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**MOBILISING INVESTMENT FOR DEVELOPMENT:  
ROLE OF ODA**

**THE 1993-2003 EXPERIENCE IN VIETNAM**

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## **MOBILISING INVESTMENT FOR DEVELOPMENT: ROLE OF ODA THE 1993-2003 EXPERIENCE IN VIETNAM**

### **EXECUTIVE SUMMARY**

1. The Vietnamese economy was in the doldrums in the 1980s and until a certain progress had been made in the context of *Doi Moi* there was little incentive for businesses to invest. The following reasons are commonly given for the sluggish economic activity: a lack of appropriate infrastructure (causing market disconnectedness even within the country); weak links to the world market; a shortage of skilled labour and managerial capacity; and an inefficient or business unfriendly public administration. ODA to Vietnam was allocated in such a way as to remedy these obstacles and the donors' well designed strategies are seen as a major factor behind the success of ODA.

2. National ownership, an important feature of ODA programmes, has mostly been strong in ODA to Vietnam. Most of the activities of the past were closely aligned with the Vietnamese government's development priorities. It should nevertheless be recognised that some ODA projects have aroused little enthusiasm among public authorities, but this does not necessarily imply a lack of national ownership. Public administrative and institutional reform in particular tends to evoke principal-agent problem. For instance, ODA-backed efforts to audit the SOEs and achieve budget disclosure met with resistance in part of the public sector. This has been a factor contributing to slowing down a number of other programmes, including SOE privatisation.

3. Consequently, "institutional infrastructure projects" which built upon a basis of sufficient domestic buy-in and political support have performed very well, while the effectiveness of others has varied from nil to mediocre. Generally, ODA in this area has had a profound impact on capacity building in central and local governments and has contributed to the upgrading of Vietnam's workforce. The present study concludes that the legal and institutional systems have greatly benefited from ODA projects – not least in the area of corporate law. Small and medium-sized enterprises have grown almost explosively in response to these efforts. Government attitudes toward private business have also improved in the course of the process.

4. The ODA projects aimed at bolster physical infrastructure, which accounted for slightly less than half of the total amounts, seem to have performed effectively. The major donors in this area have assisted Vietnam to substantially improve its transport system, made the most populous regions connected to harbours and, by extension, to the world's economic centres. The increased generating capacity, expanded rural electrification, together with newly built rural roads have spread the territory suitable for business private investment. Considerable private business investment, domestic as well as foreign, has been generated in consequence of many of the projects – not least in industrial zones localised near the new or upgraded roads. For a reasonable estimation, ODA is responsible for one fourth of the impact by physical infrastructure.

5. Effectiveness in some ODA project could have been higher. According to a survey by CIEM and JICA (2003), most participants in the ODA delivery process expressed the view that internal Vietnamese procedures for project appraisal and approval of new projects were complicated and generally not harmonised with donors' practices. A government decree aimed at redressing this problem was seen by many as having been so far been insufficiently implemented. A remaining challenge is to ensure transparency and accountability of aid management on the Vietnamese side.

6. Limited capacity of the government staff is a factor hindering the effectiveness of many ODA projects. Poor coordination between the government and donors and between the government agencies

themselves leads to delays in various steps of project design and implementation. This is the kind of situation that can easily lead to waste and inefficiencies. In order to improve ODA effectiveness, a greater investment in capacity building in local administration will be necessary.

7. Summing up, the rationale for a continuation of ODA to Vietnam remains strong. The internal rates of return from road, bridge and power generating projects have been so high that further allocation of funds into this area is justified. Foreign assistances in education and human resource development has had positive long-lasting effects on the business climate and have moreover produced spillover effects to a range of other societal activities.

8. With respect to ODA in institutional infrastructure, private enterprise representatives are bringing to the attention of authorities a number of unnecessary obstacles to business that they continue to face. Much remains to be done to improve a regulatory system that even today contains business regulations that directly contradict each other. ODA in this area can potentially have an extraordinary effect on private investment and value creation. It is necessary that a good partnership between donor and local agent to be formed in early stage in order to look hard at the state of affaires for choosing where money will be best spent.

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## **SYNERGIES BETWEEN ODA AND PRIVATE INVESTMENT: THE 1993-2003 EXPERIENCE IN VIETNAM**

1. Vietnam is one of Asia's foremost recipients of ODA and it has figured regularly among the world's top-10 destinations for development assistance over the last 1½ decades. At the same time, the economy of Vietnam has been one of the fastest-growing in the world. This naturally raises the question how much foreign factors have contributed to the country's success. The full answer to that question goes well beyond the scope of the present study, the purpose of which is to investigate the effect of ODA on FDI and domestic investment.

2. The focus of the present study is the linkage between official development assistance (ODA) and private investment in Vietnam. The evidence that is reviewed relates to the period following the introduction of *Doi Moi* (Vietnam's economic reform programme) in the late 1980s. The study draws on data for ODA and investment covering the period from 1993 to 2003.

3. The *Doi Moi* was launched at a special time of Vietnam's history. It followed a century of warfare and civil strife and a decade of unsuccessful stewardship by a government with limited economic credentials. Like several other countries at the time, the economy of Vietnam was a centrally planned. The agriculture was comparatively unproductive, the (small) industry was inefficient and the war-torn infrastructure was badly lacking. The poverty rate of Vietnam was about 70 per cent.<sup>1</sup> The road to prosperity was expected to be long and difficult – unless foreign capital could be mobilised for development.

4. The obstacles to economic growth were legion, including a scarcity of resources and know-how, outdated technology, poor infrastructure, institutional failures and many others. As was the case in many other developing countries, the Vietnamese government lacked the resources, and in some cases the competence or inclination, to correct these problems. Domestic and foreign private sector actors were equally unable to enhance the situation, which essentially concerned market failure. Thus, there was a convincing rationale for the using ODA flows to address obstacles economic growth – though most donors at the time were principally motivated by more “high-minded” motives than spurring private investment.

5. This paper is organised as follows. Section I provides an overview of recent trends in ODA into Vietnam. Section II discusses the experiences with using ODA to enhance the investment climate. The investment climate is for the purpose of the present paper defined broadly to include “institutional” and “physical” elements. The “institutional” investment climate includes legal and institutional environments, policies related to production and trade and public governance more broadly. The “physical” investment climate depends largely on infrastructure as conventionally defined. Section III analyses synergies between ODA and FDI from a broader, more macroeconomic perspective. Section IV concludes, including a brief discussion of how to improve the effectiveness of ODA/investment strategies.

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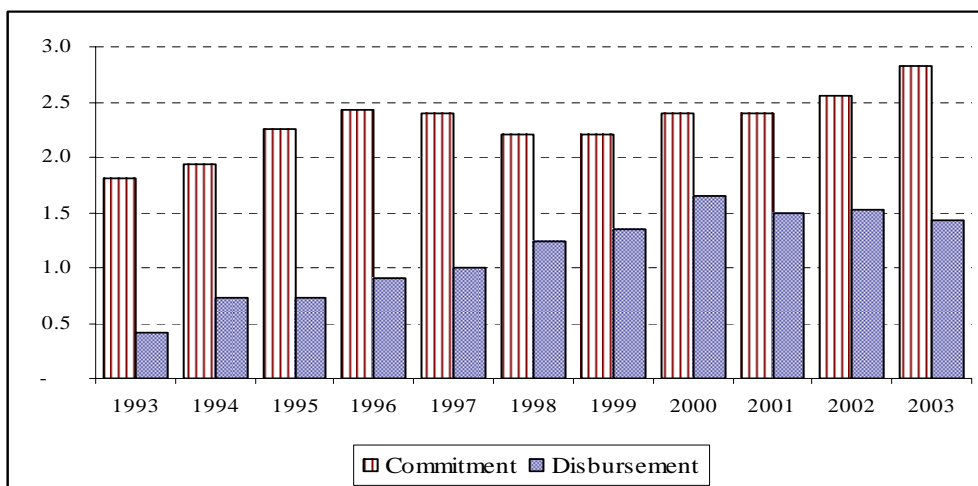
1. Dollars and Litvack (1998) estimate that poverty rate in 1994 was as high as about 75%.

## I. A history of ODA to Vietnam

6. According to the definition of the Vietnamese government, development assistance is a “cooperative activity for development between Vietnamese Government and the donors, including foreign government and intergovernmental or international organisations” (Decree 17/2001/ND-CP of 4 May 2001). ODA is received mostly in the form of non-refundable aid and preferential loans, of which the latter has been the most common. There are seven broad target areas for aid: (i) economic infrastructure; (ii) human development; (iii) rural development; (iv) policy and institutional support; (v) natural resources and environment protection; (vi) emergency relief; and (vii) general disbursement-facilitating assistance. ODA is provided as balance of payments support; programme support; and project support, which may range from technical assistance to individual investment projects.

7. Prior to the collapse of the communist block, Vietnam received ODA mainly from the Former Soviet Union, Eastern European countries and China. (The few “outside” donors included countries like Sweden and some international organisations.) In consequence, the political events in Eastern Europe around 1990 made the main source of foreign economic aid dry up and represented a major challenge for the Vietnamese authorities.

**Figure 1: ODA committed and disbursed, 1993-2003**  
(US\$ billion)



Source: MPI (2004).

8. In the early 1990s, ODA flows into Vietnam consisted mainly of small contributions by UNDP and SIDA (Sweden),<sup>2</sup> mostly in the form of technical assistance to the Government. As relations between the United States and Vietnam improved, the landmark Paris meeting of donors in November 1993 established a full cooperation between Vietnam and the international financial community. Since then the donors meetings have become first an annual, next a semi-annual, event. At the forums the Vietnamese government and donors exchange views on socio-economic policies and the implementation of the ODA committed by the donors. The stability of the committed amounts may be taken to indicate a persistent confidence in Vietnam by the donor community (Figure 1).

2. *Assessing Aid – What works, what doesn't and Why*, The World Bank policy research report, Oxford University press, 1998, p.105.

9. Figure 1 also indicates that the inflow of ODA may be trending upward, but it is not always growing. The decline in commitments in 1997 and 1998 was a reflection of the Asian financial crisis. During the period 1993-2003, donors committed US\$25.4 billion in ODA to Vietnam. The total amount of disbursed funds over the period was US\$12.5 billion, or 49 per cent of total commitments. In order to release the committed funds, the Vietnamese government often signs international treaties with the donors. Over the last decade, the total value of the signed international treaties on ODA is estimated at US\$19.6 billion, or of 77 per cent of total committed ODA. Of the sum of the international treaties signed US\$3.7 billion was non-refundable aid, and the rest was preferential loans.

**Table 1. Major ODA donors to Vietnam (million USD)**

	Total ODA	Of which:	
		Loans	Grants
Japan	7,471	6,457	1,013
World Bank	5,111	5,022	89
Asian Development Bank	3,507	3,391	115
France	749	676	73
Germany	565	288	277
Denmark	473	8	465
Switzerland	413	145	268

Source: MPI (2004)

10. Almost all the ODA loans are long-term and carry preferential interest rates and a long grace period. Almost half (49 per cent) of the loans affected by international treaties have interest rates lower than 1 per cent p.a. and a maturity of at least 30 years, of which 10 years grace period. Another third of the loans are with the annual rate of interest between 1 and 2.5 per cent p.a. (MPI, 2004). Moreover, the large share of loans in ODA should be considered in the light of Vietnam's limited external indebtedness. The country's total convertible currency debt was approximately 37 per cent of GDP in 2001 (World Bank, 2002a), so it would appear that there is no imminent danger of debt crisis in Vietnam.

11. The providers of ODA to Vietnam include 25 bilateral donors and 15 international organisations. Of all the donors, Japan, World Bank and Asian Development Bank (ADB) have been the three largest donors, providing about 80 per cent of total value of the ODA-related international treaties signed over 1993-2003 (see Table 1). Japan is the largest one, accounting for nearly 40 per cent of the total signed values. In addition, there are 350 non-government organisations, which gave Vietnam more than US\$80 million annually in grants.

**Table 2. Distribution of ODA in areas**

Areas	ODA shares
Transport	22.6
Electricity Generation and Transmission	20.3
Agriculture and Rural Development	14.9
Water Supply and Urban Infrastructure	8.3
Education, Training, Science & Technology	8.3
Medicine and Social Affairs	5.8
Others	19.8

Source: MPI (2004).

12. ODA resources have mostly been allocated in accordance with the priority the Government places on economic sectors. Infrastructure has been the largest beneficiary of ODA: 22.6 per cent of the source was allocated to transport, 20.3 per cent to electricity generation and transmission and another 8.3 per cent to water supply, drainage and urban infrastructure (Table 2). Among the other recipient areas the top scorer was agriculture and rural development with almost 15 per cent of total disbursements. The general area of education and technology received 8.3 per cent and another 5.8 per cent went to health and social development. All the other sectors received slightly less than 20% of disbursed ODA.

13. Interestingly, the regional distribution of ODA is not biased toward the poor areas of the country (Table 3). The formal justification for this has been the higher efficiency of development spending in relatively more “modern” areas in generating economic growth. The underlying hypothesis is that economic growth automatically triggers poverty reduction. Thus, large amounts of ODA were allocated to the relatively prosperous urban centres rather than to the rural and mountainous areas, where poverty concentration is high. The most prosperous South East is at the same time the biggest recipient of ODA, while the North West and the Central Highlands have low levels of ODA.

**Table 3. Regional Distribution of ODA**  
1993-2003

Regions	Poverty Rate 2002	Per capita ODA (USD)
North West	68.0	119.9
North East	38.4	117.0
Red River Delta	22.4	129.5
of which, Hanoi	5.2	440.3
Central Coasts	38.9	128.4
Central Highlands	51.8	82.1
South East	10.6	157.1
of which, HCM City	2.0	274.0
Mekong Delta	23.4	49.6

*Source: World Bank (2003), MPI, MOLISA, and GSO*

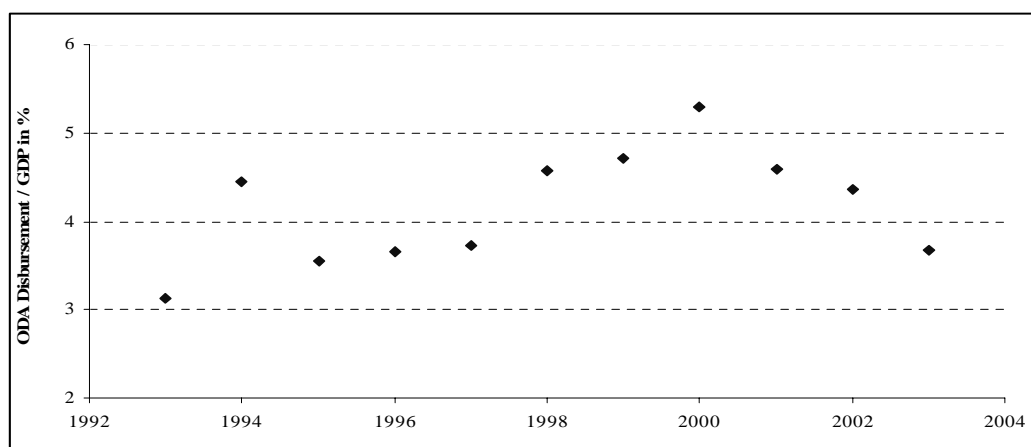
14. While the sheer size of ODA inflows to Vietnam has been internationally high, the ratio of aid dependency is relatively low (Figure 2). Over the period under consideration the average ratio of disbursed ODA to GDP is 4.2 per cent. For reference, the rate is much higher for a number of developing countries – 10-15 per cent in a number of Sub-Saharan African countries, and almost 30 per cent in the case of Mozambique (UNDP and CIEM, 2003).

## **II. ODA and the investment climate in Vietnam**

15. Foreign development agencies are aware of the weaknesses of the Vietnamese business environment and many of them have made remedial action in this area a top priority. The shortcomings in terms of relevant capital endowments are comparable to many other developing countries, including a shortage in machines and equipment, relevant human resources and adequate transportation and communication. Moreover, owing in part to Vietnam’s status as a transition economy, much remains to be done in terms of institutional infrastructure such as legal and institutional systems that effectively support a market economy. A significant share of ODA so far has been allocated to reforms in areas such as legal system development, institutional improvement and enhancing public governance more generally.

Figure 2. The Aid Dependency Ratio of Vietnam, 1993-2003

Unit: per cent



Source: MPI, 2004.

**a) ODA to reform the legal system, institutions and governance**

**1) The ODA inflow and implementation**

16. During the period under review, the signed ODA that went into public governance and institutional support amounted to US\$257 million. That amount does not include programme loans and credits for structural adjustment. If all the programme loans funded by the World Bank and Asian Development Bank, together with the Miyazawa loan from Japan, are added to this category, the amount is much higher. Thus counted, it becomes the fourth largest aid category with a funding of US\$1,681 million. The five biggest donors in this area are World Bank (US\$856 million, including US\$794 million from loans), Asian Development Bank (US\$503 million, including US\$445 million from loans), Japan (US\$160 million), Sweden (US\$42 million), and UNDP (US\$40 million).

17. The country assistance strategy of Japan<sup>3</sup> identifies institutional and legal development support as one of its five key areas. The government of Japan supports areas such as: policy advice to plans and strategies for socio-economic development; facilitating economic and structural reform to promote a market-oriented economy; and improving Vietnam's legal framework, including the Civil Law, Law of Civil Dispute, Law of Commerce, Law of Investment and the Enterprise Law.

18. The World Bank Group concentrates its assistance program in three areas. First, it supports the transition to the market-oriented economy. The strategy of the WB in this area includes: (i) financial sector development; (ii) reform of state-owned enterprises (SOE); (iii) domestic private sector support; (iv) corporate governance and social responsibility; and (v) international trade promotion. Second, it aims to create a level playing field for private and state enterprises and improve the efficiency of SOEs. Third, it supports regulatory reform and enhancement of public governance.

19. ADB has been supporting private sector development through programmes to enhance the business climate and develop the local financial sector. In this context, the Bank has funded a number of projects for institutional and policy development and good governance. ADB has provided two loans in

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3. Japanese Embassy.

banking and financial sector and one for SOE reform and corporate governance. The World Bank and ADB have moreover provided major programme loans to enable the Vietnamese government to fulfil far-reaching policy commitments toward macroeconomic stability and structural reform.

20. UNDP has also been active in providing support the business climate. Notably, it has been involved in numerous processes of enhancing the legal system. Various laws have been drafted or revised with the assistance of UNDP, including the Enterprise Law, Competition Law, the Law on Cooperatives, Law on Investment, SOEs Law, Trade Law. With the participation of UNDP, in 2003 alone around US\$10 million was raised to assist ongoing efforts toward public administration reform, and the Legal System Development Strategy and Natural Disaster Alleviation Strategy. In addition, UNDP, jointly with AusAid, and DFID, assisted the government in drafting the Revised Law on State Budget and in measures to implement this Law.

21. Demark has contributed to the government's efforts toward SOEs reform, both under DANIDA administration and under administration by multilateral donors (such as the World Bank, IFC and other). For example, under DANIDA administration Demark provides supports to enterprise restructuring and development in formulating equitisation plans and providing post equitisation assistance. Under World Bank administration, Demark has provided advisory services on implementation of the Decree on divesture and establishment and use of Support Funds for Equitisation and Restructuring.

22. In the area covered by the Vietnamese government's Public Administration Reform (PAR), ADB, Netherlands and UNDP are the major donors. Since 1997, UNDP has been supporting 6 PAR projects, of which 4 with the co-financing from Netherlands. In addition to four grants for institutional and capacity building in PAR, ADB provided a program loan to support the PAR Master Program for the period 2001 to 2010. Other contributors to PAR are Canada, Norway and Sweden.

23. The geographical distribution of ODA commitments to policy and institutional support is becoming more balanced, shifting from a concentration in the major urban centres such as Hanoi and Ho Chi Minh City to other provinces. This reflects a joint objective by the government and donors to ensure a better spread of enterprise development. However, distribution among the provinces remains uneven, and some areas are largely neglected.

## 2) *Improvement of public resource management*

24. The Public Administration Program of Vietnam has four major components: legal and institutional matters, organisation, human resources and public finance. Under the program a cross-cutting piece of legislation, the "Law on organisation of the Government", was amended in 2001. A number of policies aimed at decentralisation have been formulated, including the following:

- A one-stop-shop model for registration of new enterprises has been implemented in 28 out of 61 provinces. The purpose is both to simplify administrative procedures and to change the mindset of public officials. The new model has been overwhelmingly welcomed by all parts of the Vietnamese society, as well as the foreign business community. The central government is developing a legal framework for extending the model to all provinces.
- The introduction of block budgeting and staffing policy and result-oriented management in 19 provinces, 3 central agencies and a number of other administrative units. The measures are believed to curb waste and enhance staff efficiency and motivation.

- The State Budget Law, which was amended in December 2002, provides the People's Councils<sup>4</sup> with the authority to distribute the budget.

25. With the assistance of UNDP, the Law on SOEs was revised and enacted in November 2002. In addition to this and other efforts at restructuring and reorganising SOEs, formal auditing had been undertaken for 43 such enterprises by the end of 2003. It must, however, be noted that even though there has been great public and political pressure to speed up reform in SOEs, the process has been slow. Moreover, the scale of state ownership in the economy makes it more difficult to renovate the banking sector, because the state owned enterprises depend for their finance on state-owned commercial banks (SOCBs) which continue to dominate the banking industry.

26. During the past decade, four SOCBs have been reformed from fulfilling assignments of administratively decided lending to operating on a commercially sounder basis. The Government has embarked on a multiyear restructuring and recapitalisation program with the support of International Monetary Fund (IMF) and World Bank Group. Other measures taken include deregulation in the banking sector, including freedom to set interest rates; drawing up restructuring plans for unreconstructed SOCBs, establishing asset management companies for non-performing loans resolution; phasing in SOCB recapitalisation; and phasing out directed lending ordered by the state. SOCBs have become more independent from the State Bank of Vietnam and have begun to make a profit.

27. Sponsored by World Bank and DfID, the recently approved Public Financial Management Reform Project aims to ensure that budget execution and reporting by governmental agencies are accurate, timely, relevant, transparent and in compliance with international standard. One of the components of the project will support the strengthening of the government's ability to manage Vietnam's public debt and to begin monitoring the fiscal risks that originate from the liabilities of SOEs.

### 3) *The Enterprise Law: A success story*

28. The project VIE/97/016, which was funded by UNDP and AusAID, is considered as an example of ODA money well spent. The cost of the project was relatively small – about US\$2.3 million over four years. The money was used to hire a number of foreign experts to work with Vietnamese officials during the preparation of the law. The new Enterprise Law was approved by the National Assembly and came into effect at in January 2000. There is a consensus among economists and policy makers that the Enterprise Law is among most important reforms achieved in Vietnam over the past ten years.

29. The most important achievement of the Enterprise Law is the simplification of registration procedures for new private enterprises, involving the elimination of over one hundred business sub-licenses. Business representatives have referred to the new Law as a permission “to register first, then to check”. Alongside with reducing the time and expense needed to establish a business, the Law has also improved the confidence of business community in local authorities and limited the opportunity for corruption. On the whole, the Law is seen as having created better opportunities for all businesses, but in particular for small enterprises.

30. As at the end of September 2003, less than four years since the Law was enacted, Vietnam had witnessed the creation of 72,601 new enterprises – or 1.6 times the number of enterprises registered over the previous nine-year period. Just as important, private investment has spread to all regions, including the poorest ones, rather than concentrating on those with favourable geographic conditions as was the case prior the introduction of the Law. In the poorest Northern provinces (Hoa Binh, Bac Kan, Lai Chau and

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4. These are local bodies and used to have no authority to distribute budget, which come from central government.

Bac Giang) and the North-Central coastal province Thanh Hoa, the number of enterprises grew four to eight-fold compared to that of the 1991-99 period.<sup>5</sup>

31. Unsurprisingly, most of the new private enterprises are small. Seventy per cent of them have an average capital of VND 50 million (about US\$3,300) and employ 10-15 persons. Even so, the total employment creation has been astonishing. In 2000, the total employment created by newly established enterprises was about 400,000, and the following years this figure increased to 500,000 and 800,000, respectively.<sup>6</sup> Table 4 shows that, during 2000-2003, the annual growth rate of the private sector was close to 20 per cent, which is higher than that of state and foreign sectors.

**Table 4: Industrial output growth rate of private and other sectors in Vietnam**

Unit: per cent

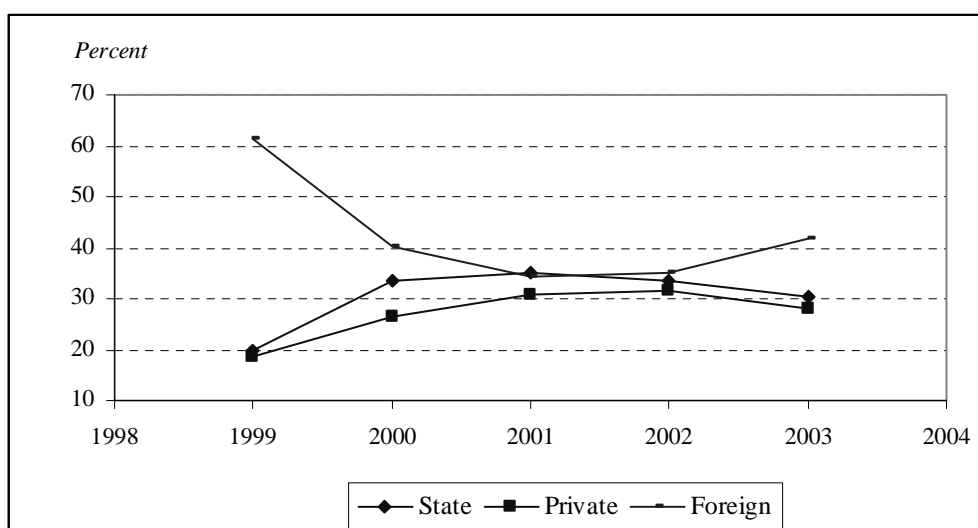
	1999	2000	2001	2002	2003
Private Sector	8.8	18.3	20.3	19.2	18.7
State Sector	4.5	12.2	12.7	11.7	12.4
Foreign Sector	20.0	18.6	12.1	14.5	18.3
Total	10.4	15.7	14.2	14.5	16.0

Source: GSO.

32. In other words, the revitalised private enterprises contribute increasingly on the overall growth of the economy. While the share of domestic private sector has increased for few percentages in total industry output (22% in 1999 to 25% in 2003), the contribution of the sector to total annual growth of industry sector has grown at a remarkable high rate. Figure 3 indicates that the contribution to total industrial output growth of the private sector increased from just 20 per cent in 1999 to close to 30 per cent in 2001 and 2002.

**Figure 3. Distribution of industrial output growth by ownership**

Unit: per cent



Source: Statistical Yearbook 2002 and GSO

5. Vietnam News, 22/10/2003.

6. Vietnam News, 14/12/2002.

33. Notwithstanding remaining obstacles to the implementation of the Enterprise Law, it is safe to say that a small amount of ODA funds has brought about a big achievement for the economy. Probably reflecting this, UNDP is committed to implement another project for developing the domestic private sector by establishing favourable business environment, improving the capacity of private firms and increasing competitiveness.

4) *Overall evaluation*

34. Despite the generosity of international donors and the remarkable successes of some particular programs such as the project VIE/97/016 which contributed greatly to the formation of the Enterprise Law, the overall effectiveness of the ODA program in the area of institutional infrastructure has been mixed. A multitude of different issues have been addressed and the scale of ODA programmes in this area is generally not large. Unsurprisingly, therefore, programme effectiveness has varied from case to case. Moreover, sensitivities within the public administration have sometimes prevented the success of ODA programmes in this area.

35. Business people have often complained about obstacles to their operations emanating from public governance. Given the transitional state of the Vietnamese economy, such obstacles are to be expected, but removing them can help greatly increase economic efficiency. Certain irrationalities in the existing institutions and system of public administration cannot be easily addressed because they are related to politically sensitive areas. For instance, the financial state of SOEs and certain state agencies is considered as classified information. Some officials may also invoke national sovereignty against a requirement of budget transparency. While such practices can sometimes be unavoidable in an economy with predominance of the state sector (including an unclearly defined role of state in providing material goods and public security to its citizens), they may equally reflect administrative inertia and vested interests.

36. In short, many programs in this area have not found “local ownership” and failed to generate enthusiasm among domestic partners. The result has been slow progress in some areas such as SOE reform. Also, the improvements in public administration, especially in budget management, have been less than expected.

b) *ODA and foreign trade policy*

37. Greater participation in trade carries developmental benefits in its own right and, in a world where multinational enterprises becomes increasingly dependent on their access to trade across borders among related enterprises and with subcontractors, it is crucial to attract investors as well. Moreover, for a transitional economy like Vietnam, the benefits of a greater participation in the world markets are not limited to the direct effects on foreign trade and inward investment. Considerable additional gains are expected from the process of aligning the country closer with international standards, and that has justified an engagement by foreign governments and international organisations to promote the foreign trade of Vietnam. The ODA in this area includes, among other things, assisting trade policy reforms, building trade capacity and working toward solutions to trade disputes. Recently, a number of donors provided broad-based assistance to help Vietnam fulfil the WTO membership criteria.

38. Total assistance for trade reform in Vietnam has been a relatively small proportion of total ODA over period 1993-2003. The two most important ODA-backed projects in this field are the EU’s Multilateral Trade Policy Assistance Program (MUTRAP – see Box 1) and the United States’ Support Trade Acceleration Project (STAR – see Box 2). Individual donor countries include Australia, Canada, Denmark, France, Sweden and Switzerland.

1) *ODA for trade policy reform*

39. Trade reform, an important component of Vietnam's economic reform programme, has walked ahead of other parts of *Doi Moi*. The government has taken note of a strong correlation between openness to trade and high growth rates in the most successful economies of East Asia. Thus, the political motivation for carrying out trade reform is strong. The major beneficiaries of technical assistance in this area have been the legislative National Assembly, the Ministry of Trade, the Ministry of Finance, the Ministry of Industry, the Ministry of Agriculture and Rural Development and a few other ministerial agencies.

40. One illustrative example is the Swedish-funded Rule of Origin (ROO) project. Internationally, Rules of Origin have been the subject of trade disputes, and so the purpose of the project was to help the National Committee for International Economic Cooperation and relevant ministries in preparing draft legislation on ROO. The work included the sharing of Swedish experience in developing legal texts on ROO, training sessions and a study tour to Sweden. It is expected that the Ministry of Justice will prepare draft regulation on ROO and make it the subject of comments and consultation with Sweden experts before the end of 2004. There are other important projects as well. For example, the AFD/DREE (France) has provided EUR 3 million the Programme of Enforcement of Vietnamese Commercial Capacities (2003-2005).

**Box 1. The Multilateral Trade Policy Assistance Program (MUTRAP)**

MUTRAP is the biggest technical assistance programme for trade reforms in term of funding, and its coverage is quite extensive. It was initiated in 2001, but came into operation only in 2003. After the completion of the first phase in March 2004, the second phase is scheduled to commence at the end of 2004.

During the first phase, the programme offered training on sanitary/phytosanitary issues, which are related to problems of seafood exports, and on technical barriers to trade (TBT) to officials from the relevant ministries. Under the programme technical assistance was also provided for Vietnam's participation in WTO negotiations on services trade. Furthermore, experts were designated to help the Ministry of Finance, Ministry of Trade and Ministry of Industry build analytical capacity in scenarios of tariff reduction and anticipation their impacts on the economy. Finally, the programme includes awareness-raising measures to provide Vietnamese policymakers and the general public with information on trade under WTO. Three business seminars on economic integration have been held in which about 500 corporate representatives participated.

2) *Facilitating WTO accession*

41. The Vietnamese government submitted its application to join the WTO in 1995 and currently has an observer status. Given the prospect of Vietnam acceding WTO in the near future, many donors provide their assistance to train on contents of the WTO agreements. So far, all technical assistance efforts for trade reforms have concentrated mainly at central level. However, donors have raised questions about the need for spreading the assistance over provinces.

42. The donor community has been implementing a number of projects in the areas of trade negotiation and facilitation. It is the express policy of Japan's government to support Vietnam with WTO-related capacity building. More specifically, the Japanese development assistance focuses on developing the trade-related aspects of the legal system, strengthening export competitiveness and trade facilitation. CIDA (Canada) has been funding a project for strengthening the capacity of the Ministry of Justice in

identifying and developing legislation in conformity with WTO accession requirements. The Italian authorities have assisted in formulating a policy for subsidies and countervailing measures, and Switzerland provides general policy advice towards Vietnam's WTO accession.

43. International trade promotion is also part of the World Bank's country assistance strategy. The Bank's total technical assistance toward Vietnam's WTO accession was about US\$57 million.<sup>7</sup> The World Bank provides financial and technical support for the Vietnam Institute of Economics to study "Vietnam's Readiness for WTO Accession" as well as a number of workshops with participation by National Assembly members and officers from the ministries. In the workshops, international and domestic experts present their analyses of the potential impacts of WTO accession on the economy.

### **Box 2. Support for Trade Adjustment and Reform Project (STAR)**

The US government's intention with this project is to assist Vietnam in reforming its policy for better implementation of the commitments in the bilateral trade agreements (BTA) between the two countries. It is the largest US technical assistance project in Vietnam since the war, and the first USAID-contract in coordination with the US Trade Representative to assist in implementing a trade agreement. STAR began operations in Hanoi in mid-October, 2001, before the BTA took effect.

Over 2001, STAR helped to conduct 23 training workshops and policy seminars, organised 4 study tours and reviewed in detail more than 9 laws and regulations. These activities have reached directly more than 2,000 government officials and business representatives, targeting key senior and mid-level government officials responsible for reforms relevant to implement the BTA.

In 2002 and 2003, STAR focused on supporting Vietnam's efforts in amendment or adoption of number of laws and administrative procedures. In particular, i) bringing Customs into conformance with WTO Standards; ii) raising awareness of Vietnamese people about the conformance with international conventions in intellectual property protection and with the WTO Agreement on TRIPS; iii) establishing a registration system for investment licensing procedures; and iv) expanding market access for services such as value-added telecommunications, accounting, architectural, engineering, computer and banking.

### *3) An assessment of the effectiveness ODA in foreign trade policy*

44. Modern Vietnam has emerged from a planned economy, under which trade policy was simple, since trade was mostly centrally decided and the notion of trade disputes was not relevant. ODA projects like MUTRAP, STAR, ROO and others were all part of the effort toward changing the country trade policy to what is deemed internationally acceptable, including by WTO rules. The fact that the openness of the Vietnamese economy has increased from 61 per cent in 1994 to 118 per cent in 2003 (Table 5) serves as an indicator of the improved trade policy environment.

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7. World Bank Reports.

**Table 5: Openness growth (1994-2002)**

(per cent of GDP)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Export	24.9	26.3	29.4	34.3	34.5	40.2	46.5	46.2	47.5	51.0
Import	35.8	39.3	45.2	43.3	42.4	40.9	50.2	49.9	56.1	66.7
Total trade	60.7	65.6	74.6	77.6	76.6	81.2	96.6	96.1	103.6	117.6

Source: GSO, IMF, MPI and the World Bank

45. STAR has certainly contributed to the successful implementation of the Vietnam-United States BTA – and a report by Riedel *et al.* (2003) indicates that Vietnamese exports to the United States increased more than four-fold over two years following the BTA. Over this period, exports to the United States contributed to over half of Vietnam’s overall export growth. The authors of the study argue that most of the growth in exports to the United States was the result of export creation, rather than a consequence of diversion away from export to other countries.

**c) ODA and infrastructure development**

46. Nearly half of the signed ODA commitments over the last decade have gone into infrastructure development. Within this group, transportation is the sector receiving the largest share. Most of the ODA resources for transport are loans. Grants have been given to transport projects mostly for helping the government undertake loan feasibility studies or enact policy adjustments. A big part of the ODA to infrastructure has been allocated for rehabilitating highways and building bridges. The support for the largest projects has come from a few donors, namely Japan, the World Bank and Asian Development Bank.

47. Japan is the biggest donor in supporting infrastructure development. The following priorities are part of this country’s operational strategy for ODA to Vietnam:

- Upgrading and improving transport and traffic system such as ports, national roads, bridges, airports and railways;
- Improving bridges in the provinces in Northern Mountain, Central Coasts and Me Kong Delta areas;
- Improvement of urban infrastructure such as improvement of traffic system in Hanoi and the Northern Thang-Long area;
- Thermal power stations. Japan provides loans for building and upgrading six power stations, which will upon completion have a 20 per cent share in the nation’s power generating capacity.

48. The second largest donor of World Bank has been supporting projects in improving infrastructure access for the Northern mountainous regions, the Mekong Delta and the Central coasts through provincial road improvement, rural electrification and community- based rural infrastructure development. ADB has provided numerous loans to projects in national and provincial road improvement, clean water supply and urban development. Developing the energy is moreover a priority for ADB. Its policy is to support a “balanced” power generation, combining hydropower (in combination with water resources management), and gas and coal power stations.

1) *Major ODA projects in transportation*

49. Vietnam's backward and, still, war-damaged infrastructure is an obstacle to attracting FDI and to investment more generally. The government recognises this and has, over last ten years, spent large amounts of state funds conjointly with ODA on the infrastructure sector. During 1996-2000, about 40 per cent of the total public investment (state budget, state credit and SOE investment) was directed to transport and power infrastructure. Moreover, since 1996/97 major infrastructure has received the largest portion of ODA, particularly in transport and energy sectors.

50. Over the period, many of large ODA-funded infrastructure projects such as National Highway No.5 and Hai-Phong Harbour (Box 3), My-Thuan Bridge (Box 4), National Highway No.1, National Road No.10 and National Road No.18 have been completed and have significantly improved the country's infrastructure. At the more local level, a large number of provincial and rural roads have been built or upgraded. Saigon Port, Cai-Lan Deep Sea Port, and about twenty fishing ports have also been upgraded with the help of ODA.

**Box 3. The National Highway No.5 upgrade and Hai-Phong Harbour rehabilitation**

The projects for upgrading National Highway No. 5 and rehabilitation of Hai-Phong Harbour were agreed upon between the Vietnamese and Japanese governments soon after the resumption of Japanese ODA loans to Vietnam in 1992. The two projects were intended to meet the needs of the rapidly increasing road traffic in the Red River Delta of Northern Vietnam and to strengthen the capacity of Hai-Phong Port. JBIC provided US\$175 million to Highway No 5 project (implementation period: 1994 to 2000) and US\$33 million to the Hai-Phong Harbour rehabilitation (phase 1: 1994 to 2000).

The National Highway No. 5 is 100 kilometres long, connecting the economic centre Hanoi to the country's most important harbour Hai-Phong. The harbour enjoys the commercial advantage of proximity to Japan, Korea, Hong Kong and mainland China. The highway is the route for transportation of raw materials, input goods and final products produced in Northern Vietnam.

According to the research done by GRPIS (2003a) and Mitsui (2003), thanks partly to the National Highway No.5 Upgrade and Hai-Phong Harbour Rehabilitation project, travel time between the Hanoi and Hai Phong was cut by half (from 3.5-4 hours to 1.5-2 hours), and the traffic volume on the Highway doubled during 1999-2003.

51. As regards the economic impact of the National Highway No. 5 and Hai-Phong Harbour project (Box 3), a report by GRPIS (2003a) indicates that, as of mid-2003, the four industrial zones around Hanoi and Hai-Phong account for about 85 per cent of total FDI to northern zones. Two-thirds of the investment arrived after 1999. The report includes an investor survey that suggests that nearly 90 per cent of the new FDI to the North would not have materialised without the improvement of the two transport facilities. Encouraged by the experience, authorities have established a number of industrial close to the National Highway, namely in Hai-Duong and Hung-Yen.

52. Domestic investment in these areas increased as well. The better transport system led to an expansion of the tourism industry at Ha Long Bay. The number of tourists (both Vietnamese and foreign) quadrupled from 1995 to 2002, with a particular increase after 2000. Thus, the total private investment that

followed this project is very large. Even though not all of the changes can be reasonably accredited to the project, it is seen as the main factor.

53. The My-Thuan Bridge and the National Highway No. 1 project (Box 4) are given credit for the fact that the Can Tho area is now the fastest growing province in the Mekong Delta. Moreover, its economic activity, previously largely agricultural, increasingly involves industry. The province currently has three industrial zones (Tra Noc I and II, and Hung Phu Industrial Zones). Taken together they host about 80 firms (including about 20 foreign-invested ones) employing 13,000 workers. Easier transport has also promoted tourism development in Can Tho, particularly since 2000.

**Box 4. My-Thuan Bridge and National Highway No.1, linking Ho-Chi-Minh City to Can-Tho**

The first component of this project was building the first-ever bridge across the Tien River. This project was jointly financed by the Australian and Vietnamese governments at a capital cost equivalent to US\$60 million. The second component was the rehabilitation of the part of National Highway No.1 that connects Ho-Chi-Minh City and Can-Tho. The cost of this component was US\$176 million, provided by the World Bank. The road project was completed half year before the inauguration of the My-Thuan Bridge in 2000.

Tien River is one of the two main branches of Mekong. Prior this project, none of them has ever been crossed by bridge. From Can-Tho, the centre of the Mekong Delta, to Ho-Chi-Minh City trucks and cars had to be carried on ferryboats, causing a major slowdown of economic activity in the Mekong Delta from where most of the Vietnamese rice export originates. After the opening of the bridge, the travel time between the two cities was reduced by 1-1½ hours. Between 1999 and 2001, traffic volume at the My-Thuan river crossing doubled. The daily traffic flows have increased from an average 3,980 vehicles in 1994 to 20,100 in 2002.

54. The outcome of the project has been deemed so satisfactory that another bridge (across the Hau River, which runs parallel with the Tien) is now under preparation. The expected benefit of this second bridge is, as the Can Tho economy gains momentum, to spread the effects more widely across the Mekong Delta.

2) *The power sector*

55. Power generation in Vietnam is entirely in the hands of Electricity of Vietnam (EVN), a state-owned monopoly, which is, in turn, administered by the Ministry of Industry. Due to the lack of competition, combined with limited a generation capacity, electricity prices are high compared to neighbouring countries. For instance, the price paid for electricity by businesses in Hanoi and Ho-Chi-Minh City is higher than in Singapore and Kuala Lumpur, twice the price in Shanghai, and more than twice the price in Bangkok and Jakarta. The current status of the energy sector is arguably one of the factors holding back private investment.

56. In order to overcome that problem, institutional reforms in the power market are necessary – and so are large amounts of money for expanding the power generation capacity. Primary sources of finance for the investment are from ODA grants and loans committed by Japan, the World Bank, ADB, other foreign governments and Vietnamese authorities. Between 1996 and 2000 donors provided US\$2.9 billion for developing the power sector, of which JBIC (Japan) US\$1.9 billion, the World Bank US\$694 million, ADB US\$180 million, and SIDA and other bilateral donors about US\$150 million. According to EU Economic and Commercial Counsellors (2004), over the last decade foreign loans provided 46 per cent of

the total investment by the EVN. Domestic credits supplied only 18 per cent of the funds and other sources accounted for the remaining 36 per cent. Thus, without ODA it would be hard to see how the problem with high energy price could be solved.

57. Counting only the projects completed before 2002, Japan had contributed to the construction of 1,865 MW worth of generating capacity, or 23 per cent of the electric power supply in Vietnam of which, between 1992 and 2001, Japanese ODA contributed 38 per cent of the increased capacity. The power generating projects built with the assistance from Japan include Phu My Thermal Power Plan, Pha Lai Thermal Power Plan, Ham Thuan-Da Mi Hydropower, Dai Ninh Hydropower.

3) *An assessment of the effectiveness of ODA in infrastructure*

58. The state investment and ODA funds caused a strong development in the infrastructure services of Vietnam. Over the period 1990-1999, the total amount of goods transported on roads more than doubled. The marine transportation increased six times. For the five-year period 1996-2000, more than 1,200 km of new roads have been constructed, and more than 4,000 km of old road upgraded. By the end of 2000, about 95 per cent of Vietnam's municipal centres were accessible by car (for comparison: 99.9 per cent in the Red River Delta; 99.4 per cent in the Southeast Region and 72.4 per cent in the Central Highland).

59. Energy generation capacity has tripled over the period 1990-1999, and the share of the population with access to electric power source increased from 47 per cent in 1990 to 75 per cent in 1999. By the end of 2003, 93 per cent of municipalities nationwide, including 83 per cent of the rural households, have access to the national grid.<sup>8</sup> Notwithstanding the progress, Vietnam needs to increase its power generation capacity for a number of years to come. Electricity prices remain high even though the share of renewable energy is relatively high compared to neighbour countries.

60. A Report by Hanoi Management Board of Industry Zones suggests that one of the main problems for starting enterprises in Vietnam is shortage of land suitable for industry or service production – that is, with electricity and adequate road access. Limitation of suburban land has led to property prices that are prohibitively high for many potential investors. The extension of road and electric grids into rural areas helps solve this twin-shortage, and in fact investment has been observed to spread into rural area for precisely as far as far as the new electric grid and roads go.

61. The change in infrastructure between 1993 and 2003 is a substantial alleviation of the congestion in the national highways and therefore increased the connectivity between regions and to world market. The progress of electrification and development of rural roads have “expanded grounds” for enterprises that would otherwise be crowded out. Given that domestic private investment in infrastructure in Vietnam<sup>9</sup> has been relatively negligible in the total and the share of roads and power generating projects in the state investment is almost the same as that in ODA.<sup>10</sup> Taken together with the indication that ODA is on average one fourth of State investment (Table 7 – below) this allows for a rough estimate: ODA would seem to have been responsible for one fourth of the change mentioned above.

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8. Vietnam Development Gateway, 2004.

9. The private funds were used exclusively for rural roads and count for minor part of the total.

10. For ODA, the share was about 43%. During 1996-2000, the ratio the infrastructure in total domestic public investment was about 40%.

*d) ODA and human resource development*

62. Vietnam has done relatively well in terms of the percentage of literate adult population. As of 2002, the literacy rate was 91 per cent – an achievement for a low income country. However, as indicated by the World Bank (2001), the quality of education is an issue. For instance, primary schooling averages 500 hours per year, which is one half of the international average, and the curriculum and style of learning has been described as outdated. Almost one-third of children do not complete fifth grade.<sup>11</sup> Potentially more important from a business viewpoint, Vietnamese tertiary education is far from meeting the demands of an increasingly international labour market.

63. The government's growth strategy emphasises the importance of education and human capital development; one of its main targets is making lower secondary education universal. A challenge in this respect is to deliver quality education to everyone, especially girls and young people in remote rural and mountainous areas. Along with schooling, vocational training is seen as key to developing a skilled workforce. The government outlay for education and training is projected to be raised from 15 per cent of total state budgets (or 3.5 per cent of GDP) in 2000 to 20 per cent in 2010, alongside with strengthening public-private partnership in human resource development.

*1) Concrete projects and experiences*

64. According to MPI, from 1993 to the end of 2003, the total committed ODA signed for the area of education and training was about US\$1,100 million, of which US\$600 million was in loans and US\$500 million in grants. The loans to this sector are not a big proportion of total ODA loans (slightly above 5 per cent), but the grants make up for almost 12 per cent of the total. Most of the ODA in this area are intended for education as opposed to vocational training.

65. Major donors in the education and training sector are World Bank, ADB, Japan, Australia and the United Kingdom. The World Bank has provided US\$354 million, principally toward primary and higher education. In the coming years, the World Bank assistance in this area will focus on the consolidated national "Education for All" programme.

66. Japan and ADB are the second largest donors, each of them having provided about US\$240 million. Most of the funds from Japan have been allocated to primary school facilities. As at the end of 2003, nearly two hundred elementary schools had been constructed by means of Japanese ODA, most of them in municipalities with a high poverty rate.<sup>12</sup> Japan has yearly been providing scholarships to Vietnamese students and government officers to study in higher education institutions of Japan.

67. Social development is one of the four strategic priorities of ADB, and within this priority education and training is given much emphasis in the Bank's assistance to Vietnam. For instance, ADB has provided major loans in co-financing with France and the Nordic Development Bank for "Technical and Vocational Training" project to help the General Department of Vocational Training (GDVT) restructure the whole vocational training system (ADB: US\$54 million, NDB: US\$7 million and France: US\$15 million). This project focuses on curriculum development, institutional strengthening, industry and school partnership development, and improvement of access (through supporting the facilities upgrading for 15 technical colleges and schools).

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11. Of which 70 per cent of dropouts are girls, see UNDP Development Cooperation Vietnam 2002 Report.

12. In addition to the educational purpose of this aid, many of the schools, being very solidly built, provide shelter for local residents against typhoons that frequently hit the localities (IDCI, 2003).

68. For the last decade Australia has been one of major donors toward education and training in Vietnam. For example, the AusAid scholarship has been given for hundreds of Vietnam student every year to go to Australia for undergraduate and graduate study. The funds provided by other countries such as South Korea, France and Switzerland may not be large by comparison, but these countries have contributed significantly to vocational training in Vietnam. They have financed various vocational training centres and supported GDVT in building capacities on vocational training. South Korea has provided three grants to support the technical schools in Hanoi, Nghe-An, and Quy-Nhon. Switzerland has provided grants to support three phases of the “Strengthening Vocational training centres in Vietnam” (see Box 5).

2) *Impacts of ODA on human resource development*

69. The coordinated efforts of the government and the assistance of international donors made significant progress for Vietnam over last ten years. The target “Education for All” is gradually being realised. The enrolment rate at the primary level rose from about 80 per cent in 1990 to nearly 94 per cent in 1999. The upper secondary education enrolment rate increased as well. The number of students in the 2002/03 academic year is 2.3 times higher than the one in 1992/93 academic year for lower secondary education and 4.3 times for the upper secondary education. By the end of 2002, 15 out of 61 provinces/cities have reached the goal of universal lower secondary education. The school facilities such as classrooms, teaching aid, laboratories and libraries have been upgraded substantially. The reformed national curriculum for primary and lower secondary schools (grades 2 and 7 respectively) continues to be phased in.

**Box 5: “Strengthening Vocational Training Centres” project**

Funded by Switzerland, the project has three phases. Phases 1 (1994-1997) and 2 (1998-2001) were with Ministry of Education and Training (MOET) and phase 3 (2001-2004) with Ministry of Labour, Invalidity and Social Affairs as counterparts. The objective of the project is to support the socio-economic reform in Vietnam through providing skills to unemployed young people to get jobs and to improve the skills for the unskilled and semi-skill workers.

Five specific objectives of the project are: (i) upgrading the vocational training equipment in classrooms and workshops; (ii) curriculum development based on the newest knowledge of subjects; (iii) teacher training capacity development; (iv) strengthening the technical and vocational training centres’ management capacity; and (v) making contribution to the policy dialogue on informal vocational training system. Impacts of the project include the following:

- Improved the technical and vocational training capacity at vocational training centres that reflected in modernised vocational training curricula, upgraded equipment; improved training quality and strengthened management capacity. The enrolment of the centres covered in this project has increased by 15-20%.
- Build administrative capacity in state management agencies at local levels though involving local authorities (provincial and district levels) and the National Institute for Education Development Studies into the project’s working groups or training workshops on management skills.
- Introduced the best practice of a vocational training centre to disseminate it national-wide through sharing with policy makers on good experience and lessons learned from the centres participating in the project.

70. For the vocational training sub-sector, most of the projects are small and cover one or some specific schools or colleges. Also, there has been little coordination among donors, and between donors and the government. The “Technical and Vocational Training” is the only project working with the technical and vocational training nationwide system. The project, however, has been delayed for a number of times. More than half the time foreseen for the project has elapsed, and less than 20 per cent of the allocated funds have been disbursed.

71. A project in this area that is commonly considered as having been successful is the Swiss-funded “Strengthening Vocational Training Centres in Vietnam” (see Box 5). Encouraged by good performance of the project, the Government of Switzerland has expanded its support for phases 2 and 3 of this project. The project has helped strengthening 18 vocational training centres through providing equipment, curriculum development, teachers training and management capacity improvement.

3) *An assessment of the use of ODA in human capital formation*

72. With the assistance of the international donors, many new skills have been introduced in vocational teaching centres, and the overall quality of training in those centres has been also improved. The graduates from ODA-supported schools have generally better met the demand of competitive industries such as telecommunication, airplane and airport service, oil and gas, garment, foot-ware, mechanical, electric and electronics industries. One indicator that the human capital provided by the technical and vocational education system has become more marketable is the fact that it has become steadily more popular with education-seeking youths.

73. However, while the benefits of educational spending are certain from a societal point of view, evidence of an immediate and visible impact on private investment may be less persuasive. Few of the projects include some sort of “graduates tracing” follow-up, and even in the big-loan projects the follow-up mechanisms largely concerned monitoring rather than a broader economic evaluation.

74. There had generally been a wide gap between the newly emerged market economy and teaching contents technical-professional schools in Vietnam, and ODA has been helpful in closing the gap. Most of curricula have been redeveloped to make the training more relevant to market needs. Teachers training competences in this respect have also been improved. The management capacity of technical and vocational training centres has been strengthened. Overall, given the moderate funding of ODA projects in the education and training sector, aid effectiveness has been high. The technical expertise transferred as part of the ODA programmes is potentially very valuable for a lowly developed economy. Nevertheless, the direct benefits from the ODA projects in the education and training sector in attracting investment are likely to continue to defy measurement in the short term.

75. Finally, a word of caution is in place. Since the government remains the dominant employer (at present, if not necessarily in the future), young people may be biased in their choice of education. Vietnamese youths continue to try hard to gain acceptance to universities that are commonly perceived no longer to provide the most relevant education, and, at the same time, do not sufficiently appreciate the value of technical or vocational educations.

e) *The reform of state-owned enterprises*

76. At the end of the Indochina war in 1954, the state owned enterprise sector of was established by both nationalising the existing private enterprises and establishing new SOEs. By the end of 1960, all industrial establishments and more than 99 per cent of commercial establishments and transportation facilities had been transformed into SOEs. In their operation, SOEs were under direct control of ministries or agencies of central and local government. The function of the SOEs was to receive and carry out plans

given to them. The plans specified detailed production targets, sources of inputs and distribution. After the unification of North and South Vietnam in 1975, the private and public business establishments in the South were also transformed into Northern-style SOEs.

77. After it had been clear that the SOEs were inefficient, partial measures to the problem had been applied. In November 1991, the Council of Ministers enacted Decree 388/HDBT on the regulations for setting up and closing down of SOEs, which forced an SOE to be dissolved or merged with another if they were judged to be inefficient or lacking capital or technology or did not have sufficient market demand for their outputs. The state sector was further reorganised with Government Decisions on establishment of General Corporations in 1994. In 1995, the law on SOEs was enacted, providing the first legal basis for the operation of SOEs.

78. Further reforms of the state sector received assistance from foreign donors. ADB has provided two parallel projects with the aim of enhancing the institutional capacity of key agencies in diagnostic audit of SOEs and in review and approval of SOEs seeking equitisation and to formulate and implement a strategy and practical method for transforming SOEs into corporations. In addition, ADB helps to implement and to enforce the adoption of international best practice in corporate governance. ASEM has also provided support for a number of projects in this area. The ASEM programmes have three components: (i) social safety net to deal with labour displaced by SOE; (ii) acceleration of equitisation and restructuring SOEs in the Ministry of Transport; and (iii) implementation of SOE reform in three line ministries (industry, agriculture, and construction) and two provinces/municipalities, one of which is Hanoi.

79. Danida (Denmark) assistance has covered a wide range of the process of SOE reform. The agency administered a project "Support to Industry Restructuring and Enterprise Development" implementing equitisation plans and providing post equitisation assistance. Moreover, Japan, Australia, Denmark and UNDP have provided large funds for more general facilitation of SOE reform activities such as data collection and monitoring system for SOEs, diagnostic audits to assess financial health and performance of selected SOEs, and strengthening the capacity of the General Department for the Management of State Capital and Assets in Enterprises.

80. In addition to the reforming at the macro scale, similar programs have been applied in specific segments of economy. For instance, DfID of the United Kingdom assisted a pilot restructuring of three individual corporations and GTZ (Germany) has supported the restructuring of SOEs in agriculture of local areas by providing advice in implementing equitisation plans.

### *Assessment*

81. It is the policy of the Vietnamese government to retain a decisive role for the public sector in the national economy, and this implies certain (not yet defined) limits to privatisation. According to World Bank (2002b), after a good start in 1990-1992, the number of transformations was very low between 1993 and 1997. From 1998 onwards, thanks to the implementation of the equitisation mechanism, the process regained some momentum. From 1998 to September 2002 almost 900 SOEs were transformed into limited companies. Equitisation does also to a greater extent go hand-in-hand with privatisation. Of the equitisation taken place between January 2001 and September 2002, seventy per cent involved the sales of two thirds or more of the equity to non-state shareholders.

82. Slow progress of SOE reform held back private investment. Nevertheless, the moderate success, thanks partly to the ODA in this area, has revealed the way SOE privatisation affected the growth of the private economy. First, by closing down some of the loss making SOEs, it reduced the financial burden for the SOCBs, which therefore can shift to financing private activities. This also reduces the pressure that

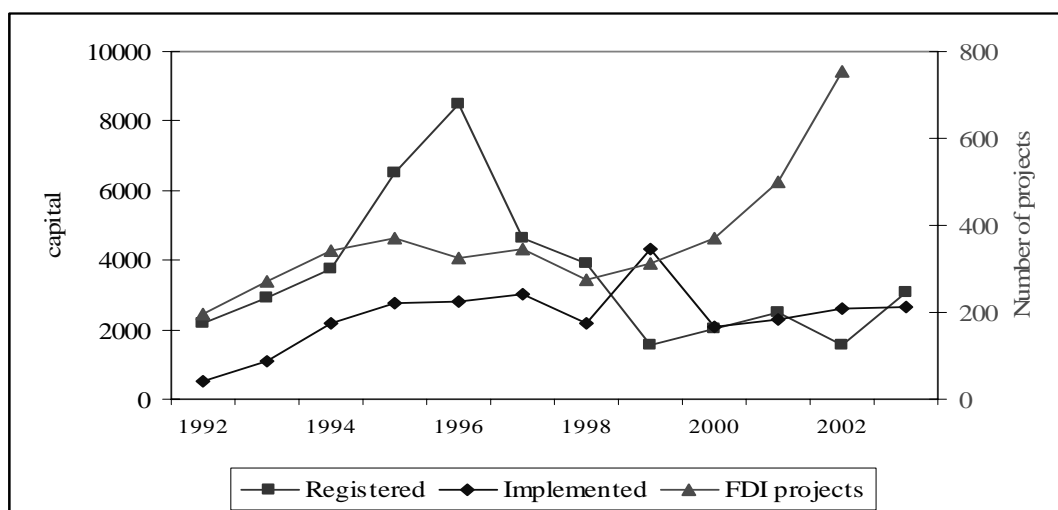
held back long-overdue reforms in banking industry. Second, the inefficiently used factors become available in the market and that benefit private enterprises, mostly human resources and production ground, which is, as mentioned earlier, scarce in Vietnam. A large body of research indicates that land has been the main asset of the liquidated SOEs.

### III. Taking the broader view: overall evidence of ODA/investment linkages

#### a) *The impact of ODA on FDI*

83. Apart from the shock to the world or regional economy such as the Asian financial crisis (i.e. the drop around 1998), the real factors have generally been improving. Three inferences can be drawn from the figure. First, following the initial euphoria in the early to mid-1990s the amount of registered FDI capital has declined. Second, this has not affected the total FDI implemented capital that has been remarkably stable. And finally, the shift in investors' perceptions in the late 1990s may have led them to reduce their project sizes, but the number of committed projects increased strikingly. One may speculate that the decline in the average project size has to do with sectoral shifts in the context of Vietnam's approaching WTO membership (discussed earlier).

Figure 4. FDI performance 1992-2003



Sources: Number of projects, capital: Statistical Yearbooks: 1996 – 2001; others: Vietnam Economic Times.

84. This in turn raises the question whether ODA, which as seen earlier has been a definite factor in mobilising domestic investment, has had a significant impact on inward FDI as well. A regional-by-region analysis may shed some light on how historic differences in ODA have influenced the ability to attract FDI.

#### *Regional co-variation between ODA and FDI*

85. The ultimate goal of FDI is profit, which means that foreign investors (to some extent contrary to domestic investors who may be attached to their location of residence) allocate their assets to areas where the expected return is highest. An important factor for attracting FDI is a developed infrastructure and a skilled workforce. The Red River Delta and the South East region are ahead of the rest of the country in terms of the amount of FDI they attract. These regions also have the nation's highest number of new

enterprise registrations per capita. Still, their local economies continue to be reinforced by large ODA inflows.

86. A high concentration of ODA in Ho-Chi-Minh City, Ha Noi, Dong Nai, Binh Duong, Ba Ria-Vung Tau, which have availed themselves of a relatively modern infrastructure, could be a major factor causing the inflow of FDI into these provinces. There is, however, an exception that is the province of Binh Duong, which has been a leading province in FDI attraction but has received very little ODA. In addition, public investment tends to favour more prosperous provinces, as the cost of providing basic services to these regions is cheaper than in remote isolated areas, owing to economies of scale.

**Table 5: Foreign Direct Investment by provinces, 1988-2004<sup>13</sup>**

Unit: US\$ mil.

Province/City	Registered FDI	ODA committed
HCM city	10,994.11	736.06
Hanoi	7,763.25	641.34
Dong Nai	7,018.07	65.24
Binh Duong	3,895.79	29.17
Baria-Vungtau	2,081.87	71.22
Hai Phong	1,698.31	197.85
Lam Dong	881.18	27.21
Long An	596.66	16.20
Hai Duong	583.68	89.78
Vinh Phuc	560.52	29.17

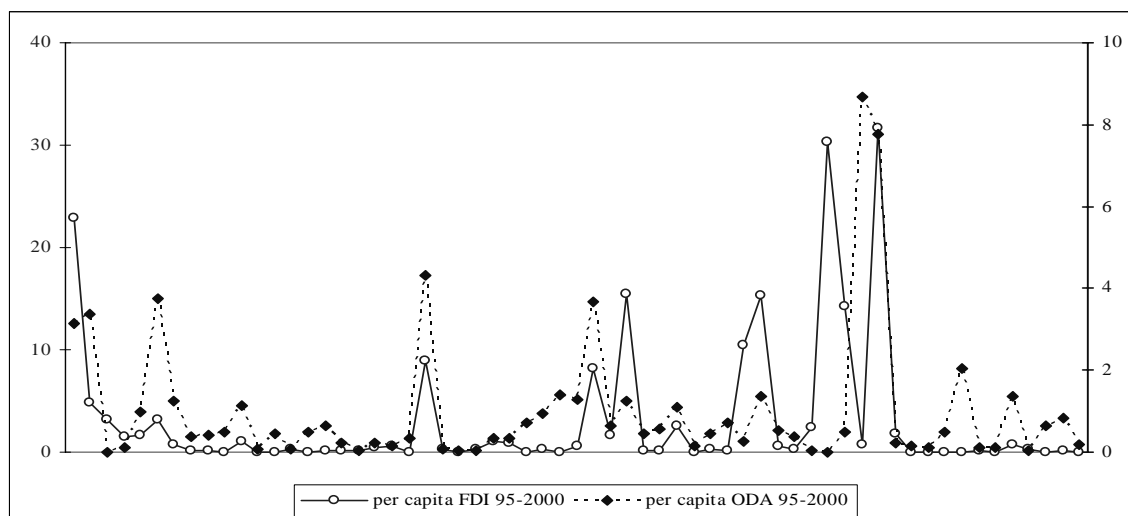
Source: MPI, 2004

87. At first glance there seems to be a strong correlation between provincial data on FDI and ODA. However, further analyses do not verify a direct causal relationship between the two. More likely, there is some third factor (perhaps, more than one factor) causing high amounts of both ODA and FDI in some of the provinces. Statistically, the connection between ODA and FDI exists, but is not always significant. The statistical significance varies substantially across sources and samples. On Table 5, we list the top ten FDI receivers-provinces and their amounts of FDI and ODA, which have a correlation coefficient of 0.82.

88. Even though economic rationale supports a strong correlation between ODA and FDI, the causality cannot be robustly established. Both variables are dependent on other economic factors, and after the relative population sizes are taken into count, the correlation weakens substantially. Figure 5 shows a more comprehensive data set including 61 provinces and cities. For this particular data set over years 1995-2000, the correlation coefficient is 0.42.

13. Data set counts all the funds available at June 2004.

**Figure 5. Correlation of provincial per capita ODA and that of FDI (1995-2000)**



Source: MPI

89. In an attempt to detect causal relationship a regression analysis was undertaken, trying to explain FDI by province (covering the period 1995 to 2000) by a number of independent variables. The regression attempted to control for the initial conditions of the province by including provincial GDP per capita of 1995 and the degree of urbanisation in the same year. Other explanatory variables are the public infrastructure investment in the province and ODA over the period 1995-2000. It was expected that ODA, together with the public investment, might contribute to explain the variation in FDI. However, the outcome of the regression (Table 6) does not support the expectation of the causal relationship between ODA and FDI. It turns out that the initial conditions decide FDI but the recent investment, whether financed by ODA or by national authorities, do not. The provincial GDP is strongly significant, and the degree of urbanisation may also be. (This is consistent with the findings of the estimations of countries' relative success in attracting FDI that are presented in Annex 2.) Against economists' expectation, neither ODA nor state investment is statistically significant in explanation of FDI.

**Table 6: An OLS Regression of FDI on ODA**

Provincial data 1995-2000

Dependent Variable: Per capita total FDI 1995-2000 of 61 provinces			
Variables	Coefficient	t-Statistic	Probability
Constant	-2.8137	-2.3927	0.0201
Per capita gross provincial product 1995	1.6475	5.7753	0.0000
Urban percentage 1995	9.6743	1.6853	0.0975
Per capita total ODA 95-00	-0.1872	-0.3882	0.6993
Per capita total state <sup>14</sup> investment 95-00	0.3428	0.4488	0.6553

R-squared: 0.56;

Probability for F-statistic: 0.00

Source: Authors' calculation on MPI data

14. The state investment in regression is the total government investment in transport, power and urban water projects.

90. The overall conclusion must be that there is a group of provinces having high concentration of both ODA and FDI, which both may be influenced by factors such as the pre-existing conditions including infrastructure, geographical position and purchasing power of local population in those provinces. That could explain why the correlation is more significant for the group of provinces in Table 5. However, there has been weak, if any, evidence of a causal relationship between these two variables over the period.

91. This sobering result should not be overstated: one difficulty for researchers is that so many shifts taken place in the Vietnamese economy have taken place – ranging from the Asian Financial Crisis to the numerous policy reforms – that a snapshot in time may provide an inadequate basis for econometric analysis. Secondly, much of the economic payoff from ODA is expected to materialise in the long run (e.g., the investment in transport, education, and healthcare) and therefore more sophisticated models, and long time series, may be needed to capture it.

**b) Macroeconomic aspects of ODA**

92. As mentioned earlier, a shortage of capital has been a major bottleneck for the private economy. The resources needed to solve problems such as Vietnam’s inadequate infrastructure are so big that the Government alone cannot provide them in the near-to-medium term, and so far there has been little private sector participation.

93. A simple, though admittedly not always accurate, way of measuring the importance of ODA in this respect is its share in total investment in the economy. In Table 7, the content of the third column are the implemented ODA funds. Over the period 1995-2002, ODA can be said to have “financed” around one fourth of state investment. Since ODA is just marginally more focused on infrastructure than state investment at large,<sup>15</sup> and given again the fact that domestic private participation in infrastructure has been negligible, this implies that about one fourth of the change in the infrastructure over the period can be accredited to ODA. The ODA funds allocated to other sectors than such as in legal system reform, institutional improvement, or human resource development have also had their impacts on private investment and FDI. Some of these projects were extraordinarily effective.

**Table 7. The public sector investment and implemented ODA, 1995-2002**

Years	State (US\$ mil.)	ODA (US\$ mil.)	ODA/State	ODA/Total Investment
1995	2,758	737	0.27	0.11
1996	3,888	900	0.23	0.11
1997	4,585	1,000	0.22	0.11
1998	4,902	1,242	0.25	0.14
1999	5,519	1,350	0.24	0.14
2000	5,898	1,650	0.28	0.16
2001	6,452	1,500	0.23	0.14
2002	6,178	1,528	0.25	0.13
<b>Average</b>			<b>0.25</b>	<b>0.13</b>

Note: ODA is in disbursed amount

Source: MPI (2003).

15. 43% in ODA against 40% in State investment.

94. Moreover, even as the roads, bridges, electric generators and classrooms built in consequence of the ODA programmes have been recognised as to contribute greatly to the economic growth of Vietnam, the total contribution of ODA is far above the sum of individual projects. According to recent report by UNDP, the most important contribution of ODA in Vietnam over the past 15 years has been in the transfer of knowledge, skills and valuable experience from elsewhere to help facilitate the *Doi Moi* process which has been initiated, led and managed by Vietnamese government since 1986.<sup>16</sup> No doubt, the knowledge, skills and valuable experience have been an important factor mobilising domestic private investment and FDI. However, it is difficult to quantify the effects knowledge transfers and tacit learning – even as these sources of productivity gains have become increasingly important in the modern economy – and an impact analysis of ODA will therefore necessarily be incomplete.

95. That said, some useful guidance can be drawn from the literature on the impacts of Japanese ODA in Vietnam. A survey was conducted by CONCETTI, a consulting and research firm, in 2001-2002 to evaluate the impact of Japan’s ODA to Vietnam. The survey was conducted in Hanoi and Ho-Chi-Minh City and focused on two groups of respondents: (i) businesses having import/export relation with the Japanese market; and (ii) government officials involved in Japan’s ODA. Within the first group, 25 per cent were foreign-invested enterprises and 41 per cent were domestic privately-owned companies. Some of the survey’s main findings are reproduced in Table 8.

**Table 8. Perceived impact of Japan’s ODA projects on companies**

<b>Question:</b>	<b>Affirmative answers:</b>
Your business benefits from better infrastructure	50.0%
Your business has benefited from the opportunity to supply goods and services to Japanese ODA projects	37.5%
Your business benefits from the more “open” policies due to the impact of Japanese-funded administrative reform programmes	25.0%
Export to and import from Japan has become easier	25.0%
Japanese investment to has Vietnam increased	22.9%
Others benefits	8.3%
Your business has received direct support from Japan’s ODA projects	6.3%

*Source:* Evaluation Results and Recommendations on Japanese ODA for Vietnam, IDCJ(2003).

96. According to the respondents, by far the most “welcome” change as a result of ODA is the enhanced infrastructure, followed by the direct business opportunities in consequence of the ODA-related activities. Beyond this, the impacts of Japanese aid have, apparently, been only moderately felt by businesses. However, this finding must be interpreted with caution: the sample of businesses with import/export links to Japan is not representative. Other things equal, one would expect countries engaged in international trade to place greater emphasis on infrastructure than purely domestic operators. Had the sample contained a large number of newly created SMEs one may speculate that the responses would have put greater emphasis on administrative reform.

16. Vietnam Investment Review, No. 675, 20 September 20, 2004.

**Table 9: Impact of Japan's ODA Loans**

Unit: per cent, except Trade Balance in US\$ mil.

	Real GDP	Export volume	Import volume	GDP deflator	Trade balance	Utility
Japan	-0.10	-0.12	-0.01	0.03	-387	-0.07
China	0.12	0.14	0.05	-0.06	139	0.08
Indonesia	0.50	0.59	0.35	-0.22	67	0.41
Malaysia	0.20	0.19	0.16	-0.13	13	0.14
Philippines	0.71	0.90	0.54	-0.60	6	0.49
Thailand	0.49	0.34	0.20	-0.29	29	0.42
Vietnam	1.65	2.53	1.24	-0.69	28	0.99
World	0.00	0.02	0.02	-0.01	0	0.00

*Source: Kawasaki (2004).*

97. A more comprehensive study by the International Development Centre of Japan (IDCJ) tells a more encouraging story. The Report by the IDCJ (2003) demonstrates that, "Japanese ODA pushed up the Vietnamese GDP by 1.57 per cent, capital stock by 4.65 per cent, imports by 5.94 per cent and exports by 3.84 per cent in the year 2000." A study by Kawasaki (2004) uses a GTAP (Global Trade Analysis Project) model to perform a simulation of the impacts of Japan's ODA loans over 1996-2000. The main results of Kawasaki's simulation are presented in Table 9. It demonstrates that the effect of Japan's ODA on Vietnam accounted for 1½ per cent increase in real GDP, and 2½ per cent increase in export volume. The trade balance of Vietnam improved as well.

98. Thus, while an assessment of the overall effectiveness of all ODA in Vietnam has not been attempted there has been evaluation of performance of the ODA projects funded by Japan. Japanese aid may not be representative of the ODA from other agencies, but it does after all account for about 40 per cent the total. According to IDCJ (2003), even though not all the hoped-for effects have fully materialised, "Japan's ODA has generated a sufficiently concrete impact to motivate a decision to invest." The IDCJ report estimated that the "macroeconomic internal rate of return" for Japanese ODA to Vietnam over the period 1991-2000 was no less than 19 per cent. According to business surveys Japanese companies place Vietnam on fourth place in the world in terms of favourable investment environment. Some firms opined that the Vietnamese business environment is "improving and poised to become Southeast Asia's best place to do business".

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