

TAKING STOCK

AN UPDATE ON VIETNAM'S
RECENT ECONOMIC DEVELOPMENTS

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SPECIAL FOCUS:

Reform Priorities for Reducing Trade Costs and
Enhancing Competitiveness in Vietnam

June 2018



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Recent Economic Developments

Special Focus:
**Reform Priorities for Reducing Trade Costs and Enhancing
Competitiveness in Vietnam**

THE WORLD BANK

June 2018

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ACRONYMS AND ABBREVIATIONS

ASEAN	Association of Southeast Asian Nations
CPI	Consumer Price Index
CPTPP	The Comprehensive and Progressive Trans-Pacific Partnership
DB	Doing Business
EAP	East Asia and Pacific Region
EMDEs	Emerging Market and Developing Economies
EU	European Union
EUVFTA	European-Vietnam Free Trade Agreement
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
GDP	Gross Domestic Product
GSO	General Statistics Office
HICs	High-income countries
ICT	Information and Communications Technology
IMF	International Monetary Fund
LMICs	Low and Middle-income countries
LPI	Logistics Performance Index
LSP	Logistics service providers
MARD	Ministry of Agriculture and Rural Development
MFN	Most-favored nation
MOF	Ministry of Finance
MOH	Ministry of Health
MOIT	Ministry of Industry and Trade
MOT	Ministry of Transport
NLAP	National Logistics Action Plan
NPLs	Non-performing Loans
NTMs	Non-tariff measures
OECD	The Organization for Economic Co-operation and Development
PISA	The Programme for International Student Assessment
PPA	Public-Private Alliance
PPP	Public-Private Partnership
SBV	State Bank of Vietnam
SCAs	Specialized control agencies
SOEs	State-owned enterprises
VAMC	Vietnam Asset Management Company
VDR	Vietnam Development Report
VLSS	Vietnam Logistics Statistical System
VSSF	Vietnam Social Security Fund
VTIP	Vietnam Trade Information Portal
WB	The World Bank
WTO	World Trade Organization

OVERVIEW

Recent Economic Developments

The external environment remains broadly favorable but risks are rising. Global demand and trade growth remain robust but are expected to gradually moderate amidst higher commodity prices, tighter financing conditions and heightened policy uncertainty. Global GDP growth is expected to peak at 3.1 percent in 2018 but to moderate slightly to an average of 3 percent in 2019–20 as the current cyclical upswing in advanced economies runs its course. Growth in the East Asia and Pacific (EAP) region is expected to moderate slightly to 6.3 percent in 2018 and then 6.1 percent on average in 2019–2020, largely reflecting a continued structural slowdown in China.

Propelled by favorable domestic and external conditions, Vietnam's economy posted its strongest first-quarter growth in a decade. Having recorded 6.8 percent in 2017, real GDP expanded nearly 7.4 percent (y/y) during the first quarter of 2018. Buoyant external demand further lifted Vietnam's export-oriented manufacturing and agricultural sectors which expanded by 13.6 percent and 4.1 percent, respectively. Meanwhile, robust domestic demand supported solid service sector performance which expanded by 6.7 percent. While the growth uptick was partly driven by a cyclical improvement in global demand, it also reflects an underlying rise in potential growth, driven by a FDI and private-sector-led recovery in investment and an ongoing shift of labor from agriculture into more productive manufacturing and service sectors.

Vietnam's external position continued to improve owing to strong trade performance and FDI inflows. Thanks to robust manufacturing and agricultural exports outpacing import growth, Vietnam recorded a widening merchandise trade surplus in the first quarter of 2018. Foreign direct investment inflows also continued to surge as traditional greenfield FDI was supplemented by rising equity inflows reflecting in part a pick-up in SOE divestment. Supported by strong inflows, the exchange rate has been relatively stable while reserves continued to rise, reaching about US\$63 billion in the first four months of 2018, more than twice the nominal level reported in December 2015 and equal to around 3.6 months of imports.

Against the backdrop of low inflation, monetary policy remains accommodative. Vietnam's consumer price index has been ticking up slightly 2.8 percent (y/y) in the first four months of 2018, driven by hikes in administered prices (for electricity and health services). Monetary policy has remained accommodative with partially unsterilized interventions in foreign exchange market, still elevated credit growth and interbank rates below policy rates. Abundant liquidity could exacerbate volatility in Vietnam's financial markets, especially against the backdrop of anticipated tightening of global monetary conditions.

After public debt stabilized in 2017, maintaining fiscal discipline remains a priority. An expenditure-led adjustment reduced the overall fiscal deficit to 4.5 percent of GDP in 2017. This together with a reduction in government guarantees and significant privatization proceeds resulted in a decline in public-debt-to-GDP ratio to 61.4 percent in 2017 from 63.7 percent in 2016. During first quarter of 2018, the government continued to contain expenditure growth to offset relatively weak revenue performance. Driven by low inflation and ample liquidity in the banking system, Government bond yields have trended downwards across the yield curve which allowed the government to meet its financing needs while extending the average maturity and lowering the cost of domestic government bonds.

Vietnam's dynamic economy continues to create jobs and real wage growth, leading to broad-based welfare gains and poverty reduction. Job creation remains buoyant with over 670 thousand new jobs created in 2017, predominantly in higher productivity sectors such as manufacturing and services. Reflecting favorable labor market conditions, average real wages are estimated to have expanded by 5 percent in 2017.

Medium-term outlook, risks, and policy implications

Vietnam's medium-term outlook has improved further since the last Taking Stock release in December 2017.

Real GDP is now projected to expand by 6.8 percent in 2018 (up from 6.5 percent in our previous projection) before moderating to 6.6 percent in 2019 and 6.5 percent in 2020 due to the envisaged cyclical moderation of global demand. Despite reduced slack in the economy, we expect inflation to remain around the 4 percent government target, predicated on some tightening of the monetary stance to counter price pressures emanating from domestic input price pressures and rising global commodity prices. On the external front, we expect the current account balance to remain in surplus, but start narrowing from 2019 reflecting widening deficits on the income and services accounts. Fiscal consolidation is expected to contain fiscal deficits and public debt over the projection period.

Selected macroeconomic indicators

	2016	2017e	2018f	2019f
GDP growth (percent)	6.2	6.8	6.8	6.6
Consumer price index (annual average, percent)	2.7	3.5	4.0	4.0
Current account balance (percent of GDP)	2.9	2.1	2.3	2.2
Fiscal balance (percent of GDP, GFS definition)	-4.8	-4.5	-4.5	-4.4
Public and PG debt (percent of GDP, GFS definition)	59.9	58.5	57.9	57.5
Public and PG debt (percent GDP, MOF definition)	63.6	61.4	61.2	61.1

Source: GSO, MOF, SBV, IMF and World Bank.

Despite improved short term prospects, risks remain significant. Domestically, slower progress in restructuring of the SOE and the banking sector could adversely impact the macro-financial situation, undermine growth prospects, and create large public-sector liabilities. External risks include escalating trade protectionism, heightened global and regional geopolitical uncertainty, and faster-than-expected tightening of global financing conditions which could lead to disorderly financial market movements.

Policymakers should take advantage of the favorable economic environment to push ahead with policies that increase macroeconomic resilience and lay the foundation for sustained growth in the future. Monetary policy should tighten liquidity in the banking sector to align interbank rates with policy interest rates and to bring credit growth in line with fundamentals. This could be supported by macro-prudential measures aimed at preventing excessive credit flows to high risk sectors such as real estate. Furthermore, steps to enhance banking supervision, resolve NPLs, and reinforce capital buffers would not only reduce risks to financial stability but also improve financial intermediation which in turn would contribute to higher medium-term growth. On the fiscal front, further deficit reduction should be underpinned by a comprehensive strategy to enhance spending efficiency and sustain medium-term revenue potential. Prudent macroeconomic policies should be accompanied by a comprehensive and deep structural reforms, including regulatory reforms to remove barriers to and reduce the cost of private sector activity, human capital and high-quality infrastructure investments, and further reforms to enhance productivity of the SOE sector.

Special Focus: Reform Priorities for Reducing Trade Costs and Enhancing Competitiveness in Vietnam

Efficient trade facilitation and logistics are lynchpin of overall competitiveness. Global trends show that gains from improving trade facilitation now outweigh gains from reducing tariffs. According to the World Economic Forum, if all countries reduced supply chain barriers halfway to that of Singapore, global GDP could increase by 4.7 percent or US\$ 2.6 trillion, and world trade by 14.5 percent or US\$ 1.6 trillion, far outweighing the benefits from the elimination of all import tariffs. Other research has shown that better logistics performance is associated higher GDP growth and trade growth.

While Vietnam has made great progress in reducing tariffs, there remains significant potential to reduce trade cost through rationalization of non-tariff measures or specialized controls, more efficient border management and logistics. Through various trade agreements Vietnam has cut tariffs significantly with the average favored-nation (MFN) tariff now in the range of 0 to five percent for almost all tariff lines and commodities at targeted markets. In contrast and despite some initial progress, Vietnam's non-tariff trade costs for both imports and exports remain relatively high and above the ASEAN-4 average. These costs are driven by compliance with specialized control regulations, border clearance procedures, port handling, transport and logistics.

Costs analysis shows that for imports, the regulatory compliance with specialized controls is the most time-consuming compliance (55 percent of total time to import), whilst the highest monetary cost to import is for port handling (39.5 percent of total cost to import). For export, the highest time cost is for port handling (44 percent of the total time to export), whilst the highest monetary cost component again is for port handling (33 percent of the total cost to export). High time and monetary costs of port handling are caused mainly from extended inventory due to delays related to cumbersome border compliance. Given that Vietnam's exports are largely characterized as low value-added (and most of materials are imported for export), the importance of reducing the time and costs to imports should be prioritized.

The Government of Vietnam has focused on progressive improvement of the business environment and competitiveness to reach the level of ASEAN-4 average by 2020. Reducing costs of border compliance and specialized controls as well as logistics costs can be achieved by a comprehensive program comprising the following four pillars:

Pillar 1: Trade facilitation. The “soft” part of non-tariff costs -- time to comply with specialized control measures and procedures before and at the border -- accounted for 72percent of the total import time and is responsible by customs and specialized control agencies. Reducing this cost requires urgent actions to: (1) Review and rationalize measures and procedures for compliance with specialized control regulations and border procedures on a cost and benefit analysis; (2) Establish an effective institutional mechanism to ensure accountability from Customs and specialized control agencies to timely deliver planned actions; (3) Sustain a trade portal to improve transparency and compliance with WTO's Trade Facilitation Agreement; (4) Use risk-based management in specialized control agencies; (5) Apply automation across agencies in particular through National Single Window; and (6) Eliminate multiple inspections. Lead agencies, which can contribute to reducing costs include Ministry of Finance (MOF) – especially its General Department of Vietnam Customs (GDVC), Ministry of Agriculture and Rural development (MARD), Ministry of Industry and Trade, and Ministry of Health (MOH) among other agencies.

Pillar 2: Trade-related infrastructure and the quality of connectivity. Vietnam's growth potential is being constrained by the lack of adequate high-quality multimodal transport network connecting major growth poles to main international gateways, and poor quality of transport and logistics services. Reform priorities should be given to: (1) Strengthening integrated planning across modes, aiming to strengthen the intermodal connectivity and based on sound data and analytical rigor; (2) Introducing participatory planning, by involving private sector stakeholders, such as shippers and logistics service providers, in the planning process for their inputs to

strengthen the quality of planning and to address supply-and-demand mismatch; and (3) Regulatory reforms to deepen private sector participation in infrastructure development, including further enabling various forms of public-private partnerships (PPP) for infrastructure delivery and attracting commercial financing for infrastructure development.

Pillar 3: Building a competitive logistics service sector. Vietnam's logistics service providers (LSPs) often lack the scale, skills and technology to provide reliable and efficient services. There is also a lack of reliable logistics statistical data to support state management agencies and the private sector to formulate appropriate policies and corporate strategies for the sector development. Among key prioritized actions to address logistics sector challenges, the development of Vietnam Logistics Statistical System (VLSS) to collect, process and report officially on a reliable logistics database is important. Successful implementation of VLSS requires learning international experience and the collaboration between Ministry of Transport, General Statistical Office, General Department of Vietnam Customs, and logistics businesses.

Pillar 4: Strengthening interagency coordination and partnership with the private sector. The recent establishment of the Trade Facilitation and National Single Window Committee is critical to lead inter-agency efforts to improve trade facilitation and to comply with the WTO's Trade Facilitation Agreement. Looking forward, it is recommended that the Committee will: (1) Extend to cover logistics development area; (2) Set a standing office to coordinate activities overseen by the Committee; (3) Set an effective mechanism to make sure government agencies accountable for planned actions; and (4) Allow relevant representatives of the private sector to participate as Committee's member.

The National Logistics Action Plan has been issued as an initial effort to put forward effective arrangements to implement integrated reform priorities on trade facilitation and logistics. Despite collective efforts, the action plan can be further improved to best reflect an integrated approach. Implementation progress and impact could be monitored based on time and cost indicators from various indexes such as Doing Business, Logistics Performance Index, ESCAP-World Bank Trade Cost Database etc. Especially, Vietnam Logistics Statistical System should be developed and used to support policy formulation for trade facilitation and logistics reform agenda and for monitoring the implementation of the reform agenda.

The World Bank stands ready to support Vietnam in developing and implementing the proposed integrated four-pillar program on trade facilitation and logistics to further boost export-led growth, to improve business environment, and to enhance competitiveness. We are committed to continue providing comprehensive analytical work and technical assistance, and stand ready to provide any financial assistance that the Government might seek.

PART I

RECENT ECONOMIC DEVELOPMENTS



External Economic Environment

The global and regional environment remains favorable, but with considerable risks

1. Global growth has eased, but remains robust, and is projected to reach 3.1 percent in 2018. It will then slightly moderate to an average of 3 percent in 2019–20, reflecting a gradual slowdown in advanced economies (figure 1). Following a broad-based recovery in 2017, growth in advanced economies is projected to inch down slightly to 2.2 percent in 2018, and moderate thereafter toward an average of 1.8 percent in 2019–20, as labor market slack diminishes and monetary policy accommodation is gradually unwound. Growth in emerging market and developing economies (EMDEs) is expected to reach a five-year high 4.5 percent in 2018, and stabilize at an average of 4.7 percent in 2019–20. This mainly reflects a further cyclical pickup of growth in commodity exporters as the effects of the earlier commodity price collapse dissipate. The investment-led recovery in advanced economies has provided tailwind to global trade growth which is estimated to have reached a stronger-than-expected 4.8 percent in 2017, following two years of pronounced weakness (figure 2). In 2018 global trade is expected to remain strong, but to moderate thereafter, as global investment growth eases.

Figure 1: Global GDP growth
(percent change)

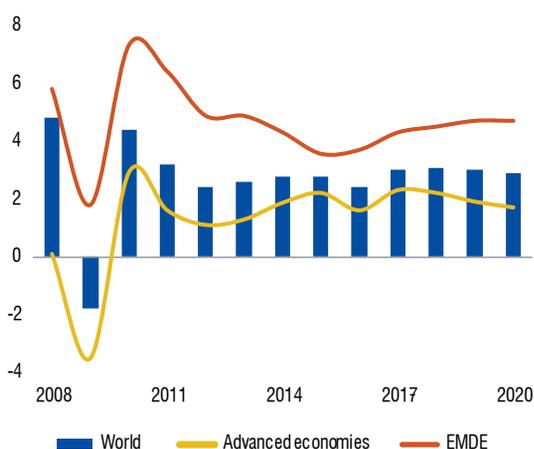
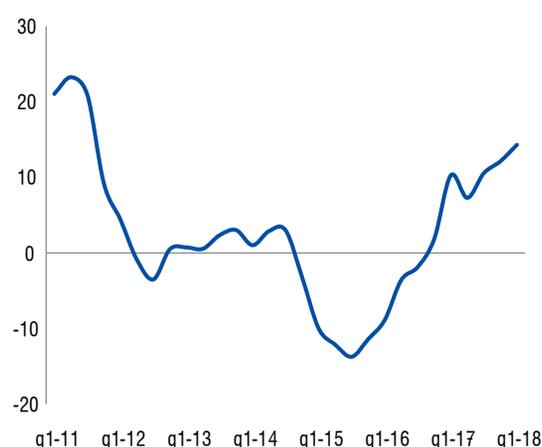


Figure 2: World merchandise exports
(percent change, y/y, current US\$)



Source: World Bank.

2. Growth in the East Asia and Pacific region is expected to gradually moderate from 6.3 percent in 2018 to 6.1 percent on average in 2019-2020. The modest slowdown in regional growth is largely due to the gradual and planned structural slowdown in China. Activity in the rest of the region is expected to peak at 5.4 percent in 2018 and remain steady, around its potential rate in 2019 (table 1). The outlook is predicated on broadly stable commodity prices in the next two years, strong but gradually moderating global demand, and a gradual tightening of global financing conditions. Despite the projected robust activity in the region in the near term, underlying potential growth—which has fallen considerably over the past decade—appears to have declined over the long term, reflecting increasingly adverse demographic patterns and projected slowing pace of capital accumulation, which is needed to rein in credit growth.

Table 1. Developing East Asia and Pacific: GDP growth projections

	2016	2017e	Forecast		
			2018	2019	2020
Developing EAP	6.3	6.6	6.3	6.1	6.0
China	6.7	6.9	6.5	6.3	6.2
Indonesia	5.0	5.1	5.2	5.3	5.4
Malaysia	4.2	5.9	5.4	5.1	4.8
Philippines	6.9	6.7	6.7	6.7	6.6
Thailand	3.2	3.9	4.1	3.8	3.8
Vietnam	6.2	6.8	6.8	6.6	6.5
Cambodia	7.0	6.8	6.9	6.7	6.6
Lao PDR	7.0	6.7	6.6	6.9	6.9
Myanmar	5.9	6.4	6.7	6.9	7.1
<i>Assumptions about the external environment</i>					
World	2.4	3.1	3.1	3.0	2.9
Advanced economies	1.7	2.3	2.2	2.0	1.7
Emerging and developing economies	3.7	4.3	4.5	4.7	4.7

Source: World Bank.

3. Risks to the outlook remain tilted to the downside. They include the possibility of disruptive financial market developments and escalating trade protectionism amid elevated policy uncertainty. The impact from a sudden tightening of global financing conditions could be particularly severe in an environment where debt levels have reached record highs, refinancing needs are mounting, and credit quality has deteriorated in a number of EMDEs (figure 3). An escalation of trade restrictions among major economies is also a major threat to the outlook, as it could derail the recovery in global trade and dampen confidence and investment worldwide. If a combination of downside risks were to materialize, it could trigger a sharper-than-expected slowdown in global growth, with particularly negative effects for countries with depleted policy buffers and sizable vulnerabilities. There is also the possibility that growth in major economies may surprise on the upside, with positive spillovers to trading partners. In the longer run, EMDEs need to tackle ongoing structural challenges and boost potential growth by promoting competitiveness, adaptability to technological change, and trade openness.

Figure 3. Sovereign spreads (basis points)



Source: JP Morgan/Haver Analytisc and WB calculation.

Recent Economic Developments in Vietnam

Coming off strong momentum in 2017, growth accelerated further in the first quarter of 2018

4. Propelled by favorable domestic and external factors, Vietnam's economy posted its strongest first-quarter growth in 10 years. Having recorded 6.8 percent in 2017, real GDP expanded nearly 7.4 percent (y/y) during the first quarter of 2018. The expansion was led by strong manufacturing growth of 13.6 percent (up from 8.6 percent in Q1 2017), reflecting a combination of statistical base effects due to relatively weak growth in the first quarter of 2017 and strong external demand which lifted electronics and other manufacturing exports. Agriculture also saw faster growth of 4.1 percent (up from 2.1 percent in Q1 2017) largely due to a good harvest, continued shifts to higher value crops and increased output in the fishery sector, which benefited from robust domestic and external demand. Performance in the service sector remained solid at 6.7 percent (up slightly from 6.4 percent during Q1 2017) supported by a higher number of tourist arrivals and buoyant retail growth, underpinned by sustained strength of domestic consumption. Meanwhile construction continued to expand by 7.5 percent – about the same pace Q1 2017 - on the back of robust investment activity and a dynamic real estate sector. Following eleven consecutive quarters of negative growth, mining output recovered modestly to 0.4 percent (from 10 percent contraction in Q1 2017), driven by a pick-up in commodity prices.

Figure 4. Sectoral GDP growth

(y/y, percent)

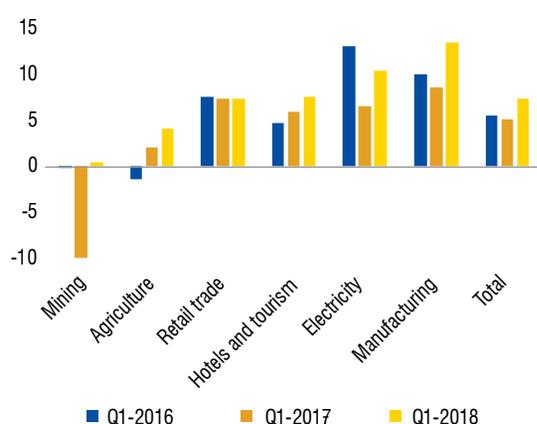
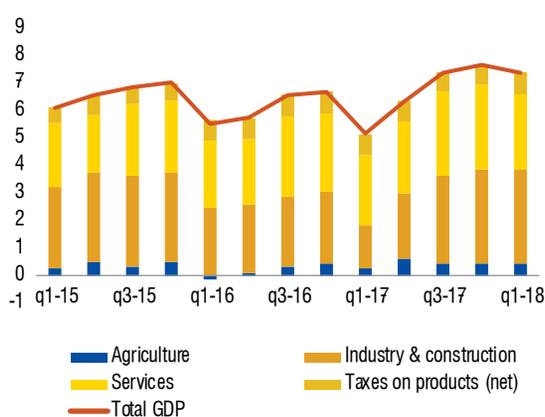


Figure 5. Contribution to the GDP growth

(percentage point)



Source: GSO and World Bank estimates.

Box 1. Vietnam's Manufacturing Miracle

Manufacturing output continues to expand rapidly contributing on average about a quarter of Vietnam GDP growth over the past five years. Over the past five years manufacturing output expanded at average 10.3 percent, annually, and an estimated 1.5 million new manufacturing jobs were added between 2014-16 alone, driven in large part by export oriented sectors, including electronics, garments and footwear. In 2017 total manufacturing exports expanded at a blistering rate of 20 percent, soaring to US\$180 - equal to about 80 percent of Vietnam's GDP. Because manufacturing jobs tend to be more productive -on average output per worker in manufacturing is about 3 times higher than the average in the economy- this has lifted actual (and potential) GDP growth, boosted labor productivity and raised wage growth which in turn contributed to rising living standards and a steady decline in poverty.

Why is manufacturing witnessing a renaissance in Vietnam, while relapsing in many parts of the world? Some basic foundations are clearly important. Wages are still low and demographics are favorable. About half the population is below

the age of 35 and Vietnam has large and growing workforce. The country is also politically stable and geographically close to major global supply chains. But this is not necessarily what sets Vietnam apart: its strong foundations through good policies. First, it has embraced trade liberalization with gusto. Second, it has complemented external liberalization with domestic reforms through deregulation and lowering the cost of doing business. Finally, Vietnam has invested heavily on human and physical capital, predominantly through public investments.

First, trade policy has arguably been the most important industrial policy for Vietnam. With Singapore, it shares the top spot in East Asia of being a member of bilateral and multilateral free trade agreements. A signatory to 16 bilateral and multilateral free trade agreements, Vietnam is a member of the WTO, ASEAN, and has concluded bilateral agreements with the US, Japan, South Korea, the EU and the Eurasian Customs Union.

Earlier this year, it became one of 11 countries to join the revived CPTPP. These trade agreements dramatically reduced tariffs, anchored difficult domestic reforms, and opened much of the economy to foreign investment. It is estimated that more than 10,000 foreign companies—including major global players such as Samsung, Intel and LG—operate in Vietnam today, mostly in export-oriented, labor-intensive manufacturing.

Second, Vietnam has leveraged its demographic dividend through effective investment in its people. Vietnam's efforts to promote access to primary education and to ensure its quality through minimum quality standards have paid off. In the latest 2015 OECD Programme for International Student Assessment (PISA)—which tests high school students in math, science and other disciplines—Vietnam ranked 8th of 72 participating countries, ahead of OECD countries such as Germany and Netherlands.

Third, relentless focus on competitiveness and the ease of doing business. Vietnam has made steady progress in improving its investment climate, as evidenced by higher scores in the World Economic Forum's competitiveness index (up five points to 55th in the world), and the 2018 World Bank's ease of doing business ranking (68th in the world, up 31 places since 2014). Vietnam also reduced the corporate income tax rate to 20 percent from 32 percent in 2003.

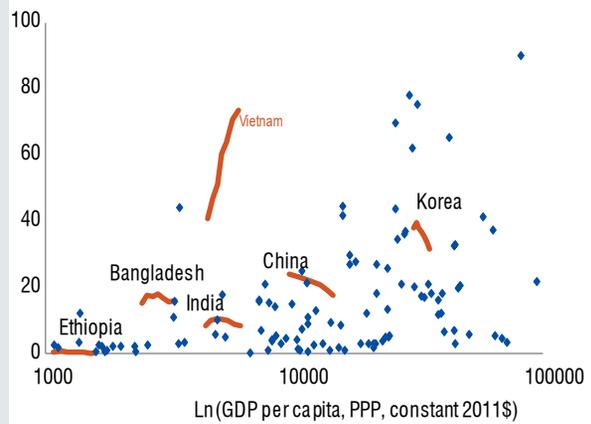
Finally, Vietnam invested in infrastructure, especially in the power sector and connectivity. Thanks in part to high public investment, power generation, transmission, and distribution capacity have been scaled up to meet rapidly rising demand. To keep pace with rapidly growing container trade (which expanded at a staggering average annual rate of 12.4 percent between 2008 and 2016), Vietnam also developed its connective infrastructure, including seaports and marine terminals.

Despite this remarkable success, challenges remain. Overall, Vietnam's manufacturing sector remains relatively small. Most of the sector is driven by foreign direct investment which accounts for close to 90 percent of manufacturing exports. Many of the newly created jobs in manufacturing are in basic assembly which requires manual labor but does not necessarily add a lot of value (per worker). Linkages between FDI and domestic firms are weak. Moreover, as wages inevitably rise, Vietnam's current comparative advantage in low-skill, labor-intensive industries will start to dissipate, a trend that may be amplified by new labor-saving technologies and automation.

Source: Sebastian Eckardt, Deepak Mishra and Viet Tuan Dinh (2018): "Vietnam's Manufacturing Miracle – Lessons for Developing Countries". Published on Brookings Institution Future Development Blog.

Made in Vietnam

Figure 6. Manufacturing exports (percent of GDP)



5. On the demand side, domestic demand remained resilient, underpinned by buoyant investment and consumption growth. In the first quarter of 2018, investment growth picked up 10.4 percent (y/y) in nominal terms, bringing total investment outlays to about 32.2 percent as a share of GDP (figure 7). While public investment has decelerated, due to the government's commitments on fiscal consolidation, private domestic investment rose

16.9 percent, supported by ample banking sector credit. FDI capital disbursements also continued to rise 8.1 percent (y/y), and accounted for about 8.5 percent of GDP. Fueled by growing wages and still subdued inflation, private consumption growth remained robust, as reflected in retail sales which rose by 9.9 percent in nominal terms (about 8.6 percent in real terms) in q1-2018 (figure 8). In terms of contribution to growth in Q1-2018, final consumption contributed about 5 percentage points, while gross capital formation and net exports of goods and services contributed 1.1 and nearly 1.2 percentage points, respectively.

Figure 7. Total investment (change in percent)

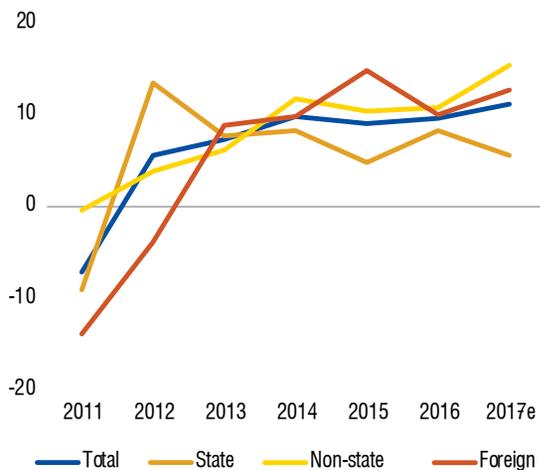


Figure 8. Retail sales (change in percent)



Source: GSO.

6. Strong GDP growth continues to translate into a dynamic labor market with strong job creation and buoyant real wages. Job creation remains buoyant with over 670 thousand new jobs created in 2017, predominantly in high productivity sectors such as manufacturing and services. Employment growth was strongest in manufacturing which benefited from expansion of production facilities, in particular in the FDI dominated labor intensive export sectors. Employment in the construction sector also expanded on the back of strong demand for housing and investment activity. In contrast, reported employment in agriculture continued to fall, as more job seekers shifted to other sectors. Reflecting favorable labor market conditions, average real wages are estimated to have expanded by 5 percent in 2017.

Figure 9. Employment and GDP growth in 2017 (percent)

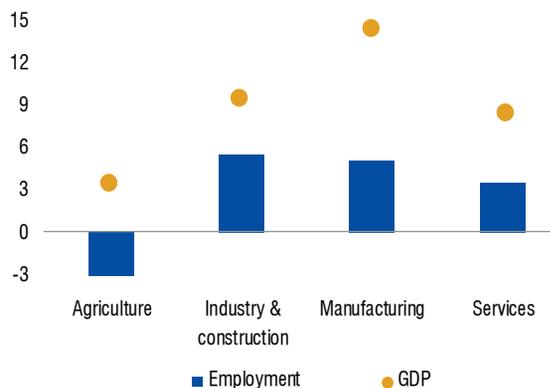
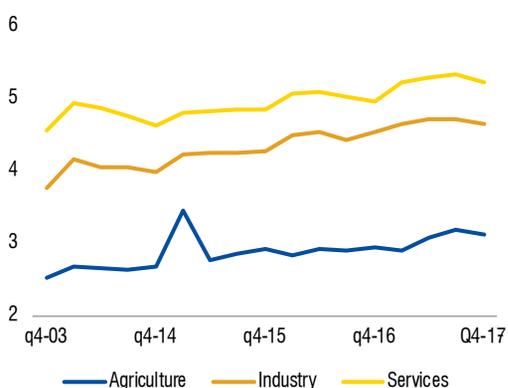


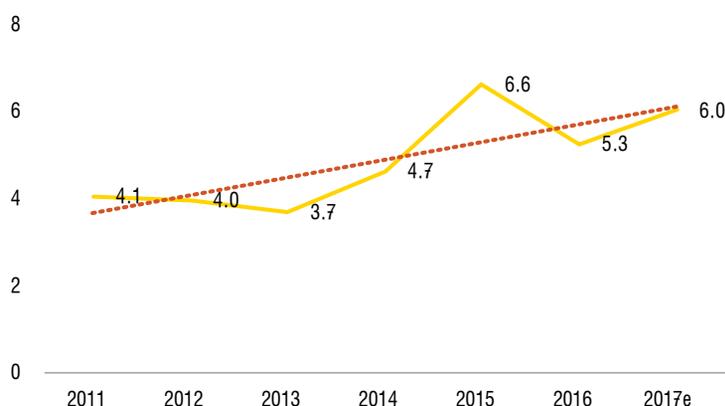
Figure 10. Real wage (mil. VND/month)



Source: GSO and WB estimates.

7. While the growth uptick is partly driven by a cyclical improvement in global demand, it also reflects an underlying rise in potential growth. Potential growth is lifted by combination of capital deepening and structural transformation which has boosted labor productivity growth to about 6 percent (3 year moving average). After a significant decline during 2011, investment growth has experienced a steady recovery. While public investment growth has moderated, the recovery was led by FDI and the private sector investment contributing to high quality capital stock. At the same time, the ongoing shift of labor from agriculture into more productive manufacturing and service sectors enhanced labor productivity growth and contributed to higher potential growth. Within the agricultural sector, falling employment was accompanied by diversification into higher value crops and products which also raised labor productivity growth.

Figure 11. Labor productivity growth (percent)



Source: GSO and WB estimates.

Box 2: Unleashing the full potential of Vietnam's Agriculture Sector

After relatively weak agricultural output growth in 2016, the sector experienced a strong rebound in 2017 which seems to carry forward to 2018. Agriculture accounts for 10 percent of GDP but accounts for 40 percent of total employment. The sector experienced strong recovery since it was hit by a severe drought and salinity intrusion in the early 2016, causing the growth to decline to the lowest level in a decade. Growth returned remarkably to 2.9 percent in 2017 and continued strongly at 4.1 percent in the first quarter 2018. Agriculture accounted for two third of the sector and rose 3.8 percent (y/y) in q1-2018. Fishery rose 4.8 percent – the highest pace since 2011 driven by aquaculture farming. Strong domestic and external demand helped to boost the agriculture and fishery output in 2017 and the first quarter 2018. Export value of agriculture key products (rice, cashew nut, vegetables, fruits and aquacultures) is estimated to increase 8.4 percent (y/y) in q1-2018 and contributed to the Vietnam's impressive overall export performance.

Figure 12. Agriculture productivity growth (percent)

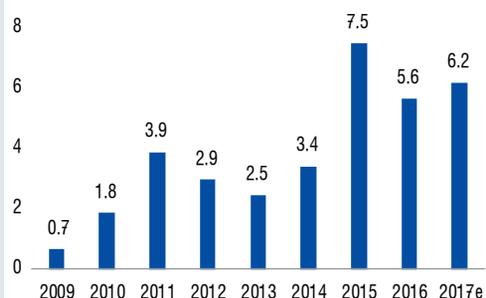
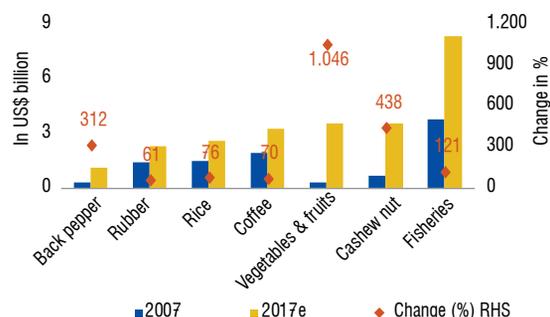


Figure 13. Key agriculture exports (US\$ billion)



Source: GSO, Vietnam Department of Customs and WB estimates.

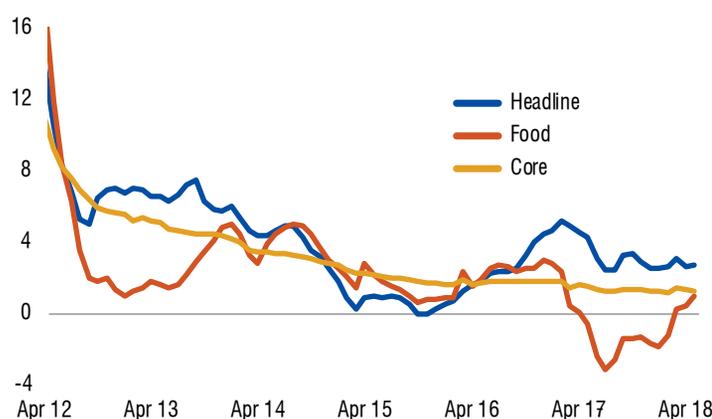
Aside of short-term fluctuations due to natural calamities and market conditions, diversification of agricultural production is boosting the sector's growth potential. The agricultural sector faces significant opportunities to contribute more strongly to growth, but also substantial challenges in terms modernizing production, raising productivity and linking more effectively with agribusiness value chains. Labor productivity growth in the sector has picked up markedly in recent years, as overall employment declined and especially higher value activities, such as fish farming, fruits and vegetables and higher value cash crops experienced stronger growth.

Nevertheless, there are remaining challenges related to the quality and sustainability of Vietnam's agricultural growth and related patterns of development. A comparatively low quality of growth is manifested by low smallholder farmer profitability, considerable under-employment among agricultural workers, mixed or uncertain product quality and food safety, low value addition, and limited technological or institutional innovation. Some agricultural growth has come at the expense of the environment in the forms of deforestation, biodiversity loss, land degradation, water pollution, and greenhouse gas emissions. In most locations, agricultural growth has involved an increase in cropping areas or intensities and ever higher uses of inputs and natural resources. Hence, more output has come from more and more inputs and increasing environmental costs.

Against the backdrop of low inflation, monetary policy remains supportive of growth

8. Despite a recent uptick in headline inflation, price pressures remain subdued. Vietnam's consumer price index has been ticking up slightly in the first four months of 2018, driven by hikes in administered prices (for electricity and health services). Headline CPI rose by 2.8 percent (y/y) in April 2018, up slightly from 2.6 percent in December 2017. However, core inflation slightly declined from 1.4 percent in to 1.3 percent during the same period. It is noteworthy that Vietnam has kept core inflation below 3 percent since November 2014 (figure 14).

Figure 14. Consumer price index (percent)



Source: GSO.

9. Against the backdrop of moderate inflationary pressures, monetary policy remains accommodative. Monetary policy targets for 2018 continue to aim at ensuring SBV's dual focus of maintaining stability while boosting overall economic growth. The targets include achieving GDP growth of 6.7 percent, maintaining CPI below 4 percent, reaching a credit growth rate of 17 percent, accelerating total liquidity (a proxy for money supply) growth rate to 16 percent. In practice, monetary policy has remained accommodative over last two years with significant unsterilized interventions in the foreign exchange market, high credit growth, and interbank rates routinely dipping well below the policy rates. With year-on-year headline inflation at 2.8 percent as of April 2018,

real short-term interest rates are effectively zero or even negative (figure 15). Abundant liquidity could exacerbate volatility in Vietnam’s financial markets, especially against the backdrop of tighter global monetary conditions and rapid domestic credit growth.

Figure 15. Policy and interbank interest rates

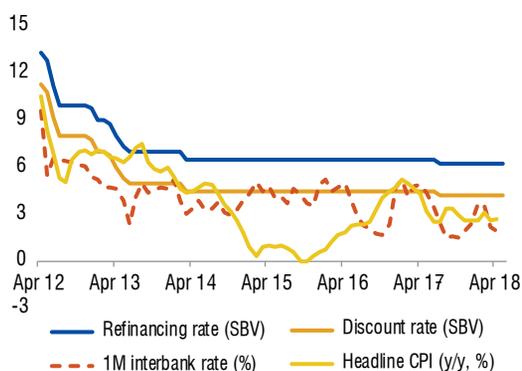
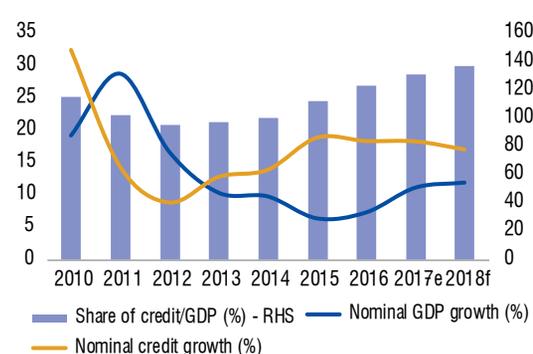


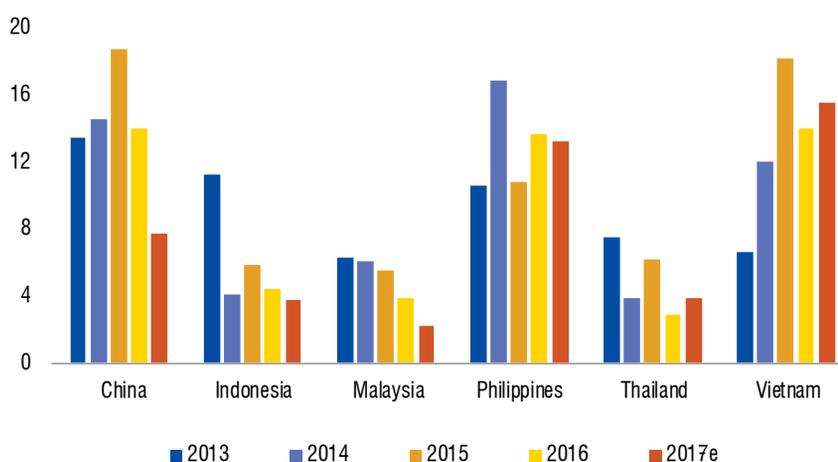
Figure 16. GDP and credit



Source: SBV and World Bank estimates.

10. Despite a slight deceleration in the first quarter 2018, credit growth remains elevated. Total banking sector lending is estimated to expand 3.6 percent (year-to-date) in the first quarter of 2018 – equivalent to about 14 percent year-on-year in nominal terms, below the estimate of 18.2 percent cumulative credit growth in 2017 (figure 17). Vietnam credit cycle stands out from trends in most other countries of the region, including China, which have seen gradual tightening. Vietnam’s overall credit to GDP is also relatively high - at about 130 percent of GDP in December 2017, and credit is expanding at around 1.4 times the growth rate of nominal GDP. This rapid pace of credit growth may present risks to banking sector stability, especially given remaining balance sheet weaknesses and thin capital buffers in some of the banks.

Figure 17. Real credit growth in EAP countries (percent)



Source: World Bank.

11. Resolving remaining asset quality problems in the banking sector remains a priority. A major step in resolving the NPLs in the banking system was the National Assembly's Resolution 42 (effective from August 2017) that granted the Vietnam Asset Management Company (VAMC) more powers to resolve NPLs. The resolution allows banks to process pledged assets if the borrower in question is not co-operating, filling previous regulatory gaps. NPLs in the banking system are officially reported equivalent to 2.3 percent of total outstanding loans of the banking sector as of December 2017, however, this only partly reflects asset quality challenges in the banking system, as the measure does not include the non-performing assets held by the VAMC. Including VAMC's NPLs and potential bad debts, total non-performing assets in the banking system are estimated at about 7.36 percent.

Bolstered by strong trade performance, remittances and FDI inflows, the external position continued to strengthen

12. Vietnam's export performance continues to be exceptionally strong, supported by robust export-oriented foreign-invested manufacturing output and improved external demand. Over the first four months of 2018, Vietnamese export growth accelerated 19.2 percent in value terms (y/y). This is mainly due to a combination of robust growth of manufacturing and agriculture exports. Exports of smart phones, which account for nearly 22 percent of total exports in value-terms, expanded by 32.5 percent, sustaining a dynamic pace of growth of over 30 percent achieved in 2017. High value manufacturing exports (smart phones, computers, electronics and cameras) together rose by healthy 25 percent and contributed a third of Vietnam export earnings in January-April period. Other traditional labor-intensive manufacturing exports (garment, footwear, travel goods, furniture) also sustained solid growth, reflecting strong external demand. The foreign investment led manufacturing sector continues to drive Vietnam's merchandise trade expansion. The foreign invested sector accounts for approximately 72 percent of total merchandise exports and 60 percent of total merchandise imports, dominating Vietnam's critical manufacturing trade sector. Hence, despite Vietnam's overall strong trade performance, enhancing participation of domestic firms in trade and global value chains remains a challenge.

13. Agricultural exports also continued to expand with increasingly diversified underlying export basket and a move into higher value crops. Exports of agriculture products also continued to expand driven by rice, cashew, coffee, fisheries, and vegetables and fruits. Importantly, Vietnam continues to diversify its agricultural exports to higher value crops, including vegetables and fruits which surged 42 percent in 2017 and 29 percent in 4M-2018. The export value of vegetables and fruits has now surpassed export earnings from traditional commodities, such as crude oil, rice and black pepper.

14. Meanwhile, oil exports declined despite rising oil prices. Oil production and hence exports continue to be constrained by technical capacity constraints related to Vietnam's maturing oil fields. While oil prices are up by 26.3 percent (y/y), a substantial decline in volumes caused oil export earnings to contract by 27 percent in the first four months of 2018.

Table 2. Merchandise Exports
(Nominal value change in percent)

	2015	2016	2017	4M-18
Total export value	7.9	9.0	21.2	19.2
Crude oil	-48.5	-36.6	22.0	-27.0
Non-oil	10.7	10.1	21.2	19.9
Agriculture products	-6.9	7.6	16.4	12.2
Rice	-4.5	-22.5	20.4	40.3
Fisheries	-16.0	7.3	17.9	14.3
Low value manufacturing	7.5	8.4	15.7	19.7
Garment	9.1	4.5	9.2	14.5
Footwear	16.3	8.2	12.7	10.0
Technology manufacturing	31.0	15.2	33.4	25.1
Phones and parts	27.9	13.7	31.9	32.5
Computer and electronics	36.5	21.5	36.8	12.8
<i>Domestic sector</i>	-2.7	5.5	17.1	21.1
<i>Foreign invested sector</i>	13.0	10.5	22.8	18.5
<i>Foreign invested sector (excl. oil and phones)</i>	14.3	11.4	19.3	14.4

Source: Vietnam Department of Customs.

15. Goods import growth decelerated to 9.5 percent (y/y) in the first four months of 2018 from 20.8 percent in 2017, in part due to a contraction in imports of machinery and equipment. Imports of machinery and equipment declined 8.9 percent in the first four months of 2018 compared with the same period last year – largely by foreign firms’ contraction of 15 percent, reflecting high statistical base effects and fluctuations due to the lumpiness of investment expenditures. Reflecting high import content of Vietnam manufacturing exports, imports of raw materials and intermediate goods remained robust, and expanded by 14 percent as result of strong export orders—albeit still a moderation from 22.8 percent growth in 2017.

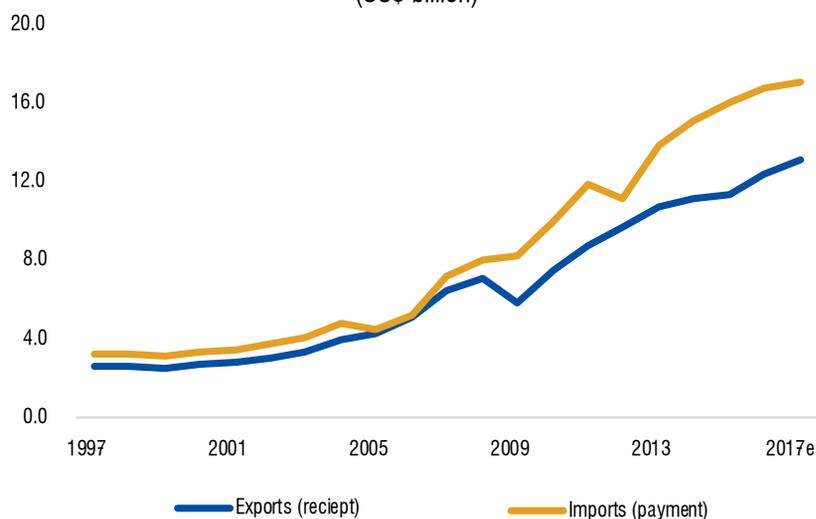
Table 3. Merchandise Imports
(Value change in percent, nominal)

	2015	2016	2017	4M-18
Total import value	12.0	5.5	20.8	9.5
Petroleum	-26.2	-9.3	37.6	30.1
Machinery and equipment	23.1	3.4	18.0	-8.9
Materials and intermediate goods	11.9	6.6	22.8	14.0
Animal feed	4.2	1.7	-7.0	7.2
Fabrics	7.8	3.2	8.4	12.9
Metal	4.7	2.2	13.2	10.5
Plastic material	-5.7	5.1	16.8	18.8
Computer and electronics parts	23.4	20.6	35.2	19.8
Phone parts and accessories	24.8	-0.3	54.6	6.4
Consumer products	21.3	8.3	12.3	1.1
Domestic sector	7.5	5.8	17.1	13.0
Foreign invested sector	15.5	5.3	23.4	7.2

Source: Vietnam Department of Customs.

16. While lagging merchandise trade, Vietnam's trade in services has also expanded quickly. In 2017, exports (receipts) of commercial services increased 6.6 percent and accounted for an estimated 5.8 percent of total exports of goods and services. Similarly, imports (payments) of commercial services rose 1.6 percent and accounted for an estimated 9.8 percent of the total of imports of goods and services. In 2017, receipts from travel services and transportation account for 68 percent and 20 percent of total Vietnamese service exports, respectively. During the same period, payments for transportation services accounted for nearly half of Vietnam's imports of services, largely driven by logistics services related to global value chains around Vietnam's manufacturing sector. Vietnam has enormous potential to enhance its tourism and logistics sectors, but this would require further strengthening in the quality of service provision and liberalization of trade barriers to trade in services.

Figure 18. Trade in services
(US\$ billion)



Source: Vietnam Department of Customs.

Figure 19. Exports of Services
(percent of total)

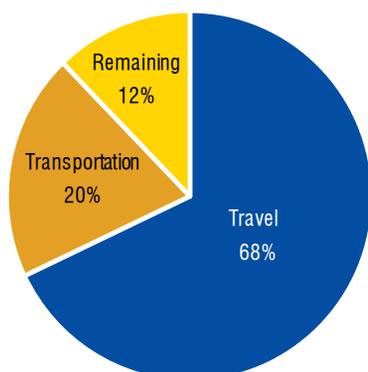
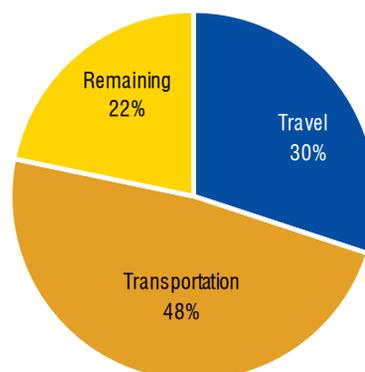


Figure 20. Imports of Services
(percent of total)



Source: GSO.

17. While Vietnam continues to receive resilient remittance inflows, the outflows of investment income including repatriation of profits of FDI sector weigh on the external income account. Net remittances from overseas Vietnamese amounted to an average of US\$ 8.7 billion, equivalent to 4.7 percent of GDP between 2011-17. On the other hand, investment income outflows, including repatriated profits and interest payments associated with Vietnam’s dynamic, export oriented FDI sector have steadily grown to US\$ 10.8 billion, equivalent to 4.9 percent of GDP in 2017, moving the overall income account into deficit and creating a growing drag on the overall current account (figure 21). As the FDI sector expands, the associated external income transfers will likely continue to increase over time.

Figure 21. Income and transfer
(percent of GDP)

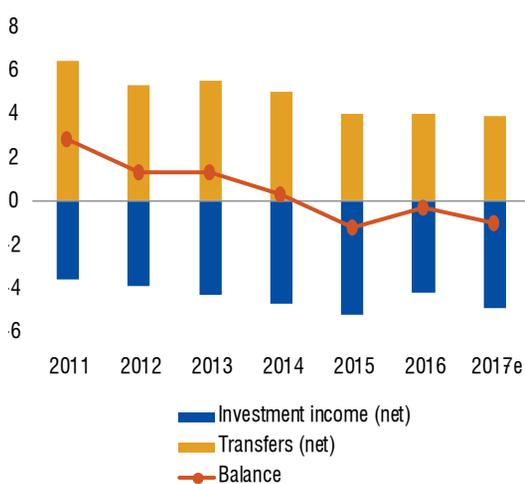
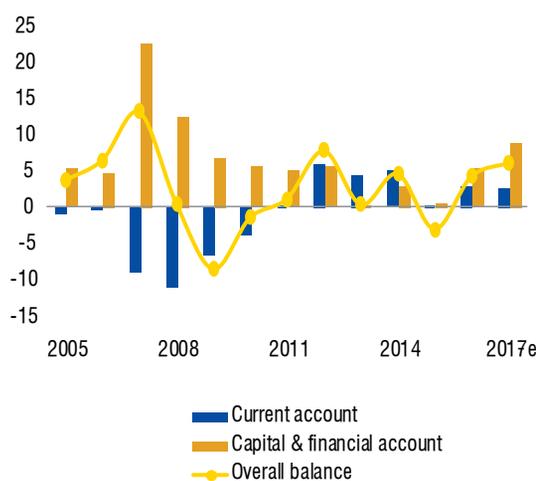


Figure 22. Balance of payments
(percent of GDP)

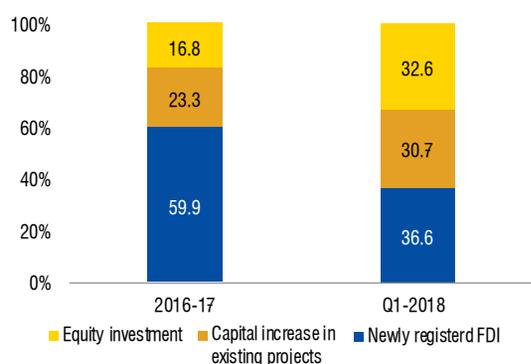


Source: SBV, IMF and WB.

18. Nevertheless, the current account, which has been in surplus in 2016-17, remained in a strong surplus in early-2018. The current account surplus is estimated at around 6.8 percent of GDP in the first quarter of 2018 owing mainly to an overall trade surplus which has expanded to US\$ 2.9 billion, following a surplus of US\$ 2.1 billion during the same period in 2017¹.

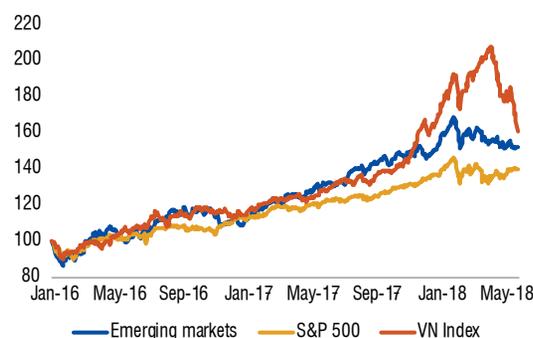
19. Reflecting positive investor sentiment, foreign direct investment inflows accelerated in 2017 and in the first quarter of 2018. Recently concluded trade agreements—such as the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) and EU Vietnam Free Trade Agreement (EV-FTA)— have further boosted investor confidence and helped usher in sustained FDI inflows. In 2017, foreign investors disbursed a record US\$17.5 billion to Vietnam across a broad and diversified range of investment activities. In the first quarter of 2018, FDI disbursement were sustained at the 7.2 percent growth rate achieved over the same period in 2017. Currently, the foreign-invested sector contributes about a fifth of Vietnam’s GDP, 26.5 percent of total investment, 72 percent of total exports, and millions of direct and indirect jobs.

Figure 23. Shifts in foreign investment
(percent of total)



Source: MPI.

Figure 24. Vietnam stock exchange index
(Dec 2015=100)



Source: HOSE and World Bank.

20. In addition to greenfield FDI, foreign investors also ramped up activity in the equity market, reflecting a pick-up in SOE divestments and easing restrictions on foreign equity participation. Foreign investors injected about US\$650 million in the form of equity investment (purchase of shares and capital contribution) in Vietnamese businesses in the first quarter of 2018—five times higher compared with the same period last year².

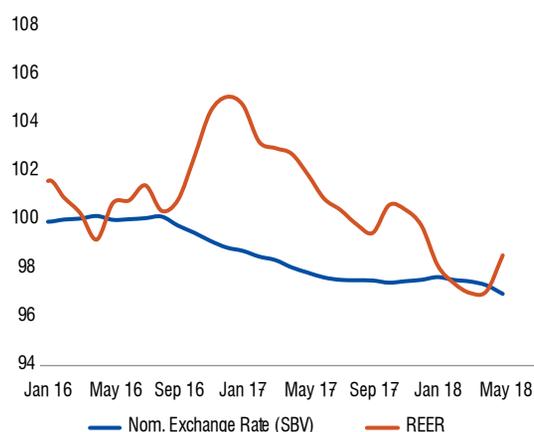
21. Supported by favorable external balances and a more flexible exchange-rate regime, the nominal exchange rate has been relatively stable and Vietnam’s foreign reserve position continues to improve. In nominal terms the official dong exchange rate to the U.S. dollar has devaluated slightly by 1.2 percent in nominal term in 2016 and 2017 (figure 25), as the SBV took advantage of strong foreign exchange inflows to accumulate reserves. Due in large part to a weaker U.S. dollar, the real effective exchange rate of the dong has depreciated by about 2.7 percent since early 2017, although this trend has reversed in recent months as U.S. dollar has shown tentative signs of a recovery. Meanwhile, the State Bank of Vietnam reported a record-high foreign reserves of about US\$63 billion³ in the first four month of 2018, more than twice the nominal level reported in December 2015 and equal to around 3.6 months of imports (figure 26).

¹ Data provided by the State Bank of Vietnam.

² Data provided by the State Bank of Vietnam.

³ Data provided by the State Bank of Vietnam.

Figure 25. Dong/US\$ exchange rate



Source: World Bank.

Figure 26. International reserves



Source: SBV, IMF and World Bank.

Box 3. Impact of Comprehensive and Progressive Trans-Pacific Partnership

On March 8, 2017 Vietnam together with ten other economies concluded the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP). The CPTPP deal covers 11 economies that together accounts for 13.5 percent of global GDP, and a \$10 trillion USD comprehensive market size that spans over 500 million people. Better access to a market of this size clearly creates significant opportunities for Vietnam's export oriented economy. Among the 11 economies in CPTPP, Vietnam has unique comparative advantages. Vietnam is the country with the lowest per capita income and hence the lowest wages. The deal is therefore expected to further boost labor intensive sectors, in particular manufacturing and agriculture/agribusiness. Simulation results suggest some of the following key impacts from CPTPP:

- **Output:** Under conservative assumptions, CPTPP is estimated to result in cumulative increase of 1.1 percent in GDP by 2030. Assuming a modest boost to productivity, the estimated increase of GDP would amount to 3.5 percent from CPTPP.
- **Exports and imports:** Exports are projected to grow by 4.2 percent, and imports by 5.3 percent; with larger increases of 6.9 and 7.6 percent respectively assuming productivity gains.
- **Sectoral impacts:** The largest growth in output is estimated to be in food, beverages and tobacco; clothing and leather; textiles; along with more modest growth in several manufacturing sub-sectors, as well as services. Export growth is expected to be strongest in food, beverages and tobacco; clothing and leather; chemical, leather and plastic products; transport equipment; and machinery and other equipment. Imports are expected to grow in all sectors.
- **Distributional impacts:** CPTPP is projected to reduce poverty by 0.6 million at poverty line \$5.50 a day relative to baseline conditions in 2030. Although all income groups are expected to benefit, the benefits will be higher for higher-skilled workers in the top 60 percent of the income distribution. This underlines the importance of investments in human capital for benefiting fully from the agreement.

Aside of the direct gains stemming from trade liberalization and improved market access, the CPTPP is expected to stimulate and accelerate domestic reforms in many areas, such as competition, services (including financial services, telecommunications, and temporary entry of service providers), customs, e-commerce, environment, government procurement, intellectual property, investment, labor standards, legal issues, market access for goods, rules of origin, non-tariff measures (including SPS and TBT measures), trade remedies etc. Moreover, delivering commitments under the CPTPP will contribute to promote transparency and support the creation of modern institutions in Vietnam.

To reap the full benefits of further trade integration, implementation of CPTPP commitments should be accompanied by further steps to enhance competitiveness and trade facilitation. Behind-the-border issues matter. The challenges involve continued improvement in connectivity to enable integration into global value chains and keep trade costs low. This requires both good physical and institutional infrastructure. Recent research outcomes show that most of the high compliance costs relate to non-tariff barriers. Despite the recent progress in Customs reform and the implementation of the National and ASEAN Single Window, the compliance costs in terms of time and money for goods clearance before and on border remain high in Vietnam. Addressing this critical bottleneck will help deliver the commitments not only under the CPTPP but also the WTO's Trade Facilitation Agreement.

Source: *Economic and Distributional Impacts Comprehensive and Progressive Trans-Pacific Partnership: the case of Vietnam*. World Bank Hanoi, March 5, 2018.

Thanks to a continued adjustment in the fiscal position, public debt stabilized in 2017

22. Vietnam's fiscal stance improved further in 2017. The overall fiscal deficit is estimated to have narrowed to an estimated 4.5 percent of GDP in 2017 from 4.8 percent in 2016 and 5.5 percent in 2015 (IMF GFS definition) (figure 27). Preliminary figures show that total revenues remained at 23.6 percent of GDP in 2017 – at about the level reported in 2015 and 2016, supported by a cyclical recovery in major tax revenues, including VAT, CIT and PIT which recovered on the back of strong consumption and income growth. Over the same period, total expenditures have gradually declined to 28.1 percent of GDP from 29.2 percent in 2015 and 28.5 percent in 2016, reflects to a large extent lower capital expenditure and rationalization of other discretionary spending items. These measures, while effective in the short term, could hamper needed investments for infrastructure and human capital development. The Government's commitment to strengthen budgetary discipline, therefore needs to be balanced with reforms that create fiscal space to maintain critical investments in infrastructure and spending on essential public services. The quality of the adjustment, including a balanced combination of revenue and expenditure measures and a strong focus on spending efficiency gains—as opposed to across-the-board curtailment of discretionary spending and investment—remains therefore important.

Figure 27. Fiscal balances (percent of GDP)

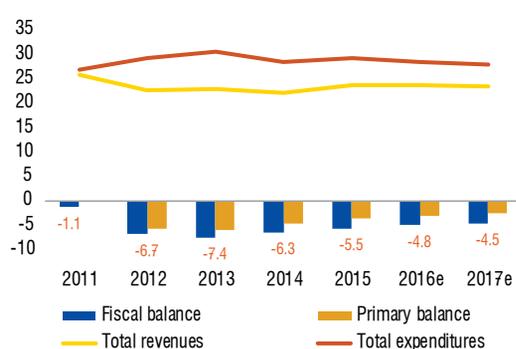
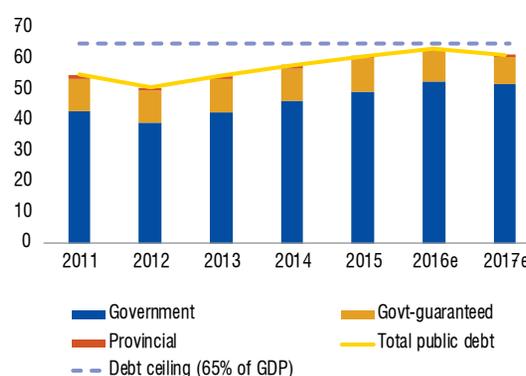


Figure 28. Public debt (percent of GDP)



Source: MOF, World Bank and IMF.

23. After a decade of steady increases in the public-debt-to-GDP ratio, 2017 saw a welcome reversal in the public debt trajectory. The lower fiscal deficit in 2017 together with a reduction in government guarantees and significant privatization proceeds helped contain further increases in public and publicly guaranteed debt. Overall, public and publicly guaranteed debt (government definition) declined to 61.4 percent in 2017 from 63.6 percent in 2016, remaining below the statutory limit of 65 percent of GDP (figure 28). Government's debt fell from 52.7 percent to 51.8 percent of GDP and remains slightly above the 50 percent statutory limit for direct public debt. Meanwhile, the government refrained from issuing new guarantees which resulted in decline in the stock of public guaranteed debt from 10.3 percent in 2016 to 9.0 percent in 2017. In the IMF GFS definition, overall public and publicly guaranteed debt declined to an estimated 59 percent of GDP in 2017, down from a recent peak of 60 percent in 2016.⁴

24. Preliminary fiscal outturns in the first quarter of 2018 suggest sustained fiscal discipline despite relatively soft revenue performance. Despite exceptionally strong GDP growth in the first quarter of 2018, estimated budget revenues increased only modestly by 5.3 percent compared with the same period last year, and stood at only 23.4 percent of the annual plan. While domestic tax revenue increased by 5.7 percent (y/y), supported by healthy economic activity including a strong 13.9 percent (y/y) rebound of oil revenues due to the higher oil price, import and export tax receipts declined by 2.8 percent (y/y) mainly because of softer import growth and tariff cuts under various FTA that became effective in January 2018. During the same period, growth in total expenditures was substantially curtailed, rising by just 1.7 percent (y/y). Total expenditures accounted for less than one-fifth (around 19 percent) of the annual plan, reflecting slow disbursement of investment outlays. Meanwhile, current expenditures increased 5.3 percent (y/y), and interest payments increased 7.8 percent, reflecting the ongoing shift from largely concessional to increasingly commercial financing which -despite historically low bond yields- has increased the average cost of financing of the government debt portfolio.

Table 4. State Budget Outturns, Q1-2018
(trillion dong and change in percent)

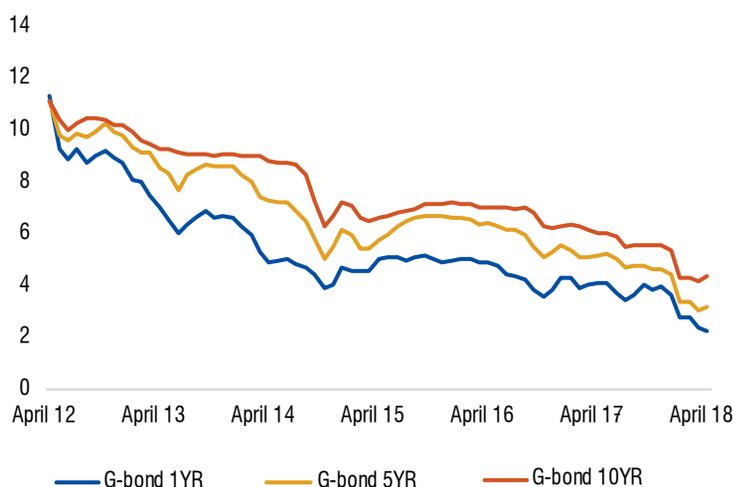
	Q1-2017	Q1-2018	Change (percent)
Total revenues	293	308	5.3
Taxes	239	253	5.7
CIT	59	63	6.1
PIT	25	26	6.9
VAT	78	83	6.5
Excise tax	22	24	6.2
Trade tax	20	20	-2.8
Fees and charges	31	32	3.8
Capital revenue	23	24	3.9
Total expenditures	285	290	1.7
Current	212	223	5.3
Interest payment	29	31	7.8
Investment	44	35	-20.1

Source: MOF and World Bank estimates.

⁴ The Government definition includes borrowings from government sources, including from the cash balance in the treasury account and the sinking fund. Since this constitutes intra-governmental debt, it is excluded in the definition used by the IMF and World Bank.

25. Taking advantage of historically low domestic bond yields, the government continued to rely mostly on the domestic bond market to meet its financing needs. Driven by low inflation and ample liquidity in the banking system, Government bond yields have trended downwards across the yield curve. For example, yields on bonds with five-year maturities declined from 5.2 percent in April 2017 to 3.2 percent in April 2018. This has allowed the government to meet its financing needs, while extending the maturity and reducing the cost of domestic debt. According to government reports, the average maturity of domestic government bonds increased from only 3.95 years (2011) to about 6.6 years (2017), while the average borrowing rate fell from 12 percent to 5.98 percent which has helped contain the increase in the interest burden despite the shift away from concessional financing. The bond market is also benefitting from an increasingly diversified investor base. Previously, 78 percent of government bonds were held by commercial banks, but this ratio has fallen to only 54 percent in part because of one-off conversion government debt held by the Vietnam Social Security Fund (VSSF) at the end of 2016 but also reflecting entrance of new investors, including insurance funds.

Figure 29. Government bond yields
(monthly average, percent)



Source: MOF.

Box 4. The Impact of FTAs on tariff reduction

Vietnam is member of several Free Trade Agreement which include commitments to further reduce import tariffs, several of which have become effective in January 2018. Reduced tariffs lead to a deeper economic integration which will reduce inputs costs, including for domestic firms and consumers, boost foreign investments, enhance productivity and create jobs. While generating positive benefits for the economy as a whole, tariff reduction trend to reduce revenue collected from import duties (although this is partially offset by growing the base). Recent trade deals include the ASEAN FTA (ATIGA), FTAs between ASEAN and Japan, India, Australia – New Zealand, the Republic of Korea, and China as well as FTAs between Vietnam and Korea, Japan, Chile and the Eurasian Economic Union. As a result of these import tariffs across a wide range of imports have slashed in January 2018.

FTA**Tariff Impact effective 2018***ASEAN Trade in Goods Agreement (ATIGA)*

Items to be subjected to zero percent import tariff include automobile, motorbike, vehicle components, vegetable oil, tropical fruits, home electronic appliances, milk, and dairy products. Exceptions only include certain agricultural products such as poultry, chicken, citrus fruits, brown rice, processed meat, and sugar will continue to have a tariff rate of five percent.

ASEAN China FTA

Tariff reduction for chicken, coffee, raw tea, processed food, apparel fabrics, clothes, electronic equipment, and electronics

Viet Nam-Japan Economic Partnership Agreement (VJEPA)

456 tariff lines with zero percent rate for items such as construction stones, steel, aluminum, sugar, machinery, equipment, and vehicle parts

Vietnam-Korea FTA

704 tariff lines will be reduced to zero percent for items such as seafood, wheat, confectionery, diesel fuel, machinery and electronic equipment

Viet Nam – Eurasian Economic Union FTA

5,535 tariff lines have been reduced to zero percent for items such as milk, dairy products, automobile and spare parts, iron and steel, and steel products.

Over the medium term, further tariff reductions are planned under commitments in various other FTAs. These include ASEAN – Korea, ASEAN – Japan (AJCEP), ASEAN – India (AIFTA), ASEAN – Australia – New Zealand, and Vietnam – Chile will progressively reduce tariffs to zero percent by 2022. For example, under the AJCEP, the existing five percent import tax rate for various commodities will reduce to zero percent by 2019. Similarly, under AIFTA, items having current import tax rates between 1 to 3 percent will be subjected to zero percent import tariffs by 2019. Under the AIFTA and VKFTA, current import tax rates ranging from 10 to 20 percent for certain commodities will see a gradual reduction to zero percent by 2022.

Source: WTO.

Medium-Term Economic Outlook, Risks, Policy Implications

26. Vietnam’s medium-term outlook has improved further since the last Taking Stock release in December 2017. Reflecting stronger than expected momentum especially of export oriented manufacturing and agriculture, we revised our forecast upwards with real GDP now projected to expand by 6.8 percent in 2018 (up from 6.5 percent in our previous projection) before moderating to 6.6 percent in 2019 and 6.5 percent in 2020. The slowdown in the outer years reflects the envisaged cyclical moderation of the global economy which is expected to dampen external demand as well as tighter monetary and fiscal policies in Vietnam.

27. Inflation is expected to remain moderate. We expect inflation to remain around the 4 percent government target. This is predicated on sufficient tightening of the monetary stance to counter price pressures that may reemerge over the medium term as a result of domestic input price pressures and/or rising global commodity prices.

28. On the external front, we expect the current account balance to remain in surplus, but start narrowing from 2019 reflecting widening deficits on the income and services accounts. While the merchandise trade surplus will continue to be supported by rising exports of the foreign-investment-driven manufacturing sector,

imports of capital and intermediate goods will also continue to grow rapidly, as supporting industries remain underdeveloped.

29. Fiscal consolidation is expected to contain fiscal deficits and public debt over the projection period.

The fiscal deficit is projected to remain at 4.5 percent of GDP in 2018, before narrowing in 2019 to 4.4 percent, reflecting continued implementation of the Government’s fiscal consolidation plans and would support a further reduction in the debt-to-GDP ratio. Fiscal consolidation will be implemented against the backdrop of robust nominal GDP and consumption growth which is expected to bolster revenue performance while expenditure growth will be contained by the government’s commitment to rein in inefficiencies.

Table 5. Selected macroeconomic indicators

	2016	2017e	2018f	2019f
GDP growth (percent)	6.2	6.8	6.8	6.6
Consumer price index (annual average, percent)	2.7	3.5	4.0	4.0
Current account balance (percent of GDP)	2.9	2.1	2.3	2.2
Fiscal balance (percent of GDP, GFS definition)	-4.8	-4.5	-4.5	-4.4
Public and PG debt (percent of GDP, GFS definition)	59.9	58.5	57.9	57.5
Public and PG debt (percent GDP, MOF definition)	63.6	61.4	61.2	61.1

Source: GSO, MOF, SBV, IMF and World Bank.

30. Strong growth accompanied by broad macroeconomic stability will continue to advance poverty reduction.

Under the assumption that the responsiveness of the poverty rate to economic growth follows historical trends, the poverty rate—based on the lower middle-income poverty line of US\$3.2/day—is projected to decline from about 10 percent in 2015 to 7.4 percent in 2018 and around 6 percent in 2020, as job creation and real wage growth boost household income and consumption growth.

31. Despite improved short term prospects, risks remain significant. Domestic risks are more prominent, while the key external risk is increasing policy uncertainty in global markets. Domestically, relatively slow progress in restructuring the SOEs⁵ and the banking sector could adversely impact the macro-financial situation, undermine growth prospects, and create large public sector liabilities. By contrast, quick and decisive restructuring and reform of SOEs and the financial sector would help Vietnam solidify macroeconomic stability, while laying the foundation for greater efficiency and productivity to drive medium and longer-term growth. In addition, rapid credit expansion will prop up short term growth but pose risks in the medium term to financial stability. External risks uncertainties also persist, including the risk Renewed protectionist sentiments in several advanced economies could elevate policy uncertainty, which could disrupt trade and foreign investment which is a particular concern for Vietnam given its reliance on FDI and exports as major drivers of growth. In addition, faster-than-expected monetary policy normalization in advanced economies that could trigger heightened financial volatility, although Vietnam is somewhat less vulnerable than more financially integrated economies due to its relatively limited exposure to portfolio investments.

32. Policymakers should take advantage of the favorable economic environment to push ahead with policies that increase macroeconomic resilience and lay the foundation for sustained growth in the future.

Strong growth and low inflation provide a uniquely conducive context for the implementation of the Government’s

⁵ The Ministry of Finance warned a slow progress of SOE equitization. In 2007 only 21 SOEs was equitized in 2017 from planned 44 SOEs. Similarly, just 5 SOEs/85 was equitized in the first five months of 2018.

ambitious economic reform plans. The central policy priorities remain twofold: i) rebuilding of macroeconomic policy buffers and ii) structural reforms to lift potential growth.

- **Strengthening macroeconomic resilience:** Monetary policy and liquidity in the banking sector should be tightened to align interbank rates with policy interest rates and to bring credit growth in line with fundamentals. This could be supported by further use of macro-prudential measures aimed at preventing excessive credit flows to risks sectors such as real estate. Furthermore, steps to enhance banking supervision and regulation and strengthen banking sector balance sheets, including NPL resolution and stronger capital buffers would not only reduce risks of financial instability but also improve financial intermediation which in turn would contribute to high medium-term growth. On the fiscal front, fiscal consolidation needs to continue to build room for countercyclical policies. However, further deficit reduction should be underpinned by a comprehensive strategy with structural measures to enhance spending efficiency and sustain medium-term revenue potential through an efficient and equitable tax mix (with a rising share of domestic revenue) and effective administration.
- **Structural reforms to boost potential growth:** Vietnam's structural reform agenda remains broad. First, it includes regulatory reforms to reduce the cost of and remove barriers to private sector activity, including ensuring fair and consistent enforcement. Second, human capital investments and education delivery are crucial for Vietnam's long-term competitiveness. This, in particular, pertains to reforms of the tertiary education system to provide skills that are relevant and suitable for the digital age. Third, high-quality infrastructure is needed, especially as Vietnam moves up the value chain. In addition to maintaining adequate public investment in core public goods, undertaking structural reforms of infrastructure sectors and developing non-bank financial markets is critical to tap private sector financing for infrastructure needs. Fourth, undertaking reforms to land ownership and land markets, including competitive land auctions to raise revenue for infrastructure investment and enable more efficient and sustainable land use in both rural and urban areas. Fifth, reforms of the SOE sector – along standing reform agenda in Vietnam- also remain important. Recent progress in divestment of SOE in commercial sectors should continue. In addition, the creation of the State Capital Management Committee to separate state ownership and regulatory authority of SOEs could potentially enable SOEs to operate at arms-length from the government and be independent but accountable. Sixth, capital markets development, including the secondary government bond market and the corporate bond market, is important to shift Vietnam gradually away from bank-based financing. Finally, to address climate change risks, steps need to be taken to counter the rising carbon intensity of GDP. For example, carbon pricing and taxes on fossil fuels could help provide stronger incentives for green growth. Building effective financial and physical disaster risks management frameworks are crucial given Vietnam's vulnerability to climate related disasters which are already taking an economic and human toll on the country.

PART II

REFORM PRIORITIES FOR REDUCING TRADE COSTS AND ENHANCING COMPETITIVENESS IN VIETNAM



Strategic Context

Why Are Trade Costs and Competitiveness Reform Priorities?

1. Vietnam's economy stands at a critical juncture. The country's consistent policy of openness and export-led growth has paid off. The economic reforms undertaken since the late 1980s helped spur growth and reduced poverty. Vietnam reached the highest trade-to-GDP ratio in the developing world at 190 percent (2017), well above what is predicted for its income level. Vietnam's exports have consistently outperformed world export growth over the past decade. However, when connected to global supply chains, Vietnam often contributes the lower value-added inputs and limited technology embedded in production.

2. Vietnam's vision of attaining high-income country status by 2035 means a move to a more sophisticated economy and export products necessary to sustain accelerated growth. In the past two decades, the country has made much progress in liberalizing trade and signed several free trade agreements. To fully realize the benefits of these initiatives, Vietnam must go further to enhance its trade competitiveness both behind and at the border.

3. Trade facilitation is critical to improving a country's competitiveness. Its goal is to make supply chains more efficient and to reduce the costs, red tape and bottlenecks faced by the traders. Trade facilitation targets both the "software" and "hardware" of trade. "Software" refers to the reengineering of systems and procedures, institutional development of trade-related agencies, and increasing the professionalism of logistics service providers. "Hardware", on the other hand, deals with infrastructure such as roads, ports, cargo handling facilities and ICT systems.

4. Inefficient trade facilitation undermines a country's comparative advantage and its ability to participate in global value chains. Global trends show that gains from improving trade facilitation outweigh gains from reducing tariffs. According to the World Economic Forum, if all countries reduced supply chain barriers halfway to that of Singapore, global GDP could increase by 4.7 percent or US\$ 2.6 trillion, and world trade by 14.5 percent or US\$ 1.6 trillion, far outweighing the benefits from the elimination of all import tariffs.

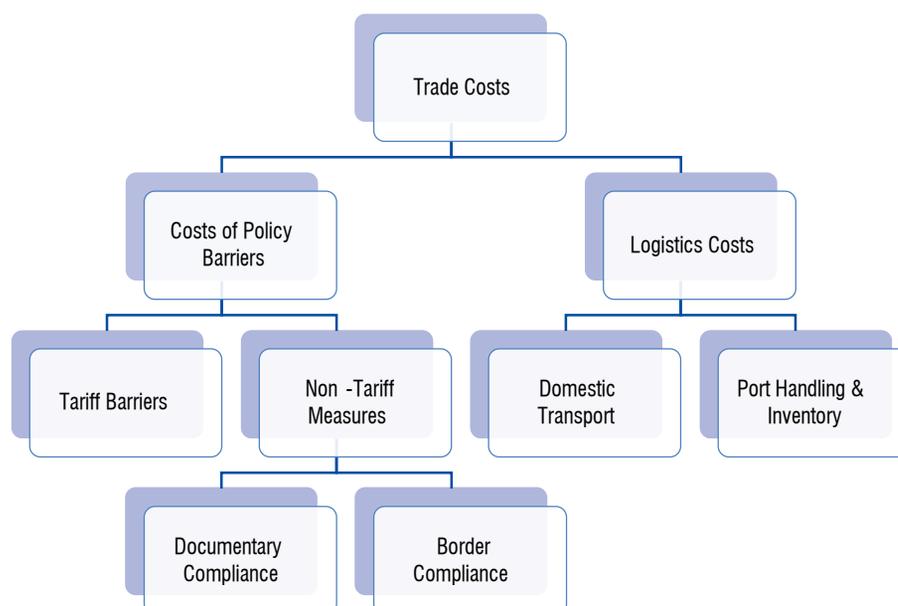
5. Integrating into global value chains can assist the move towards more sophisticated products. For this, enhancing connectivity is a must. Connectivity reflects the ability of a country to plug into international markets for goods, services and factors of production. Despite improvements in transport infrastructure connectivity, Vietnam is falling short of what is needed. Land corridors only play a minor role in exports today. The railway infrastructure needs modernization to support freight movements. As the share of bulk exports declines and container traffic expands, especially for high value products, better quality transport and logistics services will be required. With greater connectivity to neighboring countries, Vietnam will have an opportunity to become a regional hub for the region's exports.

6. Over the past decade, Vietnam has steadily improved its score in the World Bank's Logistics Performance Index, and it outperforms both its region and income group. However, with a score of 2.98 out of a maximum of 5.0 in 2016, Vietnam still has potential to improve its performance. Countries with better logistics performance have been estimated to have 1 percentage point higher GDP growth and 2 percentage points higher trade growth than countries with similar per capita incomes. Exporters with shipping costs 1 percentage point lower than their competitors may enjoy a 5 percent to 8 percent higher market share. Meanwhile, every day of delay increases production costs by 1 percent.

7. The Government of Vietnam, through a series of Resolutions 19⁶, has mandated a progressive improvement of the business environment and competitiveness to reach the level of ASEAN-4 average by 2020. All of these resolutions have been consistently aimed at reducing costs of doing business, including trade costs through improved the index on trade across borders. Top Government leaders have been emphasizing the need to undertake bold reform actions to meet these targets. Efforts have been made to show initial results. However, reform actions need to be better prioritized based on sound comprehensive analyses, and policy implementation should be strengthened with the support of a clear monitoring mechanism.

8. Trade costs, a critical indicator of competitiveness, are broadly defined to include policy barriers costs (tariff and non-tariff barriers) and logistics costs (freight costs and time), among others as shown in Figure 1. Among these costs, tariff barriers have come down to low levels across most countries with globalization. However, poor infrastructure and institutions add costs to trade activities, but with heterogeneous levels in different countries: costs associated with poor infrastructure and institutional barriers tend to be higher in low- and middle-income countries (LMICs), including Vietnam than in high-income countries (HICs). (Anderson and Vincoop, 2004).

Figure 1. Trade Costs Structure



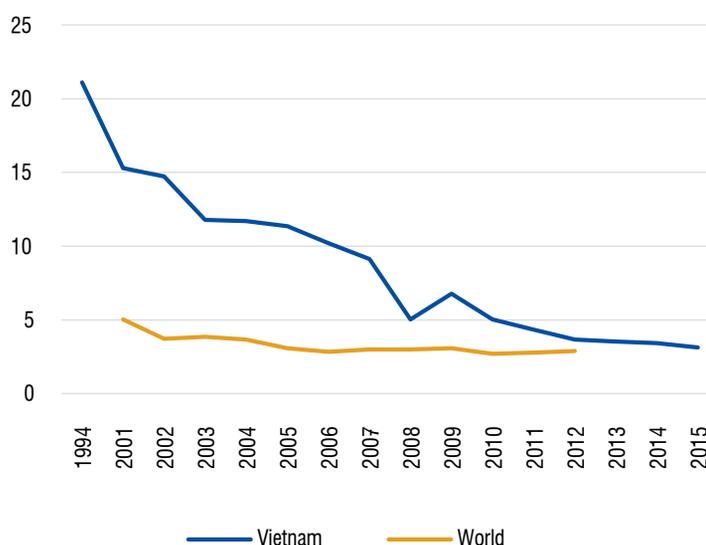
Source: Authors.

9. Cutting trade costs through tariff reduction has been highly successful in Vietnam over the past two and half decades, but has reached its limit. As shown in Figure 2, the most-favored-nation (MFN) average tariff for Vietnam has been reduced to the range of 0 percent to 5 percent for almost all tariff lines and commodities at targeted markets, contributing to reducing trade costs enormously. Undoubtedly, Vietnam will continue to deepen international integration and implement international commitments to achieve far-reaching goals on economic growth, structural adjustments, poverty reduction, and institutional modernization. However, further success in

⁶ There are five Resolutions 19/NQ-CP issued by the Government on March 18, 2014, March 12, 2015, April 28, 2016, February 6, 2018, and May 15, 2018 respectively.

reducing trade costs clearly cannot rely only on tariff reductions any longer, but instead needs to focus on lowering costs associated with non-tariff measures⁷ and logistics.

Figure 2. Average MFN



Source: WDI (2017).

10. This report aims at analyzing the structure of trade costs to benchmark Vietnam’s trade competitiveness against other countries in the East Asia and Pacific (EAP) region. It also aims at identifying key actors responsible and accountable for various cost components, and at planning and monitoring the implementation of appropriate reform priorities to contribute to reducing trade costs and enhance competitiveness.

Trade Costs Analysis

How Do Vietnam’s Trade Costs Compare Regionally?

11. This report uses the indicator “trade across borders” from the World Bank’s 2018 Doing Business (DB) to compare Vietnam’s trade competitiveness with other countries in the region⁸. This indicator measures the time and costs (excluding tariffs) associated with three sets of procedures within the overall process of exporting or importing a shipment of goods. These three sets of procedures are documentary compliance, border compliance and domestic transport, and entail the following procedures:

- *Documentary compliance:* Obtaining, preparing and submitting documents during transport, clearance, inspections and port or border handling in origin economy. Obtaining, preparing, processing, presenting and submitting documents required by the destination economy and any transit economies. Documentary compliance covers all documents required by law and in practice, including electronic submissions of information.

⁷ Non-tariff measures, referred in Vietnam’s context as specialized controls, are state management regulations applied for import and export activities, consisting sanitary and phytosanitary measures, technical barriers to trade, pre-shipment inspection and other formalities, price control measures, rules of origin, intellectual property, and export-related measures, etc.

⁸ The most recent round of data collection for the project was completed in June 2017.

- *Border compliance*: includes customs clearance and inspections, inspections by other agencies (such as phytosanitary or technical inspections), and well as handling and inspections that take place at the economy's port or land border.
- *Domestic transport and logistics*: Loading or unloading of the shipment at the warehouse or port/border. Transport between warehouse and port/border. Traffic delays and road police checks while shipment is en-route.

12. Vietnam's trade competitiveness in terms of time to trade remains behind peer economies in the region, particularly compared with the average of the ASEAN-4 (including Singapore, Malaysia, Thailand, and the Philippines). Figure 3 on the time costs of trade shows that the time to import from Vietnam tied to documentary compliance (76 hours) is significantly higher than the ASEAN-4 average (28 hours), while the border compliance time to import from Vietnam (56 hours) is equal to the ASEAN-4 average. Vietnam's time to export, both in terms of documentary compliance (50 hours) and border compliance (55 hours), is significantly higher than ASEAN-4 average (24 hours and 37 hours, respectively).

Figure 3. Time Cost to Trade:
Vietnam vs. ASEAN-4 Average

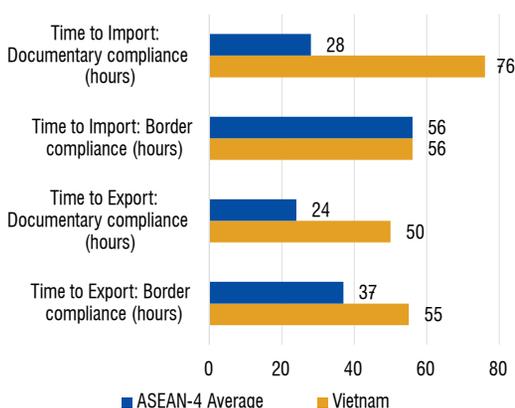
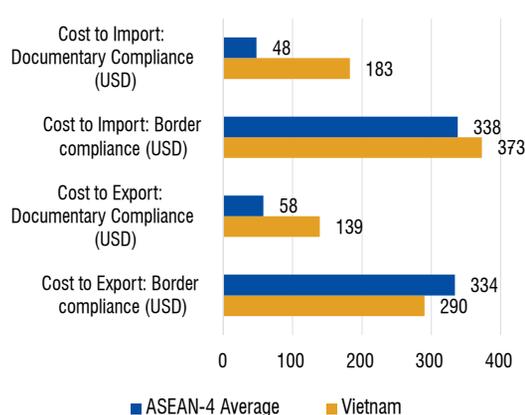


Figure 4. Monetary Cost to Trade:
Vietnam vs. ASEAN-4 Average



Source: *Doing Business*, World Bank (2018).

13. While it also lags the ASEAN-4 average, Vietnam's trade competitiveness in terms of its monetary cost to trade is better than for its time cost to trade. Documentary compliance costs for both Vietnam's imports and exports are higher than the ASEAN-4 average (Figure 4). Further, compared with the ASEAN-4 averages, Vietnam's border compliance cost to import is higher, but its border compliance cost to export is lower.

What and How Do Regulatory Compliance and Logistical Process Cost Vietnam's Traders?

14. A detailed analysis of related indicators further breaking down the time and cost of trade across borders explains which costs and in what ways they burden traders in Vietnam. Doing Business 2018 provides an updated set of data on time and costs that defines clearly trade cost structure and breakdown, including time and costs for *border compliance, documentary compliance, and domestic transport*.

15. The indicator on border compliance specifies the time and cost for customs procedures, procedures of other than customs, and port procedures.

- *Customs procedures:* The data include the time and cost to complete customs clearance, including document checks by customs. The time also includes physical inspections by customs. The cost includes the cost related to physical inspections, document checks by customs, and hiring a customs broker.
- *Procedures other than customs:* The data include the time to complete the quality test required for the issuance of an inspection report, conducted by Quatest (Quality Assurance and Testing Center). There is no monetary cost associated with this procedure, as reported by the private sector.
- *Procedures related to port handling:* The total time includes the time for customs procedures conducted at the port, storage and handling of the container, and unloading the shipment at the port, as well as queuing to exit the port. Time and costs for storage or inventory can come from warehousing capacity or delays related to extended time and costs of border compliance.

16. Documentary compliance reflects data including the entire time and cost of obtaining, preparing, processing, presenting and submitting all required documents. These documents include the bill of lading, commercial invoice, packing list, certificate of origin, cargo release order, import customs declaration, inspection report, and SOLAS certificate (for import). The most burdensome documents in terms of time and cost for private sector are certificate of origin, inspection report, bill of lading and technical standard. Although electronic submission of documents is allowed for all of the documents, except for the inspection report, hard copies are still required for all documents.

17. Domestic transport reflects the time and cost associated with transporting the shipment. The data include the time and costs of the actual transport from a warehouse in the main business city of the economy to the border most widely used for traders located in the main business city (for exports)/from the border most widely used for traders located in the main business city of the economy to the main business city (for imports), any traffic delays and road police checks, and time spent on unloading the shipment at the warehouse. Time and costs for storage or inventory during domestic transport are included and could consist of warehousing capacity and delays caused by documentary compliance.

18. For imports, regulatory compliance time consisting documentary compliance time (the time to comply with specialized controls outside the border), and customs and non-customs compliance at the border is significantly higher than logistics time comprising the time for domestic transport and port handling time. Figure 5 illustrates that, regulatory compliance time to import accounts for 72 percent of total time to import, whilst logistics time to import, accounts for 28 percent of total time to import. The time to comply with documentary compliance for specialized controls or non-tariff measures for import is the most time-consuming compliance (55 percent of total time to import). In further detail, the total time to import includes documentary compliance time

(55 percent), customs procedures time (11 percent), time for non-customs clearance procedures (6 percent), domestic transport time (5 percent), and port handling time (23 percent).

19. The breakdown of the monetary costs to import shows that logistics costs (domestic transport and port handling) account for 64 percent of the total cost, exceeding regulatory costs (documentary compliance outside the border, customs and non-customs compliance at the border, which account for 36 percent (Figure 6). The costs of port handling are the highest cost item (39.5 percent). In further detail, the total cost to import includes documentary compliance cost (25 percent), customs procedures cost (11 percent), cost for non-customs clearance procedures (zero percent - only for commodities selected for the Vietnam’s case study of Doing Business 2018), domestic transport cost (24.5 percent), and port handling time (39.5 percent).

Figure 5. Time to Import Breakdown

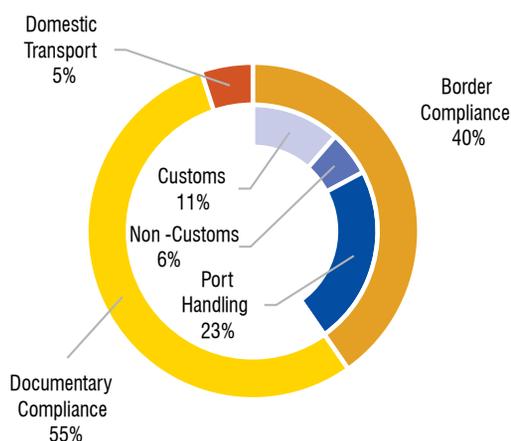
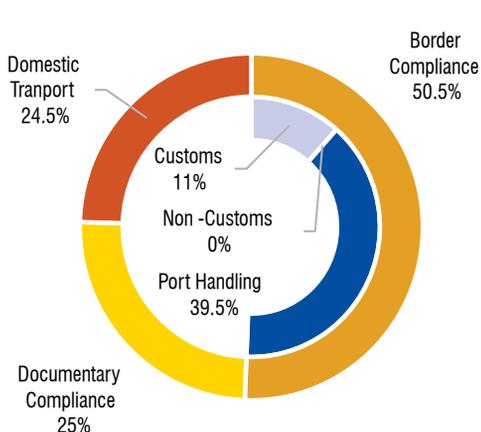


Figure 6. Cost to Import Breakdown



Source: *Doing Business*, World Bank (2018).

20. The decomposition of the time to export shows that the time for regulatory compliance (specialized controls compliance outside the border, and customs and non-customs compliance at the border) equals logistics time (domestic transport and port handling), i.e., both account for 50 percent of the total time to export (Figure 7). The process of port handling is the most time-consuming stage to export (44 percent). In further detail, the total time to export consists of documentary compliance time (40 percent), customs procedure time (4 percent), non-customs procedures time (6 percent), domestic transport time (6 percent), and port handling process time (44 percent).

21. The breakdown of the cost to export for Vietnam shows that logistics costs are higher than regulatory compliance costs. While logistics costs, consisting domestic transport and port handling, account for 63 percent of the total cost, regulatory compliance costs including documentary compliance, customs and non-customs procedures compliance, account for only 37 percent of the total costs (Figure 8). Port handling is the most costly segment of the cost to export (33 percent). In further detail, the total costs to export consist of documentary compliance costs (23 percent), customs procedure costs (10 percent), non-customs procedures costs (4 percent), domestic transport costs (30 percent), and port handling process costs (33 percent).

Figure 7. Time to Export Breakdown

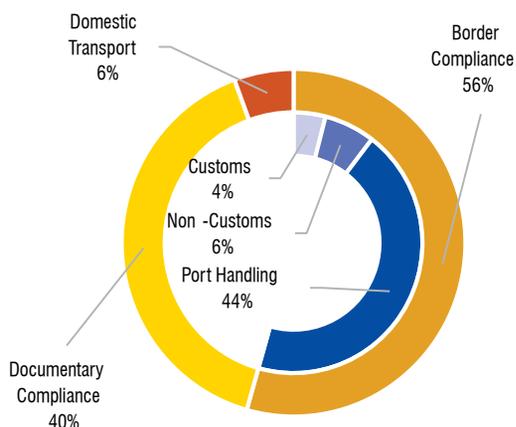
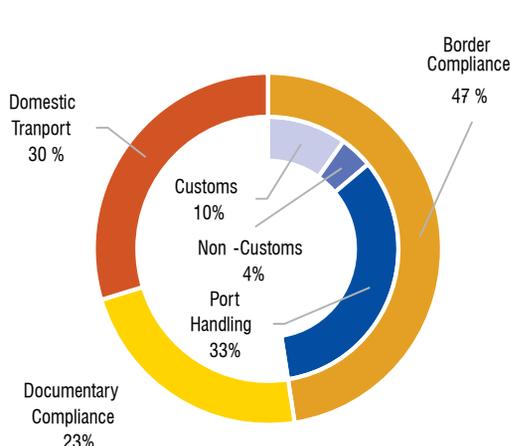


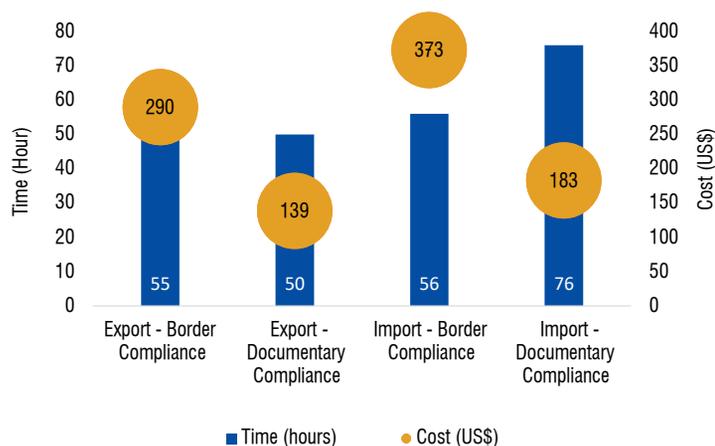
Figure 8. Cost to Export Breakdown



Source: *Doing Business*, World Bank (2018).

22. The above findings on time and cost distribution indicate that addressing two obstacles should be prioritized: (a) for imports, documentary compliance is the most time-consuming and the highest costs are coming from port handling; and, (b) for exports, the highest time and costs are coming from port handling (Figure 9). High costs of port handling is mainly from delays and extra inventory at port related to extended time of border compliance. Whilst logistical processes for both exports and imports are equally important, given that Vietnam’s exports are largely characterized as low value-added (and most of materials are imported for export), the importance of reducing the time and costs to imports should be prioritized.

Figure 9. Vietnam: Trade Time and Costs



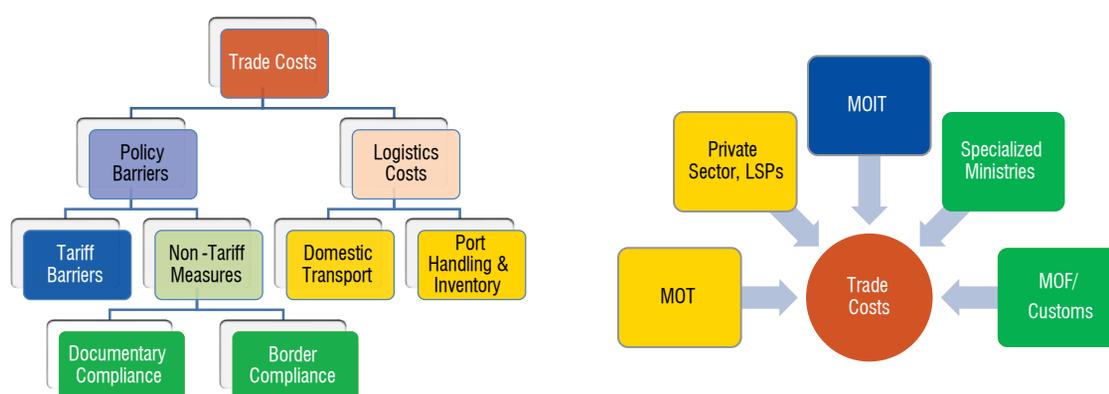
Source: *Doing Business*, World Bank (2018).

Integrated Reform Framework

Which Actors Can Contribute to Reducing Costs?

23. Relevant government agencies and the private sector are the main actors who can contribute to cutting trade costs. (Figure 10). Government agencies accountable for the time and cost structure of trade costs include the Ministry of Finance (MOF), which can contribute to reducing costs associated with customs procedures and border coordination. The Ministry of Transport (MOT) and the private sector—consisting logistics service providers and users—can influence costs of domestic transport and port handling. Specialized management ministries can contribute to reduce costs of documentary and border compliance (outside and inside border).

Figure 10. Trade Costs Structure and Accountable Agencies (Mapped by Color)



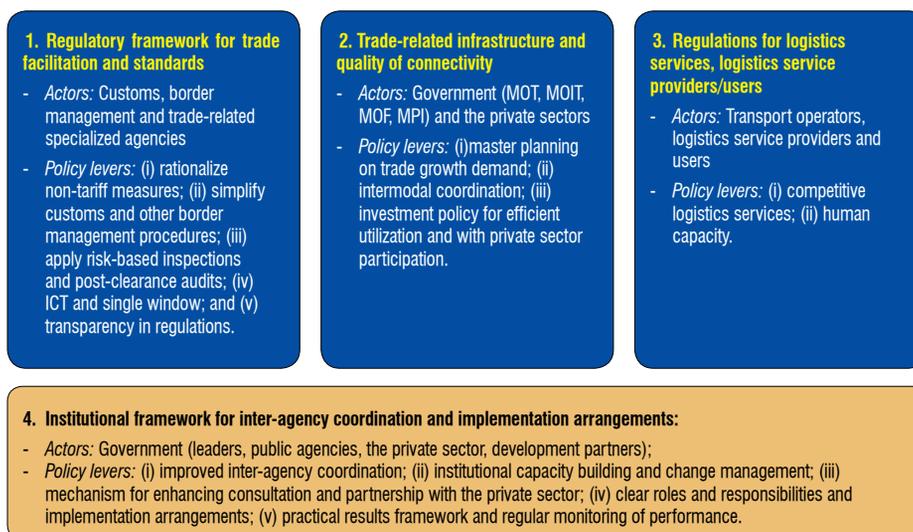
Note: Same color reflects a cost component and respective actor that is accountable for that cost.

How Can Actors Be Effectively Coordinated to Reduce Costs and Enhance Competitiveness?

24. Developing and consistently implementing an integrated program with cross-sectoral coordination that can reduce costs is needed to enhance competitiveness, given the trade costs structure and key actors involved. Figure 11 illustrates an integrated four-pillar framework on trade facilitation and logistics: (1) Regulatory framework⁹ for trade facilitation and standards; (2) Trade-related infrastructure and quality of connectivity; (3) Regulations for logistics services, logistics service providers/users; and (4) Institutional framework for inter-agency coordination and implementation arrangements.

⁹ This program is built on the conceptual framework developed in the World Bank's publication "Trade Facilitation, Value Creation and Competitiveness: Policy Implications for Vietnam's Economic Growth" (2013), and the above analysis on trade costs in Vietnam.

Figure 11. Conceptual Framework on Trade Facilitation and Logistics



Source: Authors.

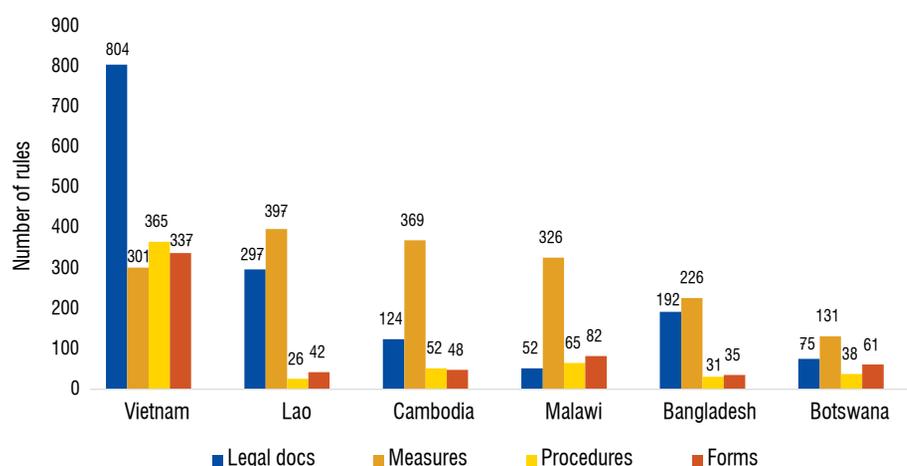
- *Pillar One on promoting trade facilitation* involves actors, including the MOF and Customs, border management, and trade-related specialized agencies. Policy levels consist of those that can help rationalize non-tariff measures (sanitary and phytosanitary measures, technical barriers to trade, pre-shipment inspection and other formalities, price control measures, rules of origin, intellectual property, export-related measures etc.), simplify customs and other border management procedures, apply risk-based inspections and post-clearance audits, implement national single window and ICT applications, and promote transparency in regulations.
- *Pillar Two on improving trade-related infrastructure and quality of connectivity* involves actors consisting of the MOT, the private sectors. Policy levels include those responsible for developing master plans for investments to support trade growth, intermodal coordination, and for formulating investment policy for efficient utilization and with private sector participation.
- *Pillar Three on enhancing the quality of logistics services* involves transport operators, and logistics service providers and users. Policy levels consist of those who support competitive logistics services and human capacity, especially for the private sector.
- *Pillar Four on consolidating the institutional framework for inter-agency coordination and implementation arrangements* involves actors including Government leaders, actors of the three above-mentioned pillars, the private sector, and development partners. Policy levels consist of those that improve inter-agency coordination, build institutional change management capacity, put in place mechanisms for enhancing consultation and partnership with the private sector, support to develop clear roles and responsibilities and implementation arrangements of key stakeholders, and develop practical results framework and regularly monitor reforms performance.

What Are Reform Priorities to Improve Trade Facilitation (Pillar 1)?

25. Key obstacles to trade facilitation include that there are many specialized controls. An exceptionally high number of rules leads to high trade costs that can significantly hamper competitiveness. Vietnam has a relatively

high number of legal documents, measures, procedures, and forms to be processed - more than double compared with a selected set of peer countries¹⁰ (Figure 12). This suggests an urgent need review and rationalization.

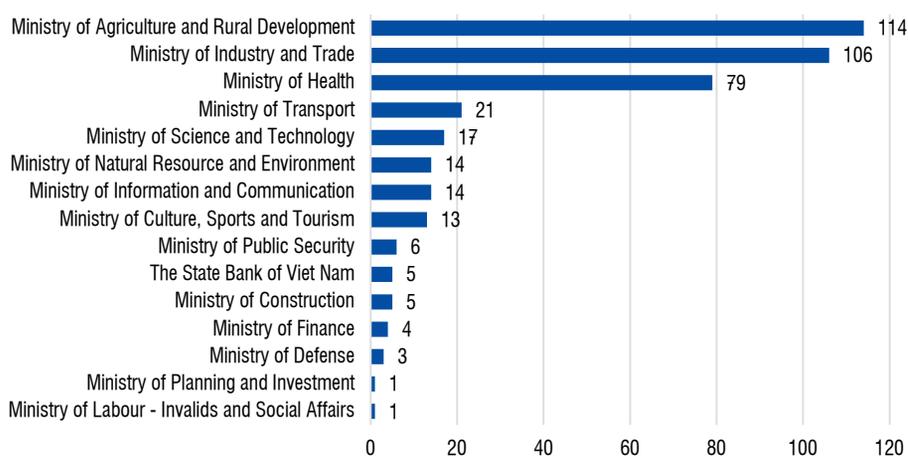
Figure 12. Number of Legal Documents, Measures, Procedures, and Forms



Source: Trade Information Portal Technically Assisted, World Bank (2017).

26. The non-tariff measures component of trade costs (documentary compliance before the border, and customs and non-customs compliance at the border) that account for 72 percent the total import time are mainly attributable to Customs and specialized control agencies. Among these regulatory compliance costs, the costs associated with documentary compliance for specialized controls outside border is highest. While many specialized management agencies are involved, 74 percent of the total cost comes from the need to comply with specialized management measures imposed by three ministries: the Ministry of Agriculture and Rural Development (MARD), the Ministry of Industry and Trade (MOIT), and the Ministry of Health (MOH), (Figure 13). This points to the importance of these agencies to be prioritized in contributing to cost reductions.

Figure 13. Number of Specialized Measures by Issuing Agencies

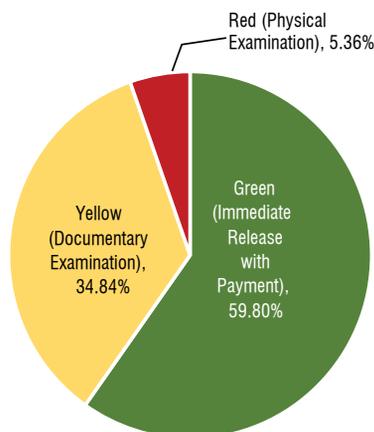


Source: Vietnam Trade Information Portal - VTIP (2017).

¹⁰ Compared countries are selected based on available database of Trade Information Portals (TIPs) for countries where World Bank provides technical assistance for TIP development.

27. Customs is responsible for the last intervention for goods clearance at border. However, compliance costs depend not only on Customs, but also on specialized agencies before and at the border.

Figure 14. Goods Cleared by Type of Channel

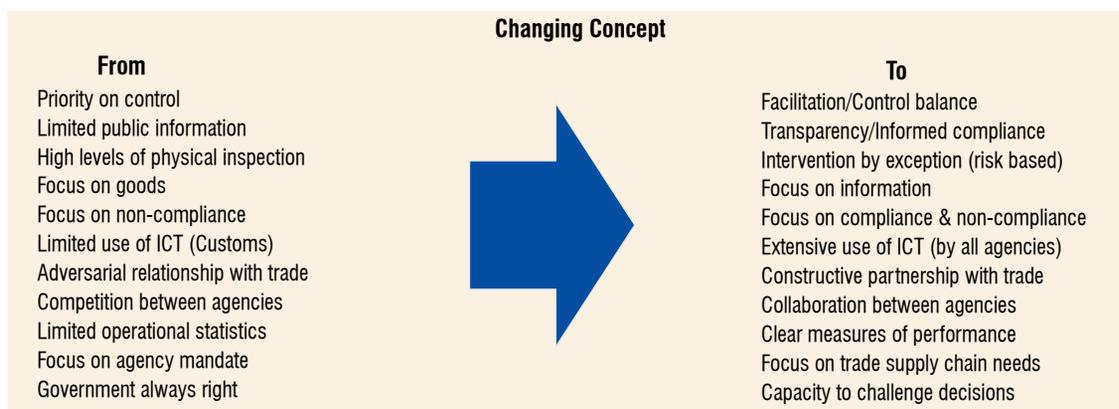


Source: Vietnam Customs (2016).

28. A survey of Vietnam Customs (2016) using 9.48 million customs declarations reveals (Figure 14) that the green channel accounts for 59.8 percent of the total number of declarations. Too many changeable legal documents guiding specialized controls potentially lead to high chance of irregularities. The yellow channel accounts for 34.8 percent, which specifies too many cases of specialized inspections. Despite that the red channel accounts for just 5.4 percent, and this rate is falling, it took too long to obtain inspection results (5-7 days), and separate physical inspections in different locations by customs and specialized agencies caused further delays.

29. International practice shows that the concept of controlling flows of trade across borders are changing from according priority to control to a balance between facilitation and control. This provides for the adversarial relationship with trade being replaced by a constructive partnership built on transparency for informed compliance (Figure 15). A high level of physical inspections is changed to applying intervention by exception, with risk-based management focused more on information than goods. Limited use of ICT for Customs has changed to extensive use of ICT by all other agencies, especially for the national single window. Trade facilitation today is focused more on supply chain needs than mandates by individual agency.

Figure 15. International Practice on Trade Facilitation

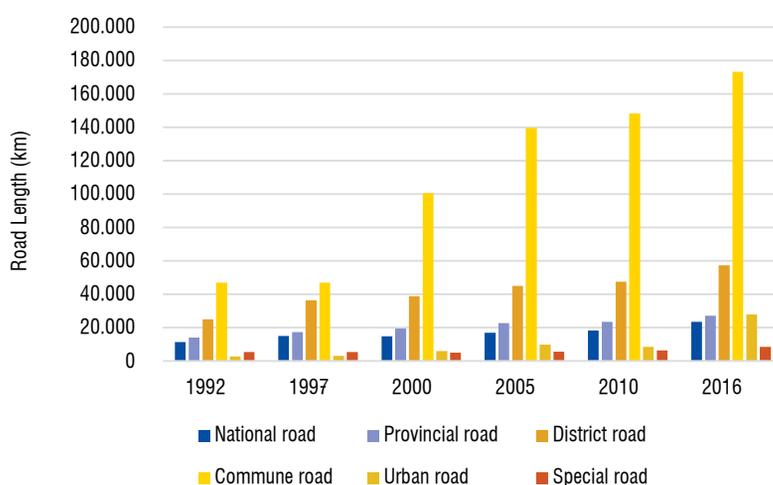


30. From international experience, Vietnam may need to take prioritized actions, among other things, as follows:

- *Apply international standard in the classification of non-tariff measures (NTMs) or specialized controls* to better benchmarking Vietnam against international practices and learning international experiences. It is advisable that UNCTAD’s classification of NTMs is applied.
- *Streamlining NTMs/specialized control measures* by development of guidelines for line ministries to control at source of a newly issued administrative procedures by appropriate impact analysis, and to streamline existing NTMs by conducting cost-benefit analysis.
- *Improving NTMs administration* by the adoption of risk-based compliance practices, the IT applications especially through national single window, and post-clearance controls by specialized control agencies (SCAs). Ensuring SCAs accountability by establishing focal points and targets of simplification of administrative procedures at SCAs.
- *Improving transparency by applying Harmonized System (HS) codes* for commodities subject to particular measures and clearly identifying HS-coded commodities prior clearance audit.
- *Enhancing the efficiency of NTMs / specialized controls monitoring* by using consistent and updated NTMs / specialized control database of Vietnam Trade Information portal (VTIP).
- *Reducing number of transactions* by maximizing mutual recognition arrangements.
- *Improving interagency coordination* of control between GDVC / SCAs both in terms of operational information sharing and secretary assistance for efficient oversight of the National Trade Facilitation Committee on overall trade facilitation program.
- *Facilitating faster testing* in the context of increase in number of transactions whilst lacking staff capacity, resources and equipment by allowing traders to outsource testing services provided by certified testing bodies.

What Are Reform Priorities to Improve Connective Infrastructure (Pillar 2)?

Figure 16. Expansion of Road Networks (km)

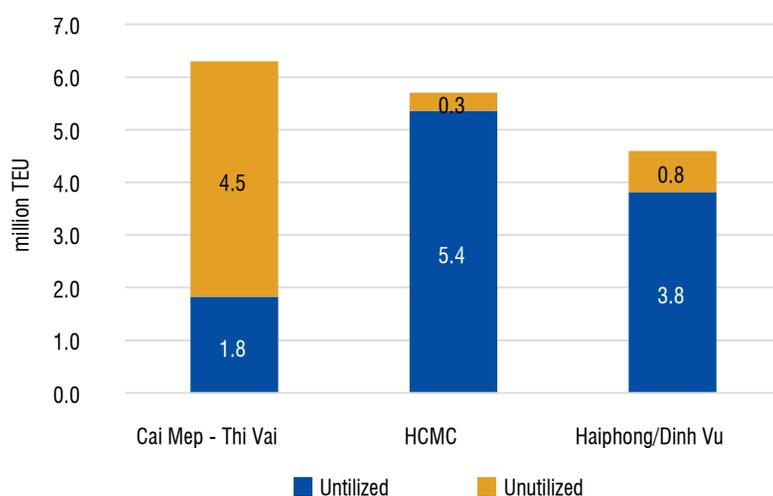


Source: Ministry of Transport (2017).

31. Vietnam has made remarkable progress in developing transport network, but focusing mostly on providing basic access. The country’s road network has expanded at an impressive rate over the past two decades, but focused mostly on providing basic access to localities (Figure 16). While the number of communes without basic access to all-weather roads dramatically decreased from 606 in 1997 to 65 in 2016, there remain significant gaps in terms of quality of infrastructure and intermodal connectivity.

32. Vietnam needs to improve infrastructure connectivity along key trade corridors by further developing high-quality, high-capacity and integrated multimodal transport networks. Vietnam still lacks major intercity corridors that can handle high-speed and high-volume traffic. Its expressway network density is much lower than other middle-and high-income countries, at around 2km per 1,000 km² of land area, compared to around 8km in Mexico and India and 13km in China. Its national railway network, which provides backbone connectivity along the north-south corridor, suffers from rapidly deteriorating infrastructure condition caused by investment/maintenance backlog, and can only achieve commercial speed at around 50km/hour or lower in most sections. Lack of high-quality and high-capacity backbone network results in low speed, poor reliability and inefficiency of transport and logistics services¹¹, increasing trade costs. Moreover, intermodal connectivity between modes (ports and roads, or ports and railways) needs significant improvement to enable efficient logistics services that meet the growing demand for increasingly sophisticated supply chain as Vietnam moves up the GVC.

Figure 17. Capacity and Cargo Throughput in Some Key Ports of Vietnam¹²



Source: GSO, Ministry of Transport (2015).

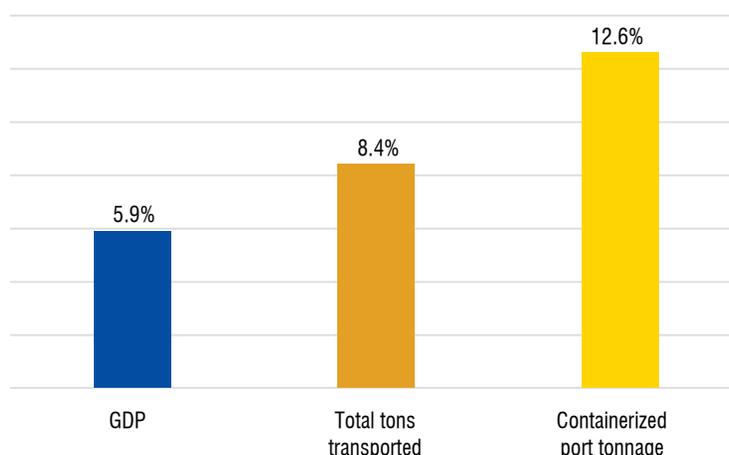
33. In various parts of Vietnam’s transport network, demand (i.e., traffic) and supply (i.e., capacity) do not match, resulting in inefficient utilization of developed infrastructure. This demand and supply mismatch is highly pronounced in maritime port sector, where some key ports are operating at or near capacity while others are severely underutilized (Figure 17). Similarly, some sections of newly built expressways carry significantly lower traffic than what was forecast (e.g., Hanoi-Haiphong expressway), notwithstanding the rapidly aggravating congestion across the road network, especially around growing urban areas. Underlying these demand-supply

¹¹ For instance, load bearing standards for bridges and vertical clearances of flyovers are inconsistent across the National Highways (the second highest road class that is one level lower than expressways), and thus, cargo loads and truck sizes are determined by the points with lowest standard of the infrastructure along the journey, undermining efficiency.

¹² It has been reported that the cargo throughput in Cai Mep – Thi Vai Port has since increased and the capacity utilization rate has improved.

mismatches is fragmented planning, in the face of competition among modes/provinces to attract more investments in their respective sub-sectors or localities.¹³

Figure 18. Average Annual Growth Rate During 2007-2015



Source: GSO, Ministry of Transport (2015).

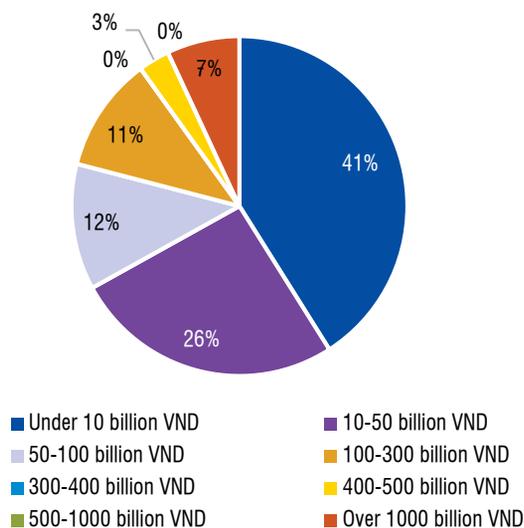
34. Fulfilling the infrastructure investment needs while balancing demand and supply will remain a challenging task, particularly given the rapid increase in demand. Cargo volume especially containerized cargo has grown faster than the pace of economic growth (Figure 18). In meeting this demand in an efficient and fiscally prudent manner, strength of planning and efficiency of delivery in infrastructure development will become more crucial than ever. Given the persistent fiscal constraint, delivering on the infrastructure investment needs will require creative solutions including private sector participation in infrastructure financing, asset management, and/or service provision. Through well-designed public-private partnerships, cost efficiency of infrastructure management can improve, and more efficient utilization of infrastructure capacity can be possible as private sector tends to respond to demand more nimbly and efficiently.

35. Based on the above, key reform priorities include the following:

- *Strengthening integrated planning across modes*, aiming to strengthen the intermodal connectivity and based on sound data and analytical rigor.
- *Introducing participatory planning*, by involving private sector stakeholders, such as shippers and logistics service providers, in the planning process for their inputs to strengthen the quality of planning and to address supply-and-demand mismatch.
- *Regulatory reforms to deepen private sector participation in infrastructure development*, including further enabling various forms of public-private partnerships (PPP) for infrastructure delivery and attracting commercial financing for infrastructure development.

¹³ Vietnam boasts 44 seaports along its long coastal line and in fewer than 30 coastal provinces, many of which aspire to become main international gateways, which would be unattainable in most cases.

Figure 19. Limited Capacity and Competitiveness of Vietnam’s LSP: LSPs by Capital



Source: Vietnam Logistics Business Association (2015).

36. Vietnam’s logistics service providers (LSP) generally offer low-cost and low-quality services, and cannot yet compete with their international counterparts. Most of them are small-sized with limited access to capital and lacks adequately trained human resources (Figure 19). The exception is found among the few LSPs serving major FDIs, which are typically joint ventures between international and Vietnamese providers, who can leverage international experiences and are driven by sophisticated demand of shippers for high-quality and reliable services. The overall inefficiency and lack of competitiveness of LSPs is observed across various sub-sectors. Trucking industry, the largest asset-based LSP, faces a significant efficiency gap: about 35 percent of truck miles are empty according to a World Bank study in 2010, and the average age of Vietnam’s active trucking fleet is 17 years, much greater than 14 years in Australia, 9 years in Canada and Japan, 8 years in the U.K., and 6-6.5 years in U.S. and France. Similar is true for inland waterway sector: the average barge size in Vietnam is at 100 deadweight tons, minuscule compared to 2,400 tons in Western Europe with well-developed waterway transport sector, due to the lack of ability to invest and grow, largely limited by access to capital.

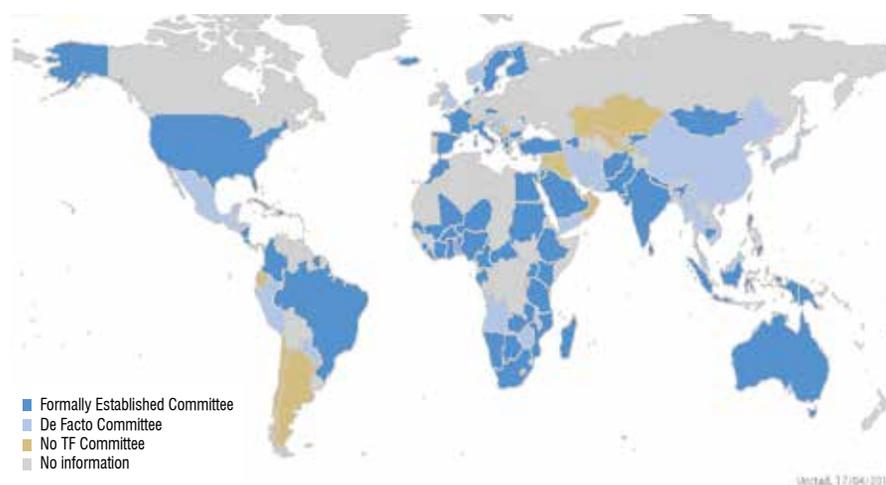
37. Beyond these apparent efficiency gaps, Vietnam lacks non-asset based LSPs, which are crucial for sophistication and competitiveness of transport and logistics services. Non-Asset based or “asset-light” service providers can improve the service quality and promote efficient logistics by performing as intermediaries between shippers and asset-based carriers, and increasing efficiencies in supply chains and reducing logistics costs by bringing together shipper demand and carrier supply, thus reducing supply-demand mismatches in service delivery (e.g., empty truck miles). Development of non-asset based LSPs in Vietnam is however nascent. Freight forwarding industry is growing fast but from very low baseline, with limited access to capital. Truck brokerage, which has played significant roles in lowering transport and logistics costs through scale and consolidation in countries with advanced logistics sector, is non-existent in Vietnam. Development of these non-asset based LSPs, alongside the improvement of competitiveness of asset-based LSPs (trucking, barging, container shipping, rail freight, air freight, warehousing, ports), would provide a foundation for efficient logistics services, which can help lowering trade costs. Well-developed intermediary and brokerage would be particularly beneficial to small businesses, which are prevalent in Vietnam’s economy.

38. In order for a truck brokerage sector to emerge, it is necessary for the asset-based portion of the trucking industry to improve service levels across the board, so that there is a level of service commoditization across carriers. Enhanced government regulation can help achieve this, through for example increased barriers to entry and permanency in the form of better enforced market access and operational safety requirements; standardization of equipment; facilitation of licensing and permits for truck brokers and other non-asset based logistics companies; greater opportunities for international firms to partner with domestic firms in this space.

What Are Reform Priorities to Consolidate Interagency Coordination (Pillar 4)?

39. The recent establishment of the Trade Facilitation and National Single Window Committee is critical to lead inter-agency efforts to improve trade facilitation and to comply with the WTO’s Trade Facilitation Agreement¹⁴. The Committee is in line with international practice. Currently, 74 countries have formally established a standard National Trade Facilitation Committee (NTFC) and 36 countries, including Vietnam, have established a De Facto Committee (Figure 20).

Figure 20. Trade Facilitation Committee Around the World



Source: UNCTAD - <http://www.unctad.org/en/DTL/TLB/Pages/TF/Committees/default.aspx>

Note: The boundaries, colors, denominations and other information shown on any map in this work do not imply any judgement on the part of The World Bank concerning the legal status of any territory or the endorsement or acceptance of such boundaries.

40. Looking forward, it is recommended that the Committee will extend its scope to cover trade-related infrastructure and logistics development areas. Given the value chain of the costs of trade across border, policy coordination could be strengthened to cover trade-related infrastructure and connectivity, as well as logistics services.

41. International experience shows that long-term key success factors include sustaining the effectiveness and efficiency of the Committee by clearly defining roles and responsibilities, along with focal points in individual agencies. Clear progress metrics should be introduced to define a monitoring framework for trade facilitation reform. Furthermore, a permanent, full-time secretariat improves the effectiveness of the Committee.

¹⁴ The National Trade Facilitation Committee (NTFC) of Vietnam was established in accordance with 1899/QĐ-TTg dated April 10, 2016. The Committee is chaired by Deputy Prime Minister Vuong Dinh Hue, with senior representatives from 20 line-ministries as members of the committee. According to Article 23.2 of the WTO TFA: “each WTO member shall establish and/or maintain a national committee on trade facilitation or designate an existing mechanism to facilitate both domestic coordination and implementation of the provisions of this Agreement”.

Partnership with the private sector is critical. According to the WTO Secretariat, 98 percent of the established NTFCs involve the private sector. The private sector is considered as a partner in identifying reform priorities, supporting implementation, and providing feedback and monitoring of implementation.

42. There are many global lessons Vietnam could learn about the benefits and successes of establishing an interagency and private sector consultation mechanism. Brazil established the Public-Private Alliance (PPA) mechanism for trade facilitation, assisted by a permanent Secretariat in 2004. Between 2011-2014, Customs, other agencies, and the private sector within the PPA reviewed and streamlined processes that helped reduce 75 percent of the approval time for temporary admissions. The PPC was vital in the implementation of subsequent reforms for Brazil's National Single Window. In Thailand, clear directives were issued for inter-agency coordination from the Prime Minister and Cabinet down, with the mandate of establishing a National Single Window. Royal Thai Customs was mandated as lead agency role in actively collaborating with other agencies to develop the National Action Plan that included the establishment of harmonized agency actions. Inter-agency cooperation for implementing the Single Window contributed to a reduction in import document requirements from 12 to 3, and almost halved import time.

43. Beyond the inclusion into the NTFC, the private sector should engage various line agencies in their respective fields. Sparking competition by making private participation easier is important. Beyond the customs formalities, private providers of trade services, such as customs brokers, transport companies and port service providers, all have important effects on the time and cost of trading across borders. Greater competition among trade service providers can lead to lower fees and higher quality of service, as can better infrastructure. For example, the Russian Federation inaugurated in 2016 a new Multifunctional Sea Cargo Complex at the Port of Bronka (located in proximity to the Port of St. Petersburg), which has decreased its prices for port and terminal handling due to growing competition. Importers and Exporters have, therefore, experienced a decrease in the cost of border compliance on merchandise going through the Port of St. Petersburg.

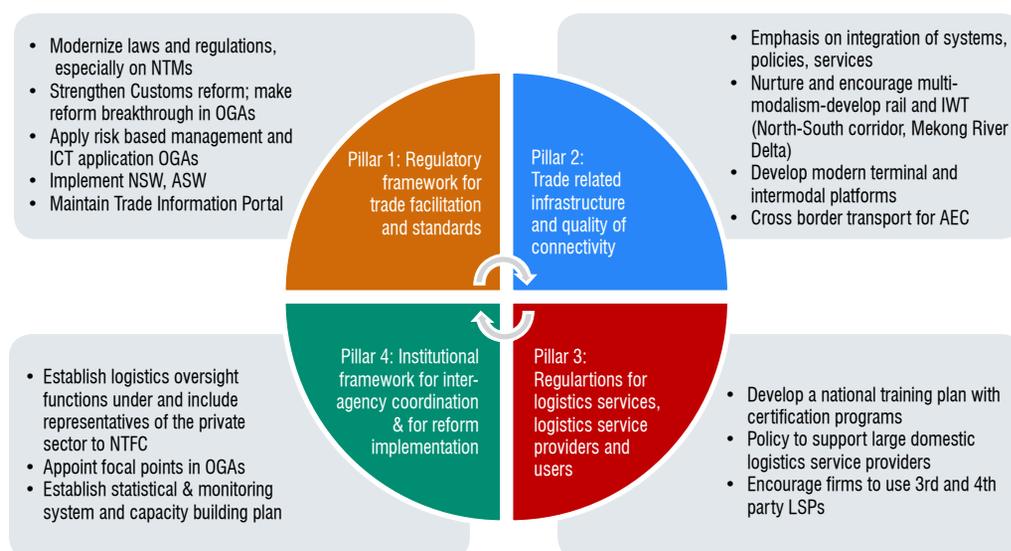
From Vision to Actions

What Are Appropriate Implementation Arrangements?

44. The National Logistics Action Plan¹⁵ has been issued as an initial effort to put forward effective arrangements to implement integrated reform priorities on trade facilitation and logistics. Despite collective efforts, the action plan can be further improved to best reflect an integrated approach, as mentioned earlier in the conceptual framework. Figure 21 highlights key elements of the proposed four-pillar program on trade facilitation and logistics.

¹⁵ National Logistics Action Plan was issued in attachment to Decision 200-QD/TTg dated on February 14, 2017. The World Bank provided a technical assistance to Ministry of Industry and Trade to work with Ministry of Transport, Ministry of Finance (Customs) and the private sector for developing this action plan.

Figure 21. Proposed 4-pillar Program for Trade Facilitation and Logistics



Source: Authors.

45. The World Bank has been providing an analytical and technical assistance program¹⁶ covering the four pillars, and stands ready to provide any financial assistance in the form of a direct budget support that the Government might seek. The World Bank’s on-going technical assistance program is designed and implemented to fit the four-pillar approach as follows:

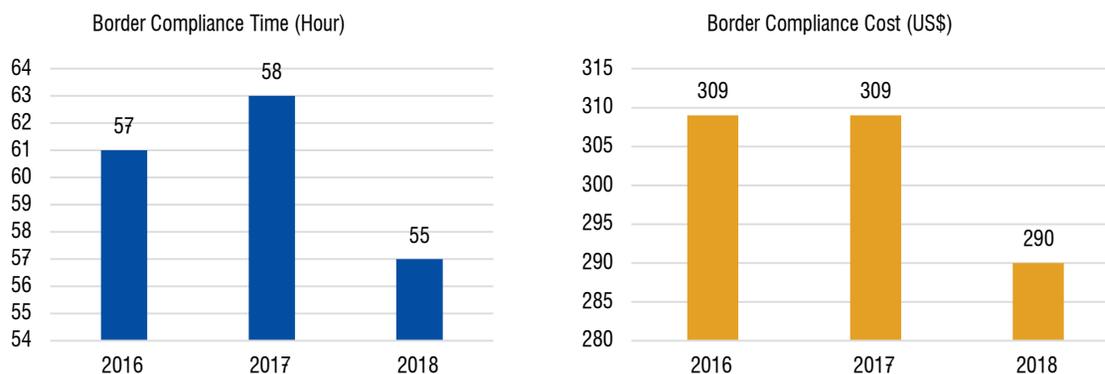
- *Pillar 1: Strengthening trade facilitation:* (i) Review to streamline administrative measures and procedures to cut trade cost; (ii) Launch and sustain Vietnam Trade Information Portal (VTIP) to promote transparency and comply with WTO’s TFA; (iii) Develop and implement a detailed administrative reform plan for trade facilitation.
- *Pillar 2: Enhancing efficiency of trade-related infrastructure and the quality of connectivity:* (i) Vietnam Development Report 2019 (VDR) “Connecting Vietnam for Growth and Shared Prosperity”; and (ii) Develop and Implement Suitable Public-Private Partnership (PPP) Models.
- *Pillar 3: Building a competitive logistics service sector:* (i) Support the establishment of Vietnam Logistics Statistical System (VLSS); and (ii) Transportation and logistics studies of key sub-sectors: trucking, railway and inland waterway.
- *Pillar 4: Consolidating interagency coordination and partnership with the private sector:* (i) Support NTFC to enhance interagency coordination role and partnership with private sector; (ii) Support the implementation of integrated reform agenda, including National Logistics Action Plan (NLAP); and, (iii) Support a development of sound result and monitoring framework with clear metrics to be achieved as defined in Government Resolutions and Action Plans.

¹⁶ The program is funded from various grant sources, in particular under the Australia-World Bank Partnership Program, executed by the World Bank.

How to Monitor Reform Progress?

46. The progress of Vietnam's trade competitiveness can be monitored by comparing time and cost indicators from the annual Doing Business Index. An example of comparing results of the Doing Business reports from 2016, 2017, and 2018 is highlighted in Figure 22, which shows that Vietnam's performance in terms of both border compliance time and costs for export improved significantly in 2018.

Figure 22. Vietnam Border Compliance Time and Cost for Export

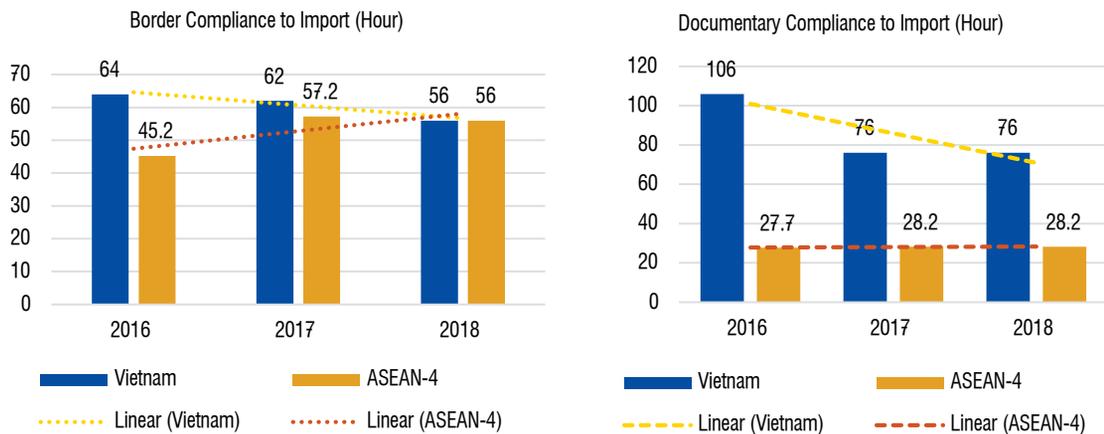


Source: *Doing Business*, World Bank (2016, 2017 and 2018).

47. Doing Business reports can also be used to benchmark Vietnam against peer countries, and therefore support a monitoring of the performance gaps between Vietnam and selected counties. The Government targets that Vietnam will need to fill the performance gap with the ASEAN-4 average by 2020¹⁷, for which a time series for comparison can be generated to monitor results achieved in meeting this objective. Figure 23 shows the trade competitiveness gap between Vietnam and the ASEAN-4 average during for the Doing Business reports from 2016 through 2018. Over this period, there has been a decline in the time for documentary compliance for specialized controls and border compliance in Vietnam and the gap of both of these indicators has narrowed. However, the size of the gaps measured for the two indicators are significantly different: while the time for border compliance in Vietnam is reached the ASEAN-4 average level, there remains a considerable gap in the time for documentary compliance on specialized controls between Vietnam and ASEAN-4 average.

¹⁷ There are five Resolution 19/NQ-CP issued by the Government on March 18, 2014, on March 12, 2015, on April 28, 2016, on February 6, 2018, and May 15, 2018 respectively. All resolutions have been consistently aiming at improving business environment and enhancing competitiveness including through improved trade across borders.

Figure 23. Performance Gap Between Vietnam and ASEAN-4



Source: *Doing Business* 2016, 2017 and 2018.

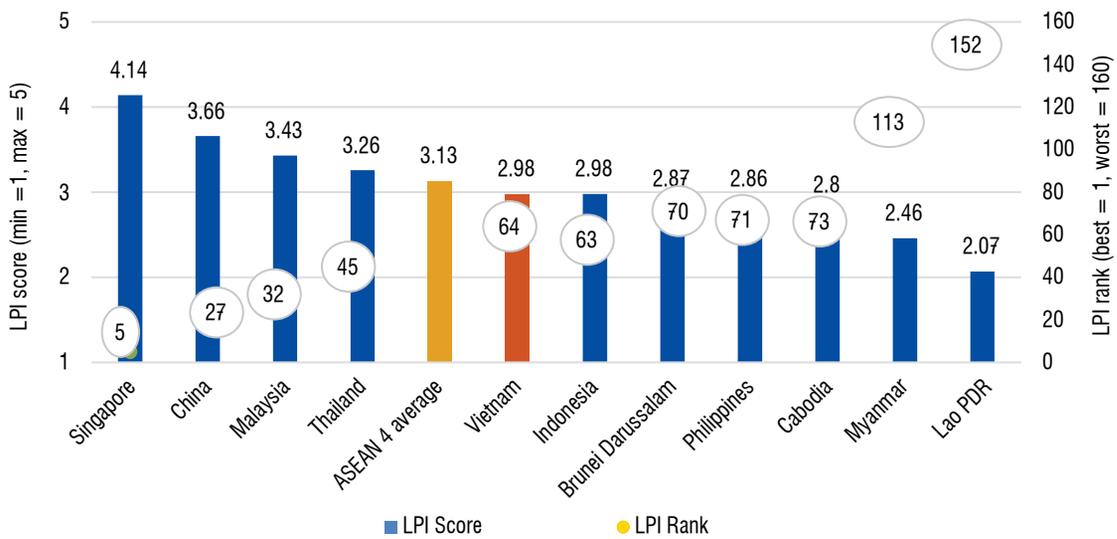
48. Another critical metric that can be used for benchmarking Vietnam against global performance and for measuring reform progress for Vietnam is the Logistics Performance Index (LPI), which is a multidimensional assessment of logistics performance. It measures performance along the logistics supply chain and offers two different perspectives: international and domestic. The International LPI provides qualitative evaluations of a country in six areas by its trading partners, i.e., logistics professionals working outside the country. The Domestic LPI provides qualitative and quantitative assessments of a country by logistics professionals working inside it. It includes information on the logistics environment, core logistics processes, institutions, and performance time and cost data. The LPI's has six core components¹⁸, of which the first three constitute areas for policy regulation (inputs), and the latter three represent supply chain performance outcomes, related to time, cost and reliability. They are: (i) Efficiency of clearance processes (Customs), (ii) Trade-and transport-related infrastructure, (iii) Competence and quality of logistics services (iv) Ease of arranging competitively priced international shipments, (v) Ability to track and trace consignments, and (vi) Timeliness of delivery.

49. Vietnam's performance is slightly below the unweighted ASEAN 4 average (3.13 versus 2.99), and is on par with the East Asia & Pacific regional average¹⁹ (Figure 24). The country ranks towards the middle of its ASEAN peers, with the same score as Indonesia.

¹⁸ The LPI ranking is solely based on the International LPI. It is constructed from around 6,000 individual country assessments by 1,000 international freight forwarders and express carriers.

¹⁹ The East Asia & Pacific regional average only captures developing countries in the region. No rank is indicated in the graph.

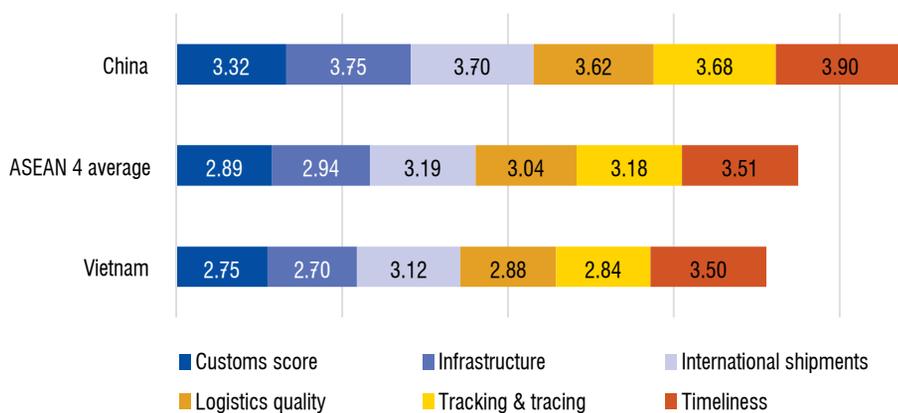
Figure 24. LPI 2016: ASEAN Overall Scores and Ranks



Source: LPI 2016.

50. In Vietnam, as in most countries, the infrastructure score is lower than the overall score (e.g., Philippines, Indonesia, and Thailand) when comparing the individual scores of the six LPI components of Vietnam with the ASEAN 4 members and China (Figure 25). The reverse is true only for the highest performing countries in this sample (China and Malaysia). The timeliness component (frequency with which shipments reach their destination within the scheduled or expected time) is higher, sometimes significantly, than the overall LPI score. This holds for all countries in this sample and can also be observed for most other countries worldwide.

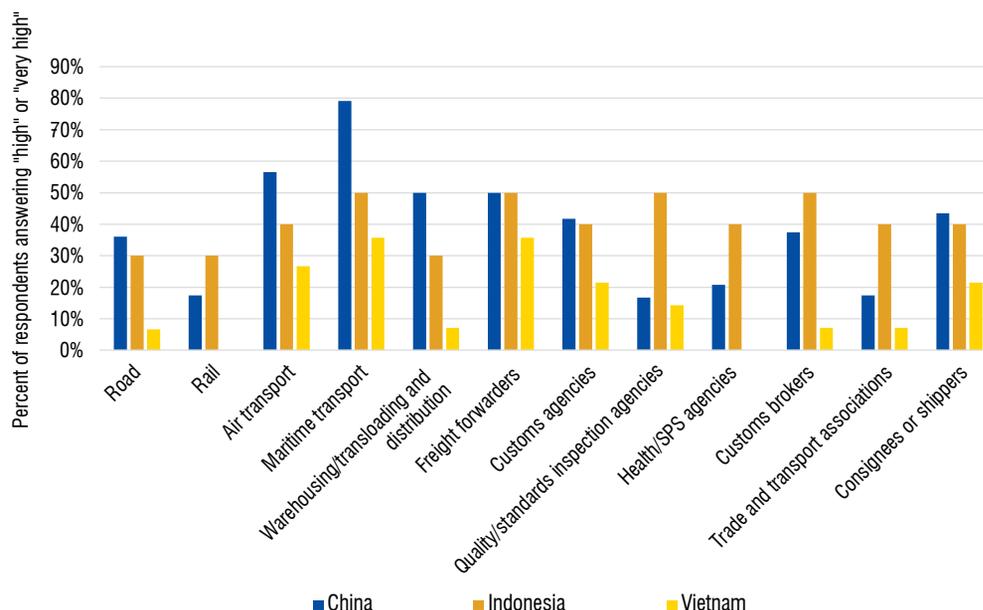
Figure 25. LPI 2016 by Component, Vietnam versus ASEAN-4 and China



Source: LPI 2016.

51. Many other indicators in the LPI survey's domestic section can be used for policy analysis and for monitoring trade facilitation and logistics reform implementation. For example, Figure 26 presents the feedback of the LPI survey's respondents on the competence and quality of logistics services in Vietnam versus China and Indonesia. Logistics services tied to the following areas are covered: road, rail, warehousing/ transloading, health/ SPS agencies, customs brokers and trade and transport associations.

Figure 26. Competence and Quality of Logistics Services



Source: LPI 2016.

Conclusion

52. Vietnam has taken impressive action on many fronts to boost trade competitiveness and to grow as an export platform. The Government recognizes the past success in reducing trade costs, which was mainly due to tariff reductions, is reaching limits. Sustaining further success will require a focus on reducing non-tariff costs, including compliance cost of administrative measures and procedures before and at borders, and logistics costs.

53. Government Resolutions 19 mandate a progressive reduction in time and costs for trade across borders, and have clearly set the target for Vietnam's performance in terms of an improved business environment and trade competitiveness to reach the level of ASEAN-4 average by 2020. Top Government leaders have been emphasizing the need to undertake bold reform actions to meet the outlined performance targets. With the ambitious trade facilitation agenda focusing on reducing trade costs and improving competitiveness and the business environment, and the establishment of the National Trade Facilitation Committee, many important steps to address these challenges are underway.

54. Reducing non-tariff costs, which currently exceed the ASEAN average, can be achieved by implementing a 4-pillar integrated program that covers: (1) Promoting trade facilitation by simplifying customs and specialized management regulations; (2) Enhancing efficiency of trade-related infrastructure and the quality of connectivity; (3) Building a competitive logistics service sector; and, (4) Strengthening interagency coordination and partnership with the private sector.

55. The World Bank stands ready to support Vietnam in developing and implementing the proposed integrated four-pillar program on trade facilitation and logistics to further boost export-led growth, to improve business environment, and to enhance competitiveness. We are committed to continue providing comprehensive analytical work and technical assistance, and stand ready to provide any financial assistance in the form of a direct budget support that the Government might seek.

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