

**Feasibility Study Concerning Possible Future Danish Budget
Support and Support to Complementary Activities
In Vietnam**

A Report to Danida

By

Henrik Hansen and Finn Tarp

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Acronyms and Abbreviations

ADB	Asian Development Bank
AFTA	ASEAN Free Trade Area
ASEAN	Association of South East Asian Nations
CAS	Country Assistance Strategy
CB	Commercial Bank
CDF	Comprehensive Development Framework
CEPT	Common Effective Preferential Tariff
CFAA	Country Financial Accountability Assessment
CG	Consultative Group
CIEM	Central Institute of Economic Management
CPAR	Country Procurement Assessment Report
CPRGS	Comprehensive Poverty Reduction and Growth Strategy
DAF	Development Assistance Fund
DFID	Department for International Development
EFA	Education for All
EIA	Environmental Impact Assessment
EU	European Union
ROSC	Report on the Observance of Standards and Codes of Fiscal Transparency
FSQL	Fundamental School Quality Level
GoV	Government of Vietnam
HCFP	Health Care Fund for the Poor
HDI	Human Development Index
HEPR	Hunger Eradication Programme
HIPC	Heavily Indebted Poor Countries
HICP AAP	Public Expenditure Tracking Assessment and Action Plan for Heavily Indebted Poor Countries
IDA	International Development Association
ICOR	Incremental Capital Output Ratio
IMF	International Monetary Fund
JBIC	Japan Bank for International Cooperation
JSA	Joint Staff Assessment
LNA	Legal Needs Assessment
LUC	Land-Use Right Certificate
MDG	Millennium Development Goals
MOF	Ministry of Finance
MPI	Ministry of Planning and Investment
MTEF	Medium-Term Expenditure Framework
NAPA	National Academy of Public Administration
NERC	National Enterprise Reform Committee
NGO	Non-Government Organization
NPL	Non-Performing Loan
ODA	Official Development Assistance
OMO	Open Market Operations
OOG	Office of the Government
PAR	Public Administration Reform
PER	Public Expenditure Review
PER-IFA	Public Expenditure Review and Integrated Fiduciary Assessment
PIP	Public Investment Programme
PMU	Project Management Units
PRGF	Poverty Reduction and Growth Facility

PRSC	Poverty Reduction Support Credit
PRSP	Poverty Reduction Strategy Paper
PTF	Poverty Task Force
RPA	Regional Poverty Assessments
SARS	Severe Acute Respiratory Syndrome
SBV	State Bank of Vietnam
Sida	Swedish International Development Agency
SME	Small and Medium Sized Enterprise
SOCB	State-Owned Commercial Bank
SOE	State-Owned Enterprise
TOR	Terms of Reference
UNDP	United Nations Development Programme
USBTA	United States Bilateral Trade Agreement
VBSP	Vietnam Bank for Social Policies
VHLSS	Vietnam Household Living Standard Survey
VND	Vietnamese Dong
VDG	Vietnam Development Goals
WTO	World Trade Organization

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1 Introduction

Vietnam has come a long way since the *doi moi* reform process was initiated in 1986. The past more than 15 years have witnessed one of the best performances in the world in terms of economic growth and poverty reduction. People's living standards have improved significantly, and the country's socio-economic achievements are impressive from a human development perspective. The commitment of the Government of Vietnam (GoV) to a process of sustained reform to underpin future growth, poverty reduction and development was strongly confirmed in 2002 with the approval of the Comprehensive Poverty Reduction and Growth Strategy (CPRGS).¹ This strategy document was prepared following a nationwide participatory consultation process that marks an important milestone in the modern history of Vietnam. In addition, the GoV has increasingly taken over full ownership of the CPRGS as witnessed by the first CPRGS Progress Report (IDA, 2004).

The CPRGS, the first Asian full Poverty Reduction Strategy Paper (PRSP) to be approved by the boards of the IMF and World Bank, is built on three main pillars or sets of action:²

- Completing the transition to a market economy, fostering competition in the production of goods and services and levelling the playing field between private enterprises and State Owned Enterprises (SOEs).
- Keeping development socially inclusive and environmentally sustainable.
- Building modern governance, covering areas such as public financial management, public administration reform (PAR) and legal reform.

To support the implementation of the CPRGS of the GoV and the development processes associated herewith, the World Bank is presently preparing its third annual Poverty Reduction Support Credit

¹ The CPRGS was published by the Statistical Publishing House (2003) in a comprehensive volume entitled *Strategies, Plans, Programs of Vietnam Socio-Economic Development Investment to the Year 2010*. This book also includes the Government's Strategy for Socio-Economic Development 2001-2010, the Five-Year Plan for Socio-Economic Development from 2001-2005 and the Public Investment Programme (PIP) 2001-2005. In 2003 a section on large-scale infrastructure was added to the CPRGS, see JBIC (2003). In much of the international debate and literature, strategy documents such as the CPRGS are referred to as the Poverty Reduction and Strategy Paper (PRSP). See for example IDA (2004), which contains the first Annual CPRGS Progress Report of the GoV and the so-called Joint Staff Assessment (JSA) Report by the IMF and the World Bank. See also Danida (2003).

² See the Vietnam Development Report 2004 (p. 95), also referred to as the VDR 2004, prepared by Martin Rama et al. (2004).

(PRSC), to be approved by mid-2004.³ The PRSC-3 will focus on deepening the economic reforms and pursuing further social and institutional reforms supported by the first two PRSCs as well as the IMF Poverty Reduction and Growth Facility (PRGF). Moreover, the PRSC-3 will lay out a set of proposed prior policy actions for the GoV to pursue and set the scene for PRSC-4 and PRSC-5.

The recent Joint Staff Assessment (JSA) by the IMF and the World Bank (IDA, 2004) of the first CPRGS annual progress report argues that the implementation of the CPRGS has recorded significant successes, with key measures adopted in the macroeconomic, structural, and social as well as governance areas in 2002-03. Accomplishments are characterized as solid, and it is also noted that they are increasingly “locked in” through international agreements. It is therefore to be expected that the size of the annual International Development Association (IDA) poverty reduction support credits to Vietnam will increase in the coming years, and increasing bilateral support to the PRSCs is regularly referred to in official reports and statements.⁴

Together with other bilateral donors, Denmark has supported PRSC-1 and PRSC-2 with a view to strengthening the focus on poverty reduction in domestic policies and public sector budgets. On this background, Danida decided to carry out a feasibility study before embarking on future actions in this field. The Terms of Reference (TOR), including the scope of the work, are attached in Annex 1, and the present study is prepared with the following two main objectives/outputs in mind:

- An assessment of the feasibility of continued multi-year budget support to Vietnam and supplementary support to public sector reform in support of poverty reduction.
- Well documented/argued suggestions for possible Danish budget support and backing of public sector reform in support of poverty reduction.

With reference to the TOR, we wish to highlight that this report was prepared awaiting the finalization of the PRSC-3 programme to which we did not have access. We did have productive and useful meetings in Hanoi on the topic, but a detailed assessment of the PRSC-3 proposal was not feasible. The draft PRSC-matrix that is presently being negotiated comes across as a sensible instrument in

³ The PRSC-1 and PRSC-2 were approved by the World Bank in respectively June of 2001 and 2002. The PRSC-1 was relatively narrowly focused on more traditional economic reform issues, whereas the PRSC-2 addresses the broader reform agenda set out in the CPRGS.

⁴ See for example the World Bank Country Assistance Strategy (CAS) Update, presented to the Board of the World Bank on 19 February 2004.

the ongoing negotiation and stocktaking exercises between the GoV and the donor community. The draft matrix reflects the broad thrust of positive policy change reflected in this report, but it is explicitly being used as a very flexible and constantly changing instrument, and individual elements are added and subtracted continuously. This makes more definitive assessments difficult. Similarly, the Public Expenditure Review and Integrated Fiduciary Assessment (PER-IFA) to be implemented between 29 March and 16 April 2004 will undoubtedly provide further background and insights about fiduciary risks and public sector budget issues, which should be carefully considered by Danida in due course. This is so, in particular, since this exercise focuses on means to mitigate some of the existing risks, including a re-examination of procurement methods, and on identifying ways to improve transparency.

As will be clear from the conclusions and recommendations set out in Section 5, we find that further Danish support to Vietnam within the framework provided by the PRSC can be recommended in both the short and medium-term. This is so on several accounts, including in particular that the PRSC comes across as an effective and productive partnership-based tool in the policy dialogue between the GoV and the donor community. There is clearly need for a number of aid modalities in Vietnam to help fill the many existing resource gaps and variegated forms of investment required. However, in Vietnam, macroeconomic budget support can play an important catalytic role in generating a variety of learning effects with economy-wide implications. Vietnam is, in her own way, eager to learn from the international community and better public sector management and experience with handling budget support in its various forms can arguably go a long way in enhancing the overall systemic impact of the actual resource transfer, which the budget support represents.

Finally, Danish budget support to Vietnam within the PRSC framework would allow Denmark improved and continuous access to information and policy interaction with central government and multilateral donor institutions. The value of feedback effects hereof to the overall and very sizeable programme supported by Denmark in Vietnam should not be underestimated. This is so because access to data and information is critical to effective aid programming and analysis in a strictly technical sense. But continued budget support could also help focus Danish efforts to take a more active part in policy monitoring and policy dialogue.

2 Growth, Poverty Alleviation and Development

2.1 Macro-economic Framework and Macroeconomic Policies

Vietnam has shown a remarkable growth record in the 1990s. The average annual growth rate of real GDP was about 6.9 percent p.a. from 1990 to 1999, implying almost a doubling of the economy. The population growth rate in the same period was modest (and declining) leading to average annual growth rates of real GDP per capita above five percent p.a. Even so, GNI per capita was US\$ 430 in 2002 (using the World Bank Atlas method), placing Vietnam spot on the average of Low-income countries.

The CPRGS formulates a set of targets for growth and poverty alleviation to be reached by 2010. Many of these targets are directly quantifiable and listed in the CPRGS document (Appendix 1: Vietnam's Development Objectives). Even though a strict evaluation of the growth and poverty targets is premature, references to the relevant targets are given below when possible.

Recent GDP growth and its components

The global economic recession in the late 1990s and the financial crises in Southeast Asia, naturally, had an impact on the economic performance in Vietnam. However, recovery has been fast and appears sustainable. From 2000 onwards annual growth rates of real GDP have been close to 7 percent (Table 2.1). In addition, the preliminary recordings for 2003 and forecasts for 2004 show no signs of slowing down. The CPRGS growth target is to double GDP from 2000 to 2010; hence, the annual average growth rate should be just above 7 percent. Seen in that perspective, the recent growth rates are acceptable, though not outstanding.

Throughout the period 1998-2002 more than half of the overall growth in GDP can be attributed to growth in the Non-state sector (including the FDI sector). This is not due to weak growth of value added in the State sector. On the contrary, in 2000 and 2002 growth rates in the State sector actually surpassed those of the Non-state sector. Consequently, the sector composition of GDP has been fairly constant with the share of the State sector remaining just around 38 percent of GDP.

Table 2.1: GDP growth and contributions by sector, industry, and uses (percent and percentage points)

	1998	1999	2000	2001	2002
Real GDP growth	5.8	4.8	6.8	6.9	7.0
Contribution by economic sector					
State	2.3	1.1	3.1	3.0	2.8
Non-state	3.5	3.7	3.7	3.9	4.2
Contribution by industrial origin					
Agriculture & forestry	0.9	1.2	1.1	0.7	0.9
Industry & construction	2.7	2.6	3.5	3.7	3.5
Services	2.2	1.0	2.2	2.5	2.7
Contribution by uses					
Total consumption	3.4	1.4	2.5	3.4	5.0
Gross capital formation	3.6	0.4	3.0	3.3	3.3
Trade balance	-1.2	3.0	1.2	-0.6	-1.8
Statistical discrepancy	-0.1	0.0	0.1	0.8	0.6

Source: VDR 2004

Value added in the agricultural sector has grown steadily during the period despite frequent calamities such as droughts in the Central Highlands and flooding in the South. The CPRGS target for average annual growth of value added in the agricultural sector is 4.0-4.5 percent. Actual growth rates are close to this target, though in the lower end. There has been a gradual transformation of agricultural production with shifts from rice paddy cultivation to fish farming and perennial crops combined with intensive farming. This resulted in remarkable growth rates in value added in fisheries, exceeding 11 percent in 2000 and 2001. Yet, growth rates of value added in several industrial sub-sectors match and even surpass this performance. Manufacturing and electricity & water boomed, with two-digit growth rates of value added in all years except for 1999. Furthermore, construction has picked up the pace from 2000 onwards. Hence, in general more than half of GDP growth was contributed by industry and construction (Table 2.1). The CPRGS target is average annual growth rates of 10-10.5 percent in industry and construction. Actual growth thus seems on target. In Services, growth rates of value added show a mildly increasing tendency in the period, surpassing 6 percent in 2001 and 2002. Here the CPRGS target is growth rates of 7-8 percent. This is ambitious, and above actual outcomes in the recent years.

Data for the first three quarters of 2003 indicate a continuation of existing trends. Value added in industry and construction is expected to increase by 10 percent (annual growth rate), while value added in services is expected to increase by 6.5 percent. The latter is remarkable given the impact of the outbreak of SARS on tourism and travel industries in the spring and summer of 2003.

Turning to the decomposition of growth by uses it is interesting to note the increasing contribution from consumption following the down-turn in 1999. Consumption growth rates in 2001 and 2002 are almost back at pre-1997 levels. Despite the lower volume of investment (gross capital formation) compared to consumption, investment was equally important to growth from 2000 onwards with contributions around three percentage points. Moreover, the composition of growth in gross capital formation illustrates the transition of the Vietnamese economy (Table 2.2). The low growth rate of gross capital formation in 1999 was mainly due to the large decline in FDI capital from 1998 to 1999. Even though FDI inflows were revived from 2000 onwards, the rate of growth in FDI capital is now more modest. Moreover, while investment by the State grew at high rates in 1999 and 2000, the growth rate declined markedly in 2001 and turned negative in 2002. In contrast, the growth rates of Non-state financed investment were outstanding, albeit from a low base. The share of Non-state investment has increased from constituting about 20 percent of total investment in 1998 to almost 29 percent in 2002. One explanation for the increase in private investment is the establishment of new private businesses. Since 1999 an average of almost 1,600 new enterprises has been registered each month.

CIEM (2003) and Dapice (2003), among others, caution against overly optimistic assessments of the growth performance, in particular in the industry and construction sector. The argument is that the Vietnamese industry is not efficient and competitive and, furthermore, that high growth is mainly found in import-substitution industries benefiting from protection and demand stimulation policies, embarked on since 1999. The argument has some support in the data, as the growth rate of the value of industrial production is somewhat larger than the growth rate of value added. However, this result could arise from several sources. One is less efficient use of input in production. Another is changes in the relative price of inputs and outputs. If input prices increase relative to output prices, value added will not grow at the same rate as the value of production. If the entrance of new enterprises in the industry sector leads to increased competition the result may be that the relative price between input and output prices drops. Hence, it is unclear from the data on value and value added in industry production whether competition has weakened or not. Additional measures of competitiveness are needed. Another piece of “evidence” working against the poor competition hypothesis is Vietnam’s increasing integration with the World economy. In 1998 total trade (imports plus exports) amounted to 77 percent of GDP. In 2002, the trade ratio had increased to 104 percent.

For comparison it can be noted that the Danish trade ratio was 70 and 82 percent in these years; Denmark being a small open economy.

Table 2.2: Real growth rates of gross capital formation

	1999	2000	2001	2002	Share of GCF 2002
Gross Capital Formation	1.2	10.1	10.8	10.6	100.0
State capital	15.5	10.7	3.9	-0.5	52.3
Non-state capital	-2.9	6.2	33.6	35.5	28.8
FDI capital	-26.3	12.4	9.2	13.6	18.8

Source: VDR 2004 and CIEM (2003)

Dapice (2003) puts forward a second argument for caution in assessing the growth performance, and this argument is restated in VDR 2004. Dapice and VDR claim that the high investment rate suggests that capital accumulation is not very productive. From 2000 to 2002 it took roughly 5 dollars of investment to get 1 dollar of GDP growth. In 1995-97 the same GDP growth was obtained for about 3.2 dollars of investment indicating a substantial decline in investment productivity. This argument is based on outdated incremental capital output ratio (ICOR) calculations, which neglect growth contributions from changes in education (human capital) and growth in the labour force in addition to changes in technology. Furthermore, the numbers could instead be used to illustrate that the gross return on investment was 20 percent (1/5) in 2000 to 2002. This is not bad by international standards. Instead of simple ICOR calculations a thorough analysis of returns to investments in different sectors is called for if claims of unproductive capital accumulation are to be substantiated.

The external balance

The trade balance contributed positively to overall growth in 1999 and 2000, but since then growth in exports has been less than growth in imports. In addition, 2002 recorded a trade deficit, which is also expected in 2003 and 2004. The very high growth in exports in 1999 and 2000 was mainly due to oil exports, although some non-oil products such as garments and footwear also contributed. Due to capacity constraints, the fast increases in oil export volumes cannot be repeated in the foreseeable future. Consequently, even though oil prices may increase in the future, this will only have a marginal effect on the growth of export earnings. Garment exports, on the other hand, increased rapidly in 2002, and are expected to have increased in 2003 as well. If so, the garments sector may well surpass crude oil and become the most important export commodity for Vietnam. The main reason for the strong performance of garment exports in recent years is improved access to the US market

under the bilateral trade agreement (USBTA). The trade agreement has had a marked impact on the export market structure. The key markets in 2003 were USA (20%), Europe (20%), Association of South East Asian Nations (ASEAN) (15%), Japan (14%) and China (14%), accounting for more than 80 percent of total exports. Hence, over the past few years, the US has surpassed both China and Japan to become the largest trading partner of Vietnam.

Table 2.3: Balance of payments (US\$ million)

	1998	1999	2000	2001	2002
Exports (fob)	9,365	11,540	14,449	15,027	16,076
Imports (fob)	10,346	10,460	14,072	14,401	17,581
Trade Balance	-981	1,080	378	627	-875
Non-Factor Services	-540	-547	-615	-573	-650
Services (net)	-668	-429	-597	-634	-745
Transfers (net)	1,122	1,185	1,477	1,251	1,900
Current Account Balance	-1,066	1,288	643	670	-370
Capital Account	580	-337	-391	-476	835
Medium and Long-Term	70	-423	305	383	962
Short-term	-290	-614	-1,496	-1,759	-1,227
Direct Investment	800	700	800	900	1,100
Errors and Omissions	-47	-183	-136	0	0
Overall Balance	-534	768	116	194	465

Note: Figures are rounded.

Source: VDR 2004

The high growth in imports in 2002, which is expected to carry over to 2003, was mainly due to increases in machinery and equipment, petroleum products and other production inputs, whereas imports of consumer goods dropped slightly. Thus, the import growth was probably for a large part supporting the growing industry sector.

The trade deficit in 2002 (2.6 percent of GDP) is expected to expand further in 2003 to 5.6 percent of GDP. Yet, the large net inflow of transfers (mainly remittances) makes the current account deficit somewhat smaller; 1.1 percent of GDP in 2002, expanding to some 3.6 percent in 2003. The foreign exchange remittances probably reflect the impact of the liberalizations of regulations on foreign currency accounts (see below), the proclaimed policy to enhance the investment environment for overseas Vietnamese (including the permission to buy land) coupled with the confidence in, and good record of, the USBTA.

Macroeconomic policies

The monetary policy as conducted by the State Bank of Vietnam (SBV) has changed over the recent period. Since 1999, the monetary policy has been aimed at adjusting the credit and foreign exchange regimes to make them more flexible and responsive to market signals. The aim is to maintain monetary stability while at the same time supporting economic growth. In July 2000, the SBV started open market operations (OMO), and the frequency of OMO transactions has increased from once every ten days in 2000 to twice a week since May 2002. Interest rate regulations have also changed. In June 2001 the lending interest rate for foreign currency denominated loans was liberalized, and in June 2002 the SBV removed the ceiling on domestic currency loans.⁵

Table 2.4: Monetary survey

	1998	1999	2000	2001	2002	Trillion Dong end of 2002
	Percentage change from beginning of year					
Net Foreign Assets	49.5	97.8	56.4	22.9	-0.1	117.5
Net Domestic Assets	15.0	13.7	28.2	27.5	-16.2	211.7
Credit to the economy	16.4	19.3	38.1	21.4	22.2	231.1
Claims on State enterprises	21.7	9.7	28.7	14.1	12.2	89.5
Claims on other sectors	11.2	29.8	46.9	27.5	29.5	141.6
Broad money (M2)	24.0	39.1	39.0	25.5	17.6	329.1

Source: VDR 2004

The somewhat “liberal” monetary policy in 1999 and 2000 with growth rates of credit and broad money (M2) approaching 40 percent year-on-year was replaced by a more “conservative” policy in 2001 (Table 2.4). Moreover, credit to State Owned Enterprises (SOEs) was restrained in line with the programme supported by the IMF. Over the period, credit to SOEs has declined from 50 percent of total credit in 1998 and 1999 to 38 percent in 2002.

Inflation rates have been declining from 1998 to 2001, with deflationary tendencies in 2000 and 2001, followed by an increase in 2002 (Table 2.5). Yet, the rate of inflation is nowhere near the level of the high inflation period in the early 1990s. The implicit deflators from the National Account largely follow this tendency, although not recording the decline in prices. Hence, the rapid

⁵ The interest rates for foreign exchange deposits of enterprises at Commercial Banks (CBs) and those of CBs at the SBV are still regulated.

growth in monetary aggregates has supported monetary deepening of the economy and strong credit demand, without leading to inflationary pressure.

Table 2.5: Measures of inflation

	1998	1999	2000	2001	2002
Consumer retail price index	7.8	4.3	-1.6	-0.4	4.0
Implicit GDP deflator	8.8	5.7	3.4	1.9	4.1
Implicit deflator for total consumption	8.4	4.6	3.3	1.7	4.1
Implicit deflator for gross capital formation	4.9	4.1	7.5	3.6	3.7

Source: VDR 2004

The main problem in the financial sector is the quality of lending of the State Owned Commercial Banks (SOCBs) and the fraction of non-performing loans (NPLs) in total credit. Exact data for the volume of NPLs are difficult to come by; however, some estimates show that NPLs from SOCBs amounted to VND 23 trillion in 2000. This equals 5 percent of GDP. A separation of policy-based lending from the SOCBs was initiated in 2000 by the creation of the Vietnam Bank for Social Policies (VBSP) and the Development Assistance Fund (DAF). Policy-based lending through DAF has been growing rapidly and DAF is becoming one of the biggest financial institutions in Vietnam. Outside evaluations and reviews of DAF-operations are therefore desirable and should be seen as an integral part of the reconstruction of the financial sector.

The budget deficit has been increasing from 1998 to 2001 (Table 2.6). However, the deficit is small relative to GDP in all years. The deficit is expected to rise in 2003 in part because of a 38 percent increase in wages and pensions. The budget revenue is around 20 percent of GDP, whereas grants are about 0.5 percent. The 2000 public expenditure review (PER 2000, see World Bank, 2000) noted the declining revenue (1998-1999) and called for revenue increases. As seen from Table 2.6 revenues have increased more than GDP from 2000 onwards. In particular the tax revenue from non-SOEs has increased. Unfortunately, it is trade related revenues (i.e., import taxes and duties) that have grown the most, and the main revenue components continue to be transfers from SOEs (including all taxes, operating surpluses and operating fees) and tax on external trade. Both of these revenue sources are under pressure in the reform process. Hence, reform of the tax system remains a policy issue that merits attention. However, given the priority, which the GoV has for many years assigned to fiscal discipline, it is expected that proper measures will be taken by the GoV to ensure the future sustainability of public budgets.

Table 2.6: State budget revenue and expenditure (percentage of GDP)

	1998	1999	2000	2001	2002/e
Revenue and Grants	20.2	19.6	20.6	21.6	22.2
Tax Revenue (non-SOEs)	8.7	9.0	7.8	8.3	9.6
Non-state Sector	3.0	2.8	2.5	2.4	2.4
External Trade	4.5	5.2	4.3	4.8	5.9
Joint Ventures	1.2	1.0	1.1	1.2	1.4
Transfers from SOEs	8.0	8.0	10.2	10.8	10.0
Other Non-Tax Revenue	2.9	2.1	2.0	2.1	2.2
Grants	0.6	0.6	0.5	0.4	0.4
Total Expenditure	20.7	21.2	23.4	24.8	24.9
Current Expenditure (exc. Interest)	14.5	13.2	15.1	15.1	14.7
Wages and Salaries	6.2	5.8	6.7	7.5	6.9
Other	8.3	7.4	8.4	8.1	7.8
Capital Expenditure	5.7	7.4	6.7	8.4	8.2
Overall Balance	-0.5	-1.6	-2.8	-3.2	-2.7

Source: VDR 2004

On the expenditure side, it is noteworthy that capital expenditure has been increasing from 2000 onwards without a similar increase in non-wage current expenditure. The share of capital expenditure in total expenditure has increased from 27 percent in 1998 to 33 percent in 2002 while non-wage current expenditure fell from 40 to 31 percent. The PER 2000 called for a better balance between capital and current expenditure, but this has not been addressed in the 2000-2002 period. As stated in VDR 2003 (World Bank, 2002); the level of public expenditure is less of a concern than its allocation.

Table 2.7: External debt and debt services (US\$ million, unless otherwise indicated)

	1998	1999	2000	2001	2002
Debt outstanding	19,874	20,481	11,581	11,433	12,165
Official creditors	15,446	16,818	8,679	9,170	10,503
Private creditors	4,428	3,663	2,902	2,263	1,662
Debt services					
Public Debt Service/XGS	9.2	10.1	7.6	6.8	6.0
Public Debt Service/GDP	4.0	4.9	4.2	3.7	3.3

Note: Figures are rounded. From 2000 onwards, data reflect the rescheduling of non-convertible Russian debt.

Source: VDR 2004

The real importance of Vietnam's stock of external debt was difficult to assess during the 1990s as most of the external borrowing was from the Soviet Union and former socialist bloc prior to 1991. However, in September 2000, Russia and Vietnam agreed on a debt-rescheduling scheme by which

Vietnam repays US\$ 1.7 billion over 23 years with an interest rate of 5 percent p.a. The rescheduling almost halved the external debt outstanding (Table 2.7). Since then, the debt has been fairly constant. Most of the external debt is on concessional terms; resulting in low interest rates and fairly low debt service ratios, well below HIPC thresholds.

Box 2.1: Public debt dynamics, 2002-2008

Gross debt of the general government is projected to increase from 36 percent of GDP in 2002 to about 51 percent of GDP in 2007, declining thereafter. The projection allows for a budget deficit of 2½ percent of GDP over the medium term, debt creation of some 7 percent of GDP to recapitalize SOCBs and restructure SOEs, and new lending via the DAF averaging 2½ percent of GDP annually.

Public Debt Dynamics							
	2002	2003	2004	2005	2006	2007	2008
(In percent of GDP unless otherwise indicated)							
Assumptions							
Budget deficit		2.3	2.8	2.5	2.5	2.5	2.5
Onlending		3.0	3.1	2.8	2.7	2.0	1.9
ODA-financed		1.5	1.2	1.4	1.4	1.3	1.2
Domestic-financed		1.4	1.9	1.4	1.3	0.7	0.7
Debt issues for SOE/SOCB reform		1.1	2.7	3.6	0.0	0.0	0.0
Public debt stock	35.7	39.4	44.9	50.1	51.0	51.0	50.9
Change in debt stock ratio		3.7	5.5	5.2	0.9	0.0	-0.2
o/w Onlending		3.0	3.1	2.8	2.7	2.0	1.9
Debt issues for restructuring		1.1	2.7	3.6	0.0	0.0	0.0
Memorandum Items							
Assets from new onlending 1/		3.0	5.8	8.0	9.9	11.0	11.9
Public debt stock sensitivity test							
with 3% deficit from 2005 onward	35.7	39.4	44.9	50.6	51.9	52.3	52.5
with doubling of reform costs	35.7	39.4	47.6	57.0	57.3	56.7	55.9

Source: MoF, DAF, and Fund staff estimates.

1/ Nominal value of onlending portfolio.

The main driver of gross debt stocks in this projection is lending by the DAF, through which ODA-financed onlending is routed and which also undertakes lending financed (outside the budgetary framework) by domestic borrowing. The budgetary burden of these lending operations will depend crucially on the quality of the lending and whether final borrowers can service their debts. With full repayment on post-2002 loans, DAF assets of some 12 percent of GDP in 2008 would fully service the corresponding debt; with zero repayment, this debt burden would fall fully on the budget.

The second determinant is the assumed cost of SOCB recapitalization and SOE restructuring, some 7 percent of GDP in these projections. Estimates of SOCB recapitalization costs are based on 2000 audits of the main SOCBs, plus assumptions on the pace (15 percent annually) and quality (5 percent loan loss provisioning) of new credit extension and a capital-adequacy target of 5 percent; estimates of SOE reform costs, such as for redundancy payments, are official estimates, made in 2001. With a doubling of SOE/SOCB reform costs, the peak in debt levels would exceed the baseline by some 6½ points of GDP.

This scenario assumes lending quality problems are significantly contained, ensuring that the pressures of maintaining a 2½ percent budget deficit are manageable; in “worse case scenarios”, where the budget has to finance the bulk of DAF debt service, and reform costs rise sharply because of bad loans (SOCBs) and soft budget constraints (SOEs), this assumption would not be acceptable.

Source: *International Monetary Fund (2003a)*.

Even though IMF debt projections indicate an increase in the debt-to-GDP ratio from 36 percent in 2002 to 50-51 percent in 2005-2008, mainly due to SOE/SOCB reform related lending operations and debt issuance, the HIPC debt-indicators are still well below threshold values (Box 2.1). Hence, there is no expectation of unsustainable development in external debt.

State Owned Enterprises

SOEs play a leading role in the Vietnamese economy, in particular in industry (e.g., coffee, seafood, cement, garments and textiles, and paper and steel) and selected services such as energy, finance, telecommunication and transport. The share of SOEs in industrial production was 45 percent in 1998 declining to 40 percent in 2002 (Table 2.8). In export, the importance has decreased at a stronger pace, though from a higher initial level. In 2002, the SOE share of non-oil exports was 35 percent, down from 62 percent in 1998. As noted above, there has been a decline in bank credit to the SOE sector such that the sector accounts for 38 percent of total credit to the economy in 2002. However, credit from DAF has increased since its creation in 2000 whereby total credit to the SOE sector remained at 40-50 percent in 2002.

Table 2.8: The role of the SOE sector in the economy

Percentage share of SOEs in	1998	1999	2000	2001	2002
Industrial output	45	43	41	41	40
Non-oil exports	62	54	48	44	35
Bank credit			45	42	38
Bank and DAF credit			50	48	46

Source: GSO (2004), IMF (2003b) and Larsen et al. (2003)

The general perception of the SOE problem is that of poor governance and lack of hard budget constraints resulting in meagre and deteriorating financial conditions. The prime example of loss-making SOEs is the sugar mills, where the sugar programme initiated in 1995 resulted in construction of 32 new mills adding to the 12 existing mills. The World Bank estimates that by 2000 none of the 44 mills could cover their capital costs. In paper and steel sectors SOEs are likewise loss-making with increasing debt. Not all SOEs are in bad shape though. In the oil/gas and aviation sectors SOEs are reporting large profits, probably due to limited competition. But also in the garment and textiles sector, SOEs are profitable and expanding. However, SOEs in this sector will face increased competition as accession to the World Trade Organization (WTO) moves closer.

Reforming the SOEs has been a gradual process, initiated in the early 1990s and further enhanced in 1997, 2001 and 2003/4. The pace of reform of the SOEs is probably the most problematic part of Vietnam's transformation to a socialist-oriented market-based economy. The outside view of the process is that it has been too slow and uneven. The reform is not one of outright privatization, although small SOEs have been liquidated, sold, leased or assigned to their workers, largely from 2000 onwards. The main reform mechanism is equitization whereby some or all of the state capital in the enterprise is sold in the form of shares at a price based on the book value of the assets. Directors and employees are given preferential treatment as purchasers of these shares, and they have often bought them all. The equity cannot be traded within a three year period, unless special permission is granted. Of the 288 transformations of SOEs in 2001, 200 were equitisations; 17 were sold; 41 were assigned to workers while 30 were liquidated. Since the beginning of 2001 some 70 percent of the equitisations have involved the sale of more than 65 percent of the equity to non-state shareholders. Throughout, the typical transformed SOE has been quite small. In 2001, 244 of the transformed enterprises had chartered capital of less than VND 10 billion. In fact, from 2000 to 2002 the number of SOEs with chartered capital of more than VND 50 billion has increased from 1216 to 1600 (GSO, 2004).

Table 2.9: Number and size indicators of SOEs and the transformation

	1998	1999	2000	2001	2002
Number of SOEs 1/	5,861	5,713	5,759	5,355	5,364
Total transformations	102	242	250	288	242
Total creations	87	94	74	43	8
Average employees per enterprise			363	395	421
Share of loss-making SOEs (percent)			17.45	16.69	14.67
Average loss (VND million)			3,283	3,815	4,043
Average gain (VND million)			4,597	5,544	6,546

1/ For 1998-99 the numbers are from IMF (2003) for 2000-2002 they are from GSO (2004).

Source: GSO (2004), IMF (2003b) and Larsen et al. (2003)

GSO (2004) also reports the number of loss- and gain-making enterprises in the years 2000-2002 based on comprehensive enterprise surveys. According to Vietnamese accounting standards, less than 20 percent of the SOEs are loss-making (Table 2.9) while the average loss per enterprise has increased from VND 3,283 million in 2000 to VND 4,030 million in 2002 resulting in a total loss of VND 3,171 billion in 2002. In contrast, the average gain was VND 6,546 million, and as the number of gainers vastly exceeds the number of loss-makers, the total gain in the SOE sector was VND 29,131 billion in 2002, yielding a net-gain (total profit before taxes) in the sector of VND 25,960

billion. For comparison GSO reports that 20.4 percent of the non-state enterprises had losses, with an average loss of VND 80 billion in 2002. The average gain was VND 115 million.

With due reservations for the Vietnamese accounting standards, these numbers call for more in-depth analysis of the SOE sector before the dysfunctional nature of the sector as a whole can be established as a stylized fact. Yet, this is not an argument against further and increased speed of the reform of the sector.

In sum, the problem in the SOE sector seems not to be as much a problem with losses on current operations as a problem of past and future operations. As discussed above in relation to monetary policy, the share of NPLs from SOCBs is estimated to be some 5 percent of GDP. Identification and adequate transformation of the “non-performing SOEs”, hence, appear to be a better target for the SOE reform process than mere transformation counting. Furthermore, in relation to future reforms, a discussion of the role of SOEs in the Vietnamese economy also appears more relevant than setting targets for the number of transformations. Of course, many of the small SOEs could in all likelihood be transformed quickly once the problems of vested interest and diffidence are overcome at the enterprise level. But a road map describing the desired division of future private and public sector activities will be a better goal. This may seem ambitious, but partnership and policy dialogue should be able to help establish a mutually understood vision for the future, which respects the particular conditions of Vietnam without putting economic rationality and profitability at risk.

2.2 Poverty and its Reduction

Vietnam’s growth record is remarkable but even so, many would claim that it is surpassed by the achievements in poverty reduction. From 1993 to 2002, the share of the population living in poverty fell from 58 to 29 percent; cutting poverty in half in ten years. The achievements have not been uniform across Vietnam or across ethnic groups, and there are signs of a slight decrease in the speed of progress, but this should not be taken as a critique of the progress achieved so far.

Vietnam has fairly good data on poverty, based on household surveys in 1993, 1998 and 2002. In addition to the household surveys the Poverty Task Force (PTF) conducted participatory poverty assessments in the preparation of VDR 2004. Hence, the present poverty situation in Vietnam appears well documented. The 2002 Vietnam household survey (VHLSS) was produced by GSO,

which will continue in the future with surveys every second year. The future surveys are expected to revisit many of the same households as in the 2002 survey, resulting in a panel-structure that is of particular interest for analyses of poverty dynamics. The household surveys provide detailed expenditure data that can be used to illustrate and analyze poverty and inequality over time and place. Detailed analyses of the situation in 1998/99 are given in Minot et al. (2003) while VDR 2004 provides a detailed update to 2002. Below a brief summary of some of the main findings in these reports is given.

The GSO poverty line in Vietnam is defined as the cost of a consumption basket, which includes food and non-food items, with food spending being large enough to secure 2,100 calories per day per person. A person is considered poor if the income or expenditure level is not high enough to afford the consumption basket. The fraction of the population considered poor by this definition defines the poverty rate (also denoted the incidence of poverty). In some households, expenditure or income is below the cost of the food part of the consumption basket (also referred to as the food poverty line). The fraction of the population below the food poverty line is denoted the food poverty rate.

The poverty rate in Vietnam declined from 58 percent in 1993 to 37 percent in 1998 and further to 29 percent in 2002; an annual average decline of more than 3 percentage points (Table 2.10). Poverty reduction was fastest in 1993-98 (average annual decline of 4 percentage points) while somewhat lower in the latter period (average annual decline of 2 percentage points). A similar pattern can be noted for food poverty, where the average annual rates of decline are about half of the declines in the poverty rates. In 2002, about one third of the poor were below the food poverty line. Poverty reduction has been strongest in urban areas leading to a widening gap between urban and rural poverty rates. Yet, the recorded poverty in urban areas may be biased downwards as illegal migrants are not covered by the household surveys. Even so, it is worth noting that food poverty has been almost eliminated in urban areas.

Table 2.10: Poverty rates 1993, 1998 and 2002

	Poverty rate			Food poverty rate		
	Total	Urban	Rural	Total	Urban	Rural
1993	58.1	25.1	66.4	24.9	7.9	29.1
1998	37.4	9.2	45.5	15.0	2.5	18.6
2002	28.9	6.6	35.6	10.9	1.9	13.6

Source: VDR 2004

Combining the growth record and poverty reduction underscores the pro-poor nature of the growth process in Vietnam. The average annual growth rate of GDP per capita was 6.9 percent in the period 1993-98 and 4.9 percent in 1998-2002. The poverty rate declined by 9.0 and 6.1 percent in the same periods, indicating growth elasticities (percent decline in poverty / percent growth) of 1.3 and 1.2, respectively. This is clearly above average in developing countries; the average being (roughly) one.

Geographical patterns of poverty

Both the level and rate of decline of the poverty rate vary strongly across regions even though all regions have experienced marked reductions (Table 2.11). The incidence of poverty is highest in the Central Highlands and the Northern Mountains followed by the North Central Coast. The two deltas (Red River Delta and Mekong Delta), the South Central Coast and the South East are the areas with poverty rates below the national average.⁶

Table 2.11: Poverty rates across regions

	1993	1998	2002
Total Poverty rate	58.1	37.4	28.9
Northern Mountains	81.5	64.2	43.9
North East	86.1	62.0	38.4
North West	81.0	73.4	68.0
Red River Delta	62.7	29.3	22.4
North Central Coast	74.5	48.1	43.9
South Central Coast	47.2	34.5	25.2
Central Highlands	70.0	52.4	51.8
South East	37.0	12.2	10.6
Mekong Delta	47.1	36.9	23.4

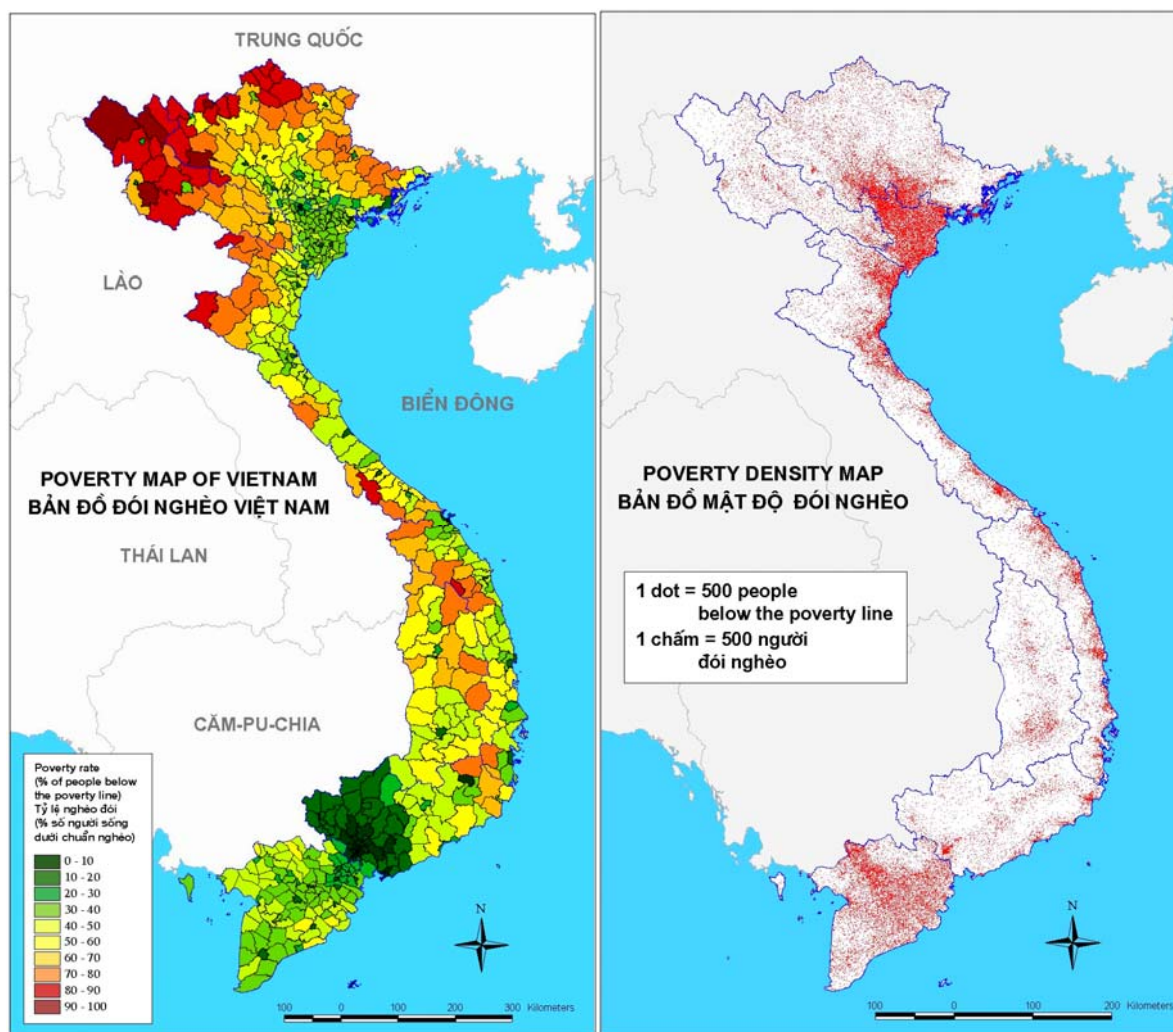
Source: VDR 2004

⁶ The regional classification has changed over time. In particular, three poor provinces from the South Central Coast and the Central Highlands were remapped to the South East between 1998 and 2002. The remapping contributed to the slow reduction in poverty in the Central Highlands and the South East.

The split of the Northern Mountains into North East and North West reveals very different achievements. The North West had a lower poverty rate than the North East in 1993, but whereas poverty reduction has been rapid in the North East, the North West remained almost stagnant from 1998 to 2002. In 2002, the North West is by far the region with the highest incidence of poverty.

The Inter-Ministerial Poverty Mapping Task Force has combined the 1998 VLSS with census data for 1999 to provide a detailed geographical mapping of poverty. It is possible to analyze poverty and inequality, along with other background data at the commune level. However, the statistical precision at the commune level is not overwhelming, which is why the spatial distribution of poverty is probably best analyzed at the region, province and district levels.

Figure 2.1: The geographical distribution of poverty rates and poverty densities



Source: Minot et al. (2003) CD-ROM.

The map on the left-hand side of Figure 2.1 shows the estimated poverty rates at the district level in 1998/1999. The additional information compared to Table 2.11 is the dispersion of poverty rates within some of the regions. In particular the North West and North East regions have large variation, even though most districts in the North West have poverty rates above 80 percent; save Son La, which had an estimated poverty rate just below 40 percent in 1998.

The map on the right-hand side of Figure 2.1 shows the location of the poor. It is interesting to note the difference in the density and the incidence of the poor which is caused by the variation in population density. Most of the poor in 1998/99 were located in the two deltas and along the coastal plains whereas districts in the North West and North East, with the highest incidences of poverty, have low densities.

The different distribution of poverty incidence and density has prompted a discussion of pro-poor policies and programmes between the Inter-Ministerial Poverty Mapping Task Force (IMPMTF, 2003) and the Poverty Task Force as indicated in VDR 2004. The question is whether policies and programmes should target areas with high poverty incidence or high poverty density, the latter being relatively rich areas. VDR 2004 provides an update of the densities, at the regional level, showing that the contribution to national poverty is declining in the two deltas (Table 2.12). In 1998, 39 percent of the poor lived in the Red River Delta and the Mekong Delta; by 2002 this share had dropped to 34 percent. In contrast, the share of poor people in the Northern Mountains, North Central Coast and the Central Highlands increased from 48 percent in 1998 to 52 percent in 2002.

Table 2.12: Percentage distribution of the poor and of the population

(Percent of total)	The poor			The population
	1993	1998	2002	2002
Northern Mountains	23	25	22	15
North East	19	20	16	12
North West	4	6	7	3
Red River Delta	24	18	17	22
North Central Coast	16	18	20	13
South Central Coast	5	8	7	8
Central Highlands	3	5	10	6
South East	11	5	5	15
Mekong Delta	17	21	17	21

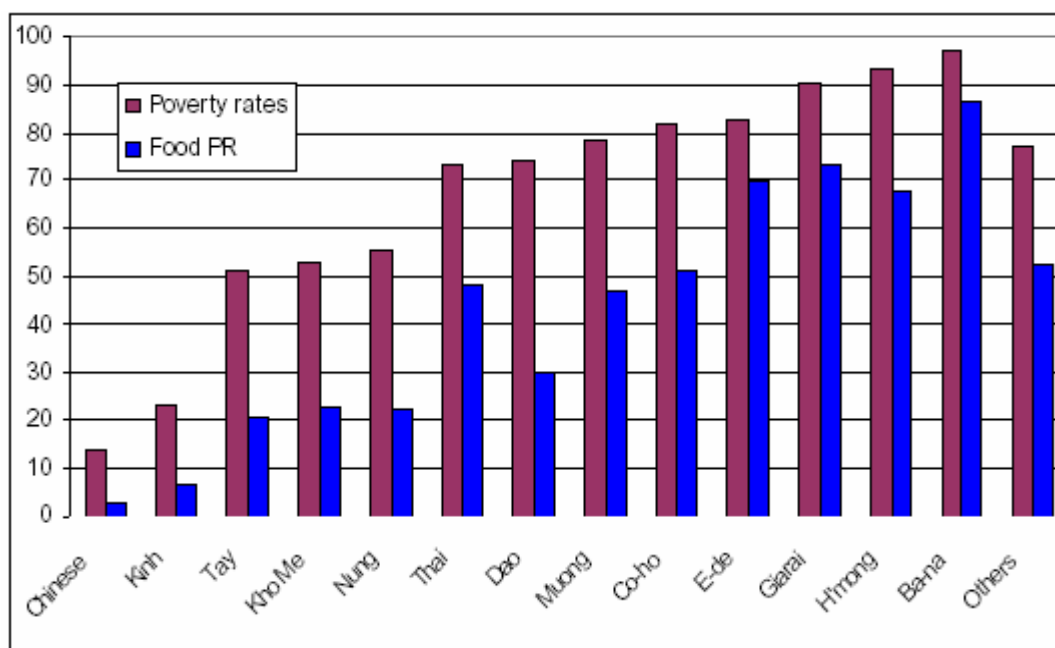
Source: VDR 2004

While this development provides arguments against concentrating the effort in (relatively rich) areas with high poverty density, it may still be cost efficient to target some programmes towards the one third of the poor living in the two deltas. Furthermore, the argument does not address the problem of the districts in the North West. The North West has by far the highest poverty incidence, yet in 2002 only 7 percent of the poor and 3 percent of the population lived in these districts.

Poverty and ethnicity

Poverty varies across ethnic groups, and the share of ethnic minorities (i.e., non-Kinh and non-Chinese) among the poor has increased from 20 percent in 1993 to more than 30 percent in 2002. This trend is even stronger when looking at food poverty rates. The decline in poverty rates has thus not been as rapid for the ethnic minorities as for the Kinh and Chinese. In fact the food poverty rate has been stagnant from 1998 to 2002 among ethnic minorities (Table 2.13). Even among the ethnic minorities there is considerable variation in poverty rates, but the main difference is still between the Kinh and Chinese, on the one hand, and the other ethnic groups on the other (Figure 2.2).

Figure 2.2: Poverty rates across ethnic groups in 2002



Source: VDR 2004

The reduction in poverty rates in Table 2.13, combined with a forecast of future poverty reduction indicates that by 2010 more than one third of the poor in Vietnam will be from an ethnic minority group. According to VDR 2004, this calls for further analyses of the poverty amongst ethnic groups

and for updates of the poverty reduction strategies to attack the many dimensions of “ethnic backwardness”.

Ethnic and geographical distribution of poverty

Even though the severity of ethnic poverty is clear, the root cause is not. First of all, the vast majority of ethnic minority people are farmers. As such, they belong to a poor segment of the population. Using the rural poverty rate for comparative purposes therefore seems in many circumstances more appropriate than using the overall poverty rate. Moreover, four of the six poorest ethnic groups are in the Central Highlands (Ba-na, Gia-rai, E-de and Co-Ho) and two are in the Northern Mountains (H’mong and Muong). Hence, the poorest minorities are located in the poorest parts of the rural areas. This suggests that the ethnic minorities are poor for a variety of reasons, which may all be relevant when focus is on designing and implementing appropriate poverty reducing policies.

Table 2.13: Poverty rates across ethnic groups

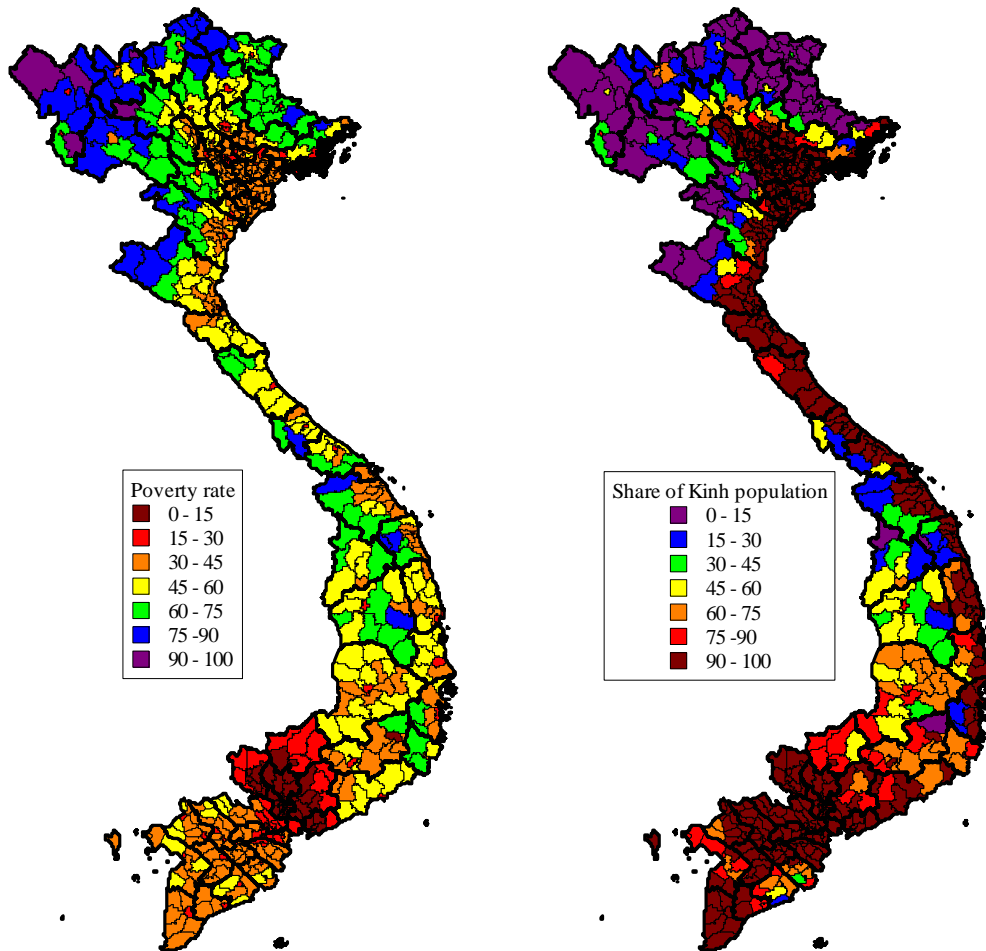
	Poverty rate			Food poverty		
	Total	Kinh and Chinese	Ethnic minorities	Total	Kinh and Chinese	Ethnic minorities
1993	58.1	53.9	86.4	24.9	20.8	52.0
1998	37.4	31.1	75.2	15.0	10.6	41.8
2002	28.9	23.1	69.3	10.9	6.5	41.5

Source: VDR 2004

Figure 2.3 shows a clear correspondence between the percentage share of Kinh in the population and the poverty rate across districts in 1998/99. These observations confirm that it is very difficult to disentangle geographical and ethnic variations in poverty rates. Moreover, the evolution of ethnic poverty rates varies considerably across geographical regions.

The minority groups in the Northern Mountains have seen steady declines in poverty rates (from almost 90 to about 66 percent) and in the Mekong Delta minority poverty rates dropped from 75 to just above 50 percent. In the Central Highlands the ethnic poverty rate declined from 1993 to 1998 and then increased to just above 80 percent. However, the Central Highlands as such had a relatively poor record compared to the other regions. In sum, it is not clear whether the high poverty rates among ethnic groups are primarily an ethnicity problem or a geographical problem, and it can be noted that the targeted programmes, to which reference will be made in subsequent sections of this report, are not defined with reference to ethnicity *per se*.

Figure 2.3: The geographical distribution of poverty rates and Kinh population shares in 1998/99



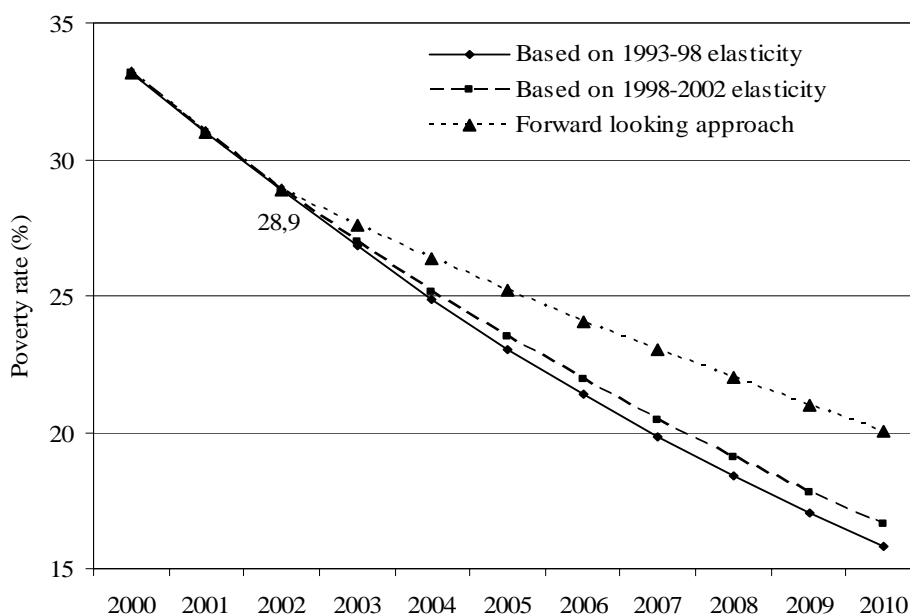
Source: Inter-Ministerial Poverty Mapping Task Force (2003), CD-ROM

A view to future poverty reduction

The CPRGS target for poverty is to reduce the poverty rate by 40 percent according to international standards and by 60 percent by national standards from 2000 to 2010. The VDR 2004 illustrates some possible outcomes under different assumptions about the growth impact on poverty reduction. Assuming that real GDP grows by 7 percent per year—as is necessary if the target of doubling GDP from 2000 to 2010 is to hold—and that population grows by 1.35 percent p.a., the resulting growth of real GDP per capita is 5.65 percent. If, furthermore, poverty declines by 1.3 percent for each one percentage point of per capita growth, as it did in the 1993-98 period, then the annual reduction of the poverty rate is 7.2 percent. A second possibility, based on the 1998-2002 observations, is that

poverty “only” declines by 1.2 percent for each percentage point per capita growth. In this case the poverty reduction amounts to 6.7 percent per year. A third approach uses the disaggregated expenditure data from the 1998 and 2002 surveys to take account of the variations in the growth rates in average expenditure per capita across ethnic and non-ethnic groups across provinces, coupled with the assumption of an overall per capita GDP growth rate of 5.65 percent p.a. This disaggregated approach yields an overall poverty elasticity of 0.8. Projections of the three scenarios are given in Figure 2.4.

Figure 2.4: Projections of the poverty rate 2000-2010



Source: VDR 2004 and authors calculations

The two projections using growth elasticities of 1.3 and 1.2 result in very similar forecasts of the poverty reduction from 2000 to 2010, and both show that the CPRGS target can be reached, as poverty is halved over the period. The disaggregated projection, denoted “Forward looking approach” in the figure, highlights a possible path in which the target is missed (though by a small margin). Furthermore, the disaggregated approach underlines the need for further analysis of – and policy actions towards – poverty reduction amongst rural ethnic minorities.

3 Socio-Economic Reforms and Governance

3.1 Background

As is clear from Section 2, Vietnam has come a long way since the *doi moi* reform process was initiated in 1986. Wide-ranging socio-economic and institutional reforms have been introduced, including a greater reliance on market forces in the allocation of resources and in the determination of prices. A shift from an economy dominated by the state and co-operative sectors to a situation where the private sector and foreign investment account for a relatively high proportion of GDP is visible. Overall, important strides have been made over a relatively short time span to further the transition from a centrally planned to a socialist market economy.

In parallel with the domestic reforms, Vietnam has initiated a process of opening up its economy to regional and global economic forces that will shape the international economic environment in which the future growth process of Vietnam will have to take place. Vietnam joined the Association of South East Asian Nations (ASEAN) in 1995, and is also a member of the Asia-Pacific Economic Co-operation (APEC). The central economic and trade programme of co-operation for ASEAN is the ASEAN Free Trade Area (AFTA), and AFTA's key instrument is a Common Effective Preferential Tariff (CEPT). By joining ASEAN, Vietnam has undertaken international commitments in the area of trade policy that are bound to have an impact on opportunities for economic development. This is particularly so in light of the intense competition that characterises today's global markets, and the rapid evolution in science and technology. Assessing the impact of trade policy and formulating appropriate policy responses is a critical area of the reform process, especially since it is a central objective of the GoV to join the World Trade Organization (WTO) as early as possible, with the end of 2005 as the current goal.

The progress achieved over the past more than 15 years is remarkable in the modern history of Vietnam; and viewed in this perspective, the commitment of the GoV to overcome the legacies of the past and put the country on a stable path of growth, poverty alleviation and broad-based development, cannot be disputed. Yet, it is also clear that Vietnam faces tremendous challenges. Vietnam remains a poor country according to the Human Development Index (HDI),⁷ and structural and in-

⁷ Vietnam is ranked as number 109 using the UNDP Human Development Index (UNDP, 2003).

stitutional reforms still to be addressed are by no means simple and straightforward.⁸ The same goes for the search for how best to organise and facilitate a socialist-oriented market economy, articulated as an overarching goal at the Ninth Party Congress in April of 2001.

In subsequent sections (grouped according to the three pillars of the CPRGS) a somewhat more detailed assessment of the reform process over the past few years and an identification of risks and challenges in the coming years are given. Focus is on the PRSC process and performance in light of the PRSC-3 triggers, presented in the PRSC-2 programme document. Table 3.1 provides the summary overview of these triggers. It is recalled that triggers should be seen as well-defined milestones, benchmarks, policy actions or indicators, which regulate the move from one PRSC to the next.⁹ It follows that performance as measured against these triggers is important in establishing whether the next PRSC should be pursued at the low, base or high case scenario in terms of IDA support. Moreover, in case of unsatisfactory performance, the PRSC should be discontinued or at least seriously reconsidered.

It is characteristic, however, that performance evaluation is complex as indicators and topics actually focused on vary,¹⁰ and it is not entirely clear how the PRSC modality relates to more traditional conditionality, compliance and reward mechanisms. It would appear that emphasis in practice in the PRSC process in Vietnam has so far been more on stocktaking than on continuous and long-run forward looking interaction. This suggests that there is scope for investing more time and resources in the policy dialogue among the multilateral and bilateral donors associated with the PRSC, and this is so at both macro and sector levels. As regards the latter, further development of the policy dialogue in the PRSC sub-groups (see Section 4) may help contribute in a constructive manner to furthering a balanced build-up of plans and action programmes from “below”.

⁸ In October of 2003, the Executive Directors of the IMF concluded the Article IV consultation with Vietnam. The Executive Directors commended the Vietnamese authorities for their strong success in achieving high growth and poverty reduction based on prudent macroeconomic management, transition to a more market-oriented economy and increased integration into the global economy. The Executive Directors also drew attention to pending issues concerning for example the compliance of the State Bank of Vietnam (SBV) with the IMF safeguards policy on preparation, audit and publication of central banks' statements.

⁹ As stated in World Bank (2003), triggers help the World Bank and the Government to anticipate critical next steps in the relevant areas of reform. They provide benchmarks against which to objectively evaluate progress on reforms and the readiness to move forward with the next operation.

¹⁰ The detailed content of the PRSC policy matrix has been constantly changing and while the broad focus in the latest draft PRSC-3 matrix is in accordance with the assessments put forward in the present report, the various collaborating partners are still exercising influence on the final outcome. This also means that the matrix is in effect a rather mixed bag of initiatives, some of more fundamental nature than others.

Table 3.1: Monitorable indicators

Related to CPRGS Pillar I	Trigger for PRSC 3
<ul style="list-style-type: none"> • Private sector development 	<ul style="list-style-type: none"> • Number of new formal sector enterprises registered
<ul style="list-style-type: none"> • State-owned enterprise reform 	<ul style="list-style-type: none"> • Share of new credit going to state-owned enterprises • Progress in resolution of inter-enterprise debts
<ul style="list-style-type: none"> • Financial sector reform 	<ul style="list-style-type: none"> • Progress in resolution of non-performing loans • Progress in operational framework for DAF
Related to CPRGS Pillar II	Trigger for PRSC 3
<ul style="list-style-type: none"> • Poverty and hunger alleviation 	<ul style="list-style-type: none"> • Proportion of people living below the poverty line • Proportion of people living below the food poverty line
<ul style="list-style-type: none"> • Education 	<ul style="list-style-type: none"> • Net primary school enrollment rate • Gender and ethnicity gaps in net primary enrollment rates • Proportion of children in full-day schooling at primary level
<ul style="list-style-type: none"> • Land 	<ul style="list-style-type: none"> • Submission of a bill for the revision of the Land Law, supporting land-tenure security, customary land-use practices and access to land for all sectors
<ul style="list-style-type: none"> • Environmental sustainability 	<ul style="list-style-type: none"> • Proportion of population with access to clean water and sanitation services
Related to CPRGS Pillar III	Trigger for PRSC 3
<ul style="list-style-type: none"> • Planning processes 	<ul style="list-style-type: none"> • Progress in implementation of CPRGS planning processes in one sector • Progress in implementation of CPRGS planning processes in several provinces
<ul style="list-style-type: none"> • Public financial management 	<ul style="list-style-type: none"> • Progress in the set up of an integrated Treasury and Budget Management Information System
<ul style="list-style-type: none"> • Legal development 	<ul style="list-style-type: none"> • Publication of legal documents in the Official Gazette

Source: World Bank (2003).

Finally, there is by way of background reason to highlight that the GoV has outlined a rather elaborate set of indicators to monitor the implementation of the CPRGS. Progress towards meeting CPRGS strategic objectives and the local version of the 2015 Millennium Development Goals (MDG), known as the Vietnam Development Goals (VDG), see Cat Van Thanh (2003), is in principle measured by no less than 134 indicators, although in practice a smaller sub-set is relied on.¹¹

¹¹ The document on the VDG was prepared in the CPRGS inter-ministerial working unit. It provides a detailed and comprehensive list of 134 indicators, definitions and data sources grouped as follows: A1: Economic Growth, A2: Resource Mobilization for Hunger Eradication and Poverty Reduction, A3: Resource Effectiveness, B1: Poverty Reduction, B2: Infrastructure, B3: Job Generation, B4: Compulsory Education, B5: Fertility, Child Mortality, and Child Mal-

It is clearly beyond the scope of the present report to assess all of these in detail, but this is an area where future technical assistance would probably be beneficial with a view to ensuring a high degree of clarity and relevance in the monitoring and evaluation effort by both the GoV and the international donor community. Strengthening the capacity for data analysis and the subsequent formulation of adequate policy advice is clearly needed across a wide range of institutions and actors in the Vietnamese reform process, including those concerned with the design and implementation of the PRSCs.

3.2 Economic Transition and Reform (CPRGS Pillar 1)

Reviewing the 2002-03 CPRGS annual progress report, there is ample evidence that the implementation of the CPRGS has so far been encouraging in the more traditional areas of economic reform. The JSA of the World Bank and the IMF (IDA, 2004) refers to significant successes, and it is stated that key measures continue to be adopted in the macroeconomic and structural areas (i.e. in CPRGS Pillar 1). The following paragraphs illustrate the present situation.

Private sector development

The new Enterprise Law, implemented in January 2000, was an important milestone in the Vietnamese reform effort. In a briefing note prepared by the Central Institute of Economic Management (CIEM, 2002), the enterprise law is characterized as a key for future job creation, and it is emphatically stated that “The wind of change is blowing in Vietnam, and nowhere is this more evident than in its private sector”. The enterprise law marked the explicit desire of the GoV to improve the climate for private businesses and establish a level playing field between the state and private sectors of the economy;¹² and by now the formal private sector employs more people than the entire SOE sector. Moreover, as noted in Section 2, the number of new registered private enterprises continues to be high, and the GoV has also unified the corporate income tax at 28 percent. This implies that income taxes became irrespective of ownership as of January 2004. All in all, an active process of

nutrition, B6: Health, HIV/AIDS, Epidemic and Social Diseases, B7: Information and Culture, B8: National Culture, B9: Sustainable Environmental Protection, B10: Vulnerability reduction, B11: Gender Equality, and B12: Good Governance.

¹² At present enterprises that are fully owned by the State operate under the Law on State Owned Enterprises, but a unified law is presently being drafted by CIEM. In this process, the particular social and responsibilities often assigned to SOEs should not be overlooked.

removing impediments to private sector development is unfolding and the investment climate has definitely been improved.

SOE-reform

The Ninth Party Congress held in 2001 established a variety of goals related to SOE reform. They focus on fostering greater competition in output markets and on hardening the budget constraint rather than on outright divestiture. The strategy also includes divestiture of non-strategic enterprises (mainly through equitization) and a move towards autonomous decision-making and enhanced accountability in enterprises that remain under state ownership. A well defined (and publicly available) road map for SOE equitization, sale etc. has been established and while the number of transformations in 2003 fell far short of this plan progress is as fast as ever before (Larsen et al., 2003) and plans for the future are well defined. Diagnostic audits also continue and, as shown in Section 2, the share of the SOE sector in the economy (as measured by the share of SOEs in GDP, exports or new banking credit) is on a downward trend while state sector efficiency is on the increase. Overall, while SOE reform continues to be contentious, it appears that the GoV is moving slowly, but decisively in the direction agreed upon, and a Decree on monitoring and evaluating SOEs was issued in December of 2003 as a confirmation hereof. This is expected to lead to an explicit classification of SOEs depending on profitability etc. A complex area still to be addressed relates to inter-enterprise debt, which in turn is closely embedded in the financial sector reform initiative.

Financial sector reform

Progress in the financial sector reform area is falling behind original plans, interlinked as it is with SOE reforms. Progress in the resolution of the issue of non-performing loans is therefore sluggish. Nevertheless, it would appear that about 30 percent of the stock of NPLs (identified in December 2000) has been resolved (Larsen et al., 2003), and as part of existing restructuring plans, loans have by now been reclassified based on norms that are close to international standards. Efforts are also being made to improve capabilities and accounting practices in the SOCBs, and there are clearly efforts by the GoV to streamline the regulatory framework for policy lending, including the areas of activity of the DAF. Much remains to be done in this area, and the transparency of the system remains somewhat clouded, but it should be kept in mind that the donor community is actively engaged in key areas of the reform process as set out in the informal Vietnam – Partnership for Development report presented in December at the Consultative Group meeting for Vietnam (Bo Thi Hong Mai, 2003).

3.3 Social Equity and Sustainable Development (CPRGS Pillar 2)

The excellent performance of Vietnam when it comes to poverty and hunger alleviation is well established and documented as shown in Section 2, and evidence suggests that the public expenditure programme of the GoV plays an important redistributive role (PER 2000 and VDR 2004). On this ground budget support appears well justified. Nevertheless, while education spending as a share of Government expenditures has been on a steady increase, public health outlays are somewhat low and have been falling as a share of total recurrent Government expenditure.

The falling share of the health sector has started to attract more attention in the policy dialogue,¹³ and it may seem paradoxical that health indicators in Vietnam are generally better than should be expected for a country as poor in income terms as Vietnam.¹⁴

Targeting of public health spending has improved over time and total public social expenditures are more equally distributed than household expenditures. However, the large share of health care and education spending financed by individuals or households has inherent inequalities. The burden of user charges on poor households in health and education is high, and the system of exemption from some fees and charges does not appear to operate in a pro-poor way. Moreover, the high level of expenditure on curative health programmes is inequitable, as much of this is focussed on hospitals, which have disproportionately large numbers of users from the more affluent sections of the community. There are also clear variations among provinces in terms of quantity and quality in the delivery of minimum services. These province-wise differences are linked to per capita public spending disparities stemming in part from differences in access to user fee and insurance-funded revenues. Disparities also result from central government resources that are neither well targeted on poor areas nor directed sufficiently to commune health sectors and other facilities used more by the poor, but went to hospitals instead.

In response to this situation, more resources for health services at the provincial level are currently in the process of being secured, through Decree 10 and Decision 139, which are still being fleshed-out and road tested. Decree 10 takes aim at the functioning of the system at the facility level. When

¹³ Note that health did not, in fact, appear as one of the trigger areas in the PRSC-2 programme document.

¹⁴ The total fertility rate is 2.4 as against an average for low-income countries of 3.8, and contraceptive prevalence is high at 75 percent as compared to 23 percent for low-income countries. However, choice is limited and abortion is widely relied on. The number of births attended by skilled medical staff is 77 percent.

fully implemented, it would give hospital managers much greater control over their budgets as well as greater through still constrained discretion regarding pay and employment issues, user charging for non-basic services and domestic borrowing.

Decision 139, issued in October 2002, entails a major increase in health spending with an additional VND 700 billion notably allocated for 2003. This measure requires provinces to use the Health Care Funds for the Poor (HCFPs), set up with central resources, to either buy health insurance cards for the poor and other disadvantaged groups, enrolling them in the social health insurance programme, or to pay directly for the costs of services supplied to the beneficiaries by hospitals and possibly other public providers. This should lead to improved service utilization, especially inpatient care for which fees, drug outlays and other costs can be prohibitively expensive without insurance coverage, and Decision 139 can be tightly targeted on the poor. Out-of-pocket health spending and purely precautionary savings should fall for those individuals covered by this measure, freeing up resources for spending on food, shelter and other goods and services.

It would appear that this is an area to which Danida may wish to pay particular attention. It is a promising avenue to sustain the poverty reduction achieved in recent years, and it is widely agreed that much can be achieved by revamping the targeted alleviation programmes. In general terms, this should be done in a way that expands their coverage of the poor, reduces leakage to the non-poor, strengthens the management of resources, and gives more responsibility to communities in the design and supervision of the local components.

In relation to other recent developments in the health sector, it is encouraging that the official concern about increased HIV/Aids prevalence has become more vocal and visible. A 10-year strategy to address this problem has been drafted by a newly established National Committee, as evidence hereof, and the effective response of the GoV to the SARS crisis underlines that the GoV is taking the health situation and related social and economic implications seriously.

Turning to the social areas that were explicitly listed in the summary overview of trigger areas in the PRSC-2 programme document, alongside poverty and hunger alleviation, the following highlights are illustrative of developments over the past few years.

Education

Vietnam has been making rapid progress in increasing educational enrolments at all levels and improving the efficiency and equity of public spending. The gender gap in enrolment and attainment has basically been closed. The female/male education ratio is for example 1.0 for net primary enrolment, and primary enrolment rates now exceed 90 percent, except for ethnic minorities and the poorest quintile of the population.¹⁵ Moreover, the 10-year strategy for education is consistent with international development goals. Finally, social safety nets have been designed to avoid any bias against women.

Targeting of education spending has improved over time and, according to VLSS 1998, the poorest quintile receives 18 percent of total public education expenditures and 26 percent of primary education expenditures. This is promising in international comparative perspective, but the level of costs borne by parents, both directly and through fees is high, and the current system of exemption from fees does not seem pro-poor. There are also issues of varying quality of the education actually provided, and higher education is largely restricted to those who can afford to pay. Systemic reform with a view to promote efficiency and equity of the education system as a whole therefore remains a challenge.

The commitment of the GoV to quality of education to all segments of the population is underscored by the recent adoption of a national Education for All (EFA) strategy. Moreover, the Fundamental School Quality Levels (FSQL), adopted in 38 provinces under the programme Public Education for Disadvantaged Children, is promising, especially since disadvantaged children are among the poorest in Vietnam. Expectations are that by 2006, at least 40 percent of the educationally disadvantaged zones will receive Government support to move towards the FSQL level, and schools that receive FSQL investments will eliminate many of the charges which currently burden poor families.

Land

The new Land Law passed on 7 November 2003 represents a distinct expression of the commitment of the GoV to establish an enabling environment for a market economy. The adopted land law sets up a legal framework for addressing land-tenure security, customary land-use practices and access

¹⁵ However, the greatest *improvements* in participation rates have been in the lower income groups.

to land for all sectors, including minority groups relying on customary land use practices. The rights of these groups have been a concern in the PRSC process, and the advances noted are no doubt directly linked with the PRSC policy dialogue. The law also specifies that Land-Use Right Certificates (LUCs) should bear the names of both spouses, promoting equal access to land use, as well as access to credit since LUCs can be used as collateral. The challenge in the coming period will be to follow-up the law with all the necessary circulars and guidelines so it becomes a daily reality.

Environmental sustainability

The key initiative in this area has been the drafting of a circular by the Ministry of Planning and Investment (MPI) on the implementation of Environmental Impact Assessments (EIA) of large projects so as to promote Vietnam's capacity to implement Agenda 21. The newly established Ministry of Natural Resources and the Environment is the new focal point for action in this area, which will assume responsibility for issuing the necessary detailed regulations.

3.4 Governance and Public Sector Management (CPRGS Pillar 3)

The third pillar of the CPRGS is concerned with building modern governance, and over the past few years there has been noticeable progress in public expenditure management. Specific comments with reference to Table 3.1 follow below.

Planning processes

The GoV recognizes that a major effort is needed to roll out the CPRGS to the provinces, and several activities have already been undertaken in this respect. They include a series of workshops and a set of Regional Poverty Assessments (RPAs), which provide qualitative insights into local poverty conditions. This process is likely to continue, so the CPRGS policy matrix will undoubtedly step by step acquire a more central position in development planning and implementation. In this regard, it appears that improved synchronization of the CPRGS and the Five- and Ten-Year plans would be desirable, but there is arguably a need for both the domestic planning documents and the CPRGS. They serve different purposes and audiences, and they are elaborated under different types of constraints. As such they have complementary – rather than competing – roles to play in the development process in Vietnam and the related interactions with the international community.

Public financial management

The 1996 State Budget Law established a clear and generally sound set of “rules of the game” for resource allocation and resource use. A revised State Budget Law was approved by the National Assembly in December 2002 and came into force in January 2004. The new law consolidates and builds on recent efforts to promote fiscal transparency and accountability, such as Decision 182/2001/QĐ-TT allowing for more detailed publication of final accounts for 2000 and the budget plan for 2002 and providing an enforcement mechanism to make communes post their budgets outside offices. Henceforth, budgets will be published as soon as they are approved, along with all procedures and regulations. The State Budget will cover all expenditure components including defence and national security (budget lines that were previously a State secret) beginning from the fiscal year 2005. Moreover, the National Assembly is given powers to decide detailed appropriations for Ministries and transfers to provinces, a clear improvement compared to previously where they only approved allocations at the sector level. It should also be noted that the CFAA from 2002 concludes that the public financial management system of Vietnam compares well with those of other countries. In addition the GoV has expressed its full agreement with all of the main recommendations.

Significant weaknesses remain, however, in the management system. Vietnam lacks even a simple mechanism for monitoring the outputs and outcomes of public spending and for feeding this information back into future resource allocation decisions. The existing mechanisms for incorporating economic and sectoral analysis are weak and there is a growing mismatch between capital expenditure and operations and maintenance expenditure in many sectors. The absence of a credible multi-year fiscal framework means that expenditure planning is conducted without reference to agreed medium-term resource constraints and prioritization is carried out separately for capital spending and for recurrent spending.

Weaknesses in transparency and accountability also continue to exist. Final accounts are not available for up to 18 months after the end of the fiscal year and there remain many inaccuracies in the data. The published data remain at a high level of aggregation and even line ministries have difficulty in assessing more detailed data on sector spending at province and district level. The still less than fully consolidated budget makes it difficult to monitor total revenues and expenditures, as well as the true fiscal position. Extra-budgetary funds, on-lent ODA and much of commune-level spending are not consolidated into the budget. Inspection of the budget and end-year accounts by the

State Audit and by the National Assembly has strengthened in recent years, but major deficiencies remain.

The GoV is working to pilot Medium-Term Expenditure Frameworks (MTEF) in four pilot sectors; education, health, transport and agriculture/rural development, and in four pilot provinces. This will be complemented with an overarching, higher-level Medium-Term Fiscal Framework (MTFF). At the same time, efforts are being made to establish a first generation performance budgeting system. Moreover, the GoV recently launched a major procurement exercise for a net Treasury and Budget Management Information System, which will greatly strengthen its ability to manage and to monitor in an accurate, detailed and timely manner how resource are used at central and local level.

Legal development

The foundation for Vietnam's legal reform strategy was laid down in a Legal Needs Assessment (LNA) in 2002 and a legal systems development strategy with detailed action plans has been developed on this basis. The 2004 legislative agenda for the National Assembly will focus on Vietnam's legal framework for WTO requirements, but an ambitious law programme has been outlined by the National Assembly for the period 2004-2007. Many of these actions are bound to have a profound effect on the Vietnamese society, including issues such as transparency, people's participation and access to justice.

3.5 Summing-up and Critical Issues

While Vietnam's achievements in terms of poverty reduction are one of the greatest successes in economic development, growing inequality has been experienced in recent years, particularly between rural and urban populations, between ethnic minorities and the majority Kinh and Chinese groups, between poor and wealthy regions, and within growing cities (see Section 2). The remaining poverty, both in marginalized areas and within growing regions, is a formidable challenge. One reason for this is accession to the WTO, which is likely to involve considerable structural shifts that are difficult to predict, and a process where there will be both winners and losers. Attention to the particular needs of groups of people, including women and children, with low level human and physical capacity endowments and limited capacity to respond in a changing economic environment will be a key to continued progress. While gender imbalances are less pronounced in Vietnam than

in many other places,¹⁶ and gender equality and freedom from violence are guaranteed under the law, attitudes perpetuating inequality and domestic violence persist in most communities, and in institutions entrusted with overseeing and implementing the law. Moreover, there are no women in the Politburo and the Secretariat, the top levels of the Party and Government. Some 26 percent of the National Assembly members are women, but at local levels of government and party structures the share ranges between only 5 and 20 percent.

In spite of concerted efforts to promote private sector development and enterprise over the past few years, there is need for continued support to further the process of transition to a market economy. Particular attention should in this regard be paid to deepening the understanding of the constraints facing the Small and Medium Scale Enterprise (SME) sector and defining programmes of action to address these. The donor community can undoubtedly play a constructive role here. It also appears as an important ingredient of the reform process to try to better the climate for enterprise development, including a level playing field so private agencies can compete on an equal footing with state companies.¹⁷

In the policy dialogue between the GoV and the donor community, slow-moving progress in the area of SOE and financial sector reforms has played a critical role and has no doubt fuelled skepticism about the intentions and will of the GoV. There is reason to continue focusing on the need for introducing hard budget constraints and streamlining the financial sector. Delivering on this double agenda would be beneficial. At the same time, it should be kept in mind throughout that these reforms are complex and if not handled in an appropriate manner could lead to highly undesired implications as witnessed from other reform processes elsewhere in the world. The GoV appears committed to continue moving in the right direction and, as such, it would be advisable to insist on continued progress rather than on unrealistic speeding up of the pace of reform. In any case, the SOE sector should be assessed on economic and financial grounds, and in this area the situation in Vietnam may not be as uniformly dismal as sometimes pictured. While some SOEs are certainly inefficient others have in fact contributed to industrial development as discussed in Section 2. Increased transparency in providing financial information and regulatory progress in this area and in the financial reform area are likely candidates for productive focal areas in the policy dialogue.

¹⁶ The female labour participation rate is 86 percent, for example.

¹⁷ It can be noted that CIEM has been assigned responsibility for drafting (before the end of 2004) legislation to promote this goal.

Government expenditure on education and training and on health services does appear to have a pro-poor bias; however, there is ample room for improvements. There is therefore reason to monitor the developments in this area closely, and the forthcoming PER-IFA should contribute to further insights in this area. The same can be said for the establishment of MTEFs, and initiatives to reduce formal and informal out-of-pocket expenses of poor people, which can have a variety of undesirable systemic effects, deserve careful attention as do policies geared towards ensuring appropriate quality and service levels in poor areas. Finally, attention to HIV/Aids is rightly attracting attention as an important issue in defining appropriate health policies.

There is a clear awareness in Vietnam of the need to build capacity for sustainable resource management, pollution prevention and control, and prevention and mitigation of natural disasters. However, actual resource allocation to environmental management remains low, and the GoV continues to face a series of well-known trade-offs when economic and environmental dimensions of development have to be assessed. This is a complex challenge, but greater awareness of issues involved and the environmental implications of economic choices is an appropriate way to approach these. The same goes for the need to turn recent regulatory improvements in relation to land into reality. While it is commendable that the legal framework has just been modified to provide equal access to assets, practice has so far been that only men's names are registered on land titles. This has reduced the access of women to mortgage based credit markets and limited their economic possibilities. All of this underlines the importance of continued attention to these cross-cutting challenges, including proper monitoring, analysis and evaluation.

Planning processes in Vietnam continue to reflect a high degree of centralization and the political single-party system remains undisputed. Efforts have been made to disseminate CPRGS processes to provincial and local authorities, but there is a clear need for increased attention to "bottom-up" planning and for greater synchronization of the CPRGS and more traditional planning processes. The Public Investment Programme (PIP) and the initiatives foreseen in the CPRGS is a case in point. Vietnam is allocating substantial resources to public investment, but at present the PIP remains largely a compilation of projects, which are inadequately screened and assessed within a comprehensive development framework. It is hoped that the recent inclusion of an infrastructure chapter in the CPRGS can help improve coordination between the CPRGS and the Five- and Ten-

Year Plans, but there is arguably a need for both the domestic planning documents and the CPRGS. They serve as noted different purposes and audiences. In any case, concerted action will be required to promote proper involvement of local level authorities and people in rolling out the CPRGS as discussed in the VDR 2004.

Public financial management continues to be non-transparent and much remains to be done in this area in spite of recent progress. Donors are well advised of the existence of a variety of fiduciary risks, but the forthcoming PER-IFA could play a critical role in contributing an up-to-date assessment and lay out detailed proposals for future actions. Particular attention could in this context be paid to the need for concrete accounting and auditing standards, reporting practices and proposals for how they can be put into practice in a timely and realistic manner. The same goes for a variety of initiatives related to the struggle against corruption. While it is not entirely evident that corruption is as widespread and destructive as sometimes depicted, it is clear that corruption remains an issue in Vietnam and that attention needs to be paid to pursuing concrete steps towards curtailing it as much as possible. Some of the recent steps in enacting punitive measures are to be noted but the systemic aspects can only be addressed through greater transparency and popular control.

Democracy and human rights is an issue in relation to Vietnam and although a signatory party to the UN convention on Civil and Political Rights, the situation regarding freedom of opinion, assembly and association and the right to protection against abuse remains unsatisfactory. Yet, it would appear that the long-term trend is positive, and human rights are receiving greater acceptance, and the present process of increased transparency, publishing laws etc. is an appropriate one. Even so, it should not be overlooked that the room for open critique and debate is limited. Here again, it is clear that the GoV will have to carry out a careful balancing act between various interests and forces in the Vietnamese society and the donor community.

In sum, the GoV is faced with many intricate issues, but reviewing experiences so far gives reason to state that it does appear that the necessary political will exists to keep the reform process moving forward in spite of the difficulties listed. Reviewing the efforts over the past few years, there is no doubt that ambitions have often been pitched at rather optimistic levels. Yet, institutional reforms are by their very nature difficult in a context such as that of Vietnam. It would therefore be advisable that donors keep focused on whether the trends in the reform process stay on track rather than

on the level of individual criteria used in the assessments. Overall, this effort could undoubtedly be improved by a more concerted focus on better and more consistent monitoring of the reform effort in its many dimensions.

4 Aid Flows and Aid Management

4.1 Aid Patterns¹⁸

Vietnam received only limited amounts of aid from OECD member countries during the 1980s where Soviet assistance was prominent. However, with the downfall of the former USSR, normalization of relations with the USA and other Western countries, and the initiation of the *doi moi* reform process in 1986, Vietnam became an attractive destination for Official Development Assistance (ODA) from the OECD donor group. This was so on social and economic as well as political and strategic grounds as argued by Bartholomew and Lister (2002). They also emphasize that *doi moi* was initiated before the upsurge in ODA which only began in the late 1980s, so reform was neither imposed from outside nor “bought” with aid. Aid may in the Vietnamese context be perceived as a reward for the reform initiative, but it did not bring *doi moi* about.

Donor support for Vietnam’s development and reform policies remains strong. Recent estimates suggest that ODA disbursements reached a level of more than US\$ 1.5 billion in 2003, corresponding to some 20 US\$ per person, about 4.5 percent of GDP, and some 20 percent of total government revenue. This makes Vietnam an important programme country to many donors, including Denmark.

ODA-flows rose more than five-fold during the decade from 1993 and they have by now recovered to the record level achieved in 2000 after a temporary decline in 2001 (Figure 4.1).¹⁹ Most of the longer-term increase in disbursements is accounted for by loans rather than grants, and loans now account for about two-third of the ODA inflows.

Japan has for years been the largest donor, in 2002 followed by the World Bank, the Asian Development Bank, France and the IMF (Figure 4.2). Denmark was sixth in 2002 and therefore a key bilateral donor.

¹⁸ This section draws on UNDP (2002), UNDP (2003), Bartholomew and Lister (2002), Lister (2003) and Bartholomew and Lister (2004). We are grateful to Anne Brolev for support in obtaining the data used.

¹⁹ Disbursements in 2001 fell some 16 percent following eight years of consecutive increases. The decrease was due largely to the completion of a number of Japanese financed projects and programmes, including the Phu My, Pha Lai, and Ham Thuan Da power plants, as well as the Miyazawa Initiative, which was in support of private sector development, and SOE and trade reform.

Figure 4.1: Annual ODA disbursements

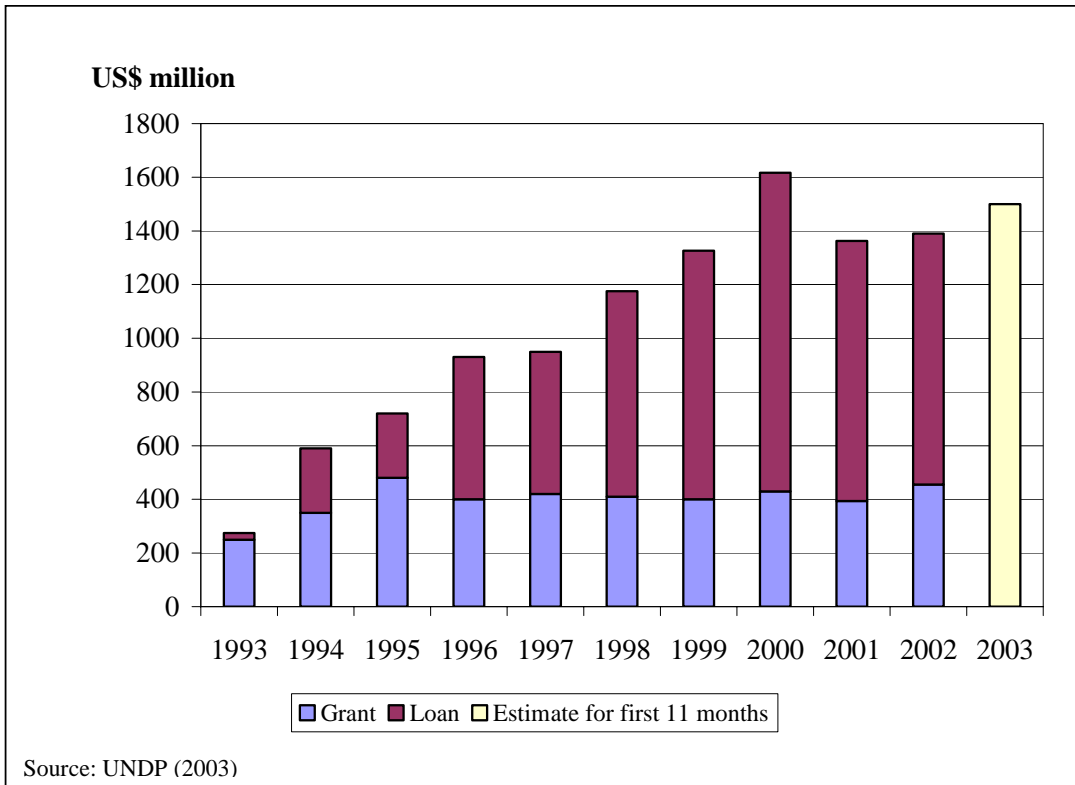
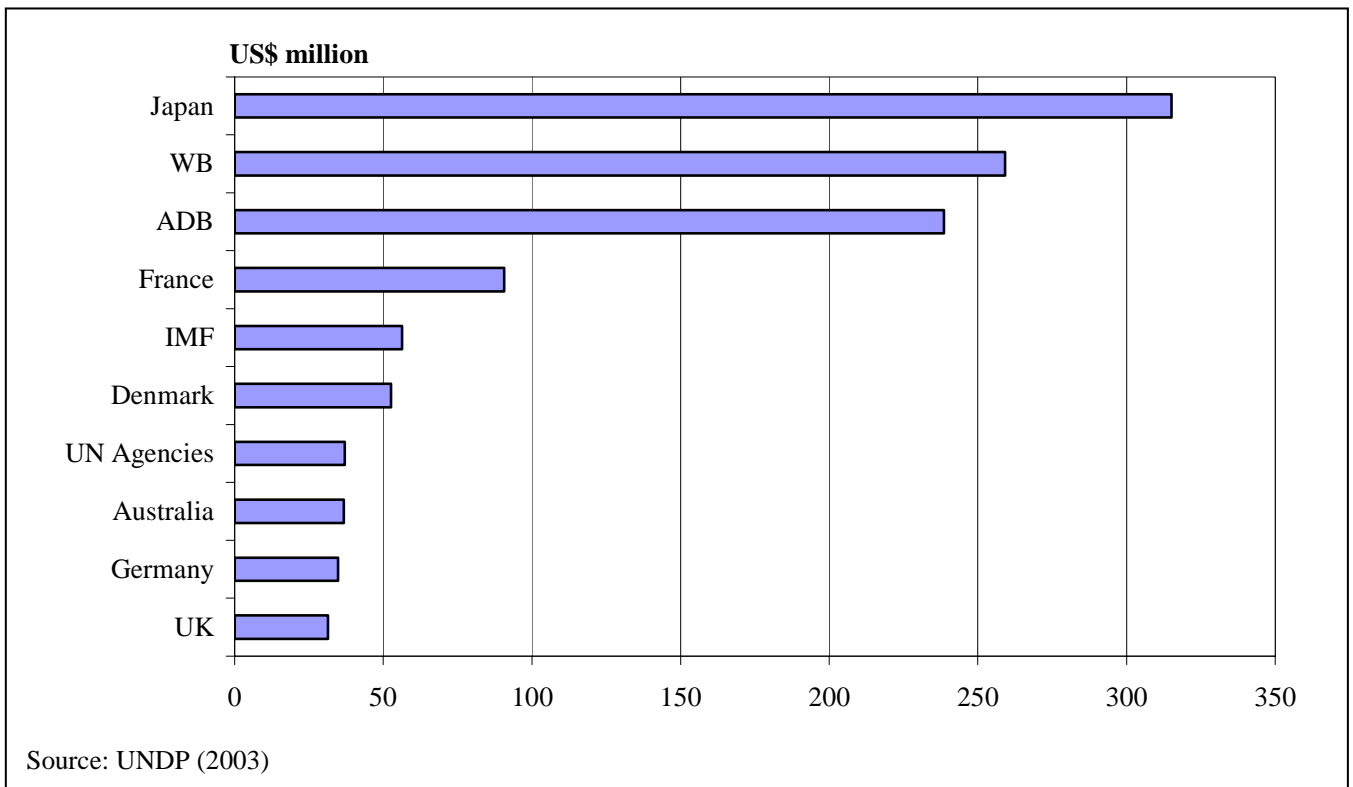
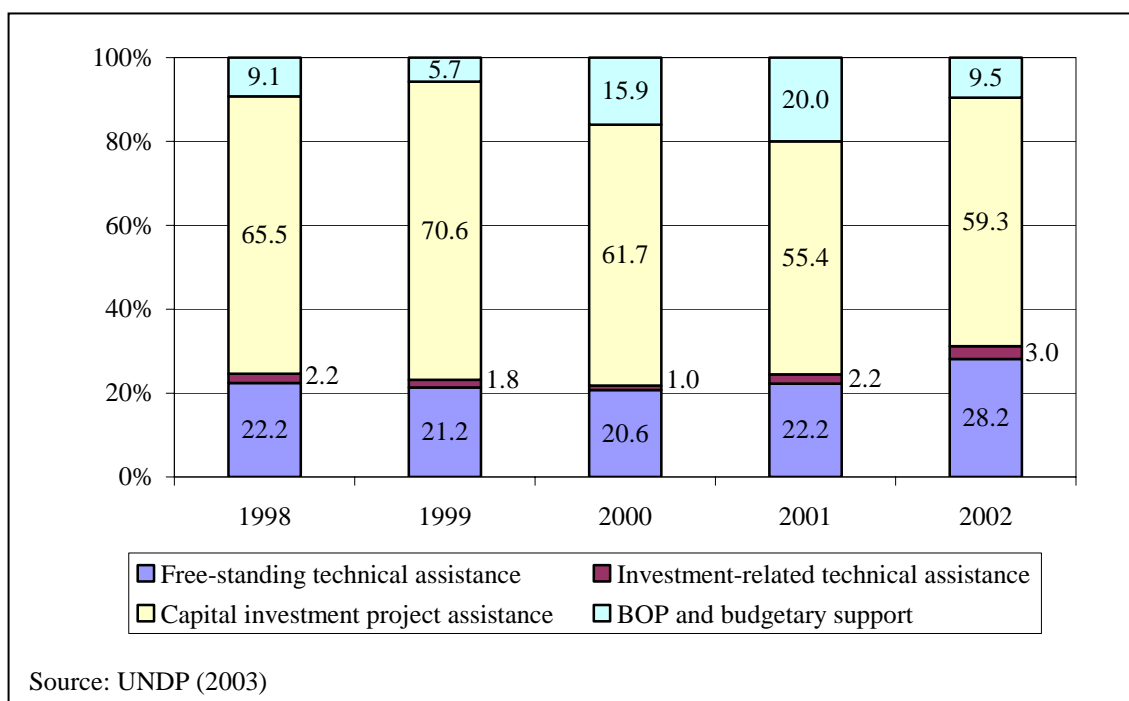


Figure 4.2: Top 10 donors in 2002



As is clear from Figure 4.3, the most important type of aid in 2002 continues to be traditional capital investment projects, representing almost 60 percent of ODA disbursements. Free standing technical assistance was second with 28 percent. Quick disbursing aid both in the form of balance of payments support and programme aid represented some 20 percent of total ODA in 2001, but this share fell to only 10 percent in 2002.

Figure 4.3: ODA disbursement by type 1998-2002

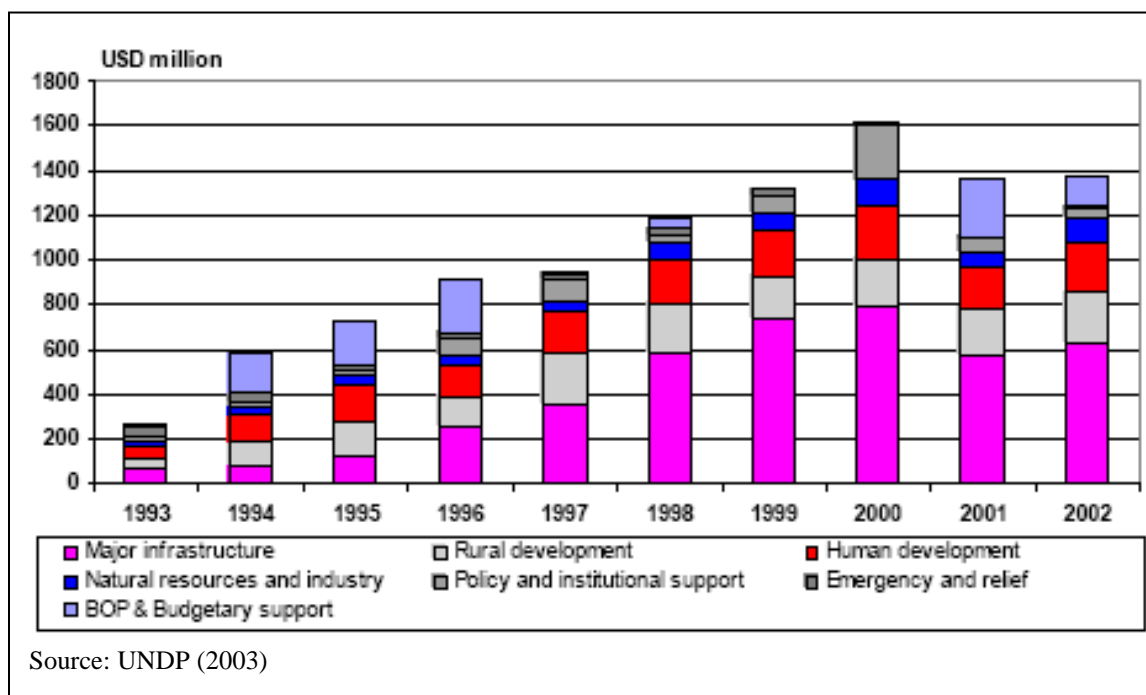


The drop in quick disbursing aid in 2002 is related in part to the fact that the no payments were made as expected under the third tranche under the IMF Poverty Reduction and Growth Facility (PRGF) due to the need to revise SBV audit and accounting procedures. Moreover, the second and final tranche of the World Bank supported PRSC-2 was only disbursed in early 2003. IMF and World Bank support is particularly aimed at supporting banking sector and SOE reform, private sector promotion, social and rural development and good governance.

With the increase in more general purpose, quick disbursing ODA facilities over time, the effectiveness of ODA will increasingly depend on the overall quality of general public expenditures. Here, the quality of the Public Investment Programme (PIP) as well as recurrent expenditures on Education and Health will be important.

The importance of capital investment projects as the major type of aid corresponds quite closely with the sectoral distribution reflected in Figure 4.4. Major infrastructure was a critically important sector and in 2002 recovered from the decline in 2001 to account for no less than 46 percent of total ODA disbursed. Under infrastructure, transport has acquired a dominating role, whereas the share of drinking water and sanitation has fallen considerably as compared to the first half of the 1990s, reflecting that needs are much better fulfilled than before.

Figure 4.4: Broad ODA trends 1993-2002



Another characteristic of ODA to which the UNDP (2003) draws attention is that disbursements towards rural development clearly lag behind the increasing demand of funds (Figure 4.4). Yet, after a brief decline in 2001, ODA directed towards human resource development registered an important increase of 21 percent in 2002, returning to the increasing trend experienced since 1993. This is well justified. The biggest challenge to further poverty reduction and improving well-being in the future will be to break down isolation in its various forms so the poorest of the poor can better join into the development process.

Among other categories, it is clear that balance of payments and budgetary support together with policy and institutional support have emerged as important types of aid.

Figure 4.5: Donor support to "economic management" (excluding World Bank and IMF) and "development administration" – 2001 disbursements

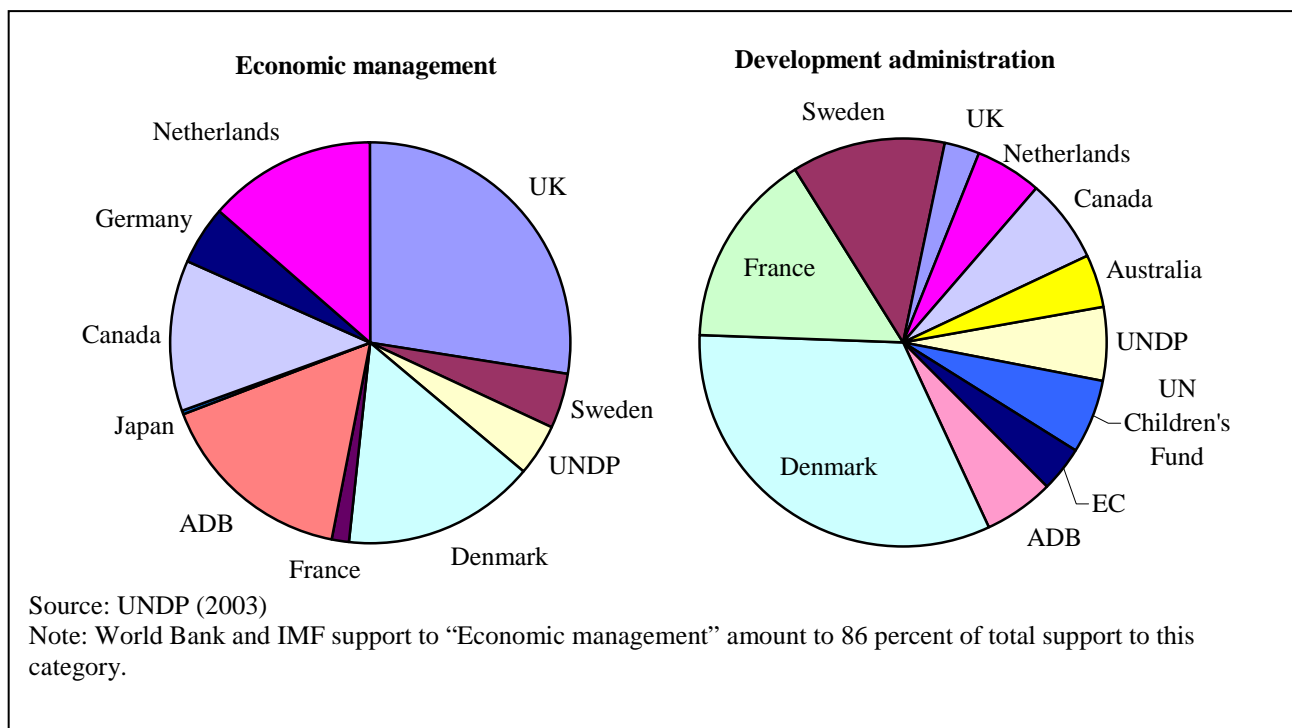


Figure 4.5 confirms that most donors are active in economic management and development administration, and Denmark is evidently an important actor in these categories. Economic management refers to assistance to macroeconomic, fiscal, monetary, and employment policy and planning, and development administration refers to public administration, foreign aid coordination, debt management, technology policy, general statistics, general cartography and foreign affairs and international law (UNDP 2003).²⁰ Consequently, the donor community is deeply involved in the economic reform process in a great number of areas with substantial resources.

Finally, turning to the regional distribution of foreign aid, some 42 percent of ODA in 2002 was disbursed to the benefit of Vietnam as a whole through central government agencies. The remaining 58 percent of ODA disbursements can be directly attributed to specific provinces. This allocation is shown in Table 4.1.

²⁰ It is highlighted that the term "development administration" is used here in accordance with the UNDP source. Development administration is a donor concept that should not be interpreted as related to foreign aid only, but to a wide variety of public activities necessary for the administration of development processes.

Recent increases in aid appear to have been spread relatively evenly across the country, although the South Central Coast seems to be somewhat favoured while the North Central Coast is overlooked when measured by the share of population, the share of poor households and the regional poverty rates. In absolute terms, the Red River Delta received the largest fraction overall. However, excluding Hanoi, the largest share went to the Northern Mountains followed by the South Central Coast and the South East. Looking at ODA per capita, there is a fairly even distribution across the regions, save the extremes, Hanoi and the Mekong Delta. The South Central Coast, the Central Highlands and the Northern Mountains received the largest flows in per capita terms. Apart from the South Central Coast and the North Central Coast, this corresponds reasonably well with the regional poverty rates and poverty densities. In sum, good reasons should be given for the high disbursements to the South Central Coast at the expense of the much poorer North Central Coast, but that apart, the regional distribution does not appear unreasonable from the criteria in focus above.

Table 4.1: Regional distribution of ODA allocated to specific provinces and urban authorities in 2002

Region	ODA (US\$ million)	Pct. share of provincial allocation	Pct. of population	Poverty density	Poverty rates	ODA per capita (US\$)
Northern Mountains	161.2	20	15	22	43.9	12.3
Red River Delta	164.3	20.4	22	17	22.4	11.1
<i>Excluding Ha Noi</i>	91.8	11.4	19			7.5
North Central Coast	84.5	10.5	13	20	43.9	8.4
South Central Coast	121.4	15.1	8	7	25.2	15.0
Central Highlands	62.3	7.7	6	10	51.8	15.3
South East	104	12.9	15	5	10.6	10.2
<i>Excluding HCMC</i>	62.6	7.8	8			12.2
Mekong Delta	108.3	13.4	21	17	23.4	6.7
Total	806	100.0	100	100	28.9	10.5

Source: UNDP (2003), Table 2.11 and 2.12.

Note: Errors due to rounding occur.

Danish aid to Vietnam

The overall objective of Danish aid to Vietnam is to support Vietnam in its efforts to promote social and economic development to the benefit of the poorest groups of people. The cooperation between Denmark and Vietnam was reactivated in 1993, and at the time it was agreed that focus should be on water, fisheries and agriculture. In the building up of programme support in these three areas much has been achieved, but the collaboration has also reflected that programme support is a relatively new form of aid where much remains to be learned on both the donor and the recipient side.

Recent reviews have confirmed the importance of the sector priorities, but considering the critical importance of the economic reform process as a precondition for continued growth and poverty reduction Danish support to the reform process in economic management and development administration has been gradually increased. This has been done both with a view to economic policy reform more specifically and to good governance and administrative reforms more broadly, including human and legal rights and democratization.

Examples of these types of activities include support to:

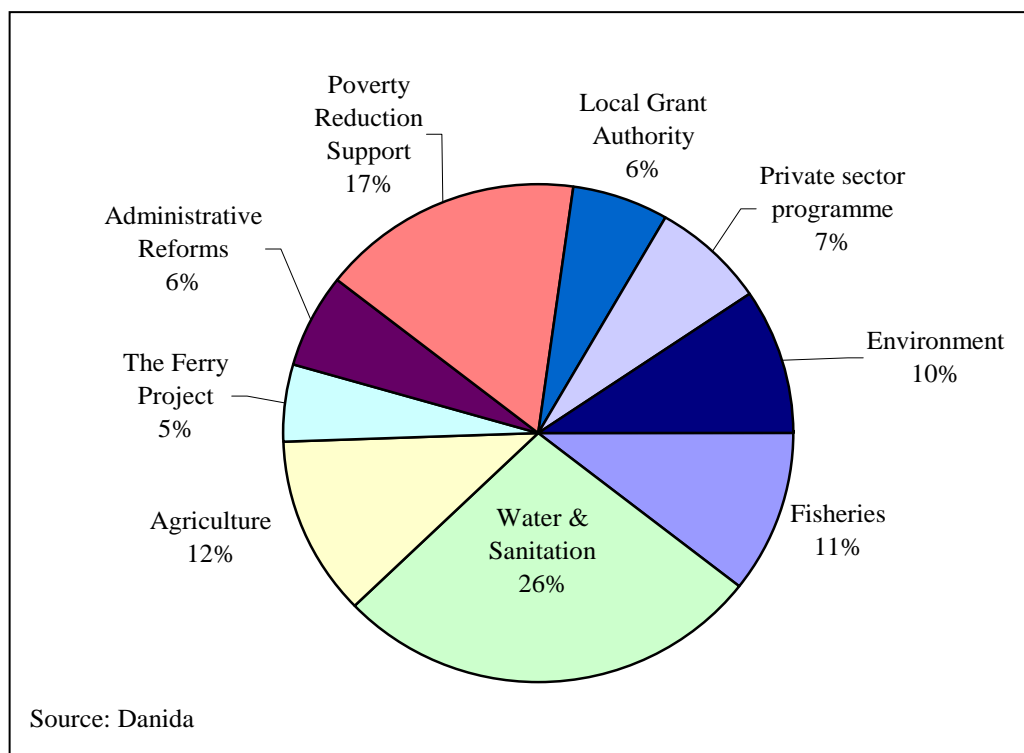
- Auditing of SOEs and GCs
- The National Enterprise Reform Committee (NERC)
- The Central Institute of Economic Management (CIEM)
- Administrative reforms in Dak Lak province
- Legal reforms (Office of the National Assembly, the Supreme People's Courts and the Supreme People's Procuracy)
- National Academy of Public Administration (NAPA)
- Reforms in the Office of the Government (OOG)

Vietnam is also one of the countries where attention to the environment has been a prominent characteristic of Danish aid. The same goes for the increasing focus on private sector development and support to a local grant facility as well as the so-called ferry project.

The local grant authority covers a variety of smaller projects (each of less than DKK 3 million) under the local approval authority of the Danish Embassy. Typical projects are: technical assistance to the State Bank of Vietnam for international accounting standards, financial audit of Vietcombank, rights promotion for ethnic minority development, legal needs assessment, Son La poverty reduction pilot project, the Danish fund for the promotion of gender equality in Vietnam (2001-2003), a seminar on the convention against torture, support from Denmark to strengthening the capacity of Thai Binh province for community involvement and client participation in population and reproductive health, and Dak Lak equitization pilot project.

The total Danish aid disbursed in 2002 amounted to approximately DKK 321 million, and the sector distribution of the Danish support is shown in Figure 4.6. Danish support to the PRSC process is not reflected in these figures but accounted for in disbursement figures for 2001 and 2003.

Figure 4.6: Sector allocation of Danish bilateral aid in 2002



4.2 Aid Management and Aid Instruments

A total of 25 bilateral donor countries, some 20 multilateral donor agencies, and nearly 400 international NGOs operate in Vietnam with substantially different procedures and disbursement criteria. The management of this system is therefore no simple task, especially as the number of donors and the amount of aid resources have been increasing quite significantly. This is reinforced by the lack of transparency that is still characteristic for the way in which Vietnamese public finances are managed.

Primary institutional responsibility for aid management rests with the Ministry of Planning and Investment (MPI). MPI has the overall coordinating role, but the Ministry of Finance (MOF), and the Office of the Government (OOG) play important supplementary roles. The State Bank of Vietnam

(SBV) coordinates general budget support and serves as counterpart to the IMF and the World Bank in the implementation of the PRGF and the PRSCs.

The tradition of central planning remains at the very core of the Vietnamese aid management system, and the lack of socio-economic screening and appraisal of projects is a critical shortcoming of the system. Moreover, only large-scale projects are included in the Public Investment Programme (PIP), which does not provide the coherent overview required to be able to prioritize in a transparent manner. The PIP does not consider recurrent costs, so trade-offs between recurrent and investment expenditures are hard to address. This highlights the need for establishing as soon as possible a set of MTEFs at both the macroeconomic and sector levels.

All the major sector ministries have departments for international cooperation, and in practice there is sometimes scope for negotiation between donors and line ministries in project development. Yet, broad priorities must be kept in mind, and all new initiatives as well as minor project revisions require the approval of the MPI. Approval procedures can therefore be quite cumbersome. The same goes for project implementation where a large number of Project Management Units (PMUs) continue to play a key role. They clearly form part of the “consensus governance” model in Vietnam where focus is on internal rather than external processes of accountability and transparency, but this does add to the complexities of the aid relationship between Vietnam and her donors. Finally, while the Vietnamese state and budget are unitary, decentralisation has increasingly given provincial and district bodies a more important role in the coordination and implementation of aid projects at local level.

Structures of dialogue and coordination

On the above background an elaborate institutional framework for coordination and dialogue between the GoV and the international donor community has evolved. A Consultative Group (CG) Meeting has taken place annually since 1994, and since 1998 Mid-Year Meetings have also been held. These meetings give the GoV and the donors the opportunity to review recent developments and jointly address emerging challenges.

The CG framework is by no means unique to Vietnam, but it has as noted by Bartholomew and Lister (2004) spawned a large set of more than 20 sectoral “partnership groups” of varying degree

of formality. Some focus on particular sectors such as banking and transport, others on cross-cutting issues, including poverty, gender and the environment. Participants are drawn from government and the donor and NGO communities. The aims of these groups also differ and a variety of approaches have been developed depending on the needs and circumstances of the group. Some groups have donor representatives only and serve mainly as information-sharing forums. Some of the informal groups also have government representatives joining meetings, as well as representatives of non-state agencies. The structure gets more formal when government has a lead role and financial resources are made available.

At the same time, the aid relationship in Vietnam is somewhat paradoxical. Two salient paradoxes identified by Bartholomew and Lister (2002) are:

- Political versus economic liberalisation. Political liberalisation has moved much more slowly than economic reform, which has been cautious and incremental. A long list of “governance” issues remain to be addressed as discussed in Sections 2 and 3, both in terms of for example the economic management of SOEs and with reference to the broader governance agenda.
- The contrast between donors’ appreciation of the GoV’s broad strategy and policies and their relatively low assessment of the degree of transparency and standards of public administration. In many areas there appears to be a high degree of trust between the GoV and the donors on policy, but low trust on GoV financial management.

All of this evidently has a bearing on the kinds of aid modalities that are perceived as the most appropriate.

Aid modalities: pro et contra

There is a continuing debate in the aid literature on the relative merits of project versus programme aid. In recent years this distinction has admittedly become rather blurred, as various intermediate forms of aid have evolved, but it is evident that the project component of aid budgets started declining from the early 1980s across the developing world. Other instruments have gradually grown in importance, such as policy-conditioned programme aid (e.g. structural adjustment lending in the form of balance-of-payments and budget support), support for the private sector, NGO support, emergency assistance and technical assistance and cooperation.

There has also been a move towards sector programme aid, which is strongly reflected in the Danish aid programme in Vietnam, and the international donor community is clearly in a process of experimentation with a view to increasing aid effectiveness and improving the dialogue both between donors and recipients and amongst donors. All of this represents an appreciation of the need to be able to respond quickly to unforeseen circumstances and shocks such as the Asian Financial Crisis. It can also potentially facilitate donor coordination to achieve an appropriate balance within sectors, across sectors within the economy and at the macroeconomic level. Increased understanding of how donor supported investment activities are linked in coherent programmes should also further more effective policy dialogue and ownership by the aid recipient.

During the early 1990s emphasis in aid delivery in Vietnam was clearly on the project modality, which corresponded very well with established economic planning and management systems in Vietnam. However, as the number of donors and the volume of aid started increasing later on in the 1990s, concerns about mounting difficulties in disbursing funds spread. The response was not to move away from projects *per se*. They continue to this date to account for a major share of aid inflows, and according to the so-called Decree 17, Vietnam actually continues to perceive of all aid as “projects”.²¹ However, efforts have been made in recent years to try to improve coordination and start focusing on underlying institutional and policy issues of particular importance to aid disbursements and effectiveness. For example, the major multilateral development banks operating in Vietnam began a process of more active consultation on implementation and disbursements and also the bilateral donors have participated in a variety of harmonization and joint working initiatives.

Much has been achieved in Vietnam in improving the way in which projects are managed and implemented, but it is widely agreed among donors and in the GoV that there are considerable transactions costs associated with the project mode of operation, and coordination among donors is far from ideal. Efforts to find alternatives to conventional project approaches have therefore been mounting, reflecting both local conditions and experiences in Vietnam as well as the international aid debate.

²¹ A corollary hereof is that when Vietnamese authorities argue for increased “ownership” this should not necessarily be interpreted as an argument for programme aid. What is in question is typically an insistence on the desirability of a greater degree of local execution of projects.

Quick disbursing loans do not of course amount to a new area of activity for the IMF. In fact, this has been at the core of IMF lending to developing countries for decades. However, the IMF PRGF and the World Bank PRSC, which is co-financed with bilateral donors, is appropriately perceived as a new generation of budget support. The IMF focuses on macroeconomic and fiscal issues, and in line with the IMF mode of operation, does not invite other donors into its dialogue with the GoV. On the other hand, the PRSC is explicitly defined and structured with a view to provide bilateral donors with an option to participate with the World Bank in high-level macro and sector policy discussions with the GoV.

Organising multi-donor interaction with the GoV is far from easy, but is facilitated by the fact that the World Bank manages the PRSC process in-country. Moreover, the World Bank's role is key both since it is an important donor in quantitative terms but also because it commands the most intellectual and management resources. The Bank is also well placed to make good use of other documents such as the Country Assistance Strategy (CAS) papers (see for example World Bank, 2004) in the PRSC process. Aligning oneself with this process as a bilateral donor opens up for the possibility of being able to better monitor and assess ongoing developments in Vietnam, and it provides an avenue of interaction with the World Bank, which is fundamentally different from the way in which the structural adjustment programmes of the 1980s were designed and implemented.

It is also to be noted that the World Bank has been highly receptive to proposals from bilateral donors in the formulation of policy matrices and outlining agendas for the dialogue with the GoV. These advantages should in no way be dismissed as minor, since they offer the bilateral donors a way of influencing the course of events. The PRSC process can also potentially offer both a bridge between developments at the macro level and efforts at sector and project levels. In addition, the PRSC is a country level mechanism geared at improved interaction, understanding and balance between the multilateral and bilateral agencies as well as between the donors and the recipient government. However, effective use of all this does of course presume that bilateral donors are in a position to play an active role, and it is also clear that the effectiveness of the dialogue will depend on the individual characteristics and abilities of out-posted staff at the World Bank office. While variation cannot be avoided, it is evident that the present situation in Vietnam is satisfactory, and Denmark has built up good experiences with the assignment of Danish nationals in the Bank office. It

would appear sensible to build on these experiences as the process of defining future PRSCs evolves.

In sum, there are significant potential advantages of participating in the PRSC process as a bilateral donor. However, this does not of course relieve the donors from having to consider very carefully proposed plans and initiatives. Moreover, while it is widely agreed that the project modality is associated with significant transactions costs and subtle issues of harmonization, it should not be overlooked that coordination among donors involved in programme aid is also demanding. Moreover, there are also disadvantages associated with programme aid. One dimension is that once budget support is relied on, it is hard to escape a complex and insufficiently understood set of issues related to auditing, monitoring and evaluation of aid impact. First of all, assessments of public financial management are still developing. Even though the donors use several assessment instruments such as the World Bank PER, CFAA and CPAR, the IMF Fiscal ROSC, the joint WB and IMF HIPC AAP and EU audits, these instruments do not give full coverage. In particular, none of the instruments provides an entirely satisfactory measure of fiduciary risk. Moreover, in some assessments, a large element of judgement based on country specific knowledge is involved and institutional and governance considerations need to be addressed in a more systematic way. Second, there is a potential conflict between the need for government ownership and the robustness of an assessment. This conflict is especially relevant to financial accountability assessments (Allen et. al, 2004).

In addition, a small bilateral donor like Denmark will have to decide on the extent to which it wishes to rely on assessments of budget support initiatives carried out by multilateral institutions, including first of all the World Bank. If it is decided to rely extensively on the Bank, this will undoubtedly raise questions about who monitors and controls the Bank. One option could be that Denmark specializes in one or two key areas such as corruption where assessments by different organizations have reached widely dissimilar conclusions.

Tony Killick (2004) puts these kinds of topics into an even broader framework in his review of how to monitor partnership-based aid relationships. He notes: “At the moment, however, all monitoring and evaluation at the country level is by donors of recipients, raising the question, who will monitor the donors?”. He goes on to review experiences from Tanzania, where jointly conducted and sponsored aid reviews carried out by independent groups drawn from the recipient country and from

outside are relied on. Moreover, Killick concludes that the Tanzanian model could readily be adopted in other aid-dependent countries.

It is beyond the scope of the present report to come up with a more comprehensive review of the above issues to which it would appear there are no easy answers. Finally, on the above background it is evident that not only macroeconomic budget support should be pursued as an essential instrument in the aid toolkit. Targeted programme support and similar initiatives need to be factored into a comprehensive support programme, in due course.

4.4 Specific Suggestions for Danish Support

Based on the overview and analysis presented in Section 2-4, it is recommended that Danida goes ahead with the formulation of a multi-year programme of budget support to Vietnam, linking this support to the PRSC-process. Budget support would enhance the mutual trust building and further demonstrate the Danish engagement in Vietnam's development process in a convincing manner. Such a step would also serve as a way to promote a promising partnership based approach to the building of better governance and it would in particular help strengthen the general government systems for budget planning, implementation and auditing. There are also various advantages to Danida of being an integral player in the PRSC process, including access to information and being able to play a more active and direct role in the policy dialogue.

It is evident that there are fiduciary risks involved in providing budget support to Vietnam, as transparency is only gradually improving. However, significant progress has been recorded in recent years. The World Bank CAS (2002) notes that the PER (2000), the CFAA (2001) and the CPAR (2002) have all led to important initiatives for change, and the MOF has recently agreed to publish the complete state budget including expenditure on defence and national security. This implies that all components of the budget will be publicly available starting from fiscal year 2005. In addition, the forthcoming PER-IFA can be expected to help ensure that relevant proposals are formulated as to how this dimension can be managed in an acceptable manner. The donor community is in any case so heavily involved in the reform process that should the process "go astray" this will relatively quickly be uncovered and taken up with the GoV.

In sum, there are many reasons why budget support is a modality that should be pursued within the framework of an overall Danish programme of development cooperation with Vietnam. We wish to stress, however, that we perceive budget support as one modality to be used alongside more traditional programme and project support, not as the only or exclusive modality to be considered. Thus:

- *Specific suggestion number 1:* we propose that Denmark establishes a multi-year programme of budget support to Vietnam, where general funds are disbursed as co-financing of the forthcoming PRSCs coordinated by the World Bank. The exact size of the funding to be disbursed as general budget can be decided upon in light of the overall framework of Danish aid to Vietnam, but a relative share of around 10 percent would probably be sensible, with explicit criteria as to how low, base and high levels of disbursements can be achieved.

It is evident that general untied budget support can in principle be used by the GoV in accordance with its own budgetary processes and priorities. As indicated above, these are likely to reflect in an acceptable manner the mutual understanding reached with the international community. Yet, it would in all likelihood be a valuable signal of priorities if Denmark were to include in due course specific support to the targeted programmes as part of the overall budget support programme.²² This would also be in line with the priorities inherent in the five-year rolling plan (*A World of Difference*) for the allocation of aid issued by the Danish Government. This plan pays particular attention to the 2015 Millennium Development goals established by the UN, with a focus on health and education. These are exactly the areas and aims being promoted through the targeted programmes, which have a distinct focus on alleviating poverty among the poorest of the poor. Thus:

- *Specific suggestion number 2:* we propose that Denmark takes an active role in the targeted programmes, which are presently being evaluated and revised by the GoV. Following an appropriate assessment, Denmark should provide funding explicitly directed to these activities. Danida may also wish to consider assuming a supporting technical role in the implementation of such activities. However, Danida should agree and discuss with the GoV to ensure that such a financial contribution would be additional to the overall targeted programme support already being planned, rather than displace it.

²² They include for example the Hunger Eradication Programme (HEPR) and the Health Care Fund for the Poor (HCFP). For a detailed overview of these programmes, see VDR 2004.

There is no “water proof” way in which Danida can guarantee complete additionality *a priori*. Fungibility of aid resources will remain an issue and judgement is inescapable, for budget as well as project modalities of aid. Promoting an effective policy dialogue between the GoV and the donor community geared towards establishing common aims and a high degree of mutual understanding of what aid resources should be used for is, however, in all likelihood the best way to promote additionality and ensure that resources are allocated to target sectors, regions and people. Furthermore, with the ongoing measures taken to improve transparency around public financial management as discussed in Section 3, the amount of data and information, which can help support in depth *ex post* assessments of any discrepancies between declared goals and actual behaviour of the GoV, is on a distinct increase. The ongoing PER-IFA can be consulted in due course for further background and suggestions on these issues, but in our assessment existing risks are manageable and the direction of change is clearly appropriate.

Finally, there is reason to highlight that Denmark, the sixth largest donors in Vietnam, could take a higher profile role in the activities related to the monitoring and evaluation of the implementation of the CPRGS and PRSCs. Relevant indicators and methods for data collection (such as household surveys) have been identified for these initiatives. Yet, data collection and analysis demands experienced analytical staff both on side of the GoV and on the donor side. Greater availability of such personnel could play a key role in furthering better and more consistent understanding of past performance and promoting greater visibility about the future based on sound economic analysis. Such strengthening is also necessary for the formulation of appropriate policy advice and action steps to be taken in the policy dialogue with the GoV. Therefore:

- *Specific suggestion number 3*: we recommend that Danida takes steps to strengthen the analytical capacity available for the monitoring and evaluation of the CPRGS and the PRSC processes. This could involve the active use of competent Danish researchers, and it would be advisable with at least one or two out-posted staff who could perform these duties. An added benefit hereof would be that they could be available to interact on a continuous basis with the Danish Embassy on how Danish priorities and views on the reform process may be effectively furthered vis-à-vis both the GoV and other donors.

5 Conclusions and Recommendations

Since 1986, Vietnam has made truly remarkable progress in terms of growth and poverty alleviation, demonstrating both national determination and will to overcome the formidable social, economic and political challenges which Vietnam has had to face over the years. Admittedly, Vietnam has to some extent benefited from being able to harvest the “low hanging fruits” (VDR 2004) associated with land reform and providing peasants with an appropriate incentive framework. As such it is worthwhile to be cautious when looking to the future. Future advances may not be quite as “easy” to achieve, and donors would do well to incorporate this into their expectations. Yet, past performance and assessments of the readiness of Vietnam to move forward certainly promise that development will be dynamic in the years to come, and there is undoubtedly a potentially important and constructive role for foreign aid to play in this process.

After a reluctant start in the 1980s, the international community became heavily involved in large-scale investment programmes in Vietnam during the 1990s, and has by now also assumed responsibility for supporting a wide variety of social and economic reform initiatives. The determination of Vietnam to maintain “ownership” of the reform process is evident, and aid conditionality as traditionally applied in the donor-recipient relationship would not only be misplaced but outright counterproductive in Vietnam. However, patient dialogue, bargaining, and technical advice have proven to be effective ways of engaging the Vietnamese authorities and people. The CG framework is by no means unique to Vietnam, but it has spawned an unusually large and vigorous set of “partnership groups” of varying degree of formality, as pointed out in this report. Some of these groups have been highly successful, especially those in which the Vietnamese have taken an active part, and they document the willingness of Vietnam to interact and move forward in an effective manner when the framework is mutually agreed and understood. In sum, Vietnam has performed very well in growth and poverty reduction and has demonstrated both capacity and political will to take a dynamic and forward-looking role in the reform process. Vietnam also appears in her own way eager to learn from the interaction with the donor community and adapt future policies accordingly. This is not only important for the effectiveness of foreign aid in Vietnam, but is potentially also of interest more broadly as the lessons learned in Vietnam may eventually be relied on elsewhere.

Given the Vietnamese context outlined in the present report, the PRSC-approach does come across as a potentially useful tool for pursuing continuous policy dialogue with the GoV. The PRSC has to

a large extent served as a stock taking exercise in the past, and the demarcation lines to more traditional conditionality and reward mechanisms are not entirely clear. There is no doubt reason to invest more in sustained long-run policy dialogue. Nevertheless, the PRSC does provide a macro-level partnership forum in which key issues related to the use and assessment of aid and public finances as well as governance more broadly can be discussed. This is crucial. Given the hierarchical structure of the Vietnamese governing institutions, it is strategically important for the donor community to have a constructive dialogue at the level of core ministries such as MPI, MOF and SBV in addition to line ministries and regional and local governing bodies. Moreover, with proper priority and care the policy matrices can be further developed so as to provide a forward-looking agenda for policy reform. While this is easier said than done given the human resource constraints faced by many donors at country level, this is undoubtedly an avenue worth pursuing.

Furthermore, while considerable capacity exists in Vietnam when it comes to the implementation of traditional projects, Vietnam has much to learn about how a modern, market-oriented State is run, including the need for fiscal transparency and effective budget preparation, implementation and auditing. In this context, budget support is a key instrument alongside more traditional aid modalities since better public sector management and experience with handling budget support in its various forms can arguably go a long way in enhancing the overall systemic impact of the resource transfer, which the budget support represents by itself. Danish budget support to Vietnam within the PRSC framework would also allow Denmark improved and continuous access to information and policy interaction at central government level and in relation to multilateral donor institutions. The value of feedback effects hereof to the overall and very sizeable programme supported by Denmark in Vietnam should not be underestimated, and the interaction with institutions such as the World Bank in Vietnam would offer a platform for Danish views and priorities influencing the way in which the reform agenda is phrased and pursued.

Finally, as discussed in Section 4, it is recommended that Denmark engages herself in the following specific ways in the PRSC over the coming years:

- General untied budget support within the PRSC framework
- Support to the targeted programmes in due time
- Strengthening of the analytical capacity to monitor and assess the CPRGS and PRSC

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Annex 1: Terms of Reference

Initialer	kontor	journalnummer	dato
ME	BFT.5		3. februar 2004

TERMS OF REFERENCE for Feasibility study concerning possible future budget support and support to complementary activities

Background

Vietnam has during the last decade or so sustained both a high economic growth rate and significant reduction in absolute poverty – by about 50 percent. This has been achieved on the background of macroeconomic policies that have helped stabilise the economy with low inflation, sustainable budget deficits, and economic and structural reform efforts in areas such as the land reform and the emphasis on education. Furthermore, Vietnam has enjoyed stable support from the international financial institutions and bilateral donors. Efforts to improve effectiveness, efficiency, transparency and accountability have also been initiated during the period, although there still remain key challenges in these areas.

The challenge for Vietnam and for the development co-operation between Vietnam and Denmark is to keep the momentum in economic growth and in poverty reduction in the years to come. This may require more focus on increasing the effectiveness and efficiency in the public sector, on improving the regulatory environment for the private sector, including development of financial intermediation, and on measures to sustain poverty reduction. There may also be a need for an improved capacity to monitor development in economic development and poverty in Vietnam in general and at the provincial level and an improved capacity to analyse data and make adequate policies based upon analysis of the data.

Denmark has for a number of years co-financed with the World Bank and DFID, Sweden and Netherlands the Poverty Reduction Strategy Credits. The aim has been to strengthen focus on poverty reduction in Vietnam's policies and public sector budgets.

This study will provide a technical basis for possible future multi-year budget support to Vietnam and support for capacity building, which will promote a poverty reduction focus in Vietnam's policies and budget allocations in the future.

Objectives

The objectives of the feasibility study will be

- An assessment of the feasibility of continued multi-year budget support to Vietnam and supplementary support to public sector reform in support of poverty reduction.
- Well documented/argued suggestions for possible Danish budget support and support to public sector reform in support of poverty reduction.

The outputs of the feasibility study will be

- A desk study based upon existing documentation from the Government of Vietnam, the World Bank etc. by 15 March
- A feasibility report, including a 5 pages summary of findings and recommendations on future Danish budget support to Vietnam and support to public sector reform in support of poverty reduction, by 1 May
- A draft programme document for Danish multi-year budget support and support for key areas public sector reform for poverty reduction, by 15 June

Scope of Work

The scope of work will at least include (reference is also made to Danida guidance note on provision of budget support <http://amg.dynamicweb.dk/default.asp?ID=99>)

- Short description of the growth and poverty developments, status and outlook in Vietnam, including provincial differences
- An assessment of the macro economic situation
- An assessment of the extent to which the budget - and actual spending and taxation – is pro-poor, instruments in place to ensure a pro-poor bias in the budget
- An assessment of the proposed PRSC 3/4,
- An assessment of fiduciary risks related to the provision of budget support
- An assessment of the public sector reform process with focus on areas relevant for effective policies and programmes for poverty reduction.
- Suggestions for Danish support to public sector reforms that are crucial to growth and poverty reduction and related governance.

Team

The Team will consist of

Finn Tarp, consultant, team leader

Henrik Hansen, consultant, economist

....; national consultant, economist

....; konsulent til at bistå med skrivningen af programdokument?

Morten Elkjaer, TAS, Ministry of Foreign Affairs will take part in part of the mission.

Organisation of work and time schedule

The work will be divided in phases.

Phase 1: A draft desk study will be ready by 15 March

Comments on the study will be provided by 1st April to feed into the feasibility study and possible adjustment of these TOR

Phase 2: Mission to Hanoi: 29 March – 2 April. Draft mission report (feasibility study and outline of proposal for budget support and capacity building for relevant activities) by 1 May.

Comment on draft by 15th May

It is foreseen that a 1-2 week mission to Vietnam will be undertaken during May-June.

Updated study and draft proposal for multi-year budget support and support to public sector reform in support of poverty reduction will be ready by 15 June

5. februar 2004

Dato

Morten Elkjær

TSA sagsbehandler (underskrift/navnestempel)