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**Vietnam: Poverty Reduction Strategy Paper—Annual Progress Report—
Joint Staff Advisory Note**

The attached Joint Staff Advisory Note (JSAN) of the Annual Progress Report on Implementation of the Poverty Reduction Strategy Paper for **Vietnam**, prepared jointly by the staffs of the World Bank and the IMF, was distributed with the member country's Annual Progress Report on Implementation of the Poverty Reduction Strategy Paper (PRSP) to the Executive Boards of the two institutions. The objective of the JSAN is to provide focused, frank, and constructive feedback to the country on progress in implementing its Poverty Reduction Strategy (PRS).

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INTERNATIONAL MONETARY FUND
AND
INTERNATIONAL DEVELOPMENT ASSOCIATION

SOCIALIST REPUBLIC OF VIETNAM

**Poverty Reduction Strategy Paper Annual Progress Report
Joint Staff Advisory Note**

Prepared by the Staff of the International Development Association (IDA)
and the International Monetary Fund (IMF)

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I. INTRODUCTION

1. The Comprehensive Poverty Reduction and Growth Strategy (CPRGS) was approved by the Prime Minister of Vietnam on May 21, 2002 and was discussed by the Boards of the IMF and IDA in July 2002. The CPRGS, which is Vietnam's PRSP, is situated within a broader framework of government strategies and plans and is regarded by Government as linked to the ten-year Socioeconomic Development Strategy (SEDS) and the five-year Socioeconomic Development Plan 2001-2005 (SEDP). The first Annual CPRGS Progress Report was prepared in November 2003 and discussed by the Boards of the IMF and IDA in February 2004. In November 2004, the Government of Vietnam completed the "Vietnam Growth and Reduction of Poverty Annual Progress Report 2003-2004" (called the "Report" in this Note).

2. The Report was prepared by the Ministry of Planning and Investment (MPI) and the Steering Committee of the CPRGS and was timed to generate discussion at the Consultative Group meeting in December 2004. Though the draft Report was shared within Government before publication, its drafting process involved less energetic consultation outside Government than the one for the last progress report and the CPRGS itself.

3. The Report generally provides a comprehensive and balanced record of socio-economic developments in Vietnam. It also synthesizes desired policy outcomes from the CPRGS and Five-Year SEDP for 2001-2005, paving the way for the planned merging of these documents for the period 2006-2010. One of the most significant developments over the last year, which is well-described in the Report, is the decision to incorporate the CPRGS into the mainstream five year planning process. The Staffs strongly welcome the Government's intention to prepare the SEDP 2006-2010 according to the same principles that guided the preparation of the CPRGS. The Staffs believe that the Prime Minister's directive, and the associated MPI instructions, that the preparation of the SEDP should emulate some of the

participatory approaches to planning that characterized the preparation of the CPRGS are an important step forward in reforming planning processes. The MPI instructions specifically require that the five year plan should address the Vietnam Development Goals (VDGs) and the Millennium Development Goals (MDGs), which might motivate a more outcome-focused strategy. And they strongly suggest that the analysis used to underpin the plan should make use of international methods and standards, which will allow a broader range of robust data to inform the development of the plan. This will be important, since one strength of the CPRGS lies in its openness in bringing some politically sensitive issues to the debate on poverty reduction.

II. IMPLEMENTATION OF THE STRATEGY

A. Macroeconomic Performance

4. The performance of the Vietnamese economy remained strong during 2004. GDP growth accelerated to 7.7 percent despite several exogenous shocks, including the outbreak of avian influenza, severe weather conditions, and a sharp rise in the price of key imported commodities. However, an adverse consequence of these supply shocks was a sharp rise in inflation, which tested the Government's macroeconomic policy-making ability.

5. In this regard, the Report could have compared recent outturns with initial targets, and could have also conveyed the policy trade-offs faced by the Government during 2004 as well as the prioritization of the real growth target versus inflation control. While the Government reduced its fiscal deficit as compared with previous years, credit expansion was in excess of 40 percent by the end of the year. The rapid growth of credit is of concern because of a potential accumulation of non-performing loans of state-owned commercial banks that could ultimately become a fiscal burden and threaten medium-term debt sustainability.

6. Looking forward, future Reports require an updated medium-term macroeconomic framework. The inclusion of such a framework was an important recommendation in the 2004 JSA. An adequate macroeconomic framework would need to include medium-term fiscal targets and associated measures and debt sustainability objectives. In addition, the depiction of monetary and foreign exchange policies as flexible does not seem consistent with the State Bank of Vietnam's public announcement that the dong's depreciation for the whole of 2005 would be limited to one percent. Furthermore, the Report could have clarified how the Government plans to address similar challenges to those faced in 2004 going forward into 2005, when real GDP would need to reach 8.6 percent to fulfill the SEDP 5-year goal. In light of downside export market risks as Vietnam remains outside the WTO and the severe competition facing Vietnam's garment exports, the real GDP target should be viewed as indicative rather than mandatory, so as to prevent imprudent macroeconomic policies toward its achievement. The Staffs understand that the Government foresees that a largely unchanged fiscal stance, together with the maintenance of broad-based stability in the exchange rate and interest rates, would suffice to contain the inflation rate below 6.5 percent in 2005. However, they would recommend the development of a contingency plan to tighten

macroeconomic policies in the event that inflation threatens to remain significantly higher than targeted in 2005.

B. Implementing structural reforms

7. The Report details the progress on reforms that support Vietnam's transition to a market economy, covering the main issues in the areas of SOE reform, international integration, tax policy and administration, and private sector development. The Staffs believe that future Reports could ensure that both the review of past performance and the future agenda could be better substantiated with data that are available to Government and with decisions that had already been announced.

8. Both in terms of recent trends as well as plans going forward, the discussion of financial sector reform is, perhaps, the most notable weakness of the Report. The gradual resolution of bad debts and bank recapitalization is viewed by the Government as having strengthened banks, but the Report could have discussed a broader range of measures that could have contributed to a faster progress or how they might have lessened medium-term public costs. Likewise there is no assessment of the Development Assistance Fund, which is mobilizing much more capital than the Vietnam Bank for Social Policies. In the forward looking section, the equitization of State-owned Commercial Banks (SOCBs) is mentioned, but the discussion is limited. The Staffs suggest that the next Report include an assessment of the asset quality of the banking sector against recently adopted standards that reflect international good practices. Also beneficial would be a commentary on reforms that are currently under discussion, such as transforming SBV into a modern and independent central bank charged with the conduct of monetary policy, and the separation of SBV's management and supervision functions with regard to SOCBs.

9. The Report assesses progress on SOE reform against the Government's Master Plan for SOE transformations. It notes that by September 2004, about 55 percent of the planned transformations had been completed. As this fell short of set targets, the Report concludes that progress has been slow. The major reasons for the slower than expected progress are also provided. These include a lack of detailed guidance on measures to value enterprises and deal with bad debts, and uncertainties related to enterprise management after equitization. The Staffs concur with the Report's assessment regarding the pace of SOE reform, but also note that the targets have been ambitious. Ownership transformation seems to be associated with more substantive restructuring and is reflected in the operation of the social safety net for redundant SOE workers. One area where SOE reform has lagged behind is performance assessment stipulated by Decision 271, but the Report does not address this issue.

10. There have been welcome revisions to the legal documents required for improving the equitization process, extending equitization to larger enterprises and listing equitized SOEs on the stock market. Decision 155 reduced the list of sectors in which state intervention is justified. It now includes only strategic activities such as national defense, printing of banknotes, the national electricity grid, and major ports. For large economic groups of SOEs

organized under the form of General Corporations (GCs) a decree to convert them to the holding company model has been approved. This model was recommended by a series of diagnostic audits and has the potential to improve corporate governance of the GCs. Key changes were also introduced in the equitization process, whereby outside agencies are allowed to conduct valuations. The ability of strategic investors and other outsiders to buy shares has been extended, and the shares themselves are sold through auctions.

11. The number of SOEs shrunk in absolute terms and an additional 35,000 new private businesses were registered in 2004, representing a year-on-year increase of 26 percent in number and 24 percent in registered capital. FDI commitments rose sharply in 2004, reaching a seven year high of \$4.2 billion, while disbursements reached \$3.1 billion. An assessment of the factors that have contributed to the impressive increase in FDI, and of the remaining constraints to more rapid disbursements of past FDI commitments, would have been helpful.

12. The Staffs appreciate the Government's policy goal of creating a more supportive environment for private enterprises during 2005. This includes the introduction of the common investment law and a "unified" enterprise law as well as a commitment to substantially streamline business registration procedures and regulations. The Report provides details on numbers of private businesses registrations, but the performance of firms in sub-sectors and constraints to their growth could have been noted. There are challenges for businesses associated with greater international integration and the Report identifies a role for Government in providing guidance to businesses to tap new markets and enhance their product quality.

13. Important progress has been made on international integration. In particular, the Staffs welcome the compliance with tariff reduction schedules on regional trade agreements and the adoption of international codes for classification of imports and exports which are noted in the Report. However, Vietnam's average MFN tariffs are still high, and various non-tariff barriers are in place. The ninth Working Party meeting for Vietnam's accession to the WTO took place in December 2004, and an informal meeting of the Working Party was held on May 20, 2005. The next meeting is tentatively scheduled for September 2005. The significant step of drafting the "Working Party Report" was achieved in November 2004. Ten WTO bilateral agreements had been concluded as of July 11, 2005 (with Argentina, Brazil, Canada, Chile, Cuba, the EU, Japan, Korea, Singapore, and Uruguay). Significant progress will be required to meet the target accession date of end-2005, since more than a dozen agreements remain to be signed before accession. To facilitate accession, the authorities are to implement an ambitious legislative agenda, including the passage of a common investment law and a unified enterprise law. Negotiations are on-going with Australia, China, Colombia, India, New Zealand, Switzerland and the U.S.

14. The Staffs welcome the Report's emphasis on the need for increased efficiency of public investment projects through better project selection, implementation and supervision. The Report's recognition of the need suggests the authorities' greater accountability for improving project quality. Public investment is clearly a major area of reform as it concerns over 30 percent of budgetary expenditure.

C. Inclusive and sustainable development

15. The Report describes a continuing trend in poverty reduction using data collected by the Ministry of Labor, Invalids and Social Affairs (MOLISA). The Staffs believe that the Vietnam Household Living Standards Survey (VHLSS) is likely to confirm that poverty has continued to decline when its new data become available in the third quarter of 2005. If confirmed, this sustained reduction in poverty represents truly remarkable success in translating growth into poverty reduction over the past decade.

16. However, continued resistance to using sound data from the VHLSS to monitor and describe broad trends in poverty may distort strategies and actions to reduce poverty in the future. For a number of methodological reasons, the use of household survey data for poverty monitoring is likely to produce a more accurate picture of changes in poverty over time than the methods that are currently used by MOLISA to meet both targeting and monitoring requirements simultaneously. The Staffs strongly recommend that the Government consider using VHLSS as an instrument for estimating poverty at national and provincial level.

17. The Report presents data on poverty in ethnic minority areas that suggests very rapid rates of poverty reduction over the past two years. These data, which in fact are not clearly disaggregated by ethnicity, may lead to the conclusion that past policies towards ethnic minorities have been more successful than is true in reality and may not motivate the most effective strategies in the future. The Staffs believe that it is particularly important to examine the full range of quantitative and qualitative data on ethnic minority poverty as the SEDP 2006-2010 is being developed. More generally, the Staffs feel that the SEDP and future Reports could provide more analysis of the drivers of growing inequality and potential actions and measures to address increasing disparities.

18. Issues related to the vulnerability of people migrating to urban areas are not covered in the Report, perhaps because data limitations have made it difficult to assess the link between mobility and socioeconomic well-being. Data from the recent mid-term Census of Ho Chi Minh City suggest that recently-arrived migrants are a significant proportion of the city population (approximately one third). The Staffs believe that the Government has made an important step forward in tackling the gaps identified in the last JSA by including questions in the VHLSS that allow the poverty of mobile populations to be tracked more carefully. The Staffs believe that the challenges of managing rapid urban development are generally not well-described in this Report and merit stronger attention in the forthcoming SEDP.

19. The Report captures the overall developments in health and education sectors. Progress in extending the coverage of the Healthcare Funds for the Poor to a national level and in establishing a structure for implementing the HIV/AIDS strategy are particularly noteworthy. The introduction of the new law on forestry is not described in the Report, though the Staffs believe that this, together with the new Land Law, sets the legal basis for important structural reform in this sector which could bring significant benefits to poor, forest-dependent communities.

20. The Staffs welcome the introduction of Resolution 41 on the improvement of environmental protection, which indicates that increasing attention is being paid to environmental issues. Going forward, the Staffs would like to encourage a more cross-cutting approach to environmental protection by locating it more centrally in the context of sustainable development and Agenda 21. Two specific areas of concern emerge from the introduction of the Environmental Protection Fund, however. The first concern is the possible distraction of funds away from maintenance of drainage systems and waste water treatment into this Fund. A second reservation lies in the centralized nature of this fund, since only half of it is retained at the sub-national level.

21. The Staffs recognize the achievements in promoting gender equity over the period. In particular they welcome the release of Circular 1 by the Ministry of Natural Resources and the Environment (MONRE), which should bring land allocation procedures in line with the legal provisions to protect women's rights to land tenure.

D. Promoting modern Governance

22. Staffs support the recent developments in unifying corporate tax rates, modifying personal income tax and piloting VAT self assessment, which are described in the Report. Looking forward, the Staffs agree that there is a need for strengthened tax administration and simplified procedures, but regret the lack of detail in this section.

23. The Report briefly mentions the use of Medium Term Expenditure Frameworks (MTEF) to improve the quality of expenditure planning and to sharpen the ability to link budgets to desired outcomes. The Government has published a CPRGS-linked report which describes the issues in managing public resources for poverty reduction and growth. It is important and welcomed that MPI has played an active role in this analysis. The Staffs strongly support the recommendations of this report, which include accelerating the MTEF process and connecting it to the CPRGS/SEDP process, thus strengthening the link between planning and budgeting. Looking forward, the Staffs encourage the use of MTEFs to ensure that the budget reflects the poverty reduction and growth goals of the SEDP and emphasize the importance of incorporating a budgetary dimension in the next SEDP.

24. Debt management is rightly stressed by the Report, but this should also be extended to publishing debt data. Consideration should also be given to the monitoring of debt arising from off-budget expenditures as well as the build-up of contingent liabilities related, for instance, to DAF operations and SOCB lending.

25. The Report notes the progress in people's participation through the Grassroots Democracy regulations. However, incentives to implement the policy remain a challenge. In this context, it is encouraging that the Ministry of Finance has supported research, proposed in the last JSA, to investigate the systemic impediments to increasing transparency and accountability in the commune budgeting process.

26. While the Report outlines a vision for strengthening community participation in preparing plans and policies, it fails to delineate specific devices for this. In this regard, the

Staffs believe that the establishment of a comprehensive legal framework for NGOs and community organizations is overdue. The Staffs note with some concern that the NGO law does not appear on the legislative agenda of the National Assembly in either 2005 or 2006. The role for civil society in contributing to policymaking, planning and monitoring processes remains vague.

27. The Staffs welcome the Government's increased emphasis on systemic measures in the fight against corruption, representing a move away from a more punitive approach. The Government Inspectorate has been requested to take the lead in drafting a new law on anti-corruption to be approved by the National Assembly in 2005. The Staffs hope that the ongoing diagnostic assessment on corruption will inform the implementation guidelines of the new anti-corruption law.

28. The progress in implementing the One Stop Shop at local levels is commendable. The One Stop Shop provides the framework for an accessible and recognizable entry point for people in need of administrative services, increasing transparency on fees and procedures, improving the quality of services, and streamlining procedures. The Staffs feel that increased focus should be devoted to ensuring the quality of the model, in particular with regard to procedural streamlining and enhanced transparency for service users.

III. MANAGEMENT AND COORDINATION MECHANISMS

29. The Report draws on the experience of collaborative pilots in reforming planning processes at sub-national levels of Government (termed "CPRGS rollout") in proposing that intensive work will take place at the provincial level in coming years. This represents progress in addressing an issue raised in previous JSAs in forging a stronger connection between nationally defined strategic targets and local realities and resource allocation decisions.

30. With the adoption of the CPRGS, the Government introduced a set of new economic and social indicators many of which referred to the attainment of actual development results as embodied in the VDGs and MDGs. As government agencies and provinces have embarked on a process to prepare the new five year plans for the period 2006-2010, clear government instructions have been issued that these should be based on reaching actual development outcomes and results, to be accompanied by an appropriate system to track the achievements of these results. The Staffs welcome this development but encourage the Government to make sure that the 'national system of indicators' is reviewed to make sure it is based on the monitoring framework of the new national and sectoral five year plans. This would require intense cross-departmental debate within ministries, and between ministries and MPI, on priority goals, social outcomes and a limited set of indicators within the VDG framework.

31. Given that information on development outcomes is often best collected directly from households and enterprises through surveys, this discussion of the national system of indicators requires close collaboration between line ministries, MPI and the General Statistics Office (GSO). Not only does the GSO have the required technical expertise in the definition

of indicators and their measurement, but also given its neutrality it is best placed to collect reliable data on the actual results and outcomes of public actions. The GSO can also collaborate in the compilation of information generated through government reporting systems. The Staffs believe that there is now an opportunity to accompany the new five year plans with a clear results framework consisting of a 'core' set of clearly defined indicators that are linked to social outcomes, and each linked to an agreed reliable method of data collection and the agency responsible. At the same time, the GSO would need to step up the dissemination of survey results and raw data to line ministries, research institutes and provinces. These results should be included in future performance reviews to allow direct comparison of outcomes with initial targets.

IV. CONCLUDING REMARKS

32. The Staffs welcome the intention of the Government to integrate the CPRGS into the next SEDP, which suggests that the next SEDP will focus strongly on the core challenges of how to promote growth and reduce poverty over the next five years. The Staffs' review of this Report indicates that the following will be important areas for consideration as the SEDP is prepared. First, the elaboration of a macroeconomic framework will allow better informed consideration of policy trade-offs and management of the economy. Second, reforms to the financial sector are now a pressing concern and require explicit articulation. Third, a decision to use high quality survey data as a basis for analyzing and monitoring trends in poverty will allow improved public actions and resource allocation for poverty reduction and management of growing inequality. Fourth, a concerted and collaborative effort across Government to identify outcomes and associated indicators will be important in building focus and accountability in the next SEDP. Fifth, determined implementation of the Government's articulated agenda for improved management of public finances in relation to clearly identified outcomes will enhance the prospects of achieving the goals of the SEDP. Finally, actions which improve the participation of poor communities in the planning and monitoring process of the next SEDP will lead to stronger accountability in the delivery of the SEDP. The latter is likely to involve empowering local civil society organizations to play a more meaningful role.