

Vietnam: 2003 Article IV Consultation—Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Vietnam

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2003 Article IV consultation with Vietnam, the following documents have been released and are included in this package:

- the staff report for the 2003 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **June 18, 2003**, with the officials of Vietnam on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on August 28, 2003.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff statement of **October 3, 2003** updating information on recent developments.
- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its October 3, 2003 discussion** of the staff report that concluded the Article IV consultation.
- a statement by the Executive Director for Vietnam.

The document(s) listed below have been or will be separately released.

Selected Issues Paper
Statistical Appendix

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

VIETNAM

Staff Report for the 2003 Article IV Consultation

Prepared by Staff Representatives for the 2003 Consultation with Vietnam

Approved by Masahiko Takeda and Mark Allen (PDR)

August 28, 2003

- A mission visited Hanoi and Ho Chi Minh City during June 2–18 to conduct discussions for the 2003 Article IV consultation and continue discussions for the third review under the PRGF-supported arrangement.
- The team comprised Messrs. Nolan (head), Untererberdoerster and Peiris (EP), Ms. Al-Mashat (all APD), Mr. Wang (PDR), Mr. Lueth (FAD), Mr. Kruse (MFD consultant), and Mr. Hemus (FIN), and worked closely with Mrs. Adams (Senior Resident Representative) and her staff. This report is a team effort, led by Mr. Nolan.
- The mission met with senior officials from the Ministries of Finance, Planning and Investment, and Trade, the State Bank of Vietnam (SBV), the State Audit of Vietnam (SAV), other government agencies, and state-owned and private enterprises and financial institutions.
- A three-year PRGF arrangement for SDR 290 million (88 percent of quota) was approved on April 13, 2001. Two reviews have been completed, broadly as scheduled. In concluding the second review under the PRGF on June 21, 2002, Directors stressed the importance of firmer implementation of the structural reform agenda, as well as continued discipline in macroeconomic management. Discussions for the third PRGF review commenced in September 2002; outstanding issues for the review are reviewed in Section VI of this report.
- The 2001 Article IV consultation was completed on November 21, 2001, along with the first PRGF review.
- Vietnam's statistical base has significant limitations for surveillance purposes; STA is providing assistance to address deficiencies in the national accounts. Vietnam wishes to be formally recognized as a subscriber to the GDDS, and is to provide STA with the relevant meta-data later this year.
- Staff reports for the PRGF and ensuing reviews have been published; the authorities agreed to consider publication of this report, but have not yet indicated their consent.
- Vietnam maintains exchange restrictions under the transitional arrangements of Article XIV, Section 2. Following recent removal of a tax on profit remittances, staff are conducting a review of exchange regulations to establish the remaining measures that would be needed to allow Vietnam accept Article VIII.

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List of Acronyms

| | |
|-------|---|
| AFTA | ASEAN Free Trade Agreement |
| AML | Anti-Money Laundering |
| BIDV | Bank for Investment and Development of Vietnam |
| BSP | Bank for Social Policies |
| CPRGS | Comprehensive Poverty Reduction and Growth Strategy |
| DAF | Development Assistance Fund |
| FDI | Foreign Direct Investment |
| FIE | Foreign-Invested Enterprises |
| GIR | Gross International Reserves |
| GSO | General Statistics Office |
| IAS | International Accounting Standards |
| ICB | Industrial and Commercial Bank of Vietnam |
| ICOR | Incremental Capital Output Ratio |
| MFN | Most Favored Nation |
| MoF | Ministry of Finance |
| MPI | Ministry of Planning and Investment |
| MTEF | Medium-Term Expenditure Framework |
| NIR | Net International Reserves |
| NPL | Non-performing loan |
| ODA | Official Development Assistance |
| SAV | State Audit of Vietnam |
| SBV | State Bank of Vietnam |
| SOCB | State-Owned Commercial Bank |
| SOE | State-Owned Enterprise |
| S&P | Standard and Poor's |
| USBTA | United States-Vietnam Bilateral Trade Agreement |
| VAS | Vietnamese Accounting Standards |
| VAT | Value Added Tax |
| VBARD | Vietnam Bank for Agriculture and Rural Development |
| VCB | Bank for Foreign Trade of Vietnam |
| WTO | World Trade Organization |

EXECUTIVE SUMMARY

Vietnam has experienced strong growth and impressive poverty reduction over the past decade. Macroeconomic management has been generally sound; the role of the state has declined but remains substantial, notably in the banking system; and integration with the international economy has increased significantly.

Recent economic performance has been strong, fueled by robust exports (notably to the US) and domestic investment; **the near-term outlook appears favorable,** notwithstanding an adverse swing in the current account position; and **the staff's medium-term outlook is for continued strong growth,** with modest inflation and sustainable fiscal/external positions.

Key risks to the positive outlook stem from Vietnam's still partial transformation to a market economy, and the dominant role the state plays in financial intermediation. A key risk is misallocation of funds being marshaled through the budget and banking system, impairing growth performance and the fiscal position. Other significant risks include (a) a slowing of private investment, if weaknesses in the business climate are not addressed, and (b) sluggish export performance, from intensified competition in export markets or impaired market access for Vietnam.

Discussions focused on macroeconomic policies and key structural reforms for maintaining strong growth performance:

- ***In the fiscal area,*** with the 2003 budget on track for a deficit of around 2½ percent of GDP, discussions focused on a) the medium-term fiscal outlook, factoring in the impact of substantial onlending activity and the budgetary cost of structural reforms, b) the pressures on budgetary revenues over the medium-term, and c) the need for effective appraisal of government-financed investment projects.
- ***In the monetary area,*** staff called for (a) some reining in of the rapid pace of credit growth, against a backdrop of weak credit risk management practices, (b) steps to develop money markets and reduce market segmentation, and (c) more flexible management of the exchange rate.
- ***On enterprise reform,*** staff pressed for measures to strengthen governance of state enterprises (SOEs), revive the equitization process for SOEs, and improve the environment for private sector development. Discussions on ***banking sector reform*** focused on strengthening credit risk management, resolving the sizeable stock of NPLs, and enhancing bank supervision. Officials agreed on the challenges ahead, while noting the need to build consensus for key reforms. They also underscored Vietnam's commitment to early membership of the WTO.

I. INTRODUCTION

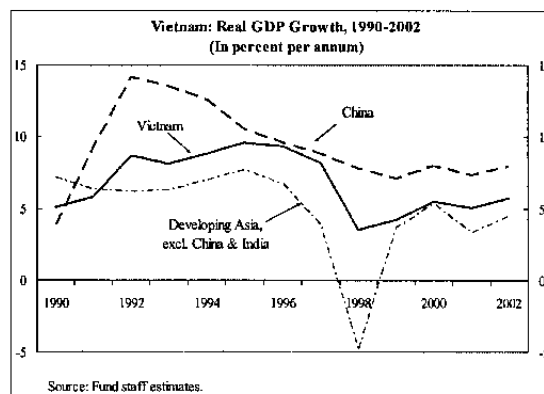
1. **Vietnam has experienced strong economic growth and impressive poverty reduction over the past decade**, aided by favorable initial conditions (education levels, oil reserves), sound macroeconomic policies, political stability, and increasing engagement in the international economy. But annual income per capita is still under \$500, and the country faces significant challenges in maintaining high growth over the medium term.

2. **Discussions for the 2003 Article IV consultation focused on the adequacy of macroeconomic and key structural policies for maintaining strong growth performance.** The Fund has been supporting the government's economic program under a three-year PRGF arrangement that commenced in April 2001, a program that was further elaborated in the Comprehensive Poverty Reduction and Growth Strategy (CPRGS), completed in May 2002.¹ The Article IV consultation provided the opportunity for a fresh look at key elements of the strategy—a chance to “check the engine” of the Vietnamese growth machine.

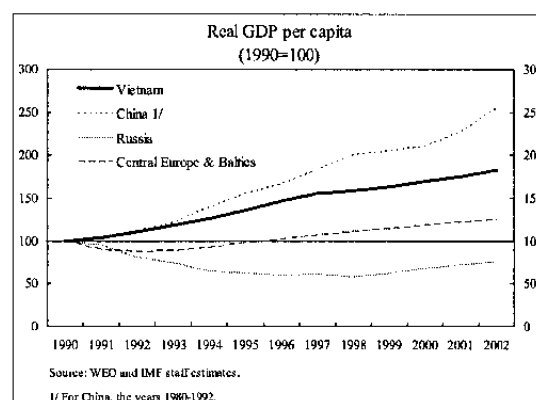
II. BACKGROUND

3. **Vietnam has experienced solid and sustained growth since it embarked on its “doi moi” reform program in the late-1980s.**

Agricultural sector liberalization provided a strong growth stimulus during the early years of the reform program, with FDI inflows providing a further boost in the period prior to the onset of the East Asian crisis. After a slowdown during the regional crisis, growth has picked up again, supported in recent years by impressive export performance.



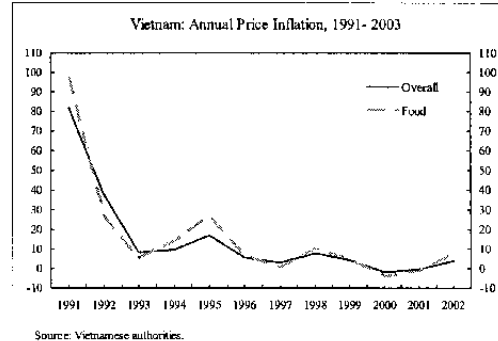
4. **Vietnam's approach to transition from a planned economy has broadly followed that of China**, with early liberalization of the agricultural sector being accompanied by more gradual transformation of the role of the state in the formal sector, notably industry and finance. Vietnam has not embarked on a broad-based privatization program, preferring to retain ownership of most large and medium-sized state enterprises (SOEs) while pursuing gradual



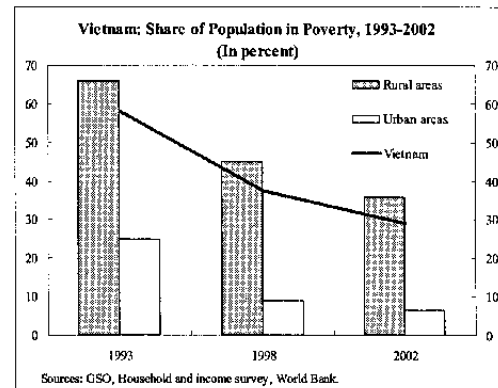
¹ A CPRGS progress report is being prepared for presentation to a Consultative Group meeting in December.

“equitization” of smaller SOEs.² Economic performance has been stronger than in transition economies that adopted “shock therapy” approaches, at least partly reflecting Vietnam’s limited industrialization and low income levels prior to transition.

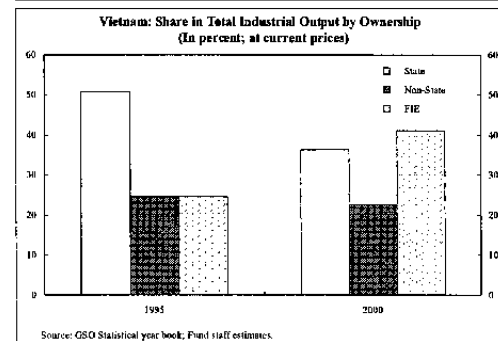
5. **Inflation was high during the early stages of the reform process, but has declined to modest levels in recent years.** National plans envisage inflation on the order of 5 percent per annum, but consumer price inflation has been running below this since 1999.



6. **Sustained economic growth has allowed Vietnam to achieve impressive reductions in poverty levels in a relatively short period.** The share of the population classified as poor (World Bank definition) declined from 58 percent in 1993 to 29 percent in 2002, among the fastest recorded declines in poverty rates in the last 30 years (Table 1, Figure 1). Land allocation to rural households provided a major boost to poverty alleviation in the first decade of reform, as has broad-based export expansion.



7. **The role of the state sector in production is declining gradually, but still remains substantial.** Private domestic ownership is the norm in the agricultural and retail sectors, but the SOE share in industrial production is still sizeable.³ The significance of foreign-invested enterprises (FIEs), typically joint ventures between a foreign partner and an SOE, has risen steadily over time, and they now contribute some 40 percent of industrial production and a quarter of non-oil exports.



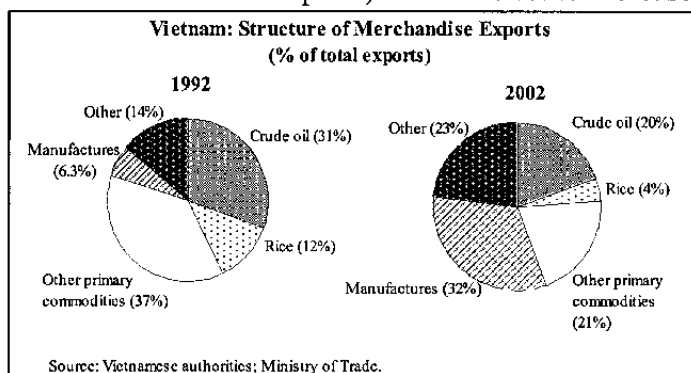
8. **The financial system is becoming more market-based, but state-owned commercial banks (SOCBs) continue to play a dominant role.** Interest rates are now largely liberalized, the exchange rate moves within a daily trading

² Equitization involves sale of state capital in an enterprise at prices based on book value of assets, with preferential terms for managers and employees of the enterprise.

³ Background papers examine the role of the state in production and the reform program for SOEs.

band set by the SBV, and policy-based lending is being shifted to specialized institutions. However, the banking system remains quite segmented and dominated by four large SOCBs, which hold some 75 percent of all deposits and are only gradually being transformed into profit-focused operations. As a result, key money markets are quite thin and underdeveloped, complicating the task of monetary management through indirect instruments; banks still closely follow SBV reference rates; and the SBV continues to play an important role in smoothing movements of the dong.

9. **Vietnam's integration with the international economy has increased significantly over the past decade**, aided by substantial liberalization of imports, and looks set to increase further as trade-expanding measures (AFTA, the USBTA) take full effect. Exports rose by some 21 percent annually in value terms during 1990–2002, with the export/GDP ratio increasing from 22 percent to 50 percent; the composition of merchandise exports has become significantly more diversified, as has the market destination of exports.⁴



10. **Budgetary management has been generally cautious, with fiscal deficits (narrowly defined) maintained in the 0–3 percent range for the past decade** and the government debt stock now at manageable levels. But quasi-fiscal activity, in the form of policy-based lending through the banking system, was significant for much of the period, contributing to sizeable loan portfolio problems for SOCBs.

11. **The once-sizeable burden of external debt has fallen significantly over the past decade**, aided by strong output growth and export expansion and a series of debt restructuring operations, most importantly with Russia in 2000. The bulk of external debt (some 80 percent) is public or publicly-guaranteed, mostly borrowed on concessional terms from multilateral or bilateral official creditors. Vietnam has received solid sovereign ratings from international credit rating agencies (BB- from S&P and Fitch, B1 from Moodys), but has not yet undertaken a sovereign bond issue.

| | 1994 | 1999 | 2002 |
|-----------------------------------|--------|--------|--------|
| Total external debt | 19,083 | 20,330 | 13,083 |
| (In percent of GDP) | 77.4 | 71.4 | 38.3 |
| Of which: | | | |
| Non-convertible debt | 10,286 | 10,574 | 0.0 |
| (In percent of GDP) | 41.7 | 37.1 | 0.0 |
| Of which: | | | |
| Public and public guaranteed debt | 15,309 | 16,552 | 10,207 |
| (In percent of GDP) | 62.1 | 58.1 | 29.9 |
| (In percent of total) | 80.2 | 81.4 | 78.0 |

Source: Vietnam authorities; and IMF staff estimates.

⁴ The trade regime and export performance are discussed in a background paper.

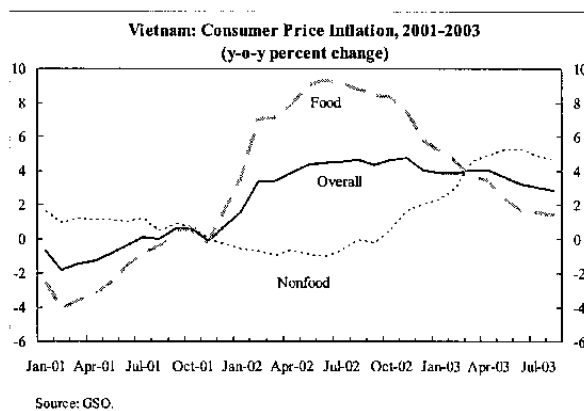
III. RECENT DEVELOPMENTS

12. **Macroeconomic performance has been strong over the past 18 months, fueled by export growth and domestic investment.** Staff estimates suggest output growth near 6 percent in 2002, with slightly faster growth projected for 2003.⁵ Nonoil exports have provided an important stimulus, as producers responded to improved access to the US market under the USBTA.⁶ Investment has also been vigorous, with imports of machinery and equipment up 38 percent in 2002 and 40 percent in S1/03 and foreign direct investment reportedly rising by around 20 percent in 2002, albeit more slowly this year (Table 2).

| | 2001 | 2002 Est. | 2003 | |
|-------------------------------------|------|--------------|-----------|------------|
| | | | June Est. | Year Proj. |
| Real GDP | 5.0 | 5.8 | ... | 6.0-6½ |
| Industrial production | 13.7 | 14.5 | 15.7 | ... |
| Retail sales | 9.1 | 14.6 | 9.7 | ... |
| Merchandise exports | 4.0 | 11.2 | 32.6 | 19.0 |
| Non-oil | 8.7 | 12.9 | 31.8 | 22.2 |
| Merchandise imports | 2.3 | 22.1 | 38.5 | 24.5 |
| Trade balance (US\$ millions) | 627 | -876 | -1,163 | -2,002 |
| Current account (percent of GDP) | 2.2 | -1.1 | ... | -3.5 |
| CPI (average) | -0.4 | 4.0 | 3.7 | 4.0 |
| Nonfood CPI | 0.8 | -0.2 | 4.2 | 4.0 |

Sources: GSO; Fund staff estimates.

13. **Inflation picked up during 2002, but has eased slightly in recent months.** Headline inflation averaged some 4 percent during 2002, after two years of mild deflation, falling back to 3 percent as of July 2003. Non-food inflation shows a distinctive trend from the headline rate, but could ease in the coming months with slower depreciation of the dong and the easing of world oil prices.⁷



14. **Stronger growth has been accompanied by a sizeable deterioration in the external current account position,** notwithstanding surging exports. The current account deficit is expected to be around 3½ percent of GDP in 2003, as compared with a surplus in 2001, financed through a combination of higher long-term capital inflows and a reversal of the previously strong build-up of foreign assets by the commercial banks (Table 3, Figure 2).

⁵ National accounts data have significant limitations; GDP growth numbers are staff estimates.

⁶ The extension of MFN status to Vietnam under the BTA, effective December 2001, is estimated to have yielded a drop in average US tariffs on Vietnamese imports from 40 percent to about 4 percent.

⁷ The background papers include an analysis of inflation dynamics.

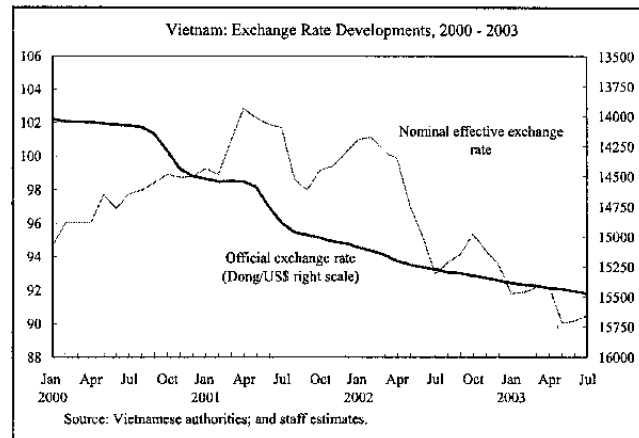
15. **The SBV recorded a modest increase in its foreign reserves during 2002, followed by sharp growth in GIR during the first half of 2003.** The jump in GIR this year reflects both sizeable intervention by the SBV and a large shift in foreign currency assets of the commercial banks from offshore to the SBV, at least partly reflecting a modest increase in the rate of remuneration paid by the SBV.

| | 2002 | 2003 1/ |
|------------------------------|-------|---------|
| (End of period) | | |
| Gross international reserves | 3,692 | 5,616 |
| Net international reserves | 2,956 | 3,826 |
| (Change during the period) | | |
| Gross international reserves | 305 | 1,924 |
| Net international reserves | 401 | 870 |

Source: SBV.
1/ As of end-June.

16. **The monetary aggregates have been growing at a rapid pace,** reflecting the pace of economic expansion, ongoing monetization of the economy, and strong credit demand. Broad money rose by some 18 percent in 2002 and the first months of 2003; credit growth continues at rates in excess of 20 percent per annum, with faster growth in credit to the non-SOE sector (30 percent) and in foreign currency credits (40 percent through April, from a low base). The SBV has adopted an accommodative stance, with the sizeable purchases of foreign currency during 2003 being largely unsterilized. Interest rates have shown little movement (Table 4, Figure 3).

17. **The dong continues to depreciate slowly against the U.S. dollar,** with the SBV intervening more heavily this year to prevent appreciation and build up reserves. The daily trading band within which the rate is allowed to fluctuate was widened to ± 0.25 percent in July 2002 (from ± 0.1 percent); realized daily movements have, in practice been much narrower than this, exceeding 0.1 percent only once during the past year. The SBV reduced the foreign exchange surrender requirement from 30 to 0 percent in April 2003.



18. **Budget performance in 2002 was strong,** aided by good non-oil revenue collections and public sector wage restraint, with the core fiscal deficit amounting to 2 percent of GDP.⁸ Revenue collections to date suggest the higher tax/GDP ratio can be at least maintained in 2003, but a sizeable (38 percent) increase in civil service wages and pensions is putting some pressure on the expenditure side of the budget. Onlending operations are on a rising trend, and could reach 3 percent of GDP this

⁸ The budgetary accounting structure employed by the staff is laid out in Table 5; the core fiscal deficit does not include onlending operations.

year;⁹ extra-budgetary debt creation from reform costs (mainly SOCB recapitalization) could be around 1 percent of GDP (Table 5, Figure 4).

19. **Important tax reform measures have been taken, or are underway.** A tax package approved by the National Assembly in May 2003, effective January 2004, will reduce the number of VAT tax rates and exemptions, unify corporate tax rates and incentives for local firms and FIEs, and eliminate a tax on profit remittances by FIEs.¹⁰ Efforts to implement self assessment-based tax administration for large tax payers on a pilot basis are proceeding well, with ongoing TA support from FAD.

20. **There has been progress in the areas of private sector development and trade policy reform.** Registration of private firms has increased rapidly since the passage of the Enterprise Law in 2000, with strong growth in employment in small and medium-sized enterprises. Quantitative restrictions on imports were further scaled back in 2002, AFTA tariff reductions are proceeding as scheduled, and a wide-ranging trade agreement with the US took effect in December 2001.¹¹

21. **Reform implementation has proven more difficult in the state-controlled sector.** The equitization program fell behind schedule in 2002 and 2003, and a revised roadmap for reform in 2003-05 has just been finalized. Limits on financial support to 200 significantly-indebted enterprises, agreed under the PRGF, were exceeded by a sizeable margin in 2002. The SOCBs have missed targets for NPL resolution during 2002-03, reflecting mainly the difficulties involved in SOE restructuring, and internal reform efforts at the banks are behind schedule (Box 1).

IV. ECONOMIC OUTLOOK

22. **The near-term economic outlook is favorable,** with most observers expecting the solid performance of the last twelve months to be maintained into next year. Exports could be affected by quota and other restrictions in importing countries, but this should not derail the underlying momentum for export expansion.

23. **The staff's medium-term scenario envisages growth averaging 7 percent per annum,** supported by continued strong export expansion (notably of manufactures) and

⁹ Onlending takes two forms: ODA-funded onlending to projects, recorded in the budget and administered by the Development Assistance Fund (DAF), and domestically-funded lending to projects, not recorded in the budget and financed and approved by the DAF.

¹⁰ Revenue mobilization issues are reviewed in a background paper.

¹¹ There are still significant restrictions stemming from bans on selected imports and limitations on trading rights.

Box 1. Vietnam: Issues in Banking Reform

The banking system has been growing rapidly in recent years, and plays a dominant role in financial intermediation. The ratio of total bank credit to GDP rose from 19 percent in 1995 to near 45 percent in 2002, and there are now some 80 credit institutions, including some 26 foreign bank branches and over 30 semi-private joint-stock banks.

The banking system is segmented, consisting of (a) 4 large SOCBs that collectively account for three-quarters of bank credit and deposits, (b) a group of small private domestic banks and two smaller SOCBs that originally served niche markets, many of whom are now seeking to expand from a regional base, and (c) subsidiaries and branches of foreign banks, who are restricted in the range of activities they can undertake.

The 4 SOCBs have weak balance sheets, reflecting the legacy of directed lending to state-supported projects. By end-2000, these banks had accumulated NPLs totaling D 23 trillion (on generous accounting standards), equivalent to about twice their capital, 5 percent of GDP, and 15 percent of all credit to the economy.

The authorities initiated a PRGF-supported banking reform program in early 2001, focused on strengthening the 4 SOCBs. The reform program envisaged: (i) phased recapitalization with public funds, conditional on banks' meeting bank-specific operational and financial reform targets; (ii) the phasing out of directed lending; and (iii) improved accounting and disclosure standards.

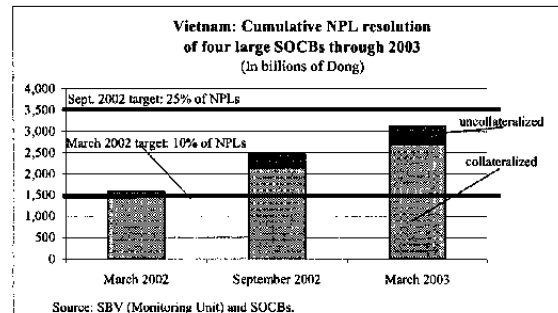
Progress with implementation has been uneven, and sluggish in areas that directly affect SOCBs' relation with SOEs. Resolution of uncollateralized NPLs (typically to SOEs) has stalled, reflecting delays in SOE restructuring and a lack of mandate for SOCBs to actively pursue loan work-outs. The SBV has sought to move loan classification closer to international standards, subjected SOCBs to continued IAS audits, and adopted plans for phasing-in loan loss provisioning. But implementation of new loan classification standards has been problematic, and a plan to address key audit qualifications has not been carried out.

Despite mixed results, all SOCBs have received initial tranches of public recapitalization funds.

To provide incentives for reform, staff has called for strict and transparent enforcement of eligibility criteria for recapitalization, focused on performance in improving lending practices and resolving NPLs. Work on new credit manuals at SOCBs is to be completed by end-year, with retraining of credit officers likely to be an important challenge. New guidelines for NPL resolution are needed to provide SOCBs with a clear mandate and more effective mechanisms, emphasizing time-bound resolution processes that are triggered by the banks and linked to SOE operational restructuring.

| | 2000 | 2003 1/ |
|-------------------------------------|--------------|---------|
| | (In percent) | |
| Share in total credit | | |
| Four large SOCBs | 73.3 | 75.9 |
| Other | 26.7 | 24.1 |
| Share in SOE credit | | |
| Four large SOCBs | 90.1 | 91.2 |
| Other | 9.9 | 8.8 |
| Share of SOE credit in total credit | | |
| Four large SOCBs | 56.3 | 47.9 |
| Other | 18.5 | 11.9 |

Source: SBV.
1/ March 2003.



investment. Inflation remains at modest levels (3-4 percent), while the real exchange rate, currently towards the lower end of the range in which it has moved since 1996, shows little change. The external position remains manageable, with current account deficits declining somewhat from the present level (3½ percent of GDP), and continuing to be financed by a mix of FDI inflows and medium-long term borrowings (still primarily ODA) (Table 6).

24. Staff projections of public and external debt levels do not point to significant sustainability concerns in the base case. Public debt projections show a significant increase in debt levels during the next few years, reflecting sizeable onlending operations and debt-issuance in support of SOE/SOCB reform, but this burden can be handled if onlending is repaid and restructuring costs are contained at current (staff-projected) levels (Box 2, Annex V). External debt and debt service projections point to continued gradual decline in debt/GDP and debt service/export ratios,¹² with conventional stress tests flagging sluggish export performance as a significant risk factor. The authorities have expressed a desire to exit formally from the HIPC initiative; a report assessing external debt sustainability is being prepared by IDA and IMF staff, and will be circulated to the Boards of the two institutions later this year.

25. This base case scenario of steady growth is subject to significant risks. Foremost among these is the risk of significant investment misallocation in the government-controlled financial intermediation process, impairing growth performance (through a higher ICOR) and the fiscal position (through bailout costs for SOEs and SOCBs). Commercially unsound lending decisions by the SOCBs or government lending institutions (notably the DAF) would be the key driver in this misallocation process—which, if sufficiently severe, would undermine the manageable fiscal scenario envisaged above. Vietnam’s still-partial transformation to a market economy, with potentially weak checks and balances on SOEs and SOCBs, leaves it particularly vulnerable to investment misallocation. It is difficult to quantify the current severity of this problem and how it is affecting the growth trajectory, given the poor quality of data on NPLs, SOE finances, and national accounts. The base case scenario assumes investment misallocation costs are significantly contained, looking ahead.¹³

26. Other significant risk factors to the growth outlook are: (a) a slowdown in private sector investment, both domestic and foreign, if weaknesses in the business climate, including infrastructure limitations and bureaucratic inefficiencies and excess regulation, are not adequately addressed; and (b) weaker-than-anticipated export demand, stemming from

¹² Debt service to the Fund would remain at modest levels (Table 7).

¹³ See Box 2 for discussion of key assumptions.

Box 2. Vietnam: Public Debt Dynamics, 2002–2008

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

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

Source: MoF, DAF, and Fund staff estimates.
1/ Nominal value of onlending portfolio.

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

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

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

some mix of a weak global economic environment, intensified competition in export markets,¹⁴ or impaired market access conditions for Vietnam (a non-WTO member).

V. POLICY DISCUSSIONS

27. **Against a backdrop of solid performance, discussions for the consultation focused on exploring potential weak links in the policy framework and identifying reform priorities for maintaining strong growth over the medium term.** Officials were in broad agreement with the staff's assessment of the medium-term outlook and the key risks identified, while arguing that the government's reform program, already well underway, was addressing some of the key risks involved. Many key elements of the policy dialogue had also featured in the Article IV consultations in 2000 and 2001.

28. **Officials were encouraged by the current strength of economic activity,** which was broadly in line with targets for 2001–05 set by the National Assembly. Investment and exports were doing well; modest inflation was not a concern, and might be better than the mild deflation experienced in 2000–01. The strength of imports was something of a surprise, but partly reflected temporary effects such as big ticket import items and stock-building ahead of the conflict in Iraq. There was no serious concern about overheating at this juncture, but the balance of payments would need to be kept under review.

A. Fiscal Issues

29. **Officials noted that implementation of the 2003 Budget was proceeding on track,** and were confident that the budget deficit would not breach the target level of 2.8 percent of GDP. Revenues would come in somewhat above target, and the practice was that about half of any revenue overperformance would be allocated to capital expenditures and emergency relief outlays, with the remainder reflected in a lower deficit. Looking ahead, officials noted that preparation for Budget 2004 was in its early stages: continued revenue buoyancy seemed assured, given strong growth, but revenue projections would, as in the past, be conservative. Pressures for higher expenditures on education and health would need to be accommodated, but the aggregate thrust of fiscal policy, while still to be determined by the government, would likely be similar to that in the 2003 budget.

30. **Staff pressed the case for setting annual budget targets within the context of a medium-term projection of the public finances.** Illustrative projections of the public debt, factoring in onlending operations, the costs of SOE/SOCB reform, and a core budget deficit maintained at current levels of around 2½ percent of GDP, would yield a sizeable increase in the debt burden in the next few years. Staff argued that this would be manageable, and

¹⁴ The elimination of quotas in 2005 under the WTO Agreement on Textiles and Clothing may create difficulties for Vietnam, given the likelihood of intensified competition in key markets. Vietnam aims to join the WTO in 2005.

sustainable over the longer-term, if onlending was to financially sound projects (and hence repaid) and some of the costs of SOE/SOCB reform were recouped through eventual equitization. Officials agreed on the need to factor in reform costs into the fiscal picture, but were reluctant to revisit official estimates that staff now believe are outdated.

31. **Staff pointed to pressures on budgetary revenues over the medium term, which would need to be addressed through adjustments in tax policy and administration.** Oil revenues would decline in relation to GDP, economic activity would gradually shift from the SOE sector to the harder-to-tax private sector, and trade liberalization would adversely affect tariff revenues. Officials agreed that these factors would be important, but noted, as mitigating factors, that the oil production outlook for the next 15–20 years was quite robust and that the revenue impact of tariff reductions already committed in trade agreements should be modest. They underscored their commitment to strengthen tax administration and reduce tax evasion, including by promoting greater use of the banking system for transactions; and were seeking to press ahead with the implementation of the FAD-assisted self-assessment project for large taxpayers as an important tool to modernize tax administration. They also envisaged a gradual shift from direct to indirect taxation over time, and were currently seeking to flesh out a tax reform agenda for the period through 2010.

32. **With government expenditures rising significantly in recent years, staff underscored the need to strengthen public expenditure management and press ahead with administrative reform.**¹⁵ There was a pressing need for better integration of capital budgeting (done by MPI) and recurrent budgeting (done by MoF) and for systematic cost-benefit appraisal of investment projects, including their impact on poverty alleviation. Public administration reform, a master plan for which was approved in September 2001, needed to be pursued more vigorously, while further public sector wage increases, in the wake of the large increases granted in January, should be tied directly to administrative reforms and reduction in unnecessary personnel. Officials explained that the recent wage increases had been from low absolute levels, and had followed a period of some restraint; staff noted the upward drift in the budgetary wage bill over time, which had limited resource availability for other purposes.

33. **Staff queried the upward trend in on-lending activity,** a rising portion of which was now being undertaken outside the budget by the DAF. Officials explained the ODA-financed onlending was agreed in dialogue with ODA partners, and carried concessional terms. Servicing of DAF loans by debtors had generally been good, although many projects were still in grace periods. Staff underscored the need for DAF loans, the bulk of which go to SOEs, to be subject to rigorous cost-benefit analysis to limit future NPLs.

¹⁵ See World Bank, *Vietnam Development Report 2003*, Chapters 12–14, for further discussion.

B. Monetary and Exchange Rate Policies

34. **Monetary policy formulation faces sizeable challenges in Vietnam**, given weak transmission mechanisms, macroeconomic data of uneven quality, and growing monetization of the economy. The SBV is tasked to provide broad support for the achievement of economic targets set by the National Assembly, rather than a more narrowly focused objective such as price stability.

35. **SBV officials viewed maintenance of growth as a priority over the near term, with inflation expected to remain subdued as compared with the plan target of 5 percent.** They viewed annual credit growth on the order of 25 percent as being appropriate in this context, with interest rate increases likely to impair growth.¹⁶

36. **The staff accepted that inflation risks appeared modest in the near term,** but needed to be kept under review given strong demand. An important concern was that the pace of credit expansion was overwhelming the banks' ability to adequately evaluate credit risk. This created significant risks for the quality of loan portfolios of banks (state and private) that are still inexperienced at credit risk management.¹⁷ Comparison with other Asian countries during high growth periods supported the view that the pace of credit expansion in Vietnam was unusually high.

| Vietnam: Credit Growth and Macroeconomic Performance: A Regional Comparison | | | |
|--|-----------|--------------|-----------|
| | Growth 1/ | Inflation 2/ | Credit 3/ |
| (Annual percentage change) | | | |
| Vietnam | | | |
| 1998-2002 | 4.8 | 2.8 | 20.8 |
| China | | | |
| 1980-2000 | 9.7 | 7.3 | 14.4 |
| 1995-2002 | 8.4 | 3.3 | 16.0 |
| Thailand | | | |
| 1965-1985 | 7.0 | 6.5 | 15.9 |
| 1982-1996 | 8.1 | 4.1 | 14.7 |
| Indonesia | | | |
| 1975-1995 | 6.5 | 10.9 | 18.6 |

Sources: Fund staff estimates.
1/ Based on WEO estimates of GDP at constant prices.
2/ Based on WEO estimates of percentage change in CPI.
3/ Real credit growth. Based on IFS Data.

37. **The staff therefore called for some reining in of the pace of credit growth,** through a combination of liquidity tightening and guidance to the main banks, focused on those with the weakest credit management skills. With foreign currency lending increasing rapidly, the SBV needed to closely monitor compliance with regulations limiting bank open positions and restricting foreign currency lending to projects with assured foreign currency receipts. SBV officials agreed on the need for vigorous supervision, but were more sanguine on the quality of bank lending.

38. **Staff welcomed the liberalization of most interest rates by mid-2002,** as an important step towards a market-based financial system. A priority now would be to develop money markets and reduce segmentation of the banking system, through the issuance on a regular basis of short-term treasury bills or the more active use of SBV paper as a liquidity

¹⁶ The SBV has since reduced its refinancing rate from 6 percent to 5 percent.

¹⁷ Data on the sectoral breakdown of credit is not available.

management tool. SBV officials agreed that this would be desirable, but cautioned that it would take time, given the structure of the banking system and weaknesses in the payment system, and would need significant coordination with the MoF. They would welcome further TA from the Fund in this area, building on assistance provided in 2000.

39. **The SBV remains committed to allowing gradual movement of the exchange rate**, but has been taking advantage of the relative strength of the dong in 2003 to build reserves. Staff argued that the SBV could allow larger daily movements in the exchange rate without creating concerns about undue volatility; and should allow more movement in the rate over time, rather than adhering to a pre-determined rate of “crawl”. Staff underscored the merits of a flexible exchange rate in an economy undergoing structural change.

40. **Staff welcomed the build-up in NIR in recent months**, and saw merit in a further gradual buildup over time, at a minimum to maintain net reserve coverage vis-à-vis the rapidly growing annual import bill. The growth in bank deposits at the SBV, which had driven much of the recent surge in GIR, was less clearly beneficial, and suggested that the SBV was providing an overly high remuneration on these deposits. SBV officials agreed, and the SBV has since set the relevant interest rate at the level of the federal funds rate (a drop of 35 basis points).

C. Enterprise Sector Issues

41. **The government’s strategy for promoting efficiency in the SOE sector is to equitize smaller ‘non-strategic’ enterprises and move towards more accountability and autonomous decision-making in strategic enterprises that remain within state control.** This would result in a significant decline in the number of SOEs, while maintaining a strategic role for SOEs in the economy in the longer term.

42. **Officials noted that the equitization program had been lagging behind schedule**, reflecting difficulties in valuing enterprises (including resolving the debts they owe and the value of the land use rights they hold) and resistance from managers and other affected agencies and parties. They expected that the new SOE reform road map, which listed each firm targeted for equitization, would re-focus efforts, noting that MoF decrees provided guidelines for debt resolution and that land valuation issues were under discussion in the National Assembly. Staff expressed concern that the drawn-out process of equitization left many firms with uncertain futures and weak incentives to perform efficiently; and noted that the SOE debt resolution framework had significant weaknesses (Box 1).

43. **Officials explained that the issue of improving governance in SOEs was under active debate**, and a new law on SOEs would likely be approved by year-end. Public utilities would remain closely supervised by line ministries; economic enterprises would be granted greater autonomy, and would likely be converted into single owner limited liability companies with a Board of Directors and Management held responsible for performance, thereby improving accountability. The appropriate roles for holding companies (owning a cluster of SOEs), line ministries, and other agencies, was also being discussed. Staff argued that strong performance by SOEs would be best assured through simple channels of control

and profit-focused mandates, hard budget constraints (including commercial-only access to credit), and explicit transparent accounting of any budgetary support.

44. **Staff argued for reconsidering plans to retain SOEs in many sectors delegated to private enterprises in market economies**, a strategy that could entail sizeable efficiency costs given weak governance structures. Consideration should be given to equitizing larger enterprises via the stock exchange and to bring in strategic equity partners to contribute capital, technology, and management skills. This could be conducted on a gradual basis, to acquire expertise in protecting state interests during sales processes.

45. **Staff expressed concern at the limited data available on SOE finances**, which itself reflected weaknesses in governance arrangements, and at the failure to use the monitoring system created under PRGF auspices to track bank debt and budget support for 200 large indebted SOEs as a tool for triggering tighter control over problem enterprises. MoF officials explained that the monitoring system had been established outside the existing bureaucratic processes, and had not received the requested external technical assistance; also, there were no mechanisms in place to force SOEs to limit credit demand.

46. **Officials noted that many key impediments to development of the private sector, both domestic and foreign, had been removed over time**, and there had been significant efforts to simplify bureaucratic procedures and regulations. Staff agreed that substantial progress had been made, notably with the passage of the 2000 Enterprise Law, but the formal domestic private sector was still very small and faced sizeable barriers in terms of access to land and capital and still-complex bureaucratic and licensing procedures. Reform priorities should include measures to: (a) improve the workings of the land market (completion of the issuance of land-use right certificates, maintenance of a registry of issuances and transfers), and (b) further scale back bureaucratic regulation and discretion (thereby reducing the burden of hidden costs and the scope for rent-seeking behavior by officials and businesses).

D. Banking Sector Issues¹⁸

47. **The banking system is growing rapidly**, with the bulk of funds still being intermediated through the major SOCBs. These banks face significant challenges in strengthening weak balance sheets and improving loan collections, while rapidly expanding their business operations.

48. **Staff noted that efforts to modernize the SOCBs, and strengthen their credit, treasury, and risk management skills were showing some results, but that much work remained to be done.** The process of drafting credit manuals was behind schedule; the quality of financial reports was poor, with uneven implementation of more realistic standards for loan classification and banks making little progress in removing the qualifications from the 2000 IAS audits. SBV officials agreed on the need for institutional strengthening of the

¹⁸ Banking sector issues are reviewed in a background paper.

SOCBs, but noted that it took time to transform large institutions and equip employees with new skills; technical assistance needs for upgrading credit manuals and processes, IT systems, and employee training were substantial, and remained largely unmet.

49. **Staff argued that priority in SOCB reform efforts should be given to improving credit-making decisions**, by ensuring that banks conduct adequate loan appraisal of new credits. Lending to long-standing SOE customers should not be automatic, nor should lending to government-endorsed projects that do not carry a formal guarantee. Officials agreed, noting that much had changed already in SOCB lending behavior and that banks no longer received, and were instructed to ignore, directions from officials to lend to particular enterprises. Staff argued that the SOCBs would need clear guidance in this regard if the lending culture were to be fully transformed.

50. **Officials explained that policy-based (or directed) lending is now being channeled through specialist institutions**, the Development Assistance Fund and the Social Policy Bank (SPB). Staff welcomed the clear institutional split between directed and commercial lending, but emphasized that: (a) interest subsidy mechanisms in policy-based lending should be transparent and routed through the state budget (as appears to be the case for the DAF); and (b) credit-worthiness and ability to repay should be given prime weight in lending decisions if the specialist institutions are to avoid insolvency.

51. **Staff argued that efforts to resolve bad loans—to tidy up the past—needed to be strengthened**, as progress had been slow. Previous missions had offered proposals on how to accelerate the resolution process for NPLs, emphasizing a time-bound process for resolving disputes where the SOE and its creditors cannot agree on a restructuring plan that ensures operational and financial viability. Officials saw merit in these proposals, but explained that the issue was under discussion within the government, with some questioning the merits of a pro-creditor shift in resolution mechanisms.

52. **SBV officials and staff agreed fully on the importance of strengthening SBV supervision of the banking system**, including shifting the focus of supervision from narrow compliance reviews to understanding and identifying risks in banks' operations and the corrective measures needed. Officials stressed the SBV's commitment to strengthen its capabilities in this area, but underscored the sizeable organizational and human resource challenges involved. They would strongly welcome TA from the Fund in this endeavor, with development of risk-based capital adequacy regulations being a current priority for the SBV.

E. Other Issues

53. **Officials emphasized Vietnam's commitment to achieve early membership in the WTO**. Staff supported this objective, while noting that the government's target for entry in

2005 was ambitious and would require concerted effort by many agencies within the government to implement the requisite reforms.¹⁹

54. **Staff supported the recent abolition of the profit remittance taxes on FIEs, which constitutes an important step toward Vietnam's acceptance of the obligations under Article VIII, Section 2, 3, and 4.** The existing exchange restrictions maintained by Vietnam are described in Annex I, Section VIII. Staffs of MFD and LEG are currently conducting a comprehensive review of Vietnam's exchange regime to clarify the remaining obstacles to acceptance of Article VIII obligations, and a mission is envisaged for later in the year.

55. **Existing governance and regulatory structures, providing extensive discretionary powers to officials and enterprise managers, create opportunities for corrupt practices.**²⁰ Staff noted that the scope for abuses would be limited by pressing ahead with the public administration reform program, a key component of the CPRGS, and with further deregulation measures and enhanced transparency.

56. **Vietnam's statistical base has important weaknesses for surveillance purposes,** notably in regard to the national income accounts, balance of payments, and enterprise statistics. Also, fiscal data need substantial improvement to allow monitoring of budgetary expenditure composition, extra-budgetary funds, and public debt levels. STA has been providing TA to help improve national accounts and price statistics; there has been reasonable progress, although efforts to strengthen price statistics have been impaired by staffing constraints in the GSO. The passage in May 2003 of a new Statistics Law, placing emphasis on improving data quality and ensuring wider accessibility to information, is an important measure for strengthening the statistical base.

57. **Vietnam subscribed to GDDS in July 2002 but has not been formally recognized as a participant,** pending provision of the metadata for review by STA. GSO officials noted the coordination challenges involved in getting the relevant agencies to complete the metadata, but hoped that this task would be completed in the next few months.

58. **The SBV's response to the staff questionnaire on AML issues is being reviewed by departments.** The government is to issue a new anti-AML decree by end-year.

¹⁹ At the sixth WTO Working Party meeting on Vietnam in May 2003, the chairperson noted that there would need to be a "quantum jump" in efforts if Vietnam were to meet its goal of joining by 2005. Areas where WTO members are seeking reform include technical barriers to trade, customs valuation, intellectual property protection, and investment policies and subsidies.

²⁰ A donor-assisted study of corruption and how it can be minimized is now underway, but will take time to complete and yield conclusions.

VI. THE STATUS OF THE PRGF

59. **The current PRGF arrangement, approved in April 2001, supports a reform program centered on sound macroeconomic policies, gradual reform of SOEs and SOCBs, and further deregulation of private sector activity and external trade.**

Discussions for the third review commenced in September 2002, but have not yet been completed.

60. **Macroeconomic performance has been broadly in line with original program targets.** While quantitative targets agreed during the second review were broadly complied with, targets relating to financial support for SOEs and NPL resolution were missed by substantial margins, the NDA target by a modest margin (Table 8).

| Vietnam: Macroeconomic Performance Under the PRGF-Supported Program | | | | | | |
|--|------------|--------|------------|--------|------------|---------------|
| | 2001 | | 2002 | | 2003 | |
| | Program 1/ | Actual | Program 1/ | Actual | Program 1/ | Current Proj. |
| Real GDP growth | 5.0 | 5.0 | 6.0 | 5.8 | 7.0 | 6-6½ |
| Inflation (annual average) | 4.0 | -0.4 | 4.2 | 4.0 | 3.8 | 3½-4 |
| Overall fiscal balance (excluding onlending and capital costs of reform) | -2.7 | -2.9 | -3.0 | -1.9 | -3.1 | -2.3 |
| Current account (percent of GDP) | -0.3 | 2.2 | -4.3 | -1.1 | -3.3 | -3.6 |
| Gross official reserves (billion US dollars) | 3.6 | 3.4 | 4.3 | 3.7 | 4.9 | 4.6 |
| Memorandum item: World growth assumptions (WEO) | 3.9 | 2.5 | 4.0 | 2.8 | 4.2 | 4.0 |

Sources: Fund staff estimates.
1/ March 2001 (EBS/01/43)

61. **Progress in implementing structural reforms has been uneven.** Most structural policy undertakings for the third review are in place by now, but staff believe further actions are needed to bring NPL resolution back on track, to strengthen budget constraints on heavily-indebted SOEs, and to move forward the process of transforming the credit culture in the SOCBs (Table 9). Agreement is also needed on an appropriate pace for credit growth.

62. **In addition, agreement is needed on remedial measures that would bring Vietnam into compliance with the Fund's safeguards policy.** Staff is reviewing the formal response of the SBV to a draft safeguards assessment report (Box 3). A summary of the assessment will be made available to the Executive Board once the report has been finalized.

Box 3. Vietnam: Background on the Safeguards Issue

A FIN mission conducted an on-site safeguards assessment of the SBV in September 2002. The mission identified important weaknesses in several areas covered under the safeguards framework, including the external audit mechanism, the financial reporting framework, and internal controls at the SBV, and called for substantial remedial measures.

The staff's "phased approach" to addressing safeguards concerns was outlined to the Board during an informal country matters discussion on January 15. The approach was to entail:

- A confidential review, by Fund staff, of the SBV's (SBV) net international reserve position.
- Fund-provided technical assistance to the State Audit of Vietnam (SAV) as it conducted its audit of the SBV's 2002 financial statements.
- The 2003 audit of the SBV to be conducted by the SAV, operating with a pairing arrangement with an international audit firm.
- Publication of the SBV's audited financial statements for 2003 and ensuing years, and adoption of a financial reporting framework for the SBV based on Vietnamese Accounting Standards, which are being brought into line with International Accounting Standards (IAS).

The Vietnamese authorities indicated that this "phased approach" was unacceptable because the NIR review would violate state secrecy laws, and the pairing of the SAV with an international audit firm would contradict the SBV law (specifying that the SBV is to be audited by the SAV). They agreed that there would be merit in adopting an IAS-based accounting framework for the SBV, although this would need agreement from the MoF (which determines accounting standards for government agencies); and agreed to publish the statutory audited financial statements beginning with the 2002 financial statements.

In an effort to accommodate the legal constraints, while ensuring compliance with the safeguards policy, staff proposed a "parallel approach" during the June 2003 mission, under which the SBV would follow two parallel tracks in its financial reporting as an interim arrangement. In addition to its obligations under existing laws, the SBV would:

- Prepare internal financial statements on a full IAS basis, including explanatory notes, commencing with the 2003 financial statements;
- Contract an independent international accounting firm to verify the internal financial statements under a special purpose engagement.
- Publish its statutory audited financial statements, starting with the 2002 financial statements.
- Provide the internal financial statements and the report of the independent accounting firm to IMF staff.

A draft safeguards assessment report was sent to the SBV following the mission; a response was received on August 15, 2003, and is now being reviewed. Staff will provide an update ahead of the Board meeting.

VII. STAFF APPRAISAL

63. **The Vietnamese economy is gradually being transformed**, delivering rising living standards and rapid poverty reduction in the process. The track record to date has been encouraging but, as the authorities are aware, does not of itself guarantee future success.

64. **Vietnam has opted for a gradual path of ownership transformation from a planned to a market economy**, while also envisaging a sizeable role for the state in industry and finance over the longer-term. This approach may help maintain social and economic stability during a development process that will inevitably be lengthy—but it has important pitfalls if corporate governance in and commercial discipline on the state-controlled sector are weak, and scarce resources are misdirected.

65. **Key challenges in sustaining growth are to ensure that** the sizeable funds being intermediated through the government and government-controlled institutions are soundly allocated and that the business environment, which has been challenging for investors in the past, is fully supportive of private investment, domestic and foreign. Maintaining external market access will also be important, and WTO membership would provide valuable protections in this regard.

66. **The near-term macroeconomic outlook appears favorable**, with solid growth, modest inflation, and a manageable external position. But the rapid pace of credit growth raises important concerns about credit quality, and the associated risks that investment will be wasted and SOCB (and DAF) solvency will be impaired. Intensified supervision might be a sufficient response in a well-developed financial system; more direct restraint, including moral suasion and some liquidity tightening, seems appropriate in a Vietnamese context, combined with close monitoring of banks' open positions and foreign currency lending.

67. **The fiscal position appears manageable**, provided the off-budget liabilities stemming from state-controlled financial intermediation are tightly controlled. There are medium-term risks to the revenue position, which will require a policy response that encompasses both tax policy reforms and enhanced administration. FAD technical assistance has been productive in the area of tax administration, and further assistance on tax policy design is also likely warranted.

68. **Improving financial markets is a priority**, with development of money markets and market infrastructure and commercialization of SOCBs being complementary instruments in this regard. Strengthened treasury operations in the SOCBs will promote market efficiency; deepening of the markets in short-term government paper (or SBV paper) will also be important in promoting alternative tools for liquidity management.

69. **The exchange rate regime—formally, a managed float—is appropriate to Vietnam's circumstances** but can be implemented with greater flexibility, allowing more movement in the rate, both intra-day and over time. The SBV has been appropriately building reserves during the recent period of sizeable foreign exchange inflows, but should be moving more actively to sterilize the impact of its purchases on bank liquidity.

70. **Policy for the SOE sector needs substantial fleshing out**, with SOEs being given simpler channels of control, profit-focused mandates, and hard budget constraints. The current approach is characterized by multiple mandates and non-transparent structures of accountability, providing significant scope for unsound investment decisions and mismanagement. Equitization programs need re-thinking, with more emphasis being given to auction-based mechanisms rather than accounting-based mechanisms in determining enterprise valuations, following a clear determination of enterprise assets and liabilities.

71. **Employment growth over the medium-term will rely heavily on private sector expansion, and hence a conducive environment for investors, both domestic and foreign.** Strengthening the operation of key markets (notably for land), simplifying regulations, and reducing bureaucratic discretion are the priorities for improving the business environment – along with the provision of competitively-priced infrastructure services.

72. **Financial intermediation is growing rapidly**, primarily through the SOCBs and the DAF. As the gate-keeper of large volumes of resources, it is imperative that these state-controlled institutions conduct effective appraisal and financial assessment of the projects to which they are committing resources—thereby imposing hard budget constraints on borrowers and assuring their own long-term solvency. Transformation of the credit culture of the SOCBs is underway, but needs to be pushed ahead. Strengthening the oversight and supervisory capabilities of the SBV is an important supporting measure, and merits full support from providers of technical assistance.

73. **Cleaning up the balance sheets of the SOCBs has made slow progress, and needs to be reinvigorated.** Guidelines that would impose a time-bound process for agreeing on financial and operational restructuring of problem SOEs are needed.

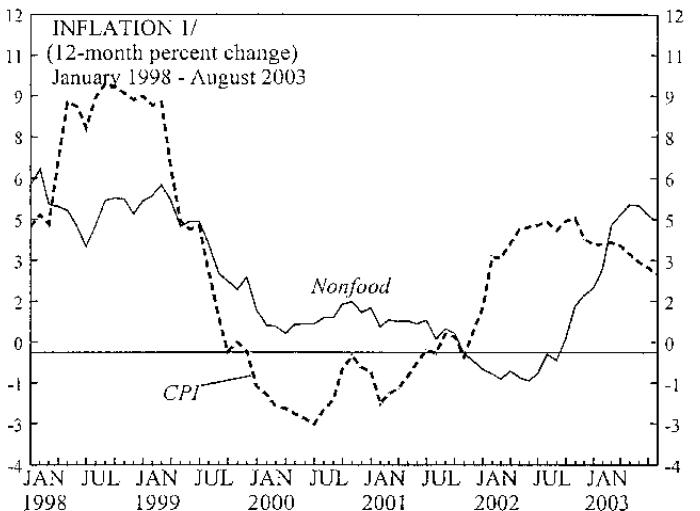
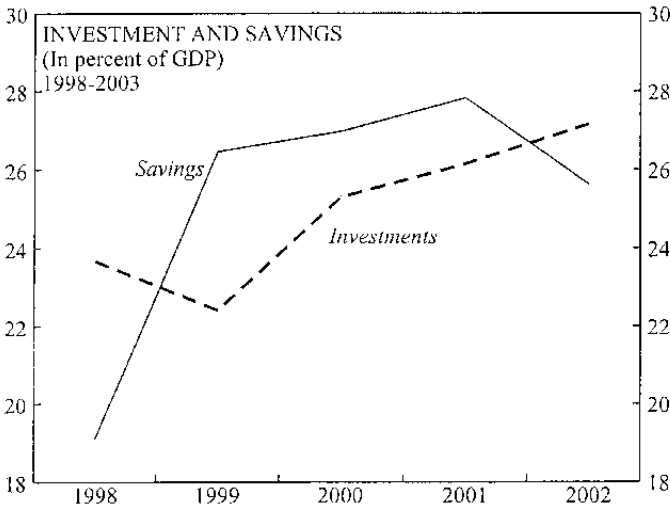
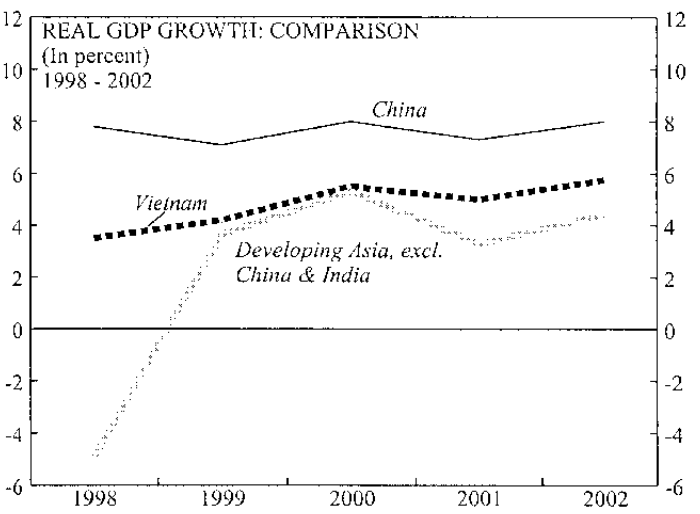
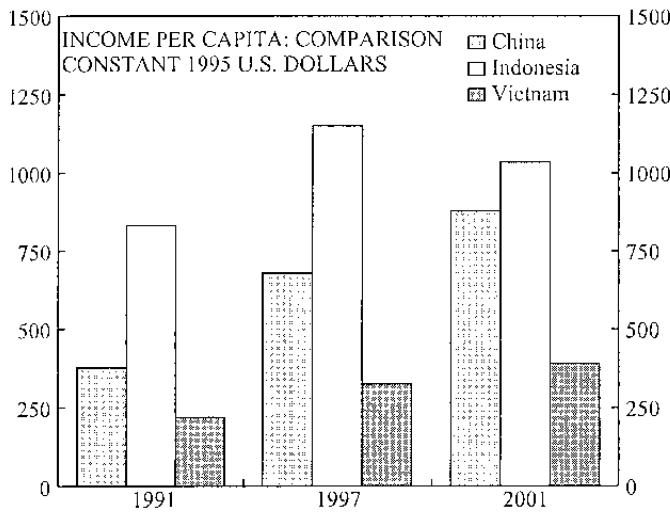
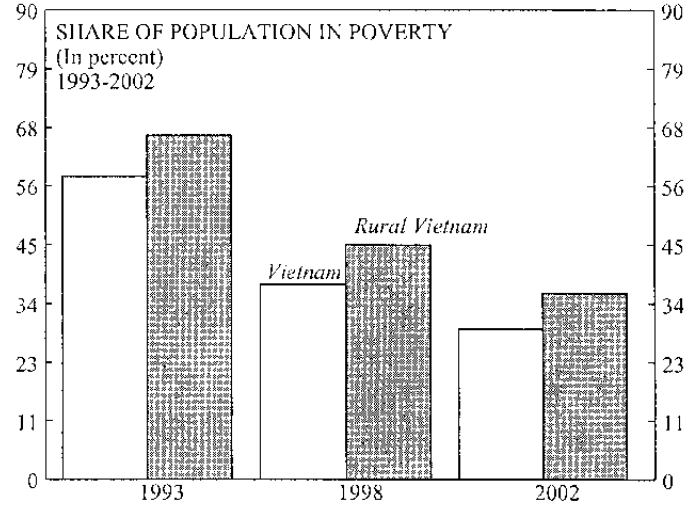
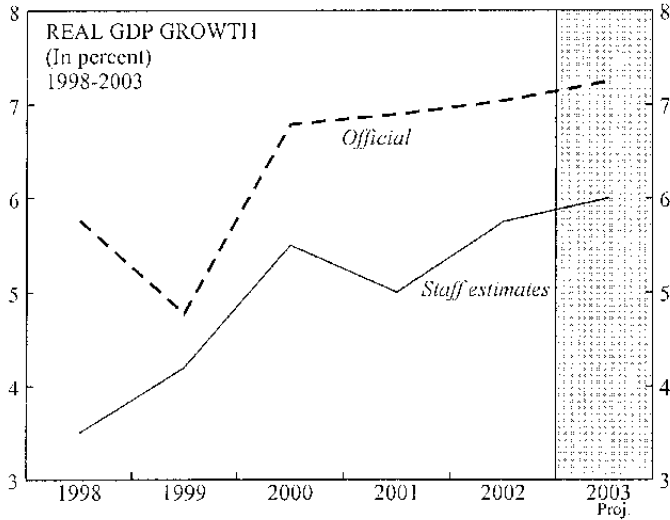
74. **Vietnam's objective of early WTO membership is strategically sound and will help sustain growth over the medium-term**, but will require substantial focused efforts to bring domestic regulations, practices, and laws into compliance with WTO practice. Acceptance of Article VIII obligations would be a welcome signal of the authorities' commitment to integration into the international economy.

75. **Improving governance in Vietnam will require vigorous implementation of the public administration reform program**, coupled with further measures to simplify the regulatory environment and enhance the transparency of decision-making.

76. **Passage of the new Statistics Law, emphasizing the principle of wider public accessibility of statistical information, is a welcome move**, but will need to be supported with adequate resource provision and improved inter-agency coordination. Publication of more disaggregated data on fiscal operations, including extra-budgetary operations such as the DAF, is also warranted.

77. It is recommended that the next Article IV consultation with Vietnam be held in accordance with the provisions of Board Decision No. 12793-(02-76) approved on July 15, 2002.

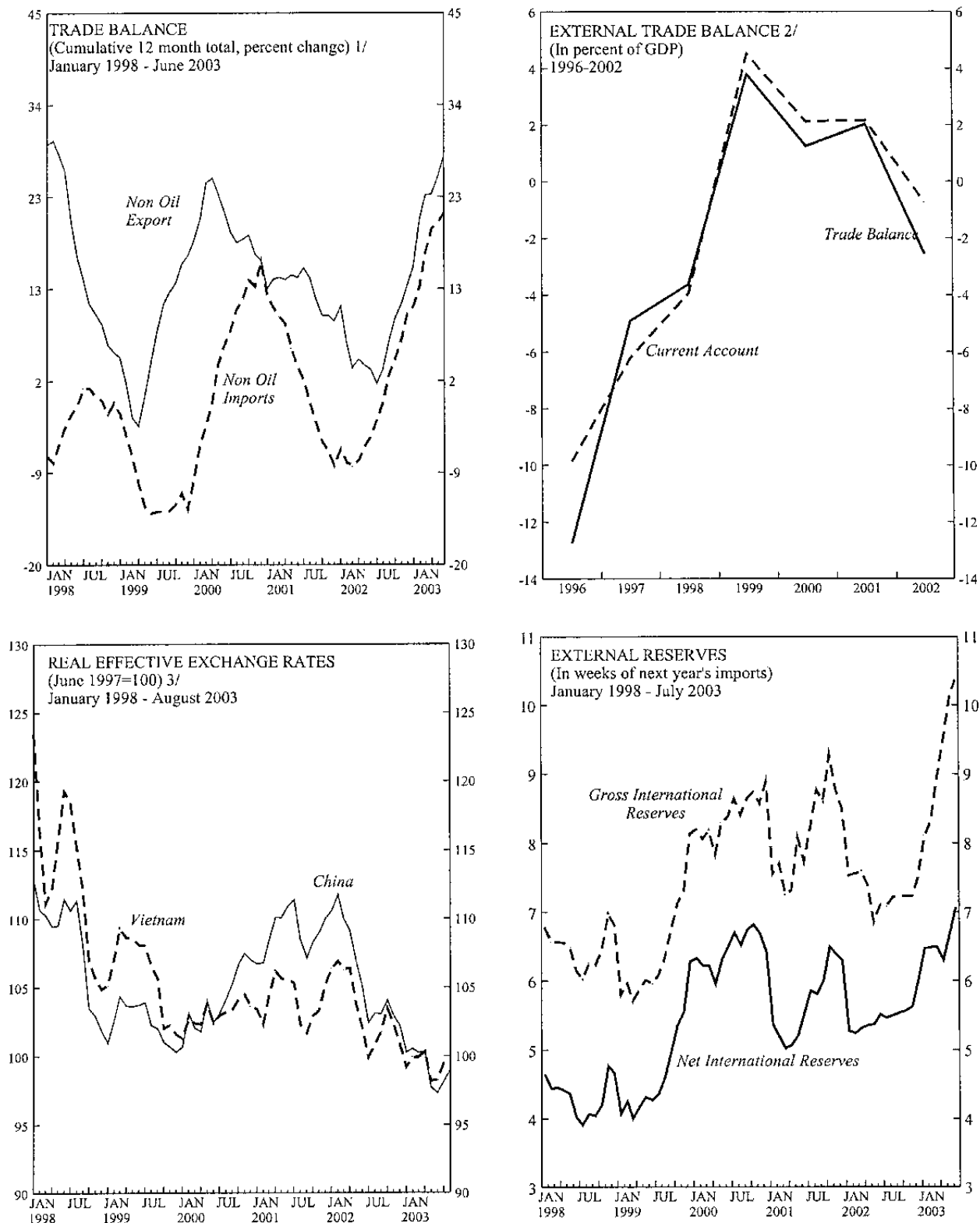
Figure 1. Vietnam: Selected Economic Indicators



Sources: Data provided by the Vietnamese authorities; World Bank; and Fund staff estimates.

1/ Based on the June 2001 CPI weights.

Figure 2. Vietnam: External Sector Background



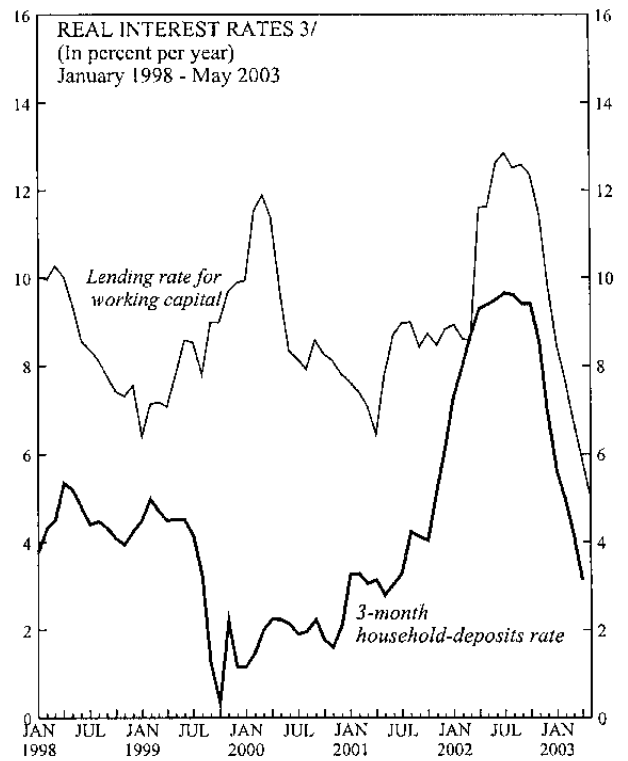
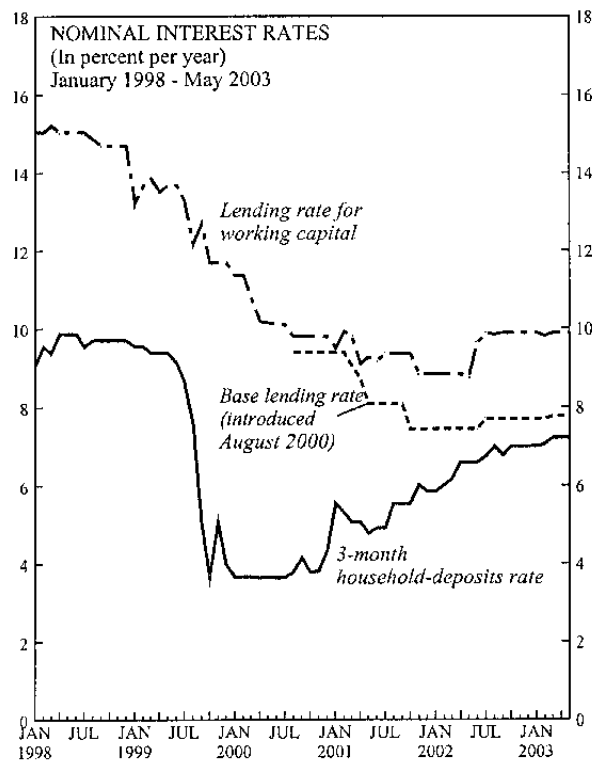
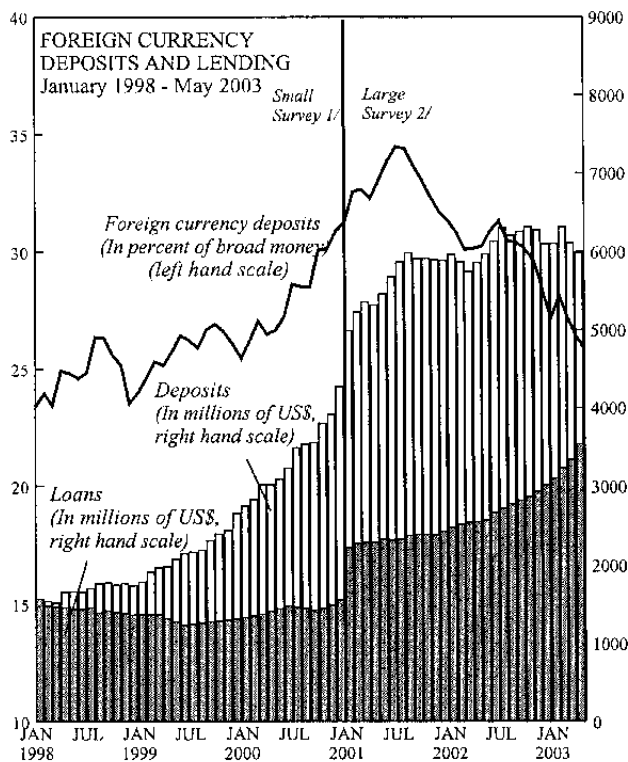
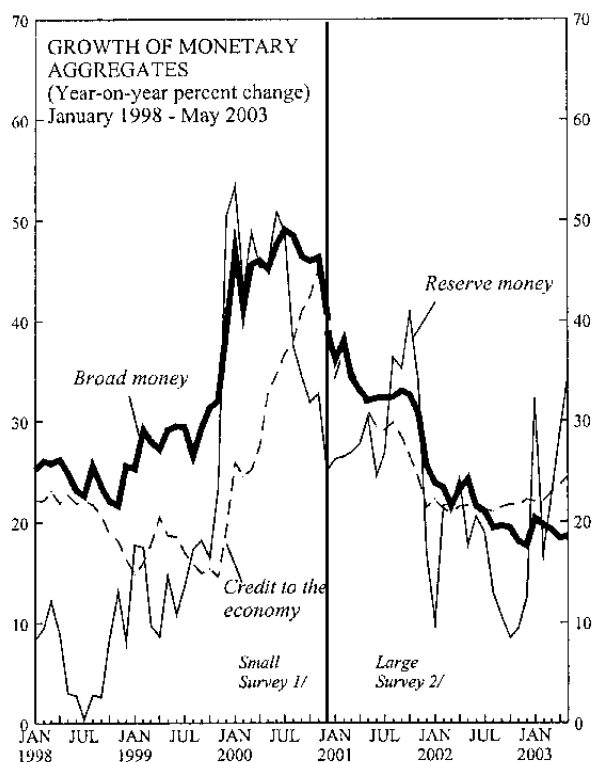
Sources: Data provided by the Vietnamese authorities; and Fund staff estimates.

1/ Monthly data based on c.i.f. imports and exports.

2/ Annual data based on f.o.b. imports and exports.

3/ Estimated for June 2003, July 2003, and August 2003.

Figure 3. Vietnam: Monetary and Financial Indicators, 1998-2003



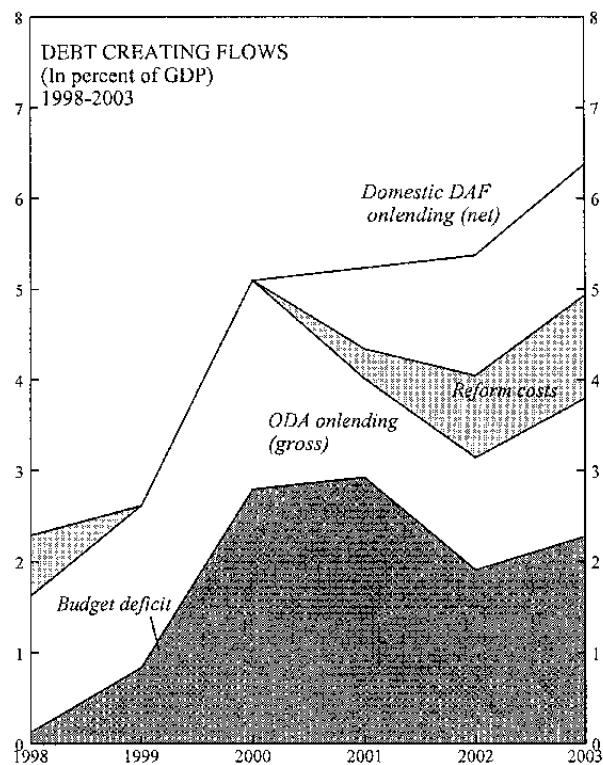
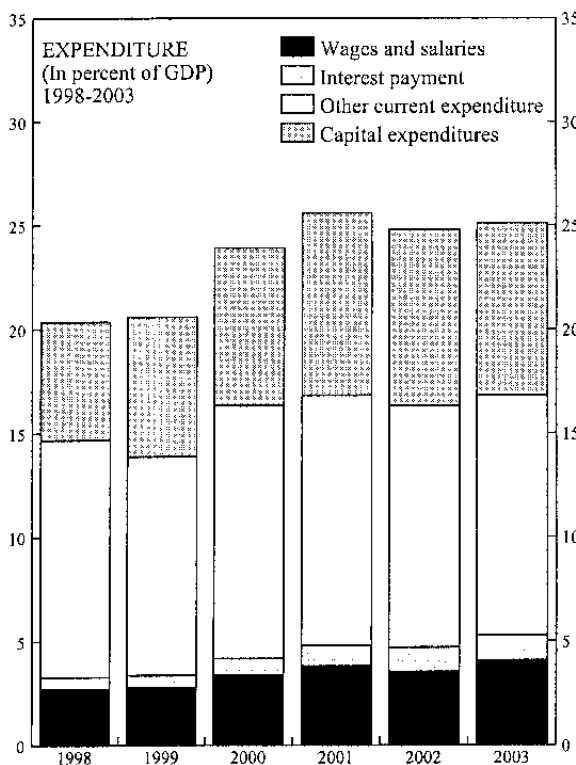
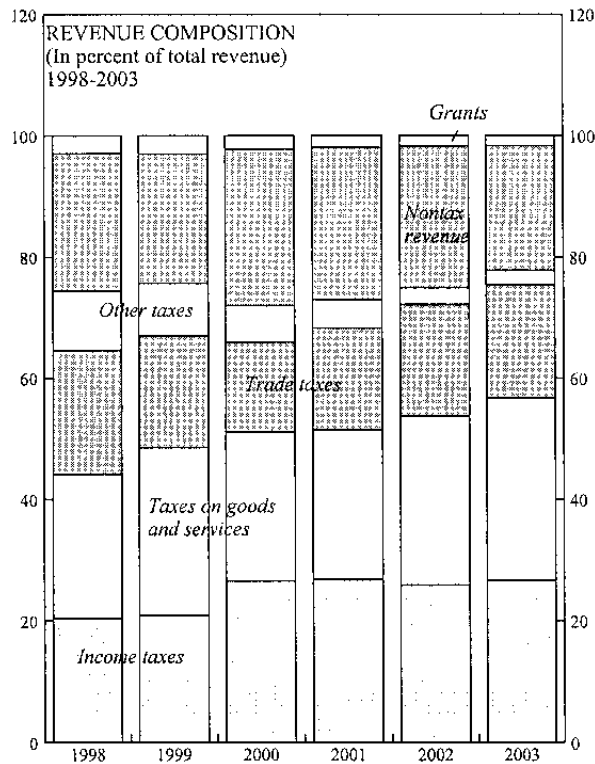
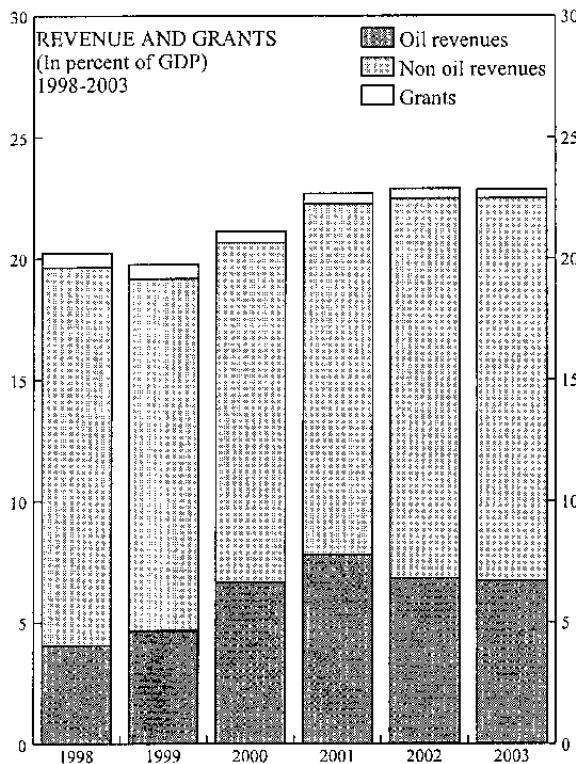
Sources: Data provided by the Vietnamese authorities; and Fund staff estimates.

1/Monetary survey comprising of State Bank of Vietnam (SBV), four large state owned commercial bank (SOCBs), and 24 non-state banks.

2/Monetary survey comprising of SBV, four large and two small SOCBs, and 78 non-state banks.

3/Adjusted for nonfood inflation.

Figure 4. Vietnam: Fiscal Sector Developments, 1998-2003



Sources: Data provided by the Vietnamese authorities; and Fund staff estimates.

Table 1. Vietnam: Social and Demographic Indicators

| Indicator | Unit of Measure | 1993 | 1998 | 1999 | 2000 | 2001 | Same Region/ Income Group | |
|------------------------------------|-------------------------------|-------|-------|-------|-------|------------------|------------------------------|----------------|
| | | | | | | Prel. Est. 1/ | East Asia | Low- Income |
| Poverty | | | | | | | | |
| Upper poverty line 1/ | Thousand dong | 1,160 | 1,790 | 1,790 | 1,790 | ... | ... | ... |
| Percent of population living below | | 58 | 37 | 37 | 37 | 32 | ... | ... |
| Food poverty line 1/ | Thousand dong | 750 | 1,287 | 1,287 | 1,287 | ... | ... | ... |
| Percent of population living below | | 25 | 15 | 15 | 15 | 13 | ... | ... |
| GDP per capita | U.S. dollars | 196 | 359 | 372 | 391 | 393 | 1,110 | 426 |
| Access to safe water: total | Percent of population | 26 | 40 | 40 | 40 | ... | ... | ... |
| Urban | Percent of population | 60 | 75 | 75 | 75 | ... | ... | ... |
| Rural | Percent of population | 17 | 29 | 29 | 29 | ... | ... | ... |
| Access to health care 2/ | Percent of population | 93 | 97 | 97 | 97 | ... | ... | ... |
| Health | | | | | | | | |
| Mortality | | | | | | | | |
| Infant mortality | Per thousand live birth | 37 | 30 | 30 | 28 | 30 | 35 | 76 |
| Under 5 mortality | Per thousand live birth | 50 | 39 | 39 | 34 | 38 | 45 | 115 |
| Immunization | | | | | | | | |
| Measles | Percent of age group | 93 | 94 | 93 | 93 | ... | 85 | 57 |
| DPT | Percent of age group | 91 | 95 | 93 | 93 | ... | 85 | 57 |
| Child malnutrition (under 5) | Percent of age group | 41 | 40 | 37 | 37 | 34 | 10 | ... |
| Maternal mortality rate | Per 100,000 live births | ... | ... | 100 | 100 | 100 | ... | ... |
| Population per physician | Persons | 2,444 | 2,208 | 2,065 | 1,980 | 1,919 | 595 | ... |
| Population per nurse | Persons | 728 | 789 | 1,683 | 1,680 | 1,714 | ... | ... |
| Population per hospital bed | Persons | 358 | 379 | 399 | 399 | ... | 420 | ... |
| Human resources | | | | | | | | |
| Population | Millions | 69.6 | 75.5 | 76.6 | 77.6 | 79.5 | 1,855 | 2,460 |
| Age dependency ratio | Ratio | 0.74 | 0.67 | 0.7 | 0.6 | 0.6 | 0.50 | 0.71 |
| Urban | Percent of population | 20.0 | 23.3 | 23.7 | 24.1 | 24.5 | 35.2 | 31.9 |
| Population growth rate | Annual percent | 1.7 | 1.5 | 1.5 | 1.4 | 1.4 | 0.9 | 1.9 |
| Urban | Annual percent | 2.7 | 3.7 | 3.5 | 4.0 | 3.6 | 2.8 | 3.4 |
| Life expectancy | Years | 66 | 68 | 68 | 69 | 69 | 69 | 59 |
| Female advantage | Years | 4.1 | 4.7 | 4.7 | 4.8 | ... | 3.6 | 2.0 |
| Total fertility rate | Births per woman | 3.3 | 2.4 | 2.3 | 2.2 | 2.2 | 2.1 | 3.6 |
| Labor force (15-64) | Millions | 31.6 | 35.2 | 36.0 | 36.7 | ... | 1,052 | 1,115 |
| Female | Percent of labor force | 49 | 49 | 49 | 49 | ... | 44 | 38 |
| Natural resources | | | | | | | | |
| Area | Thousands sq. km. | 325 | 325 | 325 | 325 | 325 | 16,385 | 32,536 |
| Density | Persons per sq. km. | 216 | 235 | 238 | 241 | 244 | 116 | 76 |
| Agricultural lands | Percent of land area | 24 | 26 | 26 | 26 | 26 | ... | ... |
| Agricultural land under irrigation | Percent | 28 | 30 | 30 | 30 | 30 | ... | ... |
| Forests and woodland | Thousand sq. km. | 83 | ... | 109 | 109 | 109 | ... | ... |
| Energy consumption per capita | Kg. of oil equivalent | 105 | ... | ... | ... | ... | 917 | 566 |
| Education | | | | | | | | |
| Gross enrollment ratios | | | | | | | | |
| Primary | Pct. of school age population | 87 | 93 | 93 | 93 | 114 | 107 | 96 |
| Male 3/ | Pct. of school age population | 86 | 93 | 93 | 93 | 116 | 106 | 103 |
| Female 3/ | Pct. of school age population | 87 | 92 | 92 | 92 | 110 | 108 | 88 |
| Secondary | Pct. of school age population | 47 | ... | ... | ... | ... | 62 | 42 |
| Pupil-teacher ratio: secondary | Pupils per teacher | 21 | 28 | 28 | 28 | ... | ... | ... |
| Illiteracy | Percent of population age 15+ | 9 | 7 | 7 | 7 | 7 | 14 | 38 |
| Female | Percent of female age 15+ | 12 | 9 | 9 | 9 | 9 | 21 | 47 |
| Male | Percent of female age 15+ | 6 | 6 | 6 | 6 | 5 | ... | ... |
| Newspaper circulation | Per thousand population | 8 | ... | 7 | 7 | 7 | ... | ... |
| Internet users | Thousand persons | .. | 10 | 100 | 200 | 1,009 | ... | ... |
| Television Sets | Per thousand persons | 45 | 184 | 184 | 185 | 186 | ... | ... |

Sources: Vietnam: *Statistical Yearbook* (various years), and General Statistical Office, *Vietnam Living Standards Survey 1997-1998*; World Bank: *Vietnam Development Report 2000: Attacking Poverty*, and *Vietnam Development Report 2001: Entering the 21st Century*, and World Development Indicators; and staff estimates.

1/ Preliminary estimate provided by World Bank and Vietnamese authorities (CPRGSP).

2/ The upper poverty line is constituted by the cost of a representative food bundle yielding 2,100 calories per day, plus a representative nonfood component. The lower poverty line represents the approximate cost of this food bundle only.

3/ For 1993 and 1998, rural population.

Table 2. Vietnam: Selected Economic Indicators, 1999–2003

Nominal GDP (2002): US\$34.1 billion
Population (2002): 79.7 million

GDP per capita (2002): US\$428
Fund quota: SDR 329.1 million

| | 1999 | 2000 | 2001 Est. | 2002 | | 2003 | |
|--|--------|--------|--------------|-------|--------|--------------|--------|
| | | | | Prog. | Est. | June Est. 1/ | Proj. |
| Real GDP (annual percentage change) 2/ | 4.2 | 5.5 | 5.0 | 5.3 | 5.8 | ... | 6-6½ |
| Industrial output | 11.6 | 18.4 | 13.7 | ... | 14.5 | 15.7 | ... |
| Saving-investment balance (in percent of GDP) | 4.0 | 1.7 | 1.7 | -2.3 | -1.5 | ... | -3.9 |
| Gross national saving | 26.5 | 27.0 | 27.8 | 24.4 | 25.6 | ... | 24.8 |
| Gross investment | 22.4 | 25.3 | 26.1 | 26.7 | 27.2 | ... | 28.7 |
| Inflation (annual percentage change) | | | | | | | |
| Period average | 4.2 | -1.6 | -0.4 | 4.1 | 4.0 | 3.9 | 3½-4 |
| End of period | 0.1 | -0.5 | 0.7 | 4.0 | 4.0 | 3.5 | 3½-4 |
| General government budget (in percent of GDP) | | | | | | | |
| Total revenue and grants | 19.8 | 21.1 | 22.7 | 20.8 | 22.9 | 21.3 3/ | 22.8 |
| of which: oil revenue | 4.7 | 6.6 | 7.8 | 6.5 | 6.8 | ... | 6.7 |
| Total Expenditure | 20.6 | 23.9 | 25.6 | 24.2 | 24.8 | 21.6 3/ | 25.1 |
| Current expenditure | 13.9 | 16.3 | 16.8 | 16.5 | 16.3 | 16.1 3/ | 16.8 |
| Capital expenditure | 6.7 | 7.6 | 8.8 | 7.7 | 8.5 | 5.5 3/ | 8.3 |
| Fiscal balance 4/ | -0.8 | -2.8 | -2.9 | -3.4 | -1.9 | -0.3 3/ | -2.3 |
| Other debt creating flows | 1.8 | 2.3 | 2.3 | ... | 3.5 | ... | 4.1 |
| Onlending | 1.8 | 2.3 | 2.0 | ... | 2.6 | ... | 3.0 |
| Reform costs | 0.0 | 0.0 | 0.3 | 2.7 | 0.9 | ... | 1.1 |
| Money and credit (annual percentage change, end of period) | | | | | | | |
| Broad money | 56.6 | 39.0 | 25.5 | 19.9 | 17.6 | 18.5 5/ | 20½ |
| Credit to the economy | 55.2 | 38.1 | 21.4 | 20.5 | 22.2 | 24.4 5/ | 25 |
| Interest rates (in percent, end of period) | | | | | | | |
| Three-month deposits (households) | 4.0 | 4.3 | 5.9 | ... | 7.0 | 7.2 | ... |
| Short-term lending (less than one year) | 11.7 | 9.8 | 8.8 | ... | 9.9 | 9.9 | ... |
| Current account (including official transfers) | | | | | | | |
| (in millions of U.S. dollars) | 1,285 | 642 | 670 | -608 | -391 | ... | -1,310 |
| (in percent of GDP) | 4.5 | 2.1 | 2.2 | -1.9 | -1.1 | ... | -3.6 |
| Exports of goods (annual percentage change, U.S. dollar terms) 6/ 7/ | 23.2 | 25.2 | 4.0 | 4.0 | 11.2 | 31.3 | 19.0 |
| Imports of goods (annual percentage change, U.S. dollar terms) 6/ 7/ | 1.1 | 34.5 | 2.3 | 10.0 | 22.1 | 38.8 | 24.5 |
| Foreign exchange reserves (in millions of U.S. dollars, end of period) | | | | | | | |
| Gross official reserves, including gold | 2,711 | 3,030 | 3,387 | 3,815 | 3,692 | 5,433 | 4,600 |
| (in weeks of next year's imports of goods and nonfactor services) | 8.1 | 8.9 | 8.3 | 9.0 | 7.5 | 10.0 | 8.5 |
| Net international reserves, including gold | 2,093 | 2,191 | 2,574 | 2,895 | 2,956 | 3,700 | 3,742 |
| External debt (in percent of GDP) 8/ | 71.4 | 39.7 | 41.6 | 41.6 | 38.3 | ... | 38.3 |
| Debt service due (in percent of exports of goods and nonfactor services) | 12.8 | 10.5 | 10.6 | 8.9 | 7.5 | ... | 7.5 |
| Exchange rate (dong per U.S. dollar) | | | | | | | |
| Period average | 13,944 | 14,170 | 14,806 | ... | 15,244 | 15,473 | ... |
| End of period | 14,028 | 14,514 | 15,084 | ... | 15,368 | 15,450 | ... |
| Real effective exchange rate (annual percentage change) | | | | | | | |
| Period average | -6.5 | -2.9 | 0.9 | ... | -0.4 | -5.5 | ... |
| End of period | -3.2 | 2.1 | 1.4 | ... | -2.7 | -3.4 | ... |
| Memorandum items: | | | | | | | |
| GDP (in trillions of dong at current market prices) 2/ | 397.3 | 429.7 | 458.1 | 505.2 | 520.4 | ... | 572.1 |
| Per capita GDP (in U.S. dollars) 1/ | 372 | 391 | 393 | 412 | 428 | ... | 455 |

Sources: Data provided by the authorities; and staff estimates and projections.

1/ Data as of June 30, unless otherwise indicated.

2/ Fund staff estimates. Official estimates of GDP growth are 6.8 percent (2000), 6.8 percent (2001) and 7.0 percent (2002).

3/ March 2003.

4/ Excluding onlending and capital costs of reform.

5/ May 2003.

6/ Growth rates of cumulative exports and imports for the year so far, compared with the same period last year.

7/ For monthly data, rate of growth based on imports c.i.f.; otherwise, based on imports f.o.b.

8/ Includes the loan component of foreign direct investment and other private sector borrowing and short-term debt.

Table 3. Vietnam: Balance of Payments, 2000–07
(In millions of U.S. dollars, unless otherwise indicated)

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 |
|--|--------|--------|--------|--------|--------|-------------|--------|--------|
| | | | Est. | | | Projections | | |
| Current account balance | 642 | 670 | -391 | -1,310 | -1,267 | -1,283 | -1,486 | -1,393 |
| Excluding official transfers | 506 | 520 | -522 | -1,438 | -1,405 | -1,432 | -1,632 | -1,537 |
| Trade balance | 378 | 627 | -875 | -2,002 | -2,209 | -2,360 | -2,478 | -2,496 |
| Exports, f.o.b. | 14,449 | 15,027 | 16,706 | 19,884 | 21,953 | 24,176 | 26,803 | 29,998 |
| Imports, f.o.b. | 14,071 | 14,400 | 17,581 | 21,886 | 24,162 | 26,536 | 29,281 | 32,494 |
| Non-factor services (net) | -615 | -572 | -648 | -602 | -546 | -484 | -398 | -198 |
| Receipts | 2,695 | 2,810 | 2,948 | 3,184 | 3,515 | 3,871 | 4,292 | 4,803 |
| Payments | 3,310 | 3,382 | 3,596 | 3,786 | 4,061 | 4,355 | 4,690 | 5,001 |
| Investment income (net) | -597 | -635 | -766 | -861 | -749 | -687 | -756 | -843 |
| Receipts | 185 | 160 | 167 | 211 | 275 | 452 | 502 | 531 |
| Payments | 782 | 795 | 933 | 1,071 | 1,024 | 1,140 | 1,257 | 1,374 |
| Of which: Interest payment | 529 | 345 | 329 | 443 | 428 | 492 | 542 | 587 |
| Dividends on FDI | ... | ... | 604 | 628 | 596 | 648 | 716 | 787 |
| Transfers (net) | 1,476 | 1,250 | 1,898 | 2,155 | 2,238 | 2,249 | 2,147 | 2,144 |
| Private | 1,340 | 1,100 | 1,767 | 2,027 | 2,100 | 2,100 | 2,000 | 2,000 |
| Official | 136 | 150 | 131 | 128 | 138 | 149 | 147 | 144 |
| Capital account balance | -772 | -307 | 1,801 | 2,507 | 1,795 | 1,888 | 1,917 | 1,830 |
| Gross foreign direct investment (FDI) inflows | 800 | 900 | 1,100 | 1,200 | 1,250 | 1,250 | 1,300 | 1,350 |
| Equity | 320 | 540 | 715 | 780 | 813 | 813 | 845 | 878 |
| Loan disbursements | 480 | 360 | 385 | 420 | 438 | 438 | 455 | 473 |
| FDI loan repayments | 601 | 819 | 414 | 442 | 453 | 537 | 624 | 712 |
| Medium and long-term loans (net) | 729 | 623 | 487 | 979 | 1,098 | 1,274 | 1,341 | 1,291 |
| Disbursements | 1,411 | 988 | 1,077 | 1,334 | 1,450 | 1,685 | 1,800 | 1,850 |
| ODA loans | 1,361 | 958 | 1,020 | 1,069 | 1,150 | 1,250 | 1,200 | 1,070 |
| Commercial loans | 50 | 30 | 56 | 265 | 300 | 435 | 600 | 780 |
| Amortization 1/ | 682 | 365 | 590 | 356 | 352 | 411 | 459 | 559 |
| Short term capital (net) | -1,700 | -1,011 | 628 | 770 | -100 | -100 | -100 | -100 |
| Errors and omissions | 246 | -169 | -946 | 0 | 0 | 0 | 0 | 0 |
| Overall balance | 115 | 194 | 464 | 1,197 | 528 | 605 | 431 | 437 |
| Financing | -115 | -194 | -464 | -1,197 | -528 | -605 | -431 | -437 |
| Change in NFA (-, increase) | -115 | -194 | -464 | -1,197 | -528 | -605 | -431 | -437 |
| Of which: use of Fund credit (net) | -21 | 56 | -14 | -71 | -67 | -49 | -30 | -22 |
| Purchases | 0 | 106 | 54 | 0 | 0 | 0 | 0 | 0 |
| Repurchases | 21 | 50 | 68 | 71 | 67 | 49 | 30 | 22 |
| Other | -94 | -250 | -450 | -1,125 | -461 | -556 | -401 | -415 |
| Memorandum items: | | | | | | | | |
| Gross official reserves 2/ | 3,030 | 3,387 | 3,692 | 4,600 | 5,128 | 5,733 | 6,165 | 6,602 |
| In weeks of next year's imports | 8.9 | 8.3 | 7.5 | 8.5 | 8.7 | 8.8 | 8.6 | 8.4 |
| Net official international reserves 3/ | 2,191 | 2,555 | 2,956 | 3,742 | ... | ... | ... | ... |
| In weeks of next year's imports | 6.4 | 6.3 | 6.0 | 6.9 | ... | ... | ... | ... |
| Current account deficit (in percent of GDP) | 2.1 | 2.2 | -1.1 | -3.6 | -3.2 | -3.0 | -3.2 | -2.8 |
| Excluding official transfers | 1.7 | 1.7 | -1.5 | -3.9 | -3.6 | -3.3 | -3.5 | -3.0 |
| Trade deficit (in percent of GDP) | 1.2 | 2.0 | -2.6 | -5.5 | -5.6 | -5.5 | -5.3 | -4.9 |
| Gross foreign direct investment/GDP (in percent) | 2.6 | 2.9 | 3.2 | 3.3 | 3.2 | 2.9 | 2.8 | 2.7 |
| Concessional loans and grants (incl. OECF) | 1,497 | 1,108 | 1,152 | 1,198 | 1,288 | 1,399 | 1,347 | 1,214 |
| Export value growth (ann. perc. change) | 25.2 | 4.0 | 11.2 | 19.0 | 10.4 | 10.1 | 10.9 | 11.9 |
| Import value growth (ann. perc. change) | 34.5 | 2.3 | 22.1 | 24.5 | 10.4 | 9.8 | 10.3 | 11.0 |
| External debt (in percent of GDP) | 39.7 | 41.6 | 38.3 | 38.3 | 38.3 | 38.1 | 37.7 | 36.8 |
| Debt service (in percent of exports of GNFS) | 10.5 | 10.6 | 7.5 | 7.5 | 7.1 | 7.3 | 7.3 | 7.4 |

Sources: Data provided by the Vietnamese authorities; and staff estimates and projections.

1/ For 2002, including a debt buyback in which US\$ 273 million was paid for US\$500 million Russian debt at face value.

2/ Foreign assets of the State-Bank of Vietnam (SBV) excluding Treasury Deposits at the SBV in foreign currency.

3/ Gross official reserves excluding foreign liabilities of the SBV and foreign currency deposits of deposit-money banks at the SBV.

Table 4. Vietnam: Monetary Survey, 2000–2003 1/2/

| | 2000 | 2001 | 2002 | | | | | | | | 2003 | | | |
|---|--|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| | | | Mar. | | June | | Sept. | | Dec. | | Mar. | May | Sept. | Dec. |
| | | | Prog. | Est. | Prog. | Est. | Prog. | Est. | Prog. | Est. | | | | |
| (In trillions of dong) | | | | | | | | | | | | | | |
| Net foreign assets | 95.7 | 117.6 | 121.3 | 116.8 | 120.8 | 120.7 | 125.9 | 120.3 | 131.0 | 117.4 | 127.4 | 122.6 | 123.2 | 123.7 |
| Foreign assets | 112.7 | 135.9 | 139.8 | 135.4 | 139.4 | 139.3 | 144.7 | 139.3 | 149.9 | 135.9 | 144.4 | 140.7 | 140.8 | 140.8 |
| Foreign liabilities | -17.0 | -18.3 | -18.5 | -18.5 | -18.6 | -18.5 | -18.8 | -19.0 | -18.9 | -18.4 | -17.0 | -18.1 | -17.5 | -17.1 |
| Net domestic assets | 127.2 | 162.2 | 172.2 | 173.0 | 182.4 | 182.0 | 193.5 | 194.7 | 204.5 | 211.7 | 218.3 | 234.0 | 255.9 | 274.7 |
| Domestic credit | 155.2 | 191.2 | 201.2 | 201.4 | 211.5 | 211.4 | 222.5 | 224.6 | 233.5 | 239.9 | 246.5 | 263.5 | 284.5 | 302.7 |
| Net claims on government | -0.5 | 2.1 | 2.8 | 2.8 | 3.5 | 2.2 | 4.6 | 5.3 | 5.6 | 8.8 | 2.6 | 6.7 | 10.8 | 13.8 |
| Credit to the economy | 155.7 | 189.1 | 198.4 | 198.6 | 208.0 | 209.2 | 218.0 | 219.3 | 227.9 | 231.1 | 243.9 | 256.8 | 273.8 | 288.9 |
| <i>of which in foreign currency</i> | 32.3 | 36.5 | ... | 38.6 | ... | 40.6 | ... | 43.1 | ... | 46.2 | 51.6 | 58.0 | ... | ... |
| Claims on state enterprises | 69.9 | 79.7 | 81.6 | 81.7 | 84.1 | 84.1 | 86.7 | 86.9 | 89.3 | 89.5 | 92.3 | ... | 100.0 | 103.8 |
| Claims on other sectors | 85.8 | 109.4 | 116.8 | 116.9 | 123.8 | 125.1 | 131.3 | 132.4 | 138.6 | 141.6 | 151.6 | ... | 173.8 | 185.1 |
| Other items, net | -28.0 | -29.0 | -29.0 | -28.4 | -29.0 | -29.4 | -29.0 | -29.9 | -29.0 | -28.2 | -28.3 | -29.5 | -28.6 | -28.0 |
| Broad money | 222.9 | 279.8 | 293.5 | 289.9 | 303.3 | 302.7 | 319.4 | 314.6 | 335.5 | 329.1 | 345.7 | 356.6 | 379.1 | 398.4 |
| Dong liquidity | 152.5 | 191.1 | 201.6 | 202.7 | 213.7 | 209.2 | 219.8 | 219.1 | 232.6 | 235.5 | 251.6 | 264.4 | 286.2 | 304.8 |
| Foreign currency deposits | 70.4 | 88.7 | 91.9 | 87.2 | 89.6 | 93.5 | 99.6 | 95.5 | 102.9 | 93.6 | 94.1 | 92.2 | 92.9 | 93.7 |
| (Annual percentage change) | | | | | | | | | | | | | | |
| Credit to the economy | 38.1 | 21.4 | 20.8 | 20.9 | 20.8 | 21.5 | 20.7 | 21.5 | 20.5 | 22.2 | 22.9 | 24.4 | 24.8 | 25.0 |
| <i>of which in foreign currency</i> | 11.8 | 13.1 | ... | 16.1 | ... | 18.0 | ... | 20.4 | ... | 26.6 | 33.7 | 48.7 | ... | ... |
| Credit to state enterprises | 28.7 | 14.1 | 11.7 | 11.8 | 12.0 | 11.9 | 12.7 | 13.0 | 12.0 | 12.2 | 13.0 | ... | 15.0 | 16.0 |
| Credit to other sectors | 46.9 | 27.5 | 28.1 | 28.2 | 27.7 | 28.9 | 26.6 | 27.7 | 26.8 | 29.5 | 29.8 | ... | 31.3 | 30.7 |
| Broad money | 39.0 | 25.5 | 23.1 | 21.6 | 21.8 | 21.6 | 21.3 | 19.4 | 19.9 | 17.6 | 19.3 | 18.5 | 20.5 | 21.1 |
| Dong liquidity | 30.8 | 25.3 | 25.5 | 26.2 | 29.7 | 27.0 | 25.8 | 25.3 | 21.7 | 23.2 | 24.1 | 25.9 | 30.6 | 29.4 |
| Foreign currency deposits | 60.5 | 26.0 | 18.1 | 12.0 | 6.3 | 10.9 | 12.4 | 7.8 | 16.1 | 5.6 | 8.0 | 1.4 | -2.7 | 0.0 |
| (Changes in percent since the beginning of the year) | | | | | | | | | | | | | | |
| Credit to the economy | 38.1 | 21.4 | 4.9 | 5.0 | 10.0 | 10.6 | 15.3 | 16.0 | 20.5 | 22.2 | 5.6 | 11.1 | 18.5 | 25.0 |
| Credit to state enterprises | 28.7 | 14.1 | 2.4 | 2.5 | 5.5 | 5.4 | 8.8 | 9.0 | 12.0 | 12.2 | 3.1 | ... | 11.7 | 16.0 |
| Credit to other sectors | 46.9 | 27.5 | 6.8 | 6.9 | 13.2 | 14.4 | 20.0 | 21.1 | 26.8 | 29.5 | 7.1 | ... | 22.8 | 30.7 |
| Broad money | 39.0 | 25.5 | 4.9 | 3.6 | 8.4 | 8.2 | 14.2 | 12.4 | 19.9 | 17.6 | 5.0 | 8.3 | 15.2 | 21.1 |
| Dong liquidity | 33.2 | 25.3 | 5.5 | 6.0 | 11.8 | 9.5 | 15.0 | 14.6 | 21.7 | 23.2 | 6.8 | 12.3 | 21.5 | 29.4 |
| Foreign currency deposits | 60.5 | 26.0 | 3.7 | -1.7 | 1.0 | 5.4 | 12.3 | 7.7 | 16.1 | 5.6 | 0.6 | -1.5 | -0.8 | 0.0 |
| (Quarterly percentage changes) | | | | | | | | | | | | | | |
| Credit to the economy | 10.7 | 4.7 | 4.9 | 5.0 | 4.7 | 5.3 | 4.8 | 4.9 | 4.6 | 5.4 | 5.6 | 7.7 | 5.0 | 5.5 |
| Credit to state enterprises | 7.8 | 3.7 | 2.4 | 2.5 | 3.0 | 2.9 | 3.1 | 3.4 | 3.0 | 3.0 | 3.1 | ... | 4.0 | 3.8 |
| Credit to other sectors | 13.2 | 5.5 | 6.8 | 6.9 | 6.0 | 7.0 | 6.0 | 5.9 | 5.6 | 6.9 | 7.1 | ... | 5.6 | 6.5 |
| Broad money | 12.5 | 6.2 | 4.9 | 3.6 | 4.6 | 4.4 | 5.3 | 3.9 | 5.0 | 4.6 | 5.0 | 3.2 | 4.8 | 5.1 |
| Dong liquidity | 6.6 | 9.3 | 5.5 | 6.0 | 5.4 | 3.2 | 2.9 | 4.7 | 5.8 | 7.5 | 6.8 | 6.5 | 6.1 | 6.5 |
| Foreign currency deposits | 19.5 | 0.1 | 3.7 | -1.7 | 2.7 | 7.2 | 11.2 | 2.2 | 3.3 | -1.9 | 0.6 | -5.0 | 0.8 | 0.8 |
| (In millions of U.S. dollars, unless otherwise indicated) | | | | | | | | | | | | | | |
| Gross official international reserves | 3,030 | 3,387 | 3,464 | 3,449 | 3,511 | 3,498 | 3,657 | 3,561 | 3,815 | 3,692 | 4,814 | 5,455 | 4,967 | 4,600 |
| (in weeks of next year's imports of goods and nonfactor services) | 8.9 | 8.3 | 7.0 | 7.0 | 7.1 | 7.1 | 7.4 | 7.2 | 7.7 | 7.5 | 8.9 | 10.1 | 9.2 | 8.5 |
| Foreign currency deposits of DMBs at the State Bank of Vietnam | 351 | 295 | 305 | 315 | 285 | 255 | 317 | 268 | 328 | 177 | 753 | 1,284 | 762 | 371 |
| Net official international reserves | 2,191 | 2,555 | 2,618 | 2,616 | 2,681 | 2,713 | 2,775 | 2,726 | 2,895 | 2,956 | 3,516 | 3,613 | 3,686 | 3,742 |
| Net foreign assets of the banking system | 6,599 | 7,805 | 8,050 | 7,699 | 8,017 | 7,911 | 8,356 | 7,856 | 8,694 | 7,640 | 8,266 | 7,939 | 8,020 | 8,052 |
| Velocity | 1.9 | 1.6 | 1.8 | 1.8 | 1.7 | 1.7 | 1.6 | 1.7 | 1.5 | 1.6 | 1.7 | 1.6 | 1.5 | 1.4 |
| Dong velocity | 2.8 | 2.5 | 2.6 | 2.6 | 2.4 | 2.5 | 2.4 | 2.4 | 2.2 | 2.2 | 2.3 | 2.2 | 2.0 | 1.9 |
| Money multiplier | 3.1 | 3.3 | 3.3 | 3.2 | 3.3 | 3.5 | 3.4 | 3.6 | 3.4 | 3.4 | 3.1 | 3.0 | 3.2 | 3.4 |
| Memorandum items: | (Changes in trillions of dong since the beginning of the year, unless otherwise indicated) | | | | | | | | | | | | | |
| Net domestic assets of the banking system 3/ 4/ | 28.0 | 36.1 | 10.0 | 11.1 | 20.3 | 20.1 | 31.3 | 31.7 | 42.3 | 46.5 | 6.5 | 22.3 | 44.2 | 63.0 |
| Net credit to the government of the banking system | -3.4 | 2.6 | 0.7 | 0.7 | 1.4 | 0.1 | 2.4 | 2.2 | 3.5 | 3.2 | -6.3 | -2.1 | 1.9 | 5.0 |
| Credit to the state-owned enterprises from the banking system | 15.6 | 9.8 | 1.9 | 2.0 | 4.4 | 4.3 | 7.0 | 7.2 | 9.6 | 9.8 | 2.8 | ... | 10.5 | 14.3 |
| Net official international reserves (in millions of U.S. dollars) | 98 | 382 | 62 | 65 | 125 | 158 | 220 | 158 | 340 | 359 | 560 | 657 | 730 | 786 |

Sources: State Bank of Vietnam; and staff estimates and projections.

1/ Currently comprising the State Bank of Vietnam (SBV), six state-owned commercial banks, and 78 nonstate-owned credit institutions.

2/ Estimates at current exchange rates, unless indicated otherwise. The program exchange rate for 2001 is D 14,501 per U.S. dollar and for 2002 it is D 15,070 per U.S. dollar.

3/ At program monitoring exchange rates.

4/ Excludes nonnegotiable government bonds for recapitalization of SOCBs.

Table 5. Vietnam: Summary of General Government Budgetary Operations, 1999-2004 1/

| | 1999 | 2000 | 2001 | 2002 | | 2003 | 2004 |
|---|-------|-------|-------|--------|--------|-------|-------|
| | | | | Actual | Budget | | |
| (In percent of GDP, unless otherwise specified) | | | | | | | |
| Total Revenue and grants | 19.8 | 21.1 | 22.7 | 22.9 | 20.8 | 22.8 | 22.0 |
| Oil revenues | 4.7 | 6.6 | 7.8 | 6.8 | ... | 6.7 | 5.8 |
| Nonoil revenue | 14.5 | 14.0 | 14.4 | 15.7 | ... | 15.8 | 15.8 |
| Tax revenue | 12.3 | 11.8 | 12.1 | 13.3 | ... | 13.3 | 13.3 |
| Nontax revenue | 2.2 | 2.2 | 2.3 | 2.4 | 2.0 | 2.5 | 2.5 |
| Grants | 0.6 | 0.5 | 0.4 | 0.4 | 0.4 | 0.3 | 0.3 |
| Total Expenditure | 20.6 | 23.9 | 25.6 | 24.8 | 23.8 | 25.1 | 24.8 |
| Current Expenditure | 13.9 | 16.3 | 16.8 | 16.3 | 16.1 | 16.8 | 17.0 |
| Wages and salaries | 2.8 | 3.4 | 3.8 | 3.5 | 3.6 | 4.1 | 3.9 |
| Interest payments | 0.6 | 0.8 | 1.0 | 1.2 | 1.2 | 1.2 | 1.2 |
| Other current expenditure | 10.5 | 12.1 | 12.0 | 11.6 | 11.3 | 11.5 | 12.0 |
| Capital Expenditure | 6.7 | 7.6 | 8.8 | 8.5 | 7.7 | 8.3 | 7.8 |
| Fiscal Balance | -0.8 | -2.8 | -2.9 | -1.9 | -3.0 | -2.3 | -2.8 |
| Financing | 0.8 | 2.8 | 2.9 | 1.9 | 3.0 | 2.3 | 2.8 |
| Domestic (net) | -0.4 | 1.3 | 1.9 | 0.9 | 1.7 | 1.3 | 1.6 |
| Banking System | -1.4 | -0.8 | 0.6 | 0.4 | ... | 0.9 | ... |
| Nonbank public | 1.0 | 2.1 | 1.3 | 0.5 | ... | 0.4 | ... |
| Foreign (net) | 1.2 | 1.5 | 1.0 | 1.0 | 1.3 | 1.0 | 1.3 |
| Borrowing | 2.0 | 2.0 | 1.5 | 1.4 | 1.8 | 1.4 | 1.7 |
| Amortization | 0.7 | 0.6 | 0.4 | 0.4 | 0.5 | 0.4 | 0.5 |
| Other debt creating flows | 1.8 | 2.3 | 2.3 | 3.5 | ... | 4.1 | 5.8 |
| Onlending 1/ | 1.8 | 2.3 | 2.0 | 2.6 | ... | 3.0 | 3.1 |
| ODA financed (gross) | 1.8 | 2.3 | 1.1 | 1.2 | 2.0 | 1.5 | 1.2 |
| Other (net) | 0.0 | 0.0 | 0.9 | 1.3 | ... | 1.4 | 1.9 |
| Reform costs 2/ | 0.0 | 0.0 | 0.3 | 0.9 | ... | 1.1 | 2.7 |
| Capital costs | 0.0 | 0.0 | 0.3 | 0.9 | ... | 0.9 | 2.3 |
| Safety net costs | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.2 | 0.4 |
| Public debt stock 3/ | ... | ... | ... | 35.7 | ... | 39.4 | 44.9 |
| Domestic | ... | ... | ... | 9.5 | ... | 12.5 | 17.5 |
| Foreign | ... | ... | ... | 26.2 | ... | 26.9 | 27.4 |
| Memorandum Items | | | | | | | |
| Non-oil deficit (as a share of nonoil GDP) | -5.7 | -9.9 | -11.2 | -9.0 | ... | -9.3 | -8.9 |
| Expenditure managed by units 4/ | 1.2 | 1.5 | 1.9 | 1.6 | 1.4 | 1.6 | 1.6 |
| Total poverty reducing expenditures 5/ | 5.1 | 5.4 | 6.0 | 6.1 | 6.0 | 6.4 | ... |
| Costs of Social safety nets | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.2 | 0.4 |
| Nonoil GDP (trillions of dong) | 382.8 | 408.6 | 438.9 | 501.3 | ... | 552.7 | 614.7 |
| Nominal GDP (trillions of dong) | 397.3 | 429.7 | 458.1 | 520.4 | 505.2 | 572.1 | 630.9 |

1/ Includes DAF operations.

2/ Includes debt issues for bank recapitalization, SOE debt assumption, and safety net costs.

3/ Includes DAF debt.

4/ Self-financed expenditures undertaken by government administrative units, which are excluded from the above budget presentation.

5/ Staff estimate based on (i) current expenditure on education, training, health, and family planning and (ii) capital expenditure on education, training, health, and poverty-related projects in the agriculture, transportation, electricity, and water sectors.

Table 6. Vietnam: Medium-Term Macroeconomic Framework, 2000-2007 1/
(In percent of GDP, unless otherwise indicated)

| | 2000 | 2001 | 2002 Est. | 2003 | 2004 | 2005 | 2006 | 2007 |
|---|-------|-------|--------------|------------|-------|-------|-------|-------|
| | | | | Projection | | | | |
| Real GDP (annual percentage change) | 5.5 | 5.0 | 5.8 | 6.0 | 7.0 | 7.0 | 7.0 | 7.0 |
| Nominal GDP (in trillions of dong) | 429.7 | 458.1 | 520.4 | 572.1 | 630.9 | 697.3 | 770.6 | 853.9 |
| Inflation (annual percentage change) | | | | | | | | |
| Consumer price index, annual average | -1.6 | -0.4 | 4.0 | 4.0 | 3.5 | 3.5 | 3.5 | 3.5 |
| Consumer price index, end of period | -0.5 | 0.7 | 4.0 | 4.0 | 3.5 | 3.5 | 3.5 | 3.5 |
| GDP deflator | 2.5 | 1.5 | 7.4 | 3.7 | 3.1 | 3.3 | 3.3 | 3.6 |
| Current account balance | | | | | | | | |
| (including official transfers) | 2.1 | 2.2 | -1.1 | -3.6 | -3.2 | -3.0 | -3.2 | -2.8 |
| (excluding official transfers) | 1.7 | 1.7 | -1.5 | -3.9 | -3.6 | -3.3 | -3.5 | -3.0 |
| Merchandise exports (annual percentage change) | 25.2 | 4.0 | 11.2 | 19.0 | 10.4 | 10.1 | 10.9 | 11.9 |
| Merchandise imports (annual percentage change) | 34.5 | 2.3 | 22.1 | 24.5 | 10.4 | 9.8 | 10.3 | 11.0 |
| Saving-investment balance | | | | | | | | |
| Gross national saving | 27.0 | 27.8 | 25.6 | 24.8 | 25.8 | 26.8 | 28.1 | 30.1 |
| Gross investment | 25.3 | 26.1 | 27.2 | 28.7 | 29.3 | 30.1 | 31.6 | 33.1 |
| Gross official reserves (in millions of US dollars) | 3,030 | 3,387 | 3,692 | 4,600 | 5,128 | 5,733 | 6,165 | 6,602 |
| (in weeks of next year's imports of goods and nonfactor services) | 8.9 | 8.3 | 7.5 | 8.5 | 8.7 | 8.8 | 8.6 | 8.4 |
| General government budget | | | | | | | | |
| Total revenue and grants | 21.1 | 22.7 | 22.9 | 22.8 | 22.0 | 22.5 | 22.5 | 22.6 |
| Revenue | 20.6 | 22.2 | 22.5 | 22.5 | 21.6 | 22.1 | 22.1 | 22.2 |
| of which: oil revenue | 6.6 | 7.8 | 6.8 | 6.7 | 5.8 | 5.2 | 4.8 | 4.4 |
| Grants | 0.5 | 0.4 | 0.4 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Total Expenditure | 23.9 | 25.6 | 24.8 | 25.1 | 24.8 | 25.0 | 25.0 | 25.1 |
| Current expenditure | 16.3 | 16.8 | 16.3 | 16.8 | 17.0 | 17.6 | 17.7 | 17.7 |
| Capital expenditure | 7.6 | 8.8 | 8.5 | 8.3 | 7.8 | 7.4 | 7.4 | 7.4 |
| Fiscal balance 2/ | -2.8 | -2.9 | -1.9 | -2.3 | -2.8 | -2.5 | -2.5 | -2.5 |
| Other debt creating flows | | | | | | | | |
| Onlending | 2.3 | 2.3 | 3.5 | 4.1 | 5.8 | 6.4 | 2.7 | 2.0 |
| Reform costs | 0.0 | 0.3 | 0.9 | 1.1 | 2.7 | 3.6 | 0.0 | 0.0 |
| Broad money (annual percentage change) | 39.0 | 25.5 | 17.6 | 21.1 | 16.4 | 14.7 | 14.0 | 13.5 |
| Velocity | 1.9 | 1.6 | 1.6 | 1.4 | 1.4 | 1.3 | 1.3 | 1.2 |
| External debt service payments (in billions of U.S. dollars) | 1.8 | 1.9 | 1.5 | 1.7 | 1.8 | 2.0 | 2.3 | 2.6 |
| (in percent of exports of goods and nonfactor services) | 10.5 | 10.6 | 7.5 | 7.5 | 7.1 | 7.3 | 7.3 | 7.4 |
| General government debt service payments (in percent of revenue) | ... | ... | 4.0 | 5.3 | 4.6 | 4.8 | 4.6 | 4.7 |
| External debt (in percent of GDP) 3/ | 39.7 | 41.6 | 38.3 | 38.3 | 38.3 | 38.1 | 37.7 | 36.8 |
| (in percent of exports of goods and nonfactor services) | 70.2 | 72.2 | 66.6 | 61.0 | 59.4 | 58.1 | 56.3 | 53.4 |

1/ Staff estimates of national accounts.

2/ Excluding onlending and capital costs of reform.

3/ London Club rescheduling was concluded in 1998. Restructuring of the Russian debt was concluded in September 2000 on comparable terms to the 1993 Paris Club rescheduling.

Table 7. Vietnam: Fund Position and Indicators of Fund Credit, 2002-07 1/

| | 2002 | Projection | | | | 2007 |
|---|-------|------------|-------|-------|-------|-------|
| | | 2003 | 2004 | 2005 | 2006 | |
| (In percent of quota) | | | | | | |
| Total Fund credit outstanding (end of period) | 85.2 | 81.8 | 92.0 | 93.6 | 86.9 | 81.8 |
| Summary Indicators (In percent) | | | | | | |
| Debt service to the Fund to exports of goods and nonfactor services | 0.4 | 0.3 | 0.3 | 0.2 | 0.1 | 0.1 |
| Debt service to the Fund to gross official reserves | 1.9 | 1.6 | 1.4 | 0.9 | 0.5 | 0.4 |
| (In millions of SDRs) | | | | | | |
| Transactions during the period (net) | -10.9 | -10.9 | 33.5 | 5.4 | -22.3 | -16.6 |
| Tranche policies and special facilities repurchases (net) | 4.0 | 4.0 | 1.0 | 0.0 | 0.0 | 0.0 |
| Enhanced Structural Adjustment Facility repayments (net) | 48.3 | 48.3 | 48.3 | 36.2 | 18.1 | 0.0 |
| Poverty Reduction and Growth Facility 1/ disbursements (net) | 41.4 | 41.4 | 82.8 | 41.6 | -4.1 | -16.6 |
| Total Fund credit outstanding (end of period) | 280.2 | 269.3 | 302.8 | 308.1 | 285.9 | 269.3 |
| Tranche policies and special facilities | 5.0 | 1.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Enhanced Structural Adjustment Facility | 151.0 | 102.7 | 54.4 | 18.1 | 0.0 | 0.0 |
| Poverty Reduction and Growth Facility | 124.2 | 165.6 | 248.4 | 290.0 | 285.9 | 269.3 |

Sources: International Monetary Fund, Finance Department; and staff projections.

1/ Assumes disbursement of four remaining PRGF tranches in December 2003, May and November 2004, and May 2005.

Table 8. Vietnam: Quantitative Performance Criteria and Indicative Targets for 2002 1/ 2/

| | Stock at Dec. 31 2001 | Maximum cumulative change from end-December 2001 to: | | | | | | | |
|--|-----------------------------|--|-------|---------|------|----------|------|---------|------|
| | | March 31 | | June 30 | | Sept. 30 | | Dec. 31 | |
| | | Program | Est. | Program | Est. | Program | Est. | Program | Est. |
| (In trillions of dong) | | | | | | | | | |
| 1. Net domestic assets of the banking system 3/ 4/ | 162.2 | 10.0 | 11.1 | 20.3 | 20.1 | 31.3 | 31.7 | 42.3 | 46.5 |
| 2. Net credit to the government of the banking system 4/ | 2.1 | 0.7 | 0.7 | 1.4 | 0.1 | 2.4 | 2.2 | 3.5 | 3.2 |
| 3. Credit to the state-owned enterprises (SOEs) from the banking system | 79.7 | 1.9 | 2.0 | 4.4 | 4.3 | 7.0 | 7.2 | 9.6 | 9.8 |
| 4. Credit from the banking system and from the budget and budget support to the 200 targeted large SOEs 5/ | 42.7 | 0.6 | 0.6 | 1.5 | 0.6 | 2.3 | 8.9 | 3.2 | 11.3 |
| (In millions of US dollars) | | | | | | | | | |
| 5. Contracting or guaranteeing of nonconcessional external debt by the government | | | | | | | | | |
| Up to one-year maturity | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Medium and long-term debt | ... | 100 | 100 | 220 | 100 | 665 | 162 | 750 | 162 |
| <i>Of which</i> : 1-5 years' maturity | ... | 0 | 0 | 0 | 0 | 300 | 0 | 300 | 0 |
| 6. External payments arrears 6/ | 60.6 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| 7. Net official international reserves 7/ | 2,555 | 62 | 65 8/ | 125 | 140 | 220 | 158 | 340 | 359 |

Sources: Vietnamese authorities; and staff estimates and projections.

1/ The measurement and reporting requirements of indicative targets and performance criteria are described in the Annex II (Technical Memorandum of Understanding) of the Memorandum on Economic and Financial Policies of the Government of Vietnam for 2002.

2/ Performance criteria for end-June 2002, and end-December 2002; and indicative target otherwise, except for (i) credit from the banking system and from the budget and budget support to 200 targeted large SOEs, which is an indicative target for end-June 2002, and end-December 2002; and (ii) external payments arrears, which is a continuous performance criterion through December 2002.

3/ At program monitoring exchange rates.

4/ Excludes non-negotiable government bonds for state-owned commercial bank reform.

5/ Ministry of Finance estimate.

6/ Represent outstanding arrears to Algeria; a rescheduling agreement is currently under discussion between the Vietnamese and Algerian authorities.

7/ Actual performance measured on the basis of program monitoring exchange rates for non-U.S. dollar-denominated foreign assets and liabilities of the State Bank of Vietnam, as described in Annex II.

8/ At program monitoring exchange rates for 2001.

Table 9. Vietnam: Structural Policy Undertakings for the Third PRGF Review

| Policy Action/Condition | Timing | Status |
|---|--|--|
| Banking reform | | |
| 1. Agree with each large SOCB the audit qualifications from year 2000 audits to be eliminated by end-2002. | Structural benchmark June 2002 | Completed. |
| 2. Subject to donor financing, each of the four large SOCBs will contract with an international accounting firm for an external audit of the year 2001 accounts based on international standards of auditing and accounting. | Structural benchmark July 2002 | Completed in September 2002 for three SOCBs and in November 2002 for the fourth. |
| 3. Resolve a cumulative total of D3.5 trillion in NPLs for the four large SOCBs in accordance with the amounts the SBV agreed with each bank. 1/ | Structural performance criterion September 2002 | D 3.1 trillion resolved as of end-March 2003. |
| 4. Apply first phase of loan-loss provisioning using the new definition of NPLs under Decision 1627. | Structural benchmark December 2002 | Full implementation of Decision 1627 pending. Provisioning plan based on IAS audits adopted December 2002. |
| 5. Pass a special SBV examination of credit file documentation. | Structural benchmark December 2002 | Completed. |
| State-owned enterprise reform | | |
| 6. Establish a quarterly monitoring system for tracking performance against annual targets on SOE reform, under which the line ministries, general corporations, and provincial People's Committees report regularly to the special monitoring unit in the NSCERD | Structural benchmark June 2002 | Completed. |
| 7. Publish a roadmap, indicating annual targets on SOE reform by type of reform action through 2004. | Structural benchmark September 2002 | Expected to be published by August 2003. |
| Fiscal management | | |
| 8. Promulgate regulations on the value-added tax and on the corporate income tax to enable self-assessment on a pilot basis. | Structural benchmark November 2002 | Completed in May 2003. |
| 9. Issue implementation guidelines for self assessment tax administration procedures on a pilot basis for large taxpayers in Ho Chi Minh City and Quang Ninh provincial offices. | Structural performance criterion December 2002 | Expected in October 2003. |
| 10. Make fully operational self assessment procedures on a pilot basis in Ho Chi Minh City and Quang Ninh provincial offices. | Structural benchmark April 2003 | Expected to be operational in January 2004. |
| Exchange system liberalization | | |
| 11. Submit a recommendation to the National Assembly to eliminate the tax on profit remittances for foreign-invested enterprises. | Structural benchmark September 2002 | Completed in May 2003. |

1/ For definition of "resolve," see the MEFP Annex on milestones for SOCBs (EBS/02/101).

Table 10. Vietnam: Indicators of External Vulnerability, 1998-2003

| | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 July |
|---|--------|--------|--------|--------|--------|--------------|
| Financial indicators | | | | | | |
| Public sector debt (in percent of GDP) 1/ 2/ | 59.3 | 58.1 | 28.4 | 32.2 | 29.9 | ... |
| Broad money (M2: annual percentage change) 3/ | 25.6 | 39.3 | 39.0 | 25.5 | 17.6 | 18.5 4/ |
| Foreign currency deposits to broad money (in percent) 3/ | 23.5 | 27.3 | 28.0 | 31.7 | 28.4 | 25.9 4/ |
| Credit to other (nonstate) sectors (annual percentage change) 3/ | 10.0 | 29.8 | 46.9 | 27.5 | 29.5 | 29.8 5/ |
| Foreign currency loans to credit to the economy (in percent) 3/ | 26.1 | 21.2 | 20.7 | 19.3 | 20.0 | 21.7 6/ |
| Net open foreign currency position of commercial banks (in percent of capital) 3/ 7/ | 43.9 | 29.6 | 53.8 | 62.7 | 48.5 | 50.9 6/ |
| External indicators | | | | | | |
| Exports (annual percentage change, in US\$) | 2.4 | 23.2 | 25.2 | 4.0 | 11.2 | 30.3 |
| Imports (annual percentage change, in US\$) | -1.1 | 1.1 | 34.5 | 2.3 | 22.1 | 33.3 |
| Current account balance (in percent of GDP, including official transfers) | -3.9 | 4.5 | 2.7 | 2.2 | -1.1 | ... |
| Capital account balance (in US\$ billion) 8/ | 0.2 | -0.3 | -0.8 | -0.3 | 1.8 | ... |
| <i>Of which:</i> | | | | | | |
| Short-term capital (net) 9/ | -0.6 | -1.0 | -1.7 | -1.0 | 0.6 | ... |
| Gross foreign direct investment (inflows) | 0.8 | 0.7 | 0.8 | 0.9 | 1.1 | ... |
| <i>Of which: Debt and loans</i> | 0.6 | 0.4 | 0.5 | 0.4 | 0.4 | ... |
| Medium-and long-term loans (net) | 0.4 | 0.6 | 0.7 | 0.6 | 0.5 | ... |
| Exchange rate (per U.S. dollar, period average, + dong appreciation) 10/ | 13,297 | 13,944 | 14,170 | 14,806 | 15,244 | 15,473 |
| (annual percentage change) | -13.6 | -4.9 | -1.6 | -4.5 | -3.0 | -1.5 |
| Exchange rate (dong per U.S. dollar, end of period, + dong appreciation) 10/ | 13,890 | 14,028 | 14,514 | 15,084 | 15,368 | 15,450 |
| (annual percentage change) | -13.0 | -1.0 | -3.5 | -3.9 | -1.9 | -0.5 |
| Real effective exchange rate (end of period, annual percentage change, + appreciation) | -9.5 | -3.2 | 2.1 | 1.4 | -2.7 | -3.4 |
| Reserve indicators | | | | | | |
| Gross official reserves, including gold (in US\$ billion) | 1.8 | 2.7 | 3.0 | 3.4 | 3.7 | 5.4 |
| (in weeks of next year's imports of goods and nonfactor services) | 6.8 | 8.1 | 8.9 | 8.3 | 7.5 | 10.0 |
| Gross official reserves excluding banks' foreign currency reserves at SBV (in US\$ billion) | 1.7 | 2.6 | 2.7 | 3.1 | 3.5 | 4.2 |
| Central bank short-term foreign liabilities (in US\$ billion) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net official international reserves (in US\$ billion) | 1.3 | 2.2 | 2.2 | 2.6 | 3.0 | 3.7 |
| Gross official reserves to broad money (M2) (in percent) | 31.3 | 23.7 | 19.7 | 18.3 | 17.2 | ... |
| Gross official reserves to short-term external debt by remaining maturity (in percent) | 160 | 219 | 339 | 481 | 713 | ... |
| Net foreign assets of commercial banks (in US\$ billion) | 2.3 | 1.5 | 3.5 | 4.6 | 4.0 | 2.3 |
| Debt indicators | | | | | | |
| Total external debt (in US\$ billion) 2/ | 20.4 | 20.3 | 12.0 | 12.9 | 13.1 | ... |
| <i>Of which: Public and publicly guaranteed debt</i> | 16.1 | 16.6 | 8.6 | 10.0 | 10.2 | ... |
| Total debt to exports of goods and services (in percent) 2/ | 170.6 | 144.9 | 70.2 | 72.2 | 66.6 | ... |
| Total debt service to exports of goods and services (in percent) 11/ | 13.9 | 12.8 | 10.5 | 10.6 | 7.5 | ... |
| <i>Of which: External interest payments to exports of goods and services (in percent)</i> | 3.7 | 3.0 | 2.9 | 2.4 | 1.7 | ... |
| Total short-term external debt by remaining maturity (in US\$ billion) | 1.1 | 1.2 | 0.9 | 0.7 | 0.5 | ... |
| Total short-term external debt by remaining maturity to total debt (in percent) | 5.4 | 6.1 | 7.4 | 5.5 | 4.0 | ... |
| Financial market indicators | | | | | | |
| Ho Chi Minh City Stock Exchange Composite Index (end of period, July 2000 = 100) | ... | ... | 207 | 235 | 183 | 150 |
| Number of listed companies | ... | ... | 5 | 12 | 21 | 21 |

Sources: Vietnamese authorities; and Fund staff estimates and projections.

1/ Excludes domestic debt and unguaranteed external debt of state-owned enterprises.

2/ Restructuring of nonconvertible Russian debt was concluded in September 2000.

3/ Starting in 2000, based on expanded monetary survey (currently comprising the State Bank of Vietnam (SBV) and 84 credit institutions); for previous periods, based on original monetary survey (SBV and 28 credit institutions).

4/ May.

5/ March.

6/ April.

7/ Foreign and foreign currency denominated assets minus foreign and foreign currency denominated liabilities.

8/ Excludes errors and omissions.

9/ Includes net external position of banking system and portfolio investment.

10/ Official mid-rate, which comprises the previous day's average interbank buying and selling rates.

11/ Accrual basis.

Vietnam—Fund Relations
(As of April 30, 2003)

I. Membership Status: Joined: 09/21/1956; Article XIV

| | | |
|---|--------------------|---------------------------|
| II. General Resources Account: | <u>SDR Million</u> | <u>Percent Quota</u> |
| Quota | 329.10 | 100.00 |
| Fund Holdings of Currency | 333.13 | 101.22 |
| Reserve position in Fund | 0.01 | 0.00 |
| | | |
| III SDR Department: | <u>SDR Million</u> | <u>Percent Allocation</u> |
| Net cumulative allocation | 47.66 | 100.00 |
| Holdings | 5.54 | 11.63 |
| | | |
| IV. Outstanding Purchases and Loans: | <u>SDR Million</u> | <u>Percent Quota</u> |
| Systemic Transformation | 4.03 | 1.22 |
| ESAF/PRGF arrangements | 263.12 | 79.95 |

V. Financial Arrangements:

| <u>Type</u> | <u>Approval Date</u> | <u>Expiration Date</u> | <u>Amount Approved (SDR Million)</u> | <u>Amount Drawn (SDR Million)</u> |
|-------------|----------------------|------------------------|--------------------------------------|-----------------------------------|
| PRGF | 04/13/2001 | 04/12/2004 | 290.00 | 124.20 |
| ESAF | 11/11/1994 | 11/10/1997 | 362.40 | 241.60 |
| Stand-by | 10/06/1993 | 11/11/1994 | 145.00 | 108.80 |

VI. Projected Obligations to Fund (in SDR Million; based on existing use of resources and present holdings of SDRs):

| | Overdue | <u>Forthcoming</u> | | | | |
|------------------|-------------------|--------------------|-------------|-------------|-------------|-------------|
| | <u>01/31/2003</u> | <u>2003</u> | <u>2004</u> | <u>2005</u> | <u>2006</u> | <u>2007</u> |
| Principal | 0.0 | 39.26 | 49.33 | 36.24 | 22.26 | 16.56 |
| Charges/Interest | 0.0 | 1.90 | 1.78 | 1.54 | 1.41 | 1.31 |
| Total | 0.0 | 41.16 | 51.11 | 37.78 | 23.67 | 17.87 |

VII. Safeguards Assessment:

Under the Fund's safeguards assessment policy, the State Bank of Vietnam (SBV) is subject to a full safeguards assessment with respect to the PRGF arrangement, which was approved on April 13, 2001, and is scheduled to expire on April 12, 2004. An on-site assessment of the SBV was completed on September 20, 2002, following a previous off-site assessment that had concluded on preliminary remedial measures. The on-site assessment confirmed that high risks exist in almost all

the areas under the safeguards framework. The proposed remedial measures and the alternatives offered have yet to be accepted by the Vietnamese authorities.

VIII. Exchange Rate Arrangement and Exchange Restrictions:

On February 25, 1999 the State Bank of Vietnam (SBV) revised the operation of the interbank foreign exchange market. Under this *de facto* managed floating regime, the SBV allows interbank foreign exchange market rates to fluctuate by a maximum of ± 0.25 percent a day (effective July 2002) from the previous day's average interbank market rate.

Vietnam currently maintains the following exchange restrictions subject to Fund jurisdiction under Article VIII: (i) a restriction arising from the limits on availability of foreign exchange for payments for imports of certain commodities, and (ii) a multiple currency practice arising from the tax on profit remittances by foreign investors.

IX. Article IV and XIV Consultations:

Vietnam is currently on a 24-month consultation cycle, subject to provisions of Board Decision No. 12794-(02-76) of July 15, 2002.

Vietnam continues to maintain restrictions on the making of payments and transfers for current international transactions under the transitional arrangements of Article XIV, Section 2, as described in EBS/01/184. The Fund encourages Vietnam to eliminate these restrictions as soon as circumstances permit.

X. Technical Assistance:

Missions:

- Tax self-assessment pilot projects (FAD), June-July 2002, November-December 2002, March-April 2003, May 2003, and August 2003.
- State-owned commercial bank (SOCB) restructuring (MFD), September 2002, November 2002, and June 2003.
- National income accounts statistics (STA) November-December 2001, August-September 2002, and May-June 2003.
- SOCB restructuring and foreign reserve management (MFD), August-September 2001.
- Tax policy and administration reform (FAD), August 2001, February-March 2002, July 2002, November 2002, and May-June 2003.
- Multisector statistics/GDDS (STA), July 2001.
- Liquidity management and open market operations (MFD), August 2000.
- Participation in Public Expenditure Review (FAD/APD), January 2000.
- Monetary and exchange operations and markets (MFD), November 1999.
- Tariff policy and customs administration reform (FAD) May 1999.
- State-owned enterprise reform (World Bank/APD), April 1999.

- Bank restructuring, banking supervision, and monetary and exchange reforms (MFD), March 1999.
- Bank insolvency law reform (LEG), March 1999.
- Tax policy (FAD), December 1998.
- Banking system restructuring (World Bank/APD), October 1998.
- Fiscal transparency (FAD), September 1998.
- Banking system soundness, monetary and foreign exchange operations, banking supervision, and central bank accounting and auditing (MFD/APD), April–May 1998.
- Money and banking statistics (STA), February–March 1998.

Resident Advisor:

Tax Computerization (FAD) through April 1998

XI. Resident Representative

Mrs. Susan Adams has been the Senior Resident Representative since August 2001.

Vietnam—World Bank-IMF Relations¹

Partnership in Vietnam's Development Strategy

The government of Vietnam's development strategy is set forth in its Comprehensive Poverty Reduction and Growth Strategy (CPRGS). The CPRGS focuses on: (i) high growth through a transition to a market economy, (ii) an equitable, socially inclusive, and sustainable path of growth, and (iii) the adoption of a modern public administration, legal, and governance system. A Joint Staff Assessment of the CPRGS was discussed by the Boards of the IMF and the World Bank in June and July 2002, respectively.

The IMF is supporting Vietnam's growth and poverty reduction efforts in the context of a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF). The IMF has taken the lead in the policy dialogue on macroeconomic policies and has been active regarding a set of structural issues, especially on trade and banking reform and related SOE reform.

The World Bank has taken the lead in supporting the Government's structural and institutional reforms in a number of sectors, and has backed the reform program through a series of Poverty Reduction Support Credit (PRSCs). The first PRSC, for US\$250 million, included measures to: (i) liberalize foreign trade; (ii) restructure or divest SOEs; (iii) strengthen the banking system; (iv) create a better climate for the development of the domestic formal private sector; and (v) improve the efficiency, equity, and transparency of public spending. The final tranche was disbursed in December 2002. This PRSC was co-financed by the UK, Netherlands, Denmark, and Sweden.

The second PRSC, signed in August 2003, was broader in scope. It extended beyond the structural reform agenda and included measures related to socially inclusive development and to modern governance. This second PRSC translated the development vision of CPRGS into a series of concrete policy measures, and laid the foundation for a series of annual PRSCs, until the revision of CPRGS, currently expected in 2006. It also established a series of triggers to assess the pace of policy reform, and linked this to the size of subsequent budget-support operations. The second PRSC, for US\$100 million, was co-financed by the UK, Netherlands and Sweden.

World Bank Group Strategy and Lending

The World Bank Group is combining all of its instruments of assistance to support the objectives laid out by the CPRGS. Those instruments include analytical and advisory activities, IDA project support, IFC, Mekong Project Development Facility (MPDF) and MIGA activities, a series of PRSCs, and partnerships and ODA coordination. A Country Assistance Strategy, presented to the World Bank Board in August 2002, sets out the planned support of the CPRGS objectives during the Bank's FY03-05.

Support for Vietnam's transition to a market economy will shift in focus from "design" to "implementation" of the policy reform agenda. The planned work will deal with financial sector

¹ Contact person: Mr. Vipul Tandon (202-473-1903).

development, the reform of SOEs, support for the domestic private sector, corporate governance, and private participation in infrastructure. IFC, MPDF, and MIGA will expand their work to improve the climate for domestic and foreign investment. Virtually all IDA credits will support policy, institutional and infrastructure support for Vietnam's ongoing transition, with the planned series of PRSCs being used as vehicles for the policy dialogue.

Several priorities are identified by the CPRGS to enhance equitable, inclusive, and sustainable development. They refer to disadvantaged and lagging areas, to the living standards of ethnic minorities, to gender equality, to access and affordability of social services for the poor, to the mitigation of impacts from natural disasters, and to enhancing environmental management. The World Bank favors a sector-wide approach for two projects supporting this agenda, Rural Roads III and Education for All. Sectoral budget support requires significant progress in the preparation of medium term expenditure frameworks, as well as improved transparency and financial management.

Efforts to improve governance will focus on public financial management, information and transparency, and legal development. Major technical assistance will be provided by the World Bank in each of these areas, and IDA projects will be undertaken in Public Financial Management, Customs Modernization, e-Government and, if requested, Legal Development. So far, AsDB, UNDP, and a number of donors have taken the lead on public administration and civil service reform, whereas the World Bank plays the leading role in public financial management.

The scale of the lending program depends on the pace of the policy and institutional reform agendas, as well as on progress in project preparation and implementation. Over the next three years, the IDA program will range from less than US\$300 million in the low case, to about US\$760 million in the high case, with a base case of US\$580 million per year. The IFC and MIGA programs are also expected to grow significantly as the investment climate improves. Today Vietnam is the largest IDA-only borrower, and the second largest user of IDA resources in the world after India.

In addition to its lending program, the World Bank will work in capacity-building and knowledge-sharing in key areas of emphasis. A complete set of core diagnostics was prepared, and new round of economic and sector work will be undertaken during the next few years. A Banking Sector Review was recently completed. A new household survey, the 2002 Vietnam Household Living Standards Survey, will serve as the basis for a Poverty Assessment in FY04. An integrated Public Expenditure Review will also be launched in FY04. Annual Vietnam Development Reports will summarize the accumulated knowledge and foster the policy and institutional reform agenda.

IMF-World Bank Collaboration in Specific Areas

Collaboration between the World Bank and the IMF was essential to launch the PRSC-PRGF program in 2001. The process leading to this program spanned four years, starting at the onset of the East Asian crisis. The overall framework for this collaboration was laid out in 1998, in preparation for what was then expected to be the second Structural Adjustment Credit for Vietnam. The lead agency in each policy area was identified in the Policy Framework Paper, and particularly in the Structural and Sectoral Policy Matrix for 1999-2001. The direct involvement

of the IMF in some of the structural areas such as financial sector reform, SOE reform and trade reform was justified because of their potential impact on macroeconomic stability.

As a result of this overall framework, the World Bank supports policy reforms in collaboration with the IMF in several areas, including external debt management, financial sector reform, SOE reform, and public expenditure management. In some of these areas, the World Bank and the IMF have identified complementary sets of policy triggers for the PRSC and the PRGF programs respectively. In others, cooperation between the two institutions has taken place in the context of specific tasks, not directly related to lending.

Trade reform has been an integral part of the Government's reform strategy, as evidenced by considerable trade liberalization through the 1990s. The World Bank has supported the following trade liberalization measures: (i) removal of quantitative restrictions on the imports a series of products; (ii) increases in the share of garment export quotas to be auctioned; (iii) further liberalization of rice exports; and (iv) reduction of tariffs on imports from ASEAN countries in the context of the ASEAN free trade agreement (AFTA). Progress in each of these areas has been achieved since early 2001. In parallel to these steps, the Government successfully completed a Bilateral Trade Agreement with the US and is currently aiming at securing accession to the WTO by 2005.

The PRSC-PRGF represented a breakthrough. It also led to a program with several atypical features, including initially retaining a relatively large share of the public sector in the economy, and a plan to restructure, rather than immediately privatize, large SOEs.

The World Bank has worked closely with the Ministry of Finance, the National Steering Committee on Enterprise Reform and Development and the Ministry of Labor, Invalids and Social Affairs in all areas of the SOE reform program. It has mobilized resources from various donors, especially in the area of transparency of SOE information and accountability. Among the measures being supported in this area are the monitoring of 200 highly indebted SOEs, the strengthening of recording and reporting of systematic data on SOE performance and a series of in-depth audits of SOEs in specific sectors. The World Bank plays a key role in the monitoring of ownership transformation (especially equitizations, sales and liquidations) and SOE creation. A series of diagnostic audits of large troubled enterprise groupings in four protected sectors are being implemented with the objective of assessing SOE viability. Restructuring three large General Corporations (SOE holding companies) in sectors where Vietnam has comparative advantage in world markets is also a priority. The design and implementation of the social safety net for redundant SOE workers has been an integral part of the World Bank's work program.

In the area of public expenditure management, key remaining challenges include: (i) integrating formulation of the recurrent and capital budgets within a medium-term expenditure framework; (ii) improving budgetary data and increasing the transparency of data and information flows; and (iii) ensuring an effective process for prioritizing and reallocating public expenditures to improve sector outcomes, reduce poverty and limit the prospective increase in inequality. To meet these challenges, the Government launched the Public Financial Management Reform Initiative (PFMRI), a medium-term program for strengthening public financial management. This overarching program deals with reforms in five areas: public expenditure management (including state budget management, investment planning, and financial management information); public

debt management; revenue management; SOE fiscal risk management; and public asset management.

The PFMRI is a Government-led initiative and donors are coordinating their financial and technical support for the program. The IMF takes the lead in revenue management while the World Bank takes the lead in public expenditure management. Currently, the IMF is providing technical assistance to help develop a comprehensive program for reforming the tax system and tax administration. The World Bank is leading the work in developing an integrated financial management information system, through a Public Financial Management credit for US\$54 million, approved in May 2003. The credit also supports the preparation of medium-term expenditure frameworks in four sectors and four provinces, and the development of a database of public debts. The credit was co-financed by the UK.

Jointly with other donors, the World Bank is also supporting an effort to modernize planning and budgeting processes at the provincial level. This effort is part of a broader attempt by the Government of Vietnam to “roll out” CPRGS to the provinces. The goal of the exercise is for local policy makers to identify monitorable targets related to growth and poverty reduction, to align resources to the attainment of those targets, and to introduce mechanisms for consultation with the local population.

The World Bank, which has had a long-term role in the modernization of the financial sector, has taken the lead in the effort to strengthen the banking system. It has worked closely with the State Bank of Vietnam (SBV) who has been the primary government contact for the sector, but a relationship has also been maintained with the Ministry of Finance (MoF). Input has been provided by way of direct technical assistance and policy dialogue, with the aim of rationalizing the Joint Stock Banks, strengthening of State-Owned Commercial Banks (SOCBs), improving the supervision of the system, and modernizing the infrastructure for banking. The areas of work with the SOCBs have included the resolution of Non-Performing Loans (NPLs), provisioning for loan loss, re-capitalizing banks as they meet their restructuring targets, introducing internal auditing, and developing a viable payments system. Current efforts aim at improving the regulatory framework for policy lending, and at developing more effective mechanisms for NPL resolution.

The IMF has assumed responsibility for advising on the monetary policy functions of the SBV. It has also been directly and intensely involved in the central area of SOCB reform because of its fiscal and macroeconomic implications, in particular NPL resolution and the resulting re-capitalization. Also included in this has been work on minimizing directed lending, interest rate liberalization and the process and timing of the recapitalization of SOCBs.

As a consequence of the many challenges facing the financial sector in its transition from a Government directed and managed system to a market-based one, assistance from the World Bank, IMF, AsDB, and other donors has been sought. The World Bank has led the effort of donor coordination in the financial sector. It hosts regular financial sector donor coordination meetings which have been recently supplemented by the IMF-hosted donor meetings specific to assistance to the SBV.

Thus far there has been cooperation and assistance between the two organizations. The conditionality of the PRSC and PRGF has been complementary. A single-voice approach has been taken on many difficult issues. Looking ahead, it will be important to avoid confusion and

duplication. The resolution of NPLs, the operation of debts and assets trading companies, the re-capitalization of the banking system and the regulatory framework for policy lending by the Government are all areas where continued collaboration is needed.

The IMF and the World Bank currently collaborate to strengthen the capacity of the General Statistics Office in the area of economic statistics. The IMF focuses on improving balance of payments, national accounts, and price statistics while the World Bank concentrates on issues related to the production of high-quality household and enterprise surveys, and to access to data.

Vietnam—Relations With the Asian Development Bank

The Asian Development Bank (AsDB) resumed its operations in Vietnam in October 1993. The new Country Strategy and Program (CSP), endorsed in January 2002, proposes a focus on four pillars to align AsDB operations in Vietnam to the overarching objective of poverty reduction: (i) sustainable growth through rural development and private sector development, with a focus on small and medium enterprise development; (ii) inclusive social development, by mainstreaming poverty, gender, and ethnic dimensions in AsDB operations, with an emphasis on human capital development through secondary education and health; (iii) good governance, with special emphasis on public administration and civil service reform; and (iv) geographic focus on the impoverished central region.

From October 1993 to September 2002, the AsDB approved 34 loans totaling about US\$2.2 billion from the concessional Asian Development Fund (ADF) and US\$40 million from Ordinary Capital Resources (OCR). Disbursements in 2001 totaled US\$176 million, and in the first seven months of 2002, US\$79 million. Since December 1998, Vietnam has been classified as a B-1 country by the AsDB, which makes it eligible to supplement borrowing at ADF terms with limited amounts of borrowing at nonconcessional OCR terms. Loans have been provided for (i) rehabilitating physical infrastructure in the agricultural, energy, and transport sectors; (ii) financial sector and state-owned enterprise (SOE) reforms and corporate governance; and (iii) social, environmental, and cross-cutting concerns. In addition, the AsDB has extended technical assistance amounting to US\$84.4 million for 124 projects.

Support for policy and structural reforms to improve public sector efficiency and to encourage the development of the private sector is a vital component of AsDB operations in Vietnam. So far, the AsDB has approved three policy-based program loans in the agricultural sector (US\$80 million in 1994), the financial sector (US\$90 million in 1996), and for SOE reform and corporate governance (US\$100 million in 1999, of which US\$40 million was from OCR). In addition to program lending, policy dialogue is an important feature in all of the AsDB's loan projects in Vietnam. This includes support for increased efficiency of state-owned utilities through reforming their rate structure and other measures to increase cost recovery and to strengthen financial management, policy analysis, and planning.

The AsDB has been reorganized as of January 2002, and Vietnam now belongs to the Mekong Department, along with Cambodia, Laos, Myanmar, and Thailand. The resident mission has been strengthened and has been performing programming functions. During the past year, the AsDB has helped the government organize regional consultations and analyze Vietnam's achievements against development targets in the areas of health and governance as part of the process of formulating the national poverty reduction and growth strategy. AsDB and Fund staff work closely together to support the process of economic reforms in Vietnam. AsDB staff participate in Fund missions, exchange information, and consult on policy matters. The resident missions of the two institutions also cooperate closely.

Table 1. Vietnam: Public Sector Lending, by Sector, October 1993–September 2002
(In millions of U.S. dollars)

| Sector | Number | Net Amount |
|-----------------------------------|--------|------------|
| Lending | 34 | 2,232.7 |
| Agriculture and agro-industry | 12 | 697.4 |
| Social infrastructure | 10 | 570.3 |
| Transportation and communication | 7 | 595.0 |
| Finance and industry | 3 | 190.0 |
| Energy | 2 | 180.0 |
| Technical assistance | 124 | 84.4 |
| Advisory and operational purposes | 93 | 61.3 |
| Project preparation | 31 | 23.1 |

Source: AsDB.

Table 2. Vietnam: Loan Approvals and Disbursements, 1997–2002
(In millions of U.S. dollars)

| | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 1/ |
|--|-------|-------|-------|-------|-------|---------|
| Loan approvals 2/ | 359.6 | 284.0 | 220.0 | 188.5 | 243.1 | - |
| Loan disbursements | 149.3 | 127.8 | 191.2 | 218.9 | 176.2 | 112.7 |
| Undisbursed balance at the beginning of the year | 994.4 | 742.8 | 804.9 | 970.7 | 895.9 | 879.4 |
| Memorandum item: | | | | | | |
| Technical assistance approvals | 9.3 | 5.9 | 10.3 | 9.1 | 7.7 | 2.4 |

Source: AsDB.

1/ As of September 30, 2002.

2/ For 1999, includes the Vietnam component of Greater Mekong Subregion: East–West Corridor.

Vietnam—Statistical Issues

The reliability and coverage of macroeconomic statistics have significant deficiencies. The methodology for compilation and dissemination of these statistics continues to need substantial improvement, so that data properly reflect economic developments and assist policy formulation, implementation, and monitoring. The authorities are cooperating with the Fund, but work is hampered in some areas by the lack of authorization to release data. Vietnam has few official statistical publications that provide coverage beyond the real sector. A Vietnam page was introduced in the *GFS Yearbook* in 1999 and in *IFS* in 2001.

Fund technical assistance has contributed to improvements in a number of statistical areas. Most recently, a STA multisector statistics/General Data Dissemination System (GDDS) mission in July 2001 reviewed statistical practices and developments in the areas of national accounts, prices, external trade, fiscal, monetary, balance of payments, and sociodemographic data. It found a number of deficiencies and recommended improvements in an action plan. A follow up STA mission took place in December 2001 to begin to address weaknesses in national accounts statistics (discussed below). The mission agreed on a program to improve national accounts and price statistics and a STA peripatetic expert has been assisting the GSO under a five-year project that commenced in January 2002. In November 2002, Vietnam nominated a GDDS coordinator and committed to use the GDDS as a framework to develop and improve the country's statistical system. Nonetheless, STA has not yet received the required methodological descriptions (metadata) for posting on the DSBB, which would permit to formally recognize Vietnam as a GDDS participant. A follow up mission will be undertaken in May-June 2003 as part of a multiyear project to improve real sector statistics.

National accounts

The General Statistical Office (GSO) provides quarterly and annual data on gross domestic product (GDP) by type of economic activity and by expenditure (both in current and constant prices), and monthly and annual data on external trade, industrial output, agricultural production, retail sales, and prices. While the methodology for producing national accounts is broadly consistent with the *System of National Accounts 1993*, the compilation process suffers from poor data collection practices and a lack of coordination and communication between data collection agencies.

Estimates of GDP by expenditure have been produced since 1998, but they are in highly aggregated form, and further work is needed to develop a set of expenditure deflators. Although coverage has been broadened recently, the available evidence suggests that the level of GDP may be understated in the official statistics, and that the authorities need to focus on improving data collection from the nonstate sector (including non-observed activities), which remains quite weak. In addition, much of the data on national accounts are compiled before the end of the reference period, requiring data providers to resort to forecasting data in the remaining period in order to derive relevant estimates.

Under the current project the peripatetic expert will assist the GSO in the following areas: promoting the effective use of enterprise and economic census data in compiling the national accounts statistics; improving estimates of GDP at constant prices; improving estimates of household final consumption expenditure; improving estimates of quarterly GDP; further development of foreign trade and producer price indices; and developing wage indices. The consultant has noted steady progress by the GSO in these areas.

Prices

The GSO has compiled and published a monthly consumer price index (CPI) in line with international standards since January 1996. The new series was phased in over a two-year period and is now reported with minimal lags. Effective July 2001, the GSO changed the CPI to reflect a larger nonfood weight and broader consumption basket. The introduction of a producer price index was planned in late 2001, but has been delayed for technical reasons. Trade price indices are also compiled, but are not used in the national accounts by the GSO because the sample size is deemed too small.

Government finance statistics

The Ministry of Finance's (MoF) State Budget Department produces provisional monthly, quarterly, and annual fiscal data on government operations shortly after the end of the reference period; final data for the fiscal (calendar) year are produced after an extended delay of about six months. These data reflect the consolidated operations of the state budget, which covers all four levels of government: central, provincial, district, and commune. They exclude data on quasi-fiscal activities of SOEs and extrabudgetary funds, among which are the Social Security Fund, Enterprise Restructuring Fund, National Development Support Fund, Export Support Fund, and Sinking Fund (for repayment of onlent funds), for which no regularly reported data are currently compiled.

The time of recording data is mainly on a cash basis for final annual data, but varies for provisional data depending on their source. As a result, government financing data, in particular domestic bank financing, cannot be reconciled as reported in the fiscal and monetary accounts. Like the national accounts, provisional data are compiled before the end of the reference period and thus involve a forecasted component. The quarterly data are only revised when data are compiled for the same quarter of the following year. The MoF's External Finance Department maintains a centralized record of all general government external debt. The MoF, with support from the UNDP, aims to strengthen the external debt management system, particularly the recording of disbursements and multiple currency loans.

Despite these shortcomings, the authorities have made progress in a number of other areas related to fiscal transparency, including implementation of an improved budget management law and adoption of a 1986 GFS-consistent budget classification at all levels of government. The authorities published for the first time in late 1998 the fiscal outturn for 1997 and the approved budget for 1999, although both in highly aggregated form. Starting in late 2001, the MoF began posting annual budget outturns and plans on its external website, including by major revenue and

expenditure items. However, considerable actions remain to be taken to improve the coverage of fiscal data as recommended in the 1998 Bank-Fund report on fiscal transparency, the 2000 Public Expenditure Review, and, most recently, the STA multisector statistics mission.

In this context, the government continues to work toward gazetteing and publishing the annual national budget, as well as having commune-level budgets, implementing the *GFS*-based functional budget classification system, initiating work on revising government accounting standards, and introducing an integrated financial management system (IFMS) for improving treasury management and fiscal reporting. The STA mission found that the functional classification had not yet been fully aligned with internationally recognized classification standards, which might hamper formulation, execution, and monitoring of fiscal policy. The IFMS will allow a detailed classification of provisional budget data (as well as final accounts). In addition, it will incorporate data on extrabudgetary funds into the Treasury database.

Monetary and financial statistics

The State Bank of Vietnam (SBV) regularly reports monetary and financial data to the Fund, including: (i) the monetary survey and the central bank balance sheet (both on a monthly basis and typically with a six-week lag); (ii) detailed consolidated balance sheets (“derivation tables”) for six state-owned and 78 nonstate deposit money banks and individual balance sheets for the four large state-owned commercial banks (SOCBs) (since the beginning of 2001 on a monthly basis and typically with an eight-week lag); and (iii) deposit and lending rates of the large SOCBs (on a monthly basis and for various maturities). Data on foreign reserves (gross and net official international reserves and net foreign assets of the banking system) are derived from the monetary survey. In addition, under the PRGF-supported program, data on official reserves are reported to the Fund at mid- and end-month with a 10-day lag.

In January 1999, the SBV and commercial banks began implementing new charts of accounts for compiling money and banking data, developed with STA assistance. The new charts of accounts were formally adopted in April 1999. However, they do not adequately sectorize credit for monetary programming purposes, in particular failing to distinguish between bank credit to state-owned enterprises (SOEs) and to other nonstate sectors of the economy. Therefore, in addition to its regular monthly reports, the SBV has designed a new monthly report form for the four large SOCBs for submitting sectorized credit data to the central bank. For program monitoring purposes, bank credit to the SOEs is being estimated based on a combination of these statistical reports and estimates for the other credit institutions. Given the SOCBs dominance in bank lending to SOEs, the overall margin of error of these estimates is believed to be below 5 percent. However, the STA mission in July 2001 encouraged the SBV to develop a reporting scheme for a comprehensive breakdown of banks’ credit to the economy by borrowing sectors, subsectors, and ownership of enterprises.

External sector statistics

The SBV compiles quarterly and annual balance of payments (BOP) data with a one- to two-month lag, although the data reported to the Fund for publication are less timely – the data

published in the August 2003 issue of the IFS are for the third quarter of 2002. Since 1995, monthly and annual trade data have been compiled using customs reports, but the coverage and accuracy of these data need to be improved. In particular, the commodity breakdown of a large share of monthly reported exports (approximately 30 percent) is unknown. Published trade data, however, contain a number of adjustments to the customs reports, which have been difficult to reconcile, as the staff is only provided data at a relatively high level of aggregation. Data on invisibles continue to be based largely on banking records, which provide incomplete coverage and identification of the types of transactions. Improvements in BOP statistics, in particular foreign direct investment (FDI), also continue to be hampered by interagency coordination problems.

Data on FDI are now compiled by the SBV based on quarterly and semi-annual survey reports received from foreign-invested enterprises operating in Vietnam and supplemented by reports from SBV branches. The Ministry of Planning and Investment (MPI) also collects administrative data on FDI. However, at the September 2000 ASEAN Workshop on Improving the Quality of FDI Data, the Vietnamese authorities indicated that problems persisted with the survey response rate, as not all FDI enterprises were providing the requested information. Moreover, the 2001 STA GDDS mission noted that no effort was made to distinguish head office and other nonresident liabilities in the reported data.

Data on contracting of commercial debt (by SOEs and privately owned firms) are maintained by the SBV. Some loans are reported only after an extended delay, and the reporting of disbursements and repayments remains poor. Data on contracting, disbursement, and service of official debt are maintained by the MoF. The MPI also reports the loan obligations of foreign investors. The STA mission found that the overlapping responsibility for debt statistics has at times resulted in some deficiencies in coverage, including the lack of monitoring certain leasing arrangements (e.g., for aircraft).

Vietnam: Core Statistical Indicators^{1/}
(As of July 31, 2003)

| | Exchange rates | International reserves | Reserve/ base money | Central bank balance sheet | Broad money | Interest rates | Consumer price index | Exports/ Imports | Current account balance | Overall government balance | GDP/GNP | External debt |
|----------------------------|-------------------|------------------------|------------------------|----------------------------|-------------|----------------|----------------------|---------------------|-------------------------|----------------------------|---------|---------------|
| Date of latest observation | 7/25/03 | 6/30/03 | 5/03 | 5/03 | 5/03 | 5/03 | 7/03 | 7/03 | 2002 | 2003Q1 | 2003Q2 | 2001 |
| Date received | 7/25/03 | 7/23/03 | 7/03 | 7/03 | 7/03 | 7/03 | 7/03 | 7/03 | 4/03 | 5/03 | 7/03 | 9/02 |
| Frequency of data | D | Fortnightly | M | M | M | M | M | M | Q | Q | Q | O |
| Frequency of reporting | D | Fortnightly | M | M | M | M | M | M | Q | Q | Q | A |
| Source of data | C/A ^{2/} | A | A | A | A | A | A | A | A | A | A | A |
| Mode of reporting | E | E | E | E | E | C | C | C | C | E | C | V |
| Confidentiality | C | B | B | B | B | C | C | C | B | C | C | B |
| Frequency of Publication | D | N | N | N | A | O | M | M | A | A | Q | N |

1/ The codes are as given below:

Frequency of data and reporting: D-daily, M-monthly, Q-quarterly, A-annual, O-irregular (when changed).

Source of data: A-direct reporting by the authorities, C-commercial electronic data provider, N-official publication.

Mode of reporting: E-electronic data transfer, C-cable or facsimile, V-irregularly in conjunction with staff visits.

Confidentiality: A-staff only, B-staff and Board, C-public.

Frequency of publication: D-daily, M-monthly, Q-quarterly, A-annual, O-irregular, N-not published.

2/ Initial source is commercial electronic data provider, which is later verified by direct reporting by the authorities

VIETNAM—DEBT SUSTAINABILITY ANALYSIS

1. Under the baseline scenario public debt would increase from some 35½ percent of GDP in 2002 to 51 percent of GDP in 2007 and fall thereafter.¹ The exercise assumes (i) a budget deficit at current levels of 2½ percent over the medium to long term, (ii) the recognition of SOCB/SOE contingent liabilities equivalent to some 10 percent of 2003 GDP, and (iii) onlending to private and state-owned enterprises, including DAF's off-budget onlending activities. The core budget deficit and the bulk of reform costs are envisaged to be increasingly funded domestically, with the share of foreign debt in total public debt decreasing from ¾ to ½ between 2002 and 2007.
2. The pronounced increase in the debt level is mainly driven by onlending and SOE/SOCB reform costs; excluding onlending, the debt level would peak at 41 percent of GDP in 2005. Abstracting from liabilities created by onlending may be warranted on the grounds that, if undertaken prudently, they would create assets of about equal magnitude. Conventional stress tests point to significant risks to debt sustainability: permanent shocks like a slump in growth (stress test 4) or the oil price (stress test 8) without any corrective actions would yield a surge in the debt-to-GDP ratio by 2015. Risks from poor-quality lending decisions by the DAF and SOCB, are discussed in Box 2.
3. Vietnam's external debt level is deemed sustainable under the baseline scenario, with a steadily declining trajectory envisaged over the medium term. As of end 2002, it is estimated that Vietnam's external debt is around 38 percent of GDP, or a NPV of external debt to exports ratio of 49 percent. These ratios are projected to decline gradually to about 32 and 37 percent, respectively, by 2007. The external debt build-up over the medium term is mainly contributed by a sizable external trade deficit, a large part of which, however, is envisaged to be offset by strong net current transfers (i.e., private remittances). The debt accumulation is also expected to be mitigated by sustained net FDI inflows.
4. Risk factors that would produce at least a transitory increase in the debt and debt service ratios include: (a) a sharp slowdown in export growth (stress test 2) or large deterioration in the current account position (stress test 3); and (b) a sizeable real exchange rate depreciation (stress test 5) – but the debt levels recorded by 2007 in these scenarios are not unmanageable by comparison with 2002 levels.

¹ Public debt is defined on a gross basis and excludes direct or government guaranteed debt by SOEs. It includes extra-budgetary borrowing by the DAF and costs of SOE/SOCB reform.

Vietnam: External Debt Sustainability Framework 1/
(in percent of GDP, unless otherwise indicated)

| | Actual | Projections | | | | | |
|--|--------|-------------|-----------|------|---------|---------|------|
| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2015 |
| NPV of external debt to exports ratio (percent) 2/ | 48.6 | 45.1 | 41.0 | 37.5 | 34.9 | 32.4 | 17.6 |
| External debt (nominal) | 38.3 | 38.3 | 38.3 | 38.1 | 37.7 | 36.8 | 23.0 |
| Change in external debt | -3.3 | 0.0 | 0.0 | -0.2 | -0.4 | -1.0 | -2.0 |
| Identified net debt-creating flows (5+10+11) | -4.8 | -1.2 | -1.6 | -1.8 | -1.6 | -2.1 | -3.5 |
| Current account deficit, excluding interest payments | 0.2 | 2.4 | 2.1 | 1.8 | 2.0 | 1.6 | -1.2 |
| Deficit in balance of goods and services | 4.5 | 7.1 | 7.0 | 6.7 | 6.2 | 5.3 | 0.8 |
| Exports | 57.6 | 62.8 | 64.5 | 65.6 | 67.0 | 68.9 | 79.4 |
| Imports | 62.0 | 69.9 | 71.5 | 72.2 | 73.2 | 74.2 | 80.2 |
| Net current transfers (negative = inflow) | -5.6 | -5.9 | -5.7 | -5.3 | -4.6 | -4.2 | -2.4 |
| o/w official | -0.4 | -0.3 | -0.3 | -0.3 | -0.3 | -0.3 | -0.1 |
| Other noninterest current account flows (negative = net inflow) | 1.3 | 1.1 | 0.8 | 0.5 | 0.5 | 0.5 | 0.5 |
| Net FDI (negative = inflow) | -2.1 | -2.1 | -2.1 | -1.9 | -1.8 | -1.7 | -1.1 |
| Endogenous debt dynamics 3/ | -2.9 | -1.5 | -1.6 | -1.8 | -1.8 | -1.9 | -1.2 |
| Contribution from nominal interest rate | 1.0 | 1.2 | 1.1 | 1.2 | 1.2 | 1.2 | 0.8 |
| Contribution from real GDP growth | -2.2 | -2.1 | -2.5 | -2.5 | -2.5 | -2.4 | -1.5 |
| Contribution from price and exchange rate changes | -1.7 | -0.5 | -0.2 | -0.5 | -0.5 | -0.7 | -0.5 |
| Residual (3-4) 4/ | 1.6 | 1.3 | 1.5 | 1.6 | 1.2 | 1.1 | 1.5 |
| Key macroeconomic and external baseline assumptions | | | | | | | |
| Nominal GDP (billions of US dollars) | 34.1 | 36.7 | 39.5 | 42.8 | 46.4 | 50.5 | 98.7 |
| Real GDP growth (in percent) | 5.8 | 6.0 | 7.0 | 7.0 | 7.0 | 7.0 | 6.5 |
| GDP deflator in US dollar terms (change in percent) | 4.3 | 1.4 | 0.6 | 1.2 | 1.4 | 1.8 | 2.1 |
| Effective interest rate (percent) 4/ | 2.6 | 3.4 | 3.0 | 3.2 | 3.3 | 3.4 | 3.5 |
| Growth of exports of G&S (US dollar terms, in percent) | 10.2 | 17.4 | 10.4 | 10.1 | 10.9 | 11.9 | 10.4 |
| Growth of imports of G&S (US dollar terms, in percent) | 19.1 | 21.2 | 9.9 | 9.5 | 10.0 | 10.4 | 9.9 |
| Price of main export commodity (natural gas) | 25.0 | 26.5 | 23.5 | 22.0 | 21.0 | 21.0 | 21.0 |
| NPV of debt ratio 2/ | | | | | | | |
| Baseline | 48.6 | 45.1 | 41.0 | 37.5 | 34.9 | 32.4 | 17.6 |
| Stress tests 6/ | | | | | | | |
| 1. Export growth and non-interest current account (NICA) at historical averages | 48.6 | 45.1 | 40.8 | 36.9 | 29.7 | 26.6 | 23.3 |
| 2. Export growth at historical average minus two standard deviations in 2004-05 | 48.6 | 45.1 | 43.1 | 43.0 | 43.8 | 42.3 | 23.0 |
| 3. NICA at historical average minus two standard deviations in 2004-05 | 48.6 | 45.1 | 53.0 | 59.3 | 54.7 | 48.6 | 18.6 |
| 4. Export growth and NICA at historical averages minus 1 standard deviation in 2004-05 | 48.6 | 45.1 | 41.9 | 39.8 | 33.7 | 31.0 | 29.7 |
| 5. 30 percent real depreciation in 2004 | 48.6 | 45.1 | 66.6 | 58.3 | 52.4 | 46.7 | 18.6 |
| 6. Net official transfers at historical average minus two standard deviations in 2004-05 | 48.6 | 45.1 | 41.1 | 37.6 | 35.0 | 32.4 | 17.6 |
| 7. 10 percent of GDP increase in other debt-creating flows in 2004 | 48.6 | 45.1 | 58.2 | 51.6 | 46.6 | 41.7 | 18.0 |
| 8. Price of main export commodity at historical average minus 2 SD in 2004-05 | 48.6 | 45.1 | 42.1 | 40.2 | 39.1 | 36.9 | 20.0 |
| Debt service ratio 7/ | | | | | | | |
| Baseline | 7.5 | 7.5 | 7.1 | 7.3 | 7.3 | 7.4 | 5.7 |
| Stress tests 5/ | | | | | | | |
| 1. Export growth and non-interest current account (NICA) at historical averages in 2003-07 | 7.5 | 7.5 | 7.0 | 6.8 | 6.7 | 6.5 | 5.6 |
| 2. Export growth at historical average minus two standard deviations in 2004-05 | 7.5 | 7.5 | 8.1 | 9.5 | 9.5 | 9.6 | 7.4 |
| 3. NICA at historical average minus two standard deviations in 2004-05 | 7.5 | 7.5 | 7.1 | 9.3 | 9.7 | 10.9 | 6.1 |
| 4. Export growth and NICA at historical averages minus 1 standard deviation in 2004-05 | 7.5 | 7.5 | 7.5 | 7.8 | 7.8 | 7.6 | 7.2 |
| 5. 30 percent real depreciation in 2004 | 7.5 | 7.5 | 7.1 | 12.8 | 12.2 | 11.8 | 6.2 |
| 6. Net official transfers at historical average minus two standard deviations in 2004-05 | 7.5 | 7.5 | 7.1 | 7.3 | 7.3 | 7.4 | 5.7 |
| 7. 10 percent of GDP increase in other debt-creating flows in 2004 | 7.5 | 7.5 | 7.1 | 10.2 | 9.9 | 9.7 | 5.9 |
| 8. Price of main export commodity at historical average minus 2 SD in 2004-05 | 7.5 | 7.5 | 7.6 | 8.3 | 8.3 | 8.4 | 6.5 |
| Averages and Standard Deviations 8/ | | | | | | | |
| | | Historical | Standard | | Average | Average | |
| | | Average | Deviation | | 2003-07 | 2008-22 | |
| Current account deficit, excluding interest payments | | 1.0 | 4.0 | | -1.7 | 0.0 | |
| Export growth (US dollar terms, in percent) | | 12.1 | 7.8 | | 10.8 | 10.6 | |
| Official grants to GDP ratio | | 0.5 | 0.1 | | 0.3 | 0.2 | |
| Net non-debt creating capital inflows | | 1.8 | 1.1 | | 1.8 | 1.3 | |
| Effective interest rate (in percent) 5/ | | 3.1 | 0.3 | | 3.3 | 3.4 | |
| Real GDP growth rate (in percent) | | 5.4 | 1.6 | | 6.9 | 6.5 | |
| GDP deflator in US dollar terms (change in percent) | | 0.2 | 2.6 | | 1.4 | 2.1 | |
| Price of main export commodity (US dollars) | | 21.3 | 5.5 | | 21.7 | 21.0 | |

Source: Authorities and staff estimates, projections and simulations.

1/ Includes both public and private sector debt.

2/ Based on three-year backward-looking average of exports of goods and services.

3/ Derived as $[r - g - \rho(1+g)] / (1+g + \rho + gp)$ times previous period debt ratio, with r = nominal interest rate;

g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

4/ Includes change in arrears, exceptional financing, change in gross foreign assets, and valuation adjustments.

5/ Based on three-year backward-looking average of exports of goods and services.

6/ Historical averages are for period 1997-2002.

7/ Based on current-year exports of goods and services.

8/ Historical averages and standard deviations are for the period of 1997-2002.

Vietnam: General Government Debt Sustainability Framework, 2002-2015

(In percent of GDP, unless otherwise indicated)

| | Actual | Projections | | | | | |
|--|-------------------|------------------|----------------|----------------|------|------|------|
| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2015 |
| I. Baseline Medium-Term Projections | | | | | | | |
| Public sector debt 1/ | 35.7 | 39.4 | 44.9 | 50.1 | 51.0 | 51.0 | 47.5 |
| o/w foreign-currency denominated | 26.2 | 26.9 | 27.4 | 27.8 | 27.7 | 27.1 | 15.4 |
| Change in public sector debt | 1.5 | 3.7 | 5.5 | 5.2 | 0.9 | 0.0 | -0.6 |
| Identified debt-creating flows | 1.8 | 3.9 | 5.5 | 5.2 | 0.9 | 0.0 | -0.6 |
| Primary deficit | 0.8 | 1.1 | 1.6 | 1.2 | 1.1 | 1.0 | 0.8 |
| Revenue and grants | 22.9 | 22.8 | 22.0 | 22.5 | 22.5 | 22.6 | 22.8 |
| of which: grants | 0.4 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.1 |
| Primary (noninterest) expenditure | 23.6 | 23.9 | 23.6 | 23.6 | 23.6 | 23.6 | 23.6 |
| Automatic debt dynamics | -2.4 | -1.3 | -1.9 | -2.4 | -2.9 | -3.1 | -2.8 |
| Contribution from interest rate/growth differential | -2.9 | -2.0 | -2.5 | -2.9 | -3.3 | -3.5 | -3.0 |
| Of which contribution from real interest rate 2/ | -1.1 | 0.0 | 0.1 | 0.0 | -0.1 | -0.2 | 0.1 |
| Of which contribution from real GDP growth 3/ | -1.9 | -2.0 | -2.6 | -2.9 | -3.3 | -3.3 | -3.2 |
| Contribution from exchange rate depreciation 4/ | 0.5 | 0.7 | 0.6 | 0.5 | 0.5 | 0.4 | 0.2 |
| Other identified debt-creating flows | 3.5 | 4.1 | 5.8 | 6.4 | 2.7 | 2.0 | 1.3 |
| Onlending | 2.6 | 3.0 | 3.1 | 2.8 | 2.7 | 2.0 | 1.3 |
| From ODA | 1.2 | 1.5 | 1.2 | 1.4 | 1.4 | 1.3 | 0.6 |
| Other (domestically mobilized by DAF) | 1.3 | 1.4 | 1.9 | 1.4 | 1.3 | 0.7 | 0.7 |
| Recognition of implicit or contingent liabilities of SOE/SOCB | 0.9 | 1.1 | 2.7 | 3.6 | 0.0 | 0.0 | 0.0 |
| Residual, including asset changes | | -0.2 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 |
| Public sector debt-to-revenue and grants ratio | 156 | 173 | 205 | 223 | 227 | 226 | 209 |
| Key Macroeconomic and Fiscal Assumptions | | | | | | | |
| Real GDP growth (in percent) | 5.8 | 6.0 | 7.0 | 7.0 | 7.0 | 7.0 | 7.0 |
| Average nominal interest rate on public debt (in percent) 5/ | 3.8 | 3.7 | 3.3 | 3.4 | 3.2 | 3.1 | 3.9 |
| Average nominal interest rate on forex debt (in percent) 5/ | 2.1 | 2.1 | 1.8 | 1.6 | 1.4 | 1.3 | 0.9 |
| Average real interest rate (in percent) 6/ | -3.3 | 0.0 | 0.3 | 0.1 | -0.1 | -0.4 | 0.2 |
| Inflation rate (GDP deflator, in percent) | 7.4 | 3.7 | 3.1 | 3.3 | 3.3 | 3.6 | 3.7 |
| Growth of real primary spending (deflated by GDP deflator, in percent) | 1.5 | 7.3 | 5.7 | 7.0 | 7.0 | 7.0 | 7.5 |
| Oil price (USD per barrel) | 25.0 | 26.5 | 23.5 | 22.0 | 21.0 | 21.0 | 21.0 |
| II. Stress Tests for Public Debt Ratio | | | | | | | |
| 1. Real GDP growth and primary balance are at historical averages | 35.7 | 39.4 | 44.3 | 49.3 | 50.1 | 50.1 | 47.0 |
| 2. Primary balance is at historical average minus two standard deviations in 2004-2005 | 35.7 | 39.4 | 46.2 | 53.2 | 54.0 | 53.9 | 50.1 |
| 3. Combination of 2-3 using one standard deviation shocks | 35.7 | 39.4 | 46.2 | 53.4 | 54.2 | 54.1 | 50.0 |
| 4. Long-run real GDP growth is at historical average minus two standard deviations | 35.7 | 39.4 | 45.8 | 52.2 | 54.7 | 56.6 | 79.3 |
| 5. One time 30 percent real depreciation in 2004 7/ | 35.7 | 39.4 | 55.7 | 60.0 | 60.1 | 59.4 | 52.1 |
| 6. 10 percent of GDP increase in other debt-creating flows in 2004 | 35.7 | 39.4 | 55.0 | 59.2 | 59.3 | 58.6 | 51.4 |
| 7. A permanent, two standard deviation negative shock to the major commodity price in 2004 | 35.7 | 39.4 | 46.9 | 53.6 | 56.1 | 57.6 | 65.3 |
| 8. Grants are at historical average minus two standard deviations in 2004-2005 | 35.7 | 39.4 | 44.9 | 50.0 | 50.9 | 50.9 | 47.5 |
| Statistics for Key Variables | Historical | Standard | Average | Average | | | |
| (for historical statistics last 5 years, unless otherwise specified) | Average | Deviation | 2002-07 | 2008-15 | | | |
| Primary deficit | 0.9 | 1.1 | 1.1 | 0.9 | | | |
| Real GDP growth, in percent (last 10 years) | 6.8 | 2.2 | 6.6 | 7.0 | | | |
| Nominal interest rate, in percent | 3.1 | 0.5 | 3.4 | 3.5 | | | |
| Real interest rate, in percent | -2.1 | 3.6 | -0.6 | -0.1 | | | |
| Inflation rate (GDP deflator), in percent | 5.7 | 3.9 | 4.1 | 3.7 | | | |
| Revenue and grants to GDP ratio | 21.3 | 1.4 | 22.5 | 22.6 | | | |
| Grants to GDP ratio | 0.5 | 0.1 | 0.4 | 0.2 | | | |
| Oil price, USD per barrel (last 10 years) | 19.8 | 4.7 | 23.2 | 21.0 | | | |

1/ Debt is defined as general government gross debt.

2/ Derived as $rd/(1+g)$, where r = average real interest rate, d = previous period debt ratio, and g = real GDP growth rate.3/ Derived as $-gd/(1+g)$, where the variables are defined as in footnote 2.4/ Derived as $aed/(1+r_f)$, where a = the share of debt denominated in foreign currency in the previous period and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar) and other variables are defined as in footnote 2.

5/ Derived as nominal interest expenditure divided by previous period debt stock.

6/ Derived as $r = (i - \pi)/(1 + \pi)$, where i = the nominal interest rate and π = the inflation rate.

7/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

**Statement by Sri Mulyani Indrawati, Executive Director for Vietnam
October 3, 2003**

Introduction

1. I would like to convey to the management and staff of the Fund the appreciation of the authorities for the continued support extended to Vietnam through policy dialogue, technical advice and financial assistance over the years. This relationship, which has been based on mutual trust and respect, has provided a conducive platform for the authorities to embark on a forward-looking economic program that is aimed at enhancing the country's economic potential and strengthening its capacity, in order to attain a more durable and broad-based growth path over the medium-term.

2. The authorities thank staff for their well-written and candid report. As recognized in the report, Vietnam has made significant strides in its move from a state-controlled economy towards a market-based one, and concomitantly produced solid performances on the macroeconomic front. The strong economic growth is expected to continue into the medium-term, as reflected in staff's projections of 7 per cent growth for 2004-2007. Nevertheless, like other countries at a similar stage of development and facing certain capacity constraints, there are obviously challenges that remain to be tackled. The time needed to fully meet reform targets necessarily reflects the prioritizing and sequencing of such efforts. Institutional capacity and frameworks have to first be strengthened. Thus far, the active consultations between the Fund and the authorities have largely resulted in a convergence of views of how reforms are to be addressed. Indeed, it is due to the cooperative efforts of all stakeholders in this process, including the government, the Fund, the World Bank and other development partners, that progress has been made and Vietnam has benefited from the efforts to strengthen its economy.

Recent Economic Developments

3. All recent macroeconomic indicators have been very encouraging. Real GDP growth continues to strengthen, inflation is low, the fiscal deficit has narrowed, external reserves are at a comfortable level, and the exchange rate is stable. In addition, the external debt level is manageable at about 38 per cent of GDP and is expected to decline. FDI inflows have slowed but remain high.

4. Growth has been fueled mainly by rapid expansion in the export sector and buoyant domestic investment. Recent estimates indicate that real GDP will grow by more than 6 per cent in 2003. The export sector has benefited from the USBTA as reflected in the strong demand from the US for textile and footwear products. Due to the recent surge in imports for machinery and intermediate products, the current account deficit is expected to widen to about 3.5 per cent of GDP, but this would largely be financed by ODA inflows and FDI, and therefore be manageable. Inflation remains subdued, with the headline rate on a downward trend consistent with moderating food prices and stability of the exchange rate.

5. The overperformance on the revenue front in 2002 has helped to reduce the fiscal deficit to 2 per cent of GDP, which is well below the targeted level of 3.25 per cent of GDP. Continued strong revenue performance and the authorities' commitment to save 50 per cent

of the revenue overperformance provide assurance that the fiscal deficit target of 2.5 per cent of GDP in 2003 is attainable.

6. In the monetary area, credit extended to the economy rose by 16.72 per cent in the first seven months of 2003 as compared to the level in December 2002. The authorities understand the concerns raised by staff, in particular, on the impact of the credit growth on NPLs. However, it should be noted that the growth in credit reflects bank financing for medium-term investment projects that would otherwise not be undertaken. This is not unusual for Vietnam's stage of development, where there is a lack other sources of financing given that the stock and bond markets are still in their infancy.

7. Foreign exchange policy has been conducted in an appropriate and flexible manner in response to market demand and supply, resulting in a reduction in the role of the parallel market. Thus far, the exchange rate has been supportive of export growth and reserve accumulation. On foreign exchange management, the surrender requirement has been totally removed, which would improve the incentives for investors. As regards to ongoing measures undertaken to comply with Article VIII of the Articles of Agreement, the authorities have removed restrictions on money transfers and international current settlement.

8. The "doi moi" economic program has led to significant achievements in poverty reduction. As pointed out in the staff report, the percentage of population living below the poverty line has fallen from 58 per cent in 1993 to an estimated 29 per cent in 2002. Key social indicators have correspondingly improved, particularly in terms of access to healthcare, safe water, immunization, education as well as overall life expectancy.

Key Medium-term Challenges

Fiscal Policy

9. The authorities see the merits of improving the structure of the budget and to design the fiscal framework in the medium-term context, as well as to incorporate extra-budgetary spending into the annual budget in order to have a holistic picture of the fiscal position. However, these steps require significant resources and additional expertise to implement. In the meantime, the authorities are prioritizing efforts to strengthen tax administration, introduce tax policy reforms, implement comprehensive civil service reforms, and adopt a systematic cost-benefit analysis for projects. More forceful implementation of reforms of the SOEs, as discussed below, would also have a positive impact on the fiscal position.

Banking Reforms

10. The authorities are mindful of the importance of improving financial intermediation to minimize resource misallocation and improve economic efficiency. Towards this end, they continue to work to strengthen the supervisory capacity of the State Bank of Vietnam (SBV), particularly in areas relating to the identification of risks in banking operations and creating incentives for banks to operate on a more commercially-oriented basis.

11. With regards to the SOCBs, while lending activities have increasingly been determined on commercial considerations, the authorities are aware of the need for further improvement in their credit, treasury and risk management techniques. Policy lending has been taken out of the commercial banking system and channeled to the newly-established Social Policy Bank, and the Development Assistance Fund. Some recent progress in SOCB reforms includes the following:

- i) As of June 2003, the SOCBs have resolved VND 3.818 trillion of NPLs.
- ii) The financial statements of the four largest SOCBs have been audited based on the IAS. New regulations on loan classification and loan-loss provisioning were issued and SOCBs have identified their provisioning needs based on 2002 IAS audit reports.
- iii) The SOCBs have been recapitalized based on their performance and implementation of their restructuring plans. As of June 2003, two phases of recapitalization have been completed with a total value of VND 6.8 trillion. These have improved the capital adequacy ratio and strengthened the SOCBs' financial position.
- iv) The SBV has completed the special examination of credit files of the SOCBs in order to review the procedures applied by each of the banks, the results of which will form the basis for the development of credit manuals.
- v) The SBV has issued an instruction requiring each of the SOCBs to identify their respective twenty heavily indebted SOEs for debt resolution.

SOE Reforms and Private Sector Development

12. With regard to SOE reform, the authorities are acutely aware of the need to refocus efforts, following delays in the equitization program. The new SOE roadmap (2003-2005), which has been made publicly available, is meant to provide a clearer plan for SOE transformation, by listing the SOEs to be divested according to a time schedule and by type of transformation. The roadmap is made up of 104 separate plans for enterprises that have been identified for divestment. Out of these 104 plans, the Prime Minister has approved 102. In order to prevent recurrence of reform slippages, the Prime Minister has issued an instruction to discharge SOE directors who fail to comply with the reform master plan. In the meantime, the National Assembly is discussing measures for addressing the complex problems pertaining to debt resolution and land valuation issues.

13. As staff have rightly noted, the 2000 Enterprise Law has provided a major stimulus to private sector activity by facilitating firms' entry into the market. The authorities have requested the Ministry of Planning and Investment and the People's Committees of provinces and cities to strengthen implementation of the Enterprise Law. Looking ahead, the authorities are committed to further improving the business climate to attract more FDI and creating a more transparent and consistent business environment for private firms.

Statistics

14. Vietnam has put in significant efforts to participate in the GDDS. As of September 30, 2003, information on the country's statistics has been disseminated on the DSBB. The authorities have worked hard with staff to realize this important step towards greater transparency.

15. In addition, a new Statistics Law will be enacted that, *inter alia*, would improve accessibility of statistics to the wider public. In order to achieve this objective, Vietnam will require technical assistance from the Fund. Specific needs include compilation of new statistics as well as improving the quality of existing data in terms of their timeliness, frequency, and coverage.

PRGF Review

16. Staff have consistently highlighted the element of gradualism in Vietnam's experience in embracing market-based economic principles, which has allowed the country to move forward at a slower but steady pace. Economic performance has been impressive, without the volatility and upheaval associated with more rapid adjustments. Despite the recognition by the Fund of the progress made by Vietnam under the PRGF arrangement, further improvements are being delayed due to the safeguards measure, which was introduced after the agreement of the PRGF was completed; its implementation would be in conflict with the prevailing legal framework of the country. The authorities are already taking steps towards improving the operations of the SBV, as they strongly hold the view that the strengthening the entire financial system, including the SBV, is a top priority of the government and the SBV's management. However, this ongoing reform exercise, including the resolving of the safeguard measure issue, should not be associated with the PRGF review.

17. Nonetheless, the authorities place a high priority on resolving this issue and are willing to discuss and explore avenues towards this end, including the proposal of technical assistance. In this regard, the authorities would welcome TA from the Fund to assist the SBV in moving its preparation of financial statements towards full IAS methodology. Moreover, the SBV already intends to publish its statutory audited financial statements, in accordance with the Accounting Law which shall enter into force on January 1, 2004. As such, the authorities hope that the third review under the PRGF will be effected soon without further delay.

Conclusion

18. While the road ahead has many challenges, the authorities are determined to overcome them, by continuing to pursue prudent economic policies as well as enhancing reform implementation in a progressive and steady manner. This will have to take into account economic considerations, capacity constraints, and more importantly, the aspirations and hence the ownership of the people of Vietnam, which will be strengthened with further improvements in economic growth and poverty reduction.

Statement by the IMF Staff Representative
October 3, 2003

1. This statement provides an update on economic and policy developments since the issuance of the staff report. These developments do not change the thrust of the staff appraisal.

Macroeconomic Developments

2. **Recent macroeconomic indicators point to continued strong growth and modest inflation**, in line with projections in the staff report. Industrial production during the first eight months of the year was up 16 percent on 2002 levels. Twelve-month inflation through September amounted to 2.7 percent, down from 3.0 percent through July on the basis of favorable food price trends. Exports and imports continue to record strong growth (28 and 33 percent, respectively, year-on-year, during January-August), but at a somewhat slower pace than in the first half of the year.

3. **The strong pace of credit growth continues**, with the annual growth of 27 percent through end-July being somewhat above the SBV's full-year target of 25 percent. Lower reserve requirements, effective August 1, and ample banking system liquidity suggest credit growth will remain strong in the coming months.

4. **Net international reserves (NIR) have risen further in recent months**, by some \$0.5 billion between end-June and mid-September, reflecting continued purchases of foreign exchange by the State Bank of Vietnam (SBV). Gross official reserves fell by some \$0.4 billion over the period, with banks reversing the large run-up in their foreign currency deposits at the SBV recorded during the first half of the year, but, at \$5.2 billion (9½ weeks of imports), are still up some \$1.5 billion since end-2002. The dong has depreciated marginally, by some 0.3 percent, vis-à-vis the U.S. dollar since end-June.

Safeguards Assessment

5. **The safeguards assessment of the SBV, flagged in Box 3 of the staff report, is in the process of being finalized.** It concludes that the SBV does not meet the requirements of the safeguards policy in several areas: (a) it does not prepare its financial statements in accordance with an established accounting framework, such as International Accounting Standards (IAS); (b) it does not have these financial statements audited independently in accordance with international standards; and (c) it does not publish these audited financial statements. Instead, the SBV prepares cash-based statutory accounts, which follow Vietnam's state budgetary accounting rules, are audited by the State Audit of Vietnam (SAV), and are unpublished.

6. **The remedial measures proposed in the safeguards assessment report are consistent with the "parallel approach" proposed by staff during the Article IV consultation mission**, and reflect staff efforts to respond to concerns previously raised by the

authorities (see Box 3 of the staff report). Specifically, the SBV should (a) prepare internal financial statements in accordance with IAS, commencing with the 2003 financial year, have these statements audited by an independent international accounting firm under a special purpose engagement, and provide these statements and the report of the accounting firm to Fund staff; and (b) publish its statutory accounts, beginning with the 2002 financial statements, in accordance with an existing commitment under the PRGF arrangement.

7. **The authorities have responded that these recommendations cannot be implemented because they run counter to Vietnam's prevailing legal framework**, in particular the legal constraint that only the SAV can audit the SBV. The authorities argue that the existing audit and control arrangements for the SBV are appropriate and adequate, and that the SAV audit of the SBV is an external audit undertaken in accordance with international standards and without interference from the executive agencies of the government.

8. **Staff are continuing to discuss with the authorities possible approaches to resolving the current impasse**, so as to be able to move ahead with the third review of the PRGF arrangement. An approach being considered, which would not involve an audit by an international accounting firm, would entail: an interim package of measures to improve the quality and transparency of the SAV audit of the SBV; a review of the SBV's NIR position by Fund staff prior to the completion of the third review; and ongoing dialogue on safeguards issues in future reviews. As part of this approach, the authorities would commit to retain future PRGF disbursements in their SDR account at the Fund until the Fund determines that the safeguards framework has been sufficiently strengthened to warrant eliminating this commitment.

Other

9. **Vietnam has begun participating in the Fund's General Data Dissemination System (GDDS)**, marking a significant step forward in the development of Vietnam's statistical base. Comprehensive information on its statistical production and dissemination practices were published on the Dissemination Standards Bulletin Board on September 30, 2003.



INTERNATIONAL MONETARY FUND

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700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes 2003 Article IV Consultation with Vietnam

On October 3, 2003, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Vietnam.¹

Background

Macroeconomic performance has been strong over the past 18 months, fueled by strong export performance and domestic investment. Staff estimates suggest output growth near 6 percent in 2002, with slightly faster growth projected for 2003. Nonoil exports have provided an important stimulus, rising by 24 percent (year-on-year) during the second half of 2002 and 32 percent during the first half of 2003, as producers responded to improved access to the US market under the United States Bilateral Trade Agreement. Investment has also been vigorous, with imports of machinery and equipment up 38 percent in 2002 and 40 percent in the first six months of 2003.

Inflation picked up during 2002, but has eased slightly in recent months. Headline inflation averaged some 4 percent during 2002, after two years of mild deflation, falling back to 3 percent as of July 2003. Non-food inflation shows a distinctive trend from the headline rate, but could ease in the coming months with slower depreciation of the dong and the easing of world oil prices.

Stronger growth has been accompanied by a sizeable deterioration in the external current account position, notwithstanding surging exports. The current account deficit is expected to

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

be around 3½ percent of GDP in 2003, as compared with a surplus in 2001, financed through a combination of higher long-term capital inflows and a reversal of the previously strong build-up of foreign assets by the commercial banks.

The State Bank of Vietnam (SBV) recorded a modest increase in its foreign reserves during 2002, followed by sharp growth in gross international reserves (GIR) during the first half of 2003. The jump in GIR this year reflects both sizeable foreign currency purchases by the SBV and a large shift in foreign currency assets of the commercial banks from offshore to the SBV. The dong continues to depreciate slowly against the US dollar, at a more modest pace in recent months. The daily trading band within which the rate is allowed to fluctuate was widened to ± 0.25 percent in July 2002 (from ± 0.1 percent).

The monetary aggregates have been growing at a rapid pace, reflecting the pace of economic expansion, ongoing monetization of the economy, and strong credit demand. Broad money rose by some 18 percent in 2002 and the first months of 2003, albeit with foreign currency deposits stagnating; credit growth continues at rates in excess of 20 percent per annum, with faster growth in credit to the non-SOE sector (30 percent) and in foreign currency credits (40 percent through April, from a low base). The SBV has adopted a largely accommodative stance, with the sizeable purchases of foreign currency during 2003 being largely unsterilized. Interest rates have shown little movement.

Budget performance was strong in 2002, aided by good non-oil revenue collections and public sector wage restraint, with the core fiscal deficit amounting to 2 percent of GDP. Revenue collections to date suggest the higher tax/GDP ratio can be at least maintained in 2003, but a sizeable (38 percent) increase in civil service wages and pensions is putting some pressure on the expenditure side of the budget. Onlending operations are on a rising trend, and could reach 3 percent of GDP this year while extra-budgetary debt creation arising from reform costs (mainly State Owned Commercial Bank recapitalization) is likely to be around 1 percent of GDP.

There has been continued progress in the areas of private sector development and trade policy reform. Registration of private firms has increased rapidly since the passage of the Enterprise Law in 2000, with strong growth in employment in small and medium-sized enterprises. Quantitative restrictions on imports were further scaled back in 2002, ASEAN Free Trade Area tariff reductions are proceeding as scheduled, and a wide-ranging Bilateral Trade Agreement with the US took effect in December 2001.

Reform implementation has proven more difficult in the state-owned sector. The equitization program fell behind schedule in 2002 and 2003, necessitating the preparation of a revised roadmap for reform in 2003-05 that has just been finalized.

The banking system is growing rapidly, with the bulk of funds still being intermediated through the major state-owned commercial banks. These banks face significant challenges in strengthening weak balance sheets and improving loan collections, while rapidly expanding their balance sheets. The SBV also faces important challenges in strengthening its supervisory capabilities to effectively monitor the expanding system.

The staff's medium-term scenario envisages growth averaging 7 percent per annum, supported by continued strong export expansion and investment. Inflation remains at modest levels (3-4 percent), while the real exchange rate, currently towards the lower end of the range in which it has moved since 1996, shows little change. The external position remains manageable, with current account deficits declining somewhat from the present level (3½ percent of GDP), and continuing to be financed by a mix of FDI inflows and medium-long term borrowings (still primarily ODA flows).

Executive Board Assessment

Executive Directors welcomed the opportunity to assess Vietnam's economic performance, and commended the authorities for their strong record of success in achieving high growth and poverty reduction in recent years. They noted that prudent macroeconomic management had provided an environment conducive to growth, and that the transition to a more market-oriented economy and increasing integration into the global economy had been key to poverty alleviation. Directors considered, however, that the transition process was still incomplete, and that the authorities faced important challenges, especially in the area of structural reform, in sustaining high growth over the medium term.

Directors welcomed the strong fiscal performance in 2002, attributable in part to buoyant oil revenues. They welcomed the authorities' intention to allocate one-half of any revenue overperformance in 2003 to deficit reduction. They recognized the need for public sector wages to remain competitive with those in the private sector but cautioned against further sharp increases in public sector wages. They encouraged the authorities to undertake a fuller assessment of the net benefits of public investments.

Directors considered that the medium-term fiscal position was manageable, provided that on-lending and off-budget liabilities are tightly controlled, and the risks to the revenue position, especially through a drop in oil prices and a reduction in import tariffs, are addressed through both tax policy reforms and improved tax administration. They welcomed the progress being made with the Fund-assisted program to introduce self-assessment by large taxpayers.

Directors welcomed the movement towards a market-based financial system, including the liberalization of most interest rates in 2002. They expressed concern, however, that the rapid pace of credit growth, including foreign exchange credits—which has supported economic growth—could overwhelm banks' still limited credit risk management capacities, and could lead to further impairment of already-weak bank balance sheets. In view of the added possibility of this credit growth contributing to inflationary pressures, which are moderate at present, they favored some liquidity tightening to slow its pace.

Directors agreed that a managed floating exchange rate regime was appropriate to Vietnam's circumstances, but argued that the policy could be implemented more flexibly over time, allowing larger movements in the rate. They noted the build-up of the State Bank of Vietnam's reserves during 2003 would help strengthen the external position. They also welcomed the removal of the foreign exchange surrender requirement.

Directors underscored the need for state-owned commercial banks and the Development Assistance Fund to conduct effective loan appraisal, which would help assure the long-term solvency of these state-controlled institutions. In this regard, they considered that strengthening the supervisory capabilities of the State Bank of Vietnam was an important supporting measure, and merited technical assistance from donors and the Fund. They emphasized the importance of accelerating the process of cleaning up the balance sheets of the state-owned commercial banks, and called for passage of guidelines that would impose a time-bound process for restructuring of financially distressed state-owned enterprises. Finally, they urged the passage of an effective anti-money laundering decree by year-end, followed by rigorous implementation.

Directors took the view that the government needed to develop more fully its strategy for the sizeable state-owned enterprise sector. They supported giving state-owned enterprises simpler channels of control, profit-focused mandates, and hard budget constraints, if they were to operate efficiently. In addition, they called for vigorous implementation of the equitization program for small and medium-sized enterprises, with greater reliance on auction-based pricing mechanisms.

Directors observed that employment growth over the medium-term would rely primarily on private sector expansion, supported by domestic and foreign investment. They emphasized that priorities for strengthening the business environment include improving transparency and governance, simplifying regulations and reducing bureaucratic discretion, strengthening the operation of key markets, notably for land, and ensuring the provision of competitively-priced infrastructure services.

Directors supported Vietnam's objective of achieving early WTO membership, while noting that it would require focused efforts to bring domestic regulations, practices, and laws into compliance with WTO norms. They encouraged the Vietnamese authorities to move towards acceptance of Article VIII obligations.

Directors welcomed the passage of the new Statistics Law and Vietnam's participation in the Fund's General Data Dissemination System. They commented, however, that Vietnam's macroeconomic statistics had significant weaknesses, and supported the provision of Fund technical assistance to improve the statistical base. They also pointed to the need for adequate resource provision to statistics-producing agencies and for effective inter-agency coordination.

Directors regretted the delays in completing the third review under the PRGF arrangement. In this regard, they noted the findings of the safeguards assessment and the remedial measures suggested in the staff report. They also noted the authorities' reservations about aspects of both the assessment and its recommendations, including the authorities' view that the safeguards measures should be in accordance with Vietnam's prevailing legal framework. Most Directors supported efforts to reach a compromise solution that would satisfy the safeguards policy within the existing framework during the period of the PRGF, while some others insisted on applying the Fund's policy on safeguard assessments vigorously and emphasized in this regard the importance of an independent external audit of the central bank in accordance with internationally accepted standards.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

Vietnam: Selected Economic Indicators, 1999-2003

| | 1999 | 2000 | 2001 | 2002 | 2003 |
|--|--------|--------|--------|--------|--------|
| | | | Est. | Est. | Proj. |
| Real GDP (annual percentage change) 1/ | 4.2 | 5.5 | 5.0 | 5.8 | 6-6½ |
| Industrial output | 11.6 | 18.4 | 13.7 | 14.5 | ... |
| Saving-investment balance (in percent of GDP) | 4.0 | 1.7 | 1.7 | -1.5 | -3.9 |
| Gross national saving | 26.5 | 27.0 | 27.8 | 25.6 | 24.8 |
| Gross investment | 22.4 | 25.3 | 26.1 | 27.2 | 28.7 |
| Inflation (annual percentage change) | | | | | |
| Period average | 4.2 | -1.6 | -0.4 | 4.0 | 3½-4 |
| End of period | 0.1 | -0.5 | 0.7 | 4.0 | 3½-4 |
| General government budget (in percent of GDP) | | | | | |
| Total revenue and grants | 19.8 | 21.1 | 22.7 | 22.9 | 22.8 |
| of which: oil revenue | 4.7 | 6.6 | 7.8 | 6.8 | 6.7 |
| Total Expenditure | 20.6 | 23.9 | 25.6 | 24.8 | 25.1 |
| Current expenditure | 13.9 | 16.3 | 16.8 | 16.3 | 16.8 |
| Capital expenditure | 6.7 | 7.6 | 8.8 | 8.5 | 8.3 |
| Fiscal balance 2/ | -0.8 | -2.8 | -2.9 | -1.9 | -2.3 |
| Other debt creating flows | 1.8 | 2.3 | 2.3 | 3.5 | 4.1 |
| Onlending | 1.8 | 2.3 | 2.0 | 2.6 | 3.0 |
| Reform costs | 0.0 | 0.0 | 0.3 | 0.9 | 1.1 |
| Money and credit (annual percentage change, end of period) | | | | | |
| Broad money | 56.6 | 39.0 | 25.5 | 17.6 | 20½ |
| Credit to the economy | 55.2 | 38.1 | 21.4 | 22.2 | 25 |
| Interest rates (in percent, end of period) | | | | | |
| Three-month deposits (households) | 4.0 | 4.3 | 5.9 | 7.0 | ... |
| Short-term lending (less than one year) | 11.7 | 9.8 | 8.8 | 9.9 | ... |
| Current account (including official transfers) | | | | | |
| (in millions of U.S. dollars) | 1,285 | 642 | 670 | -391 | -1,310 |
| (in percent of GDP) | 4.5 | 2.1 | 2.2 | -1.1 | -3.6 |
| Exports of goods (annual percentage change, U.S. dollar terms) | 23.2 | 25.2 | 4.0 | 11.2 | 19.0 |
| Imports of goods (annual percentage change, U.S. dollar terms) | 1.1 | 34.5 | 2.3 | 22.1 | 24.5 |
| Foreign exchange reserves (in millions of U.S. dollars, end of period) | | | | | |
| Gross official reserves, including gold | 2,711 | 3,030 | 3,387 | 3,692 | 4,600 |
| (in weeks of next year's imports of goods and nonfactor services) | 8.1 | 8.9 | 8.3 | 7.5 | 8.5 |
| Net international reserves, including gold | 2,093 | 2,191 | 2,574 | 2,956 | 3,742 |
| External debt (in percent of GDP) 3/ | 71.4 | 39.7 | 41.6 | 38.3 | 38.3 |
| Debt service due (in percent of exports of goods and nonfactor services) | 12.8 | 10.5 | 10.6 | 7.5 | 7.5 |
| Exchange rate (dong per U.S. dollar) | | | | | |
| Period average | 13,944 | 14,170 | 14,806 | 15,244 | ... |
| End of period | 14,028 | 14,514 | 15,084 | 15,368 | ... |
| Real effective exchange rate (annual percentage change) | | | | | |
| Period average | -6.5 | -2.9 | 0.9 | -0.4 | ... |
| End of period | -3.2 | 2.1 | 1.4 | -2.7 | ... |
| Memorandum items: | | | | | |
| GDP (in trillions of dong at current market prices) 1/ | 397.3 | 429.7 | 458.1 | 520.4 | 572.1 |
| Per capita GDP (in U.S. dollars) 1/ | 372 | 391 | 393 | 428 | 455 |

Sources: Data provided by the authorities; and staff estimates and projections.

1/ IMF staff estimates. Official estimates of GDP growth are 6.8 percent (2000), 6.8 percent (2001) and 7.0 percent (2002).

2/ Excluding onlending and capital costs of reform.

3/ Includes the loan component of foreign direct investment and other private sector borrowing and short-term debt.