

ASEM Trust Fund Review Meeting Washington D.C., April 14, 2003

Country Strategy Notes

China: ASEM Country Strategy Note March 2003

1. To date, China has benefited from grants totaling almost \$10 million under the first and second ASEM Trust Funds, supporting 15 country-focused technical assistance (TA) projects. China has also been included in several multi-country studies. Together, these activities are helping the country deal with challenges such as government financial vulnerabilities, reform of state-owned enterprises (SOEs) and the financial sector, development of a national social security system, and protection of the poor and disadvantaged from the effects of economic restructuring. Due to China's size and the scale of these problems, no one donor is able to respond adequately to its needs. The country's development partners are therefore collaborating on key issues, as dictated by their comparative advantages. For China, ASEM offers the advantages of its focus on key reform areas and access to technical experts with appropriate experience.

Background and Recent Developments Relating to ASEM-TF

2. ***Strong performance.*** Despite the weak global economy, China's economic performance in 2002 remained strong, with growth officially estimated at 8.0 percent. This reflects the impact of domestic demand, expanding exports and increasing foreign direct investment (FDI) in driving the country's aggregate economic performance. The Government's ongoing fiscal stimulus program, especially the rise in fixed asset investment, aided domestic consumption and investment growth. In addition, FDI in China reached \$53 billion last year, the largest FDI inflow to one country in the world.

3. ***But difficult challenges.*** Though macroeconomic growth has been sustained, the *Government's medium-term financial position* needs to be strengthened. Not only has recorded government debt increased, but contingent liabilities, too, have risen as a result of non-performing loans in the banking system, under-funded pensions, enterprise arrears and other liabilities. Informed estimates indicate that, under various assumptions, total public debt could account for a large proportion of GDP. Concerns about this problem existed even before the start of the latest round of macroeconomic stimulus, but the recent increase in government spending has deepened concerns and stimulated calls for fiscal consolidation and a reappraisal of the efficiency of government expenditures.

4. In the *corporate sector*, the reform of China's state enterprise sector has accelerated of the past three to four years and has some qualitatively new features. First, the scale of change has expanded to affect almost every kind of SOE – small, medium, large and very big, under both central and local control. Second, the role of the wholly state-owned non-financial company has declined substantially in many areas. Third, the range of restructuring mechanisms being used has expanded dramatically to include bankruptcies, liquidations, listings and delistings, debt-for-equity swaps, sales to private parties – domestic and foreign, auctioning of state firms, their assets or liabilities, standard corporate governance techniques, etc. Finally mass layoffs, something unheard of just four or five years ago have become a widespread phenomenon.

5. Obviously, the process of transforming China's state sector has been, and will be, socially painful. Some 25.5 million SOE workers have been laid off since 1998, and official government statistics indicate 8.7 million of these workers have not found new jobs. The practice is so widespread that almost every SOE has laid off employees. This has understandably led to social discontent. Two economic factors have emerged with critical importance for alleviating the social cost of restructuring: *development of the national social security system* (central budget expenditures on social security in recent years rose from 1% in 1997 to 6.3% in 2002), and promoting the growth of new *private enterprises* to absorb laid-off workers from the state sector.

6. The Government is keenly aware of the need to establish a national social security system and is now piloting its prospective approach in Liaoning Province, where unemployment is a major problem. Much more work is needed, however, before a nationwide system can be rolled out. Promoting the growth of Chinese private companies, now the most dynamic players in the economy, is also a priority. However, these firms still face tough challenges in the current business environment in terms of entry restrictions, uneven playing field, weak capacities to partner and compete globally, and inadequate access to intermediated financing. There are significant regional disparities regarding private sector development in China, with the interior provinces lagging behind coastal areas. Recently, the Government has intensified its reform efforts in this area by promulgating laws and regulations to promote small and medium enterprises (SMEs), introducing measures to improve private enterprises' access to financing, and gradually relaxing restrictions to private sector entry in various sectors.

7. Reform of the *financial system* has moved more slowly than the corporate sector, largely because soft-budget constraints on firms and quasi-fiscal stimulus through the banking system have been needed to support employment growth since 1998. However, several measures have been taken, such as assisting banks through partial re-capitalization and the transfer of non-performing loans to asset management companies, establishing supervisory authorities for the capital market and insurance companies, introducing current account convertibility, using indirect instruments of monetary control, and paying greater attention to portfolio quality in banks. With WTO accession and expected foreign entry into China's financial market, the country will need an overhaul of institutions and market structure.

8. In addition to its economic challenges, China faces an increase in *poverty*, predominately in rural areas (although urban poverty is a growing concern). In the first stage of economic liberalization during the 1980s and early 1990s, partial freeing of prices and markets,

introduction of individual farming (replacing collectives), and opening to trade and foreign investment resulted in high growth, poverty reduction and emerging income inequality. However, since the mid-1990s, falling grain prices and the domestic slowdown that followed the Asian financial crisis contributed to slowing the pace of poverty reduction. By some expenditure measures, the number of poor may even have risen in recent years, while income gaps are high and persistent.

9. During 1996-99, the number of poor with *expenditures* below US\$1 a day increased from 214 million to 235 million (expenditure data are used for China since income data are deceptive owing to the high savings rate, even of the poor). While detailed poverty data for 2000 and 2001 are still being processed, a slowing in poverty reduction seems to continue. This suggests that new approaches to poverty reduction now being piloted - combining income diversification with improved targeting and safety nets - need to be scaled up rapidly.

10. *Income disparities* also widened. The Gini coefficient, which rose from 28.8 in 1981 to 32.1 in 1990 and 41.6 in 1999, reflect widening income inequality *within* and *between* rural and urban areas as well as increasing income inequality between coastal and interior regions during the 1990s, although the latter declined slightly since 2000 after the Government refocused its attention to lagging areas.

11. **Priorities of the New Government.** China's newly appointed leadership, backed up by initiatives approved at the National People's Congress in March 2003, are committed to continuing the economic reform agenda promoted by their predecessors while more rigorously addressing poverty, income inequality and the lack of a social safety net. For example, a State Asset Management Commission—dedicated to managing the country's SOEs—may help accelerate the privatization of some 180,000 SOEs employing about 50 million people. To generate employment for the affected workers, private sector development is being encouraged. In the banking sector a China Banking Regulatory Commission has been established to take over regulation and supervision of China's banking industry from the People's Bank of China (the central bank), which will be freed to concentrate on monetary policy. The formation of an independent bank regulator reduces potential conflicts of interest with China's largely state-owned banking sector. And in his first news conference as Premier, Wen Jiabao saw poverty alleviation, unemployment reduction, and rural reform as his primary immediate objectives. The 2003 budget will also increase spending on pensions, re-employment programs, and subsistence allowances for poor urban residents, and the program to spur development in China's lagging Western Provinces will invest \$15.7 billion to improve infrastructure and the environment.

Impacts of and Lessons from ASEM TF1

12. Listed below are the illustrations of ASEM TF1 outcomes.

- Familiarizing the People's Bank of China with typical international practices for bank deposit insurance and recommending an approach for developing such a system for China;
- Assisting one of China's smaller banks to improve its corporate lending procedures and begin developing a retail banking strategy, in support of reducing vulnerability in China's

banking sector and developing competitors to China's four state-owned banks that now dominate the sector;

- Establishing computer infrastructure to support the Ministry of Finance's future acquisition of an integrated public debt database allowing comprehensive management of external and domestic public debt;
- To promoting corporate restructuring, facilitating debt workouts and non-performing loan resolution in the Chinese context by recommending improvements in the legal and regulatory framework as well as the processes and mechanisms for loan workouts of debt-ridden SOEs;
- For the People's Bank of China and the Cinda Asset Management Company (AMC), beginning to develop a strategy and methodology for orderly resolution and/or disposition of bad assets, establishing an institutional structure and operating guidelines for an AMC, training AMC staff, and advising on the policy framework for AMCs;
- Increasing the education budgets of poor areas by developing an intergovernmental transfer system to allow movement of substantial amounts of funds for education from the central government to poor provinces; and
- Improving health care in poor areas by analytical support strengthening the pro-poor characteristics of ongoing reforms in health resource allocation and public health programs.

13. Lessons learned under the first ASEM trust fund include:

- **Need for high-level commitment to the reforms being introduced.** Staff responsible for grant implementation often needed to report directly to, and have strong backing from, top management—whether of an enterprise, a municipality or a ministry—since introducing change affects an entire organizational structure and leads to significant conflicts with, and resistance from, existing departments;
- **Need for a train-the-trainers approach to leveraging consultants' effectiveness in implementing a TA activity;**
- **Need for a narrow scope** for reform activities;
- **Need for a longer activity time-frame** (three years rather than two per activity and possibly several activities on the same issue) to introduce reforms. A longer time-frame is also needed to handle any computer procurement, if this is included in the activity;
- **Desirability of steady Bank support (particular from staff in the field) to activity implementation but an integration of international and Chinese perspectives;**
- **Need to balance desirability of selecting consultants from ASEM-participating countries with specially technical needs, availability of expertise and timeframe;**
- **Need to disseminate findings and results of grant activities widely.**

ASEM TF2 Priorities

14. Priorities under ATF2 reflect focal areas of both China's Tenth Five-Year Plan, 2001-05 and the Bank's recently issued China Country Assistance Strategy, FY03-05, which was developed in partnership with the Government. The priorities include: (i) fiscal and financial sector reforms; (ii) creation of an enabling environment for private ownership transformation and enterprise restructuring and reform; (iii) development of a national social security system; and

(iv) social sector programs and other activities to reduce the impact of economic adjustment on the poor. The following table shows grants approved to date under ATF2.

Table 1: Activities Funded under ATF2 (as of March 24, 2003)

	ATF 2 Type	TF Project Name	Effective Date	Task Manager	Grant Amount '000	Total Disbursed	% Disbursed	Closing Date
1	Rd 1	Social Security Reform	7/11/02	Xiaoqing Yu	777.00	135.20	17%	11/30/03
2	Rd 1	Developing the Government Securities Market	7/12/01	Irene Ho	310.00	31.00	10%	2/29/04
		Round 1 Sub-Total			1,087.00	166.20	15%	
3	Rd 2	Technical Support to the State Council Office for Reform of the Economic System (SCORES)	2/06/02	David Scott	400.00	163.96	41%	1/14/04
4	Rd 2	Technical Support to the Chinese Securities Regulatory Commission (CSRC)	5/29/02	Robert Y. Liu	600.00	100.00	17%	1/7/04
5	Rd 2	Building Public Debt Management Capacity	1/14/03	Sudarshan Gooptu	500.00			6/30/04
		Round 2 Sub-Total			1,500.00	263.96	18%	
6	Rd 3	Study on Public Service Unit Reform	Not Active	Chunlin Zhang	600.00			
7	Rd 3	Strengthening Public Health Programs in Rural Poverty Areas	Not Active	Shiyong Wang	564.00			
		Round 3 Sub-Total			1,164.00			
		Total			3,751.00	430.16	11%	

15. Some particulars of these activities are given below:

- **Social Security Reform in China.** China currently lacks a national social security system to replace the social benefits provided by SOEs. To protect those in need and to facilitate corporate restructuring and the corporate shedding of social responsibilities, this grant aims to: (i) provide expert advice in analyzing social security policies and program administration in the areas of pensions, labor market, unemployment benefit and support as well as urban social safety nets using the Government's chosen pilot province (Liaoning) to test a national policy; and (ii) provide domestic and overseas capacity building for key staff in social security policy making and management.
- **Improved Cash Management Capacity for the Ministry of Finance (MOF).** To foster government securities market development, this grant would assist MOF to develop a conceptual framework and implement strategies for active cash management and to test the feasibility of a Treasury Bills program. Activities are now on track and should be substantially completed in FY04.

- **Technical Support to the State Council Office for Restructuring of the Economic System (SCORES).** This grant supports the Government in developing policies and strategies for financial sector reform and in implementing those reforms. In particular, the TA supports the authorities in formulating a comprehensive strategic framework for financial sector reform that takes into account the inter-related nature of problems faced and the inter-dependency of potential solutions. SCORES was dissolved by a government streamlining announced in March 2003, and the grant is expected to be transferred to the State Counsel's Development Research Center (DRC).
- **Technical Support to the Chinese Securities Regulatory Commission (CSRC).** To assist in the development and implementation of risk management policies and practices in the securities, capital and futures markets, this activity is the first phase of longer-term strategy and mainly aims at: (i) developing a regulatory framework for the securities and futures markets; (ii) building institutional capacity of the regulatory agency; (iii) improving risk control mechanisms in clearing and settlement systems; and (iv) designing a financial reporting mechanism for adequate monitoring of market operations. Implementation is proceeding well and in FY04 will focus on implementation of regulatory reporting and real-time monitoring of futures brokers, as recommended during the diagnostic phase of the activity, and on a diagnostic of risk management practices in securities firms as well as a workshop to disseminate the results.
- **Technical Support to Develop a Public Service Unit Reform Strategy.** A public service unit (PSU) is typically a state-owned (by central or local governments) institution providing a public service, e.g., the Xinhua News Agency, the China Academy of Sciences, primary schools, village agricultural service stations, etc. PSUs employed 26 million people in 2000, or more than 32% of public sector employment. While SOEs and the civil service have been reformed, PSUs have not, and their reform represents a critical part of the transition from a planned to a market economy. The grant, which was recently approved, will assist the Government develop a strategy and guidelines for this reform, by assessing the current situation and the experience of other countries.
- **Technical support to MOF in Developing a System for Public Debt Recording, Monitoring and Analysis.** This activity, which just began, aims to enhance China's public debt management capacity by consolidating existing debt-related databases into an integrated information system and develop and train staff to use key analytical tools to support public debt management decision-making.
- **Technical support to the Ministry of Health in Strengthening the Public Health Program in Rural Poverty Areas.** China's fiscal decentralization left poorer counties with the least capacity to maintain public health programs but populations with a poorer health status than in other areas. This activity supports new government policies addressing this issue and follows up on a previous ASEM-funded project for rural health. It aims to improve the health status of those living in China's poorest areas by improving access to and quality of health services and rationalizing the institutional structure of local health services.

China has also been included in the following Regional activities:

- **Poverty mapping in Indonesia, Thailand, and China**, to improve targeting of government assistance to the poor;
- **Corporate Dynamics and Restructuring in East Asia**, to build capacity to tackle the policy and institutional changes needed for corporate and financial sector reform; and
- **Building Capacity for Decentralized Financing and Delivery of Services**, to strengthen the policy framework for decentralization, share knowledge to improve local government service delivery and financing, and strengthen the capability of local training and professional institutions to train government officials.

Future Programs being Considered for ASEM TF Support

16. The following proposal ideas are being discussed by the authorities. The In Country Steering Committee will prioritize the proposals as they are developed and in line with the ASEM TF2 guidelines.

- **Managing State Debt Risks** - The Treasury Department of the Ministry of Finance requires support in their ongoing capacity building effort for managing the risks to state debt (explicit and implicit liabilities), including fiscal risks from contingent liabilities. (US\$300,000)
- **Service Sector Data** - China's National Bureau of Statistics requires support in preparing and conducting a service sector census and in building capacity to institute a monthly, quarterly and annual service sector statistical report. (\$400,000)
- **Capital Flow Monitoring and Vulnerability Analysis** - The State Administration of Foreign Exchange (SAFE) seeks support in enhancing its external risk management capacity, particularly by establishing capital-flow related databases (including cross-border flows) and developing staff capabilities to carry out regular vulnerability analyses. Funding needs being determined.
- **Government Bond Market Reform** - To complement ongoing ASEM-assisted work on strengthening the government bond market, the Ministry of Finance has requested support on implementation of a roadmap for government bond market reform. Funding needs being determined.
- **Rural Finance** – Several proposals on this issue are being considered. For example, one would assist the DRC, possibly in collaboration with the central bank and the new China Banking Regulatory Commission, with studies of the demand for rural finance, especially from small firms and the reform needs of existing rural credit cooperatives. Funding needs being determined.
- **Regulatory Framework for Securities Investment Funds** - The China Securities Regulatory Commission (CSRC) is seeking assistance in strengthening the regulatory framework for securities investment funds. The Ministry of Labor and Social Security (MOLSS) may also participate, in order to prepare for reform of the regulatory framework for managing social security funds. Funding needs are being determined.
- **Support for SOE Ownership Agencies** - Policy/operating advice and training are sought by the State Asset Management Commission, local Ownership Agencies, and the Development Research Center on issues such as privatization guidelines, dividend

policy, risk management, corporate governance procedures, staffing policies, budgetary issues, implementing regulations, and state asset management law. (\$650,000)

- **Insolvency Reform** – Support is sought by the Finance and Economic Committee of the National People's Congress (NPC) for development of case studies on the effect of a draft insolvency law on SOEs. The law has been in draft form since 1996. The NPC seeks international and domestic perspective on eligibility for an insolvency filing, commencement criteria, role of the trustee, and treatment of worker claims. (\$100,000)
- **Business Environment in Lagging Western Regions** – The following are needed to spur business development in China's lagging provinces: (i) assessment of the business environment—legal, regulatory, administrative, financing, infrastructure, and logistical—for SME development in sample areas; (ii) assessment of opportunities for private participation in infrastructure; and (iii) legal/regulatory impediments to development of third party logistics providers. (\$450,000)

Experience of the In-Country Steering Committee (ICSC)

17. China's ICSC includes representatives of the government, donors and the Bank. The first year of ICSC operations was a learning experience, which in particular highlighted the need for early consultation with both the government and donors on proposals being developed. While a consensus was easily reached on most proposals, in one instance competing proposals on a subject were tabled and selection proved difficult. Therefore, government and the Bank have encouraged their staff to submit proposal ideas as early as possible to avoid potential conflicts and allow sufficient time to assess approaches. In the coming year, the Committee intends to focus on the implementation and monitoring of approved activities.

Indonesia: ASEM Country Strategy Note

March 2003

1. The ASEM Trust Fund continues to play a major and visible role in shaping the crisis response in Indonesia. Under ASEM TF2 (ATF2), nine different grants have so far been approved for a total of \$2.9 million (see Attachment 1). Although the financial crisis of 1997-98 is over, the reforms initiated in the aftermath of the crisis now need to be sustained in order for growth to accelerate and poverty rates to go down to the pre-crisis levels. In this context, ***ATF2 is currently providing technical assistance to various government agencies for developing a poverty reduction strategy, improving fiscal policy analysis and macroeconomic monitoring, building the government's debt management capacity, and enhancing investor confidence by promoting good governance.***

Recent Developments Relating to ASEM TF

2. Indonesia experienced another year of modest growth with growth in the first three quarters of 2002 amounting to 3.4 percent, about the same as for the year 2001, but 1.5 percentage points below that of the year 2000. Indonesia is the only crisis-affected country in the region that has yet to reach the pre-crisis level of real GDP. However, significant progress has been made in achieving macroeconomic stability and fiscal sustainability. Sound macroeconomic policies and structural reforms have strengthened the Rupiah and stock market, interest rates and inflation have remained low, and debt ratios have improved. The Paris Club Agreement of April 2002 also led to an upgrading of the country's credit rating, although these are still below investment grade. The Seventh Review of the IMF program has been completed, and the Letter of Intent for the 2003 program is close to agreement.

3. Growth has largely been driven by consumption as the investment climate has deteriorated. The weak legal system and uncertain security situation in the country, especially in the aftermath of the October 2002 Bali bombing continues to increase the risk of doing business in Indonesia. Even long-time foreign investors such as SONY recently decided to shift their production elsewhere. Although the government has responded swiftly to the Bali tragedy, similar resolve needs to be shown in pursuing reforms that can improve the investment climate, accelerate growth, create jobs, and further reduce poverty.

4. The pace of structural reforms accelerated after the Bali attack. In recent months the government has passed the Law on the Anticorruption Commission, sold an IBRA bank, and has announced more sales. IBRA recovery targets have also been met. However, developments in trade policy have not been very positive. The government is taking a more protectionist stance by adopting various tariff and non-tariff measures.

5. Government has also made progress in undertaking financial sector reforms over the last year. It sold majority stake in two nationalized banks, IBRA has successfully sold non-performing loans (NPLs) through a transparent auction mechanism yielding a fair recovery rate, Parliament has passed an anti-money laundering law, and the government has started drafting legislation for a consolidated supervisory regulator. Although the banking sector consolidated its

recovery with improving indicators for the banking system's health, the banks remain vulnerable to asset quality problems. The reduction in NPLs of the last two years has also come to a halt. With respect to corporate sector restructuring, IBRA and Jakarta Initiative Task Force (JITF) corporate restructuring targets are on track.

6. Poverty reduction shows mixed results. Poverty has reduced from its crisis peak of 27 percent of population in 1999 to 16 percent in February 2002. This has largely been due to recovering wages and relatively modest increases in food prices. But with many Indonesians still close to the poverty line, even small increases in food prices can have a large impact on poverty. The government is committed to developing a broad-based poverty reduction strategy and has recently completed an interim poverty reduction strategy paper. In addition, the modest growth was also not enough to make a dent in unemployment.

7. Governance remains as one of Indonesia's key medium-term development challenge. The country continues to score consistently low in surveys on rule of law, corruption, and business environment. Bad governance has affected the poor across the board, including lack of an effective judicial system, lack of mechanisms to influence pro-poor budgetary choices, poor quality of services, and lack of transparency and accountability in the use of funds. Decentralization has perhaps exacerbated some of these weaknesses and making decentralized services work for the poor remains a daunting task.

Impacts of and Lessons from ASEM TF1

8. *One issue that continues to emerge is in the context of execution modalities.* In general, the Bank staff is reluctant to agree on government execution of grants because of the weak fiduciary environment and the complexity of coordination among various government agencies involved in implementation. The Bank is planning to review this with the government and intends to develop an action plan on execution arrangements over the next few months.

9. In addition, *a couple of lessons have emerged from which the Bank and the government hope to learn.* One, strong government ownership and commitment is required for successful implementation of approved activities. The availability of grant resources is not always enough if the government is not fully committed and involved in all phases of grant activities, especially the proposal design phase which is a good indication of how committed the government is to proposed technical assistance. Two, the monitoring and evaluation mechanisms by both the recipient institutions and the task teams of the World Bank need to be strengthened and designed as part of the proposal in order to increase accountability. The formulation of In-Country Steering Committee for ASEM TF2 is expected to improve this aspect.

ASEM TF2 Priority Areas

10. The government's medium-term policy directions emphasize the importance of improved governance and of addressing social inequity and poverty. The government's *Propenas* five-year plan (government FY01-05) is organized around five key priority areas: (i) building a democratic political system while maintaining national unity, (ii) realizing the supremacy of law

and clean governance; (iii) accelerating economic recovery and building a sustainable and just development platform; (iv) improving the development of people's welfare and cultural resilience; and (v) improving regional development.

11. Priority areas for ATF2 are closely linked with the development needs of Indonesia and the World Bank's Country Assistance Strategy (CAS). The overarching goal of the current CAS for Indonesia (World Bank FY01-03) is to support efforts to reduce poverty and vulnerability in a more democratic and decentralized environment¹. It focuses on three broad priority areas: (i) sustaining economic recovery and promoting broad-based growth, (ii) building national institutions for accountable government, and (iii) delivering better services to the poor.

12. The strategy for ATF2 in Indonesia largely remains as previously noted. The focus will continue to be on the medium-term development challenges and many of the priority areas identified below involve follow-up actions on activities already launched and underway. With a substantial number of Indonesians still vulnerable to episodes of extreme poverty, sustainable poverty reduction will continue to be a major issue. In addition, we will also focus on the rapid execution of current activities and work towards minimizing constraints to effective implementation of approved ATF2 activities.

- **Improving the investment climate for sustaining economic recovery and promoting broad-based growth.** The deterioration in the investment climate is constraining growth and employment. Moreover, global and regional changes, such as increased competition from China in the domestic and export markets, are putting pressure on Indonesia to improve its competitiveness while maintaining an open trade regime. In the short-run, ATF2 can be instrumental in financing the regional business environment analysis and business forums. These are increasingly playing an important role in focusing attention on constraints in the local business environment and promoting a dialogue between the local private sector and local governments in promoting investment, growth and employment. In the medium-term, efficient private sector growth and investment in human capital and infrastructure development to improve competitiveness will be required. In trade, the government wants to develop an integrated trade strategy instead of reacting to ad hoc requests for greater protection by ailing sectors. The government also wants to develop its trade analytical and statistical capacity to better assess the impact of trade policy on its economy.
- **Development and implementation of a broad-based poverty reduction strategy.** The government has already completed an interim poverty reduction strategy paper and is now working on preparing the final strategy. It is anticipated that work on agricultural policy and food security will also be part of this approach, which may require grant support. In addition, the government wants to strengthen its own poverty analysis statistical capacity so it is better placed to identify vulnerabilities, anticipate future crisis, and prepare relevant response mechanisms. The agenda in the education sector is likely to move towards securing funding for improving the quality of education, such as, curriculum reform, teacher training, and cost-effective

¹ Preparation for the new CAS (FY04-06) is now underway and the next ASEM Country Strategy Note will be based on the new CAS.

- education. This agenda will be further pursued in coordination with the donors who have supported the sector. Health programs will focus on ensuring that basic services to the poor are provided and that support is provided to private provision of health services to recover and thrive.
- **Governance and anticorruption efforts.** The Bank has accelerated its involvement in governance and anticorruption area in close collaboration with other partners, specifically by supporting the Partnership for Governance Reform in Indonesia. The Partnership consists of government, civil society, private sector and the donors, and facilitates a national dialogue on governance. Corruption and public transparency are of particular concern in Indonesia, and future ATF2 programs could help efforts to improve public procurement, financial management and audit systems. It will be important to tap international expertise in areas such as reforming the judiciary and developing civil society accountabilities.
 - **Building local and national institutions for accountable government.** This includes support for legal and judicial reforms, civil service reforms, better public financial management and procurement systems, and close attention to sustainable management of the rapidly depleting natural resource base of the country. In order to ensure effectiveness of Indonesia's poverty reduction approaches, it is necessary to develop a better understanding of local institutions, local capacity, public expenditure programs, the fiduciary environment, and the quality of public service delivery to the poor.
 - **Managing decentralization and delivery of public services.** With decentralization, the duty of ensuring public services is shifting increasingly to local governments. This priority involves assistance to help define government roles and responsibilities as the functions are decentralized, support for improved public service delivery by sub-national governments with demonstrated pro-poor, pro-growth reform procedures; and promotion of community development and selective assistance to post-conflict areas. Of special importance will be programs for evaluating and improving the quality of public service delivery in this decentralized environment.
 - **Bank and corporate restructuring.** In terms of bank restructuring, the World Bank will retain its leadership role in providing support to the government on issues related to state banks and IBRA. Priority work will also be undertaken on the design and implementation of a medium-term financial sector strategy, including strengthening the regulatory and supervisory capacity for non-bank financial institutions, the capital market, and micro-finance.

Status of ATF2 Programs

13. Government continues to appreciate access to ASEM funds and acknowledges the contribution this timely funding provides in supporting their reform agenda. ATF2 remains critical for sustaining the government's response in mitigating the adverse social and economic impact of crisis. To date, Indonesia program has drawn on ATF2 support for both social and financial/corporate sector reforms. Better balance has also been achieved between the two broad areas with social sector programs accounting for 41 percent of all approved ATF2 activities and financial/corporate sector programs amounting to 59 percent (as against 84 percent social and 16

percent financial/corporate during ATF1 programs when the other grant resources were available for financial sector activities).

14. Of the nine activities approved under ATF2, the one that has made the most progress is *Improving Fiscal Policy Analysis (TF50033)*. The main objective of this grant is to improve Ministry of Finance's (MOF) capacity for macroeconomic and fiscal policy analysis by expanding the already established macroeconomic model, integrating the model in day-to-day operations of the MOF, and training additional MOF staff in modeling. This is a recipient executed grant and the progress on grant implementation has been far ahead of schedule and successful. With a consultant's support, MOF further developed its microeconomic model, among others by including a debt module and an input-output table-based supply side of the economy. Ten additional MOF staff have been trained in the use of the model, and several other officials have become part of the implementation team. The model is now gaining increased acceptance among the high-level policy makers, and among agencies outside of MOF. More importantly, the model is now the key tool in budget preparation and for medium-term economic outlook scenarios.

15. Activities under the grant, *Building Debt Management Capacity in Government (TF50268)*, are expected to pick up pace over the coming months. This grant is providing support for building capacity to manage the country's large public debt according to sound international practices. Now that a new Law on Government Securities has been passed in September 2002, it is anticipated that the implementation of envisaged activities that are being supported by this grant will proceed shortly. Under this law, the government is allowed to issue bonds and reprofile the existing bonds to smooth the associated debt service payments. In addition, the Center for Government Bond Management (PMON) within the MOF, which is the main counterpart for this bank-executed grant, has been given the formal mandate to manage the country's domestic debt, and eventually the entire public debt.

16. Another grant on *Supporting Pro-poor Policy Development in a Decentralized Indonesia (TF50793)* is providing assistance to the recipient in building the capacity of the Coordinating Ministry for People's Welfare in assessing the nature of poverty in the country and developing a medium to long-term strategy to reduce poverty. Activities include supporting the government in defining the role of national policies in a decentralized environment and establishing priorities for policies and programs. This is a recipient executed activity and as of December 2002 had yet to disburse. This was partly due to the delay in the finalization of the Interim Poverty Reduction Strategy Paper (IPRSP), which was finalized only in January 2003.

17. *TF 050484 Building Investor Confidence by Promoting Good Corporate Governance* (recipient executed). The disbursement has not begun due to long negotiation process between the consultants and the implementing agency. It is expected that the work will commence within the next couple of weeks.

18. *TF 050567 Financial Sector Reform* was cancelled as the government counterpart was not ready to take on the activity.

Experience of the In-Country Steering Committee (ICSC)

19. Launching of the ICSC in Indonesia was delayed since the government had to announce a decree to establish the committee. Hence the review process for the proposals submitted for the September 2002 tranche was not a smooth sailing. In early October 2002, the launching of the ICSC was discussed with representatives from the government, donors, and the Bank. A decree (no. KEP. 306/M.PPN/10/2002) was approved on October 22, 2002 by the Minister of National Planning, which formally established the government membership of the ICSC². The Committee met in January 2003 to further discuss the process for reviewing and prioritizing future ATF2 proposals and the overall role and responsibility of the ICSC, including drafting of the ASEM country strategy note. ***Representatives from the government hope that in future the ICSC will play a key role not only in reviewing and prioritizing proposed ATF2 activities, but also in resolving issues related to the effective implementation of approved activities. They also hope that with the establishment of the Committee it will allow the government to play an increasing role in determining ATF2 priorities in the context of their reform agenda, thereby strengthening its ownership of approved activities. The government's strengthened commitment and proactive actions are required to achieve these goals. The donors and the Bank will also required to support the government in their efforts in leading the ICSC operations.***

² The government has yet to indicate the full membership of the ICSC. Currently, ICSC members include representatives from government (Bappenas is the chair), World Bank, and the European Commission Delegation in Jakarta.

Attachment 1

INDONESIA

Approved Activities under ASEM Trust Fund 2 Facility

March 2003

	ATF2 Type	TF Project Name	Effective Date	Task Manager	Grant Amount 'ooo	Total Disbursed	% Disbursed	Closing Date
1	Rd 1	Supporting Pro-Poor Policy Development in a Decentralized Indonesia	9/12/2002	Jehan Arulpragasam	207.50	35.00	16.86	8/31/2003
2	Rd 1	Improving Fiscal Policy Analysis	11/30/2001	Bert Hofman	200.00	158.33	79.17	3/31/2004
3	Rd 1	Building Debt Management Capacity in Government	3/5/2002	Sudarshan Gooptu	250.00	17.56	7.02	6/30/2004
4	Rd 1	Building Investor Confidence by Promoting Good Corp. Go	8/13/2002	W. Bernard Drum	451.00 (Government executed); 50.00 (Bank executed)	45.00 (Government executed); 16.6 (Bank executed)	0.10 (Government executed); 33.2 (Bank executed)	6/30/2004 (Same for both Government executed and Bank executed)
5	Rd 1	Financial Sector Reform	Cancelled	Tom Rose	344.50			
6	Rd 2	Poverty Reduction Through Collective Action	Procurement Plan being prepared	Anirudha Dasgupta	297.70	0	0	
7	Rd 2	A Methodology for Regional Civil Service Reform	Procurement Plan being prepared	Bert Hofman/ Kai Kaiser	506.40	0	0	
8	Rd 2	Housing Finance Policy Reform	Procurement Plan being prepared	Hiroaki Suzuki/ Stephen Dice	289.00	0	0	
9	Rd 2	Productivity Growth and Export Competitiveness in Indonesia	Activities being amended per government request	Milan Brahmatt/ Mona Haddad	330.00	0	0	
		TOTAL			2,581.60			

Philippines: ASEM Country Strategy Note

April 2003

1. The ASEM Trust Fund (TF) has played a critical role in supporting government activities to mitigate the adverse effects of the Asian financial crisis. Under ASEM TF1, eight country-specific projects were approved for funding for a total of US\$7.2 million (approximately Euro 6.5 million) and all of these were completed as at end-August 2002. To date, four projects were approved under ASEM TF2 for a total grant commitment of US\$2.6 million (approximately Euro 2.4 million). In addition, nine regional projects benefiting the Philippines were approved. Completed ASEM TFs have provided technical assistance activities to strengthen the financial and banking sector, completion of a poverty indicators survey, support activities to lower the incidence of out-of-school youth, assist with governance and anti-corruption reforms and develop methodologies for conducting poverty mapping exercises and procedures for community involvement in the design of community driven development-type investments. On-going ASEM TF2 grants are supporting pension reforms, corporate governance, public sector governance reforms and efforts on increasing competitiveness.

Recent Developments Relating to ASEM TF¹

2. Economic growth in 2002 surpassed expectations with GDP in real terms growing by 4.6% and export earnings growing by 9.0%. In addition, it should be noted that the Philippines exceeded its full-year GNP growth target of 4.5% in 2002, with actual GNP growth in real terms of 5.2%. Other accomplishments include: lowering inflation to below 3.1%, reducing interest rates, and reducing non-performing loan ratio for banks. Legislative accomplishments include passage of the procurement reform law, Special Purpose Vehicle Law and amendments to the Anti-Money Laundering Law.

3. However, a more holistic perspective of the country's economic performance must also consider the following challenges: growing budget deficit (as percentage of GDP was 5.4% in 2002 up from 4.0% in 2001), tax revenues remaining flat in nominal terms and hence falling as a share of GNP, peso depreciating (hitting a low of Php55.08: US\$1 on March 12, 2003), continued low stock market values and transaction volumes, and continued high rates of unemployment and poverty. In addition, the country's economy will also have to contend with the rise in external and domestic risks resulting from the continued weakness in major export partners like the U.S. and Japanese markets, the war in Iraq, renewed tension in Mindanao and a potential El Nino.

¹ Department of Finance is the source of statistical data.

Impacts of and Lessons from ASEM TF1

Table 1. Summary Table of ASEM TF1 Supported-Activities & Key Outputs

Activities	Government Executing/ Partner Agency	Grant Amount (US\$)	Disbursements (US\$)	Key Outputs
<i>Financial & Corporate Sector</i>				
Strengthening Financial Sector Infrastructure (TF021567)	Department of Finance (DOF)	928,000 (100% GOP - Executed)	927,993.00 (less than 1% undisbursed)	<ul style="list-style-type: none"> • Trained government auditors to undertake audits of government financial institutions using international auditing standards • Conducted diagnostic audit of the Philippine National Bank (PNB)
Financial Sector Monitoring and Reform (TF022102)	DOF	700,000 (100% GOP - Executed)	569,464.23 (19% undisbursed)	<ul style="list-style-type: none"> • Co-financed diagnostic audit of PNB • Established off-site surveillance tools in the central bank for monitoring the financial condition of banks • Established the Institute of Corporate Directors
<i>Social Sector</i>				
Enhanced Poverty Monitoring (TF021064 & TF020571)	National Statistics Office (NSO)	967,416 (79% GOP - Executed; 21% Bank-Executed)	780,974.60 (19% undisbursed)	<ul style="list-style-type: none"> • Implemented the Annual Poverty Indicators Survey (APIS) in 1998 • Supported a national survey on a citizen's report card on the provision of public services
Out-of-School Youth and Children Development Project (TF023513 & TF023514)	Department of Social Welfare and Development (DSWD)	980,000 (80% GOP - Executed; 20% Bank-Executed)	809,021.30 (17% undisbursed)	<ul style="list-style-type: none"> • Piloted employment entrepreneurship program for the youth • Implemented back-to-school programs for those who have access to and can attend regular school and provided alternative learning systems for those who cannot
Social Protection and Social Housing (TF022095)	DOF	980,000 (100% GOP - Executed)	220,995.51 (77% undisbursed)	<ul style="list-style-type: none"> • Conducted studies on homeowners assistance program and winding up strategy for the National Home Mortgage Finance Corporation • Grant was cancelled in December 2000 due to change in Government reform priorities
Strengthening Social Protection (TF022728)	DOF	900,000 (100% GOP - Executed)	74,419.55 (92% undisbursed)	<ul style="list-style-type: none"> • DOF staff participated in Pension Reform Courses and drafted a work program for the Presidential Retirement Income Commission • Grant was cancelled in December 2000 due to change in Government reform priorities

Poverty Reduction Through Community Empowerment (TF050462 & TF050463)	DSWD	800,000 (63% GOP - Executed & 37% Bank-Executed)	593,067.22 (26% undisbursed)	<ul style="list-style-type: none"> Produced a poverty mapping and targeting report for KALAHI-CIDSS Developed policies and processes for community involvement in community driven development projects Established monitoring and evaluation framework and management information system for the KALAHI-CIDSS
Governance				
Improving Governance and Reducing Corruption	Department of Budget and Management (DBM)	950,350 (33% GOP - Executed; 67% Bank-Executed)	837,221.60 (12% undisbursed)	<ul style="list-style-type: none"> Supported establishment of Procurement Watch, Inc. Produced the “Filipino Report Card for Pro-Poor Services” Developed and delivered an enhanced Training and Awareness Program on Corporate Governance Developed and piloted a Regional Framework for Corporate Governance Scorecard
Total		7,205,766 (81% GOP- Executed; 19% Bank-Executed)	4,813,157 (33% undisbursed)	

4. **The Financial Sector.** All ASEM TF1 financed activities in this sector were completed in 2001 and have made significant contributions in assisting the government in its effort to strengthen the financial sector. They contributed to:

- **Strengthening audit capacity within the Commission on Audit** to undertake audits of government financial institutions using international auditing standards;
- **Assisting the Government to design and implement financial sector reforms;**
- **Financing a diagnostic audit of one of the largest commercial banks in the Philippines** - the Philippine National Bank – that was then being groomed for privatization by the Government;
- **Supporting a study on strengthening the legal protection for banking supervisors,** feeding into the New Central Bank Act of 2000;
- **Establishing a computer-based early warning system** to improve the Bangko Sentral ng Pilipinas (BSP, Central Bank) off-site supervision.

5. ASEM TF1 played an important role in initiating and supporting the implementation of policy reforms, as illustrated below, and ASEM TF1 played a catalytic role by enabling innovative processes. In the absence of the ASEM TF, such activities might not have been undertaken when they were most needed (for instance, the use of technology assisted poverty surveys immediately after the crisis and governance reforms). The challenge now is to sustain the momentum on implementation of reforms that have already been started and to support the Government of the Philippines (GOP) in initiating new reform measures.

6. **The Social Sector.** As at end-August 2002, all ASEM TF1 financed activities in this sector were completed. The *Enhanced Poverty Monitoring Project*, which was completed in 2000, assisted in enhancing the Government's capacity to respond promptly to mitigate the adverse social impact of the crisis with the right interventions, such as in establishing a monitoring system that could provide timely and accurate poverty-related data. The project provided technical assistance to the National Statistics Office (NSO) to implement the Annual Poverty Indicators Survey (APIS) which was designed as a tool for regular monitoring of not only the poverty incidence, but also of other social sector indicators during and immediately after the crisis. Key achievements include:

- **The APIS significantly expanded the scope of the survey instrument beyond the collection of income and expenditure data.** It also collected information on education and health status, family planning, employment, housing and sanitation, access to services, and several questions on the impact of the crisis. It thus yielded important information on the household level welfare on a nationally representative basis that was hitherto unavailable.
- **An innovative technique was used to collect the nationwide survey data – use of hand-held computers.** This brought the NSO to a new level of information technology, which has been quite unprecedented elsewhere in the world.
- **The APIS findings have been widely disseminated and, as a result, been used by several researchers to learn more about the welfare impact of the crisis as well as the profile of the poor and determinants of household living standards.** For instance, they were used in the World Bank Poverty Assessment (2001). The widespread dissemination of key findings has also enriched the discussion between the Government and civil society on poverty-related issues.
- **A nationwide survey on users' perceptions of the provision of pro-poor Government services was partly financed by this grant.** It was administered by a private non-profit organization in the Philippines and the data was analyzed and the report has now been widely disseminated in the country. The survey findings highlighted issues from the perspective of the beneficiaries in accessing and utilizing public services in sectors such as basic education, health, drinking water, low-income housing and subsidized food. An innovative feature of this survey was that it combined the qualitative questions on public services with a quantitative consumption module taken from the APIS. The survey is now being institutionalized within selected Government departments.

7. A pilot project for the *Development of Out-of-School Youth* was completed in October 2001. The incidence of out-of-school youth was exacerbated by the crisis, and this project's objective were to develop and test mechanisms that will enable children from seven to fourteen years old to be schooled or to remain in school. It also supported piloting an employment and entrepreneurship program for youths aged fifteen to twenty-four. In terms of direct beneficiaries, the project benefited 4,872 out-of-school children and youth, exceeding its target of 3,000. Moreover, the project was able to generate 60% counterpart funding from NGOs and business groups. However, the large number of out-of-school children and youth underscores the continuing need for government, civil society and business sector to jointly remedy the situation and involvement of local level organizations is necessary for the gains to be sustained and the project to cover a larger set of beneficiaries.

8. For its part, the fast-tracked *Poverty Reduction through Community Empowerment Project*, was activated and completed in 2002 to strengthen the Government's ongoing poverty reduction program, otherwise known as KALAH-CIDSS. The project largely achieved its objectives by delivering the following outputs:

- **Articulation of a methodology for conducting poverty mapping exercises and the production of a Poverty Mapping and Targeting Report** for the KALAH-CIDSS project in the Philippines;
- **Development of processes and procedures for community involvement** in the design and implementation of community driven development-type investments in the Philippines;
- **Production of project implementation manuals and frameworks** to guide the implementation of the KALAH-CIDSS project;
- **Organization of national and regional workshops** to establish policies, principles, and mechanisms for implementing community-driven programs under the KALAH-CIDSS framework; and
- **Establishment of a monitoring and evaluation framework as well as a management information system** for the KALAH-CIDSS program.

These achievements are incorporated and will be sustained under the on-going KALAH-CIDSS project, which is financed by a US\$100 million World Bank loan.

9. **Governance.** Completed on August 2002, the two grants for *Improving Governance and Reducing Corruption* supported reforms in this area by financing knowledge sharing activities and awareness programs, enhancing the capacity for reforms, and fostering partnerships with civil society. This grant supported various initiatives including:

- **Establishment of Procurement Watch, Inc. (PWI)**, a civil society-based organization formed to help reduce graft and corruption in public procurement;
- **Workshop on tax administration strategy in October 2001, organized by the Bureau of Internal Revenue** - the goal of the workshop was to push for and strategize tax administration reform to increase tax compliance;
- **Development and delivery of an enhanced Training and Awareness Program on corporate governance** for corporate directors, managers, policy makers and regulators;
- **Development and piloting of a Regional Framework for a Corporate Governance Scorecard;**
- **Workshop to review the report on standards and codes (ROSC) in corporate governance;**
- **Legislative Oversight Planning Workshop for the Congress Secretariat in December 2001 organized by the Congressional Planning and Budget Office** - this workshop arrived at a common definition of legislative oversight, formulated a strategic framework to fast track oversight system, and drafted a basic outline for institutionalizing the Philippine legislative oversight system; and
- **Conduct of courses on investigative journalism on the conviction that a strong, responsible, and credible media is a good deterrent to corruption.**

10. Several lessons can be drawn from the experience of implementing the ASEM TF1 in the Philippines:

- **First, the catalytic effect of timely, targeted grant funds cannot be underestimated.** The government also acknowledged this during a trust fund review workshop between government implementing and oversight agencies and the World Bank in November 2001.
 - *The grants have facilitated innovative techniques and pilot activities, which are expected to have far reaching effects* (for example, a second APIS conducted in 2000 once again used hand-held computers).
 - *With the help of this funding, it has been possible to involve civil-society in activities* such as PWI to strengthen governance.
 - *It has fostered and strengthened partnerships among the private sector, government, and donors.* The formation of the tri-partite Out-of-School Children and Youth (OSCY) Committee supported by one of the grants is a good example of such a partnership.

- **Second, successful implementation of these grants hinges on strong government ownership and commitment.**
 - *For bank-executed regional grants to be successful, ownership and engagement by countries concerned is needed.* The availability of grant resources alone is not always enough if the government is not fully committed and involved in all phases of implementation.
 - *Involving the government, especially the Department of Finance (DOF) and the implementing agency, during the proposal/design stage is especially important* to get an indication of how committed they are to proposed reforms. For instance, two grants (Social Protection and Social Housing, and Strengthening Social Protection) had to be closed before full implementation due to change in priorities within the Government.
 - *Sustained attention and strong implementation capacity are critical to successful execution.* One example is that of the Improving Governance grant which benefited from sustained commitment and attention by senior officials in the Department of Budget and Management. However, competing demands on time of these officials, coupled with limited technical support contributed to slow execution and even slower processing of disbursement claims.
 - *More attention could have been paid to monitoring and evaluation mechanisms.* During the trust fund review workshop with the Government in November 2001, one of the suggestions by the participants was that a unit/committee be established within the Government (preferably DOF) to monitor and evaluate the implementation and impact of grant-funded projects. Once established, this will increase accountability and assist in resolving any implementation issues as they emerge, and this in turn will allow for faster implementation of grant activities. Meanwhile, increased country ownership has been ensured for future grants by the establishment of the Philippines ASEM In-Country Steering Committee. (See para. 22.).

ASEM TF2 Priorities

Aligning Strategies

11. While poverty reduction is at the forefront of the Government's Medium Term Philippine Development Plan 2001-2004 (MTPDP), its target growth of over 5 percent per year is attainable only if the key building blocks for sustained growth—an environment conducive to increased investment and productivity within both private and public sectors—is firmly in place. Moreover, strong growth must be complemented by increased participation in development by the poor to attain the desired rapid reduction in poverty.

12. Likewise, Government has stressed that improved governance is critical to poverty alleviation. In particular:

- **Raising fiscal revenues is essential** for government to achieve fiscal consolidation while simultaneously increasing funding of investments in poverty reducing activities;
- **Fiscal risks pertaining to contingent liabilities need to be managed and provisioned;**
- **Improving expenditure management and public procurement are critical to public sector reforms;**
- **Financial sector strengthening and deepening is important for renewed private sector development;** and
- **Investor confidence needs to be rebuilt** with continued improvements in corporate governance.

13. Accordingly, the World Bank's 2003-2005 Country Assistance Strategy for the Philippines (CAS) was designed in consultation with the Government and interested stakeholders to be closely aligned with the four themes of the MTPDP:

- **Macroeconomic stability and equitable growth based on free enterprise;**
- **Agriculture and fisheries modernization with social equity** aimed at raising rural incomes in a sustainable manner;
- **Comprehensive human development and protecting the vulnerable;** and
- **Good governance and the rule of law.**

14. In this context, the Government's policy directions for January 2003–June 2004 will be towards:

- **Reducing downside macroeconomic risks** of the war in Iraq and adopting mitigating measures for El Nino;
- **Boosting investor confidence** through fast-tracking of key bills, reducing the deficit, strengthening the banking sector and improving infrastructure; and
- **Pursuing microeconomic/structural reforms as embodied in the President's 8-point agenda** that includes: jumpstarting the housing sector, reducing inter-island transport cost, decongesting Metro Manila by building infrastructure, promoting micro, small and medium enterprises, and stimulating investments in agriculture.

15. These identified priority areas for development intervention by the Government and the World Bank fit well with the ASEM TF2 which has - financial, corporate, social and governance

reforms - for its focal areas of continued assistance. In this regard, both the Government and the World Bank considers the ASEM TF as a critical instrument in pursuing new and continuing initiatives in these areas. In addition, priorities will be given to activities that consolidate the gains from previously funded activities and to reforms that have already been introduced. Moreover, to the extent possible, development of systems (e.g., monitoring and evaluation systems, databases) will be encouraged to build upon existing ones that have been proven effective and efficient in the Philippine setting to avoid duplication and gain more value-added under the ASEM TF2.

Status of ASEM TF2 Supported Activities

16. **Financial and Corporate Sector Reforms.** An ASEM TF2 grant on *Pension Reforms* amounting to US\$992,500 (approximately Euro 898,213) was approved in November 2002 to support pension system reforms following the Government's renewed commitment to pension and financial sector reform. Through past grants, the Government established and funded the work of the Presidential Retirement Income Commission (PRIC). Further assistance in this area should allow the Government to complete this work and move forward with actions to ensure the sustainability of pension schemes. The reform of the pension system will also foster the reform and development of the financial markets by introducing new products and services and increasing public confidence in the system. Moreover, to complement corporate restructuring efforts, a grant on *Closing the Productivity Gap* amounting to US\$300,000 (approximately Euro 271,500) was also approved in November 2002 to support the establishment of key policy actions that would strengthen the foundations of firm-level productivity growth by deepening linkages between foreign trade and investment on the one hand and domestic economic activity on the other hand. Improved productivity growth in turn would complement corporate restructuring efforts by increasing the private sector's resilience to future crisis as well as deliver greater poverty reduction benefits by boosting income growth. The agreements for these two grants are currently under process.

17. **Social Sector and Protecting the Poor.** To date, a proposal in support of programs for the social sector and protecting the poor has yet to be approved for the Philippines.

Table 2. Status of ASEM TF2 Supported-Activities (as of March 28, 2003)

Activities	Government Executing/ Partner Agency	Round ²	Effective Date	Closing Date	Grant Amount (US\$)	Amount Disbursed (US\$)	% Disbursed
<i>Finance and Corporate Sector</i>							
Knowledge Enhancement of Key Issues in Corporate Governance (TF050955)	DOF	1	12/19/2002 ³	6/30/2004	444,000 (100% GOP-Executed)	0 ⁴	0%
Closing the Productivity Gap (TF051862)	Department of Trade and Industry, Department of Education, National Economic and Development Authority	3	Grant Agreement (GA) Awaiting GOP countersignature		300,000 (100% Bank-Executed)		
Pension Reform	DOF, Social Security System, Armed Forces of the Philippines Retirement and Separation Benefit System, Government Service Insurance System	3	GA under process		992,500 (100% Bank-Executed)		
<i>Social Sector & Protecting the Poor</i>							
- none yet -							
<i>Governance</i>							
Sustainable Poverty Reduction and Good Governance	DOF	3	GA under process		1,119,000 (73% GOP - Executed; 27% Bank-Executed)		
Total					2,555,500 (45% GOP-Executed; 55% Bank-Executed)		

² There were no Philippine proposals submitted under the ASEM TF2 Round.

³ Delay in processing grant agreement due to problems in turn-over of task management.

⁴ DOF preparing work program and withdrawal application for submission to the Bank.

18. **Improving Governance.** To date, two projects in this area have been approved for support under ASEM TF2 - *Knowledge Enhancement of Key Issues in Corporate Governance* (US\$493,333, approximately Euro 446,466) and *Strengthening Institutions for Sustainable Poverty Reduction and Good Governance* (US\$819,000, approximately Euro 741,195). The former, the grant agreement for which was signed in December 2002, aims to strengthen corporate governance through enhancing the development and delivery of education programs in this area including carrying out of public information campaign. The latter, the grant agreement for which is under process, will provide institution-building technical assistance to strengthen macroeconomic stability and reduce poverty and vulnerability to future crises through strengthening the management of fiscal risks, strengthening of local government units' effectiveness in poverty alleviation and service delivery, enhancing the pro-poor impact of public expenditures through more effective oversight arrangements, and improving judicial effectiveness by supporting civil society involvement in judicial appointments.

Future Programs for ASEM TF2 Support

19. **Finance and Corporate Sector Reforms.** Consistent with the Government's policy direction, additional assistance under ASEM TF2 in the financial and corporate sector is expected to include initiatives to strengthen the banking system and overall financial system and improve banking sector performance.

20. **Social Sector and Protecting the Poor.** Reducing the vulnerability of the poor by designing better targeted social protection programs and comprehensive human development is one of the key objectives of the Government's MTPDP and the Bank's CAS. In this area, ASEM TF2 may be requested to finance the following activities:

- **Developing quick response monitoring systems** that generate information on conditions among the poor, even at the *barangay* level, to help in more effectively designing decentralized pro-poor programs and human development programs in general;
- **Establishing a rural social indicator database** to monitor the effectiveness of pro-poor rural development programs - this is important for the Philippines, since a majority of the poor still reside in rural areas;
- **Promoting community-based approaches for development**, which seem to have greater impact on the ground;
- **Evaluating the response of the public institutions and NGOs** responsible for protecting the poor during a crisis and making recommendations for improvement; and
- **Supporting the institutionalization of APIS** so that this tool can continue to be used to identify the country's changing poverty dynamics.

21. **Improving Governance.** Future support in this sphere can continue to focus on the following areas, which have also been identified by the Government as key development challenges:

- **Support public sector and governance reforms** in general, including decentralization and improving service delivery of key social services (e.g, health and education);

- **Help specific public sector agencies**, particularly those directly involved in revenue administration, regulation of corporate and financial sectors, and delivery of key social services (e.g., health and education), **to implement anti-corruption programs;**
- **Provide catalytic resources to support citizen monitoring of public services;** and
- **Support capacity building and technical assistance to enforcement agencies** responsible for enforcing the anti-corruption laws and regulations.

Modalities of Programming ASEM TF2 with Clients

22. Consistent with the ASEM TF2 Standard Provisions, a Philippines ASEM In-County Steering Committee was established on September 4, 2002 with the DOF as chair and representatives from the World Bank, Delegation of the European Commission, the Royal Netherlands Embassy and the Embassy of the People’s Republic of China as members. The Government reserves the right to add another government agency to the Committee. The World Bank acts as the secretariat for the Committee. The primary responsibilities of this Committee is to review and prioritize all proposals, monitor the implementation and progress of ASEM TF2 activities, and contribute to the Philippines ASEM TF Strategy. Emphasis has also been given to the more substantial involvement of the Philippine Government in the design and preparation of grant proposals in order to reinforce the level of country ownership of the activities.

On Increasing Recipient Execution of ASEM TF2 Grants

23. To date, of the four grants approved under ASEM TF2, one will be fully recipient executed, one for split-execution and two for Bank-execution as was requested by the Government. This brings the Recipient-Bank execution ratio of ASEM TF2 grants to 45:55. Upcoming ASEM TFs will need to be heavily recipient executed to increase this ratio and to further strengthen the level of country ownership of the activities. Greater involvement of recipients at the design and preparation stage of grant proposals should also help in this regard.

Thailand: ASEM Country Strategy Note

March 2003

An Overview

1. The Asia and Europe Meeting (ASEM) Trust Fund has been instrumental in providing much needed support to critical reform programs adopted by the Royal Thai Government (RTG) after the 1997 economic and financial crisis. To lessen the negative impact caused by the crisis, the RTG moved quickly to adopt a comprehensive macroeconomic and structural reform program, with the focus on the reform of the financial and corporate sectors, as well as provide social protection to the poor. The reform programs supported by ATF1 have produced positive results, and recent macroeconomic data showed that poverty incidence has improved, and the Thai economy has recuperated. However, the reform agenda is unfinished, and important challenges remain. It is expected that a continued rigorous structural reform program will result in further poverty alleviation, improve Thailand's competitiveness, and reposition the country towards a medium-term sustainable growth path.

Recent Developments Relating to ASEM TF Activities

2. Thailand has made significant progress since the 1997 economic and financial crisis. Macroeconomic stability has been restored, the level of international reserves stabilized, external debt reduced, inflation remains low, and real GDP growth has increased to 4.8% in 2002, up from 1.8% in 2001.¹ The recovery is driven mainly by growth in domestic consumption, prompted by rising consumer confidence, low interest rates, and fiscal measures to stimulate consumptions. Exports have also contributed to the improved economic stability, with a 10.5% increase in export volume in 2002 from prior year.²

3. Despite the progress, there remain risks, due in part to the overhang of distressed assets in financial institutions and firms³, uncertainties in private investment, rising public debt relative to GDP, and global economic prospects. These risks, if not managed well, could prevent Thailand from achieving a sustainable recovery and growth over the medium-term. As a result, recovery remains fragile. Thailand's medium-term prospects now depend on its continued ability to address underlying structural reforms –such as completing financial and corporate sector reforms, improving country's competitiveness, improving public sector reform and governance, restoring the focus on environmental preservation, and scaling up social protection program for the vulnerable. Thailand must also address the paramount challenges of poverty and inequality. Income inequality is among the highest in Southeast Asia, and although poverty has declined from its crisis peak of 15.9% in 1999 to 13.0% in 2001, it still remains above the pre-crisis 1996 level of 11.4%.⁴ Poverty continues to be predominantly a rural problem, with nine of ten poor people living in rural areas, two-thirds in the Northeast.

¹ Source: Fiscal Policy Office, Ministry of Finance – Macroeconomic Forecast, December 2002

² Source: Fiscal Policy Office, Ministry of Finance – Macroeconomic Forecast, December 2002

³ Bank of Thailand: Non-performing loans (NPLs) have dropped from a high of 47% in mid-1999 to about 11% at the end of 2002. Distressed assets include NPLs, loans written off, and loans transferred to asset Management corporations.

⁴ Source: National Economic and Social Development Board

Impacts of and Lessons from ASEM TF1

4. Lessons Learned from Thailand “In Country Steering Committee” (ICSC).

Thailand ICSC was established in August 2002 following the resolution passed by the ASEM Committee in the Spring of 2002.

Establishment of ICSC: The ICSC members comprise of representatives from the Ministry of Foreign Affairs, Ministry of Finance, National Economic and Social Development Board (NESDB), the World Bank Thailand Office, and the ASEM TF donor countries. The ICSC is co-chaired by the Director-General of the Department of European Affairs, MFA and the Director-General of the Fiscal Policy Office, MOF. The co-chair agencies, MFA and MOF, share the Secretariat responsibilities.

The functions of ICSC include:

- **To review and prioritize the project proposals** before submission to ASEM Committee
- **To monitor the implementation progress** of projects and activities under ATF
- **To provide the donors through the World Bank an updated Country Strategy Note** on an annual basis
- **To disseminate ASEM related information** to the Government agencies

5. To facilitate the work of ICSC, sub-committees or working groups may be established to review, prioritize, make recommendation to ICSC and monitor approved projects on behalf of and as assigned by ICSC. The joint Secretariat agencies are currently discussing the structure of the subcommittees/working groups.

6. Since its establishment, the ICSC has convened twice. First meeting was held in September 2002 to consider the Committee’s terms of reference, and to review the project proposals for ATF 2 round two. The second meeting was held in February 2003 to finalize ICSC’s terms of reference taking into consideration inputs form ICSC members during the first meeting, and to consider the 2003 Country Strategy Note.

Aligning ATF Strategy with Thailand’s Country Vision and Strategy

7. Despite the progress in restoring the economic stability in recent years, the reform agenda is still incomplete and important challenges remain. In the medium-term, Thailand aims to complete the structural reforms, and lay the foundation for greater social protection, lessen inequality and further reduce poverty incidences to enhance the country’s competitiveness position in the global market and sustainable economic growth. Based on this, Thailand’s development vision has been articulated by the RTG with the objective to improve the fundamental in the country’s political, economic and social fabric. To realize this vision, Thailand has formulated a national development agenda and priority area – built around four pillars:

- ***Human and Social Capital***, particularly education reform has been highlighted as a top priority, with emphasis on quality of schooling and enrollment rates in higher education.

- **Competitiveness** has emerged as a key concern after the crisis. This challenge goes beyond restructuring the financial and corporate sectors and building infrastructure; it includes strengthening innovation systems, moving to a knowledge-based economy, and enabling business environment, especially for the SME sector.
- **Poverty and Inequality** has been structurally persistent and worsened during the crisis. Because economic growth alone will not be enough to address this challenge, more balanced development and better-targeted support are needed to address remaining geographical disparities.
- **Natural Resources and Environment** have come under stress due to Thailand's rapid economic development. Their management was overlooked in the high-growth years, but natural resources and the environment have now emerged as key policy priorities.

Across these four pillars, *governance* is the underlying theme – a foundation for sustained progress along the above four priority national agenda. Progress on governance is required for the public and private sectors, as well as civil society, and encompasses greater transparency, accountability, and decentralization.

8. To implement the country vision, Thailand has adopted a strategy to engage in a true development partnership with its partners in knowledge sharing and policy advice on structural reform. The partnership structure also calls for contributions from both sides of the partnership, and Thailand is readily willing to provide either a cash or in-kind contribution to match its partners. However, in some cases where there is a budgetary gap, financial support remains an important part of this partnership.

ATF2 – Approved Programs and Status of Funded Programs

9. The provision of ASEM TF 2 (ATF2) extended the reach of the unfinished reform agenda, with the same focal areas as in ATF1 on the financial and corporate sectors, as well as the social protection and poverty alleviation. ATF2 also aimed to generate sustainable economic recovery and laying the foundation for a medium-term growth. Round one of ATF2 (2001) provided three grants for a total of US\$982,000. To support three key projects – two programs in the area of social protection and poverty reduction, and one program in the area of financial/corporate sector. Round two of ATF (2002) provided another three grants for a total of US\$2,971,600. To support three reform programs – public sector governance and social service delivery, social protection, and financial sector. To date, a total of US\$3,953,600 has been approved under ATF2 for Thailand.

Table 1: Programs funded under ATF2 and status (as of January 23, 2003)

	ATF 2 Type	TF Project Name	Effective Date ⁵	Task Manager	Grant Amount '000	Total Disbursed	% Disbursed	Closing Date
1	Rd 1	Capacity Building & Strategy for Poverty Reduction	6/4/02	Kaspar Richter	207.00	20.70	10%	6/30/03
2	Rd 1	Capacity Building & Strategy for Poverty Reduction	6/4/02	Kaspar Richter	375.00	60.58	16%	6/30/03
3	Rd 1	Out-of -Court Mediation Capacity Building Project	7/17/02	Tanatat Puttasuwan	400.00	40.00	10%	9/30/03
		Round 1 Sub-Total			982.00	121.28	12.4%	
4	Rd 2	Strengthening Governance & Social Service Delivery Through Public Sector Reform	Not Active	Sethaput Suthiwart-Narueput	996.60	0	0%	
5	Rd 2	Strengthening Social Protection	Not Active	John Blomquist	985.00	0	0%	
6	Rd 2	Strategy & Implementation for a Competitive Financial Sector	Not Active	Thomas A. Rose	990.00	0	0%	
		Round 2 Sub-Total			2,971.60	0	0%	
		Total			3,953.60			

10. Given the projects under Round One only became effective in June and July 2002, the implementation progress of all three projects are on going and there is a possibility of the extension of the closing date. As of January 23, 2003, total disbursements amounted to US\$121,280, or 12.4% of the total approved amount. While it is still too early to assess the overall impact of the projects, the Implementation Status Report (ISR) for the period ending December 31, 2002 showed that all three projects were making good progress toward the development objectives as articulated in the project proposals.

11. The three projects under Round Two were approved by the ASEM Committee on November 1, 2002. At the time of this writing, the Grant Agreements are being prepared by the Task Managers in cooperation with the Bank's Legal Department. It is expected that the Ministry of Finance will countersign the Grant Agreements within the second quarter of 2003.

Programs to be Funded (In the pipeline)

12. The In-Country Steering Committee (ICSC), at the time of ATF2 Round Two submission, undertook a review of proposed programs and identified possible programs to be funded in the next round of ATF2. The so-called "projects in the pipeline" were considered based on: (1) Thailand's unfinished reform agenda and national development vision; (2) the country ownership to the projects as evidenced from the development objectives, how the projects were conceived and prepared, readiness of the implementing agency, and the project

⁵ Effective Date is the date to which the Grant Agreement is countersigned by Ministry of Finance

design to achieve maximum development impact; (3) the linkages and relations between Thailand’s development agenda and World Bank’s Country Partnership for Development Framework; and (4) the dynamics between the implementing agency and Bank’s staff or sector unit in providing relevant advice and guidance to the enhance the quality of the projects. The following projects were identified as possible recipients of future ATF support.

Focus Area	Project	Implementing Agency	Proposed Amount
Environment	Municipal Capacity Building for Cleaner Production	Ministry of Natural Resources and Environment	\$310,000.
Environment	Northeast Poverty Reduction & Environmental Management	Ministry of Natural Resources and Environment	\$500,000.
Competitiveness	Strengthening Technological Capability and Innovation for Competitiveness: The Cluster Approach	NSTDA	\$299,000.

On the regional level, the following proposed projects would be evaluated for the next round of ATF2:

- **Enabling Rural Economy in East Asia** (\$353,000.), EASRD – Thailand, Philippines, and Vietnam
- **Improving Information and Analytical Capacity for Monitoring and Evaluation of Human Development** (\$1,000,000.), EASHD – China, Indonesia, Philippines, Vietnam, and Thailand

Vietnam: ASEM Country Strategy Note

March 2003

1. ASEM Trust Fund resources have become an important source of technical assistance for Vietnam, addressing the key areas of corporate restructuring (state enterprise reform), banking reform, social policies and social protection. Vietnam has benefited from seven grants under ASEM TF1, ranging from US\$100,000 to US\$1.8 million, for a total of US\$5.8 million. Under ASEM TF2, three country-specific and one regional grant are under implementation while three other country specific grants are pending formal signature by the Government. The overall country-specific commitments for Vietnam under ASEM TF2 amount to US\$3.25 million. It is envisaged that the total amount available for Vietnam under ASEM TF2 will be in the same order as under ASEM TF1 with a \$5.5 million allocation for Vietnam specific grants and the chance of receiving funds from the regional allocation. ASEM partners and the World Bank have agreed on two key priorities for funding under ASEM TF2:

- **Financial and corporate sector restructuring**
- **Interventions** to re-orient sustainable poverty reduction efforts

2. This note set out priorities for future ASEM TF2 grants based on the main challenges Vietnam is facing for the coming decade. Furthermore, it reviews the impact and lessons from ASEM TF1 and takes stock of grants under implementation under ASEM TF2.

Recent Developments Relating to ASEM TF

3. The fourth Asia-Europe Meeting was held in Copenhagen on 23-24 September 2002. The Heads of State and Government of ten Asian and fifteen European nations and the President of the European Commission, with the Prime Minister of Denmark acting as President of the Council of the European Union, attended the Summit. Leaders, recalling their previous Summits in Bangkok (1996), London (1998) and Seoul (2000), held comprehensive, in-depth and fruitful discussions on a variety of issues of common interest and concern. Leaders underlined that the ASEM process, encompassing peoples of various cultures and from different civilizations, is an asset in international relations that merits further development

4. Leaders addressed economic and financial priorities in the context of the global economic situation and reiterated their firm intention to revitalize their economies after the transitory shock of September 11. They sent a strong political signal confirming their commitment to enhance economic relations between the two regions, thereby contributing to achieving sustainable growth in the world economy. The fifth Asia-Europe Meeting will be held in Hanoi, Vietnam, in the second part of 2004.

5. The ASEM Trust Fund was established following a decision of the ASEM Summit in London. It was part of the 2-prong ASEM response to the economic crisis that hit Asia in mid-1997. The second prong was the trade pledge. Since the start of the East-Asian economic crisis, the Government of Vietnam has been undertaking important policy measures that helped put the economy back on a medium term growth path. The ASEM TF1 grants played an important role

diagnosing and designing these policy measures

6. Confidence in the private sector has improved by the adoption of a detailed reform program in 2001. New private businesses are currently being established at a rate of 1,600 per month, and in early-2002 a special meeting of the Party Central Committee gave the strongest endorsement of the private sector ever. Investors are reacting positively to the reform announcements and commitments made by Vietnam. The country is getting better grades from sovereign risk rating agencies and the macroeconomic situation is stable. Despite an unfavorable external environment, in terms of demand and prices, exports can be expected to pick up as a result of trade liberalization efforts. The Vietnam US bilateral trade agreement has been a catalyst to export growth with an increase in exports to the US of nearly 150% from 2001 to 2002 to US\$ 2.4 billion. Exports to the European Union have more than doubled to US\$ 3.1 billion since 1997 making the European Union the largest trading partner for Vietnam.

7. This favorable outlook, combined with Vietnam's remarkable long-term growth potential, suggests that the effects of the East Asian crisis are over. A period of high GDP growth rates, possibly in the order of 7 percent per year, is likely. As in the 1990s, Vietnam could be entering a new phase of prosperity. This upbeat assessment of the macroeconomic prospects should not lead to complacency, however. Vietnam is moving towards a socialist-oriented market economy and the Government has made an impressive series of commitments. Now what matters is implementation. Also, the previous phase of rapid growth was characterized by a dramatic reduction in poverty. The poor represent 37 percent of the population in 1998, compared to 58 percent five years earlier. The question today is: will this new phase of rapid growth be as pro-poor as the previous one?

8. Vietnam is committed to socially inclusive development. The Comprehensive Poverty Reduction and Growth Strategy (CPRGS) completed in May 2002 translates a vision of transition towards a market economy with socialist orientation into concrete public actions. It aims at full openness to the global economy over the coming decade, and the creation of a level playing field between the public and the private sectors. It emphasizes that the transition should be pro-poor, and notes that this will require heavier investment in rural and lagging regions, and a more gradual reform implementation than is often recommended by international advisors. It gives strong emphasis to poverty reduction and social equity, and to a more modern system of governance. The CPRGS is a product of the government of Vietnam, involving all of the relevant agencies and sectors in its preparation. Such ownership and determination are very good augurs. But the task of implementing the CPRGS should not be underestimated.

Impacts and Lessons from ASEM TF1

9. The European Commission organized a workshop in Bangkok in March 2002 to initially evaluate outcomes from the ASEM TF1 which was setup to mitigate the social effects of the East-Asian crisis and to prevent such crisis from appearing in the future. The commission had prepared an evaluation report as input to the workshop. The report concluded that the fund over the four-years had made a useful and, at times, significant contribution to ameliorating the effects

of the post-1997 socio-economic crisis in South-East Asia, and had helped to build resilience and capacity as the region looks towards the future.

10. The report concluded that, out of the four countries evaluated, Vietnam had made the best use of ASEM TF1 funds with outcomes that will have long-term benefits through improvements to the structural reform agenda. The conclusion was reached in spite of all but one of the grants having to be extended due to a consistent failure to make allowance for the time it takes to get projects formally approved and ready to start implementation. Overall the ASEM portfolio for Vietnam rated satisfactorily with just one (out of 7) under performing projects.

11. By now, all seven ASEM TF1 projects for Vietnam are completed. The trust funded activities all supported priority Government activities, while being directly in line with the ASEM Trust Fund's own focal areas. ASEM TF1 technical assistance grants have helped bring much needed external expertise and have also exposed the Vietnamese policy makers to other countries' reform experiences. In addition, the grants' have financed studies and other analyses of issues specific to Vietnam to ensure that reform measures are tailored to Vietnam's needs. The trust fund interventions have catalyzed analytical work and fueled policy change in important ways, as illustrated by the examples discussed below.

12. **State-owned Enterprise (SOE) Reform.** ASEM TF1 grants of more than US\$2 million (together with Danish, Australian, British, and Japanese grants of US\$12 million) have supported the formulation and initial implementation of the SOE reform program in Vietnam. The support was provided to the National Steering Committee for Enterprise Reform and Development (NSCERD) and the SOE Reform Department of the Office of the Government, which are charged with developing overall policy, as well as with coordinating and monitoring implementation. Some support has also been provided to line ministries, such as the Ministry of Industry, the Ministry of Construction, the Ministry of Agriculture and Rural Development and the Ministry of Transport, as well as peoples' committees charged with implementing SOE reform.

13. The trust funds supported each recipient agency in designing strategies to implement their SOE reform plans; for example, testing alternative legally feasible methods of divestiture; improving the equitization process; identifying different ways of dealing with excess labor; advising on the NSCERD policy framework and operational modalities; assisting in launching the public information campaign regarding SOE reform; and building capacity through on-site training.

14. One of ASEM grants supporting SOE reform fund dealt specifically with enterprises under the Ministry of Transport (MoT). For this particular fund two separate workshops were conducted in Hanoi, one in mid-May 2001 and another in late-June 2001. The first workshop covered the results from the consultant's preliminary review of financial data provided for each of the Ministry's SOEs, focusing on aggregate financial performance and trends in financial performance by Corporation/company group. This workshop also introduced issues associated with the classification of SOEs, and discussed a preliminary framework for SOE classification. The second workshop focused on reform options for the Ministry's SOEs, and developed further

a reform classification and prioritization schema that could be applied by the MoT. SOE restructuring in the transport sector is still very slow despite funding from this grant.

15. **Banking Reform.** The State Bank of Vietnam (SBV) and the government of Vietnam are undertaking a significant reform of the financial sector and the implementation of detailed bank restructuring plan is the next critical step in the bank reform program. Three grants under ASEM TF1 supported these reforms by undertaking activities that can largely be split into the following areas:

- **Restructuring State-owned Commercial Banks'**
 - Advisory services for pre-audit work
 - Advisory services to implement restructuring plans
- **Restructuring Joint-stock Banks (JSBs)**
 - Assessment of 5 JSBs
 - Review of risk management procedures and techniques
 - Help in establishing a management information system
 - Risk Management training
- **Creating the institutional framework for asset resolution and disposition**
 - Establishing national Asset Management Companies (AMCs)
 - Training and workshops on AMCs.
 - Study tours to USA, Canada and Poland.
- **Accounting, Credit Reporting and Supervision and Corporate Governance for Financial Institutions**
 - Review and development of key functions for a Credit Bureau
 - Workshop on Credit Bureau
 - Bank corporate governance training
 - Review of the Banking sector legal and regulatory framework

16. **Social Equity and Inclusion.** Two types of activities were funded by ASEM TF1 grants aimed at improving social equity and inclusion. The first related to the development of “social safety nets” for workers that would be declared redundant by SOE reform. The ASEM grant permitted detailed analytical and empirical work for developing a “voluntary” redundancy package tailor-made to Vietnam’s conditions. Using data from the Vietnam Living Standard Survey (VLSS), the size of the redundancy package was based on the calculated loss of lifetime-earnings arising from loss of an SOE job. This package was expected to ensure that it would be accepted voluntarily, thereby reducing the extent of resistance to redundancy. Two workshops were held (in May 1999 and June 2000) to disseminate the findings and to generate consensus on the package and on the design of the “social safety net” for SOE workers. The ASEM TF1 grant for this work has been highly appreciated by the Government of Vietnam. It has enabled a process that brings together many different stakeholders—central Government agencies, provincial governments, SOEs, labor unions, and others—to develop a shared understanding of how best to approach this very sensitive issue in Vietnam.

17. The second grant was aimed at the rural poor. This grant was executed by the Ministry of Planning and Investment (MPI) to support preparation of a targeted poverty reduction project. The grant funded technical assistance and essential equipment for MPI to prepare a project that provides small grants to about six hundred of Vietnam's poorest communes. (IDA has provided a credit, called the Community-based Rural Infrastructure Project, of US\$ 103 million to Vietnam to support this small grants program). The grants are to be used to fill gaps in essential public infrastructure, create employment in remote areas, and help establish a demand-driven approach to project planning and implementation. Essential public infrastructure includes basic community access (roads and bridges), primary schools, health centers, water and sanitation systems, and electrification. The communes that will benefit from the small grants program are in remote areas with populations dominated by ethnic minorities. Without such targeted assistance, these poor communities would have to wait a long time for their essential infrastructure needs to be met. Between August 1999 and June 2001, this grant supported preparation of the IDA credit with 16 consultancies, six workshops (five of them in the field), and two study tours to comparable projects assisted by the World Bank elsewhere in the region (Indonesia and the Philippines).

The six key products of the consultancies were: a social assessment; a training needs assessment, a project field manual (that provides detailed and practical guidance on project implementation); a project implementation plan; the project's management information system (MIS); and the Government's own project feasibility study (approved at the level of the Prime Minister).

18. The first round of ASEM projects is now closed. Some of the key lessons they provided are:

- **The process of activating the grants and executing the procurement process has taken a long time.** Many of the recipient agencies had not executed World Bank projects before, resulting in a steep "learning curve" to be overcome in implementing ASEM TF grants.
- **Once underway, the ASEM TF grants are proving very effective in helping Vietnam to access the much-needed external expertise in funding analytical and empirical work** that help to tailor reform measures to Vietnam's specific conditions and to disseminate findings from studies to a wider set of stakeholders in the country.

ASEM TF2 Priorities for Vietnam

19. The Vietnam Development Report 2002 identifies the following three challenges for implementing the CPRGS. The first one is related to further progress in economic reform. Over the last three years, the government of Vietnam has made an impressive series of commitments, and approved a vast number of initiatives aimed at accelerating the transition to a market economy. But these efforts have proceeded at an uneven pace, and some of them may be on a collision course. Fast progress in liberalizing foreign trade and integrating with the world economy is increasingly at odds with the slowdown of state-owned enterprise reform. There is a risk that the unreformed enterprises, once confronted with competition in product markets, will

try to shift the burden of their inefficiency to other sectors of the economy, either through explicit transfers or through arrears in the service of their debts. Equally important, decisions are increasingly implemented at the local level. The uneven progress in private sector development across provinces illustrates the difficulty to align concrete policy-making at the local level with the commitments and orientations of the government as a whole.

20. The second important challenge faced by Vietnam concerns poverty alleviation. The phase of prosperity that followed *doi moi* was remarkable in that it was not accompanied by any noticeable increase in inequality. Aggregate inequality indicators such as the Gini index remained basically unchanged over the 1990s. More disaggregate analyses show that the poor did better than the rich, in relative terms. The combination of fast growth and stable inequality explains the accomplishments of Vietnam in terms of poverty reduction. However, in the absence of vigorous action inequality is likely to increase, maybe substantially, during the new phase of growth. This is because the poverty effects of land redistribution in rural areas are probably reaped by now. At the same time, integration with the world economy will make skills more valuable, so that inequalities in education will translate into increasingly bigger inequalities in opportunities and earnings. The gap between urban and rural areas will widen, as will the gap between those who can fully benefit from globalization and those who are left behind.

21. The third challenge faced by Vietnam, and certainly not the smallest, is improving the quality of its governance. It will not be possible to address the other two challenges without an effective public administration, endowed with the appropriate financial management instruments. Implementing the structural reforms and improving the outcomes in the social sectors are tasks requiring a government that can deliver in practice. But the legal framework, the budgetary system and the administrative structure of Vietnam are partly inherited from the period with a centrally planned economy, and not well adapted to its current needs. This mismatch is a source of economic inefficiency. If Vietnam fails to address its governance problems, and lets the vested interests capture government transfers to offset their inefficiencies, the new phase of prosperity could later be seen as “borrowed growth”.

22. The ASEM TF2 should help address these challenges by following-up and deepening work launched in the areas of corporate and state-enterprise restructuring, banking reform, as well as the broader implementation of Vietnam’s CPRGS. Banking reform and state-enterprise restructuring will be central to Vietnam’s growth and poverty-reduction objectives for the next three to five years. Some of the most difficult challenges ahead concern the large stock of non-performing loans (NPLs). The lack of a timely solution hampers the creation of a sound credit culture and limit enterprises access to investment finance. Banking and state-enterprise reforms also play a crucial role in ensuring that Vietnam’s domestic debt situation remains sustainable in the medium term. Designing and doing the diagnostic work underpinning these reform measures requires technical assistance both from ASEM TF2 and other donors. In addition, targeted poverty reduction interventions are needed to offset the likely increase in inequality associated with future growth.

23. The European Commission’s Country Strategy Paper for Vietnam for the period 2002 to 2006, endorsed by the European Union Member States, has as its twin focal points support for

Vietnam's human development and assistance to Vietnam in its integration into the international economy. The priorities of the strategy are coherent with those of the CPRGS and with the ambitions of the ASEM TF2.

Status of Programs funded under ASEM TF2

Banking reform –Twinning arrangement for BIDV (TF050454)

24. Since the late 1980s, important changes have occurred in the structure, the regulation, and the operations of the Vietnamese banking sector. Four large state-owned commercial banks still account for 73 percent of the total assets in the system. But a number of joint-stock banks, joint-venture banks, and branches and representative offices of foreign banks now complement them. Over the past decade the four large state-owned commercial banks slowly have started to evolve from specialized policy lending vehicles to more commercially oriented financial intermediaries, with the greatest progress seen in 2001 and 2002. The restructuring of the SOCBs continues to be a critical component of the Government's financial sector strategy and one of the key policy actions of the first Poverty Reduction Support Credit (PRSC) to Vietnam.

25. The State Bank of Vietnam (SBV) has identified the following important developmental areas for the SOCBs as part of the overall banking sector reform strategy:

- **Annual financial and portfolio audits** based on international accounting standards
- **Operational restructuring** to reduce operating expenses,
- **Development of internal control systems** and corporate governance structures,
- Improvement of management information systems,
- **Implementation of procedures and policies** to resolve specific non-performing loans (loan work-out units),
- **Development and implementation of policy, procedures and manuals** for core banking functions such as credit analysis, portfolio review, market risk management, asset and liability management,
- **Improved training for managers on best international commercial banking practices**, and:
- **Preparation for the partial equitization of the SOCBs** on a pilot basis.

26. Restructuring plans, including the areas mentioned above, are now in place at all SOCBs and ASEM and other bilateral donors are providing financing for their implementation. Prior ASEM grants for the banking sector have been used to engage legal and financial consultants to assist SBV, SOCBs and Joint-Stock Commercial Banks (JSCBs). The work has included the definition of the Government's overall banking sector strategy, the development of resolution mechanisms to tackle the substantial stock of non-performing loans in the banking system, the development of a legal framework to support the banking reform program, the financial assessments of joint stock banks, and, direct technical assistance, including diagnostic studies, for each one of the SOCBs for the development and implementation of their respective restructuring plans.

27. This particular ASEM grant (Banking Reform Program - TF050454) will finance Technical Assistance for BIDV as required for the implementation of their Restructuring Plan. A previous ASEM grant (Vietnam State-Owned Commercial Bank Restructuring- TF027944) financed similar technical assistance for Incombank's and the Netherlands is currently financing the twinning arrangement¹ for Vietcombank.

28. Implementation of this grant started in August 2002 and its main objective is to provide BIDV with the required Technical Assistance for the implementation of their restructuring plan in areas such as organizational structure, designing processes and procedures for NPL resolution and credit risk management, among others. The grant will also finance training activities aimed at improving the capacity of management and staff. The hiring of the banker/ consultant to help with the twinning arrangement is now in its final stages and the contract is expected to be signed in early March.

Social Safety Nets (TF050280)

29. The restructuring plan for state-owned enterprises could lead to about 250 thousand job separations between 2002 and 2005. Decree 41/2002/ND-CP, of April 2001, established the Social Safety Net (SSN) fund to support the workers made redundant because of the reform program. The fund gets its resources from the government budget and from concessional external resources provided by donors. It became fully operational in October 2002, after the corresponding regulations were issued. The ASEM TF1 grant for the SSN (TF020714) helped analyse labour market impacts of State-Owned Enterprises (SOE) Reform and helped the government of Vietnam to design relevant severance packages and training programs for retrenched SOE workers.

30. The fund is intended to assist redundant workers who were on long-term contracts when the restructuring of state-owned enterprises was launched in 1998. Assistance takes the form of a compensation package and support for re-training. In order to mitigate the adverse impact on the workers and to encourage voluntary separations, the package is much more generous than the one stipulated by the Labor Code. The obligations of state-owned enterprises towards their workers are not modified. But the fund provides additional support amounting to one month of basic salary per year of service, a 5 million Dong lump sum, and an additional six months of basic salary for seeking a new job.

31. This package was designed based on an analysis of the earnings of workers who are "similar" (in age, skills, region of residence etc.) to those in state-owned enterprises, except that they are self-employed, or work in the private sector. The lump-sum component, in particular, was aimed at favouring female workers, who would otherwise get much smaller packages than males because of their lower salaries. Funding for re-training for up to six months is provided as

¹ A Twinning Arrangement means having a banker or consultant working side by side with staff and management from the SOCB on all areas requiring technical assistance to restructure the bank through the use of modern banking practices and procedures, as well as hands-on training. This is a more comprehensive approach than having a series of consultants working independently on each of the areas that require improvement to restructure and modernize the SOCB.

well. Workers rehired in state-owned enterprises have to reimburse the assistance they received to the fund. The fund also assists workers who opt for early retirement.

32. Twenty state-owned enterprises applied for support from the fund within its first month of operation. Among the enterprises submitting all the documentation required, the average redundancy rate was 25 percent. But it ranged between 13 and 67 percent depending on the enterprise.

33. This ASEM TF2 grant supports the government of Vietnam to implement the SSN for retrenched SOE workers and monitor the SSN Fund's operation. It provides technical assistance to build an efficient monitoring system right from the inception of the SSN Fund. The project will help to train government staff who are in charge of assisting the redundant SOE workers to better understand the Fund's procedures. A survey of retrenched workers will also be supported so that the government can monitor the SSN Fund's performance using proper methodological guidelines.

34. The project has the following two components:

- **Assist the government to design and operate an efficient monitoring and evaluation system** right from the inception of the Fund to help assess its impact. It helps government officials from the Ministry of Finance to prepare manuals, to provide on-line help and consistent guidance on making payment to the right workers, and to make information available to the public. A unit to work with the consultant team has been set up. Part of the information system including data on supported SOEs and their retrenched workers is currently being developed. A survey of separated workers is scheduled to take place in May 2003, after the first year's operation of the fund, in order to assess their situation as a result of job loss and to evaluate the adequacy of the assistance provided. A key output from the M&E system will be an assessment report for the operation and effectiveness of the SSN Fund. Findings and recommendations from these reports will be used to fine-tune policies.
- **Develop capacity within government administrative system to implement SSN in an efficient and timely manner** through training government staff who are in charge of assisting the redundant SOE workers on the fund's procedures and management. This activity has been completed.

Strengthening Community Driven Development (TF050255)

35. The Government of Vietnam has stepped up its already well-established financial support for social equity and targeted poverty reduction through its Hunger Eradication and Poverty Reduction Program (Program 133) and its Program to Assist the Poorest Remote and Mountainous Communes (Program 135).

36. Support for about 1,100 of Vietnam's poorest communes is being provided by two IDA projects: the Community Based Rural Infrastructure Project (CBRIP, providing a credit of about

\$100 million in 13 provinces of central Vietnam) and the Northern Mountains Poverty reduction Project (NMPRP, providing a credit of about \$100 million in 6 provinces of Vietnam's northern mountain region, co-financed by the United Kingdom, DFID). These regions are home to the highest concentrations of poverty in Vietnam and the greatest numbers of poor communes, including many ethnic minorities. Both projects support capacity building for CDD and labor intensive provision of essential small-scale public works.

37. In addition, international donors and NGOs are also supporting or planning to support targeted rural CDD in several other provinces. Notable among these are the European Union (in four northern provinces), Belgium (in five south-central provinces), and Finland (in two provinces), plus Oxfam GB and CIDSE from the NGO community. Other donors proposing to support CDD in Vietnam in future years include the Asian Development Bank, Australia and Canada. Despite a huge pool of experience, the Government lacks the capacity effectively to assess and evaluate CDD, learn lessons, disseminate findings and shape policy based on experience. The potential for a sector-wide program is untouched. Improved knowledge sharing and donor coordination would benefit Government and its current and prospective CDD partners.

38. A forum for exchange of information with government about CDD in Vietnam's poorest communes was established by the Bank, ADB and UNDP in 1999. Since then, it has attracted numerous other donors and NGOs and it meets monthly. However, without the technical assistance from this grant the forum cannot grow from being an informal forum for exchange of information to a mechanism for analysis of lessons learned in different types of CDD, a force for dissemination, a medium for more effective coordination and an influence on future policy directions. This grant finances the needed TA to establish a central monitoring and evaluation system on CDD experience. It will bring analysis and assessments of the results of CDD experience and provide grounds for information sharing and dissemination. Findings will help improve policies and projects targeted for poor communities.

39. The grant will establish a small professional team to coordinate lessons learned from community driven development (CDD). Lessons and findings will be discussed and disseminated through the Partnership to Assist the Poorest Communes (PAC), a forum established in 1999 to bring government, donors and NGOs together to support (CDD). The team will support PAC's secretariat. The core group has been established and short-term consultants have been hired. The concept paper has been discussed in a plenary meeting. The process for hiring long-term consultants is in its final stage and overall progress has been rated satisfactory.

Education budget processes

44. The technical assistance under this grant builds on the activities undertaken by the government of Vietnam with the support from DFID, EU and UNDP and the World Bank. The project has three components. First, it will evaluate the current budget practices and the new initiatives that are being piloted by the government of Vietnam. Specifically, the grant will allow the Ministry of Education and Training (MOET) and related government agencies to:

- **Align provincial planning and budgeting procedures with pro-poor spending;**

- **Assess the implications of the Government's Decree 10** (financial management of revenue-generating public institutions) with respect to efficiency gains as well as the impacts toward the vulnerable service users;
- **Evaluate the experience of the government trial of block grant financing** and its implications for the annual and medium term budget processes. The second component will be built on foregoing analysis that helps MOET and other ministries such as Ministry of Finance (MOF) and Ministry of Planning and Investment (MPI) to:
- **Evaluate the pilot education medium term expenditure framework** and its applicability to the education sector budget;
- **Identify opportunities to strengthen the link between the annual budget and the public investment program;** and
- **Propose revisions and new funding mechanisms** in the application of the budget to education that mainstream poverty and efficiency objectives. Finally, the TF serves as a tool to strengthen MOET's capacity in coordinating all efforts that aim at improving the education budget processes.

45. The Grant Agreement for this grant will be sent to the Government in early March 2003. Preparatory work, financed from other sources, has already started. A review of ongoing work has been undertaken in conjunction with the ministries of Finance, Planning and Investment, and Education and Training. The review showed that there were multiple, but unconnected, initiatives that touched on the budget process at the macro and the sector levels, but that the vertical connection of these different initiatives and their integration into a coherent system had not been made. There was both an opportunity and a need to connect up this work at the national, sector, provincial and institutional levels and build such a coherent integrated system. Accordingly, a work program is being designed to link key ongoing programs and to fill-in any gaps. This program will effectively place the education planning and budget process in the forefront as one, if not the main, sector piloting the government's overall budget reform process and should lead to the development of an education medium term expenditure framework, a revised and modernized planning, budget, and resource distribution tool and improved capacity in both the sector ministry and provinces.

Monitoring transformations of SOEs (TF051834)

46. The proposed technical assistance builds upon previous work undertaken in this area including resources from previous ASEM grant (TF 22398). Specifically this grant will support the work that is being done to consolidate data obtained from over 1,000 sources so that both the Government and donors will have a clear view of the progress being achieved with State Owned Enterprise reform. This work is important because:

- **SOE reform** is a key component of Vietnam's structural reforms;
- **It will make it easier to address gridlocks** in the reform process in a timely manner; and
- **On a technical level, it will make it possible to monitor the implementation of agreements** between the Government and donors on SOE reform. The Grant Agreement for this grant was sent to SBV on February 10, 2003 and is awaiting Government's formal approval.

Banking Sector Regulation, Supervision and Development

47. This technical assistance builds upon the activities already undertaken with resources from previous ASEM grants and activities financed with resources from several bilateral donors. Specifically, this grant support the following activities:

- **Re-evaluation of the State Bank of Vietnam's (SBV) organizational structure** aimed at improving its supervisory capacity;
- **A review and update of selective banking sector laws and regulations;**
- **The definition of measures needed to accelerate the development of the banking sector** including, the need to level the playing field and widen access to credit; and,
- **The introduction of an enhanced operational environment** based on international best practice to improve the competitiveness and profitability of the banking sector. For this grant the World Bank is working with SBV to finalize the procurement plan. SBV is preparing their comments to the plan. As soon as it is finalized the Grant Agreement can be sent to Government for signature and formal approval.

Building Capacity for Decentralised Financing and Delivery of Services

40. This is a regional grant that Vietnam is benefiting from. The challenge of decentralization is that it can be done well or badly. If done well, the benefits of decentralization can be enormous: empowerment of citizens; improved economic growth, creation of new tools for developing human capital, and a potentially powerful tool for poverty alleviation. However, these benefits can be achieved only if governance capacity is developed at local and central government levels. But, if decentralization is done badly, it can lead to macroeconomic instability, corruption, and collapse of the safety net. So, whereas decentralization can help revolutionize prospects for human development, it could also lead to chaos and increased human suffering.

41. In East Asia, decentralization is often a key element of broader reforms to strengthen governance. The Philippines first embarked on intergovernmental reform, with the enactment of its far-reaching Local Government Code in 1991. In 1994, as a response to the pressures of globalization and to manage the transition from a command to a more market-oriented economy, the Peoples Republic of China initiated a comprehensive fiscal reform program, which has profoundly affected the balance of powers between central and local governments. The new Thai Constitution (passed in 1997) mandates decentralization to local administrations. In what many agree is a strategy to use intergovernmental reform to achieve national-cohesion, Indonesia initiated in 2001 a new system of decentralization that will cover nearly all aspects of fiscal and administrative management. In Vietnam, the new budget law transfers more budgetary discretion from the central level to provinces and districts.

42. How can decentralization achieve its promised benefits? One answer is to ensure that new and emerging local governments have the human and institutional capacity to carry out their decentralized (intergovernmental) responsibilities. Because most East Asian countries have historically operated in highly centralized environments, determining the appropriate

intergovernmental framework for decentralization and options (and their pros and cons) for decentralization policy are also critically important.

43. This grant focuses on establishing a proper framework for decentralization in the East Asia region (China, Indonesia, Philippines, Thailand and Vietnam), and developing a capacity building program on Decentralized Service Delivery and Financing. A core objective is to develop a region-wide program that combines traditional training with new technologies and partnerships (Global Distance Learning Networks, professional associations, etc.) to train the thousands of local officials who will be responsible for delivering and financing public services. Three activities are supported under this program:

- **Technical assistance to guide the design, implementation and evaluation of decentralization policies.** In Vietnam assistance is underway to review and assessing reforms in expenditure and revenue management, intergovernmental transfers, sub-national borrowing, sub-national taxation, and the new system of expenditure norms.
- **Various formal training and capacity building programs.** Counterparts from Vietnam (1) and Thailand (3) are participating in an international training program on Fiscal Decentralization at Georgia State University. Upon completion of the 3-week program, the counterparts will summarize what they learned and how they will apply it in their work.
- **Development of regional and global networks of government officials, academics and practitioners to share experience and knowledge.** A workshop on Intergovernmental Relations in East Asia (held in Bali, Indonesia, on 10-11 January, 2002). Participants: 33 central and local government officials, academics and practitioners from China, Indonesia, Philippines, Thailand and Vietnam. Presentations and roundtable discussions on: fiscal decentralization framework; local revenue mobilization; tax administration; intergovernmental transfers; borrowing & capital financing; participation and local democracy. Participants rated workshop's relevance to their country's needs at 4.5 (on a scale from 1 to 5)

Experience from the In-country Steering Committee

48. An in-country Steering Committee has been established for programming ASEM TF2 activities. Members of the committee include the Office of the Government, Ministry of Finance, Ministry of Planning and Investment and State Bank of Vietnam as well as representatives from the European Commission, the EU Presidency and the World Bank. The committee held its first meeting in September 2002. As expected it was time-consuming to setup the committee and agree on modalities for its composition and function. In the aftermath of the first meeting, all involved parties approved TORs. After the slow start-up this structure is expected to work smoothly and effectively in the future.

Attachment 1

VIETNAM

<p>Approved Activities under ASEM Trust Fund 2 Facility <i>March 2003</i></p>

	ATF2 Type	TF Project Name	Effective Date	Task Manager	Grant Amount '000	Total Disbursed	% Disbursed	Closing Date
1	Rd 1	Strengthening Community Driven Development	5/30/2002	Christopher J. N. Gibbs	419.00	106.99	25.5%	9/30/2003
2	Rd 2	Support for the Operation and Monitoring of the Social Safety Net for Redundant Workers	5/7/2002	Nga Nguyet Nguyen	342.00	200.26	58.55%	12/31/2003
3	Rd 2	Banking Reform Program	7/18/2002	Miguel Navarro-Martin	694.00	70.00	10.08%	12/31/2003
4	Sep-02	Banking Sector Regulation, Supervision and Development	TBD	Miguel Navarro-Martin	944.50	0	0	TBD
5	Sep-02	Poverty Reduction in the Education Budget Processes	TBD	Christopher P. Shaw	450.00	0	0	TBD
6	Sep-02	Monitoring of SOE New Establishment and Transformations	TBD	Igor E. Artemiev	400.00	0	0	TBD
		TOTAL			3,249.5	377.25	11.6%	