

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

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

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INTERNATIONAL MONETARY FUND
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VIETNAM

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

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

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I. INTRODUCTION

1. The Comprehensive Poverty Reduction and Growth Strategy (CPRGS) was approved by the Prime Minister of Vietnam on May 21, 2002 and was discussed by the Boards of the IMF and IDA in July 2002. The CPRGS, which is Vietnam's Poverty Reduction Strategy (PRS), is situated within a broader framework of government strategies and plans and is regarded by Government as linked to the ten-year Socioeconomic Development Strategy 2001-2010 (SEDS) and the five-year Socioeconomic Development Plan 2001-2005 (SEDP). Since approval of the CPRGS, the Government of Vietnam has produced three progress reports in November 2003, November 2004 and November 2005. This Note provides advice on the "Vietnam Growth and Reduction of Poverty Annual Progress Report 2004-2005" (called the "Report" in this Note) published in November 2005.

2. The Report was prepared by the Ministry of Planning and Investment (MPI) and the Steering Committee of the CPRGS and was timed to generate discussion at the Consultative Group meeting in December 2005. The Report covers progress over the last two years, describing a mix of activities and outcomes for that period. It also looks forward to the next planning period, when PRS principles are being mainstreamed into the Socio-economic Development plan (SEDP) 2006-2010. It describes both the developmental challenges that lie ahead for the coming plan period and the consultative process that is underpinning the preparation of the SEDP. This Joint Staff Advisory Note (JSAN) comments on both elements of the Report. This JSAN also indicates some areas where the progress report has been incomplete on progress in important policy reform areas and summarizes staff views on some of these.

II. REVIEW OF PAST PERFORMANCE

3. Overall progress over the period of the CPRGS has been impressive. Economic growth has averaged 7.8 percent per year between 2001 and 2005, increasing in each of the past three years. This strong performance has been accompanied by a continuation of Vietnam's remarkable success in reducing poverty, which had declined to under 20 percent of the population in 2004, from 58 percent in 1993. There have also been strong and sustained improvements in human and social development indicators over the CPRGS period.

A. Macroeconomic Management

4. Vietnam's overall macroeconomic performance remained broadly favorable in 2005. GDP growth rose to 8.4 percent, led by strong consumption and investment. Despite disruptions caused by adverse weather conditions and a return of avian flu, the momentum of growth picked up in the second half of the year, as the government stepped up implementation of public investment projects. Although garment export growth slowed in 2005 with the removal of global textile quotas on WTO members, strong growth in other non-oil exports, together with the large increase in oil export prices and decelerating import growth, kept the trade deficit in check. With continuing large inflows of emigrants' remittances and tourism receipts, and sustained FDI and ODA, gross official reserves rose to US\$8.6 billion (9½ weeks of imports) at end-2005, up from US\$6.3 billion at end-2004.

5. However, inflation remained above 8 percent in 2005. Unlike in 2004, when inflation was dominated by supply-related increases in food prices and adjustments in domestic petroleum prices, inflation was more broadly-based in 2005. This can be attributed in part to demand pressures, which seem to have been boosted by the pickup in public investment and an increase in the minimum wage in the context of broadly accommodating macroeconomic policies. In the fiscal area, despite the oil revenue windfall, a rise in the government's wage bill led to an increase in the narrowly-defined budget deficit from 0.8 percent of GDP to 1.5 percent of GDP. The overall deficit, including the government's substantial bond-financed investment as well as its on-lending operations, widened from around 3.9 percent of GDP in 2004 to 6.4 percent of GDP in 2005. Although credit growth moderated from a peak of 42 percent reached in 2004 to 31½ percent in 2005, it was still high in light of inflationary pressures and the banks' weak balance sheets. The exchange rate depreciated by 0.9 percent relative to the U.S. dollar in 2005, in line with the informal target rate of depreciation for the year announced by the Governor of the SBV in January.

6. Against this background, it would have been desirable to explore more fully the tradeoffs faced by the authorities in their pursuit of macroeconomic stability versus the ambitious growth targets of the official development plans. Looking ahead, the staffs welcome the planned integration of a medium-term macroeconomic framework into the poverty reduction strategy (PRS) in the context of the forthcoming merging of the new PRS expected in mid-2006 into the SEDP for 2006–10. It is important to include in such

a framework medium-term fiscal targets and an associated assessment of implications for debt sustainability in order to ensure that the PRS's growth and poverty reduction objectives can be attained on an enduring basis. In addition, the new PRS could usefully discuss the government's strategy for addressing policy challenges similar to those faced in 2005, especially in the event that inflation remains high. In this context, it would be desirable for the targets of the new PRS to be explicitly presented as indicative, with policies envisaged to remain sufficiently flexible, in light of the challenges that the economy will continue to face in its continuing transition to a market system and its progressive integration into the global economy.

B. The Transition to a Market Economy

7. The Report reviews some of the measures taken over the past year to strengthen the regulatory basis for the market economy. The Report is candid in its description of remaining challenges, such as addressing weaknesses in competitiveness, stepping up the pace of SOE reform, and accelerating the evolution of the economy to a stage in which economic decisions are based on market principles. On the other hand, the importance of initiatives in the financial sector over the past year could have been emphasized more or further explained.

8. Given that the banking sector continues to be weak, and could seriously limit the capacity to achieve sustainable growth, greater attention could have been paid to explaining the main objectives in financial sector reform, the remaining challenges and the initiatives under way. In particular, financial sector reform is required not only to return banks to solvency, but also to place them on a commercial footing, under governance structures that ensure both prudent lending and efficient intermediation. It is also important to emphasize the main elements of the government's banking sector reform strategy as articulated in Politburo Resolution 191 of August 2005. Based on the available information, the planned reforms will entail fundamentally re-writing the law on credit institutions and the law on the State Bank of Vietnam (SBV). These new laws which were initially planned for 2010 might be brought forward to 2007, and could be effective from 2008. The new laws would be designed to transform the SBV into a modern central bank charged with executing monetary policy and supervising the banking system. The supervision functions of SBV would be separated from its management functions in relation to State-Owned Commercial Banks (SOCBs). The laws can also be expected to be shaped by the international commitments that Vietnam takes on as part of WTO accession.

9. The Report could also have reflected in some detail the considerable progress that has been made over the last year toward providing a level playing field for all enterprises, and the remaining challenges in this area as well. The Unified Enterprise Law (UEL) approved in November 2005 paves the way for equal treatment of firms, regardless of ownership. Under the new law which will be effective from July 1, 2006, domestic and foreign enterprises should be governed by the same corporate legislation, with foreign enterprises subject to the same registration procedures as domestic firms, and able to choose the form of corporate entity that is most suitable on business grounds. At present, they are only allowed to operate as limited liability companies. Implementation of the

UEL is also expected to enable foreign enterprises to restructure, expand, or diversify their business rather than being limited to the specific lines in which their business was initiated. Alongside the Enterprise Law a new Common Investment Law (CIL) was also passed in November 2005. The CIL introduces a common investment regime for domestic and foreign investors, opens the possibility of foreign investment into a wider range of sectors, and makes Vietnam's investment regime consistent with current and prospective international commitments. There is a need to adopt appropriate implementing regulations for these two laws, and the staffs look forward to reviewing the authorities' latest plans in this area as soon as they become available.

C. Social Inclusion and Environmental Sustainability

10. There is conclusive evidence that poverty in Vietnam continues to decline. But as is noted in earlier JSANs, the analyses of poverty and the drivers of poverty reduction are confused by the use of a mix of household survey data and other poverty data based on the official poverty line. A recent shift in the official line will bring official poverty estimates much closer to the estimates derived from household expenditure data and this can reduce the confusion that has arisen in the past from the existence of parallel poverty data. The staffs would welcome a decision by government, agreed by relevant agencies, that determines one common method and one approach for measuring poverty with clearly assigned responsibilities for determining the poverty rate at the various administrative levels. Agreement to use poverty estimates from the household surveys conducted by GSO as a basis for planning and for monitoring trends in poverty at national and regional levels would be a helpful step forwards.

11. The Report puts considerable emphasis on the role of job creation in ensuring that the future growth path is inclusive. A lack of basic labour market information currently constrains a sound analysis of how labour markets are developing and the effectiveness of labour market policies in achieving desired outcomes. This gap in data indicates an important area of work for the future to ensure that the analytical underpinnings of development policies are well-grounded in good data. Improving the quality of the Labour Force Survey is a priority in this respect.

12. The Report describes actions taken by the government to tackle poverty among ethnic minority groups. Household survey data show that ethnic minorities constitute nearly 40 percent of the poor population while representing only 15 percent of the total population. This proportion is increasing rapidly over time and the persistence of ethnic minority poverty suggests that not all of the government actions undertaken may be having a maximum impact on poverty. The current progress report draws heavily on internal feedback mechanisms, which do not fully illustrate the degree to which ethnic minority populations are lagging behind. Future progress reports could rely on a broader range of analytical work on ethnic minority poverty and demonstrate the need to use high quality research and data to inform future policies.

13. The Progress Report does not thoroughly reflect the efforts that the government has made over the past year in developing sustainable, universal systems for providing access to healthcare. Politburo Resolution 46 of February 2005 urged the government to finance curative care for the poor, under-6 children and other social policy beneficiaries, in order

to create a “springboard” for upgrading health care and advancing to universal health insurance by 2010. These aspects of the Resolution are operationalized through a new decree on health insurance, in effect from July 1, 2005. The decree represents a key step in shifting from the direct funding of health care providers to demand-side financing. It mandates compulsory health insurance for several groups, including workers on fixed term contracts of 3-months and above, pensioners, children under-6, and beneficiaries under Decision 139 on the provision of health care to the poor. At the same time Decision 139 is being revised to expand the number of households eligible for benefits. First, the new and higher poverty line will be employed to define poor households. Such households will be entitled to compulsory health insurance with a premium of 60,000 dong provided by the state budget. Second, near-poor households with an income level of up to 1.5 times the poverty line will be provided a subsidy to enroll in the voluntary health insurance scheme.

14. Regulations for inclusive education for children with disabilities have been issued to ensure that disabled children have equal access to education services. The regulations apply to all educational institutions in the public education system. The preparation of these regulations is the result of effective coordination among ministries such as MOET, MOH, and MOLISA, and agencies dealing with child protection. The regulations address the special needs of disabled children in terms of classrooms, school facilities, equipment, and textbooks. Individual education plans will be prepared with materials and methodological designs tailored to their special requirements.

D. Building Modern Governance

15. The last JSAN welcomed the announcement by government that they would take actions to improve the linkage between plans and budgets. There has been notable progress over the last year in implementing this intention. The circular guiding the preparation of the 2006 budget took an important step toward linking the government budget with a medium-term framework. While the submission and approval of the budget by the National Assembly will continue to be done on an annual basis, line ministries and provincial governments were asked to prepare a budget framework for the period 2006–08, based on the SEDP. The elaboration of a medium-term budget framework jointly by the Ministry of Finance, the Ministry of Planning and Investment and line ministries should lead to a significant improvement in the integration between capital and recurrent budgets. In the years ahead, it should also help ministries and provinces to prepare more realistic annual plans and budgets, including better prioritization of policies and expenditures, and an improvement in the overall efficiency of public expenditures.

16. The last JSAN also referred to the need to tackle the systemic causes of corruption. The staffs welcome the passage of a law on corruption prevention and control by the National Assembly, to take effect in July 2006. This law, whose preparation was informed by the first-ever diagnostic study on corruption in Vietnam, is more comprehensive than a typical anti-corruption legislation. It includes chapters on corruption prevention and detection, handling of corruption, organizations and mechanisms for investigation, prosecution and judicial agencies in anti-corruption, the role of civil society and media in anti-corruption, international cooperation in

anti-corruption, and implementation provisions. Following the passage of the law, the Prime Minister has issued an action plan delineating the roles of various ministries and agencies in ensuring an effective implementation. Effectiveness will also depend on the way the mechanism to monitor the assets of civil servants and their families is set up.

17. The staffs strongly welcome the introduction of new regulations to strengthen the delivery of public services through improved monitoring of service quality, introducing user feedback, and limiting the use of proceeds from service fees to fund salary expenditure. By allowing service delivery units to charge fees, the earlier regulation, Decree 10, had introduced powerful incentives to improve quality while substantially increasing the resources available to such units. However, there were indications that the provision of basic services to be provided free of charge, or at low prices established by government regulations, had suffered as a result of such incentives. Because Decree 10 allowed considerable flexibility to use revenue from fees to pay higher salaries, there was also an incentive to charge excessively high prices for services. The new regulation makes a number of provisions that protect the delivery of basic services. These include a requirement that service delivery units set aside 25 percent of their net revenues to improve service quality, thereby limiting the amount available for salaries while simultaneously introducing salary caps that are inversely related to amount of financial support received from the government budget. These provisions also include the establishment of performance standards for service delivery units and a more rigorous approach to monitoring, incorporating feedback from users through mechanisms that go beyond “mailboxes” to potentially include instruments such as “citizens’ report card” surveys.

18. The Report provides only a limited description of the progress accomplished in reducing bureaucracy and red tape over the past year. Prime Minister’s Directive 09 instructed ministries, government agencies, and provinces to conduct a review of administrative procedures with a view toward simplifying them. By end-2005, 17 ministries, 5 government agencies and 26 provincial peoples committees had submitted actions plans to implement new procedures. Progress has been made in areas such as birth, death and marriage records; notary services; residential registration permits; business registration and related licenses; land use rights certificates; and customs and tax procedures. In the case of business registration, investment licenses, and construction permits processing times have come down to 7–10 days in most cases and even 3–5 days in some cases.

III. MAINSTREAMING PRS PRINCIPLES IN THE SEDP

19. The Progress Report sets out the process for preparing the next SEDP 2006–10 and explains how the new SEDP will incorporate PRS principles. It describes the consultation process and describes the shifts in emphasis this will require of the plan. The Report commits to integrating a stronger poverty focus throughout the plan, to assessing its implications in terms of budget resources, and to including a monitoring framework that specifies how government actions and investments will lead to desired outcomes. The staffs are supportive of government efforts to bring these positive reforms to the planning

process and expect to submit SEDP 2006–10 to the Boards of IDA and the IMF for discussion as Vietnam’s next PRS once approved by the National Assembly. Vietnam was an active participant at a recent forum on *National Plans as Poverty Reduction Strategies* in Vientiane in April, at which there was some consensus on which and how PRS principles could be mainstreamed.

20. The National Assembly discussed the draft SEDP in its November session in 2005 and is expected to formally adopt it in its May-June 2006 session. The SEDP received the endorsement of the Party Congress in April 2006. The SEDP has been built on extensive consultations not only within government but also with a broader range of stakeholders (including mass organizations, academics, the private sector, civil society and development partners). The document represents considerable progress in developing an outcome-focused, medium-term plan, which combines the twin objectives of growth and social inclusion, and describes the reforms that will provide for a robust economy. Importantly, the document explicitly recognizes the institutional and regulatory challenges associated with completing the transition to a market economy. It describes a large number of planned legislative actions which, together with the reform agenda implied in the accession to WTO, should strongly support this transition. However, the SEDP still relies to a large extent on state sector-led investment, which creates a tension with the objective of transition to a more efficient market system, and could pose risks for medium-term fiscal sustainability. The SEDP could usefully recognize these risks, and articulate a strategy to address them in a timely manner, so that they do not place the achievement of its ultimate poverty reduction objectives in jeopardy.

21. It is expected that the SEDP will serve as a framework to allocate public resources over the medium term. A weak linkage between planning objectives and budget allocations has remained a limitation of the CPRGS over the course of its implementation. As indication of how planning and budgeting processes will be more tightly linked, the draft circular for the 2007 budget includes instructions to line ministries and provinces to align budget submissions to the SEDP over the 2007–10 period.

22. At the current time, the SEDP lacks a clear policy matrix and a satisfactory monitoring framework. Though there have been very significant efforts to develop the results framework, the Government believes that more work and consultation with line ministries is necessary to produce a strong framework for measuring results. The May-June 2006 session of the National Assembly is expected to discuss the SEDP without the monitoring framework. MPI plans to continue to work on the development of a monitoring framework over the coming months. Progress in this respect will be important to give clear focus to the SEDP and facilitate the use of the SEDP as a mechanism to align donor support to national priorities.

IV. CONCLUDING REMARKS

23. The staffs believe that the Report provides a reasonable update on progress over the past year. Though there are instances where inaccurate or questionable data are used in describing progress, there is enough information and analysis available from other

sources to state with confidence that economic performance has been strong and that poverty is continuing to decline.

24. The staffs expect that many of the shortfalls experienced in the implementation of the CPRGS will be addressed by the new SEDP, a view which is based on intense interaction with government during the preparation of the SEDP and on assessments of the draft SEDP which have become available. This new SEDP is nearing completion and the staffs urge the government to close all remaining gaps, including with regard to the remaining policy challenges, the risks associated with the funding of a sustained pick-up in public sector investment, and the need for a strong results framework.