

TAKING STOCK

AN UPDATE ON VIETNAM'S
RECENT ECONOMIC DEVELOPMENTS

July, 2015





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**Special Focus on Labor Market -
Building Modern Labor Market Regulations and
Institutions in Vietnam**

THE WORLD BANK

July, 2015

ACKNOWLEDGEMENT

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ACRONYMS AND ABBREVIATIONS

ASEAN	Association of Southeast Asian Nations
CDS	Credit Default Swap
CIT	Corporate Income Tax
CPI	Consumer Price Index
EAP	East Asia and Pacific
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GDC	General Department of Customs
GSO	General Statistics Office
IMF	International Monetary Fund
MOF	Ministry of Finance
MOIT	Ministry of Industry and Trade
MOLISA	Ministry of Labor, Invalids and Social Affairs
MPI	Ministry of Planning and Investment
NSCERD	National Steering Committee of Enterprise Reform and Development
ODA	Official Development Assistance
OOG	Office of Government
PIM	Public Investment Management
PMI	Purchasing Manager Index
PPP	Purchasing Power Parity
SBV	State Bank of Vietnam
SOEs	State-owned Enterprises
SEGs	State Economic Groups
SGC	State General Corporations
TPP	Trans Pacific Partnership
VAMC	Vietnam Asset Management Company
VAT	Value Added Tax
VHLSS	Vietnam Household Living Standards Survey
WB	World Bank

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OVERVIEW

Global Economic Prospects

The global economic recovery continues at a subdued pace, still subject to a multitude of downside risks. Global growth is broadly on track to reach an expected 2.8 percent in 2015, underpinned by a stronger recovery in high income countries on account of low commodity prices and still accommodative monetary policies in the U.S., EU, and Japan. In contrast, a broad-based slowdown appears to be underway in developing countries driven by the weaker outlook in commodity exporters and several large middle-income economies. Risks to the global outlook remain tilted to the downside. In particular, tighter global financial conditions could combine with deteriorating growth prospects, especially in commodity-exporting countries, to raise the possibility of greater financial stress. The strengthening dollar could also slow the U.S. economy more than expected earlier, leading to some global strain.¹

Recent Economic Developments in Vietnam

Economic activity continued to firm up in 2015, driven by domestic demand. After coming in at 6 percent in 2014, GDP growth accelerated to 6.28 percent during the first half of 2015, the fastest first-half-of-the-year growth rate in the past five years. The recovery was driven by strong activity in manufacturing and construction, which together contributed nearly half of overall GDP growth. Retail sales also performed strongly, posting 8.3 percent (in real terms) in the first six months of 2015, up from 6.3 percent in 2014. However, despite the pickup in retail activity, overall services (which account for nearly 40 percent of GDP) rose modestly at 5.9 percent in the first half of 2015. In part, this reflected a struggling tourism sector, with tourist visits in the first six months down by 11 percent year-on-year. On the demand side, stronger growth was driven by investment (spurred by strong FDI inflows) and stronger private consumption boosted by low inflation. The contribution of net exports turned negative as sluggish external demand weighed on export growth while strengthened domestic activity continued to fuel import growth.

A low inflation environment has enabled the State Bank of Vietnam to maintain an expansionary monetary policy stance. The consumer price index rose only 1 percent year-on-year in June 2015, down from 5 percent a year earlier. The SBV cut its refinancing and discount rates by 50 basis points in 2014, and has thus far held the line on interest rates in 2015. Interest rate cuts were aided by macro-prudential measures, including relaxation of limits on short-

¹ Global Economic Prospects, the World Bank, June 2015.

term deposits and risk weights for certain lending activities. This allowed banks to maintain lower lending rates (typically in the range of 7-13 percent p.a. depending on lending terms) than in the past, thereby stimulating credit growth to an estimated 2.65 percent in Q1-2015, consistent with the SBV's target range. In response to a universally firmer US dollar and to keep pace with exchange rate movements in Vietnam's main trading partners, the SBV devalued the dong twice, in January and May 2015 by a cumulative 2 percent, in order to promote foreign exchange market stability and preserve external competitiveness.

Persistent fiscal imbalances are a concern against the backdrop of rising public debt.

The fiscal deficit stayed at 5.3 percent of GDP in 2014, reflecting weak revenue outturn and increased capital spending. Budget outturns thus far in 2015 reflect persistent fiscal pressures, with a deficit of nearly 75 trillion dong (US\$ 3.5 billion) in the first five months or a third of the annual target of 2015. Total public and publicly guaranteed debt increased further to estimated 59.6 percent in 2014 (up from 54.5 percent in 2013). While public debt levels are still within the bounds of sustainability, debt servicing costs are beginning to cut into fiscal space and risk crowding out more productive spending.

Weakening external trade balance caused the current account to move into deficit in Q1/2015.

A trade deficit of over US\$ 3 billion was recorded in the first five months of 2015 (compared to a surplus of US\$ 2.1 billion in 2014). The outturn reflected slow-down in export growth and stronger growth in imports. Export growth slowed to 7.7 percent (year-on-year) in the first five months of 2015 (down from 15.3 percent over the same period in 2014) mainly due to a sharp fall in export prices as well as declining volumes in key commodities such as crude oil, coal, rice, coffee and rubber. Meanwhile, a surge in capital goods led to a pick-up in import growth. However, robust private remittances (5.8 percent of GDP in 2010-14 average) are expected to keep the current account in surplus in 2015, albeit at a much lower level than last year.

External financing risks remain tempered by Vietnam's relatively low (and mostly concessional) external debt and the structure of capital inflows that comprises mostly FDI.

In 2015, FDI disbursements were up 9.6 percent to US\$ 6.3 billion in the first half of 2015, even though new commitments have declined to US\$ 5.5 billion, down by nearly 20 percent compared to the same period last year. External debt rollover rates also remained solid aided by stable official inflows and by credit rating upgrades as both Moody's and Fitch upgraded Vietnam's sovereign rating by one notch with a stable outlook.² Overall balance of payments slightly improved allowing for gradual build-up of international reserves to about 2.8 months of imports by the end of Q1-2015.

Progress on structural reforms has been mixed, especially with regard to SOE and banking sector reforms.

An acceleration of these reforms is deemed necessary—by policymakers and private analysts alike—to carry growth closer to the 7 percent mark and meet Vietnam's longer term aspirations to become a modern, industrialized nation. Progress on SOE equitization (divestiture of state assets) has slowed down in 2015, with only 29 SOEs having been equitized

² Vietnam is currently rated three (Fitch and Standard & Poor's) to four notches (Moody's) below investment grade by the three major rating agencies.

in the first quarter, putting in question feasibility of the 2015 target of equitizing 289 SOEs. Consolidation of the banking sector accelerated during the first half of 2015, but resolution of bad debts remains a concern. Lack of legal ownership of bad assets by the VAMC, the absence of an adequate enabling legal framework for insolvency, asset titling, and seizure of collaterals and for protecting VAMC staffs personal liability continues to hamper efforts to resolve the bad debt on VAMC's books.

The medium term outlook for Vietnam is positive on balance but subject to significant downside risks. Growth is expected to come in at just over 6 percent in 2015 underpinned by further recovery in domestic demand, in turn reflecting more robust private consumption and investment growth. Despite the expansionary monetary policy stance, inflation would remain low due to subdued global conditions and low global energy and food prices. The fiscal deficit is expected to start adjusting through consolidation efforts to avoid further increases in public debt. The trade balance is projected to narrow significantly in 2015 due to softer export growth and sustained strong import growth stoked by stronger domestic economic activity. However, robust remittances will keep the current account in surplus, albeit at a much lower level than last year. This baseline assessment is subject to downside risks, both external and domestic. On the external front, as described, global growth remains sluggish and subject to much uncertainty, with important implications for Vietnam through its significant trade linkages. Furthermore, weak global prices of rice and other agricultural products may adversely affect rural household income and consumption. On the domestic side, a credible medium-term fiscal consolidation plan together with an equally credible plan to strengthen the finances of the SOEs and state-owned banking sector would remain crucial to ward off pressures on public debt and boost private sector confidence.

SPECIAL FOCUS ON LABOR MARKET

Building Modern Labor Market Regulations and Institutions in Vietnam

The landscape of jobs in Vietnam has shifted dramatically over the last 25 years. While jobs in Vietnam were once characterized entirely by family farming, collectives, and state-owned enterprises (SOEs), over time work has shifted towards manufacturing and services, household enterprises outside agriculture, and private domestic and foreign-owned firms. In 1989, 71 percent of employed Vietnamese worked primarily in agriculture, fishing, or forestry, and private employment was almost non-existent. Today agriculture, fishing, and forestry accounted for 46 percent of jobs, and 1 in 10 Vietnamese workers - about 5 million - hold a wage job with a private firm.³

³ 1989 figures are based on analysis of the Population and Housing Census. Figures for "today" are based on analysis of the 2014 Labor Force Survey.

The expansion of private-sector wage jobs is fundamental to the improvement of living standards in Vietnam. Family farms, household enterprises, SOEs, and the government will continue to be a source of livelihoods for many workers, but private sector wage jobs have the greatest potential for the rapid productivity gains needed to boost large numbers of Vietnamese workers into the ranks of the global middle class.

Private-sector job growth is determined by many factors. The primary driver is the business environment, which includes strong, efficient market institutions, stable macroeconomic environment, and adequate infrastructure. Enterprises also need a well-educated and skilled workforce for growth. Policies regarding these “fundamentals” are the most important policy levers for job growth.

Labor regulations and institutions can also be an important determinant of private sector wage growth. Labor market policies have the potential to help people grasp economic opportunities in a risky world but need to be well calibrated to help households and society manage the risks. Labor market policies can mitigate the effects of earnings and employment losses, provide voice to workers, and facilitate the movement of labor and human capital to where they are most efficiently deployed. At the same time, inappropriate policies may increase individual and societal labor market risks. At the individual level, risks of jobs losses or sustained informality may be increased, while at a societal level they may result in slow formalization of employment, mismatches between earnings and productivity growth, or labor unrest. Poorly calibrated policies may also inhibit structural transformation by reducing movement of workers across geography, sectors, and types of work.

Vietnam's labor market policies may be an emerging constraint to private wage job growth. In the most recent data from 2009, just 1 percent of firms identified labor regulations as the chief constraint to firm growth. However, an additional 28 percent identified labor regulations as a minor or moderate constraint (World Bank, 2014a). Vietnam faces the danger that overly strict regulations today could be a future barrier to wage job growth. Regulations often benefit “insiders”—those workers who currently hold wage jobs—while smothering the creation of new jobs that would generate opportunity for “outsiders”—those who do not yet hold wage jobs. As the ranks of wage workers increase, insiders will become an increasingly powerful voice in favor of maintaining policies that are to their advantage. This could make it difficult to change overly strict policies in the future.



SECTION I

RECENT ECONOMIC DEVELOPMENTS

I.1. External Economic Environment

1. **Global growth remains broadly on track to reach about 2.8 percent in 2015 and is expected to pick up to 3.3 percent in 2016-17.** Global growth is supported by low commodity prices and accommodative monetary policies in major economies although financial conditions are expected to tighten gradually over the year with the anticipated monetary policy tightening in the US. Important shifts are emerging. The recovery in high-income countries has gathered momentum. The United States should continue to expand at a robust pace while growth is also gradually accelerating in the Euro Area and Japan. In contrast, a broad-based slowdown appears to be underway in developing countries driven by the weaker outlook in commodity exporters and several large middle-income economies. Among major emerging economies, only India's economy is expected to strengthen further while China, Russia, Brazil and South Africa are all expected to slow down during 2015.

Table 1: The Global Outlook in Summary

	2012	2013f	2014f	2015f	2016f
REAL GDP¹					
World	2.4	2.5	2.6	2.8	3.3
High income	1.4	1.4	1.8	2.1	2.4
United States	2.3	2.2	2.4	2.9	2.9
Euro Area	-0.7	-0.4	0.9	1.5	1.8
Japan	1.7	1.6	0	1.1	1.7
Russia	3.4	1.3	0.6	-2.7	0.7
Developing countries	4.9	5.1	4.6	4.4	5.2
East Asia and Pacific	7.3	7.2	6.9	6.7	6.7
Europe and Central Asia	1.9	3.7	2.4	1.8	3.4
Latin America and the Caribbean	2.9	2.7	0.9	0.4	2
Middle East and North Africa	1.3	0.5	2.2	2.2	3.7
South Asia	5.4	6.3	6.9	7.1	7.3
Sub-Saharan Africa	4.1	4.2	4.6	4.2	4.5

	2012	2013f	2014f	2015f	2016f
Memorandum Items					
World trade volume ²	3.1	3.3	3.6	4.6	4.9
Oil price ³	1	-0.9	-7.5	-39.7	9.6
Non-oil commodity price index	-8.6	-7.2	-4.6	-11.0	1.2
Manufacturing unit export value ⁴	-1.2	-1.4	-0.2	-0.2	1.9

Source: World Bank, June 2015

1. Aggregate growth rates calculated using constant 2010 U.S. dollars GDP weights.
2. World trade volume for goods and non-factor services.
3. Simple average of Dubai, Brent, and West Texas Intermediate.
4. Unit value index of manufactured exports from major economies, expressed in U.S. dollars.

2. Growth in developing East Asia and Pacific (EAP) is expected to further ease to 6.7 percent in 2015 mainly due to the continued, gradual slow-down in China. Growth in China is expected to continue to soften amidst efforts by the authorities to address vulnerabilities associated with recent rapid credit and investment growth. This should be offset by a pickup in the rest of the region, which is benefitting from lower fuel prices and the strengthening recovery in advanced countries although export growth will be constrained by broad based real appreciations of currencies in the region. Low fuel prices will benefit developing EAP as a whole, but the impact will vary across countries, reflecting the magnitude of net fuel imports, energy intensity in production, and the share of oil and gas in total energy consumption.

Table 2: East Asia Pacific GDP Growth (%)

	2012	2013f	2014f	2015f	2016f
Developing East Asia	7.3	7.2	6.9	6.7	6.7
Cambodia	7.3	7.4	7.0	6.9	6.9
China	7.7	7.7	7.4	7.1	7.0
Indonesia	6.0	5.6	5.0	4.7	5.5
Lao PDR	8.0	8.5	7.5	6.4	7.0
Malaysia	5.6	4.7	6.0	4.7	5.0
Mongolia	12.4	11.6	7.8	4.4	4.2
Myanmar	7.3	8.3	8.5	8.5	8.2
Philippines	6.8	7.2	6.1	6.5	6.5
Thailand	6.5	2.9	0.7	3.5	4.0
Vietnam	5.2	5.5	6.0	6-6.2	6.2
Memo: East Asia excluding China	6.1	5.2	4.7	5.0	5.4

Source: World Bank, June 2015

3. On balance the global economic environment is expected to provide modest tailwind to Vietnam's economy in 2015.

The strengthening recovery in high-income economies and especially the US – the largest export market for Vietnam- should lift external demand. However, the slow pace of global trade growth suggests that Vietnam's exports will accelerate only moderately, especially since less favorable terms of trade could become a drag on export growth. As a net importer of petroleum products Vietnam is generally benefitting from the drop in the oil price which has improved the terms of trade, eased inflationary pressures, boosted household real incomes and lowered input costs for businesses.⁴ Fuel tax reforms have contained the decline in oil related fiscal revenue. Meanwhile, the gradual tightening of US monetary policy is expected to moderate global capital flows and tighten overall financial conditions for developing countries, including Vietnam. However, despite low foreign reserve coverage (about 2.8 months of imports), external financing risks are tempered by Vietnam's relatively low external debt and the structure of capital inflows with relatively limited portfolio investment and significant and generally less volatile FDI.

4. Risks to the global outlook remain tilted to the downside.

The global recovery remains fragile and risks of stagnation and deflation in advanced economies are still present. Increasingly divergent monetary policies across major economies could heighten risks of increased exchange rate and financial market volatility. Sharply tightening financing conditions, abrupt realignments of asset prices and large exchange rate movements could in turn dampen global trade, investment and growth. Further broad-based appreciation of the US dollar could trigger financial instability, especially in emerging markets with large exposures to dollar-denominated assets. A weaker-than-expected recovery in high-income countries, especially in the United States, the Euro Area, Japan, and more sluggish growth in large emerging economies would weaken global and regional trade and impair external demand. Although the probability is low, the risk of a hard landing in China remains. Given its large trade exposure, Vietnam would be particularly vulnerable to trading partner slowdowns and large exchange rate shifts which could result in erosion of competitiveness.

⁴

Vietnam produces about 350,000 barrels of oil per day and is a net exporter of crude oil, but is a net importer of refined petroleum products. The oil and gas balance is.

I.2 RECENT ECONOMIC DEVELOPMENTS IN VIETNAM

Growth continues to improve gradually

5. **Economic activity has continued to firm up in 2015 led by rising industrial output and a rebound in the construction sector.** After coming in at 6 percent in 2014, GDP growth continued to accelerate to 6.28 percent during the first half of 2015, the fastest first-half-of-the-year growth rate in the past five years. The recovery is driven by strong activity in manufacturing and construction, which grew by 9.9 percent and 6.6 percent, respectively, together contributing nearly half of overall GDP growth during the first six months of the year. Retail sales and services also performed strongly, posting 8.3 percent (in real terms) in the first six months of 2015, up from 6.3 percent in 2014 and 5.6 percent in 2013. However, the rebound of economic activities remains uneven. Despite healthy growth in retail trade, overall services which account for nearly 40 percent of GDP, rose only modestly at 5.9 percent in the first half 2015 reflecting mainly the struggling tourism sector with tourist visits in the first six months down by 11.3 percent year-on-year. Following strong performance last year, agriculture, forestry, and fisheries sector grew by a meager 2.4 percent amidst falling prices of key agriculture products and unfavorable weather.

Table 3: GDP growth (y/y, %)

	2012	2013	2014	H1-2015
Total GDP	5.3	5.4	6.0	6.3
Agriculture	2.7	2.7	3.5	2.4
Industry & construction	5.8	5.4	7.1	9.1
<i>Manufacturing</i>	5.8	7.4	8.5	9.9
<i>Construction</i>	3.3	5.9	7.0	6.6
Services	5.9	6.6	6.0	5.9

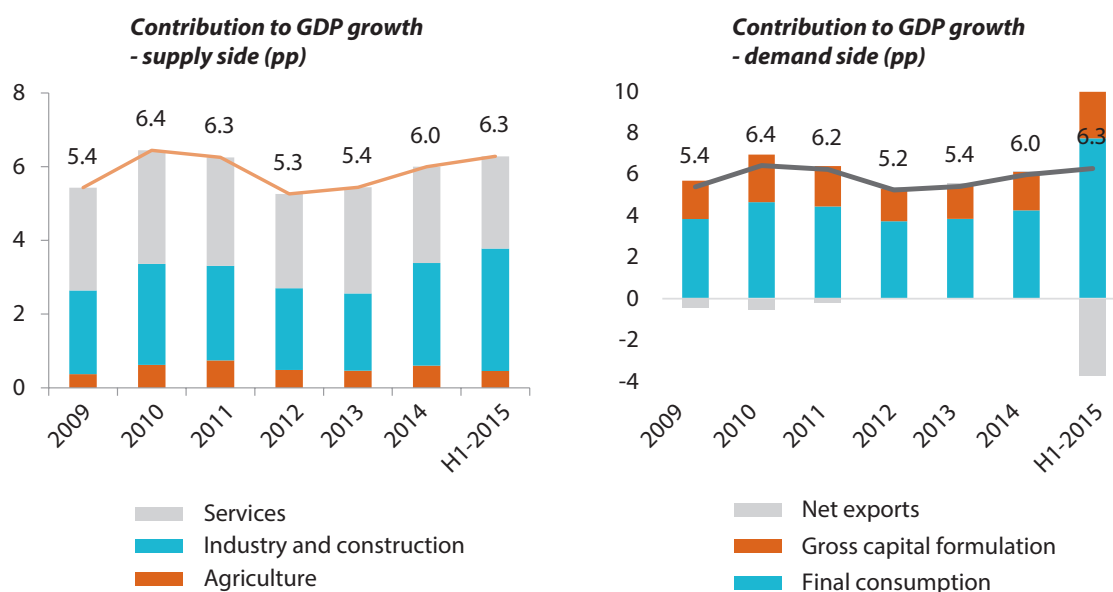
Source: GSO

6. **On the demand side, domestic demand remained the main driver of economic growth in first months of the year.** Private consumption is picking up strongly reflecting improved consumer sentiment which is boosted by low inflation and buoyant real wages. Final consumption accelerated by 8.7 percent year-on-year in the first half of 2015. Investment also strengthened with gross capital formation rising by 6.9 percent, spurred by an estimated 9.6 percent increase in FDI disbursements and lower interest rates. Overall growth was tempered by a negative contribution of net exports. While imports continued to rise rapidly stoked up by strengthening domestic activity, export growth was held back by falling export prices and sluggish external demand.

7. **While the strengthening recovery combined with stable macroeconomic conditions is expected to help sustain positive poverty trends, slower agricultural growth may dampen rural income growth.** Poverty in Vietnam is still largely a rural

phenomenon as about 95% of the poor live in rural areas. Given the dependence of the rural population, including the poor on agricultural production the recent slow-down in agricultural growth may dampen rural incomes and consumption and widen the rural-urban income gap.

Figure 1: Domestic demand driven growth

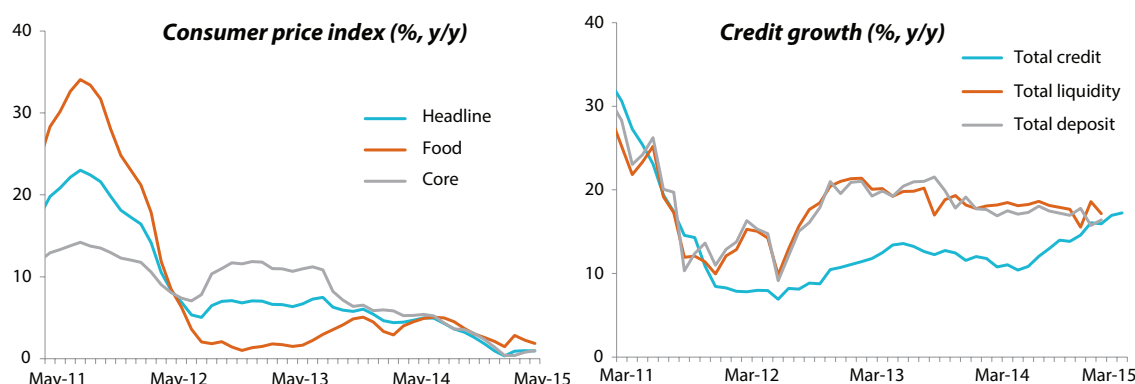


Source: GSO

Monetary policy stays accommodative amidst easing inflation

8. Against a backdrop of weak international commodity prices inflationary pressures remained low during the first half of 2015. The consumer price index rose only 1 percent year-on-year in June 2015, down from 4.7 percent a year earlier and a peak of 23 percent in August 2011. The strong decline in energy prices since July of 2014 and stable food prices through the year have been key drivers of the disinflation process. In addition, core inflation is also coming down as inflation expectations have receded.

9. The State Bank of Vietnam gradually loosened monetary policy to spur growth. With inflation falling to lower single digits The Central Bank cut its refinancing rate by 50 basis points in 2014 from 7 percent to 6.5 percent and its discount rate from 5 percent to 4.5 percent. Interest rate cuts were underpinned by relaxation of macro-prudential measures. Circular 36 (issued in November 2014) relaxed the limit on short-term deposits for medium and long-term lending significantly (60 percent from previously 30 percent) and lowered risk weights for certain lending activities. This allowed banks to maintain low lending rates (typically in the range of 7-13 percent p.a. depending on lending terms) which helped to stimulate credit growth to an estimated 14.2 percent, meeting the central bank's 12-14 percent target for 2014. By the end of March, credit expanded by 2.65 percent (year-to-date) about 16 percent (year-on-year), broadly in line with SBV's target for credit growth at 13-15 percent.

Figure 2: Inflationary pressures are easing and credit growth is picking up gradually

Source: GSO

10. Amidst rising volatility in international currency markets, the exchange rate has remained relatively stable. Vietnam continues to operate a crawling peg system, aimed at helping exports and promoting foreign exchange market stability. Weakening trade balance and rising expectations of higher interest rates in the United States have exerted downward pressure on the Vietnamese dong in 2015. In response to a firmer US dollar and increased devaluation pressure, the State Bank of Vietnam devalued its currency twice, in January and May 2015 by a cumulative 2 percent. After the SBV reaffirmed that there would be no further dong/dollar exchange rate adjustment this year, the dollar exchange rate continued to fluctuate, traded at the lower end of the +/- 1 percent band.

The fiscal accounts remain a source of concern

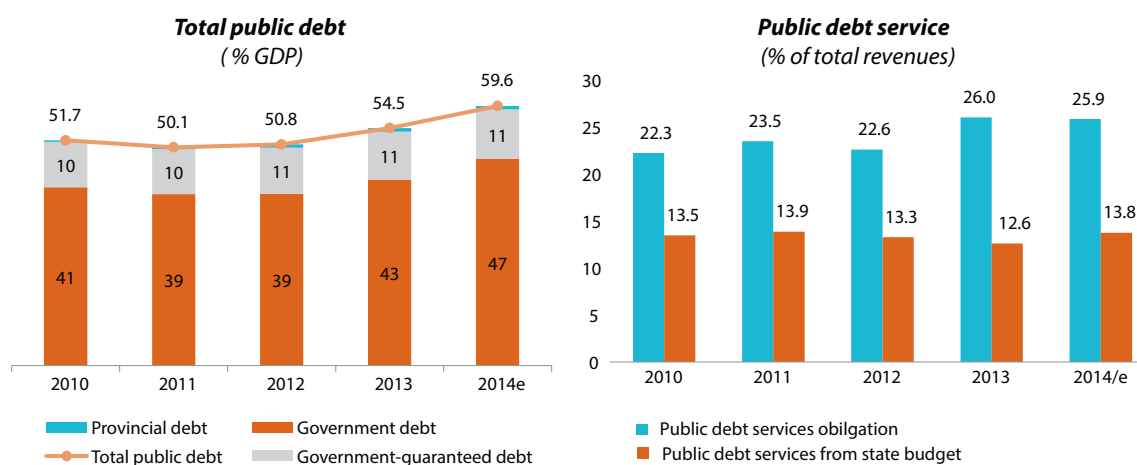
11. State budget outturns continue to show persistent fiscal pressure in the first months of 2015. In nominal terms, total revenue is projected to have increased 7.9 percent in the first five months compared with the same period the previous year. While oil revenue continued to decline substantially by 34 percent this was offset by growth in most other taxes. Revenue growth was outpaced by total expenditures which increased 8.9 percent leading to the deficit of nearly 75 trillion dong (US\$ 3.5 billion) or a third of the annual target approved by the National Assembly. Expansionary policy to avert a sharper down-turn, led to the fiscal deficit widening significantly from 1.1 percent of GDP in 2011 to 5.3 percent in 2014. Various pro-growth countercyclical measures (i.e. tax and tariff reductions and exemptions and stimulus spending) were launched over the past years to revive the economy.

Figure 3: Budget pressures remain

Source: MOF

12. Vietnam's debt has risen rapidly in recent years. As at the end of 2014, Vietnam's total outstanding public debt (government, government-guaranteed and local government) was estimated at 2,347 trillion dong (*approximately US\$110 billion*)⁵. As a share of GDP, total public debt rose quickly from 50 percent in 2011 to an estimated 59.6 percent in 2014. 79.6 percent of this was government debt, 19 percent government-guaranteed debt, and around 1.4 percent local government debt. The Ministry of Finance projects that total outstanding public debt stock could peak at about 65 percent of GDP by the end of 2017. Following that, the debt/GDP ratio would gradually decline as a result of fiscal consolidation.

⁵ All debt data comes from the government's authority.

Figure 4: Rising debt, increasing debt burden on the budget

Source: MOF

13. With rising debt came a change in the composition of debt. Since budget financing needs have grown at a faster pace than the growth of external concessional financing, Government mainly relied on domestic debt to meet its financing needs. While government external debt has remained steady at around 27-28 percent of GDP for 2010-2014, domestic debt has risen quickly from 23.1 percent of GDP in 2010 to 31.7 percent of GDP in 2014. Most of the domestic financing has been through issuance of government bonds with annual weighted- average coupon rate of 7.9 percent in 2013 and 6.6 percent in 2014. The average time-to-maturity of government bonds is relatively short – 3.1 years in 2013 and 4.8 years in 2014. This can pose rollover and maturity mismatch risks, particularly given the gestation period of debt financed infrastructure investments. Taking advantage of benign global financing conditions and recent upgrades in its sovereign credit ratings, Vietnam issued a US\$ 1 billion 10-year international bond (yield of 4.8 percent) in November 2014 – its first international issuance in 5 years. Some of the proceeds were used to buy back outstanding debt.

14. Debt servicing costs pose an increasing burden on the budget. Public debt services obligation (the sum of payment of government, government- guaranteed and local government debt) have risen from 22 percent in 2010 to about 26 percent of total budget revenues in 2014. Interest payments alone now account for estimated 7.2 percent of total budget spending, crowding out other more productive spending.

15. In addition, contingent liabilities from SOEs and the banking sector pose risks to public debt sustainability. While explicit guarantees are captured in the discussion above, it is the implicit guarantees which are not yet properly measured but can be significant in size and threaten fiscal stability. Although the government recognizes these risks, it maintains that State Budget resources will not be used to recapitalize banks or restructure SOE debt.

Vietnam's external position weakens in the first half of 2015

16. Vietnam's external position weakened in the first months of 2015, reflecting slow-down in exports and strong growth in imports. Export growth is estimated to have slowed

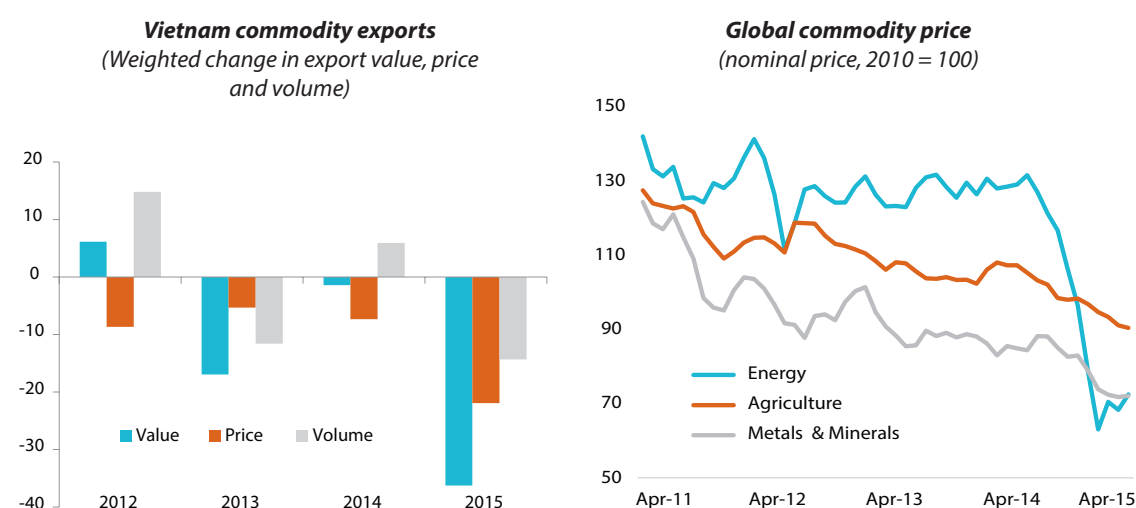
to 7.7 percent (year-on-year) in the first five months of 2015 (down from 13.8 percent in 2014 and 15.3 percent in 2013) mainly due to a sharp fall in export prices as well as declining volumes in key commodities such as crude oil, coal, rice, coffee and rubber. Manufacturing exports grew only moderately reflecting lackluster demand as global trade remains subdued despite the recent strengthening of growth in key export markets. Meanwhile, imports, especially of capital goods continued to surge resulting in an emerging trade deficit of more than US\$ 3 billion in the first five months (compared to a surplus of US\$ 2.1 billion in entire 2014).

Table 4: Vietnam export performance

	Share of total (%)			Growth (%)		
	2013	2014	5M-15	2013	2014	5M-15
Total export value	100.0	100.0	100.0	15.3	13.8	7.7
Crude oil	5.5	4.8	2.8	-11.9	-0.2	-45.7
Non-oil	94.5	95.2	97.2	17.4	14.6	10.9
Agriculture and fishery	14.9	14.7	12.7	-5.8	12.1	-10.1
Rice	2.2	2.0	1.7	-20.4	0.4	-14.6
Low value manufacturing	25.6	26.6	26.2	18.6	18.1	12.7
Garment	13.6	13.9	12.8	18.8	16.6	9.2
High value manufacturing	27.9	27.1	31.9	46.5	10.6	23.5
Phones and parts	16.1	15.7	18.9	67.1	11.1	20.2
Others	26.1	26.7	26.4	8.5	16.7	7.9
Domestic sector	33.2	32.6	29.5	3.8	11.8	-3.4
Foreign invested sector	66.8	67.4	70.5	22.0	14.8	13.1

Source: Vietnam Customs Department

Figure 5: Low commodity prices are weighing on export performance



Note: Key commodities include: crude oil, coal, rice, coffee and rubber. Data as of May 2015

Source: GSO and WB estimates

17. Imports continued to expand rapidly, reflecting strengthening investment activity especially in the FDI sector. Imports grew by 12 percent in 2014 and accelerated further to 16.4 during the first five months, driven by expanding activities in the FDI sector which heavily relies on imports of intermediate and capital goods. Due to several large investment projects, such as Samsung Electronics, Formosa Steel complex, and the Nghi Son refinery, imports of capital goods surged. Imports of raw materials and intermediate inputs for manufacturing exports, such as phone accessories, computer and electronic parts, cotton, fabrics, garment and footwear accessories have also recorded high growth rates. This recent hike of imports of capital goods indicates ongoing capacity extension in the FDI sector which should lift Vietnam's medium terms export and growth potential.

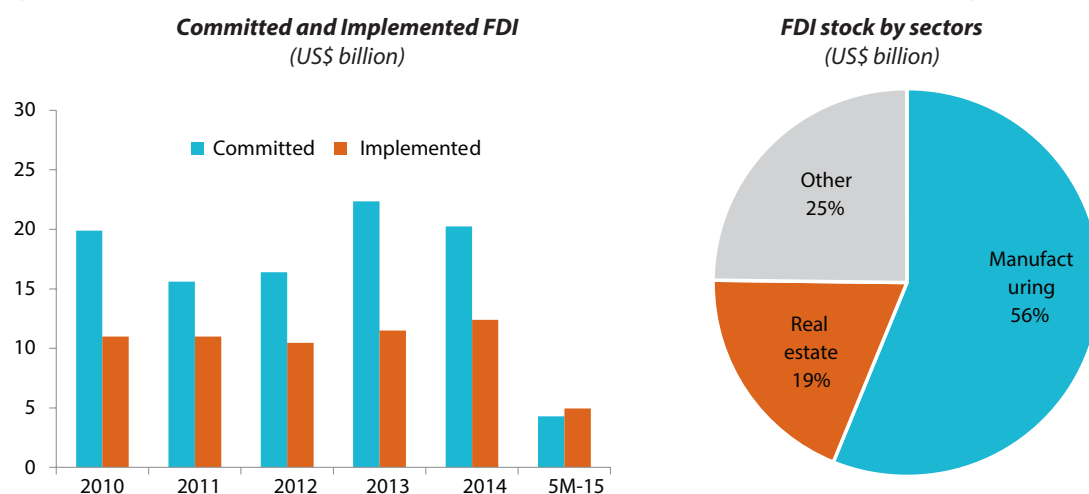
Table 5: Vietnam merchandise imports

	Share of total (%)			Growth (%)		
	2013	2014	5M-15	2013	2014	5M-15
Total import value	100.0	100.0	100.0	16.0	12.0	16.4
Machinery and equipment	14.2	15.2	17.2	16.5	20.0	35.6
Intermediate goods	22.4	21.6	23.8	38.6	8.1	31.0
Materials	22.8	22.8	21.2	15.7	12.2	6.0
Products	12.8	13.1	12.1	-5.3	17.2	2.8
Others	27.9	27.3	25.7	12.0	8.3	13.9
Domestic sector	43.6	43.0	39.9	6.9	10.5	6.6
Foreign invested sector	56.4	57.0	60.1	24.2	13.1	24.0

Source: Vietnam Customs Department

18. Due to the deterioration of the trade position, Vietnam's current account is estimated to have moved into deficit during the first quarter of 2015. After posting a healthy current account surplus of about 4.8 percent of GDP in 2014, the current account moved into deficit during the first quarter of the year. An emerging trade deficit (for goods and services) and transfer payments related to the repatriation of profits in the FDI sector were only partially offset by remittance inflows which remained robust during the year.

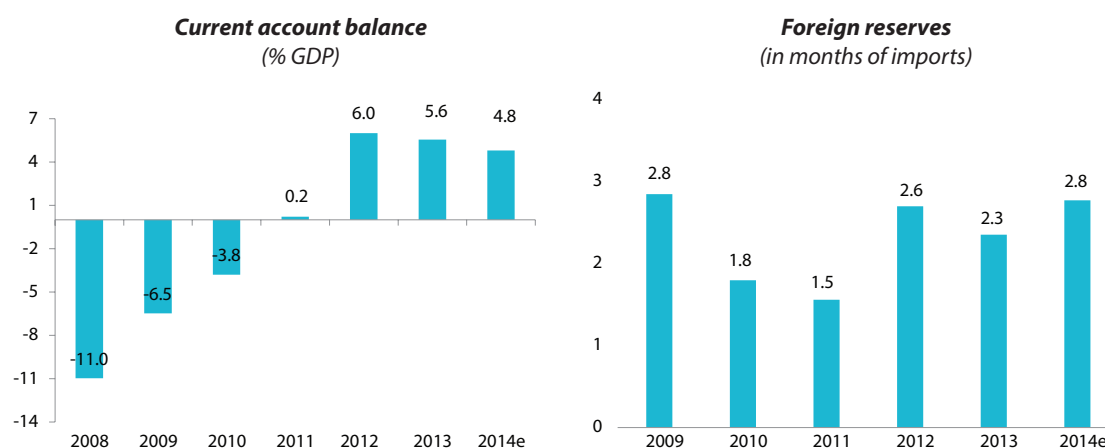
Figure 6: FDI inflows remain stable, but new commitments are on a declining trend



Source: MPI

19. Strong and diversified FDI inflows and external loans bolstered the financial account and allowed for further build-up of reserves. FDI disbursement rose 9.6 percent to about US\$ 6.3 billion in the first half of 2015. External debt rollover rates also remained solid aided by stable official inflows and by credit rating upgrades as both Moody's and Fitch upgraded Vietnam's sovereign rating by one notch with a stable outlook.⁶ Meanwhile, deposit outflows which were a major drag on the financial account last year, subsided. This allowed for continued gradual build-up of international reserves which increased to about 2.8 months of imports by the end of Q1-2015.

Figure 7: Despite recent build-up foreign reserves remain low



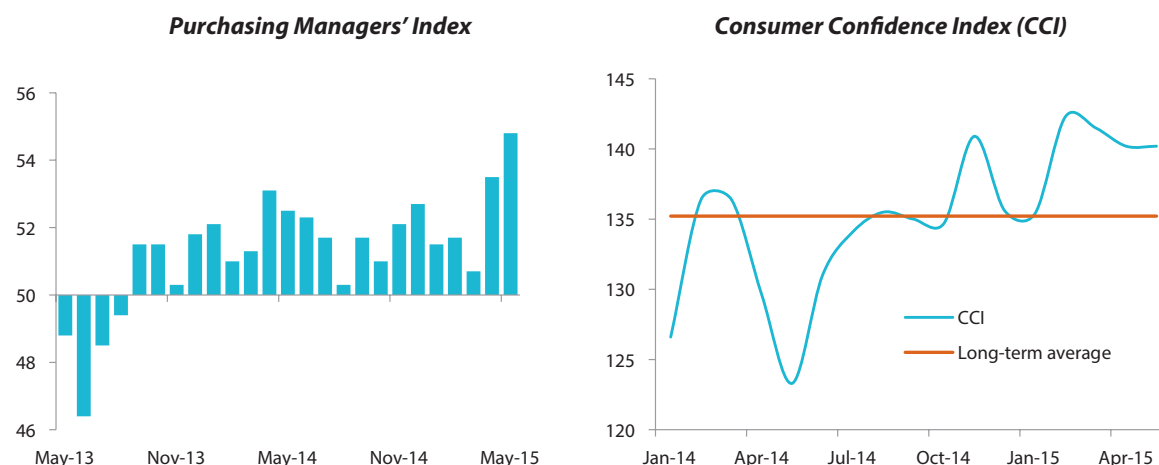
Source: SBV

Source: IMF

Short-term economic outlook and risks

20. The medium term outlook for Vietnam is positive on balance. Forward looking indicators suggest that the recovery will remain on track. The Purchasing Managers' Index (PMI) computed by HSBC has remained above 50 for 22 continuous months while the consumer confidence index stayed at 140.2 in May, well above its long-term average of 135. We expect growth to stay at around 6.0 - 6.2 percent in 2015 underpinned by further recovery in domestic demand, in turn reflecting robust private consumption and investment growth. Despite recent loosening of monetary policy, we expect inflation to remain low on account of low global energy and food prices. The fiscal deficit is expected to start adjusting through consolidation efforts to avoid further increases in public debt. We expect the trade surplus to narrow significantly this year due to a combination of weakening exports and sustained import growth stoked by stronger domestic economic activity. However, robust remittances will keep the current account in surplus, albeit at much lower level than last year.

⁶ Vietnam is currently rated three (Fitch and Standard & Poor's) to four notches (Moody's) below investment grade by the three major rating agencies.

Figure 8: Positive Outlook

Source: Markit and HSBC

Source: ANZ

Table 6: Vietnam key short-term economic indicators

	2012	2013	2014/e	2015/f
Real GDP (% change, y-y)	5.3	5.4	6.0	6.0-6.2
Consumer price index (% annual average)	9.1	6.6	4.1	2.5
Current account balance (% GDP)	6.0	5.6	4.8	0.5
Fiscal balance (% GDP)	-4.8	-5.6	-5.3	-5.0
Public debt (% GDP, MOF definition)	50.8	54.2	59.6	64.0

Source: SBV, MOF, IMF and WB

21. This baseline assessment is subject to downside risks, both external and domestic.

On the external front, global growth remains sluggish and subject to much uncertainty, with important implications for Vietnam through its significant trade linkages. Furthermore, weak global prices of rice and other agricultural products may adversely affect rural household income and consumption and widen the urban-rural gap. On the domestic side, a credible medium-term fiscal consolidation plan together with an equally credible plan to strengthen the finances of the SOEs and state-owned banking sector would remain crucial to ward off pressures on public debt sustainability and to boost the fragile private sector confidence. On the upside, emerging trade agreements provide opportunity for Vietnamese enterprises to attract more foreign investment, diversify and promote trade though reaching out to much bigger and richer markets.

22. Going forward, achieving a higher and sustainable rate of economic growth depends on Vietnam's ability to sustain macroeconomic stability and accelerate structural reforms.

On the macroeconomic front, a gradual, growth-friendly fiscal consolidation would help contain emerging public debt pressures and fiscal risks. Lower government financing requirement would also reduce risks of government bonds crowding

out private sector credit thereby enhancing the impact of accommodative monetary policies on private sector activity. The gradual reduction of fiscal deficit could be facilitated by reigning in government consumption and improving efficiency of public investment. Collecting reliable and up-to-date information on contingent liabilities (mostly in the SOE sector) and assessing their fiscal risks should remain a priority. In addition, while not a short term concern, in the medium term the combination of declining FDI commitments, subsiding ODA inflow and generally tighter global financing conditions could raise external financing risks. While the recent increase in international reserves has raised available buffers, greater exchange rate flexibility may be required to help absorb external shocks. On the structural reform front, key steps include further efforts to modernize the SOE sector and to address banking sector weaknesses, including resolution of non-performing loans. A more detailed update of recent progress and the remaining structural reform agenda is presented in the following section.

1.3. AN UPDATE OF STRUCTURAL REFORM PROGRESS AND CHALLENGES

Restructuring of state-owned enterprises

23. State owned enterprises remain important players in the economy. State owned enterprises account for about one-third of all business assets, one quarter of output, and one-eighth of employment in enterprise sector. As such their performance matters for the overall growth potential of the economy. Currently, at least some of the SOE enjoy preferential access to capital and may also benefit from favorable regulatory frameworks and enforcement which in turn prevents private firms from market entry or growth. At the same time, fragmented and sometimes overlapping responsibilities in the management of SOEs and weak corporate governance may undermine efficient use of resources at the firm level. Recognizing the potential for improved efficiency, the government has initiated comprehensive reforms to restructure the SOE sector.

24. Reforms of state owned enterprises continue to progress but at gradual pace. The government adopted plans in 2012 to restructure the roughly 1,200 remaining, fully state-owned SOEs. To avoid the need to provide budget financing to SOEs, the government intends to use dedicated enterprise restructuring funds which accumulates proceeds of asset sales to be used to finance the cost of restructuring, including capitalization and investment in restructured SOEs. Progress on equitization (divestiture of state assets) picked up in 2014, although with equitization of 143 SOEs implementation fell slightly short of the government's ambitious annual target of 200 SOEs. Progress slowed down somewhat during 2015 and only 29 SOEs were equitized in the first quarter, suggesting that the annual target of 289 SOEs may not be feasible this year. In addition to complex procedural requirements, implementation of equitization is also hampered by subdued demand for some of the assets, especially for non-controlling shares in SOEs.

25. During 2014, the Government continued to enhance the legal and regulatory framework for SOE management and corporate governance.⁷ Progress has also been made in implementing provisions related to Decree 61 which stipulates financial reporting and disclosure standards for SOE. Most SOEs now publish both financial and non-financial information on their own website and on the MPI portal. However, further efforts are needed to ensure full compliance as technical and human resource constraints impede implementation of financial management and timely reporting. These problems at the enterprise level are compounded by sometimes weak cooperation between agencies involved in the monitoring and supervision of SOE.

26. Following further improvements in the legal framework for corporate governance, implementation remains the key priority. Sustained implementation of SOE restructuring, further improvement of corporate governance practices and steps to level the playing field and create hard budget constraints could all help enhance SOE performance and overall growth prospects. While further improvement in the legal and regulatory framework are important, particular focus should be paid to ensuring consistent implementation. Further efforts are needed with regard to equitization of remaining SOEs, continued divestment from non-core assets and elimination of any preferential treatment of SOEs including access to bank capital and other sources of financing, tax treatment, public procurement preferences and other advantages.

Banking sector reform

27. After slow progress last year, banking sector reforms accelerated during the first half of 2015, especially with regard to consolidation of the banking sector. Unlike previous years, when consolidation was driven mostly by mergers of smaller (and weaker) banks, this year saw a number of acquisitions by major State Owned Commercial Banks (SOCBs) of smaller banks, e.g. BIDV and MHB, Vietinbank and PG Bank, and the forthcoming Vietcombank and SaigonBank. Moreover, rather than allowing weak banks to declare bankruptcy, the SBV also took over a number of smaller banks and placed experienced SOCBs management in key positions to facilitate a turn-around of their operations e.g. VNBC in February, OceanBank in April, and possibly another bank in coming months. There were also a few mergers among healthier joint-stock commercial banks place (e.g. Sacombank and Southern Bank, Maritime Bank and MDB). Most, if not all, of the mergers and acquisitions (M&As) are facilitated by the regulators with the aim to consolidate the banking system and address cross-ownership between banks, hence reduce some systemic risks. Despite the increasing number of M&As, the target of reducing the total number of commercial banks to 15 -17 by 2017 remains a challenging task.

⁷ In 2014, the GOV issued *Resolution 15/NQ-CP* (March) to accelerate SOE reform (including stepping up divestment) and several other SOE reform related legislations. In November 2014, the GOV has further issued *Law 67/2014/QH13* on investment and *Law 68/2014/QH13* on enterprises, which do not relate to SOEs directly but are a step towards leveling the playing field between different types of firms and increasing market competition. The Public Investment Law is a further step towards optimizing public investment (going beyond Directive 1792/CT-TTg from October 2011). This highlights considerable ownership of the program by the GOV and buy-in to the SOE reform agenda by the central government.

28. Despite recent legal revisions that allow for exceptions to the foreign ownership cap, there was no direct participation of foreign banks in any of the recent M&As.

While some of banks involved in recent deals have had foreign investments, none of the transactions directly involved foreign banks. This is likely the result of a number of factors, including lack of attractive banks and supportive regulatory framework. While the cap for total foreign holdings remains unchanged at 30 percent (consistent with Vietnam's WTO commitments), Decree 01, issued in January 2014 allows for higher foreign equity participation in special cases (i.e. weak banks) subject to Prime Ministerial approval. Aside of bringing additional capital, foreign investment participation in M&A activities could also help strengthen corporate governance, management and transparency in the institutions involved. However, thus far, it appears that no foreign investors have been interested in the weak banks in Vietnam.

29 The question on the actual size of NPLs by international best practices remains unanswered although recent regulatory changes are steps in the right direction.

Circular 02 and Circular 09 on loan loss classification and provisioning, respectively, were important regulatory changes to improve the reporting and management of NPLs. Full enforcement of Circular 02 started in April 2015, but thus far, there have been no official reported figures for NPLs under the new scheme. In addition to stricter classification with the combination of both quantitative and qualitative approaches, and cross rating through Credit Information Center's system, the Circular extends the provisioning for (i) loans via credit card; (ii) off-balance sheet items; (iii) investments in unlisted corporate bonds, (iv) trust investment and (v) deposits at other credit institutions. Among these, off-balance sheet items (L/Cs, guarantees) and corporate bond investments can be under significant impact as these assets account for noticeable portions (two-digit numbers) of the total assets for many banks. It may take a while to identify and quantify all the impacts these important regulations may have on the operation of the commercial banks, but it is believed that the banks have been able to alleviate these impacts to a large extent thanks to the long lead time for the final adjustment to the new system, as seen in the increases in provisioning, and resultant decreases in profitability across the bank balance sheets over the last two years.

30. While there has been some progress, resolution of bad debts remains a key issue of concern.

Since its establishment in July 2013, the Vietnam Asset Management Company (VAMC) has absorbed a growing share of bad assets. By the end of 2014 about 123 trillion dong in assets had been transferred to the VAMC of which it claimed to have resolved 4.8 trillion dong. Since the beginning of this year to the end of May, VAMC reported to have increased cumulative assets to 152 trillion dong and have resolved an additional 3 trillion dong. However, the majority of these assets were transferred in exchange for bonds, risks have not been fully removed from the banking system, as some unresolved assets may return as bonds mature. Moreover, efforts to resolve bad debts have been hampered by the absence of an enabling legal framework for insolvency, asset titling, and seizure of collaterals and for protecting VAMC staffs against possible lawsuits arising from potential losses to the State in case a fair market price mechanism cannot be established. In a bid to address the weaknesses, the Government issued Decree 34 in March 2015 replacing Decree 53 (issued in 2013) giving more authority to VAMC in dealing with the bad debts and underlying assets. However, most of the structural regulatory obstacles remain, and require more comprehensive changes in the legal framework, and more importantly, in the mindset

and business practices in the claim enforcement process, non-court workouts of distressed debts, etc. VAMC's capital base is too small for actually resolving the bad debt.

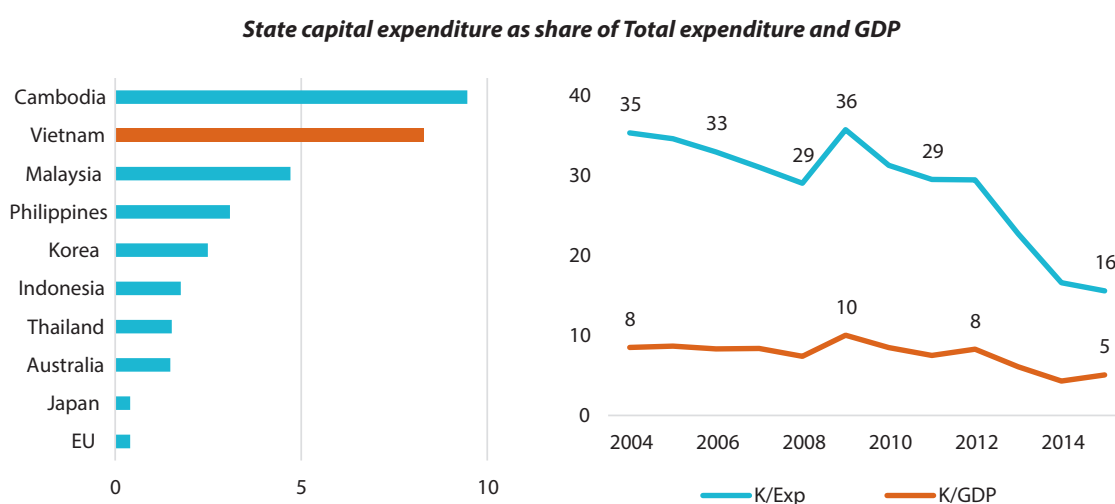
31. For the time being, confidence in the system seems to be improved, as shown in stable deposit base and hence ample liquidity in the system to support credit activities. Rising confidence is also reflected in solid increases in listed bank share prices in the first half of the year (e.g. 25 percent in Vietcombank shares and 26 percent in Vietinbank shares in Q2, 2015). The real estate market also shows initial recovery and macro conditions have improved. However, rapid monetary loosening in the context of prevailing administrative interventions in credit allocation may undermine the quality of the banking sector assets. Finance matters, both when it functions well and when it functions poorly.

Reforming public investment

32. Public investment has played an important role in Vietnam's development. The state budget remains the most important source of funding for both physical and social infrastructure. During 2004-12, Vietnam spent on average about one third of the state budget or 8.4 percent of GDP for state capital spending. This is a relatively high level compared to the majority of developing countries.

33. A combination of various factors, including sharp decline in revenue, concerns about rapidly rising public debt and the phasing out of stimulus spending has led to a significant dip in public investment since 2012. Reported investment in Q1/2015 only accounted for about 15.6 percent of total government expenditure. This is only half of the average level for 2004-12 and the lowest level recorded in the last 20 years. As share in the GDP, state capital spending was around 5 percent in 2014 and the first Quarter of 2015, or half of the 2009 level when public investment picked up as a result of the implementation of the economic stimulus package.

Figure 9: Despite the recent decline capital spending remains higher than in most countries in the region

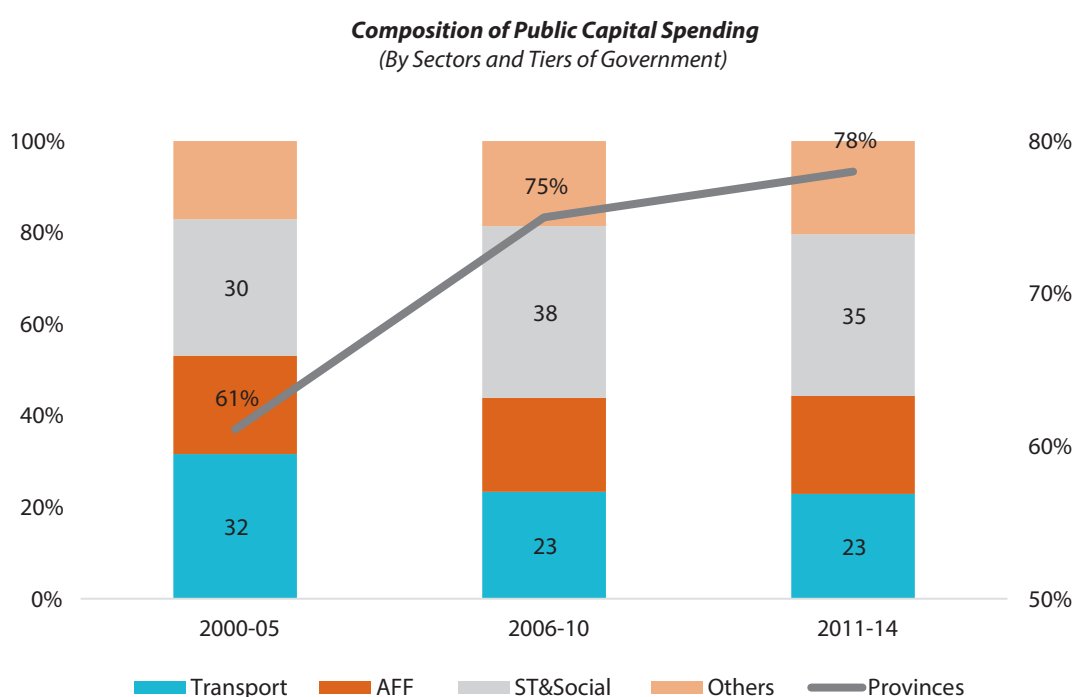


Source: MOF and IMF GFS

Note: Left panel: Percentage share of state capital spending in GDP for 2012. Right panel: Vietnam state capital spending as share of total state expenditure and GDP for 2004-15.

34. Important changes in the sectoral composition of capital spending as well as the degree of decentralization in the management of public investment have taken place over the last 15 years In the last Socio-Economic Development Plan (SEDP), capital spending for social sectors, sciences and technology increased notably at the expense of the transport sector. At the same time, nearly 80 percent of state capital spending is now managed at the subnational levels, a rapid increase from the period 2000-05. Compared to the average level of 38.4 percent for 2001-2010 for developing countries, Vietnam's level of decentralization of capital spending is among the highest in the developing world and put Vietnam in the spectrum of federal and highly decentralized countries.

Figure 10: Rising subnational investment



Source: MOF

Note: Left Axis: Sectoral composition of capital spending (bars). Right axis: Share of capital spending managed by Subnational governments (blue line).

35. The government adopted a detailed reform program for public investment management with the issuance of the Prime Minister Decision 339 in 2013. In the short term, this program aims to consolidate public investment and eliminate expenditure arrears on capital projects. In the longer term, priorities have been given to the improvement of the regulatory framework, strengthening the prioritization of spending as well as increased private participation in infrastructure projects. In addition, PM Directives 1792/2011, 27/2012 and 14/2013 enhanced public investment management. With these Directives, the first priority in capital spending allocation has been given to the timely completion of the on-going projects and for repayment of arrears and implementing new projects only if there are residual resources. As a result, Vietnam achieved good progress in 2012 in dealing with arrears to construction companies. The total value of arrears dropped to less than 47 trillion

dong (US\$ 2.1 billion) in December 2012 from about 91 trillion dong in 2011. However, the value of arrears did not change much during 2013-14, reported at nearly 45 trillion dong as of June 2014, or more than one quarter of capital spending in 2014. The Prime Minister already issued another Directive at the end of April 2015 (Directive 07) requesting line ministries and provinces to report their current status and progress in addressing arrears. Given the current progress, it is unlikely that all arrears will be eliminated by the end of 2015 as planned. Given the current high level of decentralization and the fact that provincial arrears accounted for almost 95 percent of total arrears, a complete elimination of the arrears and prevention of its reoccurrence would require fundamental overhaul of the public investment management (PIM) system and hence goes beyond the scope of recent PM Directives.

36. Major improvement in the regulatory framework for the management of public investment include the promulgation of the Public Investment Law and the amendment of the Construction Law. The Public Investment Law institutionalizes several improvements introduced in Directive 1792 such as medium-term investment planning, improvement in accountability, and strengthening prioritization of public investment projects at the concept stage. The Construction Law 2014 aims to improve the quality of construction master plans and project implementation, through measures such as professionalize the PMUs, or improvement of transparency in the issuance of construction permits, or improved accountability in construction management. Both laws are in effect from January 2015. Since these two laws regulate different aspects of the public investment management cycles it is critical to ensure consistency between them. The appraisal of project concept notes and the M&E will be managed by the Public Investment Law whereas the other steps of project preparation and project implementation will fall under the Construction Law. There are also some changes in law that potentially weaken the overall framework such as the elimination of independent review of project appraisals. Technical departments such as Departments of Construction or Departments of Agriculture and Rural development will now lead the appraisal of projects under their technical expertise rather than being led by Department of Planning and Investment as under past regulations. At the same time, they also propose and lead the preparation of the projects so potential conflicts of interests may arise.

37. Despite these legal changes, the consideration of economic benefits continues to receive inadequate attention in public investment management. While there are some specific requirements to estimate the economic benefits during the concept note stage (or initiation of the investment projects as in Vietnamese term), the amended Construction Law almost exclusively focuses on technical (as opposed to economic and financial) appraisal, even at the feasibility study stage.

38. While raising private sector participation in infrastructure investment and operation is an explicit policy objective, progress in this area is relatively slow. Some progress has been made in the regulatory environment with the issuance of Decree 15 on PPP in February 2015. The Decree facilitates a result-based approach and extends sectors for private participation to public utilities and basic social services, hence is expected to boost private participation in projects usually wholly funded by state budgets. However, it is important to note that private participation can help mobilize financing for infrastructure

investment, but the underlying funding for this infrastructure will ultimately fall to (i) taxpayers, (ii) consumers, or (iii) some combination of the two. As a result, accompanying reforms are needed to ensure quality of public services delivered by private sector and adequate consumer protection.

39. Medium term investment planning (MTIF) was introduced with Directive 1792, and then institutionalized with the Public Investment Law as an effort to introduce hard budget constraints on spending agencies. The medium-term investment plan 2016-20 is being prepared by the MPI and is expected to cover investment of all levels of the government, including both budget and off-budget investment. As such, the MTIF has the potential to contribute to improved efficiency by better linking it to the SEDP priorities and reduce fragmentation. However, planning for recurrent expenditures, including those associated with capital assets, such as operations and maintenance continues to follow the annual budget cycle. As a result, there can be inconsistencies between medium-term approach to investment planning and short-term approach to recurrent expenditure planning which could potentially undermine the appropriate mix of recurrent and investment spending. Unlike international practice, the approach to investment planning in Vietnam as specified in the Public Investment Law is also not a rolling one that is updated and revised annually, but a fixed term plan linked to the SEDP. While aiming to establish a firm budget constraint, this approach may be too rigid to accommodate changing circumstances during the planning period.

40. The preparation of the MTIF and hence the SEDP 2016-20 is moving ahead slowly. This is the first time provinces and line ministries have to prepare an MTIF so capacity is obviously one of the main causes of the delay. Majority of spending agencies have been struggling with the formulation of a credible five-year fiscal framework. In addition, the Public Investment Law requires spending agencies to prioritize the investment projects to be submitted to the MPI but the formulation of well-defined criteria for prioritization of projects within and across sectors requires long time to be completed. The formulation of allocation criteria for equalization transfer of capital spending from central government to provinces has also been slower than planned.



SECTION II

SPECIAL FOCUS ON LABOR MARKET - Building Modern Labor Market Regulations and Institutions in Vietnam

- 1. The landscape of jobs in Vietnam has shifted dramatically over the last 25 years.** While jobs in Vietnam were once characterized entirely by family farming, collectives, and state-owned enterprises (SOEs), over time employment has shifted towards manufacturing and services, household enterprises outside agriculture, and private domestic and foreign-owned firms. In 1989, 71 percent of employed Vietnamese worked primarily in agriculture, fishing, or forestry, and private employment was almost non-existent. Today agriculture, fishing, and forestry accounts for 46 percent of jobs, and 1 in 10 Vietnamese workers—about 5 million—hold a wage job with a private firm.⁸
- 2. The expansion of private-sector wage jobs is fundamental to the improvement of living standards in Vietnam.** Family farms, household enterprises, SOEs, and the government will continue to be a source of livelihoods for many workers, but only private sector wage jobs promise the potential for the rapid productivity gains needed to boost large numbers of Vietnamese workers into the ranks of the global middle class.
- 3. Private-sector job growth is determined by many factors.** The primary driver is the business environment, which includes strong, efficient market institutions, stable macroeconomic environment, and adequate infrastructure. Enterprises also need a well-educated and skilled workforce for growth. Policies regarding these “fundamentals” are the most important policy levers for job growth.

⁸ 1989 figures are based on analysis of the Population and Housing Census. Figures for “today” are based on analysis of the 2014 Labor Force Survey.

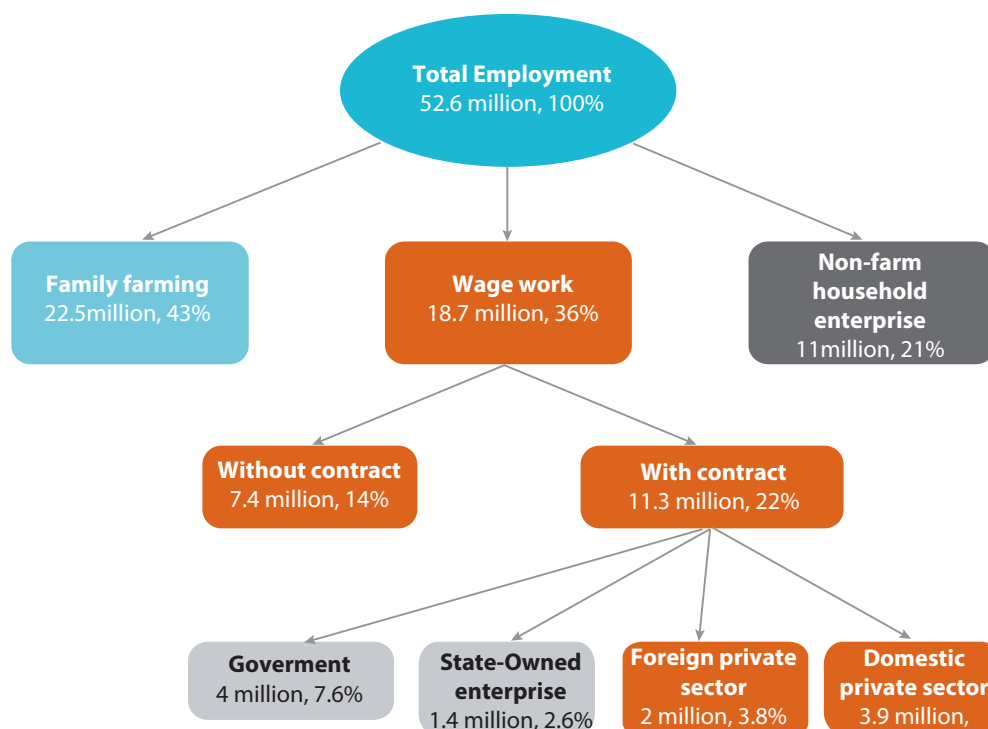
4. **Labor regulations and institutions can also be an important determinant of private sector wage growth.** Labor market policies have the potential to help people grasp economic opportunities in a risky world but need to be well calibrated to help households and society manage the risks. Labor market policies can mitigate the effects of earnings and employment losses, provide voice to workers, and facilitate the movement of labor and human capital to where they are most efficiently deployed. At the same time, inappropriate policies may increase individual and societal labor market risks. At the individual level, risks of jobs losses or sustained informality may be increased, while at a societal level they may result in slow formalization of employment, mismatches between earnings and productivity growth, or labor unrest. Poorly calibrated policies may also inhibit structural transformation by reducing movement of workers across geography, sectors, and types of work.

5. **Vietnam's labor market policies may be an emerging constraint to private wage job growth.** In the most recent data from 2009, just 1 percent of firms identified labor regulations as the chief constraint to firm growth. However, an additional 28 percent identified labor regulations as a minor or moderate constraint (World Bank, 2014a). Vietnam faces the danger that overly strict regulations today could be a future barrier to wage job growth. Regulations often benefit “insiders”—those workers who currently hold wage jobs—while smothering the creation of new jobs that would generate opportunity for “outsiders”—those who do not yet hold wage jobs. As the ranks of wage workers increase, insiders will become an increasingly powerful voice in favor of maintain policies that are to their advantage. This could make it difficult to change overly strict policies in the future.

6. **This special focus profiles key labor market issues in Vietnam.** The common theme is how to balance labor market flexibility and sustained productivity growth with policies and institutions to manage social risks in a more market-oriented economy. It begins with an outline of the structure of the labor market and continues with a look at two types of labor market regulations—the minimum wage and employment protection legislation—and then discusses the industrial relations system. It concludes with considerations for policy.

The Structure of Vietnam's Labor Market

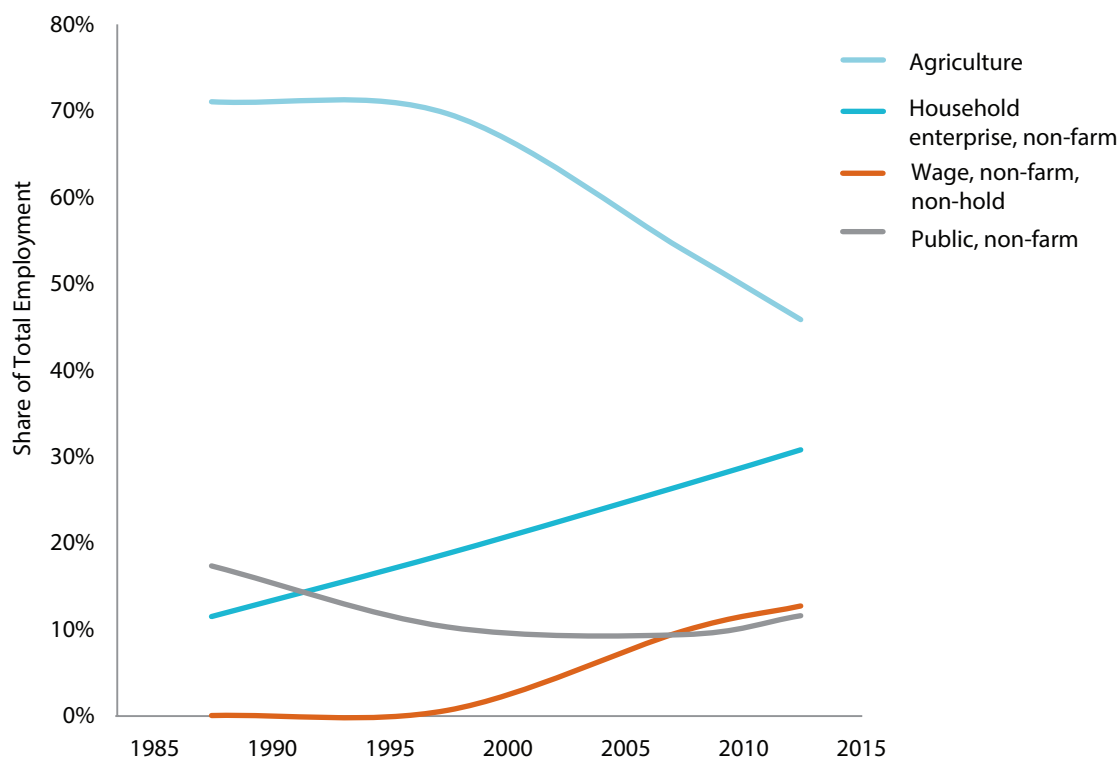
7. **Despite the rapid changes that have taken place in the last quarter-century, nearly half of Vietnamese workers still work primarily in family farming (including fishing and forestry).** Figure 1 shows a breakdown of workers in Vietnam by employer and broad type of job. Twenty-one percent of the workforce (11 million) consists of the self-employed and family workers in non-farm household enterprises. Wage workers number 18.7 million overall, but of those 7.4 million are in jobs without contracts, which would generally be classified as “informal.” Another 5.4 million wage workers work for the government or SOEs. The remaining group work in private sector wage jobs with contracts. These include 2 million in foreign-owned firms and 3.9 million in domestic private sector firms. Taking these two groups together, those working in private sector wage jobs with contracts constitute 11.3 percent of workers.

Figure 11: A Breakdown of Employment in Vietnam in 2014

Source: Analysis of 2014 Labor Force Survey data. In this breakdown, wage workers working for family farms or non-farm household enterprises are classified under “wage worker.” Nearly all such workers are without contract.

8. **Vietnam is amidst a vast transformation of its labor structure. Figure 2 shows the long-run trends by major job category.** The share of the labor force working chiefly in agriculture has dropped steadily since the start of the new millennium, at a rate of 1.6 percent point per year. At the current size of the workforce, this corresponds to a net movement of approximately 800,000 workers per year out of agriculture. These workers move into non-farm household enterprise and wage work, which have both seen their ranks swell over time. Household enterprises have generated a large boost in living standards for millions of Vietnamese but are limited in their potential for productivity growth. The future growth of Vietnam’s middle class will depend principally on the growth of wage jobs.

9. **Although the speed of the shift out of agriculture will be determined by other forces, the growth of wage jobs is influenced by labor regulations and institutions.** The following section considers three aspects of regulations and institutions in Vietnam.

Figure 12: Structural transformation*Employment Shares by Major Category, 1989-2014*

Source: Analysis of 1989, 1999, and 2009 Population Census and 2014 Labor Force Survey data. "Agriculture" includes fishing and forestry. This figure differs from Figure 12 in that here (1) the data for agriculture and non-farm household enterprise include wage employees, and (2) government and SOE employees are combined into one category: "public, non-farm".

Key Labor Market Regulations

a. Minimum Wage

10. **Vietnam's minimum wage regime has evolved over time.** The country first set a statutory minimum wage in 1992 that applied exclusively to foreign companies. The country's current minimum wage system was introduced in 2006. Under this system, minimum wages vary according to location and sector of employment. Prior to 2012, separate rates were set for government employees, domestic firms (including state-owned enterprises), and foreign companies. Since 2012, minimum wages have been aligned between foreign-owned and domestic firms. Minimum wages now vary by district; each district now has a minimum wage at one of four levels established nationally. As of January 2015, the minimum wage ranges from 2,150,000 dong to 3,100,000 dong per month. A separate and lower minimum wage-- known as the "reference wage" or "basic wage"—still applies to government workers: 1,150,000 dong.

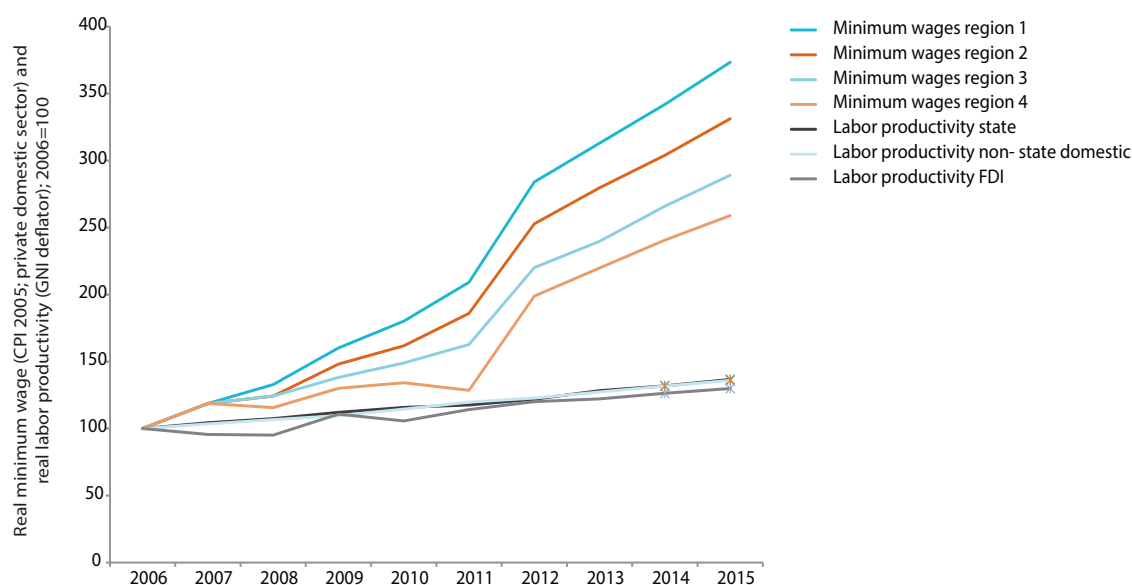
11. The minimum wage in Vietnam is envisioned by the law as a tool to guarantee basic living standards for workers. The 2012 Labor Code says, “The minimum wage is the lowest payment for an employee who performs the simplest job in normal working conditions and must ensure the employee’s minimum living needs and his/her family.” Minimum wage legislation has direct implications for the 22 percent of Vietnamese workers who hold “formal” wage jobs—those with the job contract required by the Labor Code. The minimum wage also forms the basis for calculating (a) wage scales for government staff/public sector workers; (b) wage scales for the payment of social insurance, unemployment insurance and health insurance for workers of state-owned enterprises (SOEs); (c) allowances for redundant workers due to the restructuring of SOEs; and (d) pensions, allowances for veterans, and some social transfers.

12. The theoretical impact of changes in the minimum wage on employment is uncertain. In the absence of strict enforcement, if the minimum wage exceeds worker productivity, employers may hire workers informally without contract to evade the minimum wage restrictions. Economic theory shows that in a perfectly competitive labor market with both a formal sector covered by the minimum wage laws and an uncovered informal sector, the effect of an increase in the minimum wage will be to shift employment from the formal to the informal sector. In the real world, labor markets are not perfectly competitive—large firms in particular can exert some market power—and thus the impact of the minimum wage is less clear cut. Theories of “efficiency wages” suggest that paying workers more induces higher effort, makes them more productive due to higher morale, and/or reduces worker turnover. In the presence of market power or efficiency wages, small changes in the minimum wage at low levels can have little or no effect on employment.

13. Nonetheless it is likely that an extremely high minimum wage, if enforced, will reduce formal employment. Increases in the minimum wage can also increase wages higher up the wage scale—and possibly reduce employment—through the “lighthouse effect” if some workers are paid multiples of the minimum wage. Given that Vietnam has attracted foreign direct investment (FDI) in part because of its low wages, there is a risk that a very high minimum wages will discourage further FDI and jobs it creates. Rising minimum wage levels have contributed to decreasing the country’s cost advantage relative to countries like Bangladesh or Cambodia where wages are still low relative to Vietnam (McKinsey Global Institute, 2012).

14. Outside the government sector, Vietnam’s minimum wages have risen rapidly in recent years, outstripping productivity growth. Figure 3 presents the growth of Vietnam’s minimum wages. By way of comparison, the growth of real labor productivity in the state, non-state domestic and FDI sectors are also depicted. The minimum wage increased most dramatically in 2012, when minimum wages in the domestic and foreign sectors were aligned. In real terms, the minimum wage has more than doubled since 2006, while productivity growth has been far less. It has been the Government’s stated ambition to raise minimum wages to a level that allows households to reach the “minimum monthly living standard” by 2018.⁹ This would imply further large increases.

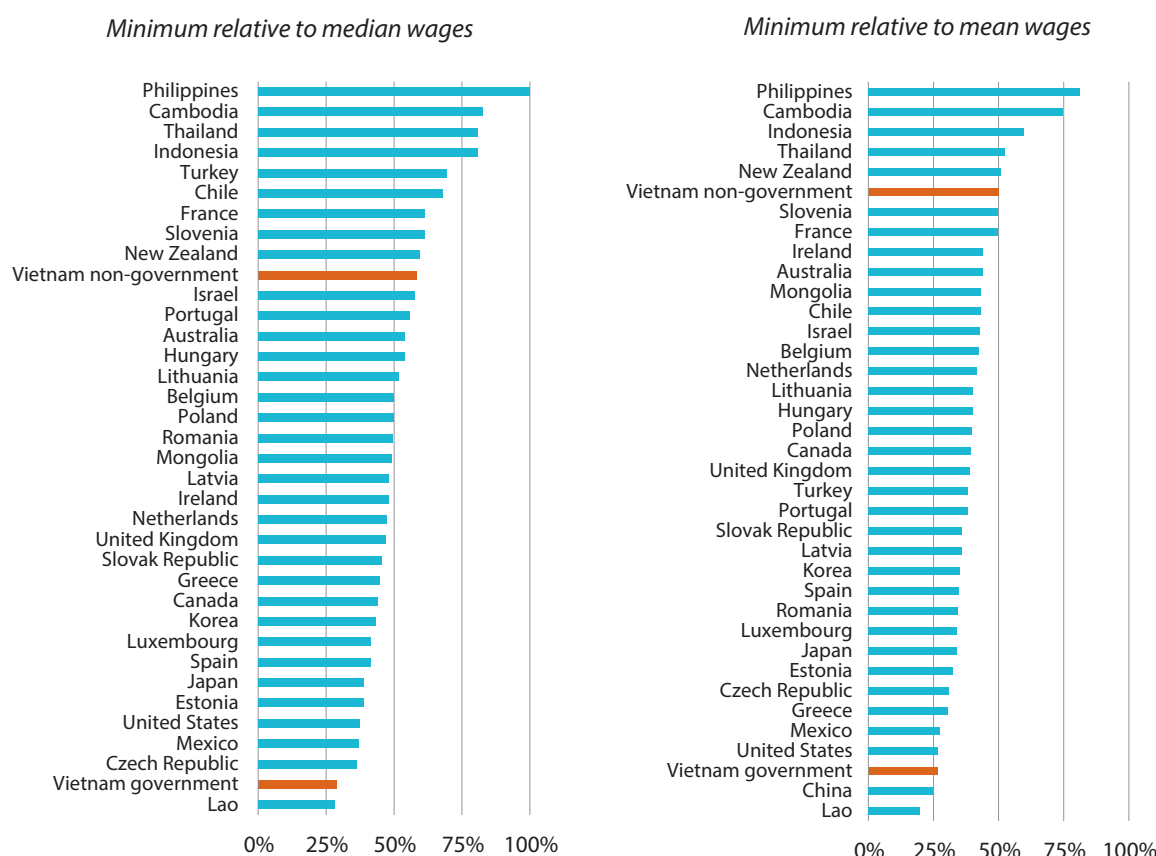
⁹ Institute for Workers and Trade Unions (2014) study set this level.

Figure 13: Real Minimum Wages Have Risen Much Faster than Productivity

Source: Calculations based on MOLISA, VGCT, GSO, World Bank WDI and IMF WEO data.

Note: Depicted are non-government sector minimum wages. Points indicated by "*" are projections.

15. By simple measures—the ratios of the minimum to mean and median wages--Vietnam's private sector minimum wage is somewhat high relative to other countries. A key benchmark of minimum wages is the relationship to median wages, and for Vietnam the picture differs sharply between the government and private sectors. Figure 3 depicts the ratios of minimum to average and median wages in Vietnam and selected countries in the OECD and EAP. The private sector minimum wage and the government sector reference wage are shown separately. Vietnam's reference wage is low by global and regional standards at around the 30 percent of the median wage, while the private sector minimum wage is high, with the average ratio of minimum to median wage around 58 percent.

Figure 14: Are minimum wages too high?***Minimum Wages Relative to Median and Mean Wages***

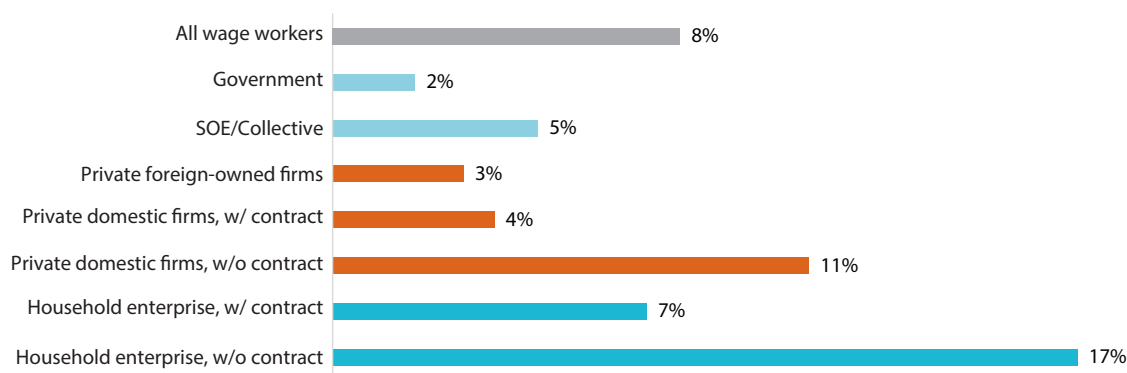
Source: OECD (2014); World Bank (2014a); Bank staff calculations based on 2013 LFS.

Notes: Full time workers; data for 2013 (2008 for Laos; 2009 for Cambodia, Mongolia and Thailand; 2010 for China, Indonesia and Philippines); average MWs for China and Vietnam. Non-government sector includes SOEs, domestic and foreign-owned private firms.

16. Studies that have examined the effects of recent changes in the minimum wage in Vietnam suggest that past minimum wage increases may have slightly depressed formal employment growth. One study using 2006-2010 data found that minimum wage changes over that period were associated with slower private sector employment growth in the domestic private sector (Del Carpio, Nguyen, Nguyen and Wang, 2012). Another found that increases in the minimum wage over 2001-2012 increased average wages and moderately lowered firm employment in both private firms and state-owned enterprises (Hansen, Rand, and Torm 2015a). A third study, of the sharp increases in the minimum wage 2011-13, found that the changes substantially boosted wages at the low end of the distribution, but only in state enterprises and foreign-invested private firms, suggesting that the minimum wage is not fully enforced in the domestic private sector (Hansen, Rand, and Torm 2015b).

Figure 15: Below Minimum

Percentage of Full-Time Wage Employees Paid Less Than the Minimum Wage, by Type of Employer and Whether Employee Has Employment Contract



Source: Analysis of 2014 Labor Force Survey.

Note: Figures shown are for employees in their primary job, working at least 35 hours per week. Minimum wages are determined by district of employment. For purposes of this analysis, the applicable minimum wage for each individual was approximated based on province of residence in the LFS.

17. The minimum wage is imperfectly enforced, particularly for workers without contracts.

Overall, 8 percent of full-time workers are paid less than the minimum wage (see Figure 5). In government, SOEs, and private foreign-owned firms, almost all workers have employment contracts, and very few are paid less than the minimum wage. In private domestic firms, 11 percent of those without contract are paid less than the minimum wage. The number receiving less than the minimum wage is highest among those working for household enterprises without contracts (17 percent.) A 2012 audit across manufacturing firms found that 20 percent of firms falsified their records, and 33 percent had violations related to wages and benefits. Manufacturing firms that violate labor regulations (typically export-oriented firms) report fewer hours in order to appear to stay compliant with international labor standards regarding hours and to boost their reported productivity rates (Level Works, 2012). A report of garment firms participating in the Better Work Vietnam program found that 7 percent did not pay at least the minimum wage for ordinary hours of work (International Labour Organization 2014).

b. Employment Protection Legislation

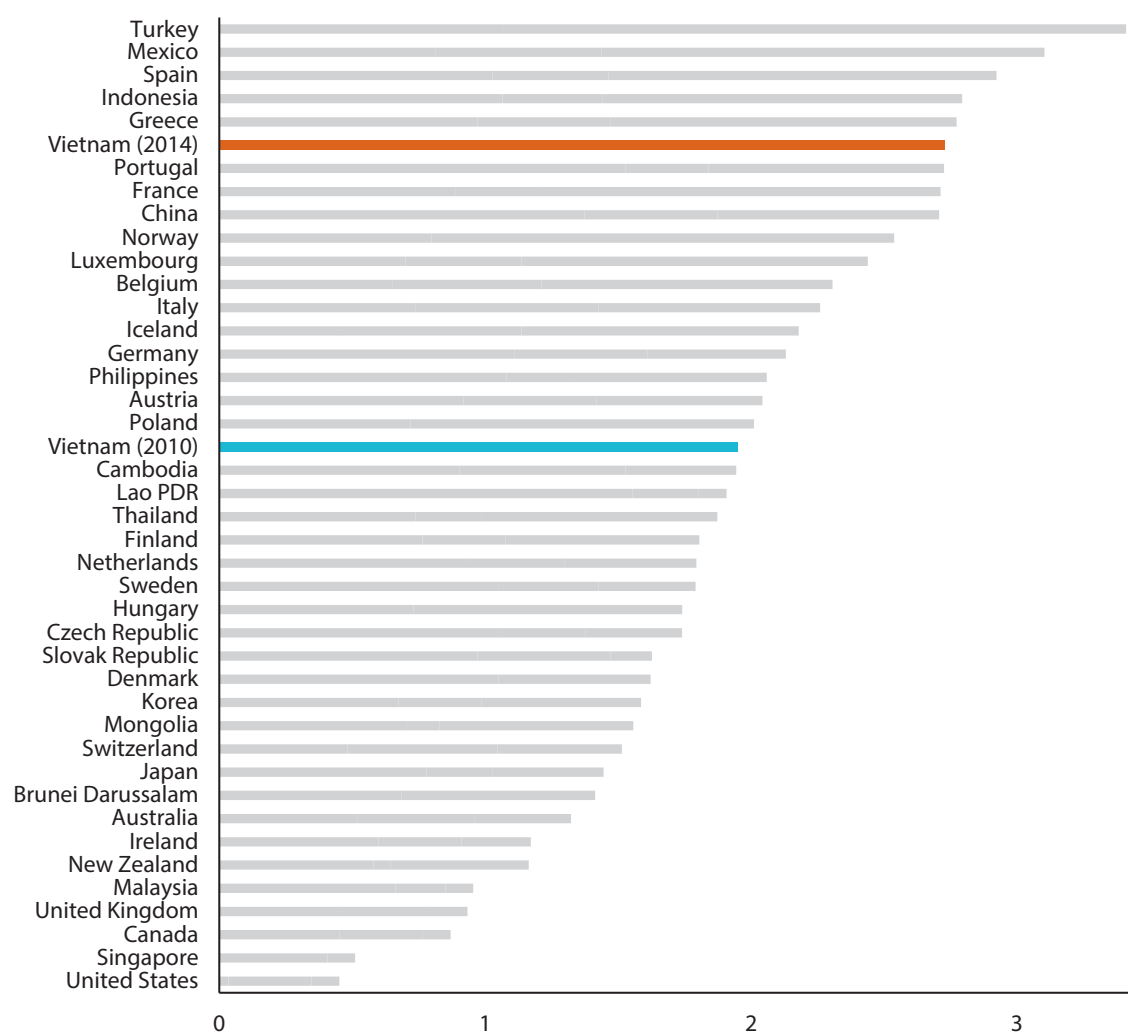
18. Employment protection legislation (EPL) establishes terms for dismissal of workers by employers. The intent of EPL is to provide some level of job security to those who are currently employed. Because overly restrictive EPL makes it more difficult to dismiss unproductive employees and to reduce employment during times of reduced demand, it may discourage firms from hiring workers in the first place, reducing both the overall level of formal sector employment and productivity.

19. The OECD calculates an EPL index that compares some of the most critical EPL components and the costs they impart on employers. The index is determined by three components: 1) protections of permanent workers against individual dismissal, 2) additional

requirements for collective dismissal, and 3) regulations and restrictions on temporary forms of employment. The value of the index ranges from zero to six, with zero being the least restrictive and six the most restrictive legislation. Figure 6 shows values of the EPL index for countries in the OECD and East Asia and the Pacific, including Vietnam's values in both 2010 and 2014.

20. Changes to the Vietnam Labor Code in 2012 have made Vietnam's employment protection legislation highly restrictive by global standards. In 2010, Vietnam's level of EPL was relatively moderate by comparison to OECD and other EAP countries. With the passage of the new Labor Code and Trade Union Law in 2012, rules on hiring and dismissals became more stringent in all three areas covered by the EPL index and, pushing Vietnam to a level of restrictiveness above that of France and Portugal.

Figure 16: Employment protection has become stricter
Index of Strictness of Employment Protection Legislation by Country



Source: Bank staff calculations based on World Bank (2014a) and OECD data for 2010; higher scores = stricter EPL.

21. The most dramatic changes in 2012 were with respect to fixed term contract regulations. The index became more stringent as a consequence of new regulations regarding outsourcing contracts and labor leasing enterprises. Under the new regulation, labor leasing enterprises have more restrictions, and outsourcing contracts are limited to a maximum cumulative duration of 12 months. These reforms moved Vietnam from being a country with moderately stringent restrictions on temporary forms of employment to one that is very restrictive.

22. Evidence from other countries shows that restrictive EPL is often associated with lower formal sector employment, especially of young workers, women, new entrants to the labor market, and unskilled workers (OECD 2004; Heckman and Pages 2004; Perry et al. 2007; Packard, Koettl, and Montenegro 2012; World Bank, 2014a). These groups tend to be among the first to be laid off when labor costs rise or to be blocked from entry altogether. Evidence suggests that more restrictive EPL raises the share of self-employment and decreases dependent employment in low- and middle-income countries (Betcherman, Luinstra, and Ogawa, 2001; Haltiwanger, Scarpetta, and Vodopivec, 2003).

23. An important complement to more flexible EPL is active and passive labor market interventions, but both remain under-developed in Vietnam currently. Protecting workers in flexible labor markets requires both “active” labor market programs like training and job search assistance, and “passive” benefits such as severance pay and unemployment insurance. Together with Thailand and China, Vietnam is one of only three developing countries in the EAP with a national unemployment insurance scheme, but coverage remains modest. Vietnam’s scheme was introduced in 2009, and is summarized in Table 2 in comparison with Thailand and China. Unemployment benefits in Vietnam are relatively generous. At 60 percent of average monthly earnings in the six months before unemployment, the replacement rate (the portion of income replaced by benefits) is higher than those of Thailand or China, and relatively high by global standards for middle income countries.

Table 7: Unemployment Insurance in Vietnam, China and Thailand

COUNTRY	AVERAGE UNEMPLOYMENT	UI BENEFIT DURATION (MONTHS)	QUALIFYING CONDITIONS
THAILAND	50 percent of average daily wage in highest paid 3 months during the 9 months before unemployment; the maximum daily benefit is 250 Bath	6 months in any 1 year	6-month contribution within 15 months before unemployment
CHINA	Flat benefit level set by local authorities; higher than local public assistance benefit, but lower than local minimum wage	12–24 months, depending on applicant's years of contribution	Maximum of 1 year with less than 5 years of contributions; maximum of 1.5 years with 5 or more but less than 10 years of contributions; maximum of 2 years with 10+ years of contributions
VIETNAM	60 percent of average monthly earnings in the 6 months before unemployment	3–12 months, varying by contribution	3 months with 12–35 months of contributions; 6 months with 36–71 months of contributions; 9 months with 72–143 months of contributions; 12 months with 144 months+ contributions.

Source: World Bank (2014a).

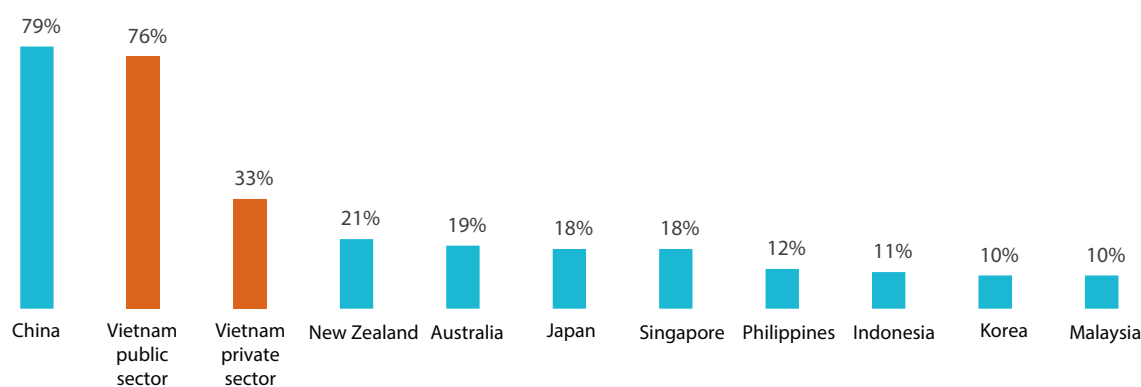
Industrial Relations

24. **Vietnam's industrial relations system exhibits the legacy of a planned economy and faces growing challenges to adapt to its central function in a market economy.** A central shortcoming is the lack of clear demarcation of the functions of unions, employers, and the state in the system, which limits the force of industrial relations as an economic and social mediator in Vietnam's economy, placing undue pressure on regulatory measures in the labor market.

25. **Vietnam has a relatively high unionization rate relative to countries in EAP, though there is a large gap between union membership in the public and private sectors.** Figure 7 shows union density rates among wage workers for Vietnam and a selection of EAP countries. For Vietnam, the figure further distinguishes between the public and the private sector. At 76 percent of wage employment, Vietnam's unionization rate in the public sector is almost on par with China's overall rate of 79 percent. Vietnam's unionization rate in the private sector is substantially lower at 33 percent. Despite this gap, even in the private sector the unionization rate in Vietnam is significantly higher than rates in most EAP countries.

Figure 17: Union membership is relatively high

Union Membership Rate (as Percent of Wage Employment) by Country



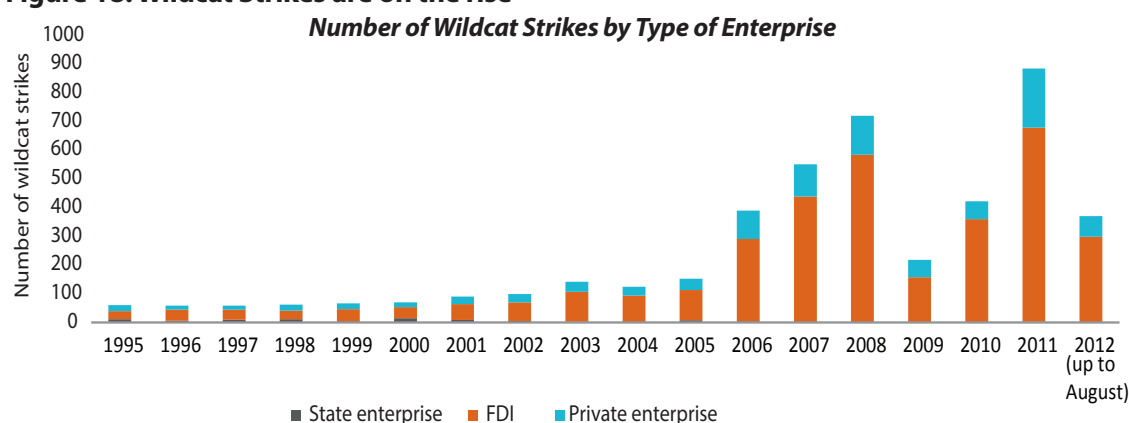
Sources: Bank staff calculations based on 2013 LFS, VGCL (2014) and World Bank (2012a).

Notes: Data for Indonesia and Philippines are for 2005, those for Vietnam for 2013, all others for 2010. Public sector includes government, public services and SOEs; private sector includes household enterprises, domestic and foreign-owned private firms.

26. **Many observers have highlighted profound weaknesses in Vietnam's industrial relations system (e.g. Clarke, Lee and Chi, 2007; Chi and van den Broek, 2013; Schweissheim, 2014).** In Vietnam all trade unions fall under the umbrella of the VGCL, which operates under the leadership of the Communist Party of Vietnam (CPV). The VGCL and its affiliated unions are tasked to fulfill a number of different roles which are not well aligned and result in conflicts of interest. First, enterprise-level unions have traditionally been close to management. Even in the foreign-owned sector, senior executives and managers are often union members and hold top union positions (Van Gramberg, Teicher and Nguyen, 2013). Second, unions act as "a transmission belt" between the CPV and working people and are supposed to represent these people in government decision making. Third, unions are tasked with representing workers' interests vis-à-vis firm management and providing welfare services to workers. This last function is at times subsidiary to other duties of union representatives. The roles for employers' associations are similarly complex.

27. **A symptom of the weaknesses in Vietnam's system of industrial relations is the country's high number of "wildcat" strikes.** While Vietnam's Labor Code explicitly regulates strikes, official procedures are so cumbersome and the role of trade unions is so unclear that apparently no strike has ever taken place that was strictly in accordance with the Labor Code. Instead, strikes have been "wildcat" strikes that have involved spontaneous work stoppages by employees and bypassed official procedures (Schweissheim, 2014). Wildcat strikes have increased notably since the mid-2000s in Vietnam, though with considerable volatility from year to year and with the bulk of strikes in the FDI sector (Figure 8). The number of strikes has increased significantly in the 2000s, reaching a peak of over 900 in 2011, though almost no strikes occurred in SOEs (ILO, 2011). The increase in strikes is indicative of the under-developed nature of other mechanisms to resolve labor disputes. For example, the capacity of mediators and arbitrators appears particularly weak. Many of them work part-time, are overburdened with multiple and sometimes conflicting tasks or have insufficient training in collective bargaining and dispute resolution.

Figure 18: Wildcat Strikes are on the rise



Source: VGCL (2012) and World Development Indicators.

28. **The 2012 legislative reforms attempted to address long-recognized problems with Vietnam's industrial relations system.** First, formal procedures for settling industrial relations disputes were introduced. Second, the government was given a more active role in facilitating collective bargaining. Third, a National Wage Council was created as a tripartite institution involved in setting of minimum wages. Despite these measures, more fundamental issues with regard to the basic roles of trade unions and employers' associations have not been resolved. As a result, there continues to be a lack of well-functioning institutions for collective bargaining and dispute resolution.

29. **Vietnam's Labor Code appears to bear the weight of weak industrial relations institutions.** Minimum wages adjustments and more stringent EPL have been used to address insufficient power of workers to negotiate adequate wages and assure decent conditions of work. This has resulted in a "one size fits all" set of regulatory parameters that fail to respond to the varying interests and demands of workers and employers and are not necessarily adequate across all sectors or geographies or types of work. Some of the symptoms caused by the dysfunction of the industrial relations system have been treated, but real cure will only be possible if the underlying causes are addressed.

Policy Considerations

30. **Many policies can influence job creation.** The 2013 World Development Report on Jobs identified three broad areas of policy relevant to employment, which it labels fundamentals, labor policies, and priorities. “Fundamentals” include macroeconomic stability, an enabling business environment, human capital accumulation, and the rule of law. “Labor policies” include those regarding regulations and industrial relations. “Priorities” refers to initiatives to promote particular types of job creation. As noted at the beginning of this Special Focus, fundamentals are the most important determinants of job creation, with priorities and labor policies like those discussed here playing supporting roles.

31. **Nonetheless, whether Vietnam can realize the further transformation of its labor market will in part depend on the labor market policies that it pursues.** More specifically, it will depend on whether the country uses the current window of opportunity to address weaknesses that are already apparent before they transition from farms to factories and firms. One concept which characterizes the policy goals which Vietnam might aim for in its labor market policies is “flexicurity”. This involves striking a balance between flexible labor regulation which maximizes productivity growth and “creative destruction”, and the needs of workers for decent employment which is fairly compensated. Put another way, Vietnam should aim to “protect workers rather than jobs” as it deepens its structural transformation. The following paragraphs discuss the policy directions which could help to achieve such a balance in LM policies.

32. **The minimum wage will be most effective if it is determined primarily with reference to productivity and competitiveness factors.** To date, Vietnam has taken a “living wage” approach to minimum wage setting, with a primary focus on cost of living. As Vietnam matures as a market economy, shifting to a “wage floor” approach which puts a primary emphasis on productivity and competitiveness as the drivers of minimum wage adjustments should be considered. Factors such as price growth and relative earnings could remain factors but productivity would become a more crucial factor in minimum wage determination. Other policy instruments are more effective – possibly in combination with the minimum wage – for assuring that people who work are able to live above the poverty line. To achieve this shift in approach, in the short run, Vietnam’s private sector would benefit from moderating the rate of minimum wage adjustments. In the medium term, existing plans to anchor minimum wage adjustments to real productivity growth should be put into place. Examples of factors that are taken into account in setting minimum wages in other countries are provided in Table 2, and indicate the potential factors for Vietnam to incorporate in a minimum wage setting mechanism aligned with the practice of upper middle and high income economies.

Table 8: Criteria in Setting Minimum Wages in Various Countries

Economy	Minimum Wage approach	Key criteria in setting MWs
Australia	Wage floor	Productivity, business competitiveness, relative standards of living, workforce participation rate
Korea, Rep. of	Wage floor	Cost of living, economic growth rate, average wage level, labour productivity, unemployment rate, consumer price index, and income distribution. No fixed weight for factors and relevance of each determined within wage council debate and varies in time.
Taiwan, China	Wage floor	Conditions of national economic development, price index, national income and average individual income, labour productivity of different industries and employment situation, workers' wages in different industries, survey and statistical figures on household income and expenditures.
United States	Wage floor	Manufacturing productivity, affordability to employers, cost of living, wage levels.
United Kingdom	Wage floor	Pay differentials, inflation, business costs, competitiveness, employment, economic conditions.
France	Living wage	Overall wages and income CPI economic conditions, needs of workers and families.
Hong Kong SAR, China	Wage floor	General economic conditions, latest economic performance and forecasts, labour market conditions, labour demand, and supply, wage level and distribution, wage differentials and employment characteristics, competitiveness, productivity growth, labour costs, operating characteristics of enterprises, entrepreneurship, business sentiment and solvency, and relative economic freedom and competitiveness, standards of living, changes in employment and earnings and inflation

Source: Hong Kong SAR. China. Provisional Minimum Wage Commission.

33. Vietnam could also benefit from streamlining existing EPL regulations to promote greater flexibility in its labor market. First, Vietnam would benefit from loosening regulation of labor leasing enterprises and temporary and outsourcing contracts. Such reforms are likely to help foster mobility and efficient allocation of workers and make the regulated part of the labor market more attractive for firms and workers. In addition, Vietnam could look more closely at the interaction between employer-provided severance and unemployment insurance. Generally speaking, unemployment insurance schemes are more efficient than severance pay arrangements in pooling risks related to job loss. The potential substitutability of severance and unemployment insurance is apparently already recognized in Vietnam's Labor Code.

34. **To ensure that increased flexibility in the regulated labor market is accompanied by adequate security for workers, Vietnam should gradually expand coverage of unemployment insurance and active labor market programs.** Well-designed and implemented UI and ALMP such as public employment services can play a useful role in enhancing labor market efficiency and worker welfare (World Bank, 2012b).

35. **Improving Vietnam's industrial relations system will be key to addressing a number of fundamental challenges in the labor market.** In the short term, Vietnam should continue to strengthen efforts to increase the capacity of unions and employers' federations through awareness campaigns, training in collective bargaining, etc. In recent years, the VGCL has begun attempts to form enterprise unions independent from management, to increase the capacity of such grassroots unions, and to assure that unions actually represent workers' interests. These efforts should be supported and strengthened.

36. **In the medium term, Vietnam needs to consider more proactive measures to strengthen its industrial relations system and promote harmony in the labor market.** First, the VGCL and its affiliated unions could bar company executives and managers from key union positions (like being head of an enterprise union). This would follow the example of other countries – for instance Singapore – where company managers cannot hold principal union positions or sometimes even union membership. Second, Vietnam should continue to simplify regulations for resolving industrial relations disputes. Third, institutional reforms that allow the creation of firm-level works councils or labor-management councils as found in many European countries and South Korea could also be considered. Labor-management councils that bring together employer and employee representatives might help facilitate information sharing, promote employees' participation in decision-making processes, and build trust between employers and employees. Fourth, it will be beneficial to be more proactive in developing labor mediation and arbitration systems which provide channels beyond the court system for resolution of labor disputes when workplace institutions are unable to resolve matters amicably.

37. **In the long term, Vietnam needs to consider fundamental institutional reforms that could create an industrial relations system suited to the needs of a mature market economy.** One goal should be development of collective bargaining where the interests of workers, employer and the state are more properly represented in a true bargaining process. This is a process which China for example has accelerated in recent years, starting from an institutional set-up not dissimilar to Vietnam. In the long run, unions would become independent of government and the CPV and concentrate solely on representing the interests of workers. The example of Singapore is one where a single national federation of trades unions has over recent decades focused strongly on its worker presentation role independent of government, but in a non-adversarial manner which has resulted in almost no strikes or lock-outs (Box 1).

Box 1: Industrial Relations Systems in China and Singapore

During the last two decades China has experienced an increasing number of labor disputes. This led to a revised industrial relations strategy which sees trade unions as a key pillar of social management that should be able to function as a “protector” of workers and not just as a subordinate partner of the government. The institutionalization of industrial relations practices such as collective bargaining and tripartite consultation has also gained renewed importance.

Under the revised strategy, China has many initiatives by the government and social partners – the All China Federation of Trade Unions (ACFTU) and the China Enterprise Confederation (CEC) – with a view to improving the legal framework for industrial relations and to building new institutions of industrial relations such as tripartite consultation mechanisms and collective bargaining at various levels. In 2015, the Central Committee of the CPC and the State Council issued a policy document on building harmonious industrial relations with the objective of strengthening management of industrial relations, easing labor unrest by securing labor rights, implementing labor contracts and collective bargaining, and strengthening labor inspections.

As a result, China today has one of the highest trade union densities in the world, and collective bargaining coverage has also expanded at an unusually rapid pace. Nevertheless, the incidence of strikes continues to rise. Some observers argue that this is because of deficiencies in the collective bargaining system in terms of the quality of the agreements and the bargaining process itself. Trades unions are often still seen as ineffective, with enterprise-level trade unions often led by either a senior Party official or by a manager of the enterprise. Finally, some see China’s legal framework for industrial relations as problematic, as it recognizes neither the freedom of association nor the right to strike. In the absence of those rights, the government needs to intervene frequently to achieve its social policy goals.

In the 1950s and 1960s, Singapore also experienced a period of labor turmoil. But over the last five decades the incidence of strikes has declined practically to zero. Observers have acknowledged the critical role of Singapore’s industrial relations system in this process. The country’s main industrial relations actors are the Ministry of Manpower (MOM), the Singapore National Employers Federation (SNEF) as the main employers association and the Singapore National Trades Union Congress (SNTUC) as the only national federation of trade unions. Affiliation to NTUC is voluntary but the vast majority of unions are affiliated.

The work of the NTUC and the Singaporean labor movement focuses on three elements: First, workplace representation and protection of workers including collective bargaining and grievance handling. Second, improvements to workers’ quality of life through provision of a range of services such as access to recreational facilities. And third, political advocacy on behalf of workers. The NTUC’s leadership of the labor movement has been marked by pragmatism. For example, in 1969 it agreed to abandon an adversarial approach to industrial relations so as to make Singapore attractive for foreign investors. Since 1981 the NTUC has pushed for skills upgrading and productivity improvements, and has even supported wage freezes and wage cuts during periods of recession.

In terms of Singapore’s practices of industrial relations and collective bargaining, private sector collective bargaining usually takes place at the enterprise level. Generally speaking, collective bargaining covers two broad categories: matters related to salary and to other conditions of employment. Unions tend to conduct collective bargaining in a coordinated manner to achieve uniform results across different enterprises and categories of workers. Singapore’s Industrial Relations Act forbids “rank and file” unions from engaging in collective bargaining on behalf of executive and managerial staff.

Sources: Lee (2006), Lee (2009), Neo and Thiagarajan (2009) and People’s Daily (2015).

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