "ideal" system of intergovernmental finances, and describes the current system in Viet Nam.

4.32 Whereas many expenditures are more efficiently made by local governments, most taxes are more efficiently collected by central governments. Therefore, an essential ingredient of the fiscal structure in most countries is also a system for transferring resources from the central to the local governments. An ideal set of intergovernmental fiscal arrangements, for example, might include the following elements: (i) adequate resources in the hands of local governments as a whole, from a

combination of local taxes and central transfers, to enable them to carry out their assigned functions; (ii) a transfer system that ensures each individual local government has sufficient resources to provide essential functions at an acceptable standard, provided local taxes are imposed at reasonable rates; (iii) sufficient flexibility in setting local taxes and charges so that local governments can respond to the preferences, special problems, and resource endowments prevailing in different regions; (iv) but at the same time, sufficient incentive to ensure that local fiscal effort is maintained at reasonable levels and that local budgets are managed efficiently; and (v) special central transfers to finance minimum levels of spending on particular programs considered of national importance.

4.33 Such an ideal system is seldom found in practice, and certainly not in countries such as Viet Nam in which traditionally a unified budget has been employed as a tool to implement central planning. Nonetheless, an essential but often unduly neglected part of the transition towards a more market-oriented economy is precisely a change in the budgetary and intergovernmental system. From this perspective, it may prove useful to keep this "ideal" in mind as a point of reference.

4.34 **Expenditure.** The assignment of expenditures to different levels of government in Viet Nam is based on a resolution of the Council of Ministers passed in November, 1989, as subsequently amended. These expenditure assignments largely follow the principles of efficiency (i.e. assigned to the level at which most benefits accrue). Local governments are responsible for law and order, while national government is responsible for national defense. Major universities are under the central government, while primary and secondary schools are covered at the provincial level. Major hospitals are national, while provincial and district hospitals and commune health centers are provincial. Major economic services (e.g., large flood control and embankment projects, interprovincial irrigation, and national highways) are central responsibility, but smaller scale services of this type are local responsibility. One notable exception to all categories of expenditure is that of public administration. The size of local civil service and their wages are determined by the center - thus eliminating flexibility in the budget of the largest single line item. As with recurrent expenditures, large investment projects, the benefits of which spill over to a number of provinces, are central responsibilities, while small projects benefiting mainly the residents of a province are undertaken by the provinces. Most investment projects -- down to the commune level -- however, must be approved by the central government.

4.35 The provinces currently employ the districts primarily as their spending agencies. They are given a share in public enterprise taxes (profits tax, turnover tax and depreciation from state enterprises). The provinces directly spend most of the capital expenditures, and the responsibility of districts is mainly to execute small investment projects and to maintain the assets within their jurisdiction. Similarly, communes are allowed to retain 10% of revenue from agricultural taxes and in addition receive a small grant, mainly for holding meetings. Most development works are directly undertaken by the provinces, and minor works are executed by the communes, often with voluntary contributions (mostly in kind) by the community itself.

4.36 The preparation of the expenditure budget at the provincial level is critical to determining the amount of transfer sent from the center to the province (in the case of poorer provinces), or sent from the province to the center (in the case of wealthier provinces). Investment decisions are made by the center (line ministries and SPC) based on the proposals submitted by various provinces and the line ministries at the center, as well as the budget constraint. The process of project selection is both complicated and non-transparent, but considerations such as the need to finance continuing projects,

relative backwardness of the provinces, priority of the projects as perceived by the central government itself, and relative ordering of the projects made by different provinces influence investment allocations. In addition, the provinces may increase investment outlay if they raise more than the targeted (budgeted) revenues in respect of taxes assigned to them.

4.37 The process of determining current expenditures is complex. The budget circular sent to the provinces details the norms to be employed for projecting different items of expenditure. These "standardized" norms are applied to expenditure items such as education, culture and information, training (higher education), sports, health, and administration. In the case of maintenance expenditures on infrastructures such as roads, bridges, embankments and irrigation works, standardized norms (on a per capita basis) cannot be applied, so expenditures are projected on the basis of specified norms for each item. The norms are developed for each expenditure item on the basis of the discussion among the Ministry of Finance, State Planning Committee and the relevant central ministry taking into account the estimated cost of providing the service as well as the budget constraint. In most cases, population is the major factor taken into account but different weights are assigned to population in different areas. The budget circular for 1994, for example, distinguishes among five different categories: (i) Cities, (ii) Plains, (iii) Midland and Coastal areas, (iv) Low Mountains and Remote areas, and (v) High Mountains and Islands. In principle, this distinction is supposed to take account of differences in the needs as well as varying unit costs of providing these services. In practice, after provincial budgets are formulated based on the "budget constrained cost" of providing services (via norms for each line item), provincial budgets are negotiated once again accommodating the budget constraint.

4.38 If properly designed, a system of establishing expenditure "norms" may constitute a useful component of a transfer program, when combined with a measure of local capacity to meet costs out of own resources. The norms can be used for (1) assessing local expenditure needs based on assigned responsibilities, then (2) determining provincial revenue requirements, and then (3) determining intergovernmental transfers. Such norms might, for instance, take into account differences in the cost of providing a "standard" level of services in different regions. Such costs might vary with population density, the terrain, and other factors. In Viet Nam, as in several other countries (e.g., Russia, Denmark) an attempt is made to "cost out" the resources required to deliver each and every line time of expenditure and then norms are set as a way of determining each province's revenue requirement.

4.39 The standardized norms for 1994 for various items of expenditure are shown in Table 4.4. In the case of education, for example, the normative per capita expenditures vary from D 26,700 to D 42,800. Since provinces may contain more than one type of area, each province is required to project its education expenditures on the basis of its composition of population in terms of the different categories.

Table 4.4: NORMS FOR DETERMINING CURRENT EXPENDITURES FOR STANDARDIZED ITEMS IN PROVINCES, 1994

	I. NORMS BASED ON CATEGORIZATION OF REGION					
EXPENDITURE ITEMS	UNIT	CITIES	PLAINS	MIDLAND AND COASTAL	LOW MOUNTAIN AND REMOTE	HIGH MOUNTAIN AND ISLANDS
1. Education:	dong per Capita	37,500	26,700	29,400	33,500	42,800
2. Culture & Information	dong per Capita	3,750	2,500	2,940	3,350	4,280
3. Sports	dong per Capita	1,540	1,250	1,150	700	960
4. Health	dong per Capita					
i) Preventive		4,750	3,340	3,700	4,170	5,340
ii) Curative		10,520	7,520	8,720	9,400	12,030
5. Administration	Mn dong per employee in payroll					
i) Provincial		9.5	6.7	8.2	13.5	—
ii) District		7.5	6.7	5.5	11.0	12.0

	II. NORMS UNIFORM FOR ALL REGIONS: EDUCATION (Million dong per student)					
LEVEL OF EDUCATION	SCIENCE & TECH	PEDAGOGY -GENERAL	PEDAGOGY-HIGHER	AGRI, FORESTRY, FISHERIES & HEALTH	ECONOMIC & LEGAL AFFAIRS	CULTURE AND ARTS
1. College & University	3.8	4.0	2.7	3.9	3.3	4.2
2. Technical (3 yrs, high school graduates)	2.4	2.5	—	2.1	1.9	3.0
3. Vocational	2.9	—	—	2.4	—	2.9

4.40 While norms can be useful for constructing provincial budgets which reflect expenditure needs, the budget constraint necessitates that line items are then negotiated between the center and the province. In the end, provincial budget expenditures (1) differ from the norms on which they were supposed to be based; and (2) are set too low to reflect actual costs, given current expenditure patterns. For example, in Thanh Hoa province, where cyclones are a recurring phenomenon, the sanctioned budget

for strengthening and maintaining 937 km of embankments is generally only about 10% of what is requested by the province - which itself is only a fraction of what is actually needed for its proper maintenance. Even after mobilizing community help by way of voluntary labor, the province is thus able to select only the very weakest segments of embankment every year for strengthening. In order for allocated resources to meet the most important local needs, greater local expenditure autonomy is necessary to enable reallocation of resources between line items and within line items.

4.41 Table 4.5 indicates the different per capita expenditures budgeted for different items. As explained in the next section on revenues, actual expenditures exceed budgeted expenditures considerably.

Table 4.5: PER CAPITA EXPENDITURES IN PROVINCES CLASSIFIED ACCORDING TO INCOME CATEGORIES, 1993

Expenditure	High Income[1] Provinces (Per Capita GDP) > 450,000 dong	Middle Income[2] Provinces (Per) Capital GDP) >300 -450,000 dong	Low Income[3] Provinces (Per Capita GDP < 300,000 dong	All Provinces
1993 (Budget Estimates)				
1. Capital expenditure	27.0	14.0	19.9	19.9
2. Working capital and subsidy to SOEs	12.4	2.8	2.4	5.6
3. Current expenditure, of which	139.2	78.9	82.5	100.6
(i) Economic services	40.4	11.1	13.7	21.9
(ii) Education	26.5	21.8	23.3	23.0
(iii) Health	14.7	9.3	4.4	11.3
(iv) Training and scientific research	6.2	4.0	9.8	4.8
(v) Others	51.4	32.7	31.3	39.6
4. Total expenditure	178.6	95.7	104.7	126.6

Note:

1. The high income provinces are: Ba Ria-Vung Tau, Ho Chi Minh City, Hanoi, Dong Nai, Kien Giang, Quang Ninh, Khanh Hoa, Hai Phong, Hoa Binh, Vinh Long, Tra Vinh, Long An, An Giang, Can Tho, Minh Hai, and Dac Lac.

2. The middle income provinces are: Tien Giang, Yen Bai, Soc Trang, Bac Thai, Tay Ninh, Ben Tre, Song Be, Lam Dong, Dong Thap, Quang Nam, Hai Hung, Vinh Phu, Thanh Hoa, Nam Ha, Thai Binh, Kon Tum, Lai Chau, Phu Yen, and Ha Tay.

3. The low income provinces are: Lang Son, Ninh Binh, Tuyen Quang, Ha Bac, Ninh Thuan, Gia Lai, Thua Thien, Quang Binh, Binh Dinh, Binh Thuan, Cao Bang, Quang Tri, Nghe An, Quang Ngai, Ha Tinh, Ha Giang, Lao Cai, and Son La.

Source: Ministry of Finance and State Planning Committee.

4.42 The norm system has not been able to ensure that expenditure needs are well assessed or that provinces are provided with sufficient resources to cover the cost of delivering the assigned expenditure items. Although the norms apparently attempt to take some account of cost differences, it is not clear that the central government has adequate cost information on which to base the norms.

Moreover, the chosen indicators of "need" could be improved. In the case of education, for example, costs are specified on per capita basis and not on the basis of population in the school-going age group or the number of students. Most importantly, despite calculation of the provincial budget based on line item norms, the reality of the budget constraint leads to negotiation of all provincial budgets. Provinces are left with a budget which no longer reflects the costs of delivering each service. As a result, provincial resources (retained taxes and intergovernmental transfers) are insufficient to cover the expenditures assigned to them. Moreover, provinces have very little flexibility to allocate resources to items of local priority. Personnel and salary decisions are centrally mandated, and thus the single largest recurrent cost item is out of provincial control. Provinces are not authorized to reallocate expenditures between line items, from say "sports and culture" to "road maintenance" even if the latter is seen to be of greater importance at that time.

4.43 The idea of the norm system (i.e., costing out each line item) is well-founded and if done accurately is the most precise method for allocating resources. Nevertheless, in reality most countries (including Viet Nam) which have tried this system have encountered difficulties with (1) its complexity and (2) matching total required costs with total available resources. As a result, the following steps are encouraged for intergovernmental design: (1) clearly assign expenditure responsibilities to each level of government; (2) determine what proportion of total revenues is required by the sub-national level to deliver the services assigned to it; (3) assess local revenue capabilities; and (4) use general purpose transfers from the center to make up the difference between local expenditure needs and revenue capabilities. As discussed below, the requisite transfers can be implemented via matching grants in a way that encourages local revenue efforts (paras. 4.56-4.57).

4.44 The benefit of general purpose grants -- rather than the specified grants currently used -- is that local governments have greater flexibility in spending. The sum of resources provided in a general purpose grant is broadly based on the cost of delivering services for which the province is responsible; yet actual expenditures are not mandated by the center. Thus actual expenditures can reflect local needs and preferences. It should be noted, however, that there is little rationale for making all grants unconditional. Not only does the central government have a legitimate interest in what is done with its grants, but the nation as a whole also has a legitimate concern in ensuring that services provided by local governments such as education and health are available throughout the country at minimum standards. There is therefore a case for at least limited conditionality, for example, by requiring that some grant funds should be spent on e.g., education or health or by requiring local governments receiving such grants to provide services of at least a specified quality and level. To ensure adequate resources to deliver these services, a detailed costing exercise is necessary. Thus, current norms would be modified and used to provide specified transfers for select local services of national importance. Given the overall budget constraint facing all local governments, the efficiency of expenditures should improve when local governments are permitted to allocate resources according to local preferences. Moving towards broader indicators of need makes sense for general purpose grants and then certain items deemed to be of national importance (e.g., education and health) can be ensured through progressive matching grants, but specified to ensure a minimum level of provision.

4.45 **Revenue projections.** The expenditure budgets of provinces are influenced by the revenue projection for domestic resources. Analysis of revenue projections, however, reveals that the tax department consistently tends to underestimate revenues. The tax department tends to set targets which can easily be reached. Underestimation is in the interest of provinces as well, for, once a tax is assigned

Table 4.6: PER CAPITA REVENUES: TARGETS AND ESTIMATES

	Per Capita Revenues - 1993			
	Targets	Latest Estimates	Increase in Estimates over Targets	Percentage Increase
	(Thousand Dong)			
High income provinces	656.43	758.10	101.67	15.5
Middle income provinces	95.43	111.19	15.76	16.5
Low income provinces	54.53	69.92	15.39	28.2
All provinces	278.60	323.89	45.29	16.3

Source: State Planning Committee and Ministry of Finance

to a province for the year, collections in excess of projections provide some flexibility in the use of funds. On the other hand, the State Planning Committee would like to have high revenue targets so as to have a larger investment budget. Often, the projections of the tax department and State Planning Committee differ widely, requiring the Prime Minister to take the final decision. Even after such negotiations, however, as Table 4.6 shows, for the last three years, actual collections have exceeded targets in every single province.

4.46 Although a larger share of some of the taxes collected in higher income provinces goes to the center and though in relative terms the increase in richer provinces was actually lower than in poor provinces, nonetheless in per capita terms, the richer provinces still retained higher excess collections and consequently had higher per capita expenditures. Estimated expenditures in per capita terms exceeded the budgeted amount by D 51,670 in high income provinces, by D 26,800 in middle income provinces, and by D 31,030 in the low income provinces. The actual distribution of public expenditures among provinces thus differed from the approved budget.

4.47 The net effect of this complex system appears to promote a fair degree of equity in the allocation of expenditures among different provinces. Data on the provincial distribution of central government expenditure are not available. Although it is quite possible that the allocation of central expenditures offsets any equalizing effects of provincial government expenditures, only the latter can be analyzed here. In general, per capita provincial expenditures are much higher in more prosperous provinces. For example, budgeted current expenditures in 1993 varied by a factor of six between Ho Chi Minh City - 286 thousand dong per capita - and Thua Thien Hue in the very poor North Central Coast region - 49 thousand dong per capita. In the aggregate, per capita expenditures in the high income provinces was 26% above average in 1991, 31% in 1992 and about 41% in 1993. Interestingly, however, the distribution of current expenditures on health and education was markedly more even.

Moreover, per capita expenditures in low income provinces were, on the whole, slightly higher than hose in the middle income provinces. To some extent this reflects the equalizing effect of the present system of intergovernmental transfers as well as the fact that some of the centrally determined salary scales of provincial employees are higher in more remote regions, thus raising nominal expenditures in those regions.

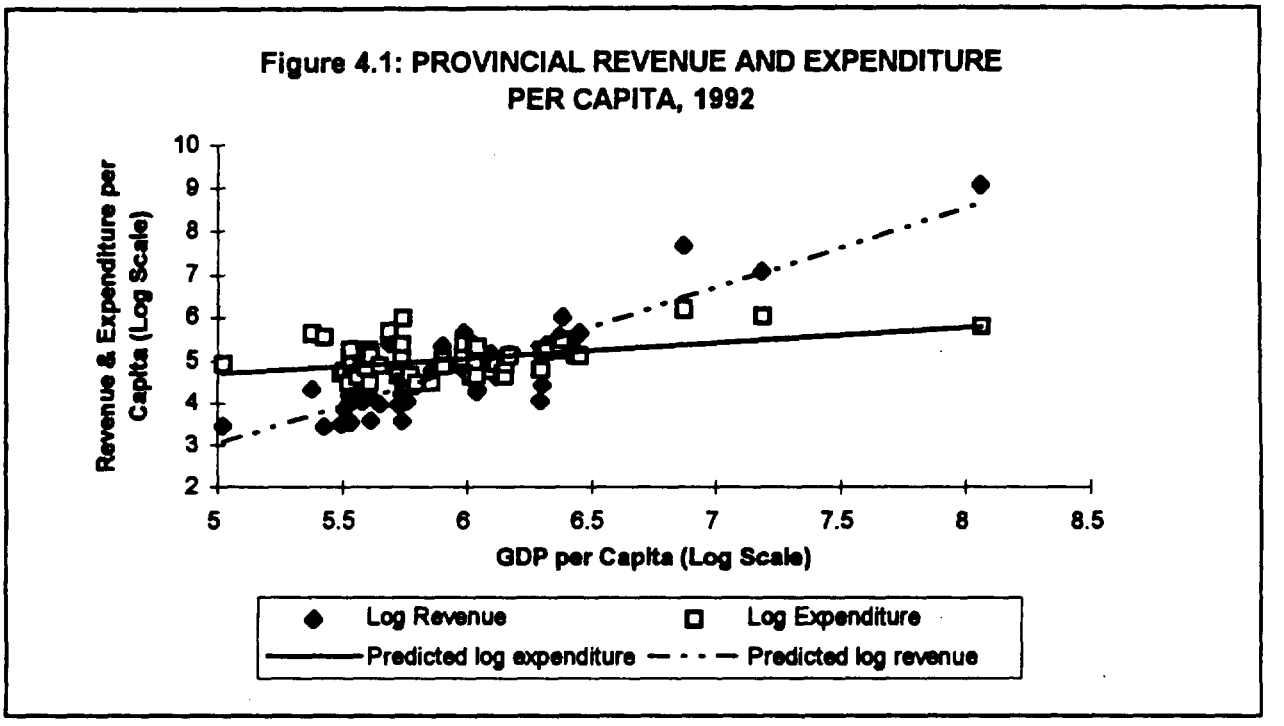
4.48 In short, there is considerable redistribution occurring among provinces: wealthier provinces relinquish locally collected resources to the center, while the poorer provinces receive funds from the center which enable them to spend more locally than they would if they had to rely on their own locally collected resources. Figure 4.1 illustrates the findings. Despite this cross-subsidization, however, the tight budget constraint coupled with very limited local expenditure flexibility prohibits many local governments from delivering services important to their economic development.

4.49 **Specific purpose transfers.** In recent years, the central government has introduced a number of special programs, as shown in Table 4.7, to cope with the perceived inadequacy of provincial spending in areas to which the center wishes to give priority. Such programs are designed by the center but implemented through the local governments. They are thus similar to the specific purpose (non-matching) transfers seen in other countries, although the expenditures on these programs are shown only in the central budget. Expenditure on all these programs taken together amounted in 1993 only to 1615 billion dong, or about four percent of total expenditure, with one-third of this figure being accounted for by reforestation. Many of these programs are directed to very specific activities, and the expenditure is spread so thinly across various sectors and provinces that it is unlikely to have any significant impact. In addition to these special programs, the central government also administers pensions to war veterans through the provinces: in 1993, expenditure on this item alone amounted to D 2374 billion, or far more than the total of all the programs shown in Table 4.7. Although in Viet Nam these specific purpose transfers are non-matching, generally such transfers have been found to be more effective when the recipient local governments -- the provinces, in this case -- are required to make matching contributions. Particularly when there remain significant disparities between localities even after the distribution of general purpose grants, as is likely to be true in Viet Nam in view of the paucity of resources available, higher subsidies (lower matching rates) may be appropriate for low-income provinces with larger concentrations of poverty.

4.50 One of the schemes specially targeted to alleviate poverty is the subsidized loan program introduced by the Treasury and implemented through the Ministry of Labor to create employment for the unemployed. The program was introduced in mid-1992 and the government has budgeted to spend about D 250 bn in 1994. The loans are given to individuals (D 50 bn) and to small enterprises and workshops (D 200 bn). Presently the scheme covers Hanoi and Ho Chi Minh cities and in mountainous low density provinces. Loans for self-employment at subsidized interest rates are given after scrutinising the applications submitted to the Provincial Peoples' Committees. The small enterprise loans, however, are not directly targeted to the poor, but are given to generate employment. In these cases too, the applications are evaluated by the Peoples' Committees. In both cases, the loans carry monthly interest rate of 0.5% for loans up to one year, 0.4% for loans up to two years, and 0.3% for loans up to three years.

4.51 While the introduction of the employment program is a welcome development, the program itself suffers from a number of shortcomings, most importantly that it is not targeted directly to the poor.

First, this is still a pilot program introduced in the two cities and only a few provinces. In fact, incidence of poverty in the two major cities is relatively low. Second, though the loans to enterprises are ostensibly given to generate employment, the recipients themselves can be quite affluent and there is no way to ensure that these enterprises in fact generate the number of jobs proposed, once the loan is received. Third, as the Peoples' Committee guarantees the loans, in the ultimate analysis it is the repayment capacity and possibly political influence and not intensity of poverty that determines the beneficiary. Experience from many countries indicates that subsidized interest rates rarely benefit the poor since competition for these funds becomes keen and the poor lack the political and economic clout to compete successfully.



4.52 The current employment program is not directly targeted at the poor; a public works scheme that would serve the very poor would be more appropriate. The sometimes acute seasonality of incomes, and the dire shortage of infrastructure, suggest that public works schemes may be a promising option for alleviating both transient and chronic rural poverty in Viet Nam. Public employment schemes offer unskilled work at low wages. Since only those who have no better alternative participate, such schemes are self-targeting. In many countries, this targeting mechanism has proved to reach the poor well.

4.53 **Reorganizing intergovernmental fiscal arrangements for poverty alleviation.** Intergovernmental fiscal arrangements in Viet Nam need to be reoriented in order to improve the consumption standards of the poor, particularly those living in the poorer areas of the country. Poverty alleviation through economic growth requires that the supply of social and economic infrastructure responds adequately to the increasing demands of the expanding market economy. Appropriate fiscal decentralization can help in this task.

Table 4.7: EXPENDITURE ON SPECIAL CENTRAL PROGRAMS IN PROVINCES

(Billion Dong)

PROGRAM	1993 (Actual)	1994 (Budgeted Estimates)
1. Education	216	430
(i) Popularizing primary education and spread of literacy	30	40
(ii) Education for mountain regions	60	80
(iii) Separation of primary schools from secondary schools	50	50
(iv) Improvement in class rooms	-	100
(v) Elimination of 3rd shift in schools	70	100
(vi) Books and Newspapers for mountain pupils	8	15
(vii) Improvement in secondary schools	6	25
(viii) Computer education for schools	-	20
2. Training Programs	10	105
(i) Improvement in teaching material and courses	10	15
(ii) Computer for schools		20
(iii) Upgrading basic materials		20
3. Medicine and health programs	132	305.2
(i) UNICEF water supply programs for mountain region	-	15.4
(ii) Anti-Malaria program	52	70
(iii) Anti-Goiter program	30	59.3
(iv) Immunization program	15	25
(v) Anti-HIV program	10	40
(vi) Upgrading material bases	25	70
(vii) Establishing health care centers in non-existent areas	-	25.5
4. Population and family planning program	93	225
5. Cultural and information programs	-	30
(i) Information and cultural activities for the communes	-	10
(ii) File making, renovation and developing	-	10
(iii) Cultural and historical heritage reproduction	-	10
6. Child care	2	30
7. Job programs	300	250
8. Support for Khmer, Cham and other minorities	10	30
9. Administration of boundary mapping	30	42
10. Price support policy for specified commodities	170	250
11. Project 327; Reforestation	584	610
12. Anti-social evils programs	60	70
(i) Anti-opium plantation	50	50
(ii) Abolition of prostitution	10	20
Total	**1615**	**2377.2**

4.54 Local governments should have much more expenditure autonomy than at present. Investment decisions which affect only local communities should be decided locally, rather than centrally, as is the case at present. Similarly, since resources are limited, local governments should have greater autonomy to adjust local spending (on most items) to reflect local preferences and realities. Provinces might be allocated a sum of money with which to provide services assigned to their level. This sum should be determined based on available resources and a distribution formula which includes considerations such as population, cost of delivering services, per capita income etc. This broad approach may need repeated fine-tuning if it appears that the wrong variables, or not enough indicators, have been chosen.

4.55 One aspect of greater fiscal autonomy is the power to raise revenues. At present, the provinces can increase their spending only when the actual collection of revenues assigned to them exceeds the budgeted targets. As the tax department is not entirely within their jurisdiction, provinces thus have little flexibility in raising revenues. Moreover, the provinces do not have the right to determine the rates of any taxes. If provinces are to be able, within centrally determined limits, to determine the level and composition of their spending, they will need more independent revenue-raising authority. Of course, the power to levy taxes whose bases are mobile across different provinces should remain with the center, and local governments should be restrained from imposing taxes that will basically be exported to other areas. The basic principles of local revenue assignment are: (i) Local own-source revenues should ideally be sufficient to enable at least the richest local governments to finance from their own resources all local services primarily benefiting local residents (as opposed to those with significant externalities such as education); and (ii) to the extent possible, local revenues should be collected from local residents only, preferably in relation to the perceived benefits they receive from local services.

4.56 When transfers are needed to finance local expenditures, they should provide incentives for local revenue mobilization and, as a rule, allow for some degree of equalization. The critical point is that local governments must, if they are to be held accountable for their actions, have some responsibility for determining tax rates. This would both allow them to vary rates to collect larger revenues to finance higher levels of public services if they so choose and at the same time allow the central government to design its transfers in such a way as to ensure that local fiscal efforts were not discouraged by the receipt of such funds. Vesting the provinces with at least some independent revenue-raising authority is essential to establishing a linkage between revenue raising and expenditure decisions at the margin. Tax administration is currently centralized (and creating local tax collection capacity at this time is unrealistic) and central collectors will have far greater incentive to collect central taxes rather than a separate local tax. Thus, as mentioned in Chapter 2, a promising option would be to permit local governments to "piggyback" onto national tax bases (i.e., add an additional rate to an already existing tax collected by the center). This would permit local governments to collect additional revenue and enable the delivery of services which correspond to local preferences and abilities.

4.57 Of course, if local governments are vested with the power to levy important taxes, inevitably richer provinces will collect larger revenues. To offset this disequalizing effect, as just noted, transfers can be designed to provide sufficient revenues to local governments to carry out a "standard" (minimum) set of local expenditure, as set for example by a revised method of determining expenditure needs, provided they levy taxes at average national rates. If they lower taxes below this level, they are not rewarded by higher transfers: the result is thus that local residents are penalized. If, on the other hand, they raise taxes above the required level, then total expenditures may be increased. The precise design

and implementation of such a transfer system would require further study, but it should certainly be feasible in Viet Nam, if desired.

4.58 Sensible local government decisions require a greater degree of stability and certainty in financial arrangements than now prevails. Uncertainty in revenues renders planning for the medium term difficult. In addition, larger revenue collections in a province in one year have typically resulted in higher targets for the next year and appear in at least some cases to result in a lower provincial share of turnover taxes. In Hanoi, for example, revenue collections in 1993 were higher than the previous year by over 50% and exceeded the budget estimates by 15 per cent. Much the same happened in 1992. Consequently, the share of turnover tax accruing to the city was reduced from 70% in 1992 to 36% in 1993 and was further reduced to just 6.3% in 1994. The new budget law should improve matters somewhat by introducing some stability in these tax-sharing arrangements. A more scientific method of forecasting revenues and expenditures would also be an improvement, although this too is a matter for further study. As in the case of transfers, simpler and more transparent arrangements in determining investment allocations are also needed.

4.59 Another area where reform seems needed is in regard to the special programs initiated by the center. Most of them are so small they seem unlikely to have any significant impact on anything. It would seem more sensible to focus on a few programs that might have an impact on poverty reduction. Providing family planning, and adult literacy, for instance, are programs that would appear useful from this perspective. Given the nationwide externalities from spending on human capital formation, provincial initiative in these areas may be encouraged by specific purpose matching grants. There may also be a place for such grants, at higher rates of subsidization, in mountainous regions and for ethnic minorities. If the provinces are given the right to levy and collect some taxes, introduction of specific purpose transfers with matching resource requirements can result in greater provincial participation and help to augment more resources for their special programs. The correct matching rate is, in this approach, set by the size of the spillovers. Basically, a matching grant program designed to encourage the optimal provision of public services should therefore vary primarily with the nature of the activity, that is, depending on the level of associated externalities. Since, however, no country has achieved full equalization of local fiscal capacities, a uniform matching level offering the same "price" to all local governments will yield non-uniform responses in rich and poor localities. Even if revenue bases are fully equalized, need or cost differentials may require an equalization element in matching grant formulas. For example, per capita grants for roads in sparsely populated and mountainous regions should as a rule be larger simply because the per capita cost of achieving any particular standard of road service will obviously be higher.

4.60 The evolution of intergovernmental fiscal arrangements should build on the existing system to the extent possible by minimizing its undesirable effects and imparting the necessary autonomy, incentives and accountability to various levels of government. The key elements in this process would include the following:

- devolution of some independent revenue-raising authority to local governments, in particular, the right to set the rates of some local taxes;
- creation of a more adequate method of resolving vertical and horizontal imbalance through revenue sharing arrangements and general purpose grants;

- identification of activities for which specific purpose transfers should be made and determination of the matching requirements that should be established for different provinces;

- provision of adequate stability in intergovernmental fiscal arrangements.

4.61 A system along these lines should prove much more responsive to the changing needs of an emerging market economy while providing social and economic infrastructure in an efficient manner. On paper, Viet Nam currently has a highly centralized public sector; in practice, however, the way the system works is to produce unplanned decentralization which basically places the poorer provinces in a relatively weaker position. Moreover, local government in rural areas throughout Viet Nam have insufficient resources to provide key public services to their populations since the cost of providing these services has not been calculated and thus revenues are inadequate to deliver the services. More formal decentralization in a coordinated and coherent framework along the lines sketched above would be a substantial improvement and could prove a major step towards the implementation of more effective policies for poverty alleviation.

C. Rural Finance and Development

Developing a Rural Financial System to Improve Access to Credit

4.62 With poverty heavily concentrated in rural areas, development of this sector is critical to poverty reduction in Viet Nam. Decentralization of certain public expenditures (investment and recurrent) and an improved system of intergovernmental finances would help local governments provide key public services in rural areas which would help households respond to market incentives and stimulate rural development. But households are greatly constrained by lack of capital. At present, there are features of the rural financial market – namely in the imposed interest rate structure and high access costs to obtaining credit – which limit the ability of households to borrow funds. Removing these constraints would help create the appropriate incentive structure which could both encourage households to save and invest, and enable and encourage rural financial institutions to lend. This section discusses the present situation in rural finance and explores what improvements could lead to greater access to capital for households and ultimately, a more vibrant rural economy.

4.63 With over 80% of Viet Nam's population residing in rural areas, agricultural activities account for a significant share of Viet Nam's employment, production, and exports. The sector has also played a lead role in the transition to a market-based economic system and in the formation of private farms. This transition has unleashed a major upward shift in the demand for capital in the private sector of agriculture, which has exceeded the capacity of the agricultural banks to respond. In this same interval the rural financial institutions also went through significant restructuring. At this juncture short-term credit for working capital dominates the type of financing offered through both the banks and informal lenders. Formal credit is severely rationed because of the inability of the banks to mobilize sufficient savings, and owing to interest rate controls exercised by the State Bank of Viet Nam (SBV).

4.64 As Viet Nam's poverty profile clearly indicates, the incidence of poverty is much higher in rural than in urban areas. Access to credit is commonly believed in Viet Nam to be a serious constraint

to poverty alleviation. Owing to inadequate collateral and high transaction costs (including travel and time), poor households have traditionally lacked access to formal credit, and have consequently relied on costly informal credit. Even with the heavy reliance on the informal sector, the credit gap in the rural sector is large and will likely remain that way until fundamental constraints are removed, competition is enhanced, and public confidence in the banking system is restored.

4.65 A system of rural credit delivery is continuing to evolve in Viet Nam from the old state bank structure (within which the Viet Nam Bank for Agriculture operated) towards a more diverse set of rural financing institutions. The VBA continues to play a major role in this changing structure, though several alternative private financial institutions have begun to emerge in rural Viet Nam. The strategy of the SBV is to license new institutions that will supplement the efforts of VBA. Foremost has been the replacement of the former rural credit cooperatives with private, rural shareholding banks (RSBs) and Popular Credit Funds (PCFs) during 1992-93. These new institutions face significant challenges; nevertheless, their emphasis on rural savings mobilization, more outreach and lower transaction costs, and access of the poorer households offers important lessons for rural financial development. Indeed, the VBA is beginning to learn this lesson as well, and has stepped up its outreach efforts for both savings and lending.

4.66 **VBA.** The VBA remains the dominant formal credit institution in rural Viet Nam. It maintains an extensive rural branch banking system which serves not only its primary role as a direct lender, but also that of an indirect lender through "economic organizations" (such as cooperatives) and other rural financial institutions (such as the rural shareholding banks). Thus, the VBA exerts a strong influence on rural financial conditions. In August 1993, there were: 5 regional offices, 51 provincial branches, 413 district branches, and 150 sub-district (commune-level) branches. In addition the VBA created 995 "deposit-taking units" which operate at the commune level. Although the VBA is currently a universal bank with authority to lend in various sectors, it remains a highly specialized, agricultural bank with a loan portfolio that is dominated by short-term, production loans to farm households, with an average size of US$122. Overall, short-term loans represented about 90% of total VBA loans outstanding at end-1993. The VBA maintains a monopoly position in a large number of the rural districts. This suggests both a high level of credit risk exposure due to the implied high level of loan concentration in agriculture, and a lack of effective competition for the VBA in the rural areas.

4.67 There are a number of positive developments in the provision of rural credit through the VBA which generally reflect a shift away from financing the state-owned enterprises and towards financing private households and businesses: new loan volume to private borrowers grew from about D 355 billion in outstanding loans at the end of 1991 to about D 3,923 billion at the end of 1993. In 1992, the VBA provided credit to only about 9% of the potential private, rural borrowers in Viet Nam. Based on end-of-year 1993 loans outstanding, the corresponding percentage of households receiving credit through the VBA had increased to about 20% of rural households.

4.68 The VBA is beginning to develop greater operational efficiency and outreach through a rationalization of its rural network and innovations in rural lending. It has begun to experiment with the extension of banking services to rural areas through the establishment of sub-district transactions offices and the formation of mobile-banking teams which visit villages in the district on a frequent basis. The transactions offices appear to provide better access for rural households by allowing more frequent savings deposits and withdrawals and loan repayments. The mobile-banking teams are primarily used

to initiate loan applications. The actual loan approvals and disbursements require the borrowers to visit a bank office for final loan signatures and the actual receipt of funds. So while these efforts are able to reduce the transaction costs of loans, the district-based lending still entails some access costs.

4.69 VBA's expanded programs are going in the right direction; nevertheless, they represent a rather fragmented approach to the general problem of insufficient rural financial services. The loan approval process places a heavy emphasis on collateral of the borrower and not the earnings and cash flows of the enterprise. The emphasis on collateral is in sharp contrast with the fact that: most loans are short-term; all loan transactions are in cash; and the default rate (the contingency for which loans are secured with property) is generally extremely low. A shift of lending orientation in the VBA and other rural banks to cash flow and earnings-based lending is highly recommended.

Other Rural Financial Institutions

4.70 **Popular credit funds (PCF).** PCFs are commune-level credit institutions which were introduced during 1993 into 14 provinces (73 districts and 173 communes) on an pilot basis by the SBV. Since the VBA was unable to fill the void created by the failure of the rural credit cooperatives in 1990-91, the creation of the PCFs was part of the SBV's strategy to increase the access of small farmers to production credit. The PCF scheme is modeled after the Caisse Populaire system in Quebec, Canada, and is built around a Central Credit Fund (with plans to eventually include a set of Regional Credit Funds at the provincial level). The Central Fund is to safeguard the local PCFs against the covariant risks to which they are exposed because of the local and highly specialized nature of their loan portfolios. The Central Fund receives 40% of its capital through the SBV and the balance through shares held by the local and regional units. The plan is to expand the scheme from 62 open local funds (out of 83 authorized funds in early 1994) to over 200 in 1995.

4.71 The scope of financing operations of the PCFs in early 1994 was quite limited - as were the funds they managed. The PCFs provide only short-term credit through small working capital loans. The average loan size among PCFs visited in the north varied from 250,000 to D 1 million (the smallest loan reported was just D 50,000 - approximately US$ 5). A majority of PCF loans are for farming activities such as crop production and livestock raising. The current credit market niche of the PCFs is to meet small farmer credit needs. Similarly, the credit shareholding cooperatives are oriented to small farms with a heavy emphasis on lending to the rural poor households in their service areas. In each case the service area is quite small which suggests that the funds will also remain small for some time.

4.72 Funding of the PCFs occurs primarily through member shares and deposits. This is a strong feature of the PCFs as rural financial institutions. Deposit growth was rapid at the onset of their operations, but still represented only about 60% of loans outstanding in February 1994. In aggregate the PCFs maintain extremely high lending positions at about 170% of their deposits and 90% of their total deposit and equity funds. However, even with those illiquid positions, the PCFs generate relatively modest operating profits because of controls placed on their deposit and lending rates by the SBV. The PCFs are allowed to lend at spreads of 1%/month over their cost of funds. In addition to deposit funds the Central Credit Fund has reportedly loaned about D 5 billion to the PCFs at a rate of 2%/month and the PCFs were allowed to on-lend at 3%/month.

4.73 The PCF system currently exhibits three features which are highly appropriate for rural credit in Viet Nam: local access of borrowers and savers through the control of transactions costs, risk-sharing across local lending units, and emphases on savings mobilization and loan repayment. As the system evolves, it will be characterized by numerous commune-level units because of the orientation to providing access for small, rural borrowers and savers to financial services. Future growth in the number of clients, the number of local PCFs (as the system expands to other provinces and districts), and the range of financial services are expected to create pressures within the PCF system to develop a set of intermediate-level institutions which can effectively deal with the administrative aspects of credit delivery, funds mobilization, and risk-sharing. Three alternative systems could be considered: a 3-level system including central (CCF), regional (RCF) and local (PCF) units; a 2-level system consisting of RCFs and PCFs with the role of the CCF redefined to be just the insurance and risk-management agency of the system; or a 2-level system where the CCF continues to operate as it does currently but the PCFs are reorganized into district-level units with commune-level offices for disbursement and collection. The second alternative provides some advantages over the other two schemes. First, it more clearly defines the unique role of the CCF with respect to system risk management. Second, it decentralizes the administrative functions of the CCF to the regional level without creating a third layer in the system. Thus, it is potentially more flexible, cost-efficient and competitive than a 3-level institution.

4.74 **Rural shareholding banks (RSBs).** RSBs have also been gradually taking the place of the old rural credit cooperatives in rural areas. The majority are located in the south and by the end of 1993 there were 44 RSBs licensed through the SBV. Their numbers have increased gradually over time: 5 (in 1991), 18 (in 1992) and 21 (in 1993). Since many of the RSBs have only recently been formed the ownership remains concentrated in the hands of a few large shareholders. RSBs that were visited reported about 50-60 shareholders with a few shareholders having large share positions.

4.75 In most cases the RSBs are focused on lending to farm households in their service areas. For example, in the south the primary emphasis of RSBs has been on rice crop intensification, land-leveling, and development of fruit gardens. The proportion of RSB credit flowing to rural traders and others is relatively small at approximately 15-20%. RSB loans carry short maturities and are generally of small average size (D 1-3 million). An additional feature of the RSBs is their relatively stronger emphasis on lending to poor rural households. Although the definition of a poor household varies somewhat across the country, the proportion of funds loaned by the RSBs to the poor significantly exceeds the proportion of poor households in the districts in which they operated. This is in contrast to the loan portfolios reported by the VBA district and provincial offices where the poor represented a minor borrower category. The RSBs have also been financial innovators. They have utilized joint-liability, group-based lending to rural borrowers and they have simplified their lending procedures. In addition they have attempted to expand savings mobilization by combining the savings and credit activities of their customers.

4.76 Large proportions (50-80%) of RSB funds are directly obtained from the VBA at rates of 2.6%/month. The RSBs onlend those funds to farmer households at 3.0%/month. In effect the RSBs are operating as service centers for the VBA and their dependency on the VBA for funds means that they do not effectively compete with the VBA. In fact, the RSBs report that they meet 10-30% of the estimated credit needs in their areas, which is nearly identical with the percentages quoted by the VBA districts. The funding problem of the RSBs emanates in significant part from the deposit interest rate limitations imposed by the SBV and the lack of access to financial markets. Savings mobilization efforts

of the RSBs are also thwarted by the fact that the primary savers are traders, who represent a relatively small clientele of the RSBs. The emerging strategy of these RSBs is to expand the offering of shares to existing shareholders and traders to develop a larger financial base from which to lend. That strategy appears to be warranted given the small numbers of existing shareholders in these institutions.

4.77 The RSBs are legitimate financial institutions and they will need greater access to funds in the future if they are to achieve their objective of extending the availability of credit and financial services to the rural population and provide a source of competition in those markets. The SBV should explore: (1) the development of an interbank funds market with flexible interest rates and access provided for the RSBs and (2) the development of a system of correspondent banking to expedite the flow of funds and increase the capacity of RSBs to meet the demands of larger rural customers. Additionally, the SBV should consider providing direct access of the RSBs to an SBV rediscount facility so that the RSBs could expand their lending capacity and reduce their dependence on the VBA. Either or both of these measures could help to release the severe funds constraint under which the RSBs currently operate.

4.78 **Group lending.** Formation and utilization of group-lending programs has become fairly widespread within the VBA, RSBs, and PCFs. Group-lending appears to be well-suited to the set of social mores that exist at the commune level. In addition, those lending arrangements are socially consistent with the cooperative forms of credit institutions that formerly existed in the rural areas. Group lending often takes the form of joint-liability whereby full loan repayment is a collective responsibility of the group and existing loans must be fully repaid before any additional funds are provided. Borrower groups have been formed from members of the Women's Union, the Farmers' Association, veterans groups, etc. Group lending reduces the transaction costs associated with making and collecting many small loans, since groups provide some cost economies of size in the lending process. At this time the cost advantages of group transactions are being partially realized on the lending side, but similar advantages would accrue to the institutions if groups were also used for savings mobilization.

4.79 Joint-liability, group-lending also potentially improves the access of the rural poor to credit, since joint-liability serves as a form of guarantee to the lender which reduces the importance of tangible collateral in the lending arrangement. While this benefit should accrue to the poor, in reality many groups still require member collateral (e.g., the house or personal property). There are indications that a significant percentage of the farmers have not been able to establish clear use rights to land because of disputed ownership and the inability of the Peoples' Committees to resolve those disputes quickly. While group-lending schemes generally improve the access of rural households to formal credit, the fundamental problem still remains that there is a severe rationing of formal credit in the rural areas. As a result, a borrower group frequently receives funds for only a fraction of the borrowing request it makes to the VBA and the balance must be found through avenues such as informal credit.

4.80 **Informal finance.** Despite the VBA's emphasis on private household loans, and the growing importance of PCFs and RSBs, growth in demand for those loans continues to far out-distance the ability of the VBA and other formal rural lenders to respond with funding. As a result, the informal credit market remains a significant source of credit in the rural areas.

4.81 Previously, informal credit markets were suppressed in Viet Nam. The recent economic liberalization has, however, contributed to the resurgence of informal credit institutions and markets. The informal agents (moneylenders, relatives, merchants, and friends) are unregulated and unsupervised in

their financing activities. The diverse financial agents which comprise the informal segment of the rural financial sector currently meet a significant part of the overall production and consumption financing requirements of the rural population. The recent Viet Nam Living Standards Survey (VNLSS) indicates that 72% of households which take loans, borrow from the informal sector, only 20% from the formal, private or government banks, and 6% from cooperatives. Since average loan size was nearly identical for informal and formal loans in the survey, the implication is that these percentages also approximately represent the loan market shares captured by the informal and formal segments - about 70% and 30%, respectively.

4.82 Informal lenders serve a very important role in the rural sector filling a critical gap created by VBA limitations. These include:

- very high transaction costs due to ineffective operation in the more remote rural areas;
- inadequate size of VBA loans necessitates gap filling with informal lending;
- short maturity of VBA loans creates cash flow difficulties and necessitates informal borrowing as bridge financing to repay;
- VBA loan collateral requirement creates a barrier to entry for some poor, rural households which lead them to informal lenders.

4.83 Despite efforts by the VBA and other rural financial institutions to expand access, informal lenders will remain an important source of rural, agricultural financing owing to the continuation of policy and capacity constraints on the government banks.

4.84 **Rural interest rates.** The SBV sets reference interest rates for all financial institutions. The VBA, RSBs, and other formal lending institutions operating in the rural areas onlend at rates that are derived from those reference rates. The basic structure of the SBV rates is one of increasing term structure on deposits, but an inverted term structure on loans.

4.85 Two problems arise out of the observed interest rate structure for VBA's loans. First, the observed variation in short-term loan rates is quite small given the likely differences in credit risk that are present between groups of short-term borrowers. For example the 2.7-3.0% range applies to farmers, traders, and processors -- each of which pose quite different production and market-related risks for the VBA's loan portfolio. This observed small variation in short-term rates suggests that differences in credit risk are not being appropriately evaluated by the VBA district offices, and training in credit evaluation procedures may be warranted. The interest rate guidelines of the SBV may also be creating an undesirable effect on the way in which short-term loan rates are applied. The 2.5%/month rate sets an artificial minimum on the short-term rate below which the VBA districts are hesitant to go, even though high-quality borrowers merit such lower rates. Thus, rates are typically varied only slightly above that rate level and do not reflect true credit quality spreads.

4.86 The second major issue is the inverted rate structure for medium-term loans. Clearly, the SBV's 1.2%/month reference rate on medium-term loans does not reflect maturity or credit risk premia, and acts as a barrier to more effective intermediation in the medium- and long-term segment of the rural

credit market. Given that banks cannot mobilize long-term deposits at those low rates, lending short-term deposits on a medium-term basis at the SBV rate would result in a negative spread for the banks and expose them to potentially significant interest rate risk. Adding to this dilemma is the recent decrease of both short-term and medium-term interest rates by 0.3%/month. That decrease actually penalized the medium-term segment of the market more than the short-term segment, because it reflected a 20% reduction in the medium-term loan rate, but only a 14% reduction in the short-term loan rate.

4.87 Although there is variation in the interest rates which informal lenders charge, short-term (1-2 month) informal rates are usually reported to be in the 6-10%/month range or about 2-3 times the level of comparable VBA rates. The VNLSS results suggest that these rate relationships differ by maturity and by comparison with formal lenders. For example, informal lender monthly rates are comparable to private bank rates, but are about three times higher than the rate available at the government banks. The corresponding interest rates on 1-year loans place private bank loan rates at about the same level as informal rates, but informal loan rates are 5-6 times those at the government banks. Thus, there is greater dispersion in longer term loan rates than among short-term rates. This may be due to the lack of competition at the longer maturities. Adding to this dispersion is the fact that the SBV has enforced an inverted interest rate structure on government bank loans (so that medium- and long-term interest rates are lower than short-term rates) while informal rates reflect a more normal term structure.

4.88 **Recommendations**. The availability of medium- and long-term credit needs to be improved as part of an overall strategy to strengthen rural financial services. Long-term loan availability does not appear to be a collateral-based problem. Rather, the banks are hesitant to lend on terms which exceed their existing deposit maturities owing to uncertainty about interest rates. To address this problem the SBV needs to reconsider its existing interest rate policy which inverts the term structure of loan rates. The SBV and commercial banks need to develop a strategy for increasing the maturity of deposits and encouraging depositors to respond. Finally, the banks should consider ways in which to extend the maturity of short-term loans from their existing 3-4 month duration to periods of 9-12 months -- particularly where livestock loans are involved.

4.89 Measures should be taken to increase the efficiency of financial intermediation in the rural financial sector by injecting greater competition and through innovations. Currently, the VBA dominates the sector and is not efficient in its operations. The PCFs are an innovation which should be expanded to other provinces according to the plan of the SBV. However, the strategy to develop a third layer of regional funds in the PCF system should be re-evaluated at this dynamic stage of institutional development. Growth and expansion of the PCF system should emphasize flexibility, cost-efficiency, and competitiveness. The SBV should assist the RSBs in their efforts to increase rural lending. The RSBs need an alternative to VBA financing and assistance in developing strategies for deposit mobilization. Access to a domestic inter-bank funds market would provide the RSBs with another source of loanable funds. As a second measure, the SBV should consider providing direct access of the RSBs to SBV refinancing facilities. If the PCFs and RSBs are lower cost providers of financial services (as expected), gains in the intermediation process associated with an expansion of activity by both financial institutions would accrue to the rural clients of the banks in the form of lower interest rates.

4.90 An innovation to gain operational efficiency would be for the banks to integrate their savings mobilization and credit delivery functions. The focus could be on a more effective use of rural client

groups. A second innovation would be to devise the means by which the RSBs could develop co-financing arrangements for rural borrowers where the loan requests exceed the lending capacity of an individual bank. A third innovation would be to develop ways in which to link the activities of the informal financing sector with those of the formal lending institutions. The primary advantage would be lower cost of credit delivery, particularly for small rural loans. A final efficiency measure would be to eliminate the role of the local Peoples' Committees in the credit approval process. Their role can be more effectively fulfilled by the banks, the courts, and the private sector.

STATISTICAL APPENDIX

Table 1.1: POPULATION

Year	Population ('000; mid-year)	Growth Rate (%)
1975	48,030	2.57
1976	49,158	2.35
1977	50,295	2.31
1978	51,436	2.27
1979	52,574	2.21
1980	53,700	2.14
1981	54,722	1.90
1982	55,687	1.76
1983	56,655	1.74
1984	57,692	1.83
1985	58,868	2.04
1986	60,249	2.35
1987	61,750	2.49
1988	63,263	2.45
1989	64,774	2.39
1990	66,233	2.25
1991	67,774	2.33
1992	69,405	2.41
1993	70,918	2.18

Source: World Bank, Population and Health Department.
Revised based on the 1988/89 Census, and most recent data.
General Statistical Office, Statistical Data of the Socialist Republic of Viet Nam, 1986–1991, Statistical Publishing House, 1992.
General Statistical Office, Economy and Finance of Viet Nam, 1986–1992, Statistical Publishing House, 1994.

Table 1.2: POPULATION BY SEX AND BY PROVINCE (thousand persons)

Region/Province	1992 Population	1991 Population Total	Male	Female
Ha Noi - Hai Phong:				
Ha Noi	2,099.6	2,095.0	1,013.2	1,081.8
Hai Phong	1,556.6	1,516.8	733.0	783.8
Sub-Total	3,656.2	3,611.8	1,746.2	1,865.6
Northern Mountains:				
Ha Giang	507.2	489.9	243.5	246.4
Tuyen Quang	614.4	597.2	296.8	300.4
Cao Bang	614.5	591.5	288.3	303.2
Lang Son	656.8	643.6	313.0	330.6
Lai Chau	485.7	467.6	230.0	237.6
Lao Cai	517.7	491.5	241.8	249.7
Yen Bai	621.4	610.4	300.3	310.1
Bac Thai	1,117.8	1,082.6	530.3	552.3
Son La	753.4	726.8	356.3	370.5
Hoa Binh	697.5	722.9	351.3	371.6
Vinh Phu	2,160.0	2,097.7	994.8	1,102.9
Ha Bac	2,218.4	2,172.9	1,039.0	1,133.9
Quang Ninh	878.8	848.2	426.7	421.5
Sub-Total	11,843.6	11,542.8	5,612.1	5,930.7
Red River Delta:				
Ha Tay	2,177.5	2,130.0	1,004.5	1,125.5
Hai Hung	2,613.6	2,554.5	1,201.9	1,352.6
Thai Binh	1,740.6	1,705.4	800.7	904.7
Nam Ha	2,537.6	2,473.7	1,171.2	1,302.5
Ninh Binh	821.5	800.1	383.8	416.3
Sub-Total	9,890.8	9,663.7	4,562.1	5,101.6
North Central Coast:				
Thanh Hoa	3,243.8	3,152.9	1,514.0	1,638.9
Nghe An	2,620.9	2,561.9	1,248.5	1,313.4
Ha Tinh	1,265.8	1,234.5	591.1	643.4
Quang Binh	718.0	693.2	336.4	356.8
Quang Tri	507.4	490.8	234.0	256.8
Sub-Total	8,355.9	8,133.3	3,924.0	4,209.3
South Central Coast:				
Thua Thien - Hue	950.4	920.9	441.5	479.4
Quang Nam - Da Nang	1,873.5	1,796.3	837.2	959.1
Quang Ngai	1,122.5	1,090.4	509.9	580.5
Binh Dinh	1,339.6	1,292.0	613.3	678.7
Phu Yen	691.7	670.5	325.7	344.8
Khanh Hoa	901.2	871.7	419.9	451.8
Ninh Thuan	834.5	412.0	200.4	211.6
Binh Thuan	436.8	823.6	400.3	423.3
Sub-Total	8,150.2	7,877.4	3,748.2	4,129.2
Central Highlands:				
Gia Lai	713.6	773.8	382.3	391.5
Kon Tum	241.1	149.8	74.3	75.5
Dac Lac	1,126.9	1,072.3	556.4	515.9
Lam Dong	722.3	693.0	339.6	353.4
Sub-Total	2,803.9	2,688.9	1,352.6	1,336.3
Ho Chi Minh City and Environs:				
Ho Chi Minh City	4,181.6	4,075.7	1,919.3	2,156.4
Song Be	1,057.4	1,017.0	497.1	519.9
Tay Ninh	848.5	827.0	396.9	430.1
Dong Nai	1,721.6	1,742.4	857.6	884.8
Baria - Vung Tau	636.4	532.1	269.8	262.3
Sub-Total	8,445.5	8,194.2	3,940.7	4,253.5
Mekong Delta:				
Long An	1,198.4	1,177.1	576.8	600.3
Dong Thap	1,433.8	1,401.6	662.1	739.5
An Giang	1,896.8	1,849.7	905.1	944.6
Tien Giang	1,590.2	1,557.4	733.6	823.8
Ben Tre	1,286.1	1,264.3	600.6	663.7
Vinh Long	1,023.2	1,003.9	474.5	529.4
Tra Vinh	919.2	901.1	425.8	475.3
Can Tho	1,741.7	1,695.0	812.8	882.2
Soc Trang	1,146.3	1,123.9	534.3	589.6
Kien Giang	1,296.5	1,266.0	610.0	656.0
Minh Hai	1,682.1	1,642.6	788.8	853.8
Sub-Total	15,214.3	14,882.6	7,124.4	7,758.2
Grand Total	69,405.3	67,774.0	33,209.1	34,469.6

Note: Data do not add to grand total, due to possible exclusion of military forces.
Source: 1992: General Statistical Office, Economy and Finance of Viet Nam, 1986-92, 1994; 1991: Statistical Yearbook, 1991.

Table 1.3: TOTAL EMPLOYMENT BY SECTOR, 1986-93

(Thousands of Persons)

	1986	1987	1988	1989	1990	1991	Rev. 1992	Prel. 1993
Total Employed Labor Force	27,399	27,968	28,477	28,941	30,294	30,974	31,819	32,716
State Sector	4,028	4,091	4,052	3,801	3,421	3,144	2,975	2,923
Cooperatives	19,730	20,283	20,658	19,750	20,414	18,071	18,629	..
Private	3,641	3,594	3,768	5,390	6,459	9,759	10,215	..
State Sector Employment (by unit)	4,028	4,091	4,052	3,801	3,421	3,144	2,975	2,923
Government	1,369	1,383	1,359	1,295	1,241	1,228	1,194	1,185
Central	343	337	327	282	253	279	264	262
Local	1,026	1,046	1032	1,013	988	949	930	923
State Enterprises	2,659	2,708	2,693	2,506	2,180	1,916	1,781	1,738
Central	1,278	1,226	1236	1,188	1,091	1,018	978	956
Local	1,380	1,482	1457	1,318	1,089	898	803	782
Employment by Sector								
Productive Sector	25,553	26,054	26,497	27,061	28,328	28,973	29,783	30,591
Industry	2,918	3,047	3,150	3,241	3,392	3,394	3,450	3,522
Construction	883	825	856	795	818	820	825	848
Agriculture	19,798	20,246	20,446	20,698	21,689	22,276	22,998	23,684
Forestry	178	173	211	197	206	207	210	214
Transportation	450	429	443	455	476	480	484	496
Telecommunications	38	42	40	40	37	47	51	51
Trade and Supply	1,259	1,268	1,331	1,606	1,681	1,719	1,735	1,776
Other	31	24	21	29	30	30	30	..
Non-Productive Sector	1,846	1,915	1,980	1,880	1,965	2,001	2,037	2,125
of which:								
Science	64	57	60	60	53	49	48	48
Education	706	750	830	768	863	804	825	848
Arts and Culture	38	46	45	43	45	46	46	46
Public Health	300	297	305	288	303	309	318	327
Finance, Insurance, State Management and Others	273	289	247	721	701	793	799	856

Note: Figures are rounded.
Source: General Statistical Office.

Table 2.1: NATIONAL INCOME AND ESTIMATED GDP, 1986-1991

(Billions of Dong at 1982 Prices)

	1986	1987	1988	1989	1990	1991
Agriculture	84.6	84.8	88.8	95.5	96.9	96.8
Forestry	1.4	1.7	1.7	1.7	1.8	1.9
Industry	48.4	52.6	57.7	56.3	58.2	61.1
Commerce	23.4	24.3	25.9	26.7	27.9	29.4
Transport and Communications	3.1	3.5	3.5	3.2	3.4	3.7
Construction	5.0	5.3	5.2	5.4	5.7	6.0
Other	3.6	3.7	3.9	3.9	4.1	4.2
National Income a/	169.6	178.7	190.3	194.1	199.6	206.0
Non-Material Services and Depreciation b/	61.1	61.0	61.6	77.9	87.0	95.0
GDP at 1982 Prices c/	230.7	239.7	251.9	272.0	286.6	301.0
GDP at Current Prices c/d/	636.0	3,099.0	13,266.0	28,135.0	41,848.0	76,707.0
Implicit GDP Deflator (1982 = 100) e/	2,757	12,929	52,664	103,438	146,015	254,841
			(Percentage Change)			
National Income	3.3	5.4	6.5	2.0	2.8	3.2
Agriculture	1.4	-3.4	4.7	7.5	1.5	-0.1
Industry	4.6	8.6	9.8	-2.5	3.3	5.1

Note: In 1989, the General Statistical Office (GSO) instituted the United Nations' System of National Accounts (SNA). The Material Product System (MPS) is no longer available. The SNA series are presented in Table 2.2.
Figures are rounded.

a/ The term "national income" refers to the MPS. The basic difference with the United Nations' SNA is that the MPS does not include non-material services or depreciation.
b/ Includes estimates of unreported economic activities.
c/ Bank staff estimates.
d/ New Dong.
e/ Proxied by average increase in consumer prices.

Source: General Statistical Office, Statistical Data of the Socialist Republic of Vietnam, 1976-1990, Hanoi: Statistical Publishing House, 1991 and Bank staff estimates.

Table 2.2: GROSS DOMESTIC PRODUCT BY INDUSTRIAL ORIGIN AT MARKET PRICES, 1989-1993
(Billions of Dong)

	1989	1990	1991	Rev. 1992	Rev. 1993
			(in 1989 Prices)		
Goods					
Agriculture and Forestry	11471	11641	11894	12751	13235
Industry	5366	5499	6042	6925	7766
Construction	1077	1128	1186	1317	1558
Other Production	347	360	370	381	399
Services					
Transport and Communications	709	743	792	842	897
Trade	3311	3485	3654	3877	4109
Finance, Insurance, and Banking)	..	368	448	496	578
State Sector)	5855	2627	2841	3040	3322
Other Services)	..	3667	4059	4362	4871
Gross Domestic Product	28135	29529	31286	33991	36735
Growth Rate	8.0%	5.0%	6.0%	8.6%	8.1%
			(Billions of Current Dong)		
Goods					
Agriculture and Forestry	11471	15625	30314	36468	39998
Industry	5366	8169	15193	23956	29371
Construction	1077	1929	3059	6179	9423
Other Production	347	356	744	1045	1476
Services					
Transport and Communications	709	1330	2860	4662	6036
Trade	3311	5576	9742	15281	17549
Finance, Insurance, and Banking)	..	710	1108	1567	2318
State Sector)	5855	4084	6807	9718	14402
Other Services)	..	4151	6880	11659	15998
Gross Domestic Product	28135	41848	76707	110535	136571
		48.7%	83.3%	44.1%	23.6%

Note: In 1989, the General Statistical Office (GSO) instituted the United Nations' System of National Accounts (SNA).
The SNA series presented here are based on the most current official version. Since these series are new, they have been going through several estimates and are still being revised and improved.
This is the series as of May 12, 1994

Source: General Statistical Office and Bank Staff estimates.

Table 2.3: FIXED INVESTMENT

	1986	1987	1988	1989	1990	1991	1992
			(Billions of Dong)				
Gross Fixed Investment	20.56	16.02	16.80	17.53	19.60	21.76	30.46
(Percent of National Income)	12.1	9.2	9.1	9.0	9.9	..	..
By Type of Management							
A. Central	12.10	9.40	10.80	12.31	11.60	13.07	19.96
B. Local	8.46	6.62	6.00	5.22	6.50	8.69	10.50
By Type of Outlay							
A. Construction Assembly Works	14.98	11.97	12.59	12.19	14.82	14.53	21.69
B. Machinery & Equipment	2.96	2.43	2.60	3.04	2.88	5.51	5.76
C. Other	2.62	1.62	1.60	2.31	1.90	1.72	3.01
By Sector							
A. Productive Sector	16.70	12.79	14.38	14.82	15.36	18.06	25.73
a. Industry	7.34	6.98	7.77	8.80	7.53	9.57	14.67
- Heavy Industry	5.47	5.25	..	..	..	..	..
- Light Industry	1.86	1.72	..	..	..	..	..
b. Agriculture & Forestry	5.03	3.21	3.82	2.73	3.35	3.41	3.86
c. Transportation & Communications	3.32	1.85	2.27	2.80	3.92	4.47	6.77
d. Other	1.01	0.75	0.52	0.49	0.57	0.61	0.43
B. Non-Productive Sector	3.86	3.23	2.41	2.71	5.63	3.71	4.73
a. Housing and Community Services	1.76	1.32	0.95	1.10	1.68	1.08	1.33
b. Science, Education, Public Health and Social Welfare	1.32	1.29	1.24	1.32	2.12	2.04	0.96
c. Other	0.79	0.62	0.22	0.28	0.44	0.59	2.44
			(Percentage)				
Gross Fixed Investment	100.0	100.0	100.0	100.0	100.0	100.0	100.0
By Type of Management:							
A. Central	58.9	58.7	64.3	70.2	59.2	60.1	65.5
B. Local	41.1	41.3	35.7	29.8	33.2	39.9	34.5
By Type of Outlay:							
A. Construction Assembly Works	72.9	74.7	75.0	69.5	75.6	66.8	71.2
B. Machinery & Equipment	14.4	15.1	15.5	17.3	14.7	25.3	18.9
C. Other	12.8	10.1	9.5	13.2	9.7	7.9	9.9
By Sector:							
A. Productive Sector:							
a. Industry:	35.7	43.5	46.3	50.2	38.4	44.0	48.2
- Heavy Industry	26.6	32.8	..	..	..	..	..
- Light Industry	9.1	10.8	..	..	..	..	..
b. Agriculture & Forestry	24.5	20.1	22.8	15.6	17.1	15.6	12.7
c. Transportation & Communications	16.2	11.6	13.5	16.0	20.0	20.5	22.2
d. Other	4.9	4.7	3.1	2.8	2.9	2.8	1.4
B. Non-Productive Sector:							
a. Housing and Community Services	8.5	8.2	5.7	6.3	8.6	5.0	4.4
b. Science, Education, Public Health and Social Welfare	6.4	8.1	7.4	7.5	10.8	9.4	3.2
c. Other	3.8	3.9	1.3	1.6	2.2	2.7	8.0

Note: a/ Official prices at which investment expenditures are calculated. These are somewhat higher than the 1982 fixed prices, but do not fully reflect price developments in the economy. Figures are rounded.

Source: General Statistical Office and GSO, Statistical Data of the Socialist Republic of Vietnam, 1976-1990, 1991, 1992.

Table 2.4: STATE INVESTMENT OUTLAYS IN INDUSTRY

	1986	1987	1988	1989	1990	1991	1992
			(Millions of Dong at 1982 Prices)				
Gross Fixed Investment	7522.0	6719.7	7629.7	8654.4	7415.3	9397.3	14667.2
Energy & Combustibles	3809.0	3788.0	4142.9	5857.9	4268.9	4537.0	9591.7
Metallurgical	67.0	71.6	83.9	8.1	205.7	216.1	154.6
Machinery	540.0	285.6	320.4	387.0	184.0	202.2	132.1
Chemical Industry	376.0	512.1	892.7	618.2	692.5	413.0	369.6
Contruction Material, Earthenware, Porcelain, Glassware, Wood Products, Cellulose Paste and Paper Products	873.0	734.0	808.7	821.1	578.1	1430.3	1269.6
Food and Foodstuffs	898.0	735.0	503.6	353.5	734.4	1075.4	1212.4
Weaving, Leather, Sewing, and Dyeing	446.0	289.0	488.3	283.6	249.0	420.3	513.0
Printing and Cultural Products	29.0	20.3	15.3	13.1	97.4	24.2	711.1
Other Industries	484.0	284.1	373.9	311.8	405.3	1078.8	713.1
				(Percent)			
Gross Fixed Investment:	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Energy & Combustibles	50.6	56.4	54.3	67.7	57.6	48.3	65.4
Metallurgical	0.9	1.1	1.1	0.1	2.8	2.3	1.1
Machinery	7.2	4.3	4.2	4.5	2.5	2.2	0.9
Chemical Industry	5.0	7.6	11.7	7.1	9.3	4.4	2.5
Contruction Material, Earthenware, Porcelain, Glassware, Wood Products, Cellulose Paste and Paper Products	11.6	10.9	10.6	9.5	7.8	15.2	8.7
Food and Foodstuffs	11.9	10.9	6.6	4.1	9.9	11.4	8.3
Weaving, Leather, Sewing, and Dyeing	5.9	4.3	6.4	3.3	3.4	4.5	3.5
Printing and Cultural Products	0.4	0.3	0.2	0.2	1.3	0.3	4.8
Other Industries	6.4	4.2	4.9	3.6	5.5	11.5	4.9

Source: General Statistical Office.

Table 2.5: STATE INVESTMENT OUTLAYS IN AGRICULTURE

	1986	1987	1988	1989	1990	1991	1992
			(Billions of Dong at 1982 Prices)				
Gross Fixed Investment	4.533	3.213	3.823	2.734	3.352	3.406	..
Detailed Composition							
Agriculture	1.535	1.574	1.595	2.176	2.966	2.974	..
Irrigation	2.515	1.346	1.631	..	..	..	..
Forestry	0.483	0.293	0.597	0.559	0.386	0.432	..

Note: For 1988 and 1989, there is no data in 1982 prices, so shares from current price data are used.

Source: General Statistical Office and Statistical Data of the Socialist Republic of Vietnam, 1976–1990, 1991, and 1992.

Table 3.1: BALANCE OF PAYMENTS, 1986-1993

	1986	1987	1988	1989	1990	1991	1992	Rev. 1993 1/
				(US$ million)				
Exports, Total	494	610	733	1320	1731	2042	2475	2850
Convertible Area	307	430	465	977	1305	1855	2475	2850
Non-Convertible Area	187	180	268	343	426	187	..	..
Imports, Total	-1121	-1184	-1412	-1670	-1772	-2105	-2535	-3505
Convertible Area	-453	-465	-603	-985	-1208	-1846	..	..
Non-Convertible Area	-667	-719	-809	-685	-564	-259	..	..
Trade Balance	-627	-575	-679	-350	-41	-63	-60	-655
Convertible Area	-146	-35	-138	-9	97	9	..	..
Non-Convertible Area	-480	-540	-541	-341	-138	-72	..	..
Services and Transfers	-28	-49	-72	-237	-218	-69	51	-214
Interest Payments	-68	-58	-146	-208	-238	-248	-282	-327
Imputed Interest on Arrears	-26	-36	-7	..	-	-	..	..
Private Remittances	30	10	4	9	50	36	..	..
Freight and Insurance	1	-2	..	..	-	-	..	..
Official Transfers	27	17	13	..	88	55	64	194
Others	9	20	63	-38	-118	88	..	330
Current Account Balance	-655	-624	-751	-586	-259	-132	-8	-869
Convertible Area	-174	-84	-196	-218	-121	-60	..	..
Non-Convertible Area	-480	-540	-555	-368	-126	-72	..	..
Capital Account Balance	363	378	405	300	122	-60	271	-161
Disbursements	517	574	727	763	233	65	487	241
Convertible Area	10	28	60	87	..	..	..	..
Non-Convertible Area	507	546	667	675	..	..	..	..
Scheduled Amortizations	-265	-233	-363	-350	-279	-256	-435	-644
Convertible Area	-237	-166	-197	-134	..	..	..	..
Non-Convertible Area	-27	-67	-166	-216	..	..	..	..
Amortization of Debt Relief	..	..	..	..	..	..	..	..
Short Term Loans (Net)	111	37	41	-213	48	-89	-41	-58
Direct Foreign Investment	..	..	..	100	120	220	260	300
Errors and Omissions	-23	-51	26	67	-6	142	5	-76
Overall Balance	-315	-297	-320	-220	-142	-50	268	-1106
Financing:	315	297	320	220	142	50	-268	1106
Change in NFA (excl. IMF)	2	..	..	-110	-159	-276	-463	527
IMF Credit (Net)	-4	..	..	..	..	-6	..	-39
Gold Revaluation	..	..	..	..	..	..	..	..
Debt Rescheduling	..	..	..	34	..	..	..	..
Change in Arrears	317	297	320	296	301	332	195	617
Memorandum Items:								
Transferable Rubles per US$	2.55	2.55	2.40	2.40	2.40	2.40	..	..

Note: Figures are rounded.

1/ Figures for 1993 are preliminary.

Source: Data provided by the Vietnamese authorities and Bank staff estimates.

Table 3.2: MERCHANDISE EXPORTS BY COMMODITY AND BY DESTINATION, 1986–93

	1986	1987	1988	1989	1990	1991	1992	Rev. 1993
					(US$ Million)			
Total Exports	494	610	733	1,320	1,732	2,042	2,475	2,850
Convertible Area	307	430	465	977	1,257	2,024	2,475	2,850
Rice	..	..	..	316	272	225	300	340
Quantity (000 tons)	..	..	..	1,405	1,455	989	1,860	1,700
Unit Value (US$/ton)	..	..	..	225	187	228	161	200
Petroleum	..	30	79	200	390	581	756	799
Quantity (000 tons)	..	235	680	1,517	2,600	3,917	5,400	6,150
Unit Value (US$/ton)	..	128	116	132	150	148	140	130
Coal	29	10	13	21	38	48	47	70
Quantity (000 tons)	550	182	650	546	1,075	1,173	1,580	2,000
Unit Value (US$/ton)	53	55	20	38	35	41	30	35
Rubber	2	6	6	14	16	50	54	68
Quantity (000 tons)	6	6	6	20	20	63	68	85
Unit Value (US$/ton)	333	1,000	1,000	700	800	789	800	800
Tea	4	2	3	3	2	14	16	20
Quantity (000 tons)	2	2	3	3	2	10	13	16
Unit Value (US$/ton)	2,000	1,000	1,000	1,000	1,000	1,370	1,231	1,250
Coffee	2	24	25	31	25	74	86	104
Quantity (000 tons)	5	12	16	36	28	94	96	115
Unit Value (US$/ton)	400	2,000	1,563	861	893	795	900	900
Marine Products	95	113	124	133	220	285	302	378
Quantity (000 tons)	11	12	13	15	29	67	72	90
Unit Value (US$/ton)	8,636	9,417	9,538	8,867	7,586	4,254	4,194	4,200
Agriculture & Forestry Products	110	138	197	211	203	440	434	492
of which:								
* Cashew Nut	..	..	..	..	13	26	41	42
Quantity (000 tons)	..	..	..	..	25	30	52	53
Unit Value (US$/ton)	..	..	..	..	508	850	799	792
* Meat	..	..	..	..	28	45	21	26
Quantity (000 tons)	..	..	..	..	16	25	12	15
Unit Value (US$/ton)	..	..	..	..				
* Pepper	..	..	..	..	12	18	15	15
Quantity (000 tons)	..	..	..	..	9	16	22	20
Unit Value (US$/ton)	..	..	..	..				
Handicrafts & Light Industrial Goods	65	30	18	20	20	224	321	400
of which:								
* Textiles and Garments	..	240	156	..	20	156	221	350
Others	..	77	..	28	71	83	158	200

Table 3.2: MERCHANDISE EXPORTS BY COMMODITY AND BY DESTINATION, 1986-93
(Continued)

	1986	1987	1988	1989	1990	1991	1992	Rev 1993
				(Millions of Transferable Rubles)				
Non-Convertible Area	480	450	644	824	1,139	43	..	..
Coal	5	2	2	2	..	..	..	..
Quantity (000 tons)	202	118	50	29	..	..	..	..
Unit Value (T.R./ton)	25	17	40	69	..	..	..	..
Rice	..	..	..	4	39	9	..	..
Quantity (000 tons)	..	..	..	20	170	44	..	..
Unit Value (T.R./ton)	..	..	..	200	229	209	..	..
Rubber	28	22	26	30	..	..	..	..
Quantity (000 tons)	30	35	32	38	..	..	..	..
Unit Value (T.R./ton)	933	629	813	789	..	..	..	..
Tea	13	14	4	19	..	..	..	..
Quantity (000 tons)	9	8	3	12	..	..	..	..
Unit Value (T.R./ton)	1,444	1,750	1,333	1,583	..	..	..	..
Coffee	14	4	7	43	60	2	..	..
Quantity (000 tons)	13	15	14	20	30	1	..	..
Unit Value (T.R./ton)	1,077	267	500	2,150	2,000	2,000	..	..
Marine Products	12	..	..	..	..	..	..	..
Agriculture & Forestry Products	105	160	205	260	285	..	..	..
Others	303	248	400	466	755	32	..	..

ource: IMF and World Bank, from data provided by the Vietnamese authorities.

Table 3.3: MAJOR IMPORTS BY COMMODITY AND BY ORIGIN, 1986–93

	1986	1987	1988	1989	1990	1991	Rev. 1992	Rev. 1993
				(US$ Million)				
Total Imports	1,121	1,184	1,412	1,670	1,772	2,105	2,535	3,505
From the Convertible Area	453	465	603	985	1,431	1,859	2,535	3,505
Petroleum	..	..	..	..	356	485	615	716
Quantity (000 tons)	..	..	..	..	2,400	2,572	3,075	3980
Unit Value (US$/ton)	..	..	..	..	148.3	188.6	200.0	179.9
Fertilizers	94	98	72	46	210	246	320	150
Quantity (000 tons)	686	702	400	506	2233	2425	1600	1020
Unit Value (US$/ton)	137.0	139.6	180.0	90.9	94.0	101.4	200.0	147.1
Steel	96	157	271	na	23	25	104	150
Quantity (000 tons)	320	380	453	na	200	113	260	500
Unit Value (US$/ton)	300.0	413.2	598.2	na	115.0	221.2	400.0	300.0
Machines and Spare Parts	..	..	..	..	..	..	100	549
Others	263	210	260	939	842	1103	1396	1940
of which:								
* Cotton Textiles	..	..	..	..	102	32	23	40
Quantity (Mil. meters)	..	..	..	..	23	29	25	30
* Raw Cotton	..	..	..	..	38	61	13	16.5
Quantity (000 tons)	..	..	..	..	62	32	10.6	12
* Wheat	..	..	..	..	32	36	59	62
Quantity (000 tons)	..	..	..	..	116	150	283	300
* Cars and Trucks	..	..	..	..	50	12	39	60
Quantity (number)	..	..	..	..	5240	1320	3502	5000
* Sugar	..	..	..	..	3	5	4	5.5
Quantity (000 tons)	..	..	..	..	60	14	13	20
* MSG	..	..	..	..	40	45	53	55
Quantity (000 tons)	..	..	..	..	24	30	38	40

Table 3.3: MAJOR IMPORTS BY COMMODITY AND BY ORIGIN, 1986–93
(Continued)

	1986	1987	1988	1989	1990	1991	1992	1993
Memo Item:								
			(Millions of Transferable Rubles)					
Non–Convertible Area	1,702	1,726	1,942	1,643	1,353	621	..	..
Petroleum Products	492	531	556	449	288	..	..	..
Quantity (000 tons)	2,028	2,100	2,200	2,305	1,320	..	..	..
Unit Value (T.R./ton)	242.6	252.9	252.7	194.8	218.2	..	..	..
Cotton Textiles	25	23	21	20	23	..	..	..
Quantity (Mil. meters)	32	29	27	29	30	..	..	..
Unit Value (T.R./meter)	781.3	793.1	777.8	689.7	766.7	..	..	..
Fertilizers	321	327	328	380	193	24	..	..
Quantity (000 tons)	2,059	2,100	2,120	2,450	1,072	182	..	..
Unit Value (T.R./ton)	155.9	155.7	154.7	155.1	180.0	131.9	..	..
Raw Cotton	53	62	65	75	91	..	..	..
Quantity (000 tons)	41	48	50	52	62	..	..	..
Unit Value (T.R./ton)	1,292.7	1,291.7	1,300.0	1,442.3	1,467.7	..	..	..
Steel Products	71	72	88	104	55	17	..	..
Quantity (000 tons)	282	285	350	373	200	62	..	..
Unit Value (T.R./ton)	251.8	252.6	251.4	278.8	275.0	274.2	..	..
Sugar	8	12	7	10	8	..	..	..
Quantity (000 tons)	55	85	50	70	60	..	..	..
Unit Value (T.R./ton)	145.5	141.2	140.0	142.9	133.3	..	..	..
Others, unclassified a/	732	699	877	605	695	580	..	..

Note: a/ Consists mainly of capital and intermediate goods.

Source: IMF, from data provided by the Vietnamese authorities.

Table 4.1: MONETARY SURVEY, 1986-93

	1986	1987	1988	1989	1990	1991	1992	Prel. 1993
				(Billions of Dong; End of Period)				
Foreign Assets (Net)	-23	210	284	1004	2626	8503	10593	5610
Net Domestic Assets	135	261	2285	6417	8731	11798	16550	26678
of which:								
Domestic Credit	153	532	2633	6717	9960	14112	17122	27166
Government (Net)	19	80	669	2600	4032	3956	1913	3957
Non-Financial Public Enterprises	117	376	1709	3606	5308	9129	12439	15511
Cooperatives	13	44	171	511	620	1026	2770	7698
Private Businesses and Households	4	32	84	..	..	..	..	..
Other Items (Net)	-18	-271	-348	-301	-1229	-2314	-572	-488
Total Liquidity (M2)	111	471	2569	8575	11357	20301	27144	32289
Currency Outside Banks	55	205	1024	2352	3735	6419	10579	14218
Deposits (in Dong)	54	237	1303	4127	3943	5528	8352	10665
Deposits (in foreign currency)	1	29	242	2096	3680	8354	8213	7406
				(Change in Percent from Previous Year)				
Foreign Assets (Net)		210.3	15.7	28.0	18.9	51.7	10.3	-18.4
Domestic Credit		342.1	446.6	159.0	37.8	36.6	14.8	37.0
Government (Net)		55.1	125.3	75.1	16.7	-0.7	-10.1	7.5
Non-Financial Public Enterprises		233.9	283.3	73.8	19.8	33.6	16.3	11.3
Cooperatives		28.0	27.0	13.2	1.3	3.6	8.6	18.2
Private Businesses and Households		25.2	11.1	-3.3	..	..	..	..
Total Liquidity (M2)		324.6	446.1	233.7	32.4	78.7	33.7	19.0
of which:								
Currency Outside Banks		134.6	174.3	51.7	16.1	23.6	20.5	13.4
Memorandum Items:								
Savings Deposits (Billions of Dong)	7.0	53.0	152.0	..	..	..	..	..
Currency a//GDP Ratio b/	4.1	4.4	4.2	6.6	6.0	5.9	..	..
Liquidity (M2)/GDP Ratio b/	8.2	10.0	10.5	24.2	18.2	18.8	..	..
Domestic Credit/GDP b/	11.3	11.3	10.8	19.0	16.0	13.0	..	..

Note: Figures are rounded.
a/ Currency in circulation.
b/ GDP in December 1989 prices.
Source: State Bank of Vietnam and IMF estimates.

Table 5.1: SUMMARY OF BUDGETARY OPERATIONS, 1986-93

	Actual							Rev.
	1986	1987	1988	1989	1990	1991	1992	1993
				(Billions of Dong)				
Revenue	84	379	1740	3899	6153	10353	21023	30500
Tax Revenue	18	68	451	1099	1698	2814	5480	11016
Transfers from State Enterprises	60	285	1110	2244	3620	6189	11913	16085
Other Non-Tax Revenue	5	27	179	556	835	1080	2782	2401
Grants	..	..	..	..	..	270	848	998
Current Expenditure (exc. Interest)	82	393	2141	4338	6156	8728	15452	25700
Wages and Salaries	6	30	255	1290	1744	2001	..	8921
Subsidies	18	151	812	..	..	..	..	..
Other	58	212	1074	3048	4412	6727	..	16779
of which: Operation and Maintenance	20	57	80	245	290	428	..	595
Capital Expenditure	38	120	673	1626	2124	2135	6450	9600
Overall Primary Balance	-36	-134	-1074	-2065	-2127	-510	-879	-4800
Interest (Scheduled) b/	1	2	26	817	1242	2333	3218	3675
Interest (Paid) b/	..	..	..	48	310	650	1000	1710
Overall Balance (Accrual Basis)	-37	-136	-1100	-2882	-3369	-2843	-4097	-8475
Overall Balance (Cash Basis)	-37	-136	-1100	-2113	-2437	-1160	-1879	-6510
Financing	37	136	1100	2113	2437	1160	1879	6510
Foreign Grants and Loans (Net) c/	14	43	370	414	1264	767	2673	1925
Utilization	..	..	..	1073	1860	1335	3481	3158
Short-Term	..	..	..	..	..	..	..	..
Medium- and Long-Term	..	..	..	..	..	..	..	..
Amortization	..	..	..	659	596	568	808	1233
Domestic Loans (Net)	23	92	467	1700	1173	393	-794	4585
State Bank (Net)	23	89	450	1931	832	689	-2208	2044
Government Securities (Net)	0	3	17	-231	341	-296	1414	2541
Gross Issue	0	3	..	..	..	..	..	..
Amortization	0	..	..	..	..	..	..	..
Arrears	..	..	263	..	..	..	..	..
				(Percent of GDP)				
Revenue	13.2	12.2	11.3	13.8	14.7	13.5	19.0	22.3
Tax Revenue	2.9	2.2	2.9	3.9	4.1	3.7	5.0	8.1
Transfers from State Enterprises	9.5	9.2	7.2	8.0	8.7	8.1	10.8	11.8
Other Non-Tax Revenue	0.8	0.9	1.2	2.0	2.0	1.4	2.5	1.8
Current Expenditure (exc. Interest)	12.9	12.7	14.0	15.4	14.7	11.4	14.0	18.8
Wages and Salaries	0.9	1.0	1.7	4.6	4.2	2.6	..	..
Subsidies	2.9	4.9	5.3	0.0	0.0	0.0	..	..
Other	9.2	6.8	7.0	10.8	10.5	8.8	..	..
of which: Operation and Maintenance	3.2	1.8	0.5	0.9	0.7	0.6	..	..
Capital Expenditure	5.9	3.9	4.4	5.8	5.1	2.8	5.8	7.0
Overall Primary Balance	-5.7	-4.3	-7.0	-7.2	-5.1	-0.7	-0.8	-3.5
Interest (Scheduled) b/	0.2	0.1	0.2	2.9	3.0	3.0	2.9	2.7
Interest (Paid) b/				0.2	0.7	0.8	0.9	1.3
Overall Balance (Accrual Basis)	-5.8	-4.4	-7.2	-10.2	-8.1	-3.8	-3.7	-6.2
Overall Balance (Cash Basis)	-5.8	-4.4	-7.2	-7.5	-5.8	-1.5	-1.7	-4.8
Financing	5.8	4.4	7.2	7.5	5.8	1.5	1.7	4.8
Foreign Grants and Loans (Net) c/	2.2	1.4	2.4	1.5	3.0	1.0	2.4	1.4
Domestic Loans (Net)	3.6	3.0	3.0	6.0	2.8	0.5	-0.7	3.4
State Bank (Net)	3.6	2.9	2.9	6.8	2.0	0.9	-2.0	1.5
Government Securities (Net)	0.0	0.1	0.1	-0.8	0.8	-0.4	1.3	1.9
Arrears	..	..	1.7	..	..	..	..	..

Note: a. For 1986-88, figures include amortization.

Source: Ministry of Finance and staff estimates.

Table 5.2: GOVERNMENT REVENUE, 1986-93

	Actual							Rev.
	1986	1987	1988	1989	1990	1991	1992	1993
				(Billions of Dong)				
State Enterprises:	60	285	1110	2244	3620	5927	11383	15279
- Taxes and Transfers	57	270	1028	2029	3112	5305	9106	12685
- Depreciation	3	15	82	215	508	622	2277	2594
Non-State Sector:	12	50	320	736	965	1977	3816	5533
- Agricultural Tax	4	12	136	308	298	707	1294	1351
- Non-Agricultural Tax:	8	38	184	428	667	1008	1992	3376
Turnover Tax	3	16	72	160	262	250	582	863
Profits Tax	2	11	33	73	118	161	420	593
Personal Income Tax	..	..	..	..	..	62	153	184
License Tax	0	1	23	24	31	..	72	112
Commodities Tax	1	2	21	72	75	69	22	16
Wholesale Tax	1	3	8	18	32	..	..	..
Slaughter Tax	0	2	10	16	26	35	45	52
Land Tax	..	..	..	..	..	5	18	180
Other	1	3	17	65	123	426	680	1376
- Other Taxes	..	..	..	..	..	262	530	806
External Trade:	6	17	131	363	733	1099	2194	5900
- Non-Commercial Import Tax	6	17	56	109	126	..	..	..
- Import and Export Duties	..	..	75	254	607	1099	2194	5900
Joint Ventures	..	..	..	..	..	..	..	389
Other Revenue	5	27	179	556	835	1080	2782	2401
Grants	..	..	..	..	..	270	848	998
Total Revenue (inc. Grants)	84	379	1740	3899	6153	10353	21023	30500
				(Percent of GDP)				
State Enterprises:	9.5	9.2	7.2	8.0	8.7	7.7	10.3	11.2
- Taxes and Transfers	8.9	8.7	6.7	7.2	7.4	6.9	8.2	9.3
- Depreciation	0.5	0.5	0.5	0.8	1.2	0.8	2.1	1.9
Non-State Sector:	1.9	1.6	2.1	2.6	2.3	2.6	3.5	4.1
- Agricultural Tax	0.6	0.4	0.9	1.1	0.7	0.9	1.2	1.0
- Non-Agricultural Tax	1.3	1.2	1.2	1.5	1.6	1.3	1.8	2.5
External Trade:	1.0	0.6	0.8	1.3	1.8	1.4	2.0	4.3
- Non-Commercial Import Tax	1.0	0.6	0.4	0.4	0.3	0.0	0.0	0.0
- Import and Export Duties	0.0	0.0	0.5	0.9	1.5	1.4	2.0	4.3
Joint Ventures	..	..	..	..	..	..	..	0.3
Other Revenue	0.8	0.9	1.2	2.0	2.0	1.4	2.5	1.8
Grants	..	..	..	..	..	0.4	0.8	0.7
Total Revenue (inc. Grants)	13.2	12.2	11.3	13.8	14.6	13.5	19.0	22.3
				(Percent of Total Revenue)				
State Enterprises:	72.2	75.1	63.8	57.6	58.8	57.2	54.1	50.1
- Taxes and Transfers	68.0	71.2	59.1	52.0	50.6	51.2	43.3	41.6
- Depreciation	4.2	3.8	4.7	5.5	8.3	6.0	10.8	8.5
Non-State Sector:	14.5	13.2	18.4	18.9	15.7	19.1	18.2	18.1
- Agricultural Tax	4.6	3.2	7.8	7.9	4.8	6.8	6.2	4.4
- Non-Agricultural Tax	10.0	10.0	10.6	11.0	10.8	9.7	9.5	11.1
External Trade:	7.4	4.6	7.5	9.3	11.9	10.6	10.4	19.3
- Non-Commercial Import Tax	7.4	4.6	3.2	2.8	2.0	0.0	0.0	0.0
- Import and Export Duties	..	..	4.3	6.5	9.9	10.6	10.4	19.3
Joint Ventures	..	..	..	..	..	..	..	1.3
Other Revenue	5.9	7.1	10.3	14.3	13.6	10.4	13.2	7.9
Grants	..	..	..	..	..	2.6	4.0	3.3

Source: Ministry of Finance and staff estimates.

Table 5.3: FUNCTIONAL CLASSIFICATION OF CURRENT EXPENDITURES, 1986–93

	Actual							Rev.
	1986	1987	1988	1989	1990	1991	1992	1993
				(Billions of Dong)				
General Administrative Service	5.4	18.8	144.0	460.0	676.0	1290.0	2404.0	3245.0
Economic Services	20.5	58.1	149.0	389.0	523.0	784.0	1490.0	2997.0
Agriculture	1.5	..	..	..	..	..	..	..
Forestry	0.5	..	..	..	..	..	..	..
Industry	1.2	..	..	..	..	..	..	..
Transportation, Cooperative, Public Works, and Other	17.3	..	..	..	..	..	..	..
Social Service	19.4	70.8	345.0	1252.0	1998.0	3343.0	6245.0	10854.0
Education	8.1	30.7	85.0	317.0	439.0	748.0	1495.0	2910.0
Health	3.3	13.2	74.0	209.0	368.0	636.0	1136.0	1656.0
Pensions, Social Relief	6.8	21.8	113.0	448.0	695.0	1278.0	2374.0	4135.0
Other	1.2	5.0	73.0	278.0	496.0	681.0	1240.0	2153.0
Interest due a/	1.1	2.1	2.6	817.0	1242.0	2333.0	3218.0	3925.0
Interest Paid	..	..	..	48.0	310.0	651.0	1000.0	1710.0
Other (inc. Subsidies and excl. Contingency)	38.5	245.0	1503.0	2237.0	2959.0	3311.0	5313.0	8604.0
Total Current Expenditures (Cash Basis, incl. Interest)	83.8	392.7	2141.0	4386.0	6466.0	9379.0	16452.0	27410.0
				(Percent of GDP)				
General Administrative Service	0.8	0.6	0.9	1.6	1.6	1.7	2.2	2.4
Economic Services	3.2	1.9	1.0	1.4	1.2	1.0	1.3	2.2
Social Service	3.1	2.3	2.2	4.5	4.8	4.4	5.6	7.9
Interest due a/	0.2	0.1	0.0	2.9	3.0	3.0	2.9	2.9
Interest Paid	..	..	..	0.2	0.7	0.8	0.9	1.3
Other (inc. Subsidies)	6.1	7.9	9.7	8.0	7.1	4.3	4.8	6.3
Total Current Expenditures (incl. Interest)	13.2	12.7	13.9	15.6	15.5	12.2	14.9	20.1

Note: a/ For 1986–88, figures include amortization.

Source: Ministry of Finance and staff estimates.

Table 5.4: ECONOMIC CLASSIFICATION OF CURRENT EXPENDITURES, 1986–93

	Actual							Rev.
	1986	1987	1988	1989	1990	1991	1992	1993
				(Billions of Dong)				
Wage and Salaries	5.5	29.5	255.0	1290.0	1744.0	2001.0	..	8921.0
Subsidies	18.2	150.9	812.0	..	..	..	..	170.0
Food Procurement	12.4	104.3	486.0	..	..	..	..	..
Production	2.3	8.2	51.0	..	..	..	..	..
Exports	3.5	38.4	275.0	..	..	..	..	..
Interest due a/	1.1	2.1	26.0	817.0	1242.0	2333.0	3218.0	3675.0
Interest paid a/	..	..	..	48.0	310.0	651.0	1000.0	1710.0
Other	60.1	212.3	1074.0	3048.0	4412.0	6727.0	..	16609.0
Working Capital for SOEs	1.2	13.8	88.0	128.0	68.0	..	..	680.0
Administrative Expenses	4.8	14.7	30.0	63.5	181.0	241.0	..	2752.0
Medical and Social Benefits	2.5	9.7	47.0	124.0	295.0	433.0	..	2024.0
Education and Scholarship	3.8	14.4	37.0	83.0	261.2	385.0	..	2111.0
Operation and Maintenance	20.1	57.1	80.0	245.0	290.4	428.0	..	595.0
Residual b/	27.7	102.7	792.0	2404.5	3316.4	5240.0	..	8447.0
Total Current Expenditures (Cash basis; exc. Cont.; Inc. Interest)	83.8	392.7	2141.0	4386.0	6466.0	9379.0	16453.0	27410.0
				(Percent of GDP)				
Wage and Salaries	0.9	1.0	1.7	4.6	4.2	2.6	..	6.5
Subsidies	2.9	4.9	5.3	..	..	..	..	0.1
Food Procurement	2.0	3.4	3.1	..	..	..	..	..
Interest due a/	0.2	0.1	0.2	2.9	3.0	3.0	2.9	2.7
Interest paid a/	..	..	..	0.2	0.7	0.8	0.9	1.3
Other	9.4	6.8	7.0	10.8	10.5	8.8	..	12.2
of which:								
Operation and Maintenance	3.2	1.8	0.5	0.9	0.7	0.6	..	0.4
Residual d/	4.3	3.3	5.1	8.6	7.9	6.8	..	6.2
Total Current Expenditures (Cash basis; exc. Cont.; Inc. Interest)	13.2	12.7	13.9	15.6	15.5	12.2	14.9	20.1

Note: a/ For 1986–88, interest includes amortization.
b/ Primarily spending on national defense.

Source: Ministry of Finance and staff estimates.

Table 5.5: GOVERNMENT CAPITAL EXPENDITURES, 1986–93

	1986	1987	1988	1989	1990	1991	1992	Rev. 1993
				(Billions of Dong)				
Industry and Construction	12.4	51.7	319.0	766.0	745.8	48.9	2284.0	5692.0
Agriculture and Forestry	5.4	13.6	52.3	68.1	112.8	70.3	345.0	266.0
Irrigation	2.7	9.6	37.7	130.9	243.6	244.1	456.0	623.0
Transportation and Communications	5.4	13.5	76.0	197.0	323.3	335.3	612.8	1020.0
Commerce and Services	1.1	3.9	32.0	47.0	90.9	22.7	16.8	27.0
Non-Productive Sector a/	6.3	23.5	105.0	410.0	424.8	367.0	789.7	763.0
Contingency Fund b/	2.5	4.3	48.0	..	0.0	135.9	..	..
Other	2.0	0.4	3.0	7.0	5.9	566.3	451.5	1209.0
Unallocated	..	..	..	..	177.0	344.3	1494.2	..
Total Capital Expenditure	37.8	120.4	673.0	1626.0	2124.0	2135.0	6450.0	9600.0
				(Percent of GDP)				
Industry and Construction	1.9	1.7	2.1	2.7	1.8	0.1	2.1	4.2
Agriculture and Forestry	0.9	0.4	0.3	0.2	0.3	0.1	0.3	0.2
Irrigation	0.4	0.3	0.2	0.5	0.6	0.3	0.4	0.5
Transportation and Communications	0.8	0.4	0.5	0.7	0.8	0.4	0.6	0.7
Commerce and Services	0.2	0.1	0.2	0.2	0.2	0.0	0.0	0.0
Non-Productive Sector a/	1.0	0.8	0.7	1.5	1.0	0.5	0.7	0.6
Contingency Fund b/	0.4	0.1	0.3	0.0	0.0	0.2	0.0	0.0
Other	0.3	0.0	0.0	0.0	0.0	0.7	0.4	0.9
Unallocated	..	..	..	..	0.4	..	..	..
Total Capital Expenditure	5.9	3.9	4.4	5.8	5.1	2.8	5.8	7.0

Note: a/ Includes education, health, culture, finance and government.
b/ Stockpiling of key commodities and materials.

Source: Ministry of Finance and staff estimates.

Table 6.1: RETAIL PRICE INDEX
(Rate of Change from Previous Year; in Percent)

Item	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
General Price Index	125.2	169.5	195.4	149.5	164.9	191.6	487.3	301.3	308.2	74.3	36.4	82.7	37.7	8.3
Foodgrain and Foodstuff	133.8	152.0	182.0	155.1	155.0	191.6	553.2	314.6	367.3	43.0	..	..	28.1	6.3
Foodgrain	121.0	146.8	152.8	134.4	162.0	288.3	254.2	405.1	446.4	30.0	..	..	5.5	-3.5
Foodstuff	138.5	152.6	185.6	157.3	152.0	181.8	591.6	287.3	340.5	50.0	..	..	34.5	10.3
Other Consumer Goods	117.8	195.1	205.4	138.8	179.9	190.8	492.7	289.3	265.0	101.0	..	..	44.9	23.0
Agri-Production Materials	131.8	127.0	194.3	119.7	139.3	204.4	650.8	291.7	269.0	101.0	..	..	..	..
Official Price Index a/	109.8	202.0	241.8	142.8	155.8	210.9	457.4	289.9	313.2	b/	b/	b/	b/	b/
Foodgrain and Foodstuff	116.7	160.0	217.9	150.1	155.1	210.8	546.4	311.2	378.5					
Foodgrain	105.7	144.1	168.3	135.0	151.7	365.2	227.9	416.8	458.7					
Foodstuff	125.8	161.0	225.6	153.1	158.9	195.2	602.5	272.4	344.4					
Other Consumer Goods	107.1	236.0	245.9	130.9	157.2	210.3	395.5	274.9	287.6					
Agri-Production Materials	101.4	122.0	250.0	101.5	153.2	220.9	592.0	270.2	287.6					
Free Market Price Index a/	143.8	147.4	165.0	157.5	176.3	154.7	582.3	337.5	294.8	b/	b/	b/	b/	b/
Foodgrain and Foodstuff	142.5	147.8	164.2	159.5	154.5	160.2	568.9	322.5	341.0					
Foodgrain	131.9	148.6	143.8	134.1	173.0	147.0	458.3	353.2	382.4					
Foodstuff	145.0	147.6	166.4	163.3	149.0	163.1	573.4	317.0	335.2					
Other Consumer Goods	146.5	154.0	163.9	150.8	217.4	146.8	536.1	352.9	217.1					
Agri-Production Materials	141.1	131.1	166.0	163.9	126.9	179.5	791.7	342.1	315.0					

Note: a/ The weights of the official and free market price indices in the general price index are adjusted annually. The weights for 1988 were 0.743 and 0.257, respectively.
b/ With price reforms in 1989, there is no longer any distinction between official and free market price indices.
Source: Data provided by the Vietnamese authorities.

TABLE 6.2: CONSUMER PRICE INDEX BY COMMODITY GROUPS:
Monthly Growth Rates

Year	Month	Goods	Total Food	Agr Products	Proc Food	Manu-factures	Services
	Dec						
1991	Jan	14.30%	19.10%	15.80%	20.60%	14.30%	4.30%
	Feb	8.84%	11.92%	14.59%	11.11%	8.84%	7.38%
	Mar	0.16%	-2.33%	0.53%	-3.43%	0.16%	2.41%
	Apr	2.41%	3.07%	-2.92%	5.72%	2.41%	1.39%
	May	3.21%	4.47%	1.39%	5.70%	3.21%	1.81%
	Jun	1.67%	0.78%	-0.30%	1.38%	1.67%	1.69%
	Jul	2.69%	2.90%	3.44%	2.73%	2.69%	1.50%
	Aug	3.64%	3.65%	3.77%	3.59%	3.64%	2.62%
	Sep	3.79%	2.65%	2.28%	2.82%	3.79%	2.47%
	Oct	3.11%	1.87%	0.35%	2.87%	3.11%	1.40%
	Nov	5.97%	4.19%	2.50%	5.21%	5.97%	3.15%
	Dec	6.25%	4.99%	4.40%	5.13%	6.25%	4.99%
1992	Jan	4.19%	4.00%	4.47%	5.75%	4.19%	6.17%
	Feb	5.20%	7.03%	1.61%	9.84%	5.20%	7.41%
	Mar	0.00%	-2.40%	-3.60%	-1.79%	0.00%	2.80%
	Apr	0.80%	0.21%	-2.09%	1.06%	0.80%	1.21%
	May	0.79%	0.59%	-2.39%	2.23%	0.79%	4.54%
	Jun	0.00%	-0.69%	-5.30%	1.91%	0.00%	0.69%
	Jul	0.10%	-0.21%	-1.89%	0.50%	0.10%	1.70%
	Aug	0.00%	-0.21%	-1.28%	0.27%	0.00%	2.18%
	Sep	-0.21%	-1.29%	-4.55%	0.32%	-0.21%	1.04%
	Oct	-0.68%	-1.19%	-5.45%	-0.72%	-0.68%	2.86%
	Nov	2.00%	1.98%	4.80%	0.59%	2.00%	2.42%
	Dec	1.19%	0.11%	0.53%	-0.27%	1.19%	2.10%
1993	Jan	1.58%	1.88%	2.74%	1.81%	1.58%	2.41%
	Feb	2.01%	4.80%	3.62%	5.56%	2.01%	1.67%
	Mar	-0.59%	-0.40%	2.00%	-1.18%	-0.59%	0.72%
	Apr	-0.30%	0.30%	0.49%	0.21%	-0.30%	0.29%
	May	1.19%	1.31%	1.88%	0.77%	1.19%	2.91%
	Jun	-0.59%	-0.60%	-3.83%	1.10%	-0.59%	1.30%
	Jul	-0.35%	-0.10%	-2.77%	1.34%	-0.54%	0.18%
	Aug	0.35%	0.50%	0.07%	0.66%	0.10%	1.42%
	Sep	-0.25%	-0.50%	-0.37%	-0.98%	0.10%	0.77%
	Oct	-0.50%	-0.80%	-1.32%	-0.58%	-0.10%	0.63%
	Nov	-0.30%	-1.01%	0.00%	-1.50%	0.45%	1.69%
	Dec	0.80%	1.43%	4.09%	0.00%	0.30%	3.50%

Table 7.1: AGRICULTURAL PRODUCTION

	1986	1987	1988	1989	1990	1991	1992	Prel. 1993
	<——— (Millions of Dong at 1982 prices) ———>					<——— (1989 Million Dong) ———>		
Gross Output	96,044	96,383	100,602	108,030	109,405	15,358,792	1,560,475	17,059,197
Crop Cultivation	72,342	70,628	75,969	81,943	82,364	11,511,701	12,331,464	12,597,516
Food Crops	49,702	47,701	53,118	58,336	..	7,541,957	8,280,914	..
Industrial Crops	22,640	22,927	22,851	23,606	..	1,913,293	1,903,383	..
Animal Husbandry	23,702	25,755	24,598	26,162	27,062	3,847,091	4,276,311	4,461,681
of which:								
Livestock a/	14,067	15,420	14,487	15,664	..	2,000,186	2,261,195	..
	(Thousands of metric tons)							
Foodgrains b/	18,379	17,529	19,583	21,516	21,488	21,989	24,214	25,000
Paddy	16,003	15,103	17,000	18,996	19,225	19,622	212,590	22,300
Other	2,376	2,426	2,583	2,519	2,263	2,367	2,624	2,700
Memorandum Items:								
Area Cultivated (000 ha) c/	6,812	6,710	6,968	7,090	7,111	7,448	7,707	7,692
Fertilizer Availability (000 tons	1,631	1,542	1,833	1,985	..	..	..	..
Foodgrain Output per Capita (kg	301	281	307	332	323	323	346	357

Note: a/ Excluding poultry.
b/ Paddy equivalent.
c/ Foodgrains.

Source: General Statistical Office.

Table 7.2: INDUSTRIAL CROP PRODUCTION AND YIELDS

	1986	1987	1988	1989	1990	1991	1992	Est. 1993
Production (000 metic tons)								
Jute	54.5	57.5	36.8	34.3	29.0	25.2	26	28
Rush	97.5	104.2	83.7	81.2	78.0	54.0	77.0	75
Mulberry	56.9	53.9	45.7	56.9	99.0	103.0	143.0	160
Sugarcane	4964.6	5470.3	5700.4	5344.6	5400.0	6130.9	6,437	6,656
Peanuts	211.1	231.6	213.9	205.8	218.0	234.8	227	240
Soybeans	84.7	95.8	85.3	82.0	85.0	80.1	80	81
Tobacco	33.4	33.4	35.5	23.9	17.6	40.4	27	32
Tea	30.1	29.0	29.7	30.2	30.9	33.1	36.2	39
Coffee	18.8	20.5	31.3	40.8	45.2	67.0	71.8	74
Rubber	50.1	51.7	49.7	50.6	52.0	64.6	67	70
Coconut	711.4	790.9	856.5	922.1	..	..	..	..
Area Cultivated (000 ha)								
Jute	26.1	32.0	17.1	15.7	13.0	10.4	11.6	12
Rush	16.9	17.0	17.5	14.4	11.4	9.4	11.0	10
Mulberry	6.7	6.7	5.7	6.5	11.0	13.9	..	..
Sugarcane	125.2	136.9	142.1	131.3	135.0	141.1	..	..
Peanuts	224.5	237.8	224.4	208.6	210.0	196.2	..	..
Soybeans	106.5	118.1	103.0	100.2	105.0	115.4	..	..
Tobacco	36.2	38.8	39.5	28.0	22.0	30.8	..	..
Tea	58.1	59.2	59.1	58.3	60.0	60.0	62.9	..
Coffee	65.6	92.3	111.9	123.1	119.3	115.0	103.7	..
Rubber	202.0	203.7	210.5	215.6	221.7	220.6	212.4	..
Coconut	157.7	199.3	210.6	206.3	212.3	214.2	204.1	..
Average Yield (Metric ton/Ha)								
Jute	2.1	1.8	2.2	2.2	2.2	2.4	2.2	..
Rush	5.8	6.1	4.8	5.6	..	5.7	7.0	..
Mulberry	8.5	8.0	8.0	8.8	9.0	7.4	..	..
Sugarcane	39.7	40.0	40.1	40.7	40.0	43.5	..	..
Peanuts	0.9	1.0	1.0	1.0	1.0	1.2	..	..
Soybeans	0.8	0.8	0.8	0.8	0.8	0.7	..	..
Tobacco	0.9	0.9	0.9	0.9	0.8	1.3	..	..
Tea	0.5	0.5	0.5	0.5	..	0.6	0.6	..
Coffee	0.3	0.2	0.3	0.3	..	0.6	0.7	..
Rubber	0.2	0.3	0.2	0.2	..	0.3	0.3	..
Coconut	4.5	4.0	4.1	4.5	..	0.0	0.0	..

Source: General Statistical Office, Statistical Data of the Socialist Republic of Vietnam, 1991.

Table 7.3: FOODGRAIN PRODUCTION AND YIELDS

	1986	1987	1988	1989	1990	1991	1992	Est. 1993
Production (000 metic tons)	18,379	17,529	19,583	21,516	21,488	21,989	24,214	25,000
By Product								
Paddy	16,003	15,103	17,000	18,996	19,225	19,622	21,590	22,300
Spring and Summer Crop	9,127	8,029	10,353	11,603	11,956	11,506	14,063	14,272
Winter Crop	6,876	7,074	6,647	7,394	7,269	8,116	7,527	8,028
Subsidiary Crops a/	2,376	2,426	2,583	2,519	2,263	2,367	2,624	2,700
By Region								
North b/	7,688	7,620	8,369	8,955	8,448	7,835	9,701	10,640
South	10,691	9,909	11,214	12,561	13,040	14,154	14,513	14,360
Mekong Delta	8,203	6,576	7,743	9,024	9,608	10,464	11,067	10,840
Area Cultivated (000 ha)	6,812	6,709	6,968	7,090	7,111	7448	7,707	7,692
By Product								
Paddy c/	5,689	5,588	5,726	5,896	6,028	6,303	6,475	6,466
Spring and Summer Crop	2,743	2,732	2,876	3,133	3,290	3,543	3,727	3,896
Winter Crop	2,946	2,856	2,850	2,763	2,738	2,760	2,748	2,660
Subsidiary Crops a/	1,123	1,121	1,241	1,194	1,083	1,145	1,232	1,226
By Region								
North b/	2,442	3,170	2,465	2,481	3,224	3,301	3,398	3,390
South	3,247	3,540	3,262	3,415	3,887	4,147	4,309	4,302
Mekong Delta	2,291	2,254	2,314	2,445	2,625	2,846	2,966	2,962
Average Yield (Metric ton/Ha)	2.70	2.61	2.81	3.03	3.02	2.95	3.14	3.25
By Product								
Paddy	2.81	2.70	2.97	3.22	3.19	3.11	3.33	3.45
Spring and Summer Crop	3.33	2.94	3.60	3.70	3.63	3.25	3.77	3.66
Winter Crop	2.33	2.48	2.33	2.68	2.65	2.94	2.74	3.02
Subsidiary Crops a/	2.12	2.16	2.08	2.11	2.09	2.07	2.13	2.20
By Region								
North b/	3.15	2.40	3.40	3.61	2.62	2.37	2.85	3.14
South	3.29	2.80	3.44	3.68	3.35	3.41	3.37	3.34
Mekong Delta	3.58	2.92	3.35	3.69	3.66	3.68	3.73	3.66
Fertilizer Availability d/								
Quantity (000 metric tons)	1631	1542	1833	1985	2511	3026	3089	3100
Average per Ha (Kg/Ha)	239	230	263	280	..	..	..	..

Note: a/ In paddy equivalent.
b/ The North is defined as comprising the 17 provinces north of Da-Nang.
c/ Pertaining to "sown" area, taking into account multiple cropping.
d/ Nitrogenous fertilizer, ammonium sulphate (SA) equivalent. Not all the available fertilizer is used for foodgrain production. For 1990, figures include nitrogenous and phosphatic fertilizers.

Source: General Statistical Office, Statistical Data of the Socialist Republic of Vietnam, 1976-90, 1991.
GSO, Statistical Data of Agriculture, Forestry and Fishery, 1985-1993, 1994.

Table 8.1: INDUSTRIAL PRODUCTION AND NUMBER OF STATE ENTERPRISES

Item	1987	1988	1989	1990	1990	1991	1992	1993
	(Millions of Dong at 1982 prices)				(Billions of 1989 Dong)			
Gross Industrial Production	130,551	137,819	133,311	137,506	14,011	15,471	18,117	20,300
By Sector								
Heavy Industry	37,265	41,272	40,560	47,972	5,283	6,283	7,756	..
Light Industry	93,286	96,548	92,751	89,534	8,728	9,188	10,361	..
By Type of Management	120,551	137,819	133,311	137,506	14,011	15,471	18,117	20,300
Central	39,535	44,413	47,020	54,224	6,438	7,435	9,155	..
Local	81,015	93,406	86,291	83,282	7,573	8036	8,962	..
By Industrial Branches	121,781	137,819	133,311	137,506	14,011	15,471	18,118	20,300
Energy Combustible	7,353	7,800	11,220	15,072	2,597	3,242	4,124	4,609
Metallurgy	1,089	2,057	2,048	2,313	219	319	406	488
Machinery	18,606	23,851	20,707	20,860	870	866	968	1,049
Chemical Industry	12,080	12,991	12,209	13,626	920	1,114	1,355	1,592
Other Manufacturing a/	24,465	24,496	21,107	22,856	2,355	2,548	2,864	3,116
Food and Foodstuffs	32,458	36,573	38,303	36,013	5,040	5,378	6,140	6,982
Weaving, Leather, Sewing, and Dyeing	20,392	23,437	21,982	21,285	1,555	1,552	1,764	1,856
Printing and Cultural Products	498	785	699	789	97	108	128	152
Other Industries	4,840	5,830	5,036	4,692	357	344	368	456
Number of Enterprises	3,157	3,092	3,020	2,762	2,762	2,599	2,268	..
By Sector								
Heavy Industry	1,579	1,449	1,450	1,384	1,384	1,192	990	..
Light Industry	1,578	1,643	1,570	1,378	1,378	1,407	1,278	..
By Type of Management	3,157	3,092	3,020	2,762	2,762	2,599	2,268	..
Central	682	681	666	589	589	546	537	..
Local	2,475	2,411	2,354	2,173	2,173	2,053	1,731	..

Note: a/ Including construction material, earthenware, porcelain, glassware, wood, forest products, cellulose part, and paper industries.

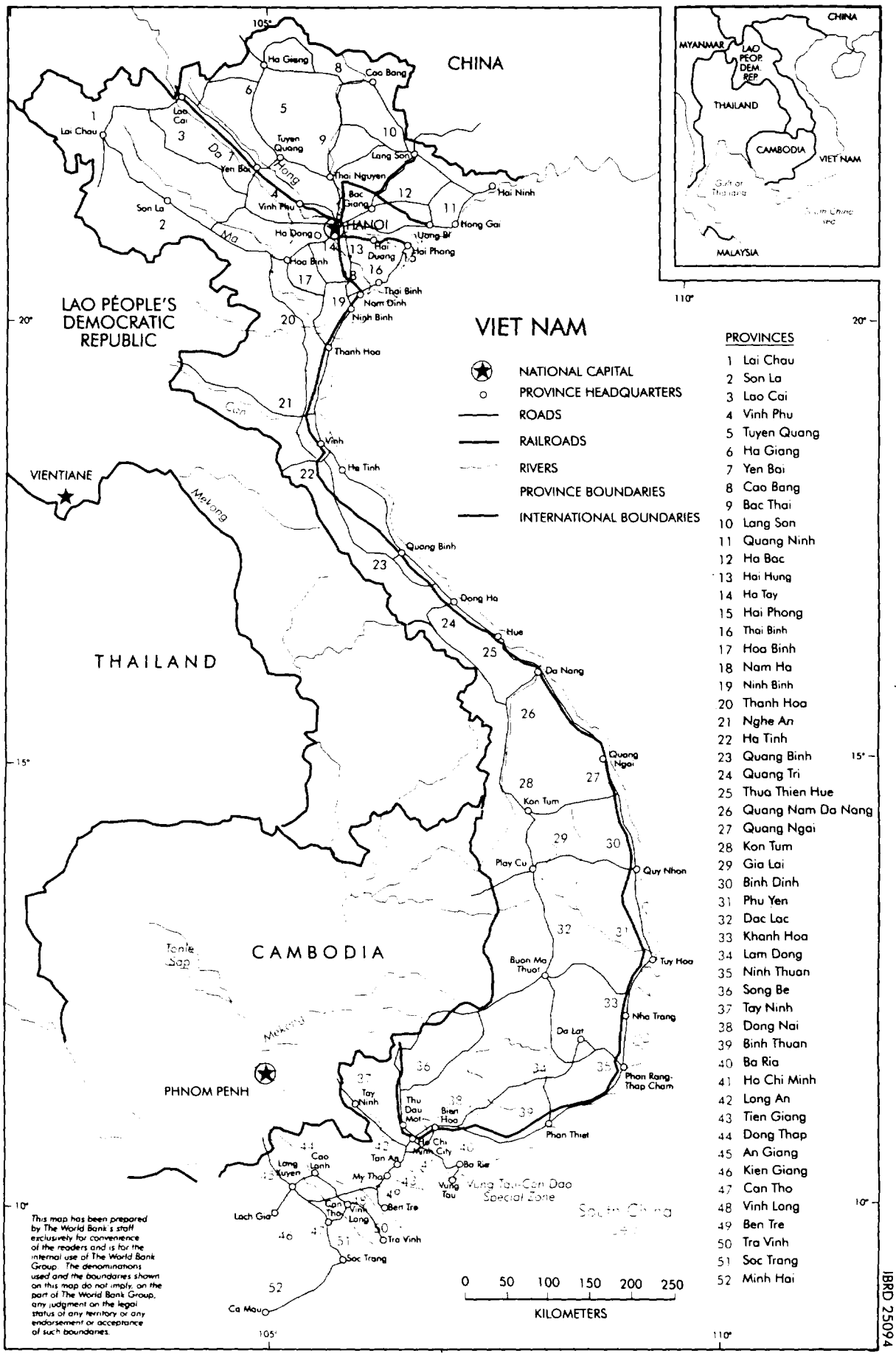
Source: General Statistical Service, Statistical Data of the Socialist Republic of Vietnam, 1976–90, 1991.
General Statistical Service, Statistical Data of the Socialist Republic of Vietnam, 1986–91, 1992.

Table 8.2: MAJOR INDUSTRIAL PRODUCTS

Item	1986	1987	1988	1989	1990	1991	1992	1993
Energy								
Electricity (Mil. KWh)	5,656	6,194	6,955	7,948	9,053	9,307	9,799	10,928
Coal (Mil. Tons)	6.2	6.8	6.8	3.8	4.2	4.7	5.0	5
Crude Oil (Mil. Tons)	-	0.2	0.7	1.5	2.7	4.0	5.5	6
Raw Material								
Steel (000 tons)	66.5	69.1	74.1	84.5	101.5	141.0	175.0	236
Chromium	3.2	4.0	2.6	4.0	4.6	6.0	36.0	35
Manufacturing Goods								
Metalworking, Machine Tools (Piece)	1,208	1,190	1,115	928	730	..	..	..
Electric Rotating Engines (Piece)	15,149	13,846	19,833	11,900	9,900	9,865	13,923	21,363
Transformers (Piece)	447	720	880	1,648	2,612	1,964	1,310	..
Water Pump (Piece)	850	690	1,336	1,357	430.0	412	330	360
Rice Mill Equipment (Piece)	1,302	1,176	1,209	859	800	657	706	820
Ploughs and Harrows (Piece)	323	352	316	161	172	190	188	..
Chemical Fertilizers (000 tons)	516	481	502	373	327	405	507	661
Insecticides (000 tons)	7	12	5	7	9	10	11	9
Bicycle Tires (000 pieces)	10,586	12,028	11,275	7,589	8,632	9,805	8,458	8,144
Bicycle Tubes (000 pieces)	4,501	5,622	6,431	5,270	8349	8,533	9,177	9,100
Cement (000 tons)	1,526	1,635	1,954	2,088	2,546	3,111	3,926	4,413
Bricks (Mil. pieces)	3,283	3,332	3,807	3,519	3,567	3,825	4,274	4,370
Consumer Goods								
Glass and Glass Products (000 tons)	60	53	53	51	52	32	37	47
Porcelain (Mil. pieces)	169	185	208	134	140	136	130	168
Sawn Wood (000 cubic meters)	1,680	1,488	..	..	..	..	..	..
Matches (Mil packets)	146	138	117	58	94	151	184	..
Paper (000 tons)	90	88	88	66	79	107	112	128
Salt (000 tons)	763	847	851	645	625	583	542	488
Sea Fish (000 tons)	563	561	629	683	667	666	679	737
Sugar (000 tons)	346	340	366	376	376	372	365	341
Beer (Mil. liters)	87	87	98	85	88	103	114	..
Cigarettes (Mil. packets)	1,118	995	888	1,164	1,250	1,298	1,524	1,604
Tea (000 tons)	19	22	24	25	24	23	22	28
Fish Sauce (Mil. liters)	158	155	176	159	156	150	148	..
Textile Fibers (000 tons)	52	57	62	56	59	40	43	40
Cotton Fabrics (Mil. meters)	357	357	384	336	311	298	276	225
Cotton Fabrics for Mosquito Nets (Mil. mete	109	113	106	62	67	36	86	..
Soap (000 tons)	72	74	52	40	54	68	71	78

Note: a/ State enterprises.

Source: General Statistical Office, Statistical Data of the Socialist Republic of Vietnam, 1976–90, 1991.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PROVINCES
1 Lai Chau
2 Son La
3 Lao Cai
4 Vinh Phu
5 Tuyen Quang
6 Ha Giang
7 Yen Bai
8 Cao Bang
9 Bac Thai
10 Lang Son
11 Quang Ninh
12 Ha Bac
13 Hai Hung
14 Ha Tay
15 Hai Phong
16 Thai Binh
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19 Ninh Binh
20 Thanh Hoa
21 Nghe An
22 Ha Tinh
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42 Long An
43 Tien Giang
44 Dong Thap
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49 Ben Tre
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KILOMETERS
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AUGUST 1993
IBRD 25094