

VIETNAM SYSTEMATIC COUNTRY DIAGNOSTIC 2016

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# SUSTAINING SUCCESS

PRIORITIES FOR INCLUSIVE AND SUSTAINABLE GROWTH





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## CURRENCY EQUIVALENTS

Exchange Rate Effective as of December, 2015

Currency Unit = Vietnamese dong

VN21,000 =US\$1.00

Fiscal Year = January to December

## ACRONYMS AND ABBREVIATIONS

<b>EACC</b>	Economics of Adaptation to Climate Change	<b>MIC</b>	Medium Income Country
<b>ADB</b>	Asian Development Bank	<b>MOF</b>	Ministry of Finance
<b>AEC</b>	ASEAN Economic Community	<b>MONRE</b>	Ministry of Natural Resources and Environment
<b>ASEAN</b>	Association of South East Asia Nations	<b>MPI</b>	Ministry of Planning and Investment
<b>BOT</b>	Build-Operate Transfer	<b>MOIT</b>	Ministry of Industry and Trade
<b>CH</b>	Central Highlands	<b>NIAPP</b>	National Institute of Agriculture Planning and Projection
<b>CEMA</b>	Committee on Ethnic Minority Affairs	<b>NMA</b>	Northern Mountainous Areas
<b>CEQ</b>	Commitment to Equity	<b>NPL</b>	Non-performing Loan
<b>CMT</b>	Cut-Make-Trim	<b>NTP</b>	National Target Program
<b>CP</b>	Cleaner Production	<b>OADR</b>	Old-age Dependency Ratio
<b>CPI</b>	Consumer Price Index	<b>OECD</b>	Organization for Economic Co-operation and Development
<b>EAP</b>	East Asia and Pacific	<b>PFES</b>	Payment for Forest Ecosystem Services
<b>EU</b>	European Union	<b>RCEP</b>	Regional Comprehensive Economic Partnership
<b>FAO</b>	Food and Agriculture Organization	<b>SCD</b>	Systematic Country Diagnostic
<b>FDI</b>	Foreign Direct Investment	<b>SEDP</b>	Socio-Economic Development Plan
<b>GDP</b>	Gross Domestic Product	<b>SOE</b>	State-owned Enterprise
<b>GSO</b>	General Statistics Office of Vietnam	<b>SSF</b>	Social Security Fund
<b>ICT</b>	Information and Communication Technology	<b>SBV</b>	State Bank of Vietnam
<b>IFC</b>	International Finance Corporation	<b>TPP</b>	Trans-Pacific Partnership
<b>IMF</b>	International Monetary Fund	<b>VHLSS</b>	Vietnam Household Living Standards Survey
<b>LIC</b>	Low Income Country	<b>WSP</b>	Water Sanitation Program
<b>LDC</b>	Least Developed Country	<b>WTO</b>	World Trade Organization
<b>LUC</b>	Land Use Certificate		

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# FOREWORD



Vietnam's development success over the last 30 years has been truly remarkable. One of the poorest countries in the world just a generation ago, Vietnam has emerged as a thriving middle income economy. Largely isolated from international trade at the beginning of its transition, Vietnam is today an export powerhouse and major destination of foreign direct investment. Most importantly, this economic dynamism has dramatically improved peoples' lives. Incomes have not only risen exceptionally fast, but also broadly across the entire income distribution with only modest increases in inequality. Extreme poverty fell dramatically from 50 percent in 1993 to less than 3 percent today. Key human development outcomes and access to basic infrastructure have also improved substantially.

Looking ahead, Vietnam's development prospects remain bright. As presented in this report, Vietnam has every potential to sustain its remarkable success. In recent years, growth has proven resilient, despite the subdued global recovery. Real incomes continue to rise broadly and poverty continues to fall. With abundant human and natural resources, strong economic fundamentals and a keen focus on leveraging global and regional integration, Vietnam is well placed to continue to deliver high growth, more and better jobs and greater prosperity for all.

Yet, Vietnam will face new and complex choices in order to reach its full potential. Persistent welfare gaps among the country's ethnic minorities, stagnant productivity growth and growing environmental vulnerabilities all pose challenges that will require bold action. The reform agenda is necessarily complex and comprehensive. It encompasses steps to further strengthen economic governance and build more effective market institutions, to develop the country's infrastructure (especially power, transport and urban infrastructure) to meet the demands of a rapidly growing economy, to modernize agriculture and use of natural assets, to improve public service delivery and enhance climate change resilience.

As a long term development partner of Vietnam, the World Bank stands ready to support the country in tackling these emerging challenges and meeting its own ambitious goals for the future. This report will serve as the analytical underpinning to identify priorities for the next chapter in the evolving partnership between Vietnam and the World Bank. Its purpose is to systematically understand Vietnam's opportunities and constraints in eliminating poverty and realizing further gains in shared prosperity in a sustainable manner and to help both the World Bank and Vietnam direct financial and knowledge resources to the most pressing development challenges. As such, it will be a key input into the upcoming Country Partnership Framework for 2018-2022 which will lay the foundation for the World Bank's support over the coming years.



**Victoria Kwakwa**  
**Regional Vice President, East Asia and Pacific Region**

# EXECUTIVE SUMMARY



**Vietnam is a leading case of a country that has achieved rapid growth, poverty reduction, and shared prosperity.** Apart from China, no country in the world has undergone such a rapid transformation in recent decades. In 1990, Vietnam was one of the poorest countries in the world, still scarred by decades of conflict and with an economy stifled by a central planning system. Today, extreme poverty has been all but eliminated, and the benefits of growth have been widely shared, both over the long haul since the launch of the Doi Moi reforms in the late 1980s and in recent years. Vietnam has been and continues to be the envy of developing countries around the world.

**Vietnam's past achievements came through a combination of different developments.** Growth in the 1990s was principally a product of agricultural productivity gains which came in the wake of decollectivization and the creation of individual land usage rights. In the first decade of the new millennium, growth continued with the emergence of private sector enterprises after severe constraints on business registration were relaxed in 2000. Job creation was driven by strong growth in the service sector and export oriented manufacturing with the latter being propelled by decisive steps at trade liberalization and in particular Vietnam's accession to the WTO in 2007. Capitalizing on its comparative advantage in labor intensive manufacturing, Vietnam attracted a significant and steady inflow of foreign direct investment (FDI). Growth was also underpinned by a significant demographic dividend in the form of a growing labor force as well as investments in productive and inclusive infrastructure, effective basic health care and education.

**The purpose of this Systematic Country Diagnostic (SCD) is to identify priorities for supporting Vietnam in sustaining its past success and reaching its own ambitious goals for the future.** In many respects Vietnam's future looks bright. Growth has proven resilient, despite the subdued global recovery. Real incomes continue to rise broadly and poverty continues to fall. Numerous important trade agreements offer expanding opportunities. Nonetheless, coasting along the current path will not lift the country to achieve its aspiration of following the great success of economies such as South Korea and Taiwan, China. To reach its very high potential Vietnam will need to overcome a series of emerging constraints.

**First, Vietnam's current model of inclusive growth and job creation will eventually face limits.** Economic growth-while more resilient than elsewhere-has moderated in recent years compared to earlier years. Perhaps more importantly, the sources of growth have shifted. Productivity growth, the major driver of GDP growth in the early years of Vietnam's transition, has diminished over the past decade. Labor productivity growth has stagnated. The rate of return to investments have deteriorated, partly reflecting diminishing returns, but also pointing to inefficiencies in the allocation of capital. Structural transformation - a major source of productivity growth in earlier years-has slowed since the global financial crisis. Meanwhile, within sector and firm productivity growth is dampened by a combination of incomplete restructuring of state owned enterprises and a still infant domestic private sector, dominated by small firms that lack the scale, access to technology and competitive pressure needed to boost productivity. Moreover, as wages inevitably rise, Vietnam's current comparative advantage in low skill, labor intensive industries will start to dissipate.

**Second, Vietnam faces both an unfinished agenda and new challenges for inclusion and service delivery.** Vietnam differs from many countries in that the poverty challenge is now largely separate from that of shared prosperity. After a quarter century of poverty reduction driven by broad-based growth, the remaining poor by the national poverty line will soon be almost exclusively ethnic minorities, who make up only 14% of the population but are projected to comprise 84% of the poor by 2020. Most ethnic minorities have historically been detached from the country's greater economic success and face social exclusion due to discrimination and lack of ability in the Vietnamese language. A further inclusion challenge is building on Vietnam's relatively strong record on gender equality. Across broader issues of service delivery, the country faces new challenges generated by the country's demographic and economic evolution. Rapid aging will place new demands on the social assistance and health systems, while the growing middle class has higher expectations for public services. Specifically while the basic education system is a worldwide standout, the upper secondary and tertiary systems are not equipping students with the skills they need to drive the next phase of inclusive growth.

**Third, Vietnam needs to reinforce its rapid growth with productive use of its natural assets and environment, and minimize the cost of pollution, unsustainable resource use and climate change on growth.** Unsustainable exploitation of water, land, fish, and forests results in missed opportunities to more efficiently and competitively use and add value to these natural assets and agriculture for growth, resilience, and household wellbeing. This impacts 25 to 30 percent of the population for which agriculture is expected to remain the primary source of income and livelihood. Furthermore, the current growth model, with its increasing consumption of energy and limited enforcement of environmental regulations, is imposing hidden costs from air and water pollution. More than 83 percent of the country's population is exposed to unhealthy levels of air pollution, and current levels of water pollution are a cause of water borne illnesses and deaths. Maintaining the current energy generation and use trajectory (with growing reliance on coal) will substantially worsen air pollution. Vietnam is also one of the most vulnerable countries to extreme weather events and long-term climate change (e.g., sea level rise). The former has already resulted in 0.4 to 1.7 percent of GDP being lost over the past 25 years.

**Finally, governance weaknesses are likely to become a drag on future growth and social outcomes.** By international measures, Vietnam performs reasonably well in terms of government effectiveness, control of corruption, and rule of law but lags behind other lower middle income countries in regulatory quality as well as voice and accountability. Vietnam's transition to modern market and government institutions remains incomplete. Private firms compete on a playing field tilted by the heavy role of state owned and politically connected enterprise. Weaknesses in public administration management and fragmentation hamper the government's ability to meet the public service demands of an increasingly complex economy.

**Against this backdrop, Vietnam faces opportunities and risks for poverty reduction, shared prosperity and environmental sustainability.** On the one hand, persistent ethnic minority poverty, rapid population aging, macroeconomic vulnerabilities, a growing environmental footprint, and climate change all pose risks to Vietnam reaching its full potential. On the other hand, key opportunities include reinvigorating structural transformation, leveraging global integration, and reaping the benefits of rapid urbanization.

**Mitigating risks and making most of the opportunities will require concerted actions on a broad set of priorities.** This broad agenda reflects the complexity of Vietnam's development challenges and opportunities. It posits that investments in a broad set of productive endowments are needed for Vietnam to reach its aspirations. Effective market institutions and good governance (institutional capital), quality infrastructure (physical capital), a productive labor force with relevant skills (human capital) and sustainable use of Vietnam's abundant natural resource asset (natural capital) are all critical ingredients of future growth and prosperity. While broad in terms of the areas covered, the analysis suggest focused efforts within individual priority areas.

**The first priority is targeted and tailored efforts to reduce poverty among ethnic minorities.** Defying worldwide trends, their rates of infant mortality have increased in recent years, and malnutrition and secondary school dropout levels continue to be high. Targeted efforts are needed to address the interlaced weaknesses in upper secondary education, nutrition, health, and sanitation access for ethnic minorities. Given the strong dependence of ethnic minorities on agriculture and natural resources, they will benefit from efforts to improve resilience and productivity in these areas, including effective targeted approaches. Efforts can employ successful behavioral approaches and rely in part on experimentation and evaluation to determine what works. Enhancing ethnic voice can also make interventions more effective.

**The second priority is delivering productive infrastructure and competitive cities.** Emerging infrastructure bottlenecks threaten to become a constraint to growth and job creation, especially in high value added manufacturing and service sectors. Another key challenge is to put in place the infrastructure to support economic activities, ease mobility, and provide services in the country's rapidly growing cities. Faced with these significant needs on the one hand and tight financing constraints on the other hand, more efficient public investment management coordination across levels of government are becoming more critical. Integrated urban planning, effective land use management and coordinated investments in municipal infrastructure are crucial to maximizing the economic benefits of agglomeration while mitigating risks of congestion and costly urban sprawl. In addition, Vietnam needs to create an enabling environment for more private sector participation in infrastructure financing and delivery.

**The third priority is strengthening economic management and market institutions.** While Vietnam has maintained macroeconomic stability, rising public debt and remaining financial sector vulnerabilities need to be addressed to solidify macroeconomic stability and resilience. Structural reforms also remain important to lift the medium term growth potential of the economy. Institutional legacies, incomplete market institutions and a cumbersome investment climate have become impediments to productivity growth, especially of the domestic private sector. Firm surveys conducted in Vietnam confirm that a majority of firms perceive government conduct to be uneven and favoring connected firms in the enforcement of regulations, government procurement, and allocation of land use rights. These policy distortions undermine efficiency and provide incentives to firms to engage in rent seeking rather than productive activities. More efficient factor markets for capital and land, deeper reforms of the state owned sector and a more levelled playing field and enabling environment for the domestic private sector are important in this regard.

**The fourth priority is transforming agriculture and use of natural assets.** Agriculture and natural assets will remain an important part of Vietnam's development in the future. The agriculture sector, however, needs to be transformed to enhance the influence of markets, improved practices, and modern technologies on farmers' decisions. A tighter link should be formed between farmers and the expanding agro-food system. Vertical integration of value chains, quality improvements, and investments in food processing will help create better jobs and enhance rural livelihoods. Converting forest assets to higher value products, and ensuring the sector responds to market signals for sustainable forests management will also have positive economic and environmental impacts. In the water sector, the focus must be on optimizing the use of water through better integrated planning and institutional coordination over water management. All these transformations will require the government to play a more facilitative role. Institutional arrangements that foster broad based innovation will also be necessary. The public sector will have to encourage households to maximize economies of scale, incentivize product, crop and species diversification, and reward environmental stewardship.

**The fifth priority is adapting service delivery in health, social protection, and education to new expectation and an aging population.** The health system needs a series of reforms to upgrade the quality of care, deal with the rise of non-communicable diseases among the aging population, and reduce high out-of-pocket costs. The pension system needs reforms to stay fiscally sustainable while expanding to prevent rising poverty as the old-age population doubles in size. Most critically, the education system needs to move to towards universal upper secondary completion while at the same time making upper secondary and tertiary more relevant to the job market and the country's human capital needs. In regards to gender, action is needed in three areas, starting with efforts to reduce the extremely high sex ratio at birth which is a consequence of selective abortion and strong son preference. Other areas for action on gender are reducing levels of domestic violence and boosting the participation of women in leadership positions in both the public and private sectors.

**The sixth priority is augmenting resilience to climate change and generating mitigation benefits while reducing environmental pollution.** Current and projected climate change can set back development gains unless there is a concerted effort to enable climate smart investments and plans. The effort must include reforms that reduce the vulnerability of income and human capital to climate change, scale up approaches for disaster preparedness, response and recovery, support climate smart investments, and promote coordinated planning. Vietnam should also put in place measures that lower emissions from energy production, reduce reliance on coal, and mitigate pollution from transport and industry. This will reduce the significant costs of pollution and the irreversible damage from environmental degradation that often accompanies rapid growth. These are all no regret measures as they assist Vietnam to meet its nationally determined contribution to GHG emissions reduction without compromising growth.

**Finally, attention needs to be given to modernizing Vietnam's core government institutions to enable them to continue to support a rapidly developing middle income economy.** An effective government and public administration is an essential prerequisite for delivering the other six priorities identified in this report. It requires capabilities to mobilize resources, implement public investment and spending programs, promulgate quality regulations and provide fair and transparent enforcement. Modernizing Vietnam's

governance system will hinge on a continued evolution of the respective roles of the state and the market to ensure independent regulation of product and factor markets and to institutionally separate state and commercial functions. Issues of coordination, including steps to strengthen the center of government and enhance intergovernmental fiscal and administrative relations also remain critical to address fragmentation within and across levels of government. Reforms of core, cross-cutting government systems, including public financial management, revenue administration and public administration management are also critical for enhancing state capabilities. Finally, transparency and voice in decision making, resource allocation, regulatory reform and service delivery could be strengthened further to provide the foundation for more accountability.

**There are important synergies and linkages between these different priorities.** For example, education and skill development are an important prerequisite for economic growth and especially gains in labor productivity. Closing the education gap between the poor and non-poor is also a central element of the inclusion agenda, given the sharp drop in enrolment rates among children of poorer households and ethnic minorities, in particular at secondary and tertiary levels. But a skilled labor force can only be productive if there are a sufficient number of quality jobs. Job creation in turn hinges on functioning market institutions, including sound fiscal management, a stable and efficient financial system, and functioning markets for land use rights that ensure the most productive firms and farms have access to the resources they need to flourish and expand. At the same time, ensuring environmental sustainability and mitigating climate change and disaster risks is key to preserving productive assets and jobs, especially in natural resource-intensive sectors, including in agriculture, which remain a key livelihood source, especially for the poor and bottom 40 percent.

**TABLE 1: SUMMARY OF PRIORITIES**

Priority Areas	Impact on Twin Goals			Synergies with other priorities
	Poverty Reduction	Shared Prosperity	Sustainability	
<b>Expand inclusion of ethnic minorities</b> 	✓✓✓ ✓✓✓			✓ ✓
<b>Deliver productive infrastructure and competitive cities</b> 	✓✓✓ ✓✓ ✓✓✓	✓✓ ✓ ✓	✓✓ ✓ ✓	✓✓✓ ✓✓ ✓✓
<b>Strengthen economic management and market institutions</b> 	✓ ✓✓ ✓✓	✓✓ ✓✓✓ ✓✓	✓ ✓ ✓	✓✓✓ ✓✓✓ ✓✓

## Transform agriculture and use of natural assets



- Improve the structure of primary production and value chains
- Reduce the environmental footprint of agriculture and land and water polluting sectors
- Enable markets institutions, knowledge of improved practices, and modern technology inform investments in natural resources, agriculture and the agro-food system

✓	✓✓	✓✓	✓✓✓
	✓✓	✓✓✓	✓✓
	✓✓	✓✓	✓

## Adapt service delivery to new expectations and aging population



- Boost completion rates and quality of upper secondary and tertiary education
- Expand and reform pension, health, and social protection systems
- Address particular gender equity challenges

✓✓	✓✓✓	✓✓✓
✓✓	✓✓	✓
✓	✓	✓✓

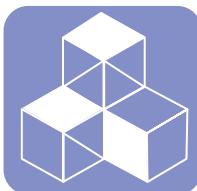
## Augment resilience to climate change and benefits from mitigation



- Scale up approaches for disaster preparedness, response and recovery
- Plan and invest in resilience to climate change
- Lower greenhouse gas emissions by reducing pollution from key sectors

✓	✓✓	✓✓✓	✓✓✓
✓	✓	✓✓✓	✓✓
		✓✓✓	✓

## Strengthen Institutional Foundations



- Transform state-market relations
- Enhance coordination and implementation capacity
- Strengthen voice and accountability

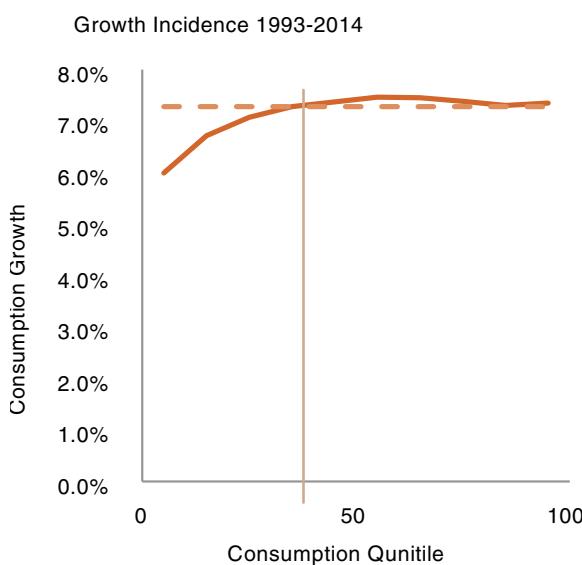
Note: ✓✓✓: Significant, ✓✓: Notable, ✓: Modest

# INTRODUCTION

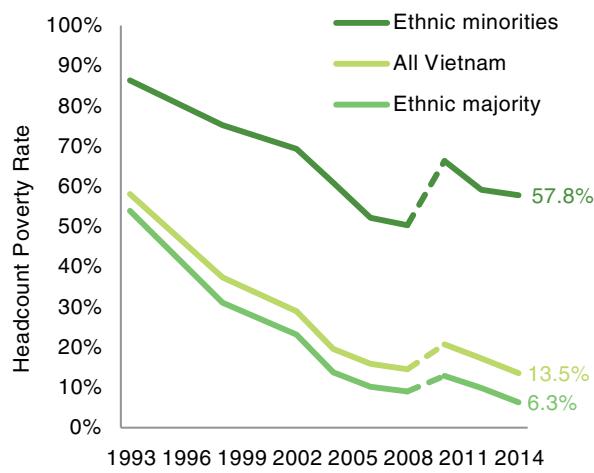


**Vietnam is a remarkable success story of rapid growth, poverty reduction and shared prosperity.** Beginning with the launch of the Doi Moi reforms in the late 1980s Vietnam has sustained rapid economic growth rates that catapulted the country from the bottom ranks of poor nations to middle income status in one generation. With GDP growth averaging 5.5 percent annually, real per capita GDP more than tripled between 1990 and 2014, and more than 40 million people were lifted out of poverty, using the national poverty line. Extreme poverty has been nearly eliminated.<sup>1</sup> Unlike other fast growing economies, Vietnam has not experienced major increases in income inequality, with its income Gini coefficient (0.39 in 2012) remaining substantially lower than China, Indonesia and Thailand. The country has achieved widely shared prosperity: average consumption of the bottom 40 percent of the consumption distribution (bottom 40) grew 6.8 percent annually over the period 1993-2014. Social indicators have also greatly improved, underpinned by wider access to basic services including broad access to primary education, health care, and vital infrastructure such as paved roads, electricity, piped water, and sanitation.

**Figure 1: A strong record of shared prosperity ...**



**Figure 2: ... and tremendous poverty reduction**



Source: World Bank staff analysis of household survey data.

Note: Poverty figures are using the GSO-WB national poverty lines. Dashed lines on the poverty figure indicate the interval of major revisions to the survey and measurement methodology.

<sup>1</sup> By the \$1.90-a-day poverty line, the extreme poverty rate was 3% in 2014 and is projected to have fallen to below 3% in 2015. Most of the discussion throughout the SCD uses the GSO-WB national poverty line, which is the most relevant poverty line for policy and analysis in Vietnam. The GSO-WB national poverty line is \$3.49-a-day in 2011 PPP terms.

**Past success has naturally led to ambitious goals for the future.** According to the Socio-Economic Development Plan (SEDP) for 2016 - 2020, the government aims to achieve a per capita GDP of US\$ 3,141 - 3,261 by 2020. This translates into 6.5 - 7 percent annual growth over the next five years. The SEDP also lays out an ambitious agenda for inclusion and service delivery which provides for continued drops in the poverty rate by 1.3-1.5 percent point per year, expanding health insurance coverage to 80 percent of the population and reducing child malnutrition rates to below 10 percent. The SEDP agenda for sustainability consists of expanding clean water access to 95 percent of the urban population and 90 percent of the rural population, maintaining forest coverage of at least 42 percent, and a series of goals associated with pollution control and waste management. The plan goes on to reconfirm the government's key priorities: macroeconomic stability, strengthened market institutions, and investments in modern infrastructure and a skilled labor force.

**While Vietnam has great potential to meet these ambitions, success cannot be taken for granted.** Vietnam now faces a new set of challenges to achieving further poverty reduction, shared prosperity, and sustainability. The poverty reduction agenda now largely revolves around the need to close the gap in poverty and living conditions among marginalized groups, more remote populations, and, particularly, ethnic minorities, which constitute only 14 percent of the population, but 60 percent of the poor. The slow rate of poverty reduction among ethnic minorities in recent years suggests that advances in overall growth will not be sufficient to eliminate poverty among ethnic minorities. The poverty agenda is substantially distinct from the broader agenda around shared prosperity. Vietnam's employment-driven economic growth model is expected to continue to drive shared prosperity at least in the near term. However, relative to earlier years, the pace of economic expansion has moderated, reflecting a cyclical slowdown, but also emerging structural constraints on a growth model that has become increasingly reliant on growth in capital investments and the labor force rather than productivity. Enhancing the prosperity of the Bottom 40 percent rests in large part on the implementation of reforms to return the economy to a productivity led growth path. In addition, there is a broader agenda around the sustainability of broadly inclusive public service delivery in a context of the rapidly aging population and the rise of the middle class. In parallel, ensuring sustainable growth will require improvements in the productivity of natural resource - based sectors that, while accounting for a declining share of overall GDP, are significant in some regions, where they represent slightly less than 50 percent of the income among the rural poor. It will also require adapting to and mitigating climate change and reducing the impact of pollution and degraded natural assets on labor and human capital.

**The purpose of this Systematic Country Diagnostic (SCD) is to identify priorities for supporting Vietnam in sustaining its past success and reaching its own ambitious goals for the future.** The SCD assesses achievements and emerging constraints and opportunities for Vietnam. The SCD is designed to inform the upcoming Country Partnership Framework by informing a set of focus areas to help accelerate progress toward the World Bank Group's twin goals of reducing poverty and achieving share prosperity in a sustainable manner.

# STRUCTURE



**The SCD is divided into two main parts.** The first part provides the main diagnostic. This part starts with an analysis of trends and patterns of poverty reduction and shared prosperity. It then moves into discussing both accomplishments and emerging challenges for Vietnam around three main themes: 1) inclusive growth and job creation, 2) inclusive service delivery, and 3) sustainable management of natural assets and the environment. The second part outlines and motivates the proposed priority areas for Vietnam. This second part first identifies a set of risks and opportunities Vietnam faces in terms of progress towards the twin goals in a sustainable manner which is recasting the main diagnostic results. It then proposes six priority areas to mitigate the risks and make most of the opportunities presented. The second part concludes with short section summarizing key governance challenges that emerge as cross-cutting issues.

**For cross-country benchmarking, a group of structural “peers” is used.** The peers are used to consider Vietnam’s performance in comparison to countries that share some of Vietnam’s main characteristics. The criteria used to select the peers are as follows:

- lower or upper middle income
- not a fragile state
- not classified as a commodity exporter
- population of at least 35 million. (This population cutoff corresponds to the 80<sup>th</sup> percentile among all countries, and Vietnam’s population of 90 million places it at the 93<sup>rd</sup> percentile.)

Countries in this peers group are as follows: Bangladesh, China, Egypt, India, Mexico, Pakistan, Philippines, Thailand, and Turkey. Due to varying data availability, not all the peers are included in all comparisons.

**The SCD rests on a foundation of a variety of recent analytical work, most importantly the recently completed joint Government of Vietnam- World Bank Vietnam 2035 Report.** While the net was cast widely to encompass existing relevant analytical work, emphasis has been given to World Bank sector studies and reports. In particular, the SCD builds upon the Vietnam 2035 report, which is a joint product of the World Bank and the Government of Vietnam.

**Figure 3: The SCD on one page**



# PART 1

## ACHIEVEMENTS AND CHALLENGES



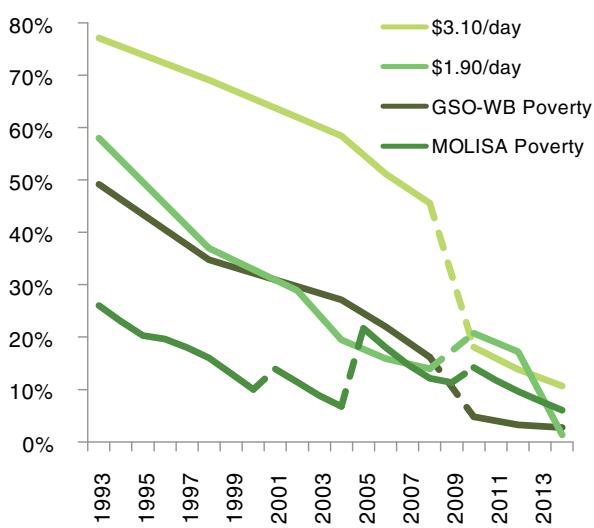
## 1. Trends and patterns of poverty reduction and shared prosperity

**Over the long term, poverty reduction and shared prosperity in Vietnam has been driven by a combination of inclusive economic growth and effective delivery of basic services.**

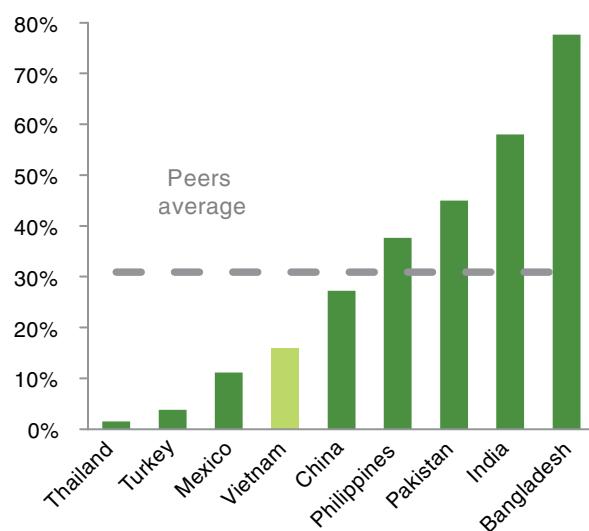
Among the most important early reforms under Doi Moi was the de-collectivization of agriculture in 1988 and the creation of tradable land use rights in 1993. The relatively equitable allocation of land rights provided the basis for broad-based growth and a surge in poverty-reducing agricultural production during the 1990s. In the 2000s, inclusive growth continued with the rise of labor-intensive export-driven manufacturing and expanding employment opportunities in service sectors. Equitable service delivery in health, education, and social protection as well as widespread provision of water, sanitation, and electricity access has been a key element of Vietnam's shared prosperity story.

### VIETNAM HAS ACHIEVED TREMENDOUS POVERTY REDUCTION

**Figure 4: Poverty rates, various poverty lines**

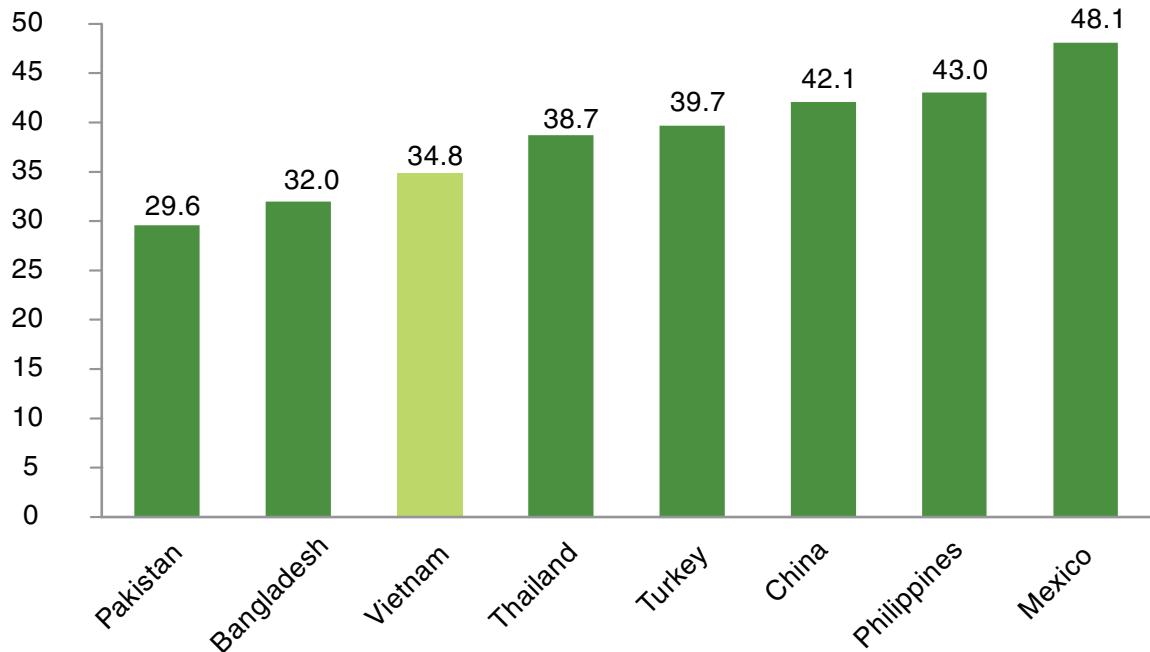


**Figure 5: Recent poverty rates, \$3.10-a-day poverty line**



Source: Analysis of Vietnam Household Living Standards Surveys and WDI data using the Find My Friends tool.

Note: Dotted lines indicate periods when substantial methodology changes were made.

**Figure 6: Gini coefficient measure of inequality**

**Vietnam has been a celebrated success in terms of poverty reduction.** In 1993, shortly after the start of the Doi Moi period, half of the population lived on less than \$1.90-a-day (in 2011 PPP terms). By 2014 the fraction living in extreme poverty by this measure had fallen to 2.8 percent. By the \$3.10-a-day poverty line, 77 percent were poor in 1993, falling to 10.7 percent in 2012. Although comparisons over time are complicated by periodic changes in measurement and survey methodology, these international poverty measure as well as the MOLISA and GSO-WB poverty measures all show the same pattern of consistent, large drops in poverty over time.<sup>2</sup> Using the \$3.10-a-day poverty line, poverty rates are Vietnam are substantially below those of most peers.

**Overall poverty reduction has been paired with a record of broadly shared prosperity over the long term.** The World Bank's measure of shared prosperity is the income (or consumption) growth of the bottom 40 percent of the population. By this measure, Vietnam is one of the most outstanding cases of long-term shared prosperity worldwide. The average consumption level of Vietnamese in the bottom 40 percent grew by 6.8 percent annually over the period 1993-2014.

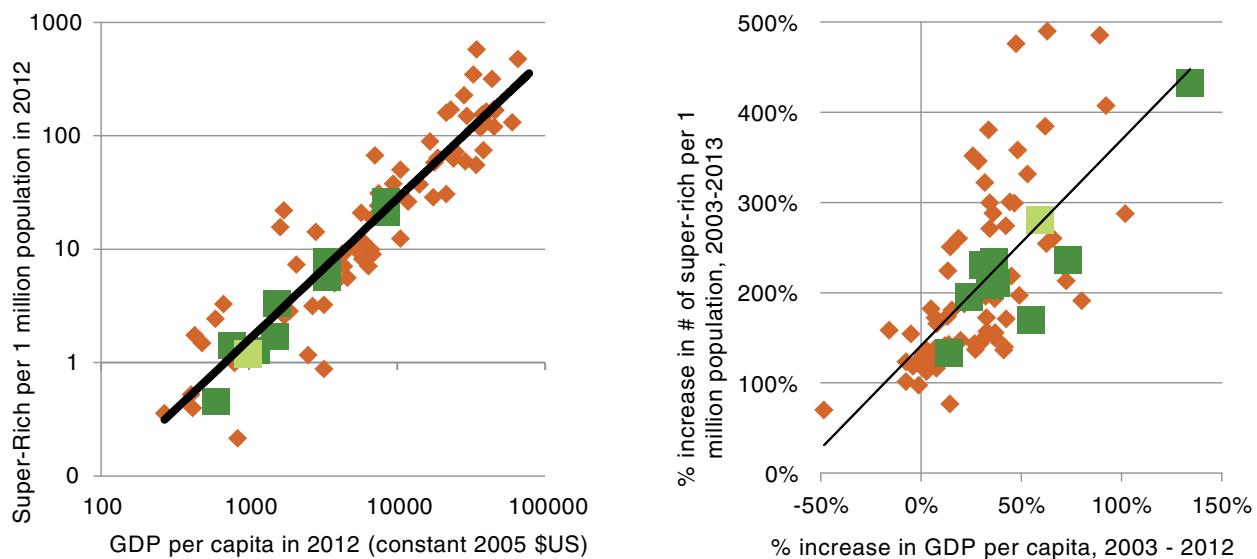
**Shared prosperity has resulted in modest increases in inequality over time.** The Gini coefficient for 2014 is estimated to have been 34.8 in 2014 compared to 32.6 in 1993. Vietnam's Gini coefficient is substantially below the average among its peers. It is well-known that household surveys often fail to capture the wealthy, and consequently survey-

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<sup>2</sup> These \$1.90-a-day and \$3.10-a-day figures are identical to those that will appear in the forthcoming EAP Flagship report, the EAP Economic Update, and the EAP Poverty Portal. Due to small changes in methodology, they differ slightly from the figures that will appear in PovcalNet and the World Development Indicators.

based estimates may underestimate the true level of inequality and its growth over time. The number of super-rich nearly tripled over the period 2003-2013. This expansion of the ranks of the wealth is in line with that of other countries that have experienced similar levels of growth, and the prevalence of super-rich is no higher than in other countries at similar levels of income.<sup>3</sup>

**Figure 7: The number and the rate of increase in the number of super-rich in Vietnam are similar to that of other countries with similar levels of GDP and GDP growth**



Source: World Bank (2014) based on counts of super-rich population from Knight Frank Research (2014) and population and GDP data from World Development Indicators. Red dots correspond to Vietnam. Blue dots correspond to peers. Black dots are other countries.

**Large gains in both poverty reduction and shared prosperity have continued in recent years even in a context of lower economic growth.** Over the period 2010-2014, the overall poverty rate (using the GSO-WB poverty rate) fell from 20.7 percent to 13.5 percent, corresponding to approximately 6.5 million people exiting from poverty in this period. Mean consumption of the bottom 40 percent and median consumption each grew by 5.5 percent, exceeding the overall growth rate of mean consumption of 3.3 percent.<sup>4</sup>

<sup>3</sup> An analysis of underrepresentation of inequality in Vietnam, including the underrepresentation of the wealthy in household surveys and growth of the super-rich population was conducted for the Special Focus of the World Bank's July 2014 Vietnam Taking Stock.

<sup>4</sup> The growth in mean consumption observed in the household survey 2010-14 is lower than that of both GDP per capita growth and private consumption growth in the national accounts. Deaton (2005) notes that a similar pattern is seen in most countries, and Ravallion (2003) observes "It is evident that when the levels or growth rates from these two data sources differ, there can be no presumption that the NAS is right and the surveys are wrong, or vice versa, since they are not really measuring the same thing, and both are prone to errors."

**Table 2: Poverty has continued to decline steeply in recent years**  
**Key poverty trends, 2010-2014**

	Headcount Poverty Rate			Share of Population		Share of Poor	
	2010	2012	2014	2010	2014	2010	2014
All Vietnam	20.7%	17.2%	13.5%	100%	100%	100%	100%
Urban	6.0%	5.4%	3.8%	30%	34%	9%	10%
Rural	26.9%	22.1%	18.6%	70%	66%	91%	91%
Ethnic minority	66.3%	59.2%	57.8%	15%	14%	47%	60%
Kinh/Hoa	12.9%	9.9%	6.3%	85%	86%	53%	40%
<i>Region</i>							
Red River Delta	11.4%	7.4%	4.9%	22%	22%	12%	8%
East Northern Mtns	37.7%	33.5%	29.1%	11%	11%	21%	24%
West Northern Mtns	60.1%	58.7%	54.3%	3%	3%	9%	13%
North Central Coast	28.4%	21.2%	19.4%	12%	11%	16%	16%
South Central Coast	18.1%	15.3%	9.7%	8%	8%	7%	6%
Central Highlands	32.7%	29.7%	30.4%	6%	6%	10%	14%
Southeast	8.6%	5.8%	4.1%	18%	19%	7%	6%
Mekong Delta	18.7%	16.2%	9.8%	19%	19%	17%	14%

Source: World Bank staff analysis of VHLSS data.

Note: All figures are based on the GSO-WB poverty line.

**While poverty reduction has continued in recent years, the nature of the poverty reduction challenge is changing.** The table above summarizes poverty information from the most recent surveys for 2010-14 and reveals several points:

- The poverty headcount fell sharply over this short period, from 20.7 to 13.5 percent, meaning that more than 6 million people were lifted out of poverty.
- Poverty has become increasingly concentrated among ethnic minorities, with the share of the poor who are ethnic minorities rising from 47 to 60 percent.
- The decline of poverty among ethnic minorities stalled 2012-14.
- A growing share of the poor live in the Northern Mountains and Central Highlands—where ethnic minorities are concentrated—and a declining share are found in the Red River Delta (which includes Hanoi), the Southeast (including HCMC), and the Mekong Delta.
- In the face of declines in poverty in all other regions, the poverty rate has been essentially flat in the Central Highlands since 2010.
- The population is continuing to shift to shift from rural to urban areas at a rate of roughly 1% of the overall population per year.
- Nine out of ten poor people in Vietnam live in rural areas.

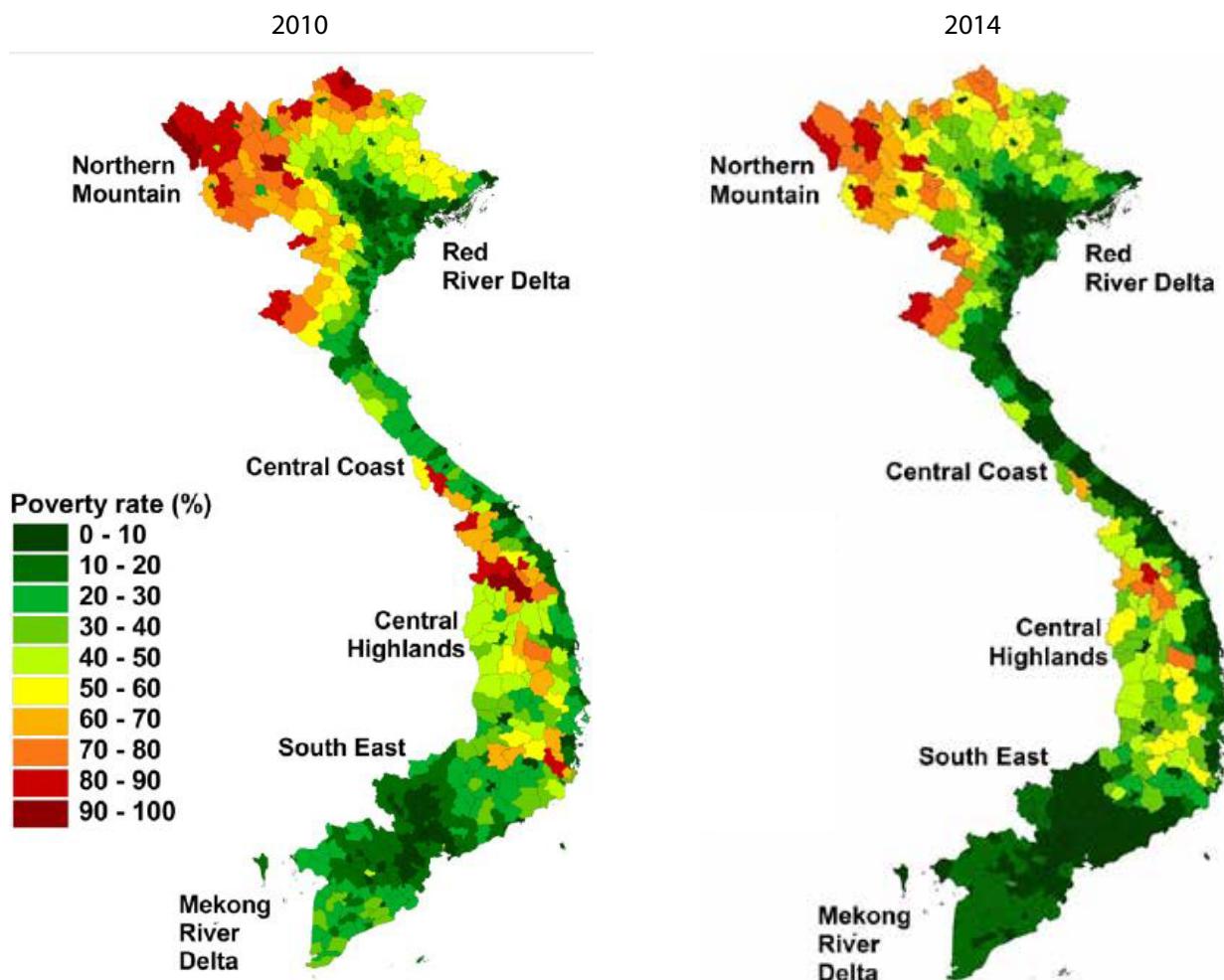
**Table 3: Where are the poor, near-poor, non-poor, bottom 40%, and top 60%?**  
**Shares of each group by location and ethnic group in 2014**

	All Population	Poor	Near poor	Non-Poor (Including near-poor)	Bottom 40%	Top 60%
Rural	66%	91%	82%	59%	84%	54%
Urban	<u>34%</u>	<u>9%</u>	<u>18%</u>	<u>41%</u>	<u>16%</u>	<u>46%</u>
	100%	100%	100%	100%	100%	100%
Major Urban	14%	2%	4%	18%	3%	22%
Other Urban	20%	8%	14%	23%	13%	25%
Ethnic Minority	14%	60%	20%	5%	30%	4%
Kinh and Hoa	<u>86%</u>	<u>40%</u>	<u>80%</u>	<u>95%</u>	<u>71%</u>	<u>96%</u>
	100%	100%	100%	100%	100%	100%
Red River Delta	22%	8%	17%	26%	17%	26%
East Northern Mountains	11%	24%	15%	8%	17%	7%
West Northern Mountains	3%	13%	4%	1%	6%	1%
North Central Coast	11%	17%	13%	10%	15%	9%
South Central Coast	8%	6%	8%	8%	7%	9%
Central Highlands	6%	14%	6%	5%	8%	5%
Southeast	19%	6%	11%	23%	9%	26%
Mekong Delta	<u>19%</u>	<u>14%</u>	<u>25%</u>	<u>19%</u>	<u>21%</u>	<u>18%</u>
	100%	100%	100%	100%	100%	100%

Source: World Bank staff analysis of VHLSS data.

Notes: “Major urban” areas are defined as urban communes of Hanoi, Ho Chi Minh City, Hai Phong, Da Nang, and Can Tho. Poverty calculations use the GSO-WB poverty line. The “near poor” population was estimated using a near poor line is 30% higher than the GSO-WB poverty line.

**The poor, the near poor, and the bottom 40 percent are found across the country but are substantially concentrated in rural areas.** The table above provides a snapshot for 2014 with a fuller breakdown of where various economic subgroups are located. The groups shown in this table include not only the poor but also the near-poor, the non-poor, the bottom 40 percent and the top 60 percent of the socioeconomic distribution (all measured using consumption data). The “near poor” using the definition employed here constitute 11 percent of the overall population. Less well-off Vietnamese are substantially concentrated in rural areas: 82 percent of the near poor and 84 percent of the bottom 40 are located there. Only very small numbers are located in the major urban centers (urban communes of the 5 largest cities), which are home to 2 percent of the poor, 4 percent of the near poor, and 3 percent of the bottom 40 percent. Large portions of the near poor are found in the Red River Delta and the Mekong Delta regions. Seventy percent of the bottom 40 are located in four regions: Red River Delta, Eastern Northern Mountains, North Central Coast, and Mekong Delta.

**Figure 8: Poverty Rates by District in 2010 and 2014**

Source: Lanjouw, Marra, and Nguyen (2013) for 2010 and SCD team analysis for 2014.

**District-level poverty maps from 2010 and 2014 illustrates the changing geographical profile of poverty.** It is evident in the maps that little change has taken place in poverty rates in the Central Highlands region. The spread of dark green shades in the Red River Delta, Central Coast, Southeast, and Mekong River Delta shows the decline of poverty to low levels in those areas. It is important to note that because population density is also high in those areas, they are still home to substantial absolute numbers of poor despite their low poverty rates.

**Over 2010-14, nearly half the poor moved out of poverty.** The table below shows movements over the period 2010-2014 between three groups: the poor, the near poor, and those that are neither poor nor near poor. This analysis is based on a panel of households followed over time between 2010 and 2014. A breakdown is shown by poverty status at the start of the period. More than half (54 percent) of the poor in 2010 were still poor in 2014, while 22 percent had moved to near poor, and 24% had moved up out of the ranks of both the poor and the non-poor. Among the near poor, 17 percent had fallen back into poverty, while 57 percent moved

out of the ranks of the near poor.<sup>5</sup> An analysis of correlates of changes in consumption (not shown) finds few variables that predict these changes. One notable exception is that ethnic minority households saw much smaller increases on average. Controlling for region and the household head's baseline demographic and employment characteristics, ethnic minority households in the bottom 40 percent had consumption growth that was 12.6 percent points lower than that of Kinh and Hoa households.

**Table 4: How many people move in and out of poverty over time?**  
**Poverty dynamics 2010-2014**

	Poverty status in 2010		
	Poor	Near poor	Neither poor nor near poor
Poverty status in 2014			
Poor	54%	17%	3%
Near poor	22%	26%	7%
Neither poor nor near poor	24%	57%	91%
	100%	100%	100%

<sup>5</sup> An important caveat to this discussion is that the movements here are in part driven by measurement error. The impact of measurement error is uncertain. Classical measurement error would exaggerate movements, suggesting that these results be taken as upper bounds on the actual rate of movement across categories.

**Table 5: Both the poor and wealthy have diverse livelihoods:  
Sources of income and own consumption patterns for various geographic and  
socioeconomic groups**

	Ag. enterprise	Non-ag. enterprise	Ag. wage	Non-ag. wage	Remit-tance	Public transfer	Other	Total	Own consump-tion in total consumption
All Vietnam	24%	17%	5%	38%	9%	3%	3%	100%	16%
Rural	33%	13%	7%	31%	9%	4%	3%	100%	21%
Urban	7%	23%	3%	53%	8%	2%	5%	100%	5%
Major urban	2%	21%	1%	61%	8%	1%	7%	100%	1%
Other urban	10%	25%	4%	47%	8%	2%	3%	100%	7%
Ethnic Minority	53%	4%	12%	21%	4%	3%	2%	100%	34%
Kinh & Hoa	20%	18%	4%	40%	10%	3%	4%	100%	13%
Poor	46%	4%	14%	20%	8%	6%	3%	100%	35%
Non-poor	22%	18%	4%	41%	9%	3%	3%	100%	13%
Near- poor	34%	11%	8%	32%	9%	4%	2%	100%	24%
Bottom 40%	36%	10%	9%	29%	9%	5%	2%	100%	26%
Top 60%	17%	21%	3%	43%	9%	3%	4%	100%	10%
Poorest quintile	42%	7%	12%	24%	8%	5%	3%	100%	31%
Quintile 2	31%	12%	7%	34%	9%	4%	2%	100%	21%
Quintile 3	25%	18%	5%	38%	9%	3%	2%	100%	14%
Quintile 4	19%	22%	2%	42%	9%	3%	3%	100%	10%
Wealthiest quintile	10%	22%	1%	49%	9%	2%	6%	100%	6%
Red River Delta	17%	19%	1%	45%	10%	4%	4%	100%	17%
East Northern Mountains	37%	13%	5%	34%	6%	3%	2%	100%	30%
West Northern Mountains	54%	9%	5%	26%	4%	2%	1%	100%	34%
North Central Coast	29%	14%	4%	34%	10%	6%	2%	100%	25%
South Central Coast	20%	18%	7%	38%	9%	5%	4%	100%	13%
Central Highlands	46%	13%	14%	19%	3%	3%	2%	100%	14%
Southeast	11%	19%	6%	51%	8%	2%	4%	100%	4%
Mekong Delta	29%	17%	8%	28%	11%	3%	4%	100%	12%

Source: World Bank staff analysis of VHLSS data.

Notes: Agriculture includes livestock, forestry, and aquaculture. The final column is the average share of total consumption that is made up of consumption of goods produced by the household.

**Across all socioeconomic and geographic groups, there are diverse sources of income.**

Income from family farming (agriculture excluding wages) accounts for a quarter (24 percent) of income for the average household nationally and 46% of income for the poor. Notably, wage income is substantial for all groups; wages constitute 34% of income of the poor, and most wage income for all groups is for non-agricultural work. Remittances (including gifts and other private transfers from both domestic and international sources) are a substantial share (8-10%) of income for almost all groups, with the notable exception of ethnic minorities, who have much lower migration rates. Public transfers constitute 6% of income for the poor and lower shares for higher income groups. A separate calculation shows that own consumption (consumption of goods produced by the household such as rice) constitutes a large share of household consumption for poorer groups. Specifically, own consumption is on average 35% of consumption for the poor and 26% of consumption for the bottom 40%.

**By 2020, nearly all remaining poor in Vietnam will be members of ethnic minority groups.** Poverty-growth elasticity calculations illustrate the very focused nature of Vietnam's poverty challenge. In recent years—as over the long term—economic growth has been strong associated with overall poverty reduction. This relationship is usefully summarized by the growth elasticity of poverty. Over the 4-year period from 2010 to 2014, the growth elasticity of poverty was reasonably high at 1.8, and over the most recent 2 year period, it was 2.3. However, the growth elasticity of ethnic minority poverty was only 0.65 for 2010-2014 and just 0.02 for 2012-2014.<sup>6</sup> If current patterns continue, by 2020, 84% of remaining poor, defined using the GSO-WB national poverty line, will be members of ethnic minority groups.<sup>7</sup>

**In summary, both over the long term and in the more recent period, Vietnam is a standout in both poverty reduction and shared prosperity.** Vietnam since 1990 has been perhaps the signature case in the developing world of “a rising tide lifts all boats.” The drivers of these achievements were a combination of rapid growth and job creation, inclusive service delivery, especially in health and education and use of Vietnam’s abundant natural resources. In the subsequent section these pathways and emerging opportunities and constraints associated with them will be analyzed in more detail.

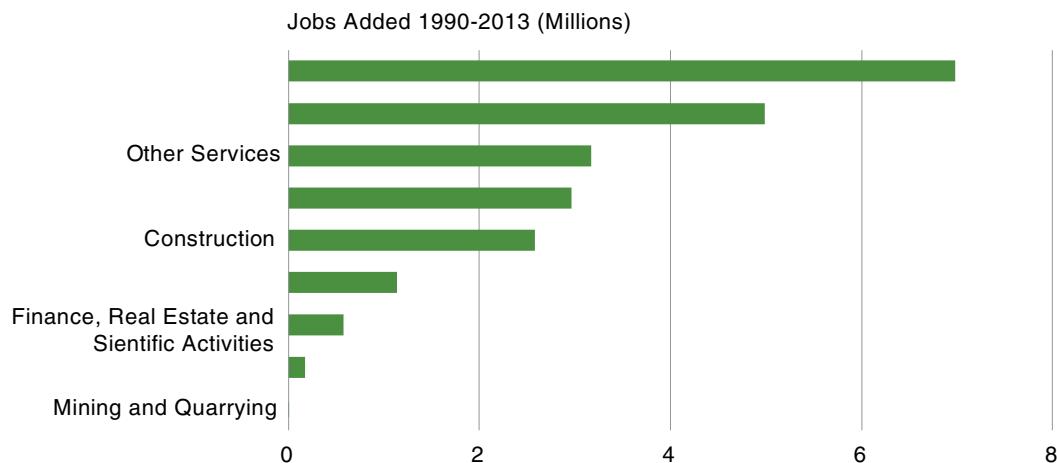
## 2. Inclusive growth and job creation

**Inclusive growth and job creation, especially of higher productivity jobs, has been one of the pathways to shared prosperity and poverty reduction in Vietnam.** As shown in the previous section, wages account for the largest share of income among the bottom forty and the poor. Overall, Vietnam’s impressive growth spurt over the past three decades was underpinned by the creation of over 20 million new, largely private sector jobs in labor-intensive manufacturing and services. While the vast majority, especially of the poor and lower income groups remain self-employed or work on family farms, expanding opportunities for productive employment and especially better-paid formal wage employment is one of the pathways to income growth and upward social mobility.

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<sup>6</sup> The growth elasticity of overall poverty is calculated here as the percentage decline in the overall poverty rate divided by the percentage change in GDP per capita. The growth elasticity of ethnic minority poverty is calculated here as the percentage decline in the poverty rate among ethnic minorities divided by the percentage change in GDP per capita.

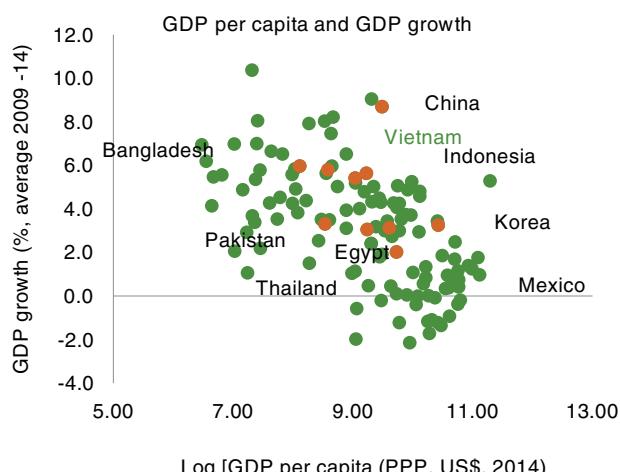
<sup>7</sup> This figure is based on a simple projection, assuming constant growth in GDP per capita and constant poverty elasticities, calculated separately for ethnic minorities and the Kinh/Hoa majority. A similar concentration of the poor among ethnic minorities using the \$3.10-a-day poverty line.

**Figure 9: Vietnam's growth has been job intensive**

Source: World Bank Staff based on official data

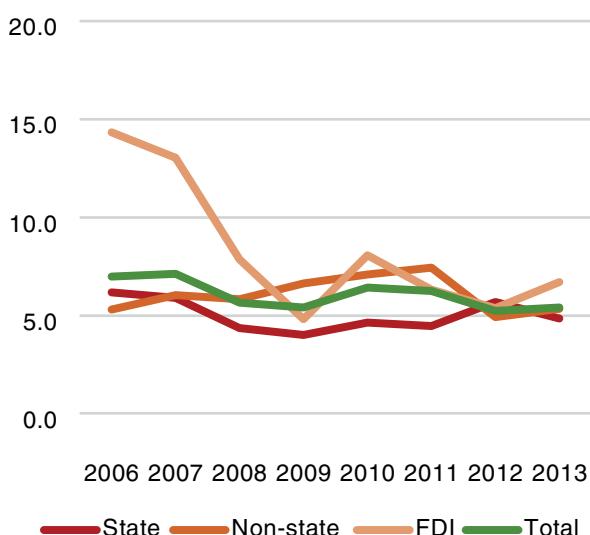
## 2.1 Drivers of rapid economic growth

**Almost thirty years after embarking on the transition from a centrally planned to a socialist-oriented market economy, Vietnam has emerged as a dynamic middle-income economy.** In 1986, Vietnam, then one of the poorest countries in the world, launched the economic renewal program known as Doi Moi. This marked the beginning of Vietnam's remarkable development success story. Per capita income has more than tripled since 1990, and during this period Vietnam enjoyed one of the highest sustained GDP growth rates in the World, second only to China. Despite moderation in recent years, Vietnam's growth record remains as one of the fast growing lower-middle income countries, outperforming all structural comparator countries, except China and Bangladesh. This rapid economic expansion of Vietnam's economy has been underpinned by four key transformations: 1) an institutional transformation from plan to market, 2) a structural transformation from agrarian to manufacturing and services, 3) a spatial transformation from rural to urban, and 4) a transformation from a large closed to an open export driven and globally integrated economy.

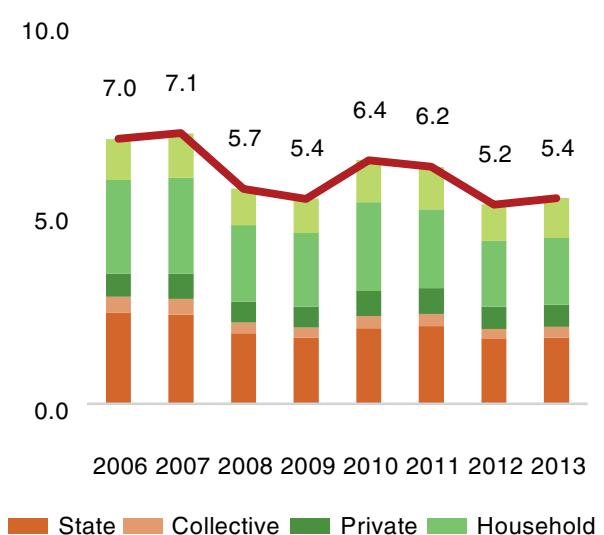
**Figure 10: Despite the recent slowdown Vietnam continues to grow faster than most other middle income countries**

## THE ENGINE OF GROWTH

**Figure 11: GDP Growth rates by Ownership**



**Figure 12: Contribution to GDP growth by ownership (percentage points)**



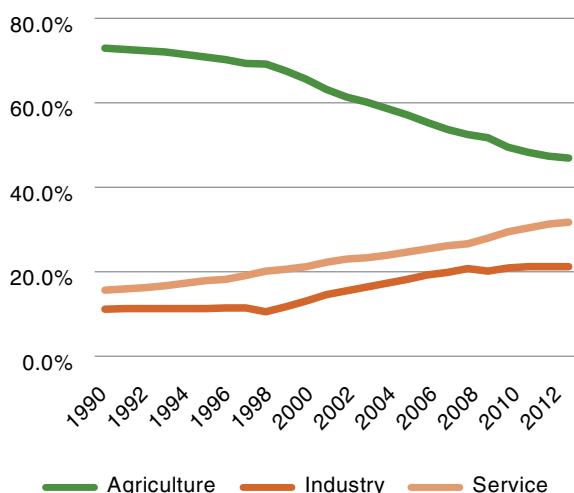
Source: World Bank Staff based on official data.

**First, Vietnam pursued a gradual transition from a centrally planned economy to a socialist-oriented market economy.** Initial reforms decentralized decision making, liberalized prices and increased the autonomy of individual firms, and largely replaced central planning with market-based resource allocation. Trade and foreign exchange controls were lifted, setting the stage for country's reintegration into the global economy. Early reforms of land use rights provided the basis for renewed agricultural growth. Driven by successive rounds of restructuring, liquidation, divestment and equitization, the number of enterprises fully owned by the state fell from over 12,000 in 1989 to fewer than 750 in 2014. Private sector enterprises—both domestic and foreign—sprung up since the early 1990s and especially after enactment of the Enterprise Law in 2000 which legalized private firm creation. There are over 650,000 domestic private enterprises registered today, compared to only 40,000 in 1999 and virtually none in 1990. The private sector has become Vietnam's main engine of economic growth, underpinned by a shift of productive resources to private enterprise. The non-state sector- including private, household, collective and foreign invested enterprises-on average contributed about 70 percent of Vietnam's growth over the last five years. For most years, growth rates of the non-state sector have exceeded growth in the state owned sector. Evidence at both the macro and micro levels confirm that there has been a major reallocation of production resources –both labor and capital- to private sector enterprises. Private sector enterprises have absorbed a growing share of banking sector credit, they have become more capital intensive, accounting for a rising share of investment and they have been the prime job creators. This shift in resource allocation has underpinned the rapid expansion of private sector.

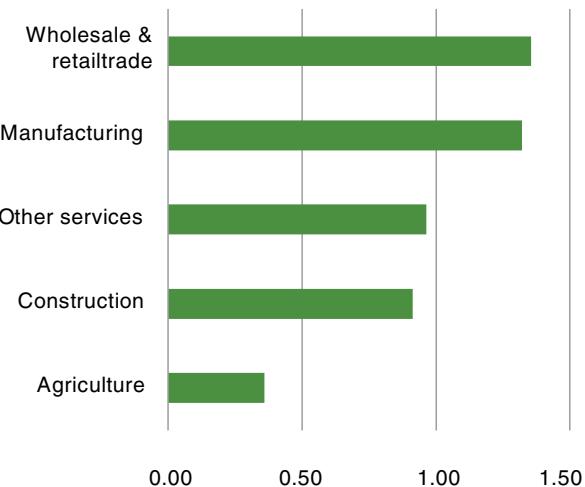
**Second, economic growth was driven by a structural transformation from a largely agrarian economy to one based on manufacturing and services.** In Vietnam, as in other East Asian economies, structural transformation has been at the heart of Vietnam's growth model. The shift out of agriculture has been dramatic, with the sector's share in GDP falling from over 40 percent in the late 1980s to less than 20 percent of GDP today. The share of manufacturing in GDP –after an initial dip– has been rising steadily since the early 1990s, leveling off at slightly less than 20 percent in the 2000s. Equally, service sector share has increased from just over 30 percent 1980s to slightly more than 40 percent today. These sectoral trends in GDP have been broadly matched by those in employment. Rapid job creation and rising wages in manufacturing and services has pulled an expanding share of Vietnam's work force away from agricultural production. This shift in employment to higher productivity sectors contributed about 40 percent of the labor productivity growth during 1990-2010. This rise of manufacturing and services was accompanied by gains in agricultural productivity in some regions of Vietnam which were underpinned by liberalized land use rights, increased mechanization and use of more modern production inputs.

### FROM FARMS TO FACTORIES AND SERVICE FACILITIES

**Figure 13: Employment Share by Sector**



**Figure 14: Sectoral Labor Productivity  
(Percent of Aggregate Labor Productivity), 2013**



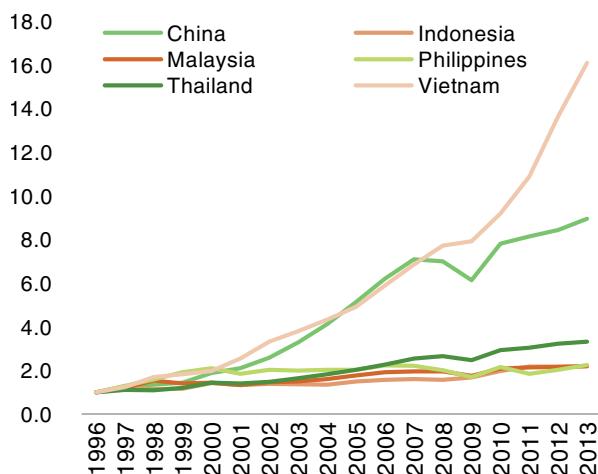
Source: World Bank Staff based on official data.

**Third, Vietnam's economic geography was reshaped by rapid urbanization.** Coinciding with Vietnam's growth acceleration and structural transformation, the country has urbanized rapidly as people moved from farming and related rural activities into more productive industrial and service jobs. In 1986, the country had fewer than 13 million urban residents; it now has 30 million. While accounting for only about one third of its population, urban areas—foremost its two major cities Hanoi and Ho Chi Minh City and their surrounding areas—are estimated to account for over half of Vietnam's GDP. By generating agglomeration economies and fostering innovation, Vietnam's cities and their surrounding areas have become drivers

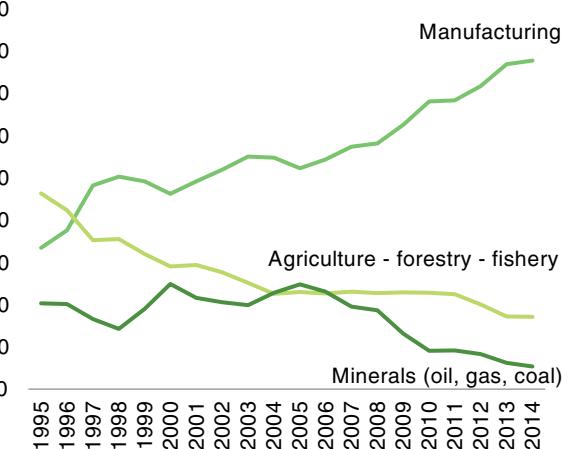
of rapid growth and contributed to the industrialization and modernization of the country. Labor productivity is higher in cities and especially in the two metropolitan areas, reflected in higher wage premiums (9 percent in Hanoi and 16 percent in Ho Chi Minh City) in addition to the 8 percent general wage premium for urban areas over rural areas.<sup>8</sup>

### RAPID EXPORT GROWTH AND DIVERSIFICATION HAS BEEN A DRIVER OF VIETNAM'S GROWTH MODEL

**Figure 15: Real export growth index, 1996=1**



**Figure 16: Share of total exports**



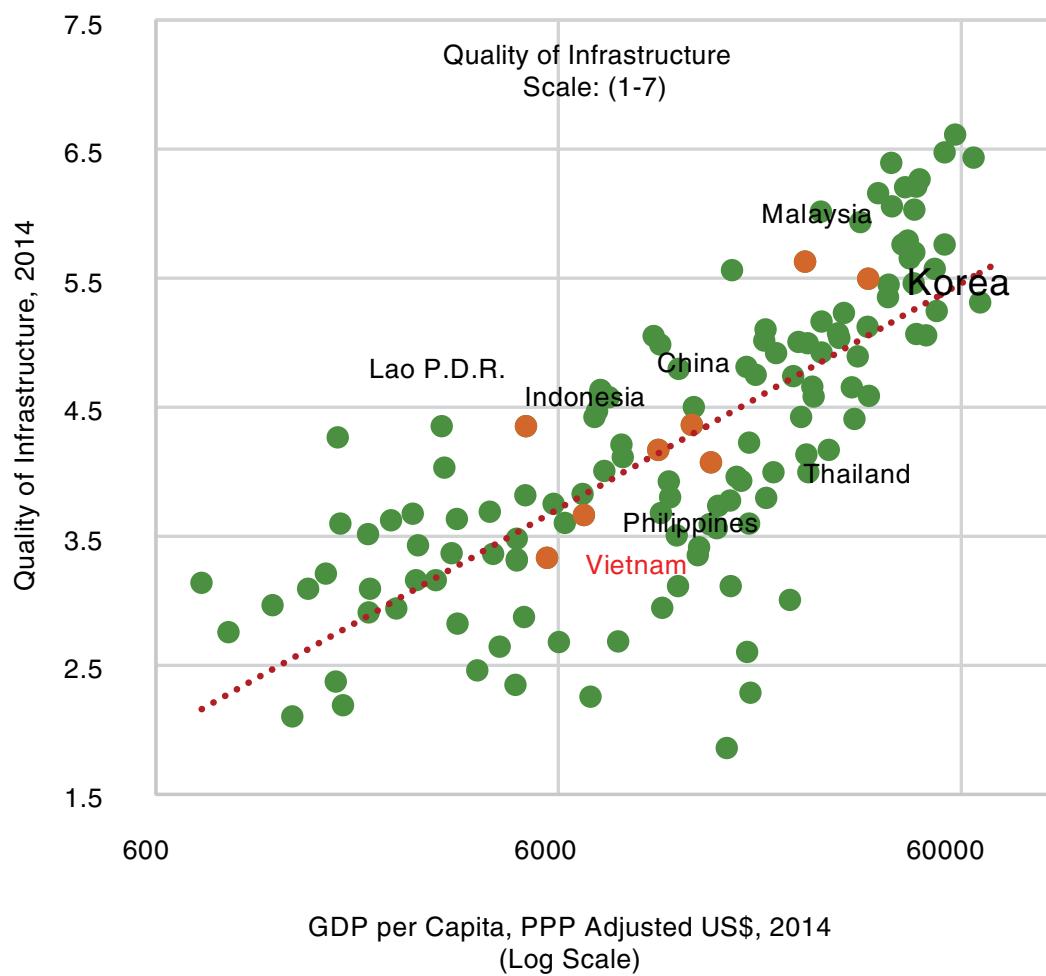
Source: World Bank Staff based on COMTRADE

**Fourth, Vietnam has successfully integrated into the global economy.** Largely isolated from international trade and investment flows at the onset of the reforms, Vietnam has become a major destination for inflows of foreign direct investment and a thriving export economy. With a trade ratio (exports plus imports) of 170 percent of GDP, Vietnam is today one of the most open economies in the World, strongly integrated in global value and production chains. This process has been underpinned by decisive trade liberalization. Vietnam acceded to the World Trade Organization (WTO) in 2007 and has signed 15 bilateral and multilateral trade agreements. Capitalizing on its comparative advantages in labor-intensive manufacturing, Vietnam attracted significant FDI which has expanded dramatically from 2.8 percent of GDP in the early 1990s to 14 percent of GDP in 2014. Meanwhile, exports grew at a blistering annual rate of more than 18 percent over the past two decades with imports trailing not far behind (reflecting high import content, significantly outperforming not only

<sup>8</sup> Preliminary analysis of 2014 Labor Force Survey by the SCD Team. These figures are derived from wage regressions controlling for job, sector, education, gender, and age.

global trade growth, but also regional peers. Perhaps more importantly, driven by foreign invested manufacturing and growing integration in global value chains, Vietnam's export basket underwent a spectacular diversification. Vietnam has become the second largest rice exporter in the world, as well as the second largest exporter of coffee, the top exporter of pepper and cashew, and an important supplier of fish and shellfish. In manufacturing, garment, footwear, and more recently, electronics assembly have grown at extremely rapid rates. Manufacturing exports now account for 84 percent, up from a little more than half in 2005. The growth of electronic equipment manufacturing —largely mobile phones — has been exponential as global companies like Samsung and LG have commenced assembly operations. Higher value exports, namely phones, computers and related components increased from less than 5 percent ten years ago to almost one third now. By the same token, the share of primary commodities decreased steadily. In particular, oil exports as a share of total exports have fallen significantly in the last decade—from nearly 23 percent in 2005 to 2.5 percent in 2015.

**Figure 17: Vietnam's infrastructure is on par with its income level, but will need to keep pace with rapid growth**

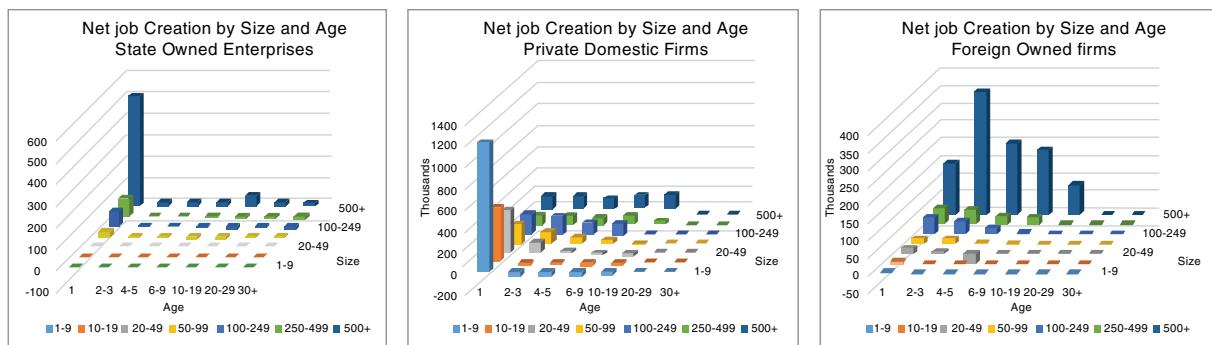


Source: World Bank Staff Estimates based on IMF WEO, World Bank and World Economic Forum

**Finally, Vietnam's growth performance has also been underpinned by significant infrastructure development.** Over the past decade, Government capital expenditures have averaged almost 8 percent of GDP annually. In addition, SOEs, including large infrastructure providers –including the electricity company EVN- have invested about 5 percent of GDP annually. This remarkably high level of investment has resulted in a rapid expansion of infrastructure stocks and improved access, enabling Vietnam to provide basic infrastructure access to its fast growing industrial and manufacturing base. Power generation, transmission, and distribution capacity has been scaled up to meet rapidly rising electricity demand with Vietnam's per capita electricity consumption more than tripling over the past decade. Concurrently, the total length of paved roads also increased more than three-fold from 30,000 km in 2000 to about 110,000 km in 2012. To keep pace with rapidly growing container trade (which expanded at a staggering average annual rate of 16.8 percent between 2000 and 2011), Vietnam also developed its seaports and marine terminals, especially around its main industrial centers of HCMC in the South and Haiphong in the North, alongside their respective satellite ports of Cai Mep and Cai Lan. Meanwhile, investment in rural infrastructure, foremost rural roads and irrigation systems contributed to inclusion and poverty reduction by boosting agricultural productivity and connecting farmers and rural communities to larger markets. Available evidence suggests that Vietnam's infrastructure quality is commensurate with Vietnam's income level and relatively few firms in Vietnam currently identify infrastructure as main constraints to growth.<sup>9</sup>

## 2.2 More and better jobs

**Vietnam's impressive growth spurt created 20 million new jobs. Overall, the employment elasticity of growth has been around 0.4 percent over the past 20 years.** Every 1 percent increase in output has been associated with roughly 160 thousand new jobs. Vietnam's economic transformation has been associated with dramatic shifts in labor demand. Of the approximately 20 million new jobs about half were added in service sectors and 5 million jobs were created in manufacturing. The vast majority of these jobs were created in the domestic private sector which accounts for 15 million jobs while the FDI sector –virtually non-existent in 1990- now employs 1.6 million workers. While jobs in Vietnam were once characterized entirely by family farming, collectives, and state-owned enterprises (SOEs), over time employment opportunities have shifted towards manufacturing and services, household enterprises outside agriculture, and private domestic and foreign-owned firms. In 1989, 71 percent of employed Vietnamese worked primarily in agriculture, fishing, or forestry, and private employment was almost non-existent. Today the share of agriculture, fishing, and forestry has declined to 46 percent of jobs, and only 1 in 10 workers holds a job with the state sector.

**Figure 18: Which firms create jobs?**

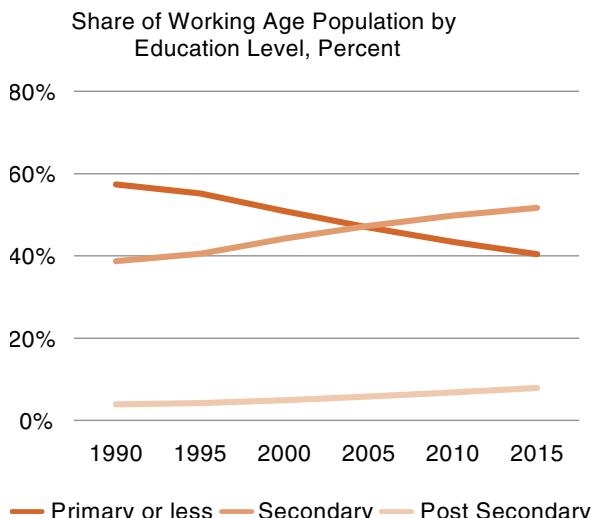
Source: World Bank Staff Estimates. Aterido, Hallward-Diremeier (2015)

**On the demand side, job creation in Vietnam has been driven by both entry of new firms and expansion of existing ones.** Firm level evidence suggests that net job creation (job creation minus job destruction) in the wage sector is largely driven by entry of new firms –including domestic and FDI firms with firm entry has accounted for more than half of the jobs created during 2005-13. Growth among existing firms also played a role in expanding employment opportunities but job creation is offset by incumbent firms shedding labor due to downsizing. There is some variation across different types of firms. Jobs in the domestic private sector firm are mostly created in small, relatively young firms, although small scale expansion also plays a role. In contrast larger firms and large and medium sized firms are the main job creators in the SOE and FDI sector, respectively. Overall, these patterns reflect the structural features of Vietnam’s enterprise sector where the domestic private sector is dominated by small and micro enterprises with relatively few larger establishments.

**On the supply side of the labor market Vietnam benefited from steady labor force growth which was compounded by early investment in human capital.** In addition to the growing working-age population which boosted labor supply by an average of 2.5 percent per year over the past two decades, expanding educational attainment of the workforce has contributed to the shifts in the labor market. Vietnam’s early effort to promote access to primary education for all and to ensure its quality through centrally setting minimum quality standards has paid off. The share of Vietnamese without or with only primary education has declined significantly and more than half of the workers, especially in professional and technical occupations, now have secondary and higher degrees.<sup>10</sup>

10 Vietnam’s accomplishments and challenges in regards to education are treated under the pathway 2 section of the report.

**Figure 19: The education level of the labor force has expanded...**



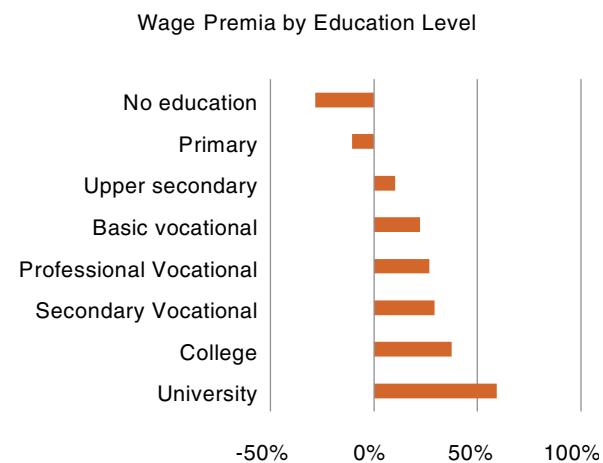
Source: World Bank Staff based on official data, Wittgenstein Institute Global Human Capital Database and Labor Force Survey.

**Despite expanding human capital, demand for well-educated workers remains strong.** While the large increase in the number of lower and upper secondary graduates has eroded the wage premium at these lower levels, is particularly noticeable at the top end of the education distribution, where the number of college graduates has expanded significantly but not enough to keep up with demand. While upper secondary graduates in wage work could expect to earn only 10 percent more than lower secondary school graduates, high returns to vocational, and especially college and university education indicate that workers with advanced education levels remain in short supply. This is true despite ample room for improvement of the quality of tertiary education. Indeed, the World Bank Enterprise Survey 2015 identifies skill shortages as one of the top three constraints to business expansion in Vietnam.

**A growing share of the labor force holds wage jobs.** Analysis of the labor force survey (LFS) suggests that wage employment has increased from only 32% of the total labor force in 2007 to 38% of the labor force in 2014. The increase in wage employment was driven by wage employment with contract, especially in private domestic and FDI firms. Formal sector wage employment in total labor force increased from only 18% in 2007 to 23% in 2015.<sup>11</sup> Formal employment (with contract) in the wage sector is associated not only with higher incomes but a number of other benefits such as health and social insurance. Education level matter significantly in terms of access to wage and in particular formal wage jobs.

**Women and ethnic minorities are less likely to hold wage jobs and are paid less.** Controlling for observable characteristics, women are 9% less likely to hold a wage job than

**Figure 20: ...but demand for skilled labor remains strong**



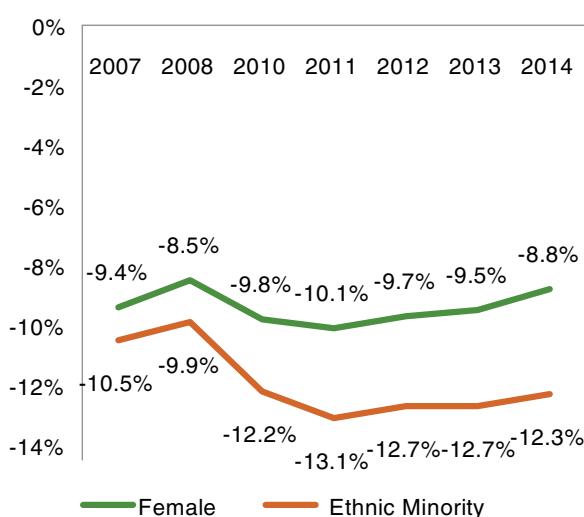
<sup>11</sup> In the wage sector, there is a large overlap in the characteristics usually associated with formal jobs. Out of all workers in the wage sector, 59% have a written contract, 51% have health insurance and 50.2% have social insurance. Almost 50% of the total wage workforce reports to have a written contract and be covered by both health and social insurance, while 38.3% of the workforce in this sector reports to be employed in a job with none of these characteristics.

men, and ethnic minorities are 12% less likely than members of the Kinh and Hoa ethnic group to hold wage jobs. These differences have been roughly flat over time. Among those who hold wage jobs, ethnic minorities face a “wage penalty” of 7%. The wage penalty faced by women is 13% and has steadily declined in recent years.<sup>12</sup>

**The forthcoming Country Gender Assessment provides a highly focused analysis of gender and employment.**<sup>13</sup> It notes that women form a large share of unpaid family workers, particularly in agriculture. The Assessment also points out that only 6 percent of households in the poorest quintile have access to tap water at home and that women and girls are typically responsible for obtaining and treating water. Women with wage jobs have more favorable working conditions than men on average, reflecting the fact that a large share work either in the private sector or foreign-owned firms. Women with wage jobs are more likely to have a written contract than men with wage jobs. The study also notes that employment growth has been substantial in manufacturing sectors that have employed substantial shares of women since their inception (such as garments) and also in sectors that have become increasingly intensive in the employment of women over time (notably electronics and motor vehicles), suggesting that the growth of manufacturing is expanding job opportunities for women. The Assessment also highlights the gap between female and male earnings.

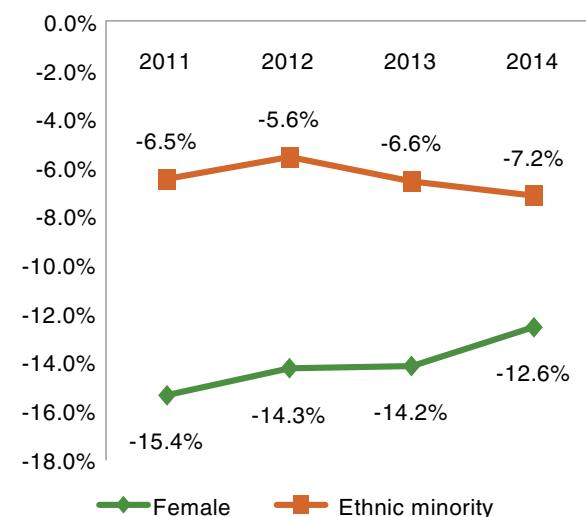
**Figure 21: Women and ethnic minorities are less likely to hold wage jobs than similar men**

**Relative probability of holding a wage job for women and ethnic minorities**



**Figure 22: Women and ethnic minorities with wage jobs are paid less, but the gap for women is closing**

**Wage premia for women and ethnic minorities**



Source: Demombynes and Testaverde (2016) based on analysis of Labor Force Survey data.

Note: Figure (a) shows estimated marginal effects for female and ethnic minority dummy variables from probit regressions of employment, with controls for education, a quadratic in age, urban/rural, and region.

Figure (b) shows coefficients on female and ethnic minority dummy variables from regressions of log wages with controls for education, a quadratic in age, urban/rural, and region.

12 Demombynes and Testaverde (2016)

13 *Towards gender equality in Vietnam: Making inclusive growth for women*, UN Women Vietnam (forthcoming)

**Table 6: Education is a pathway to better jobs and hence shared prosperity**

	Effect on probability of having wage job	Effect on probability of having wage job w/written contract
Upper secondary	6.7%	11.8%
Secondary Vocational	29.4%	38.3%
Professional vocational	41.5%	52.3%
College	49.9%	62.4%
University	56.1%	72.2%

Source: World Bank staff analysis of 2014 Labor Force Survey data.

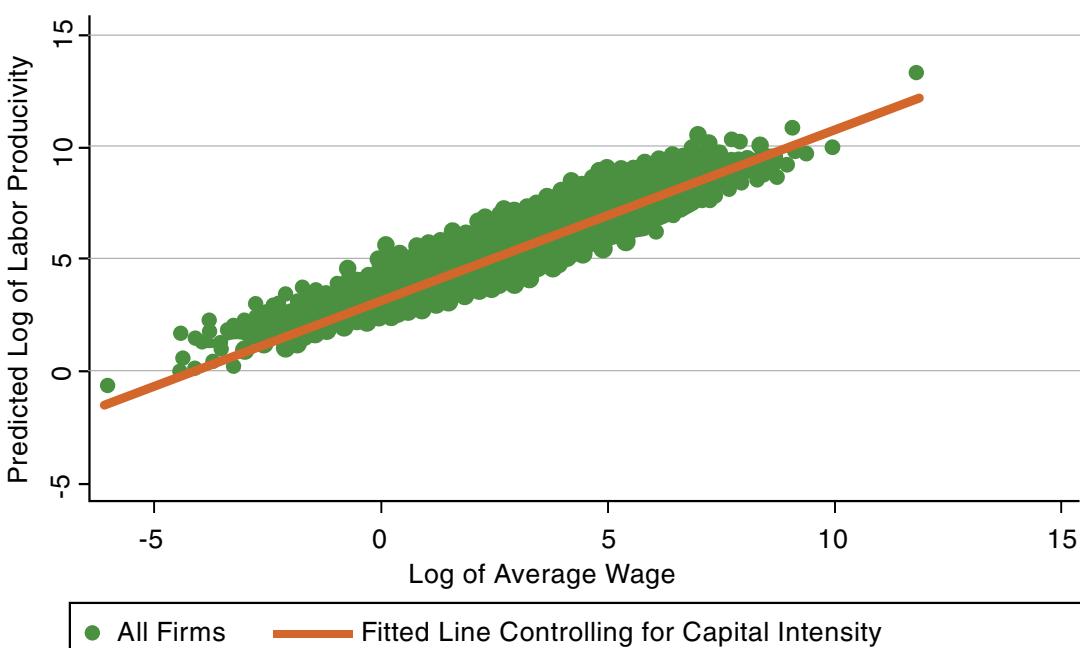
Note: Effects are estimates from regressions controlling for a quadratic in age, gender, ethnic minority status, and region. All probabilities are relative to a lower secondary graduate.

**Human capital investment is not only a driver of aggregate growth, but also determines pathways to prosperity.** At the individual level, the education level is strongly correlated with the probability of wage employment and especially formal wage employment which tends to pay higher wages. As such, enabling higher educational attainment is pathway to achieving shared prosperity. Against this background, uneven access across income groups at the upper secondary and higher levels is not only constraining skilled labor supply but also poses constraints to social mobility.

**Figure 23: More productive jobs pay better**

Labor Productivity vs. Average Wage

Enterprise Sector - Vietnam - 2001-2013



Source: World Bank Staff based on enterprise census

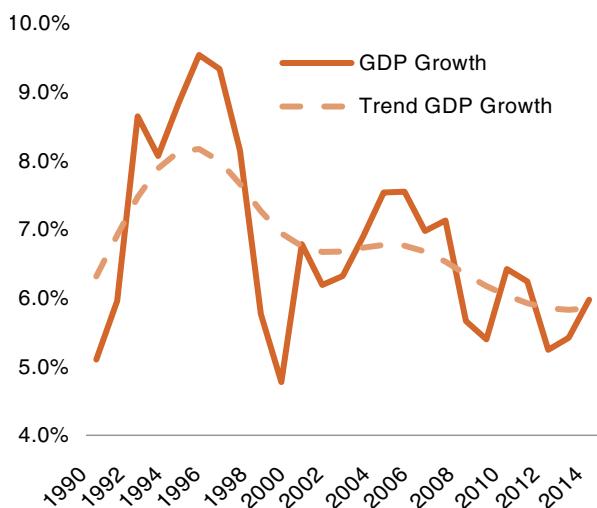
**More productive jobs pay higher real wages and are thus a critical precondition for rising living standards.** Differences in wage growth within and across countries can be traced largely to different rates of labor productivity growth. Indeed, firms with higher labor productivity in Vietnam tend to pay higher average wages to their employees. The issues of creating an environment conducive to labor productivity growth is therefore intrinsically linked to the question of sustaining progress in achieving the World Bank's twin goals of reducing poverty and boosting share prosperity.

**Creating more and more productive jobs is therefore the cornerstone of the inclusive growth strategy.** On the demand side, further job creation will require Vietnam to sustain high growth rates which is in turn related to the ability to create an environment conducive to higher productivity growth, driven by a dynamic private sector and further global integration. On the supply side, the agenda is about enabling a responsive education system, especially at secondary and post-secondary levels (vocational and tertiary) that can provide qualifications and skills that are relevant to evolving labor market demands. Boosting skilled labor supply and human capital accumulation is particularly important against the background of slowing labor force growth. After achieving universal primary education, Vietnam is now moving towards universal secondary education. Institutionally, reforms to education governance, financing and delivery mechanisms, including more provider autonomy, competition and involvement of private providers can help boost efficiency, quality and relevance.

### **2.3 Emerging constraints to the current growth model**

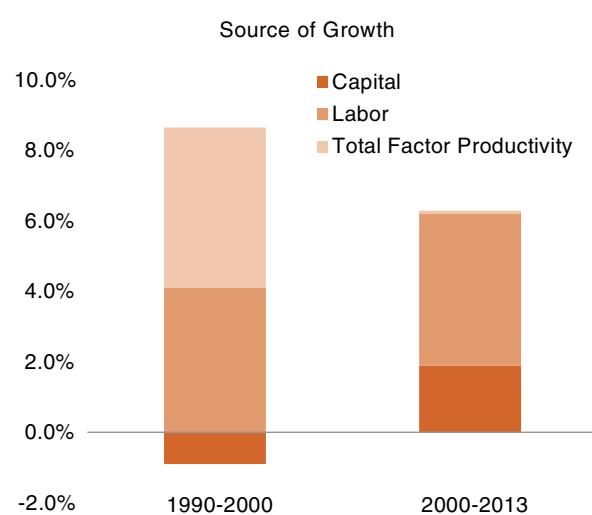
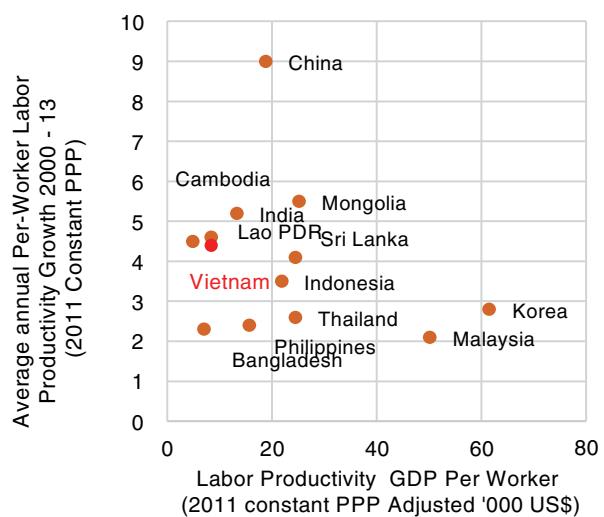
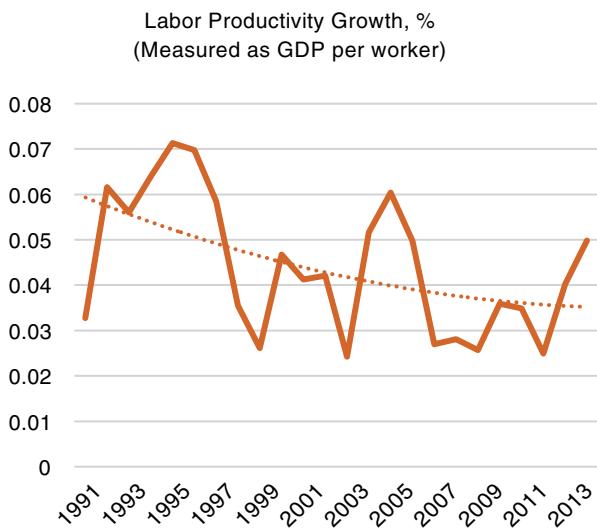
**Vietnam's economic success notwithstanding, there are concerns about whether the current growth model can sustain past performance.** Economic growth has moderated in recent years. During 2008-14 GDP growth averaged about 6 percent annually, still almost two percentage points above the average growth rate of lower middle income economies during this period (4.1 percent). This slow-down partly reflects cyclical factors and a weaker global economy but there are also emerging structural constraints that may be holding back Vietnam's growth. Addressing these constraints is a crucial precondition for Vietnam to meet its full potential not only in terms of aggregate economic growth but also in terms of tackling remaining poverty challenges and achieving shared prosperity.

**In recent years, Vietnam experienced recurrent macroeconomic and financial sector turbulence.** While volatility originated from external developments—an unprecedented economic boom caused by massive foreign capital inflows, followed by an external demand shock triggered by the global financial crisis—the episodes of economic disturbances were exacerbated by sharp swings in the macroeconomic policy stance, erratic credit growth and asset price bubbles in the real estate sector. Inflation spiked twice in 2009 and 2011 coinciding with a marked slow-down in growth. While macroeconomic stability has been restored the economy still suffers from vulnerabilities built up as a by-product of past crises. Lingering problems in asset quality and unresolved non-performing loans (NPLs) remain a drag on the bank's balance sheets and pose a risk to macroeconomic stability and undermine the ability of banks to provide long term financing needed for development. Indeed, access to finance is the most common constraint to business expansion, cited in the 2015 World Bank Enterprise Survey. At the same time, the need to address large fiscal deficits and rapidly rising public debt will constrain public finances in years to come.

**Figure 24: Growth has slowed...**

Source: World Bank Staff based on official data.

**Economic growth has not just decelerated but the underlying growth model changed.** While productivity growth was the main driver of GDP growth in the early years of Vietnam's transition, the contribution from productivity growth declined drastically over the past decade. Growth accounting across a range of assumptions presents a picture of generally low rates of total factor productivity growth in the last decade. Instead growth became almost exclusively reliant on factor accumulation, underpinned by a rapidly expanding labor force and high investment rates, especially in the run up to the 2008/09 global financial crisis. While this growth model has delivered solid growth rates, there are reasons to believe that the accumulation of labor and capital is waning in its power to propel future growth.

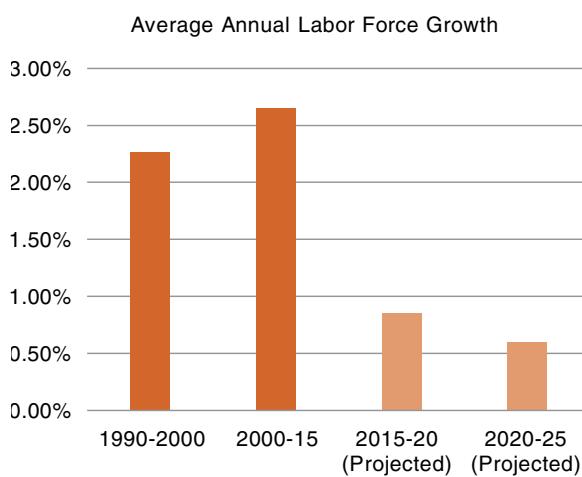
**Figure 25: ...and is driven by factor accumulation with limited contribution from productivity growth****Figure 26: Vietnam's labor productivity growth has stagnated**

Source: World Bank Staff based on official data and Asian Productivity Organization

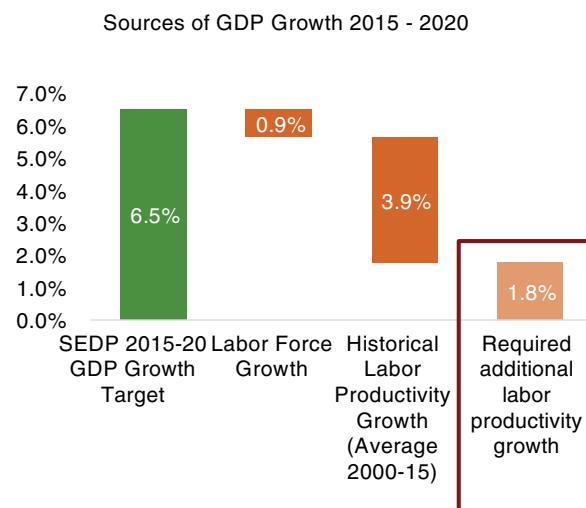
**Vietnam's demographic dividend is starting to dissipate.** In recent decades Vietnam reaped a significant demographic dividend. Since 1990 almost 25 million Vietnamese have come of working age. This greater labor supply translated into average annual labor force growth of about 2.5 percent, almost doubling Vietnam's work force between 1990 and 2013. Indeed, about one third of Vietnam's historical average GDP growth rate (6.7 percent) can be attributed to the expanding work force while two-thirds traditionally came from labor productivity growth. However, looking ahead, this demographic dividend will start to dissipate and potential employment growth is expected to decline due to demographic factors. In coming decades Vietnam will become one of the fastest ageing societies in the world with significant implications for the labor market, fiscal policies, public services and growth. While the working age population and labor force will continue to expand for another two decades, the rate of increase will be markedly lower--about half of the recent historical average. In fact the working age population is already in decline as a share of the population. Furthermore, the already quite high labor force participation rate (around 77 percent) implies limited reserves to boost aggregate labor supply.

**This means Vietnam will need to boost labor productivity to sustain high growth.** GDP per employed person more than tripled between 1990 and 2015—reflecting a combination of improved agricultural efficiency and a rapid shift of employment out of low productivity agriculture into higher productivity non-farm jobs. However, following a bout of labor productivity growth after the initial liberalization of the economy, Vietnam's labor productivity growth has levelled off just shy of 4 percent over the past decade. While this is close to other emerging economies in Asia at Vietnam's current productivity level (and high by comparison with emerging economies in other parts of the world), it is less than half of China's labor productivity growth. Against the backdrop of slowing labor force growth, the current rate of labor productivity growth would not be sufficient to lift Vietnam's potential growth rate to the levels targeted in the SEDP.

**Figure 27: A lower demographic dividend...**



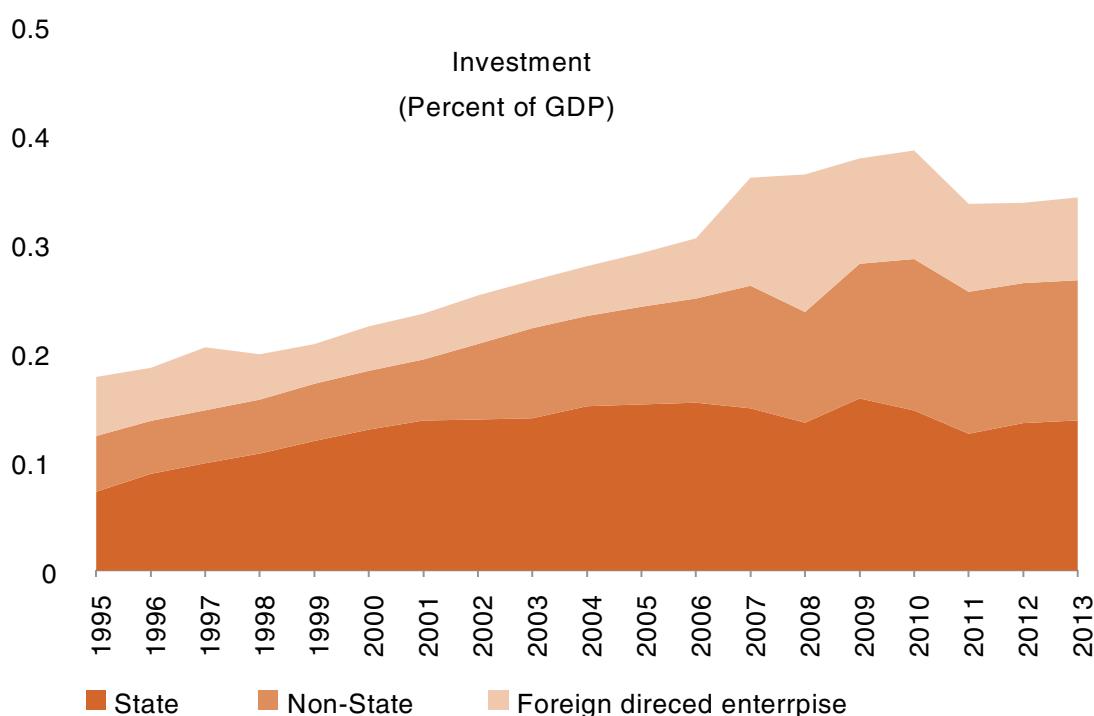
**Figure 28: ... requires productivity gains to sustain growth**



Source: World Bank Staff based on official data

**Vietnam's high savings and investment rate has been an increasingly important driver of economic growth.** Because it is a relatively capital-scarce economy, Vietnam's growth path has been underpinned by a rapid accumulation of the capital stock. Vietnam's investment rate more than tripled from less 10 percent in the early 1990s to now about 30 percent of GDP, markedly higher than the average investment rate of 23 percent in other lower middle income economies. Capital accumulation became a major growth driver, accounting for about one third of Vietnam's GDP growth over the past decade. The growth in investment has been faster in the private sector than in the state sector, with the domestic private sector being the strongest performer (both in absolute and in relative terms). As a result, the composition of investment has changed dramatically since the acceleration of economic reforms. In 2001, the state sector accounted for almost 60 percent of total capital accumulation in Vietnam, with the rest divided roughly equally between FDI companies and the domestic private sector. While public investment, by both the general government and state owned enterprises remains high—together accounting for about 40 percent of total investment, it was rapid growth of domestic private sector investment, fueled by rapid credit growth (about 40 percent of investment) and significant and rising FDI inflows (about 20 percent of investment) that boosted Vietnam's investment rate. Indeed, firm level evidence confirms rising capital intensity of domestic private sector firms.

**Figure 29: While public sector investment remains important, the private sector share has been expanding rapidly**



Source: World Bank Staff based on official data.

**Meanwhile, the rates of returns to investments have deteriorated, partly reflecting diminishing returns, but also pointing to inefficiencies in the allocation of capital.** Declining returns to investment mean that it takes more and more investment to generate the same growth impact. Returns are expected to decrease gradually as the capital stock of the economy expands and the most urgent gaps are addressed. However, the rapid decline experienced by Vietnam is unlikely to be the sole effect of a relative abundance of capital; especially because infrastructure and capital needs remain substantial in Vietnam. Rather it is at least in part a question of whether additional capital is being allocated to the sectors, activities and projects that generate the highest returns.

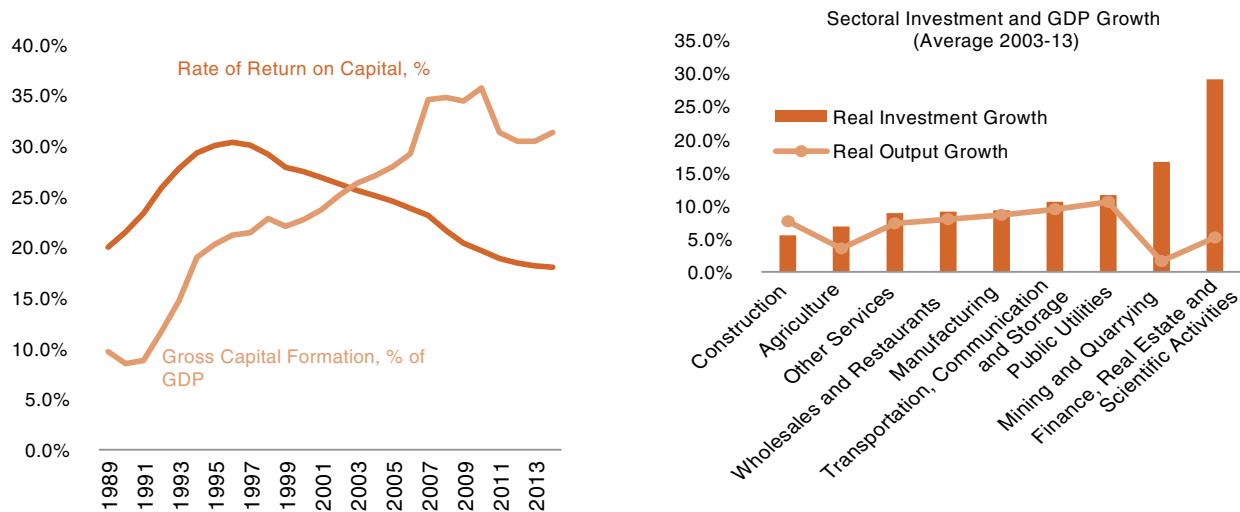
**Investment from the state budget and SOEs is fragmented.** While sustained public investment has led to rapid expansion of infrastructure, investment efficiency is hampered by lack of coordination in an increasingly devolved intergovernmental fiscal system. Provincial governments -which now account for about 80 percent of total state budget investment- and SOE tend to select and undertake their own infrastructure projects often in isolation, without employing a strategic approach linked to national priorities and with little regard to supply-demand considerations. Against the backdrop of increasingly tight fiscal constraints a focus on efficiency, value for money and asset management is crucial to enable effective public investment in growth enhancing infrastructure.

**Meanwhile the growth performance of the domestic private sector has not been commensurate with its command of an increasing share of capital and investment.** Private sector firms have become increasingly capital-intensive over time, yet returns on capital have eroded–albeit private sector capital productivity seems to remain above the state owned sector.<sup>14</sup> Distorted price signals have caused capital to flow into speculative sectors and fueled asset price bubbles, rather being deployed in expanding productive capacities. For example, real estate investment expanded by 29 percent per year on average in real terms over the last decade while average annual output growth in the sector was a meager 5.2 percent over the same period.

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<sup>14</sup> Notably, the recent credit boom was driven by an expansion of lending to the private sector. While the credit portfolio of some SOCBs remains heavily tilted towards the SOE sector, the overall share of SOE in total credit has declined in recent years from about 30 percent in 2007 to around 16 percent. This is mirrored in firm level data, that suggests that private sector firms –which had traditionally been subject to financing constraints - significantly increased their leverage ratios (consistent with the rising share of the domestic private sector in total investment during this period). However, rather than financing productivity and growth enhancing investments, a large portion of lending went into speculative sectors, such as real estate. Meanwhile some poor performing SOEs remain highly leveraged, poses significant exposure to the SOE sector and a continued risk to the banking sector.

**Figure 30: The investment boom was associated with declining capital productivity**

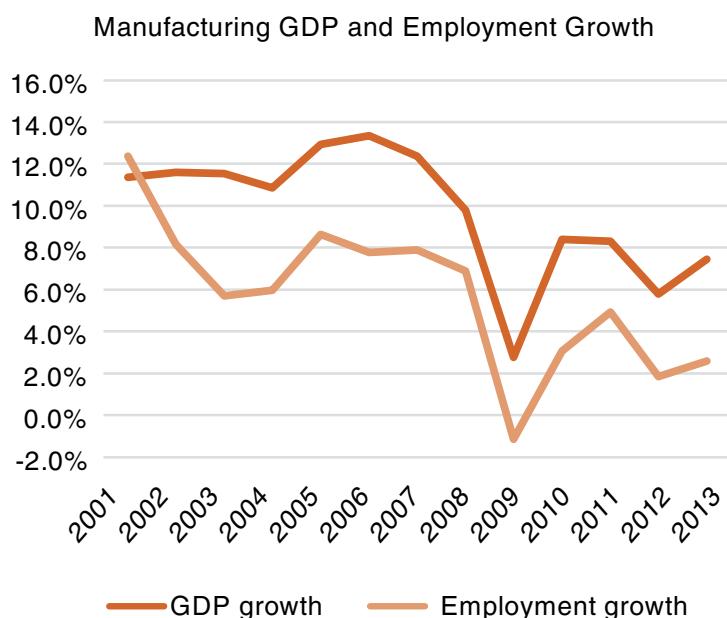


Source: World Bank Staff based on official data.

**Moreover with the investment rate already high, further accelerating capital stock growth is becoming challenging.** Vietnam's savings and investment rates are high by international comparison. While investment is expected to remain an important growth driver, raising the investment rate substantially above the current levels is not likely to be feasible, especially since domestic private and public investment are constrained by crisis legacies, financial sector weaknesses, and relatively high public debt. Rather the focus should be on providing incentives for higher investment efficiency to revive returns both in the public and the private sector.

**Declining productivity growth is a symptom, rooted in rising inefficiencies in resource allocation and deployment in the economy.** Productivity growth reflects patterns of resource allocation across enterprises, between and within industries. This points to deeper questions about what is holding back a more efficient allocation and use of Vietnam's abundant production factors.

**Figure 31: The rate of manufacturing job creation has slowed down, dampening structural transformation**



Source: World Bank Staff based on official data.

**While the potential productivity gains from reallocating resources across sectors remain substantial, structural transformation has slowed.** With agriculture still accounting for almost half the labor force, and with significantly lower labor productivity than the industrial and services sectors, future gains from structural transformation remain substantial (even if not as great as before). Labor productivity in agriculture is only about 40 percent of average labor productivity, in part due to underemployment. How rapidly structural transformation will continue will mostly depend on the pace of job creation in services and manufacturing. The contrasting experiences of other countries in the region is instructive. China had a similar share of agriculture in employment (47%) in 2004, yet by 2011 this had fallen to 35%. In contrast, it took two decades (1993-2012) for agriculture's share in employment to fall from 46% to 32% in the Philippines. Slow change is also evident in Thailand with the share of agriculture in employment falling only from 46% to 40% between 2001 and 2012. Outside East Asia, Turkey nearly halved its agricultural employment share (from 47 to 24%) over two decades (1990 to 2010).<sup>15</sup> Sufficient job creation in services and manufacturing is a precondition to generate demand and pull more workers from agriculture. However, tracking slower manufacturing output growth since 2008, the rate of job creation has slowed down as well. Manufacturing jobs expanded at about same rate as labor force growth keeping the share of manufacturing employment in total employment flat at around 20 percent over the past 5 years.

<sup>15</sup> Vietnam Development Report 2016, Transforming Vietnamese Agriculture: Gaining More from Less. April. Washington, DC: World Bank.

**At the same time, labor productivity in agriculture remains low.** Aggregate land productivity (measured as value added per ha of agricultural land), increased rapidly in the 1990 and is higher than most regional peers. However, aggregate patterns for labor productivity in agriculture show a less favorable picture with both productivity levels<sup>16</sup> and growth rates lagging behind most regional peers, although there is a lot of variation within Vietnamese agriculture across regions and farming systems. Productivity of other inputs, including water, fertilizers and pesticides also point to some inefficiencies when benchmarked against regional comparators. The relative resource intensity of Vietnam's agriculture is a concern both in terms of growth and competitiveness but also from the point of view of sustainability (discussed in more detail under the third pillar). Administrative controls on land, and direct state involvement in both input and output markets, were important factors in the sector's stability and inclusive growth over recent decades. Yet these policies and institutional legacies seem to now be delaying further transformation of the sector. Agricultural land consolidation remains at an early phase due in large part to a lack of functioning land and land lease markets. Shifts in land use patterns (towards higher value crops) have also been relatively slow reflecting administrative land use controls that favor rice production. Land consolidation and more market driven land use will be critical to enable mechanization and crop diversification and hence productivity gains. In parallel tackling the challenges of food quality and safety, factor productivity, pollution, resource scarcity, and climate change, will rest heavily on a dynamic agricultural innovation system that is capable of generating responsive technical and management solutions, and ensuring their diffusion across the sector.

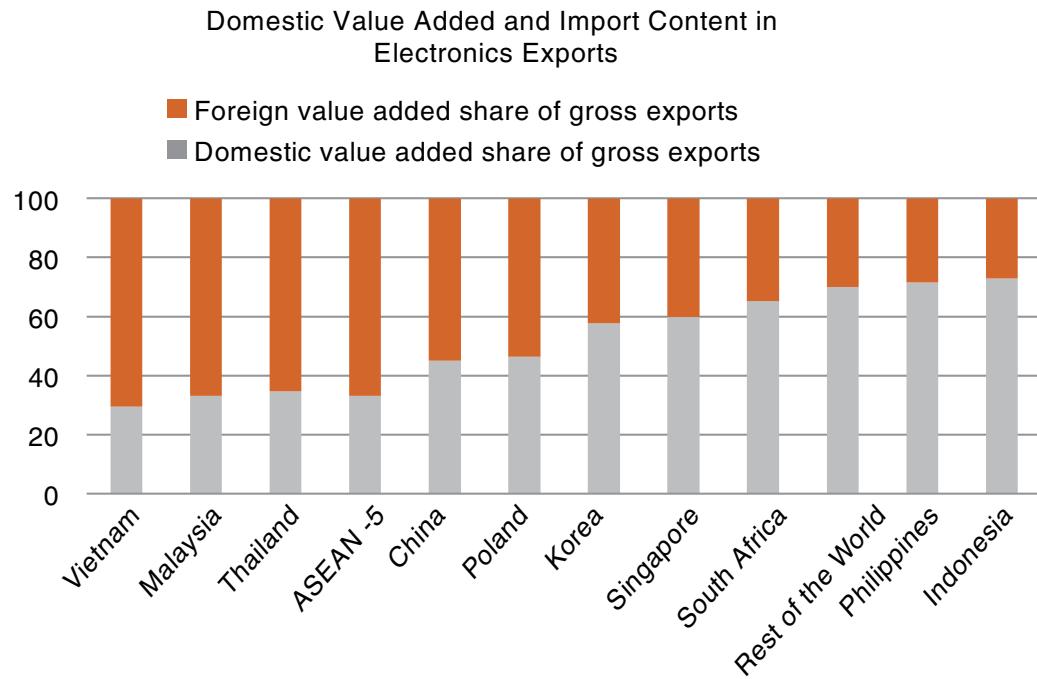
**Outside agriculture, within sector and firm productivity growth was dampened by a combination of incomplete restructuring of the state owned enterprises and a weak domestic private sector.** Over the past two decades, Vietnam has gradually reduced the footprint of state owned enterprises in the economy. While their relative importance has declined significantly (reflecting a combination of restructuring of the SOE sector and rapid growth of private sector enterprises), state owned enterprises still account for about one-third of all business assets and one quarter of output in the enterprise sector. SOEs remain dominant players in several sectors including fertilizer, coal, utilities, banking, rubber and plastics, and construction sectors. Many SOE enjoy preferential access to resources and may also benefit from favorable regulatory frameworks and enforcement. Natural resource producers like Petro Vietnam and Vinacomin have exclusive access to mineral reserves. Others, such as EVN, Vinalines and Vietnam Airlines operate in highly regulated markets, giving them significant advantages over private and foreign-invested companies. Fragmented and sometimes overlapping responsibilities in the management of SOEs and weak corporate governance all undermine efficient use of resources in the state owned sector and the SOE sector has been lagging performance. Growth rates have been consistently lower than private sector, although the gap has narrowed substantially since global financial crisis. Controlling for capital intensity –reflecting the fact that many SOE are capital intensive- shows that the average labor productivity of SOEs is about 40 percent lower than the private sector. As such, weak productivity of SOEs continues to act as a drag on economic performance.

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<sup>16</sup> In part lower labor productivity may be caused by statistical measurement problems related to underemployment and seasonal employment in agriculture which may result in over reporting of labor input in the sector (compared to other sectors).

**Despite having become a major engine of growth and job creation, the domestic private sector is facing its own set of constraints.** Following the 2002 enterprise law there has been rapid private firm creation. However most domestic private firms are small. Household enterprises and corporates account for over 70 percent of private sector firms. Production is dominated by family farms in agriculture and small workshops in manufacturing. Most of these firms are inward oriented, serving the domestic market. Only about 17 percent of domestic private sector firms are directly engaged in export activities. Many of these firms simply lack the scale, access to technology and competitive pressure needed to boost productivity and few of these enterprises ever reach medium size. As a result, larger, technologically more advanced firms engaging in manufacturing and higher value services linked to export markets and global value chains are largely missing. Most of the few Vietnam's existing medium and large domestic firms —many of them either SOEs or closely connected to the state sector —are engaged mostly in property development and finance where they are able to capitalize on preferential access to state-controlled land, capital or licensees.

**Figure 32: High import content**



Source: World Bank Staff based on data in TiVA (Trade in Value Added) (database), Organisation for Economic Co-operation and Development.

**Despite the country's exceptionally strong export performance, the domestic value contribution in key exports is low and the linkages of domestic firms to global value chains are weak.** In key exports, Vietnam's domestic value added is relatively shallow. For overall manufacturing domestic value added is only about 51 percent but it is even lower (about 30 percent for high value products such as electronics). In part this reflects the nature of cross border supply chains and in part a dual track economy. On the one hand there are export oriented foreign invested firms, which are closely integrated in global supply chains. While accounting for less than 10 percent of Vietnam's GDP, these enterprises produce 70 percent of Vietnam's export value and account for 60 percent of its imports. On the other

hand, there are domestic firms which are largely inward oriented and serving the domestic market. The linkages between these two segments are very limited. As such, the FDI sector operates in isolation rather than serving as a broader catalyst for growth, with limited spillovers to the domestic private sector in the form of increased demand for inputs, access to new technology and managerial techniques, demonstration effects and agglomeration benefits. The expanding labor intensive manufacturing sector has not stimulated the development of supplier industries such as cotton and synthetic cloth, dyes, chemicals, plastics and steel. As the experience of Japan, Korea, Taiwan, China, Singapore, and now China shows, export value added can be enhanced through heightened technological intensity in exported products and services. These examples also show that an export model that is primarily based on low labor cost and labor intensive, low technology exports will ultimately diminish as wages inevitably rise.

#### **Box 1: Integration in Global Value Chains – A tale of two sectors**

##### **ELECTRONICS**

**Vietnam has emerged as a major ICT hardware assembly hub.** Export turnover in this industry in 2014 was USD\$ 32.2 billion, top among the country's exports. ICT hardware exports consist mainly of communications equipment (75%), computers and storage devices (12%) and automotive electronics (6%). The FDI sector account for 90% of Vietnam's electronics exports while only the remaining 10% by domestic companies. In communication equipment (mainly handsets), Samsung Electronics Vietnam alone is responsible for 98 percent of Vietnam's mobile handset and component exports. Perhaps more importantly, only about 30% of Vietnam's electronics exports in 2011 were comprised of local value added with the rest being import content. Most ICT hardware is manufactured based on foreign designs and specifications, making the industry deeply depended on imported components, and leading to low value added value from domestic firms.

**To increase domestic companies linking into the ICT global value chain presents an enormous challenge.** In this highly competitive sector, there are high entry barriers of capital and technology intensity, stringent technical requirements (high quality, large volume, just-in-time delivery) and the ability to innovate and adapt, and engage in product design. Most Vietnamese firms do not possess the capacity to overcome these barriers as this would require cutting inventory costs, keeping up with technological changes through investment in research and development, and managing second-third tier suppliers – all of which relies on significant capital, skills and process upgrading. This reality explains why linkages and spillovers from ICT hardware are weak.

**Opportunities for FDI spillover in the electronics/ICT hardware industry can occur through Vietnamese firms increasing their value-add in providing services to support the industry.** Integration, including through joint venture, has been easier with smaller FDI companies or first and second tier suppliers in the subsector of electrical appliances, where competition is less fierce and the need for co-location of suppliers is higher. High transport cost-to-value ratios for electronic appliances has forced the end-product manufactures to seek geographic co-location. Correspondingly, opportunities exist for Vietnam to increase its global value-add in this subsector.

## TEXTILES AND APPAREL

**Vietnam has comparative advantages in producing and exporting textile products.** Vietnam is one of the world's top apparel producers, exporting USD \$17.8 billion worth of products in 2013, and employing an estimated 1.2 million workers in more than 3000 registered businesses. The majority of these small domestic firms are trapped in low-productivity, low-value production mostly in the cut-make-and-trim market using imported raw materials. A crucial consequence has been that buyers provide all product and engineering specifications, as well as production equipment. This has translated into local textile manufacturers not developing in-house design and engineering capabilities. They have thus not been able to graduate from the role of subcontractor to the role of product/brand developer.

**The textile sector faces a number of constraints. Low labor productivity is, for example, apparent through the cost disadvantage per shirt in Vietnam, especially when compared to China.** A 2013 study showed that while producers in Vietnam manufacture an average of 12 polo shirts per worker per day, garment manufacturers in China's Guangzhou Province produce an average of 25 shirts per worker per day. The study concluded that while production costs of export-quality polo shirts is lower in Vietnam than in China, Vietnamese producers are unable to capture a higher price from buyers, relative to their Chinese competitors, because of differences in volume, timely, consistent delivery and quality. Another challenge is dependence on imported raw materials. An estimated 80-90 percent of textile production relies on imported raw materials, making the industry vulnerable to global price fluctuations and to downward pressure on profits; if input costs were to increase. Lastly, the fragmented nature of SMEs in the textiles industry highlights the need to capture economies of scale. Clustering can allow the Government of Vietnam to do this through shared learning and reducing transaction and transportation costs. Cluster links among firms would be beneficial for large exports and would help them succeed.

**The Trans Pacific Partnership opens up opportunities for Vietnam to increase exports in the textiles sector, and to maintain its competitiveness, but lifting productivity is key.** The textile sector needs critical investments in upstream activities (such as fabric and cotton ginning) and downstream activities (such as design and marketing) to make most of the Trans Pacific Partnership. Producers must be linked more closely with buyers and suppliers so that they can adapt production designs to meet quality standards and shorten lead times. There is a need for a long-term investment strategy in design, marketing, and the creation of new styles; the absence of such strategies underlines why so few well known Vietnamese fashion brands exist, even though Vietnam is one of the world top garment and textile exporters.

### 3. Inclusive service delivery

**As the review of trends of patterns of poverty reduction and shared prosperity earlier in this chapter makes clear, Vietnam has achieved broad success at inclusion.** Growth has been highly inclusive in terms of the distribution of income gains, and equitable service delivery has also generated widespread improvement in non-monetary measures of welfare. This record of equity is seen in both human development outcomes and the distribution of health and education expenditure in a comprehensive fiscal incidence analysis. Looking towards the future, the inclusion challenge has two components: an unfinished agenda around marginalized groups and gender equality, and a net set of service delivery challenges driven by the country's demographic and economic evolution.

#### 3.1 A record of success in basic service delivery

**The country's extraordinary accomplishments in poverty reduction and shared prosperity have been paired with tremendous advances in basic service delivery.** Along simple measures of education, health, and access to infrastructure. Progress along a number of basic social indicators are summarized in the table below.

**Vietnam's achievements with regard to basic education quality are particularly remarkable.** Evidence for the effectiveness of Vietnamese schools come from both the Young Lives longitudinal study and the Programme for International Student Assessment (PISA), in which Vietnam participated for the first time in 2012. In the Young Lives study, children in Vietnamese schools learn more by a wide margin compared with children in schools in Peru, Ethiopia, and India. While Vietnam and India have similar levels of GDP per capita, at age 15 nearly all Vietnamese students outperform the top 5 percent of Indian students in math. In PISA, the performance of its students exceeded that of many OECD countries. There is also relatively little variation in scores by socio-economic status. Scores at the 5th percentile of the distribution in Vietnam are approximately equivalent to the 25th percentile in Mexico, Thailand, and Turkey. Analysis has found that likely factors behind this success include strong motivation by students, high expectations from parents, high level of commitment by teachers (measured through very low absenteeism), effective management and evaluation of teachers, and substantial investment in pre-school education and school infrastructure.<sup>17</sup>

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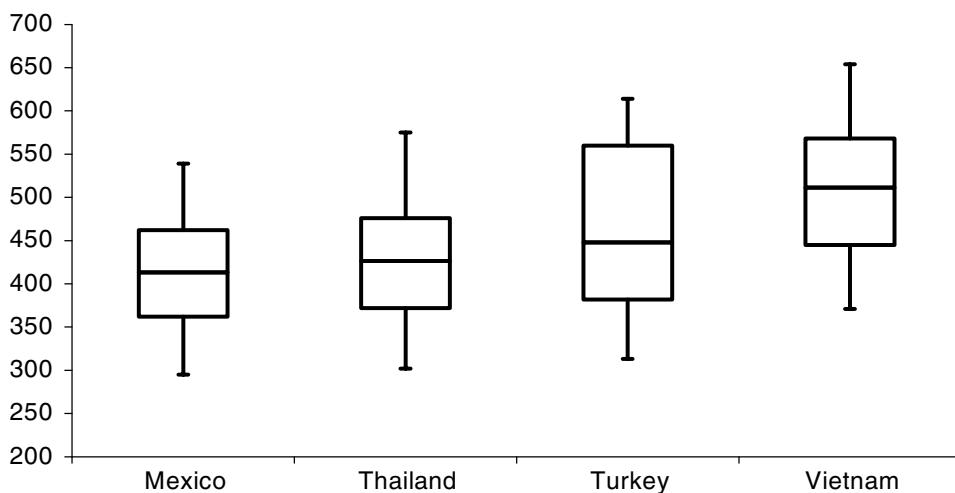
<sup>17</sup> Suhas D. Parandekar and Elisabeth K. Sedmik (2016), "Unraveling a Secret: Vietnam's Outstanding Performance on the PISA Test," World Bank Policy Research Working Paper 7630

**Table 7: By various social indicators, Vietnam has made great progress over time**

	1993	circa 2012
<b>Education</b>		
% of 15-24 who have not completed primary school	24%	6%
Primary enrollment rate (net)		
Female	87%	93%
Male	86%	92%
Lower secondary enrollment rate (net)		
Female	29%	83%
Male	31%	80%
Upper secondary enrollment rate (net)		
Female	6%	64%
Male	8%	56%
<b>Health</b>		
Infant mortality (per 1000 live births)	33	19
Under 5 mortality (per 1000 live births)	45	24
Incidence of stunting (low height for age), under 5	61	23
Incidence of underweight (low weight for age), under 5	37	12
Life expectancy at birth (years)	71	76
<b>Access to household infrastructure</b>		
% using electricity as main source of lighting	48%	98%
% with access to an improved water source	67%	95%
Rural	60%	94%
Urban	91%	98%
% with access to clean water		70%
Rural	17%	61%
Urban	60%	90%
% with access to sanitation facilities	43%	75%
Rural	36%	67%
Urban	68%	93%
<b>Ownership of assets</b>		
% of households with assets		
TV	22%	92%
Fan	31%	88%
Refrigerator	4%	49%
Car	0%	1%
Motorbike	11%	80%

Sources: Analysis of 2003 Vietnam Living Standards Surveys (VLSS), 2011 Multiple Indicator Cluster Survey (MICS), and 2012 Vietnam Household Living Standards Surveys (VHLSS).

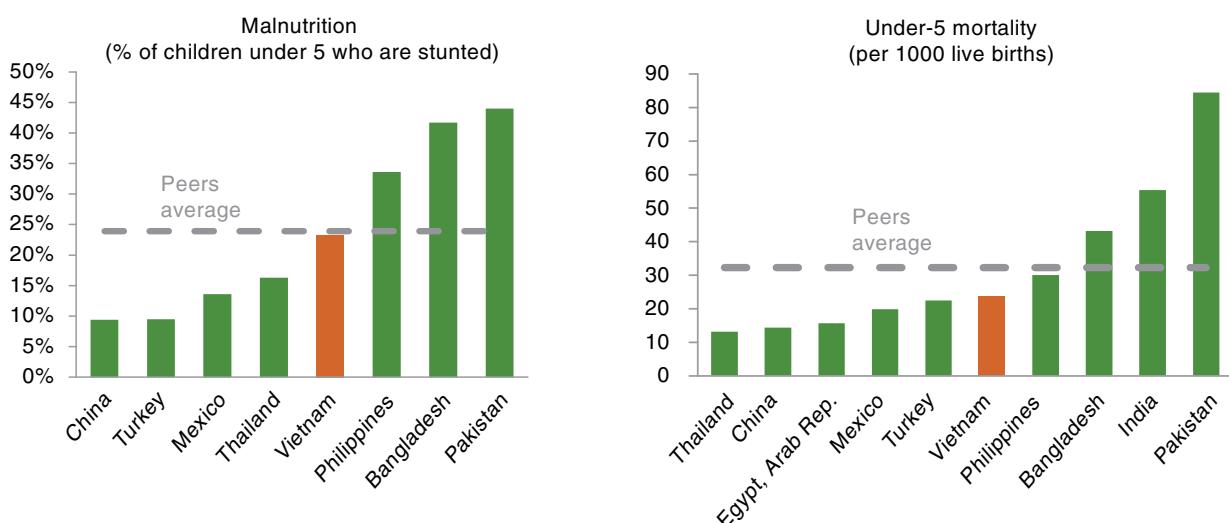
Notes: "Clean water" is defined to include piped water, bottled water, water from deep wells with pumps, and rainwater. "Improved water sources" are defined as clean water sources plus hand-dug, reinforced wells and filtered spring sources. Life expectancy at birth figures shown are from WDI, which shows higher levels than government estimates.

**Figure 33: Distribution of PISA math scores in comparison to peers**

Source: Analysis of 2012 PISA data.

Note: These box plots show the 95<sup>th</sup> percentile, 75<sup>th</sup> percentile, mean, 25<sup>th</sup> percentile, and 5<sup>th</sup> percentile for each country.

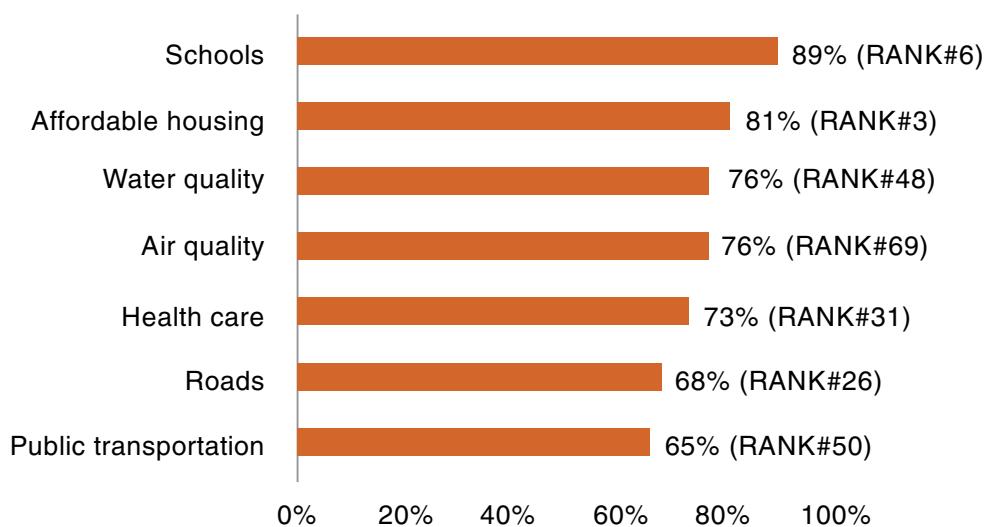
**In health, Vietnam has also made great progress.** Overall rates of child mortality and child stunting have fallen rapidly over time, and life expectancy has increased markedly. Child mortality levels are below those of peers and low for Vietnam's level of income. No single factor explains the long term gains in child health, which have occurred during a period of great investment in health care. Among the contributing factors were a large expansion of health care facilities and workers and implementation of a series of measures including special programs targeting women's and children's health, promotion of family planning, and targeted use of community health workers. After a period of decline, malnutrition rates are at the average among peers, although in recent years progress has been minimal, and malnutrition rates are still high among ethnic minorities.

**Figure 34: Child health measures in comparison to peers**

Source: Find My Friends using the World Development Indicators.

**Inclusive infrastructure access has been a hallmark of Vietnam's experience, most notably in the areas of electricity as well as information and communications technology (ICT) access.** The country made huge gains in electricity access during an astounding push over the period 1994-1997, when the share of households increased from 14 percent to 61 percent. Today 99 percent of Vietnamese households have access to electricity. While mobile phones and internet access were nearly non-existent in 2000, in 2014 there were 147 mobile phone subscriptions for every 100 Vietnamese, 90% of Vietnamese households owned a mobile phone, and 48% of Vietnamese used the Internet.<sup>18</sup>

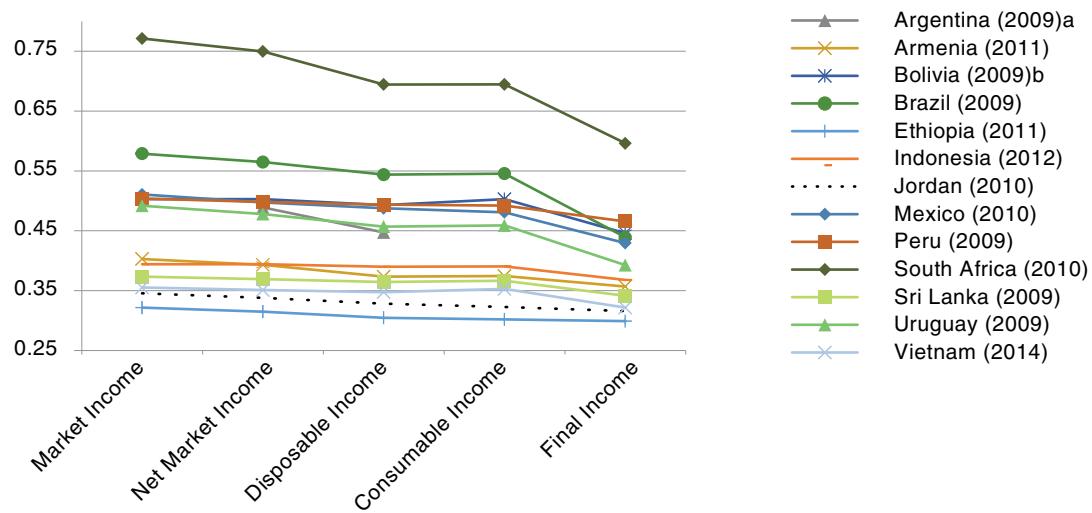
**Figure 35: Vietnamese citizens express relatively high rates of satisfaction with most areas related to service delivery**



Source: World Bank staff analysis of 2014 Gallup World Poll

**Another way to see Vietnam's strong performance in service delivery is via the high rates of satisfaction with most aspects of public services and conditions influenced by public policy.** In addition to objective measures, subjective measures show that Vietnamese are pleased with various conditions that are influenced by government policy. Results from the Gallup World Poll show that large majorities of people in Vietnam express satisfaction with schools, availability of affordable housing, water quality, air quality, health care, roads, and public transportation. The greatest standouts are in the areas of schools and affordable housing, where Vietnam ranks sixth and third, respectively among all 143 countries surveyed in the fraction of people who say they are satisfied. In contrast, air and water quality are the two areas where Vietnam ranks lowest in satisfaction as compared to other countries.

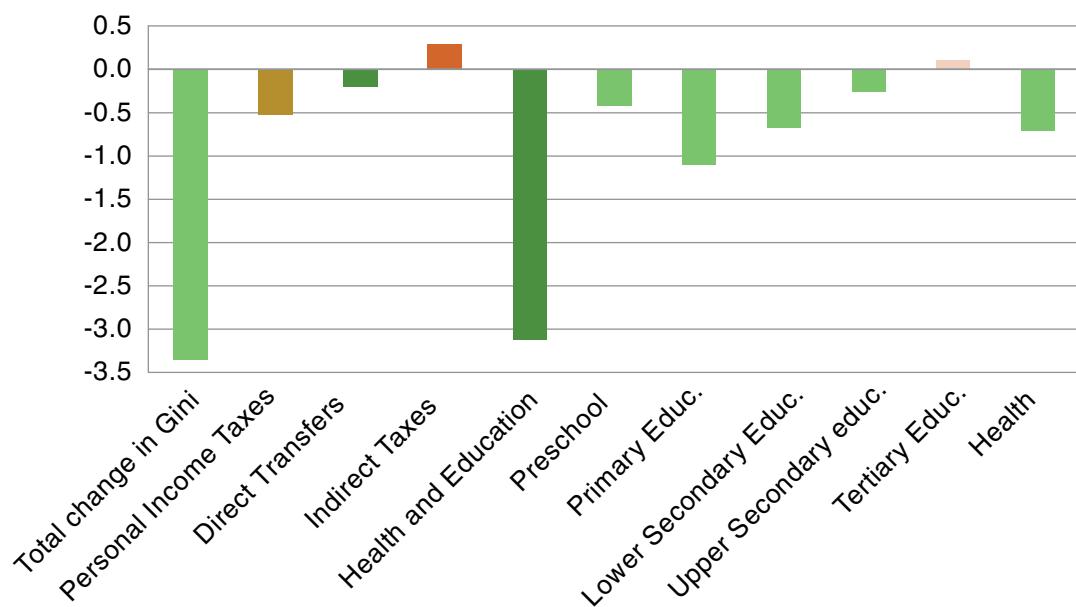
<sup>18</sup> Mobile phone subscription figures are from the International Telecommunications Union database, and the mobile phone ownership figure is from World Bank staff analysis of the 2014 VHLSS.

**Figure 36: Gini coefficient for various CEQ income concepts, various countries**

**Vietnam stands out in the extent that service provision has been equitable.** One way to see this is through the Commitment to Equity (CEQ) analysis that was completed during the preparation of the SCD. The CEQ is a comprehensive fiscal incidence analysis of the impact of expenditure and tax policies on inequality and poverty. CEQ analysis produces a variety of “income” measures starting with market income and then progressively adding and subtracting various taxes and expenditures. A flowchart illustrating the precise composition of each of the income measures is shown in an annex. The “final income” measure treats health and education expenditures as if they were transfers to households. Thus the difference in the distribution between “final income” and other measures reflects the extent to which such expenditures are equitable.

**In the set of countries for which CEQ has been conducted, Vietnam stands out for its low inequality by any income concept.** In this figure above, moving from left to right the income concepts increasingly incorporate additional elements of fiscal policy. Vietnam’s pre-fiscal level of inequality (using market income) is low in comparison to the rest of the world and fiscal policy is inequality-reducing, but the impact of Vietnam’s fiscal policy on inequality is approximately average.

**Figure 37: Total changes in inequality in Gini points in Vietnam from fiscal interventions, moving from market to final income**



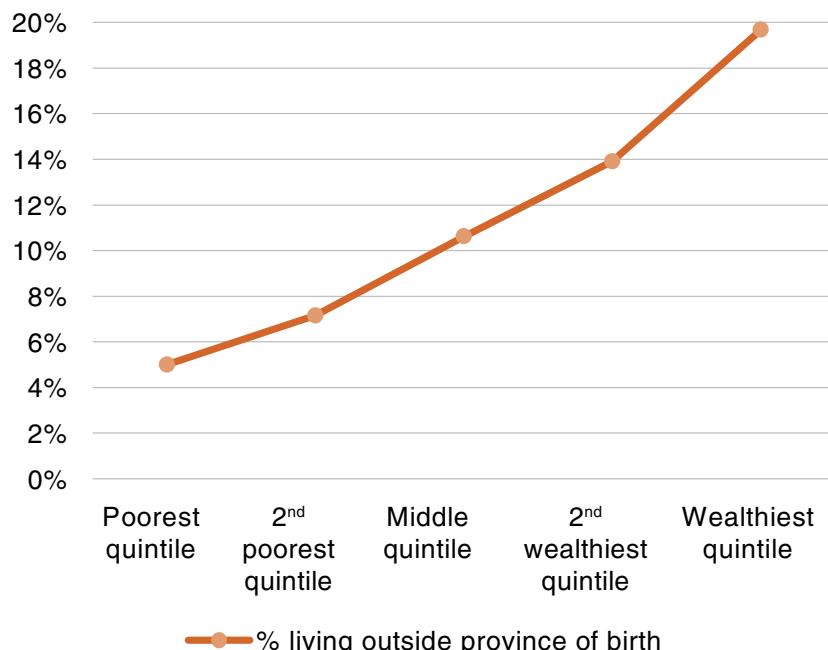
**Measured using the CEQ “final income” concept, expenditure on health and education account make the largest contribution to inequality reduction via fiscal activity.** A summary of the changes in inequality from various fiscal activities is shown in the figure below. Inequality reduction from in-kind spending alone accounts for over 90 percent of total inequality reduction (from fiscal activity) and education’s share in inequality-reduction from in-kind fiscal expenditures is approximately 75 percent, indicating that approximately 2/3rds of all inequality-reduction is produced by education spending alone. Within education expenditures, spending at the primary and lower-secondary levels account for nearly 4/5ths of the marginal impact on inequality from education. Health expenditures also reduce inequality, but the estimated impact of health is about 1/3rd of the estimated impact of education. The personal income tax system is progressive—reducing inequality by half a Gini point—but the tax system as a whole has relatively little impact on inequality.<sup>19</sup>

**Looking to the future, Vietnam faces both an unfinished agenda and an emerging agenda of social inclusion challenges.** The unfinished agenda encompasses ethnic minorities as well as other marginalized groups and a set of concerns related to gender. Key marginalized groups include urban migrants and people with disabilities. The emerging agenda concerns service delivery challenges associated with Vietnam’s move to middle income status, with a growing middle class and rapidly aging population. The following section reviews these issues, starting with ethnic minorities.

<sup>19</sup> This analysis is subject to several caveats. Most importantly it relies on an imperfect matching of budget data with service usage information drawn from the 2014 Household Living Standard Survey (VHLSS), and service usage information drawn from a household survey is subject to substantial error in reporting. Some elements of direct transfers and subsidies that could not be matched between budget data and the VHLSS are not included in the analysis.

### 3.2 An unfinished agenda: marginalized groups and gender equality

**Figure 38: Fraction by wealth quintile who are migrants**



A critical question is whether growth will continue to translate into poverty reduction now that poverty is increasingly concentrated among ethnic minorities. In the most recent period for which we have data (2012-2014), although income continued to rise across the distribution (and in the bottom 40%), progress on ethnic minority stalled. Since ethnic minorities now comprise 60% of the poor and will make up an increasing share of the poor going forward, it is less clear that growth will necessarily translate into poverty reduction in the near future.

Over the longer term poverty reduction for ethnic minorities can be expected to be driven by greater economic integration with the overall economy. A critical channel for overall growth to feed into poverty reduction is via migration. One reason poverty reduction has lagged among ethnic minorities is that their out-migration rates have been historically low.<sup>20</sup> Migration is strongly correlated with higher income, and just 3.8% of ethnic minorities live outside their province of birth, compared to 12.3% of Kinh and Hoa. The reasons for low migration include language and cultural barriers and the household registration system, which has discouraged migration, particularly for those without social connections in the place of destination. A recent World Bank study on the registration system found that there are extremely few ethnic minorities with permanent registration status in major urban areas (just 1% of the permanent registrant population).<sup>21</sup> There is, however, evidence that the force of these factors is diminishing and that ethnic minority migration rates are increasing. First, large increases in completion of primary and lower secondary education completion

<sup>20</sup> See for example the recent analysis of Coxhead, Cuong, and Vu (2015) which concludes “lack of mobility is a leading candidate to explain the distinctive persistence of poverty among Vietnam’s ethnic minority populations, even as national poverty has sharply diminished.”

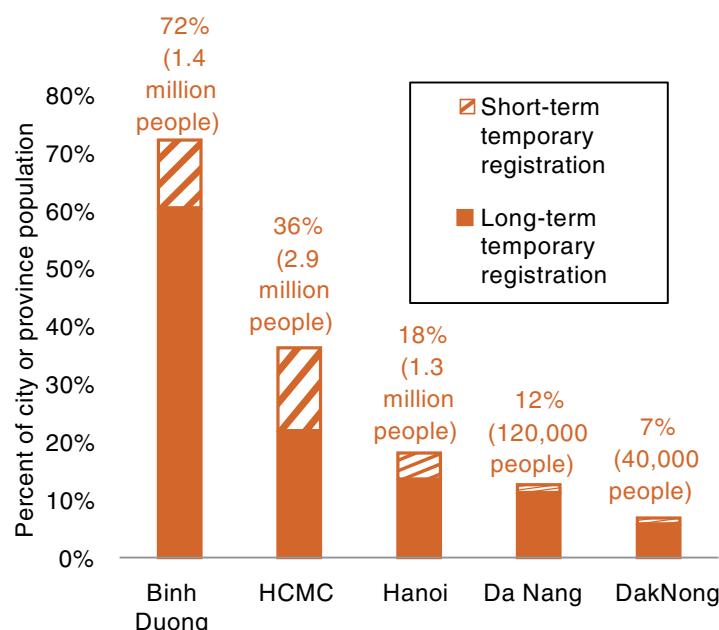
<sup>21</sup> World Bank (2016) *Vietnam’s Household Registration System*

rates mean that young ethnic minorities are now more likely to speak Vietnamese. Second, the force of the household registration system has diminished, and acquiring temporary registration in urban areas is no longer difficult. The household registration study found that in the southern industrial center of Binh Duong, ethnic minorities make up a surprisingly high fraction of the population, including 11% of recent migrants.

**Thus recent patterns, although mixed, provide some basis for optimism that growth will continue to drive poverty reduction among ethnic minorities.** However, it may take time for social networks to develop to facilitate migration among ethnic minorities more broadly. And although language and cultural barriers are diminishing, worldwide experience suggests that ethnic division will persist. This suggests that in the short-term targeted efforts for ethnic minorities will be needed. A fuller discussion of the ethnic minority situation is found in the priority section of this SCD.

**Urban migrants are another potentially marginalized group.** The household registration system known as *ho khau* was developed initially to control migration and to serve as an instrument of public security. Although the system has become less rigid over time, concerns persist that *ho khau* limits the rights and access to public services of those who lack permanent registration in their place of residence. A recent World Bank study found that at least 5.6 million people lack permanent *ho khau* in their place of residence (and have only temporary registrant status) including 36% of the population of Ho Chi Minh City and 18% of the population of the Hanoi. Those without permanent registration work overwhelmingly in the private sector, mostly in manufacturing, and make up three-fourths of all employees of foreign firms in the surveyed areas (Ho Chi Minh City, Hanoi, Da Nang, Binh Duong, and Dak Nong.)

**Figure 39: Large numbers of urban migrants lack permanent registration status:  
Percent of population lacking permanent registration in province of residence**



**The household registration system is a source of inequality of opportunity for migrants.** In material economic terms and in the labor market, temporary registrants no longer face disadvantages, except that they are largely excluded from public sector employment. However temporary registrants continue to face some limitations in service access, particularly for public school, health insurance for young children, and basic procedures like obtaining a birth certificate. The World Bank study also found that 70% of citizens in surveyed areas believe the system limits the rights of people without ho khau and should be made less restrictive.<sup>22</sup>

**The household registration issue is closely linked to service delivery challenges that urban centers face due to the influx of urban migrants.** City governments have faced strains in providing services to migrants, which has led some to partially exclude those without permanent registration. This phenomenon is a consequence of both existing capacity constraints (for example, for schools), and the fiscal burden cities face in providing services. However, taking into account impacts on revenue and transfers, the net fiscal impact is likely positive or only mildly negative. Additionally, some urban centers face particular issues due to the large number of migrants who locate in areas at high risk of flooding. Some policymakers have raised concerns that relaxing the system could result in increased migration to urban centers, straining public services and municipal finances.<sup>23</sup>

**People with disabilities comprise a large and growing group of people who are not fully included in Vietnamese society.** Vietnam has a substantial population of people with disabilities, in part because of the legacy of conflict, and as the old-age population expands rapidly, so well the fraction with some form of disability.<sup>24</sup> Disability in Vietnam is highly correlated with poverty (Mont 2011). Those with disabilities have faced obstacles in access to health, education, social assistance, transportation and infrastructure, information and communications, as well as culture and sports (NCCD 2010). Most notably, more than half of children with severe disabilities never attend school.

**The Vietnamese government has made a number of strong commitments to advancing the rights of people with disabilities.** Foremost among these are the Law on Disabilities, ratification of the UN Convention on the Rights of Persons with Disabilities (CRPD), and elements of the Constitution. Both the Law and the CRPD reflect a modern approach to disability, which differs substantially from the how disability has been understood in Vietnam and in much of the world until recently. Policy has shifted towards a view of people with disabilities not as victims and objects of charity, but as subjects of the law with clearly defined rights. Tangible implementation of these commitments has been very limited.

**On gender equality, across a wide variety of measures, Vietnam rates very high.** School enrollment rates are similar for men and women, and female labor force participation rates are high. In three areas gender concerns are particularly important: the extremely high sex ratio at birth, the lack of women in leadership positions, and the prevalence of domestic violence.

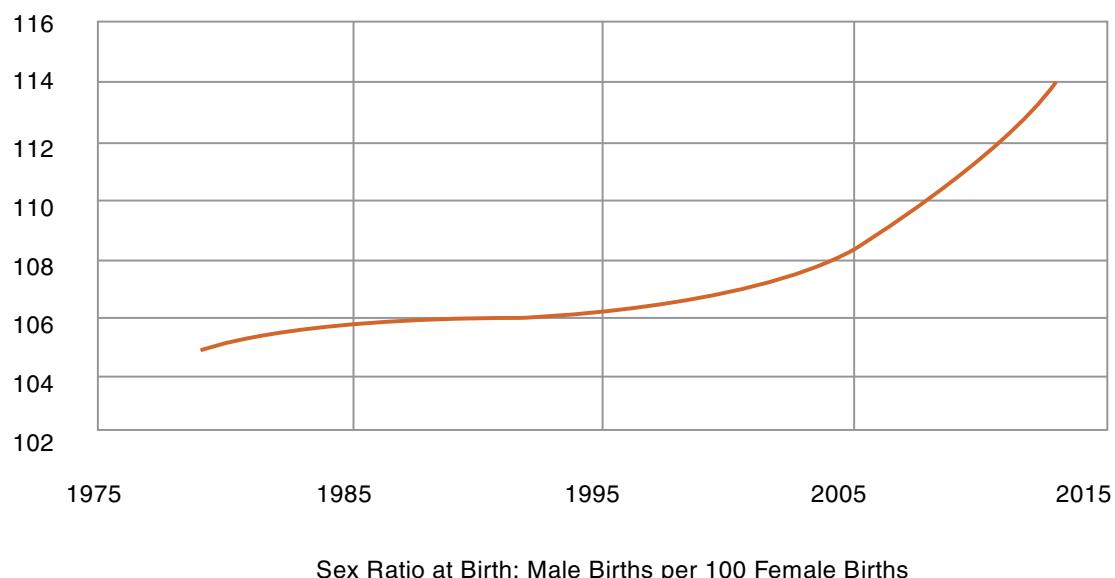
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<sup>22</sup> The material here regarding the household registration is drawn from a recent report on the issue, World Bank (2016) The study includes analysis of representative household survey in migrant areas, a qualitative study, and an analysis of the fiscal implications of reforming the system.

<sup>23</sup> The Ministry of Construction is currently preparing a study on urban poverty issues under an existing Bank project.

<sup>24</sup> Data and issues associated with people with disabilities are reviewed in the Vietnam 2035 study.

**Figure 40: Vietnam has a large imbalance in the sex ratio at birth, with 114 boys born for every 100 girls**



Source: World Bank staff analysis of various data sources.

**While Vietnam has achieved broad success in gender equality, there are three key areas of concern.** First, in business and particularly in government and political spheres, the face of leadership is still overwhelmingly male. The civil service has a large share of women, but their representation in leadership positions is small and tends to be at lower levels. A World Bank study of commune health stations and district hospitals in six provinces found that women make up 39% of doctors but just 6% of hospital directors. In the last decade and a half, the share of women in the National Assembly has been declining and is now at 24.4 percent. Few chairs of National Assembly committees are female. Women's representation also remains low in key bodies of the Communist Party: the Politburo, the Central Committee, and the Secretariat. Women constitute only 18.3 percent of Party leadership at the commune level, 14.2 percent at the district level, and 11.3 percent at the province level. Similar imbalances appear in the private sector. While substantial numbers of women are employed in wage jobs, few are in management positions. In the 2015 Enterprise Survey, just 22% of firms reported that they have a female top manager (compared to an average of 27% across EAP countries.)

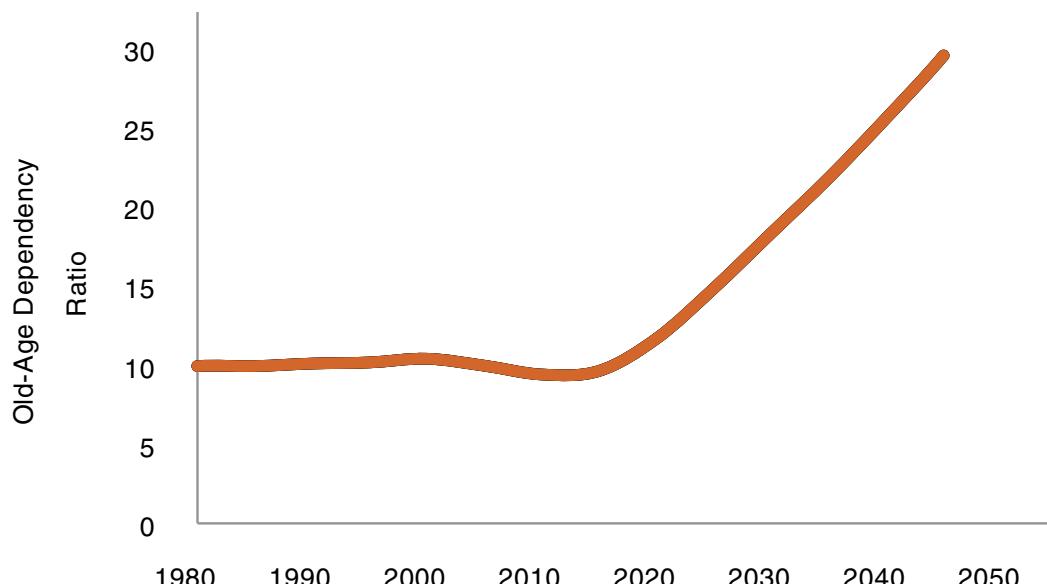
**A second area of great concern for gender is the large imbalance in the sex ratio at birth (SRB), the number of male births per 100 female births.** The much higher number of boys than girls born in Vietnam is a product of sex-selective abortion resulting from the combination of son preference and the ready availability of sex identification of fetuses through ultrasound technology. Sex-selective abortion is a form of gender discrimination in itself and a threat to gender equity over the long term. Starting around 2006, the SRB has risen rapidly, reaching nearly 114 in 2013, placing Vietnam—with India and China—among the countries of the world with the highest SRBs. This imbalance will result in a large number of surplus men starting in about 20 years, which may result in an increased level of antisocial behavior, violence, and human trafficking.

**A third area of concern is domestic violence.** In a 2010 study, 34% of women who had ever been married reported that they had experienced physical and/or sexual violence at some point in their lives, and 9% reported having experienced violence in the previous 12 months. Five percent of women had ever been pregnant reported experiencing physical violence during a pregnancy. Rates of experiencing physical violence were higher among younger and less educated women. Rates of current sexual violence did not vary substantially by age or education level.<sup>25</sup>

### 3.3 The emerging agenda for service delivery

**In addition to the challenges associated with marginalized groups and gender equity, Vietnam faces a new set of challenges for inclusion and service delivery.** The new challenges are driven by two developments: the rapid aging of the population and the rise of the middle class.

**Figure 41: Vietnam is just starting to age very rapidly**



Source: World Bank staff analysis of UN Population Prospects (2015).

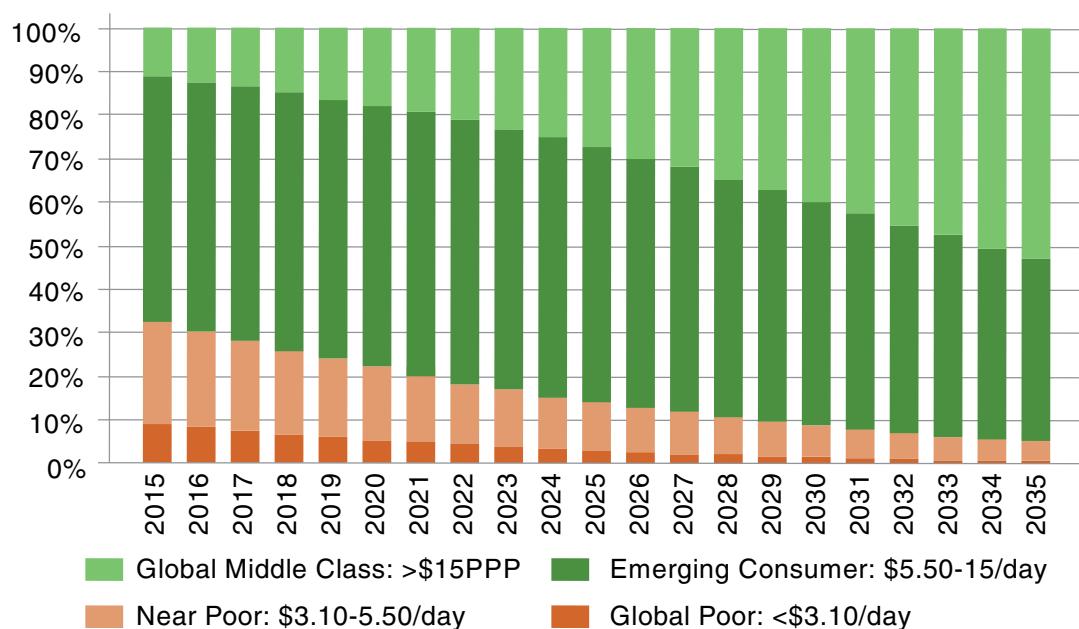
<sup>25</sup> Keeping silent is dying: Results from the National Study on Domestic Violence against Women in Vietnam, GSO (2010)

**One of two major trends that will impact the shared prosperity agenda is Vietnam's current seismic demographic shift, which now makes it one of the most rapidly aging countries in the world.** The fraction of the population that is of working age peaked in 2014 and is now in decline, while the fraction over 65 is growing very rapidly. As a result, the old-age dependency ratio (OADR), which has been roughly flat for decades, will climb steeply and double in the next twenty years.<sup>26</sup>

**This extremely rapid aging is the consequence of a constellation of factors.** First, the current old-age population (and thus the OADR) in Vietnam is small. This is due to the low birth rate and high child mortality during the famines that took place 1940-45 as well as the high adult mortality rates during the ensuing conflicts. Second, the post-1945 birth cohorts, who are just reaching old-age, are quite large due to the high fertility rate of that period. Finally, because fertility fell rapidly in the 1990s, the cohort of people entering working age is quite small. In other words, the numerator of the OADR has just started to increase rapidly from a low base, while the denominator is shrinking.

**This rapid aging will generate new service delivery challenges.** Most clearly, it will put strain on the social insurance and broader social assistance system. Second, it will mean new challenges for the health care system as the burden of disease shifts from infectious disease towards non-communicable disease. Third, concerns about inclusion of people with disabilities will rise as that population grows with population aging. Finally, provision of long-term care of the old-age population will become an issue of widespread concern.

**Figure 42: Half the population will enter the “Global Middle Class” within 20 years**



Source: World Bank staff projections using VHLSS 2014, assuming 4 percent per capita growth.

26 The old-age dependency ratio is the number of people age 65 and older divided by the population ages 15-64. A full analysis of aging issues in Vietnam is found in the EAP regional aging study and in the Vietnam 2035 report.

**A second major trend determining challenges for shared prosperity is the expansion of the middle class.** The fraction of the population that is part of the “Global Middle Class” with consumption level of at least \$15-a-day (2011 PPP) terms is projected to rise from 11% to more than half of the population by 2035. This trend will generate new challenges for service delivery, as this expanded group of the relatively wealthy bring rising expectations for government services.

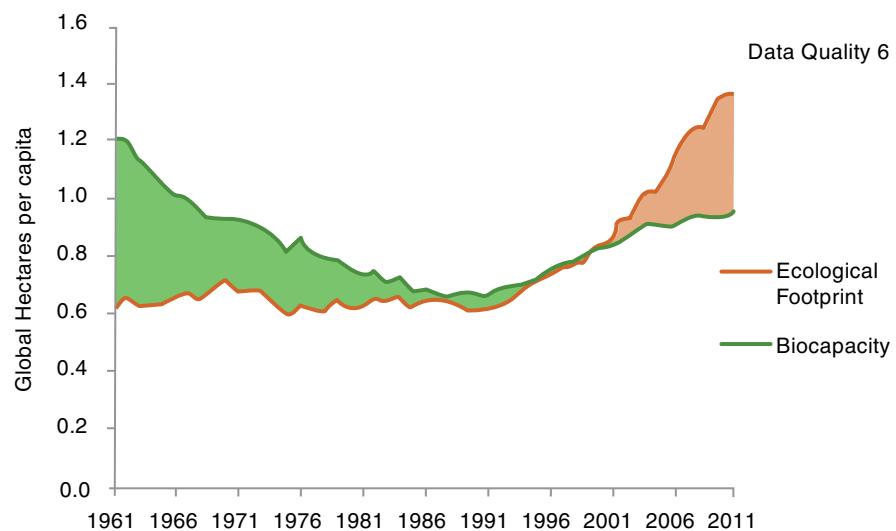
**Experience from other countries suggests that the growing middle class is characterized by several features.** First, it expects government to deliver quality services and provide citizens with greater voice and choice. Second, it is subject to new challenges, many of them the result of earlier successes: changing family structures, a growing burden of lifestyle diseases, and economic needs for a higher- and more relevantly-skilled workforce. Third, in the transition towards higher income status, the emerging middle class faces old and new risks. With a more open and marketized economy comes increased economic volatility, creating new risks such as unemployment, wage and price shocks, rising inequality and integration of migrant populations into cities, and the need for constant skill upgrading. These new realities in turn create fiscal risks as governments seek to expand social security systems, provide universal health coverage at affordable cost, and expand coverage, relevance, and quality of education to higher levels. Managing new risks in the face of rising expectations from the middle class will place new demands on social policy and institutions.

#### 4. Sustainable management of natural assets and environment

**Natural resources (fish, forest, land and water) have contributed to the impressive growth Vietnam has achieved since 1990. Going forward, they need to be better managed to capitalize on their contribution to boosting shared prosperity and achieving sustainability.** Land, water, fish and forest are direct inputs to agricultural production (including timber production and aquaculture) and also generate ecosystem services. Using these primary inputs, Vietnam’s agricultural value addition grew at an average rate of 3.7 percent between 2000 and 2013, outperforming all other middle-income Asian countries other than China. The most rapid growth has occurred for livestock, aquaculture, and beverage/industrial crops, reflecting changes in domestic demand and improved trade opportunities. Vietnam’s agro-food exports now exceeds US\$ 25 billion, and the country is among the top five global exporters in commodities as diverse as rice, shrimp, coffee, cashews, black pepper and rubber. In 2012, the sector accounted for about 4 percent of GDP (similar to the garment/textile industry) and 8 percent of Vietnam’s merchandise. Sustaining these contributions will require Vietnam to adopt a path involving sustainable management of its natural assets and environment rather than exploiting them beyond their carrying capacity.<sup>27</sup> The urgency with which Vietnam must adjust its growth pathways is underscored by its exposure to pollution, natural hazards and climate variability, because of the contribution of natural systems to resilience and the potential impact of climate change on the resource base and in turn income.

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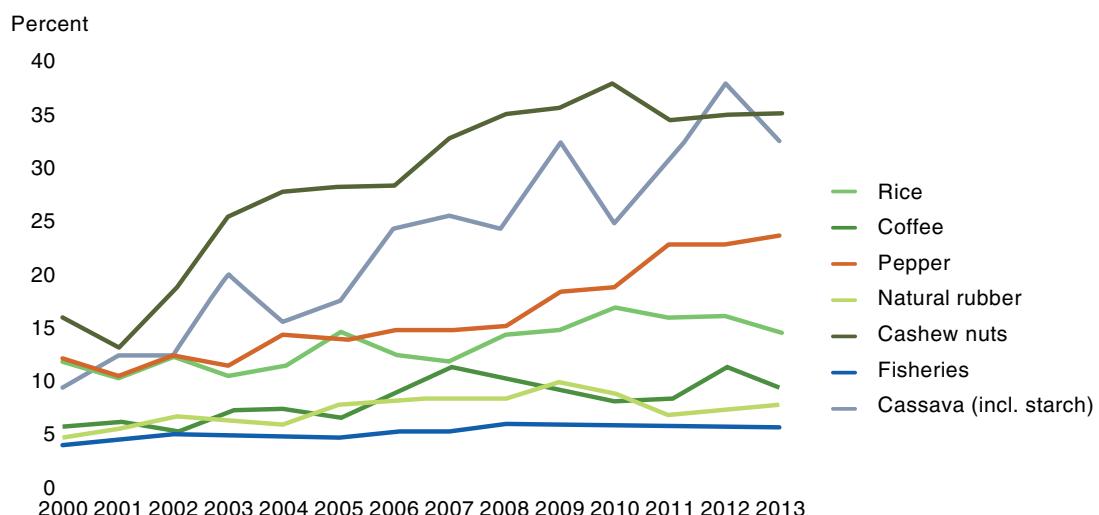
27 Global Footprint Network (accessed November 2015)

**Figure 43: Vietnam's current ecological footprint is not sustainable**

Source: Global Footprint Network, Oakland, CA (accessed November 2015)

#### **4.1 Advancements in transforming agriculture, sustainable use of natural resource and the environment, and climate resilience**

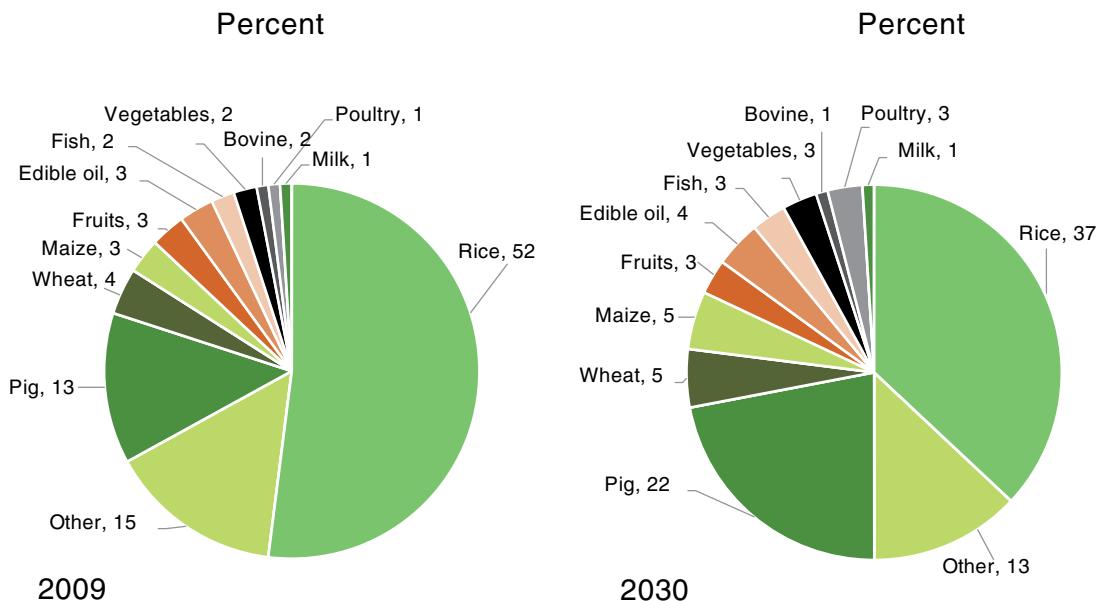
**Vietnam is a major supplier in international agricultural commodity markets.** Currently, Vietnam has more than \$1 billion in trade for seven different commodities (or commodity groups), and it ranks among the top five global exporters of each. The domestic market for commodities is also expanding in Vietnam with the growing middle class. Shifts in consumer taste and growing urbanization are also increasing mass market grocery sales which accounted for an estimated 15 percent of total food sales in 2013, and has doubled between 2005 and 2013. Vietnam's agriculture is at a turning point and going forward needs to ensure that the benefits of additional sectoral growth exceed the costs. The government's Agricultural Restructuring Plan recognizes the need to increase efficiency, innovation, diversification, and value addition for the sector and agro-food system to remain competitive in international and domestic markets.

**Figure 44: Vietnam is a significant player in international commodity markets**

Source: OECD 2015 based on UN Comtrade data.

**Farmers in Vietnam are gradually transitioning to a more diverse set of crops as households demand different food products.** Changes in consumption patterns, with greater emphasis on nutrition and increase in spending on protein sources, are underway in Vietnam. Farmers are slowly diversifying primary agriculture to respond to these changing consumption patterns. Diversification allows for greater variation in processed/prepared foods and other agro-industries, creating opportunities for employment and improved production systems.

**Figure 45: Vietnam will be getting its calories\* from different foods (2009 and 2030)**



Source: Jamora and Labaste 2015 as cited in World Bank 2016

**While not a replacement for effective land markets, the government has been allocating land use rights over land to households, communities and economic entities.** By 2010, the Vietnam had issued approximately 31.3 million Land Use Rights Certificates (LURCs), covering roughly half of Vietnam's land area and 90 percent of farm households. Through the certificates, the government seeks to provide greater land-tenure security, facilitate access to credit, and enable the transferability of use rights. The certificates are also necessary for accessing payment systems that aim to internalize positive externalities of land management practices – for example, payment for forest ecosystem services.<sup>28</sup> The certificates help provide an incentive for land stewardship and an opportunity to engage in the land rental market and consolidate land.

<sup>28</sup> The payment for forest ecosystem services program promotes the maintenance of natural forest cover and transfers financial resources from the beneficiaries to the producers of ecosystem services. While the performance of the program has been mixed, it is seen to be successful because it contains a legal requirement to pay financial resources from sectors such as hydropower and tourism to smallholders who are managing the land. This augments the willingness of households to reverse land degradation.

**There has been some consolidation of agricultural production in parts of Vietnam.** This is evident in rice production where 85 percent of the surplus is accounted for by the top two quintiles. This statistics points to a trend toward greater concentration in commercial rice production, with approximately 300,000 households responsible for most of the country's exports. Similar trends are evident in aquaculture and emerging in livestock production. This makes enhancing competitiveness of agriculture and improving value-addition more manageable.

**While Vietnam works to maintain its position in agro industries, it is also starting to tackle the management of key inputs to the value chain, such as fisheries.** Vietnam has adopted fisheries comanagement approaches with formalized fisheries groups in closed systems (for example, lagoons and reservoirs). The comanagement of coastal fisheries is now occurring at a pilot scale, and has only recently been extended to open access areas (such as coastal areas) following Decree No. 33 issued by the government in 2010. Technical and financial support is being provided to all stakeholders who engage in the practice of comanagement.

**Beyond agriculture, Vietnam has put in place comprehensive strategies and policies on green growth, climate change, and environmental protection.** Vietnam's Green Growth strategy identifies strategic tasks such as reducing the intensity of greenhouse gas (GHG) emissions, promoting the use of clean and renewable energy according to greening production and greening lifestyle, and promoting sustainable consumption. Public agencies are gradually being strengthened to protect the environment and promote green growth at the central and local levels. Financing for environmental protection, while still insufficient, is also being increased.

**Vietnam has developed strategies to respond to climate-driven risks (both extreme and chronic events) in the medium (5-10 years) and long term (35-40 years).** Vietnam's climate change strategy emphasizes, among other things, proactively coping with natural disasters, monitoring climate, adopting measures to adapt to climate induced events, enhancing coping capacity, and investing in advanced science and technology to cope with climate change. In 2007, The Government approved the National Strategy for Natural Disaster Prevention, Response and Mitigation to 2020 (NDPRM). The strategy, recognizing the exposure of Vietnam to extreme events, recommends the development of catastrophe risk financing solutions to complement other disaster risk management measures. Along with a National Target Program, the NDPRM forms the overarching policy framework for disaster risk management and climate change adaptation activities. They are complemented by other dedicated decrees and laws, such as the country's first-ever law on Natural Disaster Prevention, Response and Mitigation (No. 22/2013/QH13)<sup>29</sup> which became effective in May 2014. Implementation of these strategies helps reduce Vietnam's ability to cope with multiple natural hazards including typhoons, floods, droughts, sea water intrusion, landslides, forest fires, and occasional earthquakes

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29 The Law emphasizes the importance of comprehensive disaster risk management.

**Vietnam has been undertaking activities to improve investments in the country's infrastructure in order to enhance resilience to climate change.** Vietnam has been, with support from development partners, developing and adopting decision-support tools that integrate forecasts of climate change into planning processes. In the Mekong River Delta, several provinces and cities have come together to translate into action the vision for integrated development articulated in the Mekong Delta Plan rather than unintentionally undermining each other's investments in resilience. This includes jointly planning for investments related to a rise in sea level and changing flood risks, through enhanced attention to the siting of infrastructures and residential communities.

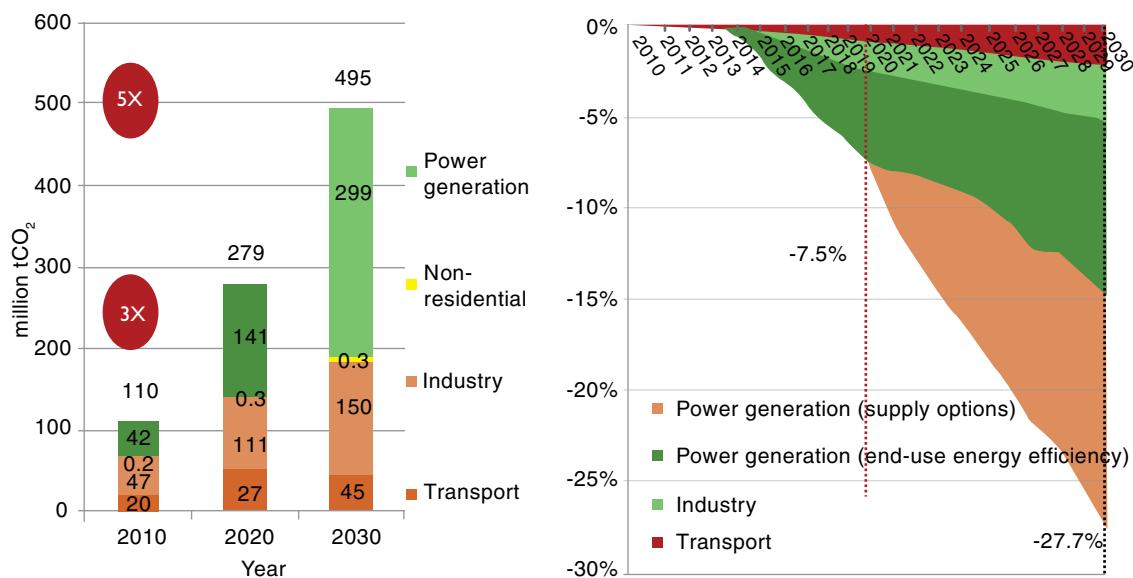
**Vietnam has pledged its own domestic resources of \$3.2 billion to reduce GHG emissions by eight percent by 2030 relative to the business as usual scenario, contributing to the global effort to mitigate climate change.** This represents Vietnam's contribution to the UN target of keeping global warming at less than 2o C by the end of the 21st century. With support from the international community, to the order of \$18 billion, Vietnam's commitment could increase to 25 percent. If the target of eight percent (or 25 percent) GHG emission reduction is achieved in 2030, emission intensity (emission per unit of GDP) will be reduced by 20 percent (or 30 percent), respectively, relative to 2010 levels. Many sectors will need to contribute to achieve the GHG reduction targets including energy (proposed through changes in fuel combustion and fugitive emissions), transport, waste, land use and forestry, and agriculture.

**The government has recently developed a revised power sector plan that envisages increasing the amount of wind and solar capacity to 18 gigawatts by 2030.** Vietnam's current energy mix is dominated by hydro (42%), coal (30%) and gas (20%) with almost no wind or solar capacity (figure 45). Installing approximately 18 gigawatts of renewable capacity would contribute to a reduction in incremental coal investments over the next 15 years to 44 gigawatts. Investments in renewables plus other measures would enable Vietnam to achieve a 27.7 percent reduction in the business as usual CO<sub>2</sub> emission levels from the energy sector by 2030. The measures needed for this change (including increased renewable capacity) have a marginal abatement cost of less than \$10 per ton of CO<sub>2</sub>.<sup>30</sup>

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30 Audinet et al., 2015 and Gerner, 2016.

**Figure 46: Vietnam's emissions of CO<sub>2</sub> will increase five-fold by 2030 unless alternative supply options and other measures are adopted**



Source: Audinet et al., 2015

**The government has been taking regulatory action to address air pollution over the last two decades from the energy and transport sectors.** Guided particularly by the Ministry of Transport (MOT), Vietnam has introduced several regulations to control vehicle emissions while transport demand has grown. The government has also adopted regulations on vehicle emission standards and on fuel quality.

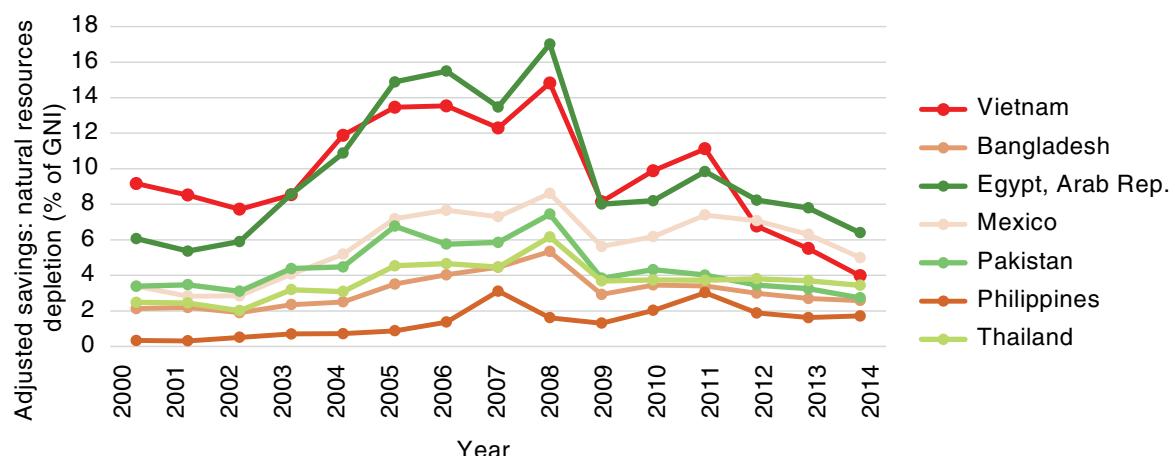
**Vietnam's achievements in reducing the impact of its growth trajectory on the environment and addressing issues of climate change are noteworthy, yet significant work remains.** Vietnam has the opportunity to leapfrog some of the environmental and natural resource degradation challenges faced by other fast growing economies based on how it handles unsustainable exploitation of natural resources, transformation of the agriculture sector and agro-food system, pollution, and adaptation to climate change. Vietnam needs to accelerate the pace at which it reforms policies and translates some of its current policies into actions to avoid lock-in effects and irreversible outcomes. The next three subsections describe key existing challenges that need to be tackled to deliver on reducing extreme poverty and shared prosperity in a sustainable manner.

#### 4.2 Constraints to improving agriculture

**Vietnam performs poorly compared to its peers when examining the natural resource depletion as a percentage of GNI.** The graph shows how nearly 15 percent of GNI was lost to natural resource depletion during a peak growth year. The percentage has, however, been declining in the recent past, and could be explained by various factors including the extent of natural resources degradation that has already taken place. Vietnam faces several challenges to effectively using its natural assets to achieve the twin goals in an environmentally sustainable manner. Declining productivity, is one of the issues Vietnam

needs to address. Vietnam also needs to strengthen its enforcement of policies and laws on environmental protection and deter violations of environmental laws.

**Figure 47: Vietnam's natural resources are severely depleted**



**Vietnam's agricultural productivity could be higher. Land productivity in Vietnam is wide-ranging.** Vietnam's rice yields have been relatively high compared with regional peers. Its coffee yields have also been the highest among major coffee producers. Yields in other main crops, however, have exhibited low productivity. The share of agricultural growth accounted for by total factor productivity is much lower in Vietnam than among regional peers (Table 8). Labor productivity in Vietnamese agriculture overall is low compared with other emerging middle income countries although there is regional variation. The limited use of suitable land, low investment in technology for crops other than rice, and the part-time nature of labor in agriculture explain the recorded levels of productivity. Water productivity is also low because of an aged irrigation structure that is not optimizing water management and use. There is a need for 'smarter' crop water management and infrastructure investments that help the system to catch up with the ongoing transformation and constraints in land and water resources.

**Table 8: Average annual growth rate in agricultural total factor productivity (%)**

	Vietnam	China	India	Indonesia	Malaysia	Philippines	Thailand
1991-00	2.86	4.13	1.12	1.23	1.87	0.46	3.27
2001-05	2.52	2.39	1.11	3.36	3.73	2.64	2.18
2006-10	2.18	3.25	2.36	2.62	2.94	1.68	1.60
1991-10	2.65	3.10	1.25	2.26	2.92	1.67	2.73

Source: Data of Organisation for Economic Co-operation and Development, based on Fuglie and Rada, 2013

**The low productivity means that Vietnam's agricultural growth has resulted from the expansion of agricultural land and intensive use of fertilizers, pesticides and water for crops, and the use of antibiotics in aquaculture.** Fertilizer application rates grew rapidly during the 1990s but have more or less stabilized since the early 2000s. At nearly 300 kilograms per hectare, the application use rate in Vietnam is about double that of other Southeast Asian countries; and with the excess amounts running off into bodies of water, agriculture is a non-point source of water pollution. Rice production practices are also a significant source of GHG emissions (which are about half of the agriculture sector's aggregate GHG emissions, about 42% of the national level). These trends have resulted in Vietnamese agriculture having a rather large and extensive environmental footprint that needs to change by modernizing agricultural practices.

**Low productivity in the forest sector is partly due to the institutions and incentives for forest management.** State Forestry Companies (SFCs), manage about 14 percent of the country's 13.8 million ha of forests and are plagued with numerous problems including poor forestry practices. This results in the degradation of the resource base and low yields. In addition, due to inadequate incentives, Vietnam is missing the opportunity to generate higher value from forest resources by supplying the lucrative domestic market for sawnwood. Vietnam currently depends on neighboring countries for sawnwood.

**Land fragmentation is a constraint on agricultural modernization.** Currently there are regulatory factors that limit consolidation. However, the government is exploring options for reducing land fragmentation. In Vietnam, agricultural land consolidation remains fairly nascent, although consolidation of commercial production is occurring at a faster pace – especially for livestock, aquaculture and commercial rice – as noted above.

**Vietnam is not taking full advantage of the market opportunities for generating increased value or having the transformative impact on farmers and communities that are the sources of the agro-food exports.** Projections are that by the early 2030's primary agriculture would account for 6-8 percent of Vietnam's GDP, while the agro industry, together with food distribution and logistics (and other services), could account for double this share (12-16 percent)<sup>31,32</sup>. There is expected growth in consumption of agrofood products, which creates opportunities for Vietnam. Vietnam's exports, however, sell at a discount to that of other leading producers. The bulk of Vietnam's agrofood exports are sold as primary commodities or initially processed products. While this is not a constraint, Vietnam has relatively scarce resources (especially land) and therefore needs to get more value from its land. In addition, Vietnam has not promoted vertical integration of the supply chain, limiting the linkage between farmers and private sector. The exception is aquaculture, where, in 2015, an estimated 70 percent of pangasius production was raised by processing companies in vertically integrated operations (up from 10 percent in 2010).

**The mixed record of Vietnam's agricultural export – with expansion in trade volumes while having shortcomings in quality and sustainability - is partly explained by the rapid rate at which change has occurred.** It is also a result of government policy and

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31 World Bank, 2016

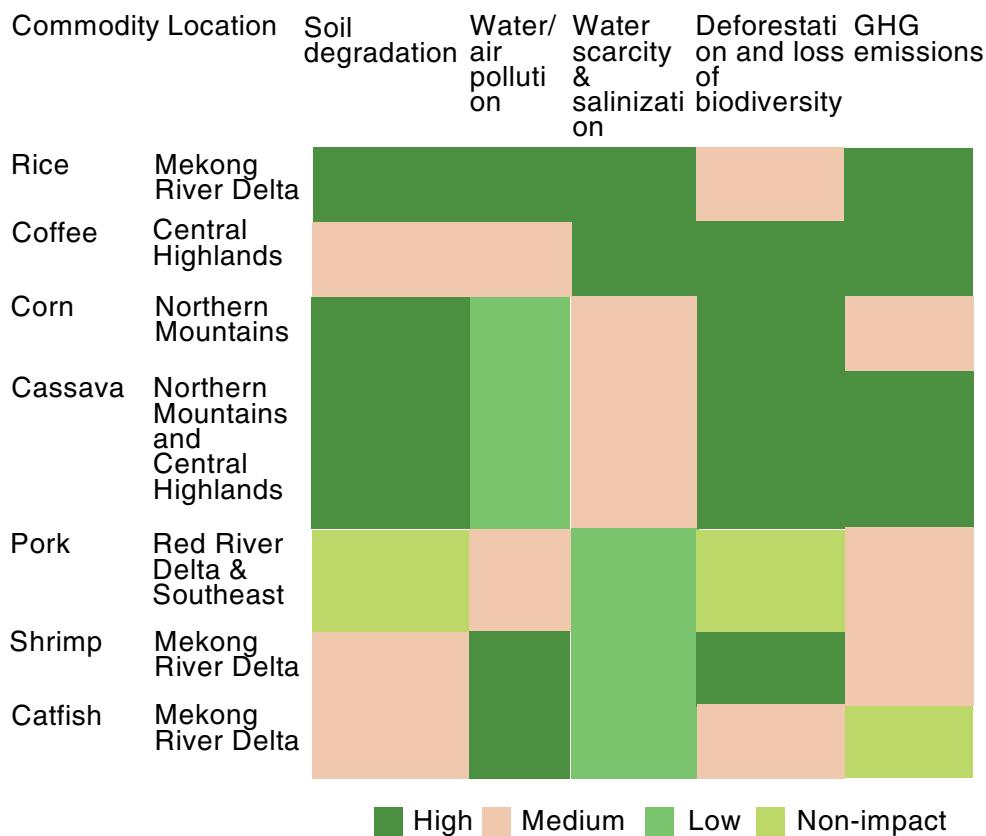
32 In 2011, food and beverages accounted for some 20% of Vietnam's industrial output. Its growth in output and output per worker over the 2000-09 were quite similar to that of many of industrial sub-sectors. (Nguyen et al 2014)

engagement in certain industries. While administrative controls on land, and direct state involvement in both input and output markets assisted with the sector's stability and inclusive growth over recent decades, these policies and associated legacy institutions are now delaying the transformation of the agriculture sector. For example, state-owned farms and /or processing/trading companies have played a very prominent role. Keeping their status quo as SOEs, however, maintains a 'culture' of low product quality.

**Vietnam's agriculture has contributed significantly to degradation of natural assets.** Shrimp aquaculture in the Mekong Delta has been the cause for large-scale destruction of mangroves and a major source of water pollution. Under so-called extensive systems, shrimp farmers use large amounts of chemicals and antibiotics to keep the shrimp in dense shrimp ponds healthy. The organic and inorganic matter in the effluent from these ponds often contaminates surrounding freshwater and coastal waters. In the agricultural sector, Vietnam has one of the highest fertilizer uses per hectare in the world and has continued to expand along with expanded and also intensified livestock production, both of which have contributed to increases in emissions of ammonia ( $\text{NH}_3$ ) and nitrous oxide ( $\text{N}_2\text{O}$ ). These subsectors are also responsible for producing  $\text{PM}_{2.5}^{33}$ , which is harmful to human health. The table on environmental impacts of Vietnam's key agricultural commodities summarizes Vietnam's agro-environmental 'hotspots'—locations/landscapes where the environmental problems associated with agricultural commodity production are either moderate or severe.

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<sup>33</sup> Through reactions with  $\text{NH}_3$  (mainly from agriculture),  $\text{SOx}$  (mainly from energy and industrial sources) and  $\text{NOx}$  (mainly transport and partly energy/industrial sources).

**Table 9: Environmental impacts of key agriculture commodities, Vietnam**

Source: Khoi et al, 2015

**Land is being cultivated more intensively.** While the area under paddy rice has not really changed, the total harvested area grew by an average of 1.7 percent a year during the 2000s due to a shift toward double and triple cropping. The expansion of the ‘third rice crop’ in the Mekong Delta has disrupted natural flooding processes, restricting the transfer of nutrients and normal cleansing effects, leading farmers to use more fertilizers and pesticides. The intensification of rice production has also contributed to water pollution, biodiversity loss, and the growth of GHG emissions. In upland areas, the fallow periods of shifting cultivation have been shortened to the point of almost continuous cultivation, leading to soil degradation. The growth in livestock production has also been accompanied with an increase in water pollution and GHG emissions.

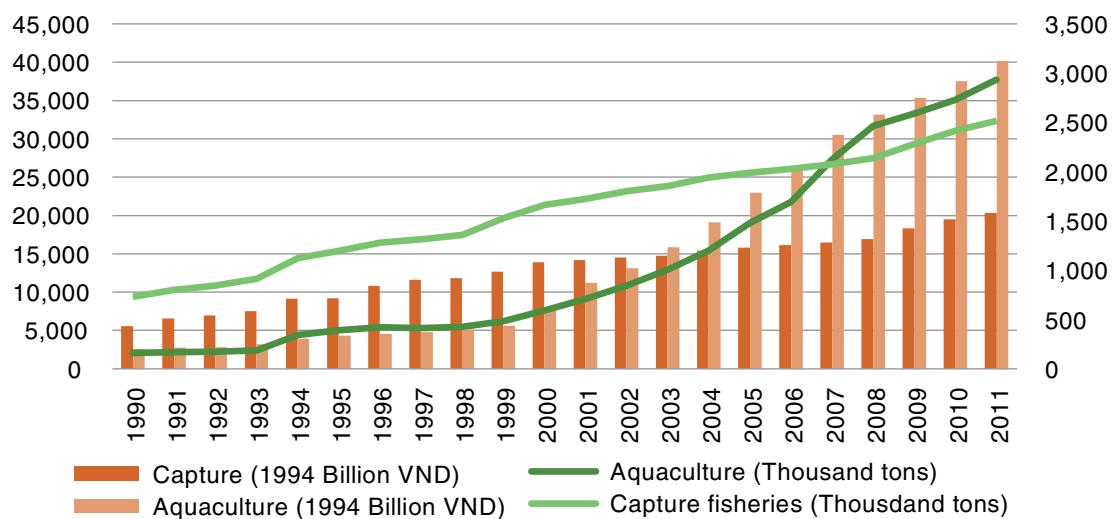
**Since the early 1990s, the Northern Mountainous Areas and the Central Highlands have witnessed deforestation and serious erosion problems due to the cultivation of rubber, upland rice, maize, soybean cassava and expansion of coffee.** The earlier (1990s) expansion of coffee and aquaculture production also occurred largely at the expense of upland forest or mangrove forests respectively.<sup>34</sup> Some 74 percent of coffee planted in Dak

<sup>34</sup> Nearly half of the mangrove forests in the Mekong Delta were destroyed by shrimp aquaculture expansion.

Lak Province lies on unsuitable and sloping land (>15 degree), where production causes soil erosion in excess of 100 tons per hectare per year. Also, despite the conversion of an estimated 700,000 hectares from agricultural to non-agricultural uses, the total area under agriculture has grown nearly 15 percent (from 8.9 million to 10.2 million hectares) since 2000. Expansion continues by the increased use of steeply sloped land for cassava production in upland areas and a surge in rubber plantation areas on following recent price increases.

**Statistical data indicates that the total erosion-prone area amounts to 13 million hectare or 40 percent of natural areas.<sup>35</sup>** At present, the country has about two million hectare of land deemed to be ‘seriously degraded,’ and another 9.3 million ha encountering problems of desertification.<sup>36,37</sup> The latter is 20 percent of the total land area and supports about 22 million people. Studies of National Institute of Agriculture Planning and Projection (NIAPP) showed that up to 60% of cultivation areas has been affected by soil runoff. The amount of soil lost every year is from several dozen tons/ha in secondary forest and grown perennial crop land to several hundred tons/ha on bare soil. The amount of annual soil loss on annual crop land without erosion control ranges from 50 to 100 tons/ha in the whole country.

**Figure 48: Declining capture fisheries production**



35 Nguyen 2010

36 Quyet et al. 2014

37 UNCCD 2006

**Overexploitation of marine fisheries has resulted in declining yields and quality for an extended period (figure 47).** The share of the catch consisting of ‘trash fish’ and small fish now account for an estimated 60 percent of the total marine catch, raising concerns regarding overfishing. More than two-thirds of the volume of fish caught or produced is consumed domestically, and the small fish are part of the feed for aquaculture. Domestic consumption of fish is growing rapidly, with an estimated 50 percent of Vietnamese obtaining their dietary protein from aquatic products.

**Overfishing is especially evident in the near shore areas, which are the fishing grounds for some 85 percent of country’s fleet and the primary source of livelihood for poor or near poor coastal communities.** Although the exact fisheries stock is unknown, it is evident that fishers continue to catch above the allowed limits, restricting the regeneration and restoration of fisheries. Some fishers also adopt destructive practices in prohibited areas and during times of spawning, aggravating the situation.

**Until recently, some 80 percent of total freshwater withdrawals in Vietnam were for agriculture.** While irrigation coverage is high with most amenable areas equipped, the current irrigation systems were designed primarily for rice and several factors impede increased water productivity. Incomplete structures and/or water losses during operations have many schemes operating at only 60-70 percent of their capacity.<sup>38</sup> Low water productivity is only part of the problem. In regions, like the central highlands, drought and water shortages have been increasingly affecting the region and threatening coffee production of the smallholder farmers. At the same time, hydropower, aquaculture, municipal and industrial water needs are increasing, but institutional arrangements for water sharing are lacking.

#### 4.3 Limited abatement of environmental pollution

**Vietnam is among the top ten countries affected by air pollution due to lack of control of polluting sources, including power and transportation<sup>39</sup>.** Satellite-derived images show that average fine particulate matter (PM2.5) levels are high, approaching the levels in China, including some pockets of very high concentrations in urban and industrial zones. The major sources of PM pollution in Vietnam include fuel combustion by industry and the power sector, transport (from fuel combustion and re-suspension of road dust), domestic and commercial emissions from using coal and biomass (rice husks) for cooking and heating and, during the harvest season, the burning of field residues.

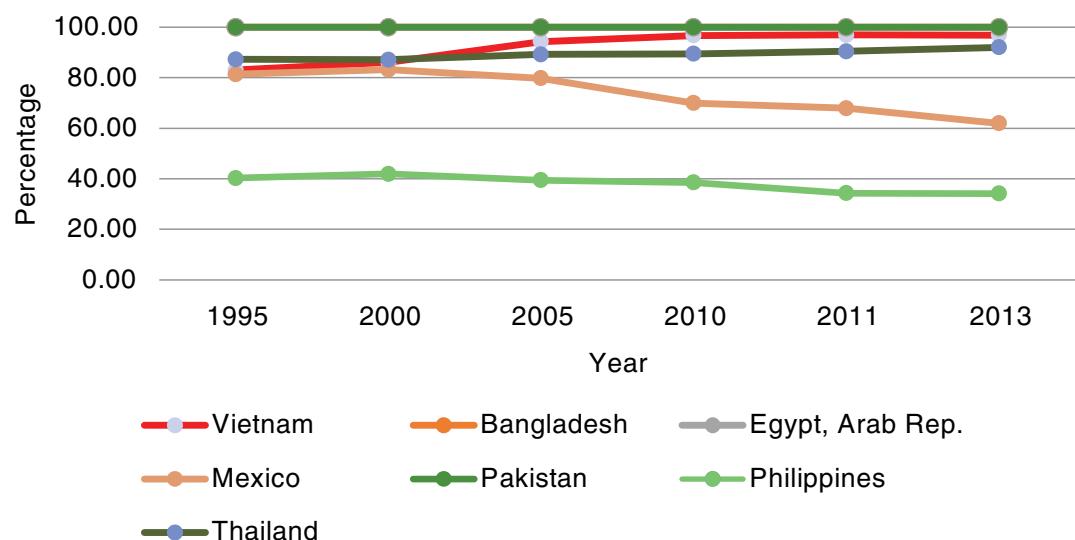
**More than 83 percent of the Vietnamese population (mostly in urban areas) are exposed to fine particulate matter (PM2.5) levels that exceed WHO guideline values** since 1995 and the percentage has been increasing (figure 48). Approximately 14 million Vietnamese living in 26 cities are exposed to more than 70 grams of urban vehicle emissions for each ton emitted, with higher levels in some cities—87 grams for each ton of emissions in Ho Chi Minh City and 120 in Hanoi. Evidence from epidemiological studies in Ho Chi Minh City revealed associations between NO<sub>2</sub> concentrations and hospital admissions for lung and respiratory problems during the dry season, pointing to a potential role of pollution exposure in causing poor health.

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38 World Bank, 2013

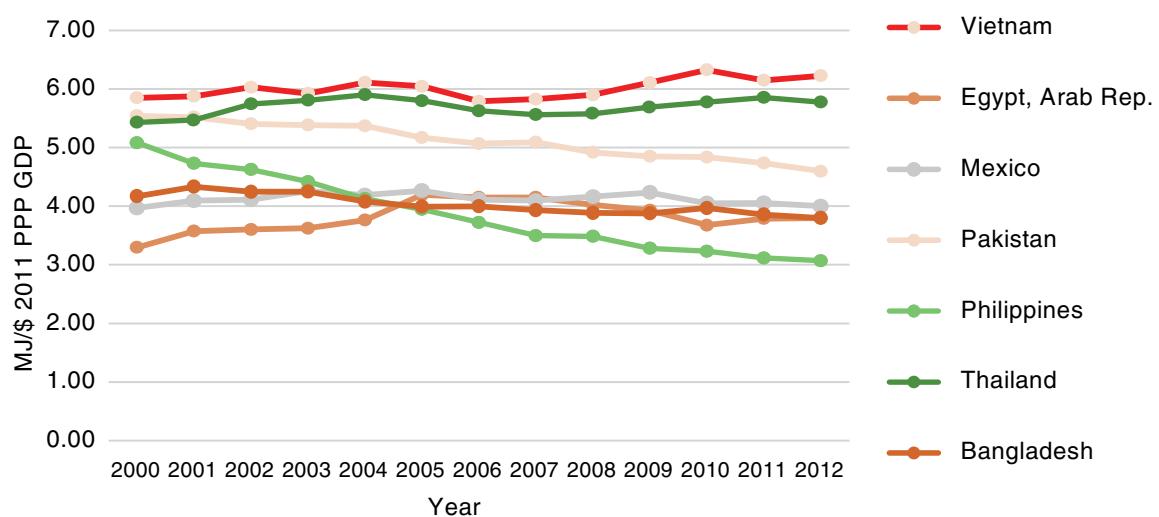
39 World Economic Forum in 2012 in Davos, Switzerland

**Figure 49: Vietnam performs worse than most of its economic peers with regards to exposing its population to air pollution**



**Vietnam is the most energy intensive economy in South East Asia and among its economic peers, making the energy sector a significant emitter of GHGs.** Vietnam has been increasingly dependent on non-renewable energy sources since 1990.<sup>40</sup> For every unit of GDP produced the country uses 2 units of energy. This indicates large energy savings potential and opportunity to become more competitive.

**Figure 50: Energy intensity level of primary energy**



**From 2004 to 2014, overall CO<sub>2</sub> emission in Vietnam from power generation sources increased by 73 percent.** Energy intensity influences the GHG emissions from the sector. In 2010, 28.1 percent of emissions related to energy were estimated to come from electricity generation, 27.6 percent from the consumption of energy in the industrial sector, 24.9 percent from transport and 12.4 percent from household energy use (UN, 2013). A significant challenge for Vietnam is meeting its future power demand while complying with government's commitment to reduce GHG emissions in its Nationally Determined Contribution (NDC) presented at the 2015 Convention of the Parties for the UNFCCC.

**Electricity demand will continue to rapidly grow, reflecting economic growth and catch up in per capita consumption, which is low by international standards** (e.g. one third of China). The latter suggests a high level of unmet demand. The projection of needing only 44 gigawatts of new coal fired power generation until 2030 is the best case scenario (from an environmental and GHG emissions standpoint) for Vietnam to be able to meet its growing demand. Limiting new coal generation to this level will require that nuclear, combined cycle gas plants, 18 gigawatts of solar/wind are online by 2030 as outlined in the revised power sector plan. Should the alternative energy sources not be developed, there will be the need to add an additional 20 gigawatts of coal over the next 15 years. Establishing the alternative energy sources is very ambitious and points to the need for Vietnam to address air pollution by doing more than changing Vietnam's energy mix.

**Water pollution is another serious environmental issue in Vietnam.** In some rural areas, toxics have become a problem and are affecting water quality because water management practices in agriculture result in a large proportion of applied fertilizer and pesticides in streams and groundwater or emitted as nitrous oxide.<sup>41, 42</sup> While smaller in volume, water pollution in craft villages is of significant concern because of the impact it has on those working in the villages. Urban wastewater, however, is the largest contributor to water pollution in many parts of the country, meaning that both now and in the future, sanitation and wastewater collection and treatment will be critical issues for improving water quality.

**In urban areas, water pollution is imposing a significant cost for those who cannot manage the health effects.** The Economics of Sanitation Initiative (2009) found that diarrhea is the sanitation-related disease associated with the highest number of cases at over 7 million a year. The economic cost of treating patients can be estimated using an average cost of \$4.50 per case of water-borne illness, resulting in a cost of \$31.7 million. Diarrhea is also the main cause of death from poor sanitation and hygiene, accounting for around 4,600 deaths a year.

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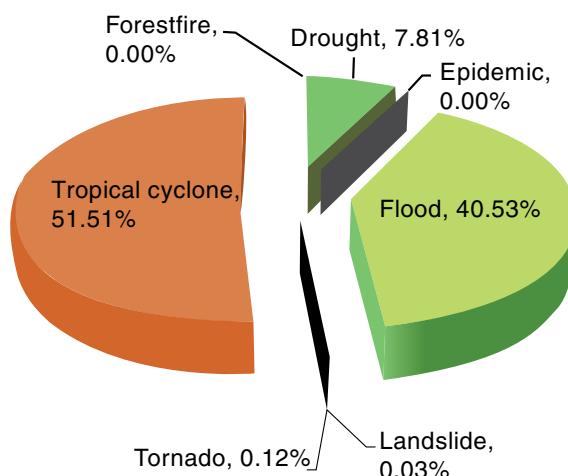
41 Scott and Greenhill, 2014

42 FAO estimates that some 80% of the nitrous oxide emissions in Vietnam derive from agriculture.

#### 4.4 Vulnerability to climate change

The impacts of climate change are already evident in Vietnam and will only intensify over the coming decades. Vietnam has a high and increasing exposure to impacts from rising sea level, ocean warming and increasing acidification combined with extreme weather events.<sup>43</sup> Official climate change scenarios (from the Ministry of Natural Resources and Environment), have projected that annual mean temperature will increase 0.6°C to 1.2°C by 2040 (depending on location) relative to the average during the period 1980-1999 and from 1.1°C -1.9°C to 2.1°C - 3.6°C by 2100.<sup>44</sup>

**Figure 51: Vietnam is exposed to multiple climate hazards**



**Vietnam is vulnerable to multiple hazards, some chronic and some extreme (Figure 50).** Almost 60 percent of Vietnam's land area and over 70 percent of its population are at risk of multiple natural hazards including typhoons, floods, droughts, sea water intrusion, landslides, forest fires, and occasional earthquakes. Climate change is likely to increase the impact of disasters, especially the frequency, severity, and intensity of the hydro-meteorological events. Many of Vietnam's cities are likely to be increasingly affected by natural disasters. This poses a serious challenge not only because of the large concentrations of people and assets in urban areas, but because cities are a critical element of Vietnam's impressive economic growth and its poverty-reduction record.

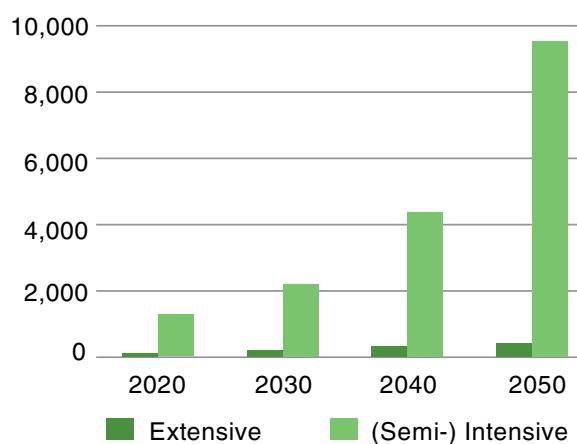
**Projections show that sea levels are likely to rise significantly over the coming decades, compounding the impacts on already exposed communities.** In Deltaic regions which are at risk of land subsidence due to natural processes, human activities such as drainage and groundwater extraction significantly exacerbate the process, increasing the threat of coastal

<sup>43</sup> Larger irrigation schemes are managed by state-owned irrigation and drainage management companies, whose operating revenues come from a combination of public subsidies and water use charges to industry and municipalities. Since 2008, most farmers have been exempt from paying fees for services provided by the irrigation and drainage management companies. While this measure was adopted to improve farmer welfare, it has weakened the accountability of the companies before local water user organizations. The Food and Agriculture Organization of the United Nations estimates that some 80 percent of the nitrous oxide emissions in Vietnam derive from agriculture.

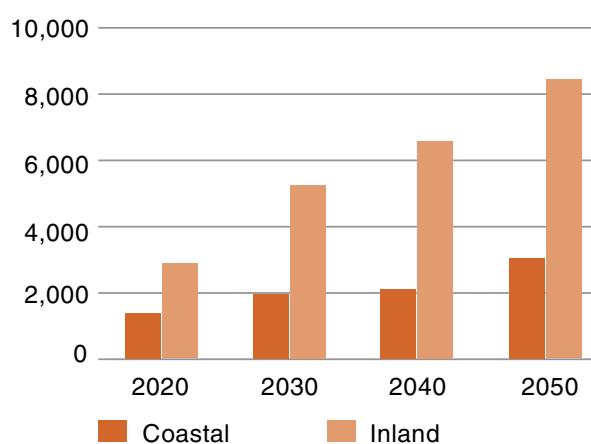
<sup>44</sup> MONRE, 2012

flooding. This is prominently displayed in the Mekong where such manmade subsidence is found to be 6 mm per year.<sup>45</sup> The projected loss of mangrove forests because of sea level rise and human activities is a significant concern and is likely to accelerate coastal erosion. Considerable increase of salinity intrusion is projected in coastal areas as a result of climate change. With an un-fixed saline-brackish border, the Delta is particularly vulnerable to increased salinity intrusion associated with sea level rise. The total area affected by salinity intrusion in the Mekong River Delta with concentrations higher than 4 g/l will increase from 1,303,000 hectares to 1,723,000 hectares with a 30 cm sea level rise.<sup>46</sup>

**Figure 52: Reduction in net income from shrimp farming due to climate change without adaptation**



**Figure 53: Reduction in net income from catfish farming due to climate change**



Note: Figures are in D millions per hectare

**Climate change and sea level rise will affect both yields and production of key crops such as rice, maize, cassava, sugarcane and coffee.** For rice the worst yield reductions are about 12 percent in the Mekong River Delta and about 24 percent in the Red River Delta. In the Mekong River Delta, a 30 cm rise by 2050 would result in a loss of 193,000 ha of rice area due to inundation and 294,000 ha due to salinity intrusion, both without adaptation. The loss of rice area would lead to a decline in rice production of about 2.6 million tons per year based on current yields. These changes will occur in conjunction with the projected large changes in agricultural land use due to market conditions. In the context of rice, however, the country has a large exportable surplus cushion that the impact of climate change is not expected to impact food security (especially once changes in consumption pattern are also accounted for). Coffee on the other hand could be negatively affected by climate change because of its reliance on expansion into areas that are marginally suited for the crop and therefore vulnerability to water and temperature disruptions that are often associated with increases in evapotranspiration and increased frequency of hot days and nights, and increased occurrence of drought.

45 Syvitski et al 2009

46 World Bank, 2010

**The effects of climate change are likely to affect fish physiology and ecology as well as the operation of aquaculture.** Some fish species, such as catfish, may grow more rapidly with higher temperatures, but at the same time be more vulnerable to disease. The main impacts of climate change on aquaculture seem likely to be a consequence of increased flooding and salinity. Semi-intensive and intensive shrimp producers may incur additional costs of water pumping to maintain water and salinity levels. Since the industry is both capital intensive and growing rapidly, adaptation is likely to be autonomous with the costs borne by operators. The total cost of adaptation is estimated at an average of \$130 million per year from 2010–50, which is equivalent to 2.4 percent of total costs.

**Fisheries, particularly coral reef fisheries, are also likely to be affected by the impacts of sea level rise, warmer oceans, and ocean acidification.** Substantial reductions in catch potential are projected with 16-percent decrease in maximum catch potential projected in the waters of Vietnam.<sup>47</sup> Given a 100 cm sea level rise, Vietnam is expected to lose 8,533 square kilometers of freshwater marsh (a 65-percent loss)<sup>48</sup>, which contributes to human well-being through provisioning (timber, fuel wood, and charcoal), regulating (flood, storm, erosion control, and the prevention of saltwater intrusion), habitat (breeding, spawning, and nursery habitats for commercial fish species and biodiversity), and cultural services (recreation, aesthetic, non-use).

**Estimations of economic losses of public assets from extreme events revealed increasing losses since 2005, though these are relatively stable as a proportion of GDP for the same period.** There is a wide range in the cost of impact, and over the past 25 years the losses range from between 0.4 percent to 1.7 percent of GDP. 80 percent of the numbers of losses were for values up to 5,000Bn VND, representing approximately 21 percent of the total cost for both floods and storms. There also are a number of events with large losses exceeding 45,000Bn VND. 2.9 percent of GDP is the highest estimated loss from the 25 years of data.<sup>49</sup> In addition, disaster events in Vietnam have caused more than 13,000 deaths over a period of two decades (till 2010). There is seasonality and different levels of severity to the natural hazards by region, with the north having a greater proportion of higher category storms and being a relatively ‘higher risk’ areas.<sup>50</sup>

**Coastal cities in Vietnam are projected to be affected by increased tropical cyclone intensity, in addition to sea level rise augmenting the impact of coastal flooding.** Floods associated with sea level rise and storm surges carry significant risks in informal settlements where a significant portion of the urban population in Vietnam live—41 percent in 2005<sup>51</sup>—and where lack of drainage and damages to sanitation and water facilities are accompanied by health threats. Ho Chi Minh City is projected to be particularly exposed to climate risks. A study that quantified current and future citywide flood risks to Ho Chi Minh City projects that up to 60 percent of the built-up area will be exposed to a 100 cm sea level rise.<sup>52, 53</sup> In the absence of adaptation, the planned urban development for the year 2025 further increases by 17 percent Ho Chi Minh City’s exposure to sea level rise.

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47 Cheung et al., 2010

48 Blakespoor et al., 2012

49 World Bank, 2015.

50 Ibid.

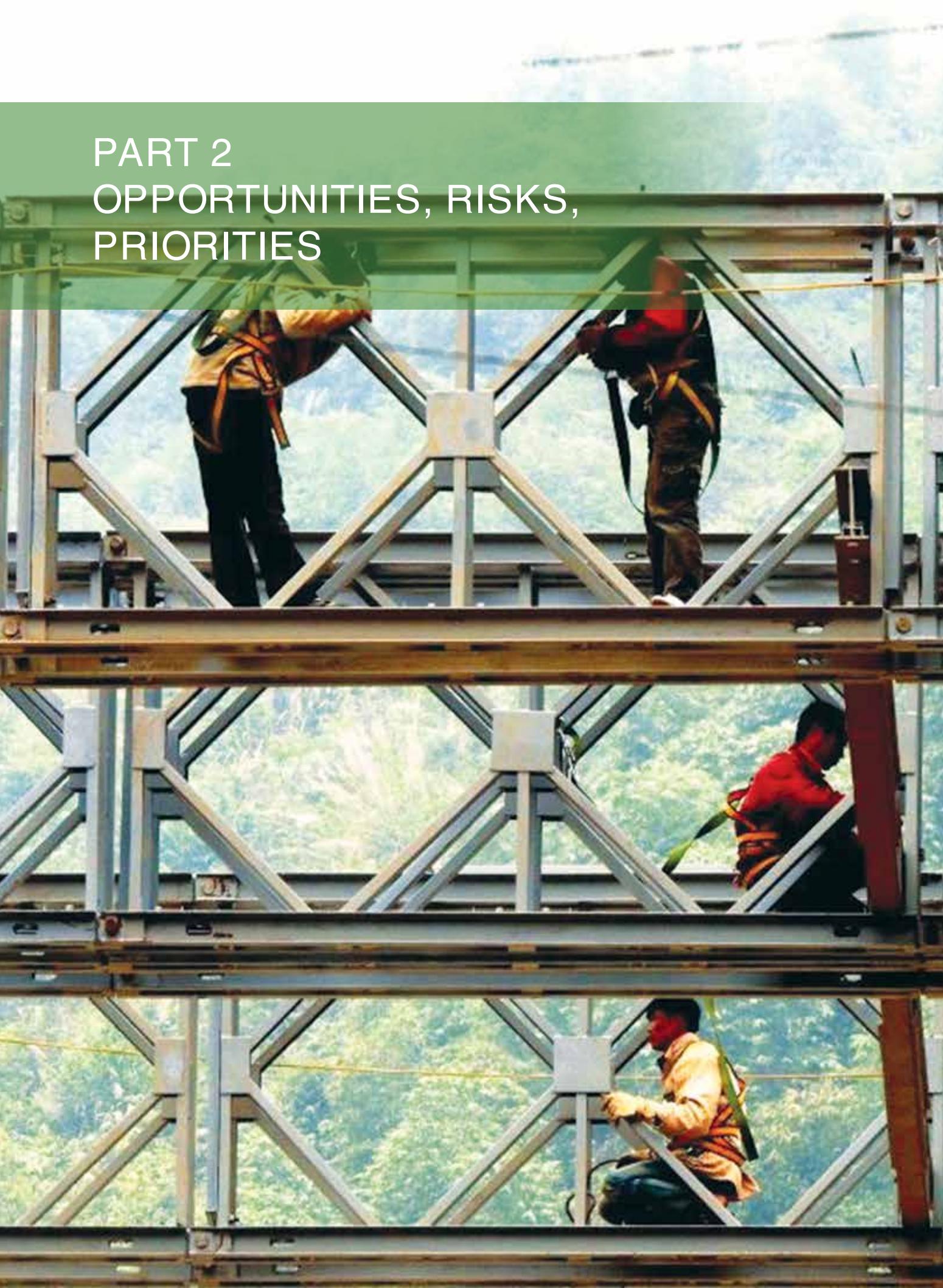
51 UN-HABITAT, 2007

52 Storch and Downs, 2011

53 Due to the lack of data available on land subsidence for the city, however, their assessment does not include subsidence

## PART 2

# OPPORTUNITIES, RISKS, PRIORITIES



**Based on the diagnostic in the previous section, further progress in achieving poverty reduction, shared prosperity and sustainability depends on whether Vietnam will seize emerging opportunities and manage critical risks.** On the one hand, persistent ethnic minority poverty, rapid population aging, a volatile global environment and macroeconomic vulnerabilities, governance weaknesses and the growing environmental footprint and vulnerability to climate change pose risks to Vietnam reaching its full potential. On the other hand, key opportunities exist to reignite productivity led growth by reinvigorating structural transformation and agricultural productivity growth, creating an environment for vibrant private sector growth, leveraging global integration and reaping the benefits of rapid urbanization.

## 5. Opportunities

**Reinvigorating structural transformation:** Enhancing the prosperity for the bottom 40 percent rests in large part on the implementation of reforms to return the economy to a productivity-led growth path. Since a considerable share of Vietnam's labor force employed in relatively low productivity agriculture, unlocking future productivity growth can to some extent rely on reinvigorated structural transformation with continued sectoral shifts of workers into higher productivity sectors and activities, especially in manufacturing and services. This will require steps to ensure a competitive environment for manufacturing and service sector in terms of provision of quality infrastructure and conducive regulatory and institutional environment. It also puts attention on modernizing agriculture –where Vietnam also enjoys strong comparative advantages- to boost labor productivity and deepen and extend agricultural value chains, including by fostering forward linkages with food processing industries.

**Creating an environment for vibrant private sector growth:** At the same time, there are also great opportunities to foster within sector and within firm productivity growth. Further restructuring of state enterprise sector remains crucial in this respect, but perhaps even more critical is the creation of a more enabling environment where private sector firms have even access to productive resources and face competitive pressure to innovate and improve efficiency. This requires broad structural reforms aimed at creating effective and efficient factor markets, mainly for land and capital, an investment-friendly business climate and quality regulatory environment and enforcement.

**Leveraging global and regional integration:** Vietnam continues to enjoy strong comparative advantages that could propel further foreign investment and export driven growth, especially in context of further global and regional integration. Making most of upcoming trade agreements, such as the TPP, ASEAN AEC and the EU FTA both in terms of greater market access but perhaps more importantly in terms of facilitating domestic reforms presents a key opportunity for Vietnam. While the direct gains of trade and investment are apparent in Vietnam's remarkable export performance, there is room to garner indirect effects. This would require creating an environment where the potential productivity gains associated with foreign direct investment and a competitive export sector transpire more broadly across the economy in the form of forward and backward linkages with domestic firms, technology and innovation spill overs and increased competition.

**Reaping the benefits while mitigating the cost of urbanization:** Vietnam remains one of the most rapidly urbanizing countries in the World. Having doubled over the last 25 years, Vietnam's urban population is projected to double once again in the next 30 years. By 2025 about half of Vietnam's population is projected to reside in metropolitan areas. Urbanization holds significant promise in terms of fostering agglomeration and economic density (which in turn boost productivity) but

also significant risks. Without effective and integrated urban planning and adequate investment in urban infrastructure and service delivery, Vietnam could see these positive impact of urbanization reverse course. Vietnam's major cities are already experiencing unprecedented traffic congestion, pressure on core municipal services and the urban environment. Ensuring well managed cities and scaling up of urban infrastructure and services as well as connecting cities with each other and the global economy will be essential to reaping the benefits and mitigating the costs of urbanization.

## 6. Risks

**Persistent ethnic minority poverty and welfare gaps:** Ethnic minority poverty is a growing and persistent challenge and the most significant risk to the elimination of extreme poverty in Vietnam. Already today ethnic minorities account for 60 percent of the remaining poor and this share will grow further over the coming years. Eliminating extreme poverty in Vietnam will therefore largely (and increasingly) hinge on closing persistent welfare gaps of ethnic minorities. These remaining poor are harder to reach; they face difficult challenges — of isolation, limited assets, low levels of education, poor health status—and poverty reduction among ethnic minorities has become less responsive to economic growth in recent years. To mitigate this risk it is important to consider specific and targeted investments in ethnic minority communities, especially in terms of providing inclusive public services (water and sanitation, nutrition, education).

**Volatile global environment and macroeconomic vulnerabilities:** Vietnam's efforts to sustain poverty reduction and shared prosperity face the risk macroeconomic shocks and volatility. While global integration may hold the key to prosperity, it also intensifies vulnerabilities to external shocks. Indeed, Vietnam experienced significant turbulence in recent years. While some of the economic difficulties have originated from external developments—an unprecedented economic boom caused by massive foreign capital inflows, followed by an external demand shock triggered by the global financial crisis—the episodes of economic disturbances were exacerbated by sharp swings in macroeconomic policy stance. Recent years have seen macroeconomic stability restored, but rising public debt, low forex reserves and lingering asset quality problems present macroeconomic vulnerabilities. Fiscal consolidation, a gradual move towards using inflation as a nominal anchor with greater exchange rate flexibility and more decisive measures to resolve NPLs, ensure adequate capitalization and further consolidate the banking sector would all help bolster macroeconomic resilience – a key prerequisite for sustained growth and prosperity.

**Growing environmental footprint and vulnerability to climate change:** Rapidly increasing air and water pollution and GHG emissions impact the quality and health of both urban and rural households and also hamper efforts to meet Vietnam's commitment to global emission targets. The degradation of Vietnam's natural resource assets pose additional risks to sustainable gains in poverty reduction and shared prosperity. With most of the poor relying on these assets (e.g. agricultural land) as their main source of income the sustainable use of these assets is important to control the vulnerability of the natural resource dependent households to shocks. Vietnam is also vulnerable to natural hazards and climate change, such as typhoons, floods and droughts. Vietnam has incurred significant costs and loss of life due to variable weather patterns. Vietnam will increasingly bear such setbacks if the degradation of natural systems is not addressed, as these systems are important for resilience. The shortcomings in the current mechanisms for planning and disaster preparedness, response and recovery make Vietnam vulnerable to additional losses due to climate change.

**Governance weaknesses:** While Vietnam's existing governance structure has facilitated economic growth and poverty reduction during the past decades, there is a substantial risk that governance weaknesses will constrain future growth and social outcomes. Government effectiveness is being hindered by both horizontal and vertical fragmentation and blurry boundaries between private and public spheres which result in a lack of transparency and accountability in decision making and distortions in resource allocation. How Vietnam manages the transition process and the shifting boundaries between the state and the emerging private sector will fundamentally shape Vietnam's future economy, state and society.

**Rapidly aging population:** Vietnam has reaped the benefits of a demographic dividend in recent decades, with a large bulge in the share of the population of working age resulting from a steep decline in fertility. Now the country faces the downside—a population that is aging at one the fastest rates ever seen worldwide. The working age population as a share of the overall population has already peaked and is projected to decline in absolute terms within two decades. This situation will be transformative in several ways. First, it means that one factor in the country's past rapid growth has faded. Second, the growth in the old-age population will place new demands on service delivery. This includes means a rapid shift in the profile of the disease burden facing the health system. It also poses the danger of a rise in poverty among the old-age population.

## 7. Priorities for poverty reduction, shared prosperity and sustainability

**There are seven key priorities for achieving further progress in poverty reduction, shared prosperity and sustainability in Vietnam.** These priorities are aimed at making the most of Vietnam's opportunities while mitigating some of the identified risks that could undermine future gains in poverty reduction, shared prosperity and sustainability. The proposed agenda cuts across many areas that affect the economy and perhaps more importantly the welfare of the poor and bottom 40. This relatively broad agenda reflects the complexity of Vietnam's development challenges and opportunities. It posits that investments in a broad set of productive endowments are needed for Vietnam to reach its aspirations. Effective market institutions and good governance (institutional capital), quality infrastructure (physical capital), a productive labor force with relevant skills (human capital) and sustainable use of Vietnam's abundant natural resource asset (natural capital) are all critical ingredients of future growth and prosperity. While board in terms of the areas covered, the analysis suggest focused efforts within individual priority areas.

**While the agenda is relatively broad not all priorities are equally important.** There are two main criteria that are used to determine the relative importance of the proposed priorities. The first criterion is the expected impact on poverty reduction, shared prosperity and sustainability. In judging impact, the approach takes into account the critically of the priority to addressing constraints to achieving the twin goals as well as the degree of urgency with emphasis given to those priorities that require short term action, defined as the next five years, coinciding with period of the upcoming Country Partnership Framework. The second criterion is synergies between priorities, e.g. whether a given priorities would affect the twin goals through multiple, cross-cutting channels. An example is reform of factor markets for land and capital, which through their impact on allocation of resources and investment affect productivity of farms and firms and would have substantial positive spillovers and benefits in terms overall growth prospects of Vietnam's economy. While anchored in evidence and analysis, this prioritization exercise relies in an important ways on judgement and benefitted from a process of consultations with the country team, the government and other stakeholders (a summary of consultations is provided in Annex 1).

**TABLE 10 SUMMARY OF PRIORITIES**

Priority Areas	Impact on Twin Goals			Synergies with other priorities
	Poverty Reduction	Shared Prosperity	Sustainability	
<b>Expand inclusion of ethnic minorities</b> 	✓✓✓ ✓✓✓			✓ ✓
<b>Deliver productive infrastructure and competitive cities</b> 	✓✓✓ ✓✓ ✓✓✓	✓✓ ✓ ✓	✓✓ ✓ ✓	✓✓✓ ✓✓ ✓✓
<b>Strengthen economic management and market institutions</b> 	✓ ✓✓ ✓✓	✓✓ ✓✓✓ ✓✓	✓ ✓ ✓	✓✓✓ ✓✓✓ ✓✓

## Transform agriculture and use of natural assets



- Improve the structure of primary production and value chains
- Reduce the environmental footprint of agriculture and land and water polluting sectors
- Enable markets institutions, knowledge of improved practices, and modern technology inform investments in natural resources, agriculture and the agro-food system

✓	✓✓	✓✓	✓✓✓
	✓✓	✓✓✓	✓✓
	✓✓	✓✓	✓

## Adapt service delivery to new expectations and aging population



- Boost completion rates and quality of upper secondary and tertiary education
- Expand and reform pension, health, and social protection systems
- Address particular gender equity challenges

✓✓	✓✓✓		✓✓✓
✓✓	✓✓	✓	✓✓
✓	✓		✓✓

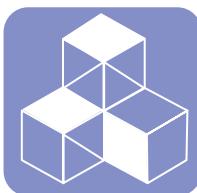
## Augment resilience to climate change and benefits from mitigation



- Scale up approaches for disaster preparedness, response and recovery
- Plan and invest in resilience to climate change
- Lower greenhouse gas emissions by reducing pollution from key sectors

✓	✓✓	✓✓✓	✓✓✓
✓	✓	✓✓✓	✓✓
		✓✓✓	✓

## Strengthen Institutional Foundations



- Transform state-market relations
- Enhance coordination and implementation capacity
- Strengthen voice and accountability

Note: ✓✓✓: Significant, ✓✓: Notable, ✓: Modest

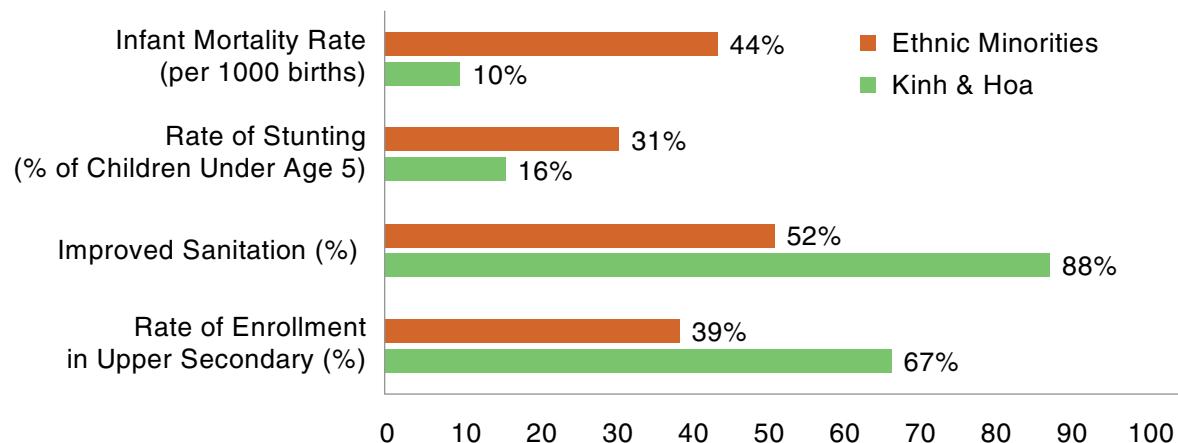
**There are important synergies and linkages between these different priorities.** Beyond their individual relevance, many of the priorities are complementary and mutually reinforcing. A few simple examples illustrate this. Education and skill development are an important prerequisite for economic growth and especially gains in labor productivity. Closing the education gap between the poor and non-poor is also a central element of the inclusion agenda, given the sharp drop in enrolment rates among children of poorer households and ethnic minorities, in particular at secondary and tertiary levels. But a skilled labor force can only be productive if there are a sufficient number of quality jobs. Job creation in turn hinges on functioning market institutions, including sound fiscal management, a stable and efficient financial system, and functioning markets for land use rights that ensure the most productive firms and farms have access to the resources they need to flourish and expand. At the same time, ensuring environmental sustainability and mitigating climate change and disaster risks is key to preserving productive assets and jobs, especially in natural resource-intensive sectors, including in agriculture, which remain a key livelihood source, especially for the poor and bottom 40.

## Priority 1: Expand inclusion of ethnic minorities

**Addressing persistent ethnic minority poverty is the critical poverty challenge.** Although poverty measured by the \$1.90-a-day line, has already been all but eliminated, substantial numbers of people still fall below the national poverty line. Projections indicate that approximately 84 percent of Vietnam's remaining poverty, measured using the national line) will be ethnic minorities by 2020. By the spirit of the twin goals, ethnic minorities constitute the core remaining "extreme poverty" challenge in Vietnam.

**Members of Vietnam's 52 ethnic minority groups have historically been much poorer than members of the majority Kinh group and the Hoa (Chinese) ethnic group.** Very large gaps in socioeconomic between ethnic minorities and the Kinh/Hoa are evident in the earliest data (from the 1989 census), reflecting a longstanding divide. Analysis shows that from 1989 forward the conditions of ethnic minorities have advanced substantially, and in a comparison of experiences of ethnic minorities around the world, Vietnam stands out as a case where minorities have shared to a great extent in the benefits of overall economic growth.<sup>54</sup>

**Figure 54: Substantial gaps remain for ethnic minorities**

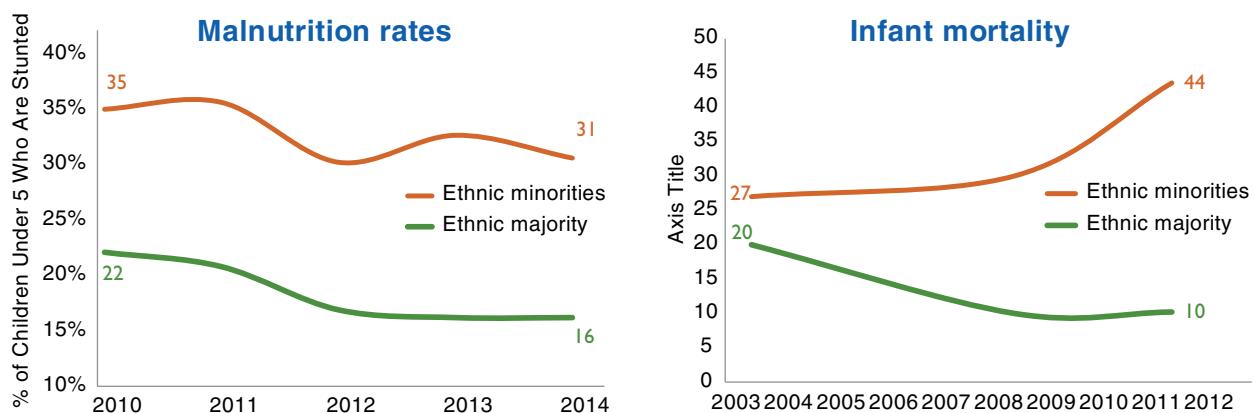


Source: World Bank staff analysis of VHLSS 2014 and MICS 2014 data.

**Despite progress, ethnic minorities remain disproportionately poor.** The most recent data from various sources provides reason for alarm: child malnutrition rates for ethnic minorities remain flat, progress on ethnic minority poverty reduction has stalled, and infant mortality rates for ethnic minorities have actually increased. These developments indicate that growth alone cannot be counted on to boost ethnic minorities out of poverty.

<sup>54</sup> The causes of poverty of ethnic minorities in Vietnam has been the subject of a large number of studies, e.g., ADB (2003), DFID and UNDP (2003), Oxfam and ActionAid (2009), and World Bank (2009, 2012). A series of studies have carried out statistical decompositions of majority-minority differences in consumption or earnings, including van de Valle and Gunewardena (2001), Baulch et al (2007), Baulch et al (2010), and Dang (2012). Hall and Patrinos (2012) include Vietnam in a book-length treatment of poverty of ethnic minorities and indigenous peoples around the world. A comprehensive survey of the literature on these gaps is found in the Vietnam 2035 study. The discussion presented here is limited to some key issues.

**Figure 55: Little improvement in nutrition and increased infant mortality for ethnic minorities**



Sources: Analysis of National Institute of Nutrition surveys and MICS 2006, 2011, and 2014 reports.

Note: For the nutrition figures, the ethnic-majority group includes only Kinh, while in the infant-mortality figures it includes both Kinh and Hoa.

**The persistence of ethnic minority poverty is the product of disadvantages across a broad set of domains.** These include social exclusion and lack of ability in the Vietnamese language; geographical isolation and low mobility; limited access to quality land; low levels of educational attainment and systemic obstacles to educational advancement; poor health and nutrition; and limited service access. The Vietnamese government has recognized the challenge of ethnic minority poverty, and commitments to promote ethnic minority development are prominent in recent government decrees, the draft 2016-2020 Socio-economic Development Plan, and the 2013 Constitution.

**There is no special ethnic minority path out of poverty.** A Bank study found that ethnic minorities who have moved out of poverty follow paths very much like those of successful Kinh and Hoa. They move from subsistence agriculture to pursue cash crop production and activities including aquaculture and forestry, diversify into off-farm activities, and then investing more in their children's education. However, the combination of disadvantages faced by ethnic minorities has limited the number who have followed this path.

**In practice, much of the policy effort towards ethnic minorities has focused on ethnic minority education, infrastructure (particularly local roads) in ethnic minority areas, and livelihoods interventions to encourage ethnic minority productive activities.** Rigorous evidence shows that schools are effective in closing educational achievement gaps for ethnic minorities and that rural infrastructure boosts ethnic minority incomes. Evidence is thin on the effectiveness of livelihoods interventions for ethnic minorities.<sup>55</sup> Some such efforts have lacked a clear rationale or have not been well tailored to ethnic minorities.

<sup>55</sup> Unpublished findings from the Young Lives study show the effectiveness of schools for ethnic minorities, and Mu and Van de Walle (2009) shows the impact of rural roads for ethnic minorities.

**Given the concentration of ethnic minorities in agriculture and natural resource activities, one part of policy should be aimed at improving their productivity.** This could include renewed livelihood efforts, coupled with careful and critical evaluation to determine what particularly types of initiatives are successful. Support is also need to ensure that their natural resource-based safety net remains resilient to weather and other shocks and that they are not subject to displacement as a result of other land consolidation efforts or infrastructure investments. Other policy changes to boost productivity in these areas, with reference to ethnic minorities, are discussed under Priority 4 in this document. Additionally, tourism has untapped potential as a driver of economic activity in some areas with substantial ethnic minority populations.

**Policy should also draw from the recognition that over the long term, migration will be a pathway to economic integration for many ethnic minorities.** Vietnamese language ability among ethnic minorities, previously an obstacle to migration, is improving among the younger generation, and over time ethnic minorities will develop migrant networks that will ease the path of future migrants. The prospect of migration points to a need to focus on providing equality of opportunity for the next generation ethnic minority children.

**Three interrelated circumstances generate a triangle of inequality of opportunity for ethnic minority children: poor education, malnutrition, and low access to sanitation.** The higher poverty of ethnic minorities can be attributed largely to low educational attainment. The modest levels of ethnic minority enrollment at tertiary and upper secondary levels are a consequence of many factors, including childhood malnutrition, which is in turn driven by a set of causes including poor sanitation. Completing the cycle, children who grow up in poor households are much more likely to drop out of school early, be malnourished, and lack adequate sanitation. In these three areas, policy interventions could close the opportunity gap. These interventions should be implemented on the areas where ethnic minorities are concentrated—the Northern Mountains, the Central Highlands—and be particularly targeted at ethnic minorities specifically.

**Improving education access for ethnic minority children is a first policy priority to boost equality of opportunity.** High-quality early childhood education programs can boost preparation, particularly for ethnic minority children. Placing teaching assistants who know the local language in the first few years of primary school can ease the transition for children who do not learn Vietnamese at home. And financially supporting ethnic minority children can raise attendance rates in upper secondary school.

**Improving nutrition is a second priority.** Early childhood nutrition has substantial effects on early cognitive development and readiness to learn in school. Despite existing programs, high rates of malnutrition persist among ethnic minority children. Two of the most important factors in undernutrition are inadequate knowledge about the benefits of exclusive breastfeeding, complementary feeding practices, and micronutrients, and the lack of time women have for childcare and for themselves during pregnancy.

**A third policy priority is sanitation. A major driver of malnutrition is lack of improved sanitation facilities.** Poor access to sanitation is also one factor behind the high levels of infant mortality among ethnic minorities. A national sanitation program can achieve universal usage of improved sanitation. Policies, targets, and incentives under such a program should be aligned to promote community-wide behavior change, including targeted support for the

poor, such as low-interest household financing and/or targeted output-based subsidies. Affordable and accessible toilets provided through local private suppliers can move more people from open defecation and unimproved sanitation to improved sanitation. Community mobilization and behavioral-change communications can support a new social norm within communities.

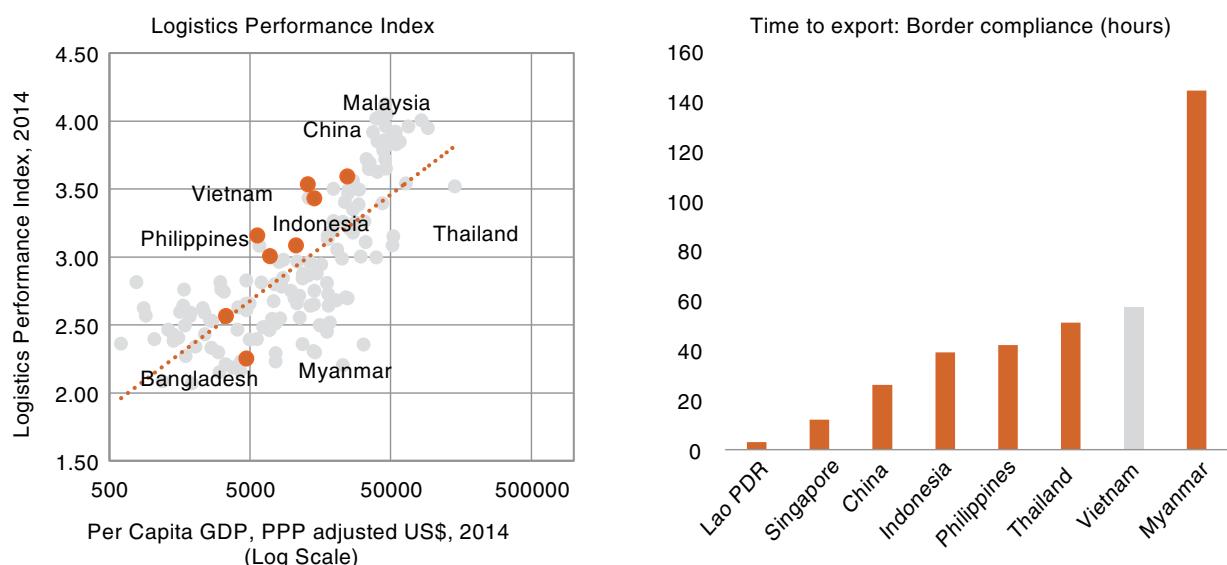
**In developing programs to address ethnic minority poverty more generally the government could benefit from experimenting, monitoring, and evaluating, since in many cases the evidence on “what works” is thin.** Pilot approaches could be carefully evaluated before programs are expanded to scale. And in many cases initiatives could draw on promising new insights from behavioral economics. Choices about sending children to school, feeding infants, and constructing latrines are determined by a variety of factors other than cost–benefit calculations. Interventions that seek to “nudge” behavior can be effective and cost-efficient.

**Finally, lack of voice in policy development and program implementation has been a factor in the persistence of ethnic minority poverty.** At the central level, relevant policy is chiefly in the hands of the Committee on Ethnic Minority Affairs (CEMA). Few individuals in the CEMA organization at a high level, however, are ethnic minorities themselves. District and commune-level authorities, even in areas with substantial populations of ethnic minorities are typically dominated by members of the ethnic majority groups. Consequently, ethnic minorities typically have little role in local decision making. Civil society organizations advocating for ethnic minorities have a low profile and are discouraged by the existing legal framework. Opening opportunities for ethnic minority organizations and promoting ethnic minorities in government bodies could help make policies towards ethnic minorities more effective.

## Priority 2: Build productive infrastructure and competitive cities

**Sustained investment in and effective management of infrastructure assets is an important priority to prevent emerging infrastructure bottlenecks from becoming a constraint to growth and job creation.** Ensuring reliable electricity supply, efficient logistics and transportation, access to cost effective and reliable telecommunication services are critical preconditions especially for the development of high value added manufacturing and service sectors. Economic growth is putting increasing pressure on Vietnam's infrastructure. Freight volumes and electricity demand are projected to expand rapidly, driven by and in turn driving Vietnam's future growth performance. Meanwhile, Vietnamese cities are growing fast and a key challenge for municipal governments is to rapidly put in place the infrastructure to support economic activities, ease urban mobility and provide water, sanitation and other municipal services to the growing urban population. There are also infrastructure gaps in rural areas. Priority infrastructure there include investments that would expand access water and sanitation especially in poor and remote and poor communities. Accordingly, Vietnam's Socio-Economic Development Strategy (2011–2020) places high priority on infrastructure development to achieve high-quality and sustainable economic growth. The Socio-Economic Development Plan 2016-20 (SEDP) estimates demands for investment capital at about US\$139.4 billion, equal to about 10-12 percent of GDP per year between 2015 and 2020.

**Figure 56: Facilitating trade**



Source: World Bank Staff Estimates based on IMF WEO, World Bank

**Further development of connective infrastructure is critical to make most of the opportunities coming with Vietnam's further integration into global value chains.** Vietnam is ranked highest on the World Logistics Performance Index among the lower middle-income countries, but it lags behind its higher-income competitors, including China, Malaysia, and Thailand. Despite its reliance on road transportation (which accounts for three quarters of its inland freight traffic in 2014), Vietnam has only 525 km of operational international-standard expressways. Highway congestion is estimated to cost beneficial

cargo owners (BCOs) \$274 million in 2020; the economic cost of congestion to all users is estimated to be \$1.7 billion annually. Intercity truck speeds in Vietnam average only about 35km/hour. A fragmented trucking industry delivers substandard service to BCOs relative to peer countries.<sup>56</sup> Rail and inland waterways are underdeveloped. Meanwhile, Vietnam's port and marine terminal system is highly fragmented, leading to overcapacity and poor landside integration with other transport modes. Addressing these emerging logistics bottlenecks will require development of multimodal transportation infrastructure (including railway and waterways) using an integrated corridor approach; and modernizing logistics services, including trucking industry, freight forwarding and warehousing as well as further investments in the customs clearance system to make cross-border trade more efficient and reliable (building on the implementation of the ASEAN single window).

**In the power sector, electricity demand will continue to grow fast, necessitating sustained investment in generation, transmission and distribution capacities to ensure sustainable, reliable and affordable energy supply.** It is anticipated that electricity demand will continue to grow by 7-10% annually through 2030. This will require the installation of 25GW of new generation capacity by 2020 and an additional 40-50 GW by 2030 (more than doubling the current capacity of 35 GW). Meanwhile, the lack of cost-reflective electricity tariffs has eroded the financial capacity of the sector and diminished incentives for private investment. On the supply side, balancing economic growth and environmental and climate objectives will require an efficient mix of different energy sources. With hydro already accounting for over 40 percent of Vietnam's generation capacity, renewable resource potential is now mostly solar and wind but unlikely to be sufficient to fully meet future demand.<sup>57</sup> Vietnam has estimated natural gas reserves at around 600 billion cubic meters (bcm), largely offshore, currently underutilized with production in 2013 at approximately 10 bcm. Large undeveloped gas reserves are located offshore in the Malay - Tho Chu and Phu Khanh basin, in the center and south of Vietnam, both with active development interest. Development of these offshore fields and integration with combined cycle power generation is estimated to be cost-competitive with imported coal fired power generation and would have positive balance of payments and carbon footprint impacts. However timely development remains contingent upon mobilization of necessary large-scale project finance and leveraging of capable strategic and technical partners. On the demand side, Vietnam is one of the most energy inefficient economies in South East Asia. Encouraging investments in more energy efficient technologies and infrastructure –including through adequate, cost reflective pricing - could lower electricity demand thereby reducing the need for upgrades in generation capacity (at a potentially lower cost).

**In the water and sanitation sector, lack of access to clean water and particularly to adequate sanitation facilities is a key driver of both child mortality and malnutrition.** Despite great progress over time, many Vietnamese households do not have adequate water and sanitation. Overall in rural areas, 33% lack sanitary latrines and 39% do not have access to clean water.<sup>58</sup> Those without access are disproportionately poor and ethnic minority households. There are also growing urban sanitation concerns: only 10% of wastewater and 4% of fecal sludge is treated. In communities without improved latrines, children are often exposed to bacteria, viruses, fungi, or parasites that cause intestinal infection. Chronic infection limits the ability of the body to absorb nutrients and reduces growth. Children who are

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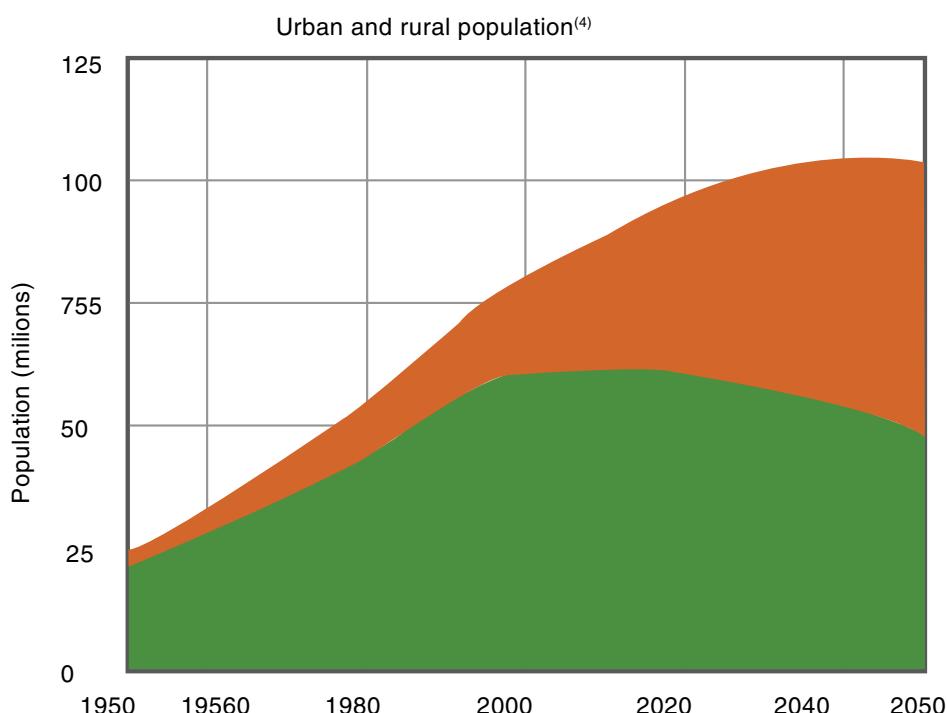
56 "Efficient Logistics" World Bank 2014.

57 World Bank (2015) Power Sector Background Note: Sector Achievements, Challenges, and the Role of Renewable Energy and Coal.

58 World Bank staff analysis of 2012 VHLSS data.

malnourished in part due to poor water and sanitation are much more likely to have cognitive deficiencies and drop out of school. In Vietnam, stunting rates are high precisely among the communities that are most likely to lack improved sanitation facilities.<sup>59</sup> A WSP study found that poor sanitation causes considerable financial and economic losses in Vietnam. Financial losses---reflecting expenditure or income losses resulting from poor sanitation---are equal to roughly 0.5% of annual GDP, while overall population welfare losses are equal to 1.3% of GDP.<sup>60</sup> Experience has demonstrated that expanding access is not entirely a question of providing infrastructure. Complementary to infrastructure is an adequate regulatory framework, and well-designed targeted support for the poor. Additionally, in regards to rural sanitation—which is chiefly a question of private infrastructure—community mobilization and behavioral change campaigns are needed to support a new social norms within communities.

**Figure 57: The rise of Vietnam's cities will continue**



Source: UN World Urbanization Prospects.

**Finally, Vietnam's rapid urbanization process is intensifying pressures on urban infrastructure and services.** Drawn by the economic opportunities offered by Vietnam's major urban centers rural-urban migration continues unabatedly. Having doubled over the last 25 years, Vietnam's urban population is projected to double once again in the next 30 years. All of Vietnam's population growth is now taking place in cities. This coming urban age holds potentially significant economic benefits for Vietnam. Cities tend to have higher productivity due to economies of scale and clustering of firms allowing for knowledge spill-overs, innovation and dense ecosystems of service providers, suppliers and thick labor markets in which firms can flourish.

59 Quatri and Smets 2014

60 Water and Sanitation Program (2008).

**While urbanization initially achieved high levels of density, many cities are now experiencing unprecedented (and in some cases uncoordinated) land expansion.** Urban land increased by about 50 percent between 2000 and 2010 while urban residential land almost doubled during the same period. Density fell from 19.4 urban residents per hectare in 2005 to 18.6 in 2010, despite more 3 million city dwellers. Low density development increases the cost of municipal service delivery and dampens agglomeration benefits.

**Relatively low and declining urban density is aggravated by the lack of efficient mass public transportation systems.** As a result, Vietnam's urban areas are fragmented and do not function like economically and physically integrated metropolitan regions. And urban mobility needs will continue to change. Not only will the growing urban population exert pressure but with rising household incomes (and likely decline of car prices after the elimination of import duties in 2018 under the ASEAN free trade agreement) cars are likely to increasingly replace the now ubiquitous motorcycles as the preferred mode of transport. If such patterns persist, Vietnam's cities will be overwhelmed by traffic congestion and emissions without reaping the full benefits of agglomeration.

**Without effective and integrated urban planning and adequate investment in urban infrastructure and service delivery, Vietnam could see these positive agglomeration economies reverse course.** Foreshadowing these risks, Vietnam's major cities are already experiencing unprecedented traffic congestion and pressure on core municipal services, as urban transportation, water and sanitation systems, health and education services, and other physical and social infrastructure have struggled to keep pace. Moreover, rapidly rising urban populations strain natural resources and pollute the environment.

**These significant national and subnational infrastructure needs will have to be addressed under tight financing constraint.** Over recent years Vietnam's public debt has risen rapidly limiting the room for further reliance on debt financing. These existing debt pressures are amplified by Vietnam's declining access to concessional external borrowing which has served as major source for infrastructure investment to date. Meanwhile, a steady decline in the revenue-to-GDP combined with rising recurrent spending have constrained fiscal space for needed investment in physical infrastructure. After peaking at 11 percent of GDP in 2010, government budget capital spending has fallen to estimated 6 percent of GDP in 2015. Moreover, at the subnational level few subnational governments can raise sufficient revenue to finance infrastructure on their own, leaving many heavily dependent on the central government transfers.

**These tight financing constraints reinforce a focus on institutional reforms to enhance efficient planning, selection, financing and implementation of infrastructure projects and better coordination across levels of government.** Fragmentation of public infrastructure investment, poor master planning and project design, lack of capability in site management and supervision, and delays and cost overruns have all contributed to inefficiencies in public investment. With provincial governments now account for about 80 percent of total public investment, provinces often select and undertake their own infrastructure projects often in isolation, without employing a strategic approach linked to national priorities and with little regard to supply-demand considerations. This has resulted in over-investment and duplication of infrastructure assets while at the same time limiting resources available for investment in national trunk infrastructure and spatially and functionally integrated infrastructure

development.<sup>61</sup> Stronger mechanisms and incentives to ensure cross-provincial and cross-functional coordination especially for investment in trunk infrastructure would go a long way to achieving greater returns.

**In addition, Vietnam aims to mobilize more private sector participation in infrastructure financing and delivery.** While the government has put emphasis on attracting private investors to infrastructure sectors, interest is dampened by a challenging legal and regulatory environment and cumbersome approval processes. A fairly rigid approach to risk sharing between public and private sector pose often an impediment to greater private sector participation. Nevertheless, Vietnam's PPP projects have averaged about \$1 billion per year from 2000 to 2014<sup>62</sup>, mostly for build–operate–transfer (BOT) projects in the power sector. To strengthen the legal framework for PPPs, the Government of Vietnam in 2015 promulgated Decree No. 15/2015/NĐ-CP (Decree 15) on public-private partnerships (PPP) to help address Vietnam's infrastructure challenges and provide an enabling business environment that promotes private sector participation in long-term strategic public infrastructure development.

**In terms of managing urban growth, integrated urban planning, effective land markets and investments in municipal infrastructure are crucial to maximizing the economic benefits of agglomeration and density while mitigating risks of congestion and costly urban sprawl.** The core of urban policy reform is the need to let urban land markets emerge. Better managing land use and zoning is crucial to avoid environmentally- and economically-costly urban sprawl. Reforming land institutions — like strengthening land registration and adopting market land valuation— and discontinuing land-for-development deals are priorities to reduce excessive and fragmented urban land conversion. This would need to be underpinned by integrated urban planning and investment in municipal service delivery. Strengthening coordination between urban development and transport planning could help achieve transit-oriented development and promote high-density mixed-use development around (intermodal) mass transit corridors and systems. Finally, reforms of the system of intergovernmental relations need to continue to empower local authorities –both financially and administratively- to be responsive to local needs while strengthening accountability mechanisms and performance incentives. This could include clarifying expenditure responsibilities, expanding revenue autonomy (including development of a property tax system) and putting in place a prudent framework for municipal borrowing.

**Developing a portfolio of cities comprising of large and secondary cities that can facilitate effective rural-urban transformation.** Besides an absence of a well-functioning land markets, Vietnam will have to amplify economic density around large metropolitan areas and secondary cities with demonstrated potential. It will have to shorten the economic distance to large markets to enable specialization. And it will have to dissipate social division in access to services between migrants and urban residents to encourage human capital development for greater agglomeration economies. This will require a mindset change about urbanization, the benefit will be agglomeration economies across a vibrant portfolio of towns

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<sup>61</sup> World Bank. 2013. *Assessment of the financing framework for municipal infrastructure in Vietnam*. Hanoi.

<sup>62</sup> World Bank. Private Participation in Infrastructure Project Database. <http://ppi.worldbank.org/> (accessed 17 September 2015)

and cities performing complementary functions. Metropolises such as Hanoi and Ho Chi Minh City will interact with the global economy and provide the urban diversity that encourages learning, innovation, and new product development, connecting people and firms to the world. Cities such as Can Tho, Da Nang and Hai Phong will allow producers both to benefit from clustering because they can choose workers and materials from a bigger pool and to engage in beneficial competition. These cities will be aggregators for the hinterland economy and be part of global value chains. Towns such as Buon Ma Thuot in the Central Highlands, which is famous for its coffee, will let firms and farms exploit plant-level scale economies by providing roads (for inputs and outputs) and schools and other amenities (for workers' families).

## **Priority 3: Strengthen economic management and market institutions**

**Enhancing the prosperity of the Bottom 40 percent rest in large part on the implementation of reforms to return the economy to a productivity led growth path.** The weakening trend in private sector productivity growth reflects that redirecting resources to private enterprises alone is not sufficient to create productivity growth, but needs to be accompanied by strong market institutions. For private sector firms and markets, to work as they should, they need strong market institutions, in particular rule-of-law, sound competition framework, effective factor markets, quality regulations and transparent, efficient and fair enforcement. In this regard, Vietnam's institutional reform agenda remains unfinished. There is a growing recognition that institutional legacies, incomplete market institutions, a cumbersome investment climate have become impediments to growth, especially of the domestic private sector. Despite recent improvements, available cross-country competitiveness assessments show that Vietnam is lagging behind other countries, especially on dimensions related to the policy and institutional environment. Firm surveys conducted in Vietnam also confirm that a majority of firms perceive government conduct to be uneven and favoring connected firms in the enforcement of regulations, government procurement and allocation of land use rights. While benefiting individual firms, these policy distortions undermine efficiency and provide incentives to firms to engage in rent seeking rather than productive activities. Vietnam has the potential to join the ranks of industrialized countries within a generation, but this will require tough choices and actions to deepen market institutions and create an environment more conducive to private sector led growth. This entails steps to i) solidify recent gains in macroeconomic stability, ii) bolster financial sector stability while enhancing the sector's role in engendering more efficient allocation of capital, iii) deepen reforms of the state owned sector and iv) creating a more levelled playing field, quality regulations and enforcement.

**First, maintaining macroeconomic stability and resilience is a necessary prerequisite for sustained growth and private sector development.** Vietnam's deeper global integration and further transition to a market-based economy will expose the economy to more macroeconomic volatility, underscoring the importance of sound macroeconomic management to safeguard against shocks.

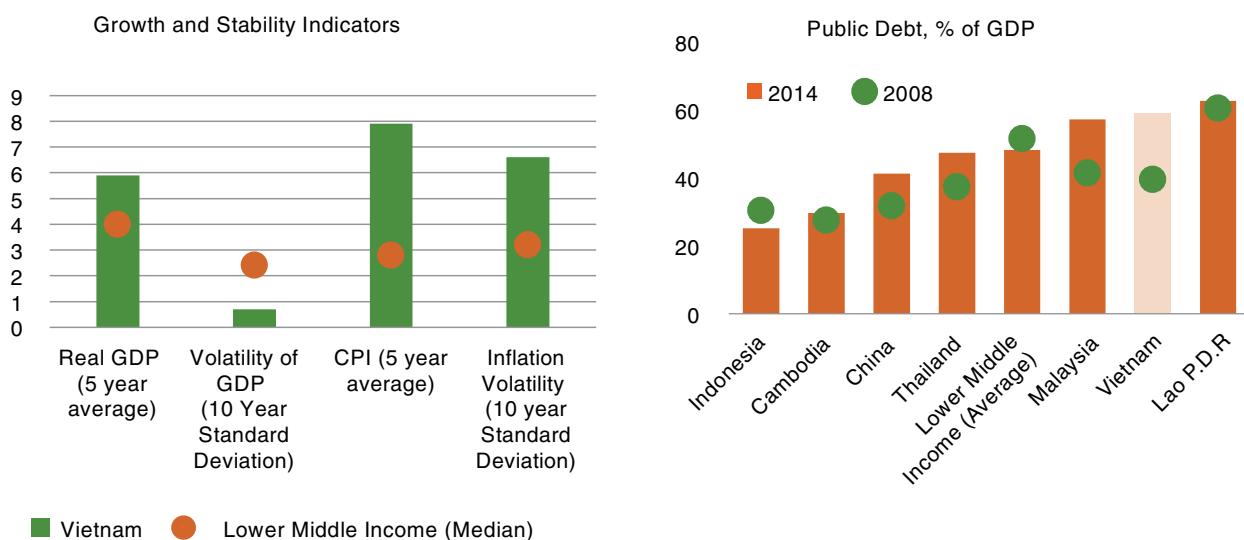
**Despite relatively resilient growth, Vietnam's recent past has been characterized by recurrent bouts of macroeconomic instability.** Unlike other emerging markets, Vietnam did not experience sharp swings in economic activity. However, despite Vietnam's more resilient growth record, macroeconomic volatility has been more severe than in other economies in the region and at Vietnam's income level. While some of the economic difficulties originated from external shocks—overheating caused by massive foreign capital inflows, followed by an external demand shock triggered by the global financial crisis—macroeconomic turmoil was exacerbated by stop-and-go macroeconomic policies, including erratic credit

growth and fiscal expansion. While tentative stability has been restored, the economy still suffers from vulnerabilities built up as a by-product of past policies. Deep-seated banking sector vulnerabilities, sizable fiscal imbalances, high and rapidly rising public debt, volatile fiscal revenues and inefficiencies of public expenditure, especially public investment pose headwinds to future stability and growth.

**Solidifying macroeconomic stability will require fiscal consolidation while tackling vulnerabilities in the banking and SOE sector.** Reining in fiscal imbalances and creating fiscal space to address potential contingent liabilities while safeguarding critical social and investment spending, would mitigate macroeconomic risks and facilitate achievement of development goals. Moving gradually toward using inflation as a nominal anchor with greater exchange rate flexibility would provide a monetary policy framework more conducive to maintaining stability and buffering external shocks. Building on recent gains in stabilizing the banking sector, more decisive measures could be undertaken to resolve NPLs, ensure adequate capitalization and further consolidate the banking sector.

**Figure 58: Resilient growth, but recurrent instability...**

**...and limited fiscal buffers**



Source: World Bank Staff based on IMF WEO.

**Vietnam faces a significant fiscal reform agenda to rein in accumulated imbalances, enhance domestic revenue mobilization and strengthen expenditure efficiency.** The average fiscal deficit during 2009-14 increased to about 5 percent of GDP, markedly higher than the 1.2 percent during 2003-2008. After large increases in public debt over the past few years, fiscal consolidation is important to stabilize and then gradually reduce the public debt, through a combination of both revenue and expenditure measures. On the revenue side, coordinated tax policy and administration efforts are needed to stabilize the revenue-to-GDP ratio while creating a balanced tax structure suitable for an emerging middle income economy. On the expenditure side, necessary reforms should focus on enhancing spending efficiency, including of public investment and ensuring sustainable financing models in key sectors such as health, education, and pension. In addition, Vietnam faces increasing risks

on its public debt portfolio. Having benefited from access to highly concessional long-term multilateral financing over recent decades, it must now increasingly confront important policy trade-offs and choices in managing the costs and risks associated with available domestic and external financing sources.

**Fiscal policy reforms could be underpinned by steps to strengthen the institutional foundations for sound fiscal and public financial management.** Coordination between the main institutions of fiscal management, both at the center (Ministry of Finance and Ministry of Planning and Investment), and between the central and provincial governments, is relatively weak and could be strengthened. In addition, further efforts are needed to enhance the comprehensiveness of the budget given the still large number of fiscal and quasi-fiscal activities that are not reflected in the core fiscal accounts. This could be accompanied by efforts to modernize budgeting procedures (along the lines of the recently adopted budget code), including instilling a more medium term perspective in fiscal policy and stronger systems of expenditure prioritization, underpinned by improved information systems and fiscal transparency. A more unified debt management function would help to both use the opportunities and manage the risks that will arise with Vietnam's transition to a more market based financing model. Finally, the system of intergovernmental fiscal relations also deserves attention to ensure fiscal resources and authorities are appropriately distributed across central, provincial and commune levels in a way that encourages efficient delivery of services, including increased revenue autonomy; review of allocation norms and intergovernmental transfers and more autonomy especially for provinces with high fiscal capacity like Hanoi and HMC to access borrowing from domestic markets.

**Second, a stable and efficient financial system is crucial for allocating Vietnam's high national savings—32 percent of gross domestic product (GDP) in 2014—toward productive investment.** Vietnam's has a fairly large financial system for a low middle-income country. But the system is relatively undiversified and continues to be dominated by banking sector with banking sector asset accounting for about 135 percent of Vietnam's GDP and 80 percent of total financial system assets. Moreover, despite its relatively large size the impact of the financial system on long-term economic growth happens more through improving the productivity of capital rather than through simply increasing capital intensity. Boosting credit growth may induce short term economic growth but if capital allocation is impaired this may lead to poor investment and asset quality and hence intensify risks of instability. For the financial system to support sustainable, long term growth, it needs to face incentives to distribute capital and risks efficiently, so that growing credit is allocated to productive enterprises and investments.

**State presence in the banking sector remains large and involves both direct and indirect ownership links.** Five major state-owned commercial banks continue to account for almost 40 percent of banking sector assets in addition to cross-ownership of the state, SOEs and State Owned Commercial Banks (SOCBs) in several other commercial banks, which undermines the corporate governance of the banking sector and amplifies the potential for systemic risks. The share of foreign banks in total commercial banking assets has remained small and relatively stable at 10 percent, partly reflecting the statutory foreign ownership limit in the banking sector.

**Figure 59: Vietnam's financial system is dominated by a large banking sector**



Source: World Bank Staff based on data from SBV, ADB and World Bank.

**Despite growth in recent years, Vietnam's capital markets remain shallow.** Corporate bond and equity markets - a major source of investment financing and long-term capital in many middle-income economies- are at a nascent stage of development. The domestic fixed-income market is small, dominated by government bonds. The Social Security Fund (SSF) is the only institutional investor of significant size, managing pension reserves amounting to 6.5 percent of GDP. Equity markets have grown rapidly but are still at an early stage of development. While the number of companies listed in the two exchanges has increased dramatically, primarily due to the "equitization" of SOEs, total equity market capitalization is relatively small at 20 percent of GDP, reflecting the fact that listed firms in Vietnam are generally small.

**The banking system is still struggling to overcome vulnerabilities that have built up as a result of a credit boom in the recent past.** Erratic credit growth has been a major source of macroeconomic instability. A rapid credit expansion through the 2008 global financial crisis was followed by a credit squeeze in 2011, triggered by a decline in real estate prices and economic slow-down. As a result, the banking system accumulated a significant amount of non-performing loans (NPLs), and several small banks have experienced liquidity and solvency problems and there are lingering concerns with regards to the overall capitalization of the system. Despite looser monetary policy in 2012, credit growth remained sluggish reflecting strained banks' balance sheets and the need for deleveraging. The banking sector continues to exhibit lingering asset quality risks. System-wide nonperforming loans (NPLs) are reported to have declined to about 3 percent of total loans, but this is likely to understate the true level of problem loans. Part of the reduction in reported NPLs is due to transfers

of NPLs (equal to about 3.8 percent of gross loans) to the Vietnam Asset Management Company (VAMC).<sup>63</sup> While Banks are required to gradually provision against assets transferred to VAMC, the underlying credit and associated capital impairment risks have not been fully eliminated. In addition, resolution of NPLs by VAMC has progressed slowly, with less than 5 percent of the transferred bad debts resolved. Efforts in this regard have been hampered by the absence of an enabling legal framework for insolvency and asset titling as well as for protecting VAMC and commercial bank staff against possible lawsuits arising from potential losses to the state in case a fair-market-price-mechanism cannot be established. However, new regulations that took effect on October 15, 2015, introduced a fair-market-value mechanism for NPL purchase by VAMC and allow greater flexibility in the disposal of NPLs, including through direct sale of bad debts. More recently, credit has expanded in 2015, reaching 20 percent of GDP, and the target is the same for 2016. This again poses stability risks that could undermine longer term financial intermediation.

**Putting the financial sector on a more stable footing and enabling healthy financial intermediation will require addressing a complex array of institutional and regulatory factors.** Given the central role of the banking sector in the economy the immediate priority is to address remaining vulnerabilities in the banking sector. While the SBV has taken steps to contain risks of banking sector instability, deeper structural reforms remain important. These include more decisive steps to resolve NPLs, enhance governance structures and risk management capacity, mitigate connected lending practices, and improve financial reporting and supervision. To achieve this loan classification and loan-loss provisioning will be brought in line with international standards and the legal framework for creditor rights and asset resolution will have to be further strengthened. Improving the regulatory and supervisory framework under which banks operate is critical to transparency and accountability in the banking sector and to strengthen incentives for Banks to become more competitive, especially in the context of Vietnam's further integration in the regional and global economy. Vietnam's three supervisory agencies lack independence, supervisory powers, and have weak technical capacity. Despite improvements since 2011, on-site inspection is still deficient and the largest banks have not been inspected in accordance with international financial reporting standards. The supervision of large state-owned financial institutions is impaired by conflicts of interest, as supervisory agencies frequently exercise ownership rights in the same institutions that they supervise. Accordingly it is important to ensure adequate systemic risk monitoring and enhancing the use of adequate macro-prudential tools.

**A strengthened financial sector will contribute towards expanding financial inclusion in Vietnam.** Exclusion from the formal financial sector has been shown broadly to intensify income inequality, as the “unbanked” pay higher costs for financial services or are unable to invest, consume or plan adequately for financial risks. The World Bank's 2014 Global Findex survey found that only 31 percent of Vietnamese adults held an account at a formal institution. This rose from 21 percent in 2011 and although this is a substantial improvement more needs to be done, particularly in rural areas where the number of Vietnamese adults with access to formal financial services is much less than the national average.

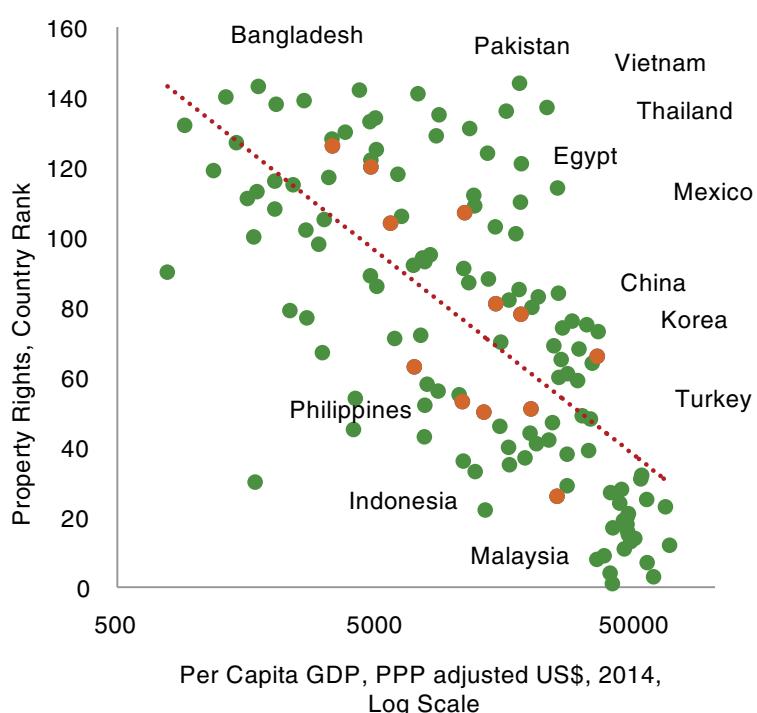
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<sup>63</sup> VAMC purchases are done in exchange for VAMC bonds and banks are required to provide for provisioning against transferred assets within five years (coinciding with the maturity of VAMC bonds).

**The more medium term priority is to further develop capital markets and non-bank financial institutions, which currently remain small and underutilized.** The reliance on the banking sector for long term credit and the slow development of capital markets also undermines access to longer term financing in the economy. While the macroeconomic situation appears to have stabilized since 2012, financial vulnerabilities still need to be addressed by a coherent reform program. Healthy and liquid equity and bond markets could help provide a more reliable source of long-term funding to the private sector and improve corporate governance. Reforms in these markets could mitigate risks posed by an overreliance on the banking sector and help improve the allocation of resources.

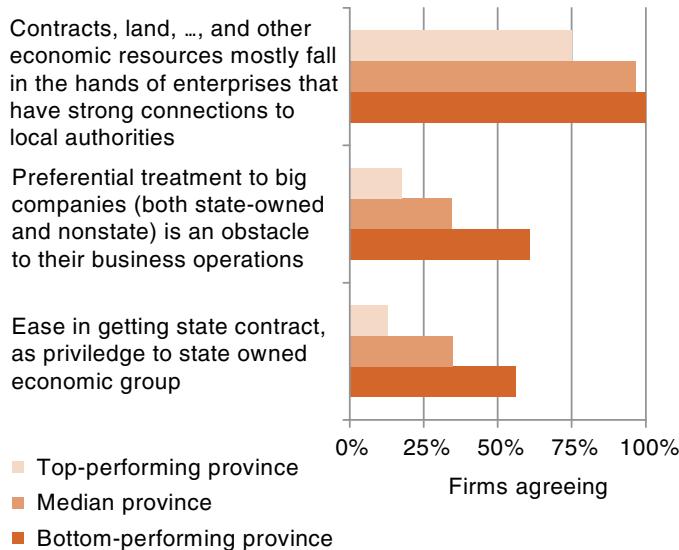
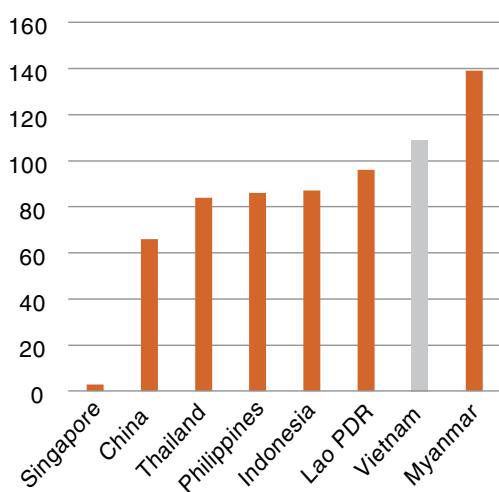
**Third, deeper reforms of the SOE sector remain an important priority.** Enhancing incentives and creating an enabling environment for the restructuring of the state owned sector remains an important economic reform priority for Vietnam. Overall, the SOE legal framework has improved markedly with the issuance of a number of Laws, Decrees and other legal documents in the last five years. Important changes were introduced by the amendments to the Enterprise Law, passed in 2014 which aims at ensuring more equal treatment of enterprises irrespective of ownership types as well as improved corporate governance of SOEs. In 2014 the Law on Management and Use of State Capital Invested in Production and Business and its associated Decrees laid the legal foundation for a more effective ownership function and strengthened the overall management framework for SOE. These improvements in the legal and regulatory framework are important, but the focus now needs to shift towards ensuring consistent implementation. This includes further progress in equitizing remaining SOEs (including divesting from controlling shares), continued divestment from non-core assets, enhanced transparency and elimination of any preferential treatment of SOEs.

**Figure 60: Property rights**



**Finally, creating a more competitive business climate is crucial for private sector and productivity led growth and job creation and for Vietnam to take full advantage of the opportunities offered by further global and regional integration.** Available cross-country competitiveness assessments show that Vietnam is lagging behind other countries, especially on dimensions related to the policy and institutional environment. Vietnam's performance on structural policies in the Bank's Country Policy and Institutional Assessment remains slightly below the average for low income countries, even though it performs better in other dimensions. While Vietnam's ranking in the Doing Business survey has improved to 90th position in 2016 (from 93<sup>rd</sup> in 2015) it remains below China, Thailand and Malaysia. In the Global Competitiveness Index, although Vietnam has regained some ground, overall it has fallen from 59th position in 2011-12 to 68th in 2014/15 assessment.

**Vietnam's institutional environment remains an uneven playing field, considerably reducing the pressure on and ability of domestic private sector firms to expand and grow.** Firm surveys consistently report that connections to the state are necessary to succeed in business and that vested interests' power is on the rise. For example, firms in the PCI surveys report that state connections are critical in accessing contracts, land and other resources. Faced with limited access to productive resources (foremost land and capital), regulatory obstacles and red tape the vast majority of private firms are discouraged from investing and expanding and many have gravitated toward lower productivity, less capital-intensive activities. Most of the few existing larger firms outside the FDI sector are either SOEs or private sector firms engaged in a web of interactions in which state authorities provide direct and indirect support including preferential access to land and capital, while firms in turn provide state authorities with opportunities to participate in and benefit from commercial activities. This has muted pressures to innovate and improve efficiency while attracting significant resources to activities that benefit from connections with the state rather than to productive sectors and activities. Addressing inequalities in the regulatory environment, access to finance, infrastructure and markets (i.e. level the playing field) and removing the relative disadvantages the majority of private domestic sector face is crucial to enabling these firms to become the engines of future productivity and employment growth.

**Figure 61: Vietnam's economy of favors****Figure 62: Irregular payments (Scale 1-7)**

Source: World Bank Staff based on Provincial Competitiveness Survey and Global competitiveness data base.

**While early liberalization has created competitive product markets factor markets – for land and capital- remain subject to government intervention.** As discussed earlier, financial sector reforms are crucial not only to maintain financial stability but also to enable more market driven financial intermediation and more efficient allocation of capital in the economy. Vietnam has maintained exclusive state ownership of land. While there is legal framework for land use rights which principally aims to mimic the efficiency of land property rights and markets within the constraint of state ownership, in practice state authorities, especially at the provincial level, remain heavily involved in the distribution of both rural and urban commercial land. Provincial governments control the primary market for most commercial plots while SOEs –many of which hold significant land use rights- are key players in the secondary market. In the absence of clear market and price signals the allocation of land is driven by administrative controls and vulnerable to inefficiencies at best and favoritism at worst. The allocation of land, its ownership and management is an area in which reforms would be most likely be arduous, requiring major institutional and governance changes. The benefits of these reforms, however, would be cross-cutting for infrastructure development, agriculture, urban development and environmental sustainability.

**Going forward, deep and comprehensive trade agreements, such as TPP and the EU FTA can serve as an external anchor for productivity enhancing structural reforms.** TPP is not only removing tariff barriers, but will also have tangible impacts on regulatory quality, intellectual property rights, investor protection, competition, SOE management, labor and environmental standards, food safety, public procurement and liberalization of services, including financial services and telecommunications. While implementation of these commitments will be particularly challenging for Vietnam –given its gradual reform path and institutional legacies (e.g. large SOE sector, incomplete market institutions, etc.), Vietnam has shown in the context of its accession to WTO that it is able to leverage external commitments to advance domestic reforms, especially in challenging reforms areas.

## Priority 4: Transform agriculture and use of natural assets

**Agriculture (including fisheries and forests and the agro food system) plays an important role in Vietnam and will continue to contribute to achieving the twin goals in a sustainable manner.** Although, reliance on agriculture is declining on average, there is significant variation across and within regions. For example, there is significant decline in agriculture as an income source in the Red River Delta and Northern Mountain areas, while agriculture remains a leading source of income in the Mekong Delta and Central Highlands. The natural resources that directly and indirectly contribute to agriculture also remain an important part of the livelihood portfolio of marginalized households, including ethnic minorities.

**This priority focuses on measures needed to transform agriculture and promote the sustainable use of natural assets.** It emphasizes more market-driven production systems, value addition, strengthening the role of private sector and agribusiness as a means to link smallholder farmers to market and enhance productivity, and reduce environmental footprint of subsector activities. It also calls for some economy-wide reforms especially in relation to land consolidation and land markets, the operating conditions of state-owned companies, policies and institutions associated with research and development, collaboration among private entities, the role of government, and public spending in the relevant sectors. The reform priority highlights the importance of using vertical integration, innovation, knowledge of good practices, and modern technology to improve competitiveness in domestic and international markets. The aim is to produce ‘more from less’, that is generate greater economic value (including producer and consumer welfare) while using less human and natural capital. This would increase productivity, enhance competitiveness, and help reduce the environmental footprint of agriculture and other natural resource based industries.

**Reform measures should support producers of agricultural and natural resource based commodities to seize opportunities created by the changing consumption patterns.** As Vietnam’s middle class grows, there are opportunities in the domestic market resulting from increased consumption of livestock, dairy and other sources of protein. There are also changing consumption patterns for wood-based products and concerns regarding sustainability. Going forward, the expanding domestic market will present opportunities similar to export markets. To respond to these opportunities, landholders should have greater choice and flexibility in land-uses. The government should lift some of the existing restrictions on conversion of agricultural rice land and consider reallocating large areas of lowland for cultivation of crops other than rice. This would help catalyze investment in agriculture and promote diversification, which in turn would spur activities and employment in the agro-food

system. Complementing these measures should be improved access to finance, as this would support adopting new and innovative practices. In the forest sector, access to technical know-how, credit and opportunities to internalize public benefits from sectoral investments (for example in sawnwood production or coastal forestry) would motivate positive changes in forest management.

**Land consolidation opportunities, that mitigate potential negative social impacts, will be important for improving the production structure of agriculture.** In 2011, 69 percent of farm units were less than 0.5 hectares. For small landholders, land consolidation could help upgrade their production systems to more commercial systems and benefit from economies of scale. Amendments to policies that restrict land consolidation, such as the regulations that place limits on the annual cropland holding sizes (which was three hectares in 2015 with some exception) and policies that designate the best farmland for rice production are necessary to enable local entrepreneurs or other investors to optimize resource use.<sup>64</sup> The government needs to increase efforts such as those known as “small farms large fields” which promote cooperative farming, or facilitate plot exchanges between households. In some cases, households have leased out their land to companies and arranged for certain household members to continue working on the professionally managed farms.<sup>65</sup>

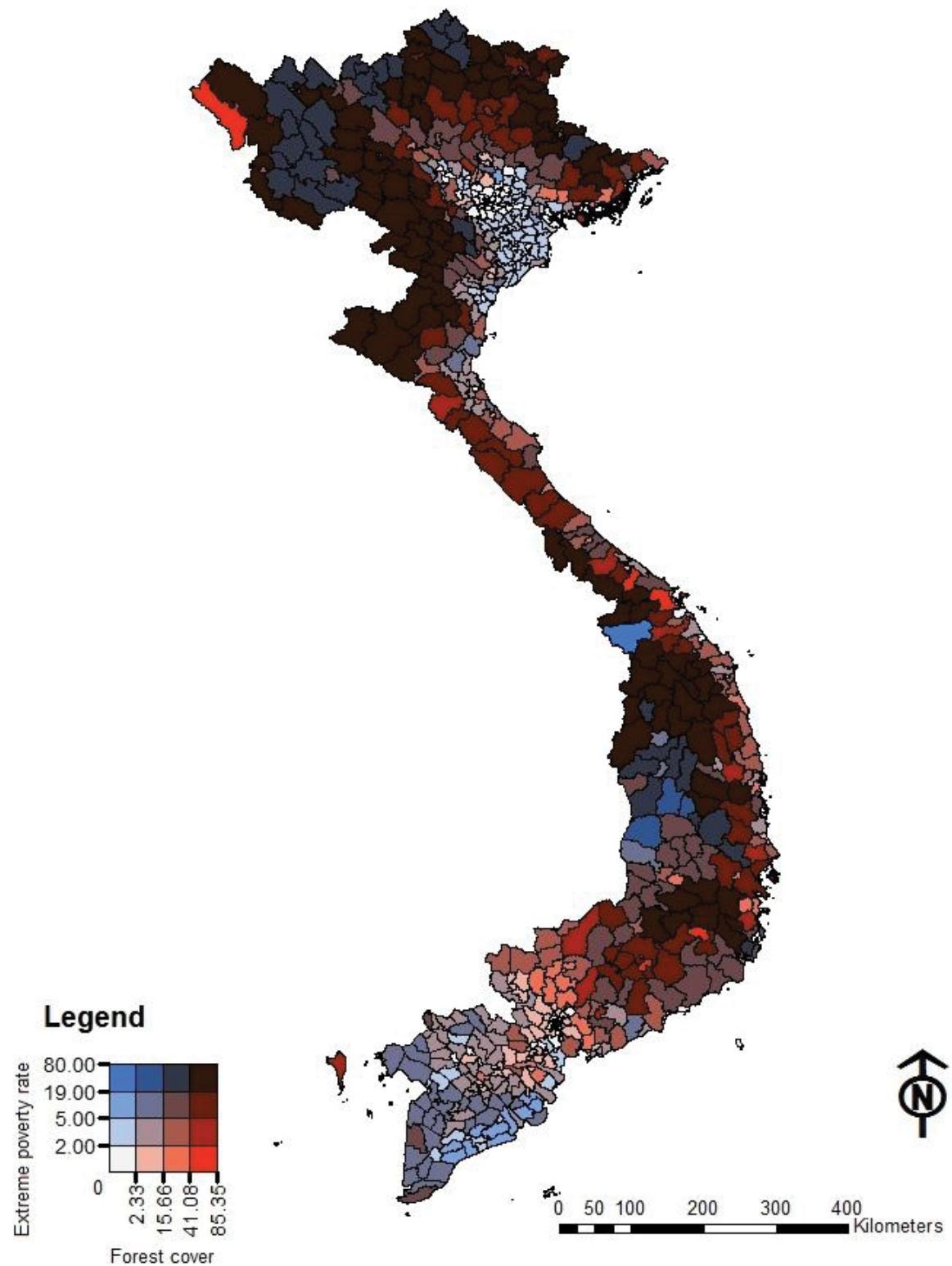
**Land consolidation should not, however, be equally applied across all rural areas of Vietnam.** In parts of the Northern Mountains and Central Highlands, where poor and ethnic minority households reside in close proximity to forests, land consolidation may not result in its intended benefits as many of these areas are not suitable for agricultural food crops. For many of these communities limited access to alternatives and cultural practices create an inextricable connection between them and the environment. They rely on natural resources for a wide array of subsistence and economic services, including foods, medicines, fuel, building materials, traditional handicrafts, and income generating activities. Many of these communities also manage agroforestry systems which include perennial and subsistence crops. For these households, key support is to ensure that their natural resource-based safety net remains resilient to weather and other shocks. It is also important to ensure they are not subject to displacement as a result of other land consolidation efforts or infrastructure investments.

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64 World Bank, 2012

65 World Bank, 2016

**Figure 63: Extreme poverty vs Forest cover**



**The government should make public investments that catalyze improved land management among private investors.** Public budget could be used to co-finance private land managers' environmentally friendly investments that generate public goods (for example, by subsidizing landowner restoration of riparian areas and coastal forests). It could also be used to pay or provide financial incentives to producers and communities for ecosystem stewardship (for example, through preferential credit to producers who adopt long rotation timber and produce carbon sequestration benefits or use sustainable water management practices). In Dak Lak, the government is cost-sharing coffee farmers' adoption of water saving technologies and providing preferential credit to farmers whose replanting of coffee is being accompanied by improvements in soil and water management practices. Initiatives similar to the Payment for Forest Ecosystem Services (PFES), such as performance based payments for reducing emissions from deforestation and forest degradation, should also be considered.

**Vietnam should enable land markets because they help lower the environmental footprint of agriculture and reduce pollution of land and water.** Currently there are many industrial and other high-polluting activities located in rapidly growing urban areas of Vietnam. The market solution to rising urban land values is to displace lower-valued industrial sites. In Vietnam, however, the market is not playing this role. Finding alternative sources of revenue for local governments – such as through property sales, or income taxes – would help remove highly polluting industries from densely populated areas. The example of industrial relocation from Dalian, China illustrates how transforming land markets can be used to the benefit of environmental quality. In the case of agriculture, well-functioning land markets would result in relocating the production of commodities such as coffee and rice to where it is environmentally and financially sensible.

**Vietnam should adopt policy reforms that help manage pollution and optimize use of water resources.** The government could put in place and enforce incentives (e.g., effluent fees) to effectively reduce water pollution and help public wastewater utilities cover investment and operation and maintenance expenses. Raising wastewater fees would also meet a prerequisite for greater private sector investment. Similarly, management practices and technical solutions that can lower water and fertilizer use, and approaches to rejuvenating aging plantations (for example rice production practices that alternate wet and dry rice, lowering water use and GHG emissions) would help reduce excessive use and pollution of water.

**Better integrated planning, regulations and incentives are also needed to efficiently allocate water resources across different sectors.** In the agriculture sector, many support policies in Vietnam are working counter to the environment, such as waiving of water use fees. Reversing this, while maintaining measures to protect the rural poor, could help reduce wasteful water use. Adoption of measures to expand water supply and availability will be important in some regions and sectors. This could include well-planned investments in multi-year storage infrastructure such as dams, development of regional water supply schemes, rainwater harvesting, and more. Such measures will contribute to more than agricultural transformation and promote sustainable water use more widely.

**Modernization of agriculture and improved management of natural resources will require adopting more knowledge-driven approaches.** Producers will need information and technical support on meeting food safety requirements and climate-smart agriculture, land and forest management technologies. This will require investment in human resources and infrastructure for research and development (for example, investments in laboratories

and people to research how to meet food safety requirements in domestic and export markets), data collection, and transfer of information. The public sector should not generate all the necessary information and innovations. Instead, it should focus on collecting and maintaining reliable data on critical environmental and natural resource parameters and facilitating transfer of information and catalyzing greater private sector involvement in knowledge generation. More generally, there will be a need for service providers who can assist with improving production, meeting the quality standards of more mature and informed domestic and international consumers. Promotion of collective action through industry associations and encouragement of these associations to serve technical and professional functions will be beneficial. It also could result in more income and skilled jobs in agriculture and management of natural resources.

**The government should generate and make publicly available key data including slope, precipitation, land suitability, pollution and more.** To improve the quality, consistency, and public and private sector access to data, the government should:

- Consider putting in place a platform for harmonizing and maintaining updated information
- Promote the use of current and affordable information and communication technology and publicly accessible spatial data apps to readily collect and share real time information on climate, weather, water, soils, air quality, and more
- Build the capacity among research organizations and think tanks to analyze data, and ensure these organizations prioritize approaches to improve public agencies' use of data and new ways of sourcing information to improve monitoring and enforcement, and develop methods for using data to inform decision-making
- Require coordination between research organization and public agencies, to ensure the technical assistance on improving environmental management and natural resource use contributes to policy implementation
- Improve access to information on key variables (for example, water consumption and pollution). Publicly accessible information will also help identify laggards in making investments and adopting improved processes for handling environmental issues (for example, waste water treatment).

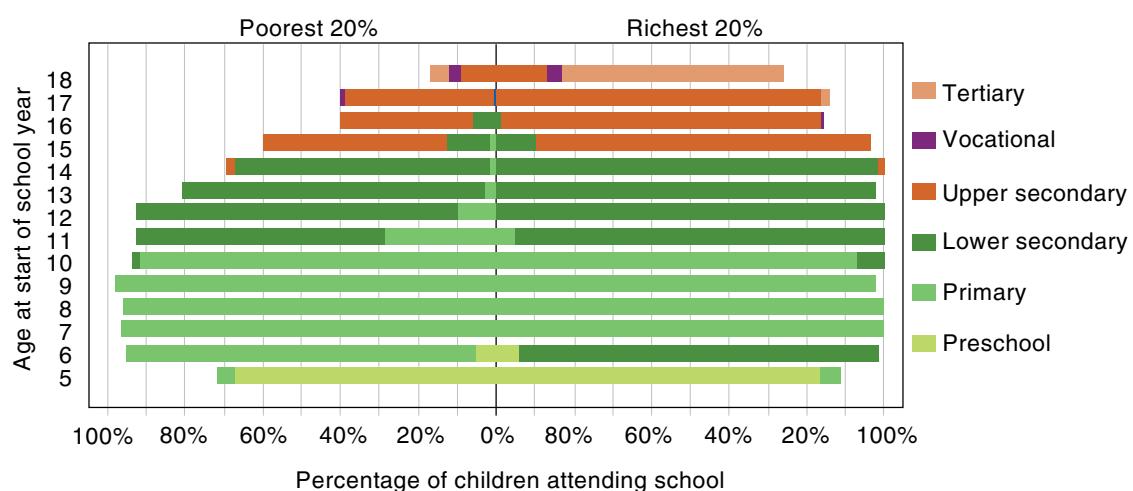
**Vietnam should bolster the capacity of its public institutions to play more of a facilitative role in agriculture, natural resource use, and environmental management.** As the pressures and economic justification for the modernization of agriculture (including fisheries and forestry) increases, continued government management of change could constrain the innovativeness and resilience of Vietnamese farmers, and potentially deter investment in the subsectors. This should be avoided in order to capitalize on the opportunities to create jobs and improve income generation from agriculture and use of natural resources. During this period of transformation, the government should monitor and enforce programs and policies that aim to reduce negative environmental impacts, rather than prescribe what needs to be done.

## Priority 5: Adapt service delivery to new expectations and aging population

**Service delivery across a broad set of areas emerges as a priority for two reasons.** First, investments in human capital are a critical ingredient of the broader growth agenda, as Vietnam seeks to move towards a new growth model, which will drive continued growth in the incomes of the bottom 40 percent. Second, access to and quality of services delivered are a principal determinant of the direct welfare of the bottom 40 percent and the poor. Additionally, addressing the challenges faced by disadvantaged groups including ethnic minorities, people with disabilities, and urban migrants is in large part a question of service delivery. The agenda under this priority encompasses a set of initiatives in education, health, and social protection, along with some particular actions to address critical gender inequity.

**While internationally renowned for its success at delivering high-quality basic education, Vietnam's education system fails to capitalize on this excellent foundation as students progress.** Although the system achieves high overall quality and low variation in learning outcomes, many poorer students fail to advance. Large gaps between the poor and the wealthy in school enrollment are visible at upper secondary ages, and very few poor children attend tertiary education. Overall, only approximately half of students now complete upper secondary.<sup>66</sup>

**Figure 64: Large gaps in school enrollment emerge at the upper secondary level: school enrollment pyramid by age and level**



Source: World Bank staff analysis of 2014 VHLSS.

<sup>66</sup> Key sources on education include the World Bank (2013) Vietnam Development Report on skills, the Vietnam 2035 study chapters on innovation and inclusion, and the Vietnam 2035 background paper "Tertiary Education in Vietnam: Characteristic and Challenges."

**Access and equity are diminished by an exam-based system that allocates the limited places in academic high schools.** Vietnamese education policy puts the onus on the student to demonstrate sufficient academic talent to merit a place in upper secondary education, preventing student with marginal exam performance from entering upper secondary school.

**Drop out may be exacerbated by scarce options for relevant, high-quality secondary school.** Students who decide not to continue or who do not do well enough on exams are tracked into technical and vocational schools and programs. The labor market returns to these programs and to stopping after academic upper secondary are low, and may add to low progression and high drop out.<sup>67</sup> While some technical and vocational programs allow students to finish secondary school and obtain a post-secondary credential, many are outdated, too short, and/or not relevant to job success. Often parents report viewing secondary TVET through the stigma of failure to win a spot in academic secondary school. It is possible that the returns to upper secondary will rise as the overall demand for skills increases, but it also likely that reforms will be needed to improve the quality of upper secondary education and make it more relevant to the labor market.

**Despite the high returns, tertiary education also suffers from problems of quality and relevance.** Tertiary graduates relatively higher salaries are thought to reflect their scarcity and inherent talent more than knowledge and skills obtained in their degree programs. With some notable exceptions, tertiary education quality and relevance are hampered by numerous deficiencies. Full-time faculty with PhDs are rare; low salaries oblige many professors to take on large teaching loads at numerous institutions. Numerous bureaucratic obstacles either promote or fail to encourage innovative classroom practices, regular updating of curricula, and/or connecting research and instruction. Required classes and restricted student choice of study programs lower student interest. Much instruction is reported to be overly theoretical and unconnected to the demands of future employment.

**Tertiary education quality and relevance problems have their roots in challenges to implementing an effective regulatory framework.** Over the past decade, Vietnam's de jure regulatory framework for tertiary education has advanced considerably, including a 2012 law promoting university autonomy. Implementation and de facto changes have been much slower in arriving. In this context, the World Bank (2013) highlighted evidence of disconnects between skills needed for employment and those developed by universities and colleges. The narrow definition of tertiary education—with its heavy emphasis on traditional university disciplines and careers—is a final educational obstacle for poorer students. Their greater ranges of academic abilities and future career opportunities should be met with a continually-updated supply of tertiary-level study options. The current regulatory framework, however, retards the growth of responsive tertiary institutions—alike for universities and non-university institutions. Policies suppress revenue generation, fail to reward merit, discourage innovation, and limit the number of providers and types of provision. Paradoxically, limitations on tuition and a purported concern for quality—both of potential benefit poorer students—are the main levers through which access is restricted and innovative change is stifled.

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<sup>67</sup> A preliminary analysis of the returns to education by level is presented in the pillar one section of this concept note, and a more detailed analysis is being conducted for the full SCD.

**Within the education sector there are several specific subpriorities.** These include (i) a focus on early childhood education for the poorest students and especially for ethnic minority students, to equalize readiness-to-learn; (ii) continued improvements to quality through a focus on inquiry-based learning at a grade levels; (iii) specific attention and policies in secondary school and beyond that remove exam-based allocation of advancement opportunities and other obstacles for high school completion by poor students; and (iv) providing a growing array of university and non-university choices for young adult learners.

**There is also a need to ensure that the education system provides equal access to disadvantaged groups.** Completion rates are low for ethnic minorities, particularly beyond the lower secondary level, while more than half of children with severe disabilities never attend school, and children of urban migrants without permanent registration status face barriers to enrollment. For children with disabilities, schools need to make accommodations to provide for their special needs, and for urban migrants, reforms are needed to eliminate the impact of the registration system for enrollment.<sup>68</sup>

**In health, there are there are a number of key challenges relevant to the country's stated commitment to providing Universal Health Coverage including quality care without impoverishment.** These include improving basic health outcomes for disadvantage populations which require differentiated approaches, providing a health financing system that allows access to care without impoverishment while also providing stronger incentives for more efficient and quality care, and a public health and service delivery system that can respond to the populations changing health needs, particularly focusing on improved quality, addressing key lifestyle risk factors and strengthening the grassroots health system as a trusted provider of quality care.<sup>69</sup>

**The lingering basic health agenda concerns remote areas and among ethnic minorities.** Child and maternal mortality rates in mountainous rural areas are 3 to 4 times higher than in rural plains and urban areas. As noted earlier, malnutrition remains high among ethnic minorities. This leaves disadvantaged populations vulnerable, and results in inequality of opportunity. Malnutrition, in particular, has long term implications for schooling, learning, employment, and productivity.

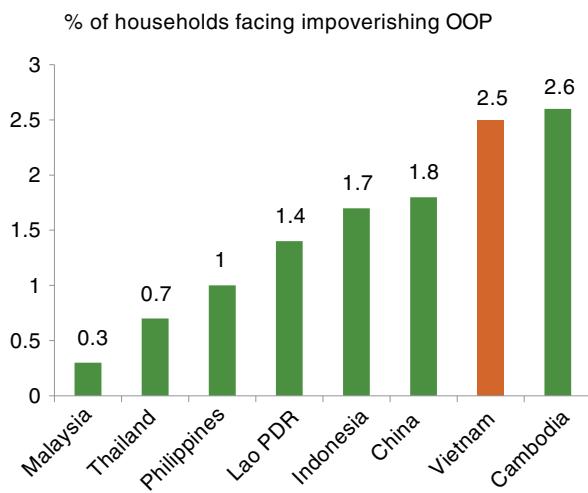
**Out-of-pocket payments for health have a significant impact on poverty (headcount and gap) in Vietnam.** About half of all health spending in Vietnam is paid for out-of-pocket (OOP), and as a share of GDP it is high by regional standards (about 2.5-3% of GDP). Survey evidence indicates that just over 4 percent of Vietnamese households experienced catastrophic health expenditures in 2012 (exceeding 40 percent of the household budget), while 2.5 percent (over 2 million people) were pushed below the poverty line. Both figures improved in the period 2008-10, but progress then stalled between 2010 and 2012. The rate of impoverishment due to OOP in Vietnam is higher than most countries in Asia.

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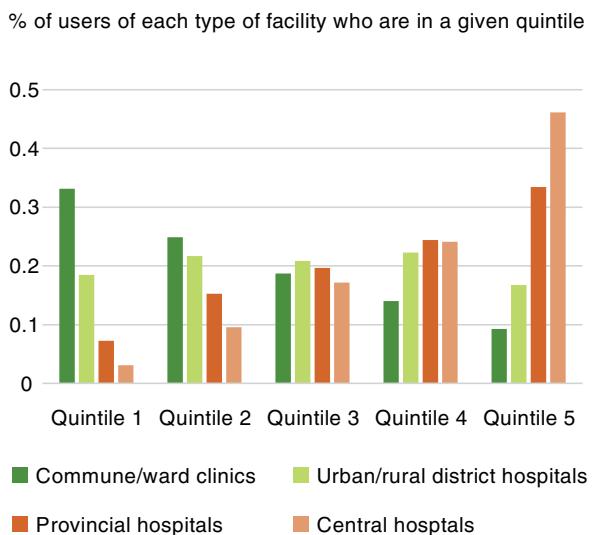
68 Education for ethnic minorities is addressed under Priority 1.

69 Key recent sources on the health sector include a 2015 Public Expenditure Review, the 2014 Vietnam Social Health Insurance Review, and the most recent Joint Annual Review of Health Sector Performance and a forthcoming Health Quality and Equity study based on a health facilities survey.

**Figure 65: Out of pocket health expenditures put substantial numbers of households into poverty**



**Figure 66: Central and provincial hospitals are principally used by the well-off, while**



Source: World Bank staff analysis of VHLSS for Vietnam data

**The national health financing system puts Vietnam on track to become a high cost and inefficient health system, crowding out other health expenditures that may improve health outcomes or financial protection.** At more than 6% of GDP, Vietnam already spends significantly on health and more than most East Asian countries except countries such as Japan and Korea that have already reached high income and aged demographics.<sup>70</sup> Health insurance coverage has increased to more than 70% of the population, however a large share of the population in the bottom 40% do not have health insurance because they are in the agricultural or informal labor market; at the same time, health insurance does not necessarily protect against impoverishing or catastrophic expenditures. Current policies on hospital financial autonomy, fee-for-service payment mechanisms and the reduction in the state subsidy of health service prices exacerbate the impoverishing effect of health expenditures.

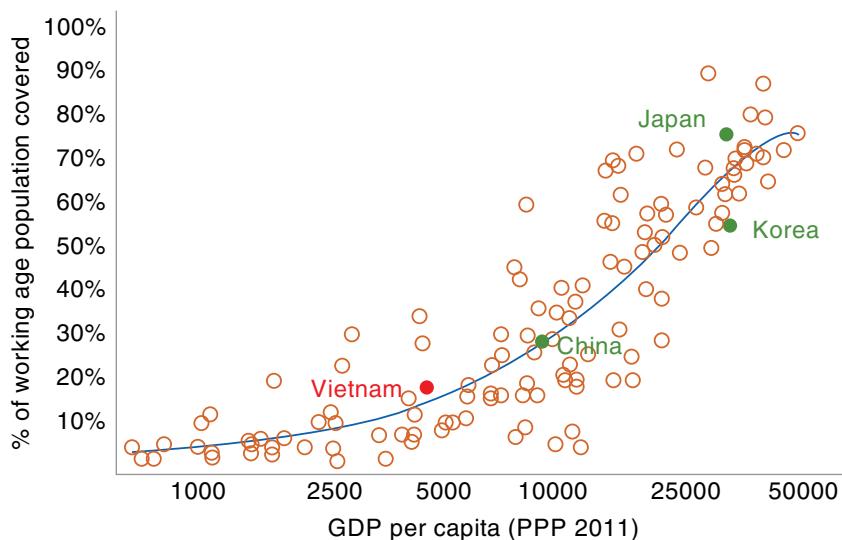
**The grassroots level health system is not seen as a trusted provider of good-quality essential health services at the grassroots level and there are legitimate reasons for concern.** The primary outpatient and basic hospital services offered at the district and commune levels are disproportionately used by the poor, but the quality of care and availability of services could be substantially improved, with direct relevance to key indicators of shared prosperity. Staffing and resources at this level are inadequate due to the systemic drivers that pull patients and resources to higher-level hospitals. Those who have the means or the proximity to higher levels of care, will go directly to provincial and central level health facilities in order to seek access to access to the better health professionals, diagnostic capacity and treatment capacity.

70 This issue is analyzed in the forthcoming Public Expenditure Review.

**A forthcoming study (World Bank 2016b) based on a detailed health facility survey found that equity of the quality of care between poor and wealthier areas is surprisingly high but that quality problems are commons.** The study examined care at commune health stations and district hospitals in six provinces. It found that substantial numbers of health care providers do not follow the applicable checklist when presented with symptoms typical of basic health care cases, i.e. overall ability levels are low. Ability levels of health care providers at district hospitals are higher on average than those at commune health stations, but the local poverty rate is uncorrelated with health care provider's ability level. The study found that there is very high use of unnecessary and harmful treatments (as in other countries.) There is much greater use of drugs in Vietnam than in other countries and in particular extremely high use of antibiotics. Doctor knowledge of correct treatment is particularly low for tuberculosis and child pneumonia.

**The public health system will increasingly have to respond to new challenges that require different approaches, including motivating behavior changes due to lifestyle risk factors and responding to emergencies due to climatic changes.** Some of the key health changes will require population wide and community-level behavior change either in feeding practices, sanitation, smoking, or alcohol consumption. From international experience, further improvement in health outcomes will come from reducing the population risk factors or in managing the health impact of these risk factors before they become severe. Vietnam public health systems or the coordination between the health and other sectors directly involved in these areas are not yet developed to address these kind of behavior change challenges. A number of measures are proposed as priorities for the health sector. These include measures to increase the attention to culturally sensitive outreach of basic health services to reach ethnic minorities in disadvantaged highland areas; reduce the percentage of health financing that is paid out-of-pocket through higher insurance enrolment among the informal sector; continued strengthening improvement in the purchasing of health goods and services, including pharmaceutical procurement reforms to help lower the high price of drugs; and hospital accountability to deter rent-seeking by hospitals. Proposed policy measures to strengthen grassroots service delivery include a range of interventions to establish a stronger focus on delivering preventive, outpatient and community based services including addressing those bottlenecks in service delivery such as competency of providers and availability of necessary drugs and laboratory services; and also policy changes in the overall service delivery system to improve coordination and cooperation and reduce the current fragmentation and competition among providers.

**In light of both the middle class and aging trends, Vietnam's pension system faces serious challenges.** Greater coverage will be needed to match growing expectations so that the very rapidly growing old-age population does not fall into poverty. Coverage of contributory pensions in Vietnam remains low, though not out of line with countries at similar income levels globally. Figure 3 shows the global relationship between share of working age population participating in contributory pension schemes and GDP per capita. Vietnam is around where one might expect given its income level and high labor market informality. At end-2013, social insurance covered about 10.9 million people in the compulsory scheme and 176,000 people in the voluntary scheme. This is just 20 percent of the total workforce, with coverage heavily concentrated among the top 40 percent of the distribution.

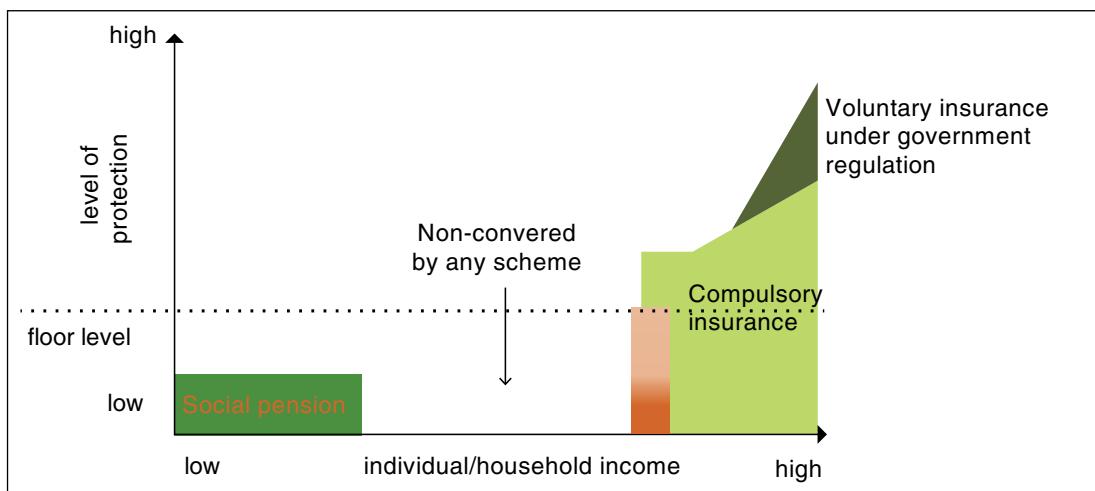
**Figure 67: Pension coverage rates are in line with countries at similar income levels**

Source: World Bank Pension Database

**In terms of generosity within the contributory pension system, Vietnam has been an outlier within the EAP region and globally.** This is a product of high accrual rates in its pension system. This situation will improve somewhat with the 2014 reforms, which reduced annual accrual rates, though the adjustments only become fully effective from 2022. This is a welcome reform, but falls short of making the system sustainable and still leaves Vietnam with globally high accrual rates. A complicating factor in Vietnam is that workers have typically contributed against a minimum base salary, so people combine high replacement rates with low absolute value of pensions.

**Even after recent reforms, the current pension system is not sustainable.** Prior to the 2014 reform, the pension fund was projected to enter into deficit from 2021 and to have depleted all reserves by 2034. Another way of putting this is that the contribution rate required to keep the fund in balance would have had to rise to almost 30 percent of salary by 2035, and to 80 percent of salary by 2080. This would clearly not be sustainable from a competitiveness perspective and would imply major subsidies from the budget. The 2014 reforms are steps in the right direction in this regard, but do not go far enough or fast enough to make the system sustainable long term, though they do push back the point at which the system goes into deficit.

**Figure 68: Vietnam has a large “missing middle” of old age support**



Source: Galian (2014)13

**Overall, well over half of people 60 and over has neither a formal sector pension nor a social pension, and half of those with some pension have a very low benefit.** Combined, these benefits cover under 20 percent of the population 60+, which is modest by the standards of neighbors such as China and Thailand. The current system is represented in Figure 12, and exhibits a common problem of developing country pension systems of a large “missing middle”, between the relatively small and better-off formal sector covered by the existing VSS system and even smaller (and concentrated among the very old) group covered by social pensions.

**A number of priorities are proposed to expand coverage to all workers, including those in the informal sector.** Perhaps the most pressing priority is further reform of the formal sector pension system to achieve long-run financial sustainability of the system. Expanding coverage of the formal system without further reform will simply create a deeper fiscal burden in the future. Further reform is necessary also to create the fiscal space to allow for public subsidies to incentivize participation of informal sector workers and gradually reduce the eligibility age for social pensions. Global experience, as well as Vietnam’s own experience with health insurance coverage expansion, strongly suggests that public subsidies will be needed to achieve widespread old age financial protection. Policy and financing reforms can be complemented by modernization of SI administration to improve compliance, reduce the burden of compliance on enterprises, and promote a service-oriented SI delivery system.

**The social assistance system has been characterized by uncoordinated policy and program development in recent years.** Social assistance programs have been expanded without adequate attention to program design and with poor delivery systems. New policies and programs have been introduced ad hoc with overlapping target populations and objectives. Delivery systems for social assistance programs are weak – much below what one would expect from country at Vietnam’s level of development. These include systems for beneficiary identification, targeting, program beneficiary management, benefit payments (improving current cash payments by using third party agents for greater transparency and

accountability, eventually moving to electronic payments), community mobilization and social work networks, feedback/grievance redress, monitoring and evaluation, and management information systems.

**There are also knowledge gaps on both assistance program spending, outcomes and impacts.** Such evidence is needed to enable an informed discussion on how the system can evolve to address current risks and vulnerabilities (e.g., who should be covered, what is the appropriate policy mix, how should these programs be financed).

**There are a number of proposed priority areas for reform of social assistance.** These include 1) a more coherent approach for household-based transfers, moving away from multiple fragmented programs with overlapping target populations and objectives, 2) better systems for beneficiary identification and screening in targeted social assistance programs to improve the poverty reduction impact of a given level of spending, 3) the consolidation of delivery systems through investment in payment systems, management information systems, and improved client outreach and case-management mechanisms for households with complex needs, and 4) rethink the design of area-based anti-poverty programs to emphasize more diversified community-driven income-generation approaches.

**Various changes in service delivery and public administration are also needed to advance gender equity.** Three critical areas of concern for gender equity are the lack of women in leadership positions in both the private and the public sectors, high rates of domestic violence, and the extremely elevated sex ratio at birth, and. Measures to boost women's leadership include childcare support, training opportunities, and eliminating gender discrimination in the retirement age. The government may want to consider setting up such a special program for women's leadership in the public service. Multi-sectoral evidence-based approaches directed at both genders can help reduce domestic violence.<sup>71</sup> One measure that could reverse the alarming rise in the sex ratio at birth is easing the two-child policy, but the SRB will probably only change substantially as parent preferences evolve. The government policy may be able to speed this evolution through education campaigns to emphasize the value of daughters, and pension expansion to lessen the concern of parents concerned about having a male offspring to support them in their later years.

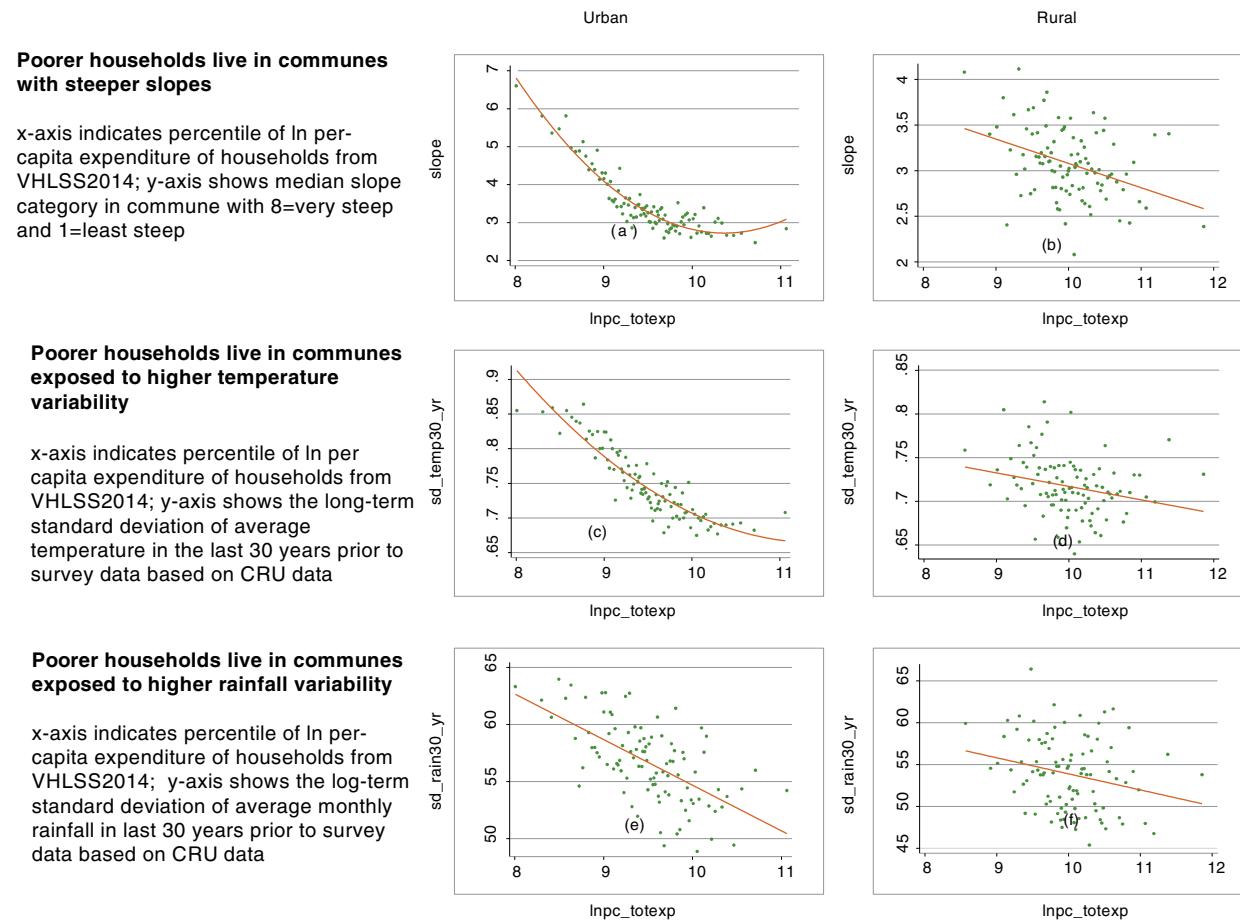
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<sup>71</sup> Ellsberg et al. (2015) provides a useful survey of evidence.

## Priority 6: Augment resilience to climate change and benefits from mitigation

**The poor in Vietnam are more exposed to climate and therefore more vulnerable to its impacts.** Recent work by Narloch and Bangalore (forthcoming) found that poorer households live in communes with steeper slopes, greater rainfall variability and temperature variability.

**Figure 69: The Poor are more exposed to climate risks**



Source: Narloch and Bangalore (forthcoming)

**Ongoing climate events and projected climate change can set back development gains unless there is a concerted effort to make climate smart investments and pursue a sustainable and climate resilient growth trajectory.** This priority area focuses on reforms that can reduce the impact of climate change on income and human capital. It focuses on efforts to scale up approaches for disaster preparedness, response and recovery, manage natural hazards, incentivize climate smart interventions, and coordinate planning and investments. It also includes reforms that could reduce emissions from coal, enabling Vietnam to deliver on its nationally determined contribution to mitigating climate change.

**Vietnam, being highly decentralized, needs to more effectively coordinate and plan for climate change across sectors and levels of government.** In the Mekong and Red River Delta, limited coordination among public institutions, prevents planners and decision makers from making strategic decisions, across sectors and provinces, on the future direction and nature of development. For example, one city may build infrastructure to protect its own investments while increasing the risk of flooding in other areas. To change the current situation, cities and provinces need to jointly plan for investments related to a rise in sea level and changing flood risks. They need to jointly pay greater attention to the siting of infrastructures and residential communities. Several cities on the Mekong Delta have started to adopt such an approach.

**At the provincial and municipal level, there is the need to design land use plans that account for disaster risks, and promote the scale up of disaster preparedness, response and recovery while also recognizing reasons for households to live in risk prone areas.** The impact of climate change on high flood risk areas is proportional to the development and activities that are found in these areas. The systems in place to prepare, respond and recover from a climate event also influences extent of the impact. Land use planning processes should consider the vulnerability of areas to disasters in an effort to minimize the physical and financial impact of disaster events. The process, however, must also recognize the constraints of those who are currently exposed to disasters when proposing alternatives if the plans are to be effective. For example, recent work in Ho Chi Minh City, found that local and migrant households will not move from their current residential location despite high flood risk and health impacts (World Bank and Australian AID 2014) because the rents are cheaper and people can live closer to their workplace. In such cases, investments in infrastructure that enable people to maintain comparable jobs should complement flood zoning efforts.

**To adapt to climate change, Vietnam needs to improve the information base it uses to inform plans and investments.** The analytical underpinnings of decisions today remain weak. Vietnam needs to invest in upstream analytics that is based on robust data collection processes, information, and analysis. For Vietnam, this could require putting in place mechanisms for monitoring and collecting additional data (for example, enhance systems for collecting data on land use, predicting impacts of sea level rise, and so on) and investing in non-structural instruments such as early warning systems and upgrading hydromet systems. It would also require developing a comprehensive, user friendly and publically accessible platform for the data and information. The data should improve the government's ability to reexamine sectoral policies relating to agriculture (for example, triple rice cropping), urban development (for example, nature and spatial development), coastal zone management (for example, siting of mangroves and sea dykes) and water resources management (for example, choice of infrastructure or non-structural measures to control floods and saline intrusion). It should also help adjust land-use to changing water regimes (between fresh, saline, and brackish waters). Such platforms should improve the information base used for ex-ante planning, mitigation and response to disasters (especially by adequately accounting for disasters and having a systematic approach for assessing disaster impacts). The data should also be accessible to private sector.

**Vietnam needs to build subnational capacity to conduct risk and uncertainty analysis of chronic events and to use decision-support frameworks to identify and prioritize needs and attract private investments.** This would enable the government (at multiple levels) to internalize natural resource conditions and trends, capture the influence of climate

change, natural processes and human actions, and optimize opportunities for public and private investment, resource. Vietnam's effort to build capacity to mainstream climate risks into development policies should enable provinces to undertake improved integrated spatial planning across sectors, and ensure that land and water resources are managed in a manner that takes into account the potential longer term climate and development impacts. Having the right incentives and information available would engender smart decisions by both public and private sector, and could further motivate private sector engagement in climate resilient infrastructure.

**Increased investments in reducing exposure and vulnerability of cities and rural communities to climate change are necessary.** The financing needs for adaptation to climate change during 2010–50 was estimated to be on the order of \$75–100 billion per year<sup>72</sup>. Cities that are vulnerable to climate change need to invest in appropriate adaptation measures which should include ecosystem based measures (for example, placing a greater emphasis on integrated coastal zone management, protecting mangrove and coastal forests, and natural reef ecosystems), and “climate-proofing” infrastructure, including storm-drainage systems, water supply and treatment plants, and protection or relocation of energy or solid waste management facilities. The investments could include spending on the maintenance and extension of coastal and flood defenses (both physical infrastructure and natural systems such as mangroves) to minimize the impacts of sea inundations, salinity intrusion and river flooding, to protecting urban infrastructure and the most valuable agricultural land. It could also include expanding and improving the irrigation infrastructure, especially in the central regions where the opportunities for irrigation expansion are greatest and could assist with changes in water availability.<sup>73</sup> Investments are also needed to reduce the significant risks of informal settlements in cities that are highly exposed to sea level rise. Given the scale of investments required, Vietnam will need to conduct evidence-based prioritization efforts to identify the investments that generate the most benefits, while contributing to reducing poverty and boosting shared prosperity.

**Social assistance that is climate responsive can help alleviate the exposure bias faced by the poor.** The poor, in addition to residing in areas with greater exposure or vulnerability to climate risks, confront major disadvantage with respect to having financial resources and access to financial instruments (e.g., insurance) that can buffer them against these risk. This underscores the importance of bolstering existing social assistance programs to help those who are vulnerable and overexposed to climate change and natural hazards to adapt and recover. Such efforts would lower the likelihood of these households slipping back into extreme poverty and becoming the “new” extreme poor. The International Institute for Environment and Development estimated that the total (direct and indirect) annual economic losses due to flooding in Can Tho city was US\$642 per household, which represents 11 percent of each household’s annual income.<sup>74</sup> In such cases, social assistance programs that are climate responsive can be very beneficial. In Can Tho, making such a reform is also a relatively modest investment, as it involves leveraging the infrastructure associated with the existing social assistance systems and modifying the program to provide social assistance to households affected by flooding.

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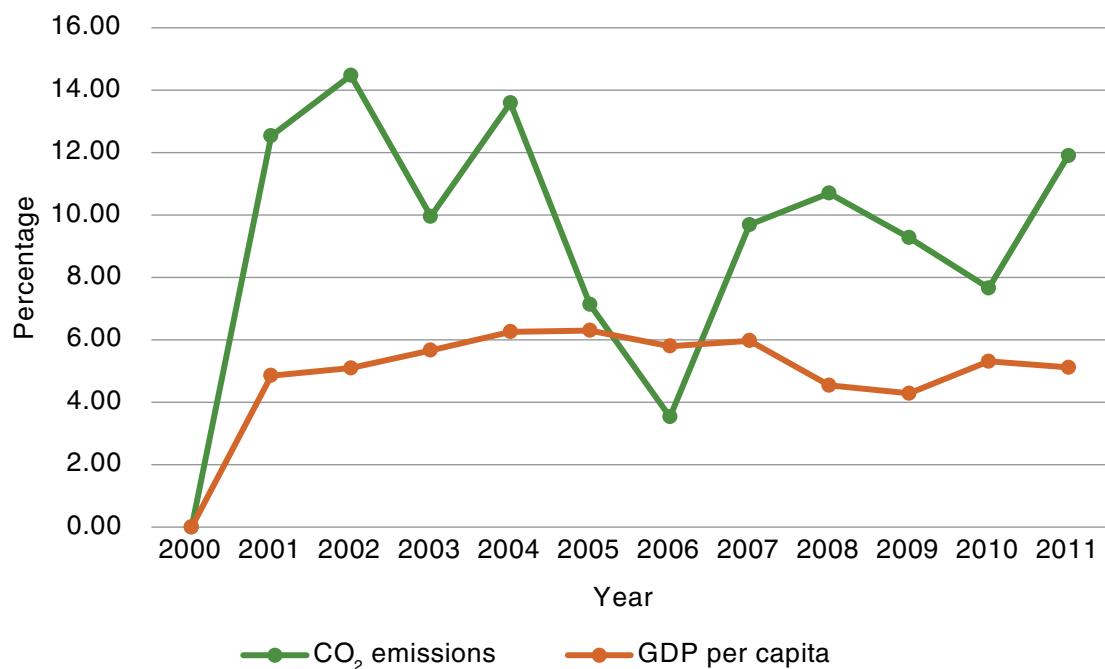
72 World Bank, 2010.

73 World Bank, 2010.

74 IIED, 2015 as cited in World Bank, 2016.

**Development of suitable risk financing instruments (in addition to insurance) will improve Vietnam's ability to cope with disaster response and recovery.** The government has taken important steps to strengthen the country's financial resilience to disasters. In May 2014, the law on "Natural Disaster Prevention, Response and Mitigation (No. 22/2013/QH13)" became effective, shifting the emphasis from ex-post disaster response to comprehensive disaster risk management. It also provides for the use of state budget funds for natural disaster prevention and control and sets out a state policy to support the development of the domestic disaster risk insurance market. To effectively implement this law, Vietnam needs to invest in assessing the underlying risk factors – a quantitative risk profile of the government's contingent liabilities in the face of future disasters - in order to take informed decision on disaster risk financing. The government will then need to a cost-effective financial protection strategy, relying on an optimal combination of financial instruments to cover sovereign risk including contingency budgets, national disaster (multi-year) reserves, contingent credit and risk transfer instruments (including insurance). A dedicated disaster reserve fund or parametric insurance could be included to help secure additional financing in case of a major disaster.

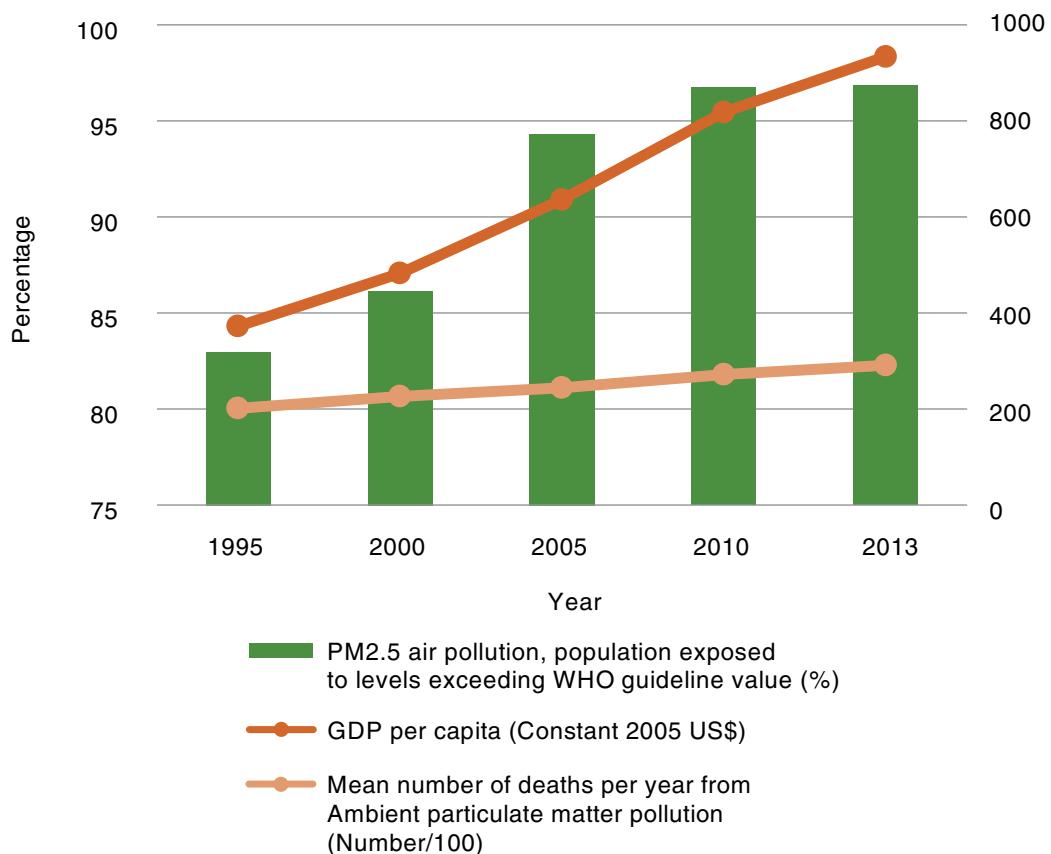
**Figure 70: Change in CO<sub>2</sub> emissions and GDP per year**



**Stabilizing climate change globally requires every country to commit to reducing emissions.** Vietnam is not a significant emitter of CO<sub>2</sub> globally, yet it has a high level of CO<sub>2</sub> emission per unit of GDP. This suggests there is room for improvement. Delivering on its nationally determined commitment to mitigate climate change, will require adoption of measures that do not slow growth or poverty reduction. From among the potential 'no-regrets' measures which have immediate and local co-benefits, Vietnam should prioritize improving energy efficiency and lowering the carbon footprint of the energy and transportation sectors. The latter, in addition to lowering GHG emissions, will also generate immediate and local benefits from reduced air pollution.

**Effective Air Quality Management (AQM) policies and programs will reduce GHG emissions.** They will also improve public health and reduce negative impacts on the environment. Air pollution in Vietnam is estimated to result in labor productivity losses of 14 percent of GNI annually<sup>75</sup> and a reduction in the adjusted net saving of 2.5 percent<sup>76</sup>. Addressing air pollution in Vietnam will require reforms that support the government to adopt the national action plan for AQM along with a series of sequential policy actions that will enable the implementation of the plan by 2020. The policy actions that would support planning, include: (i) monitoring and data collection, (ii) the development of multi-pollutant AQM implementation plans for cities and city/urban clusters, (iii) the development and adoption of regulations on vehicle emissions standards and on fuel quality, (iv) the initiation of industrial permits for control of air emissions from the relevant industrial sectors, and (v) coordination and planning across institutions and sectors.

**Figure 71: Impact of air pollution**



75 World Bank. 2010b.

76 Adjusted net saving equals gross national saving, minus consumption of fixed capital, plus investment in human capital, minus depletion of natural capital, and minus pollution damages. It represents a more inclusive measure of changes in a comprehensive set of capital assets that constitute a nation's wealth base, by accounting for physical capital, human capital, natural capital, and environmental degradation.

**Information on levels and sources of air pollution need to be generated and made publically accessible to galvanize broad public interest in and support for government measures to address pollution.** Vietnam needs to adopt current technology and systems for information generation and validation, and to facilitate public access to information. Vietnam must also improve the capacity of public institutions to improve coordination, monitoring and enforcement, which is important for managing pollution.

**Incentives for private sector to operate in green and low carbon industrial zones could contribute to achieving lower GHG emissions and promoting pollution abatement from industry.** Vietnam should start by assessing the feasibility of scaling up policies and programs that it has successfully adopted. *Cleaner Production* (CP) is one of the best known, and has been used to both reduce waste and lower resource use in the industrial sector while improving industry performance. It is estimated that in sectors like textile, food processing and leather there is an average savings potential of 30 percent for water without major investments in infrastructure. Based on government surveys in Vietnam, only 11 percent of industrial facilities were using CP techniques to reduce their energy, fuel, and materials consumption in 2010, pointing to significant room for improvement. Vietnam could also design low carbon industrial zones by factoring in, at the design stage itself, opportunities to minimize the industries adverse environmental impact based on where it is situated. Such economic zones could also focus on attracting investors that produce green products and services.

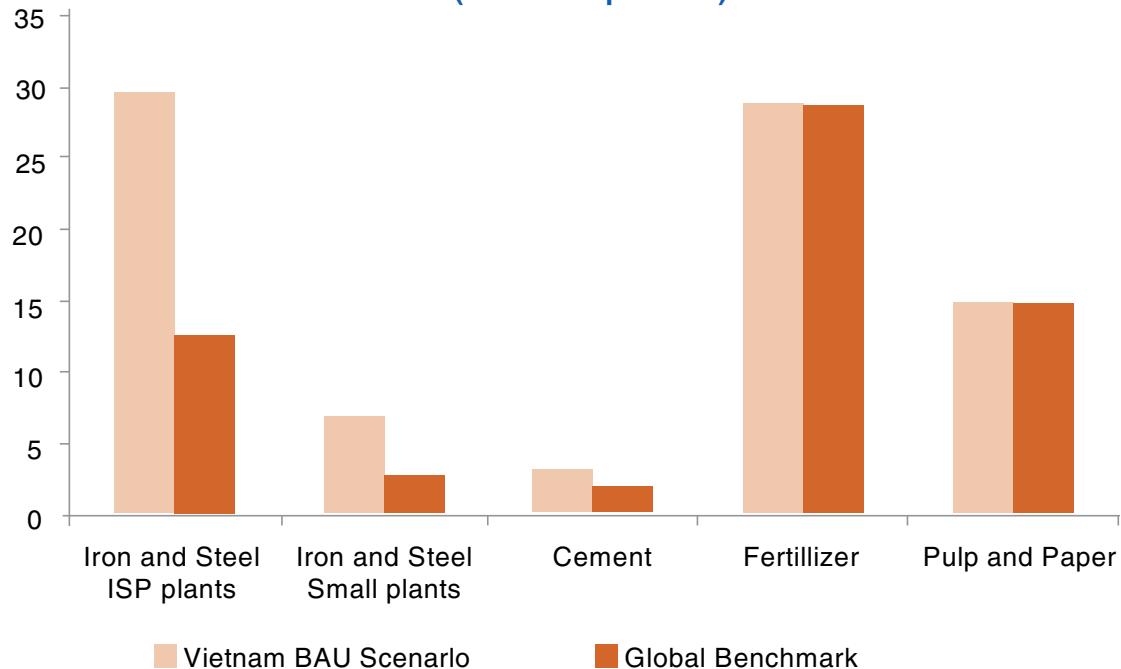
**Vietnam needs to also adopt policies that incentivize private sector investments in cleaner energy production, and improve the sector's infrastructure and environmental performance.** Currently, low electricity prices are partly responsible for Vietnam's high energy intensity. They also limit any incentive for energy efficiency. Although Vietnam increased average tariffs by 44 percent between 2010 and 2012, cumulative inflation amounted to 53 percent over this same period.<sup>77</sup> As a result, real electricity tariffs went down, and are among the lowest in the region. In addition to the negative budgetary and energy efficiency implications, artificially low tariffs constrain the ability of utilities to finance their investment and O&M expenditures or to attract private sector investment. The overall investment required in the energy sector is estimated at approximately US\$ 6 billion per year till 2030. Without incentives for private sector engagement, Vietnam will struggle to finance the large amount of power sector infrastructure that is needed to move to newer and lower carbon-intensity fuels including liquefied natural gas, wind, and solar.

**The government needs to be the regulator of operations in the energy sector by setting and enforcing environmental standards.** Vietnam could reduce its air pollution by improving energy efficiency in the industrial sector, and putting in place mandatory performance based targets combined with financial incentives for industry and provinces. Within the Ministry of Industry and Trade, an industrial energy efficiency and conservation office could facilitate this program.

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<sup>77</sup> To protect low-income consumers, the subsidized social tariff was maintained at 993 VNK/kwh (4.9 US cents/kwh) for the first 50kWh.

**Figure 72: Energy intensity of select industrial sectors in Vietnam  
(GJ/ton of product)**



Source: Audinet et al, 2015.

Notes: BAU: business as usual; GJ: gigajoule; ISP: integrated steel plants.

**Standards should also be used to improve energy efficiency among end-users.** A number of countries have establishing minimum energy performance standards for common electrical devices, including the European Union, Australia, Canada, the United States, as well as India, Korea, Mexico and Russia. In the residential sector, there is nearly 140,000 GWh of energy efficiency potential. Over 87 percent of this amount could be achieved through energy efficiency for lighting, refrigeration, air conditioning, water heating, and fans.

## Cross-Cutting Priority: Strengthen Institutional Foundations and Governance

**As Vietnam embarks upon the next phase of reforms, the interplay between policies and governance will become even more important.** The institutional environment will determine the direction of policy changes and whether policy and regulatory changes are properly implemented. Without reforms of the governance system, it will be difficult to deliver most of the other priorities identified in this report. Maintaining macroeconomic stability, delivering growth-enhancing infrastructure and regulatory reforms, tackling ethnic minority poverty, boosting health insurance coverage and secondary education completion, ensuring prosperous and livable cities, enhancing trade logistics and “greening” growth will all require an effective public administration that has the capabilities to mobilize domestic resources, implement public investment and spending programs, promulgate quality regulations and provide fair and transparent enforcement. This section summarizes some of the key cross-cutting governance challenges that emerge from the analysis.

**Table 11: Governance challenges across the three pathways**

<b>Governance Challenge</b>	<b>Inclusive Growth and Job Creation</b>	<b>Inclusion and Service Delivery</b>	<b>Sustainable Management of Natural Assets and Environment</b>
<b>Transform state-market relations</b>	<ul style="list-style-type: none"> <li>• Insufficient separation of ownership and regulatory functions</li> <li>• Uneven playing field and weak competition framework</li> <li>• Distorted factor markets for land and capital</li> </ul>	<ul style="list-style-type: none"> <li>• Limited provider autonomy</li> <li>• Lack of modern regulatory and institutional environment for market based service provision</li> </ul>	<ul style="list-style-type: none"> <li>• Insufficient separation of commercial and regulatory functions</li> <li>• Lack of market based payments for ecosystem services (internalization of externalities)</li> <li>• Lack of effective land markets</li> </ul>
<b>Strengthen coordination and implementation capacity</b>	<ul style="list-style-type: none"> <li>• Fragmented public investment and public financial management</li> <li>• Fragmented intergovernmental relations</li> <li>• Weak coordination between center and provinces</li> <li>• Inconsistent implementation of national policies</li> </ul>		
<b>Enhance voice and transparency</b>	<ul style="list-style-type: none"> <li>• Weak transparency in financial reporting of enterprises and banks</li> <li>• Limited fiscal transparency and budget comprehensiveness</li> <li>• Limited transparency in land use and resource allocation</li> <li>• Limited private sector participation in policy formulation</li> </ul>	<ul style="list-style-type: none"> <li>• Limited ethnic minority voice in service delivery</li> </ul>	<ul style="list-style-type: none"> <li>• Limited access to information and benchmarking on environmental performance (sectoral and subnational level).</li> </ul>

**Vietnam continues to face a number of cross-cutting governance challenges.** These challenges can be broadly grouped into three core aspects of governance. First, the respective roles of the state and the market will need to continue to evolve. With the state still involving in productive activities and resource allocation, questions about a level playing field, independent regulation of markets and an effective competition framework remain pertinent. Second, issues of coordination and implementation capacity also remain critical with government effectiveness being hindered by fragmentation within and across levels of government and weakness in public administration management. Thirdly, transparency and voice in decision making, resource allocation, regulatory reform and service delivery could be strengthened further to provide the foundation for more accountability. While Vietnam has sustained high growth rates and strong public service outcomes in the early stage of development, governance weaknesses may become a drag on future growth and social outcomes. Attention needs to be given to modernizing Vietnam's core government institutions to enable them to continue to support a rapidly developing middle income economy.

## Transform state market relations

**Institutional legacies of Vietnam's past state driven development model continue to affect state market relationships.** Starting out from a centralized system in which the private sector played an exceedingly marginal role, in which price signals were largely absent and the state essentially retained monopoly power in the allocation of resources, Vietnam has come a long way in creating markets. Today the vast majority of transactions in the economy are market based and prices for most products and services are determined based on supply and demand. This notwithstanding, there are institutional legacies that distinguish Vietnam from other market economies. These legacies manifest themselves in the economic realm where state authorities still play an important role in the allocation of resources, especially capital and land, and where state-owned enterprises continue to engage in a range of commercial activities. As a result the institutional context is characterized by a blurry delineation of commercial and regulatory functions which has created opportunities for corruption and in turn undermined effective and independent regulation of markets and consistent enforcement. It has also given rise to what the recent Vietnam 2035 report has called a "commercialized state" where state authorities and enterprises directly engage in and benefit from the opportunities offered by the market.

**The incomplete transition to the market is also evident in public service delivery.** For example, Vietnam's health sector model is evolving from a historically centrally planned and financed system to a more decentralized market-based system where providers have a large degree of autonomy. Another example is the higher education system. Despite many years of efforts to grant them greater autonomy, public universities remain burdened by central government control, which limits their freedom to determine curricula, hire faculty, and raise funds. This legacy of centralized planning is an obstacle for universities seeking to attract competent faculty and to update their programs to provide graduates with relevant job market skills.

**The role of the state will need to continue to evolve towards a provider of public goods and an enabler of private sector enterprise.** While the withdrawal of the state from commercial activities may continue to proceed in gradual manner, it is important to ensure that the regulatory environment and enforcement is even, regardless of enterprise ownership and relationship with state authorities. A clearer functional separation of commercial and regulatory functions remains an important unfinished institutional reform agenda in this regard. In the sphere of public services, modern service delivery mechanisms often imply moves towards more competitive service provision which in turns requires higher degrees of managerial and financial autonomy of service providers and some case opening up to private sector provision. Separation of these functions are critical in sectors and enterprises that generate negative externalities (for example, pollution or inefficient use of water) and where disregard for the 'public bad' increases revenue. In Vietnam, inefficiencies and waste in the irrigation sector is an example. Vietnam has already started to move in this direction but it yet has to develop the institutional underpinnings required to make these more devolved service delivery models work effectively.

## Strengthen coordination and implementation capacity

**Core government institutions are fragmented, often with overlapping mandates for policy formulation and implementation splintered across agencies and between the center and provinces.** This has contributed to inconsistent policy setting, lagged implementation and inefficiencies in resource use. For example, less than 10 percent of firms in the Provincial Competitiveness Index surveys during the past 10 years believe that central laws will be consistently implemented in provinces. The need for better coordination between different national government agencies and provinces also manifests itself in the management of natural resources and climate change. For example, for air pollution, the ministries involved in the national action plan for air quality management include MONRE, Ministry of Home Affairs, Ministry of Transport, Ministry of Industry and Technology, Ministry of Construction, Ministry of Housing, along with the provinces and cities. In the social sectors there are similar issues, particularly associated with implementation of existing policies. In many cases, province and local officials poorly or only partially implement centrally-designed policies and programs. This is often a particular challenge for policies towards ethnic minorities, given that local authorities even in ethnic minority areas are typically from the majority Kinh.

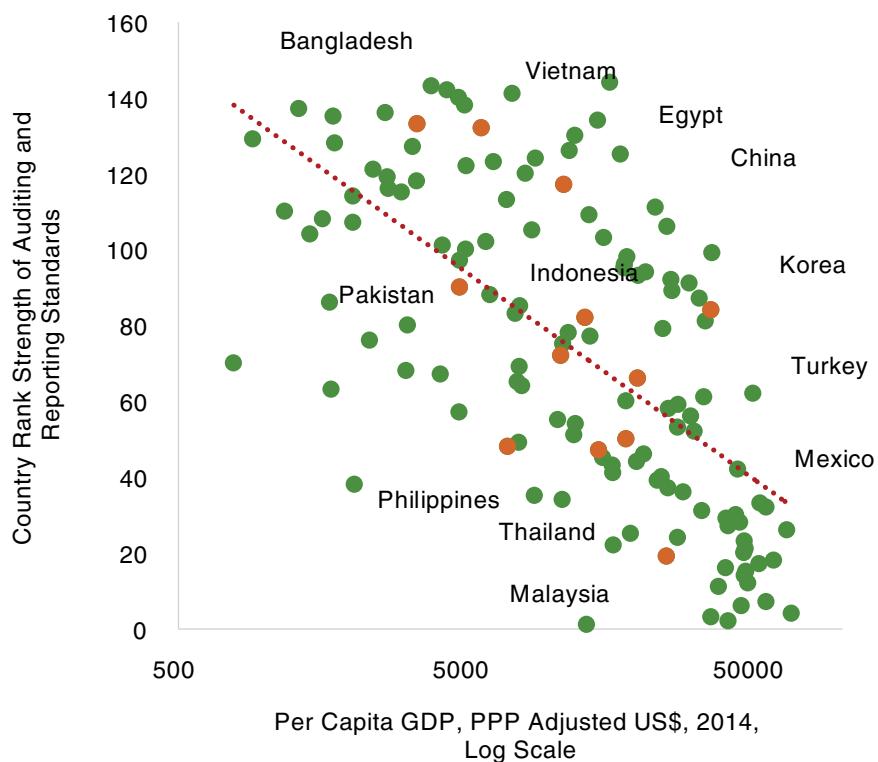
**Systematic changes in coordination will be needed to facilitate integrated work across ministries/ departments and provincial governments.** Coordination is necessary to promote improved integrated planning among provinces and across sectors. Improved coordination and clarity over mandates can reduce the transaction costs of public and private interventions. Institutional reform required to enhance coordination needs a long term commitment to public service reform, incentives and institutional structures that support good governance.

## Enhance voice and transparency

**Enhancing transparency and providing reliable and timely information is critical for both the functioning of markets and of the government.** While Vietnam has made progress in establishing legal requirements for information disclosure, there are significant remaining gaps. For example, the quality of corporate financial reporting in Vietnam remains below that of Vietnam's middle income-country peers within the Association of Southeast Asian Nations (ASEAN) Economic Community.<sup>78</sup> Despite progress there is also still considerable room for improvement on the government side. For example, Vietnam scores 18 on the Open Budget Index, above China and Cambodia but considerably below the global average of 45 and below most other ASEAN economies. Even with the transparency standards that Vietnam set for itself, such as in land management and SOE sector, there is still a large gap between the standards and the actual levels of transparency.

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<sup>78</sup> Vietnam Accounting Standards (VAS) have not been kept up to date with developments in International Financial Reporting Standards (IFRS). Prudential and other regulatory financial reporting requirements take precedence over accounting standards. Monitoring and enforcement of compliance with the accounting standards are lacking. The result is that the financial statements are not prepared on a basis comparable with those in other jurisdictions. REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC) on ACCOUNTING AND AUDITING, World Bank 2016.

**Figure 73: Strength of Auditing and Reporting Standards**

**Limited implementation of information disclosure requirements, and high transaction costs associated with obtaining sectoral or provincial data often result in the use of inconsistent data for planning.** For example, differing information between sectors or between levels of government on land cover, suitability and use, and limited information on land ownership affect the prioritization of interventions and often result in suboptimal measures and investments. Similarly, limited information on performance make it difficult for the public to benchmark their local government, and to add their support to or perspectives on specific issues.

**At the same time, the oversight bodies are constrained by the lack of independence in their efforts to impose limits on the actions of the government.** A final set of governance challenges relates to the lack of voice for marginalized groups. In many countries around the world, progress on inclusion has been driven by advocacy by civil society organizations. For example, indigenous people's groups in many countries in Latin America have helped focus government attention on the need for inclusive policies. Likewise, the agenda for inclusion of people with disabilities has been advanced globally by advocacy organizations driven in large part by people with disabilities themselves. Space for such organizations in Vietnam remains limited, as many of the organizations fall under the Communist Party umbrella, and existing government organizations—such as the Committee on Ethnic Minority Affairs and the National Coordinating Council on Disability—have limited advocacy roles.

## ANNEXES

### Annex 1: Summary of Consultations

Four consultation events of the draft SCD were held in Hanoi, Ho Chi Minh City, Buon Ma Thuot (Central Highlands). In Ho Chi Minh City on April 6 we discussed the draft SCD analysis and messages with a group from the private sector at an event organized by the Vietnam Chamber of Commerce and Industry. In Buon Ma Thuot on April 7 the team conducted similar consultation with students and faculty from Tay Nguyen University. The presentation used in both events is attached. In Hanoi consultations were held on May 22 and May 27 with development partners, representative of the government and think tanks. Overall the consultations revealed broad agreement among stakeholders on the main analytical underpinnings and general tenets of the draft SCD, including the proposed three pathways and six priorities for achieving progress towards shared prosperity and poverty reduction in a sustainable manner. The main results of the consultations are summarized below.

#### **Inclusive growth and job creation**

Participants expressed broad agreement with the principal analysis underpinning the SCD. While noting that Vietnam has indeed achieved high and sustained growth which turn led to major gains in poverty reduction and shared prosperity, participants agreed that there are emerging constraints to the existing growth model. In particular, they underscored concerns about stagnating labor productivity growth and declining investment efficiency. Private sector participants supported the strong focus on enabling the private sector to become the key driver of growth and job creation. Much of the discussion revolved around the specific constraints faced by private sector firms and policy to ease the constraints so as to unleash its full potential. The discussions highlighted the need to further improve the investment climate, ease the administrative burden and level the playing field. For example, private sector representatives raised the issue of providing more even access to capital for firms regardless of their ownership. They also highlighted the opportunities coming with further global integration, and agreed that there was tremendous potential for domestic private firms to deepen linkages with the FDI sector and increase participation in global value chains. In terms of specific sectors, participants at both events noted Vietnam's potential in enhancing productivity and value-added from agriculture and that this should deserve specific attention. Participants in both discussions also emphasized the importance of investment skills that are relevant to businesses as a way to enable labor productivity growth. Finally, participants agreed that infrastructure development, especially in key sectors, such as power generation, was important, but raised questions about these investments could be financed, given tight fiscal situation and rising public debt.

#### **Social inclusion and poverty reduction**

Participants voiced support for the analysis and priorities related to social inclusion. Several private sector representatives highlighted the issues around education, echoing the treatment of SCD and the push for universal high-quality secondary education. They noted that firms are very concerned with whether the quality of education is adequate to satisfy their human resource needs and that education is a critical are for the inclusion of the next generation. They also mentioned that there are quality concerns around vocational education as well. Members of the private sector group also raised other questions related to social inclusion

around the impact of rising material conditions on welfare. They asked whether lower levels of material poverty necessarily translated into lower “spiritual poverty” and greater happiness, suggesting that “social infrastructure” is as important as physical infrastructure. They also suggested that the SCD consider questions of how to develop remote areas and create jobs for the population in such areas. Finally, they emphasized the importance of understanding the distributional impacts of economic growth going forward. The policy issues around ethnic minority poverty were highlighted at all event but were particularly prominent at the Tay Nguyen University (where 20 percent of students are members of ethnic minority groups). They asked why ethnic minorities are still poor and in particular why have some policies towards ethnic minorities not been so effective? Participants agreed that ethnic minority inclusion is the principal extreme poverty challenge facing Vietnam.

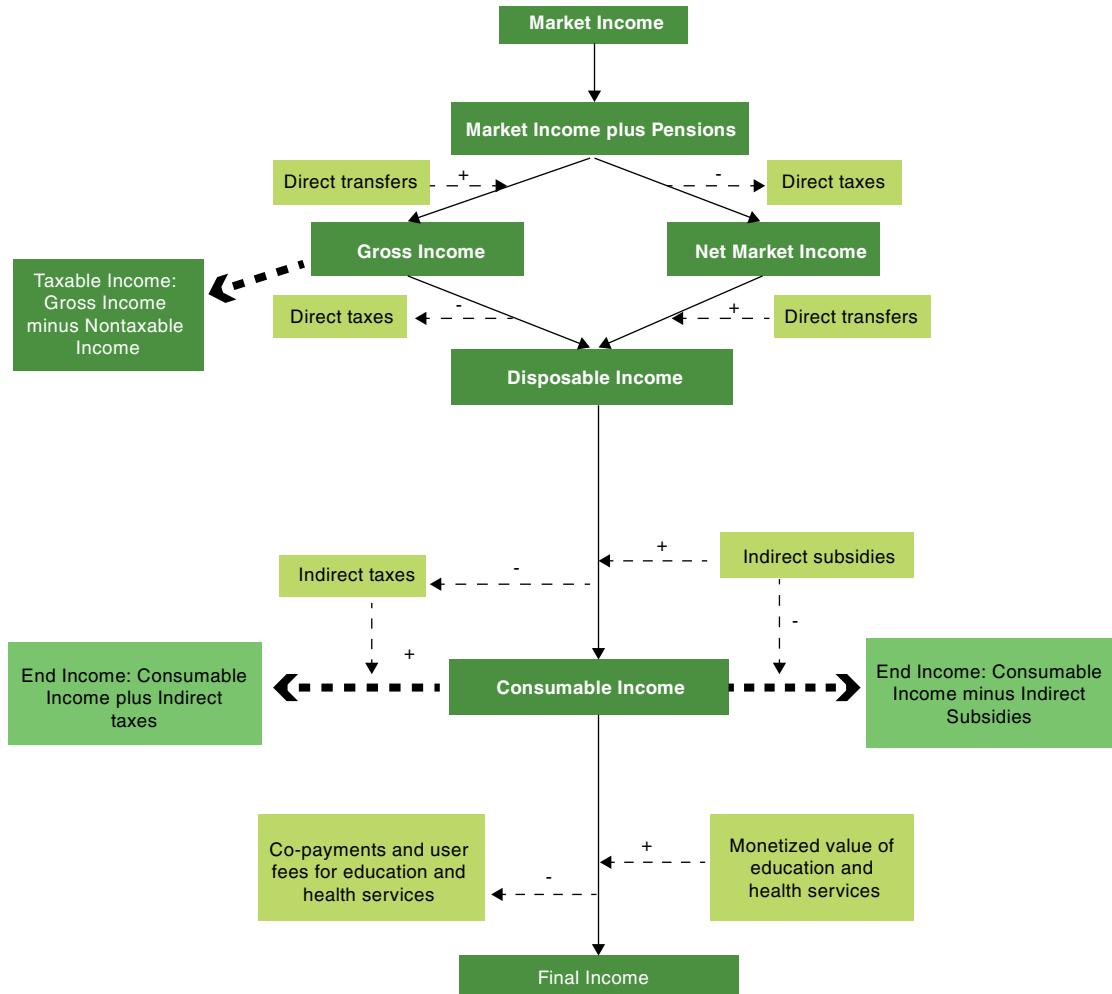
### **Environmental sustainability and natural resource management**

Participants had numerous comments on issues of environmental management and natural resources. Private sector representatives asked questions about how workers can move out of agriculture, whether agricultural production should move away from rice and into other crops, and the extent to which modernizing agriculture can have spillover effects on other industries. They discussed the possibility of seeing climate change impacts in the Mekong Delta as an opportunity to move into higher value production. Participants at Tay Nguyen University applauded the SCD’s focus on improving natural resource management and modernizing agriculture. They suggested the SCD consider issues of modernizing forestry and capacity building for management of natural resources. They also recommended that the SCD recognize the tension between maximizing development and protecting natural resources, noting for example that with increasing energy demands there is increased pressure to further exploit hydropower potential, while dams can have some negative impacts.

### **Governance**

Participants largely agreed with the analysis on the governance challenges that Vietnam is facing as well as the way the SCD addresses governance as a cross cutting theme. The private sector representatives emphasized the untimeliness, unfairness, and inconsistencies in the implementation of policies toward the private sector. They also pointed to the lack of coordination and overlapping functions between ministries, citing three to five ministries being responsible for one area of work. The private sector participants noted the poor performance in the public sector, and coupling with the lack of accountability mechanisms, it is difficult to hold anyone accountable if corruption happens. Students and faculties at the Tay Nguyen University suggested that looking at corruption is not enough and that more public scrutiny is needed to avoid waste and inefficiency in public investment. Participants also suggested the need to promote social feedback and public oversight in the conduct of the state, and to have a clear monitoring framework to gauge results.

## Annex 2: Income Concepts, Fiscal Interventions, in the Commitment to Equity (CEQ) Assessment<sup>79</sup>



<sup>79</sup> Adapted from the Commitment to Equity Handbook: *Estimating the Redistributive Impact of Fiscal Policy*, (Nora Lustig, ed.) Tulane University and the World Bank, in progress.

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**The World Bank in Vietnam**

63 Ly Thai To Street, Hanoi

Tel: (84-4) 3934 6600

Fax: (84-4) 3935 0752

Website: [www.worldbank.org.vn](http://www.worldbank.org.vn)