

TAKING STOCK

An Update on Vietnam's Economic Developments and Reforms

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ACRONYMS AND ABBREVIATIONS

CDM	Clean Development Mechanism
CPI	Consumer Price Index
DAF	Development Assistance Fund
EIA	Environment Impact Assessment
EU	European Union
EVN	Electricity of Vietnam
FDI	Foreign Direct Investment
FSQL	Fundamental School Quality Levels
GCs	General Corporations
GDC	General Department of Customs
GDP	Gross Domestic Product
GI	General Inspectorate
GSO	General Statistic Office
HERA	Higher Education Reform Agenda
HI	Health Insurance
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
ITA	Information Technology Agreement
MPI	Ministry of Planning and Investment
MOH	Ministry of Health
MOHA	Ministry of Home Affairs
MOET	Ministry of Education and Training
MOF	Ministry of Finance
MONRE	Ministry of Natural Resources and Environment
MOLISA	Ministry of Labor, Invalid and Social Affairs
MOPS	Ministry of Public Security
MTEF	Medium-Term Expenditure Framework
NME	Non-Market Economy
NSCERD	National Steering Committee for Enterprise Reform and Development
ODA	Official Development Assistance
OTC	Over-the-Counter
PNTR	Permanent Normal Trade Relations
SBV	State Bank of Vietnam
SEA	Strategic Environmental Assessment

SEDP	Socio-Economic Development Plan
SCIC	State Capital Investment Corporation
SOCB	State Owned Commercial Bank
SOE	State-Owned Enterprise
SPS	Sanitary and Phytosanitary Standards
SSC	State Securities Commission
STC	Securities Trading Center
TRIPS	Trade Related Intellectual Property Rights
TRIMS	Trade Related Investment Measures
UNCAC	United Nations Convention Against Corruption
U.S.	United States
VHLSS	Vietnam Household Living Standard Survey
VSD	Vietnam Securities Depository
VSI	Vietnam Social Insurance
WTO	World Trade Organization

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PART I
RECENT ECONOMIC DEVELOPMENTS

Trends in economic growth have remained encouraging in 2006 following a strong performance in 2005. Exports grew by 24 percent in the first five months of 2006, helped by a recovery in the garments sector. Import growth slowed in 2006 partly due to lower prices, though machinery imports picked up. With the trade deficit narrowing sharply, the current account deficit shrunk in 2005. The budget deficit in 2005 though lower than targeted was higher than in 2004 mainly due to higher current expenditures. Off-budget public spending was higher as well. Reassuringly, credit growth slowed significantly from around 40 percent in early 2005 to about 25 percent in February 2006. Supply shocks continued to exert their influence on prices, though demand pressures may have emerged. Inflation stood at 7.5 percent in May 2006 compared with 8.5 percent in December 2005. Foreign exchange reserves increased strongly to reach 8.6 billion dollars by end-2005. The spread on Vietnam's sovereign bond has fallen by more than 100 basis points since October 2005, reflecting increasing investor interest. Prudent macroeconomic policy, especially in light of possible asset price bubbles, and a transparent financing of infrastructure development, will be key to ensuring sustainable growth.

Economic growth remains strong

The Gross Domestic Product (GDP) grew by 8.4 percent in 2005, the highest level in nine years. In the first quarter of 2006, GDP is estimated to have risen by 7.2 percent year-on-year (Table 1). A slowdown was apparent in the agricultural sector which can largely be attributed to natural calamities: drought in the north, floods in the north-central region and the Mekong River delta, and pests in the south. The services sector on the other hand maintained the strength it had acquired in 2005. During the past year, tourism-related services were especially buoyant.

Table 1: GDP Growth by Sector

	2002	2003	2004	2005e	Q1-04	Q1-05	Q1-06
Total GDP	7.0	7.2	7.7	8.4	7.1	7.3	7.2
Agriculture, forestry & fishery	4.1	3.2	3.5	4.0	2.8	4.3	2.1
Industry & construction	9.4	10.3	10.2	10.6	9.6	8.5	8.7
Industry	9.1	10.3	10.5	10.6	10.3	8.6	8.8
o/w Manufacturing	11.6	11.5	10.1	13.1	9.2	10.3	11.0
Construction	10.6	10.6	9.0	10.8	6.1	8.1	8.1
Services	6.5	6.6	7.5	8.5	6.3	7.2	7.4

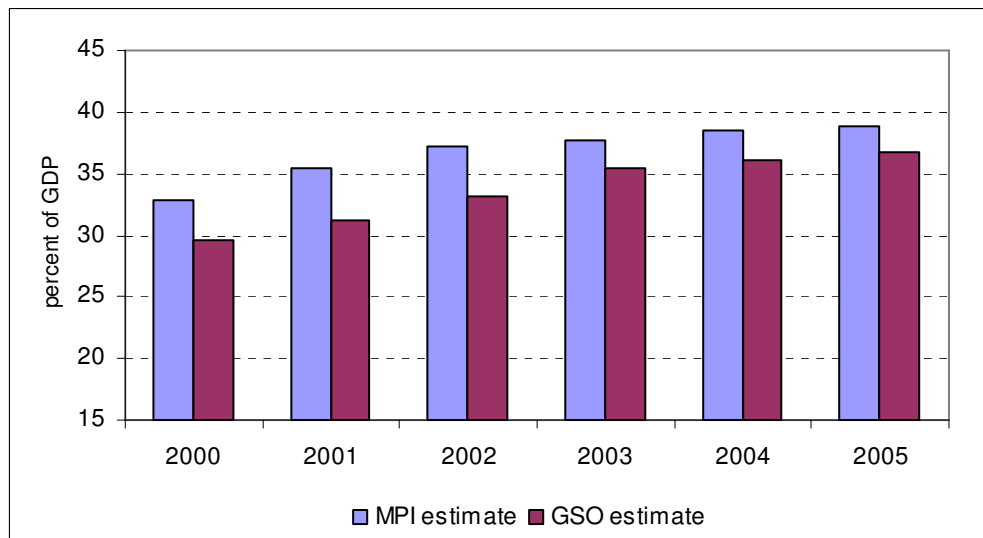
Source: General Statistics Office (GSO).

Note: In percent per year for annual data, and percent year-on-year Q1 of 2004-06.

Industrial performance, as measured by the value of turnover, rose by 17.2 percent year-on-year in the first five months of 2006. Value of turnover of the private sector rose 24.1 percent, followed by the foreign invested sector at 20.9 percent and the state sector at 8.7 percent.

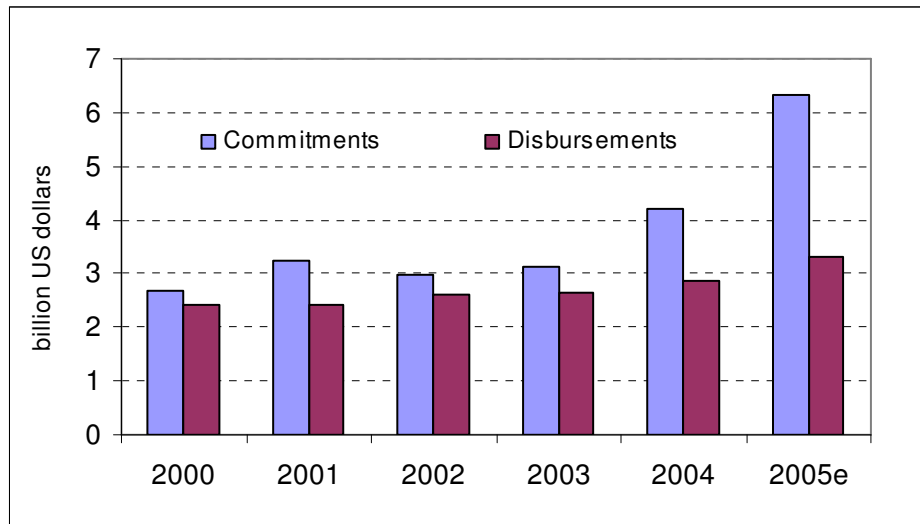
Domestic consumption and investment remained strong in 2005. The retail sales index, an indicator of household expenditure, rose by 20.5 percent during 2005, followed by 19.6 percent year-on-year in the first five months of 2006. On the investment side, new business registrations in 2005 are estimated to have reached 40,000, representing an increase of 9 percent in number and 43 percent in registered capital over the previous year. The average capital of these new enterprises at about 170 thousand dollars, though small, has doubled in the last five years. In 2005, the ratio of investment to GDP as reported by the Ministry of Planning and Investment (MPI) rose to 38.9 percent from 38.4 percent in 2004. This definition of investment results in a higher number than the one computed by the GSO using the national accounts method, as it includes items that are not regarded as investment under the latter method. The gap is about 2 percent of GDP. The methodology followed by the GSO, which estimates gross fixed capital formation plus the change in inventories, is closer to international practice for computing investment. The advantage of the MPI estimate is that it is available to policymakers sooner and more frequently than the GSO estimate. Figure 1 presents a comparison of the two estimates.

Figure 1: Investment to GDP Ratio



Source: MPI and GSO

After attaining a seven-year high of 4.2 billion dollars in 2004, Foreign Director Investment (FDI) commitments improved further to 6.3 billion dollars by end 2005. These include 4.2 billion dollars of new commitments and 2.1 billion dollars for capital expansion by existing firms. Disbursements, including domestic borrowing by joint ventures reached 3.2 billion dollars implying an increase of 15 percent over the previous year (Figure 2). In the first four months of 2006, FDI commitments have reached 2.3 billion dollars or about 7.4 percent more than the same period last year.

Figure 2: FDI Commitments and Disbursements

Source: GSO and MPI.

Garment exports rebound

In 2005, total exports grew by 22.4 percent in value terms, followed by 24.2 percent year-on-year in the first 5 months of 2006 (Table 2). The main manufactured export, garments, after being flat in the first half of 2005, recovered in the second half to record an annual growth of 14.4 percent. Their strength has continued in the first five months of 2006 with a year-on-year growth of 31 percent, with exports to the United States (U.S.) experiencing a sharp turnaround compared with last year (Table 3). Footwear, the next largest manufacturing export, also witnessed strong growth in the first five months of 2006 rising 21 percent year-on-year. However, exports to the main market, the European Union (EU), are likely to be dampened by an antidumping suit which has resulted in a duty of 4.2 percent being imposed on leather footwear sourced from Vietnam. The duty rate will increase to 8.4 percent in June, to 12.6 percent in July, and 16.8 percent in September 2006. Exports of wood products maintained their solid performance of the last two years, and rose by nearly 30 percent year-on-year in the first five months of 2006.

Crude oil exports continued to be buoyed by high international prices, and recorded growth rates of 30 percent in 2005 and 21 percent in the first five months of 2006 in value terms. This was despite the fact the volumes exported fell by 6.5 percent and 7 percent in 2005 and the first five months of 2006 respectively. The drop in volumes is principally due to shrinking yields from key oil fields in the country.

Table 2: Export Structure and Growth

	Value (\$mn) 2005	Share %			Growth %		
		2004	2005	5M-06	2004	2005	5M-06
Total export earnings	32,442	100.0	100.0	100.0	31.4	22.4	24.2
Crude oil	7,373	21.4	22.7	22.4	48.4	30.1	20.6
Non-oil	25,068	78.6	77.3	77.6	27.4	20.3	25.3
Rice	1,407	3.6	4.3	4.0	31.9	48.2	-6.1
Other agriculture	2,557	8.0	7.9	8.5	39.0	20.2	31.5
Seafood	2,739	9.1	8.4	7.3	9.2	14.1	23.2
Coal	669	1.3	2.1	2.2	92.6	88.4	34.5
Garments	4,838	16.5	14.9	14.1	19.0	10.3	31.1
Footwear	3,040	10.2	9.4	9.0	18.7	13.0	21.1
Electronics & computers	1,427	4.1	4.4	4.2	60.0	32.7	18.0
Handicrafts	569	1.6	1.8	1.4	16.1	9.2	29.9
Wood products	1,563	4.3	4.8	5.3	100.9	37.2	29.8
Other	6,259	19.9	19.3	21.6	27.0	20.5	28.9

Source: General Department of Customs (GDC) and GSO.

Table 3: Destination and Growth of Selected Exports

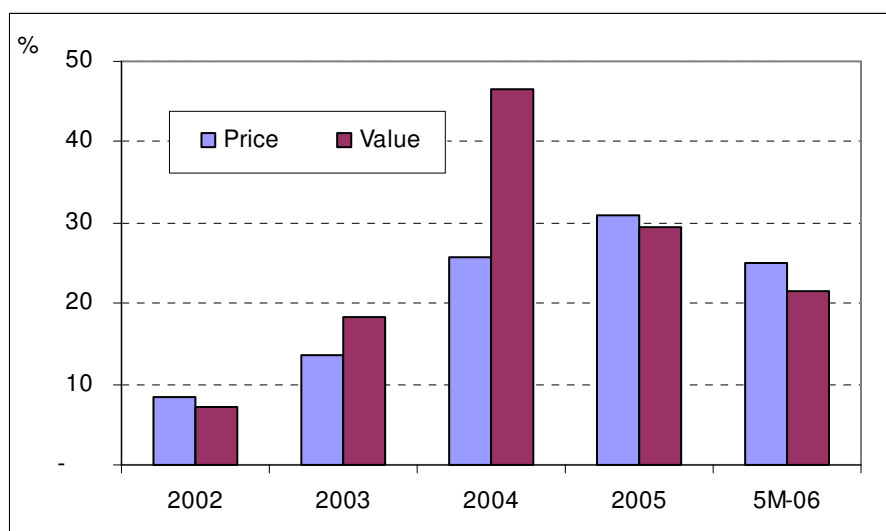
	Footwear			Garments			Seafood		
	2004	2005	Q1-06	2004	2005	Q1-06	2004	2005	Q1-06
Japan									
Share	2.6	3.1	3.8	12.1	13.0	11.4	31.1	29.9	22.0
Growth	14.5	32.8	24.1	11.1	18.8	3.7	18.2	6.6	-10.1
US									
Share	15.4	20.1	22.7	56.4	23.8	55.8	25.0	23	20.2
Growth	47.0	47.1	63.6	25.4	5.2	41.8	-22.7	5.3	-1.0
EU									
Share	65.5	58.1	53.9	15.8	16.9	19.0	10.7	15.1	20.4
Growth	10.5	0.2	11.5	28.0	18.2	81.0	57.1	60.8	65.6

Source: GSO and GDC.

Note: Share in percent. Growth rates in percent per year.

Exports of other main commodities such as rice, coffee, rubber and coal also benefited from increased prices in 2005 (Figure 3). However the picture thus far in 2006 is mixed. The price of rice has declined, as has the volume exported. In the case of coal the quantity exported has soared by more than 60 percent, but with prices falling, the value of exports has increased only by 34 percent. Conversely, coffee has witnessed a decline in volume of 17 percent, but a rise in value of 26 percent in the first five months due to higher prices. However, coffee prices dipped sharply in May 2006.

Figure 3: Key Commodity Exports – Value and Price Increase



Source: GSO and GDC.

Note: Commodities are crude oil, rubber, rice, coffee, and coal.

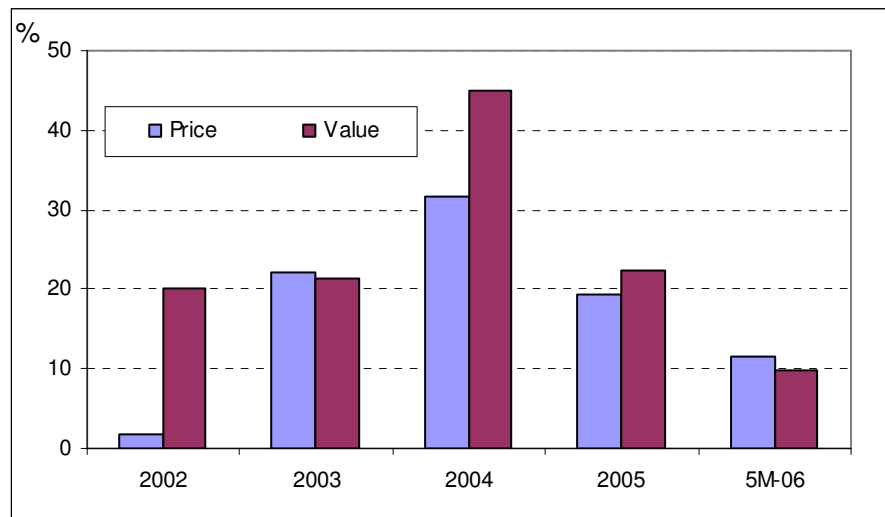
Machinery imports recover

During 2005 imports grew 15.7 percent in value terms, followed by 7.3 percent year-on-year in the first five months of 2006 (Table 4). Compared with the slow down in 2004 and 2005, machinery and equipment imports appear to be picking up. In the first five months of 2006, their value rose by 13 percent. Imports of two main commodities, oil products and steel, have seen declines in their volume in the first five months of 2006. However for oil products, the increase in international prices more than compensated for the decline in volume, and as result their import bill rose by 18 percent year-on-year. In the case of steel on the other hand, there was a reduction in the average price of 12 percent compared with the first five months of 2005, leading to a decline in the value of imports by 18 percent year-on-year. However, the price of steel products though lower than the peak reached in 2005, has started to trend upwards. Overall, the impact of prices on the growth of import values has been lower so far in 2006 compared with 2005 (Figure 4). The rapid pick up in garment exports is also reflected on the import side, with fabric imports recording an increase of 34 percent year-on-year.

Table 4: Import Structure and Growth

	Value (\$mn)	Share (%)			Growth (%)		
	2005	2004	2005	5m-06	2004	2005	5m-06
Total import value	36,970	100.0	100.0	100.0	26.7	15.7	7.3
Petroleum products	5,024	11.2	9.6	14.4	46.9	40.6	17.8
Final Goods							
Machinery and equipment	5,281	16.4	21.2	15.0	-2.0	0.6	13.2
Computer and electronics	1,706	4.2	3.9	4.8	37.7	27.1	17.2
Pharmaceuticals	502	1.6	1.5	1.4	36.2	22.5	27.0
Intermediate and raw materials							
Garment and leather materials	2,282	7.0	8.1	5.3	10.7	1.3	-3.8
Iron & Steel	2,931	8.1	6.6	6.4	55.2	13.9	-17.8
Fertilizer	641	2.6	2.5	1.7	31.0	-22.2	15.0
Plastics	1,456	3.7	3.0	4.3	51.8	22.2	27.5
Fabrics	2,399	6.0	5.4	7.3	41.2	24.5	34.3
Chemicals	865	2.1	2.0	2.3	33.9	26.7	6.9
Chemical products	841	2.2	2.3	2.4	21.2	19.2	21.1
Automobiles (CKD/IKD)	909	2.0	3.6	1.1	-22.8	40.5	-57.5
Fibers	340	1.1	1.2	1.2	13.6	0.2	33.6
Pesticides	244	0.7	0.6	0.8	44.1	15.9	24.1
Cotton	167	0.6	0.4	0.5	80.1	-12.1	9.0
Paper	362	0.8	0.9	1.2	7.5	46.1	39.5
Other	11,020	29.7	27.2	29.8	37.5	14.9	1.9

Source: GDC and GSO.

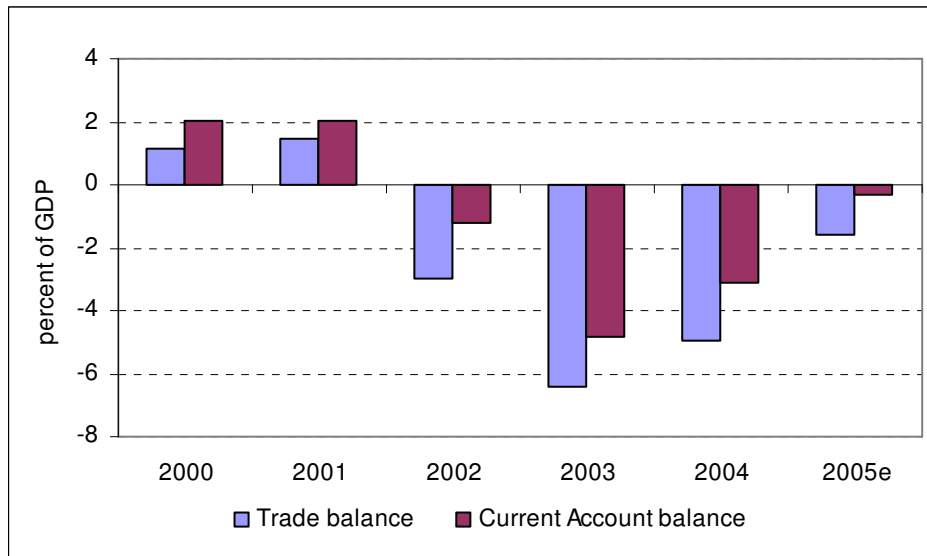
Figure 4: Key Commodity Imports – Value and Price Increase

Source: GSO and GDC. Commodities are petroleum products, clinker, plastics, fertilizers, paper, cotton, fiber, steel.

External deficits narrow

The trade deficit narrowed to 1.6 percent of GDP in 2005 compared with 5 percent in 2004. As exports far outpaced imports in the first quarter of 2006, the trade balance swung to a surplus of 8 percent of GDP. With overseas remittances estimated to have ranged from 3.5 to 4 billion dollars, the current account deficit is estimated to have narrowed to 0.3 percent of GDP in 2005 from 3 percent in 2004 (Figure 5).

Figure 5: Trade and Current Account Balances



Source: International Monetary Fund (IMF) and World Bank..

The deficit is mainly financed through official development assistance (ODA) and non-debt-creating FDI inflows. Data from MPI reveal that in 2005, about 1.8 billion dollars of ODA was disbursed, of which around 85 percent was in concessional loans. Between January and May this year ODA disbursements stood at 545 million dollars, equal to the same period of last year, but lower than the target set by the MPI. Of the disbursed amount, around 461 million dollars was in concessional loans. Vietnam's external debt-to-GDP ratio currently stands at around 33 percent of GDP. This relatively low level of debt, combined with its highly concessional nature, implies that Vietnam faces a low level of risk of external debt distress. Foreign exchange reserves have risen strongly from 6.3 billion dollars at end-2004 to 8.6 billion dollars in December 2005, representing around 12 weeks of imports of goods and non-factor services.

Buoyant revenues and higher expenditure

Revenues, including grants, exceeded their budget amount by over 15 percent in 2005, reaching 25.1 percent of GDP. With oil prices turning out to be significantly higher than anticipated, oil revenues surpassed their budgeted levels by nearly 45 percent. Oil

prices have been a mixed blessing for the government. While they have boosted revenues they have also led to higher expenditures. To shield consumers, domestic oil price adjustments have lagged behind international prices especially for diesel. The government has had to compensate oil distribution companies for the gap between domestic and international prices. Such expenditure is estimated to have attained around 1-1.5 percent of GDP in 2005.

Both recurrent and capital expenditures exceeded their budget amounts in 2005, as total expenditure reached 26.6 percent of GDP. Recurrent expenditure was greater than its budgeted amount by nearly 13 percent. Capital expenditure which accounts for about a third of total expenditure picked up in the second half of 2005 and exceeded its target by about 6 percent. It may thus be reasoned that the government has used its oil windfall to finance higher expenditures. Given pressing infrastructure needs, higher capital expenditure can be justified assuming that the investment projects have been appropriately selected. To the extent the windfall has been used for higher recurrent expenditures, the government will need to be vigilant, especially if the outlook for oil revenues deteriorates. In the past, the government has shown prudence by being conservative in its oil price forecasts for budgeting purposes.

Overall, the budget deficit for 2005 (excluding on-lending) is estimated at 1.5 percent of GDP. This is below the planned level of 2.3 percent of GDP, but higher than the level of 0.8 percent attained in 2004.¹ The budgeted deficit for 2006 is 2.6 percent of GDP.

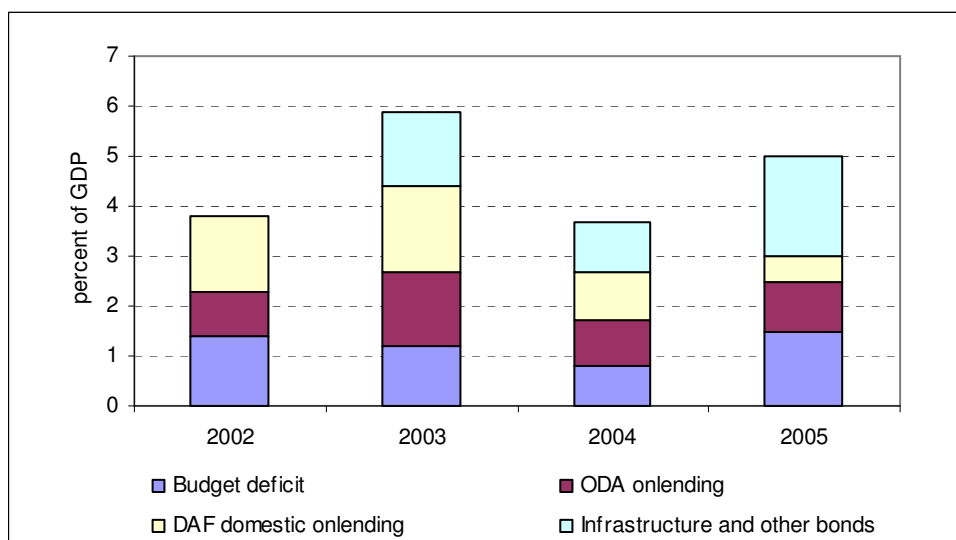
To obtain a more complete picture of public expenditures it is important to also consider certain extra budgetary outlays (Figure 6). First, the government has been issuing bonds in order to finance infrastructure spending related to transport and irrigation, as well as for upgrading schools. While the enhanced spending program is justifiable on the basis of infrastructure requirements, its implementation needs to be accompanied by moving the expenditure on-budget. In terms of the latter, the government has already presented the aggregate amount of the expenditure along with the budget, though it has not been integrated with the other accounts. The planned level of such expenditure is 1.8 percent of GDP for 2006, compared with around 1.6 percent in 2005. There have been problems with disbursing the funds raised through bonds and reportedly only 75 percent of the planned disbursements occurred by the end of 2005.

Second, at the city or province level, bonds have been issued to finance local infrastructure. So far these have been limited chiefly to Ho Chi Minh City and Hanoi and stood at 0.4 percent of GDP in 2005. The third extra budgetary outlay relates to on-lending of both ODA as well as of domestically raised resources through the Development Assistance Fund (DAF). For 2005, these are estimated at 1.0 percent and 0.5 percent of GDP respectively.

¹ The government's definition of the budget deficit is non-standard in that it includes amortization payments and carry-over of revenues and expenditures. According to this definition the budget deficit is estimated at 4.9 percent of GDP in 2004 and 2005 against a target of 5 percent in both years.

Public debt related to budgetary operations currently stands at about 32 percent of GDP. Including the above noted off-budget items, DAF, the bonds issued to recapitalize state-owned commercial banks (SOCBs) in the past, as well as the recently issued sovereign bond, the level of debt rises to around 43 percent. About two-thirds of the debt is highly concessional ODA, and debt servicing is considered manageable.

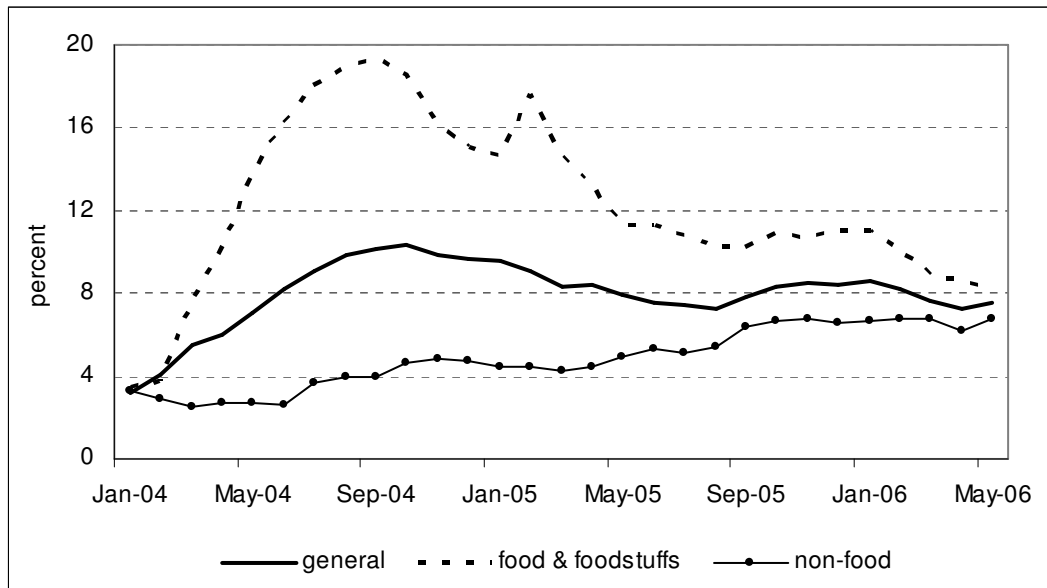
Figure 6: Budget Deficit and Off-budget Expenditure



Source: Ministry of Finance (MOF) and World Bank..

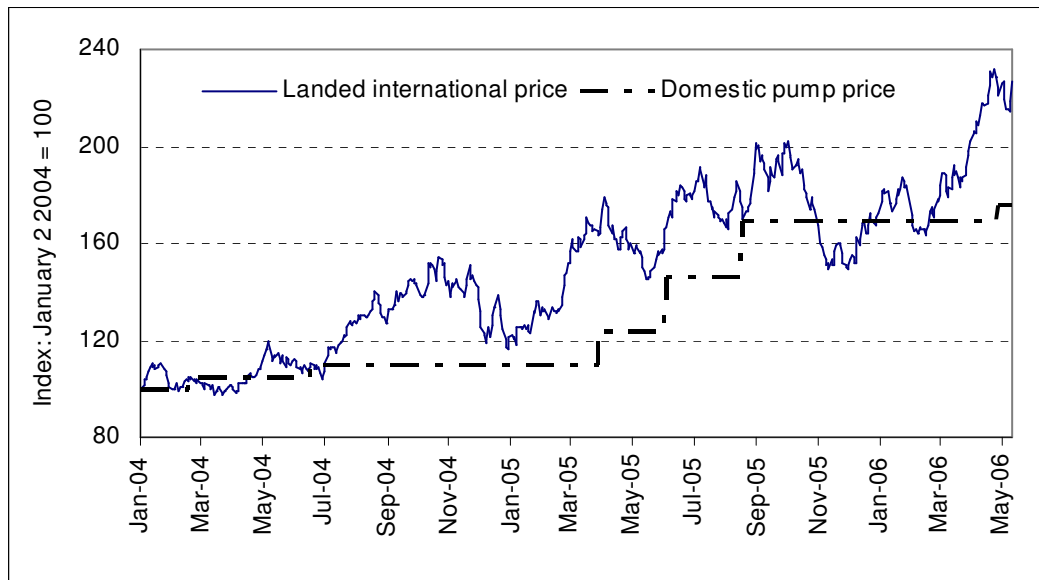
Inflation remains high

Supply side-shocks continued to exert their influence on inflation in 2005. These shocks included a recurrence of avian influenza, poor weather conditions, and hardened international prices of key imports such as oil, fertilizer, cement and steel. With increases in wages, strong public investment, and initially high credit growth, demand-side pressures possibly emerged as well. Inflation, as measured by the Consumer Price Index (CPI), remained over 8 percent year-on-year for most months of 2005 averaging 8.2 percent for the year (Figure 7). In May 2006, the CPI grew by 7.5 percent year-on-year compared with 8.5 percent in December 2005, and 8 percent in May 2005. Food price inflation has trended down since the peak reached in September 2004, while non-food inflation has crept up reaching 6.8 percent in May 2006. Food comprises nearly 50 percent of the basket used to compute the CPI.

Figure 7: Change in Consumer Price Index

Source: GSO.

While policy makers had been mindful of the potential inflationary impacts of high growth targets, they had been reluctant to apply strong monetary restraint as it could have entailed a high cost in terms of foregone output. In 2005, the difficult task of macroeconomic policy was thus to support the government's ambitious growth target of 8.5 percent without overly exacerbating inflationary pressures. The final outcome of 8.4 percent growth in 2005, and an inflation rate which had fallen to 7.5 percent by May 2006, suggests a measure of success. During the current phase of inflation, the government has not allowed the oil, coal, steel, and cement sectors to fully raise their prices, in order to prevent an aggravation of the impact of supply shocks. A proposal to raise electricity prices, which have remained unchanged, by an average of 8.8 percent has been submitted to the Prime Minister, but has not yet been approved. Oil prices increases have lagged international price movements and the pass through, especially for diesel, has been partial (Figure 8).

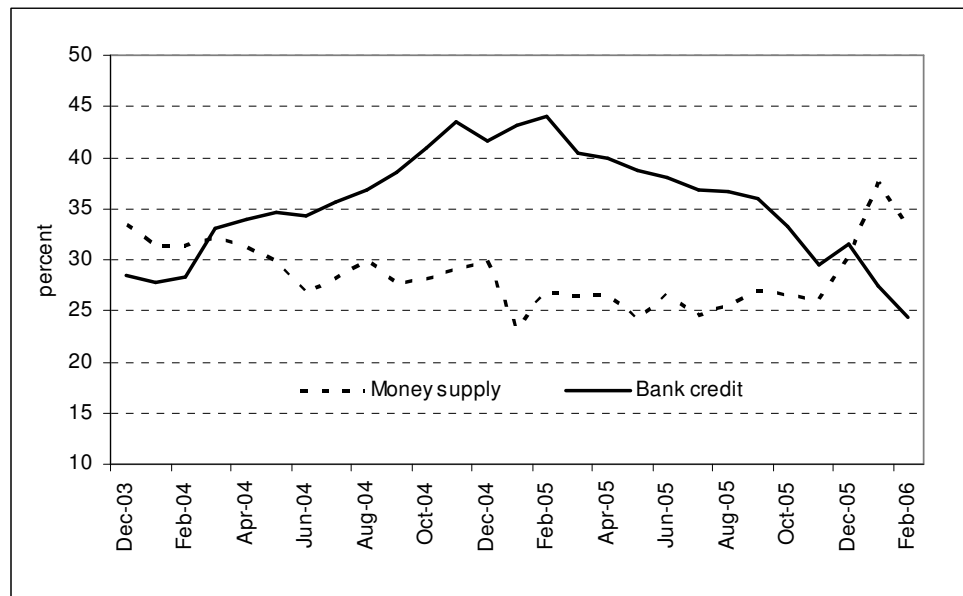
Figure 8: Trends in International and Domestic Price of Diesel

Source: World Bank staff estimates.

Note: The international price excludes taxes and domestic distribution costs.

Credit growth decelerates

After having climbed to 42 percent year-on-year in December 2004, the pace of credit growth slowed to around 32 percent in December 2005, and 25 percent in February 2006 (Figure 9). Between end-2004 and end-2005, credit to the private sector slowed from 45 to 35 percent year-on-year while that to state-owned enterprises (SOEs) slowed from 36 to 26 percent. Lending growth in foreign currency dropped sharply from about 60 percent year-on-year in December 2004, to 22 percent year-on-year in January 2006. The above trends are reassuring. The main concern with rapidly expanding credit has been its quality. This is due to the weak, though improving, ability of banks to adequately assess risks, especially when the volume of loans was increasing at a fast pace. Also, even though the regulations governing loan classification had been tightened their implementation has been slower than anticipated. This is in part due to differences between the banks and the State Bank of Vietnam (SBV) in interpreting the new regulations. The boom in foreign currency lending was also a concern as it was not clear if the borrowers were adequately hedged against currency risks. Expectations of a slow depreciation of the dong combined with lower interest rates on foreign currency lending, had made such borrowing more attractive. Finally, a slow down in credit growth in an inflationary environment will tend to dampen demand pressures.

Figure 9: Credit and Money Supply Growth

Source: SBV and IMF.

The base interest rate currently stands at 8.25 percent. The base rate is set by the SBV and is used by the commercial banks to determine their lending rates. In 2005, the base rate was raised from 7.5 percent to 7.8 percent.

The stagnant real estate market has often been cited as a source of risk for the banking sector. Reportedly, real estate loans make up about 10 percent of total bank loans with SOCBs being responsible for 80 percent of these. Nearly 45 percent of the projects are located in Ho Chi Minh City. Property transactions have reportedly declined by 70 percent in 2005, though prices fell much less than that. Another risk that the SBV has cautioned against relates to the use of shares as collateral, with the borrowed funds being used to purchase more shares. The level of such lending is mostly from joint-stock banks, and though still quite small needs to be watched.

Stock market soars

In the last eight months or so, six new companies have been listed on the stock market bringing their total number to thirty six. Market capitalization, although still tiny by regional standards, has risen from under 300 million dollars in mid-2005 to over 1.5 billion dollars in May 2006. At the same time the number of enterprises listed on the official over-the-counter (OTC) exchange in Hanoi increased from 5 to 11. The fast growing market capitalization has resulted both from the new listings, as well as soaring share prices. The stock market index has grown by more than 75 percent between December 2005 and May 2006. However, the market has also witnessed volatility. At the beginning of one week in May the index fell nearly 10 percent only to recover by the end of the week. The rise in prices reflects too many investors chasing too few stocks.

However, the availability of stocks could increase dramatically if the listing plans of companies materialize, including attractive propositions in the mobile phone, banking and insurance sectors. The increasing interest of the public in the stock market could be related to a decline in the attractiveness of the real estate sector where prices have been falling, rather than a commensurate improvement in the prospects of the listed companies. Money has also increasingly flowed into the stock market from overseas investors. Although the market is still very small, the creation and ultimate bursting of price bubbles could easily dent the confidence of investors thereby retarding the development of a modern securities market.

Rising wage employment reduces poverty

The Vietnam Household Living Standards Survey (VHLSS) gathers information on household incomes and expenditures across all of Vietnam. Poverty estimates calculated from expenditure data indicate a continuation of rapid poverty reduction in Vietnam: from 37 percent in 1998 to 20 percent in 2004. They also show but a widening gap with ethnic minorities, 61 percent of which live in poverty. Analysis of latest VHLSS data shows that between 2002 and 2004 households witnessed a large rise in real per capita income of about 21 percent on average. Gains were large across all income quintiles, but especially so in the middle three income groups. Average income per capita in the richest quintile in 2004 was 18 percent higher than in 2002, while this figure was 20 percent for the poorest one fifth (Table 5).

Table 5. Sources of income growth by income quintile (2002 – 2004)

	Income quintile					Total
	Poorest	Near-poorest	Middle	Near-richest	Richest	
Real income per capita per year ('000 dong)						
2002	1414	2322	3212	4667	10790	4480
2004	1696	2826	4025	5850	12725	5424
Real income growth 2002-2004 (percent)	20	22	25	25	18	21
Contribution to total income 2004 (percent)						
Agriculture	55.5	46.1	37.3	28.5	14.7	26.9
Wage	25.6	27.9	29.3	32.1	32.6	31.1
Non-farm self-employment	7.7	13.1	19.3	22.4	26.0	21.8
Other	11.1	12.9	14.1	17.0	26.7	20.3
Total	100.0	100.0	100.0	100.0	100.0	100.0
Contribution to total income growth 2002-2004 (percent)						
Agriculture	27.2	35.0	21.5	21.9	8.1	17.9
Wage	49.2	34.5	30.8	26.3	28.0	30.0
Non-farm self-employment	8.3	11.9	26.9	26.4	4.7	15.0
Other	15.3	18.6	20.7	25.4	59.3	37.1
Total	100.0	100.0	100.0	100.0	100.0	100.0

Note: Income source categories reflect main occupation only.

Source: Phung Duc Tung (2006).

In 2004, though earnings from agriculture still provided 56 percent of the income of poor people, it is earnings from wage employment that contributed most substantially to the growth in the incomes of the poor. Between 2002 and 2004, wages were responsible for nearly half the growth in incomes for people in the lowest quintile. People in richer quintiles typically have a more balanced range of income sources, with non-farm self-employment representing a much more significant share of total income than for lower quintiles. While income from non-farm self-employment contributes only 8 percent of total income for those in the lowest quintile, it provides more than one quarter of total incomes for those in the middle and near rich quintile.

There are some important differences between Kinh people and ethnic minorities in the structure of incomes and in sources of income growth. Income from agriculture represents nearly half the total income of ethnic minorities, but only one quarter for the Kinh people. Wages are an important contributor to the growth in incomes of the Kinh people, but a negligible source of income growth for ethnic minorities.

Land ownership patterns change

Analysis of the specialized land module of VHLSS (2004) indicates some important changes in patterns of land ownership across the country. The data show that the proportion of rural households without agricultural landholdings has increased from 7 percent to 14 percent between 1993 and 2004 (Table 6). There are marked differences across regions in the levels of rural landlessness, and these differences are becoming more significant over time. In 2004, 1.5 percent of rural households in the North West region were landless, while 26 percent of rural households in the Mekong delta and nearly 40 percent of rural households in the South East were landless. The level of inequality in landholdings across rural households has increased over time, with the Gini coefficient rising from 0.49 to 0.64 between 1993 and 2004. Again, levels of inequality vary across regions, with the rural south exhibiting higher levels of inequality than the rural north.

Table 6: Inequality in agricultural landholdings in rural Vietnam, 1993 to 2004

	2004		1993	
	Landless (%)	Gini	Landless (%)	Gini
Red River Delta	6.0	0.38	2.8	0.28
North East	4.5	0.59	1.7	0.42
North West	1.5	0.52	0.0	0.38
North Central Coast	8.5	0.59	4.2	0.41
South Central Coast	13.9	0.69	10.6	0.34
Central Highlands	4.2	0.43	6.3	0.52
South East	38.8	0.75	17.5	0.54
Mekong River Delta	26.2	0.62	15.9	0.51
All	14.4	0.64	7.2	0.49

Note: A higher Gini indicates a more unequal distribution.

Importantly, there is no evidence so far to suggest that these increases in landlessness and inequality of land holdings have been disadvantageous to poor rural households. The data shows that better off households are more likely to be landless than poorer households. And the per capita incomes of all landless people have risen between 1993 and 2004. In most cases, moving out of agriculture is also moving up in terms of income and expenditure. However, this pattern is not consistent across all regions. In the Mekong delta where wages for agricultural labor are low, landless households may have difficulty in escaping poverty.

PART II

DEVELOPMENT POLICIES

Vietnam took a major step towards World Trade Organization (WTO) accession through successfully concluding its bilateral negotiations with the U.S. Implementing the reforms entailed by WTO commitments should help Vietnam complete its transition to a market economy. The transformation of SOEs has continued steadily. Eight General Corporations (GCs), which have the potential to become global players are being transformed into “economic groups.” A roadmap to guide banking sector reforms has been approved. The SBV is to be transformed into a modern central bank charged with monetary policy and banking sector supervision. On the social front, a sustained effort to improve the quality of primary schools is underway. The financing of healthcare for the poor and near-poor has been considerably strengthened. Free compulsory health insurance (HI) has been mandated for the poor, and other social policy beneficiaries, and voluntary HI for the near-poor will be subsidized. The Socio-Economic Development Plan (SEDP) 2006-2010 has been built on extensive consultations not only within government but also with a broader range of stakeholders. It represents considerable progress in developing an outcome-focused plan, which rests on three pillars: economic growth, social inclusion, and environmental sustainability. However, some of the most important challenges ahead lie in the governance area which can be seen as the underlying foundation for success in the three explicit pillars of the SEDP. An effective implementation of the anti-corruption law and the strengthening of government systems across the board, will be key in this respect.

WTO accession in sight

Adopting a policy and regulatory framework consistent with WTO rules will signal Vietnam’s progress in its transition to a market economy. A huge step towards WTO membership was the conclusion of the bilateral agreement with the U.S. Vietnam has now finalized all 28 bilateral agreements with countries or regions that were needed for membership. This has greatly boosted the chances of Vietnam’s accession to the WTO in 2006. The next round of multilateral negotiations will commence in July 2006.

Under the agreement with the U.S., about 94 percent of Vietnam’s imports from the U.S. will face duties of 15 percent or less. On key products in the construction equipment, pharmaceutical and aircraft sectors duties will range from 0 to 5 percent. Vietnam, like other WTO applicants, has agreed to join the Information Technology Agreement (ITA) and to embrace more than 75 percent of the chemical harmonization initiative. The ITA participant countries will completely eliminate duties on IT products covered by the Agreement with developing countries being granted extended periods for some products. Vietnam has also committed to low duties on nearly all medical equipment immediately upon accession. Approximately three-fourths of U.S. agricultural exports to Vietnam will face bound rates of 15 percent or less. Products subject to these reduced tariffs include cotton, selected beef, pork, and variety meats, whey, grapes, apples and pears, and soybeans. Being part of the WTO process, all the above tariff rates will be available on a most-favored nation basis to all countries. The tariff reductions suggest that Vietnam’s average tariff rate is likely to have declined appreciably from its earlier offer of 18 percent. Vietnam has also agreed to recognize the U.S. systems of inspecting beef, pork and poultry as equivalent to its inspection systems.

In the area of services, Vietnam has made substantial commitments to open up key sectors, like telecom (including satellite services), distribution, financial services, and energy services to foreign participation. Vietnam has offered to open up for branching in insurance (non-life) and securities, and it already provides for bank branching. Restrictions on the goods that foreign-invested companies can import will be eliminated. A very limited number of products are subject to a short transition period before trading rights will be granted, and the importation of a few products will be through state trading enterprises.

Vietnam will eliminate prohibited subsidies that it provides to its industries. For most industries, including textiles and apparel, this will be in effect immediately upon WTO accession. Benefits under two specific programs will be phased out over a five-year period. The affected subsidies are, however, much smaller in magnitude than has reported in the press.

The U.S. will remove all remaining quotas on textile and apparel imports from Vietnam. But the U.S. will have the ability to re-impose quotas if it believes that Vietnam has not complied with its obligation to eliminate prohibited subsidies for the textile and apparel sector. This will be under a special enforcement mechanism that will be available to the U.S. for the first 12 months after Vietnam's WTO accession. If the U.S. believes that Vietnam has not complied with its obligation to eliminate the prohibited subsidies, it will be able to request consultations with Vietnam. If the dispute is not resolved through consultations, it would be referred to a WTO arbitrator. If no decision is reached within 120 days, or if the arbitrator finds that Vietnam is in violation, the U.S. will be able to immediately re-impose quotas.

On a downside for Vietnam, it will continue to remain a non-market economy (NME) for the U.S. trade remedy purposes. The U.S. will continue to use non-market methodology in antidumping cases until such time as Vietnam is no longer treated as a NME or for 12 years after Vietnam becomes a WTO member. Invoking NME rules makes it less onerous for US producers to file and win antidumping suits.

Under the U.S. Trade Law Vietnam currently has conditional normal trade relations status. It is conditional in that it must be renewed annually. Obtaining permanent normal trade relations (PNTR) status or, in the WTO language, unconditional MFN status, will require a vote in the U.S. Congress. Granting of PNTR status by the U.S. is not necessary for Vietnam's accession. If Vietnam does not get PNTR, it will have the right to withhold from the U.S. the benefits of its accession commitments that have been granted to other WTO members (unless covered under the Bilateral Trade Agreement). Thus far, six countries have become full members of the WTO prior to their receiving PNTR from the U.S.

Vietnam up till now has committed to implement upon WTO accession the following agreements: TRIPS (intellectual property), TRIMs (investment measures), CVA (Customs Valuation Agreement), TBT (technical barriers to trade), SPS (sanitary and phytosanitary measures), ILP (import licensing provisions), A/D & C/V (anti-dumping), and ROO (rules of origin).

Reforming state-owned enterprises

The number of SOEs had been reduced to less than 2,600 at the end of April 2006 compared with more than 5,600 in 2001. The annual number of transformations continued to increase through 2004 and 2005 (Table 7). The figures reported in Table 6 are lower than officially released data. This is because the official data cover transformations under implementation, while only completed transformations are reported in Table 7.

Table 7: Number of SOE Transformations

	2001	2002	2003	2004	2005
Equitizations	198	213	358	643	709
Sales/Assignments	59	39	48	44	71
Liquidation/Bankruptcy	21	24	29	41	40
Single Member LLCs	0	2	8	34	0
Sub-total	278	278	443	762	820
Mergers	2	60	118	43	6
Total	280	338	561	805	826

Source: Project on Monitoring of SOE New Establishments and Transformations, National Steering Committee for Enterprise Reform and Development (NSCERD).

The average size of SOEs undergoing transformation has been increasing over time. In 2005, the average equitized SOE had a state capital of 17 billion dong, bank debt of 22 billion dong, and 329 employees, all of which are higher than in 2004 (Table 8). The incidence of “closed” equitizations is reducing: the percentage of SOEs that did not sell any shares to outsiders has come down from 52 percent in 2003 to 26 percent in 2005. In the past, given the small size of many equitizing SOEs, once the employees had exercised their option to buy, there was little left for other potential investors.

Table 8: Selected Features of SOE Transformation

	2001	2002	2003	2004	2005
Average charter capital (VND billion)	7.7	7.1	8.8	9.9	17.3
Average bank debt (VND billion)	5.4	5.4	8.0	9.9	21.7
Average number of employees	199	198	195	238	329
Share of transformed SOEs with State holding remaining above 35 (percent)	26	27	45	55	57
Share of transformed SOEs with no shares sold to outsiders	50	50	52	46	26

Source: Project on Monitoring of SOE New Establishments and Transformations, NSCERD.

After several delays, SOEs are being classified according to their performance. Decision 271 set up a mechanism to monitor SOE performance and apply sanctions in the case of consistently poor performance. SOEs are to be classified into one of three groups (A, B, or C) based on four criteria: turnover, profitability, solvency and compliance with laws and regulations. For the first three criteria, quantitative benchmarks are established, so that SOEs with a strong performance are classified as A whereas those with a weak performance are rated C. These four criteria are combined into a single ranking. Only those SOEs with a strong performance in all four criteria are ranked as A, whereas weak performance on any single indicator leads to a C ranking. Enterprises ranked as C for two consecutive years are in principle subject to reorganization, including changes in management.

Until recently, few SOEs had complied with the reporting requirements under Decision 271 and government agencies in charge had not made serious enforcement efforts. But over the last year or so, the MOF compiled reports on the performance of most SOEs during 2004, and is now conducting an in-depth evaluation of the reliability of those reports. Preliminary results indicate that in 2004 about 85 percent of the SOEs belonged to groups A and B. Preliminary checks using records from the 2004 enterprise census roughly confirm this assessment. They also suggest that weak performance is more common among small SOEs. Among the largest SOEs, only 7 percent fall in category C.

An area of SOE reform that is receiving greater attention relates to the conversion of GCs and selected independent SOEs into “mother-child” holding companies. The regulations for such transformation are provided by Decree 153 of August 9, 2004. Of around 130 GCs/SOEs that have announced the intention to be converted into mother-child companies 55 have had their proposals approved. Eight of the GCs with potential to become global players are to be converted to “economic groups.” These are: Baoviet (insurance), Vinacomin (minerals), VNPT (telecommunications), Vinashin, (shipping), Vinatex (garments and textiles), EVN (electricity), Vietnam Rubber Corporation, and Petrovietnam (oil). The first five of these have received approvals for their transformation plans. The GCs to be converted to economic groups must have capital greater than 10 trillion dong (650 million dollars) and their scope of operations must be international. The mother company of the transformed entity will be a 100 percent state-owned limited liability company and will operate under the Enterprise Law.

The SCIC was established by the Prime Minister in July 2005, to make key decisions on state capital allocation. The SCIC will absorb state ownership rights in equitized SOEs and SOCBs from line ministries and provinces, thus consolidating all shareholdings in one institution. By moving ownership rights out of ministries, it should alleviate the conflict of interest between ownership and regulation. It will also have a charter capital to allocate selectively across its affiliated enterprises; for now this charter capital has been set at five trillion dong. In its initial phase the SCIC will receive state capital from “independent SOEs” only, i.e., those that are not part of the GCs. The SCIC has a profit orientation and its mandate is to maximize returns on state capital. It will be important that its operations are kept transparent, embodying modern corporate governance principles.

A roadmap for banking reform

A comprehensive roadmap for banking sector reform was issued through Prime Minister's Decision 112 of May 24, 2006. A key step is to fundamentally re-write the Law on Credit Institutions and the Law on the SBV. The SBV governor has appointed a team headed by a deputy governor for drafting the laws, both of which are to be submitted to the National Assembly in 2008. The new laws will be designed to transform the SBV into a modern central bank charged with executing monetary policy and supervising the banking system. They will also be shaped by the international commitments that Vietnam takes on as part of WTO accession. At present, the SBV is responsible for exercising the ownership (or shareholding) rights of the state in the SOCBs, a function which conflicts with its role as supervisor of the same banks. Under the proposed changes to the legal framework, the ownership role of the SBV is to be eliminated. The supervision functions of SBV will be separated from its management functions in relation to SOCBs, and the operation of SOCBs on a commercial basis will be ensured.

The planned restructuring of the SBV will also see a reduction in the number of its branches. Key functions of provincial offices will gradually be transferred to regional ones, thereby containing the interference of provincial governments in the operations of the banking system at the branch level. Such interference has limited the effectiveness of banking supervision and rendered the control of policy lending less effective. The reform program will also include a transformation of central bank governance to clarify and enhance management and accountability structures.

The strengthening of banking supervision is expected to happen in two phases. In the first one the banking supervision department of SBV will be upgraded. The focus of its activities will mainly be on banks as they are likely to remain dominant players in the financial sector in the medium term. In the second and longer-term phase, an independent financial supervision board will be established. The SBV has already undertaken measures to begin upgrading its supervision functions. In October 2005, it initiated an assessment of its supervision practices against international standards, the Basel Core Principles. The assessment is scheduled for completion in the first half of 2006 with the production of a comprehensive supervision development plan. It has been stressed that the pace of reform will be tailored to the human resource capacities within the SBV and the SOCBs. As the envisaged changes are fundamental in nature, they will need to be accompanied by an equally major development of human resources and a realignment of the incentives structure to the objectives of the institutions.

The organizational and financial restructuring of SOCBs to support their commercial orientation is to happen alongside their equitization. All SOCBs are due to be equitized by 2010. The process has been set in motion for two of them. Vietcombank has already sold convertible bonds worth 1.36 trillion dong to boost its capital before equitization. Share sales are to take place through auction at the securities exchange and will begin towards the end of 2006 or in early 2007. The Mekong Housing Bank will be equitized with a strategic investor. The state's shareholding in these two banks is to be gradually reduced: to no less than 70 percent by end-2006 and eventually to 51 percent by 2010. Under current regulations total foreign holding of shares will be limited to 30

percent with a single institutional investor allowed to hold a maximum of 10 percent. But these limits, especially the latter may be revised upwards to accommodate strategic investors. The valuation of both banks is to be conducted through reputed external advisors selected who are currently being selected through a competitive process. The external advisors will also help in selecting strategic investors.

Securities market development

A draft Securities Law, aimed at developing Vietnam's capital market, was discussed by the National Assembly in May 2006. The proposed law is supposed to take effect from January 2007. The law will replace Decree 144. One of key limitations of Decree 144 is that the regulated securities market is defined to include only the securities trading centers (STCs), leaving a large OTC market unregulated. As a result companies not listed on one of the two STCs are subject to much weaker disclosure requirements, and brokers operating only in this informal market do not need to be licensed by the State Securities Commission (SSC). The draft Securities Law aims to correct this situation by introducing the concept of a publicly held company, and specifying its rights, obligations, and reporting requirements. A company with shares issued to the public; with shares listed on a STC; or with shares owned by 100 or more investors is considered publicly held. This definition should presumably bring under the law many of the companies whose shares are being informally traded. The law will provide the SSC the authority to regulate the issuer, intermediaries and investors as long as the issuance is a public offering, the securities are publicly traded ones, and the issuer is a publicly held company. Brokers and intermediaries dealing in such securities will need to be licensed by the SSC.

The securities law is also expected to provide for the transformation of the Ho Chi Minh City Stock Trading Center into a full-fledged stock exchange, owned privately by its members. Its formal regulation and supervision will be left to the SSC. The law will also provide for a formal legal basis for the establishment of the Vietnam Securities Depository (VSD) which had already been set up by the SSC. Under the law, the VSD is also expected to become a privately owned entity.

The organizational independence of the SSC has been a point of debate in the National Assembly. At present, the SSC falls under the MOF. As such, the ultimate authority to take legislative initiatives, license market participants, recognize a new instrument as a security, etc. is likely to stay with the MOF. If the SSC becomes an independent body, such authority will be given to the Chairman of the SSC. International Organization of Securities Commissions (IOSCO) Principles, considered as an international benchmark of sound practice, emphasize only the need of "operational independence" rather than organizational independence. In principle, the SSC could have operational independence even though it is part of the MOF. This will require ensuring that the role of the MOF as an issuer of securities does not, in practice, conflict with its role as regulator.

Two main policy decisions were taken in 2005 to help expand the stock market. The first, Decision 528 of June 2005, directed around 170 joint-stock companies with dominant stake held by the state to list on the stock market, and 75 SOEs to auction their

shares on the securities trading centers. The 170 joint-stock companies have a total registered capital of 4.8 trillion dong (nearly 306 million US dollars) with 76 percent contributed by the state. The 75 SOEs include many well-performing ones in the fields of telecommunications, petroleum, electricity and cement. By the end of March 2006, 24 of the SOEs had auctioned their shares. In terms of listing, the results have been disappointing. Only Vinamilk, the largest company on the list, with a capital of 1.5 trillion dong, has listed successfully.

The second policy development, Decision 238 of the Prime Minister issued in September 2005, increased the cap on the total foreign shareholdings in listed companies from 30 percent to 49 percent. Foreign investors had already hit the older ceiling of 30 percent in five companies, and were close to it in another five. By some estimates, foreign investors currently own around 25 percent of the shares listed in the stock market.

Better and more inclusive education

Regulations for inclusive education for children with disabilities were issued in May 2006, aiming for their equal access to education services. The regulations apply to all educational institutions in the public education system. The preparation of these regulations is the result of effective coordination among ministries such as the Ministry of Education and Training (MOET), Ministry of Health (MOH), and the Ministry of Labor, Invalids and Social Affairs (MOLISA), and agencies dealing with child protection. The regulations address the special needs of children living with disabilities in terms of classrooms, school facilities, equipment, and textbooks. Individual education plans will be prepared with materials and methodological designs tailored to their special requirements. The regulations allow for educational institutions to hire specialized staff and helpers, and entitle them to make investments in facilities and equipment which meet the special needs of children living with disabilities. Inclusive education staff will be entitled to training and refresher courses and to reduced norms for teaching hours. Early intervention is promoted by the regulations in order to minimize disability-caused constraints. People living with disabilities will also be given priority in entrance exams for vocational secondary schools and institutions providing continuing and higher education services.

A sustained effort is under way to raise the quality of primary schools nationwide, with an emphasis on schools in poorer areas. An important step towards implementation was the adoption of FSQL. These are a set of monitoring indicators covering a range of aspects, from school management to infrastructure, teachers training to the availability of classroom materials. A baseline assessment of compliance with FSQLs, nationwide, had been compiled for the school year ending in 2004. The annual audit conducted one year later allowed assessing the progress accomplished. The comparison, finalized at the end of 2005, showed that the average FSQL ratio, across all the quality indicators considered, had increased from 62.1 to 66.1, out of a maximum of 100. This represents an annual increase by 6.4 percent in the average FSQL index. A subsequent analysis, combining the results of the FSQL audits with a poverty map, showed that gains were more important in poorer districts (Table 9).

Table 9: Assessment of Primary Schools by Quality

Districts by quintile	Poverty rate in 1999 (percent)	Average FSQI index (on a scale of 0 to 100)		Change (percent, relative to 2004)
		2004	2005	
Richest	12.4	68.7	69.6	1.28
Near Richest	32.3	67.5	69.3	2.58
Middle	41.3	64.9	67.8	4.39
Near Poorest	51.5	62.8	65.5	4.41
Poorest	73.7	55.9	60.5	8.30

Note: World Bank staff estimates, based on data from GSO and MOET. The classification of districts by poverty rate is based on the 1999 poverty map.

Quality of education has become a major focus of government policy and is viewed as a key driver for sustainable growth. The introduction of new curricula for all sub-sectors aims at enhancing the capacity of students to master basic literacy and numeracy as well as nurturing creativity and problem solving skills. At the primary level, professional standards have been developed to guide teacher training needs, teacher appraisal and deployment. Similar tools are being developed for the secondary level.

At the tertiary level, the government has released its "Higher Education Reform Agenda 2006-2020" (HERA). This document spells out the specific actions that the MOET will be required to take in fulfillment of the broad goals set out for the higher education sector in the SEDP 2006-2010. HERA has an overall quantitative goal of "increasing enrollment in universities and colleges by 10 percent annually, to reach a level of 200 students per 10,000 population by 2010." HERA also contains an overall qualitative goal, aiming to develop a higher education system that approaches "the advanced education standards of the region and the world". MOET intends achieving these goals by: renovating curricula and teaching methods; developing systems that increase study opportunities through transfers; and reforms to make institutions more pro-active and responsible for finance and personnel. Decentralization will be emphasized with clearer responsibilities and authorities for different entities. Quality assurance and accreditation schemes will be implemented, with a gradual application of standards used by developed countries. The establishment of private institutions, including accredited and 100 percent foreign-invested institutions in science, technology, and economic management will be promoted. Foreign scientific and educational experts, as well as Vietnamese expatriates will also be encouraged to teach in Vietnam.

Health care finance

The financing of healthcare for the poor and near-poor has been considerably strengthened. Politburo Resolution 46 of February 2005 urged the government to finance curative care for the poor, for children under the age of six and for other social policy

beneficiaries, in order to advance towards universal HI by 2010. Decree 63 and its component circulars (21 and 22) are the operational dimension or ‘action plan’ of Resolution 46. The Decree represents a key step in shifting from the direct funding of health care providers to demand-side funding. It mandates compulsory HI for several groups, including workers on contracts of three months or more, pensioners, children under the age of six and beneficiaries under Decision 139 on the provision of health care to the poor. Health services can be received from public or private providers as long as they are contracted by Vietnam Social Insurance (VSI). Compulsory HI holders will be entitled to both in-patient and out-patient services. Transportation costs will be covered in case of referral for the poor and those in remote areas. Voluntary HI is available to all, including those under compulsory HI who wish to obtain a higher coverage.

Current figures indicate that about 25 percent of the population is covered by HI. VSI projects that this will rise to 64 percent by 2008, to a 100 percent by 2010. It is estimated that about 28 percent of the population will be covered by compulsory HI by 2010. VSI is the agency in-charge of the implementation of the HI policy. The MOH will issue technical standards against which VSI will assess and contract providers. The MOH and MOF will provide guidance on the management of insurance funds. The MOH will deal with complaints relating to health care, while the MOF will deal with complaints on fund management. The VSI will handle administration for the compulsory and voluntary schemes, accreditation and registration of providers, and dissemination of information about HI. The VSI will emerge as the key purchaser of health services. This role would open up opportunities for new forms of contractual arrangements between the VSI and health service providers, and for more vigorous engagement of the private sector and civil society organizations in health care. The VSI capacity to execute this role will require considerable strengthening.

At the same time Decision 139 is being revised to expand the number of households who are eligible for benefits. Beneficiaries will be “the poor” as defined by the revised and higher poverty line, ethnic minority people, and “near-poor” people living in rural and mountainous regions who have an income level of more than 1 to 1.5 times of the national poverty line. The poor and ethnic minority people will be entitled to compulsory HI, and will be fully supported by the state budget with a premium of 60,000 dong. The “near poor” will be financially supported to enroll in voluntary HI from 2007, at a minimum level of 30 percent of the insurance premium. Provincial health care funds for the poor will support treatment costs, not covered by compulsory HI, up to a maximum of 10 million dong per hospital stay. For the near poor these funds will provide support to cover catastrophic illnesses. The revised poverty line will see a large increase in those classified as “poor” people who are eligible for free HI. Province-level Departments of Health are welcoming this change, but reservations exist regarding the increased administrative burden associated with reaching this expanded group and informing them of their rights.

Strengthening poverty reduction programs

Program 135 has been revised to more effectively support the development of communes facing extreme hardship in ethnic minority and mountainous areas. Program 135 is one of the national targeted programs that Vietnam employs to ensure that national

goals are met in the context of increasing decentralization. Under the program, which was first approved in 1998, communes receive a resource allocation that is most often used to develop local infrastructure, such as roads, irrigation systems, schools and health centers. Seven years of implementation have seen both successes and shortcomings. The revision to the design, components, and procedures of the program builds on the success and addresses the shortcomings. The main objective of the program is to eliminate food poverty and achieve a poverty rate of less than 30 percent in the selected communes by 2010, thereby also reducing the widening poverty gap between ethnic minorities living in remote areas and the rest of the country. In its second phase the program is better targeted, which should help in reaching a higher proportion of remote ethnic minority communities. The budget allocation for agriculture and forestry extension and support has been considerably increased, from around 3-4 percent to around 20 percent. This reflects the recognition that infrastructure investments alone were not enough to reduce poverty among ethnic minorities and that greater effort was needed to improve their livelihood opportunities. The allocation for operation and maintenance of infrastructure has also been raised to about 10 percent. This should enable a reduction in the burden of local contributions borne by already poor communes. The revised program will devolve greater control over investment decisions to commune (and even village) level, with measures to increase participation and capacity in scheme selection, siting, technical design and construction supervision. Increased effort will be devoted to promoting public access to information as a tool in achieving greater transparency and accountability.

Environmental Sustainability

Economic tools for environmental protection have been developed and strategic environmental assessments are being piloted. The new Law on Environmental Protection (LEP) will take effect from July 1, 2006. The law includes provisions for adoption of “polluter pays” measures; for instance for waste discharge into water bodies and the disposal of hazardous wastes. The law also foresees payments for natural resources use and rehabilitation, and reliance on environmental protection funds. In addition, the LEP improves the requirements for Environmental Impact Assessments (EIA) and introduces a requirement for Strategic Environmental Assessment (SEA) of sectoral and regional development plans.

The first decree to guide the implementation of the LEP has been prepared. It focuses on the application of national environmental standards, responsibilities for hazardous waste management, and the procedures for EIA and SEA application. In parallel, MONRE has also further developed the regulations to implement Decree 67, on Environmental Protection Charges for Waste Water, which will enable improved control of water pollution. The draft Circular on Wastewater Pollution Coefficients, identifying the volume of pollutants in industrial waste water as a basis for fees to be levied under Decree 67, was submitted in April 2006, and is expected to come into force in early July 2006.

SEAs should improve the integration of measures for environment protection into strategies, plans, and programs. Such “upstream” environmental analyses take place “above” the project level. They represent an important step for Vietnam, at a stage of rapid economic growth and massive public investment in infrastructure, when large cumulative

impacts at the regional and landscape levels can be expected. Two SEA pilots were carried out on socio-economic development plans, one for Ha Tay province and the other for Dai Tu District, to promote sustainable development and management of the Tam Dao National Park and its buffer zone. Two additional SEA pilots are underway, one for the Vung Tau port development plan, and the other for EVN's hydropower master plan, focusing on biodiversity impacts.

Vietnam is also improving the implementation arrangements for the Kyoto Protocol on climate change, through Decision 35 of the Prime Minister approved in October, 2005. This decision assigns responsibilities among the ministries for expanding Vietnam's participation in the Clean Development Mechanism (CDM) and mainstreaming CDM activities into provincial and sectoral development plans. To date, four CDM projects have been approved and an additional 25 projects are in various stages of development.

Improved Planning

The government has submitted its SEDP 2006-2010. The SEDP has been built on extensive consultations not only within government but also with a broader range of stakeholders (including mass organizations, academics, the private sector, civil society and development partners). The National Assembly discussed the draft SEDP in its November 2005 session and will formally adopt it during its current session. The SEDP received the endorsement of the Party Congress in April 2006. The document represents considerable progress in developing an outcome-focused, medium-term plan, which combines the twin objectives of economic growth and social inclusion, and describes the reforms that will ensure sustainability in the long run. Importantly, the document explicitly recognizes the institutional and regulatory challenges associated with completing the transition to a market economy. It describes a large number of planned legislative actions which, together with the reform agenda implied in the accession to the WTO, will strongly support this transition. The SEDP should thus serve as a framework to allocate public resources over the medium term and as a mechanism to align donor support to national priorities. A monitoring and evaluation system for the implementation of SEDP has also been developed, and is being finalized. The recognition of three explicit pillars: economic, social and environmental, reveals the importance attached to keeping development inclusive and sustainable. In implementing the SEDP, however, it will be crucial to emphasize the cross-cutting issues underlying all three pillars, which are mainly related to governance.

Strengthening public service delivery

New regulations have been issued to strengthen the delivery of public services through improved monitoring, the introduction of user feedback, and limits on salary expenditure. This has been done through the issuance of Decree 43 which replaces Decree 10 on the autonomy and accountability of public service entities in sectors such as health, education, transport, culture and sports. By allowing public service delivery units to charge fees, the earlier decree had introduced powerful incentives to improve quality. However, there were indications that the provision of basic services to be provided free of charge, or

at low prices established by government regulations, had suffered as a result of such incentives. Moreover, many service delivery units face limited competition at the local level. Because Decree 10 allowed considerable flexibility to use revenue from fees to pay higher salaries, there was also an incentive to charge excessively high prices for services. The new regulation, Decree 43, makes it compulsory for service delivery units to set aside 25 percent of their net revenues to improve service quality, thereby limiting the amount available for salary increments. Decree 43 also includes salary caps that are inversely related to amount of financial support received from the government budget. The decree requires that performance standards be set for service delivery units under guidelines provided by the responsible line ministry. The criteria to evaluate service delivery units will include workload, quality of the service, time taken to provide the service, and compliance with relevant regulations. Monitoring and evaluation is to be conducted not only by the line ministries, but also by relevant state inspection and audit agencies. The decree also introduces mechanisms for eliciting feedback from service users that go beyond “mailboxes” to potentially include instruments such as “citizens’ report card” surveys.

Fighting corruption

A Law on Corruption Prevention and Control was passed by the National Assembly in November 2005, and will take effect in June 2006. In February 2006 the Prime Minister issued an Action Plan delineating the roles of various ministries and agencies in ensuring its effective implementation of the law. The law was drafted in parallel with the preparation of the first comprehensive diagnostic study on corruption in Vietnam. A central anti-corruption steering committee is to be established. This committee is expected to comprise representatives from the government, the National Assembly, state procurator, court and police, and will be headed by the Prime Minister. Its powers may include the ability to temporarily suspend ministers and chairpersons of people’s committees and people’s councils from their posts if suspected of wrongdoing.

The main initiatives introduced for fighting and controlling corruption include increased public disclosure and transparency in areas such as public procurement, civil works, management and equitization of SOEs, auditing of the state budget, management and use of land, and personnel management. The law specifies the contents and modalities of such disclosure. It also provides individuals with the right to request for information from specified bodies, such as people’s committees. The law strengthens the accountability of heads of organizations and agencies by specifying that they shall be responsible for corruption occurring inside the entities under their management and authority. Greater simplification of administrative procedures, including increased reliance on electronic interfaces, is another tool for preventing corruption. The government will also specify and regulate transactions that must be settled through the banking system. The law encourages “whistle-blowing” by the public and other agencies, and the rewarding of such actions.

The Action Plan instructs ministries and people’s committees of the provinces and cities to urgently review legal documents under their management and remove those contents which are inconsistent with policies and laws of the state, which overlap, are excessively bureaucratic, and have become a source of harassment for the general public

and enterprises. Ministries, agencies and provinces are to codify regulations on procedures, including specifying necessary documents for the procedures, and the time limit for completing the procedures. These details are to be publicized through the mass media, as well as posted at the office premises. The actions are in line with the overall program for Public Administration Reform.

A key provision of the law relates to the compulsory declaration of assets and income of state employees. The broader definition of the “declarer”, so as to include “spouses and children in the same residential certificate,” is commendable. A separate decree will be prepared by the Government Inspectorate (GI) to guide the implementation of this provision. A widespread application of asset declaration in the initial period could risk overwhelming the capacity of inspectors, thereby diluting its efficacy. To ensure its effectiveness a phased approach could be employed, for instance, by piloting asset declaration in the most corruption-prone agencies or for high-ranking public officials. The Ministry of Home Affairs (MOHA), in coordination with the MOF and the SBV, has been tasked to prepare, by October 2006, a plan on monitoring incomes of officials of high-rank or holding a position of power. The MOF will take the lead in drafting the regulation, by October 2006, regarding the receipt and offering of gifts by public employees.

An inspection plan being prepared by the GI will focus on four areas: public works, land use management, management of budget revenues and expenditures, and management of public assets. The GI will take the lead and coordinate with MOHA, the Ministry of Natural Resources and Environment (MONRE), Ministry of Public Security (MOPS), and the MOF in conducting inspections in following areas where public complaints are common: management of housing and land; investment and construction licensing; taxation, customs; motor vehicles examination and registration, driving licenses; residential registration. The MOPS and the GI, in coordination with MOHA, will take the lead in drafting the decree detailing the functions and powers of the Specialized Anti-corruption Units under the MOPS and the GI. The GI will also submit to the government a report for ratification of the United Nations Convention Against Corruption (UNCAC).