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ACRONYMS AND ABBREVIATIONS

ADB	Asian Development Bank
AFTA	ASEAN Free Trade Area
AHBS	Annual Household Business Survey
AMC	Asset Management Corporation
ASEAN	Association of South East Asian Nations
BIDV	Bank for Investment and Development of Vietnam
BOLUC	Building Ownership and Land-Use Right Certificate
BOT	Build-Operate-Transfer
CEO	Chief Executive Officer
CGE	Computable General Equilibrium
CIEM	Central Institute for Economic Management
CIL	Common Investment Law
CIT	Corporate Income Tax
CPIA	Country Policy and Institutional Assessment
CPRGS	Comprehensive Poverty Reduction and Growth Strategy
CSR	Corporate Social Responsibility
DAF	Development Assistance Fund
DATC	Debt and Asset Trading Corporation
DFID	Department for International Development
DOF	Department of Finance
DONRE	Department of Natural Resources and the Environment
DPI	Department for Planning and Investment
EVN	Electricity of Vietnam
FDI	Foreign Direct Investment
GC	General Corporation
GDC	General Department of Customs
GDP	Gross Domestic Product
GSO	General Statistics Office
GTZ	German Agency for Technical Cooperation
HCFP	Health Care Fund for the Poor
HCMC	Ho Chi Minh City
HIFU	HCMC Investment Fund for Urban Development
IAS	International Accounting Standard
ICS	Investment Climate Survey
ILO	International Labour Organisation
ILSSA	Institute for Labor Studies and Social Affairs

IMF	International Monetary Fund
JBIC	Japan Bank for International Cooperation
JSB	Joint Stock Bank
JSC	Joint Stock Company
LDIF	Local Development Investment Fund
LEFASO	Vietnam Leather and Footwear Association
LUC	Land-Use Right Certificate
MARD	Ministry of Agriculture and Rural Development
MDG	Millennium Development Goal
MOC	Ministry of Construction
MOET	Ministry of Education and Training
MOF	Ministry of Finance
MOH	Ministry of Health
MOHA	Ministry of Home Affairs
MOI	Ministry of Industry
MOLISA	Ministry of Labor, Invalids and Social Affairs
MONRE	Ministry of Natural Resources and the Environment
MOT	Ministry of Transport
MPDF	Mekong Private Sector Development Facility
MPI	Ministry of Planning and Investment
NBIC	National Business Information Center
NGO	Non-Governmental Organization
NOIP	National Office for Intellectual Property
NPL	Non-Performing Loan
NPV	Net Present Value
ODA	Official Development Assistance
OOG	Office of Government
OSS	One-Stop Shop
PCF	People's Credit Fund
PCI	Provincial Competitiveness Index
PER-IFA	Public Expenditure Review-Integrated Fiduciary Assessment
PFMB	Protection Forest Management Board
PMRC	Prime Minister Research Commission
SAV	State Audit of Vietnam
SBV	State Bank of Vietnam
SCIC	State Capital Investment Corporation
SEDP	Socio-Economic Development Plan
SFE	State Forest Enterprise
SIDA	Swedish International Development Agency
SME	Small and Medium Enterprise
SOCB	State-Owned Commercial Bank
SOE	State-Owned Enterprises
SPS	Sanitary and Phyto-Sanitary
SSC	State Securities Commission
UAIC	Union of Associations of Industry and Commerce
UNCTAD	United Nations Conference for Trade and Development
UNDP	United Nations Development Program
UNICEF	United Nations Children's Fund
U.S.	The United States
USAID	US Agency for International Development
USBTA	US-Vietnam Bilateral Trade Agreement

VAS	Vietnamese Accounting Standard
VASS	Vietnamese Academy of Social Sciences
VAT	Value Added Tax
VBARD	Vietnam Bank for Agriculture and Rural Development
VBF	Vietnam Business Forum
VBP	Vietnam Bank for the Poor
VBSP	Vietnam Bank for Social Policies
VCA	Vietnam Cooperative Alliance
VCCI	Vietnam Chamber of Commerce and Industry
VDG	Vietnam Development Goal
VGCL	Vietnam General Confederation of Labor
VHLSS	Vietnam Household Living Standards Survey
VITAS	Vietnam Textiles Association
VLSS	Vietnam Living Standards Survey
VNPT	Vietnam Post and Telecommunications Corporation
VSI	Vietnam Social Insurance
WHO	World Health Organization
WTO	World Trade Organization
WVS	World Values Survey

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EXECUTIVE SUMMARY

Business development has been one of the main forces behind rapid poverty reduction in Vietnam. Together with the redistribution of agricultural land, and the broad coverage of social services, it allowed a large fraction of the population to engage in more productive occupations and raise their living standards. The reform process launched almost two decades ago unleashed an enormous entrepreneurial energy. Rural households started commercializing their agricultural output, and running small business activities. Foreign investors were attracted in large numbers, and state-owned enterprises (SOEs) initiated a long (albeit gradual) restructuring process, paving the way to the development of a multi-sector economy. Private sector enterprises started formalizing and expanding, in a process that caught speed after 2000; they account now for 33 percent of the value of production in manufacturing. Together with thousands of foreign companies and several million household businesses, they provide wage employment to 21 percent of Vietnam's labor force. Massive job creation has allowed absorbing 1.4 to 1.5 million entrants to the labor market every year, and offered a way out of farming for the rural population, and especially for young women. Over the last decade, the average wage has grown at around 10 percent per year in nominal terms, or roughly 7 percent in real terms. The enormous opportunities created through this process have led to an inclusive growth pattern. While real GDP per capita has increased by 5.9 percent per year since 1993, the Gini index (measuring inequality) has increased only slightly, reaching 0.37 in 2004. During that period, the poverty rate fell from 57 to less than 20 percent.

This virtually unmatched performance should not hide the fact that businesses are struggling with important constraints. Insufficient availability of finance, difficulties in accessing land and continuous gaps in infrastructure services (in spite of enormous investment efforts) are among the most important obstacles identified by entrepreneurs. In a booming labor market, retaining qualified personnel and finding the skills required to move up the ladder are also perceived as barriers to business development. As a result of these constraints, the domestic private sector remains dominated by small enterprises. In between a myriad household businesses and a few thousand large SOEs and foreign companies, there are not so many small and medium enterprises, and only a handful of domestic private firms have made it to the top. Sustaining business development in Vietnam requires the completion of the structural reform agenda. Fully developing the land market, restructuring the financial sector, managing state assets in a more efficient and transparent manner, mobilizing resources for infrastructure development, are the key priorities in this respect. Further integration with the world economy, especially through the accession to the World Trade Organization (WTO), is bound to lock-in some of these changes, and level the playing field between domestic and foreign enterprises. But there is also a complementary reform agenda, aimed at leveling the playing field between the domestic private sector and SOEs and mobilizing capital (both public and private) in an efficient way. Global integration and domestic reforms are needed to sustain rapid economic growth while avoiding the accumulation of large contingent liabilities for the government.

As Vietnam fully emerges from the grim poverty that prevailed barely one decade ago, business development also holds the key to building a prosperous and inclusive society. Targets for the future are still phrased, much too often, in terms of growth rates of GDP, thus evoking a mechanical accumulation process. But Vietnam can by now hold a higher ambition: that of

becoming a middle-income country. This will entail going beyond structural reforms and laying the foundations of a modern market economy. Introducing competition and proper regulation in infrastructure services, modernizing tax administration, reforming the legal and judiciary systems, reducing corruption, improving governance at local levels, are all part of a second generation of reforms that need to be put on track for Vietnam to move up to the next phase. These reforms are bound to further boost business development and living standards more generally. But they should also be accompanied by reforms aimed at keeping growth inclusive. Effective safety nets and budget allocation norms can help households and regions cope with adverse shocks, or increasing disparities, as the economy restructures and Vietnam becomes a global player. In the longer term, modernizing the social sectors holds the key to preserving social inclusion.

A solid performance

In less than two decades, since the beginning of economic reforms, Vietnam managed to nurture an unusually diverse business sector. Building on a thriving, entrepreneurial culture, roughly every other household runs by now a small business of one kind or another. Owing to a state-led development strategy after independence, the government still owns thousands of SOEs, some very big. Vietnam has also been one of the largest recipients of Foreign Direct Investment (FDI) in the entire world, in relative terms, with the value of projects registered getting at times close to a tenth of the country's Gross Domestic Product (GDP). And over the last five years, the registration of private sector enterprises has boomed, reflecting both the formalization of existing businesses but also, to a large extent, the creation of new ones. This remarkable diversity is acknowledged as one of the key features, if not one of the strengths, of Vietnam's economic transition. But the very diversity of Vietnam's enterprise sector is a challenge for economic analysis and policy making. Different types of businesses contribute differently to economic growth and poverty reduction. For government policies to be effective, it is necessary to make sense of the main building blocks of Vietnam's business sector, and how they fit together. When the various data sources available are analyzed and brought together, it appears that there is indeed a "missing middle" in the distribution of firms by size. But it is gradually being filled in, whereas enterprises at the low end are becoming increasingly formal.

Whether the performance of Vietnam's business sector compares favorably or unfavorably to that of other countries, especially in the East Asia region, is more controversial. Competitiveness assessments, relying on the characteristics of the regulatory framework in which firms operate, put Vietnam in the bottom half of the world distribution or close to the middle at best. On the other hand, direct assessments by foreign companies, under the form of opinion surveys or actual investments flow, rank it in the top quarter, or even higher. Deeper insights can be gained by analyzing the way in which Vietnam's businesses actually operate and participate in the global economy, either directly or indirectly. Those analyses show that Vietnam's pattern of integration in world trade is closer to that of China than to that of other countries in the Association of South East Asian Nations (ASEAN). But they also reveal a still insufficient integration of domestic companies in global value chains. Total factor productivity is growing very rapidly across the board; but growth is faster in foreign companies than in domestic ones, regardless of their ownership. Productivity spillovers occur between foreign and domestic companies, especially private ones, but labor turnover and outright imitation seem to be more important channels of transmission than business-to-business transactions. The equitization of SOEs, in spite of its limitations, appears to be contributing to productivity gains, as it establishes a more arms-length relationship with government authorities.

For Vietnam's business sector to continue its expansion, it is necessary to remove several important constraints currently faced by enterprises. A recently completed investment climate survey (ICS), with a representative sample made of domestic private enterprises, SOEs and foreign companies, goes a long way towards identifying those constraints. For more than one third of the respondents, access to credit is reported as a major or severe obstacle to business growth. Apart from foreign companies, which do not appear to face credit rationing, the importance attached to this constraint is similar for the other types of enterprises. Access to land is the second most important constraint. It is seen as particularly severe by foreign companies, but not surprisingly it does not affect SOEs much. Insufficient skills and education of the workforce, and poor transportation infrastructure, rank third and fourth. In all four cases (except maybe for skills) the severity of the constraints is significantly higher in Vietnam than in the rest of the East Asia region or in the rest of the world.

On the other hand, some of the issues emphasized by competitiveness rankings, such as the legal system, bureaucratic procedures and corruption, are downplayed by respondents. The fraction rating any of these issues as a severe or major constraint to business growth in Vietnam is significantly lower than in either the rest of East Asia or the rest of the world. The ability to conduct business-to-business transactions on a trust basis, or using rudimentary but reliable enforcement mechanisms, may explain the low importance attached to the legal system. The considerable simplification of procedures introduced in 2000, and reinforced through mechanisms like one-stop shops (OSSs), could account for the downplaying of bureaucracy and red tape. The lack of importance attached to corruption is more unexpected. This result is further probed using a variety of sources. They all yield a consistent picture, one where corruption directly affecting businesses is quite prevalent, but petty. More common in agencies like the traffic police, customs, tax administration or land registration offices, it translates into many small bribes, accounting for about 0.7 percent of total sales, which is less than in other countries at a similar development level. This is not to ignore other modalities of corruption or collusion, as in SOEs and in public investment projects; because these other modalities may not affect businesses directly, they cannot be appropriately captured through ICS. But overall, these findings should give pause to reassess commonly held, largely anecdotal views on corruption in Vietnam and stimulate further empirical research.

Binding constraints

The prominence of access to finance as a constraint to business development seems in contradiction with the substantial financial deepening achieved by Vietnam over a relatively short period of time. The number of active savings and loan accounts is high for a country at its development level, whereas banking credit has been growing steadily; even too fast, probably, given current deficiencies in the assessment of credit risk. But perceptions and facts can be reconciled by analyzing the allocation of credit in Vietnam. Small-scale loans are easily available to farmers and small businesses, probably reflecting government policies towards poverty reduction. But collateral is needed for more sizeable enterprises to get access to credit, and it is valued in a very conservative way. Still limited progress in the issuance of land-use right certificates (LUCs) thus compounds credit rationing. Heavy reliance on collateral is the flip side of limited risk assessment by lenders, and especially by the four major state-owned commercial banks (SOCBs) which account for three quarters of total credit. Their insufficient profit orientation and the interference by government authorities, especially at local levels, have led to the accumulation of a sizeable volume of non-performing loans (NPLs) in the banking system. The poor quality of many loans creates a substantial fiscal burden for the government, aggravated

by the absence of effective mechanisms to seize the assets of bad debtors. As for formal capital markets, they are still too under-developed to channel a sizeable volume of resources to new projects. But thriving informal transactions on unlisted stocks raise the prospect of faster capital market development, provided that proper regulations are in place.

A land market has already emerged in Vietnam, despite the still partial development of formal titling. Many transactions take place in the absence of proper legal documentation, simply because local officials know which piece of land or property "belongs" to whom, and arbitrate in case of conflict. From this perspective, the absence of formal property rights has not been incompatible with market development. But land titling is bound to increase efficiency, and it should also provide a more sound foundation for the development of a real estate market. However, the dynamics of the property market in recent years also show that titling alone is not enough to ensure efficiency. Price "bubbles" in real estate need to be kept under control by making speculative transactions more burdensome, as the Vietnamese government did recently. And some of the most difficult issues, such as facilitating the consolidation of agricultural land, restructuring state forest land, supporting community-based land management among ethnic minorities, and recovering idle land from urban SOEs, will still require specific policies, going beyond the issuance of LUCs. As Vietnam develops and urbanizes, one of the most difficult challenges will be the conversion of agricultural land into residential and industrial land, on a massive scale. Success will critically depend on fighting corruption in land conversion and properly compensating the affected populations.

Enormous progress has been accomplished in recent years in infrastructure development Vietnam is by now investing about one tenth of its GDP in power, transport, telecommunications and water and sanitation projects; as a result, it is rapidly catching up with its neighbors in terms of availability and cost of services. Electrification and telephone penetration have seen the most remarkable improvements, and the road network has expanded considerably as well. Still, enterprises in Vietnam complain about insufficient transport infrastructure, and excessively expensive electricity and telephone services. Making further progress in infrastructure development requires a diversification of funding sources and improved transparency in resource mobilization, especially at local levels. The adoption of sound regulatory frameworks, facilitating cost recovery and promoting competition, could also help attract private participation in infrastructure and further contribute to business development in Vietnam. There have been a few promising initiatives in this respect, across most infrastructure sub-sectors, especially in terms of increasing competition among suppliers. However, most business participants are still SOEs. Looking forward, private sector participation cannot be relied upon to address, alone, the infrastructure needs of Vietnam in the coming years. Nor even to cover a large share of those needs. In this area, business development crucially depends on the quality of public investment, and on the appropriate pricing of the services it provides.

Unfinished reforms

Integration in the world economy has been one of the main drivers of economic reform in Vietnam. From participation in the ASEAN Free Trade Area (AFTA) to the implementation of the USBTA, it has made markets more competitive and has forced domestic enterprises to improve their productivity. But the impending accession to the WTO takes the agenda even farther, because of the encompassing nature of the commitments it implies, both at the border and behind the border. Much the same as participation in AFTA, it will lead to a reduction in trade barriers. In spite of the considerable progress accomplished so far in removing import quotas and reducing tariffs and subsidies, protection rates remain high in Vietnam. Further liberalization

should lead to increased efficiency. The process needs to be supplemented by substantive improvements in trade logistics. Increasingly congested ports, with relatively expensive services, and a customs department focused on control (legally or otherwise), rather than on trade facilitation, are obstacles to business development. Much the same as adherence to the USBTA, accession to the WTO is about institutional changes, from a more level playing field among enterprises, to competition in key services such as banking, to improved sanitary standards to strengthened intellectual property rights. These changes will boost productivity in the medium to long term, but they will represent an important challenge for Vietnamese enterprises in the short term.

If global integration is one of the main drivers of economic reforms in Vietnam, their engine is clearly homegrown. Since the beginning of the renovation process the government has been steadily pushing for change across all policy areas, with the objective of building a market economy with a socialist orientation. The five-year plans articulating this vision are also changing along the way. They rely less on quantitative targets for material production, and focus more on policies and development outcomes. Consultation with stakeholders at large is also becoming part of the process, and business associations are having increasingly more clout.

Improving the mobilization of capital, both private and public, is one of the main components of the unfinished reform agenda. On the private front, the banking system needs to be thoroughly reformed. This involves transforming SOCBs into autonomous profit-making institutions and creating a modern central bank, in charge of banking supervision and monetary policy. Banking reform should lead to a more efficient allocation of credit and mitigate the potential burden of bad loans on the government budget. On the public front, the equitization process needs to be completed, and the SOEs remaining in state hands need to be managed at arms length from the ministries regulating the sectors they operate in, so as to promote competition throughout the economy. Strengthening governance is another key component of the unfinished reform agenda. This includes completing the reform of public financial management, starting that of tax administration, setting up mechanisms to manage public debt at all levels, and increasing transparency in public procurement. Closely related to this, there is also a need to fight corruption, especially at a time when rapid economic growth will make the opportunities for graft grow faster than government systems improve. And the legal and judiciary reform agenda, which is much influenced by the implementation of the USBTA and the accession to the WTO, needs to be pursued vigorously. Transactions based on trust and relatively simple enforcement mechanisms will become increasingly ill-suited to the needs of businesses as the economy develops and domestic firms grow.

In a country as decentralized as Vietnam, some of the most important changes will have to take place at the local level. Increased delegation of decision-making power to local authorities has led to vast gaps in business buoyancy, and more generally in economic and social development, across Vietnam. Contiguous provinces, with similar endowments but different commitment of the local authorities to economic reform, are often worlds apart in terms of enterprise registration, investment by foreign companies and the availability of wage employment. Rigorously measuring the quality of governance (either locally or at the national level) is not easy, but benchmarking provinces on key aspects potentially affecting business activity is a step in the right direction. The modernization of provincial planning processes, along the lines observed at the national level, relying on consultation with the local business community, should encourage further improvements. Combined with appropriate budget allocations for provinces with stronger needs, the promotion of local leaders who succeed in fostering growth and reducing poverty would provide a powerful incentive for change.

Keeping growth inclusive

The next five-year cycle offers the prospect for Vietnam to complete its transition, across several dimensions: towards increasing reliance on market mechanisms, towards full membership in the global economy, and towards middle-income country status. But success in these multiple transitions will also require that business development benefit the population at large, as it has so far. The labor market and the social sectors are fundamental in this respect.

The surge in business activity prompted by economic reforms has led to a en enormous increase in the demand for labor. This has translated into a double mobility: occupational, from agricultural jobs to non-farm employment; and geographical, from rural to urban areas. But wage employment is unevenly distributed across the country. And the same is true of labor earnings, which vary considerably from province to province. Disparities in earnings have been reduced with economic growth, as also has the earnings gap between men and women. But the labor market reward to education has increased, opening the prospect of a different kind of inequality as Vietnam develops. Importantly, in spite of the enormous structural transformation, unemployment has not been a major issue. Most of the jobless are young, relatively educated entrants to the labor market, although over-staffing is still common in the state sector. It is rather the excessive turnover of qualified workers that creates a problem for business. But the main weakness of Vietnam's labor market is the social protection system built on it. Traditionally conceived for public sector workers only, this system still needs to complete the transition to a market economy, so as provide affordable insurance against major risks to workers who are increasingly mobile, occupationally and geographically.

Further integrating into the world economy, completing the unfinished reform agenda and strengthening governance at local levels, are all bound to foster business activity and increase economy efficiency. In a way, these developments hold the key for Vietnam to become a middle-income country. But an important issue is whether there will be a social or an environmental price to pay for increased efficiency. Increasingly relying on market mechanisms will unleash the potential of the most productive members of society, but it could also harm some of the weakest ones. And even a perfect market could be unable to address environmental externalities, so that rapid growth would lead to increasing pollution and degradation. Based on a systematic review of the available evidence, the foreseeable adverse effects do not appear to be large; except maybe for the environment. This calls for a more systematic use of enforceable environmental standards. But potentially larger social impacts might simply be unforeseeable with the relatively rudimentary analytical tools at hand. It is therefore important to put in place effective mechanisms to rapidly cope with the unforeseen. Assistance to workers who lose their jobs and budget transfers, from the provinces benefiting the most from economic reforms to those adversely hit, could ensure that in the quest for prosperity inclusion is not sacrificed.

Looking forward, social services need to be upgraded, as part of what could be seen as a second generation of economic reforms. Vietnam managed to build inclusive basic health and education systems in the period under central planning, reaching a vast majority of the population and delivering social indicators comparable to those of middle-income countries. But these systems did not cope well with the transition to a market economy, and they were anyway ill-suited to address the more complex and expensive needs of an increasingly more prosperous population. The challenge now is to combine the efficiency of market mechanisms with the broad coverage that characterized education and health services in the period under central planning. Success in this combination could lay the foundations of modern universal systems. In a paradoxical way, the relatively good quality of targeting mechanisms makes it possible to use them as a tool to attain universal coverage. Not by providing transfers and subsidized credit, as

they still do to some extent, but rather by giving the poor access to services which are otherwise delivered for a fee. Targeting and "socialization" policies can then go hand in hand. But proper attention to incentives is needed for this combination to work.

The links between this social inclusion agenda and business development are stronger than it may seem at first. Businesses should become important suppliers of social services over time, as public funding should not be confused with public provision. Tertiary education, health care services and, maybe in a not-so-distant future, pension programs, can all be supplied by non-state organizations, including private enterprises, cooperatives and non-government organizations (NGOs). Meanwhile, social insurance, if properly reformed, could accumulate a massive amount of resources before the active workers of today start retiring. Those resources will need to be invested; if managed in a sound and transparent manner, they could make a major contribution to capital accumulation. Third, and most obviously, good human resources cannot be dissociated from a healthy and educated population. The development of the education system, in particular, is the key to tap all the talent available in each generation of Vietnamese children, and to build up the skills the business community needs. Last but not least, inclusive development is at the root of social stability. And this has been one of the main advantages of Vietnam over its competitors.

PART I:
AN EMERGING ECONOMY

1. BUSINESSES OF ALL SORTS

Few countries can match the staggering diversity of Vietnam's business sector. Building on a thriving, entrepreneurial culture, roughly every other household runs a small business of one kind or another. Owing to a state-led development strategy after independence, the government still owns thousands of SOEs, some of them very big. Vietnam has also been one of the largest recipients of FDI in the entire world, in relative terms, with the value of projects registered getting at times close to a tenth of the country's GDP. And over the last five years, the registration of private sector enterprises has boomed, reflecting both the formalization of existing businesses but also, to a large extent, the creation of new ones. This remarkable diversity of the business sector is acknowledged as one of the key features, if not one of the strengths, of Vietnam's economic transition. In 1986, the Sixth Communist Party Congress adopted a program of major reforms, to abolish the system of "bureaucratic centralized management based on state subsidies" and move to "a multi-stakeholder, market oriented" economy, including a role for the private sector. In 2001, the Ninth Party Congress explicitly recognized FDI as one of the sectors in the economy. In 2006, the Tenth Party Congress could well admit private sector entrepreneurs as Party members, thus stressing the equal status and legitimacy acquired by businesses of all sorts. But the very diversity of Vietnam's enterprise sector is a challenge for economic analysis and policy making. Different types of businesses contribute differently to economic growth and poverty reduction. For government policies to be effective, it is necessary to make sense of the main building blocks of Vietnam's business sector, and how they fit together. When the various data sources available are analyzed and brought together, it appears that there is indeed a "missing middle" in the distribution of firms by size. But it is gradually being filled in, whereas enterprises at the low end are becoming increasingly formal.

Household businesses

It may be surprising to learn that the Vietnamese population is even more business-oriented than the Chinese. This was one of the findings of the World Values Survey (WVS) conducted in more than 65 countries across all continents. The WVS was implemented for the first time in Vietnam by the Institute of Human Studies, in 2001. Its questionnaire aims, among other objectives, at assessing the respondents' attitudes toward a market economy. One question uses a ten-point scale to elicit support for private business ownership (10 points in the scale) versus government ownership (one point). The mean score among Vietnamese respondents was 5.6, compared to 4.2 among Chinese. Overall, respondents in these two countries are more attached to government participation than citizens in more established market economies. However, the magnitude of the differences is small, with the attitude of Vietnamese respondents being quite close to that of the Japanese.

Expectedly, younger respondents are more favorable to private ownership and competition than their elders. This can be seen by classifying WVS respondents according to their birth age, with 1975 as the cutoff point. In this respect, it is worth keeping in mind that roughly two thirds of the Vietnamese population was born after reunification. Educational attainment is also associated with a stronger support for the market economy.

Results are somewhat more unexpected when classifying respondents by region of residence. In many ways, the North and the South of Vietnam are culturally different. Southerners originally came from the North but when conquering the new land they relied more on individual initiative than on collective, village-level decision making. Southerners also used to be immersed in a market economy before reunification. Yet respondents from the North are more positive towards the market than people from the South. This may be due to economic reforms having had a bigger impact on everyday life in the North than in the South.

Box 1.1: How Many Household Businesses?

According to GSO's Vietnam Household Living Standards Survey (VHLSS) of 2004, there are around 9.3 million non-farm household enterprises. But the Annual Household Business Survey (AHBS) of 2004, also conducted by GSO, puts the figure at about 2.9 million. At 6.4 million, the gap between both sources is very large. Such understanding should also help assess the consequences for the measurement of GDP, which relies on the AHBS.

Within the VHLSS 2004, a non-farm household enterprise covers all kinds of income-earning activities that are on own account and are unrelated to the production or sales of agricultural products (in its various forms). The VHLSS gathers information referring to the 12 months prior to the visit of the enumerator, thus including low-season activities by farming households. The AHBS, on the other hand, refers to its unit of observation as an "individual business establishment."

A practical way to examine the gap between the AHBS and the VHLSS is to assume that the latter offers an exhaustive account of all non-farm self-employment activities, regardless of how insignificant they may be, and to impose the AHBS inclusion conditions on those activities. The objective of the VHLSS is to measure income, poverty and living standards in households, thus making it plausible that non-farm self-employment activities are indeed covered well.

Six inclusion conditions are applied to the VHLSS set of household activities: (i) the revenue source is valid, (ii) responses are complete, (iii) enterprises must be in operation for at least three months during the year, unless they are new, (iv) enterprises must have a fixed location, unless they are in the transport sector, (v) enterprises operate a significant part of the month, and (vi) enterprises are in operation on the first day of October. These inclusion conditions reduce the total number of household enterprises to 6.1 million. Therefore, there are 3.2 million household enterprises not accounted for by the AHBS.

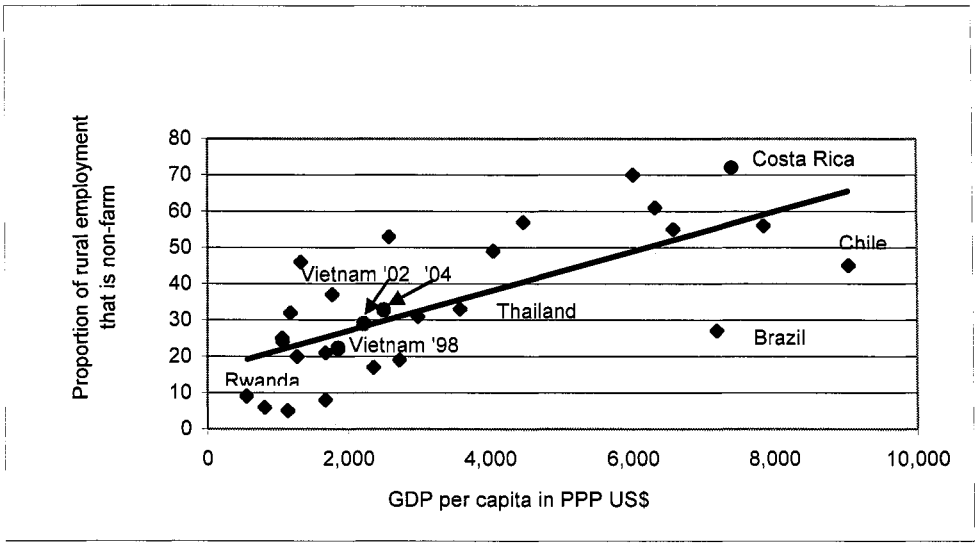
The under-estimation of the number of household businesses by the AHBS has implications for the measurement of Vietnam's GDP. The average value added generated over a year by a household enterprise, according to the VHLSS, is about 15.5 million dong. Multiplying this figure by 6.1 million yields the total value added of the household business sector in Vietnam, equivalent to roughly 13 percent of total GDP. Given that 3.2 out of the 6.1 million household enterprises are unaccounted for by the AHBS, national accounts could underestimate the value added of the sector by the same proportion. This would imply that Vietnam's GDP is roughly 7 percent higher than officially reported. But the under-reporting is probably less, as the 3.2 million household enterprises not covered by the AHBS are presumably the smallest ones.

Source: Based on Wim Vijverberg (2005).

This nationwide support for private initiative is fully reflected in the extent to which Vietnamese households own and run small businesses. Assessing exactly how many household businesses there are in operation is not straightforward, with different survey instruments providing different answers (Box 1.1). But a plausible estimate, including the business activities of farming households in the low season, puts their number at 7.4 million, or roughly one every other household.

An international comparison might help put Vietnam's dynamism in perspective. Statistics on the number of household businesses are not readily available for many countries; understandably so, given the inherent measurement difficulties. But more comparable statistics exist on the fraction of rural self-employment accounted for by non-farm activities. The analysis of those statistics shows that the fraction increases with a country's level of development (Figure 1.1). What is remarkable about Vietnam is the much faster speed at which this has been happening since the beginning of economic reforms.

Figure 1.1: An Entrepreneurial Country



Source: Own estimates, based on data from GSO and Jean O. Lanjouw and Peter Lanjouw (2001). Employment figures are based on main occupation.

Household businesses are more prevalent in the lowlands. In 2004, they accounted for 28 percent of employment in the Red River delta region, and for 28 percent in the Mekong delta region. Employment here means having a household business as either a main or second source of income. Over time, however, the contribution of non-farm self-employment to household income declined across all regions, except the South Central Coast and South East. In 1993, almost 30 percent of the employed population of Vietnam worked in a household business. By 2004, the fraction had declined to roughly 25 percent. The decline can be explained by the substantial expansion of wage employment, from 26 percent of the total in 1993 to 31 percent in 2004. However, at any point in time, better-off households have a higher share of income originated in non-farm business activities. This pattern is consistent across household surveys. Running a household business is associated, other things equal, with higher living standards.

The sectoral distribution of household businesses has not changed much over time. The two most popular industries are "commerce" and "processing and manufacturing". The former account for more than 40 percent of all household businesses; the latter represent about one quarter. At the other end, "construction" and "mining" account for roughly 1 percent of total household businesses each.

The characteristics of household business entrepreneurs also vary across sectors. The average business owner is 38 years old and has nearly eight years of education. Entrepreneurs in construction, "other services" and transportation have comparatively higher levels of education. Household businesses in commerce, food processing and manufacturing are mainly operated or managed by women. Those in construction and transportation industries are largely run by men. Overall, women entrepreneurs headed 55.7 percent of all household businesses in 2002, compared to 52.5 percent in 1998 and only 49 percent in 1993. In 2004, businesses in women-headed households are more profitable than those in men-headed households.

A systematic comparison of data from 1993, 1998, 2002 and 2004 also suggests that household businesses are becoming gradually more "professional". The number of operating days per month, and months per year, has increased. The percentage of enterprises with a fixed location has increased as well. Also, the share of loss-making household businesses was 0.3 percent in 2004 compared to 4.8 percent in 2002, compared to 7.3 percent in 1993 and 8.2 percent in 1998.

The emerging private sector

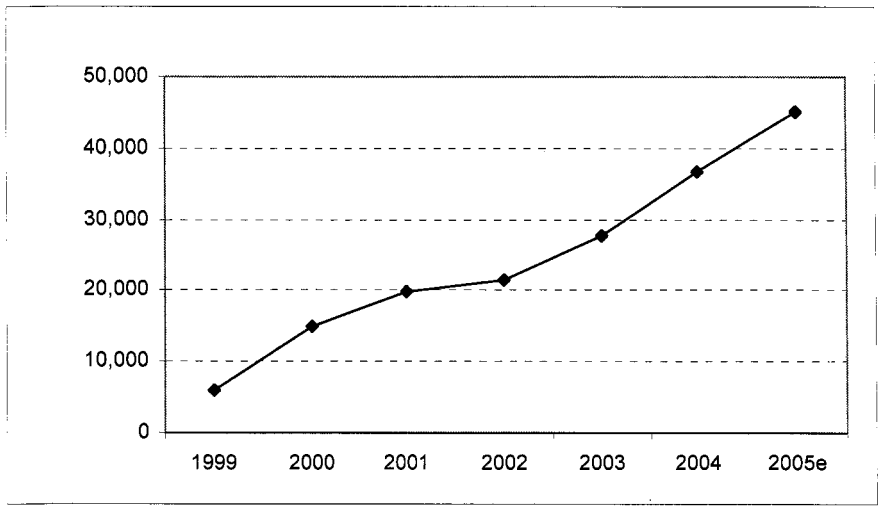
A series of policy reforms gradually laid the foundations for sustained private sector development. The passage of the Foreign Direct Investment Law, in 1986, benefited domestic entrepreneurs, albeit indirectly. A legal framework was first established in 1990, with the approval of the Private Enterprise Law and the Company Law. The Constitution officially recognized the role of the private sector in 1992. The Domestic Investment Promotion Law, promulgated in 1994 and revised in 1998, gave Vietnamese investors access to some of the incentives available to foreigners. But the most important milestone for private sector development was, undoubtedly, the Enterprise Law of January 2000. On the surface, this piece of legislation combined the previous Company Law and Private Enterprise Law. In practice, it represented a radical change in approach. Until then private enterprises had been allowed to operate provided that they complied with a series of government approvals and controls. The Enterprise Law, by contrast, protected the right of citizens to establish and operate private businesses without unnecessary intervention from government officials.

The most important innovation introduced by the Enterprise Law was the simplification of registration procedures. The business community refers to this innovation as the permission "to register first, then to check". The Enterprise Law also led to the elimination of over one hundred business licenses. As a result, it reduced the time and cost needed to register businesses. It also improved the confidence of business community in local government apparatus, by reducing the opportunities for corruption. The number of private enterprises registered every year has been increasingly steadily, ever since (Figure 1.2).

A controversial issue, hotly debated at times, is how many of the enterprises registered under the Enterprise Law are actually new. Or even, how many of them do actually exist. This uncertainty has been on occasion used to cast doubts on the vibrancy of Vietnam's private sector.

Data on enterprise registration are collected by the National Business Information Center (NBIC), under the Ministry of Planning and Investment (MPI). The information feeding the NBIC database is provided by the various offices of the Department for Planning and Investment (DPI) across the country. The enterprise census uses a business register that is updated through a link with the tax database of the Ministry of Finance (MOF). It is to DPI offices that would-be entrepreneurs submit their applications for company registration and from which they receive a business registration license. On the other hand, data on firms in operation comes mainly from GSO's enterprise censuses, which are conducted annually since 2000. Taken literally, data from enterprise censuses suggests that only half of the registered firms are actually in existence.

Figure 1.2: Enterprise Registration is on the Rise...



Source: Own calculations using data from NBIC. Figures reflect new registrations per year.

The figures from these two sources are not as inconsistent as it appears, however. Not all businesses that register actually start operations. Some fail to obtain funding, the market opportunity that others were trying to capture may pass, and the potential partners of yet others may lose interest. In a small survey of enterprises conducted by the World Bank, about eight percent of the firms that registered never made it to the tax code stage, suggesting that they never actually started operations. More importantly, not all businesses that start operations survive. A three-wave survey of small and medium enterprises (SMEs) conducted by the Institute for Labor Studies and Social Affairs (ILSSA) found an exit rate in excess of 15 percent per year in the early 1990s; but it had declined to less than 10 percent in recent years. These figures are not unusually high by international standards. But most closures go unregistered in Vietnam, as there are no incentives to report them. Over the years, this turnover accumulates into a sizeable share of all registered enterprises, accounting for most of the gap between NBIC and GSO figures.

The other controversial issue is how many of these enterprises are new. A variety of sources suggest that the answer is: a majority, but by no means all. About 45 percent of the enterprises in the small survey conducted by the World Bank, mentioned above, were already in existence in 2000, mainly under the form of household businesses. One of the most important reasons for them to register was to obtain invoice books for the Value Added Tax (VAT), without which goods and services cannot be sold to government and SOEs. Another survey conducted in

2001 by VCCI found that roughly 70 percent of the registered enterprises were truly new. In the ILSSA survey, in turn, the mean establishment year was 1990, with a standard deviation of 8.3 years. But an in-depth analysis revealed how difficult it was to determine the actual origins of participating firms, as their backgrounds varied greatly and were in many cases complicated and circuitous. However, the analysis suggested that many of the enterprises had been "upgraded" from household businesses, while others had been registered by people who have been working illegally or unofficially in the same industry for years.

One reason to believe that many of the registered enterprises are new is the sustained flow of remittances from overseas Vietnamese. It is estimated about 3 million people of Vietnamese origin, or close to 4 percent of the country's population, live abroad on a permanent basis. Their transfer of resources to Vietnam has grown steadily in recent years, from a mere 35 million dollars in 1991 to over four billion by 2005. While these estimates are subject to some uncertainty, many observers believe that most of the remittances are already being channeled through formal mechanisms. According to the IMF, a substantial part of the transfers corresponds to investments in real estate, the capital market and small businesses. Such investments are sometimes reported as unrequited transfers, rather than FDI or portfolio investment. Registering the investment in the name of a family member, who is a citizen and legal resident of Vietnam, is a way to avoid the more burdensome administrative requirements or procedures required for nonresidents.

Registration data can be used to infer the characteristics of private enterprises in Vietnam. Simple corporate forms, such as sole proprietorships and limited liability, account for about 90 percent of registrations. But there is a distinct trend towards more complicated forms such as joint stock companies (JSC). Registered enterprises are also small in size, both in terms of their number of employees and their registered capital. At the end of 2003, the average sole proprietor firm had 15 employees; the corresponding figures for limited liability companies and JSC were 38 and 53, respectively.

According to the ILSSA survey, the main customers were individuals for two thirds of the firms, and other private firms for about a fifth. SOEs were the main outlet for 9 percent of private enterprises, followed by local authorities (two percent) and state trading companies (1 percent). Export markets and FDI firms were the main market for only 2 percent of private firms. Enterprise registration is also very unevenly distributed across provinces, both in terms of numbers of firms and total capital (Figure 1.3). A few companies, such as Biti's, Kinh Do and Trung Nguyen Coffee, have succeeded in developing a recognized brand name. However, examples of this kind are far and between.

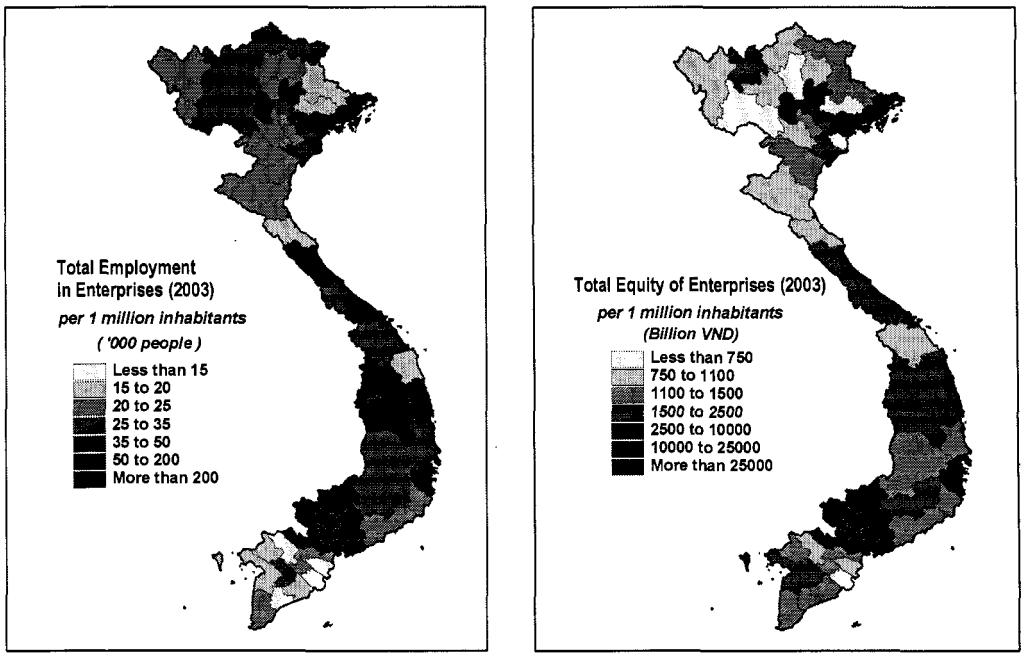
The ILSSA survey also provides interesting information on the characteristics of private sector entrepreneurs in Vietnam. The overall picture that emerges is that of a middle-aged male with 10 or more years of education and previous employment in a position of responsibility, most probably in the state sector. About a quarter of the owner-managers are actually older than 50, and very few of them are less than 29 years old. Only one-fifth of private sector entrepreneurs are women, although there are important regional differences. For instance, in Ho Chi Minh City (HCMC) 63 percent of the enterprises are male-owned, compared to 89 percent in Ha Tay and Quang Nam.

State-owned enterprises

The state sector of Vietnam was established shortly after independence from France, in 1954, by both nationalizing existing privately owned enterprises and building new SOEs. Given

the backward state of its agrarian economy, Vietnam's leaders argued that the SOE sector should be constructed using the Soviet Union economic model, which at the time was perceived to be the quickest way to develop the economy. Significant investment was devoted to industrial SOEs after reunification, through the second five-year plan. The business establishments of the former administration in the South were forcefully transformed into northern-style SOEs. Meanwhile, by early 1978, 1,500 private enterprises from the South, employing 130,000 workers, had been nationalized and converted into 650 SOEs.

Figure 1.3: ... but Unevenly Spread across the Country



Source: Own calculations, based on data from GSO and NBIC.

The reversal of this trend started in 1986, with the Sixth Party Congress. In 1987, autonomy was given to SOEs to formulate and implement their own long-term, medium-term and short-term operating plans. Mandatory production targets were reduced to no more than three and the system whereby government provided the inputs was abolished. Outputs outside the mandatory plan could now be sold to other trading firms or even to consumers directly. Profits were to be calculated based on true costs. And except for compulsory transfers to the budget, they could be retained by the enterprise and used at its own discretion. In 1991, SOEs deemed inefficient or lacking capital and technology or not having sufficient demand for their products were forced to dissolve or merge with other units. As a result, by April 1994 the number of SOEs had been reduced to 6,264, or roughly half those in operation at the heyday of state-led development. In 1995, the Law on SOEs was enacted. Apart from conferring equal legal status to all of them, this law gave them the right to do business freely with each other and with non-state enterprises, including foreign partners under the form of joint ventures. SOEs were also allowed to hire and fire employees and set wages, within policy guidelines. However, they could not freely dispose of the capital that the government had entrusted them with.

The next stage in the transformation of SOEs was organized around the so-called ownership transformation process, the most important part of which is known as equitization.

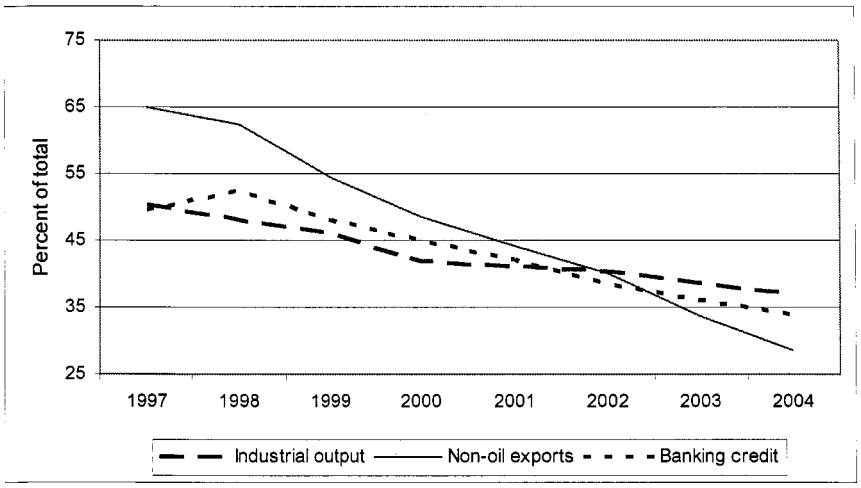
This process amounts to divesting some of the state capital to the private sector. Until quite recently, those acquiring the divested capital were mainly workers and directors of the SOEs, making equitization resemble an "insider privatization".

Many of the SOE managers gaining control through this process are engineers by training, with a specialization in their particular industry. This professional background enables them to master new technology, such as that transferred by foreign investors to a joint venture, and to implement it in the production process. However, they often lack business education and management skills, which limits their capacity to engage in fundamental management change, including the reorganization of work processes and the delegation of decision-making authority.

More recently, however, the equitization of larger companies and the auctioning of their shares have succeeded in attracting outside investors. On average, the state holds roughly 46 percent of the capital in equitized enterprises, employees own 38 percent, and outsiders 15 percent. The outsiders' share doubled since 2003. But so far there are only 20 equitized enterprises with foreign ownership.

The equitization process started very slowly, with only about 100 SOEs divested in 1998. It doubled its speed over subsequent years, and accelerated in 2003, when roughly 300 SOEs were divested. At present, ownership transformation affects some 500 SOEs every year. More than 2,500 of them have been equitized by now, and about 900 more (many of them quite large) should follow in the next two years or so. Meanwhile, the creation of SOEs effectively came to a halt in 2001. The combination of these two trends has resulted in a substantial decline in the number of SOEs, and an increase in the number of JSCs. At present, some 3,200 SOEs are in operation. By end 2006, there should be some 3,500 JSCs, of which 900 with dominant state ownership. All of this is resulting in a sustained (albeit gradual) decline of the state share of the economy (Figure 1.4).

Figure 1.4: A Declining State Share of the Economy



Source: Own calculations, using data from GSO and SBV.

From an administrative perspective, there are three types of SOEs: those associated with General Corporations (GCs) 91, which report to the Office of Government (OOG), those reporting to line ministries, and those under the authority of provincial governments. GCs 91 are

sometimes referred to as "giants", but they are in reality more modestly sized. Only three of them have capital or turnover in excess of one billion dollars. Some of them have elements of a monopoly business. In the case of power generation, oil production, and railways, there is more of a "natural" monopoly situation, determined by technological constraints. Other GCs have a market share in excess of 30 percent of the market for some aspect of their business. CGs related to cement, shipping lines, coal, air transport, steel and tobacco, among others, fall in this category. Whether they can actually exploit this market power is unclear, as they do not own their affiliated SOEs, which are linked to them only from an administrative point of view.

Because of political patronage from their respective authority, SOEs tend to be exposed to conflicting interests, including those of the state in general, their direct authority and their employees. This conflict leads them to pursue not only profits, but also a broader set of objectives, reflecting the interests of their various stakeholders. Not surprisingly, they have come under criticism for poor performance. It appears indeed that their rates of return have been low (Table 1.1). But large losses are uncommon. An indication that SOEs in Vietnam are not as poor performers as in other countries is given by their contribution to government revenue. Currently, some 54 percent of all corporate income tax (CIT) revenue, and about 42 percent of all VAT revenue from domestic production, are paid for by SOEs.

Table 1.1: Not too Profitable, but Paying Taxes

Rate of return on equity (in percent)	Number of SOEs	Revenues (trillion dong)	Liabilities (trillion dong)	Profits (billion dong)	Corporate tax (billion dong)	Number of employees per firm
Insolvent	295	14	26	(1,347)	12	345
Negative	709	56	25	(1,208)	1	244
Less than 2	907	63	37	228	58	298
2 to 5	617	74	33	477	123	434
5 to 10	605	80	44	1,173	299	480
10 to 15	353	45	25	1,348	320	532
15 to 20	234	104	20	1,313	307	521
20 or more	566	113	48	13,024	3,794	617
Total	4,286	549	228	15,008	4,914	411

Source: Own calculations, based on data from GSO. Figures are for 2003.

However, there are important weaknesses hidden behind the relatively solid performance of SOEs in Vietnam. The most obvious one is the implicit transfer many of them receive from the rest of society, by operating in sectors sheltered by tariffs and barriers to competition, by getting access to considerable amounts of land at low cost, and also by getting their bad debts rolled over or even written off. The profitability of SOEs would be lower if these costs (which are very real to society) were factored in. A more subtle reason has to do with the mechanisms underlying this relatively solid performance. Unlike other transition economies, Vietnam has barred SOE managers from appropriating state capital or land, thus avoiding the worst forms of asset stripping observed elsewhere. But it has not been able to prevent SOE directors from appropriating some of the profits of the companies they manage. This gives them an incentive to

make the companies efficient, which is one of the reasons why their performance is relatively solid, but it has been an important source of corruption.

Foreign direct investment

One of the first concrete steps towards economic renovation, in 1987, was to promulgate a Law on Foreign Investment. Together with the establishment and gradual improvement of the legal framework for FDI, Vietnam also signed international bilateral and multilateral agreements on investment encouragement and protection. Such agreements, which concern 45 countries and territories so far, have a wider scope of application than the regulations stipulated in the Law on Foreign Investment. The trend was consolidated by the Ninth Party Congress, in 2001, which emphasized the role of FDI in "export orientation, construction of socio-economic infrastructure facilities, as well as transfer of advance technology and creation of additional employment." Because of this important role, the Party put forward the task of "generating fundamental changes in attracting FDI". The main goal was to raise the quality of FDI inflows to Vietnam, by further attracting investments from multinationals, particularly in industries with high technological content.

Although foreign investors are more limited in the range of sectors in which they can operate than domestic firms, the gap is narrowing quickly. In 2002, foreign ownership in non-state enterprises was allowed in 35 designated industries, including agriculture, forestry and fisheries, science and technology, education and medicine. In 2003, both domestic and foreign investors were allowed to build power plants of up to 100 MW. In 2004, one-hundred-percent foreign-owned banks were authorized. These policies resulted in a rapid increase of FDI commitments, albeit from a low level.

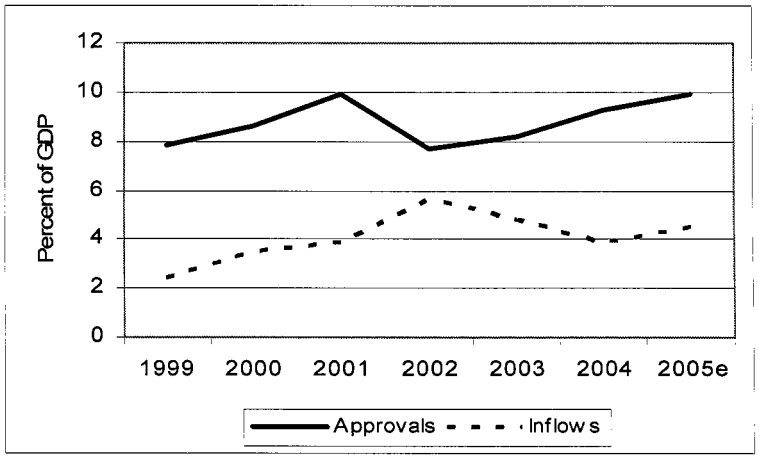
Admittedly, measuring FDI inflows is difficult. GSO provides data on commitments as well as on implemented investments. However, the latter include domestic borrowing, so that they are higher than inflow data. IMF data focuses on actual inflows, because of their relevance from a balance-of-payments perspective. This includes not only the equity inflows, but also the foreign borrowing of FDI enterprises, and it could be argued that such borrowing is not really FDI, because it is debt creating. But the distinction is not as clear when borrowing is from the parent company. Data from the United Nations Conference for Trade and Development (UNCTAD) are the closest to equity inflows, as they do not include borrowing.

Based on GSO data, cumulative FDI rose from 28 projects for a total of 140 million dollars in 1988, to over 700 projects and 5.5 billion dollars in 1993, to nearly 2,400 projects for more than 30 billion dollars in 2000. Two phases can be distinguished in this process. FDI inflows were unusually large in the mid-1990s. With commitments almost 10 percent of GDP between 1994 and 1997, Vietnam became then the top recipient of FDI among all developing countries and transition economies. But the East Asia crisis broke this trend, and it is only since the beginning of the decade that FDI to Vietnam started growing again, after experiencing a sharp decline (Figure 1.5). Only now, almost a decade after the onset of the East Asian crisis, is the volume of FDI commitments getting again close to 10 percent of GDP.

The characteristics of FDI projects have also changed over time. In 1996, the average project size was about 23 million dollars. But it had declined to 5 millions in 2000, and to 2.5 millions in 2003. This said, even at their highest point, prior to the East Asian crisis, FDI projects in Vietnam were relatively small by international standards. It is worth noting that only about 80 of the 500 biggest multinational corporations in the world have established a presence in Vietnam, compared to roughly 400 in China.

This relatively small project size is associated with the country origins of FDI to Vietnam. Asia is, by far, the most important source of capital. The main home economies are Singapore, Taiwan (China), Korea, Hong Kong (China) and Japan. Taken together, these countries account for almost two thirds of total FDI to Vietnam. Such predominance of regional investors partly explains why FDI inflows fell so sharply following the East Asian. Outside of Asia, France, Netherlands and the United Kingdom are among the most important investors.

Figure 1.5: FDI Regaining Momentum...



Source: Own calculations based on data from GSO, IMF and MPI.

The United States does not feature prominently, but this is to some extent misleading. After the signing of the US-Vietnam Bilateral Trade Agreement (USBTA), investment from the U.S. companies in Vietnam has increased steadily. Between 2002 and 2004, United States-related FDI grew by 27 percent per year, compared to just around 3 percent from 1996 to 2001. However, much of this growth has been managed from the regional subsidiaries of the U.S. companies, and it thus appears as if it originated in Asia. While on the surface the accumulated FDI from the United States only accounts for 730 million dollars, taking regional subsidiaries into account brings this figure up to about 2.6 billion.

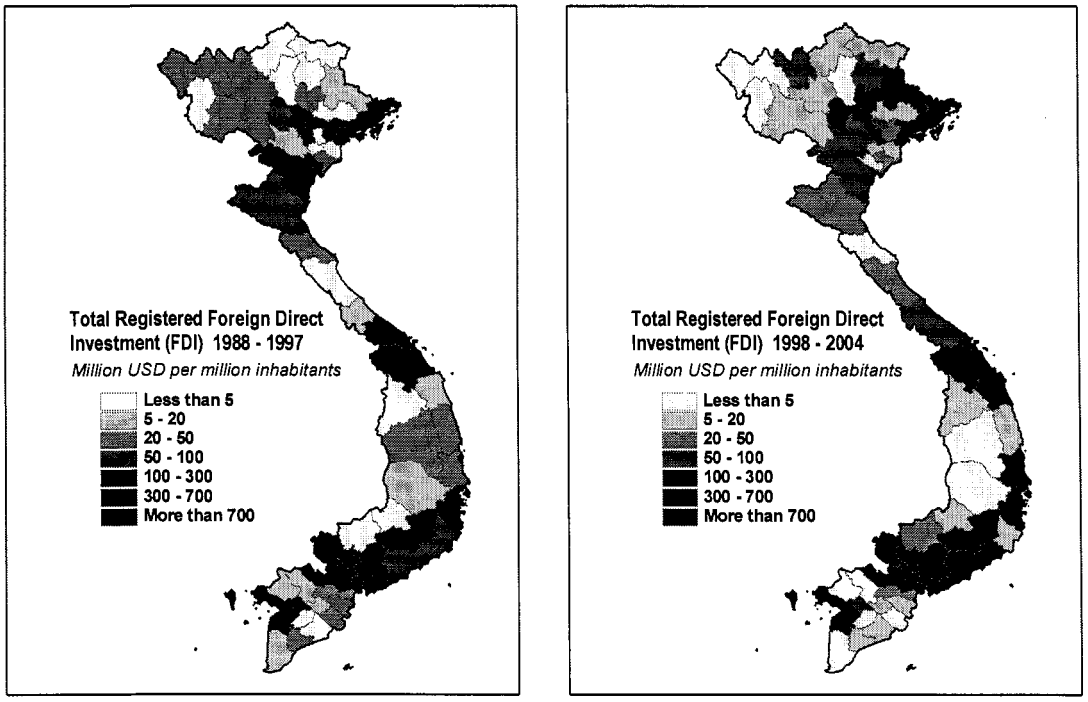
The industry distribution of FDI has changed over the years as well. Construction was one of the most important industries at the beginning of the period, with a peak in 1996. The average project size in this industry has been traditionally large, with projects focusing on hotels, office construction and infrastructure. Manufacturing industries (such as chemicals, construction materials and electric equipment) and services (mainly transportation, communication and finance) have become more important in recent years. FDI in agriculture and textiles and clothing has been low but stable. On the other hand, there is a substantial amount of FDI in oil and gas exploration, most often under the form of business contracts.

Foreign-invested enterprises now account for a large share of the value of production in some sectors, including oil and gas (almost 100 percent), automobile assembling (84 percent), electronics (45 percent), textile and garments (41 percent), chemicals (38 percent), steel (32 percent), cement (30 percent), rubber and plastics (26 percent), and food and beverages (25 percent).

The distribution of FDI across industries has been similar for Asian and non-Asian investors, except for a somewhat higher presence of Asian firms in textile industries. On the

other hand, FDI investments display a considerable geographical concentration, although an increasingly large number of provinces have become important recipients in the period before the East Asian crisis (Figure 1.6).

Figure 1.6: ... but Concentrated in Few Areas



Source: Own calculations based on data from GSO and MPI. Figures are based on FDI commitments.

During the first FDI wave, until the East Asian crisis, joint ventures were the most common form of investment, often with an SOE as the Vietnamese partner. Up to 1998, about two thirds of total FDI commitments were under this form. There are several reasons for this bias. In the early years of economic reform, SOEs were the only possible legal partners for foreign investors. And domestic private sector firms were still very weak anyway. Moreover, the privileged position of SOEs also made the joint venture modality more attractive, compared to green-field investments. SOEs have better access to commercial land, as well as good political contacts, which are essential in areas where the rule of the law is not fully established.

The composition of FDI has substantially changed in recent years. In 1997, legal restrictions to partner up with private investors were removed. Since then, the share of joint ventures in total registered capital has fallen to 42.5 percent, and the number of joint ventures with private sector firms has increased dramatically. Fully-owned foreign enterprises now account for 45.5 percent of committed capital, with build, operate and transfer (BOT) contracts and business cooperation contracts accounting for the rest. In 1991, wholly owned foreign affiliates accounted for about 20 percent of total invested capital and 10 percent of the number of projects. By 2000 these proportions had increased to almost 90 percent and 83 percent, respectively.

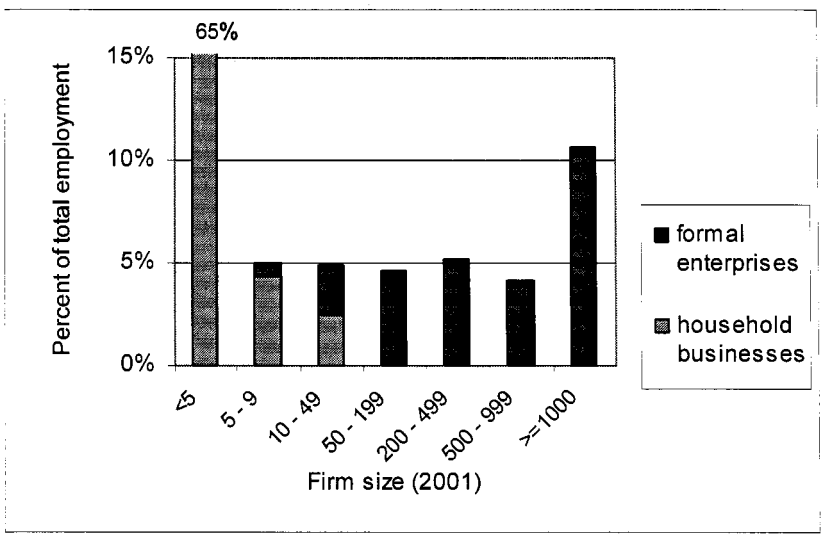
Vietnam is also becoming an exporter of capital. It recently licensed 13 overseas investment projects, for nearly 34 million dollars. The projects include exploration and

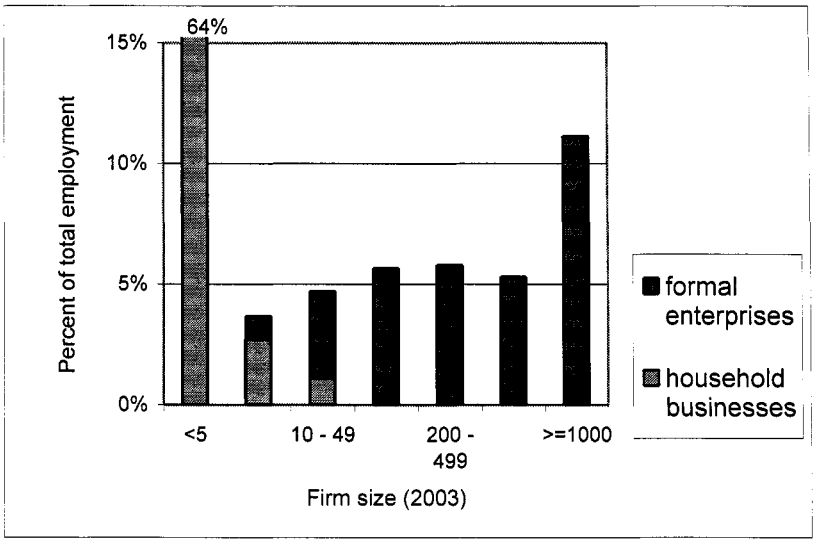
exploitation of crude oil in Malaysia, exploiting salt mines in Laos, and processing wood and establishing a supermarket in South Africa. Between 2000 and 2004, licenses for investment abroad were granted to 122 projects, totaling 230 million dollars. In 2005, Vietnam is expected to invest more than 300 million dollars abroad.

Firm sizes: a missing middle?

One of the main concerns that can be raised, almost twenty years after the beginning of economic reforms, refers to the size distribution of enterprises in the resulting "multi-stakeholder" economy. Vibrant economic development and massive job creation are often associated with a dynamic SME sector. And it is true that Vietnam has seen a steady decline in the number of SOEs, combined with a dramatic increase in the number of private firms, both domestic and foreign-owned. But this change in the distribution of enterprises by institutional type may not be associated with a change in their distribution by size. The concerns in this respect is that thriving enterprises are either very small (in the case of the domestic private sector) or quite large (in the case of the FDI sector), whereas the "middle" of the distribution remains more or less empty.

Figure 1.7: Employment by Firm Size





Source: Own calculations using data from GSO. Figures refer to businesses in activity only. The top panel combines household survey data from 1998 and enterprise census data from 2001. The bottom panel uses data from 2004 and 2003 respectively.

A careful analysis of data on enterprises which are actually in operation can be used to assess whether there is a missing middle in the distribution of enterprises by size. Two data sources need to be combined: household surveys such as the VHLSS, to account for household enterprises, and GSO' enterprise censuses, to capture registered enterprises.

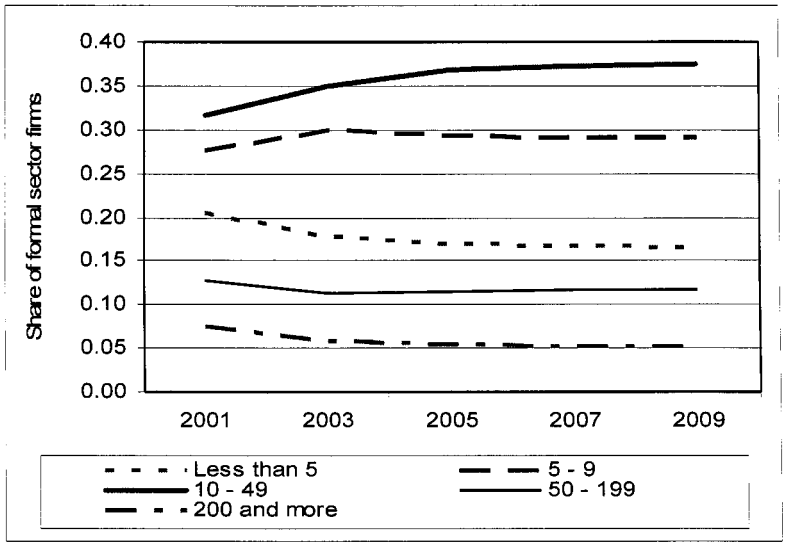
One important difference between the businesses covered by these two data sources refer to their formality, or lack thereof. Businesses in the GSO enterprise censuses can be SOEs, or privately owned, or foreign-owned companies; and they can operate under different corporate models, such as sole proprietorship, limited-liability or joint-stock company. But they are all formal. On the other hand, businesses in the VHLSS are informal; or, more precisely, they are a hybrid between the formal and informal sector. They are not formally registered under the Enterprise Law, but they are most often "listed" by local authorities. In principle, businesses with 10 employees or more should register under the Enterprise Law. But remaining informal reflects to some extent a choice, involving a trade-off between barriers to enter into certain kinds of contracts with suppliers, customers and creditors, on the one hand, and less stringent regulations on taxation, accounting requirements and transparency on the other.

When combining these two sources of data, it appears indeed that both very small enterprises, with up to five workers, and very large ones, with more than 1,000, account for the bulk of employment in Vietnam (Figure 1.8). However, the comparison between 2001 and 2003 also shows that this pattern is changing. The share of enterprises employing between 50 and 1000 workers increases during this period, whereas the share of those employing between five and 50 workers declines. Importantly, the share of informal businesses in total employment falls quite rapidly. Formalization is particularly strong among businesses with five to 50 workers.

Information on the growth, decline or disappearance of enterprises over time can also be used to forecast changes how the distribution of enterprises by size will change in the coming years. Enterprise censuses allow constructing so-called transition matrices, reporting the change in size (including possible closure) of enterprises between two points in time. They also provide

information on the size distribution of new enterprises between two points in time. A hypothetical distribution can thus be generated, assuming the same growth rate in the number of enterprises, year after year, the same distribution by size of the newly created ones, and the same probabilities of growing, declining or closing as implied by transition matrices.

Figure 1.8: Growth, Decline and Exit: the Implicit Trends.



Source: Own calculations based on GSO data. Enterprise sizes are measured in number of persons employed.

Using data from the enterprise censuses of 2001 and 2003, this exercise suggests that the share of businesses with 10 to 50 workers will increase steadily in the coming years, until accounting for close to 40 percent of total employment by formal businesses (Figure 1.9). This will be at the expense of the employment shares of both very large and very small businesses.

2. BUSINESS AND DEVELOPMENT

The growth of business is seldom viewed as a development objective on its own. Much the same as good governance, it is rather seen as an instrumental objective, aimed at building a better society, one with higher living standards and lower poverty levels. A thriving business environment is, above all, a way to elicit the energy and the creativity of the entire population, offering a reward to those who accumulate and innovate simply because they make more and better goods and services available to the rest. In Vietnam, business development has been one of the main forces behind rapid poverty reduction. Together with the redistribution of agricultural land, and the broad coverage of social services, it allowed a large fraction of the population to engage in more productive occupations and raise their living standards. The reform process launched almost two decades ago unleashed an enormous entrepreneurial energy, and led to massive job creation. Business development has allowed absorbing 1.4 to 1.5 million entrants to the labor market every year, and offered a way out of farming for the rural population, especially for young women. Over the last decade, the average wage has grown at around 10 percent per year in nominal terms, or roughly 7 percent in real terms. The enormous opportunities created through this process have led to an inclusive growth pattern. While real GDP per capita has increased by 5.9 percent per year since 1993, the Gini index (measuring inequality) has increased only slightly, reaching 0.37 in 2004. During that period, the poverty rate fell from 57 to less than 20 percent.

Job creation

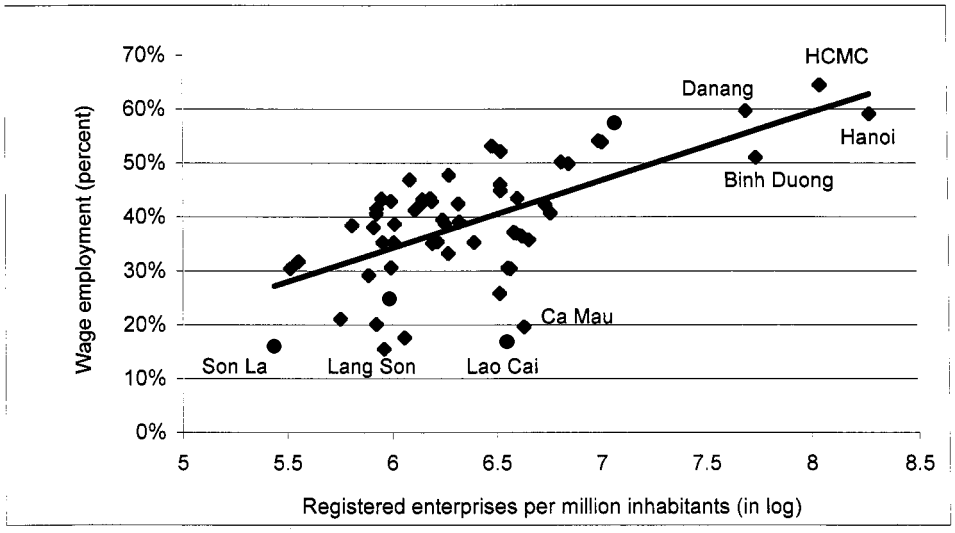
Every year, some 1.4 to 1.5 million young Vietnamese enter the labor market. Sustained growth in living standards, and even overall social stability, very much depend on their ability to find jobs. A recent study on Vietnamese youth conducted by the United Nations Children's Fund (UNICEF) jointly with the Ministry of Health (MOH) and GSO is quite telling regarding the insertion of these new entrants into the labor market. Its findings are based on a nationally representative sample of men and women who are 14 to 25 years old. More than half of this group has a simple job, such as non-skilled worker, but there are important differences between urban and rural areas. Urban youth tend to report occupations that require a higher level of professional skills, with only one third of them having simple jobs. Also, more than a third of the working youth are self-employed, whereas about a fifth works in a household business, and close to one tenth have a salaried job with the private sector. SOEs account for less than 7 percent of total employment among the Vietnamese youth.

The UNICEF survey uncovers a high level of satisfaction with current jobs. On average, 78 percent of respondents are satisfied, but the proportion climbs to almost 82 percent among urban groups and women. Its lowest level corresponds to unskilled agricultural jobs; but even there, at 73 percent, it is remarkably high. While there are no major gaps in job satisfaction across regions, it is clear that a booming economy helps. Indeed, the highest job satisfaction levels (close to 81 percent) are in the Red River delta and the South East. The lowest ones (below 70 percent) are in the North Central coast.

In questions relating to future aspirations, half of the respondents identify work as their highest priority. The answer is quite similar across all age groups, between male and female respondents, and in urban and rural areas. When invited to make recommendations to the government, on what could improve young people's lives, more than 40 percent state that increased opportunities for work should be the number one priority.

The recent experience of Vietnam suggests that business development is fundamental to address this concern. This is revealed by the enormous diversity of experiences across provinces. Growth in wage employment has been strongly associated with business registration under the Enterprise Law (Figure 2.1).

Figure 2.1: The Private Sector as an Employment Engine



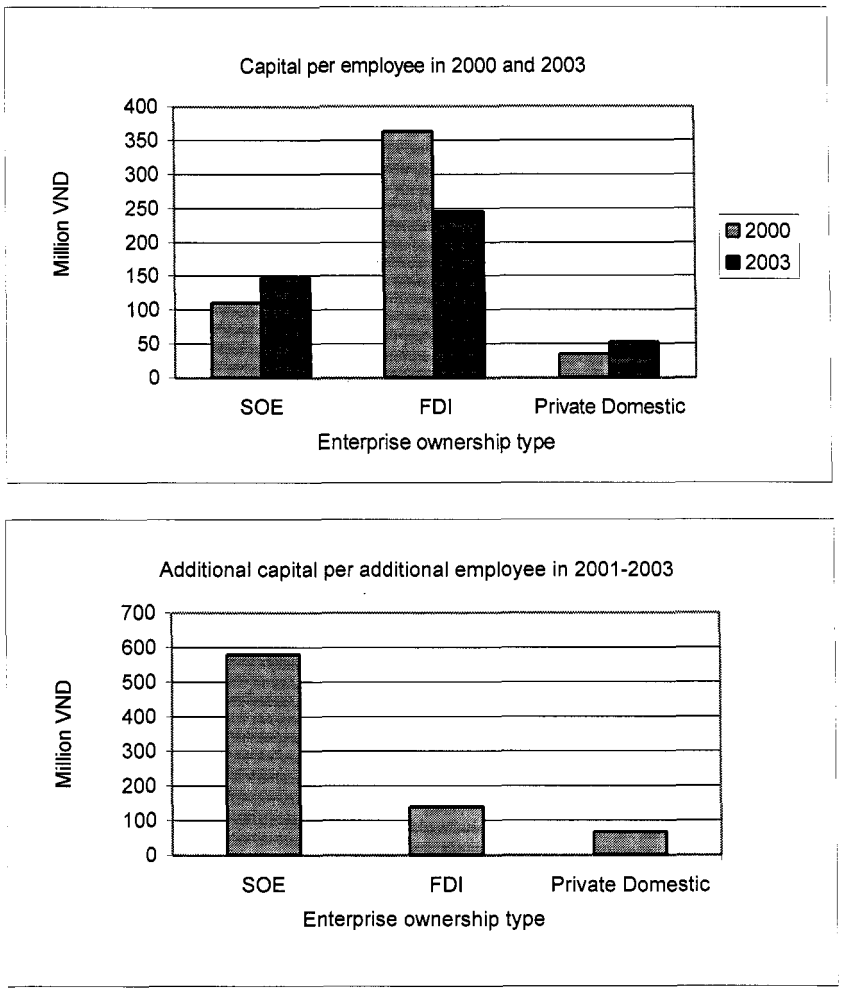
Source: Own calculations based on data from MPI and GSO. Figures on enterprise registration correspond to the period 2000-2004; figures on employment creation are for 2002-2004.

The recent experience of Vietnam also suggests that the "cost" of creating a job varies considerably across businesses of different sorts. Admittedly, referring to the "cost" of jobs is a shortcut that could be questioned on analytical grounds. The idea of a given cost implicitly assumes a lack of flexibility in the way the factors of production can be combined, as if every job had a given capital requirement. In fact, more expensive jobs, associated with more capital per work, also tend to be more productive. So, from an economic perspective, high-cost jobs could (at least in principle) be preferred to low-cost ones. However, a country facing 1.4 to 1.5 million entrants to the labor market, and having limited resources for capital accumulation, cannot afford to offer jobs with high capital intensity to everybody.

In recent years, the domestic private sector has been the most effective in terms of generating employment at a low cost (Figure 2.2). A very crude way to see this is to compute the average capital per worker across SOEs, FDI firms and the domestic private sector. It then appears that capital intensity is highest in FDI firms and lowest in the domestic private sector. But this comparison is potentially misleading, as some SOEs are still suffering from the over-staffing they inherited from the period under central planning. If their workforce were adjusted downwards, so as to maximize profits, their capital endowment per worker would increase.

A slightly more rigorous way to assess the cost of a job in each sector is to look at changes in capital and labor endowments over time (as opposed to their levels at any point in time). It then appears that the higher capital cost per job is in SOEs, not in FDI firms. Again, this does not necessarily imply that SOEs are inefficient. For instance, the power sector requires very heavy capital investments to cope with the booming demand for energy, but stable employment in this sector would actually indicate a increase in its productivity. What is clear, when looking at this somewhat more rigorous assessment, is that only the domestic private sector is in a position to massively create jobs in an affordable way.

Figure 2.2: The "Cost" of Creating a Job



Source: Own calculations based on data from GSO.

Output growth

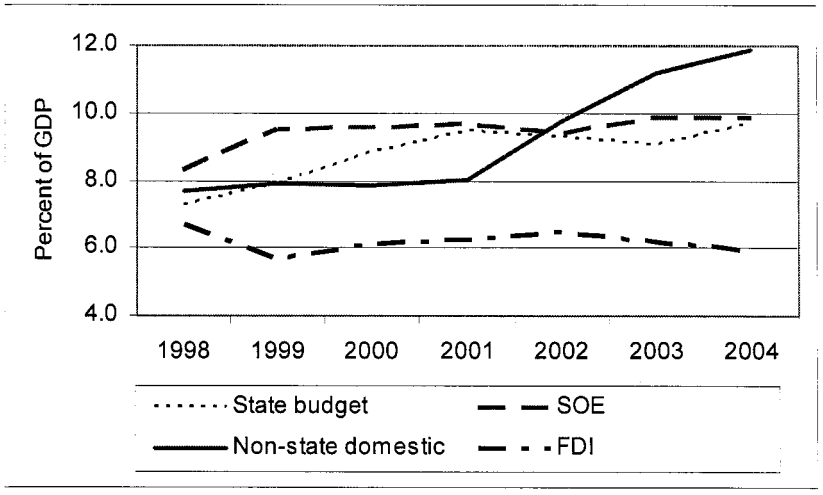
At the risk of simplifying, there are two main ways to increase output per worker in the short to medium term. These are to raise the endowment of capital available to each worker and

to use whatever capital is available more efficiently. These two main drivers are often referred to as capital accumulation and total factor productivity growth. (Note that the in the longer term, total factor productivity growth cannot be dissociated from the upgrading of skills). A rigorous analysis of the contribution of these two drivers to labor productivity growth can only be conducted at a disaggregated level. Ideally, the analysis should focus on individual enterprises; if not, at least on relatively homogeneous sectors. Economy-wide indictors of capital accumulation and total factor productivity growth need to be interpreted with much caution. Still, they can be used to illustrate broad economic trends.

The speed at which capital is being accumulated in the Vietnamese economy can be measured through the fraction of total income that is invested every year. This investment rate has increased steadily in recent years. By now, about 37 percent of the country's GDP is devoted to increasing the stock of capital, compared to 30 percent during the East Asian crisis. This is one of the highest investment rates in the world, and it may not be advisable to raise it even further. Mobilizing such a huge amount of resources in a transparent and efficient way is indeed a challenge. Banks may not be able to rigorously assess the risk of all the projects they are financing, whereas the capacity of the public sector to conduct rigorous appraisals on its own investments is still very limited.

However, it is encouraging to see that the composition of capital accumulation is changing as well. Over the last few years, the investment rate of the domestic private sector has increased by half; it now accounts for a third of total capital accumulation (Figure 2.3). Because of the private sector's strong profitability focus, it is likely that its investments are carefully screened out. A similar, if not more demanding type of screening applies to FDI investments, which were relatively stable until 2004, but are gaining speed of late. It is reassuring to see that public investments funded directly by the budget have increased steadily. Most of these investments are related to the development of large-scale infrastructure, which tends to have high payoffs in a low-income country. Moreover, the transparency of budget allocations has improved considerably in recent years, with appropriations now subject to closer scrutiny by the National Assembly and People's Councils at all levels.

Figure 2.3: Investment by Institutional Sector



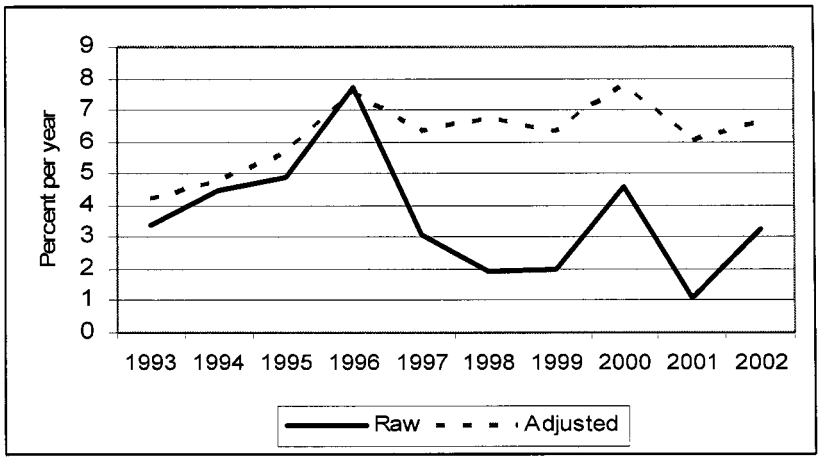
Source: Own calculations based on data from GSO.

On the other hand, it is not clear that investment projects by SOE are always subject to rigorous appraisal procedures. The pressure to invest profitably could be undermined in their case by the involvement of multiple stakeholders, with potentially conflicting interests. SOEs also tend to have better access to financial resources, from SOCBs and policy lending institutions such as the Development Assistance Fund (DAF). The "softer" budget constraint they face, compared to their private sector counterparts, could also result in less discipline when preparing and appraising investment projects.

Measuring total factor productivity gains is considerably more difficult than measuring capital accumulation. The standard technique involves several questionable assumptions. It basically amounts to estimating the productivity of an additional unit of capital and an additional unit of labor, then multiplying the actual change in the amounts of capital and labor used in the economy by the corresponding productivities, and finally comparing the result to the actual change in output. The gap between the actual change in output, and its predicted increase based on estimated productivities, gives a measure of the gain in efficiency experienced by the economy. Estimates of total factor productivity gains based on the standard technique have been conducted on many countries. They usually range from 1 to 4 percent per year.

Note, however, that the standard technique requires a reliable measure of the change in the capital stock from one year to the next. While more-or-less accurate figures can be produced for aggregate investment, reliable indicators of the overall stock of capital tend to be unavailable in developing countries. The problem is actually worse in a transition economy, where old investments were registered based on administrative costs often bearing little resemblance with reality. Under-estimating the stock of old capital leads to over-estimating the rate at which the capital stock is growing, hence to under-estimating total factor productivity gains. A related problem concerns capacity utilization. In an economic downturn, like the one experienced by Vietnam in the aftermath of the East Asian crisis, some existing capital is under-utilized and output falls short of its potential. In measuring total factor productivity gains it is the potential output that counts, more than the observed output.

Figure 2.4: Productivity Gains at the Aggregate Level

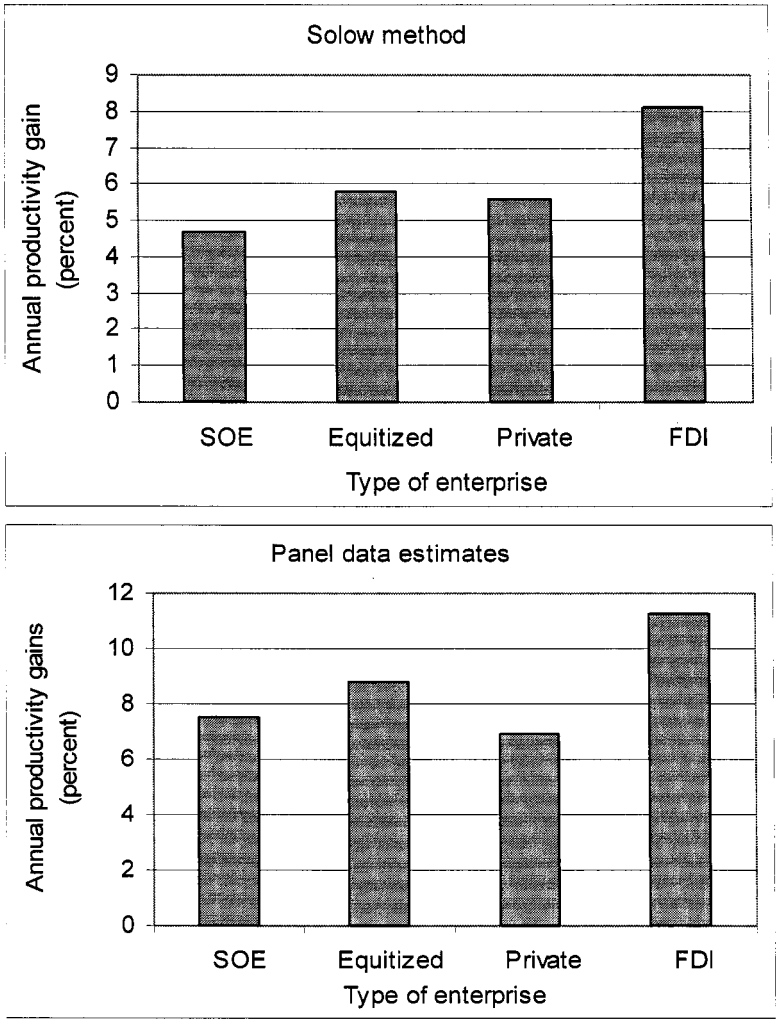


Source: Khoi Quang Chu (2004).

With these caveats in mind, it is still interesting to see that, according to available estimates, total factor productivity gains have been quite high in Vietnam (Figure 2.4). "Raw"

figures, not taking capacity utilization into account, put the annual gains at two to three percent per year after the East Asian crisis. This is comparable to estimates available for good economic performers such as the United States. "Adjusted" estimates, taking into account the decline in capacity utilization after the East Asian crisis, are much higher. They increase from roughly 4 percent per year in the early 1990s to more than 6 percent at present. On the surface, this is too high to be credible. However, estimates at the enterprise level, using a totally different data source, yield comparable figures.

Figure 2.5: Productivity Gains at the Enterprise Level



Source: Own estimates based on GSO data.

Productivity gains

Total factor productivity gains are somewhat easier to evaluate at the enterprise level, as this is where innovations actually occur. The availability of disaggregated data from enterprise

censuses allows conducting a more refined estimate than macroeconomic data permit. Also, the availability of tens of thousands of observations, and the possibility to observe the same enterprise at two points in time, make it possible to use more sophisticated (and potentially more reliable) estimation techniques. The focus here is on firms in manufacturing; agricultural enterprises and most firms in services are set aside. Interestingly, different techniques yield relatively similar results. Reassuringly, the results are also similar to those obtained with the standard, crude technique at the aggregate level. What is striking, in all cases, is the sheer magnitude of the estimated total factor productivity gains (Figure 2.5).

Equally interesting is the variation in total factor productivity gains across businesses of different sorts. Regardless of the estimation technique, gains appear to be substantially higher in the FDI sector. This may be due to the fact that many FDI investments are new, with many establishments still in the process of reaching their full capacity. Their growth in output could be unusually high during this start-up phase, without this implying that they are becoming much more efficient. At the other end, total factor productivity gains are lowest, but still high by international standards, for both SOEs and domestic private enterprises.

Box 2.1: Public Sector Champions: Electricity of Vietnam

Unlike many other Vietnamese SOEs, EVN has been successful in establishing a corporate culture and a commercial orientation, particularly in recent years. EVN's financial accounts are strictly separate from the government budget, and EVN receives no government budget subsidy support for investment or its operations, with the exception of certain resettlement financing. The company is now facing commercial terms for borrowings, except in areas with a social objective, such as rural electrification. It introduced international accounting standards (IAS) early on, and relies quite systematically on competitive bidding for its procurement.

EVN has been profitable until now, which is unusual for a public utility of this sort. It covers all its costs, including depreciation and financial expenditures related to its borrowing, from revenues. This has been accomplished while keeping costs to consumers at levels which are in line with international standards. Management of consumer accounts receivable is exceptionally effective for a developing country. Steady reductions in transmission and distribution losses have also helped. Non-technical losses, including theft of electricity, are low compared to many countries. However, benchmarking EVN's efficiency would require more disclosure about its cost structure.

Primarily managed by EVN, Vietnam's power sector has kept pace with extraordinary increases in demand, and succeeded at maintaining basic service for its customers most of the time. Its rural electrification program has been one of the most successful in the world. The number of rural households with access to electricity increased from 51 percent in 1996 to 88 percent in 2004. Widespread anecdotal evidence also points to substantial increases in the quality of electricity service over the last ten years, with supply to most customers in urban and peri-urban areas becoming noticeably more reliable. However, service is not yet seen as reliable enough by firms, which report an average of 12 power outages or surges per year and, in the case of small and medium-sized firms, losses amounting to two to three percent of sales due to outages.

Looking forward, EVN's own success raises new challenges. As a market for electricity is gradually being set up, EVN will need to be broken up into truly separate corporations. The existing model of EVN as the holding company for all of the state's assets in the power sector cannot be retained if true competition is to be achieved among existing and new generators, and later, in wholesale and retail supply of electricity. The market requires independence among players, to avoid perceived conflicts of interests or potential collusion.

Source: World Bank (forthcoming).

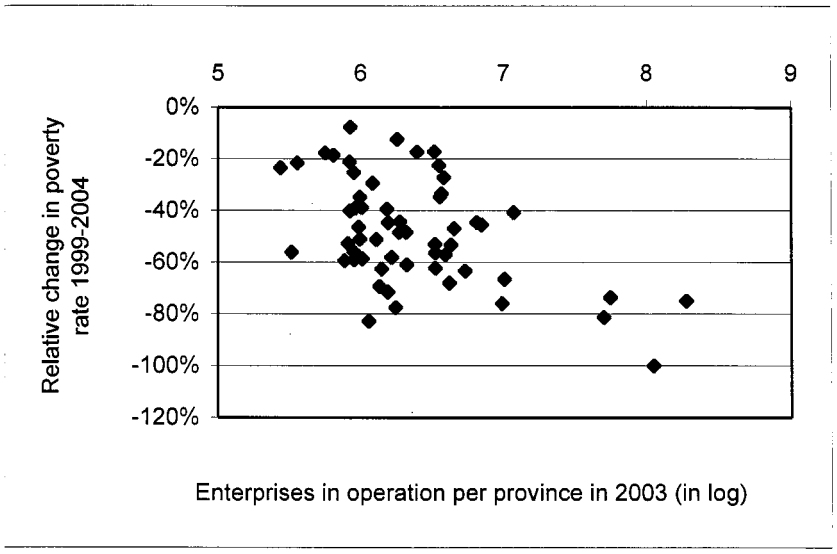
The similarity in the performance of these two types of businesses could be misleading, however. SOEs still enjoy considerable advantages compared to domestic private enterprises, especially in terms of their access to land and finance. If the playing field were more level, private sector firms could be expected to outperform SOEs in terms of their total factor productivity gains. However, it should not be concluded that all SOEs are inefficient. The example of Electricity of Vietnam (EVN) suggests that public sector entities are capable to deliver remarkable performances as well (Box 2.1).

It is also worth noting that equitized SOEs do better than both unrestructured SOEs and domestic private firms. To some extent, as in the case of FDI enterprises, such remarkable performance could be to a large extent reflect a "catch-up" effect. Equitization reduces the administrative burden on enterprises and makes them more independent from the often conflicting interests of their main stakeholders. It therefore allows them to move closer to the efficiency frontier. Standard estimation techniques are likely to confuse this movement with a shift of the efficiency frontier. After the catch-up effect is over, equitized SOEs should not be expected to do much better than private sector firms. But the estimated total factor productivity gains, no matter how temporary, suggest that the equitization process has been an effective tool to raise efficiency in the SOE sector.

Poverty reduction

There is a clear correlation between the number of enterprises in a province, relative to its population, and the speed at which poverty is being reduced (Figure 2.6). Thus, the dynamic business environments of Binh Duong, Danang, Hanoi and HCMC have provided the context for improved welfare for the local populations. Of course, correlation is not causation. But there is evidence that the jobs created by these enterprises are helping people to move out of poverty.

Figure 2.6: Business Activity and Poverty



Source: Own calculations based on data from GSO.

At a national level, the proportion of those at work deriving their main income from wage employment rose from 16 percent in 1993 to 27 percent in 2004. The drop in household dependence on farm incomes almost mirrors this pattern. Meanwhile, the average wage grew by about 10 percent in nominal terms over this period, or roughly 7 percent in real terms. Regional patterns confirm that reductions in poverty are more rapid where non-farm wage employment is more dominant. About 35 percent of the population in the Red River Delta and 45 percent of the population in the Southeast report that their main source of income is wage employment. But the proportion is only 10 percent in the North West.

However, the relationship between wage employment and poverty reduction is not entirely straightforward. Those deriving their income from wage employment are also representing an increasingly large share of the poor. In the Southeast, 19 percent of those in the poorest fifth of the population depend on non-farm wage employment as their main income source. The story is similar in the Red River delta. This suggests that not all jobs created by businesses are associated with poverty reduction.

Many of those employed in the areas where enterprises are developing rapidly come from across the country. Those migrating to the Hanoi and the industrial areas in the north are traveling primarily from the Red River Delta. Those migrating to HCMC and the industrial zones in the Southeast come from a broader range of regions. A recent survey of 5000 migrants found that more than two-thirds of migrants had remitted at least one million dong during the previous 12 months. Migrants reported that the funds they were remitting home were spent largely on meeting everyday expenses, including health and education costs.

Gender equality

A thriving business environment can also foster economic and social development objectives in less obvious ways. Empowering women is one of them. Vietnam has a solid track record in terms of gender equality, compared to other countries. Educational attainment is similar for men and women, health indicators are roughly comparable too, and even labor force participation is unusually even across sexes, with women accounting for 49 percent of the work force between ages 16 and 55. However, at 40 percent, the share of Vietnamese women in total wage work is substantially lower. And not so many women are in managerial positions. Bringing a sizeable share of cash income to the household, and being champions in the business arena, should raise the voice of women at home and in society at large, while giving them more independence. Business development could be helping in this respect.

Garment and footwear production have been among the most dynamic sectors of the Vietnamese economy in recent years. More than 80 percent of the workers in this sector are female. At present, there are some 1,100 textile and garment factories in operation, including 231 SOEs, 500 private or joint-venture companies and 354 FDI enterprises; together, they employ more than 2 million workers. There are also 240 footwear enterprises, of which 76 are SOEs, 84 are private or joint-ventures and 80 are foreign-invested. Taken together, they employ 400 thousand workers.

A recent study by Mekong Economics, on women workers in 21 of these garment and footwear enterprises, provides revealing information regarding their profile, working conditions, overall satisfaction and aspirations.

The study found that most female workers were young, single, migrants. Through their employment in the garment and footwear industries they were able to earn money, live away from

their villages and in some instances study or access more information on social issues. Moving away from the village also means that these young women had to rent accommodation, live independently of their families and negotiate a new living environment, including on access to basic social and health services.

On the positive side, the average income of these female workers was approximately one million dong per month, which is considerably more than the minimum wage. On the negative side, while women occupied all kinds of positions, including managerial and technical positions, they were mainly concentrated on the production line, mainly on sewing and over-locking jobs. These positions are characterized by low salaries, long working hours and minimal opportunities for skills development. Also, the research found that female workers were not receiving all the benefits stipulated by labor legislation. Working conditions were especially poor in some private and SOE factories, characterized by uncomfortable workshops, few breaks and limited access to snacks, clean toilets and rest places.

Yet the study found that most workers, male and female, were satisfied with their jobs. More than 40 percent of them stated that they were motivated to work in a factory, because they thought it was a good opportunity for them. More women than men declared that their wages were sufficient to meet their needs. Migrant workers were especially upbeat. The city or industrial zone their factory was located in was seen by them a place of opportunity, where it was possible to gain experience and acquire information that was unavailable in rural areas. Some also referred to the possibility of working and studying at the same time, although very few of them were actually doing so. In spite of the shortcomings, when putting all the pieces together the authors of the study conclude that the garment and footwear industry has provided young Vietnamese women a route out of farming.

Vietnamese women are also making their way into top managerial positions (Box 2.2). While both sexes are equally represented in the day-to-day running of household businesses, relatively fewer women lead registered enterprises. The case of those who do helps understand how business development affects their lives.

A survey of Vietnamese women entrepreneurs was recently conducted by MPDF. It found that 69 percent of them were in the 35-54 age bracket, and 80 percent were married. Their average household size, including spouse, children, parents or other relatives was slightly above five persons. Just 12 percent had only a primary level of education, while 25 percent had secondary schooling, 27 percent some post-secondary education, and fully 34 percent had a university or graduate degree. Only 6 percent of them were from ethnic minorities. The women answering the survey were the owners of established, substantial business enterprises. Most had been in business for five or more years. On average, they employed 68 permanent workers and 25 part-time or seasonal workers.

The MPDF survey revealed that these women share many of the same concerns as male business owners. For instance, the ability to find and retain good staff, the acquisition of financial management skills, and the existence of restrictive laws and regulations were judged to be either important or extremely important by between 70 to 80 percent of respondents. The majority of respondents declared that gender made no difference in dealing with bureaucracy and corruption, or in gaining access to capital.

However, respondents also reflected on aspects of business ownership and management which were more difficult for them because they were women. The main challenge was to balance their professional activity and their family life, given the long hours needed to manage their businesses. Respondents also described personal safety issues and the ability to network and develop business relationships as more problematic for women than for men. On the other hand, dealing with clients and customers was seen as easier for women.

On balance, Vietnam's businesswomen claim that their gender does not put them at a disadvantage. When asked whether being a woman was a net negative, net positive, or made no difference in their business, two thirds of respondents chose the third option. While a 54 percent majority feels that there is no gender difference in "being taken seriously as a business owner," 30 percent say this is easier as a woman, and only 7 percent say it is more challenging. Perhaps this is why Vietnam's businesswomen largely feel that they are, indeed, taken seriously.

Box 2.2: Private Sector Champions: Women Entrepreneurs

Ms. My Le started her business from zero. In 1987, when she had been married for nine years and had five children, she left the SOE factory she was working for. At that time, a new policy had been introduced stipulating that families should not have more than two children. My Le moved then into trading on agricultural products. At first her husband was not supportive, because he thought that she had been dragged into that line of business by people he did not trust. Moreover, the business was risky, and My Le was losing money. Only in 1990 did the husband recognize that she was trying very hard and deserved to be supported.

My Le registered her private enterprise, later called My Le Co. Ltd., in 1993. Hers was the first private company in what was then Song Be province (transformed into Binh Phuoc and Vinh Long today). At that time, farmers lacked a market for raw cashew nuts. My Le and her husband ventured to invest in a factory to process the nuts. The company did not have enough capital, management experience or skilled workers. The small amount of money My Le borrowed through Vietnam's Women Union was fundamental to get her started.

By 1996, the company had about 200 workers and a turnover of 2.5 billion dong. Ten years later, employment has increased tenfold, and turnover has reached 150 billion dong. The factory has a work floor of 25,000 square meters, is equipped with modern technology, and processes more than 30 tons of raw cashew nuts every day. About 95 percent of the output is exported to the United States, the European Union, China, Singapore and other foreign markets. The company has built its customer base on its reputation for high-quality nuts reliability in delivery.

Similar stories to My Le's echo around the community of women entrepreneurs. A recent study that captures the experiences of more than 60 of them relates the common hurdles they encounter: access to capital and land, a lack of business management skills, and the difficulties associated with managing a business and a family simultaneously. Many of those finally succeeding in business have a number of false starts, with previous businesses either faltering or failing as they develop the skills to handle these constraints.

Source: Based on Froniga Greig and Thi Nguyen (2004) and Hang Thi Thu Pham (2005).

3. EFFICIENCY AND COMPETITIVENESS

Few would question that the business sector of Vietnam is thriving, and has made a substantial contribution to economic and social development in recent years. But whether its performance compares favorably or unfavorably to that of other countries, especially in the East Asia region, is more controversial. Assessments of Vietnam's strengths and weaknesses, and collective anxiety about its capacity to make a place for itself in the global marketplace, often take the form of discussions about "competitiveness". This is a somewhat elusive concept, considered fundamental by most management experts and meaningless by many professional economists. However, it captures the idea of relative position, a concept which is somewhat easier to grasp. Unfortunately, the available competitiveness ratings provide radically different assessments of Vietnam's relative position, which can only add to the confusion. Ratings relying on the characteristics of the regulatory framework in which firms operate put Vietnam in the bottom half of the world distribution or close to the middle at best. On the other hand, direct assessments by foreign companies, under the form of opinion surveys or actual investments flow, rank it in the top quarter, or even higher. Deeper insights can be gained by analyzing the way in which Vietnam's businesses actually operate and participate in the global economy, either directly or indirectly. Those analyses show that Vietnam's pattern of integration in world trade is closer to that of China than to that of other ASEAN countries. But they also reveal a still insufficient integration of domestic companies in global value chains. Total factor productivity is growing very rapidly across the board; but growth is faster in foreign companies than in domestic ones, regardless of their ownership. Productivity spillovers occur between foreign and domestic companies, especially private ones, but labor turnover and outright imitation seem to be more important channels of transmission than business-to-business transactions. The equitization of SOEs, in spite of its limitations, appears to be contributing to productivity gains, as it establishes a more arms-length relationship with government authorities. In the end, the key to competitiveness is the ability of businesses to transform themselves, with the public sector having a very important role to play in this respect. Based on this broader perspective, a more comprehensive rating system to assess Vietnam's strengths and weaknesses can be proposed.

The conventional wisdom(s)

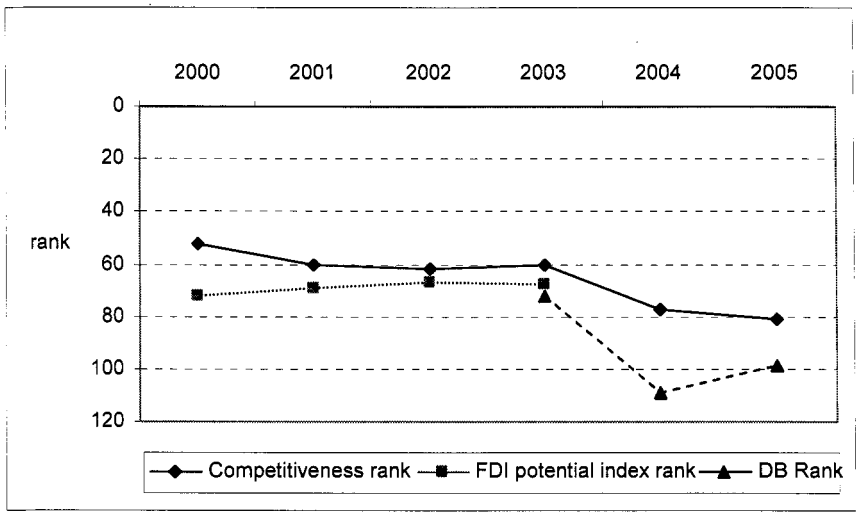
There are a variety of cross-country ratings which can be linked, in one way or another, to the concept of competitiveness. In some cases, the link is rather tenuous. For instance, several risk rating agencies classify countries into a number of categories, depending on the risk level associated with their sovereign bonds. While sovereign risk is quite far removed from competitiveness, ratings of this sort do have an influence on FDI inflows.

Other ratings get much closer to the competitiveness notion, if nothing else because of their name. Three have received especial attention in Vietnam in recent years. These are: the Growth Competitiveness Index produced by the World Economic Forum, the Doing Business ratings produced by the International Finance Corporation, and the FDI Potential index produced by UNCTAD. Each of these ratings covers more than one hundred countries. All of them put

Vietnam in the bottom part of the worldwide competitiveness distribution, or around its middle at best (Figure 3.1).

The Growth Competitiveness Index is a complex combination of a vast number of cross-country indicators, such as the corruption perceptions index by Transparency International. These indicators are classified under the headings of "technology", "public institutions" and "macroeconomic environment", and grouped into various categories such as openness, government, finance, infrastructure, management, labor, and institutions. The Growth and Competitiveness Index shows a sustained decline of Vietnam's absolute ranking over time; currently, it is in 81th position among 117 countries. But the decline is mainly due to the constant addition of (typically poorer) developing countries to the database. If the relative position is considered instead, Vietnam's rating has improved quite steadily. In the year 2000, it was in the 90th percentile; by 2005, it had moved up to the 70th percentile.

Figure 3.1: A Bad Place to do Business...?



Source: Own calculations, using data from World Economic Forum (2005), World Investment Report (2005) and World Bank (2005). Figures refer to a country's position among all those considered, from best (at the top) to worst (at the bottom).

The Doing Business index considers 10 topics: starting a business, protecting investors, hiring and firing workers, enforcing contracts, registering property, closing a business, getting credit, dealing with licenses, paying taxes, and trading across borders. In its most recent release, the aggregate index is calculated as the average of the rankings (in a scale from zero to one hundred) for each of the 10 topics. The ranking on each topic, in turn, is the average of the rankings for its component indicators. The most recent Doing Business report ranks Vietnam as number 99 out of 155 countries. Comparative ratings had not been provided in previous years, when the number of topics covered by the report was smaller. But it is relatively straightforward to apply the same methodology to data from previous years. The result does not uncover any clear trend, with Vietnam fluctuating around the 70th percentile.

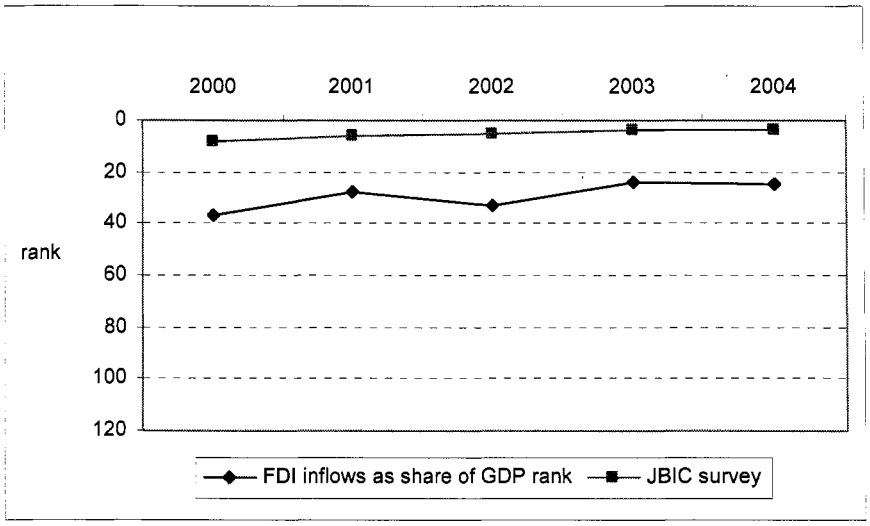
The FDI Potential Index captures several factors, apart from market size, which are expected to affect a country's attractiveness to foreign investors. These factors include GDP per capita, the growth rate of GDP over the last decade, the share of exports to GDP, indicators of

telephone density, a measure of commercial energy use per capita, the share of research spending in GDP, the share of tertiary students in the population, a country risk indicator, the share in worldwide exports of natural resources, the share in worldwide imports of parts and components for automobiles and electronic products, and the worldwide share in inward FDI. The FDI Potential Index is an average of the values of all twelve factors (each normalized to a scale going from zero to one hundred). It makes Vietnam appear under a more favorable light, as it ranks 68 out of 140 countries. There is no fundamental change in this ranking over time.

Beyond the diversity of their underlying indicators, what these three rankings have in common is their focus on factors that could potentially make a country attractive to investors. Now, which are those factors in reality is a matter for debate. It could be argued, for instance, that the topics selected by the Doing Business report give more weight to the regulatory environment than a "real" investor would. While a scholarly discourse would emphasize transaction costs and limited protection of property rights as major obstacles to business, investors in a developing country might be used to operate informally, enforcing deals through trust or reputation, while seldom having recourse to the legal system.

A different approach is to focus on what investors actually do. In this respect, the flow of FDI into a country is a good measure of its attractiveness. To make this indicator comparable across economies of different sizes, the FDI inflow can be scaled by the country's GDP. From this perspective, and after excluding economies with a total GDP below 10 billion dollars per year, Vietnam ranks 25 out of 88 countries. While its ranking was much higher before the East Asian crisis, there is a steady improvement since the year 2000 (Figure 3.2).

Figure 3.2: ...or One of the Most Attractive Destinations?



Source: Own calculations, based on data from WIR (2005) and JBIC (2004). Figures refer to a country's position among all those considered, from best (at the top) to worst (at the bottom).

Vietnam's ranking is even higher in the eyes of Japanese investors. For the last 15 years, a survey has been conducted in Japan to assess trends of overseas business operations and FDI activities. In 2004, the survey covered 932 manufacturing companies that had three or more foreign affiliates, including at least one manufacturing base. When asked about promising countries for business operations in the medium term, Vietnam ranked number four, worldwide,

after China, Thailand and India. This represents an improvement compared to previous years, although Vietnam has featured high in this survey in recent years.

The main reasons for Japanese survey respondents to select Vietnam were its inexpensive labor force, its potential for growth as a market, its excellent human resources and its potential as a source of risk diversification. Interestingly, two of these reasons, namely the quality of the workforce and the cost of labor, are not among the indicators considered by the World Competitiveness Index, the Doing Business Index, or the FDI Potential index.

International integration

Another way to assess the competitiveness of the Vietnamese economy is to look at its actual performance in world markets.

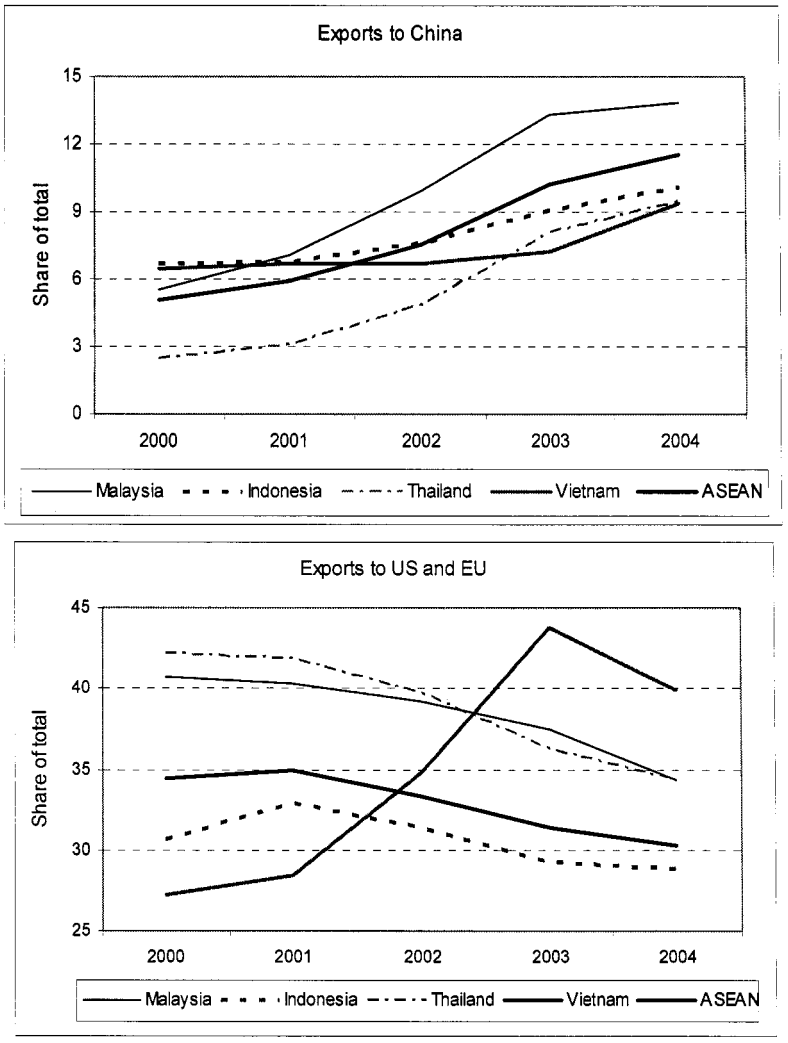
Increased integration in the world economy has been a central objective of the economic reform process in Vietnam. There have been several important milestones in this respect. In 1993, all enterprises with a business license were authorized to engage in foreign trade in the goods specified in their license, without requiring any additional authorization. In 1991, a duty rebate scheme was introduced, enabling export-oriented firms not to pay trade taxes on their imported inputs. In 1995, Vietnam became a member of AFTA. Under this agreement, it committed to reducing tariffs on imports from AFTA members, on all but a few sensitive products, to less than five percent by the year 2006. In 2001, long and protracted negotiations culminated in the signing of the USBTA, which is considered the most comprehensive of all bilateral trading agreements signed between the United States and a developing country. In 2004, the requirement for exporters to surrender foreign exchange to the State Bank of Vietnam (SBV) was abolished, after having considerably weakened in 1999 and 2001. Export duties and import quotas have been gradually dismantled; by now the former only apply to crude oil and scrap metal, and the latter to sugar and refined petroleum products. And it is expected that Vietnam will be able to join the WTO as early as 2006.

The result has been a remarkably open economy, with the sum of exports and imports representing by now more than 130 percent of total GDP. Exports have grown at an average rate of 18 percent per year since 2000. The pessimism that prevailed in some circles before the signing of the USBTA, regarding the prospects for Vietnamese companies to expand exports to the United States, is by now forgotten.

Interestingly, the trade patterns of Vietnam have some resemblance with those of China, a country whose competitiveness is seldom put in doubt (Figure 3.3). China is now seen as the factory of the world, processing raw materials and semi-finished inputs from developing countries, especially in the East Asia region, and selling the output to industrial countries. China's share in ASEAN exports more than doubled between 2000 and 2004; it tripled in the case of Thailand and the Philippines. But not so in Vietnam, where it remained stable until 2003. On the other hand, the share of the United States and the European Union in ASEAN exports declined during this period. Not so in Vietnam, where it tripled between 2000 and 2003, and most likely would have continued growing, had it not been for the textile quotas and anti-dumping procedures imposed by the United States in 2004.

At present, China is a less important market for Vietnam than for ASEAN, while the opposite was true in 2000. Conversely, the United States and the European Union absorb a higher share of exports in the case of Vietnam than in the case of ASEAN; it was the other way around in 2000.

Figure 3.3: More like China, less like ASEAN



Source: Own calculations based on data from WDI (2005).

More generally, Vietnam's main sources of imports are developing countries, while its main export outlets are industrial countries. In 2004, one quarter of Vietnam's imports originated in ASEAN countries, and another 14 percent in China. Japan, the European Union and the United States jointly accounted for only one quarter of Vietnam's imports. But they absorbed more than half of its exports. In a way, Vietnam has also become one of the factories of the world.

Domestic integration

One relevant question is whether global integration touches in any way the vast majority of Vietnamese businesses which are not directly involved in international trade. If it does not, then it would be difficult to claim that the Vietnamese economy as a whole is competitive.

The emerging private sector is still, to a large extent, inward-oriented. Based on the three-wave survey of SMEs by ILSSA, only 9 percent of the sales correspond to direct exports. Most of this fraction is accounted for by firms in Hanoi, Haiphong and HCMC, with the figure being much lower elsewhere in the country. Moreover, exports are not being processed through indirect channels either. For instance, state trading agencies only absorb 1 percent of all sales by SMEs. This inward orientation is worrisome, given that the labor productivity of the average exporting enterprise is nearly twice as high as the average productivity of SMEs.

However, there are mechanisms linking non-exporting businesses with world markets and ensuring the transmission of international price signals from ports and airports all the way to farms. Those mechanisms are often referred to as "value chains", and can traced from producers, collectors, processors, wholesalers, retailers and exporters. Value chains in rice and tea have been the subject of careful studies in Vietnam (Box 3.1). One pattern that emerges from these studies is the reliance on trading through SOEs, which results in an emphasis on volume, as opposed to quality. A stronger involvement of the private sector in the supply chains could help identify new overseas partners and establish higher quality standards. In this way, Vietnam could move up the ladder in world markets, and farmers (which tend to be poorer than the population at large) could appropriate more of the export value.

Business-to-business transactions contribute to the integration of domestic markets in other sectors as well. A small survey of enterprises conducted by the World Bank shed some light on the relationship between contractors and suppliers in Vietnam. Detailed interviews were conducted in nine large SOEs and 11 FDI companies on the contractors' side, and in 10 small SOEs and 11 private domestic enterprises on the suppliers' side. It appeared that for a third of the contractors, the value of the inputs purchased was equivalent to more than half of their total revenue. The process typically involved a large number of sub-contracts (more than 300 a year, on average) with many different parties. The commercial relationship was even more important when seen from the suppliers' end. On average, suppliers generated two thirds of their total turnover out of these business-to-business transactions. But the entire annual revenue was generated through the contracting process for one third of the suppliers.

Patterns are similar in the three-wave survey of SMEs conducted by ILSSA. The time dimension of this survey reveals that non-state enterprises have become much more important customers, especially in Hanoi. Their share of sales doubled between 1991 and 2002. By now they account for about half of the suppliers' turnover. SOEs diminished somewhat in importance but the most remarkable change was the almost complete disappearance of that state trading companies from the picture, not only in Hanoi but nationwide. Production on advance order is the most common mode of business-to-business contracting. But the percentage of enterprises always selling on the security of an order has decreased. By now, in HCMC a third of the enterprises never sell on order.

Technology spillovers

Foreign firms in Vietnam are not yet considered to be an important source of contracting opportunity, and this raises questions as to their contribution (or lack thereof) to technological development among domestic private enterprises. For instance, more than half of the large FDI and SOE firms interviewed as part of the small survey conducted by the World Bank considered firms located overseas, rather than domestically based companies, to be their most important group of suppliers. Small domestic firms tended to supply other private domestic firms or low-end SOEs, but rarely to FDI companies or to high-end SOEs. A clear illustration is provided by

Fujitsu, which was the largest FDI exporter in 2004. On that year, it recorded sales abroad for over 400 million dollars, but spent 94 percent of this amount on imported inputs. Unlike other East Asian countries at an early stage of their industrialization, it would appear that Vietnam has not integrated well its exporters with its local producers.

Box 3.1: Linking Farmers to World Markets

The production and commercialization of rice and tea affects, in one way or another, a substantial share of the Vietnamese population. Some 10.3 million households cultivate rice. About 400,000 households are involved in growing tea; many of them are from ethnic minorities.

In the case of rice, a high share of the export price (about 80 percent) is appropriated by farmers, but the export price is not particularly high. Vietnam is indeed the second largest exporter of rice in terms of volume, but only the fourth in terms of revenue. The main reason for the low price is the large proportion of "broken rice" in total production. This is partly the result of a very fragmented rice-processing system, leading to the mixing of paddy varieties by a large number of small de-huskers. Mixing reduces the incentives for farmers to supply high-quality, less-breakable paddy. Other reasons contributing to the low quality of rice are the outdated technology of small domestic millers and processors, the preferential access of state-owned mills to government contracts and credit, a government focus on export volumes rather than quality, and the lack of appropriate seed standards.

Several measures can be identified to add further value to the rice chain. Improving infrastructure would reduce transport costs, and bring farm-gate prices even closer to world prices. The promotion of farmer organizations that can negotiate on quality and price with millers and traders, would be another important measure. Proper commercial incentives could help improve the quality of rice seed. Finally, the development of niche products such as aromatic rice, organic rice, and varieties well adapted to the uplands could also lead to higher export prices.

In the case of tea, on the other hand, barely more than 40 percent of the export price is appropriated by farmers. The analysis shows that yields are low, product quality is poor, and transaction costs in distribution are high. Two main supply channels operate in parallel. Some farmers produce directly for export markets, through contracts with traders and processors. Many of these farmers lease their land from a processing company, under the condition that they only grow tea on it, and have to sell it later to the company. However, about 90 of the farmers are "unlinked" and operate through a second channel, which consists of selling their tea on a free market, without any coordination or linkage to buyers. The final step in the chain, the export of tea, traditionally took place through SOEs. However, since 2003 a growing share of exports is conducted through the private sector.

Contract farmers tend to have lower production costs than unlinked farmers. In addition, they have somewhat higher yields and profits. Contract farmers also enjoy other important benefits such as stable sales and prices, and technical training, inputs and credit. Unlinked farmers, by contrast, are constrained by limited access to high-value markets.

As unlinked farmers form the bulk of tea growers in Vietnam, and many of them are poor, an important way forward for them appears to be closer integration in the value chain. Collective action, channeled through producer associations, could help develop better links with processors and traders, from a stronger bargaining position, so as to shift towards higher quality levels and to mobilize capital accordingly. The private sector can also play a major role by establishing clear quality standards across the value chain. Improvements in the marketing of tea products are needed as well. But this will require the identification of new overseas partners. Tapping the growing domestic demand for specialty teas would also contribute to diversify output and reduce risk.

Source: Based on Agrifood Consulting International (2002), Arulpragasam and others (2004), and ADB (2005a and 2005b).

To some extent, the bypassing of domestic suppliers is not totally surprising. Increasingly, companies that operate in international markets tend to have a production network transcending national borders. The geography of Vietnam can only support this trend. A Hanoi-based enterprise is 1,400 kilometers away from HCMC, but only 1,000 kilometers away from Bangkok and 800 kilometers away from Guangzhou. Admittedly, a few FDI-dominated industries do have a high rate of local procurement. Motorbike production is a case in point, as some 40 to 80 percent of the procurement of FDI companies is done locally. But even there, the "virtuous circle of assemblers and parts suppliers" has not reached the same level of development as in competitor countries such as Indonesia and Thailand.

However, it is important to keep in mind that business-to-business transactions are only one vehicle for the transmission of best practices in production, management or marketing. Other important channels include quality certifications and outright imitation. Certifications provide an independent quality "stamp" which can go a long way towards reassuring perspective buyers or contractors, regarding the quality standards of the concerned enterprise. Imitation operates through turnover in personnel, as skilled workers move from FDI firms to their local counterparts, and when middle managers of those firms start their own businesses. In both cases, knowledge is transferred through people. But imitation can also be based on outright copying.

Whatever the mechanism, there is some evidence that the higher technological standards of FDI companies are gradually permeating domestic firms, in one way or another (Box 3.2). It also appears that the impact is larger on small and medium private domestic firms, while it seems to be negligible on SOEs. This result needs to be interpreted with caution, as it could be related to the age of the enterprises, rather than to their size or ownership. However, a smaller impact on SOEs is plausible, and this in turn stresses the importance of their restructuring if the country as a whole is to be competitive.

Enterprise restructuring

Ownership transformation has been one of the main mechanisms used so far to restructure the state sector. As more than 2,500 SOEs have gone through this process already, and another 900 should follow over the next couple of years, it is important to assess whether ownership transformation actually leads to a better performance. Assessments of total factor productivity gains across businesses of different sorts, reported in the previous chapter, suggest an affirmative answer. But such assessments should not be taken too literally, because the data are not reliable enough and the methodology can be questioned. A rigorous answer can only be based on an in-depth analysis of the performance of SOEs that were subject to ownership transformation. Fortunately, this analysis exists.

In 2005, CIEM conducted its second post-equitization study, focusing on a sample of 400 SOEs, randomly selected among those which had completed the ownership transformation process at least one year earlier. The sample size was similar to that of the first post-equitization study, which had been conducted in 2002. But the response rate was much higher. In 2002, information could be collected on only 60 percent of the SOEs approached by CIEM; in 2005 the response rate climbed to 94 percent, dispelling concerns that the results could be tainted by a bias in the responses (if respondents were systematically different from non-respondents).

The assessment of the consequences of equitization by survey respondents was overwhelmingly positive. Some 88 of the enterprises declared that their performance was better or much better than before equitization, whereas 9 percent considered that it had not changed

much. Enterprises where the state retained only a minority share were slightly more upbeat in their assessment, but the difference was not statistically significant.

Box 3.2: Learning from FDI Enterprises

A recent econometric study tried to assess whether Vietnamese firms operating in a sector with a large FDI presence were more productive than otherwise similar firms. The study was conducted using detailed data from more than 12,000 firms from GSO's enterprise census of 2001. The sample included 5,673 domestic private firms, 4,895 SOEs and 1,456 FDI companies (both joint ventures and wholly foreign-owned enterprises). The focus of the analysis was on the determinants of value added per worker across firms.

The approach allowed disentangling two different effects of FDI on productivity. One, direct, concerned the gap in productivity between FDI companies and other firms. Not surprisingly, after controlling for other enterprise characteristics, it appeared that FDI companies were indeed more productive than the rest, regardless of whether a majority or a minority of capital was foreign. The gap with domestic firms was biggest in the mechanics and electronics industry.

The other effect, indirect, concerned the gap in productivity between domestic enterprises, depending on the output share of FDI companies in the sectors they were operating in. A fine disaggregation was used for this analysis, with sectors defined at the fourth-digit level of the industrial classification. After discarding observations with missing information, the sample for this analysis consisted of 9,590 domestic enterprises, of which 2,865 in food processing, 1,121 in textiles and garments, and 381 in the mechanics and electronics industry. The results showed a positive impact of the FDI share of sectoral output on the labor productivity of domestic enterprises. The impact was statistically significant in the case of the food processing industry and of textiles and garments.

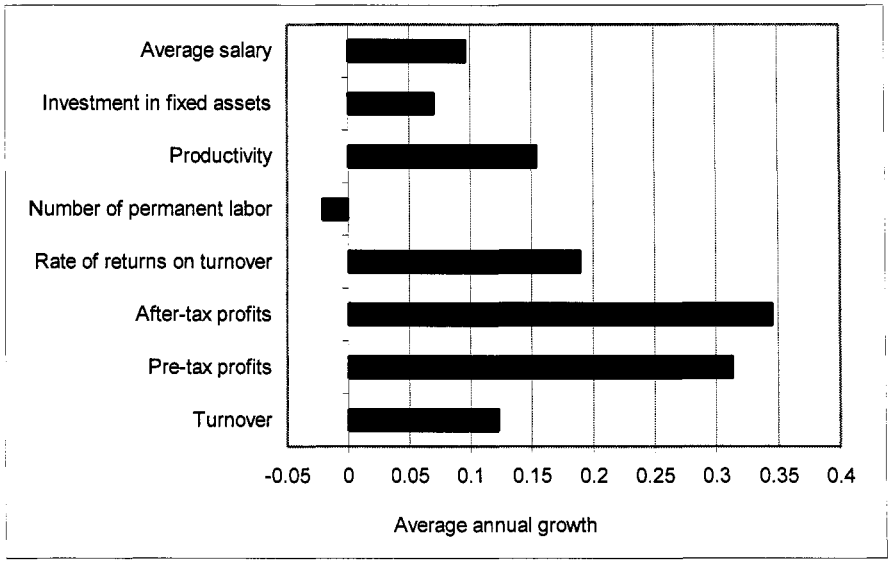
Interesting patterns emerged as well across businesses of different sorts. Within the private sector, the positive impact of FDI presence was larger among SMEs than among large-scale firms. On the other hand, FDI presence had no effect on the productivity of SOEs. These patterns need to be interpreted with caution, as the study did not control for firm age. It could simply be that younger firms are more flexible and responsive than older ones. And younger firms tend to be both private and small.

Assuming that the findings are right, it is interesting to speculate why FDI presence has no impact on SOE productivity. The authors of the study attribute this result to SOEs' lack of management flexibility, in terms of investment decisions and labor management. Such lack of managerial flexibility would prevent them from translating into practice what they learn from the FDI firms operating in their sector.

Source: Based on Anh Thi Tue Nguyen and others (2005).

Objective indicators of performance, measuring the change between the year preceding equitization and 2004 confirm the respondents' views (Figure 3.4). The vast majority of indicators considered improved after equitization; some of them substantially. Only the number of permanent workers declined, but this mainly reflects the initial over-staffing of the equitized SOEs, estimated at around 14 percent of their workforce. By 2004, less than 4 percent of the equitized SOEs were making losses. For the rest, the average rate of return was 17 percent, three times higher than in the year preceding equitization.

Figure 3.4: Key Performance Indicators after Equitization



Source: CIEM and World Bank (2005). Figures are median values across respondents, measured from the year before equitization until 2004.

These results appear to be reliable. In the case of the 2002 survey, it could be argued that the positive assessment resulted from the fact that the "best" SOEs were equitized first. Indeed, in the pilot equitization period, priority was given to the selection of efficient enterprises rather than loss-making enterprises, in order to attract more investors. Equitization could then be seen the result of good performance, rather than the other way around. By now, however, the fraction of loss-making enterprises among those selected for equitization is much higher.

It could also be argued that some of the indicators are over-stated precisely as a result of the policies underlying the equitization process. For instance, the value of investment could be exaggerated due to the necessary asset re-evaluation. And after-tax profits could have grown mainly because of the tax break equitized enterprises get during a period of two to four years. While all this is possibly true, the increase in labor productivity, turnover and pre-tax profits suggests that the improvement in performance is real.

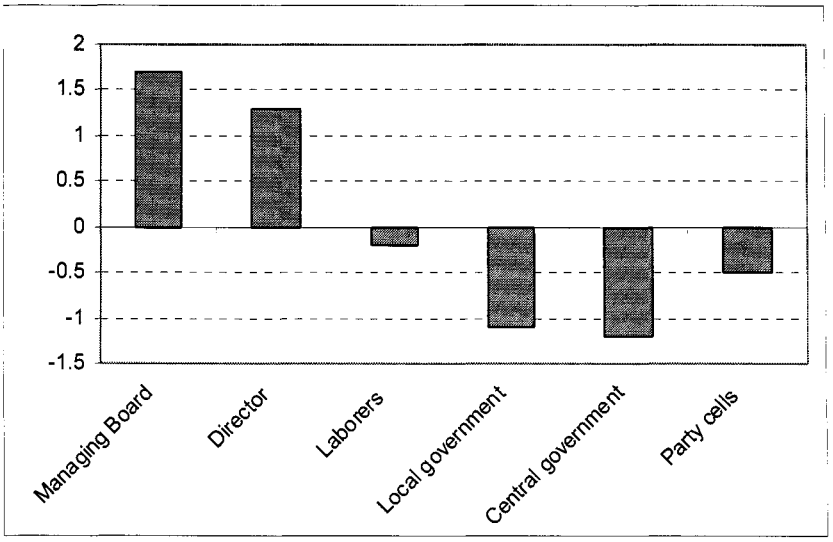
This improvement is not due to a change in the management team of equitized SOEs. In more than 80 percent of the cases, the chairman of the Managing Board, the director, the deputy directors and the chief accountant remained in their jobs. Workers are the main shareholders, and outsiders only hold, on average, 10 percent of the capital of equitized SOEs. Moreover, there is a clear concentration of power, as the chairman of the Managing Board is also, in roughly 70 percent of the cases, the director of the enterprise.

The real change is in the motivation and autonomy of the management team. More than 96 percent of the respondents to the 2005 survey stated that their managers paid more attention to performance, and enjoyed a higher autonomy to pursue profit objectives. This higher autonomy came mainly at the expense of the old supervisory agencies (Figure 3.5).

There are also some indications, though not exceedingly strong, that equitization curtails access to credit from SOCBs. Four fifths of the respondents see no change in the relationship between their enterprise and state agencies such as the tax office, customs or land administration agencies. But the fraction drops to a half when asked about the relationship with banks and

financial organizations. Some 28 percent of the respondents declare that the relationship became more difficult, especially in the case of SOCBs and the DAF.

Figure 3.5: Who Gained Power with Equitization?



Source: CIEM and World Bank (2005). The bars indicate the average score to a question on the changing influence of concerned stakeholders, based on the following options: much more (+2), more (+1), no change (0), less (-1) and much less (-2).

It does not follow that equitization solves all the corporate governance problems faced by these enterprises. Considerable confusion remains regarding asset ownership, especially on the transfer of LUCs, the distinction between land allocation and land lease, and the documentation certifying ownership of the main technological lines. As a result, 38 percent of respondents say that ownership rights are similar to those of non-equitized SOEs, 20 declare that they are similar to those of private enterprises, and a staggering 42 percent answer "both". In practice, land continues to belong to the state, and equitized enterprises cannot use the corresponding LUC as collateral when trying to obtain credit from banks. Which shows that equitization is a model with interwoven features from both SOEs and the private sector.

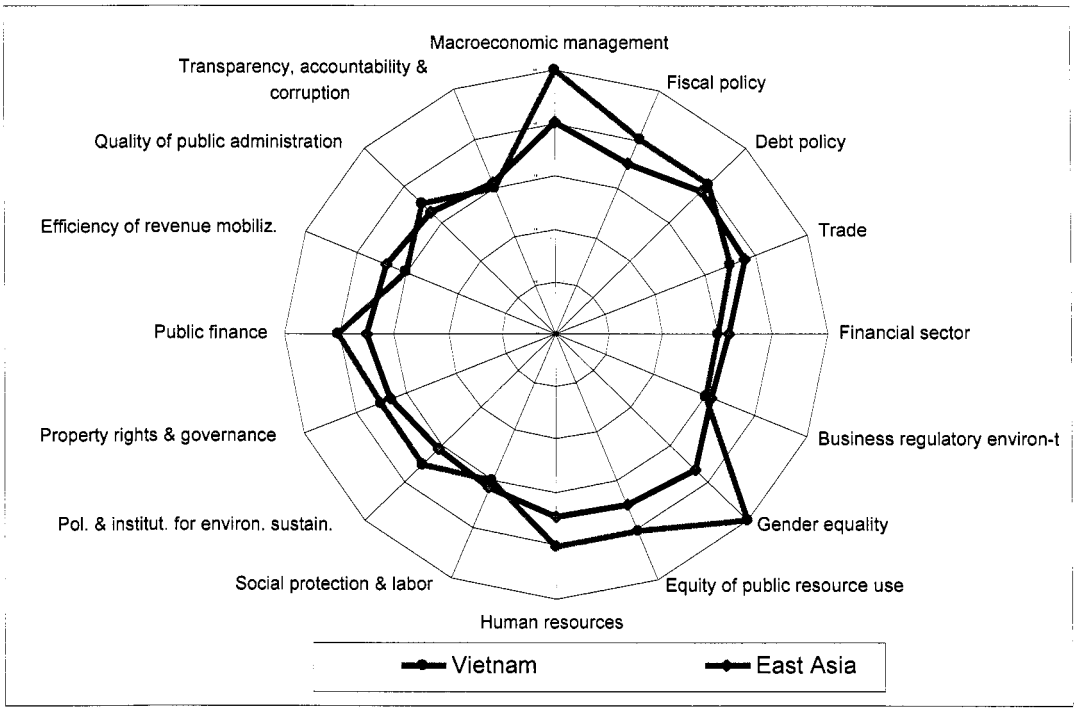
A comprehensive rating

The list of potential determinants of a country's ability to prosper in the global market place is bound to be long. Trying to nail it down to a few key features, such as the regulatory framework firms operate in, is bound to give a partial picture of a country's relative position in the global market place. Productive efficiency and international competitiveness depend on a range of factors, from macroeconomic stability to sound policies for business to high-quality human resources to limited corruption. While it is perfectly legitimate for different cross-country ratings to focus on specific determinants of business performance, a comprehensive assessment of the strengths and weaknesses of a country needs to take them all into account.

Such is the idea behind the so-called Country Policy and Institutional Assessment (CPIA) of the World Bank, and also of similar indices increasingly used by other multilateral and bilateral organizations. The CPIA is a tool to decide how much support a country should be given. CPIA ratings are reviewed on an annual basis. A high CPIA is in principle associated with potentially better economic performance, which in turn could make foreign aid more effective. Regardless of its aid implications, a rating that is considered a reasonable predictor of economic performance could arguably be used to identify a country's strengths and weaknesses, and to produce an overall rating for its position among other developing countries.

The CPIA covers four main areas. These are: macroeconomic management, structural reform, social inclusion and equity, and public sector management and institutions. Each of these four areas is disaggregated into a series of more specific indicators. Thus, macroeconomic management includes macroeconomic stability, fiscal policy and debt policy. Structural reform refers to trade integration, financial sector policies and the business regulatory environment. Policies for social inclusion and equity consider gender equality, equity in the use of public resources, human resource development, social protection and labor and environmental sustainability. Finally, public sector management and institutions covers property rights and governance, budgetary and financial management, the efficiency of revenue mobilization, the quality of public administration, and transparency, accountability and corruption. Therefore, the CPIA includes 16 indicators in total, each of them further disaggregated into a series of specific questions, with examples given for possible answers.

Figure 3.6: Vietnam's Strengths and Weaknesses



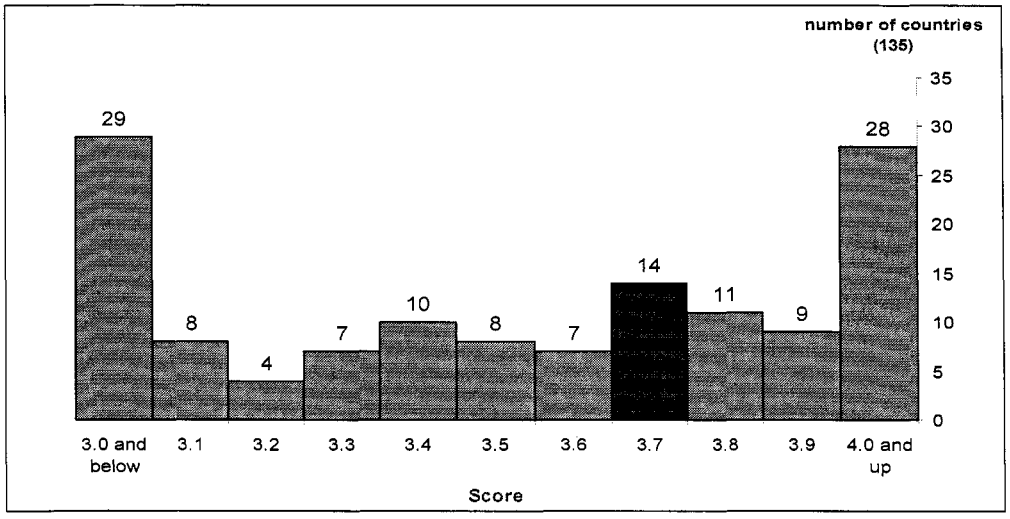
Source: Based on data from the World Bank.

A rating from one to five is thus generated for each of the 16 indicators in the four policy areas, with five meaning highly satisfactory and one meaning unsatisfactory. The specific

questions behind each of the 16 indicators are answered by the World Bank teams working on each (and often in each) of the countries, but subject to a vetting process aimed at strengthening international comparability. As a first step, the process involves benchmarking with respect to two countries in each region. While not being perfect, the CPIA is by now one of the most reliable cross-country rating systems available. When considered on an indicator-by-indicator basis, the resulting ratings help identify a country's strengths and weakness. When taken together, under the form of an aggregate rating, the provide information on the country's relative position in the world.

Disaggregated CPIA ratings suggest Vietnam's main strengths are in macroeconomic management and in fiscal policies. Public financial management gets relatively high ratings too. Vietnam also does well in the social area, including gender equality, the equity in the use of public resources and the quality of its human resources. But Vietnam still has important weaknesses. One of them is structural reform: ratings are low for trade policies, the financial sector and the regulatory environment for businesses. Vietnam's other weakness concerns the institutional area, with the ratings on the efficiency of revenue mobilization, on transparency, accountability and corruption, and on social protection, being below the average for other East Asian countries (Figure 3.6).

Figure 3.7: Vietnam Ratings in International Perspective



Source: Based on data from the World Bank.

As for the overall rating, in 2004 Vietnam scored 3.7 in a scale from one to five. Among the 135 developing countries and transition economies for which the CPIA was computed, there were another 13 with the same rating as Vietnam, and 38 with higher ratings. In relative terms, this means that Vietnam is somewhere between the 36th and the 51st percentiles of the worldwide distribution (Figure 3.7). But its position improves substantially when only the 81 low-income countries in the group are considered, as only 13 of them score higher than 3.7. Within this group of countries, Vietnam falls between the 10th and the 22nd percentile, or roughly in the second decile of the distribution.

4. THE INVESTMENT CLIMATE

For Vietnam's business sector to continue its expansion, and support the attainment of development objectives such as economic growth and poverty reduction, it is necessary to remove the constraints faced by enterprises. Some of those constraints can be identified through quantitative analysis; for instance, on the determinants of productivity gains over time, or on competitiveness ratings across countries. However, much the same as a poverty assessment lacks credibility if the poor have not been heard, an evaluation of the investment climate requires listening to entrepreneurs. A recently completed investment climate survey for Vietnam, with a representative sample made of domestic private enterprises, SOEs and foreign companies, allows benchmarking the constraints they face. For more than one third of the respondents, access to credit is reported as a major or severe obstacle to business growth; access to land is the second most important constraint; insufficient skills and education of the workforce, and poor transportation infrastructure, rank third and fourth. In all four cases (except maybe for skills) the severity of the constraints is significantly higher in Vietnam than in the rest of the East Asia region or in the rest of the world. On the other hand, some of the issues emphasized by competitiveness rankings, such as the legal system, bureaucratic procedures and corruption, are downplayed by respondents. The ability to conduct business-to-business transactions on a trust basis, or using rudimentary but reliable enforcement mechanisms, may explain the low importance attached to the legal system. The considerable simplification of procedures introduced in 2000, and reinforced through mechanisms like OSSs, could account for the downplaying of bureaucracy and red tape. The lack of importance attached to corruption is more unexpected. This result is further probed using a variety of sources. They all yield a consistent picture, one where corruption directly affecting businesses is quite prevalent, but petty. But this is not to ignore other modalities of corruption in Vietnam, as in SOEs and in public investment projects; these other modalities may not affect businesses directly but they do undermine governance and society more broadly.

The views of entrepreneurs

Investment climate assessments draw on the experience of businesses in operation to pinpoint the areas where reform is most needed. Their cornerstone is the ICS, typically produced by the World Bank and ADB in partnership with a local research institution. The ICS asks entrepreneurs in developing countries about the difficulties they encounter in starting and running a business; and, if the business fails, in exiting. It also captures their experience in a range of areas: financing, governance, regulation, tax policy, labor relations, conflict resolution, infrastructure services, supplies and marketing, technology and training. All these are areas where difficulties can add substantially to the costs of doing business. The ICS attempts to quantify these costs using objective measures, such as monetary costs or time.

The ICS for Vietnam, conducted by the International Development Center of Japan and Concetti in the summer of 2005, has one of the biggest samples in the world. It comprises 1,150 firms, located in 25 provinces across five of the eight regions of the country, which gives it an

unusual regional coverage. Among 58 surveys of this type completed so far, only those for China (3,948 enterprises), India (2,722), Brazil (1,642) and Thailand (1,385) had bigger samples.

In preparing the ICS, the overall enterprise population of Vietnam was first identified, by combining GSO's enterprise censuses with data on business registrations from NBIC and data from provincial tax authorities. This led to a listing of more than 60,000 enterprises in operation by 2004. Within this population, the target of the ICS were manufacturing firms with at least 10 employees in the Red River Delta, the North Central Coast, the South Central Coast, the Southeast and the Mekong River Delta. This represents a total of 9,632 enterprises, including foreign direct invested companies, private firms, un-restructured SOEs and equitized SOEs.

Table 4.1: Binding Constraints in Vietnam and Elsewhere

Constraint	East Asia	Vietnam	The World
Access to finance	17.4 **	37.4	30.1 **
Access to land	9.9 **	26.4	14.5 **
Labor skills and education	23.8	22.3	20.4 *
Transportation	15.2 **	21.6	12.4 **
Cost of finance	20.2	21.3	36.1 **
Macroeconomic instability	34.1 **	16.8	40.2 **
Electricity	24.4 **	15.7	24.4 **
Policy uncertainty	32.5 **	14.7	40.2 **
Tax rates	28.2 **	13.8	40.5 **
Corruption	28.6 **	12.8	36.8 **
Customs and trade regulation	20.1 **	12.5	21.6 **
Anti-competitive behavior	21.6 **	12.3	29.7 **
Labor relations	17.4 **	10.9	17.3 **
Tax administration	22.4 **	8.7	32.4 **
Telecommunications	12.9 **	6.5	10.3 **
Legal system	27.3 **	5.5	21.6 **
Crime and theft	19.3 **	4.0	25.7 **
Licenses and permits	14.4 **	1.4	15.9 **

Source: ICS database of the World Bank, using un-weighted averages. Figures indicate the percentage of firms which consider that the constraint is either major or severe. Figures for East Asia are based on observations from Cambodia, China, Indonesia, Malaysia, the Philippines and Thailand. Figures for the world include 57 developing countries and transition economies, but exclude Vietnam. An asterisk indicates that the figure is statistically different from that for Vietnam at the 90 percent confidence level; two asterisks indicate 99 percent confidence.

The wealth of the responses is such that an entire, separate volume is devoted to their interpretation. Here, it is useful to focus on what is perceived as "severe" or "major" constraints for the growth of business, out of a list including 18 possibilities (Table 4.1). The top constraint in Vietnam is access to finance; it was identified as a severe or major obstacle to business growth

by more than 37 percent of respondents. At 26 percent, the second most important constraint is access to land. Next come labor skills and transportation. These are in fact the only four cases in which constraints appear to be more severe than elsewhere in the region, or across all developing counties. To be precise, the skills constraint is only marginally more important in Vietnam than it is worldwide; and it is not more severe (in statistical terms) than in other East Asian countries. As for the other three top constraints, their high ratings are not surprising, as they clearly match anecdotal assessments. It should be noted that the top four constraints are the subject of the second part of this report, whose chapters focus on land, finance, labor and infrastructure.

All other constraints are significantly less severe in Vietnam than in the region or across all developing countries, some of them by a vast margin. Again, in many cases the low ratings could be expected. For instance, most observers would agree that Vietnam is characterized by macroeconomic stability, low crime, and predictable government policies. It is also clear that enormous progress has been made in terms of increasing access to electricity and telecommunication services, and reducing their cost. However, the rating for some of the constraints defies the conventional wisdom. This is the case, in particular, for the legal system, licenses and permits, and corruption. Because of the importance attached to these constraints in the public discourse, a closer examination is warranted.

Property rights

Only 5.5 percent of ICS respondents see the legal system as a severe or a major constraint in Vietnam, compared to about a quarter elsewhere in the region or in the world. This is despite the fact, widely recognized, that Vietnam still has enormous legal development needs, and a poorly functioning judiciary. Enforcing a contract through the courts would actually be considered a hopeless endeavor by many. Which casts doubts on the effective protection of property rights in Vietnam: how can commercial obligations be honored, or assets transferred, if a written contracts has little more legal value than a piece of paper? In light of the obvious weaknesses of the legal system, why do so few entrepreneurs rate it as a severe or major constraint? One possible answer is that the enforcement of property rights operates through more informal, but not dramatically less effective mechanisms. Two examples stand out in this respect; they refer to business-to-business transactions and to land sales.

The small-scale survey of enterprises conducted by the World Bank, mentioned in previous chapters, allowed analyzing in detail how business-to-business deals are conducted in Vietnam. All the firms in the survey do indeed use some form of written contract to formalize their deals. However, none of them places much faith in the ultimate legal enforcement power of those contacts, nor do they seriously entertain the possibility of resorting to legal action if the other party violates its obligations. The main purpose of the contracts seems to be to minimize the room for misunderstanding between the parties. And although very few firms adhere strictly to their terms, suppliers generally attempt to fulfill them. They do so for the sake of building their reputation and boost the goodwill of the contractor, rather than because they are concerned about the possibility of any legal consequences of a breach.

Reputation, through repeated interaction, is the cornerstone of business-to-business deals in Vietnam. In virtually all cases, contractors and suppliers have known each other for a number of years, usually several times longer than the term of their business deal. In the small-scale survey, 98 percent of the contracts were with suppliers that the contracting firm had known for three or more years, whereas the longest contractual agreement was for 12 months.

Apart from carefully selecting their counterparts, the contractors in the sample use a range of mitigation strategies to protect themselves from a contract breach. For instance, they keep their contracts relatively short-term, with an option to renew. This is to limit exposure, but also to provide an incentive for the supplier to perform, in the expectation of getting a new contract. Contractors also limit the size of individual contracts, and diversify suppliers wherever possible. They tend to transfer the financial risk to the supplier, by withholding payments until the terms of the contract are fulfilled. In some cases, contractors even withhold payments on previous contracts, as a device to guarantee the timing and quality of the delivery. And they often use guaranteed accounts (effectively frozen deposit accounts in commercial banks) to ensure that parties abide by their commitments.

Box 4.1: A Market without Property Rights: Real Estate in HCMC

In HCMC several newspapers were posting real estate advertisements as early as 1993. These listings offer insight into how the market was valuing property, in spite of a very limited legal development. Some sellers advertised that their property had *giay to hop le* (literally meaning "legal papers"), others that it had *chu quyen tu nhan* ("house ownership") and others mentioned both. "Legal papers" are documents that can be used to apply for a title, under the form of a Building Ownership and LUC. The process involves several administrative steps, through various levels of government, and requires the payment of official and unofficial fees.

An analysis of the determinants of listed prices was conducted based on a compilation of listing from *Tuoi Tre*, the leading newspaper in HCMC. *Tuoi Tre* began a real estate section after the Land Law established private transferable land-use rights. While in the beginning there were few listings, their number increased rapidly over the years. Some of them were posted by development companies and land brokers; but a vast majority was by owners.

The information provided by sellers in the advertisements includes the address of the property, the dimensions of the house and land parcel, the number of floors and bedrooms, whether it is connected to water, electricity, and phone, whether it has a yard, its number of toilets, its proximity to markets and schools, whether the ground floor is convenient for commercial activities, and whether the property is in a quiet and safe neighborhood. Many also indicate their property rights status.

The data analysis was based on listings from the spring and fall of every year between 1998 and 2001. The results are plausible. Prices increase with proximity to the city center, with the size of the house, with its proximity to the street, with amenities such as toilet and telephone, and with the quality of the neighborhood. Prices also increase over time, reflecting the upward trend in HCMC and other urban areas of Vietnam. The mention of any kind of legal documentation is associated with higher property prices; on average, by seven percent. However, properties having both a title and "legal papers" have list prices which are significantly higher than those of properties offering having only a title, even after controlling for all other characteristics.

This result would not make any sense in a western legal environment, where the title is all that matters. The fact that "legal papers" add to the value of the property shows that the title is just one among several documents helping make a case out of courts, mainly with neighbors and local government authorities.

Source: Based on Annette Kim (2004).

From a Western perspective, it is equally surprising to learn that many land transactions in Vietnam involve no contract. In the western legal context, there is an entire institutional

apparatus where a set of private professionals (including insurers, lawyers, brokers and notaries) make sure that the property title is clear before buyers and sellers can transact. But in Vietnam the real estate market emerged, and boomed, despite incomplete legal titling. In the absence of alternative institutions, a majority of property disputes is negotiated with neighborhood block committees and ward officials, under the guidance of accepted social norms. So, in effect, one has property rights over land if neighbors and local government officials agree. Possessing more documentation on the property helps in the negotiation with neighbors and local officials. Having an LUC is better than having just "legal papers", and the latter are still better than nothing at all. But in the end, there is a market price for every piece of real estate. The price is higher when "legal papers" of one sort or another are available. But it does not drop to zero in their absence (Box 4.1).

However, it is by no means clear that larger business transactions can be conducted in the same way. For instance, investors willing to launch large housing and development projects would be reluctant to operate on "legal papers" only. The lack of a modern legal and judiciary system may not be a major problem for small transactions, where trust-based mechanisms do well, and for large firms, which can get more direct access to government if needed. But it is probably an obstacle for small businesses to grow, and fill the "missing middle".

Bureaucracy and red tape

A mere 1 percent of the ICS respondents in Vietnam see licenses and permits as a "severe" or a "major" constraint, compared to an average of about 15 percent elsewhere, both in the region and across all developing countries. This positive perception is a testimony to the dramatic simplifications in business registration introduced by the Enterprise Law of 2000. This law also led to a considerable reduction in the number of licenses in force. The positive perception on licenses and permits might be also reflecting the success in introducing the OSS model for administrative procedures at the local level. But it still defies the conventional wisdom.

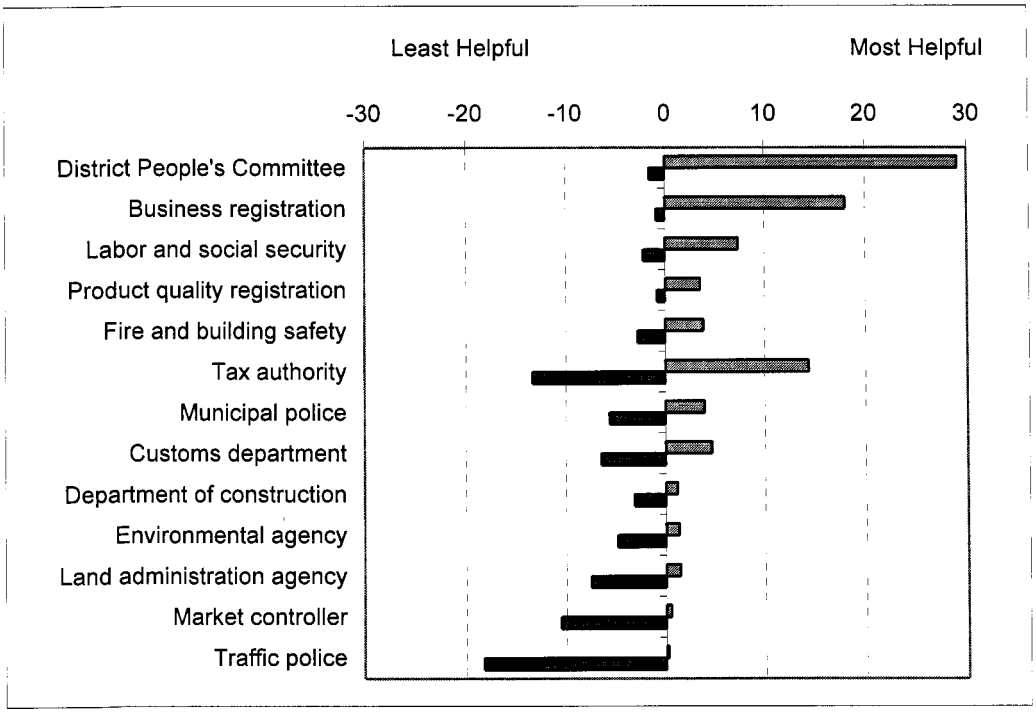
To some extent, the gap between the ICS responses and the conventional wisdom could just be semantic. For instance, a survey of enterprises jointly conducted by CIEM and the German Agency for Technical Cooperation (Gesellschaft fur Technische Zusammenarbeit, GTZ) suggests that before an enterprise can be in operation, it needs to go through 13 administrative procedures, taking 260 days altogether. However, 231 days in this estimate correspond to the time needed to acquire land, under the assumption that the enterprise wants to purchase it from the government and needs to go through land clearance and compensation of resettled populations. Getting land in an industrial zone would reduce the waiting period, on average, from 231 days to 83. And delays would be much shorter if the land was purchased or rented from other enterprises. As regards the more narrow business registration process, the Enterprise Law requires its completion within 15 days. The CIEM-GTZ study found that this deadline was respected in two thirds of the cases, with only 5 percent of enterprises having to wait for 30 days or more. In many provinces the registration process was actually completed in less than one week. Similarly, 70 percent of the companies surveyed received their tax code within seven days, and only 6 percent of them had to wait for more than 15 days. This kind of expeditious administrative response is probably what ICS respondents have in mind, whereas the 231 additional days are likely seen as a severe or major constraint in having access to land, not in registration or licensing.

Findings were similar in the three-round survey of SMEs conducted by ILSSA, already mentioned in previous chapters. An impressive 97 percent of the manufacturing firms covered by

this survey reported that licensing and operating permits were either no obstacle or only a minor obstacle to their business. On average, only five to six days per year were lost to administrative procedures. Also, few respondents saw cumbersome governmental regulations and official attitudes as a severe burden. On the contrary, about 61 percent of urban enterprises had received some form of assistance from the government, mainly under the form of help with application and registration formalities.

The relative cordiality of government agencies is actually one of the salient findings of the ICS for Vietnam. Respondents were asked to choose, among a long list of options, the two agencies which had been the most supportive, and the two which had been the least helpful. At one end of the spectrum, District People's Committees were perceived as the friendliest, followed by the Business Registration and Licensing offices under DPI. The traffic police came at the other end (Figure 4.1). The perception was quite negative about the Customs Department as well. In between, the two extremes, the Tax Authority was seen as most supportive by some respondents, and as least helpful by others.

Figure 4.1: Government Agencies: Friends or Foes?



Source: Based on ICS by the World Bank.

Tax officials are seldom popular, anywhere in the world, which makes the mixed views about them in Vietnam somewhat intriguing. One possibility is that they are willing to keep tax payments down, maybe in exchange for "gifts". Indeed, it is generally believed that the amount of taxes payable by businesses in Vietnam is determined through negotiations with tax officials. However, the ICS does not confirm this presumption, as most respondents declare that the tax was either completely or largely determined by the firm itself. In addition, aggregate data contradicts the idea that tax payments are set at low levels. The "productivity" of Vietnam's

VAT, meaning the revenue obtained for each point of the main VAT rate, is among the highest in the world. The productivity of CIT is about average. The reason why so many ICS respondents find the tax department helpful is therefore unclear.

The very low percentage of ICS respondents who see licenses and permits as a serious constraint also clashes with the perception that their number has been increasing surreptitiously in recent years. The Enterprise Law led to the removal of 159 licenses of all sorts; it also limited the power to introduce new ones to a narrow list of national authorities. However, this has created some confusion. For some, "license" refers to any type of document issued by a competent authority that enterprises are required to obtain in order to legally conduct their business activities. Permits, certifications, authorizations, approvals, attestations and the like, all fall under this broad definition. The vagueness of the concept makes it difficult to determine whether "licenses" are indeed making a discrete comeback in recent years. According to an estimate by VCCI, they are. From 194 licenses in force in 2002, their number would have increased to 246 in 2003 and to 298 in 2004. Moreover, 55 percent of these licenses were apparently issued by provincial authorities, and another 22 percent by local authorities at district, commune and village levels, which seems to contradict the Enterprise Law of 2000.

It is still possible to reconcile this upward trend with the low percentage of ICS respondents who see licenses and permits as a serious constraint. To begin with, at around 300, their number would be low by international standards. For instance, the radical regulatory reform introduced by Korea in the aftermath of the East Asian crisis slashed the number of business regulations by half; but there were still 6,308 of them in force once the process was completed. Also, some of the licenses and permits are sensible. Thus, a concrete mixer struck serving construction sites in Hanoi needs a license to circulate in the city (and only at night). This license is issued for each construction site and is valid for one month only. This is a common practice in other countries.

Other licenses are clearly questionable, especially in the services sector. In areas such as accounting, professionals with university diplomas are required to get further accreditations, including weeks of mandatory training, before being authorized to work. Barriers of this sort may be downplayed in the ICS survey because of its focus on enterprises in manufacturing.

Corruption

Perhaps the most surprising result of the ICS for Vietnam is the relatively low importance attached by respondents to corruption. In 2005, the Corruption Perceptions Index of Transparency International gave a rating of 2.6 to Vietnam, on a scale of one to 10 where 10 corresponds to the highest integrity standards. Most other countries in the region got higher grades, including Malaysia (5.1), Korea (5.0), Thailand (3.8), Laos (3.3) and China (3.2). Only the Philippines (2.5) and Indonesia (2.2) appeared to be more corrupt. Yet, according to the ICS, corruption is less severe in Vietnam than in any other developing country in the region, save Malaysia (Table 4.2). Can this inverse ranking be trusted?

One possibility is that entrepreneurs in Vietnam simply have learned how to live with corruption, to the point where they don't see it as a constraint anymore. The ICS uncovers bribes and gifts in dealings with most government agencies. For instance, the average bribe payment is estimated at approximately 3.6 million dong in the case of customs, 3.4 million for tax administration, 1.9 million for the police and for market controllers, 1.4 million in the case of environmental agencies and 1.2 million for business registration and licensing. The average bribe is less than one million dong in the case of district People's Committees, labor and social

security, fire and building safety and construction inspectors. However, many respondents declare that they do not pay bribes.

Table 4.2: Corruption in the East Asia Region

	Is corruption a constraint to business? (percent of responses)		
	No	Minor	Severe or major
Cambodia	4.7	39.4	55.9
China	24.1	48.5	27.3
Indonesia	29.3	29.2	41.5
Malaysia	53.8	31.7	14.5
Philippines	40.6	24.3	35.2
Thailand	49.7	32.1	18.3
Vietnam	52.3	17.8	14.2

Source: ICS database of the World Bank, using un-weighted averages.

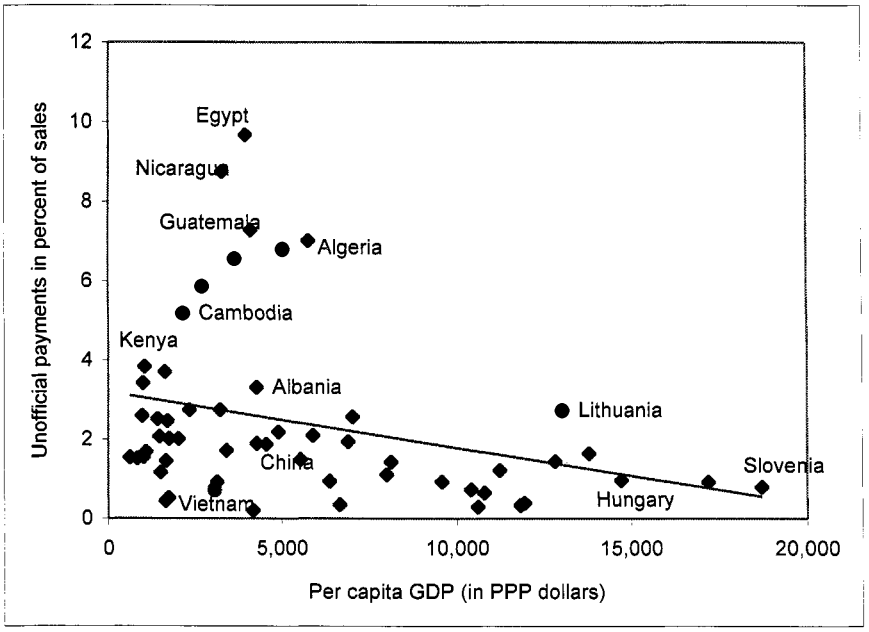
On average across all agencies, taking into account the fact that no unofficial payments are made in many cases, the average bribe is 1.8 million dong. This is consistent with the findings of the pilot corruption diagnostic study by the Internal Affairs Committee of the Party. This diagnostic study is based on the "triangulation" of responses from households, enterprises and government officials. Its enterprise sample was randomly drawn from a population which was similar to the one considered by the ICS. But the overlap between them is probably minimal, or non-existent. The pilot corruption diagnostic study estimates that the average additional cost per transaction ranges from 0.1 to 2.1 million dong.

Some of these payments take place several times a year. Yet, the overall amount of bribes paid by enterprises in Vietnam is not high when compared to other developing countries; certainly not as high as could be expected, given Vietnam's development level (Figure 4.2). From this perspective, the picture that emerges is one of a country where corruption is widespread, but petty.

Another possibility is that the ICS responses in relation to corruption are biased or inaccurate. Yet, there is substantial coincidence between those responses and the findings of several other studies, based on entirely independent data sources. First is a previous, ICS-like survey conducted by MPDF in 2001. Among other possible constraints, the questionnaire asked whether corruption was a severe obstacle, a major one, a minor one or no obstacle at all. The scores associated to these answers were four, three, two and one respectively. The average score for corruption was 2.02, indicating that it was perceived as a minor constraint. Second is the three-round survey of SMEs by ILSSA. Again, "informal fees" did not appear to impose a very heavy burden on business, although about 70 percent of respondents stated that they had paid such fees in the past year. Third is the small survey of enterprises conducted by the World Bank. This survey paid particular attention to inspections and visits by officials from various government agencies, such as the police, firemen, market controllers, officials from information and culture departments, health staff from the labor department, and environmental inspectors. Based on the responses provided by interviewees, MPDF grouped the responses into three broad

categories: demanding, neutral, and undemanding. Only a fifth of the respondents had experienced demanding inspection visits. Finally, there is the survey of women entrepreneurs conducted by MPDF in the summer of 2005. Some 60 percent of respondents declared that racketeering or the need to make informal payments were not an important concern. Overall, then, there is a broad coincidence with the ICS results.

Figure 4.2: Spending on Unofficial Payments and "Gifts"



Source: ICS database of the World Bank, using un-weighted averages.

Further evidence that ICS responses are not biased or inaccurate comes from the resulting ranking of government agencies, according to their levels of corruption. This ranking is strikingly similar to the one emerging from the pilot corruption diagnostic by the Internal Affairs Committee of the Party (Figure 4.3). This, again, gives credibility to the ICS results.

However, these results refer only to corruption modalities directly affecting businesses. They do not cover graft in SOEs or in land conversion, two areas where anecdotal evidence and press reports reveal much more serious problems. They do not refer to public investment projects either, an area where outright corruption might not be as prevalent as it is often claimed, but where collusion by bidders and distribution of public contracts among SOEs remain common practices. Moreover, an average bribe of 1.8 million dong, while small from the point of view of an enterprise, represents an average monthly salary in Vietnam. The implications of generalized corruption of this sort on social morality are not petty by any means. Together with unofficial payments in social services, from allegedly voluntary "private lessons" in education to unaffordable health care, petty corruption of this sort is deeply resented by the Vietnamese population. This can explain the gap between a relatively relaxed business sector, and the perception of generalized corruption reflected in cross-country comparisons like that conducted by Transparency International.

Table 4.3: Which Are The Most Corrupt Government Agencies?

Investment Climate Survey	Corruption Diagnostic Survey
Traffic police	Land administration agency
Customs department	Customs department
Tax department	Traffic police
Land administration agency	Tax department
Market controller	Regulators in construction
Construction permit authorities	Construction permit authorities
Import/ export license authorities	Health care
	Planning and investment agencies
	Regulators in transportation
	Economic police

Source: Based on data from ICS by the World Bank and on Communist Party of Vietnam (2005). In the case of the ICS, rankings are based on the share of respondents declaring that corruption is widespread or gifts are required to get a favorable decision. Only agencies with a share in excess of 5 percent are reported.

A level playing field?

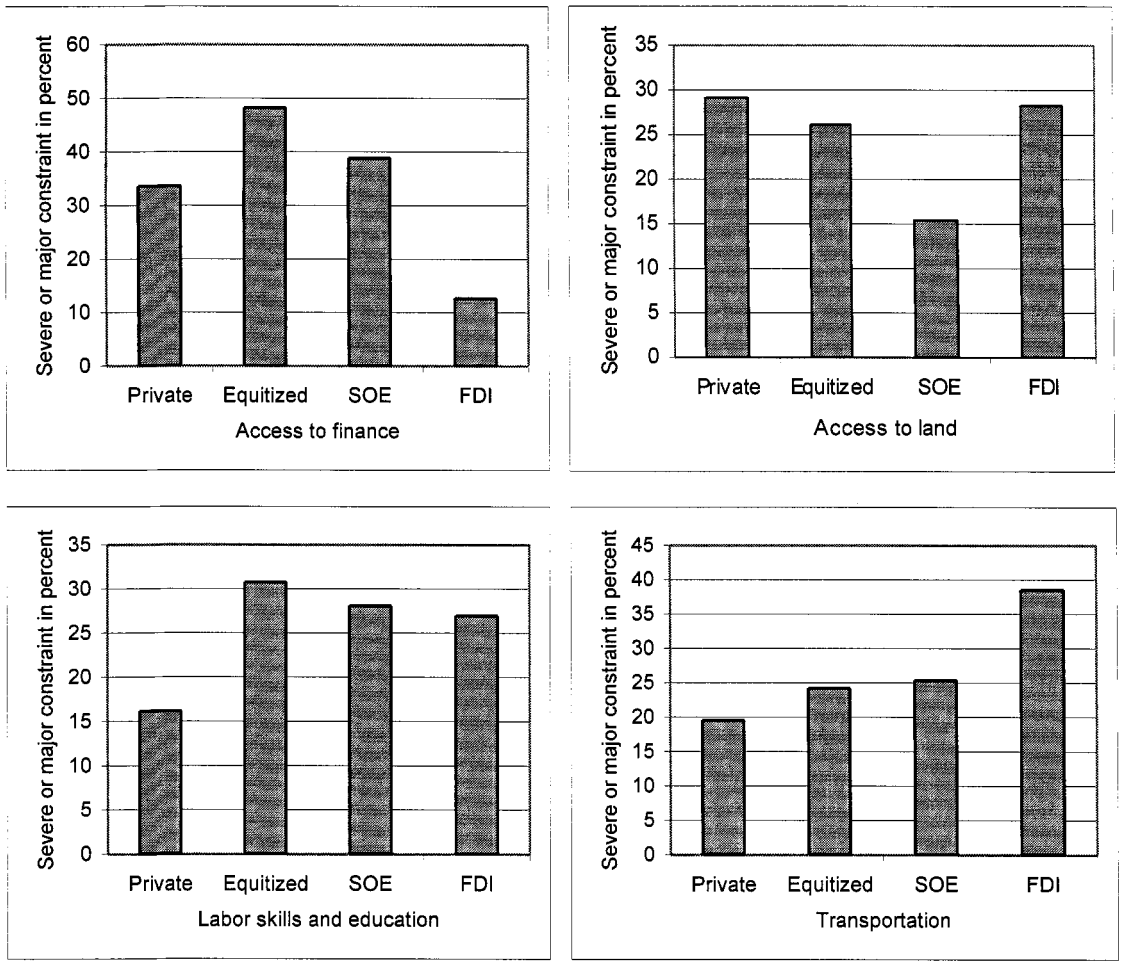
A comparison of binding constraints across enterprises with different ownership structures shows that not all of them experience the same problems (Figure 4.3). Access to finance is not an issue for foreign companies, whereas it affects in a similar way all domestic firms, regardless of whether the state owns some of their capital. Remarkably, equitized enterprises are the ones suffering the most, which suggests that divestiture has been effective at hardening the budget constraint. On the other hand, SOEs are clearly at an advantage compared to all other firms when it comes to access to land. The fraction of private enterprises and foreign companies seeing land as a severe or major constraint is almost twice as high.

Private sector firms are the outlier regarding labor skills. This is a much less severe constraint for them than it is for the other, usually larger businesses. A more limited concern about skills is consistent with a situation of high labor turnover, whereby qualified workers learn on the job in large companies, and especially in foreign ones, and then move into taking jobs with bigger responsibilities in smaller enterprises, or even creating their own. On the other hand, it is foreign companies which appear as outsiders in relation to transportation infrastructure. This may reflect their much higher needs, especially to support timely delivery of their products to world markets. Enterprises operating mainly in a less demanding domestic market might be able to cope better with the constraints imposed by poor infrastructure development.

One important area in which the playing field is not level yet is public procurement. In the ICS questionnaire, this area falls under the broader heading of anti-competitive behavior. And in this respect, Vietnam fares better than other countries in the East Asia region or in the world. But the relatively upbeat assessment of ICS respondents probably says more about the gradual opening of markets to competition, as the country integrates into the global economy,

than about access to public contracts. While public procurement has become increasingly transparent in Vietnam, some areas remain dominated by SOEs. This is the case, in particular, of infrastructure contracts, given that relatively few private enterprises operate in large-scale construction activities. SOEs are increasingly competing with each other, and bidding for projects away from their own provinces. But reliance on common cost norms, and in some cases outright collusion, reduce the efficiency of public markets.

Figure 4.3: Binding Constraints by Enterprise Ownership



Source: ICS database of the World Bank, using weighted averages.

On the other hand, the Common Investment Law (CIL) passed in late 2005 represents a significant step towards leveling the playing field, as it applies to all forms of businesses, regardless of ownership or corporate structure. Until the passage of this law, there were separate investment regimes for foreign companies, for domestic private firms, and for cooperatives. The CIL also encourages private participation in a wider range of sectors, with firms being free to invest in any activity that is not explicitly included in a "negative list." This approach provides greater certainty and clarity to investors than "positive lists."

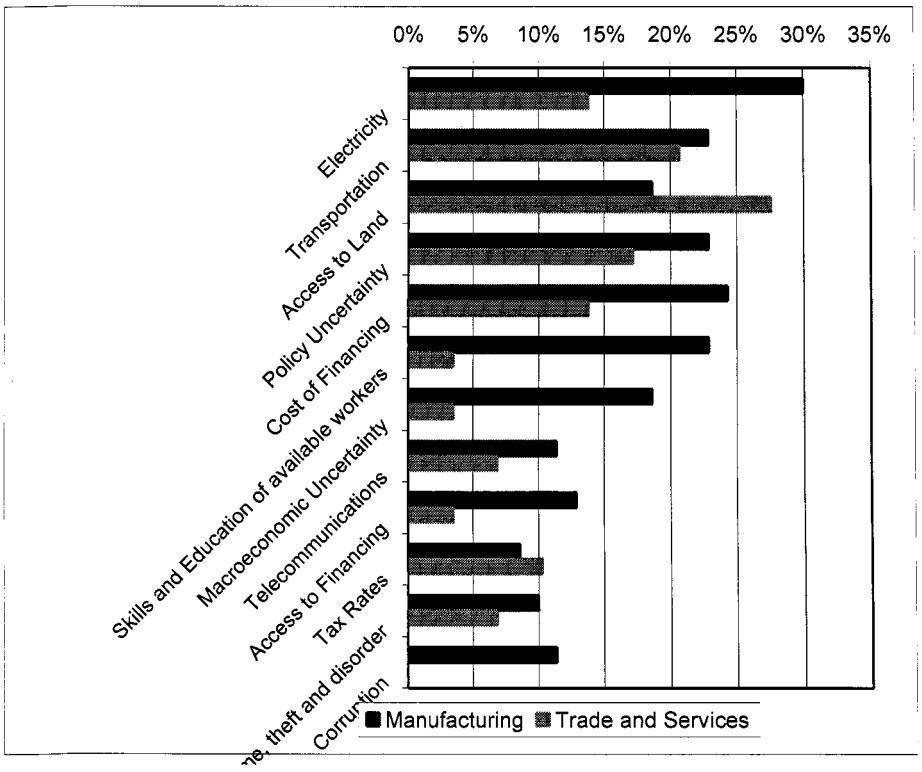
The rural investment climate

Investment climate assessments based on surveys in the spirit of the ICS of the World Bank focus on urban areas. For instance, the ICS for Vietnam included only enterprises with more than 10 employees and was limited to the manufacturing sector. However, there are compelling reasons to pay attention to the investment climate in rural areas as well. That is where most of the poor live, and the creation of wage jobs is one of the main avenues out of poverty. But in addition, the binding constraints to business development could be very different. Rural areas have lower population densities, which make infrastructure and many services costly to maintain. Small enterprises, many of them owned and operated by households, dominate. Markets are less developed and transaction costs are higher. There are also distinct patterns of seasonality, affecting production, employment, accessibility and migration. And services are generally less developed.

Unfortunately, there is very limited experience to date in implementing rural investment climate surveys, with just a precedent in Sri Lanka and ongoing work in Pakistan and Tanzania. In Vietnam, a pilot exercise was conducted during the summer of 2005 in Ha Tay and Vinh Phuc provinces, as a joint endeavor of GSO, VASS and the World Bank. This pilot rural investment climate survey aimed at covering the full spectrum of business activities. It included 100 formally registered enterprises, half of them in manufacturing and the rest in services, some with less than 10 employees. It also included 200 household businesses not formally registered as enterprises, and 100 enterprises which did not have any business. The latter group served to uncover possible constraints preventing business start-ups. The survey was limited to an area defined by GSO as rural. Given the interest in comparing the findings of the rural investment climate assessment with those of the ICS, the questionnaires were kept as similar as possible.

On the surface, the rating of constraints is quite different in rural and urban areas (Figure 4.4). A systematic comparison with the ICS suggests that access to electricity, ambiguous policies, and crime appear to be much more serious constraints for rural businesses than for larger urban ones. For instance, more than two fifths of all formal businesses have a generator to provide back-up during power interruptions. In contrast, access to finance, customs and trade regulations, corruption, and labor issues are more important for rural businesses.

Figure 4.4: Binding Constraints in Rural Areas



Source: Based on pilot Rural Investment Climate Survey by GSO, VASS and the World Bank. Figures indicate the fraction of respondents identifying each of the issues as a severe or major obstacle for running their businesses.

However, this comparison is to some extent deceiving. Households which do not operate a business indicated that the main obstacle for starting one is lack of start-up capital. Limited access to finance was a severe or major constraint for half of the households. As for household businesses, less than one third of them currently have a loan from a financial institution, compared to roughly two thirds of formal enterprises. To obtain the loan, borrowers typically have used land and buildings as a guarantee, but the collateral was worth one to three times the amount of the loan. Credit is typically short terms and mainly used to purchase inputs. Most household businesses without a loan say that they never applied for one. The heavy collateral requirements and the short-term nature of the loans could be among the reasons for limited access to finance among rural entrepreneurs.

Businesses in trade and services, in turn, saw access to land as the biggest obstacle, with 28 percent of them reporting it as a major or severe constraint. About a seventh of respondents said that they had to wait for more than 18 months to get their land requests approved and building permits processed.

Respondents were also asked to describe the attitude and behavior of public officials towards their business establishment. The answers were overwhelmingly positive and many, especially household businesses, were reluctant to give a negative score to any government agency, with the exception of the traffic police. Reluctance to be critical can be due to the fact

that survey was conducted by a government agency (GSO), and not by a private consultancy firm, as the ICS. Still, figures on unofficial payments were consistent with those gathered through the ICS. The median spending on bribes and gifts was 2.0 million dong. Both household businesses and formal enterprises ranked the traffic police as being most corrupt, followed by the customs office. However, only 8 percent of respondents indicated that corruption was a serious constraint for the growth of their business.

PART II: KEY MARKETS AND INPUTS

5. BANKING AND FINANCE

Based on entrepreneurs' own assessment, insufficient access to finance is the most important obstacle to business growth in Vietnam. The share of firms that see it as a "severe" or "major" constraint to their development is also significantly higher than in other countries, either in the region or worldwide. This may come as a surprise, given that Vietnam has achieved a substantial financial deepening over a relatively short period of time. The number of active savings and loan accounts is high for a country at its development level, whereas banking credit has been growing steadily; even too fast, probably, given current deficiencies in the assessment of credit risk. Reconciling perception and facts requires a better understanding of bank lending practices in Vietnam, disentangling who has access to credit and under which terms. Looking forward, it is also clear that the structural weaknesses of the banking system need to be addressed. The poor quality of many loans creates a substantial fiscal burden for the government, aggravated by the absence of effective mechanisms to seize the assets of bad debtors. As for formal capital markets, they are still too under-developed to channel a sizeable volume of resources to new projects. But thriving informal transactions on unlisted stocks raise the prospect of faster capital market development, provided that proper regulations are in place.

Access to credit

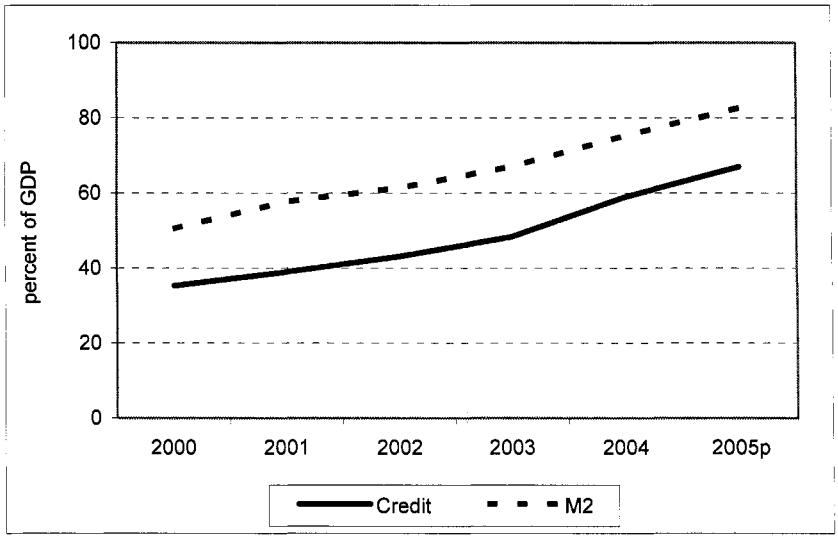
The last decade has been characterized by remarkable financial deepening in Vietnam. In the initial stages of economic transition, banks were mainly serving as government windows to channel resources to SOEs. Among individuals, large transactions were often conducted in gold or in dollars. By contrast, total credit represents now more than 60 percent of GDP, and the figure has been increasing steadily (Figure 5.1). The growth in mobilized deposits has averaged 25 percent per year. It has been twice as large in the case of the Vietnam Bank for Agriculture and Rural Development (VBARD), thanks to its large branch network. The overall monetization of the economy, measured by the standard ratio between the M2 monetary aggregate and GDP, has been increasing steadily as well.

Needless to say, the financial deepening of Vietnam does not match that of its neighbors yet. The ratio of bank credit to GDP is almost twice as high in Thailand, and three times higher in China and Malaysia. But in a way, this is reassuring. The quality of credit in Vietnam is still poor, due to a legacy of policy lending to SOEs, but also to the inability (or the unwillingness) of SOCBs to properly assess the risk associated with loan applications. A relatively modest ratio of credit to GDP means that even if the share of NPLs is high, the problem remains manageable; at least for now.

The depth attained by Vietnam's financial deepening is even more impressive when looking at the fraction of economic units which use the banking system. Based on a rough estimate, there are about 25 million active savings accounts, which is close to the total number of households. This figure was compiled by the World Bank based on annual reports by banks and other sources. The total number of microfinance accounts, including savings and credit, exceeds 9 million, which again is high by international standards.

Semi-formal institutions have played an important role in extending the reach of financial instruments among the population at large. Chiefly among them are the People's Credit Funds (PCFs). Established in 1997, these are commune-level savings and credit cooperatives whose objective is to promote self-help and mutual assistance. Other mechanisms to provide credit at the local level include the National Target Program for Poverty Reduction, and an increasingly large number of microfinance schemes supported by international NGOs.

Figure 5.1: Rapid Financial Deepening



Source: Own estimates, based on data from GSO and SBV.

Nevertheless, the share of these informal and semi-formal mechanisms as a source of credit has gradually declined during the last 10 years, in favor of the formal sector. For instance, VBARD is now responsible for a majority of the loans made to rural households. This was not always so: data from the 1993 Vietnam Living Standards Survey (VLSS) shows that 40 percent of loans in rural areas were from private individuals, 33 percent from private money lenders, and 25 percent only percent from banks and other formal sources.

Another illustration of the extent of formalization is provided by a two-round survey of farm households conducted by Hanoi Agricultural University and the University of Sydney in four provinces: Ha Tay and Yen Bai in the North, and Binh Duong and Can Tho in the South. Roughly 400 households were surveyed in 16 communes, from two districts in each province. Almost two thirds of them had a loan, with formal credit institutions accounting for the bulk of them. On average, about 30 percent of households had borrowed from VBARD, with the share being much higher in Can Tho. Loans from other commercial banks were also common in the southern provinces, but virtually absent in the north. Households in northern provinces relied on a more diverse range of semi-informal credit sources, including PCFs and local mass organizations such as the Farmers' Union and the Women's Union.

As for firms, a survey of nearly 500 women entrepreneurs conducted by MPDF revealed that 80 percent of them had access to external sources of finance, and more than half felt that their access to capital was sufficient to support the continued growth of their businesses. However, private sources of finance, including retained earnings and resources from family and friends,

remained important in their case. Other studies, dealing with household businesses and private enterprises more broadly, uncover some systematic patterns in access to credit (Box 5.1).

Box 5.1: Who Gets Access to Credit?

Combining information on who has had access to loan and who has been denied such access provides useful information on how the credit market actually operates. Comparing the number of successful and unsuccessful borrowers it is possible to assess the extent of credit rationing, which is one of the key mechanisms through which loan applications considered too risky are turned down, even in a well-functioning market. More importantly, this comparison sheds light on the criteria used by lenders to decide whether a loan application is worth supporting. In Vietnam, several studies have attempted to assess the extent of credit rationing, and its determinants.

One of those studies concerned Ba Be district in Bac Kan province, and Yen Chau and Mai Son districts in Son La province. These are poor communities in the mountainous regions of northern Vietnam. In Ba Be district, 57 percent of all households surveyed had applied for a formal loan. And only 15 percent, or less than one third of them, had seen their application turned down. From an international perspective, this relatively low extent of credit rationing in a poor area is somewhat surprising, suggesting a high availability of funding at local levels.

In the same vein, a study conducted in Yen Bai province shows that 67 percent of the households classified as poor had accessed credit in 2000, compared too 41 percent of the "average" group and 34 percent of the "above average" group.

Another study focused on small an medium enterprises from the private sector in four provinces (Ha Tay, Long An, Quang Nam and Phu Tho) and three cities (HCMC, Hanoi and Hai Phong). It revealed that rejected applicants and discouraged borrowers represented only 14 to 25 percent of the sample, depending on the definition of "discouraged". In the absence of credit constraints, the liabilities of the enterprises surveyed would have been 8 to 24 percent higher. Access to credit was more likely among larger enterprises. It also appears that older enterprises get less credit, but this may simply reflect a more limited reliance on external finance, given that it is easier for them to mobilize retained earnings. The study also shows that SMEs obtain credit more frequently when the owner is a man. Consistent with the studies described above, the probability of accessing credit is higher in rural areas. This suggests a deliberate intervention of local governments to support economic development in the poorer parts of the country.

Finally, a database compiled by ADB to study the formalization of economic activities in Vietnam was used to evaluate access to credit among household businesses and private enterprises. The ADB survey had included 20 household businesses and 20 private enterprises in each of two rural provinces with relatively large formal sectors (Dong Thap and Ca Mau), two rural provinces with relatively large informal sectors (Thanh Hoa and Ha Tay) and the two major urban centers of Hanoi and HCMC. The results reveal that the possession of property rights in the form of LUCs has a large impact on access to credit. Only 12 percent of firms without an LUC find it easy or very easy to obtain a loan. The fraction increases to 21 percent for firms with some legal documents on their land, and climbs further to 32 percent for firms with a full LUC. "Connectedness", measured by the fact that the owner of the business had a job in the state sector, has a large impact as well.

Source: Based on Thomas Dufhues and others (2004), Sally P. Marsh and others (2004), John Rand (2005) and Edmund J. Malesky and Markus Taussig (2005).

The characteristics of outstanding loans (as opposed to borrowers) can also be used to shed light on the operation of the credit market in Vietnam. At the low end, credit from microfinance institutions is based on group-lending schemes, also known as joint liability groups. In practice, however, individual borrowers are not held liable for each other. If one member of the group defaults, the only consequence is that the group is deprived from access to credit in the future. But expelling the defaulter from the group is often enough to make it eligible again. This option reduces peer pressure considerably.

The alternative to microfinance, for borrowers at this low-end of the market, is to resort to private moneylenders. No collateral is required in this case. But at 2 percent per month or more, the interest rate represents a substantial charge. By comparison, the interest rate on a formal loan is usually below 1 percent per month.

Households engaged in farming, forestry and fishing can borrow from VBARD without any collateral if the loan does not exceed 10 million dong. However, households are still required to submit their LUCs, which are then retained by the local bank branch as a means of enhancing their "responsibility" to repay the loan. The importance of this type of arrangement at the local level is revealed by the case of the Nghi Loc branch of VBARD, where almost 90 percent of outstanding loans were extended in this way, without involving formal mortgages. In An Giang province, only 15 to 33 percent of the households which held agricultural land had mortgaged their LUCs to obtain loans from VBARD.

At the other end, joint stock banks and SOCBs other than VBARD continue to rely heavily on collateral as the basis for their lending decisions. Only exceptionally is credit appraisal based on an analysis of the applicant's cash flow, or its credit worthiness. However, banks are also aware of the practical difficulties to seize the borrowers' land in the event of a default. Instability in land prices and the inaccuracy of the land boundaries reported in many LUCs also encourage a cautious approach when it comes to valuing the collateral. Some banks have internal rules capping loans at 50 percent of the face value of LUCs. Others only lend against buildings, not against land.

Requirements in terms of collateral value appear to be higher for private firms than for SOEs. Based on the ICS conducted by the World Bank, the average value of the collateral provided by private firms is equivalent to 173 percent of the value of the loan, compared to 130 percent in the case of SOEs. There are signs that SOEs are finding it increasingly harder to get access to finance. According to the ICS, a quarter of SOEs were refused a loan the last time they applied, compared to 10 percent of private firms. However, it could simply be that private firms apply for credit less often, either because they lack the collateral or because they do not expect that commercial banks will support them.

The banking sector

Considering all sources of credit, including private moneylenders as well as friends and relatives, the formal financial sector is responsible for close to two thirds of the financial resources mobilized in Vietnam. Within the formal sector, the four major SOCBs retain a dominant position (Table 5.1). In addition, the DAF, which channels policy lending on behalf of the government, has become a major player, second only to VBARD in size. DAF provides subsidized credit to SOEs and private enterprises, supports the development of infrastructure, and is in charge of the on-lending of the Official Development Assistance (ODA). Even without taking DAF into account, SOCBs still account for 70 percent of total assets in the banking system, and of total banking credit as well.

Table 5.1: Relative Size of Financial Institutions

	Chartered Capital		Outstanding Loans	
	2003	2004	2003	2004
Four large SOCBs	14.53	17.37	214.80	296.07
VBARD	5.45	6.14	87.08	123.47
VCB	2.42	4.03	30.00	46.49
BIDV	3.75	3.87	48.09	64.01
ICB	2.91	3.33	49.63	62.10
DAF	4.98	4.98	64.81	76.93

Source: Based on data from IMF and SBV. Figures are in trillion dong. DAF credit includes state lending, short-term export loans and ODA on-lending.

There are also 36 joint stock banks (JSBs), accounting for about 15 percent ot total credit and 5 percent of the total chartered capital in the banking system. Their customer base is mainly made of small and medium enterprises. In spite of a period of restructuring around 2001, several JSBs are weak. But others have become clear front-runners in the market and are seen as models for bank transformation in Vietnam. These JSBs have also focused on improving operations, corporate governance, and transparency and have developed new products and services for specific market segments. It is estimated that their profits have increased by up to 30 percent recently. Confidence in their performance has been reflected in active trading of their shares in the informal stock market, at two to four times their part value.

Three groups of foreign credit institutions are operating in the market as well. These are: branches of foreign banks, joint-venture banks and fully foreign-owned banks. Together, they account for just 10 percent of banking credit. Their limited development is mainly due to restrictions on the type of clientele they can serve, and the amount and type of currencies they can hold and trade. The extent of these restrictions varies between branches of foreign banks. But these foreign credit institutions have clear advantages over local ones, including their technical expertise and the huge capital base of their parent banks.

Until recently, foreign credit institutions were only allowed to set up joint-venture banks, branches or representative offices. By now they can also contribute capital to existing credit institutions, or to purchase their shares. ANZ Bank was the first foreign-owned institution to gain approval for a 10 percent stake in a domestic joint-stock bank (Sacombank), for 27 million dollars. Shortly after, Standard Chartered paid 22 million dollars for an 8.6 percent stake in ACB. Several other applications by foreign credit institutions to purchase shares of Vietnamese banks are awaiting approval.

The banking system of Vietnam is complemented by two policy lending institutions: DAF, which was mentioned earlier, and the Vietnam Bank for Social Policies (VBSP). The latter replaces the Vietnam Bank for the Poor (VBP), an organization which had no structures of its own below its head office and operated in practice through VBARD branches and the facilities of mass organizations at commune and village levels. VBSP was created in 2002 to take over the small-scale programs of VBP and other directed lending programs previously administered by

SOCBs and government entities. It is currently in the process of absorbing the 14 million accounts (plus the duties, capital, assets, records and staff) of the VBP, as well as some operations of VBARD. VBSP has branches in all provinces and 600 transaction offices throughout the country.

A plan to reform the banking sector and improve the performance of SOCBs was adopted in 2001. The plan included solving the backlog of NPLs, making progress in reclassifying loans according to the quality of their servicing, provisioning accordingly, and bringing the capital adequacy ratio up to international levels. Since then, SOCBs have also undertaken important changes to improve information management systems, loan approval procedures, credit risk control and the recovery process of delinquent loans. For instance, most of them have much stronger information technology by now, and they have all issued credit manuals.

Capital injections of roughly 10 trillion dong have boosted the equity of the four SOCBs. However, it is not at all clear that the restructuring measures have made them truly profitable. The resolution of old NPLs was accomplished mainly through debt write-offs. And in the meantime, the quality of new lending did not improve substantially. Assessing the performance of a loan portfolio is not easy in general; it is much more difficult in Vietnam, where until very recently the accounting standards used by SOCBs were not in line with international practice. An attempt to provide estimates can be found below. But beyond the precise figures, it is clear that new NPLs were being created more or less at the same speed at which the old ones were being solved (or rather, written off), if not faster.

The lack of a substantial improvement in the quality of lending is due to the inability of the restructuring plan to introduce a strong profit orientation in SOCBs. If management was determined to maximize returns, it would make sure that credit risk is subject to close scrutiny, at all levels. This in turn would mitigate the potential pressures to lend for projects lacking merit from a business perspective. But this strong profit orientation has been missing at two levels. The most obvious one is at the top of the banking system, as the SBV remains heavily involved in the day-to-day management of SOCBs. The SBV Governor is responsible for the appointment of Advisory Boards, top management positions and the Chairperson at each SOCB. This responsibility is regularly exercised, to the point where more standard Annual Shareholder meetings have not taken place in any of the SOCBs. At a more fundamental level, the situation simply reflects that SBV is not truly a central bank yet. It can rather be seen as similar to a ministry, both in terms of rank and autonomy.

Even more important is the lack of a strong profit orientation at the local level, where most lending decisions are made. Currently, the SBV has branches in all provinces. While in principle mandated to exercise banking supervision, the management of these branches is close to both provincial People's Committees and the management of the provincial branches of SOCBs. This cozy relationship may result in credit decisions favoring the broader objectives of local authorities, rather than the profitability of the SOCBs. Decisions of this sort include assisting farmers in difficulty, by freezing their loan repayment obligations, or supporting the attainment of growth targets, by funding the provincial SOEs in charge of implementing local infrastructure projects. Such decisions would probably fail to get the approval of profit-oriented shareholders, but they are likely to get the blessing of local authorities.

The quality of bank loans

Insufficient separation between the SBV and SOCBs, and the closeness between the provincial branches of SOCBs and the corresponding local governments, have in practice

translated into weak mechanisms to assess the quality of loan applications. Risk and Credit Committees directly reporting to the SOCBs' boards have been created, but they are not vested with powers of credit decision. Equally important, there is no proper separation of commercial loan generation, credit risk assessment and loan approval. The same branch managers are involved all along. And they do have considerable decision-making power, as their lending approval limits vary between 80 and 100 billion dong.

The lack of a functioning credit scoring system also prevents a proper evaluation of the creditworthiness of borrowers. While the SBV does maintain a credit bureau, it only tracks information on large corporate borrowers and SOEs. On the other hand, some technical mechanisms to screen loan applications seem to be operating effectively. The required matching between the maturity of deposits and that of loans falls in this category. Many investors would like to get medium- or long-term credit, but banks are unable to meet this demand because medium- and long-term deposits only account for about a third of the total.

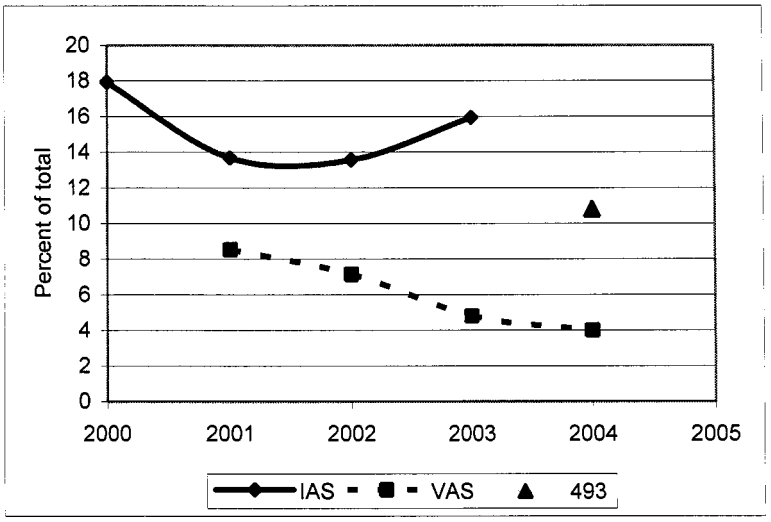
On the surface, the repayment rate of credits is strong in Vietnam. But this is to a large extent due to loan rescheduling. For instance, VBARD does not count frozen loans as non-performing, or overdue. Admittedly, as the seizure of collateral is difficult in practice, the rescheduling of NPLs is at times the only alternative left to banks. But the mere servicing of interest payments becomes then a poor indicator of their quality.

Differences in the treatment of rescheduled loans are one of the main reasons for the wide dispersion of estimates of NPLs in Vietnam. One frequently used approach counts as non-performing any loan whose service is overdue by 90 days or more, as well as any loan which is overdue by less than 90 days but has been rescheduled. At the risk of simplifying, this is the approach underlying a series of independent audits conducted since the year 2000 on SOCBs, using international accounting standards (IAS). At the other end, Vietnamese accounting standards (VAS) ignore rescheduling. The main consequence of this difference in their underlying approaches is a widening gap between IAS and VAS estimates of NPLs (Figure 5.2).

In practice, however, the differences between these two approaches are not as straightforward as the previous paragraph suggests. Loan classification in an emerging market is an evolving process. Audits based on IAS usually contain important qualifications. This is due to the inability of the auditors to assess the collateral of the loans, to the lack of accurate and timely information on credit exposure, to insufficient record of off-balance sheet commitments, and to unavailable documentation on rescheduled and refinanced loans. The expanding share of loans to small and medium enterprises, which typically entail a higher risk than large firms, is an additional source of uncertainty.

The issuance of Decision 493, in April of 2005, is an important step towards bringing Vietnam's loan classification and provisioning practices closer to international standards. Decision 493 is indeed in accordance with IAS, although it will take three years to move from quantitative assessments (based on the number of days the servicing of a loan is overdue) to more elaborate, qualitative ones. The initial application of this decision yields a share of NPLs which is much higher than under the old VAS, although not as high as the share estimated on the basis of IAS. A closer analysis of the gap would require an in-depth review of loan documentation, trying to identify where exactly do IAS auditors and the SBV officials in charge of applying Decision 493 arrive at different conclusions. But there is no doubt that Decision 493 is a step in the right direction. Applied consistently, it should exercise considerable pressure on SOCBs to improve the quality of their lending. Such pressure was diluted under the much more lenient VAS approach.

Figure 5.2: Bad Loans as a Share of Total Credit



Source: Based on data from SBV and the World Bank. Figures are for NPLs of the four main SOCBs, expressed in percentage of their total outstanding credit.

How costly to fix?

The large share of NPLs in the portfolio of SOCBs creates a fiscal liability. Even assuming that a more determined restructuring of the banking system can be implemented in the short to medium term, and leads to a rapid improvement in the quality of new loans, someone will need to absorb the losses from poor lending decisions made in the past. And in a way or another, that someone will be tax payer, through the budget. But how big would the budgetary burden be? While the share of NPLs in total credit is an important piece of information to answer this question, it is clearly not sufficient. Classifying loans as performing or non-performing ignores the diversity in recovery rates, from total losses to partial losses. Moreover, any serious restructuring of the banking sector will require that the capital adequacy ratios of SOCBs be increased up to international levels, especially if they are going to be equitized. This will also entail an additional burden on the budget.

Decision 493 provides a reasonable starting point to capture the gradation in recovery rates across loans with different degrees of non-performance. According to this decision, banks need to provision 5 percent of the value of loans which are not current but are less than 90 days overdue. The provisioning rate increases to 20 percent for loans which are overdue by 90 to 180 days, to 50 percent for loans overdue up to 360 days, and to 100 percent above the one-year threshold. Loans which are being properly serviced but have been rescheduled are treated as if they were 90 to 180 days overdue. Provisioning rates aim to capture the expected loss (in probabilistic terms) for loans in each category. They may not really match the recovery rate that can be secured in Vietnam, which in turn may require that Decision 493 be revised from time to time. But they are based on international experience, and can therefore be used to produce a rough estimate of the losses the four main SOCBs can expect.

The independent IAS audits conducted on SOCBs provide information on the structure of their loan portfolio, in terms of delays in the servicing of debts. Unfortunately, the level of

disaggregation does not always match the breakdown considered in Decision 493. For example, some of the IAS audits would lump together loans which are overdue by less than 90 days, which loans which are overdue by 90 to 180 days. In those cases, a safe assumption is to treat all the loans in these broader categories as if they belonged to the segment with the higher risk (90 to 180 days in the example). Also, the most recent IAS audits of SOCBs are, in a majority of cases, for the year 2003. The volume of credit has grown considerably since then, although at different paces in each of the SOCBs. To capture these trends, the loan structures of the four SOCBs were weighted by their outstanding credit as of end-2004. The result was an (estimated) overall structure of the SOCB portfolio, by loan quality, as of end-2004.

Applying the provisioning rates established by Decision 493 to this estimated structure leads to an expected loss equivalent to 13.3 percent of outstanding credit. Note that this is less than the share of NPLs in outstanding credit, reflecting the expectation that not all NPLs will be a total loss. This average provisioning rate was also applied to off-balance sheet items, assuming that such items amount to 15 percent of the figures captured by the IAS audits. And to err on the side of caution, the total provisioning (including both balance sheet and off-balance sheet items) was increased by 50 percent.

The direct fiscal burden from NPLs is represented by the gap between the required provisioning and the actual provisioning by SOCBs. But there is an additional burden represented by the gap between the actual capital levels of SOCBs, and the levels they should meet in order to comply with international standards (a capital adequacy ratio of 8 percent was used as the objective in this case). The sum of the gaps in required provisioning and in required capitalization amounts to roughly 8 percent of Vietnam's GDP.

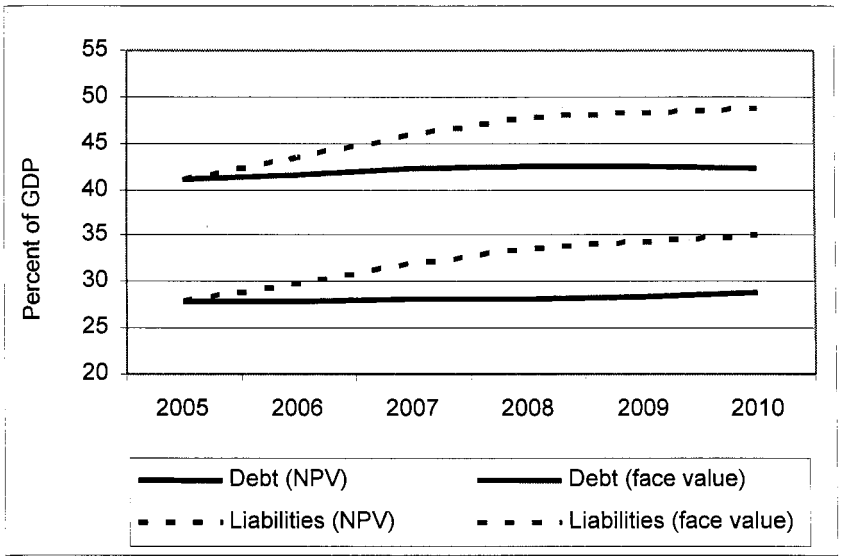
This is a considerable sum, which cannot be mobilized in just one year or two, even under a determined effort to reform the banking system. It is more reasonable to assume that the government would have to issue bonds and transfer the resources to the SOCBs as they restructure. This in turn, would increase the overall public debt of Vietnam. A debt sustainability assessment jointly conducted by the IMF and the World Bank tried to estimate by how much. It assumed that the issuance of government bonds to support SOCB reform would be spread over the five-year period covered by the new Socio-Economic Development Plan (SEDP). The assessment also considered that the economy would continue growing as it did in recent years, at about 7.5 percent per year. Macroeconomic management was supposed to remain prudent, with the budget deficit being gradually brought down, until reaching 1.5 percent of GDP by 2010. Under these assumptions, public debt would increase from 41.2 percent of GDP at present, to 48.7 percent in 2010 (Figure 5.3). By contrast, if SOCBs had been performing well, and not generated fiscal liabilities, the stock of public debt would remain almost stable, reaching 42.4 percent of GDP in 2010.

These numbers are to some extent deceiving, because a considerable portion of Vietnam's public debt is in concessional terms. This means that the net present value (NPV) of the long-term obligations faced by the government is considerably less than its face value. On a present-value basis, the burden of SOCB restructuring would increase public debt from 28 percent of GDP at present to 35.2 percent in 2010. This figure is high, but it remains manageable. Delaying SOCB reform, on the other hand, could result in a much heavier burden. Even maintaining a stable share of NPLs in total credit would translate into an increasing fiscal liability, because credit is growing much faster than GDP.

The assessment of fiscal liabilities from NPLs assumes that the provisioning ratios introduced by Decision 493 are a good estimate of the losses associated with loans in different performance categories. Whether this is so will very much depend on the ability to bring delinquent debtors to foreclosure, and seize their assets. So far, the experience in this respect has been disappointing.

The SOCB restructuring effort launched in 2001 led to the creation of Asset Management Corporations (AMC) at each SOCB. The goal of these AMCs was to expedite recovery efforts and eventually lead to the liquidation of bad debtors. But this approach has not been effective in practice. This is because the AMCs face the same problem as the SOCBs themselves, namely they cannot seize the assets of bad debtors, especially when those debtors are SOEs and "their" assets actually belong to the state.

Figure 5.3: Public Debt over Time



Source: From IMF (2005). Figures based on selected scenarios from a joint Debt Sustainability Assessment by the IMF and the World Bank.

Yet, many bad debtors are probably solvable, and asset recovery might still be feasible, although through other mechanisms. Vietnamese firms generally have a low ratio of debts to assets, which reflects their reliance on retained earnings as a source of funding. This suggests that not all delinquent borrowers are actually unable to service their debts. Equally important, the experience of several provincial branches of SOCBs revealed successes in seizing assets. A study conducted in three provinces by MONRE and the Swedish International Development Agency (SIDA) showed that pressure on borrowers to sell the land themselves, combined with close cooperation with the local authorities, proved an efficient means of ensuring repayment. The reluctance of banks to resort to the judicial system highlights the need to rely on other, non-judicial means to enforce debt obligations and reach foreclosure if needed.

Capital markets

Vietnam's stock market remains relatively small, even by Southeast Asian standards (Table 5.2). It comprises two organized trading centers, in HCMC and Hanoi, both operating as non-business units attached to the State Securities Commission (SSC). The HCMC trading center started its operations with just two companies listed on it, in July 2000. It still had 30 companies, 281 bond issues, and one closed-end fund listed on it by late 2005. The total market

capitalization stood at 5.9 trillion dong for listed stocks, 33.7 trillion for bond issuances, and 0.3 trillion for the investment fund respectively. Established in March 2005, the Hanoi trading center is intended to serve SMEs. It is open for listing to firms which have at least 5 billion dong in chartered capital and 50 shareholders, and made profits in the preceding year. So far, this secondary center has conducted two auctions for initial public offerings and three for government bonds.

Table 5.2: A Small Stock Market

	2000	2001	2002	2003	2004	2005e
Individual trading accounts	2,870	8,703	13,398	15,569	21,402	24,000
Institutional trading accounts	38	71	122	166	193	250
Stocks listed	5	10	20	26	26	30
Market capitalization	n.a.	n.a.	n.a.	2.3	3.8	5.9
Trading volume	3,641	19,028	35,795	28,024	72,894	82,300

Source: Based on data from SSC. Monetary figures are in trillion dong.

Secondary market activity of the listed stocks has not started yet in Hanoi and has been overall modest in the HCMC. The exception was during the first year after the opening of the HCMC trading center, when activity was buoyed by foreign investment. As a result, the composite index reached 571 on June 2001. But the boom came soon to an end, leading to a sharp market correction. Currently, the average daily trading is about 3.9 billion dong in stocks, and 78.4 billion in bonds.

Of the 30 companies listed on the HCMC trading center, 29 are former SOEs which enacted public share issuances as part of the equitization program, before actually being listed. Few companies have used the stock market as a platform for raising funds through an initial public offering. Also, most market intermediaries are closely connected to state-owned financial institutions. The market is currently served by 13 securities firms, one fund management company, three custodial banks and one settlement bank. Of the 13 securities firms, seven are wholly owned by commercial banks and one by the state-owned insurance company.

Meanwhile, a much more vibrant informal market for shares has developed. At present, it has an estimated value equivalent to approximately four to five times the organized trading centers. The informal market actually emerged even before the HCMC trading centers was created, as a by-product of the equitization process. Over time, this process has created as many as 300,000 shareholders, mainly among SOE workers, without a market to make their shares liquid. According to one estimate, there are some 750 equitized companies, 30-or-so joint stock banks, and around 100 JSCs whose shares are being actively traded in the informal market.

Two kinds of intermediaries operate in this informal market. The first one is made of some 60 to 80 independent, unlicensed brokers. Some of them deal in securities as a secondary job, but a majority works for financial institutions, including licensed brokerage firms. A typical unlicensed broker has about 10 regularly trading customers, out of a clientele of about 100 investors. The second group comprises brokers who are licensed to intermediate in stocks in the any of the two official trading centers, but who nevertheless engage in brokering unlisted stocks in the informal market.

Box 5.2: The Stock Exchange versus the Informal Market

The official stock exchange and the informal market differ in at least three ways in Vietnam. These are: the range and characteristics of the companies whose stocks are traded, the extent of disclosure on the performance of those companies, and the rules guiding market intermediation. Current efforts by the government to develop the official stock exchange focus on the first aspect. Frequently invoked transparency considerations argue in favor of strengthening the second one. The third aspect has been somewhat neglected so far.

It is generally agreed that the attractiveness of the 30 companies listed in the HCMC stock exchange is not particularly high. On the other hand, there are many solid performers among the 6,700 JSCs registered so far in Vietnam. Some of the JSCs trading in the informal market are among those considered "good" by the Vietnamese public, such as Vinamilk. Bringing more of those "good" companies into the official stock market would thus help make it more attractive. This is what the government is trying to accomplish at present.

However, there are specific disclosure requirements that a company needs to meet in order to be listed in the official stock exchange. Those disclosure requirements act as a deterrent for companies preferring to maintain opaque financial accounts, predominantly for tax reasons. A strong incentive for companies to participate in the official stock market will not exist as long as corporate transparency standards at large remain low. It could be argued that even more demanding listing requirements are needed to attract investors to the official stock market. However, unlicensed brokers in the informal market claim that they have not faced with any serious trouble related to poor disclosure. Raising corporate transparency standards at large (as opposed to disclosure requirements for listed companies) may thus more to boost the official stock market. Indeed, listing would then become less burdensome for enterprises, in relative terms.

Last but not least, the informal market is characterized by flexibility in the conduct of business, whereas rigid rules apply in the official stock exchange. Transactions in the HCMC trading center are executed through periodic call auctions conducted on every weekday in two sessions, between 9:00 and 9:20 AM and between 10:00 and 10:30 AM, and through over-the-counter transactions between 10:30 and 11:00 AM. The seller is required to deposit the securities through a broker before placing an order, whereas the purchaser is required to deposit at least 70 percent (and sometimes 100 percent) of the buy order. In the absence of a match between deposits, transactions do not occur. As a result of these stringent requirements, the official stock exchange is free from trade fails. But this is at the expense of turnover efficiency and trading volumes.

Source: Based on DFC (2005), Nick J. Freeman (2004) and World Bank (2005).

At present, the government is making a series of efforts to boost the activity of the official stock exchange. In August 2005, it instructed equitized SOEs to quickly list their shares at the two trading centers in Hanoi and HCMC. Licenses were also granted to six foreign-invested companies for their conversion into JSCs, on a trial basis. In addition, the government has committed to facilitating the establishment and development of foreign and domestic investment funds in the country. And since September 2005, foreign organizations and individuals as a group can hold a maximum of 49 percent of a listed company's total outstanding shares, compared to 30 percent previously. While these are encouraging steps, understanding why the informal market has thrived while the official stock exchanges have languished requires a closer look at their differences (Box 5.2).

It should be recognized, however, that equity financing will not be a viable source of long-term funding for most of Vietnam's SMEs. The minimum company size needed to conduct a public share offering, or simply to be listed, is markedly larger than that of the vast majority of private enterprises. For most SMEs, the banking sector, informal funding sources and possibly leasing will be the main ways to have access to finance. As regards larger enterprises, the development of a well-functioning bond market should be a priority.

A first step in this direction is the development of an active government securities market. Such market typically serves multiple purposes. It allows government to finance the budget deficit at a low cost; it provides the investment community with safe and liquid medium- to long-term savings instruments; and it is the foundation for the term structure of a country's interest rates. The controversial transformation of SSC from an independent body into an agency under MOF might reflect the importance attached to the development of a government securities market. At roughly 3 percent of GDP, such market is already bigger than the equity market. For instance, in 2004 bond trading represented almost 90 percent of all transactions at the HCMC trading center. And some licensed securities firms actually make the majority of their profits on bond intermediation. By now, there are more than 100 issuances per year of treasury bills. DAF, the HCMC Investment Fund for Urban Development (HIFU) and Vietnam's Oil and Gas Corporation (PetroVietnam) are among the few other issuers of bonds in Vietnam. The corporate bond market is still nearly non-existent.

6. THE LAND MARKET

A land market has already emerged in Vietnam, despite the still partial development of formal titling. Many transactions take place in the absence of proper legal documentation, simply because local officials know which piece of land or property "belongs" to whom, and arbitrate in case of conflict. From this perspective, the absence of formal property rights has not been incompatible with market development. But land titling is bound to increase efficiency. LUCs can be used as collateral to obtain credit, and insufficient access to finance is arguably the main constraint to business development in Vietnam. Property titles should also provide a more sound foundation for the development of a real estate market. From a social perspective, they could help formalize the situation of urban migrants, who continue to be registered as "temporary residents" despite having lived in the cities for years, if not decades. However, the dynamics of the property market in recent years also show that titling alone is not enough to ensure efficiency. Price "bubbles" in real estate need to be kept under control by making speculative transactions more burdensome, as the Vietnamese government did recently. And some of the most difficult issues, such as facilitating the consolidation of agricultural land, restructuring state forest land, supporting community-based land management among ethnic minorities, and recovering idle land from urban SOEs, will still require specific policies, going beyond the issuance of LUCs. Looking forward, one of the most difficult challenges ahead is the conversion of agricultural land into residential and industrial land, which will be needed on a massive scale as Vietnam develops and urbanizes. Success will critically depend on fighting corruption in land conversion and properly compensating the affected populations.

Land titling

While only the state can own land in Vietnam, a private person or entity can also own "use rights" to a parcel of land for a specific period of time. The allocation of those use rights, launched with the Land Law of 1987 and accelerated after its 1993 revision, has been at the center of economic reform.

The fraction of households using land in Vietnam is very large, because the economy is still to a large extent agrarian. According to the VHLSS 2004, the fraction could be as high as 86 percent. The allocation of use rights in urban areas, while affecting a smaller share of the population, presents additional difficulties. Allegedly temporary forms of land occupation are common; in other instances, several households share the same dwelling. Because of its scale and complexity, the process of allocating land use rights in Vietnam can be seen as one of the most ambitious privatization programs ever attempted

The 2004 revision of the Land Law is an important milestone towards completing the land titling process. Under this law, LUCs can be leased, sub-leased, transferred or given in inheritance. They can also be used as a capital contribution to a business project, and mortgaged as a security for loans. It should be noted, however, that land titles are allocated for periods ranging from 20 to 50 years, and this raises questions as to how the values of the LUCs will be affected as their expiration date gets closer. For now, the oldest LUCs are only a dozen years old.

The Land Law of 2004 suggests that the terms will be renewed "if the land users are still in need of such land and have strictly complied with land legislation during their period of occupancy, and the use of such land is in accordance with the approved land use planning". But the specifics are unclear at this stage.

Much progress has been accomplished in the issuance of LUCs for agricultural land, popularly known as "red books". This is confirmed by both administrative data compiled by MONRE and household survey data (Table 6.1). Direct allocation by local authorities has been the most important allocation mechanism. In 2004, 48 percent of the agricultural land held by households had been obtained from communes, 16 percent has been purchased and 8 percent had been reclaimed. The remaining had been inherited; the mechanism through which the deceased had originally acquired the land is unfortunately unclear. There are important regional differences, however. Direct allocation by the communes was more important in the North, where it affected two thirds of all agricultural land. Communes only played a marginal role in the South, where inheritance and the market were much more important.

Table 6.1: Progress in the Titling of Agricultural Land

	MONRE Plots (percent) 2004	Vietnam Household Living Standards Survey (2004)						
		Plots with LUC (percent)			Area (percent) 2004	Percent of 2004 titling under		
Region		1993	1998	2004		Male	Female	Both
Red River Delta	66	13	33	70	69	63	20	15
North East	66	12	42	82	81	77	13	7
North West	53	9	27	73	70	76	7	7
North Central Coast	71	15	44	74	73	64	14	19
South Central Coast	60	11	56	83	81	59	22	15
Central Highlands	57	4	19	55	53	70	16	12
South East	67	11	35	71	71	65	17	14
Mekong Delta	90	22	59	90	90	67	21	7
All	72	14	42	76	76	66	18	12

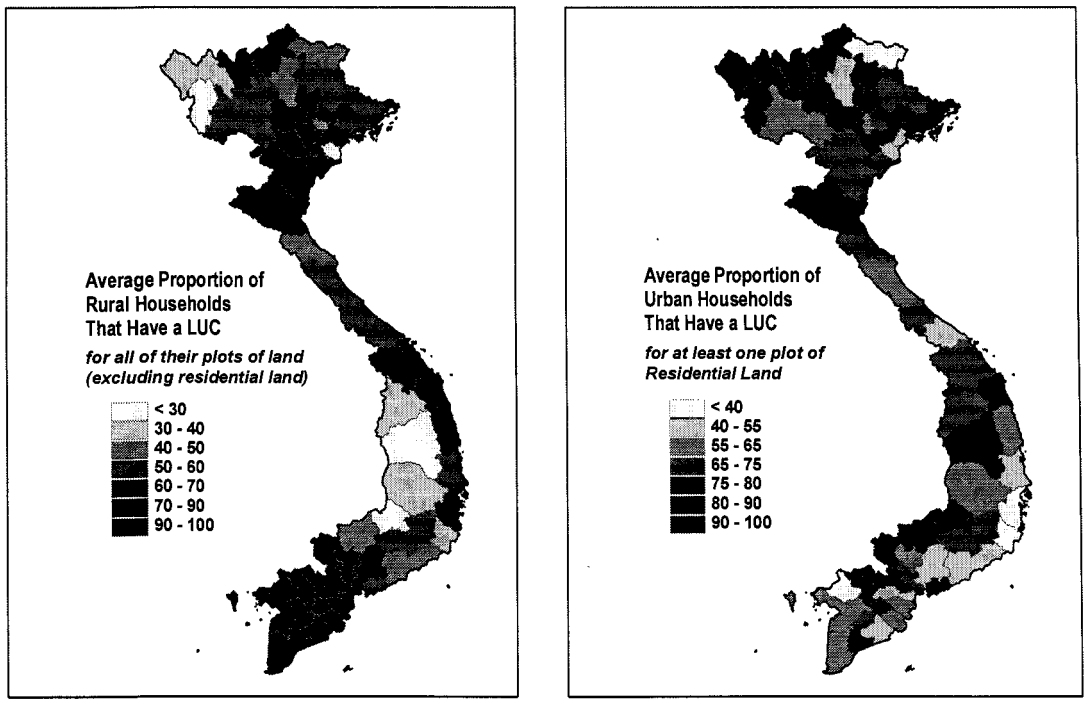
Source: MONRE and own calculations based on 2004 VHLSS by GSO. Figures refer to annual and perennial agricultural land only.

Field research conducted by ADB in six provinces across Vietnam shows considerable improvements in the land allocation process. Procedures are now relatively quick and simple, with most land transfers registered within one or two months. Since 2000, official transfer taxes and fees were reduced to a level that is low by international standards. Because procedures are less onerous procedures, households increasingly seek to register land transactions formally.

However, the extent to which land and urban property have been given proper titling varies considerably from province to province (Figure 6.1). In the South, many of them were able to build on a reasonably well-developed system of informal-customary law that established ownership at the village level. Cadastral maps also existed. As a result, disputes over ownership and boundaries were minimal. In the North, a large fraction of agricultural land is covered by

new titles, whereas in the south LUCs have been used mainly for land that was not titled under the old system. In both cases, there is a clear tendency by households to register previous, unofficial transfers under the terms of the new Land Law.

Figure 6.1: Land Registration across Provinces



Source: Own calculations based on 2004 VHLSS by GSO.

Progress in the issuance of land titles for urban property has been much slower. The year 1994 saw the introduction of Building Ownership and Land-Use Right Certificates (BOLUCs), popularly know as "pink certificates". A BOLUC combines home ownership with the land-use right into a single legal document. Its possession amounts to having a fully-titled house. But obtaining a BOLUC is complicated. Depending on the occupancy date, specific legal documents have been identified as being acceptable in claiming ownership. But even property owners with relatively long period of tenancy may not have those particular papers, and the regulations do not specify what to do in cases. Moreover, BOLUCs are not given to urban migrants without permanent household registration, nor when there are unresolved disputes over ownership. In Hanoi, disputes are aggravated by the sharing of old, colonial-period dwellings by several households over many decades. In HCMC, problems were exacerbated by the incorporation of large portions of formally agricultural land on the periphery into five new urban districts, in 1997.

As a result of all this, there is a considerable bureaucratic limbo hanging over BOLUCs. In 2005, a new decree introduced separate certificates, to be issued under the authority of the Ministry of Construction (MOC), to state owners' rights over buildings. In parallel, a new Real Estate Registration Office is to be established in each province, under the management either of the Department of Justice, the Provincial People's Committee or the provincial Department of Natural Resources and the Environment (DONRE). This office would register all land and assets on land, as well as all real estate transactions. User or ownership rights would be registered on

the basis of existing LUCs, building licenses or other documents. These initiatives raise the prospect of potential inconsistencies, slowing down the completion of land titling in urban areas.

The new Land Law also expanded the mechanisms by which enterprises can obtain land. In addition to the direct allocation or lease by People's Committees, and the transfer of LUCs among entities, it is now possible to auction LUCs. Because this third mechanism is new, very few enterprises have benefited from it so far. To date the most common way of acquiring land is through direct transfer from a previous land user, at an agreed price. In the ICS sample, 56 percent of manufacturing firms and 65 percent of SMEs had used this mechanism for the most recent land acquisition. Direct allocation by People's Committee is more important for large-scale firms, often needing large plots of land. It is uncommon (and probably difficult to process) in the case of small firms.

The process to acquire land directly from People's Committees has been considerably streamlined. In the past, applicants had to submit a cadastral map, a feasibility study for the investment project, a plan for site clearance and the compensation of the affected populations, and the written opinions of all the relevant agencies. By now, the documentary requirements have been streamlined to only three: an application form for land allocation or lease, an investment decision or certified copy of an investment license, and a certification letter from DONRE on the effective record of land use by the applicant. A 30-day time limit exists to process applications on land that is already cleared; the limit is 45 days for sites which are not yet cleared. This compares with an actual average of more than eight months at present. The revised Land Law also requires DONRE to be the sole contact for applicants during the whole process, so that applicants do not need to be running from one government agency to another anymore.

Land prices

There are at least three different "prices" for land in Vietnam. One of them refers to the initial transaction, on allocated land, between the state and the recipient of the LUC. The life of this administrative price extends in practice beyond the initial transaction, as levies and fees on subsequent LUC transfers are based on it. This is also the price most often considered by banks, when LUCs are used as mortgage to obtain a loan. A second relevant price is the one used for transactions among households or enterprises, when transferring LUCs. And a third one is the rental price of land or property, again between households or enterprises. The first two prices concern the entire lifespan of the LUC; the third one covers a shorter period of time.

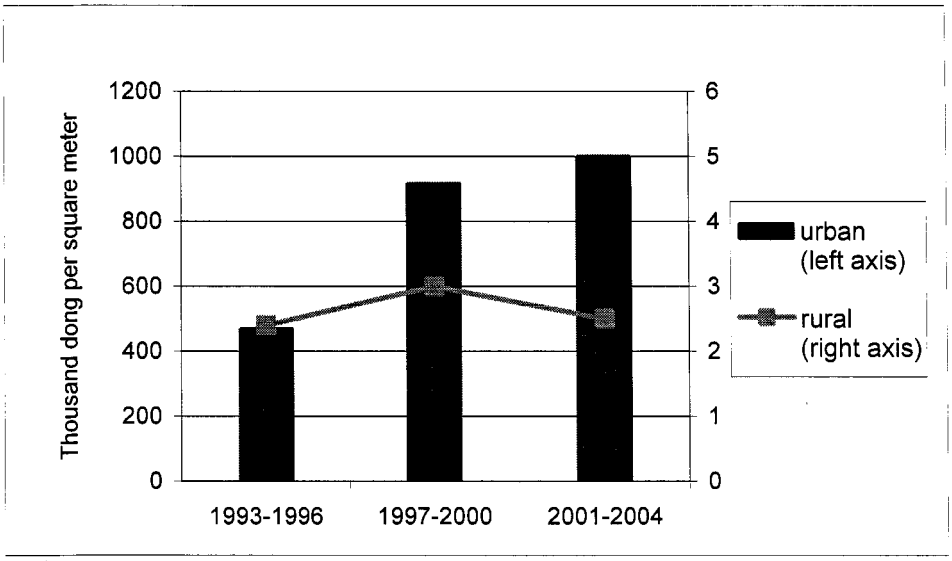
Gaps between these three prices shed light on the operation of the land market in Vietnam. Diverging trends between the first and the second one are bound to create distortions, and to provide incentives for corruption in land administration. The new Land Law represents an important attempt to bring these two prices closer together, as it favors the use of market-oriented mechanisms to set the price of LUCs, including auctioning, competitive bidding and appraisal by external evaluators. Diverging trends between the second and the third prices can be used to assess whether property markets are experiencing a "bubble". A booming market for LUC transfers, if not accompanied by a booming rental market, is not sustainable in the long run.

Estimating the actual level of land prices, in transfer or rental transactions between households and enterprises, is not an easy task. The role of land rental markets in agriculture is still thin. In 2004, only 3.6 percent of all agriculture land was rented, with 10.7 percent of all rural households having rented-in land, and 6.0 percent rented-out land. Moreover, some of these transactions are not really at "arms length", as they often involved relatives and entail no payment. The development of land sales is limited too. In 2004, only 8.3 percent of all

households reported that they had bought land, but this is probably an over-estimate, including the acquisition of LUCs from communes. At 2.7 percent, the fraction of households reporting that they had sold land was actually much lower. The number of observations available on actual "market" transactions is thus small.

Moreover, an estimation of market prices for property in general would hide important disparities between provinces, depending on the supply of land with proper titling. Danang is a case in point. In 2002 the provincial authorities launched a slew of projects to fully exploit the availability of large amounts of land around the city, creating thousands of lots for sale. This resulted in temporary excess supply, and a downward price spiral. The trend was at odds with the steady increase in property prices observed at the aggregate level (Figure 6.2). Only now, when prices elsewhere are falling, is Danang coming out of its prolonged property market slump, as large investors show interest in developing tourism and residential projects.

Figure 6.2: Property Prices for Urban and Rural Land



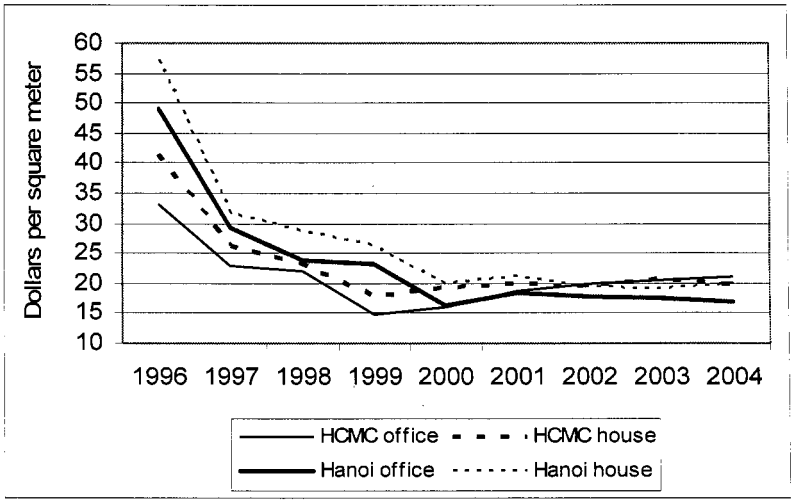
Source: Own calculations based on 2004 VHLSS by GSO. Urban land prices are from 106 observations in nine major cities. Rural land prices from 1,319 observations in rural areas.

The trend is almost opposite in the case of rental prices (Figure 6.3). Information is even more fragmentary in this case. Some, however, has been compiled on a systematic basis by real estate agencies catering to the upper end of the market. These agencies deal on a narrow set of well-defined properties, such as offices meeting international standards of service, and housing for expatriates. The trends are thus unlikely to be reflecting changes in quality over time. The dramatic decline in rental prices in the second half of the 1990s reflects the steady increase in supply, as new buildings and residences came off the ground. The relative stability of rental prices since the year 2000 or so is clearly at odds with the boom in sale prices.

However, there is clear evidence that the real estate bubble is over by now. A major reduction in transaction started at the beginning of 2005. Over the first six months of the year, transactions registered at DONRE's property center in HCMC fell by 68 percent compared with the previous year. According to press reports, by end 2005 Hanoi still topped the country with a

median sales price of around 150,000 dollars for street-front homes. But this was 10 percent less than the previous year, and many listings were staying on the market for long periods of time. Domestic demand for construction materials declined as a result, with the number of civil construction projects in HCMC down by more than 25 percent compared to 2004.

Figure 6.3: Rental Prices for Upscale Housing and Offices



Source: Based on data from Chesterton Petty Vietnam. Figures correspond to international standard office buildings and residential units meeting expatriate standards respectively.

Two policy measures were instrumental in stopping the real estate bubble. First was the taxation of land transactions, at 5 percent of the value of the LUC, introduced in early 2005 as a result of the new Land Law. The tax rate is not high by international standards, and should not have a deterrent effect on non-speculative land transactions. But the re-evaluation of the administrative price of LUCs, on which the tax applies, implies that the tax amount is not negligible anymore. Buying and selling again over a short period of time, which was common during the bubble period becomes then expensive.

The other important measure was the ban imposed on real estate developers from selling small plots of land that do not have houses built on then. Now, land allocated to developers for the construction of residential property projects cannot be divided up into individual plots and sold prior to construction of the infrastructure and housing outlined in the project plan. This measure blocked a loophole which allowed developers to reap significant profits by converting low-cost agricultural land into residential land without making any substantial investment.

Rural Land

The attempt to distribute land to rural households in an egalitarian way, so that each of them would have a similar endowment in terms of both quantity and quality, has resulted in a considerable fragmentation of land holdings. This objective, clearly stated in the Land Law on 1988, was attained through the allocation of sizeable numbers of non-contiguous to each

household. The problem is particularly severe in the North of Vietnam, where the average rural household has 6.5 plots of land. In some places, such as the Tu Son district of Bac Ninh province, the mean area per plot is barely one *sao*, or 360 square meters. But it exists also in the south, where the average is close to 3.4 plots per household.

Fragmentation does not appear to be associated with a lower level of mechanization, but it still affects agricultural production in other way. Households with more fragmented land endowments are more likely to cultivate rice, to spend more time on the farm, and to achieve a lower productivity. A crude estimate suggests that a doubling in the number of land plots per household is associated, other things equal, with a 15 percent lower productivity.

The issuance of transferable LUCs, under the revised Land Law on 1993, was expected to solve the fragmentation problem, with market forces inducing spontaneous land consolidation. But this did not happen in practice. Market-based land consolidation requires multilateral and more or less simultaneous deals among several potential buyers and sellers. The presence of irrigation and transportation networks, whose shape depends on plot boundaries, can make those multilateral deals remarkably complex. Administrative constraints on crop choice represent another major obstacle. In the absence of crop choice, some of the possible economies of scale from land consolidation cannot materialize, which reduces the incentive for farmers to swap land with others. Credit constraints can also prevent or slow down market-based consolidation.

As land fragmentation did not decline in a spontaneous manner, in 2003 the government adopted an explicit land consolidation policy. Localities where then encouraged to facilitate the transfer of LUCs and the conversion of land-use purposes so that parcel sizes would be suitable for efficient production. Implementation is just beginning, as many local authorities are not even aware of the new policy. But some of the ones who are have been testing various models for the consolidation on land plots, including voluntary exchanges coordinated by local authorities, compulsory exchanges, and market-based models in which households are encouraged to buy and sell plots. So far, land consolidation projects appear to have been slightly redistributive in nature, with newly-married households being the main beneficiaries.

Some provinces actually started land consolidation campaigns even before a national policy had been adopted. In Nghe An province, following a local Party directive of 2001, such campaigns were conducted in 333 out of 363 communes. Consolidation was conducted by village authorities, either through adjustment of adjacent plots or through complete re-organization and reallocation through the drawing of lots. Participation in the process was compulsory for farmers with annual crop land. The process was deemed to be successful, as it allowed shifting from rice to higher value peanut cultivation. For instance, in the district of Nghi Loc, the total number of plots was reduced from 382,948 to 165,139. However, LUCs issued prior to the land consolidation process have only been amended or reissued in 6 of the 333 participating communes.

Another area in which additional government activism is needed is the reform of State Forest Enterprises (SFEs), which still control about 40 percent of all forest land in Vietnam. Much of this land is located in the poorest parts of the country and managed inefficiently. Over the last decade, a series of steps have been adopted towards the restructuring of SFEs. The main objective underlying those steps is to separate commercial forest activities, such as wood production, from public service functions, such as maintaining bio-diversity, and protecting watersheds. In the process, SFEs which carry out mainly public service functions will be turned into Protection Forest Management Boards (PFMBs), whereas the land they use inefficiently will be transferred to local communities. A key decree was adopted in 2004 to accelerate this process.

As of May 2005, there still were 362 SFEs still in existence. Of these, 114 were to be converted into PFMBs, 27 into public utility enterprises, six were to be liquidated, and the rest

was to be converted into commercial enterprises. But the unclear boundaries between "protection", "special use" and "production" forests are delaying decisions on what land should be retained by PFMBs and SFEs, and what land should be reserved for allocation to households. Following a desire to maximize funding from government, provinces and SFEs have classified many areas as "protection" and "special use" forests, whereas in reality "production" would be more appropriate. A thorough re-classification might be necessary before final land allocation decisions can be made. Several other issues will need to be addressed, including the funding and staffing of PFMBs, and the revision of the incentives faced by SFEs in provinces where logging bans are in force.

Beyond the specifics, it is expected that 500,000 to one million hectares of forest land could be released to communities through this process. This should benefit the almost one million households who use forest land to support their livelihoods, most of whom are poor. However, an effective transfer may require the use of customary land titling, a possibility first formalized in Vietnam by the revised Land Law of 2003, but piloted before that in several provinces, including Dak Lak and Son La. Those pilots amounted to the recognition, by local authorities, of the long tradition of sustainable land management by ethnic minorities, especially in relation to community-held forest land and so-called "unused land" (Box 6.1). In Dak Lak, between 1999 and 2002 around 16,000 hectares of forest land were allocated to ethnic minorities, of which one third went to villages and one third to groups of households. In Son La, between 2001 and 2003, some 685,000 of forest land were allocated to local people, of which half went directly to village communities. Currently, communities throughout the country are de facto managing some 2.5 million hectares of forest land.

Urban Land

Even if all land titles for residential property could be issued, urban areas would still be confronted with the need to re-allocate their commercial and industrial land. At present, such land is mainly in the hands of SOEs, whereas non-state enterprises face considerable difficulties in getting access to land.

The ICS sample gives a sense of the magnitude of the problem. Among enterprises with 250 employees or more, SOEs have on average five times more land than private firms. Across all institutional types and sizes, only 54 percent of respondents to the ICS declare that they have the right to sell or mortgage the piece of land they acquired more recently. And only 10 percent of them are located in what they considered to be their own land.

To some extent, limited access to industrial land simply reflects the overwhelming population density and the ensuing shortage of idle space within urban boundaries. Most of the existing industrial land is already occupied by SOEs, whereas the conversion of agricultural land into industrial land at the fringes of the cities is a slow and often controversial process. Thus, the supply of available land coming on to the market is too small to meet the demand. But in addition, SOEs often get priority in the allocation of whichever land is available. The case of Hanoi illustrates the point. In the period from 1994 to 2002, only 428 new rental contracts covering about 3 million square meters were issued. More than half of these contracts were to SOEs. By now, an overwhelming 95 percent of land under lease to organizations in Hanoi is in the hands of SOEs, leaving less than 5 percent to private firms, cooperatives and other production groups.

Box 6.1: Land Relations in Black Thai Villages

The Black Thai communities of Chieng Dong have resisted land allocation vigorously. Not only did they ignore and circumvented the new regulations on the issuance of LUCs: they also continued to modify plot sizes and exchange plots among one another, ignoring their registration and the associated legal duty to report changes in landholdings. Whole villages disregarded land classifications commanded by the state, preserving overlapping and seasonally changing uses of land for cultivation, animal husbandry and forestry. Black Thai resistance to land allocation even included open protest against the registration of some fields, forcing local authorities to exclude them from LUCs.

Traditionally, a local lord (or *phia*) was considered the formal owner of Black Thai land; yet his actual powers were mainly symbolic. At the next tier, village communities exerted collective control rights over the land, but could not intervene in its day-to-day management. At the bottom of the hierarchy, households held rights to cultivate wet rice fields and upland fields, to graze water buffaloes and to collect forest products. In exchange for these rights households owed shares of labor and products to the village collectives and the *phia*.

The balance of individual entitlements and collective control varied between different land uses. Village collectives exercised strong control over the highly priced wet rice fields. They periodically adjusted allocations in response to changes in household and village demography. On the other hand, collective control did not extend into the uplands, where households were free to clear suitable forest for new fields provided that no other household had worked the land previously. Similarly, all households enjoyed the rights to graze their water buffaloes and collect forest products in the uplands, with no village boundaries applying.

The Black Thai of Chieng Dong also resisted the complete collectivization of agriculture during the period under central planning. Collective production remained limited to wet rice and some upland rice fields. Households continued to grow rice and other supplementary crops, and to raise pigs and poultry, on their own account. The Black Thai also opposed the formation of larger cooperatives, including more than one village.

In the end, collectivization reinforced some of the key features of land relations among the Black Thai. The district authorities and cooperative leadership took over the estates of administration previously held by the phia and village collectives. Access to wet rice land remained contingent upon the fulfillment of obligations towards the village, now cooperative. The leadership of cooperatives allocated labor duties, hence shares in total product, to all adult villagers. Access to land thus became contingent upon the number of main laborers in a household, unifying the allocation formula across villages.

During the late 1970s and 1980s the balance of power gradually shifted away from the cooperatives and the district administration. Villagers expanded individual upland fields up the slopes and increased their engagement in own-account activities. The village collectives did not stop this expansion of individual cultivation. By the early 1990s land relations in Chieng Dong resembled those that had existed before collectivization. This is when land allocation took place. District authorities then asked villagers to declare their wet rice fields. But the request was met with protest, because long-term allocation would conflict with the to adjust plot sizes to changes in household need. In response, the district leadership instructed the cadastral office to leave the fields out of the land certificates.

In the years following land allocation, all villages in Chieng Dong continued to reallocate their wet rice fields. When asked about their motivations to continuously reallocate land, village leaders unanimously referred to a concern for equity.

Source: Based on Thomas Sikor (2004).

Officially, SOEs are not allowed to sub-lease their land to other enterprises, but they do so in practice. In the small-scale enterprise survey conducted by the World Bank, 11 percent of the respondents had rented land from SOEs. Leases had most typically a short- or medium-term horizon, with 10 years being the maximum contract length. In addition, as the rent is unofficial, the private enterprise is in a vulnerable position, should a dispute arise.

Unofficial sub-lease arrangements of this sort may appear to be a convenient, market-based solution to address the shortage of land, but they are far from ideal. The combination of relatively short lease terms with the overall insecurity associated with unofficial arrangements could be a deterrent for investment on the land by the lessees. Profitability is further eroded by the fact that the rent a private firm pays to an SOEs cannot be considered a tax-deductible expense. Conversely, revenue generated from sub-leasing the land is not recorded in the annual accounts of SOEs. This is a potentially important source of corruption.

The new Land Law mandates SOEs to return to the state any land that is not required for the conduct of the business operations. In practice, few have done so. The process of recovering idle SOE land is in fact quite laborious. The lack of a precise definition of what constitutes idle land, or an effective mechanism for land surrender, has led different provincial governments to try different approaches. Danang, for instance, has relied on the authority of the Party to recover considerable amounts of SOE land for its urban development projects. Hanoi is by now auctioning state land, and houses in the inner city, in a move which could generate up to 100 million dollars in revenue for the city in 2005.

But the case of HCMC highlights the magnitude of the challenges. The Prime Minister had issued a decision to solve and rearrange state-owned land and houses in HCMC in 2001, creating a legal ground for their proper and use by enterprises and individuals in accordance with city approved plans. Since then, the HCMC Department of Finance (DOF) has been able to inspect about 2,000 sites, out of the 6,812 plots of state-owned land being used by enterprises or individuals. These inspections show that most often land has not been used for the intended purpose, and has instead been leased to a third party. The rent charged to the third party is substantially higher than the fees the official users have to pay for the state-owned land. Enterprises and individuals have often built houses or hotels on the land without permission, while others have simply failed to pay their fees to the state.

Zoning and conversion

The state allocates land-use rights, but it also enjoys the powers to recover them in prescribed circumstances. With Vietnam's rapid economic development and urbanization, the recovery of agricultural land for residential, commercial, industrial and infrastructure projects has become increasingly common. In many cases, the recovery is aimed at building industrial zones. By the end of 2004, there were 192 major industrial zones and clusters in 13 provinces, with a total surface close to 30 thousand hectares of land. Originally, some 84 percent of this land was agricultural. It was recovered from over 100 thousand households. The most common recovery procedure was the compulsory recall of farmers' LUCs by the state. The most common allocation mechanism was the discretionary leasing of recovered land to enterprises.

However, the process of land conversion has proved especially controversial. In some cases, land conversion has been met with resistance by the affected households, leading to social unrest and considerable delays in land clearance. Land conversion has also been marred with corruption cases. Given the gap between the administrative price at which the state allocates the

converted land and the price at which it can be sold, capital gains can be sizeable. And this in turn creates pervert incentives for the government officials involved in the conversion process.

A recent assessment of the implementation of the new Land Law by MONRE included a review of 17,480 letters of denunciation. Out of this total, more than 70 percent were related to site clearance and compensation. The largest numbers of denunciation letters were from HCMC, Hanoi, Phu Tho, Dien Bien, Bac Kan, Ha Tay, Khanh Hoa and Quang Ninh. Lack of proper legal documentation on the reclaimed land was identified as the main cause for conflict and discontent. But this is not the only problem. In spite of the introduction of market-based mechanisms to set the administrative price of land, the latter are still consider insufficient. Many complaints arise from the fact that neighboring, similar pieces of land may be valued differently if they lie within different administrative jurisdictions.

Even when administrative prices are close to the market price of equivalent agricultural land, they are substantially lower than the price it can fetch once it is converted into commercial, industrial or residential land. The users of the agricultural land being reclaimed do not benefit from the resulting capital gain and often complain about it.

Problems are aggravated by corruption and poor communication. Several studies put land and housing agencies at the top of the corruption ranking in Vietnam, or close to it. The list includes the ICS of the World Bank, the pilot corruption diagnostic study conducted by the Internal Affairs Committee of the Party in seven cities, and a report cards study done in four cities by the World Bank with support from the Ministry of Home Affairs (MOHA) yield all a consistent message in this respect. Payment of informal fees is common, although there are important regional differences. For instance, based on the ICS, less than 20 percent of firms make additional payments to receive a LUC in the South Central Coast, compared to nearly 60 percent in the Red River Delta.

As for communication, the report cards study mentioned above uncovered a high demand for information on land-use plans and zoning decisions. But less than one fifth of respondents were aware of them. An additional complication comes from the different timeframes for zone planning cycles and land leases. Under the new Land Law, long-term land use plans are to be drafted for a period of ten years, broken down into more detailed five-year plans. But the timeframe for land leases is from 20 to 50 years. At present, continuation rights are not well spelled out. Neither are the redemption rights for enterprises whose LUC is withdrawn as a result of land re-classification.

Disagreements over the compensation of affected populations have resulted in considerable delays in the conversion of agricultural land. A publicized case concerns Ha Tay province. In 2002, Kim Bai company submitted a request to lease 6,442 square meters of pond land behind the company's head office, in Thanh Oai. The provincial People's Committee approved the application in 2004, after a two-year consultation and bargaining process with the affected households. The company agreed to pay 11,000 dong per square meter in compensation, and to contribute 3.3 million dong per *sao* in support of infrastructure building by the People's Committee. However, shortly after the local residents prevented the company from filling in the ponds. They were afraid that the new factory would pollute their stream. The dispute continued despite several new rounds of negotiations and assurances by the company that its factory would have an international-standard waste water filter system.

Since 2004, provincial People's Committees are required to establish resettlement zones to provide housing for households whose land has been recovered by the state. In practice, few of these zones have been created, and complaints abound on the lack of provision of proper housing for households whose land has been reclaimed. And since 2005, foreign investors are no longer required to pay for the reimbursement of existing tenants of the land they are allocated. Under

the revised policy, investors pay the lease and the provincial government takes charge of all resettlement and ground clearing expenses. If the investor incurs such expenses, it can deduct them from the cost of the lease.

7. THE LABOR MARKET

Vietnam is well-known for its disciplined, hard-working, fast-learning population. This is the country's main asset in its drive for economic development. Low wage costs also make it one of the main sources of its international competitiveness. Not surprisingly, the surge in business activity associated with economic reforms has led to a huge increase in the demand for labor. This has translated into a double mobility: occupational, from agricultural jobs to non-farm employment; and geographical, from rural to urban areas. But wage employment is unevenly distributed across the country. And the same is true of labor earnings, which vary considerably from province to province. Disparities in earnings have been reduced with economic growth, as also has the earnings gap between men and women. But the labor market reward to education has increased, opening the prospect of a different kind of inequality as Vietnam develops. Improvements in labor earnings have not been associated with labor conflict. Strikes have been uncommon, and have basically bypassed the official industrial relations system. Overall, Vietnam is characterized by rather decent working conditions, and corporate social responsibility (CSR) principles are gradually being accepted in key export sectors. Unemployment has not been a major issue either, with most of the jobless being young, relatively educated entrants to the labor market. Over-staffing is still common in the state sector. It is rather the excessive turnover of qualified workers that creates a problem for business. But the main weakness of Vietnam's labor market is the social protection system built on it. Traditionally conceived for public sector workers only, this system still needs to complete the transition to a market economy, so as provide affordable insurance against major risks to workers who are increasingly mobile, occupationally and geographically.

Employment and migration

Labor force participation rates are unusually high in Vietnam, both for men and for women, whereas unemployment rates are unusually low. From the onset, this establishes a clear difference with other countries, where the most pressing labor market issue is often to understand why so many people are inactive or out of a job. In Vietnam, a large majority of the working-age population is active, and most often employed (Table 7.1). Understanding the characteristics of the jobs available as the economy develops, or the determinants of the earnings they provide, are thus the most important labor market issue.

Rapid economic growth has resulted in two, related forms of job mobility. From an occupational perspective, an increasingly large share of the population works out of agriculture. Farming jobs absorb less than 40 percent of the working-age population nowadays, compared to roughly half in the 1990s. This decline has been compensated by an increase in the share of wage jobs, relatively minor in the state sector, but considerable in the private sector. By now, household businesses, registered domestic private enterprises and foreign invested companies provide wage employment to more than 18 percent of the working age population. This is slightly higher than the share of self-employment, and more than twice the share of the state sector (government and SOEs combined). If anything, these figures may under-estimate the role of the private sector, as they are based on household survey data. Individuals working for

equitized enterprises and for joint ventures involving the state sector may declare that they work for SOEs, thus inflating the share of the latter in the working-age population.

Table 7.1: The Structure of the Labor Force

	1993	1998	2002	2004
Inactive	19.42	15.32	16.69	17.17
Active	80.58	84.68	83.31	82.83
Employed				
Government	3.08	3.55	4.44	5.25
SOEs	2.50	2.57	3.30	3.14
Private enterprises	10.78	10.14	15.71	16.99
FDI companies	0.10	1.12	0.80	1.33
Non-farm self-employment	14.67	16.52	19.05	16.52
Farmers	49.46	50.15	38.2	38.77
Unemployed		0.63	1.80	0.83
Total unemployment rate		0.74	2.16	1.00
Urban unemployment rate		1.44	3.31	1.96
Urban unemployment rate (MOLISA)		6.85	6.01	5.60

Source: Own calculations based on data from GSO and MOLISA. All figures are in percent of the population aged 15 to 64, except for unemployment rates, which are in percent of the active population. The last row is based on MOLISA's labor force survey. All other figures are from VLSS and VHLSS. Household businesses are treated as private enterprises for their hiring of wage workers, and as a source of non-farm self-employment for the jobs they provide to household members on an unpaid basis.

The second form of mobility characterizing the Vietnamese labor market in recent years is geographical. Some people engage in non-farm employment without leaving the rural areas they live in. But for a large share of the population, moving from farming to wage employment also entails moving from rural to urban areas. Migrants now make up a large proportion of urban residents. Migration into large cities, most notably Hanoi and HCMC, has been happening at a faster pace. The extent of this phenomenon is probably under-estimated, as data from population censuses gets quickly outdated. The recent, mid-term population census of HCMC uncovered 420,000 more people living in the city than had been predicted by GSO. It also appeared that roughly 30 percent of HCMC's population is made of migrants who have non-permanent registrations.

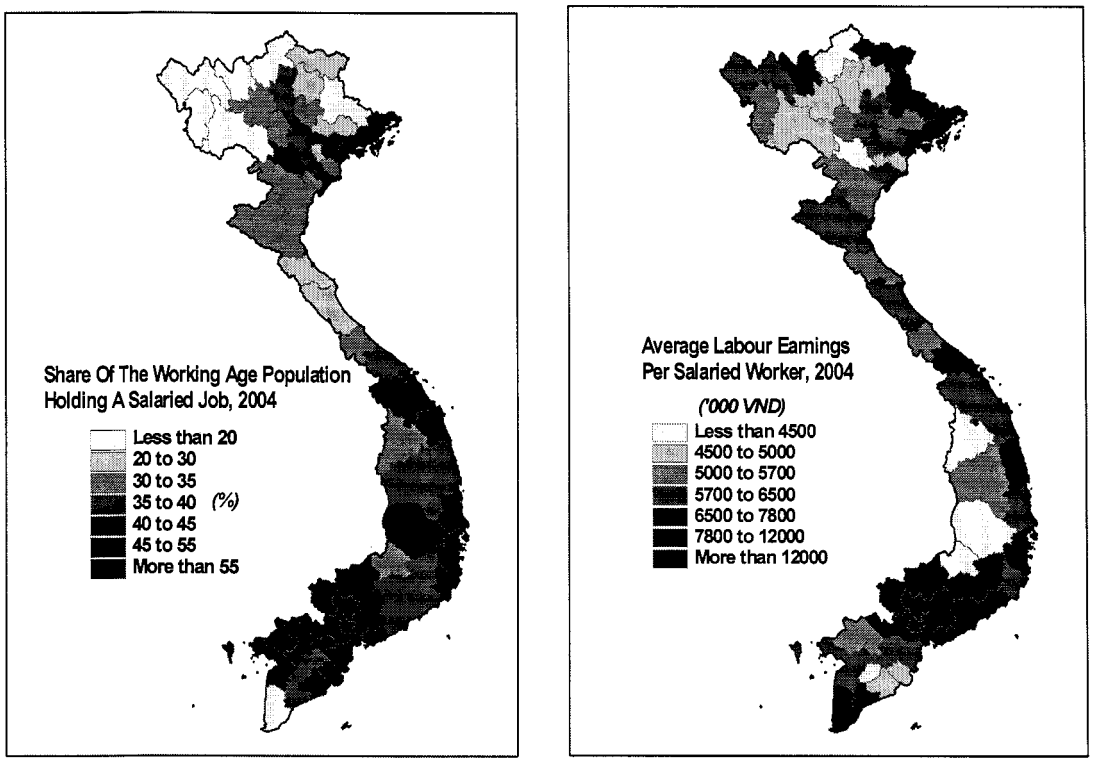
In Vietnam, the right of individuals to freely choose their place of residence and work is enshrined in the Constitution. As the migration flow puts additional pressures on already overloaded infrastructures and public services in major cities, local authorities have established implicit barriers to labor movements leading to additional costs borne by migrants, apart from natural relocation costs. The registration system, whereby migrants who do not have a place of residence do not get access to some basic services, is the main administrative barrier to

geographical mobility. But it has not deterred a massive move to the provinces, districts and communes where the jobs are.

A recent study of migration issues in Thanh Hoa and Nghe An provinces, by ADB, GSO and VASS, shows that 42 percent of the households count a migrant among their members. In more than 80 percent of the cases, these migrant members work in a different province. And in most cases, they contribute to higher living standards at home. About 36 percent of the respondents in this study declare that migration has led to a substantial increase in family income, and an additional 61 percent report a marginal increase. Less than 4 percent consider that their situation is worse due to the migration of a household member.

Migration is partly driven by the huge geographical dispersion of wage jobs (Figure 7.1; left panel). Almost two thirds of those at work in HCMC do it for a wage or a salary, and the share is around 60 percent in Danang and Hanoi. This is where the opportunities for work are. At the other end, the share of wage employment in the total is below 20 percent in Dien Bien, Son La, Lang Son and Lao Cai. These figures should be interpreted with some caution, as the VHLSS is not precise enough in the case of small provinces, especially if the number of wage workers is low. Weak precision makes comparisons between two consecutive surveys hazardous. But the gaps in the shares of wage employment across provinces, in any particular point in time, are large enough to be significant. It clearly appears that wage employment is more prevalent in some areas, and especially in the South East and the north east corridor to China.

Figure 7.1: Where Are the Jobs? And how much Do They Pay?



Source: Own calculations based on GSO data.

Wages and the cost of labor

The average wage in Vietnam, based on the VHLSS 2004, is about 824 thousand dong per month, or roughly 55 dollars. This figure is an average computed over both salaried workers and casual laborers, including the value of in-kind benefits. The figure is admittedly crude; for instance, in-kind benefits are most likely under-estimated. But even if it is not highly precise, it confirms that labor is cheaper in Vietnam than in neighboring countries. The picture is similar when data from FDI companies is considered instead. According to a recent report by MPI, the average wage of a laborer in this sector is around 75 to 80 dollars per month, the average salary of an engineer is about 220 to 250 dollars, and that of an administrative officer is close to 500 dollars. And this is despite the fact that wages in FDI companies are considerably higher than in domestic enterprises operating in the same sectors.

Labor costs are by and large unaffected by minimum wages. At 350 thousand dong per month, the most generally applicable minimum wage is below what most registered enterprises pay; and substantially below the earnings of skilled workers. A higher minimum wage applies to foreign companies, but the dual regime will need to be abolished once Vietnam enters the WTO, as it contradicts the "national treatment" principle. In fact, the minimum wage is relevant in Vietnam mainly because of its implications for public sector pay, and potentially for the pension obligations of the government. But it can hardly be considered as a binding constraint from a labor market perspective.

Moreover, focusing on remuneration levels only leads to an over-estimation of the "true" cost of labor in Vietnam. It amounts to ignoring the remarkable work ethic of Vietnamese workers. In many countries, one of the main problems faced by business is how to elicit effort from their employees. But shirking is much less prevalent in a population which can be described as workaholic. This unusual willingness to work hard is confirmed by the WVS. Many respondents in Vietnam declare that work is an important part of their lives, which is common in many other societies around the world. What is uncommon, however, is the attitude towards leisure. Only 7 percent of Vietnamese respondents see it as an important part of their lives. This is a remarkably low percentage even by the standards of other hard-working societies, such as Japan (40 percent) or the United States (43 percent).

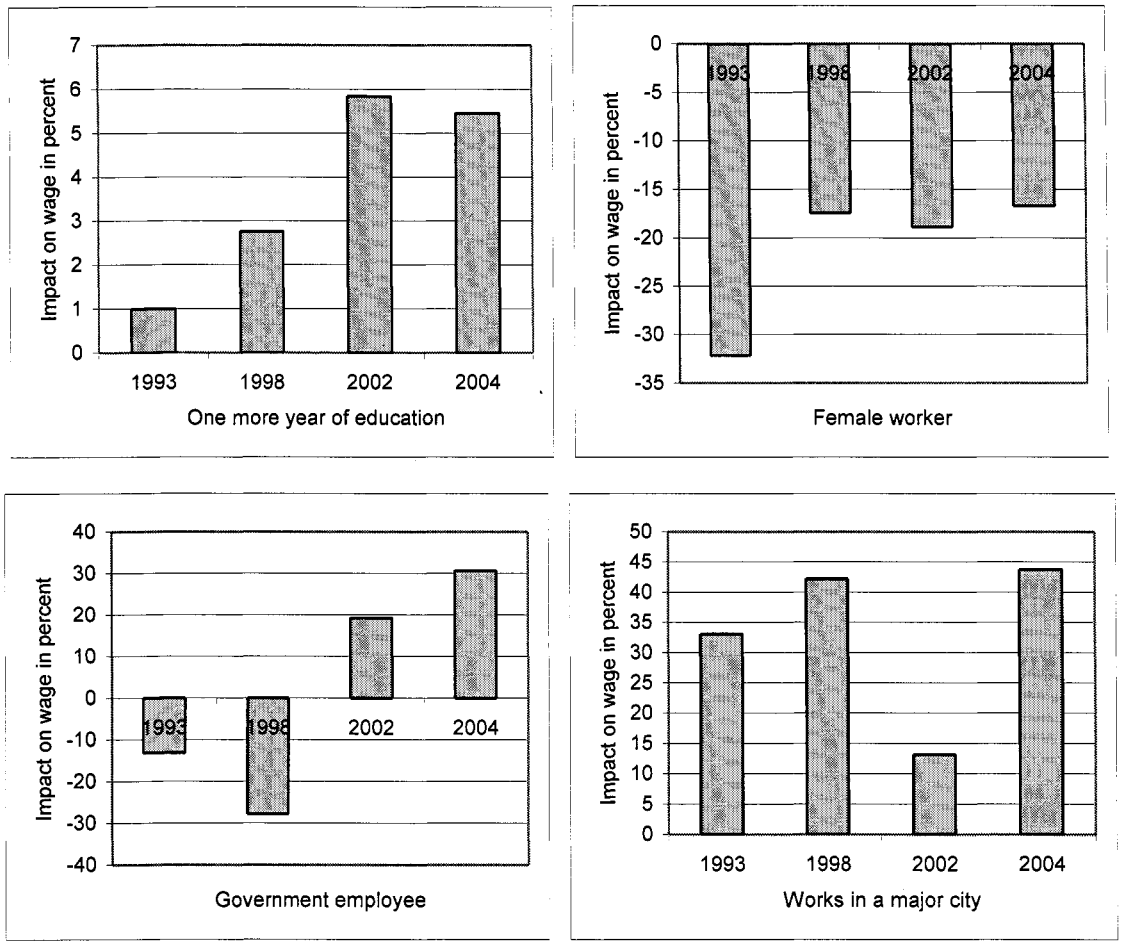
However, there are considerable differences in remuneration levels within Vietnam, and this is another important driver of migration (Figure 7.1; right panel). Again, using data from the VHLSS 2004, the average monthly wage in HCMC was close to 1.5 million dong per month, and it exceeded 1.2 million in Quang Ninh and Hanoi. At the other end, monthly wages in Hau Giang, Tra Vinh, Soc Trang, Ha Nam and An Giang were below 0.5 million. It is also interesting to note the contrast between the Mekong Delta and the North East mountains. In the former, a large fraction of those at work are wage earners, but they do not make much. This is because of the prevalence of casual, agricultural work. In the latter, wage earners are a small fraction of all employed, but their earnings are high. This is because most wage earners work for the public sector, in one way or another, whereas private sector employment is not much developed.

Remuneration levels depend not only on the province workers live in, but also on their own characteristics. Educational attainment and work experience are among the most important determinants of earnings at the individual level. But the labor market does not necessarily treat equal individuals in an equal way. Important gaps exist across jobs, and especially between the public and the private sectors. Pay levels in the former are not necessarily aligned with the market, which may result in some public sector workers being privileged and others being under-

paid compared to their private sector counterparts. There are also important gaps between jobs in urban and in rural areas. And women tend to earn less than men in every society, with the magnitude of the gender gap in pay saying something relevant about the extent of inequality among sexes.

Standard statistical tools allow estimating these gaps on the basis of individual data from surveys such as the VHLSS. The estimates can be interpreted as the percentage change in earnings associated with a change in the individual or job characteristic considered. For instance: by how much does remuneration increase if the person has one more year of education, or if the person lives in an urban area, or works for government, or is a male? While such interpretation involves some important methodological caveats, it still provides a telling picture of the Vietnamese labor market, and how it has changed over time.

Figure 7.2: Determinants of Labor Earnings



Source: Own calculations based on GSO data.

The labor market premium to education has become more important over time. In 1993, one additional year of schooling was associated with a 1 percent increase in wages, everything else equal; ten years later it was associated with a 6 percent increase (Figure 7.2). This apparently

minor gap makes a substantial difference when compounded over several years of schooling. In 1993, an employed person with a university degree earned, on average, 10 percent more than someone with primary education only. By 2002, the average gap had widened to 80 percent. On the other hand, women are less disadvantaged than in the past. In the early 1990s, the average woman worker earned 32 percent less than a man of the same age, education and experience living in the same area. By 2004 the gender gap had fallen to 17 percent.

The relative position of government employees also changed considerably during this period. By 1998, a civil servant earned 28 percent less than an otherwise identical wage earner out of government. However, as a result of the public administration reform agenda and its associated pay increases, by 2004 the situation had been reverted, and civil servants earned 30 percent more than their equivalents out of government. It should be noted, however, that these figures are averages across all government employees. Pay tends to be more compressed in the public sector than out of it. Therefore, civil servants in professional and technical occupations could still be underpaid compared to their private sector counterparts. Civil servants at the low end of the hierarchy, however, are most likely overpaid.

Finally, the results indicate a substantial wage premium associated with employment in major cities, compared to rural areas. Except for the year 2002, for a worker with average characteristics in terms of age, education and experience, the gap was between 33 and 44 percent. The smaller gap estimated for 2002 may say more about the quality of household survey data on that particular year than about the wage gap. Admittedly, living in cities is more expensive as well. But the magnitude of the gap is revealing of the migratory attraction large cities might exert on rural populations. On the other hand, the wage premium associated with small cities, not reported here, is much more modest.

Several other studies, relying on different methodologies, add important nuances to these findings. An analysis of wage inequality conducted by ILSSA, using data from the 1998 VLSS and the 2002 VHLSS, shows that the payoff to an additional year of education varies across groups of workers. The returns to schooling are indeed higher in urban areas than in rural areas. They are highest in FDI companies, followed by the domestic private sector. Interestingly, they are also higher for female workers than for male.

Data from the three-wave round of SMEs, also by ILSSA, reveals a remarkable equalization of wages over time. In the 1991 round, there were large differences in labor remuneration between the north and the south, between rural and urban areas, and between men and women. By the 1997 round, these differences had diminished greatly, with the notable exception of the rural-urban gap. For instance, in the 1991 round, average wages in HCMC were roughly twice those in Hanoi and Haiphong; by 1997, the gap was in the range of 30 to 50 percent. Wage differences across ownership forms also diminished considerably. For instance, by 1997 remuneration levels in household business had more or less caught up with pay in registered enterprises.

The gap in remuneration levels between urban and rural areas is suggestive of labor market segmentation. Barriers to geographical mobility, from transportation costs to registration permits, make segmentation likely. In practice, this means that urban jobs are "better" than the jobs available to those living in rural areas. Evidence on this gap in job "quality" is reported in a study by Mekong Economics, showing that four out of five factory workers were satisfied, and would promote working in a factory to their friends and families. Further proof is provided by the willingness of many workers to pay a recruitment fee to get a factory job. Interestingly, the study found that more than 11 percent of women pay for their jobs, compared to only 7 percent of men. The average payment to work in a foreign company was 274,000 dong; roughly half of that is paid for an SOE job. There is also evidence that migrant workers "pay" for these better jobs

through lower levels of remuneration, compared to their non-migrant colleagues, as if their migrant status put them in a weaker position when bargaining with employers (Box 7.1).

Box 7.1: Migrants in the Textile and Garment Sectors

Do migrant workers earn less than what can be expected on the basis of their education and experience? And are they less likely to receive training than similar non-migrant workers? A survey of 150 textile and garment firms, including individual interviews with eight workers in each, can be used to attempt an answer to these questions. Overall, 15 percent of the interviewed workers were migrants; and three quarters of the migrants were female.

Migrant workers in the survey are 25 years old on average, as opposed to 30 years for non-migrant workers. They have less education too: only 26 percent has completed upper secondary school, against 55 percent of the non-migrant workers. And they also work for less than their non-migrant counterparts. On average, they make 877,000 dong per month, compared to 937,000 in the case of non-migrants. But do they really earn less after taking into account the fact that they are younger and less educated? Not on the surface. Standard statistical tools suggest that they do earn more. But this is a spurious result, due to very nature of geographical mobility. Migrants tend to move to the regions and firms that pay relatively well. Once the overall "premium" for firm and location are taken into account, the results suggest that migrant workers earn 13 percent less, everything less equal, than non-migrant workers.

The same methodology, involving individual characteristics but controlling for firm and location, can be used to evaluate access to training. In this case, it appears that migrant workers do better than non-migrants, as they receive more training. However, in spite of this additional training, they are less to work in skilled jobs compared to similar, non-migrant workers.

Source: Based on Remco Oostendorp (2004).

Other common forms of labor market segmentation appear to be less prevalent in Vietnam. In particular, a recent study by ADB did not uncover significant gaps in the labor market payoffs to individual characteristics between formal and informal sector jobs, nor between farming and off-farm jobs.

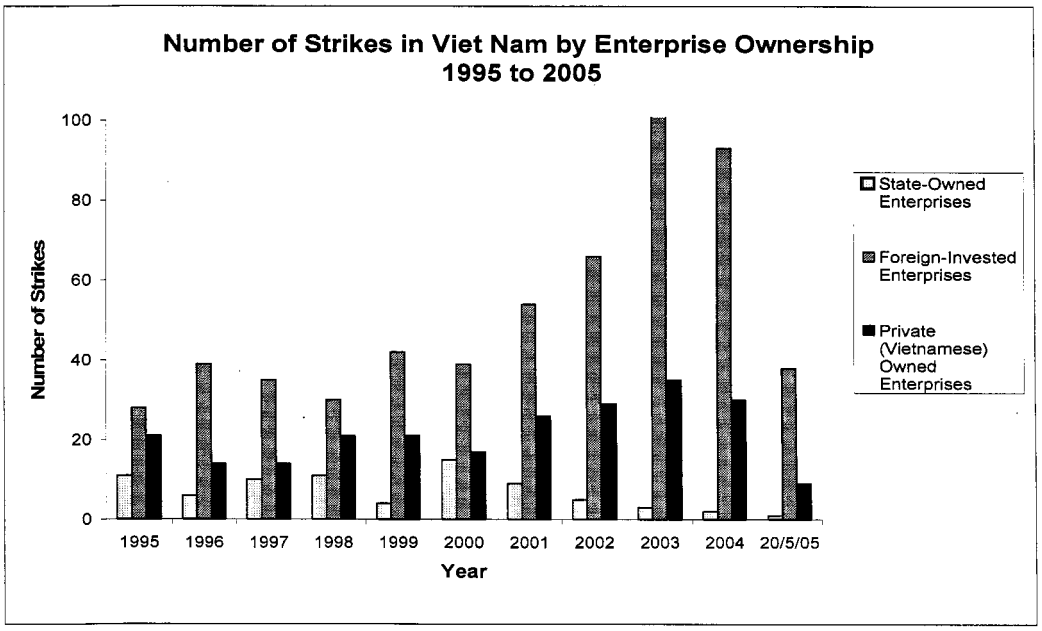
Industrial relations

There is limited industrial conflict in Vietnam. While the number of work stoppages has increased in recent years, data collected by the Vietnam General Confederation of Labor (VGCL) and the ILO reveals barely more than 700 strikes since the introduction of the Labor Code, in 1994 (Figure 7.3). Most of these stoppages were in foreign companies in the South. But even there, strikes remain a rare event. There were only 100 of them in 2003, at a time when there were about 2,650 foreign companies in operation. The domestic private sector is even less disrupted by industrial strife. In 2003, at a time when the number of private domestic enterprises reached 65,000, there were still less than 40 strikes.

Reports suggest that most strikes have resulted from legal or contractual breaches, including failure to pay wages and benefits, failure to pay social insurance contributions, and failure to pay severance pay at termination. In some cases, industrial conflict was prompted by demands by workers to do overtime beyond what is allowed by law. SOEs seem to comply with

labor regulations more thoroughly than private firms. For instance, they report a larger share of their workforce for social insurance and health insurance.

Figure 7.3: Number of Strikes by Enterprise Ownership



Source: Jan Jung-Min Sunoo (2005) and Simon Clarke (2004).

However, formal compliance is not always reflected in better working conditions. For instance, in a series of formal interviews conducted in the garment and footwear sectors, by Mekong Economics, workers at SOEs reported more access to first aid, protective clothing, drinking water and wash rooms than in other factories. Workers employed by foreign companies reported the least access. But this contradicted the findings from the focus group discussions and the observations carried out for the study. In practice, infrastructure in SOEs was found to be poor compared to foreign companies. Working conditions in the latter also appear to be better than in their counterparts in neighboring countries (Box 7.2).

The 2002 revision of the labor code sets out the procedures to follow in case of collective labor disputes. But these procedures are clearly not followed in practice. In principle, in case of conflict a written request for conciliation must be submitted to the Labor Conciliation Council in the enterprise, which must react within seven days. If either part rejects the Labor Conciliation Council's proposal to resolve the dispute, it can refer the dispute to the Labor Arbitration Council, which begins work within 10 days of receipt of a written submission. If either part disagrees with the proposed solution, the matter can be referred to the People's Court. But at this stage, the Executive Committee of the trade union can decide to strike, based on a secret ballot. A strike which occurs while this reconciliation process is underway, or which is not endorsed by more than half the union members, is considered illegal. Although all strikes have been technically illegal, sanctions which can be used against unlawful strikers have almost never been invoked. Police action against striking workers has not been part of the government response either. In practice, collective labor disputes may be resolved through other channels, such as the human resources manager of the enterprise calling DOLISA to play a mediating role, despite this not being part of its formal mandate.

Most factories have trade unions, but many of these do not operate in practice, and some exist in name only. Trade unions are more active in SOEs. But only one third of foreign companies and 15 percent of domestic private enterprises have a collective agreement in place. The study on the garment and footwear industry by Mekong Economics, mentioned above, shows that trade unions mainly provide social services to their members, such as organizing social events, sporting activities and field trips. In some cases they provide interest-free loans to their members, as well as bonuses and gifts on special occasions such as Tet, International Women's Day or Children's Day. In a similar vein, a survey conducted by ILSSA in 24 enterprises found that only 16 percent of workers felt that the trade union had a role in dispute resolution.

Box 7.2: Taiwanese Firms in China and Vietnam

How is human resource management affected by the host-country environment? A recent study tried to answer this question by interviewing local officials, trade union representatives and expatriate middle-level managers in 36 Taiwanese enterprises. The study concluded that working conditions were better in Vietnam than in China, with labor standards being more rigorously upheld, especially in relation to working hours and penalties.

Taiwanese managers said that the "militaristic" style of management that they apply in China was not effective in Vietnam and that they were therefore adopting a "soft" management technique. The following quotes illustrated the difference in approaches and emphasize the workers' awareness of their rights as an important factor:

> *"You cannot even touch Vietnamese workers, let alone abuse them. In China, we have used a Taiwanese management style. When we began our operations in China, we frequently resorted to punishment. Physical punishments were very common, including even hitting, like in the military."*

> *"Their human rights awareness is very high.... That is why I think Taiwanese who are into shoemaking here have to face a lot of labor disturbances and strikes. They easily stage mass protests. In our company this happened last year on the night of the Moon Festival. Their labor and democratic consciousness is very high. .... This is not just a problem only at my factory; this is a problem of the entire society. In Vietnam their protection of labor rights is too stringent. This is something totally unexpected."*

The study identified other factors which have been important in improving working conditions, relative to China. Of primary importance was the different application of the household registration system. In China, employers may withhold documents, effectively preventing workers from changing jobs. In Vietnam, by contrast, employers are not involved in household registration. The provision of company dormitories, which is common practice in China but not in Vietnam, also allowed greater control over workers' movements. The study also argues that the VGCL, though still a state-controlled organization, enjoys more autonomy, and some support from the international labor movement. It claims, finally, that differences in the decentralization process have reduced government control over labor standards more quickly in China than in Vietnam.

Source: Anita Chan and Hongzen Wang (2004).

Labor inspections are not a particularly effective mechanism to enforce labor standards either. As of 2004, the labor inspectorate of MOLISA had a staff of about 300 inspectors and related officers. Since 1995, inspections have been carried out in only 1,635 enterprises. Respondents to the ICS by the World Bank are ambivalent about visits by labor inspectors, which

are regarded as being neither particularly helpful nor unhelpful; perhaps because there are not many of them. Nor are they especially demanding: ICS respondents reported that gifts or unofficial payments were expected in about one quarter of inspections by MOLISA, which is considerably less than with other government agencies.

On the other hand, the concept of CSR has been embraced by some private enterprises in Vietnam. CSR is based on the notion that businesses can voluntarily adopt social, environmental and ethical practices which are both profitable and good for economic development. The incentive to introduce CSR is stronger among multinational companies with valuable brands, among labor-intensive firms working under contract and in enterprises with a high visibility (publicly traded, or in high-impact sectors such as oil or mining), among others. In Vietnam, adoption of CSR principles is emerging in garments and footwear, where enterprises have been required or encouraged to adopt one or more codes of conduct (Box 7.3). These codes of conduct normally force compliance with the Labor Code and with a set of principles covered by the ILO "core conventions" on forced labor, child labor, discrimination, freedom of association and collective bargaining. They also typically cover health and safety, wages and hours of work.

Box 7.3: Corporate Social Responsibility in Vietnam

Almost all Vietnamese suppliers to the global chain in textile and footwear production first confront CSR through codes of conduct developed by individual buyers. Through these codes, the buyer specifies social and environmental standards to be met and acts as the monitoring partner (either directly or through third parties). Suppliers usually accept the terms in the hope of improving their reputation and attracting larger and more stable contracts.

About 1,000 codes are in operation globally, almost all developed by individual companies focusing of their business needs. Not all of these codes are being used in Vietnam. But many suppliers in Vietnam are working with more than one buyer, so that they have to comply with more than one code. Some large suppliers deal with up to six of them.

Significant numbers of workers are covered by some company codes of conduct. For example, Nike, a producer of athletic shoes and sports apparel, estimates that 84,000 workers are covered by its code of conduct across the 34 Vietnamese firms in its supply chain. Adidas-Salomon, a competitor, reports nearly 43,000 workers under its own code. These codes appear to be enforced. In 2004, Adidas-Salomon terminated business relations with one of supplier due to excessive working hours, insufficient time-recording systems, incorrect payment of wages and benefits, improper worker-management communication and poor health, safety and environment conditions.

Basic information on CSR is provided by business associations, such as VITAS in the case of textile, and LEFASO in the case of footwear. But the specifics of the codes are detailed by the buyer. This top-down relationship between buyers and suppliers means that most Vietnamese enterprises engaged in CSR are passive implementers. Few of them are developing CSR practices on their own, in the hope of increasing their market share. However, suppliers which were initially responding passively to buyer requirements now see CSR investments as a way to increase workers' satisfaction and reduce turnover and reported ill health.

In parallel, a growing number of enterprises are choosing to demonstrate commitment to responsible practices by complying with internationally-recognized factory certification schemes, such as WRAP and SA8000. Vietnam had 27 SA8000-certified facilities in September 2005, covering nearly 28,000 workers. This placed it in fifth place, worldwide (after China, India, Italy and Brazil), in terms of number of workers covered.

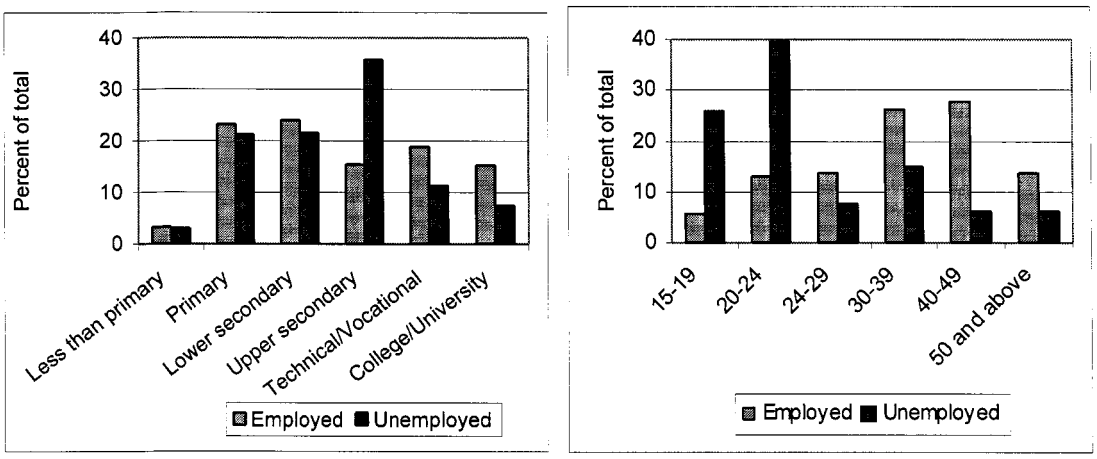
Source: World Bank (2003), ILSSA (2004).

Unemployment

The unemployment rate of Vietnam is low by international standards. Admittedly, household surveys and labor force surveys yield estimates which are not strictly comparable (Table 7.1). The former have a more representative coverage of the population, whereas the latter allow computing the unemployment rate in exactly the same way as the ILO would recommend. But for the country as a whole, there is no doubt that the unemployment rate is very low. For instance, the Survey on Employment and Labor, conducted by MOLISA in 2003 reports 0.95 million unemployed, at a time when they were 41.31 million labor force participants. This is equivalent to an unemployment rate of 2.30 percent, very close to the 2.16 percent rate estimated based on household survey data.

Low unemployment rates are not surprising in a still predominantly rural economy. The problem in rural areas is seasonal underemployment, rather than open unemployment. But even for urban areas, unemployment rates are quite low, ranging between 2 and 6 percent depending on the data source used. Moreover, detailed information on the characteristics of the unemployed, obtained from the VHLSS 2004, shows that they are mainly young and relatively educated (Figure 7.4). Needless to say, joblessness can be a painful experience, even for first-time job seekers who enjoy considerable family support; and it may become a source of frustration and social tensions. Also, a low unemployment rate may hide considerable under-employment, especially in rural areas during periods of low agricultural activity. But based on this key statistic, open unemployment is not of Vietnam's main problems.

Figure 7.4: Key Characteristics of the Unemployed



Source: Own estimates based on data from GSO. Figures are for 2004.

The flip side of a low unemployment rate is usually a high vacancy rate, and this is probably what respondents to the ICS by the World Bank complain about, when they identify skills and education of available workers as a major or severe constraint. A high vacancy rate is associated with high labor turnover, with the best workers voluntarily moving to (or being poached by) other enterprises. A recent study on FDI, by CIEM, is quite compelling in this respect. It shows that over the period from 2001 to 2003, the labor turnover rate among foreign companies reached a stunning 43.4 percent. Turnover is highest in textiles, garments and

footwear. Among those changing jobs, 42 percent are skilled. According to information provided by the companies which lost workers, 32 percent of them moved to other foreign companies, 23 went on to establish their own business and 18 percent took jobs in domestic enterprises (information about the rest is not available).

Labor turnover also appears to be highest in the south. The three-round survey of SMEs conducted by ILSSA found a marked difference between Hanoi and Haiphong on the one hand, and HCMC on the other. In Hanoi a little more than 10 percent of the enterprises surveyed in the second round had lost any wage workers, and almost as few had recruited any new workers. In HCMC, by contrast, almost half of the enterprises had lost workers and an equal proportion had hired new workers. It also appeared that this high turnover was mainly voluntary, with very few instances of workers being fired. In the vast majority of cases the initiative seems to have come from the worker, not from the enterprise.

On the other hand, there is a latent unemployment problem in SOEs, many of which inherited a bloated workforce from the period under central planning. The extent of labor redundancy is difficult to estimate in practice. However, there are several indications to suggest that labor redundancy in SOEs is still considerable, although its distribution across activities is probably quite uneven.

One indication comes from the ICS conducted by the World Bank, as it directly asks managers what they would do if they were allowed to cut their workforce without restrictions. All firms responded that they would downsize to some degree, but SOEs would go on average for a 14 percent cut, compared to only 3 percent for domestic private firms. Yet, SOE directors may not have an incentive to fully report the extent of over-staffing, as a bloated workforce could be seen as reflecting poor management.

Another piece of evidence comes from the operation of the social safety net fund for redundant SOE workers, instituted under MOF in 2002 to assist the equitization process. This safety net fund provides more generous compensation for job loss than stipulated in the Labor Code. Workers who are either separated from their jobs or volunteer to leave are offered two months of basic salary per year of service. In addition, they receive a training allowance and a job-seeking subsidy together equivalent to 12 months of salary, and a lump-sum of 5 million dong. Two tracer studies of retrenched SOE workers assisted by this fund indicate a relatively high level of satisfaction, suggesting that SOEs may not be afraid of downsizing through this mechanism. On average, 49 workers were separated from the 2,228 SOEs supported by the fund, which corresponds to an average redundancy rate of 19 percent. But this figure is an under-estimate too, as it does not include workers separated through early retirement, or workers hired after the beginning of the equitization process, who are not eligible for assistance by the fund.

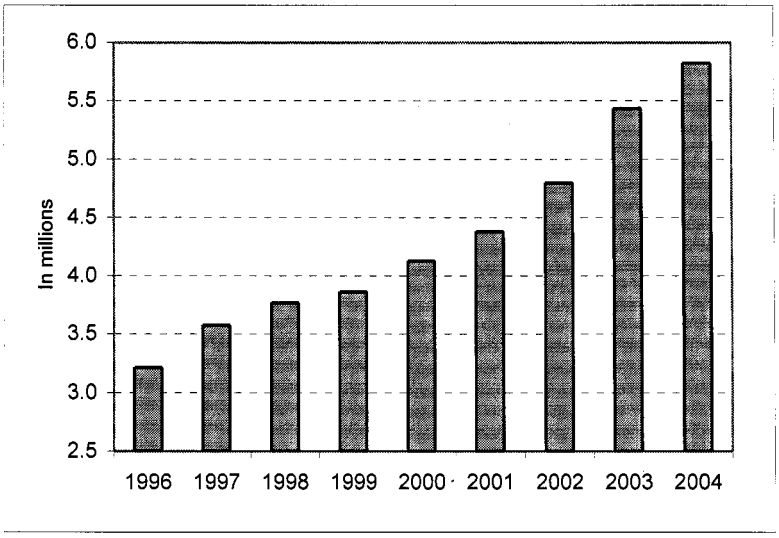
Social protection

Before the approval of the Labor Code, in 1994, only public sector workers were entitled to formal social protection in Vietnam. The Labor Code stipulated that all workers who engaged in labor contract longer than three months or with an indefinite term were to be covered by a compulsory social insurance program. The total contribution rate towards this program amounts to 20 percent of the salary, formally split between 15 percent to be paid by employers and 5 percent by workers. The Labor Code also places the responsibility on businesses engaged in agriculture, forestry, fisheries and salt production to participate in forms of social insurance suitable to their production and employment characteristics. In 2005, coverage was extended to all workers in registered enterprises, regardless of their type of contract.

The social insurance system provides a series of short- and long-term benefits, the most important of which is old-age pension. Men are eligible to retire at age 60 and women at age 55, provided that they have contributed for a minimum of 20 years. The pension level is defined by a formula involving the average wage over a certain period of time and a replacement rate. The latter varies with the number of years of contribution, from 45 to 75 percent. The former is computed over the last five years for public sector workers, but over the entire enrollment span for private sector workers. Because there is no indexation mechanism in the formula, the "average" wage to which the replacement rate is applied falls short of the average real wage of the retiring workers. In the case of the private sector, where the average is computed over the entire contribution period, it does so by a considerable margin. Those who have contributed for less than 20 years are entitled to a lump-sum payment, much lower than the present value of the contributions made. Given the relatively low coverage of social insurance in Vietnam, workers changing jobs run the risk of losing their entitlement to old-age pension.

The expansion in the number of enterprises which are formally registered and the sustained growth in wage employment had led to an increased formalization of the economy (Figure 7.5). This is reflected in the growing share of labor relationships involving enrollment with social insurance, a long-term horizon, written contracts or other elements of protection, as captured by household surveys and other statistical instruments focusing on individuals. But the trend is also captured through the administrative records of the Vietnam Social Insurance (VSI) agency. Moreover, a substantial increase in formality is expected in 2005, due to the extension of coverage to all salaried workers in registered enterprises, regardless of their type of contract.

Figure 7.5: A gradual Formalization of Employment



Source: Based on data from VSI.

The formalization process could hide, for quite a long time, the fact that the current social insurance program of Vietnam is not financially viable. At present, and setting aside retirees from the program that was in place until 1995, the ratio of contributors to beneficiaries is close to 17, which is abnormally high by international standards. Moreover, this ratio only decline slowly. Because the population is young, over a long period the cohorts entering the labor market will be much larger than those reaching retirement age. Also, because the economy will become

more urban and more formal, the share of the labor force contributing to social insurance will increase steadily. As a result, the ratio of contributors to retirees could be roughly two by the middle of the century. Yet, in spite of this favorable context, the current social insurance system could be expected to move from surplus to deficit in about three decades. Under realistic assumptions, the surplus would never exceed 1.5 percent of GDP; by 2050 the deficit could be in the range of 3 to 5 percent of GDP. Either budget support or much higher contribution rates would be needed to fill the gap.

The financial weakness of the current program is aggravated by its benefit formula, which discourages long contribution periods. On the surface, the compulsory program is generous, as the payable pension increases by 2 percent of the average salary for every additional year of contribution in the case of men; and by 3 percent in the case of women. But this apparent generosity applies to an "average" salary computed without any indexation, which brings its value down compared to the actual salary at retirement age. This combination of nominal generosity and real tightness creates a considerable wedge compared to a "purely" actuarial formula. Pension benefits in Vietnam are higher than actuarial benefits when the number of years of contribution is low, but they become lower as the number of years increases.

Last but not least, the gradual expansion of the compulsory system through the formalization of employment only will fail to provide social protection to a large share of the population, including the poor. Even the introduction of voluntary social insurance programs could fail in this respect, despite the fact that the poor stand to lose more than other groups from adverse shocks. But precisely because they are poor, they might be unable to afford even the minimum level of contributions needed to participate in a voluntary program. Laying the foundations for a universal system requires that specific mechanisms be considered to reach this group. Those mechanisms necessarily involve an element of subsidy, to be paid out of general tax revenue.

Fortunately, the government of Vietnam is fully aware of these shortcomings of the current social insurance system, and a new law is under preparation to address them. The specifics may still evolve, but the intention is to make the system viable, to expand the coverage of the compulsory program, and to lay the foundations of a universal social protection system.

8. INFRASTRUCTURE SERVICES

Enormous progress in infrastructure development has been accomplished in Vietnam in recent years. The country is by now investing more than one third of its GDP. About a tenth of GDP goes into infrastructure; as a result, it is rapidly catching up with its neighbors in terms of availability and cost of services. Electrification and telephone penetration have seen the most remarkable improvements, and the road network has expanded considerably as well. Still, enterprises in Vietnam complain about insufficient transport infrastructure, and excessively expensive electricity and telephone services. Making further progress in infrastructure development requires a diversification of funding sources and improved transparency in resource mobilization, especially at local levels. The adoption of sound regulatory frameworks, facilitating cost recovery and promoting competition, could also help attract private participation in infrastructure and further contribute to business development in Vietnam. There have been a few promising initiatives in this respect, across most infrastructure sub-sectors, especially in terms of increasing competition among suppliers. However, most business participants are SOEs. Looking forward, private sector participation cannot be relied upon to address, alone, the infrastructure needs of Vietnam in the coming years. Nor even to cover a large share of those needs. In this area, business development crucially depends on the quality of public investment, and on the appropriate pricing of the services it provides.

A regional perspective

There has been impressive growth in access to infrastructure services since the early 1990s. All urban areas in Vietnam are electrified by now. In rural areas, electrification expanded from 51 percent of all households in 1996 to 88 percent in 2004. The length of the road network increased from 96,100 km in 1990 to 224,500 km in 2004. In the case of national-level roads, the increase was from 15,100 km in 1997 to 17,300 km. By 2002, 45 percent were deemed in good condition, compared to 37 percent in 1997. Access to improved water grew from around 35 percent of the population in 1993 to 87 percent in 2004, and access to hygienic latrines from 10 to 32 percent. The number of fixed and mobile lines per 100 people increased from 1.1 in 1995 to 9.2 in 2002. It is on target to reach a total of 10 million lines in 2006-2007, achieving one of the fastest growth rates of tele-density on record.

Regional comparisons confirm how far Vietnam has come in terms of infrastructure development. In some sub-sectors, such as electricity and water, access to infrastructure services approaches those of richer countries in the region. In others, like sanitation and telephones, access levels are some distance behind the best regional performers. But at comparable development levels, Vietnam does better than average for sanitation and about average for telephones. Overall, the increased availability of infrastructure has resulted in prices increasingly aligned to those in the region (Table 8.1).

Perceptions by entrepreneurs are not necessarily that positive, however. The ICS by the World Bank uncovers concerns about both the quality and the prices of the available infrastructure services (Figure 8.1). Insufficient roads and an excessive cost of electricity and

telephone services are among the main concerns of respondents. Interestingly, it is the SOEs which are most concerned about electricity prices, with much fewer domestic private firms considering it a severe or major constraint.

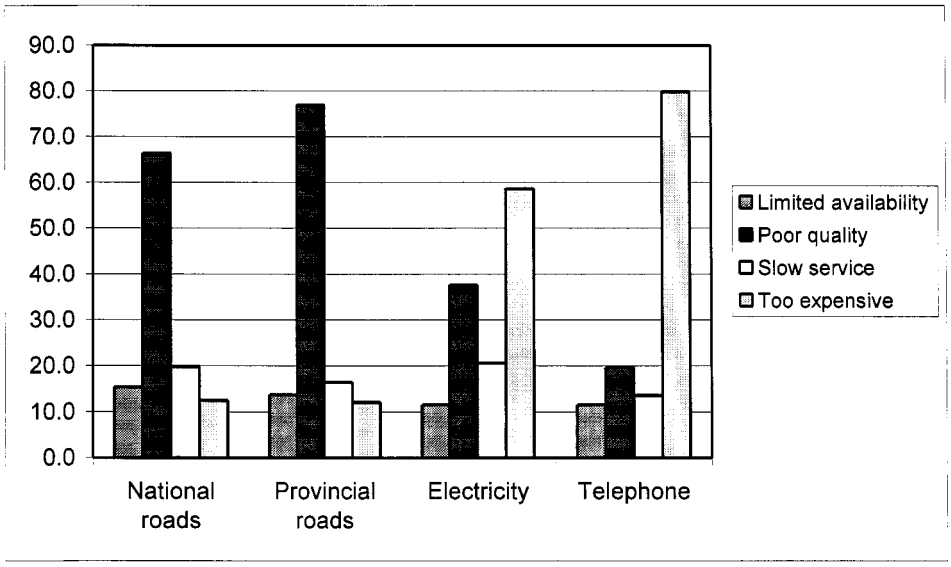
Table 8.1: Catching Up with the Neighbors

	Hanoi	HCMC	Bangkok	Jakarta	Manila	K.Lumpur
Industrial electricity (cents/kWh)	5.5	5.5	4.2	5.0	10.0	5.0
40-feet container to Yokohama (dollars)	1630	1150	1300	990	950	725
Call to Japan (dollars/three minutes)	1.95	1.95	1.49	3.78	1.20	1.42
ADSL connection (dollars/month)	76.3	76.3	14.6	782.1	25.4	162.6

Source: JETRO (2005). Figures refer to 2004.

When are asked which infrastructure improvements would have the greatest impact on their business, more than 40 percent of ICS respondents agree that improvements to roads and electricity would be most beneficial. In contrast, firms felt that improvements to railways and airports were much less important for their business. But even in the case of roads, there are interesting regional differences. Respondents in the Southeast and the South Central Coast would give priority to upgrading the national network; those in the Red River Delta, on the other hand, favor better inter-provincial roads.

Figure 8.1: Problems with Infrastructure: the Views of Entrepreneurs



Source: Based on ICS survey.

The funding for infrastructure

At more than one third of GDP, Vietnam's investment rate is already very high by international standards. Although it is difficult to estimate precisely the share of infrastructure in this total, at present Vietnam could be devoting close to 9 percent of GDP to improvements in electricity, transport, water and sanitation and telecommunications (Table 8.2). The figure would be substantially higher if investments in oil and gas were counted as well.

Table 8.2: Investment in Infrastructure as a Share of GDP

	1999	2000	2001	2002	2003
Electricity			2.81	3.39	3.23
Transport	2.81	2.64	3.71	4.03	
Water and sanitation	0.53	0.52	0.53	0.52	
Telecommunications					0.80

Source: World Bank (forthcoming). Figures are in percent of GDP.

While fast accumulation boosts future productivity, the cost is a diminution of current consumption, possibly leading to slower poverty reduction. It would be difficult to lift the investment rate much above its current level. But even without thinking of an increase, just funding the current investment effort represents a formidable challenge, in terms of both resource mobilization and transparency.

The resources mobilized in the process come from a variety of sources, including the government budget at both central and local levels, state development credit provided by DAF, the issuance of infrastructure bonds, borrowing from SOCBs, own-source revenues, and partnerships with the private sector (Table 8.3).

Apart from the budget, the key public financing institution for infrastructure is DAF. Established in 2000, in an attempt to take policy lending activities out of SOCBs, DAF is a specialized facility operated by MOF, with branches throughout the country. It serves as a mechanism for aggregating and managing funds from a variety of public sources, and on-lend to a range of projects. Its interest rates are lower than the cost of raising funds, with the government subsidizing the difference. In 2004, about 40 percent of DAF's resources were from ODA, 15 from the issuance of government bonds, 12 percent from domestic trust funds, 10 percent from social security fund, and 6 percent from postal savings, among others. Of the resources mobilized domestically, about 80 percent has been on-lent to SOEs, although this is often for the implementation of public infrastructure projects. In 2004, the DAF's outstanding loans amounted to 11 percent of GDP.

More recently, the government started issuing bonds for specific infrastructure undertakings. For instance, during the next five-year cycle bond issuance will be used to finance projects such as the north-south Ho Chi Minh Highway, roads along the borders with China and Cambodia, and irrigation works in the disaster-prone central provinces. In 2004 the government issued bonds for about 0.7 percent of GDP. In 2005 it issued Vietnam's first sovereign bond, for

roughly 1.5 percent of GDP. Bonds are kept off-budget, to comply with the State Budget Law, which limits the budget deficit at 5 percent of GDP.

Table 8.3: Where Do the Resources Come From?

Source	Percent of GDP					Percent of total
	Transport	Electricity	Telecoms	Water	All	
Budget	0.8	0.1		0.1	1.0	11
ODA	1.7	1.2		0.3	3.2	36
Govt. Bonds	1.2				1.2	14
SOCBs	0.1				0.1	1
Users		0.9	0.8	0.1	1.8	20
BOT	0.2	1.2			1.4	16
Private				0.1	0.1	1
Total	4.0	3.4	0.8	0.6	8.8	100

Source: World Bank (forthcoming). Figures are estimates around the years 2002 and 2003. ODA is channeled through DAF.

At the provincial level, the first municipal bonds were issued by the HCMC government in 2003. Provincial governments are allowed to borrow up to 30 percent of their annual budget for development investments; but the cap is 100 percent in the case of Hanoi and HCMC. Other rules for issuance of municipal debt are not yet clear; for instance; the tenure and the coupon rates of the bonds are largely determined by MOF, rather than the concerned province.

Issuance of corporate bonds for infrastructure development was pioneered by EVN, in 2001. One of the main reasons to issue the sovereign bond in 2005 was actually to provide a benchmark for corporate bonds by state conglomerates such as Vinashin. This is in fact the ultimate beneficiary of the resources raised through the sovereign bond. The justification for this use of the proceeds comes from the inability of Vinashin to borrow on a long-tem basis from commercial banks, despite having large export orders, due to the short-term nature of their deposits. From this perspective, the sovereign bond issuance can be seen as the combination of a corporate bond issuance and a government guarantee.

Except for construction SOEs working for transport projects transport sector, borrowing from SOCBs has not been a common way to finance infrastructure development. In fact, SOE borrowing illustrates the failure of SOCBs to award credit on a strictly commercial basis. Between 1999 and 2002, about 35 percent of transport commitments had been approved by the Prime Minister's office had not been allocated funding. Notwithstanding, the MOC and the Ministry of Transport (MOT) contracted their affiliated SOEs to undertake the work on the promise of subsequent reimbursement. SOCBs were encouraged to lend to these SOEs. Eventually, SOCBs had no choice but to grant loan rollovers, as the interest payments due exceeded enterprise capitalization. Arrears amounted to one trillion dong in MOC, and 1.2 trillion dong in MOT.

More recently, Local Development Investment Funds (LDIFs) have gained importance at the local level. In principle, LDIFs offer an operational and legal structure for the provincial

governments to focus on infrastructure, including the ability to enter into contracts with the private sector (Box 8.1).

Box 8.1: Local Development Investment Funds

In light of the enormous infrastructure development needs at the local level, provincial governments have been encouraged to take greater responsibility for financing their own investment projects. LDIFs were thus established in 13 provinces, with the approval and support of the central government. They have become increasingly important in Binh Duong, Dong Nai, Hanoi and HCMC. In 2004, the corresponding provincial governments channeled 7, 9, 33 and 13 percent of local investments through these funds. The HIFU, established in 1996, is the oldest of all. There has been a ten-fold increase in the combined operational capital of LDIFs since then. Meanwhile, their activities have expanded from lending to establishing joint stock companies engaged in infrastructure development.

Yet, the legal basis for the creation, organization and operation of LDIFs is still weak. They are not covered by the State Budget Law, and no national regulations govern their operation functions, including accounting and personnel management. A decree on LDIFs is still in draft form. Standards in terms of sector focus, risk weight, or portfolio quality are non-existent. As a result, provincial governments have significant discretion over their operations. Depending on the provinces, LDIFs combine in various ways elements of the accounting, financial management and personnel regimes of DAF, SOEs and SOCBs.

In practice, LDIFs play the role of a contracting vehicle with a unique legal standing, allowing the provincial government to directly partner with the private sector through joint ventures and other financial arrangements. They are also a legal entity that can be used to mobilize funds for infrastructure development from the market and other sources. From a budgeting perspective, they are used as a tool to earmark resources. Provinces such as HCMC and Dong Nai are also taking advantage of their LDIFs as units with dedicated staff specializing in infrastructure projects.

LDIFs support the development of transportation, water, health, education, housing and industrial park projects. This support is conducted in various forms, such as the direct financing of projects, joint investments with other business entities, and contribution of capital to establish enterprises which in turn develop and implement infrastructure projects. However, lending constitutes the bulk of LDIF activities so far. For instance, during its eight years of operation, HIFU it has provided 2.9 trillion dong in loans and only 0.2 trillion in direct investment. Lending tends to fall under any of three main modalities. First, there are syndicated loans, in which LDIFs take the lead in calling for capital from local banks, and especially SOCBs. Second, there is lending in combination with central government development investment credit. And third, there is independent lending for priority projects in the province.

The funds managed by LDIFs are a combination of direct contributions from the state budget, proceeds from the sale of state-owned housing and borrowing from SOCBs and DAF. In the case of HIFU, they also include the issuance of municipal bonds. The direct participation of the private sector in HIFU, either as an owner or operator of infrastructure assets, remains minimal. But it could increase thanks to a recently established framework for contracting.

Source: World Bank (forthcoming) and ADB (2005).

Large utilities are to an extent self-financing their investments. In the electricity sector, EVN covers its operating and maintenance costs, and makes a contribution to capital costs. Over the period 1997-2002, roughly a third of EVN's investments were funded through retained

earnings. EVN further diversified its finance sources in 2004, when it started issuing bonds and selling part of its equity. In transport, ports and railways earn enough revenue to roughly cover their operating costs. Water utilities, on the other hand, have struggled to cover even operating expenses but a new tariff-setting directive encourages full cost-recovery including capital costs. In the telecommunications sector, the Vietnam Post and Telecommunications Administration (VNPT) is entirely self-financing. It funds its own investments from retained earnings and by borrowing, and makes enough profits to contribute to the State budget with dividends.

Private participation

Energy has been the principal recipient of private investments, mainly under the form of operators involved in small-scale generation and distribution. There are approximately 100 of these operators, jointly providing close to 1000 MW of power. The largest is the 375 MW Hiep Phuoc plant built by a Taiwanese company to supply an industrial zone south of HCMC. Only two projects involving private participation in infrastructure development have been completed to date. These are Phu My 2.2 and 3, both of which are generating power from gas. These two projects, the first to be done under Vietnam's BOT laws, were funded by foreign consortiums and ODA loans. Both were structured with government guarantees, with Phu My 2.2 receiving in addition a World Bank partial credit guarantee. A third project of this is under development at Oh Mon 2, with investment from Unocal and Mitsui, among others.

There has also been progress in the introduction of private equity into the energy sector through the equitization program. In 2005 EVN sold 35 percent of shares in a hydro-electric subsidiary company, raising about 30 million dollars. There are plans to equitize seven generating plants although the timetable is not clear.

Private participation in roads is very limited. In Quang Linh, a private sector company built a segment of road in exchange for LUCs along the road corridor, a model which has been replicated in other locations. But with the exception of the road to the Tan Thuan export processing zone, all other toll roads currently operational in the country are owned and managed by SOEs or LDIFs, most notably in HCMC. Complex land acquisition procedures and the difficulty to recover costs, given current tariff levels, have deterred private consortia from developing new toll roads. A BOT scheme will be used for the Phu My bridge, linking districts 2 and 7 in HCMC, but it involves a consortium of SOEs. However, there are a few instances of private companies obtaining construction and maintenance contracts.

Looking forward, the government is seeking private participation in four highway BOTs, linking HCMC and Can Tho, Danang and Quang Ngai, Noi Bai and Ha Long, and Hanoi and Haiphong. It is not clear whether the proposed private BOT deals will be financially viable without counterpart funding from government. A fifth BOT, for the highways linking HCMC, Long Thanh, Dau Day and Vung Tau, is scheduled to be completed by the state-owned Vietnam Expressway Corporation.

There has been no significant involvement of the private sector in the development of railways and airports to date. Yet, MPI has issued a list of four rail corridors in which the government is seeking BOT participation. Meanwhile, HCMC has made progress regarding an unsolicited BOT project proposal to build an underground metro rail. In airports, private participation has been limited to small scale supply and construction contracts, but no significant concessions, management contracts or BOTs have been developed. Opportunities for private sector participation in this sector remain limited due to the definition of strategic sectors in which full state ownership is justified, under Decision 155.

Developments have been more encouraging in ports. Despite the dominance of public operators in the sector, three private ports have been developed under greenfield BOT schemes: a bulk cargo facility at Baria Serese, a container handling terminal in HCMC, and a small private terminal serving the industrial zone at Dinh Vu. Two other private port projects are under development at Cai Map and Cailan. The government is also seeking private sector participation in two large transshipment ports, at Ben Dinh-Sao Mai and Van Phong.

Water and sanitation sectors are decentralized, with the central government setting policies and approving the largest projects, whereas provincial governments are actually responsible for delivering water supply services. This is done through water resource companies which are in fact provincially controlled SOEs. Maximum tariffs are set by the State Price Committee and typically cover operating expenses only, not maintenance or investment costs. Low revenue makes private sector participation unattractive. So far, it remains limited to small-scale water retailers and some waste removal businesses. Private sector investment should be viable in bulk water supply, but only two attempts have been made to negotiate BOTs in this area, and they both failed.

In telecommunications, the liberalization of the sector has allowed multiple operators to enter the market. The leading player is VNPT, a government agency which receives financial support from the state budget. However, there is a clear intention to promote competition. For instance, the two mobile phone operators controlled by VNPT, namely Mobiphone and Vinaphone, do compete with each other, perhaps in part because they business cooperation contracts with different foreign partners. The planned restructuring of VNPT into three separate regional telecommunication companies, for the North, Central and South regions, is expected to further promote competition.

Several enterprises have been licensed to enter the telecommunications market so far. Three of them, namely Electricity Telecommunications and Information Company (ETIC), Hanoi Telecom and the Military Communications Company (Vietel), are SOEs; one is semi-private (Saigon Postel) and one is fully private (S-Fone). Some of these enterprises had a small presence in the fixed-line market to begin with, because they operated their own networks. The mobile market is still controlled by Mobiphone and Vinafone. But the five competitors in operation are gradually gaining market share. In addition, there is private sector participation through business cooperation contracts in the mobile, internet and paging lines of business. In Internet services, the dominant providers are state-owned. The Vietnam Data-communications Company (VDC) controls 62 percent of the market, followed by the Corporation for Financing and Promoting Technology (FPT), which controls 23 percent. However, the sector is open to private investment, both domestic and foreign, except for Internet exchange provision, which is still reserved for SOEs or enterprises in which the government holds absolute majority shares.

Quality and prices

Even if the relative share of the private sector in infrastructure development was to double in the coming years, the public sector would remain in charge of about two thirds of infrastructure investments. And the hypothesis of a doubling is probably over-optimistic. Between 1997 and 2003, private projects amounted to roughly 15 percent of all infrastructure spending. But if a single large project for the development of the Nam Con Son gas field and its pipeline is excluded, commitments fall to about 8.5 percent of the total. The private share increased to about 16 percent in recent years, mainly due to the Phu My 2.2 and Phu My 3 generation projects, and the equitization of power plants could boost this figure. Further

increasing this share will difficult. Therefore, in the coming years the access to quality infrastructure at reasonable prices will still depend, crucially, on public investment. Improving the process through which infrastructure sectors are regulated and investment projects are selected is a top priority in the coming years. The gradual phasing out of ODA funding in concessional terms will make this priority all the more important.

Assessing the quality of investment projects was less crucial in earlier stages of the transition, for the simple reason that returns were bound to be very high in almost all circumstances, due to the dramatic shortage of modern infrastructure. As the most glaring gaps are being filled, and Vietnam catches up with its neighbors, the risk of making poor decisions becomes higher. Yet, the preparation of feasibility studies for public investment projects is still characterized by important weaknesses (Box 8.2).

In many cases, these feasibility studies serve relatively narrow objectives, such as securing funding from donors, or providing estimates of the required budget support. More rigorous analyses of financial and economic returns, or the contribution of a project to the attainment of broader development objectives, or the risks associated with the project, or its potential impacts on the environment or on vulnerable social groups, are generally absent from Vietnamese feasibility studies. The process reflects a concern not for efficiency in the allocation of resources, but rather for getting the most value for money once budgets are allocated. This concern is understandable in an economy where resource shortages were the norm. But as a result of it, project scrutiny before approval is less developed than it should, given Vietnam's current development stage.

As regards the pricing of infrastructure services, there is a wide diversity across sub-sectors. Much remains to be done in water and sanitation. Issues are admittedly complex. Social and public health considerations may justify that relatively low prices be charged to households, and especially to the poor. But in this case a key issue is to determine who should cover the difference. If water resources companies are not financially viable, it will be difficult to attract private participation to the sector and, more generally, to fund the investments needed to extend coverage (and it is mainly the poor who currently lack coverage). User prices below cost recovery thus call for a subsidy from either central or local government.

Public health considerations are even more prominent in the case of sanitation, although to a different extent across waste types and service users. Thus, solid waste disposal, hazardous waste management and industrial wastewater treatment require a specific pricing policy each. And depending on the gap between prices and costs, each of these policies may also involve transfers from or to the budget. There are also challenging technical issues. For instance, water and wastewater services tend to be tightly linked, as many households use both. This often calls for a single "water" bill, with a single fee covering both services. However, in a developing country many households have access to water but not to sanitation, so that a single fee makes them pay for a service they do not receive.

At the other end, much progress has been accomplished in telecommunications and electricity. In both cases, progress is facilitated by the fact that most providers of infrastructure services (power companies, for instance) need to connect to a common network. Access protocols, involving technical specifications, pricing rules and dispute resolution mechanisms, are therefore the foundation for the development of these two sub-sectors. But there are still important issues involved. The price of transactions between the network operator and service providers can be spelled out in the protocol or determined on the spot. As for the price charged by service providers to end-users, modalities vary across sub-sectors. In telecommunications, where users can switch service providers easily, competition is the norm, so that government

intervention is not required. Electricity, on the other hand, tends to involve more price regulation, as well as obligations in terms of service coverage.

Box 8.2: Common Weaknesses of Vietnamese Feasibility Studies

Appraisal requirements	Most frequent shortcomings
A. OVERALL JUSTIFICATION	
Country and sector issues	Lack of national and sectoral perspective, especially in relation to master plans.
Development objectives	Usually not derived from high-level plans and strategies; generally narrow in focus.
Funding options	Top-down approach; possible overlap with other projects in case of donor funding.
B. PROJECT DESCRIPTION	
Key indicators	Logical frameworks linking actions and indicators are not commonly used.
Alternatives considered	Limited analysis of options based on technical, economic, social and environmental criteria.
C. IMPLEMENTATION AND OPERATION	
Institutional arrangements	Insufficient analysis of the commitment and capacity of the project executing agency.
Sustainability	Less attention than warranted to operation and maintenance aspects of the project.
Monitoring and evaluation	Usually based on outputs, not involving baselines or impact assessments.
Critical risks	Insufficient analysis of risks (e.g. difficulties in land acquisition) and mitigation strategies.
D. PROJECT SUMMARY	
Technical	Limited detail on standards, operational aspects and environmental implications.
Economic and financial	Estimates driven by cost norms; unreliable methodology for estimation of returns.
Fiduciary	Assessment of fiduciary risks and corruption mitigation strategies usually absent.
Social	Insufficient consultation and assessment of potential impacts on vulnerable groups.
Environmental	Limited use of environmental impact assessments and safeguards.

Source: Adapted from KFW (2005).

The Electricity Law, which came into effect in July 2005, is an important step towards efficient regulation. The Law basically calls for the unbundling of the electricity sector and the

creation of a competitive power supply market. This ambitious objective is to be phased in over a period of two decades, beginning with a single buyer model and eventually developing into wholesale and finally retail competition. However, critical strategic choices will need to be made over the next couple of years, and major restructuring will need to be completed before 2009, when full competition in generation is envisaged.

Under this so-called "electricity market roadmap", it is expected that transmission assets will remain under state control. In the near term, the transformation of the sector will require the divesting of EVN generating units, so that they can compete in equal terms with private generators. This will be particularly challenging from a corporate governance point of view, as EVN will remain the buyer of electricity in the near term.

The plan calls for the introduction of greater competition in three phases. In the first one, generators would bid to sell electricity into a power pool, with EVN as the single buyer. This would lead to a simulated market, determining dispatch order of generating plants, but without real financial transfers (most generators would still be owned by EVN; as for the others, they would be paid according to their private participation agreements). In the second phase, the simulated transactions would become real. And in the third phase, large consumers such as distribution companies or major industrial firms would be given the right to make bilateral contracts with generators, avoiding EVN as the single buyer.

A number of issues will need to be addressed to implement this plan, including the mechanics of spot trading, the roles and responsibilities of the electricity regulator, and the conditions and procedures for licensing each electricity activity. The Ministry of Industry (MOI), will place these responsibilities with a new regulator. Recommendations on electricity retail tariffs will be made by MOI with the assistance of the regulator and approved by the Prime Minister. Wholesale tariffs for electricity, fees for transmission and distribution, and for auxiliary services, will be proposed by the entities involved in each of these activities, evaluated by the regulator and approved by MOI.

PART III: POLICIES FOR BUSINESS

9. GLOBAL INTEGRATION

Integration in the world economy has been one of the main drivers of economic reform in Vietnam. From participation in AFTA to the implementation of the USBTA, it has made markets more competitive and has forced domestic enterprises to restructure. But the impending accession to the WTO takes the agenda even farther, because of the encompassing nature of the commitments it implies. This is not to defend the accession process, which puts increasingly harder demands on newcomers. But regardless of the virtues of the process, WTO accession will entail important changes both at the border and behind the border. On the one hand, much the same as participation in AFTA, it will lead to a reduction in trade barriers. In spite of the considerable progress accomplished so far in removing import quotas and reducing tariffs and subsidies, protection rates remain high in Vietnam. Further liberalization should lead to increased efficiency. The process needs to be supplemented by substantive improvements in trade logistics. Increasingly congested ports, with relatively expensive services, and a customs department focused on control (legally or otherwise), rather than on trade facilitation, are obstacles to further international integration. On the other hand, much the same as adherence to the USBTA, accession to the WTO is about institutional changes, from a more level playing field among enterprises, to competition in key services such as banking, to improved sanitary standards to strengthened intellectual property rights. All these changes should boost productivity in the medium to long term, but they will represent an important challenge for Vietnamese enterprises (including SOCBs) in the medium term.

The WTO accession process

Vietnam's road to membership in the WTO began in 1995, when a formal request for accession was submitted. In the following year, a comprehensive memorandum on the foreign trade regime was prepared. Regular meetings of the Working Party started in 1998, but Vietnam only submitted its first market access offer for both goods and services in 2002, to a lukewarm reception. In 2003, the highest authorities decided to accelerate the process, trying to enter the WTO as early as 2005, if possible. The completion of China's own accession negotiation, the prospect of remaining subject to textile quotas at the expiration of the Multi-Fiber Agreement, the successful experience with export growth under the USBTA, and the difficulty to oppose protectionist measures abroad, may all have increased the attractiveness of joining the WTO, thus explaining this renewed determination.

After several rounds of negotiations not resulting in substantive progress, the more ambitious market access offer made by Vietnam at the eighth Working Party meeting, in June 2004, represented a breakthrough. At that point, the 28 negotiating partners agreed to move forward and draft the Working Party Report of Vietnam's accession, thus paving the way to bilateral negotiations. These negotiations are often subject to criticism, as an acceding country can be requested to meet more stringent requirements than those applying to current member countries (Box 9.1). But Vietnam has shown a remarkable willingness to address the concerns of the negotiating partners.

Box 9.1: Incumbents versus Newcomers in the WTO

Accession to the WTO is guided by rules that make it different from joining other multilateral organizations. In addition to a common body of commitments, known as the single undertaking, the aspiring country needs to satisfy all the member countries who may want to ask for further concessions, in return for their support for the application. Without the support of key WTO members, a country cannot join. Over time, this approach has led to increasingly higher standards for the accession of new entrants. Vietnam, for instance, may need to make more sweeping changes than China.

The primary motive for developing countries in seeking to join the WTO is the boost that they hope membership will give to their exports, thanks to their improved access to international markets. Vietnam expects expanding sales of agricultural and fishery products, and textiles and garments. But WTO membership also makes a country more attractive to foreign investors. And it gives access to the WTO dispute-settlement mechanism, which enforces international trading rules. As a WTO member, Vietnam would also have a say in shaping those rules.

One controversial access of the WTO accession process, in Vietnam's case, concerns agricultural protection. Despite the fact that the majority of population (and a vast majority of the poor) lives in rural areas, WTO members are asking Vietnam to further liberalize its agricultural sector. Vietnam's market access offer to the eighth Working Party meeting set the average agricultural bound tariff at 25 per cent. This is substantially lower than the levels of neighboring countries such as Thailand and the Philippines.

Another concern is the "non-market-economy" status that Vietnam may get when it enters the WTO. This status was one of the so-called "WTO plus" commitments China had to agree to during its accession negotiations. It implies a special methodology for assessing potential subsidies in anti-dumping cases brought against Chinese companies, which considerably reduces the burden of proof. China is already the target for one fifth of the anti-dumping measures worldwide. Vietnam may have to accept similar terms.

Source: Oxfam International (2004).

Vietnam's market access offer includes a commitment to cut tariffs to an average of about 18 percent, with industrial tariffs of around 17 percent and agricultural tariffs bound at 25 percent on average. There is also a commitment to cease export subsidies for coffee on the date of entry, and for rice, pork and vegetables in three following years. Upon accession, Vietnam will also adopt WTO-compliant rules on intellectual property rights, investment incentives, customs valuation, technical barriers to trade, sanitary and phyto-sanitary (SPS) standards, import licensing provisions, anti-dumping procedures, and rules of origin.

Accession to the WTO has important legal implications as well. About 100 major government documents need to be issued or revised. This has forced the National Assembly to speed up its legislative program, in the hope of passing as many WTO-related laws as possible. The seventh session, held in May and June 2005, dealt with the amended Civil Code, the amended Commercial Law, the Law on State Auditing, the Law on signing of Accession to and Implementation of International Treaties, the amended Customs Law, the amended Law on Export and Import Duties, the amended Mineral Law and the amended Law on Complaints and Denunciations. The eighth session, in October and November, debated the Law on Intellectual Property, the Law on Electronic Transactions, the Unified Enterprise Law, the Common Investment Law, the amended Law on Value Added Tax, the amended Law on Special

Consumption Tax. Looking forward, an "omnibus law" may be needed to ensure the prevalence of WTO commitments over existing legislation in case of conflict.

There is some contradiction between the encompassing nature of the commitments made by Vietnam and the limited awareness of the business community regarding the implications of WTO accession in particular, and of global integration more generally. The three-round survey of SMEs conducted by ILSSA asked, in its most recent edition, what were the risks and challenges associated with further market liberalization. Responses were analyzed as part of a project by the SIDA.

A somewhat worrying finding is that only 12 percent of respondents had positive expectations. Limited liability companies and joint stock enterprises (the most modern corporate governance forms) were more optimistic than sole proprietorship companies and household businesses. However, the number of respondents holding a negative view was small as well. A majority responded that they did not know what further liberalization will mean, or that they did not expect any notable changes.

One possible explanation for this finding is that SMEs have a limited experience of internationalization: many of them are not in formal contact with foreign firms and, for a large part, they do not compete with imports either. Among those with some international exposure, expectations were more positive. For instance, 53 percent of exporters expected benefits from further trade liberalization, compared to 12 percent of non-exporters. But for a vast majority of Vietnamese entrepreneurs, the implications of WTO accession probably remain unclear.

Trade distortions

Some of the most immediately visible implications of WTO accession are related to trade liberalization. Vietnam has made commitments concerning both import duties and export subsidies. But predicting the consequences of those commitments is not straightforward. Trade regimes are a complex web of wedges affecting the prices of both inputs and final products. They clearly cannot protect all sectors at the same time, because they basically redistribute resources across the economy. But understanding which sectors benefit from the trade regime, and which ones are at a disadvantage is technically challenging. Still, this is an important first step to assess what the implications of WTO accession could be.

The number of products subject to import quotas in Vietnam has declined since 1999. By end 2005, there were quotas only on sugar and petroleum. However, seven other agricultural commodities were brought under tariff rate quotas in 2003. These are raw milk, condensed milk, eggs, maize, raw tobacco, salt, and cotton. Tariff rate quotas are not quantitative restrictions, but they allow applying a higher duty once imports exceed some threshold. The Ministry of Trade was given the authority to activate this mechanism if the conditions of domestic production and foreign trade make it necessary.

There is also a list of items for which trade is currently prohibited. It includes military equipment, toxic chemicals, antiquities, narcotics, firecrackers, poisonous toys, cigarettes, used consumer goods and right-hand driving automobiles. In addition, a considerable number of products require approval from relevant ministries before they can be traded. Some pharmaceuticals, chemicals, food products, fertilizer and recording and broadcasting equipment are part of the list. As in other countries, the need for approval is justified on heath and security grounds. The commitment to comply with WTO rules on technical barriers to trade, SPS

standards and import licensing provisions, should introduce more transparency in this area, making it less prone to disguised protectionism or abuse.

Tariffs have been declining too (Table 9.1). Their maximum level was brought down from 200 percent in 1997 to 120 percent in 2001 and to 113 percent in 2003. By then, less than one hundredth of tariff lines, accounting for around one twentieth of all import value was subject to tariff rates above 50 percent. High tariff rates remain concentrated in a few areas such as beverages, spirits, tobacco and cigarettes, used clothes, vehicles and vehicle parts. There has also been a reduction in the dispersion of tariffs, mainly through a compression at the low end of the distribution. For instance, the number of tariff lines in the range of 1 to10 percent declined from about one quarter of the total in 1995 to 13 percent in 2003.

Table 9.1: Trade Barriers and the Effective Protection Rate

	1997		2001		2003	
Weighted average	Nominal	Effective	Nominal	Effective	Nominal	Effective
Agriculture	8.1	7.7	6.3	7.4	11.1	12.5
Mining	9.4	6.1	8.9	16.4	3.6	-0.0
Manufacturing	30.6	121.5	25.3	96.0	29.2	43.9
Total	21.0	72.2	17.9	58.5	18.2	24.9
Simple average	23.3	59.5	20.1	54.1	20.0	26.2
Rate dispersion	133.8	156.0	149.9	172.3	106.5	134.9

Source: Based on Premachandra Athukorala (forthcoming). The nominal rate of protection is estimated based on most-favored nation tariffs. The effective rate of protection measures the gap in value added computed at domestic prices and at border prices. It is estimated using the input-output table for the year 2000. Rate dispersion is measured as the ratio of standard deviation over mean, in percent.

As a result of all these changes, the average tariff rate of Vietnam is close to 18 percent at present. This is the figure Vietnam committed to in its market access offer to the eighth Working Party meeting. It is comparable to China's average before its accession to the WTO. But it is considerably higher than the average tariffs of Indonesia, Malaysia and the Philippines. And much higher than China's average tariff after its accession to the WTO. As in China's case, Vietnam's average tariff can be expected to decline further as a result of the bilateral negotiations to accede to the WTO.

A reduction in the dispersion of tariffs, like that observed in Vietnam in recent years, brings down the overall transfer made to the manufacturing sector. This is because tariffs on final products (typically the highest) become lower while tariffs on inputs (usually the lowest) become higher. The overall transfer to a sector is measured through the so-called "effective rate" of protection, which indicates how much higher the value added of an industry is compared to a situation where international prices would prevail. In the case of Vietnam, the lower dispersion in tariffs brought about a dramatic decline in the effective protection rate for the manufacturing sector between 2001 and 2003. The reduction in peak rates committed during WTO negotiations should reduce effective protection rates even further.

Tariffs had also been used in recent years in ways which were not consistent with WTO principles. At stake were motor vehicles and a wide range of mechanical, electric and electronic products, including color television sets. In all these cases, an implicit subsidy was delivered under the form of a preferential tariff on imported final products and components linked to meeting mandatory local content targets. Arrangements of this sort are not allowed under WTO's agreement on trade-related incentives. They were thus terminated for motorbikes in 2003; for cars they will be terminated upon accession.

The new CIL includes an article on opening markets and investments related to trade, which is designed to ensure compatibility with WTO rules. It stipulates that government will not require investors to give priority to the purchase or use of domestic goods and services, or to purchase them from a specific domestic supplier. Firms will not be compelled to export a fixed percentage of goods or services, and restrictions will not apply to the quantity, value or type of goods and services which may be exported. There will be no requirement to balance import needs with the quantity or value exported. Investors will not be subjected to localization ratios during manufacture of goods, to supply goods or provide services in a specific region, or to establish their head office at a particular location.

More explicit subsidies had proliferated too. An Export Reward Fund was established under MOF in 1999, to assist Vietnamese exporters. It initially focused on agricultural products such as rice, coffee, pork, canned fruits and vegetables. Assistance was provided under the form of interest rate support, direct financial assistance to first-time exporters, and export bonuses. Cash rewards were also paid to exporters provided that they would meet a minimum exports volume or a minimum exports growth rate. More recently, subsidies were extended to other agricultural products, including beef, poultry meat, semi-processed fruits and vegetables, tea, peanuts, pepper and processed cashew nuts. And they also reached some industrial products, such as plastic and mechanical goods, handicrafts, and rattan and bamboo products. Other, more indirect transfers can be counted as subsidies as well. For instance, there is a sizeable price support for the electricity used in irrigation. And it has been suggested that there are significant subsidies to several agricultural inputs, including fertilizers and seeds.

Given the multiplicity of mechanisms at work, computing the net subsidy on a product-by-product basis is difficult. However, a study conducted by ADB and MOF concluded that only two products, cotton and sugar, were receiving a substantial transfer. Measured in percent of value added, and using a concept akin to the "effective protection" rate, the implicit subsidy rate was estimated at roughly 45 percent for sugar, and at 7 to 11 percent for cotton. For all other products, the subsidy equivalent was probably lower than 5 percent. For rice and pork, it was insignificant.

Working Party members adopted the position that Vietnam would not be entitled to the concessions allowed to the poorest countries, so that subsidies had to be abolished upon accession to the WTO. However, as a developing country, Vietnam can still retain support measures for up to 10 percent of the value of production. In practice, this means that only the subsidy for sugar will need to be reduced.

When putting all the pieces of this complex web of trade distortions together, it appears that protection is highest in Vietnam for industries which are dominated by SOEs, foreign companies, or both. For instance, as of 2003 effective protection rates exceeded 100 percent for liquor, beer and processed rice. And they fell in the range of 50 to 88 for tea, bricks and tiles, home appliances, textiles, clothing, carpets, plastic products, home appliances, motorcycles, bicycles and motor vehicles. At the other end, most of the industries with substantial participation of domestic private enterprises, such as leather, rubber and plastic products and furniture, were operating under relatively low protection.

Admittedly, sectoral analyses of this sort need to be interpreted with caution. An obvious question, when looking at these results is: how did Vietnam achieve rapid export growth in sectors where selling domestically allowed 50 to 88 percent more value added than selling abroad? Part of the answer is that effective protection rates refer to averages across sectors. Even within a well-defined activity like clothing, there is great variation across firms in terms of product variety, quality, scale and technology. For instance, the relatively small firms that produce the type of clothing favored by local consumers may bear little resemblance to the large-scale clothing manufacturers that often use advanced technology to produce a limited variety of clothing items under contract to buyers in the world market.

International comparisons are difficult as well, because of differences in the treatment of various elements of the trade regime in each country. However, it appears that the effective rate of protection of Vietnam's manufacturing sector, as of 2003, was above that of other countries in the region. It was twice as high as in Indonesia, Malaysia or the Philippines in the 1990s. It was comparable to that of Thailand, but this was because of the high protection given to automobile industry, which has been scaled down in recent years. And it was also higher than the effective protection enjoyed by manufacturers in Korea at the early stage of its industrialization.

Trade logistics

While quotas, tariffs and subsidies can all distort the trade patterns of a country, some of the most important barriers to global integration are sometimes found elsewhere. Inefficient ports, cumbersome customs procedures, rent extraction from corrupt government officials or powerful trading companies, can all discourage participation in world markets. These aspects of the global integration agenda are only partially covered by WTO negotiations. But the broader trade logistics need to be tackled to make the most of the accession process.

Consider ports first. Vietnam has seven international seaports, and five special ports through which only oil and coal are shipped. The most important ones are Haiphong in the north, Danang in the centre and HCMC in the south, with the latter accounting for 70 percent of all traffic. A significant amount of investment has gone into upgrading these ports over the past decade. As a result, by now they can handle approximately 14 million tons of freight per year (excluding crude oil), compared to only 4.5 million tons in 1993.

Despite these upgrades, however, the main HCMC port is considered substandard by comparison to regional and international competitors. Its scale could prove insufficient to meet demand by as early as 2006. Most of the other major ports in the country are congested, poorly maintained and managed, and have inadequate access by water channels and roads. The current state of the ports results in relatively high unit costs for shipping lines, and reduced competitiveness for Vietnamese enterprises.

This is clearly one area where private sector participation is needed, not only to mobilize capital for investment, but also to foster competition and bring unit costs down. Ports in Vietnam are managed by several state organizations. The Vietnam National Maritime Group (Vinamarine), under the auspices of MOT, is responsible for the planning, construction and management of ports in general. It also operates the country's three major ports. Another seven large national ports are operated by Vinaline, a General Corporation reporting directly to the Prime Minister. The country's 60 other ports are operated by local SOEs and various ministries. But tariff levels for port services are determined by MOT and are the same for all ports in the country. Only container charges are set by the individual ports.

The government has already developed a framework for third-party management of ports. And Vinaline already signed, in 2004, a formal lease with Vinamarine for the management of Cailan port in 2004. In principle, this leasing framework could be replicated with private sector participation. But current regulations do not allow it. The list of so-called strategic sectors currently in force prescribes that the management and maintenance of large ports is to remain under state ownership. Thus, despite the fact that three private ports have already been developed under greenfield BOT schemes and two others are under construction, the full benefits of competition in port services are not being reaped.

Clearing goods through customs can also add to the cost of importing or exporting goods, thus operating as another barrier to global integration. An efficient and ethical customs administration can facilitate trade, raise trade-related revenue for the government, generate reliable trade statistics, and protect society from crimes such as counterfeiting, smuggling or narcotics trafficking. For now, however, Vietnamese customs are still considered slow, unresponsive, inconsistent and vulnerable to corruption (Box 9.2).

Box 9.2: Customs Reform: Trade, Governance or Both?

Current customs procedures are based on verification before clearance, heavily relying on physical examinations. Audits conducted after the release of goods are mainly seen as an enforcement measure, not as a compliance management mechanism, and they are not regularly carried out anyway. Progress has been made regarding the valuation of goods. In the past, to minimize duty evasion, minimum prices were applied. Their removal is a requirement under the WTO accession process. But alternative mechanisms to verify the correct value of goods cleared through customs are not in place yet. Information systems are weak too. Well-functioning procedures are in place in several offices, but not across the board. Meanwhile, both the ICS of the World Bank and the Corruption Diagnostic Study of the Internal Affairs Committee of the Party identify the customs department as one of the agencies most exposed to graft.

The recent passage of the revised Customs Law by the National Assembly provides a sound legal basis for reform in this area. The key to success lies on revamping business processes, more than on technology. Verifications prior to clearance and physical examinations favor rent-seeking behavior by the officials in charge. Instead, a risk management approach is needed. Statistical regularities can be used to identify possible cases of fraud, whereas randomized procedures can support physical examinations (for instance, regarding which part of a container should be inspected). In the general case, however, compliance with the law should be assumed.

Technology should be put at the service of the change in business processes. A risk management approach requires reliable databases on previous clearances and audits, so as to infer the statistical regularities associated with fraud. It also relies on effective inspection equipment, such as X-ray and other scanning hardware, so as to process examinations in a rapid and non-intrusive manner. Matching records on the outcome of examinations with clearance records, in turn, can help identify and deter misbehavior by customs officers.

Appropriate performance indicators will be needed to monitor that customs reform is on track. Statistics on average clearance times at each customs office, on declarations processed per staff, or on revenue collected, should be part of the monitoring system. User surveys, in the spirit of report cards, can also provide feedback on the operation of customs offices around the country.

Source: Based on World Bank (2005c).

A moot question is whether state-owned trading companies are a serious obstacle to global integration as well. The state monopoly over foreign trade was formally abolished in 1989, but license requirements applied before an enterprise could import or export. Only in 1998 were those requirements removed. Since 2001, private companies as well as SOEs are allowed to export most products without any license. In principle, private enterprises have the same rights as SOEs, but the latter tend to have a closer relationship with the ministry in charge of the sector, which puts them in a more advantageous position.

Several years later, state trading companies still handle roughly half of Vietnam's foreign trade (Table 9.2). They remain dominant for the export of important agricultural commodities, such as rice, coffee, rubber and tea. For instance, state trading companies control almost 100 percent of the rice export market, whereas SOEs affiliated with Vinacafe control 35 to 40 percent of the export market for coffee. But does imply that they have market power and can extract rents from producers? The answer is not clear.

Table 9.2: Key Indicators of Trading Companies

	2000	2001	2002	2003
Number of enterprises	17,547	20,722	24,794	28,396
State	1,194	1,064	1,047	896
Non-state	16,308	19,593	23,682	27,437
Foreign-invested	45	65	65	63
Total turnover (trillion dong)	345	376	515	585
State	210	214	303	301
Non-state	130	156	205	273
Foreign-invested	4	6	7	11

Source: Based on data from GSO.

There are numerous state trading companies operating in each sector, so that collusion among them would be needed to push producer prices down. The experience elsewhere, from textiles to telecommunications, suggests that Vietnamese SOEs do compete with each other. An indication that state trading companies do not exploit their potential market power comes from their low profitability. Measured in relation to turnover, their profits are below those of private traders, domestic or foreign. In the case of rice, value chain studies indicate that Vietnamese farmers do appropriate a very high share of the world price, which again is incompatible with substantial rent extraction.

If anything, the problem with these state trading companies is reminiscent of the conflict of interests plaguing other, non-equitized SOEs. There is anecdotal evidence that SOEs affiliated with Vinacafe were used to implicitly subsidize farmers when coffee prices were low in world markets. Another state trading company is allegedly content to export at small or even negative margins in order to secure foreign exchange for the government. Non-commercial objectives, determined by the authorities the state trading companies report to, allow reconciling market dominance with low profitability.

Behind the border

Some of the most important changes prompted by WTO accession do not actually happen at the border between the acceding country and the rest of the world, but rather behind its border. The national treatment principle is crucial in this respect. It basically means that foreign companies cannot be subject to more stringent rules, or asked to pay higher fees, or charged more for services, than domestic companies. This makes WTO accession a formidable tool to level the playing field. Businesses of all sorts have to be treated equally by the government. And this is what many of the legislative changes being frantically introduced by the National Assembly in its recent sessions are about.

One of the implications of the national treatment principle is that government support to domestic enterprises needs to be discontinued. In Vietnam, this support is channeled by DAF, under the form of subsidized loans for investment, interest rate refunds on commercial borrowing, and investment credit guarantees. DAF targets disadvantaged and priority areas with its assistance. It also funds an export credit program for "priority industries and products", which includes fishery products, sugar, and mechanical products. To the extent that only domestic enterprises are eligible, DAF support is not compatible with WTO rules. DAF will thus need to be transformed into a WTO-compliant policy lending institutions; for instance under the form of a provider of credit to exporters and importers, regardless of their nationality (in the spirit of the "eximbanks" of many other countries).

It could be argued that WTO accession then amounts to preventing any "industrial policy", while this was one of the main levers used by richer East Asian countries to support rapid economic growth. And there is some truth to that argument. However, not all industrial policies are barred by WTO rules. Investment incentives are allowed provided that they are not linked to export or import subsidies, or to local-content schemes.

So-called "green box" measures are allowed as well, without any limit. They include budgetary support for infrastructure services, regional assistance programs and extension and advisory services. As part of the Doha Ministerial Conference of 2001, WTO members agreed that developing countries could use subsidies to achieve goals such as regional growth, technology research and development funding, production diversification and development and implementation of environmentally sustainable methods of production. Thus, for instance, investing in research, and in fostering links between universities and enterprises, would qualify as a WTO-compliant industrial policy. Given the quality of human resources in Vietnam, this could be an alternative worth exploring. On the other hand, the experience with the kind of direct support to enterprises that has been available in Vietnam is not that encouraging (Box 9.3).

Another important way in which WTO accession affects the workings of the economy behind its borders is by fostering competition in services. In this case, reform is about ensuring that all players have access to the market under the same conditions. This aspect of WTO accession has important implications in telecommunications and in banking.

In these two sectors, the USBTA gives some indication of what can be expected from the WTO accession process. In telecommunications, under the USBTA American companies will be able to enter the mobile and internet market by the end of 2005 and the fixed-line services market by the end of 2007. US ownership in these two services is capped at 49 percent and 45 percent respectively.

Box 9.3: Government Assistance and Enterprise Survival

Data from the three-round survey of SMEs conducted by ILSSA can be used to assess the impact of assistance during start-up on subsequent enterprise growth. Based on the interviews, assistance to SMEs can take several forms. The government can give advice or recommendations on the line of business to adopt, it can help in completing applications and registration procedures, it can provide subsidized credit, and it can allow tax exemptions. The analysis compared the performance of SMEs across the three rounds of the survey, depending on whether they had benefited from any of these forms of assistance.

Performance was measured through survival and growth rates between two consecutive rounds of the survey. Statistical tools were used to estimate how different variables, including government assistance, affected the probability of survival, or the rate of growth. The variables considered in the analysis included the individual characteristics of the entrepreneur, such as age, gender and educational attainment. Among other things, the study found that smaller enterprises tend to grow faster, which is a common result around the world.

When it comes to government assistance, the study found that government credit was indeed an important determinant of enterprise growth. However, a closer look revealed important differences over time. Government credit was positively related to enterprise growth in the 1990s, but there was no significant impact of this kind of government support on the growth rates of new enterprises interviewed in the 2002 round of the survey.

The contrast between the two sub-periods probably says more about the economic conditions prevailing at the time than about the effectiveness of government support. The 1990s were characterized by considerably more turbulence. Survival rates between the first and the second rounds of the survey are much lower than between the second and the third one. Large changes in enterprises size (either considerable growth or decline) are more common in the early years as well. It could then be that subsidized government credit really makes a difference in turbulent times, but is unlikely to produce "champions" in normal times.

Source: Based on Henrik Hansen and others (2005).

Considerable competition has already been introduced in the telecommunications sector of Vietnam, and teledensity has been growing faster than in almost any other country in the world. WTO accession could further increase efficiency, but radical changes should not be expected. Things are different in banking, where important restrictions still apply on the type of business foreign banks are allowed to conduct, which might be one of the reasons why SOCBs remain dominant (Box 9.4).

SPS standards are another important area affected by WTO accession, despite being "behind the border". In this case, it is the entire farm-to-table chain that is affected, with implications for both economic efficiency and public health.

Box 9.4: Will Customers Abandon Domestic Banks?

A survey of 335 individuals and 60 enterprises was conducted to predict customer reactions to banking liberalization. Almost half of the individuals had incomes between 2 and 5 millions dong per month; one third was below 2 million. Their level of financial sophistication varied considerably. Savings deposits were the most popular service they used, followed by ATMs, money transfers, and loans. The use of securities, e-banking, and consulting was limited among individuals. As for enterprises, 42 percent were domestic private firms, 36 percent were SOEs and the rest were foreign companies. About a quarter of the enterprises made more than 75 percent of their sales abroad, but 46 percent exported very little, or nothing at all. Among this sample of corporate customers, money transfers and payment services were the most widely used financial services. One quarter of the firms in the sample had outstanding loans from banks at the time of the interview.

Participants in the survey were asked about their preferences in using banking services, and their reaction to the expanded choices that would open to them as a result of banking liberalization. The questionnaire was designed under the assumption that foreign entry would be allowed on a national treatment basis.

The survey revealed striking differences between customers' intentions and bankers' perceptions. Most bankers still believe that their depositors will not migrate to foreign banks, because of stronger trust in Vietnamese institutions and a tighter cultural link to them. But based on the responses to the survey, customers could prove them wrong, as roughly half of them are willing to switch allegiances and migrate to foreign banks.

Simpler procedures were the most important justification for the declared intention to switch in the case of corporate customers; professionalism was cited by individual customers. Interest rate considerations only ranked third in importance for both groups of respondents. Trustworthiness did not appear to matter much for any of the two groups.

Enterprises	Switch	Do not	Enterprises	Switch	Do not
Loans in dong	43	57	Deposits in dong	47	53
Loans in dollars	44	56	Deposits in dollars	58	42
Individuals	Switch	Do not	Individuals	Switch	Do not
Loans in dong	47	53	Deposits in dong	52	48
Loans in dollars	41	59	Deposits in dollars	57	43

Note: Figures are in percent of respondents.

Source: Based on work by VASS and on UNDP (2005).

The timing is actually right to improve SPS standards, as Vietnam's agricultural sector is undergoing major structural changes. Production and trade of high-value commodities such as fruit, vegetables, meat, fish and seafood products has grown considerably over the last decade, whereas that of traditional bulk products, such as rice, rubber and sugar cane, has stabilized. However, in the case of fruit, vegetables and meat, growth remains almost entirely driven by domestic demand. International market access is hampered by Vietnam's difficulty in complying

with quality and health standards. High levels of food-borne pathogens and toxic residues, as well as the presence of plant pests and animal diseases, are among the most common problems.

An action plan has been prepared to make progress on this front. It includes measures for disease and pest exclusion, leading to investments in quarantine facilities. It also includes the development of active surveillance systems and early response measures. It requires an improvement in diagnostic capacity and an upgrading of the laboratory infrastructure. And it involves the expansion of certification mechanisms. One of the advantages of WTO accession is forcing an effective coordination between all these activities.

Last but not least, WTO accession should also lead to a stronger enforcement of intellectual property rights. This is sometimes considered a mixed blessing from the perspective of developing countries. For instance, stronger enforcement will no doubt make software use more expensive for domestic SMEs. For now, these enterprises take advantage of widespread software piracy. Indeed, the international Business Software Association estimates the piracy rate in Vietnam to be 92 percent, the highest in the world.

More worryingly, a stronger enforcement of property rights could reduce access to generic drugs, with adverse consequences for public health. The most obvious example in this respect concerns retroviral drugs for the treatment of HIV/AIDS. But adverse implications could also be expected in other, less notorious cases. As the bilateral negotiations for WTO accession are coming to an end, it is hoped that Vietnam will be given a treatment which is consistent with its developing country status.

These legitimate concerns should not overshadow the interest of Vietnamese enterprises in having their patents and trademarks protected. This interest is illustrated by the cases of Trung Nguyen Coffee and PetroVietnam which, upon attempting to get their trade names and trademarks recognized in the US, found that they had already been registered by other entities. In the domestic market, the brand names and logos of La Vie (drinking water) and the Golden Pig (animal feed) have been repeatedly copied and imitated.

Even in relation to software, Vietnam could soon be concerned about piracy by others. According to the Vietnam Software Association, there are 1,000 companies which name software development as one of their businesses. It is estimated that about 400 of them are actually engaged in this activity. Furthermore, the HCMC Association for Information Processing lists 50 software enterprises with at least 30 employees in their payroll and annual revenues exceeding 100,000 dollars. Lower piracy levels are needed for this sector to thrive.

As Vietnamese businesses increasingly realize the importance of trademark protection, the number of applications for registration is increasing rapidly. In 2004 alone, the National Office for Intellectual Property (NOIP) received almost 15,000 of them, and granted 7,600. More than two thirds of the applications were by Vietnamese.

10. DOMESTIC REFORMS

If global integration is one of the main drivers of economic reforms in Vietnam, their engine is clearly homegrown. Since the beginning of the renovation process, almost two decades ago, the government has been steadily pushing for change across all policy areas, with the objective of building a market economy with a socialist orientation. The five-year plans articulating this vision are also changing along the way. They rely less on quantitative targets for material production, and focus more on policies and development outcomes. Consultation with stakeholders at large is also becoming part of the process, and business associations are having increasingly more clout. The next five-year cycle offers the prospect for Vietnam to complete its transition, across several dimensions: towards increasingly relying on market mechanisms, towards full membership in the global economy, and towards middle-income country status. But success in these multiple transitions will also require a policy gear-up. Vietnam needs to complete the first generation of reforms, the ones that allowed the emergence of businesses of all sorts and a spectacular reduction in poverty. But it also needs to embark into a second generation of reforms, adapted to the increasingly complex problems it faces as it prospers. In the economic front, it has to improve the efficiency of capital mobilization, by reforming its financial sector and better managing state assets. In the social front, it should lay the foundations of more modern universal systems, combining market efficiency with broad coverage in education, health and social insurance. In the institutional front, it has to strive for transparency and accountability, further strengthening public financial management, reducing corruption and creating a modern judiciary. Progress across all these fronts would contribute much to business development.

Planning and consultation

The preparation of the SEDP for the period 2006-2010 provides an opportunity to articulate the domestic reform agenda so that it complements the global integration process. In a way, commitments towards the international community in the context of WTO accession can be seen as the flip side of commitments to the Vietnamese people through the SEDP. From this perspective, the timing could hardly be better, as the implementation of both WTO obligations and SEDP contents will start more or less simultaneously. At the end of this five-year period, if it all goes well, there is a reasonable chance that Vietnam will be at the verge of becoming a middle-income country. Ensuring that the reforms supported by the SEDP allow getting there is thus of fundamental importance.

Consultation is one of the key mechanisms to improve the relevance and quality of planning documents. And consultation with stakeholders at large, not only across government agencies and with mass organizations, is becoming more common in Vietnam. As part of the transition to a market economy, there is a move away from setting production and investment targets, towards relying on development outcomes as motivators for public action. In the preparation of the SEDP for 2006-2010, there is also a noticeable openness to seek feedback from communities, non-government organizations and business associations, in a way that is reminiscent of the 2001-2002 consultations to inform the Comprehensive Poverty Reduction and

Growth Strategy (CPRGS). In fact, the CPRGS principles have been officially integrated into the preparation of the SEDP for 2006-2010. While fully moving away of the traditional command approach to planning will take time, a more strategic and consultative approach is already emerging from this integration.

Box 10.1: Business Associations in Vietnam

Some of the most relevant business associations are:

- VCCI: Established by the government in 1960, its original objective was to promote economic relations between Vietnam and the rest of the world. According to its current statutes, it is "an independent, non-governmental organization" operating on the basis of financial autonomy, but carrying out its activities "with the support and under the supervision of the Vietnamese state". VCCI has 5,270 members, of which 1,394 are SOEs. Its officials are public sector employees, and about a fifth of the funding is provided by the government.
- Vietnam Cooperative Alliance (VCA): It is also sponsored by the government, and has its staff appointed from government ranks. VCA has branches in all provinces. Any cooperative can become a member.
- The Union of Associations of Industry and Commerce (UAIC): This is the heir of business organizations which existed in the south prior to reunification, such as the General Association of Industrialists of the former Saigon. In 1989, with the encouragement of the Fatherland Front and the permission of the provincial government, the Association of Industrialists of HCMC was established by a group of business people with a trajectory before 1975. This was the first business association to include members from the private sector. It was later reorganized into a series of sectoral organization; there are 12 of them at present. Originally the UAIC membership consisted of private enterprises only, but in recent years the association has opened its doors to SOEs. Currently, the UAIC has approximately 1,800 members.
- Young Business Associations and Clubs: They are active in many provinces. The majority of their members are private companies. The first one was established by the HCMC Youth Union; others started very informally. The Young Entrepreneur's Club in Hanoi, for example, was launched by about ten of the first private company directors of Vietnam, in the early 1990s. The group began to meet mainly to network and socialize. Gradually, it became a forum in which members could discuss experiences and make business connections.
- There are also a number of sectoral associations, whose members are predominantly from the state sector. The Vietnam Leather and Footwear Association (LEFASO), for example, was created out of an earlier production alliance by SOEs, whereas the Vietnam Textiles Association (VITAS) emerged from a GC.
- In addition, there are about 20 associations involving foreign companies, such as the American, Australian, British and European Chambers of Commerce, which meet regularly to advance the interests of their constituencies.

Source: Based on Trang Quynh Phuong Nguyen and Jonathan A. Stromseth (2002) and ADB (2005d).

However, business associations are still weak in Vietnam. The current legal framework allows entrepreneurs to organize on their own, but the formation of an association still requires government approval. A study by MPDF, which included a survey of 414 enterprises, revealed

that only half of them were formal members of a business club or association. Participation was more frequent among larger enterprises, among those in the manufacturing sector, and among those exporting some of their production. Moreover, the study revealed that only a few of the many business associations registered were actually providing any services to their members. The diversity of their nature and membership became apparent as well (Box 10.1).

The active business associations active are performing fairly well at providing information to their members on policies and legal issues at delivering or organizing short-term training courses. On the other hand, their provision of business services tends to be weak. And a majority of the associations do not consider themselves capable of engaging in a policy dialogue with the government on behalf of their members.

At the risk of simplifying, the dialogue between the business community and government agencies takes place at three levels. The highest one brings together representatives from a number of business associations and a range of line ministries and government agencies. It is organized twice a year, under the name of Vietnam Business Forum (VBF). These regular gatherings have led to the identification of a series of policy priorities for business development. Progress in addressing these priorities is monitored and evaluated at the bi-annual VBF meetings. Participation by the highest national authorities allows the business community to convey its views and concerns in an effective manner.

A second level of policy dialogue is between specific ministries or agencies and the relevant stakeholders in the business community. These exchanges occur mainly in the process of drafting new laws or decrees, and are becoming more regular over time. One of their venues is the Monthly Business Forum organized in Hanoi and HCMC by VCCI and the Asia Foundation. The third level involves provincial authorities and the corresponding business community. These exchanges are most generally aimed at improving the local investment environment and attracting investors to the province.

Meanwhile, the foreign business community has established working groups focusing on specific issues, such as banking, manufacturing, distribution and infrastructure. These groups meet with varying frequency throughout the year and report on their activities and concerns to the VBF. Overall, it is fair to say that foreign business associations tend to have better access to policy makers than domestic ones. Among the latter, participation in the policy dialogue tends to be limited to large organizations such as VCCI and the UAICs from Hanoi and HCMC. These groups often contribute comments and opinions to the drafting committees in charge of formulating new laws and regulations. In the case of VCCI, they occasionally serve on the drafting committees themselves. Sometimes this participation has had a tangible positive effect on policies affecting the private sector. But a stronger voice from representatives of SMEs (and even household enterprises) would be welcome, as it would ensure a better balance between the views of businesses of all sorts.

Structural reforms

The structural reform agenda is broad, as it traditionally includes objectives such as trade liberalization, SOE restructuring, financial sector modernization and private sector development. In a transition economy like Vietnam, much needs to be done in each of these areas, even after almost two decades into the renovation process. Yet, at this stage the most crucial components of the structural reform agenda relate to capital mobilization. The reform of the financial sector needs to be completed, so that it can swiftly channel resources to the most productive businesses.

And the management of state assets needs to strengthened, so that whichever capital is in the hands of government is used in an efficient and transparent manner.

Many of the technical aspects of banking reform are already in place, from an improved payments system to modern credit manuals. But in spite of these efforts, SOCBs remain weak. The share of NPLs in their total credit does not show any clear sign of abating; rather the contrary. As a result, the contingent liability for the government could by now be as high as 8 percent of GDP, if not more. At a superficial level, bad SOCB portfolios result from still weak operational, credit appraisal and risk management procedures. At a more fundamental level, the problem is that SOCBs remain too exposed to implicit pressures for non-commercial or politically-preferred lending, especially in their provincial branches. Supporting SOEs, helping farmers when commodity prices are low, and financing infrastructure projects for which no budget allocation is available, are among the most common sources of NPLs. Clearly, those who make lending decisions of this sort are not trying to maximize returns, but rather to do "the right thing", as defined by the relevant authorities. However, at a time when the investment needs of Vietnam are enormous, allocating the available capital to the projects with the highest returns would be a preferable choice.

In the absence of determined banking reform, the situation of SOCBs is bound to deteriorate, thus increasing the burden from contingent liabilities. Accession to the WTO implies that foreign banks will be able to bring their sophisticated technology and streamlined procedures to bear on Vietnam. This will surely benefit the economy as a whole; but it just as surely represents a threat to the SOCBs. The most profitable and forward-looking enterprises, especially those involved in international trade, will be tempted to switch to foreign banks. Skilled and promising SOCB staff will be attracted to work for them, as they offer more interesting challenges and more attractive remuneration packages. If SOCBs retain their existing goals and incentive structures, they will not be able to compete successfully with the newcomers.

The transparent classification of loans based on IAS, as required by Decision 493, is an encouraging first step towards benchmarking banks' performance and setting milestones for the gradual resolution of NPLs. But transparency alone will not be enough. The flow of new NPLs can only be contained if the management of the SOCBs is held accountable for their profitability. Equitization is another potentially important step. However, selling equity shares to the public at large will not be enough either. Bringing in strategic investors would to more to strengthen the profit orientation of SOCBs, and keep lending at local levels under control.

A key complement to reforming the SOCBs is to re-position the SBV as a modern central bank, in charge of supervision and monetary policy. Ensuring financial stability in an increasingly open environment will require that the supervision function of the SBV be considerably upgraded. Not by checking individual transactions, with overly detailed legal requirements, but rather by appraising the banks' own risk management and strategies. Also, the recent inflationary shocks experienced by Vietnam show how important it is to develop the capacity of SBV as the leading institution for monetary policy.

Fortunately, the government of Vietnam is fully aware of these problems, and the recently adopted roadmap for banking reform contains the right ingredients to tackle them (Box 10.2). Its implementation will be challenging, however.

Banking reform should be complemented by the strengthening of capital markets, as this is the other main vehicle to channel resources to the most productive businesses. In this case, the problems are more technical in nature. The rigid rules for the conduct of business applying to the official stock exchange ensure that trade fails do not occur, but they adversely affect turnover efficiency and trading volumes. At the other end, there are neither rules nor information systems for the informal market, which raises the prospect of abuse of investors' trust.

Box 10.2: A Roadmap for Banking Reform

In early 2005 the SBV prepared an ambitious submission on banking reform, as an input for the SEDP for 2006-2010. While this submission was based on a close consultation with the Prime Minister's office, it was considered a departure from the banking reform strategy followed since 2001, thus warranting consideration by the top leadership of the country. The terms of the submission were endorsed, indeed strengthened, in the summer of 2005. This led to the preparation of a decision by the Prime Minister, giving the overall sense of direction for the new strategy.

It will take some time for the various building blocks of this new strategy to be spelled out in detail and to be translated into concrete policy actions. But the current roadmap for banking reform appears to revolve around four main tasks:

- Revision of the laws on SBV and credit institutions: These laws will be drafted in 2006 and issued in 2007. They should transform the SBV into an independent central bank, and be consistent with WTO commitments and other international best-practice principles. Supervision will be the center of SBV's activities, with first the creation of a supervision board and subsequently its transformation into an independent body within SBV. There will also be a strengthening of the monetary policy functions of the SBV.
- Separation of SBV from SOCBs: Any decisions related to the management of SOCBs will be moved out of SBV. The shareholding rights of the state will be exercised out of SOCB, either by MOF or by a specialized agency. To reinforce the separation between SBV and SOCB at local levels, SBV branches will be re-organized on a regional basis. Regional branches will have similar responsibilities to those of the central office, except for monetary policy. The functions and responsibilities of existing, provincial branches will be gradually curtailed.
- Speeding up the SOCB equitization process: VCB and Mekong Housing Bank should be equitized in 2006. The Bank for Investment and Development of Vietnam (BIDV) should follow in 2007, and the Industrial and Commercial Bank (Incombank) in 2008-2009. By 2010, there should be progress towards the equitization of the VBARD. Following equitization, these banks will issue shares with the intention of bringing state ownership down, to as low as WTO commitments establish.
- Upgrading human resources and IT technology: this will also require adapting the overall business process, focusing on banking supervision and monetary policy. Efforts will go into developing supervision manuals and training programs for supervision staff which are adapted to the characteristics of the banking business in Vietnam, including the nature of the information systems of joint stock banks. A salary reform will aim at making SBV competitive with them.

Source: Based on information from SBV.

Both an active official stock market and a vibrant market of unlisted securities are needed in order to support business development. In the official stock market, the rigid rules governing transactions need to be replaced by reliable information systems, on both securities and brokers. As for the informal market, securities listing and registration should be dissociated, so as to increase the transparency of transactions occurring out of the official stock exchange. Moreover, current systems do not provide information on brokers and dealers who are not members of the official stock exchange. It is thus difficult to hold them accountable in case of misconduct.

Efficiency is also needed in the allocation of state capital. Some of this capital has been divested through the equitization program. Equitization has also resulted in better enterprise performance, by reducing the power of the line ministries and provinces the SOEs are affiliated

with. By the time the equitization process is completed, some 4,000 SOEs will have gone through this kind of transformation. The newly approved Common Enterprise Law is bound to scale up this approach, by giving a maximum of four years to all remaining SOEs to move under its corporate governance rules.

Yet, even if the equitization process could be completed on schedule, which is unlikely to happen, there would still be some 1,800 SOEs in Vietnam by 2007. Because many of these enterprises are quite large, their combined capital is considerable. A crude estimate suggests that their equity could be close to 200 trillion dong, or 25 percent of Vietnam's GDP. Their total capital, partly mobilized through long-term debt, could be twice as high. Proper management of the state shareholder rights on this capital is fundamental to increase the overall efficiency of the economy and to ensure transparency.

Unfortunately, this is easier said than done. There are not too many "models" where the state has retained control over a large portion of the capital of an economy, and succeeded at managing it efficiently. Arguably, Singapore is one of them, and this might be the reason why Vietnam seems keen to learn from the experience of Temasek (Singapore's agency for the management of state assets). For now, there are discussions about fully divesting many more small SOEs, so as to retain state ownership in "only" 1,000 enterprises. These would be organized around five to seven economic groups, operating in a narrow set of strategic sectors from electricity to air transport. It would also seem that a multiple ownership structure would be adopted, so that none of those economic groups would be purely owned by the state. Further evidence of the move towards private-style management is provided by the recent decision to allow five GCs to hire outsiders as chief executive officers (CEOs). Up to now, senior management of state-owned corporations had been appointed by government. Vinashin, the biggest shipbuilder in Vietnam and a very dynamic enterprise, is the first state corporation in the country to hire a foreign CEO. This move could be followed by about 100 other entities with state ownership in the coming times.

More important than the precise number of enterprises to be retained, or their sectors of activity, is the institutional architecture to support an efficient and transparent management of state capital. The lack of planning documents articulating the government's intentions in this area makes it difficult to predict how this institutional architecture will look like. However, it will most probably revolve around three components.

The first one is a management unit making the key decisions on capital allocation. This role should be played by the State Capital Investment Corporation (SCIC), created by the Prime Minister in July 2005. The SCIC will absorb state ownership rights in equitized SOEs from line ministries and government agencies, thus consolidating all shareholdings in one institution. By moving ownership rights out of ministries, it should alleviate the conflict of interest between ownership and regulation. Finally, it will also have a charter capital to allocate selectively across its affiliated enterprises; for now this charter capital has been set at five trillion dong. Whether the SCIC would also manage the state ownership rights on SOCBs after their equitization will only become clear after the details of the banking reform roadmap are spelled out.

The second component of this institutional architecture is a performance evaluation mechanism, to determine which enterprises deserve support, and which ones need to be restructured. Initially, this role could be played by Decision 271 of 2003, which leads to the classification of SOE performance in one of three categories, on an annual basis. Arrears in the servicing of debts automatically put the enterprise in the lowest performance category. Two consecutive years of poor performance can lead to the restructuring of the enterprise and the removal of its director. For now, the implementation of Decision 271 by MOF has been slow, but

it is expected to accelerate in the coming months. Looking forward, the planned listing of many equitized SOEs in the stock market will provide another mechanism to assess their performance.

The third component is a restructuring unit, in charge of handling the assets and debts of poor performers. The Debt and Asset Trading Corporation (DATC), created on a pilot basis in 2003, under MOF too, should play this role. DATC has spent most of the time since its inception dealing with organizational, procedural and legal issues. Operations started in earnest in late 2005, when one SOCB signed a factoring contract with the DATC in an attempt to speed up the collecting of unpaid debts with two debtors. On the surface, DATC could face the same difficulties as the asset management companies of the SOCBs. However, by being directly under MOF it might be better positioned to reach foreclosure and seize assets if needed.

The recent handling of Pacific Airlines by MOF is suggestive of how this emerging institutional architecture could be operating in the future (Box 10.3). It is also telling regarding its associated governance risks, if insufficient attention is paid to the transparency of SCIC's dealings and its overall accountability as a government agency.

Box 10.3: Fostering Competition in Air Transport?

Pacific Airlines was formed in 1992 as a joint stock company between state-owned Vietnam Airlines and other SOEs, including Saigon Tourist, VASCO, SASCVO and Airimex. Vietnam Airlines held 86 percent of the capital.

With a staff of 561 employees and four leased planes, Pacific Airlines offers similar standards of service to Vietnam Airlines, charges similar prices, operates from the same airports and owns no routes. In practice, the two companies complement each other. But Pacific Airlines is nonetheless unprofitable; in 2003 its losses reached 19 billion dong. This made it an exception among joint stock companies with a majority state share. Poor load factors, too many passengers not paying fares, and inadequate aircraft utilization could be among the reasons underlying this poor performance. At the end of 2003 the capital of Pacific Airlines totaled 230 billion dong, and its liabilities 213 billion. By 2004 it had presumably become insolvent, and was not paying its maintenance bills anymore.

In April 2005, MOF reclaimed all the shares Vietnam Airlines had in Pacific Airlines, and hired Temasek to diagnose the company and propose a restructuring plan. The assessment was conducted in four months, and subsequently Temasek (which is the owner of Singapore Airlines) agreed to buy 30 percent of the shares of Pacific Airlines, for 50 million dollars. MOF retained the unsold shares. After the deal was signed, MOT announced that it would not allow a third carrier in the domestic market. However, during 2005 two regional low-cost carriers were authorized to operate flights from Vietnam to Bangkok and Singapore.

Source: Based on information from MOF.

Social inclusion

Vietnam managed to build inclusive basic health and education systems in the period under central planning, reaching a vast majority of the population and delivering social indicators comparable to those of middle-income countries. But these systems did not cope well with the transition to a market economy, and they were anyway ill-suited to address the more complex and expensive needs of an increasingly more prosperous population. The provision of services for a

fee allowed coping with the demands of the most affluent, but ended up penalizing the poor. Meanwhile, Vietnam had not managed to build an equally inclusive social protection system. Assistance to the poor was targeted and delivered quite effectively at local levels, but more modern social insurance mechanisms were only available to those working in government or SOEs or, more recently, in the formal private sector.

The challenge for Vietnam now is to combine the efficiency of market mechanisms with the broad coverage that characterized education and health services in the period under central planning. Success in this combination could lay the foundations of modern universal systems. In a paradoxical way, the relatively good quality of targeting mechanisms makes it possible to use them as a tool to attain universal coverage. Not by providing transfers and subsidized credit, as they still do to some extent, but rather by giving the poor access to services which are otherwise delivered for a fee. Targeting and "socialization" policies can then go hand in hand. But proper attention to incentives is needed for this combination to work.

On the surface, education is the easiest case. Targeted programs have been used for quite some time to deliver exemptions of education fees to the poor. Exemptions allow all children, regardless of family income, to attend the same schools. Empirical assessments of the performance of these exemptions show, consistently, that they are effective at increasing school enrollment among the poor. In principle, differentiation in the nature of the services accessible to households only occurs at higher education levels. For instance, private providers are by now authorized in tertiary education, and public universities can increasingly charge fees for the courses they offer.

However, this does not mean that universalism has already been reached in basic education. There is still a fraction of children who do not attend primary school, mainly among the ethnic minorities. And the quality of the education imparted varies considerably. The poorest districts and communes have worse schools, resulting in much lower achievement in standardized tests. Local fees for school maintenance, and unofficial charges (for instance, under the form of nominally voluntary private lessons after school) also fall on the poor. Enforcement of quality standards, larger budget allocations for poorer communes and districts, and a shift to full-day education are thus part of the social inclusion agenda in this area.

In health, targeting mechanisms had traditionally been used to deliver health care "cards" to the poor. Under such scheme, public health facilities were mandated to provide some services to card holders for free; in exchange, they were supposedly refunded by the government. In practice, services were not always delivered, as the health facilities lacked an incentive to do more than the bare minimum for poor, non-paying patients. A breakthrough happened in 2002, with the creation of provincial health care funds for the poor (HCFPs). Targeted mechanisms were to be used to deliver health insurance cards to the poor, of the same type available to formal sector workers. But despite a substantial allocation of resources from the central government to HCFPs, most provinces continued reimbursing the public health facilities directly.

However, conditions are now better to aim for universal coverage. Health insurance has been restructured, with the introduction of a voluntary program offering benefits similar to those accessible to formal sector workers. The HCFPs have been reorganized as well, now forcing provinces to provide health insurance cards to the poor, and banning the direct reimbursement to public health facilities. This way, targeting mechanisms can be used to deliver the same kind of health insurance cards available under the voluntary program. MOF is working on the increased budget allocations needed to support the revamped HCFPs.

What is pending for health reform to be successful is the strengthening of incentives for the delivery of quality services at reasonable cost. For now, Vietnam Social Insurance (VSI) simply uses its resources to reimburse public health facilities. It does not yet behave as a

strategic, wholesale purchaser of health care packages from public and private providers. But it is in a good position to do so, as it is bound to manage an increasingly large volume of resources, both from those paying a premium for their health insurance, and from the budget, which pays for the premium on behalf of the poor. The social inclusion agenda in health is then to effectively combine modern insurance principles, effective targeting mechanisms, and the development of a market for wholesale health service packages.

The biggest challenges are in social insurance, where Vietnam has much less of a trajectory. Not surprisingly for an agrarian economy, protection against poverty in old age was not delivered through a formal pension system. The latter was only accessible to the minority of the labor force working for government or SOEs, and it did not involve any contribution by the beneficiaries. In 1995, a social insurance system was created, with its coverage extending to formal sector workers in the private sector. Workers and employers had then to pay social insurance contributions, to defray the cost of their future benefits. But the resulting compulsory program had serious weaknesses that need to be addressed. In 2005, the government identified the key priorities for its reform, and the first ever Social Insurance Law should be issued in 2006. The drafting of this law raises difficult technical issues, and its implementation is likely to be demanding as well.

The first priority identified by the government is to revamp the compulsory social insurance program for formal sector workers, in a way that makes it financially viable in the long term. As currently designed, the program is unlikely to generate a surplus in excess of 1.5 percent of GDP in any year, and will start running a deficit in about three decades. This is despite a young and rapidly formalizing labor force, which implies that the number of contributors will vastly exceed the number of beneficiaries for quite a long time. To make the compulsory program financially viable, the formulas setting the level of pensions need to be much closer to an actuarial benchmark. The latter indicates the income flow that could be derived from past contributions, had they been invested in a sound manner. Currently, different pension formulas apply to men and women, and especially to public and private sector workers. And they are all quite far removed from the actuarial benchmark.

A second, closely related priority is to extend the coverage of the compulsory program. But for this to happen, it is necessary to modify the incentives for participation by private sector workers. Under its current design, the program discourages long periods of contribution, or the full reporting of earnings after some number of years. This is again due to inadequate benefit formulas. Past some point, the increase in the pension level is simply not commensurate with the contribution effort (Box 10.4). Lack of attention to incentives will lead to insufficient revenue for the social insurance system and, eventually, to an increase in the contribution rate in order to cover the deficit. This would in turn discourage employers from declaring their workers, further undermining the chances of extending the coverage of the system.

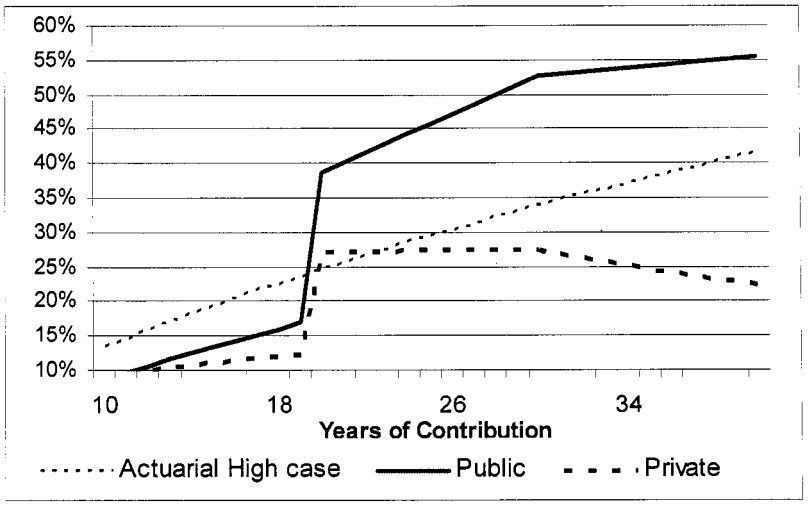
A third priority identified by the government is to set up a voluntary social insurance program, available to farmers and the self-employed, so that those in the informal sector can have access to a basic set of benefits as well. The reform approach adopted in the health sector could serve as a model in this respect. In the health sector there are not different programs, but rather a single program (health insurance) with three access modalities: compulsory, voluntary or through targeting mechanisms. But such model would be out of reach in social insurance if the compulsory and the voluntary programs were too far apart. The "portability" of past contributions between the compulsory and the voluntary programs, and the similarity of the benefits those contributions purchase, is key to support labor mobility (occupational and geographical) in an economy where the informal sector is likely to remain dominant for quite some time.

Box 10.4: Social Insurance: Getting the Incentives Right

The generosity of the benefits offered by a social insurance system is often difficult to gauge. On the surface, it is clearly spelled out in a formula. For instance, under Vietnam's current regulations, the payable pension increases by two percent of the average salary for every additional year of contribution in the case of men; and by three percent in the case of women. This is very generous by international standards. But for private sector workers, the "average" salary is computed based on all the work history of each individual, without any indexation. For civil servants, only the last five years count. In an economy where real incomes (including wages) can be expected to grow substantially over the next few decades, this lack of indexation pushes the level of the average salary down, compared to the actual salary at retirement age; especially so for private sector workers. This combination of nominal generosity and real tightness produces unexpected outcomes.

One practical way to see this is to compare the resulting benefit with a hypothetical, actuarial benchmark. The two broken lines in the figure indicate the level of old-age pension as a fraction of the salary at retirement under the current social insurance regulations of Vietnam. They are computed in the case of a man, depending on the years of contribution, and on whether he works for the public sector (solid line) or the private sector (dotted line). They are drawn under the assumption that incomes grow by 6 percent per year in real terms, and the inflation rate is 3.5 percent. The smooth line, in turn, is the old-age pension an actuarial system would pay if its real rate of return on past contributions were 4 percent per year.

Pension as Percentage of Salary at Retirement Age



There are three striking results in this figure. First, workers lose most of what they contributed if they remain enrolled for less than 20 years (the two broken lines lay clearly below the actuarial benchmark). This is because they get a lump sum payment which is too small to sustain an income flow, even if invested profitably. Second, public sector workers get a much better deal than under an actuarial system (the solid, broken line is substantially above the actuarial benchmark). And third, it is not in the interest of private sector workers to contribute beyond some 22 years. They clearly lose after the 30th year. This is because the additional benefit from an extra year is offset by a decline in the "average" salary it applies to. As the work history on which the average is computed becomes longer, older wages bring the real value of the average down.

Source: Based on Paulette Castel and Martin Rama (2005).

However, the poor are unlikely to enroll in a voluntary social insurance program no matter how vulnerable they are to risks, simply because they cannot afford it. The social inclusion agenda, in this case, amounts to setting up a mechanism to provide them with some of the social insurance benefits that will increasingly be available to the population at large. One option in this respect is to pay a minimum pension to the poor in their old age, even if they never contributed. Another alternative, more similar in spirit to the HCFP approach, is for the government to make a minimum contribution to voluntary social insurance on behalf of the poor, on an annual basis, much the same as it does with health insurance cards.

The relationship between this social inclusion agenda and business development might look thin at first. But it would be a mistake to downplay the links between the two. There are at least four of those links. First, businesses should become important suppliers of social services over time. Public funding should not be confused with public provision. Tertiary education, health care services and, maybe in a not-so-distant future, pension programs, can all be supplied by non-state organizations, including private enterprises, cooperatives and NGOs. A second link concerns the social insurance system specifically. If properly reformed, social insurance could accumulate a massive amount of resources before the active workers of today start retiring. Those resources will need to be invested; if managed in a sound and transparent manner, they could make a major contribution to capital accumulation. Third, and most obviously, good human resources cannot be dissociated from a healthy and educated population. The development of the education system, in particular, is the key to tap all the talent available in each cohort of Vietnamese children, and to build up the skills the business community needs. Last but not least, inclusive development is a major foundation of social stability. And this has been one of the main advantages of Vietnam over its competitors.

Modern governance

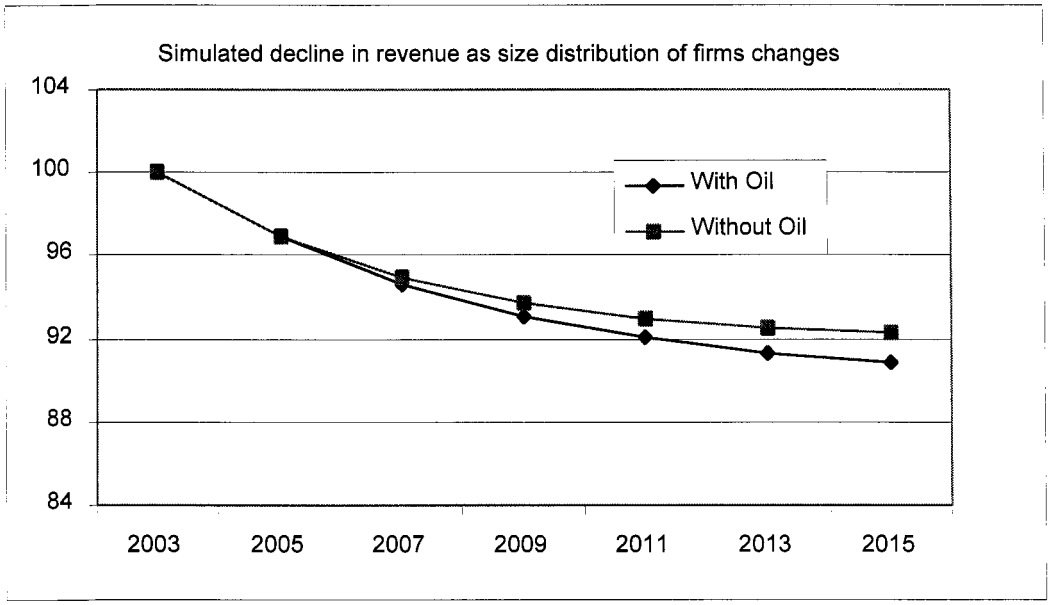
As Vietnam gradually gears up to middle-income status, the governance agenda is bound to become increasingly important. In the early stages of development, the economy could function on relatively rudimentary but well-tested systems. Land transactions took place in the absence of titling, because local authorities "knew" what belonged to whom; the lack of a legal system was not an obstacle to business transactions, because direct knowledge of counterparts allowed operating on a trust basis; corruption was rampant, but the amounts at stake were seldom large, simply because the population was poor. But reliance on market mechanisms requires that more elaborate transactions be sustained, in interactions often involving anonymous partners and considerable resources. This may not happen without further institutional development, aimed at fostering transparency and accountability.

Completing the modernization of public financial management is a central part of the governance agenda. Much progress has been made regarding public expenditures. The full disclosure of the budget, the increasing say of the National Assembly and People's Councils at all levels in allocations, the creation of a single Treasury account, the introduction of international accounting standards, the upgrading of the functions and independence of the State Audit of Vietnam (SAV) and the adoption of modern information management systems are all steps towards reducing fiduciary risk. The increasingly large number of donors delivering aid to Vietnam under the form of general budget support is a testimony of the progress accomplished in this respect. The agenda emerging from the recent Public Expenditure Review-Integrated Fiduciary Assessment (PER-IFA), conducted by MOF and the World Bank with the participation of several donors, has charted a clear agenda for the next steps of this process.

Progress has been much more modest in the management of state assets and liabilities. The need to strengthen asset management was discussed above, when describing the structural reform agenda. But from a governance perspective, the gradual centralization of government ownership rights in the hands of the SCIC is a double-edged sword. On the one hand, it could substantially increase efficiency in the use of capital, and be combined with the development of key markets, from electricity to air transport. On the other hand, it raises the spectrum of non-transparent deals involving colossal sums of money. Strengthening accountability in the management of state assets should thus be considered part of the governance agenda, and not only of the structural reform agenda.

Better control over liabilities is important as well. At present, the government of Vietnam does not have a centralized information system for public debt. More worryingly, it has limited clarity on its contingent liabilities, which are just beginning to be assessed systematically. For now, the most important liabilities are associated with the provisioning for bad loans in DAF and in SOCBs, with the need to recapitalize the latter in view of their equitization, and with the fulfillment of pension obligations towards civil servants who did not contribute to social insurance. Over time, however, especial attention will need to be paid to provincial finances. In their drive to develop local infrastructure, many local governments are embarking in "creative" deals through their local development investment funds (LDIFs). Mobilizing syndicated loans and SOE resources to create joint ventures with the private sector and implement transport and sanitation projects might be necessary for rapid economic growth. But it could also be a source of important losses for the provincial governments and, eventually, and eventually a burden on the national budget.

Figure 10.1: Tax Revenue and the Emergence of Small and Medium Enterprises



Source: Own estimates, based on data from GSO and MOF. The distribution of enterprises by size represented in Figure 1.8 is used for the simulations. The ratio of tax revenue over sales for each size group is assumed constant. Tax revenue includes CIT, VAT, trade taxes, natural resources tax and special consumption tax.

The public financial management agenda for the coming years also includes tax administration reform. Integration with the global economy may not reduce government revenue immediately, as the volume of trade will grow faster than tariffs rates will decline, at least for some time. At present, trade-related revenue represents 12 percent of all government revenue, or slightly more than 3 percent of GDP. But in a few years this share will start declining, and the shortfall will need to be replaced by revenue from other sources.

Equally important, the high "productivity" of taxes such as CIT, and especially VAT, is to a large extent due to the unusual distribution by size of Vietnamese businesses. Taxing a few large enterprises, be them SOEs or foreign companies, is easier than going after a myriad of small and medium ones. As the "missing middle" of the size distribution gets increasingly filled, revenue from CIT and VAT will be affected. A simple way to visualize this is to assume that the ratio of tax revenue to sales remains unchanged for enterprises in each size segment, but the distribution of enterprises by size changes in the way the enterprise censuses suggest it will. The result, with unchanged tax capacity collection, would be a decline in total tax revenue by 7 to 9 percent in a decade (Figure 10.1). This simple exercise shows the urgency of developing a tax administration that can effectively deal with large numbers of SMEs.

Finally, there is the need to make public markets more competitive. Nationwide open competitive bidding in public procurement was introduced in 1996. This system was improved in 1999 and further strengthened in 2003, when the use of standard bidding documents became mandatory. The first of these documents, for the procurement of goods, was issued in late 2005. Another tool for increased transparency, the public procurement bulletin, has been in use since early 2005. Both bidding opportunities and information on the awarding of large contracts must be reported in it. The development of an e-procurement bulletin is at an advanced stage, and the recently passed Law on Procurement should help consolidate a still fragmented legal framework. However, lack of competition in public markets is not always due to regulatory imperfections. The limited number of suppliers, especially for civil works, opens the prospect of collusion among bidders (mainly SOEs).

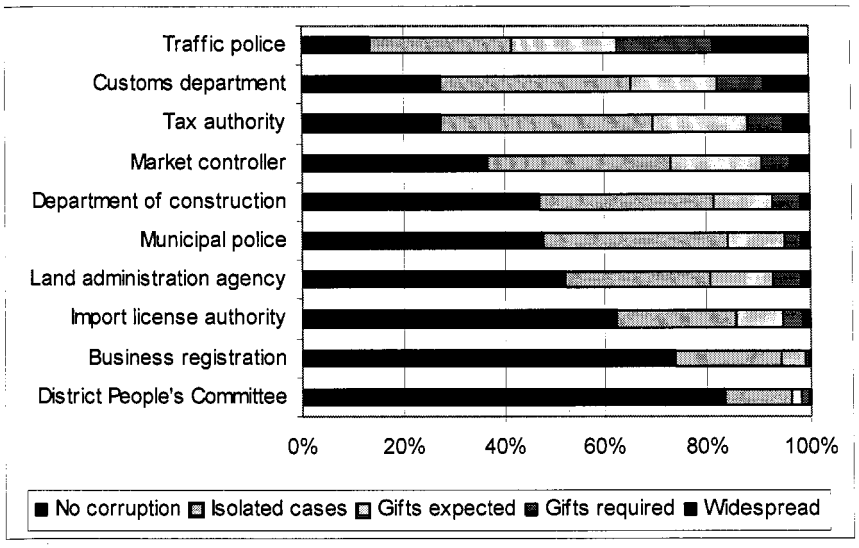
Another important part of the governance agenda, closely related to the previous point, is to first contain and then reduce corruption. Apart from public markets, SOEs, land conversion and some social services are particularly vulnerable to it. The ICS survey by the World Bank suggests that corruption modalities directly affecting businesses are not as burdensome as often claimed, which offers some hope to tackle them. But seemingly minor bribes, from a business perspective, often amount to the equivalent of a month of salary. Seen from a household perspective, corruption is not so petty then. Failure to tackle it could undermine public morality, and eventually affect the business community as well.

Both the ICS survey and the corruption diagnostic study by the Internal Affairs Committee of the Party also suggest that the extent of corruption varies considerably across government agencies (Figure 10.2). Some of them appear to be much "cleaner" than is usually acknowledged. Others clearly require determined government action. But determined is not synonymous of punitive. While sanctions are a central component of an anti-corruption strategy, they alone will not be enough to overcome corruption in Vietnam.

An effective anti-corruption strategy will have to combine a few other elements. Simplification of procedures, so as to reduce the discretionary power of government officials, is one of them. The Public Administration Reform Agenda has measures going in this direction, such as the generalization of OSSs and the development of electronic interfaces and other forms of e-government. It would also be important, for agencies such as the traffic police, to set fines at levels which are not unreasonably high, so that those breaking the rules have less incentive to pay bribes. The strengthening of government systems is another important element in an anti-

corruption strategy. This is already happening in public financial management, and should also happen in government agencies such as the customs department, of the tax administration authority. Monitoring the assets of civil servants and their immediate families can also help, although the effectiveness of this component very much depends on the way it is implemented. There is no way for the government to monitor the assets of all civil servants. On the other hand, focusing on senior government officials (and especially on those whose responsibilities make them more vulnerable to corruption) may have higher payoffs. This calls for a phased-in introduction of this component, with low coverage but close scrutiny in the initial stages. Last but not least, investigative media can help uncover instances of corruption, and act as a deterrent for misbehavior. Civil servants need to be protected against defamation, but journalists need to be protected if they do their job honestly.

Figure 10.2: Corruption by Agency: the Good, the Bad and the Ugly



Source: Based on ICS survey by the World Bank.

Finally, a functioning legal system supported by a judiciary capable of interpreting and enforcing the law is essential to support business development. In its absence, there is no assurance that contracts will be honored, which in turn results in high risks and lower competitiveness.

Admittedly, Vietnam has done relatively well so far, despite the fact that firms can not effectively solve disputes in court, and hold business partners or government accountable for their commitments. For instance, in Hanoi there were only 70 cases brought to the Economic Court in 2003, and 20 to the International Arbitration Center operated by VCCI. Firms generally avoid the courts because the process is lengthy and expensive, decisions are considered arbitrary and enforcement mechanisms are ineffective. But the current institutional arrangements work well mainly for firms at both ends of the size distribution. Household businesses and small-scale enterprises can rely on personal relationships and trust. At the other end, SOEs and foreign companies (through their business associations and embassies) have privileged access to government, in case of disputes. But these options are not available for middle-sized enterprises.

11. THE LOCAL DIMENSION

The attitude of public officials towards businesses, and how they choose to exercise their official discretion as a result, makes an enormous difference in the provincial investment climate. The decentralization process and the increased delegation of decision-making power to local authorities have led to vast gaps in business buoyancy, and more generally in economic and social development, across Vietnam. Contiguous provinces, with similar endowments but different commitment of the local authorities to a multi-stakeholder economy, are often worlds apart in terms of enterprise registration, investment by foreign companies and the availability of wage employment. Gaps can be found in a range of apparently small decisions which, compounded, make all the difference. Registering an enterprise, obtaining a license, having access to land, securing a credit, dealing with tax officials, relying on good infrastructure or being protected from corruption, all these key aspects of the business activity are shaped by the attitude of provincial authorities. Rigorously measuring the quality of governance (either locally or at the national level) is not an easy task, and any specific indicator is bound to be questioned on methodological grounds. Identifying which aspects of local governance have a stronger impact on business performance, from access to land to quality of infrastructure to extent of corruption, is not easy either. In spite of these caveats, benchmarking provinces on key aspects potentially affecting business activity is a step in the right direction. The modernization of provincial planning processes, along the lines observed at the national level, relying on consultation with the local business community, should encourage further improvements. Combined with appropriate budget allocations for provinces with stronger needs, the promotion of local leaders who succeed in fostering growth and reducing poverty would provide a powerful incentive for change.

Wide provincial variation

Striking contrasts in overall performance can be found between otherwise similar provinces across all of Vietnam, from North to South. It is difficult to account for those contrasts on the basis of history, location, topography, population size, or conditions at the beginning of the reform process. On these bases, it would have been reasonable to expect a convergence in trajectories. Instead, divergence is often observed, and it seems to a large extent due to the quality of provincial leadership.

Consider the North first. On the surface, neighboring provinces, Ha Tay and Vinh Phuc, have a number of similarities (Table 11.1). For instance, by 2004 the population of these two provinces had roughly the same access to roads and electricity, and their poverty rates were almost identical. In some respects, Ha Tay does better than Vinh Phuc. At 51 percent, the fraction of households with access to safe water was much lower in the latter than in the former, where it reached 72 percent.

Yet, Vinh Phuc has been much more dynamic than Ha Tay in recent years. Based on enterprises censuses, between 2001 and 2003 the profitability of registered firms was much higher. Also, the share of formal employment relative to population grew twice as fast in Vinh

Phuc, and the growth of non-state industrial output was much higher as well. The reported similarity in poverty rates as of 2004 is in fact a stunning accomplishment: by 2002 the poverty rate of Vinh Phuc was 39 percent, compared to 26 percent for Ha Tay. These figures need to be interpreted with caution, as they are computed on samples of less than a thousand households per province. But the contrast is suggestive of a substantially different performance between the two provinces. Part of the gap in performance could be related to the higher levels of public expenditure enjoyed by Vinh Phuc, although this higher level does not translate into large investment projects. But a large part seems to be due to the quality of local leadership and its ability to innovate and create a climate for vibrant enterprise development.

Table 11.1: Striking Contrasts: from North to South

	North		Center		South	
Indicators	Ha Tay	Vinh Phuc	Hue	Danang	Long An	Binh Duong
GDP per capita (current dollars, as of 2003)	275	365	271	733	408	771
Poverty rate (percent of population, in 2004)	16	17	15	3	11	2
Employment in registered enterprises (per thousand inhabitants in 2003)	25	27	38	159	43	379
Registered enterprises in operation (per million inhabitants in 2003)	409	467	750	2202	680	2306
Average capital per enterprise (in billion dong in 2003)	9.0	16.7	7.7	12.1	10.1	27.6
Accumulated FDI (in dollars per inhabitant)	117	385	127	364	233	1556
Government promotes private sector (from 1 to 10)	1.2	8.1	5.1	7.2	5.9	9.3
Speed to register, get land and licenses (from 1 to 10)	4.3	7.5	6.3	8.8	7.2	7.7
Communication on plans and policies (from 1 to 10)	3.8	5.4	4.5	6.7	3.5	6.1

Source: Based on data from GSO and VNCI (2005b). The last three indicators are compiled out of responses by firms operating in each of the provinces.

In the central region of Vietnam, a clear example of diverging trajectories is provided by the case of two contiguous provinces: Hue and Danang. Both are on the coast and both have remarkable assets to attract tourism. But Danang does better on most counts. Its poverty rate is one fifth of Hue's. Its population has much better access to roads, safe water and education. And the ratio of its employment in registered enterprises to the total population is four times higher. It could be objected that most of these differences are due to the fact that Danang is more urban than Hue. A more defensible comparison needs to focus on the growth rates of key indicators, as opposed to their levels. But Danang does better on this count too. Based on data from enterprise censuses, between 2001 and 2003 it added twice as many people (relative to the population) to the ranks of the formally employed as did Hue.

The attitude of local authorities is not as different across these two central provinces as it is between Ha Tay and Vinh Phuc. Admittedly, doing business is easier in Danang than in Hue. For instance, the time needed to register an enterprise, acquire land and receive licenses (if at all needed) is much shorter. Danang has also being more successful at attracting FDI. By now its accumulated investment by foreign companies is three times higher than in Hue. But this is not necessarily due to different attitudes of the two provincial governments towards the involvement of the state in economic activity. In fact, the industrial output from provincially managed SOEs is seven times higher in Danang than in Hue. The main difference between the two provinces seems to be related to their investment in infrastructure. In 2003, Hue's spending per capita in large investment projects was about 60 percent below that of Danang. The result has been a vast disparity between the two provinces in the availability of land with proper infrastructure services.

In the south, finally, an interesting contrast is offered by Long An and Binh Duong. Strictly speaking, these two provinces are not neighbors, but they do occupy similar positions on either side of HCMC, Vietnam's largest urban and economic centre. Though both provinces do remarkably well compared with national averages, Long An has a higher proportion of the population living in poverty than Binh Duong. Part of the gap can be attributed to a much stronger economy in Binh Duong. Its number of registered enterprises, relative to its population, is three times higher than in Long An. Nearly nine times as many people (again relative to the population) are employed by employed by registered enterprises. Strikingly, Binh Duong has attracted nearly seven times as much foreign investment per capita than has Long An (and, by the way, almost four times as much as Danang).

In this case, the difference cannot be attributed to large-scale public investment. Admittedly, access to roads is poorer in Long An, due to the seasonal flooding that takes place in some parts of the province. But in 2003, allocations from the Public Investment Program were almost identical, in per capita terms, in the two provinces. (Interestingly, they were clearly below those of Danang and Hue at the time). The two southern provinces also have a similar industrial output produced by SOEs. But Binh Duong has a non-state industrial output which is about 16 times higher than that of Long An.

As in the case of Vinh Phuc and Ha Tay, an important part of the gap between the two provinces seems to be related to the difference in the attitude of provincial governments towards the private sector. Based on data from a provincial competitiveness initiative supported by USAID, enterprises in Binh Duong rate the pro-activity of local leadership at over nine, on a one-to-ten scale. This is by far the highest score in the country. Enterprises in Binh Duong also give higher ratings to their government than those of Long An on issues such as access to planning and legal documents, communication of new laws and regulations, and predictable implementation of announced policies.

Governance quality

The contrast between similar and even some times contiguous provinces, in the North, Center and South of Vietnam, is suggestive of the diversity of the mechanisms through which attitudes and decisions by local governments can influence performance. A range of studies and anecdotal evidence can be used to shed more light on those mechanisms. What those studies and evidence reveal is the considerable lee way given by the decentralization process to local authorities in the implementation, and even in the interpretation, of supposedly common national policies. Opportunities for diversity are further amplified by the inconsistencies and overlaps of a still emerging legal framework. As a result of such inconsistencies and overlaps, which law or

regulation is valid in each particular case, and how it should be applied, is not always clear. Increased decentralization and still considerable ambiguity make the quality of provincial governance central to the success of economic reforms.

From a business perspective, differences in the implementation of the Enterprise Law warrant close examination. In general, enterprise feedback gathered by the ICS by the World Bank is quite positive about the attitude of the Business Registration and Licensing Agency under the DPIs. Efforts to facilitate the entry of new firms, through the simplification of the administration process, and the enhancement of capacity at registration offices, seem to be widespread. Yet, a small-scale survey of enterprises, conducted by the World Bank too, revealed some striking differences between locations. In Hung Yen province, for example, all of the registered companies sampled had succeeded in completing all administrative procedures and were operational, compared to just 44 percent in Bac Ninh and none in Ha Tay. The sample of this survey was too small to make any strong assertion out of these results, but they do suggest that differences exist in the way provincial DPI offices register and monitor private companies under their remit.

A study jointly conducted by CIEM and GTZ yields similar results. Based on the field survey underlying this study, a number of provinces failed to meet the 15-day deadline to issue business registration certificates. In Hung Yen, 41 percent of the enterprises surveyed reported receiving their certificates past the official deadline. They were 48 percent in Đak Lak and Ha Nam, and 67 percent in Ha Tay. This compares with only 26 percent in An Giang, 17 percent in Lao Cai and only 7 percent in Quang Nam. It appears then that despite the simplifications brought about by the Enterprise Law, a number of provinces are finding it difficult to comply.

Even generally successful administrative tools, like the OSS model, can prove to be double-edged swords. The OSS model provides business people with a means to submit and apply for business registration, a tax code and a seal simultaneously, dealing with a single government outfit. The study by CIEM and GTZ found that this "three-in-one" system worked well in Lao Cai. But it had effectively added one more step to business registration procedures in Dak Lak, where applicants were forced to use the OSS to simply pass the documents on to the business registrar and back to the business.

Licensing is another area deserving attention. Despite the intention of the Enterprise Law to ban provincial governments from issuing licenses, some forms of regulation of local activity are bound to be required. The example, provided before, of access by concrete mixer trucks to city streets during day hours is illustrative in this respect. Based on a survey finalized in 2002 by VCCI, only 23 percent of business licenses are imposed by the central government, whereas 55 percent are issued by provincial or district authorities. However, these local licenses can be more or less burdensome depending on the inclination of provincial and district authorities towards facilitation, as opposed to control, in the pursuit of the common good. The very interpretation of the common good may also vary from place to place, as revealed by business activities which might be considered akin to "social evils". In some provinces, for instance, karaoke bars, accommodation rental, massage services, nightclubs and coffee shops are regarded as vulnerable and, therefore, explicitly or implicitly prohibited from doing business.

Local governments also have a central to play in relation to land. In addition to deciding on zoning and land conversion, provincial governments are in charge of setting the administrative price for land. In recent times, press articles have described a whole series of scandals involving abuse of local government authority in the allocation of land. Irregularities were uncovered in Bac Lieu and Kien Giang provinces, as well as in Do Son town (Haiphong province), Phu Tho town (Phu Tho) and Nha Trang town (Khanh Hoa). But the actual list is presumably longer. On the other hand, in Nghe An province the allocation of new residential land to households was

conducted fairly, with priority for vulnerable groups and war veterans' households. Nghe An and Quang Nam provinces have also made the most progress in terms of recovering land from SFEs. Hue and Binh Dinh have made considerable progress as well.

Investment incentives are another area in which local governments have considerable discretion. MPI increased the investment threshold below which investment projects can be approved by Provincial People's Committees from 5 to 20 million dollars. In addition to approving, provincial governments can also add several types of incentives. Industrial zones and clusters have been used for this purpose. But their operation varies considerably across provinces. In some of them, private sector enterprises, including joint ventures, lease the land from the government, develop the relevant infrastructure and then sub-lease to enterprises; an example is Hanh Phuc company, in charge of Duc Hoa 1 Industrial Zone in Long An province. In other cases, non-profit state enterprises have been established to carry out a similar function; IZ Infrastructure Development company, in Phu Tai Industrial Zone, Binh Dinh province is an example of this arrangement. In many provinces in the North, industrial zones are managed directly by state Management Boards.

Provincial authorities frequently use low land rents as an additional incentive to draw private investment into their realm. Long An province, for example, exempts all new investment projects from land rental fees throughout the term of their licence. This runs counter to declared government efforts to reduce subsidies within the land market. The time needed to get an industrial land lease matters as well. According to an ADB study, enterprises in Long An province reported the completion of leasing procedures and the issuance of LUCs within 15 days of approaching the companies in charge of industrial zones. Among the seven provinces surveyed by CIEM and GTZ, the shortest time period for granting or leasing land was in Dak Lak, followed by Hung Yen, Quang Nam, Ha Nam, Lao Cai, Ha Tay, and finally An Giang.

Interactions between businesses and government officials on issues such as tax payments are especially important, because they are a potential source of corruption. How tax payments are determined could in principle be influenced by enterprise characteristics such as size and turnover, but it should not be influenced by the province the enterprise is based on. Yet, the ICS by the World Bank reveals considerable differences in approach across regions. In the Mekong River delta about 85 percent of respondents say that government officials accept their tax calculation without requiring any changes. But only 40 percent of respondents in the Red River delta and 37 percent of respondents in the Southeast say so.

More broadly, corruption is by no means uniform throughout Vietnam. Nationwide, there are clear differences across government agencies; in some, it is infrequent or even rare for public officials to expect a payment. But some of these differences are exacerbated at provincial levels. For instance, according to the ICS of the World Bank, it is uncommon for officials to expect or request a gift when a firm applies for a license in the South Central Coast; but this is not unusual in the Red River Delta. The Mekong Delta region stands out, because entrepreneurs spend less time dealing with government officials, and the official payments they make are only a fraction of what is paid in other regions.

Perhaps one of the areas in which provinces differ most is in their handling of infrastructure development needs. Some of the most dynamic ones have created LDIFs, to mobilize resources from a variety of sources, get into joint ventures with the private sector, implement investment projects and, in some cases, divest the state share in those joint ventures. But a recent analysis of the performance of several LDIFs shows that gaps across provinces can be to a large extent attributed to differences in the commitment of local governments. Out of the 13 LDIFs established so far, HIFU leads the field. A second tier, in terms of performance, includes Binh Duong, Dong Nai and Hanoi (in alphabetic order). The remaining nine LDIFs are

far behind. Provincial commitment will also be fundamental to mitigate the risks created by arrangements of this sort. Where LDIFs are very effective at raising funds and establishing risk-sharing arrangements with the private sector, their operation raises substantial governance issues. The creation of new enterprises using state capital, the lack of unified accounting and reporting standards, the possible conflict of interest between investment and regulation, and the prospect of contingent liabilities building up are among the main risks posed by LDIFs. Whether provincial governments will manage to establish an arms-length relationship with their LDIFs remains to be seen, and the answer, again, is likely to vary from province to province.

Can it be measured?

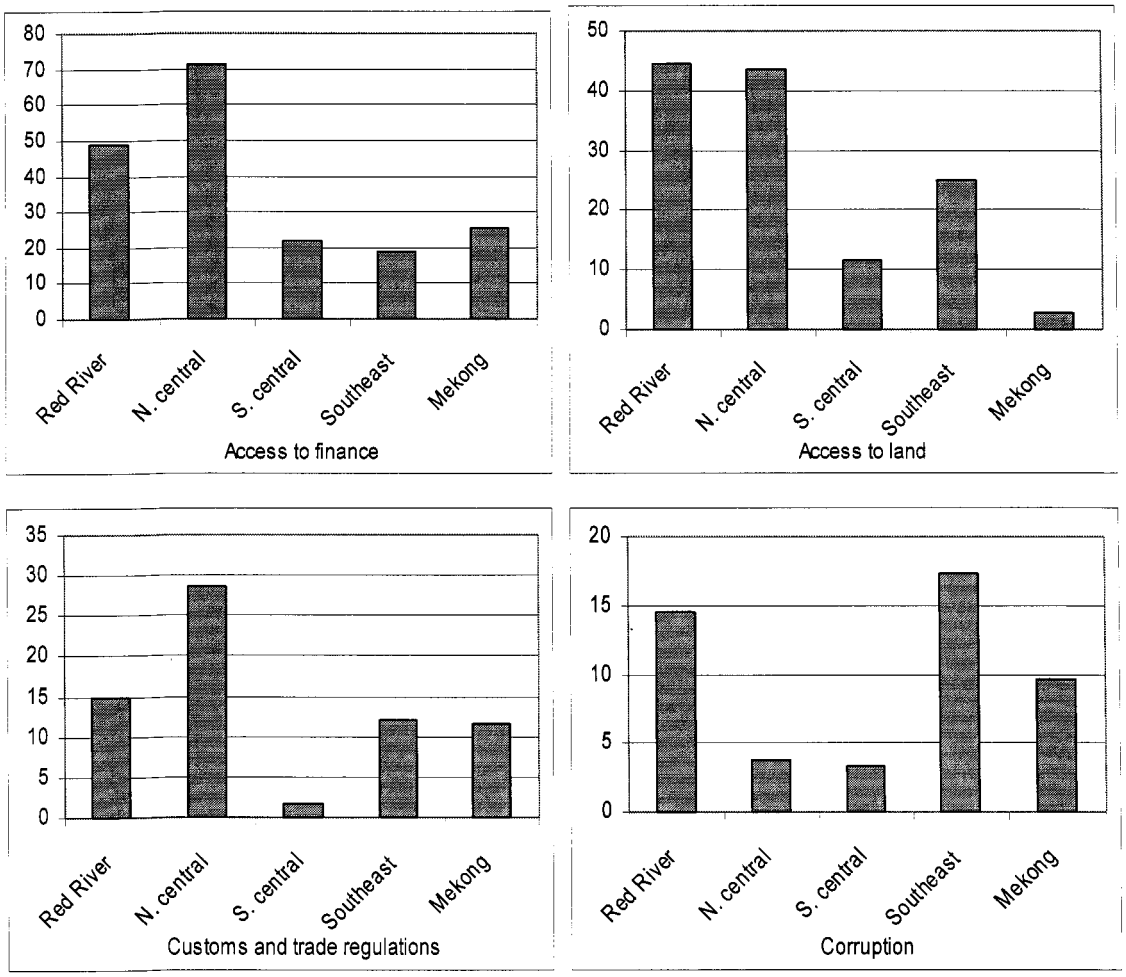
One practical way to monitor what local governments do is to ask entrepreneurs to indicate what they perceive as severe or major constraints for the development of their business. This is the approach underlying investment climate assessments. Unfortunately, the ICS for Vietnam, by the World Bank, does not have a sample size allowing a rigorous analysis of constraints at the provincial level. And this is despite Vietnam's ICS having the fourth largest sample, worldwide. But moving up to one level it is possible to count with a couple of hundred observations for each of five regions: the Red River Delta, the North Central Coast, the South Central Coast, the Southeast, and the Mekong River Delta. This is enough to uncover some telling differences in the nature of the constraints faced by enterprises (Figure 11.1). Given that even contiguous provinces within one region can differ considerably in the quality of their governance, these regional estimates most certainly underestimate the gap between best and worst performers.

Based on this crude regional comparison, access to finance and access to land are among the biggest obstacles to business development in the North of Vietnam. More than 70 percent of respondents in the North Central Coast and almost 50 percent in the Red River Delta complain about the difficulties to get credit; more than 40 percent of respondents in both regions also complain about limited access to land. Except for the Southeast, where land is an issue, problems appear to be much less severe in the south of Vietnam. It is interesting to note that access to land is not at all perceived as a constraint in the Mekong River Delta, which is also the region where the land market is most developed.

On the other hand, the Center seems to do much better than other regions in terms of corruption. Less than 5 percent of respondents in the North Central and South Central Coasts report it as a major or a severe obstacle to business development, compared to almost 15 percent in the Red River Delta and even more in the Southeast. However, this finding should not be interpreted as a wholesale clearing of the central provinces of Vietnam. For instance, almost 30 percent of respondents in the North Central Coast see customs and trade regulations as severe or major obstacles to business development.

Another approach to benchmark provincial performance is to rate a range of government processes which are potentially relevant for business performance. This is what the recently developed Provincial Competitiveness Index (PCI) does. This index, developed as part of a research project supported by USAID, assesses and ranks provinces by their regulatory environments for private sector development (Box 11.1). Based on its results, Binh Duong and Danang are the best performers across the 42 provinces considered, whereas Ha Tay and Ninh Binh are the worst.

Figure 11.1: Binding Constraints across Regions



Source: Based on the ICS survey by the World Bank.

Much the same as with cross-country indicators of competitiveness, its release has attracted an enormous amount of attention by the media, and prompted a variety of responses by provincial governments. Some provinces doing well in terms of economic growth and poverty reduction have complained about their low ratings in the PCI; others have seized the opportunity to try to improve theirs. While there is room to strengthen the methodology underlying the PCI, the systematic rating of local government processes and the enthusiastic response by public opinion at large highlight the potential of this kind of benchmarking as a tool to motivate improvements in governance at the provincial level.

The impact of local policies

The comparison between similar and sometimes even contiguous provinces in the north, center and south of Vietnam had hinted at the possibility of different drivers of success in each case. Economic analysis can certainly help identify areas where better policies and more

effective implementation should help businesses thrive. But much the same as in the assessment of competitiveness rankings across countries, it is important to focus on actual outcomes as well. Entrepreneurial capacity includes the ability to prosper in less-than-perfect regulatory environments, circumventing obstacles that may seem at first insurmountable. Identify which obstacles can be bypassed and which ones can undermine business development may thus help focus the efforts to improve local governance.

Box 11.1: The Provincial Competitiveness Index

Building on previous work by the Asia Foundation and VCCI, the PCI represents an effort to quantify the business environment in which private sector firms operate. The indicators chosen are selected based on a review of the literature on competitiveness in general, and of factors highlighted by researchers and practitioners in Vietnam. Specifically, nine sub-indexes are constructed. They deal with entry costs, access to land, transparency and access to information, time costs and regulatory compliance, informal charges, implementation of policies, state sector favoritism, pro-activity of provincial leadership, and private sector development policies.

Three main sources of information are used to compute the sub-indices. The first is a mail-out survey of 16,200 enterprises in 42 provinces, directly asking entrepreneurs to report their perceptions. A second source of information includes available statistics on issues such as the state share of output, or the variation in the number of provincial SOEs over time. Finally, a third source is made of a set of subjective assessments by the research team, for instance regarding the overall quality of provincial governments' websites. These three sources were combined through a two-stage process. In the first one, more than 40 detailed indicators were constructed; each of them was standardized to a ten-point scale, and related indicators were averaged to become the nine sub-indexes. In the second stage, different weights were applied to each sub-index in order to construct the overall PCI. The weights were derived from a statistical analysis of the importance of the sub-indexes as determinants of private sector investment per capita.

Looking forward, there are two main areas in which this methodology could be improved. One of them refers to the survey of perceptions by entrepreneurs. The mail-out approach resulted in a low response rate; at only 13 percent, the risk of dealing with a non-representative group of respondents is quite high. Moreover, the sample size is such that barely more than 25 observations are available for some provinces. The other area for improvement concerns the list of indicators considered. At present, several of them reflect outcomes, rather than government processes. For instance, the state share of output depends on how vibrant the private sector is, so that using it to explain private sector investment per capita involves some circularity.

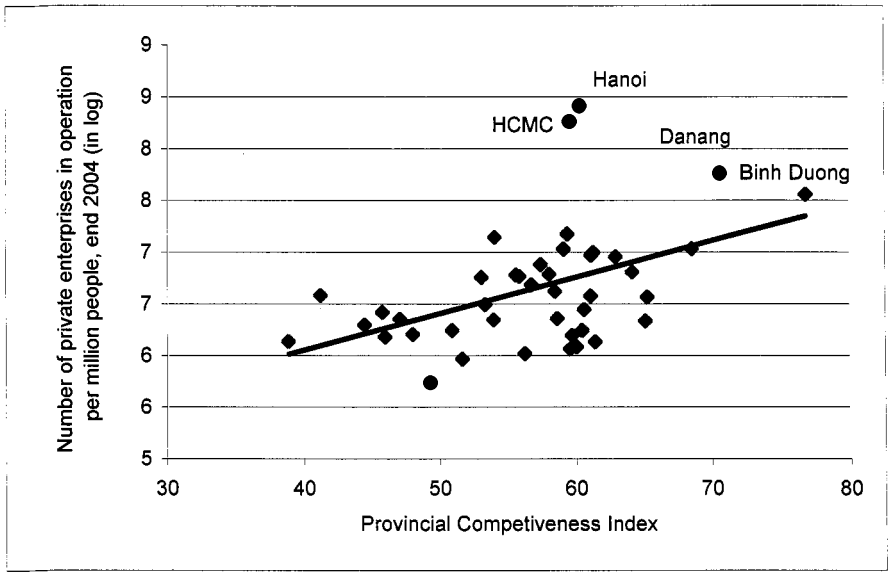
Improvements in these two areas may lead to some re-ranking of provinces, but are unlikely to alter much the overall picture emerging from the PCI. If anything, such improvements would make it an even more effective tool to benchmark the policies and attitudes of provincial government towards business development.

Source: Based on VNCI (2005).

Overall, there is little doubt that indicators such as those considered by the PCI do have an influence on business performance. The higher this index is, the larger is the number of registered enterprises in operation in a province, relative to its population (Figure 11.2). This pattern is not affected if other indicators of provincial governance are used instead. This is true, in particular, if only a few variables which are totally in control of provincial authorities are used

to measure local governance. A simplified index, involving only a dozen selected indicators out of the more than 40 that underlie the PCI, and averaging without using any weights, yielded basically the same result. The pattern is such that moving for the bottom to the top of the local governance league would increase business activity by more than 25 percent. This should be seen as evidence that local governance matters.

Figure 11.2: Provincial Governance and Enterprise Registration



Source: Own estimates based on data from GSO and VNCI (2005b).

At the same time, it is clear that the quality of local governance does not explain all the variation in performance across provinces. Some do substantially worse than could be expected, given their attitudes towards business activity, and some do quite better. Binh Duong, Danang, Hanoi and HCMC fall in this latter group. If they were removed from the analysis, the relationship between the PCI and business activity would become flatter, and the predicted impact of moving from the bottom to the top of the league would be much attenuated. This calls for a closer look at the role of specific governance indicators.

The research supported by USAID tried to disentangle the contribution of each of the sub-indexes of the PCI to private sector investment per capita. It found that entry costs and transparency have the highest impact; on the other hand, access to land and informal charges have a smaller impact. It also hinted at the possible interaction between sub-indexes. For instance, informal charges appear to matter in transparent environments, but not to do too much harm to business development in non-transparent ones. However, these results should be seen as preliminary findings only. Their meaning is somewhat blurred by the classification of specific indicators under each sub-index. For instance, the sub-index for the allegedly important entry costs includes an indicator for the waiting time for land. It is thus difficult to tell whether access to land has a high or a low impact on business.

Detailed analyses using enterprise data bear more promise. In Vietnam, such analyses have been conducted on the survival rate of enterprises and on the location of foreign companies. Enterprise survival and growth rates were examined using the three-round survey of SMEs

conducted by ILSSA, as part of a research project supported by DANIDA. It appeared that the probability of survival in Ha Tay and Long An was higher than in HCMC. This result was interpreted as evidence that competition in the former provinces is less pronounced than in the latter, probably reflecting administrative and structural barriers to entry.

Meanwhile, a couple of studies have focused on location decisions by foreign investors. One of them, slightly dated by now, considers the period 1988-1998. It concludes that infrastructure, the quality of labor force and the size of the local market are the most important factors influencing the allocation of FDI flows. Government tax incentives, on the other hand, do not appear to be effective at attracting foreign companies to poor and remote provinces.

Another, more recent study in the same spirit focuses on the cumulative number of FDI projects up to the year 2000, as well as on the number of new FDI projects in that particular year. The findings indicate that the availability of land in industrial zones is a highly significant determinant of location, and actually has the highest explanatory power. On the other hand, SOEs do not significantly inhibit the inflow of FDI. A possible interpretation is that provincial SOEs may not perceive foreign entrants as a threat to their market share, or might be able to protect their interests in different ways. Where the strength of SOE does matter is in the selection of the FDI modality. Greenfield investments are more common in provinces with a limited SOE presence, whereas joint ventures dominate when the provincial state sector is large. Other variables having a significant impact on FDI inflows are the provincial population size, its transport infrastructure, its education level and its GDP growth rate.

Incentives for change

This review of provincial business performance and its determinants confirms the general perception that the quality of local leadership is decisive. It also shows that local governance may impact business activity through a variety of mechanisms. Measuring the quality of local governance regarding each of those mechanisms is not an easy task, and identifying which ones have the highest impact on the investment climate in a specific context is not straightforward either. But the review suggests several ways to support business development, and more generally economic growth and poverty reduction, at provincial levels.

A first way to encourage improvements is to systematically benchmark provincial policies, across the broad range of areas that could affect business decisions. The success of the PCI in capturing the attention of the media and local authorities shows the potential impact of this approach. If anything, the recommendation would be to simplify and strengthen the indicators used in the benchmarking process. Not mixing up indicators of different nature and not using complex procedures to aggregate them into broader indexes would make the meaning of the benchmarks even more transparent to the public at large. Using larger samples and securing higher response rates would reduce the risk of biased responses, and bring the benchmarking process closer to more standard report cards approaches. Regardless of the specifics, this is a line to pursue, and the remarkable take up of the PCI is very promising.

A second, related change is to work with provincial governments to modernize their planning process, in the spirit of the changes that have occurred at the national level. The modernization of planning involves relying on development objectives as motivators for public actions, while downplaying quantitative targets for material production. It also implies identifying the most appropriate policies to attain the selected development objectives, and it would be surprising if many of these policies were not related, in one way or another, to the improvement of local governance and the development of a vibrant investment climate. Last but

not least, modern planning cannot be dissociated from consultation. Establishing mechanisms to seize the pulse of the provincial business community, much the same as the VBF does at the national level, would be a direct way to get inputs from local business associations and the community more generally.

Last but not least, the incentives faced by local authorities should be reconsidered. Laggard provinces, with the highest incidence of poverty, need more resources to make investments in infrastructure and deliver social services. Without such resources, their ability to catch up could be hampered. And current budget allocation mechanisms already do some of this, by transferring considerable amounts of resources from richer to poorer provinces. But in the absence of other, parallel incentives, just giving more resources to laggard provinces would create a perverse incentive for change. An indispensable complement to budget-based redistribution is to hold provincial authorities accountable for nurturing business development, promoting economic growth and achieving poverty reduction.

12. SOCIAL IMPACTS

Further integrating into the world economy, completing the first generation of reforms, embracing a second, more ambitious one, and strengthening governance at local levels, are all bound to foster business activity and increase economy efficiency. In a way, these developments hold the key for Vietnam to become a middle-income country. But will there be a social or an environmental price to pay for increased efficiency? Increased reliance on market mechanisms will unleash the potential of the most productive members of society, but it could also harm some of the weakest ones. For instance, in a more developed land market, poor farmers could more easily lose their land in the event of a bad shock. Similarly, in a more open economy, the least competitive sectors could be forced to shed workers in large numbers. And even a perfected market mechanism could be unable to address environmental externalities, so that rapid growth would lead to increasing pollution and degradation. Based on a systematic review of the available evidence, the foreseeable adverse effects do not appear to be large; except maybe for the environment. This calls for a more systematic use of enforceable environmental standards. But potentially larger social impacts might simply be unforeseeable with the relatively rudimentary analytical tools at hand. It is therefore important to put in place effective mechanisms to rapidly cope with the unforeseen. Assistance to ailing firms should not be one of them. Not just because it is restricted under WTO rules, but also because it could lead to rent seeking and disguised protectionism. Assistance to workers who lose their jobs bears more potential, as shown by the successful safety net for redundant SOE workers. But large-scale mitigation policies will require budget transfers, from the provinces benefiting the most from economic reforms to those adversely hit. Transfers of this sort would not damage efficiency, and could do much to ensure that in the quest for prosperity no one is left behind.

Landlessness

The initial allocation of agricultural land to rural households, in the late 1980s and early 1990s, was remarkably egalitarian. A privatization process of such a massive scale could have been vulnerable to capture by local authorities, especially given that land was Vietnam's most valuable asset at the time. And yet, there is clear evidence that the annual land allocated by communes was distributed evenly across households. Even in the case of residential land, allocations were conducted quite fairly, on the basis of need. The priority given to vulnerable groups and war veterans probably helped in this respect. Only in the case of perennial and forestry land was the initial allocation unequal.

Distributing land on an egalitarian basis is not necessarily good for efficiency. If more of it had gone to the most productive (presumably wealthier) households, the overall productivity of agriculture would have been higher. By one estimate, total household incomes ended up being 5 percent lower than an efficiency-oriented allocation of land would have allowed. But market forces could gradually make the initial egalitarian allocation drift in the direction of the efficient one. As land transactions become easier, less productive (presumably poorer) households could gradually be forced to sell some of the land they received, while more productive households

would stand a chance to acquire more land. This prospect is a source of concern, and warrants a careful examination of land market developments.

A land market has indeed emerged in Vietnam. Initially, few transactions were registered. An analysis of 34 informal land transfers for ADB concluded that deals were conducted within one or two days, without any transaction costs. The deals were supported through a variety of mechanisms, including verbal and handwritten contracts, involvement of witnesses, and informal notification to commune authorities. The reduction of taxes on LUC transfers, in 2000, prompted a substantial formalization of transactions. At that time, the tax rate was set at 2 percent for agricultural land, and 4 percent for residential land. The new Land Law of 2003 further promoted market development, by stipulating that allocations of land subject to land-use levies must be conducted through tenders. Evidence also suggests that rental markets have been able to develop efficiently, even without formal registration.

In spite of these developments, the total volume of land transactions remains relatively small. Based on household survey data, only 8 percent of households have bought land during the last decade, and a meager 2 percent sold any. Given the limited amount of land changing hands, there has not been a widening of consumption inequality across households, or a surge in poverty associated with landlessness. Admittedly, the same period, the Gini coefficient for land inequality among rural households rose from 0.49 to 0.64 between 1993 and 2004. But the correlation between rural land inequality and income inequality turns out to be weak in Vietnam. However, there could still be localized impacts deserving closer examination.

A household can be considered landless if it has no land, other than residential. The share of the population living in landless households in rural Vietnam increased from 8 percent in 1993 to 12 percent in 2004. This modest increase hides important regional differences, however. The south is characterized by levels of landlessness which are higher than the national average, and also increase faster than the average. For instance, between 1993 and 2004, the fraction of landless rural households in the Mekong River Delta rose by 9 percentage points, from 14 to 23 percent. The rise was even steeper in the South East.

Yet landlessness is not necessarily associated with poverty. In Vietnam it is rather the opposite: the poor are the least likely to be landless, and households at middle levels of consumption are the most likely. This is because many families moving out of poverty also moved out of farming. It is estimated that roughly three quarters of the overall increase in landlessness was due to falling poverty. If anything, the trend is becoming stronger over time.

But there are also notable regional differences, with the Mekong River Delta and the Southeast standing out as the exceptions to the pattern elsewhere. There, signs of polarization are emerging, with higher landlessness being more common among the poor.

The Central Highlands display a different pattern too. This is mainly due to the policies adopted after reunification, to facilitate the massive migration of people of the Kinh ethnic majority into the region and promote the establishment of SFEs. These policies were successful at raising agricultural output. By now the region has become the main producer of coffee, rubber, cashew, tea and cotton, among others. But in the process, the native hill-tribe people became a minority group. They gradually lost their land and moved deeper into the forest.

Land issues had led to social tensions in the Central Highlands, including demonstrations and riots by the hill-tribe people in 2001. In response to these tensions, the government vowed to allocate residential land to all ethnic minority households in the region. This was part of a broader program to improve their production and living conditions. In principle, every ethnic minority family in the region should be provided with 400 square meters of land for accommodation, and one hectare of mountain fields or half a hectare of plain fields for

production. The government also pledged to provide 5 million dongs in aid to each family to build or buy their houses. So far, slightly less than two thirds of the target has been attained.

Environmental degradation

The ambitious reform agenda of Vietnam could raise two types on environmental issues. First is the emergence of previously hidden environmental liabilities, particularly in the state sector. As SOEs are gradually equitized, restructured, or managed more efficiently, their older ways of handling pollution and natural resource degradation are bound to become more "visible", and increasingly more unacceptable. Who will bear responsibility to control such pollution and redress the inherited misdoings is an open question. The second important issue is related to the growth pattern of an economy that becomes more globally integrated. The comparative advantages of Vietnam could favor the growth of sectors which are more intensive in water or toxic pollution. And low environmental standards could also attract foreign investors to those sectors, in the expectation of operating at lower costs than elsewhere.

The sector with potentially largest environmental liabilities is coal. An operational review of four SOEs affiliated with Vinacoal, by Ernst and Young, is revealing in this respect. Poor standards in areas such as mine water discharge, dust emissions, and waste dump rehabilitation in open-cut mines are common. Two mines discharge water that is clearly in the acid range. And their waste dump areas, some of them directly facing Halong bay, have been subject to little or no rehabilitation work. Their height, drainage control and overall stability are a matter for concern.

The quality of dust management is uneven too. Near major buildings, around the coal preparation plants and on major internal roads, the level of housekeeping is good, with these areas generally being clear of dust and rubbish. Trucks and fixed sprays are used to apply water to internal roadways and stockpiles, thus limiting the amount of dust. But a build-up of fine coal, which can be a significant source of dust, is noticeable around train tracks and roads. And the inside of two preparation plants is very dirty and untidy, with a large build-up of fines, mud and coal spillages. This may partly be a result of the age and condition of the equipment.

However, there are also indications of good practice. In one mine, a wastewater management system was introduced in 2000, with support from Japan. It includes 16 settling ponds, where water is treated to remove all solids, to be then returned with make-up water for re-use in the coal preparation facility. Thanks to this system, water is now re-circulated in a closed circuit and no longer discharged to sea. As an additional safeguard, the company has prepared a dam to catch drainage water. The dam is cleaned out by dredge every month. The surface drainage system is routinely dredged, and annually cleared out, to ensure sufficient holding capacity in the rainy season and minimize the risk of slurry being discharged to sea.

Environmental monitoring is conducted at 27 nominated sites. Weather, dust levels and noise are recorded at most locations; vibration, water quality and hazardous gases are checked only at selected ones. Monitoring is conducted four times per year, as a spot check, by a Hanoi-based private company. Current best practice for dust fallout is the continuous collection of samples, with analysis at least monthly; for water quality, it involves weekly or monthly sampling. Thus, while the selection of sites and the type of sampling and testing seem appropriate, the frequency of monitoring is not.

As for the environmental impacts of global integration, and of economic reforms more broadly, they can be divided into three main components. The first one refers to the way trade

patterns affect the overall scale of the economy; the second one, to the way they influence the techniques of production; and the third one, to their impact on the sectoral composition of output. Experience elsewhere suggests that the third effect is in practice the most important one. Integration into the world economy can substantially modify the specialization pattern of a country. Specializing in the production of more pollution-intensive goods leads to dirtier environments. This may be Vietnam's case at present (Box 12.1).

Box 12.1: Becoming a Pollution Heaven?

The sectoral composition of output in Vietnam has change in parallel with the gradual opening up of the economy. Manufacturing output from sectors with a high intensity of water pollution has grown faster than the output of less pollution-intensive sectors. There is also evidence indicating that exports from sectors with a high intensity of toxic pollution have increased significantly, and investments by foreign companies have been particularly important in those sectors. This trend is not surprising, as it is not uncommon among developing countries. However, Vietnam is an increasingly large exporter of garments, which have a low intensity of pollution, whereas it imports large volumes of textiles, which have a high intensity. This makes it a net importer of pollution-intensive goods.

The sectors which have displayed the highest increase in exports are textiles, leather and rubber products. Of these, the textile industry is also a major consumer of industrial chemicals. Therefore, increased exports of textiles have fueled a simultaneous increase in the production of industrial chemicals. Similarly, export revenues from craft villages have expanded significantly in recent years, and are now close to half a billion dollars. But craft villages are a major source of toxic and water pollution. It is thus not surprising to note that exports are getting "dirtier" over time. This is the result of a change in overall trade pattern of Vietnam. The export specialization has drifted away from oil and primary commodities towards manufacturing, especially leather and textiles.

These findings suggest that rapid integration with the world economy, while boosting economic growth, might be having adverse environmental consequences. However, they should be interpreted with caution, as the input-output data underlying the results do not allow a clear differentiation between highly polluting textiles and relatively clean garments. More generally, the data on which they are grounded does not distinguish between value added and output value, which questions the precision of the results.

Beyond the precise estimates, the possibility of adverse environmental impacts calls for further improvements in environmental standards, especially in the fast-growing industries with the highest intensity in water and toxic pollution. Policies to protect natural assets and public health are needed as well. While some of them may result in an additional cost for businesses, they should reassure those foreign investors concerned about corporate responsibility.

Source: Based on Muthukurama Mani and Shreyasi Jha (2005).

Job losses

Changes in the sectoral composition of output, as Vietnam further integrates with the world economy, could also have adverse effects on employment. At an aggregate level, global integration should lead to faster economic growth and an overall increase in labor demand. But

the process may entail both job creation in the sectors expanding and job destruction in the ones contracting. A flexible labor market, like that of Vietnam, should reduce the social cost of this kind of job churning. Indeed, workers who are retrenched by one employer can hope to get work with a different one within a short period of time. But jobs are not all equal; for instance in terms of their access to social insurance. Churning might thus be associated with some workers losing "good" formal sector jobs and ending up in the informal sector. For them, knowing that overall wage employment is expanding may not be a consolation.

Unfortunately, knowing in advance which sectors may contract is not easy. Consider accession to the WTO. The commitments made throughout the process involve a myriad changes in the level of trade barriers, the extent of competition in services, and the overall operation of markets. Moreover, the government could react to these changes in various ways. A fall in trade-related revenue, for instance, could be compensated through higher tax rates elsewhere, or through lower public spending, or through higher levels of public debt. All this would be on top of other changes, such as those related to AFTA commitments.

In summary, assessing the sectoral implications of further global integration might sound like a straightforward concept, but there is actually a range of mechanisms through which business activity could be affected, and it is virtually impossible to factor them in all in a single analysis. Different studies on the consequences of further global integration emphasize different mechanisms to construct integration "scenarios". And they all tend to be quite plausible. So, rather than choosing a preferred scenario to infer possible sectoral impacts of global intergration, there might be something to be learned from their combination.

A recent assessment of the potential impacts of WTO accession pooled the findings of two dozen studies recently conducted on Vietnam's integration process to try to infer some common patterns. Such studies were of two sorts. One group, quite popular among economists, relies on so-called computable general equilibrium (CGE) models to simulate the effects of changes in tariffs and subsidies, all the way to wage levels, returns to capital and land rent. The core of these models is the combination of an input-output table, summarizing the technology of each sector, and simulated markets for goods and factors of production, mimicking the equalization of supply and demand in each of them. Another group of studies ignores links between markets and activities, relying instead on an in-depth knowledge of specific sectors, and the economic actors who participate in them, to predict how their production and employment levels could react as the economy opens up.

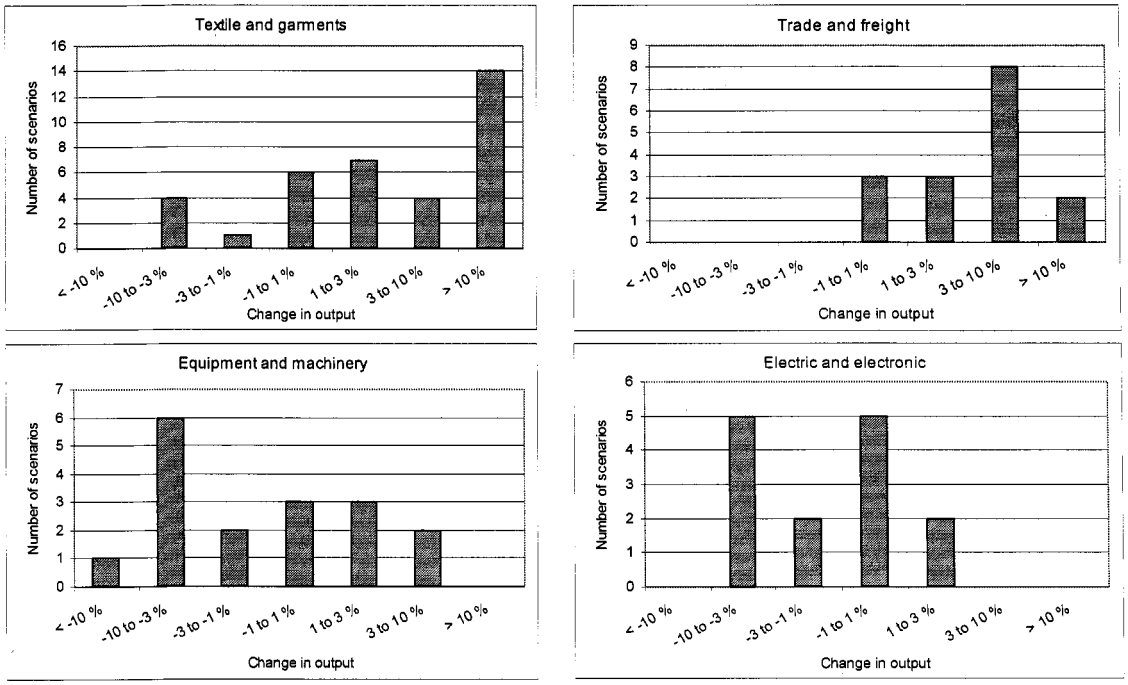
The dozen CGE studies considered in this broader assessment differ in the way they model the economy. The number of sectors included in the analysis ranges from 9 to 33, and the number of factors of production, from two (just capital and labor) to 14 (including a range of labor skills, for instance). Put together, this dozen CGE studies includes 36 scenarios for Vietnam's global integration. Almost all of them involve changes in Vietnamese trade barriers. But 11 also consider changes in trade barriers abroad, two assume changes in the extent of market competition, and three in technology. Two thirds of the scenarios introduce adjustments in tax rates to compensate for the lost in trade-related government revenue.

Some common patterns emerge from the comparison of the 36, pooled scenarios. If the findings of these studies are to be believed, global integration could lead to a strong expansion in textile and garments, in trade and freight, in petroleum and lubricants, and in paper products. But it could also lead to a substantial contraction in equipment and machinery, electric equipment, personal services, and transport vehicles (Figure 12.1). The picture is more blurred for other sectors, which appear to expand or contract depending on the scenario considered.

The dozen sectoral studies display an enormous diversity in their methodology. Partial equilibrium models are used in eight of them, household surveys in five and focus group

discussions in two. Some of the studies use more than one methodology. There is also a considerable diversity in their coverage. Six of the studies refer to rice, three to textiles, three to sugar, two to maize, two to coffee and two to tea. For some sectors, such as fisheries, only one study could be identified. But some studies cover several sectors at once.

Figure 12.1: Changes in Sectoral Output due to Global Integration



Source: Based on Martin Rama and Sa Kim Le (2005). Figures are constructed out of a pool of 36 global integration scenarios from CGE models for Vietnam. The height of the bars indicates how many scenarios fall in each category. Information on all sectors was not available for all scenarios, implying that the sum of the bars is generally less than 36.

Because of their narrower focus, and their direct consultation of key stakeholders, sectoral studies tend to provide richer detail on the possible impacts of further global integration. Compared to CGE models, where changes in employment are linked to changes in output in a rather mechanical way (through their input-output table), some of the sectoral studies allow disentangling economic and social impacts. This is because of their ability to differentiate impacts across enterprises of different sizes, or operating with different technologies, or with different degrees of formality. However, some of the sectoral studies also reflect a high level of concern for adverse social impacts, and a few are actually close to advocacy pieces. Not surprisingly, their assessment of the consequences of further global integration is somewhat more negative than the one emerging from CGE studies (Table 12.1).

Poverty and inequality

Through the simulation of the effects of trade integration on wage levels, returns to capital and land rent, CGE studies also allow identifying possible impacts on poverty or inequality. To do this, they rely on a typology of households with different endowments of factors of production. For instance, poorer households usually have little more than unskilled labor and some land; on the other hand, richer households typically own capital and their working-age members are skilled. These typologies are constructed using household survey data. In the case of Vietnam, the studies reviewed include a range of breakdowns, from just two types of households at one end (urban and rural) to 20 at the other (by income deciles, in both urban and rural areas).

Table 12.1: Economic and Social Impacts in Selected Sectors

Sector	Economic Impact	Social Impact
Livestock	Positive	Unknown
Fisheries	Positive	Unknown
Rice	Positive	Positive
Maize	Unknown	Negative
Sugar	Positive	Negative
Coffee	Positive	Unknown
Tea	Positive	Unknown
Textiles	Negative	Unknown

Source: Based on Martin Rama and Sa Kim Le (2005).

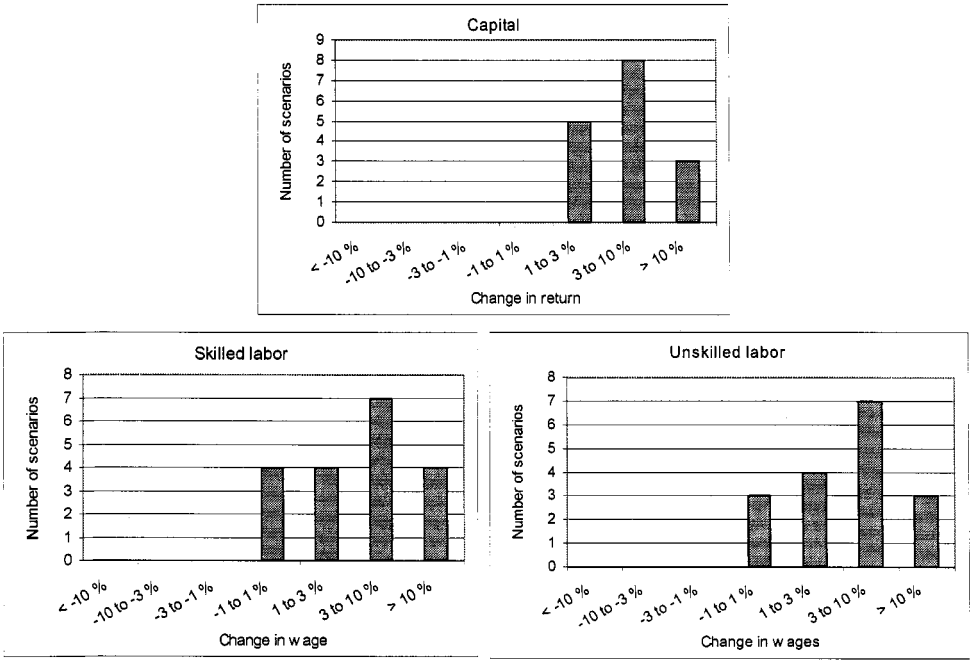
The changes in factor prices induced by further global integration can then be used to estimate the change in total income by household type. For instance, if returns to capital were to increase by a smaller percentage than wages for unskilled labor, richer households would less (in relative terms) than poorer ones, and inequality would decrease. If, on the other hand, the wages for unskilled labor were to decline, poverty would increase. Each global integration scenario can then be associated with a change in the overall income distribution, and in the poverty rate.

In the studies reviewed for Vietnam, however, results tend to be quite ambiguous. This is because all factor prices tend to change by a similar percentage (Figure 12.2). Across all the integration scenarios for which data could be gathered, the prices of factors of production tend to vary by a similar amount, thus leading to very minor changes in either poverty or inequality. On the surface, the predicted increase in returns to capital appears to be slightly more robust than the predicted increase in wage levels. For the latter, there are a few scenarios predicting no increase at all. However, the difference is probably too small to be of any significance. Overall, then, the available CGE studies for Vietnam do not allow foreseeing any major change in poverty or inequality stemming from further global integration.

Do We Really Know?

These analyses convey a reassuring sense of technical rigor, but it would be safer to treat their results as broad indications of the possible impacts only, not as precise estimates. One limitation of studies of this sort concerns their inability to mimic the effects of increased competition on capital accumulation and on productivity at the firm level. Accession to the WTO should bring more foreign companies into play in Vietnam, domestic enterprises could be tempted to imitate their more performing processes, and stronger exposure to imported products can be expected to lead to quality upgrades. None of these potentially important developments is captured by the studies reviewed. Their underlying CGE models are basically static, in the sense that they take the capital endowment and production technology of each sector as given, or modify them on the basis of ad hoc assumptions.

Figure 12.2: Changes in Returns to Capital and Wages

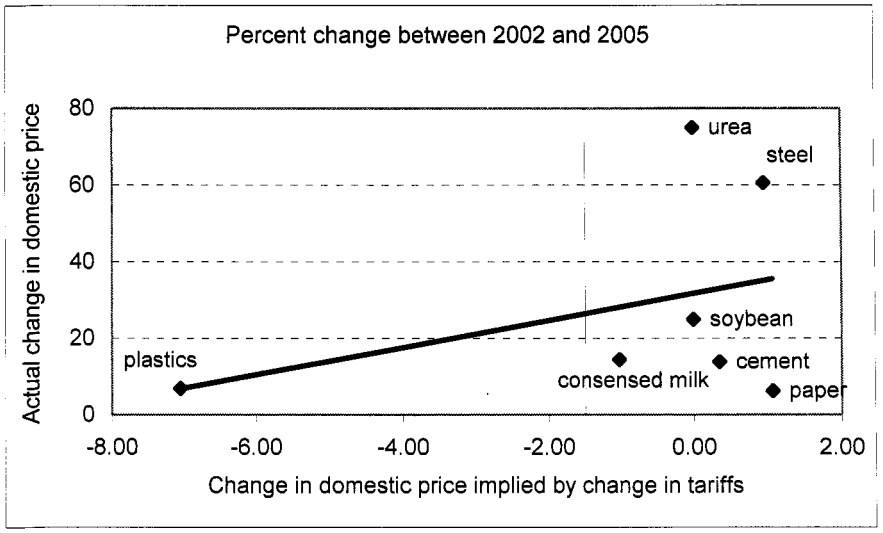


Source: Based on Martin Rama and Sa Kim Le (2005). See Figure 12.1 for details.

Careful comparisons between expected and actual outcomes, after a major episode of trade integration such as the North American Free Trade Agreement, show that CGE models do a poor job at predicting the surge in exports occurring in sectors that initially did not trade much with the rest of the world. But there are additional reasons to be prudent in a transition economy like Vietnam. One of the most important impacts of WTO accession is to foster competition behind the border, thus helping to perfect market mechanisms "behind the border". But CGE models assume that domestic markets are perfectly competitive to begin with. The local dimension of business development in Vietnam makes this assumption all the more questionable. Assuming that the impact of global integration on, say the wages of unskilled workers will be the same across all regions does not sound realistic.

Moreover, the studies reviewed focus mainly on the impact of changes in trade barriers such as tariff cuts or the suppression of quotas, but these changes are simply be dwarfed by changes in international prices. From rice, to coffee to oil, worldwide instability in commodity markets has been a more important source of economic fluctuations for Vietnam than trade liberalization (Figure 12.3). Because global integration makes the domestic economy more integrated with world markets, these economic fluctuations should also be considered as social impacts of the reform agenda. And they are of course much more unpredictable than tariff cuts or the suppression of quotas.

Figure 12.3: Reform Impacts versus External Shocks



Source: Own calculations, based on data from GSO and GDC. The price changes in both axes are measured in percent, over the period 2002-2005.

Addressing the potentially adverse effects of further integration with the world economy requires that mechanisms to deal with the unforeseen be put in place. The unforeseen could be job losses in a sector that is suddenly facing a tougher competition than expected; or it could be an increase in poverty in a region specializing in some crop whose price suddenly declines. Neither the workers nor the regions affected can be identified in advance with great confidence. This makes the problem faced by policy makers similar in nature to the problem faced by insurers. Rather than trying to guess where the next hazard will occur, the task is to estimate the damage accurately if and when it occurs, and to swiftly provide commensurate assistance.

Towards rapid response

Several options exist for the government to provide assistance in the event of adverse social impacts from economic reforms, or simply from external shocks. Those options can in fact be seen as potential complements of the global integration agenda. However, not all of them are bound to be equally effective, so that it is worth discussing the way they would operate in practice and what their implications would be.

A first option is to focus on trade policy instruments. In practice, this option amounts to introducing safeguards in the commitments for WTO accession. For instance, by negotiating higher tariff rates for agricultural products which are deemed vulnerable to foreign competition, and whose production is fundamental to sustain the livelihoods of the poor. Or to try to maintain tariff rate quotas, triggering higher duties when imports exceed some threshold. While technically feasible, this option could be excessively costly to Vietnam. Not knowing exactly which sectors could need safeguards, it would be necessary to introduce a large number of them. And this in turn would require substantial concessions to negotiating partners in other sectors, if their support to WTO accession is to be secured. Moreover, trade policy instruments are not particularly efficient redistribution tools. Therefore, this first option is not particularly appealing.

A second option is to focus on enterprises, by relying on industrial policy tools. For example, by using government transfers to support enterprises or sectors which find it difficult to cope with a surge in imports, or which face more efficient suppliers in foreign markets. Unlike the previous one, this option might simply not be feasible. WTO rules regarding subsidies basically tie the hands of the government, preventing it from making transfers that violate the national treatment principle.

The third option is to focus on those who lose their jobs. This is what the social safety net for redundant SOE workers does. The fund has been in operation for three years now, and has assisted more than 100,000 people (Table 12.2). The severance pay package made available to those who lose their jobs is roughly commensurate with the loss in earning and wellbeing they experience. This has resulted in relatively high levels of satisfaction with the assistance received, as revealed by two tracer surveys of retrenched workers.

Table 12.2: The Safety Net for Redundant SOE workers

	2002	2003	2004	2005	Total
Total spending (billion dong)	29	533	1,299	1,466	3,327
Workers assisted (persons)	1,147	18,445	43,659	46,815	110,066
Participant SOEs (number)	34	453	873	868	2,228
Assistance (million dong per worker)	25.5	28.9	29.8	31.3	30.2
Workers assisted per SOE (number)	33.7	40.7	50.0	53.9	49.4

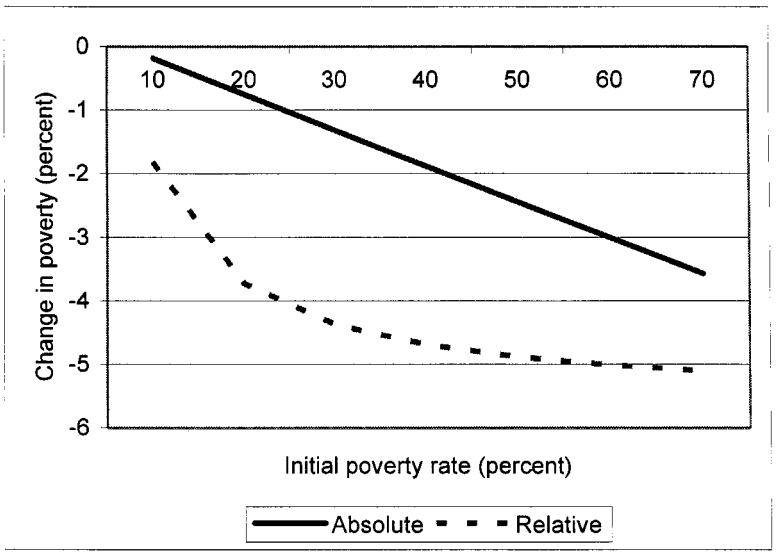
Source: Based on data from MOF. Figures for 2005 are for the first nine months of the year. Reported assistance figures are averages across retrenched workers.

The very existence of this safety net fund means that the third option is already effective in Vietnam. The question is whether more is needed. Given that the most protected industries, hence the most vulnerable to global integration, are those with a dominant state sector, the answer could be negative. Moreover, scaling up the safety net so as to cover private sector workers as well could be prohibitively expensive, because of the generous assistance provided. Private sector workers with formal jobs are entitled to severance pay, to be provided by their employers, in the event of job loss. This is a relatively effective way to provide income support to those becoming unemployed in a country at Vietnam's development level. It could then be argued that not much more should be done on this front.

Finally, the fourth option is to focus assistance on provinces, if they either suffer disproportionately from adverse shocks, or simply if they lag behind while other parts of the

country thrive. Budget transfers targeting geographical areas (as opposed to enterprises) are compatible with WTO rules. Moreover, due to the geographical concentration of several crops, it is likely that adverse impacts would be felt more severely in some provinces than in others. And Vietnam already has in place an effective mechanism to transfer budget resources from richer provinces to poorer one. This mechanism combines the fraction of tax revenue that each province can retain, the equalization grants provided by the National Assembly, spending in large-scale infrastructure, and transfers from national targeted programs. The result has been a massive redistribution of resources across provinces in recent years. And this redistribution has in turn proved effective at reducing poverty (Figure 12.4).

Figure 12.4: Budget Transfers to Provinces and Poverty Reduction



Source: Own estimates based on data from GSO, MOF and MPI. The lines indicate the reduction in poverty associated with a net budget transfer of one million dong per person, depending on the initial poverty rate of the province. The effects were estimated for the changes in poverty between 2002 and 2004, using data on transfers around 2003 and controlling for other province characteristics. The initial poverty rate refers to 1998.

The size of the budget transfer to each province varies from year to year. Some of its components, such as large-scale infrastructure investments, are difficult to modulate on a short notice. But equalization grants are determined on an annual basis, as part of the budget. Several budget allocation norms guide those grants. Now that Vietnam is moving towards a more reliable way to measure poverty, these norms could be revised so as to explicitly include poverty rates among their parameters. This would ensure that provinces which are not doing well can receive more assistance (although in that case it would be important not to reward provincial authorities, to avoid introducing perverse incentives). However, there could be cases in which assistance cannot wait for an entire budget cycle. In preparation for those cases, a contingent fund could be set aside in the budget, in the spirit of the contingent resources which are allocated on an emergency basis to provinces hit by typhoons.

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STATISTICAL APPENDIX

Table 1.1: POPULATION
(thousand persons)

Year	Population (mid-year)	Growth Rate	By Sex		By Area	
			Male	Female	Urban	Rural
1976	49,160	2.35	23,597	25,563	10,127	39,033
1977	50,237	2.19	24,197	26,039	10,116	40,114
1978	51,337	2.19	24,813	26,524	10,105	41,226
1979	52,462	2.19	25,444	27,018	10,094	42,368
1980	53,630	2.23	26,047	27,583	10,295	43,335
1981	54,824	2.23	26,665	28,159	10,499	44,324
1982	56,045	2.23	27,297	28,747	10,708	45,336
1983	57,292	2.23	27,944	29,348	10,921	46,371
1984	58,568	2.23	28,607	29,961	11,138	47,429
1985	59,872	2.23	29,285	30,587	11,360	48,512
1986	61,109	2.07	29,912	31,197	11,817	49,292
1987	62,452	2.20	30,611	31,841	12,271	50,181
1988	63,727	2.04	31,450	32,277	12,662	51,065
1989	64,774	1.64	31,589	33,185	12,919	50,801
1990	66,017	1.92	32,203	33,814	12,880	53,136
1991	67,242	1.86	32,814	34,428	13,228	54,015
1992	68,450	1.80	33,242	35,208	13,588	54,863
1993	69,645	1.74	34,028	35,616	13,961	55,683
1994	70,825	1.69	34,633	36,191	14,426	56,399
1995	71,996	1.65	35,237	36,758	16,938	55,057
1996	73,157	1.61	35,857	37,299	15,420	57,737
1997	74,037	1.20	36,473	37,564	16,835	57,202
1998	75,456	1.92	37,090	38,367	17,465	57,992
1999	76,597	1.51	37,662	38,935	18,082	58,515
2000	77,635	1.36	38,166	39,469	18,805	58,830
2001	78,686	1.35	38,684	40,002	19,481	59,205
2002	79,727	1.32	39,197	40,530	20,004	59,723
2003	80,902	1.47	39,755	41,147	20,870	60,033
2004	82,032	1.40	40,318	41,714	21,591	60,441

Note: Population by sex and by area may not add to the total due to the possible exclusion of the armed force and migrant worker
Source: GSO, Statistical Yearbook 2004.

Table 1.2: POPULATION BY SEX AND LOCALITY IN 2004

(thousand persons)

Provinces/Cities	Total	By sex		By locality	
		Male	Female	Urban	Rural
Ha Noi	3,083	1,543	1,540	2,000	1,083
Hai Phong	1,771	897	874	708	1,063
Ha Giang	661	327	334	73	588
Tuyen Quang	718	355	363	70	648
Cao Bang	508	249	259	68	440
Lang Son	722	363	359	146	575
Lai Chau	308	155	153	26	282
Dien bien	405	221	183	71	334
Lao Cai	566	282	284	104	462
Yen Bai	724	359	365	143	581
Bac Can	296	148	148	45	251
Thai nguyen	1,095	539	557	218	877
Son La	973	488	485	106	867
Hoa Binh	803	399	404	123	681
Vinh Phuc	1,155	558	597	160	995
Phu Tho	1,315	647	668	196	1,119
Bac ninh	987	480	508	130	858
Bac Giang	1,564	773	791	143	1,421
Quang Ninh	1,067	543	524	506	561
Ha Tay	2,500	1,213	1,288	225	2,275
Hai Duong	1,698	822	877	263	1,436
Hung Yen	1,120	543	577	123	997
Thai Binh	1,843	884	958	133	1,710
Nam Dinh	1,947	948	999	302	1,645
Ha Nam	820	400	421	79	741
Ninh Binh	912	443	468	124	788
Thanh Hoa	3,647	1,785	1,862	354	3,293
Nghe An	3,003	1,475	1,529	317	2,686
Ha Tinh	1,287	636	651	141	1,146
Quang Binh	832	411	420	115	717
Quang Tri	617	305	312	150	466
Thua Thien - Hue	1,120	549	571	350	770
Quang Nam	1,145	703	442	248	898
Da Nang	765	376	389	610	155
Quang Ngai	1,259	611	648	180	1,079
Binh Dinh	1,545	751	795	387	1,158
Phu Yen	849	421	428	177	672
Khanh Hoa	1,111	551	561	441	671
Ninh Thuan	555	274	281	179	375
Binh Thuan	1,136	566	570	394	742
Gia Lai	1,096	545	551	290	806
Kon Tum	336	184	153	127	209
Dac Lac	1,688	864	824	375	1,313
Dac Nong	386	198	188	50	336
Lam Dong	1,139	570	569	428	711
Ho Chi Minh City	5,731	2,774	2,957	4,888	842
Binh Duong	883	419	464	258	625
Tay Ninh	1,030	505	525	174	856
Binh Phuoc	784	398	386	119	665
Dong Nai	2,175	1,077	1,098	702	1,473
Baria - Vung Tau	898	449	449	398	500
Long An	1,401	687	713	230	1,170
Dong Thap	1,639	799	841	246	1,393
An Giang	2,170	1,065	1,105	560	1,610
Tien Giang	1,682	815	867	249	1,433
Ben Tre	1,346	653	693	131	1,215
Vinh Long	1,045	507	538	155	890
Tra Vinh	1,016	492	524	145	870
Can Tho	1,123	551	572	560	563
Hau giang	791	383	408	119	672
Soc Trang	1,527	613	915	232	1,296
Kien Giang	1,630	805	825	389	1,241
Bac Lieu	786	385	401	206	580
Ca Mau	1,201	592	609	238	962

Note: Population by sex and by area may not add to the total due to the possible exclusion of the armed force and migrant workers.

Source: GSO, Statistical Yearbook 2004.

Table 1.3: TOTAL EMPLOYMENT BY SECTOR
(thousand of persons)

	1999	2000	2001	2002	Rev 2003	Prel. 2004
Total Employed Labor Force	35,976	37,610	38,563	39,508	40,574	41,586
State	3,433	3,501	3,604	3,751	4,035	4,142
Non-state	32,543	34,109	34,959	35,757	36,538	37,445
State Sector Employment	3,433	3,501	3,604	3,751	4,035	4,142
Central	1,422	1,442	1,499	1,569	1,628	1,641
Local	2,011	2,059	2,105	2,181	2,407	2,501
Employment by Sector						
Agriculture, forestry & fisheries	24,792	23,492	23,386	23,174	23,117	23,026
Industry and Construction	4,300	4,930	5,552	6,085	6,671	7,217
Services	6,884	9,188	9,625	10,249	10,786	11,344

Note: Figures are rounded.
Source: GSO, Statistical Yearbook 2004.

Table 2.1: GDP BY INDUSTRIAL ORIGIN AND BY ECONOMIC SECTOR

(VND billion, current price)

	1999	2000	2001	2002	Rev 2003	Prel 2004
Total	399,942	441,646	481,295	535,762	613,533	713,071
State	154,927	170,141	184,836	205,652	239,736	279,704
Non-State	245,015	271,505	296,459	330,110	373,797	433,367
Agri, Forestry and Fishery	101,723	108,356	111,858	123,383	138,375	155,144
Agriculture	83,335	87,537	87,861	96,543	106,385	118,258
Forestry	5,737	5,913	6,093	6,500	7,775	9,412
Fisheries	12,651	14,906	17,904	20,340	24,215	27,474
Industry and Construction	137,959	162,220	183,515	206,197	242,126	285,864
Mining	33,703	42,606	44,345	46,153	57,326	72,492
Manufacturing	70,767	81,979	95,211	110,285	125,476	144,924
Electricity and Water	11,725	13,993	16,028	18,201	22,224	23,890
Construction	21,764	23,642	27,931	31,558	37,100	44,558
Services	160,260	171,070	185,922	206,182	233,032	272,063
Trade	59,384	62,836	67,788	75,617	83,297	97,508
Hotel and Restaurant	13,412	14,343	15,412	17,154	18,472	22,381
Transportation and Communication	15,546	17,341	19,431	21,095	24,725	30,402
Finance, Banking and Insurance	7,488	8,148	8,762	9,763	10,858	12,737
Science and Technology	1,902	2,345	2,646	3,009	3,694	4,315
Real Estate and Renting	18,260	19,173	21,589	24,452	27,287	31,304
Public Administration	11,683	12,066	12,784	13,816	16,676	19,061
Education and Training	14,004	14,841	16,245	18,071	21,403	23,335
Healthcare and social welfare	5,401	5,999	6,417	7,057	8,865	10,851
Culture and Recreation	2,378	2,558	2,800	2,987	3,376	3,693
Party and Association	584	614	651	712	774	885
Community and Social Service	9,323	9,853	10,412	11,412	12,497	14,354
Private Household Employment	895	953	985	1,037	1,108	1,237

Source: GSO, Statistical Yearbook 2004.

Table 2.2: GDP BY INDUSTRIAL ORIGIN AND BY ECONOMIC SECTOR

(VND billion, constant 1994 price)

	1999	2000	2001	2002	Prel 2003	Prel 2004
Total	256,272	273,666	292,535	313,247	336,242	362,092
State	103,531	111,522	119,824	128,343	138,160	148,865
Non-State	152,741	162,144	172,711	184,904	198,082	213,227
Agri, Forestry and Fishery	60,895	63,717	65,618	68,352	70,827	73,309
Agriculture	52,372	54,493	55,613	57,912	59,761	61,499
Forestry	2,535	2,544	2,556	2,568	2,589	2,610
Fisheries	5,988	6,680	7,449	7,872	8,477	9,200
Industry and Construction	88,047	96,913	106,986	117,126	129,399	142,601
Mining	17,200	18,430	19,185	19,396	20,611	22,948
Manufacturing	46,105	51,492	57,335	63,983	71,363	78,585
Electricity and Water	5,531	6,337	7,173	7,992	8,944	10,015
Construction	19,211	20,654	23,293	25,755	28,481	31,053
Services	107,330	113,036	119,931	127,769	136,016	146,182
Trade	41,994	44,644	47,779	51,245	54,747	59,338
Hotel and Restaurant	8,517	8,863	9,458	10,125	10,646	11,432
Transportation and Telecom	10,141	10,729	11,441	12,252	12,925	13,975
Finance, Banking and Insurance	5,327	5,650	6,005	6,424	6,935	7,495
Science and Technology	1,267	1,571	1,749	1,909	2,044	2,196
Real Estate and Renting	11,926	12,231	12,631	13,106	13,796	14,396
Public Administration	7,723	8,021	8,439	8,768	9,228	9,773
Education and Training	8,809	9,162	9,687	10,475	11,260	12,125
Healthcare and social welfare	3,707	3,946	4,151	4,464	4,853	5,234
Culture and Recreation	1,505	1,601	1,648	1,706	1,857	1,997
Party and Association	300	317	334	353	372	395
Community and Social Service	5,564	5,734	6,026	6,353	6,743	7,194
Private Household Employment	550	567	583	589	610	632

Source: GSO, Statistical Yearbook 2004.

Table 2.2B: GDP BY INDUSTRIAL ORIGIN -- GROWTH RATE
(Billions of Dong in Constant 1994 Prices)

	1999	2000	2001	2002	Prel 2003	Prel 2004
Total	4.8	6.8	6.9	7.1	7.3	7.7
State	2.6	7.7	7.4	7.1	7.6	7.7
Non-State	6.3	6.2	6.5	7.1	7.1	7.6
Agri, Forestry and Fishery	5.2	4.6	3.0	4.2	3.6	3.5
Agriculture	5.5	4.0	2.1	4.1	3.2	2.9
Forestry	3.1	0.4	0.5	0.5	0.8	0.8
Fisheries	3.8	11.6	11.5	5.7	7.7	8.5
Industry and Construction	7.7	10.1	10.4	9.5	10.5	10.2
Mining	13.4	7.2	4.1	1.1	6.3	11.3
Manufacturing	8.0	11.7	11.3	11.6	11.5	10.1
Electricity and Water	7.7	14.6	13.2	11.4	11.9	12.0
Construction	2.4	7.5	12.8	10.6	10.6	9.0
Services	2.3	5.3	6.1	6.5	6.5	7.5
Trade	2.0	6.3	7.0	7.3	6.8	8.4
Hotel and Restaurant	2.5	4.1	6.7	7.1	5.1	7.4
Transportation and Telecom	6.3	5.8	6.6	7.1	5.5	8.1
Finance, Banking and Insurance	10.0	6.1	6.3	7.0	8.0	8.1
Science and Technology	-9.0	24.0	11.3	9.1	7.1	7.4
Real Estate and Renting	2.1	2.6	3.3	3.8	5.3	4.3
Public Administration	-5.5	3.9	5.2	3.9	5.2	5.9
Education and Training	2.3	4.0	5.7	8.1	7.5	7.7
Healthcare and social welfare	4.0	6.4	5.2	7.5	8.7	7.9
Culture and Recreation	6.6	6.4	2.9	3.5	8.9	7.5
Party and Association	1.0	5.7	5.4	5.7	5.4	6.2
Community and Social Service	2.4	3.1	5.1	5.4	6.1	6.7
Private Household Employment	1.5	3.1	2.8	1.0	3.6	3.6

Source : GSO, Statistical Yearbook 2004.

Table 2.3A: GDP DEFLATOR

	1999	2000	2001	2002	Prel 2003	Prel 2004
Total	156.1	161.4	164.5	171.0	182.5	196.9
State	149.6	152.6	154.3	160.2	173.5	187.9
Non-State	160.4	167.4	171.7	178.5	188.7	203.2
Agri, Forestry and Fishery	167.0	170.1	170.5	180.5	195.4	211.6
Agriculture	159.1	160.6	158.0	166.7	178.0	192.3
Forestry	226.3	232.4	238.4	253.1	300.3	360.6
Fisheries	211.3	223.1	240.4	258.4	285.7	298.6
Industry and Construction	156.7	167.4	171.5	176.0	187.1	200.5
Mining	195.9	231.2	231.1	238.0	278.1	315.9
Manufacturing	153.5	159.2	166.1	172.4	175.8	184.4
Electricity and Water	212.0	220.8	223.4	227.7	248.5	238.5
Construction	113.3	114.5	119.9	122.5	130.3	143.5
Services	149.3	151.3	155.0	161.4	171.3	186.1
Trade	141.4	140.7	141.9	147.6	152.1	164.3
Hotel and Restaurant	157.5	161.8	163.0	169.4	173.5	195.8
Transportation and Telecom	153.3	161.6	169.8	172.2	191.3	217.5
Finance, Banking and Insurance	140.6	144.2	145.9	152.0	156.6	169.9
Science and Technology	150.1	149.3	151.3	157.6	180.7	196.5
Real Estate and Renting	153.1	156.8	170.9	186.6	197.8	217.4
Public Administration	151.3	150.4	151.5	157.6	180.7	195.0
Education and Training	159.0	162.0	167.7	172.5	190.1	192.5
Healthcare and social welfare	145.7	152.0	154.6	158.1	182.7	207.3
Culture and Recreation	158.0	159.8	169.9	175.1	181.8	184.9
Party and Association	194.7	193.7	194.9	201.7	208.1	224.1
Community and Social Service	167.6	171.8	172.8	179.6	185.3	199.5
Private Household Employment	162.7	168.1	169.0	176.1	181.6	195.7

Source: GSO, Statistical Yearbook 2004.

Table 2.3B: CHANGE IN GDP DEFLATOR

(1995=100)

	1999	2000	2001	2002	Prel 2003	Prel 2004
Total	156.1	161.4	164.5	171.0	182.5	196.9
State	127.3	129.8	131.3	136.4	147.7	159.9
Non-State	176.5	184.2	188.8	196.4	207.6	223.6
Agri, Forestry and Fishery	137.8	140.3	140.6	148.9	161.1	174.6
Agriculture	131.8	133.0	130.8	138.1	147.4	159.3
Forestry	191.0	196.2	201.2	213.7	253.5	304.4
Fisheries						
Industry and Construction	139.4	148.9	152.6	156.6	166.4	178.3
Mining	184.1	217.2	217.2	223.6	261.4	296.8
Manufacturing	135.2	140.2	146.3	151.8	154.9	162.5
Electricity and Water	152.6	159.0	160.8	163.9	178.9	171.7
Construction	104.7	105.8	110.8	113.2	120.3	132.6
Services	126.9	128.7	131.8	137.2	145.7	158.2
Trade	126.7	126.1	127.1	132.2	136.3	147.2
Hotel and Restaurant	123.1	126.5	127.4	132.4	135.6	153.0
Transportation and Telecom	132.0	139.2	146.3	148.3	164.7	187.3
Finance, Banking and Insurance	120.3	123.4	124.9	130.1	134.0	145.4
Science and Technology	127.3	126.5	128.2	133.6	153.2	166.6
Real Estate and Renting	120.3	123.2	134.3	146.6	155.4	170.9
Public Administration	129.1	128.4	129.3	134.4	154.2	166.4
Education and Training	133.6	136.1	140.9	145.0	159.7	161.7
Healthcare and social welfare	120.4	125.6	127.7	130.6	150.9	171.3
Culture and Recreation	138.1	139.6	148.4	153.0	158.8	161.6
Party and Association	153.6	152.9	153.8	159.2	164.2	176.8
Community and Social Service	131.2	134.6	135.3	140.7	145.1	156.2
Private Household Employment	140.9	145.6	146.3	152.5	157.3	169.5

Source: GSO, Statistical Yearbook 2004.

Table 2.4/a: NATIONAL ACCOUNTS: SOURCES AND USES

(VND billion, current price)

	1999	2000	2001	2002	Rev 2003	Prel 2004
Sources	411,360	452,524	492,277	563,446	664,671	767,071
GDP	399,942	441,646	481,295	535,762	613,443	713,071
Trade Balance	11,418	10,878	10,982	27,684	51,228	54,000
Uses	411,360	452,524	492,277	563,446	664,731	767,071
Total Consumption	301,690	321,853	342,607	382,137	445,221	511,221
Gross Capital Formation	110,503	130,771	150,033	177,983	217,434	253,686
Statistical Discrepancy	-833	-100	-363	3,326	2,076	2,164

Source : GSO, Statistical Yearbook 2004.

Table 2.4/b: NATIONAL ACCOUNTS: SOURCES AND USES

(VND billion, constant 1994 price)

	1999	2000	2001	2002	Rev 2003	Prel 2004
Sources	269,429	283,751	304,230	334,640	357,691	392,216
GDP	256,272	273,666	292,535	313,247	336,243	362,093
Trade Balance	13,157	10,085	11,695	21,393	21,448	30,123
Uses	269,429	283,751	304,232	334,640	367,691	392,216
Total Consumption	194,350	200,665	210,029	225,610	243,515	260,940
Gross Capital Formation	75,830	83,496	92,487	104,256	116,623	128,916
Statistical Discrepancy	-751	-410	1,716	4,774	7,553	2,360

Source: GSO, Statistical Yearbook 2004.

Table 3.1: BALANCE OF PAYMENTS
(US$ million, unless otherwise indicated)

	1999	2000	2001	2002	Rev 2003	Prel 2004
Exports (fob)	11,540	14,448	15,029	16,706	20,149	26,503
Imports (fob)	10,463	14,071	14,399	17,620	22,745	28,860
Trade Balance	1,077	377	630	-914	-2,596	-2,357
Non-Factor Services	-548	-615	-573	-640	-775	-880
Services (net)	-427	-597	-635	-795	-815	-950
Transfers (net)	1,180	1,476	1,250	1,931	2,240	2,485
- Official Transfers	130	136	150	131	140	175
- Private Transfers (net)	1,050	1,340	1,100	1,800	2,100	2,310
Current Account Balance (incl. Grants)	1,153	641	672	-418	-1,946	-1,702
Capital Account	-323	-527	-479	865	4,092	2,375
Medium and Long-Term	-423	729	623	526	1,047	1,443
- Disbursements	944	1,411	988	1,100	1,540	1,920
ODA Loans	787	1,361	958	1,075	1,260	1,394
Non-concessional LT Borrowing	0	50	30	25	280	526
- Amortizations	1,367	682	365	574	493	655
Short-Term	-600	-1,755	-1,535	-1,270	1,745	-290
Direct Investment	700	1,100	1,252	2,023	1,900	1,950
FDI loan repayments	603	601	819	414	600	550
Overall Balance	0.8	114	193	447	2,146	673
Financing	0.8	-114	-193	-447	-2,146	-673

Source: SBV, IMF and WB estimates.

Table 3.2: MAJOR EXPORTS BY COMMODITY

(US$ million)

	1999	2000	2001	2002	Rev 2003	Pre 2004
Total Exports	11,540	14,448	15,027	16,706	20,176	26,503
Rice	1,025	667	625	726	721	950
Quantity (000 tons)	4,508	3,477	3,729	3,241	3,813	4,060
Average Unit Value (US$/ton)	227	192	168	224	189	234
Crude oil	2,092	3,503	3,126	3,270	3,812	5,671
Quantity (000 tons)	14,882	15,424	16,732	16,879	17,143	19,501
Average Unit Value (US$/ton)	141	227	187	194	222	291
Coal	96	94	113	156	184	355
Quantity (000 tons)	3,260	3,251	4,290	6,049	7,246	11,624
Average Unit Value (US$/ton)	29	29	26	26	25	31
Rubber	147	166	166	268	378	641
Quantity (000 tons)	265	273	308	449	433	975
Average Unit Value (US$/ton)	555	607	539	597	872	658
Tea	45	70	78	83	60	96
Quantity (000 tons)	36	56	68	75	60	99
Average Unit Value (US$/ton)	1,250	1,250	1,150	1,103	1,002	961
Coffee	585	501	391	322	505	641
Quantity (000 tons)	482	734	931	719	749	975
Average Unit Value (US$/ton)	1,214	683	420	449	674	658
Cashew Nut	110	167	152	209	284	436
Quantity (000 tons)	18	34	44	62	84	105
Average Unit Value (US$/ton)	5,978	4,892	3,474	3,358	3,390	4,150
Black Pepper	137	146	91	107	105	152
Quantity (000 tons)	35	37	57	77	74	112
Average Unit Value (US$/ton)	3,914	3,943	1,601	1,399	1,416	1,362
Marine Products	974	1,479	1,778	2,023	2,200	2,401
Vegetable & Fruits	107	214	330	201	151	179
Textiles and Garments	1,747	1,892	1,975	2,752	3,687	4,386
Footwear	1,387	1,465	1,559	1,867	2,268	2,692
Handicraft	168	237	235	331	367	426
Wood products	221	294	335	435	567	1,139
Electronic and Computer parts	585	7,884	709	605	855	1,075
Electric cables and wires			154	186	263	389
Plastic products	76	100	134	153	154	261

Source : GSO, Statistical Yearbook 2004.

Table 3.3: MAJOR IMPORTS BY COMMODITY
(US$ millions)

	1999	2000	2001	2002	Rev 2003	Pre 2004
Total Imports	11,742	15,637	16,162	19,733	25,227	31,954
Petroleum products	1,054	2,058	1,828	2,017	2,433	3,574
Quantity (000 tons)	7,403	8,777	8,998	9,966	9,995	11,050
Average Unit Value (US$/ton)	142	234	203	202	243	323
Fertilizers	464	509	404	477	628	824
Quantity (000 tons)	3,782	3,973	3,189	3,824	4,119	4,079
Average Unit Value (US$/ton)	123	128	127	125	152	202
Steel and Irons	587	812	965	1,334	1,657	2,573
Quantity (000 tons)	2,264	2,868	3,938	4,951	4,574	5,186
Average Unit Value (US$/ton)	259	283	245	269	362	496
Others						
Machinery and Equipment	2,005	2,571	2,741	3,793	5,359	5,249
Textile fiber and yarn	194	231	247	314	298	339
Cotton	91	101	132	97	106	190
Material for garment & footwear	1,096	1,422	1,590	1,711	2,034	2,253
Motor vehicles	130	238	433	604	834	904
Motorbikes	399	787	670	422	329	452
Pharmaceutical material	57	62	69	83	76	100
Medicine	263	325	296	320	374	410
Paper of all kinds	102	142	159	193	230	248
Chemicals	258	307	352	406	510	683
Chemical products	227	304	361	482	582	706
Plastic materials	346	480	495	617	785	1,191
Electronic components	518	748	503	431	526	430
Computer and component	112	134	163	233	449	912
Wood - sawn and log	91	158	163	179	274	539
Milk and dairy products	101	141	247	122	164	206
Animal feed and materials	115	159	179	234	421	475

Source: GSO, Statistical Yearbook 2004.

Table 4.1: MONETARY SURVEY

ACCOUNT	1999	2000	2001	2002	2003	2004e
			(in trillion dong, end of period)			
Net Foreign Assets	61.2	95.7	117.6	117.4	131.4	145.8
Foreign assets	77.7	112.7	135.9	135.9	150.5	172.3
Foreign liabilities	-16.5	-17.0	-18.3	-18.4	-19.1	-26.4
Net Domestic Assets	99.2	127.2	162.2	211.7	279.8	390.3
Domestic credit	115.7	155.2	191.2	239.9	316.9	435.2
Net claims on government	3.0	-0.5	2.1	8.8	20.1	14.9
Credit to the economy	112.7	155.7	189.1	231.1	296.7	420.3
Claims on state enterprises	54.3	69.9	79.7	89.5	105.4	142.9
Claims on other sectors	58.4	85.8	109.4	141.6	191.3	277.4
Other items, net	-16.5	-28.0	-29.0	-28.2	-37.0	-44.9
Broad money (M2)	160.5	222.9	279.8	329.1	411.2	536.2
of which: total deposit	119.1	170.7	213.5	254.9	320.6	427.1
Dong liquidity	116.7	152.5	191.1	235.5	314.1	408.1
Currency outside banks	41.4	52.2	66.3	74.3	90.6	109.1
Deposits	75.3	100.3	124.8	161.2	223.6	299.0
Foreign currency deposits	43.8	70.4	88.7	93.6	97.1	128.1
			(Annual change in percent)			
Net Foreign Assets	96.2	56.4	22.9	-0.2	11.9	11.0
Net Domestic Assets	39.1	28.2	27.5	30.5	32.2	39.5
Domestic credit	42.7	34.1	23.2	25.5	32.1	37.4
Credit to the economy	55.0	38.2	21.5	22.2	28.4	41.7
Claims on state enterprises	42.5	28.7	14.0	12.3	17.8	35.6
Claims on other sectors	68.8	46.9	27.5	29.4	35.1	45.0
Total liquidity	56.6	38.9	25.5	17.6	25.0	30.4
of which: total deposit	57.7	43.3	25.1	19.4	25.8	33.2
Dong liquidity	48.9	30.7	25.3	23.2	33.4	29.9
Currency outside banks	53.3	26.1	27.0	12.0	22.0	20.4
Deposits	46.5	33.2	24.4	29.2	38.7	33.7
Foreign currency deposits	81.7	60.7	26.0	5.6	3.7	32.0

Note: Data from 1999 onwards comprise the SBV, six SOCBs and 83 non-state banks.
Source: SBV and IMF.

Table 5.1: STATE BUDGET REVENUES
(VN dong billion)

		1999	2000	2001	2002	2003	2004
				final account			est
A	Total revenues and grants	78,489	90,794	103,888	121,716	157,056	180,397
I	Current revenues	75,357	87,928	100,918	118,346	144,822	163,884
II	Taxes	63,942	79,497	91,688	106,154	126,947	153,432
1	Corporate income tax	17,419	28,950	33,298	36,826	47,410	55,290
2	Individual income tax	1,856	1,831	2,058	2,338	2,951	3,521
3	Land and housing tax	342	366	330	336	359	438
4	License tax	361	381	400	407	778	629
5	Tax on the transfer of properties	1,046	934	1,191	1,332	1,817	2,610
6	Tax on land use right transfer	347	213	298	327	408	640
7	Value added tax	17,239	17,072	19,327	25,916	33,130	41,394
8	Special consumption tax	4,475	5,250	6,229	7,272	8,850	14,212
9	Natural resources tax	4,552	7,487	8,416	8,543	9,719	13,026
10	Agricultural tax	1,973	1,776	814	772	151	130
11	Export & import tax	14,441	13,437	17,458	21,915	21,374	21,542
12	Other taxes	1,236	158	158	170		
III	Fees, charges and non-tax	11,415	8,431	9,230	12,192	17,875	10,452
13	Revenue from discrepancy of import prices	950	131	116	168	133	40
14	Fees and charges	3,558	4,950	5,120	6,016	6,483	6,841
15	Rental of land	574	568	570	459	513	1,053
16	Others	3,446	2,782	3,424	5,549	10,746	2,518
IV	Capital revenues	771	838	959	1,120	9,265	14,199
VIII	Grants	2,361	2,028	2,011	2,250	2,969	2,314
B	Carry-over			3,400	2,145	19,353	16,390

Source: MOF.

Table 5.2: STATE BUDGET REVENUES
(share of GDP)

		1999	2000	2001	2002	2003	2004
				final account			est
A	Total revenues and grants	19.6	20.6	21.6	22.7	25.6	25.3
I	Current revenues	18.8	19.9	21.0	22.1	23.6	23.0
I.1	Taxes	16.0	18.0	19.1	19.8	20.7	21.5
1	Corporate income tax	4.4	6.6	6.9	6.9	7.7	7.8
2	Individual income tax	0.5	0.4	0.4	0.4	0.5	0.5
3	Land and housing tax	0.1	0.1	0.1	0.1	0.1	0.1
4	License tax	0.1	0.1	0.1	0.1	0.1	0.1
5	Tax on the transfer of properties	0.3	0.2	0.2	0.2	0.3	0.4
6	Tax on land use right transfer	0.1	0.0	0.1	0.1	0.1	0.1
7	Value added tax	4.3	3.9	4.0	4.8	5.4	5.8
8	Special consumption tax	1.1	1.2	1.3	1.4	1.4	2.0
9	Natural resources tax	1.1	1.7	1.7	1.6	1.6	1.8
10	Agricultural tax	0.5	0.4	0.2	0.1	0.0	0.0
11	Export & import tax	3.6	3.0	3.6	4.1	3.5	3.0
12	Other taxes	0.3	0.0	0.0	0.0	0.0	0.0
I.2	Fees, charges and non-tax	2.9	1.9	1.9	2.3	2.9	1.5
13	Revenue from discrepancy of import prices	0.2	0.0	0.0	0.0	0.0	0.0
14	Fees and charges	0.9	1.1	1.1	1.1	1.1	1.0
15	Rental of land	0.1	0.1	0.1	0.1	0.1	0.1
16	Others	0.9	0.6	0.7	1.0	1.8	0.4
II	Capital revenues	0.2	0.2	0.2	0.2	1.5	2.0
III	Grants	0.6	0.5	0.4	0.4	0.5	0.3
B	Carry-over	0.0	0.0	0.7	0.4	3.2	2.3

Source: MOF.

Table 5.3: STATE BUDGET EXPENDITURES

(VN dong billion)

		1999	2000	2001	2002	2003	2004
				final account			est
A	Total expenditures	81,817	99,751	117,285	129,434	162,150	186,299
I	Current expenditures	55,120	70,127	77,049	84,216	102,521	123,425
1	Administration expenditure	6,793	8,089	8,734	8,599	11,359	14,710
2	Expenditure on economic affairs & services	4,772	5,796	6,288	7,987	8,164	11,423
3	Social expenditures	25,576	30,694	37,369	40,747	50,185	59,750
3.1	Education	7,994	9,910	12,006	13,758	17,390	21,337
3.2	Training	2,341	2,767	3,426	4,086	5,491	6,265
3.3	Health	3,117	3,453	4,211	4,656	5,372	6,976
3.4	Science, technology & environment	859	1,243	1,625	1,852	1,853	2,411
3.5	Culture	713	919	921	1,066	1,258	1,490
3.6	Radio and television	682	717	838	681	1,056	1,121
3.7	Sports	321	387	483	586	648	643
3.8	Population and family planning	547	559	434	841	666	473
3.9	Social subsidies	9,002	10,739	13,425	13,221	16,451	19,034
4	Interest payment	2,327	3,514	4,485	5,330	6,395	6,450
5	Defence					13,058	14,968
6	Public security					5,745	7,054
7	Others	15,652	22,034	20,173	21,553	7,615	9,070
II	Investment expenditure	26,697	29,624	40,236	45,218	59,629	62,874
1	Capital expenditure	24,684	26,211	36,139	40,740	54,430	58,125
2	Others	2,013	3,413	4,097	4,478	5,199	4,749
B	Carry-over		3,400	2,145	4,443	16,390	22,513

Source : MOF.

Table 5.4: STATE BUDGET EXPENDITURES
(share of GDP)

		1999	2000	2001	2002	2003	2004
				final account			est
A	Total expenditures	20.5	22.6	24.4	24.2	26.4	26.1
I	Current expenditures	13.8	15.9	16.0	15.7	16.7	17.3
1	Administration expenditure	1.7	1.8	1.8	1.6	1.9	2.1
2	Expenditure on economic affairs & services	1.2	1.3	1.3	1.5	1.3	1.6
3	Social expenditures	6.4	6.9	7.8	7.6	8.2	8.4
3.1	Education	2.0	2.2	2.5	2.6	2.8	3.0
3.2	Training	0.6	0.6	0.7	0.8	0.9	0.9
3.3	Health	0.8	0.8	0.9	0.9	0.9	1.0
3.4	Science, technology & environment	0.2	0.3	0.3	0.3	0.3	0.3
3.5	Culture	0.2	0.2	0.2	0.2	0.2	0.2
3.6	Radio and television	0.2	0.2	0.2	0.1	0.2	0.2
3.7	Sports	0.1	0.1	0.1	0.1	0.1	0.1
3.8	Population and family planning	0.1	0.1	0.1	0.2	0.1	0.1
3.9	Social subsidies	2.3	2.4	2.8	2.5	2.7	2.7
4	Interest payment	0.6	0.8	0.9	1.0	1.0	0.9
5	Defence					2.1	2.1
6	Public security					0.9	1.0
7	Others	3.9	5.0	4.2	4.0	1.2	1.3
II	Investment expenditure	6.7	6.7	8.4	8.4	9.7	8.8
1	Capital expenditure	6.2	5.9	7.5	7.6	8.9	8.2
2	Others	0.5	0.8	0.9	0.8	0.8	0.7
B	Carry-over		0.8	0.4	0.8	2.7	3.2

Source : MOF.

Table 5.5. PUBLIC DEBT
(US$ million, unless otherwise indicated)

	1999	2000	2001	2002	2003 rev
DEBT OUTSTANDING (LDOD)	20,479	11,581	11,427	12,160	14,189
Public and publicly guaranteed	20,479	11,581	11,427	12,160	14,189
Official creditors	16,817	8,677	9,165	10,508	12,745
Multilateral	1,606	1,895	2,210	2,868	3,560
Concessional	1,584	1,846	2,156	2,794	3,852
Bilateral (1)	15,211	6,782	6,955	7,639	8,819
Concessional	3,975	6,015	6,193	6,850	7,828
Private creditors	3,662	2,904	2,262	1,652	1,444
Bonds	560	560	560	560	560
Commercial banks	2,322	1,685	1,101	552	406
Other private	781	659	602	540	464
Memorandum item					
IDA	989	1,113	1,344	1,715	2,472
Debt services - public					
- in percent of XGS	10.0	7.5	6.7	6.0	3.4
- in percent of GDP	4.9	4.2	3.7	3.4	2.0

Note: Figures are rounded.

(1) From 2000 onwards, data reflects the rescheduling of non-convertible Russian debt.

Source: World Bank, Global Development Finance 2005.

Table 6.1A: MONTHLY CHANGE IN CONSUMER RETAIL PRICES

Month/Year	1999	2000	2001	2002	2003	2004
January	1.7	0.4	0.3	1.1	0.9	1.1
February	1.9	1.6	0.4	2.2	2.2	3.0
March	-0.7	-1.1	-0.7	-0.8	-0.6	0.8
April	-0.6	-0.7	-0.5	0.0	0.0	0.5
May	-0.4	-0.6	-0.2	0.3	-0.1	0.9
June	-0.3	-0.5	0.0	0.1	-0.3	0.8
July	-0.4	-0.6	-0.2	-0.1	-0.3	0.5
August	-0.4	0.1	0.0	0.0	-0.1	0.6
September	-0.6	-0.2	0.5	0.2	0.1	0.3
October	-1.0	0.1	0.0	0.3	-0.2	0.0
November	0.4	0.9	0.2	0.3	0.6	0.2
December	0.5	0.1	1.0	0.3	0.8	0.6

Source : GSO, Statistical Yearbooks 2004.

Table 6.1B: MONTHLY CONSUMER RETAIL PRICE INDEX (Jan 1995=100)

Month/Year	1999	2000	2001	2002	2003	2004
January	130.7	129.1	128.3	130.4	135.3	139.5
February	133.2	131.2	128.8	133.2	138.2	143.6
March	132.3	129.8	127.9	132.2	137.4	144.8
April	131.5	128.9	127.3	132.2	137.4	145.6
May	131.0	128.1	127.0	132.6	137.2	146.9
June	130.6	127.4	127.0	132.7	136.8	148.1
July	130.1	126.7	126.8	132.6	136.4	148.8
August	129.5	126.8	126.8	132.6	136.3	149.7
September	128.8	126.6	127.4	132.8	136.4	150.1
October	127.5	126.7	127.4	133.2	136.1	150.1
November	128.0	127.8	127.7	133.7	137.0	150.3
December	128.6	127.9	129.0	134.1	138.0	151.2
Annual Index: (Jan 1995=100)	130.2	128.1	127.6	132.7	136.9	147.4
Annual Growth Rate	4.3	-1.6	-0.4	4.0	3.2	7.7
Dec/Dec Growth Rate	0.1	-0.5	0.8	4.0	3.0	9.5

Source: GSO, Statistical Yearbooks 2004.

Table 6.2A: PRICE INDEX BY COMMODITY GROUPS --- Monthly Change

GOODS and SERVICES	Jan-04	Feb-04	Mar-04	Apr-04	May-04	Jun-04	Jul-04	Aug-04	Sep-04	Oct-04	Nov-04	Dec-04
General Index	1.0	3.0	0.8	0.5	0.9	0.8	0.5	0.6	0.3	0.0	0.2	0.6
Food & foodstuff	1.6	5.1	1.6	0.9	1.8	1.5	0.4	0.7	0.4	-0.2	0.0	0.7
of which: Food	*2.1*	*1.5*	*2.8*	*1.8*	*2.3*	*0.5*	*-0.2*	*0.8*	*0.4*	*-0.2*	*0.7*	*1.1*
Foodstuff	*1.6*	*6.8*	*1.3*	*0.6*	*1.8*	*1.8*	*0.7*	*0.8*	*0.4*	*-0.2*	*-0.3*	*0.7*
Beverage & tobacco	2.9	0.5	-1.7	0.3	0.4	0.0	0.2	0.4	0.4	0.0	0.0	0.3
Garment, hats, footwear	1.2	-0.3	0.5	0.7	-0.1	0.1	0.2	0.4	0.5	0.2	0.2	0.5
Housing & construction materials	0.8	1.5	2.1	0.4	0.2	-0.2	0.0	0.6	0.5	0.5	0.5	0.5
Household appliancies	0.5	0.7	-0.3	0.5	0.1	0.1	0.5	0.4	0.3	0.4	0.1	0.3
Healthcare, pharmaceutical items	0.7	0.5	3.1	1.2	1.0	-0.1	1.0	0.8	0.1	0.2	0.1	0.1
Transport & Telecommunication	0.0	0.7	-0.1	0.1	0.2	0.0	3.1	0.0	0.1	0.1	1.2	0.4
Educational items	0.2	0	-3.4	0.1	0.1	-0.1	0.4	0.4	0.4	0.3	-0.3	0.1
Cultural and recreation items	0.4	1.6	0.8	0.5	0.0	-0.4	-0.2	-0.1	-0.1	-0.4	0.0	0.1
Goods and other services	0.9	1.8	-1.0	0.0	0.4	0.0	0.9	0.4	0.3	0.4	0.1	1.0
Gold	3.1	-0.9	0.2	2.3	-4.1	-1.4	0.5	0.4	1.5	1.7	3.2	4.9
US Dollar	-0.3	0.4	0.5	-0.1	-0.3	0.0	-0.1	0.1	0.1	0.0	0.0	0.1

Source: GSO, Statistical Yearbooks 2004.

Table 6.2B: PRICE INDEX BY COMMODITY GROUPS --- Jan 2004 = 100

GOODS and SERVICES	Jan-04	Feb-04	Mar-04	Apr-04	May-04	Jun-04	Jul-04	Aug-04	Sep-04	Oct-04	Nov-04	Dec-04
General Index	101.0	104.0	104.8	105.3	106.3	107.1	107.7	108.3	108.6	108.6	108.8	109.5
Food & foodstuff	101.6	106.8	108.5	109.5	111.4	113.1	113.6	114.4	114.8	114.6	114.6	115.4
of which: Food	102.1	103.6	106.5	108.5	110.9	111.5	111.3	112.2	112.6	112.4	113.2	114.4
Foodstuff	101.6	108.5	109.9	110.6	112.6	114.6	115.4	116.3	116.8	116.6	116.2	117.0
Beverage & tobacco	102.9	103.4	101.7	102.0	102.4	102.4	102.6	103.0	103.4	103.4	103.4	103.9
Garment, hats, footwear	101.2	100.9	101.4	102.1	102.0	102.1	102.3	102.7	103.2	103.4	103.7	104.2
Housing & construction materials	100.8	102.3	104.5	104.9	105.1	104.9	104.9	105.5	106.0	106.6	107.1	107.4
Household appliancies	100.5	101.2	100.9	101.4	101.5	101.6	102.1	102.5	102.8	103.2	103.3	103.4
Healthcare, pharmaceutical items	100.7	101.2	104.3	105.6	106.6	106.5	107.6	108.5	108.6	108.8	108.9	109.3
Transport & Telecommunication	100.0	100.7	100.6	100.7	100.9	100.9	104.0	104.0	104.1	104.2	105.5	105.6
Educational items	100.2	100.2	96.8	96.9	97.0	96.9	97.3	97.7	98.1	98.4	98.1	98.2
Cultural and recreation items	100.4	102.0	102.8	103.3	103.3	102.9	102.7	102.6	102.5	102.1	102.1	103.1
Goods and other services	100.9	102.7	101.7	101.7	102.1	102.1	103.0	103.4	103.7	104.2	104.3	104.3
	100.0											
Gold	103.1	102.2	102.4	104.7	100.4	99.0	99.5	99.9	101.4	103.1	106.4	111.7
US Dollar	99.7	100.1	100.6	100.5	100.2	100.2	100.1	100.2	100.3	100.3	100.3	100.4

Source: GSO, Statistical Yearbooks 2004.

Table 7.1: AGRICULTURAL PRODUCTION
(VND billion, current prices)

	1999	2000	2001	2002	Rev 2003	Prel 2004
Gross Output	128,416	129,141	130,178	145,021	153,955	172,696
Crop Cultivation	101,648	101,044	101,403	111,172	116,066	131,754
Livestock	23,773	24,960	25,501	30,575	34,457	37,344
Services	2,995	3,137	3,273	3,275	3,433	3,598

Source: GSO, Statistical Yearbooks 2004.

Table 7.2: AGRICULTURAL PRODUCTION
(VND billion, constant 1994 prices)

	1999	2000	2001	2002	Rev 2003	Prel 2004
Gross Output	106,368	112,112	118,990	122,150	127,628	133,046
Crop Cultivation	86,309	90,858	92,907	98,061	101,763	106,581
Food Crops	52,720	55,163	55,066	59,619	61,029	63,538
Industrial Crops	19,906	21,782	23,109	22,247	24,175	25,351
Livestock	17,337	18,505	19,283	21,200	22,907	23,439
Services	2,650	2,748	2,800	2,890	2,958	3,026
Memorandum Items:						
Paddy Ouput (000 tons)	31,394	32,530	32,108	34,447	34,569	35,868
Cultivated Area (000 ha)	7,654	7,666	7,493	7,504	7,452	7,444
Yield (ton/ha)	4.10	4.24	4.29	4.59	4.64	4.82

Source: GSO, Statistical Yearbooks 2004.

Table 7.3: INDUSTRIAL CROP PRODUCTION AND YIELDS

	1999	2000	2001	2002	Rev 2003	Prel 2004
Production (000 metric tons)						
Cotton	22	19	34	40	35	30
Jute	9	11	15	20	12	14
Sedge	73	61	65	88	96	89
Sugar cane	17,760	15,044	14,657	17,120	16,855	15,880
Peanut	318	355	363	400	406	451
Soya-beans	147	149	174	206	220	242
Tobacco	36	27	32	33	32	28
Tea - raw and fresh	317	315	340	424	449	488
Coffee	553	803	841	700	794	835
Rubber	249	291	313	298	364	400
Black pepper	31	39	44	47	69	74
Coconut	1,104	885	892	915	893	931
Area Cultivated (000 ha)						
Cotton	21	19	28	34	28	27
Jute	4	6	8	10	5	5
Sedge	11	9	10	12	14	13
Sugar cane	344	302	291	320	313	287
Peanut	248	245	245	247	244	259
Soya-beans	129	124	140	159	166	183
Tobacco	33	24	24	27	23	19
Tea	85	88	98	109	116	119
Coffee	478	562	565	522	510	503
Rubber	395	412	416	429	441	451
Black pepper	18	28	36	48	51	51
Coconut	164	161	156	140	134	133
Average Yield (metric ton/ha)						
Cotton	1.0	1.0	1.2	1.2	1.3	1.1
Jute	2.3	2.1	1.9	2.1	2.6	3.0
Sedge	6.7	6.6	6.6	7.2	6.8	7.0
Sugar cane	51.6	49.8	50.4	53.5	53.8	55.3
Peanut	1.3	1.5	1.5	1.6	1.7	1.7
Soya-beans	1.1	1.2	1.2	1.3	1.3	1.3
Tobacco	1.1	1.1	1.3	1.2	1.4	1.5
Tea - raw and fresh	3.7	3.6	3.5	3.9	3.9	4.1
Coffee	1.2	1.4	1.5	1.3	1.6	1.7
Rubber	0.6	0.7	0.8	0.7	0.8	0.9
Black pepper	1.8	1.4	1.2	1.0	1.4	1.4
Coconut	6.8	5.5	5.7	6.5	6.7	7.0

Source : GSO, Statistical Yearbook 2004.

Table 8.1: INDUSTRIAL PRODUCTION OUTPUT

(VND billion, constant 1994 price)

	1999	2000	2001	2002	Rev 2003	Prel. 2004
Gross Industrial Output	168,749	198,326	227,342	261,092	305,080	354,030
State sector	73,208	82,897	93,434	105,119	117,637	131,570
Central	48,395	54,962	62,119	69,640	80,917	92,653
Local	24,813	27,935	31,316	35,479	36,720	38,917
Non-state sector	37,027	44,144	53,647	63,474	78,292	96,150
Collectives	1,076	1,334	1,575	1,668	1,770	1,912
Private, households and mixed	35,951	42,810	52,072	61,807	76,522	94,238
Foreign-invested sector	58,515	71,285	80,261	92,499	109,152	126,310
Key Industries						
Coal	2,048	2,366	2,695	3,189	3,689	4,910
Oil and gas	20,582	22,746	23,766	23,817	25,132	28,648
Mining and metal ores	191	209	239	281	244	439
Stones and other mining	1,759	2,015	2,398	3,039	3,597	4,306
Food and beverage	37,744	43,634	50,373	56,061	64,585	73,636
Cigarettes and tobacco	4,796	5,744	6,690	7,658	9,189	10,037
Textile products	8,388	10,046	10,641	12,338	14,214	16,415
Garment - apparel	5,218	6,042	6,862	8,182	10,466	12,709
Leather tanning and processing	7,725	8,851	9,529	11,096	13,535	15,976
Wood and wood products	3,180	3,598	3,903	4,488	5,485	6,646
Paper and paper products	3,470	3,930	4,562	4,877	5,655	6,697
Printing and publishing	2,012	2,274	2,453	2,876	3,515	4,746
Chemicals	9,682	11,123	12,852	14,714	16,323	18,578
Rubber products and plastic	5,427	6,456	8,128	9,706	11,291	13,260
Non-metallic products	14,785	18,259	21,625	25,913	29,855	34,709
Metalic production	5,000	5,914	6,842	8,516	10,430	12,063
Metallic products	5,036	5,768	7,063	8,506	10,646	13,274
Machinery and equipment	2,163	2,761	3,421	3,711	4,612	5,601
Computer and office equipment	1,703	1,295	977	1,003	1,538	1,918
Electric and electronic equipments	2,944	3,622	5,172	6,520	7,462	8,704
Radio, TV and telecom	3,993	4,395	5,407	6,169	7,162	8,230
Production & repairing motor vehicles	1,846	3,232	4,265	5,774	8,306	8,282
Production & repairing other transport means	4,574	6,414	7,090	8,534	9,676	10,911
Furnitures	3,395	3,931	4,759	6,057	7,846	9,977
Recycles products	127	150	151	174	204	241
Electricity and gas	9,496	11,828	13,551	15,741	18,071	20,656
Water supply	971	1,066	1,152	1,328	1,361	1,451

Source: GSO, Statistical Yearbook 2004.

Table 8.2: MAJOR INDUSTRIAL PRODUCTS

(VND billion, constant 1994 price)

Product	Unit	1999	2000	2001	2002	Rev 2003	Prel 2004
Assembled automobiles	unit	n/a	13,547	20,526	29,536	47,701	42,651
Assembled motorbikes	000' unit	242	643	610	1,052	1,180	1,569
Assembled tivi sets	1,000	903	1,013	1,126	1,597	2,188	2,479
Beverage	mil. liters	690	779	971	940	1,119	1,166
Bicycle tires	000 Pieces	18,326	20,675	21,656	22,778	26,686	27,000
Bicycle tubes	000 pieces	21,544	21,917	22,997	24,032	36,083	37,600
Bricks	mil. pieces	7,831	9,087	9,811	11,365	12,810	14,501
Cement	000 tons	10,489	13,298	16,073	21,121	24,127	25,329
Chemical fertilizers	000 tons	1,143	1,210	1,270	1,158	1,294	1,453
Chromium ore	000 tons	59	76	70	66	91	95
Cigarettes	mil. packs	2,147	2,836	3,075	3,375	3,871	4,065
Coal	mil. tons	10	12	13	16	19	26
Crude oil	mil. tons	15	16	17	17	18	20
Diesel engines	Pieces	15,347	15,623	18,721	32,570	184,418	192,838
Electric engines	Pieces	38,091	45,855	53,442	64,085	95,779	100,208
Electricity	mil. kWh.	23,599	26,682	30,673	35,888	40,546	46,048
Fabrics of all kinds	mil. meters	322	356	410	470	496	518
Fish sauce	mil. liters	174	167	162	176	191	202
Glass products	000 tons	106	113	115	115	147	152
Insecticides	000 tons	21.9	20.1	20.0	20.7	40.9	44.3
Paper and paper products	000 tons	349	408	445	490	687	781
Porcelain	mil. pieces	220	247	314	284	524	530
Rice mill equipment	pieces	12,136	12,484	18,298	13,433	10,112	10,200
Salt	000 tons	653	590	699	974	909	880
Sawn wood	000 m3	1,466	1,744	2,036	2,667	3,291	4,115
Soap and detergent	000 tons	214	247	326	361	377	459
Steel	000 tons	1,375	1,583	1,914	2,503	2,954	2,929
Sugar	000 tons	947	1,209	1,067	1,069	1,360	1,371
Tea	000 tons	64	70	82	100	85	88
Textile fibers	000 tons	79	130	162	227	235	239
Tin (sticks)	Tons	1,693	1,803	1,728	1,565	1,915	2,000
Transformers	pieces	10,264	13,535	15,664	18,633	33,364	35,634
Water pumps for agri	pieces	3,031	3,496	4,238	3,578	7,787	7,975

Source: GSO, Statistical Yearbooks 2004.