

IDA AT WORK

Vietnam: Laying the Foundation for Sustainable, Inclusive Growth

Vietnam is one of the fastest growing economies in the world. It is going through a far-reaching transformation from an inward-looking planned economy to one that is globalized and market-based. It has the potential to be one of the great success stories in development.

Country Indicators	1993	2007	2008 (est.)
GNI per capita (Atlas Method, US\$)	170	790	910
Inflation (CPI, annual rate, %)	8.4	12.7	19.9
External debt (% of GNI)	191	34.3	33
Poverty incidence (% of population with consumption below basic needs level)	58	15.9 (2006)	14
Net primary school enrollment rate (%)	77 (1990)	97 (2006)	n/a
Under-five child mortality rate (per 1000 live births)	53 (1990)	25.9	n/a
Maternal mortality rate (per 100,000 live births)	200 (1990)	75	n/a
Population (millions)	70.3	85.2	86.2
Population growth rate (% per year)	2.0	1.2	1.2

Source: Vietnam, General Statistics Office; World Bank, Development Data Group.

Real income in Vietnam has grown 7.2 percent per year over the last 10 years. When the World Bank reengaged with Vietnam in 1993, income per capita was US\$170. In 2008, GDP per capita crossed the US\$1,000 mark. The poverty rate has fallen from 58 percent in 1993 to 16 percent in 2006. Vietnam can reach most of the Millennium Development Goals.

Vietnam is a major recipient of IDA resources, although it is not an aid-dependent country. The World Bank is the coordinator of foreign aid to Vietnam because of the large volume of resources it mobilizes and especially because of the Bank's recognized technical expertise. This has led to a very effective dialogue on the policy reforms that underpin Vietnam's transition to a market-based economy.

COUNTRY ACHIEVEMENTS

Vietnam's development achievements have been remarkable.

By the mid-1980s, ravaged by war and a failing command economy, the country faced famine. The government launched a renovation process (*Doi Moi*) in 1986, with the goal of adopting market mechanisms wherever possible while preserving social inclusion.

An egalitarian redistribution of farmland, coupled with freer trade in agricultural products and better agricultural support services at the local level, led to a boom in farm exports and a dramatic reduction in rural poverty.

Foreign investment grew as the domestic entrepreneurial spirit was unleashed. Urban residents moved into paid employment, helping to reduce the number of rural poor even more.

Vietnam's economy expanded rapidly. It avoided the economic collapse that other transition economies went through in the early 1990s. It also managed to sustain positive growth rates during the East Asian crisis of the late 1990s and the more recent global financial crisis. In spite of the slowdown associated with the latter, Vietnam is now entering the group of middle-income countries.

An institutional overhaul

Vietnam's development strategy involves comprehensive reforms across all policy areas, so as to ensure business development, preserve social inclusion, manage natural resources and strengthen governance. How-

ever, reforms have not progressed at the same pace across all areas.

Much has been accomplished in relation to public financial management. Increased decentralization, improved transparency, a growing role of the National Assembly in deciding appropriations and strengthened auditing mechanisms are all part of this process. The gap between budget plans and budget execution remains large, however, and the management of public investment projects needs to be strengthened.

The introduction of common regulations and models of corporate governance for all enterprises, regardless of their ownership, has contributed to a level playing field. Private participation has been allowed in most sectors and in state-owned enterprises. State ownership in enterprises is now being transferred out of ministries and provinces, so that those in charge of issuing or enforcing regulations do not face a conflict of interest. Less progress has been accomplished in relation to large state-owned economic groups.

Progress has been most decisive in relation to global integration. Accession to the World Trade Organization (WTO) in January 2007 resulted in lower barriers to trade. Most importantly, it opened service sectors to competition and is resulting in a thorough revamping of the legal system.

Important measures have also been taken to fight corruption. Vietnam is a country where bribes and unofficial payments put a burden on households, even if they tend to be modest by enterprise standards. An effort is underway to simplify administrative procedures and reduce red tape. Government systems are

being strengthened in the most vulnerable agencies, including construction, customs, tax administration and land administration. A mechanism to monitor the assets of senior civil servants has been implemented.

On the other hand, progress has been slower in financial sector reform. While the stock market and the insurance sector have developed considerably, Vietnam is still in the process of establishing a modern central bank and upgrading its capacity to supervise commercial banks and monitor international capital flows.

Private sector-led growth

The transition to a competitive market economy is well under way, driving Vietnam's growth and increasing its resilience.

Formal private enterprises, whose activities were negligible in 1993, now account for two-thirds of the investments made each year. When faced with increased domestic and international competition and a harder budget constraint, state-owned enterprises have done reasonably well.

The equitization process cut the number of state-owned enterprises by more than half, from 3,786 to 1,546 over the past nine years, although not across all sectors. Starting with smaller enterprises and insider privatization, the process is now reaching large General Corporations and state-owned commercial banks. Remaining ownership rights by the state are being transferred out of ministries and provinces to avoid a conflict of interest between management and regulation.

As the private sector expands rapidly, both domestic and foreign-invested firms have

connected solidly with global markets. Private firms now contribute nearly 80 percent of manufactured products and over 70 percent of non-oil exports. Vietnam is more and more an integral part of international production and distribution chains.

IDA'S CONTRIBUTIONS

The International Development Association (IDA), the World Bank's fund for world's poorest countries has helped Vietnam fight poverty through finance for agriculture, infrastructure, health programs, and schools, among other things. The country has received US\$9.7 billion in interest-free credits, grants, and guarantees from IDA, the second largest provider of aid to Vietnam after Japan.

Still, Vietnam is not aid-dependent. Foreign assistance disbursements represent only about 15 percent of total public spending. Donors focus their efforts on policy dialogue, research, and investments in key development areas.

The Bank's partnership with Vietnam since 1993, has contributed to achieving notable results.

Supporting policy reforms

Policy dialogue arguably has had the biggest impact of all donor contributions as it underpins the reforms that are transforming the entire economic system.

Some work has directly affected the government's programs and policies. For example, community-driven development programs funded by the World Bank, with a strong emphasis on participation, resulted in a redesign of the national target program for

the most disadvantaged communes, which operates mainly in ethnic minority areas.

Eight poverty reduction support credits (PRSCs) have now been completed with the active participation of 20 donors¹ and co-financing by 13 of them. These credits have supported reforms across 17 policy areas, including trade integration; financial and state owned enterprise reform; infrastructure; social sector issues (health, education, social protection); natural resource management; and governance. Specific actions in each area were sequenced carefully to match implementation capacity and exploit synergies across sectors.

Building local capacity

According to the World Bank's latest client survey, knowledge and technical expertise are among IDA's greatest contributions. The approach has been to build government capacity to undertake its own research for its own purposes.

For example, while the Bank conducted Vietnam's first poverty assessment, the second was undertaken jointly with the government. Now the government is doing its own, with the Bank's advice.

In education, the Bank has helped build capacity in setting minimum standards for primary education (for example in teacher qualification), the quality of textbooks, and primary teacher competency profiles. These standards link to national budget allocations.

1. The 20 donors are: Asian Development Bank, Australia, Belgium, Canada, Denmark, the European Commission, Finland, France, Germany, Ireland, Japan, Luxemburg, the Netherlands, New Zealand, Norway, Spain, Sweden, Switzerland, the United Kingdom, and UNDP.

Some of the benefits of reforms supported by IDA credits include:

- The decision to bring strategic investors into all state-owned commercial banks.
- School quality standards that have improved the quality of teaching
- Land user certificates that list the names of both husbands and wives, thereby allowing women to use the certificates as collateral for bank credits
- A state budget plan disclosed to the public for the first time in 2005
- A State Audit reporting directly to the National Assembly and effectively auditing a growing number of state-funded entities
- A Unified Enterprises Law introducing the same set of corporate governance models for all enterprises, regardless of ownership.
- A National Target Program on adaptation to climate change and allocation of responsibilities for its implementation.
- Regulation issued in 2008 on charter for first "new model" university with academic, managerial and financial autonomy.
- A pricing system for electricity from renewable energy, and incentives for government procurement of energy-efficient equipment, effective in 2009.

Through a series of IDA education projects, including the Bank's first development policy credit for higher education in 2009, the government is scaling up these innovations geographically and through higher levels of the education system.

Several investment credits aim to revamp business processes in ways that improve efficiency in the use of public resources and increase transparency. They target the agencies more vulnerable to corruption, including customs, tax and land administration.

Providing good-practice models

Investment credits and technical assistance—for example, on river basin management or infrastructure—have provided demonstration effects, influencing government approaches at the technical and policy levels.

IDA expertise on phasing, sequencing, and working across sectors has strengthened the effectiveness of development aid. For example, in the context of the broader infrastructure development undertaken at the national and provincial level, the government has embraced projects that are driven by local communities rather than managed from Hanoi. Energy projects have opened the door to private participation in infrastructure. A credit to support schools in poor areas has led to nationwide standards on school quality and the regular auditing of schools against those standards.

IDA's impact is felt across sectors.

Transport: There have been remarkable improvements in rural access over the last few years. In 1998, little more than half the rural ethnic minority population of Vietnam lived close to an all-weather road. By 2006, 91 percent of the majority Kinh population and 80 percent of the ethnic minority population resident in rural areas were living within 2 kilometers (km) of an all-weather road. IDA has financed the rehabilitation of 1,000 km of Highway One—the country's main transportation artery—with another 350 km. It has also provided funds to improve 600 km of another 18 national highways and to perform preventive maintenance of 1,100 km of the national highway network. IDA has also helped build more than 7,000 km of district-level roads. As a result, **6 to 8 million people have bet-**

ter access to the transport system, speeding up their ability to reach markets, schools and health centers. In addition, IDA has financed the rehabilitation or dredging of 1,100 km of inland waterways in the Mekong Delta and a further 540 km is being improved in the Red River Delta.

Electricity: As a result of the government's rural electrification program, more than **93 percent of rural households now have electricity** compared with just over 50 percent 10 years ago. IDA helped design this overall effort and has supported the implementation of it through several projects. The first brought electricity to around 2.7 million people in poor rural areas and the second now under implementation will help connect or improve the supply for another 5.6 million. Already, this has transformed thousands of rural communities, enabling small businesses to grow and improving the services of schools and health facilities. IDA is also supporting substantial upgrades to the high voltage networks to support industrial development and to ensure that consumers get electricity in sufficient quantity and of acceptable quality for their needs. IDA is supporting wide-ranging reforms to the power sector, to ensure that it is attractive for investors and that the supply of electricity for economic growth is secure.

Education: The primary education net enrollment rate has increased from 81 percent in 1999 to 97 percent in 2006, and the primary **education completion rate from 72 to 91 percent** over the same period. While the government continues to promote equity and quality of education, especially primary education, significant gaps remain, most notably between majority Kinh and minority ethnic groups. IDA has facilitated improvements in the provision of primary school services

in the poorest districts: after four years of implementation, the rate of schools meeting minimum service standards increased at a rate nearly double the national average.

Health: IDA is contributing to improvements in the **quality of health care services for more than 20 million people** through three regional health support projects. IDA supports the implementation of the National Strategy on HIV/AIDS Prevention in 18 provinces and two cities, as well as the development of a National Monitoring and Evaluation Framework. IDA also finances **three regional blood transfusion centers** to ensure safe blood supply to the country. IDA's contributions have included support for the national programs for malaria, tuberculosis and acute respiratory infections; essential drugs for healthcare centers; construction and upgrade of 15 health and family planning centers, 137 obstetric and operating rooms in district hospitals, and 2,500 communal health centers; and training for about 22,000 health workers in country's poorest provinces. Under-five child mortality has dropped from 53 per 1,000 in 1990 to 26 in 2006; maternal mortality rate has fallen from 200 per 100,000 in 1990 to 75 in 2007.

Agriculture and rural development: By spring 2009, **nearly a million loans** from IDA-supported rural finance projects have been provided to households throughout rural Vietnam for expanding farm production and off-farm employment. **Over 50,000 smallholder farmers** will be supported through enhanced access to markets with the provision of technology services, farmer organization, and linkages to agribusinesses. Millions of poor people have benefited from improved basic infrastructure and social services financed by IDA in remote areas of the Central and Northern Mountains. Their

capacity has been greatly enhanced through decentralized systems and institutional initiatives. IDA financing has included budget support for the government's community-driven development initiative covering 47 provinces (Program 135 Phase II). IDA is also enhancing the livelihoods of millions of rural households by supporting the establishment of more than 44,000 hectares of forest production and the modernization of **irrigation for over 130,000 hectares of agricultural land**.

Urban development: With the urban population of Vietnam expected to double by 2020 and reach 50 percent by 2030, sustainable urban development will remain a central challenge in Vietnam for many years to come. IDA assistance has supported the provision of integrated environmental sanitation services for 2.7 million people in many cities, including financing the country's first waste water treatment plants and introducing user fees for these services, and is continuing to finance the provision of clean water and sanitation to over 4 million people in several cities. Projects are also under way to improve livelihoods of an additional 3 million urban citizens, by providing access to basic infrastructure services, improved flood control, access to community services such as health centers and schools, and access to micro credit loans for housing improvements, water and sanitation connections and income generation activities.

A Virtuous Circle

Infrastructure services are proving to be affordable and sustainable. The expansion of services was coordinated with budgetary and financial reforms. Rapid growth and economic diversification, in turn, have increased demand for services while allowing service providers to increase the scale of their operations and lower their costs.

PARTNERSHIPS

Vietnam currently receives over US\$5 billion a year from more than 30 bilateral and multilateral donor institutions. The World Bank serves as the coordinator and, often, a catalyst for foreign aid to Vietnam not only because of the funds it mobilizes but also because of its recognized technical expertise.

It co-chairs consultative group meetings with the government, leads the policy dialogue, especially in relation to PRSC operations, and increasingly fosters multi-donor credits and initiatives. This includes the public financial management modernization, education for all, and forestry partnerships—all good examples of multi-donor support for government programs.² Vietnam has made good progress on aid harmonization.

CHALLENGES AHEAD

The global crisis has led to a noticeable slowdown in Vietnam's economic growth.

The impact was severe in the first quarter of 2009, when GDP increased by 3.1 percent compared to the same period in 2008. This is more than 4 percentage points below potential, given that the average for first quarter growth over the last few years has been 7.2 percent. However, growth bounced back in the second quarter, when it reached 4.5 percent. A range of indicators, from electricity consumption to retail sales, suggest that economic performance will continue to improve during the remainder of the year.

2. The donors involved in public financial management are: Australia, Canada, Denmark, the European Commission, Netherlands and the UK. Education initiatives involve Australia, Belgium, Canada, the European Commission, New Zealand, Norway, Spain and the United Kingdom. Forestry is supported by the Netherlands, Finland, the European Commission and GEF.

Exports declined, but are holding relatively better than in other countries. Meanwhile, a timely stimulus package has effectively supported domestic demand and is leading to rapid growth in construction.

Sustaining economic growth during the global economic crisis will require stronger reliance on domestic demand.

The stimulus measures adopted by the government in 2009 included tax cuts and deferrals, social transfers and additional public expenditures, especially in relation to infrastructure investments. The first phase of an interest rate subsidy scheme allowed a rapid refinancing of enterprise debt contracted at high interest rates during the stabilization phase of 2008. The success of these measures shifts the focus from the size of the stimulus package to the quality of its financing.

Several IDA development policy credits were increased in 2009 to help finance some of these measures, in particular the Eighth Poverty Reduction Support Operation (increased to US\$350 million equivalent and processed using the IDA Fast-Track Facility) and the Program 135 Phase 2 Support Operation for Communes Facing Extreme Hardship in Ethnic Minority and Mountainous Areas (increased to US\$100 million equivalent).

Even apart from the stresses caused by the global economic situation, new challenges emerge as Vietnam's economy becomes more sophisticated.

The next few years will be critical.

Vietnam is likely to complete its transition to a market economy and will have laid the institutional foundations of a middle-income

Extreme Vulnerability to Climate Change

Vietnam is widely considered one of the highest priority countries in the world for urgent action on climate change, due to its extreme vulnerability to sea level rise and extreme weather events, with the bulk of its population and economic activity in two low-lying deltas.

The government understands the seriousness of these threats to the country's future and development. A National Target Program on Adaptation to Climate Change was approved in 2008 and many sectoral plans or strategies are focused on climate change. Virtually all donors and NGOs in Vietnam are moving forward with efforts to counter or adapt to climate change. In this context, IDA's role will be pivotal in mobilizing financial resources to Vietnam for both mitigation and adaptation over the next decade. A number of ideas for stand-alone projects or climate change components are being developed over the next several years.

In partnership with the IFC, the Bank is looking at ways to enable the private sector to play a more proactive role in both mitigation and adaptation.

country. Whether those foundations will be strong enough to keep growth sustainable and inclusive as the global economy continues to reel from the ongoing crisis, will depend on policy decisions made during the next few years. This makes it all the more important for donors to sustain a high level of assistance in support of the country's move to middle-income country status.

Mobilizing resources for infrastructure requires stronger frameworks for private participation, including the organization of a market for electricity.

In health, the challenge will be to combine efficiency with adequate access for the poor.

Rapid growth and poor compliance with environmental laws have created major environmental problems in Vietnam, in areas such as water and air pollution, depletion of natural resources, and loss of biodiversity. Understanding is growing about what will be the major and negative impacts of climate change on people and the environment. There is an urgent need for more balanced attention to environmental issues in Vietnam and in the use of IDA resources.

A more sophisticated economy requires better feedback mechanisms from the people on the quality of public policies, and that means increased transparency and accountability.

Reforms of banking and state-owned enterprises will need to focus on competition and set best practice standards of transparency and good governance; this has become more pressing with Vietnam's accession to the WTO.

Massive urbanization and land conversion and a still weak legal system will amplify opportunities for corruption.

Continued economic growth will depend very much on the government's ability to tackle these issues over the coming years.

The need for stronger IDA support.

Supporting good policy choices, especially for governance, and strengthening government systems are important priorities in the short to medium term. But the cost of implementing these will be high.

Recapitalizing state-owned commercial banks and divesting and reforming large state-owned enterprises will lead to redun-

dancies and require an effective social safety net. Funding infrastructure development is another costly priority.

Tax revenue alone will not be enough and massive borrowing in international markets could raise the public debt burden beyond prudent levels. Aid on concessionary terms has an important role to play until Vietnam's infrastructure catches up with that of its neighbors and competitors.

Resources are still needed to keep growth inclusive. For most of the period after Doi Moi, reducing poverty was mainly an economic issue. Now, poverty efforts are increasingly focused on ethnic minority groups.

Sustained transfers of funds are needed to ensure that the living standards of these groups do not fall further behind those of the majority.

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