

Viet Nam

Priority Area Strategy Paper

“Sustainable Economic Development”

(June 12, 2008)

1. Summary

Viet Nam has made remarkable progress towards reaching the Millennium Development Goals (MDGs) and is perceived as a good example for Pro-poor growth (PPG). Taking into account the shared goals of poverty reduction and sustainable economic development, the Federal Ministry for Economic Cooperation and Development (BMZ) is ready to support Viet Nam in implementing its Socio-Economic Development Plan (SEDP) 2006-2010 in two areas of German Development Cooperation's (GDC) core competency: economic and social policy, and vocational training. It thus contributes to the social and environmental soundness of the broad-based growth process, which is increasingly being propelled by the entrepreneurial spirit of a vibrant private sector. In the area of economic and social policy, the focus is on building the capacity of institutions at the central and regional levels that are needed for the effective operation of central aspects of a social and ecological market economy. In the area of vocational training, cooperation focuses on providing an appropriate environment for a vocational training system that corresponds to the needs of the business sector, and on setting up model training institutions. Our cooperation in these areas also serves Germany's interest in long-term cooperation with an important partner country which is expected to move beyond primarily development-related forms of cooperation over the next ten to fifteen years.

2. General situation and national sector strategy

2.1 General situation in the priority area

Since the beginning of the reform policy ("doi moi") in the late 1980s, Viet Nam has made great progress and has become one of the most successful developing countries. The economic growth rate has averaged about 8 per cent in the recent decade thus facilitating a self-sustaining, pro-poor growth process which will allow Viet Nam to leave the status of low-income country behind by about 2010 and become a middle-income country.

Not least thanks to the high level of economic growth and Viet Nam's comparatively successful policies for inclusive growth, especially in the areas of rural development, education and health, the country has already achieved some of the Millennium Development Goals (MDGs) and is on track to achieve several others.¹ So poverty reduction is increasingly becoming a matter for specific areas: the development of geographically disadvantaged regions and the inclusion of ethnic minorities in the growth process.

¹ Viet Nam's progress is particularly remarkable as regards MDG 1. The country has succeeded in more than halving the proportion of people in absolute poverty, from 54% (1994) to 15% (2007). However, there is still great need for action as regards MDG 7, "Ensure environmental sustainability." In this area, German development cooperation is making its contribution through the support provided in the area of environmental protection (cf. relevant Priority Area Strategy Paper).

One milestone in Viet Nam's reform policy was its accession to the WTO in January 2007, which, on the one hand, further improved the basis for the country's integration into the global economy but, on the other, considerably toughened the competition faced by some industries. The continued economic integration will lead to increased structural change in sectors that had previously been protected from competition (e.g., services) and will require further structural reforms in a variety of areas that are relevant for Viet Nam's competitiveness and social cohesion. The Government of Viet Nam and the donor community share the view that for tapping further growth potential it is necessary to:

- further improve the regulatory and administrative environment for the dynamic private sector,
- adapt public administration at the central and regional levels to the needs of a modern market economy, with systematic attention being given to social and ecological aspects,
- reform and enhance the education system, especially vocational education,
- adjust the social security system to the changing social, economic and demographic environment,
- accelerate implementation of the activities that have been launched to modernize the legal system,
- properly address the challenges of increasing urban-rural disparities, and
- improve women's opportunities for equal participation in political, economic, social and cultural life (implementation of the 2007 Gender Equality Law).

2.2 Main challenges and potential

Challenges

- There continues to be a great need for reform in the area of regulatory policy (market-economy institutions and economic policy instruments; horizontal and vertical policy coordination; reform and equitization of state-owned enterprises; public financial management; capital market regulation) and with regard to the creation and institutional design of a reliable legal environment, including commercial law
- Competitive gaps in the business sector (in particular, weaknesses regarding the absorption of new technologies, production processes, and compliance with international social and environmental standards)
- Limited financial sector capacity (insufficient financing for public and private investment; financial system stability threatened by nonperforming loans and underdeveloped capital market)
- Modernization of social security institutions and instruments (e.g., for cushioning the impact of reform-related structural change)

Potential

- Viet Nam's location in a dynamic economic region.
- Government's and CPV's commitment to continuing the reform policy
- The vibrant private sector
- Great motivation of the Vietnamese people to learn (which is a good basis for the sustainability of training and further efforts in capacity development/capacity building)

2.3 Cooperation country's sector strategy and goals

The relevant strategic framework for the priority area of Sustainable Economic Development is Viet Nam's Socio-Economic Development Plan (SEDP) 2006-2010, which addresses the four pillars of Viet Nam's reform policy: (1) business development, (2) social inclusion, (3) natural resources, and (4) modern governance.

The SEDP's overall objective is the attainment of middle-income status by 2010 based on continued GNP growth of about 8 per cent. The following targets are relevant for the priority area:

- Further development of “the institutional framework of the socialist-oriented market economy”: definition of property rights, competition policy, development and regulation of markets, increased regional decentralization ("expand powers and responsibilities of local authorities"), new Planning Law ("establish a legal and institutional framework for clear assignment and decentralization")
- Enhanced competitiveness, especially in the industrial sector. In this area, the Plan recognizes the role of the private sector as the driving force. It is assumed that up to 320,000 new enterprises will be established by 2010. Private small and medium-sized enterprises (SMEs) are to develop to become competitive
- Development of the legal and institutional environment for the banking system and the capital market (for example the bond market), especially with a view to a further international opening of the financial sector
- Upgrading of the vocational education system. The SEDP contains quantified goals for this area: "Trained labor rate reaches 40% of the total social labor. Vocational training is offered to 7.5 million people, in which 25-30% receive long-term training"¹
- Modernization of the social security system. "Complete social insurance policies with a view to expanding social insurance coverage to all people, including those working in non-official economic sectors"

The donor community has embraced the SEDP as a basis for planning bilateral and multilateral development cooperation. It is being implemented within the framework of sectoral and multi-sector plans of action. This implies that the SEDP also serves as binding guidance for Germany's development activities in the priority area of Sustainable Economic Development

3. Donor activities

In 2007, official development assistance (ODA) commitments for Viet Nam amounted to almost US\$ 5.4 billion, which makes Viet Nam one of the countries with the highest levels of ODA in absolute terms. However, in view of the fact that the level of disbursements was substantially lower (about US\$ 2 billion, which translates into an ODA level of about US\$25 per capita), it is more appropriate to say that Viet Nam is somewhere in the middle.

It must be expected that once Viet Nam attains the status of a middle-income country, ODA will decline not only in relative but also in absolute terms. Multilateral assistance on IDA terms, which are particularly favorable, will then be reduced, and a variety of donors have already announced

¹ In parallel with the SEDP, a comprehensive education reform was launched (2005 education law, 2006 vocational training law) which provides a sound basis for defining the government's policymaking and regulatory role in the area of human resource development and vocational training on a mutually complementary basis with the activities of the business sector.

that they will withdraw from Viet Nam in the medium term to focus on other countries that are less developed (LDCs).

The most important donors are the World Bank, ADB, and Japan, whose contributions (based on disbursements in the past few years) together account for more than two thirds of all aid to Viet Nam. Through its lead role in the area of policy-based lending and through the conditions attached to the PRSCs, the World Bank has some influence on Viet Nam's socio-economic development strategy as well as on the debate about the suitable poverty reduction strategy.¹

Another prominent donor is the European Union (Commission and Member States).² The Commissions current strategic orientation in development cooperation is mapped out in the “Vietnam – European Community Strategy Paper for the Period 2007 to 2013” and serves also as an important reference for German Development Cooperation.³

Viet Nam is considered a pioneer when it comes to implementing the Paris Declaration. Impressive evidence of this was provided when the Hanoi Core Statement (HCS) was adopted in 2005, in which Viet Nam committed itself to systematically implementing the principles of aid effectiveness. However, in view of the large number of development players active in Viet Nam and their (in some cases) highly diversified portfolios, effective donor coordination continues to be a great challenge for the government.⁴

Broader issues regarding donor coordination are discussed primarily in the Partnership Group on Aid Effectiveness (PGAE), which includes almost all donors.⁵ In addition, there are numerous coordination fora, most of which are sector-based. Their level of effectiveness varies.

Of the great number of coordination groups some are of particular importance for GDC's program/project portfolio in the priority area of Sustainable Economic Development:

- In the field of *economic and social policy*/implementation of the poverty reduction strategy, the PRSC/budget support group has become a central forum for donor harmonization. It now comprises as many as 19 donors (including Germany). The group and the Vietnamese side agree annual policy actions within the framework of strategy implementation.
- In the area of *private sector and SME development*, the donor community works together in the SME Partnership Group, which has several working groups, and is also working together on an ADB policy loan, to which AFD and Germany through KfW have contributed.
- In the field of *vocational training*, major donors apart from Germany are ADB, Canada, the EU, Japan, France, and Korea. In the past, the Vietnamese side's policies had been somewhat unclear. Now the 2006 vocational training law and the strategy on vocational training for the

¹ However, the high level of ownership regarding the reform processes that have been launched, the party's claim to power, and the consensus philosophy that prevails in Viet Nam's society and also in political life mean that donor influence is *de facto* limited. Internationally recommended reforms do not necessarily translate into immediate action of the Vietnamese government. This is true, in particular, when it comes to fundamental strategic policy decisions and politically sensitive policy areas.

² The EU's annual ODA pledges account (in average) for 20 % of all donor commitments.

³ The linkages between the EC strategy and the medium-term orientation of German Development Cooperation in Viet Nam will be elaborated in the upcoming revision BMZ's Country Strategy Paper Viet Nam.

⁴ The efforts for enhanced division of labor have been reinforced through the related EU Code of Conduct, which was adopted during Germany's EU Presidency in May 2007. The Code envisages each EU donor concentrating on a maximum of three areas of support and no more than three EU donors being active in any single sector.

⁵ In addition, the "6-Banks Initiative" (comprising the World Bank, ADB, JBIC, AFD, KfW, and newly KOICA), which was set up in 2003, has been a driving force for the harmonization of procedures. Based on dialogue with the Vietnamese government, procedures have successfully been harmonized at the operational level for the areas of procurement, project reporting, project preparation, and environmental and social standards.

period up to 2010 provide a good basis for working toward improved donor coordination, even though there is some overlap of competencies, in particular between the Ministry of Labor, Invalids and Social Affairs (MOLISA) and the Ministry of Education and Training (MOET).

- In the area of *public financial management*, there is a Partnership Group led by the Ministry of Finance which follows up on the recommendations of the Public Expenditure Review (PER). Implementation of these recommendations is very important for the donors that provide budget support via the PRSC group (Germany is one of them). On the basis of the PER, the Ministry of Finance has produced what is called a “single document”. That document is to serve as a basis for all donor contributions. In the field of *external auditing*, coordination is in the hands of the State Audit of Viet Nam (SAV). The only donors involved in providing broad support to build the capacity of SAV are the EU and Germany; other donors have worked with SAV in individual instances or voiced interest in providing long-term support.
- In the area of *financial system reform* (excluding the capital market), there is a Partnership Group that is led jointly by the World Bank and the State Bank of Viet Nam. This group discusses new donor contributions and support requirements. The main donors are the World Bank, CIDA, USAID, IFC, and Japan. The IMF is also providing some advice on monetary policy.

Represented by so-called Priority Area Coordinators in the sub-sectors of economic policy and of vocational training GDC will actively participate in these fora with the aim of increasing efforts in alignment, harmonisation and the effective division of labour among donors.

4. German contribution

4.1 Areas of intervention and goals of German activities

Germany's contributions in the priority area of Sustainable Economic Development are directly based on the SEDP and focus on assisting Viet Nam in attaining the goals laid down in that document. German development activities support the government's efforts to make Viet Nam a competitive economy in the region and in the global economy. As German development cooperation is based on a set of specific values, Germany's activities give great attention to closely linking the economic, social and ecological dimensions of development. These goals are also in line with Germany's bilateral political and economic interests. They will provide a sound long-term basis for German-Vietnamese cooperation as the country gradually moves beyond primarily development-related forms of cooperation over the next ten to fifteen years. It is intended to tap the great interest of German businesses in Viet Nam to further increase the number of public-private partnership (PPP) projects, especially in the existing priority areas of cooperation.¹

Based on the commitments made by both sides (Paris Declaration on Aid Effectiveness, Hanoi Core Statement), the two sides agreed to concentrate their cooperation in the priority area of Sustainable Economic Development on two areas of core competency:

1. Economic policy
2. Vocational training

Joint efforts in the area of **economic policy** concentrate on strengthening the government's core functions in the course of further economic and social policy reforms (timeframe: up to five years):

¹ This goal does not only relate to the priority area of Sustainable Economic Development but also to the other agreed cooperation areas, that is, environment (especially sanitation and waste management) and health. Thought is currently being given to whether such cooperation should be based on a closer institutional link with German Industry and Commerce Viet Nam (GIC), for instance by deploying a CIM expert.

- focus on the government's policymaking and regulatory role based on the vision of a competition-oriented social and ecological market economy; this will also include conceptual assistance in regional development issues with a view to support the decentralization process that has been launched
- focus on institutional development (including the legal environment for institutions) with the participation of relevant German institutions;
- special attention on the implementation of policy reforms in the practical work of the various institutions.

The **goal** is to improve the capacity of selected institutions with regard to market-oriented and social policymaking and regulation.

Indicators:

- Appropriate implementation of the triggers that have been agreed for the new PRSC cycle (especially pillar I – business development, pillar II – social inclusion, and pillar IV – modern governance)
- Analytical work by international organizations (e.g., World Bank review documents, minutes of Article IV consultations with the IMF, WTO trade policy reviews) suggest the Vietnamese government to have made further progress on performing core functions within the context of a market economy

Joint efforts in the area of **vocational training** focus on support for a vocational training system that corresponds to needs of the productive sector and which facilitates further improvements in the competitiveness of the Vietnamese business sector (timeframe: up to ten years):

- focus on creating a more differentiated regulatory framework (standardization, examination system, certification, permeability of the vocational training system) and on institutional development including private and governmental training institutions;
- focus on practice-oriented training, including on modern technology;
- qualification demands of the private sector are priority;
- improved opportunities for women to access vocational training.

The **goal** is to improve the supply of labor with qualifications that meet demand.

Indicators:

- Independent surveys among enterprises confirm significant improvements that have been made in the demand- and practice-oriented training (provided by vocational training facilities that are supported by German development cooperation)
- Data on the proportion of vocational school graduates finding jobs shows a trend toward shorter average periods of job-hunting

The ongoing support for Small and Medium-sized Enterprise (SME) development will be phased out by April 2009. In view of the large number of donor initiatives in this area, and since Germany has been involved in private sector support for 15 years both sides believe that with the ending of

the current phase national and local institutions are capable to replicate the SME development models that have been tested in recent years.

The concentration of German development cooperation on the two areas of core competency mentioned – economic and social policy and vocational training – is a clear reflection of Germany's comparative advantages as a donor and thus corresponds to our commitment in implementing the Paris Declaration as well as the EU-Code of Conduct on “Complementarity and Division of Labour in Development Policy”. In the upcoming phase of Viet Nam's transition to a modern social and also ecological market economy, Germany constitutes an interesting model for Viet Nam. Germany's own history, especially its recent history, provides many examples of specific institutional answers to fundamental regulatory issues in the transition to a competition-based, social and ecological market economy. In the area of vocational training, Viet Nam is very interested in the successful cooperative relations between German enterprises and public training institutions. Viet Nam would like to replicate this approach, but in an adapted form and within the framework of WTO commitments into which it has entered. These two areas of core competency are particularly attractive for Viet Nam, not least, because it is expected that Germany as a "technology nation" will help Viet Nam develop its own knowledge-based competitive advantages.

4.2 Instruments and levels of intervention

Economic policy¹

Area of intervention 1: Reform of planning procedures and instruments

- Advice on planning law, implementation of investment law in the context of advancing decentralization and growing regional disparity; improvement of coordination at the central government level and exchange of experience between provinces
- Central level (MPI, MoF, SBV, MoHA): abandoning central investment planning and instead engaging in indirect market-oriented policymaking; analysis and forecasts, monitoring, reporting
- Assistance in designing integrated policies for regional economic development² (regional planning, infrastructure planning, business sector development, enhancement of public services) with a view to reducing disparities between regions

Instruments: Technical Cooperation and "Technical Cooperation in the broad sense"

Area of intervention 2: Reform of public financial management and auditing

- Institutional capacity-building for the Ministry of Finance (MoF) with regard to amending the state budget law and related laws and arrangements as well as with regard to the definition of a framework at the central government level for fiscal decentralization
- Support for selected provincial governments in implementing fiscal decentralization

¹ In addition to its bilateral activities in the area of economic and social policy, Germany is also involved on a broader level in the PRSC donor group, taking part in the dialogue with Viet Nam on the implementation of the poverty reduction strategy (SEDP 2006-2010). Germany is currently represented in that forum by an advisor on program-oriented joint financing and is thus able to share its expertise and policy recommendations from the priority areas of Vietnamese-German development cooperation.

² Developed concepts are eligible for field testing in those provinces where German Development Cooperation is engaged through joint FC/TC-programs.

- Institutional support for the State Audit of Viet Nam (follow-up) and with regard to auditing at the regional level

Instruments: Technical Cooperation and "Technical Cooperation in the broad sense"

Area of intervention 3: Institutional reform and regulation of the financial system

- Support for central bank structural reform, including banking supervision
- Corporate governance in the banking sector including amendment of banking law
- Support with regard to capital market development and regulation: bond market, securitization, leasing
- Institutional support for the development of the Vietnam Development Bank (VDB) through a KfW promotional loan and up to two integrated experts (CIM)

Instruments: Financial Cooperation, Technical Cooperation and "Technical Cooperation in the broad sense"

Area of intervention 4: Further development of the social protection and insurance system

- Dialogue and advice on the future design of social protection and insurance system (beyond the Social Security Law of 2006)
- Development of the regulatory, institutional and infrastructural capacity for social protection and insurance (e.g. in the areas of health and safety at work, occupational accidents, old age and survivors' benefits, unemployment), including improvement of inter-agency coordination capacity (with links to health insurance and MoH)

Instruments: Combined program – Financial Cooperation, Technical Cooperation and "Technical Cooperation in the broad sense" (subject to agreement in 2010 negotiations)

Vocational training

Area of intervention 1: Support for vocational training system reform

- Institutionalization of the demand orientation of the vocational training system at the policy level (legal framework; cooperation with the business sector; analysis and monitoring tools)
- Strategy for vocational training system financing
- Quality management including standardization, examination system and certification

Instruments: Technical Cooperation, "Technical Cooperation in the broad sense", cooperation with the Federal Ministry of Education and Research (specifically, with the Federal Institute for Vocational Training – BIBB)

Area of intervention 2: Support for model vocational schools and teacher training facilities

- Provision of materials for further/new vocational training centers and training centers for vocational school teachers
- Advisory services and training for agencies, teachers, and representatives of the local private sector
- Systematic action to tap the PPP potential in the vocational education sector

Instruments: Combined programs – Financial Cooperation, Technical Cooperation and "Technical Cooperation in the broad sense"

5. Topics for the dialogue on the priority area

- Prospects in the vocational training sector (discussion with MoLISA and MoET)¹
- Improvement of donor coordination in the vocational training sector, including M&E
- Potential German support regarding the drafting of the long-term development strategy for 2011-2020
- Utilization of the Study and Expert Funds for the emerging issues of social protection and competition policy
- Ways of accompanying the decentralization process
- Business associations and other civil society organizations as an instrument to foster entrepreneurship and market economy orientation
- Further consolidation of the program portfolio in the priority area "Sustainable Economic Development" (dialogue starting at the end of 2009)

¹ Medium term orientation (in approx. 5 years): support for vocational education at a higher level (colleges of advanced vocational studies, universities of applied sciences).