RESTRUCTURING FOR A MORE COMPETITIVE

VIETNAM PROJECT

MACROECONOMIC REPORT
FOURTH QUARTER - 2014

INTRODUCTION

Vietnam's economy is entering an important stage of reform. The macroeconomic environment is more stable. The economic recovery appears to be more robust, accompanied by improved confidence of investors and the business community. On the other hand, the traditional drivers of economic growth have diminished rapidly, and the room for loosening fiscal and monetary policies is modest. The international economic integration process is reducing the scope for Government intervention in production and business activities. In this context, comprehensive reforms to strengthen the microeconomic foundations to facilitate production and business activities emerge as a profound need. Substantive policy efforts and early achievements were made in this direction during 2014, creating the momentum for further progress in 2015 and beyond. Nonetheless, just facilitating production and business activities is not sufficient. The policy message for 2015 should emphasize the need to establish an orderly and self-disciplined environment to foster and enhance sound competition, as well as to strengthen the confidence of the people and enterprises.

The Macroeconomic Report for the 4th quarter of 2014 serves several objectives, namely: (i) to provide an update on macroeconomic developments and policy changes in the quarter, and in 2014 as a whole, with expert analyses and comments; (ii) to assess the macroeconomic outlook for 2015; and (iii) to provide recommendations on macroeconomic policies for 2015 and beyond in line with Vietnam's reform requirements. During preparation of this Report, the authors have received valuable comments and suggestions from experts of the Central Institute for Economic Management (CIEM) and other Ministries and agencies.

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All remaining errors, views and opinions presented in the Report are solely of the authors and may not necessarily reflect those of RCV Project and/or CIEM.

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LIST OF ABBREVIATIONS

ADB	Asian Development Bank
AEC	ASEAN Economic Community
ASEAN	Association of Southeast Asian Nations
MPI	Ministry of Planning and Investment
CIT	Corporate Income Tax
CPI	Consumer Price Index
SOEs	State-Owned Enterprises
EU	European Union
EVFTA	EU-Vietnam Free Trade Agreement
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
GDP	Gross Domestic Product
VA	Value Added
HSBC	The Hongkong and Shanghai Banking Corporation
IEA	International Energy Agency
IFS	International Financial Statistics
IIP	Index of Industrial Production
IMF	International Monetary Fund
M2	Money Supply
MoM	Month-on-month
NPL	Non-Performing Loan
SBV	State Bank of Vietnam
OECD	Organization for Economic Co-operation and Development
OPEC	Organization of the Petroleum Exporting Countries
PCI	Provincial Competitiveness Index
PMI	Purchasing Managers Index
PIT	Personal Income Tax
Q4	Quarter 4 (2014)
RCEP	Regional Comprehensive Economic Partnership
REER	Real Effective Exchange Rate
GSO	General Statistics Office (Vietnam)
TFP	Total Factor Productivity

TPP	Trans-Pacific Partnership
TTIP	The Trans-Atlantic Trade and Investment Partnership
UNCTAD	United Nations Conference on Trade and Development
USD	US Dollar
VCCI	The Vietnam Chamber of Commerce and Industry
VND	Vietnam Dong
WTO	World Trade Organization
YoY	Year-on-year

EXECUTIVE SUMMARY

1. The year 2014 presented an array of complicated economic and political issues in various parts of the world. These issues include, for example, warfare in Middle East, mounting conflicts between Russia and the Western countries in the first half of 2014, maritime boundary conflicts in Asia, and political turbulence in Ukraine. Adverse consequences for the world economy became more visible in the fourth quarter of 2014 (Q4) as crude oil price fell sharply and many currencies depreciated against the USD.
2. The major economies attained slow and uneven growth recovery in 2014. According to the latest IMF's forecast, the world economy may only grow by 3.5% in 2015 (0.3 percentage point lower than forecast in October 2014). Negotiations of several major FTAs continued, albeit with slower than expected progress.
3. Regarding domestic institutions, significantly more laws were passed in 2014 than in previous years. Some laws incorporate fundamental reforms in conformity with the direction of developing a market-oriented economy in Vietnam. A key result of 2014 institutional reforms was to further simplify, streamline and reduce the cost and procedures for starting businesses, investment, and other procedures related to production and business activities.
4. Vietnam's GDP increased by 5.98% in 2014, higher than the target of 5.8%, and higher than in the 2012-2013 period. GDP grew by 6.78% YoY in Q4 of 2014, contributing to accelerated growth for the whole year. This outcome further consolidated optimism for a more robust growth recovery in 2015. Still, GDP growth in 2014 remained much lower than the average figure for 1990-2010. And the slow pace of gross capital formation (8.9%) limited economic growth recovery in 2014.
5. There was little change in economy structure in 2014. Growth in value added of agriculture, forestry and fishery reached a relatively high 4.7% (YoY) in Q4 of 2014. This reflects a substantive improvement over Q3, contributing to an overall improvement in 2014 GDP growth. The services sector grew by 5.9% (YoY) in Q4, and by 5.96% for all 2014. Most growth in 2014 was in the information and communication; science and technology, and finance, banking and insurance sub-sectors. Total retail sales of goods and services in 2014 reached VND 2,945.2 trillion (10.6% higher than in 2013), with the domestic non-State sector accounting for 86.5% of retail sales. The value added of the industry-construction sector grew by 7.1% in 2014, and 8.7% in Q4 (YoY).
6. At the end of 2014, Vietnam had a labour force of 54.48 million people, 782,000 more than in 2013. There was positive YoY growth in the number of employees at the end of each quarter. Despite employment growth, the working-age underemployment rate tended to increase at the end of 2014. The working-age unemployment rate was 2.1% in 2014.
7. Labour productivity in 2014 was estimated to be VND 74.3 million (at current prices) per employed person, 4.3% higher than in 2013. However, Vietnam's labour productivity continues to lag far behind other regional countries.

8. The ceiling on VND-denominated deposit rate decreased further to 5.5% per annum in Q4 (for deposits with term shorter than 6 months). The ceiling rate was lowered twice in 2014. Actual deposit rates also declined. The VND-denominated lending rate declined faster in Q4, by 1.0-2.0 percentage points (annualized). The USD-denominated lending rate remained stable.
9. Credit outstanding increased more rapidly, and steadily, in Q4. Foreign currency loans increased more slowly. Toward the end of Q4, credit growth was partly constrained by the planned restriction of foreign currency loans (from 1 January 2015), and concerns about the impacts of Circular No. 36/TT-NHNN.
10. The inter-bank VND/USD exchange rate remained unchanged in Q4. The VND/USD exchange rates in the parallel market and in commercial banks were mostly stable in October-November, and only climbed in December. The depreciation of the real effective exchange rate in Q4 meant that Vietnam's goods became cheaper relative to foreign goods.
11. The NPL ratio tended to decrease further. The SBV published more information on NPL and progress of restructuring banking system. Total liquidity (M2) increased faster in November-December, even faster than in June.
12. The consumer price index (CPI) increased slowly in 2014, with YoY inflation declining to 1.84% at the end of 2014. The international crude oil price and the domestic retail price of oil and petroleum products decreased but the spillover impacts on the prices of other goods were modest.
13. Gross investment increased faster in 2014 than in 2011-2013, with accelerated growth of investment by the domestic private sector and the State sector. Despite substantial growth in FDI approvals in Q4, actual investment by FDI enterprises grew more slowly in 2014 than in 2013. The ratio of investment to GDP was only 30.6% in Q4.
14. Exports grew by 13.6% and imports by 12.1% in 2014 mainly due to increases in trade volume. Declines in prices of crude oil and other key export products of Vietnam weakened export growth in Q4 and throughout 2014. FDI enterprises still accounted for the lion's share of exports and imports. Vietnam ran an overall trade surplus of USD 2 billion in the year.
15. Budget revenues in 2014 were estimated at 108.1% of the planned target. Domestic revenues accounted for 67.8% of all revenues, with revenues from oil accounting for 12.6%. Budget expenditure for the whole year was estimated at 107.5% of the planned figure, with development investment expenditures accounting for 16.6% of the total and current expenditures for 77.1%.
16. Regarding the macroeconomic outlook for 2015, under "business-as-usual" conditions, economic growth and export growth are projected at 6.07% and 11.2%, respectively. The trade deficit is projected at USD 3.9 billion, mainly because of declining revenues from oil exports. CPI-based inflation is projected to increase by 4.14% in 2015, higher than in 2014.
17. The Report covers an in-depth analysis of public debt sustainability. The analysis of both the authors of this report, and the IMF (2014), argue that public debt remains sustainable in the period 2015-2020. However, restraining public debt

in line with faster debt repayment is an urgent task to broaden fiscal space for the future. In addition to improving investment efficiency (including Government bond-funded investments), Vietnam may consider: (i) gradually increasing the scale of principal repayment till 2020; or (ii) prioritizing resources for public investment (with efficiency a key requirement) till 2017, and then allocate more resources to repay debts. The key point is that the Government needs to make a clear and transparent commitment to repay debt in line with a more prudent fiscal policy.

18. The Report also analyses contributions by FDI. Most FDI inflows to Vietnam come from a limited number of countries and are located in limited geographical areas. The implication is that location-specific preferential policies have failed to significantly affect FDI inflows. Notwithstanding volatility of registered capital, actual implemented capital from FDI remained rather stable (with only a slight increase in Q4), raising concerns about the absorptive capacity for future increases in capital. An inadequate supply of skilled labour still presents a serious bottleneck in attracting FDI.

19. Reigning policies tend to provide preferential treatments for FDI enterprises, especially for large projects, which may create adverse precedents and consequences for the State Budget. There are signs that some FDI enterprises engage in transfer pricing and other tax evasion. Recent research indicates that FDI can crowd out investment by domestic enterprises, largely due to limitations in the capacity of domestic enterprises.

20. FDI has made important contributions in terms of job creation, economic growth and exports. However, building on these contributions will depend upon domestic enterprises and Government policies governing FDI.

21. The macroeconomic environment is becoming more stable, and there are signs of a more robust recovery in economic growth and market confidence. International economic integration continues to deepen. Important FTAs involving Vietnam may be signed and implemented in 2015. In this context, policy priorities should focus on strengthening the microeconomic foundation and reforming the economic institutions for a modern market economy. Efforts to improve the business environment, to simplify administrative procedures, to reduce costs, to liberalize markets, to facilitate business activities, and to encourage and improve technological capacity associated with sustainable productivity improvement – which was initiated in 2014 - should be maintained and deepened. Thus, the policy message for 2015-2016 should emphasize the need to establish and strengthen market order and discipline. The Report concludes with specific recommendations on reforming microeconomic foundations and conducting macroeconomic policies (including monetary policy, fiscal policy, trade policy, pricing policy, and FDI policy).

I. ECONOMIC CONTEXT IN 2014

1. Global and regional economic context

1. An array of complicated economic and political issues faced various parts of the world in 2014. These issues include, for example, warfare in Middle East, mounting conflicts between Russia and the Western countries in the first half of 2014, maritime boundary conflicts in Asia, and political turbulence in Ukraine. Adverse consequences for the world economy became more visible in the last quarter of 2014 (Q4) as crude oil price fell sharply and many currencies depreciated against the USD. These issues and changes then produced significant impacts on the economic and trade performances of the concerned countries, and the world economy.

Table 1: Economic prospects in some major economies

	2013	*2014*	*2015*	*2016*	*Difference**
World GDP (growth rate: %)	3.3	3.3	3.5	3.7	-0.3
Developed countries	1.3	1.8	2.4	2.4	0.1
United States	*2.2*	*2.4*	*3.6*	*3.3*	*0.5*
Japan	*1.6*	*0.1*	*0.6*	*0.8*	*-0.2*
Euro zone	*-0.5*	*0.8*	*1.2*	*1.4*	*-0.2*
Developing and emerging countries	4.7	4.4	4.3	4.7	-0.6
Developing countries in Asia	6.6	6.5	6.4	6.2	-0.2
China	*7.8*	*7.4*	*6.8*	*6.3*	*-0.3*
ASEAN-5	*5.2*	*4.5*	*5.2*	*5.3*	*-0.2*
World trade (growth rate: %)	3.4	3.1	3.8	5.3	-1.1
Non-fuel price (% increase, USD)	-1.2	-4.0	-9.3	-0.7	-5.2

Source: International Monetary Fund (IMF, 1/2015).
Note: * Difference between the latest forecast and forecast published in October 2014 (for 2015).
ASEAN-5 includes Indonesia, Malaysia, Philippines, Vietnam and Thailand.

2. The major economies attained slow and uneven growth recovery in 2014. Despite weaker than expected performance in early months, economic growth in the United States accelerated to 5% in Q3, before declining to 2.6% in Q4. The Federal Reserve (FED) extended quantitative easing by maintaining low interest rate (0-0.25% per annum).[1]

3. The USD continued to appreciate relative to most major currencies (Figure 1). Only the GBP appreciated slightly relative to USD. However, the real effective exchange rate (REER) of USD was fairly stable (Figure 2).

[1] The FED's statement at the meeting on 17 December 2014.

4. The European economies have not escaped slowing growth. Signs of improvement became more apparent at the end of Q4 when crude oil price decreased rapidly, lowering production and consumption costs. At the Winter Summit (18-19 December 2014), the EU leaders approved an Investment Plan for Europe and urged Russia to change its position on Ukraine.

5. Under US and EU sanctions Russia's economy remained unstable in Q4. The Russian ruble depreciated continuously, losing 20-26% of its value in a single day in the Moscow market.[2] In this context, Russia had to implement some urgent measures such as increasing its lending rate, restraining cereal exports, controlling capital and requiring two major crude oil and gas exporting companies to surrender foreign currencies, to help limit the ruble crisis.

Figure 1: Exchange rate of USD relative to major currencies

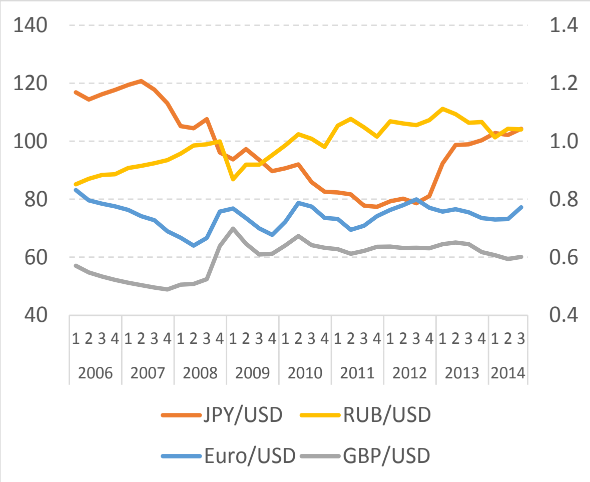
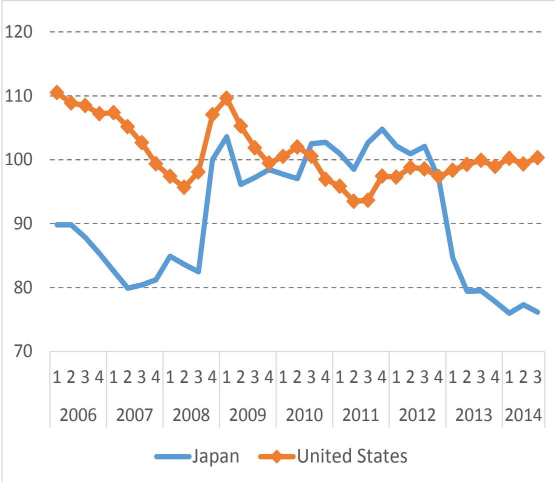


Figure 2: REER of United States and Japan (2010 = 100)



Source: International Financial Statistics (IFS).

6. Japan's economic growth continued to decelerate toward the end of 2014. Declines in business capital expenditure and in the REER (Figure 2) exacerbated concern about the widening trade deficit. The Japanese Government adopted an urgent economic stimulus package in December, loosening monetary policy to foster economic growth. Previously, the Japanese Government had postponed plans to increase taxes.

7. Economic growth in China was slower despite the declining oil price. The Chinese Government responded by lower economic growth targets to focus on fostering structural reform in 2015 via pro-active fiscal policy and prudent monetary policy. Chinese enterprises are diverting more attention to domestic market opportunities.

8. While the USD appreciated, prices of some commodities such as food, agricultural products, and crude oil tended to decrease (Figure 4). The crude oil price declined sharply in Q4, falling to 50% of the level in June. Recent analyses show that the declining oil price has induced consumption, private investment and improve balance of payment in net oil-importing economies.

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[2] The Ruble/USD exchange rate recorded an all-time low of 80 on 16 December 2014.

In contrast, decreasing oil price has had both positive and negative impacts on net oil-exporting economies. According to the forecasts of the Organization of the Petroleum Exporting Countries (OPEC) and the International Energy Agency (IEA), the oil price may fall further in 2015, because consumption demand is declining but oil producers are reluctant to cut supply.

Figure 3: International gold price

Source: Goldprice.org

Figure 4: Prices of crude oil and foods

Source: IFS.

9. Negotiations over mega free trade agreements (FTA) continue to progress, albeit slower than expected. The Trans-Pacific Partnership (TPP) agreement is in the final stage of negotiation, and is expected to be concluded in the first half of 2015. EU-Vietnam Free Trade Agreement (EVFTA) negotiations are also in the final stage. The depth and scope of commitments in these agreements have become less ambitious as many member countries want to push up the negotiation process. Vietnam has officially concluded negotiations for FTAs with South Korea and the Russia-Belarus-Kazakhstan Customs Union. The Regional Comprehensive Economic Partnership (RCEP) between ASEAN and its partners is tentatively targeted for conclusion by the end of 2015, the same time the ASEAN Economic Community (AEC) will be launched.

2. Basic institutional renovations and impacts on business environment

10. The number of regulations and the enforcement modalities changed little in 2014. During the year, the National Assembly passed 29 new or supplemented and amended laws; the Government issued 125 Decrees; the Prime Minister issued 75 Decisions; the ministries and agencies issued 496 Circulars, in addition to 3,930 documents to guide policy implementation.

11. The number of laws passed in 2014 was significantly higher than in previous years. Some laws incorporated fundamental reforms and conformity with the direction of developing a market-oriented economy in Vietnam. After amendments to the Constitution in 2013, the focus shifted in 2014 to laying the foundations for institutional reforms, including fundamental changes to economic institutions. If the reform momentum is maintained and promptly

implemented, the business environment will better evolve in line with demand of the business community.

12. Among the key institutional reforms in 2014 was to further simplify, rationalize and reduce the cost and procedures of starting businesses and making investments. According to the World Bank's Doing Business ranking, the amended Enterprise Law abolished 5 procedures (compared with 10 procedures before); the time for business registration was shortened from 34 days to 6 days. These improvements may be equivalent to an increase of 60 ranks in terms of Starting-A-Business indicator compared to 2013 (ranking 109th).
13. Together with abolishing the need to list all business activities in business licenses, all previous requirements, procedures and cost for supplementing or adjusting business activities will be nullified. This should reduce the workload of business registration agencies in Hanoi and Ho Chi Minh City by up to two thirds.
14. The amended Investment Law abolishes requirements for investment certificates for all domestic investment projects irrespective of scale and area of business. It also narrows the scope of foreign-invested projects that require investment certificates. Foreign invested projects and FDI enterprises are required to apply for investment certificate if the foreign invested share in chartered capital is at least 51%, or if the total share of foreign investor(s) and FDI enterprise in chartered capital reaches 51% or more. The maximum time for granting investment certificate is shortened to 15 days, instead of 45 days.
15. The freedom to do business has been widened and better secured. The amended Investment Law stipulates 6 areas and sectors in which business activities are prohibited. As a result, enterprises have secured rights to undertake all business activities that are not prohibited by laws, instead of doing the registered business activities. All legal risks related to "*doing unregistered business activities*", "*doing business activities which are unlisted in business registration certificate*", etc. have now been eliminated. The trap of "*doing illegal business*" has been basically removed for enterprises, their owners and managers.
16. The amended Investment Law stipulates a list of 267 conditional business activities. The new law considers conditional business and respective business conditions as forms of restraining people's rights in doing business. The regulations on conditional business and appropriate business conditions must be compliant with Clause 2, Article 14 of Constitution 2013: *"Human rights and citizens' rights may not be limited unless prescribed by a law solely in case of necessity for reasons of national defense, national security, social order and safety, social morality and community well-being".* The policy implications of the afore-mentioned changes of thought will surely pave the way for a breakthrough to reform current regulations on business conditions.

17. The new regulations aim at better and more effectively protecting investors' rights in line with the core features of a modern market economy. Specific changes include: (i) facilitating small shareholders to sue managers by reducing the costs of such actions; (ii) broadening the definition of stakeholders in company in accordance with international practices; increasing the authority of General Meeting of Shareholders in considering and approving transactions between the company and its stakeholders; publishing information widely and transparently and increasing supervision over transactions between the company and its related people; *and* (iii) enhancing and disciplining responsibilities of managers and stakeholders in publishing information widely and transparently, and in compensating for the losses from the transactions mentioned in point (ii).

18. The term "*state-owned enterprise*" (SOE) was also re-defined to cover only those enterprises in which the State owns 100% of the chartered capital. This change reflects a full and fair respect of the rights of shareholders in State-invested companies. Also, shareholders' rights and interests will be protected by good corporate governance principles and practices.

19. Changes mean that Vietnam is approaching good international practices. These improvements are equivalent to a rise by 100 positions in Vietnam's rank of Investor Protection indicator (from the rank of 165 in 2013). Vietnam ranked 117th in terms of protecting minority shareholders in 2014.

20. Government Resolution No. 19/NQ-CP (18 March 2014) marked an important breakthrough in initiating action to significantly reduce compliance costs and facilitate business activities. The Resolution put forward 50 measures and considers 2014-2015 as a critical time to concentrate on improving indicators of national competitiveness according to World Bank's ranking. The Resolutions targets Doing Business indicators for Vietnam to be at least equal to the average of ASEAN6 by the end of 2015.

21. By the end of 2014, line ministries and agencies had implemented 30 of these measures, of which 10 had produced significant improvements. The time required to paying taxes and insurance was reduced from 872 hours per annum to only 170 hours per annum. Enterprises will now be able to pay taxes on a quarterly basis, rather than on a monthly basis as was the earlier practice. Tax declaration documents have been simplified considerably, to reduce compliance costs and limit the risks of errors. The maximum time for accessing electricity from medium voltage stations is to be reduced to only 18 days, a reduction of 42 days.

22. Time and customs procedures for export and import have been reduced sharply. The remaining issues related to the Trading Across Border indicator lie mainly in the stages prior to, or after, customs clearance. In fact, about 200 types of licenses and specialized certificates are currently regulated in various legal documents. Some shortcomings still prevail in terms of capacity; division of function and time in testing and checking quality of imported

goods, sanitary and phytosanitary measures, foods safety and sanitation, etc. Therefore, further reductions in the time and procedures for customs clearance across borders will require cooperation among Ministries and agencies to improve specific technical regulations and their enforcement.

23. In its last meeting of 2014, the National Assembly approved two laws to simultaneously amend six tax laws: Law on Corporate Income Tax (CIT), Law on Personal Income Tax (PIT), Law on Value Added Tax (VAT), Law on Special Sales Tax, Law on Natural Resource Tax, and Law on Tax Management. The main idea underlying the amendments is to reduce tax burdens and facilitate related activities for the people and enterprises.

24. The major changes in afore-mentioned laws include:

    i. Removal of the 15% ceiling previously applied to deductible expenditures for advertising, marketing, sales promotion, and commissions; expenditures for reception, festivities and workshops; supportive expenditures for marketing activities, supportive expenditures, etc.

    ii. Increase in preferential CIT treatment and beneficiaries of such treatment, including: greenfield investment projects under the List of supporting industries for high technologies; projects for supporting textiles-garment, footwear, electronics-informatics, automobile production and assembling, mechanic manufacturing, where the products had not been produced domestically or could be produced domestically but must meet EU's technical standards; investment projects requiring large amounts of capital, high technologies and timely disbursement; investment projects in agriculture and fishery planting, breeding, processing in all areas; investment projects to produce, multiply and cross-breed plant and animal varieties; salt production, exploitation and refinement; post-harvest preservation of agricultural products and preservation of agricultural and fishery products and foods,.

    iii. Exemption of PIT for individuals who conduct business and have an income of VND 100 million or less per annum; individuals who conduct business and have an income of over VND 100 million per annum will pay PIT as a percentage of revenue depending on type of activities: 0.5% for distribution/supply of goods; 2% for services, construction without materials; 1.5% of revenue applied for production, transportation, services associated with goods, construction with materials; 1% of revenue applied for other business activities. 5% of revenue applied for asset leasing and insurance/multi-level marketing/lottery agent.

    iv. Exemption of PIT for Vietnamese crews working for foreign shipping companies or Vietnamese international transportation companies; individual ship owner or operator who provide goods and services directly for offshore fishing and income of crews working on ship.

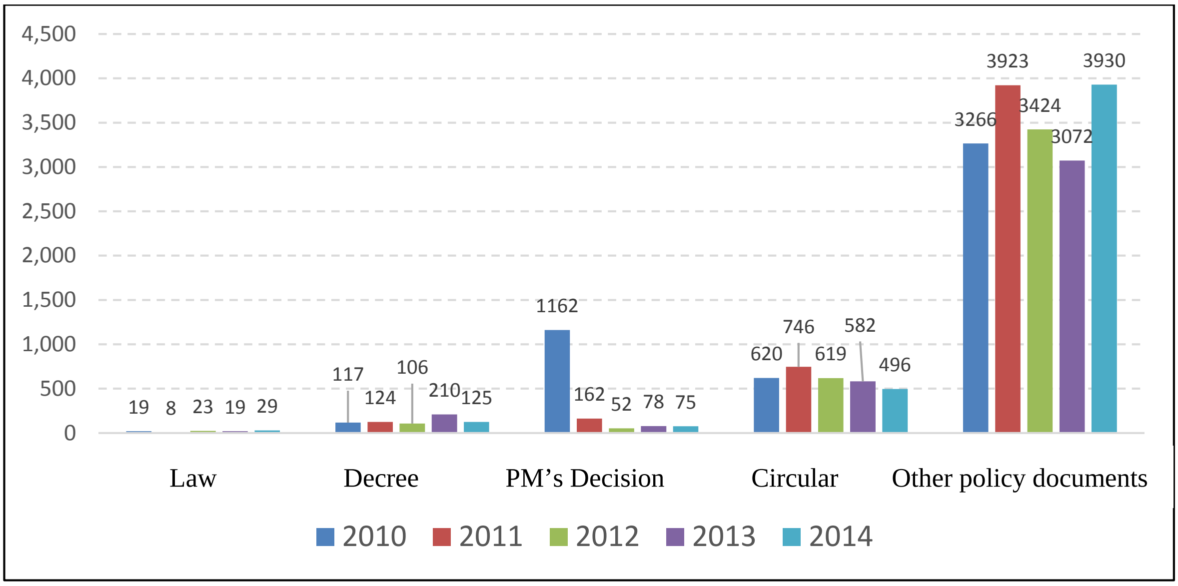
v. VAT exemption for building new ships for offshore fishing; fertilizer, animal feeds, and agricultural machinery and equipment (the previously applied VAT rate was 5%). This exemption aims to facilitate agriculture and fishery activities.

vi. Interest on overdue taxes reduced from 0.07% per day to 0.05% per day. Such interest will not apply if the supply of goods and services was financed by the State budget while the payment has not been made.

25. The Law on Public Investment and (amended) Law on Bidding establish a hard budget discipline for investments funded from the state budget and Government bonds. Relevant authorities are responsible for appraising and mobilizing capital resources for approved investment projects. The laws also increase the accountability of related state agencies in selecting and approving investment projects, and allocating investment capital. If these laws are fully and strictly implemented, public investment decision-makers will be more prudent and accountable. As a result, the distortion and bias in mobilizing and distributing investment capital via the capital market can be reduced.

26. In conclusion, important breakthroughs in reforming economic institutions were made in 2014, further consolidating earlier reform achievements and laying the foundations for a market economy in Vietnam. Freedom to do business is enhanced and secured, thereby increasing legal safety, and reducing risks and compliance costs. Tax burdens are reduced in parallel with more favorable conditions for doing business. Therefore, Vietnam's business environment will have greater appeal to the business community, and its ranking will significantly improve. Together with a sound macroeconomic environment, these improvements will enhance incentives for and build the confidence of enterprises and investors.

Figure 5: Number of issued documents, 2010-2014



Source: http://chinhphu.vn.

27. Nonetheless, implementing institutional reforms and improvement of business environment in line with international practices and standards still encounter major challenges. The enforcement of laws and policies depends heavily on circulars and guiding policy documents issued by ministries and other authorities (Figure 5). More fundamentally, legal enforcement remains influenced by the "ask-give" administrative mechanism; heavily subject to perceptions and interpretations of laws and regulations by state administrative management agencies. Inconsistency, non-transparency, changeability and unpredictability embedded in the laws and policies, add to the material legal risks and compliance costs faced by enterprises and investors.

28. The "Positive list" approach, instead of the "negative list" used in the amended Investment Law and (amended) Enterprise Law, still dominates the contents of other laws and their guiding documents. Such documents set out thousands of different business conditions, creating significant barriers for market entry in certain sectors whilst increasing inequality and business costs.

29. The "negative list" approach, instead of a "positive list" approach, requires more time to fully understand and implement. The "negative list" approach ensures that state management matches and is aligned with development demands, and facilitates development. This "negative list" approach should also be applied in supplementing and amending other laws, especially sector specific laws and regulations on conditions for certain business activities. The perception that management goes in line with management agencies' capacity and requirements ("*capacity decides management scope*") must be replaced. To do this, the authorities must be active and able to assess, predict, adapt to and manage changes. More fundamentally, the authorities must be self-innovative, and willing to accept, support and nurture innovation. The biggest challenge lies in the readiness of the whole state management apparatus in general, and each official in particular, to accept new ways of thinking, and to develop their capacity to transform new understandings into concrete actions.

30. The afore-mentioned breakthroughs in institutional reforms have focused on facilitating market entry and business activities. Few material changes were made in the other components of market economic institutions.

Figure 6: Main components of market economic institutions

31. Institutions for ensuring property rights and maintaining and ensuring market order and discipline in Vietnam remain insufficient and ineffective. In fact, monopolistic behaviors, unfair competition, smuggling, production and sale of counterfeit, pirated or low-quality goods, etc. still occur frequently and tend

to be increasing. These issues have undermined market competition and distorted the value system of a comprehensive and modern market economy. As a result, potential benefits to enterprises, consumers and the whole economy are lowered. Therefore, the future institutional reforms and efforts to strengthen legal enforcement need to focus more on other components of market economic institutions. In particular, the message in 2015-2016 should be to emphasize the establishment of market order and discipline. Reforms should specifically focus on market regulations, organizational structure, functions and authorities of market management agencies, and modalities and instruments for market management.

II. MACROECONOMIC PERFORMANCE AND OUTLOOK

1. Macroeconomic performance in Q4 and 2014

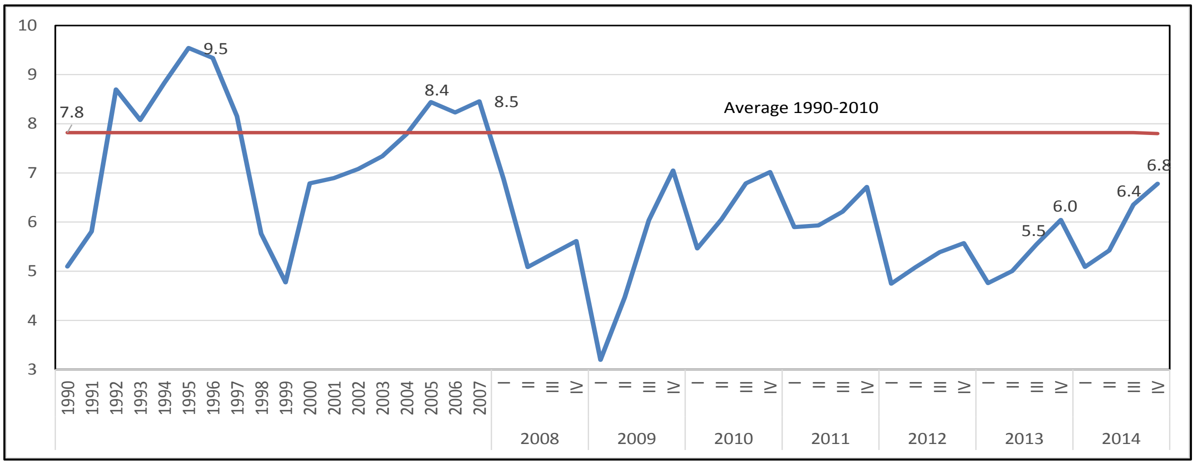
<u>1.1. Real economy</u>

1.1.1. Economic growth

32. Growth of Gross Domestic Product (GDP) was 5.98% in 2014, higher than the target of 5.8% and in the 2012-2013 period[3]. GDP growth accelerated over each quarter, reaching 6.8% in Q4 of 2014. This outcome further consolidated optimism for a more robust growth recovery in 2015. Still, GDP growth in 2014 remained much lower than the average growth for 1990-2010.

Figure 7: GDP growth rate, 1990-2014

Unit: %

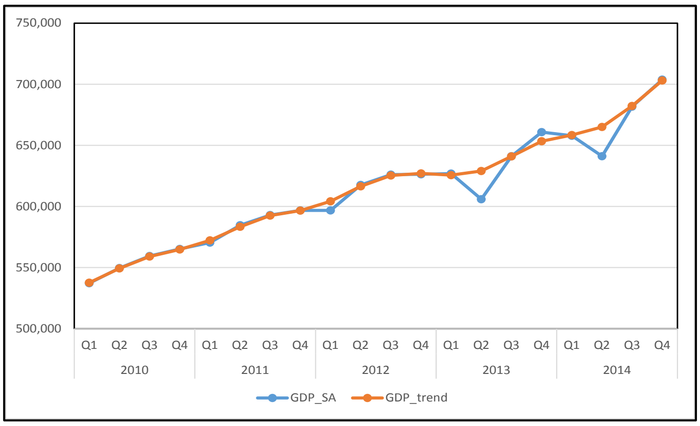


Source: General Statistics Office (GSO).

33. Excluding seasonal variations, GDP growth in Q3 and Q4 was almost equal to medium-term trends. More signs of sustainable growth recovery became visible. More importantly, the reforms of business environment and administrative procedures since Q3, helped increase economic growth in Q4 (Figure 8).

Figure 8: Quarterly GDP compared with trend

Unit: billion VND



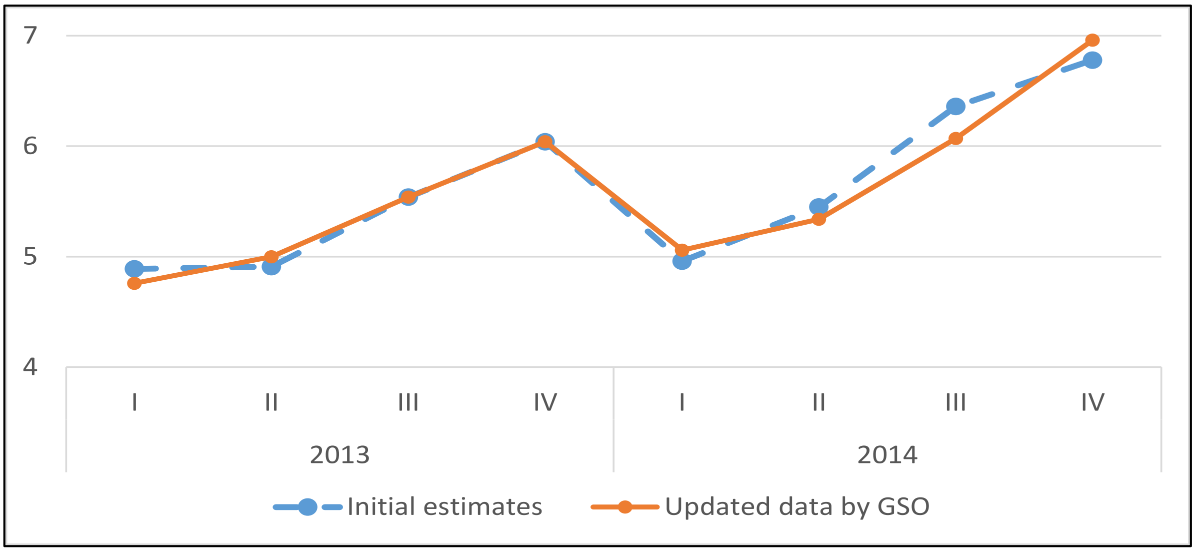
Source: Authors' calculation.
Note: GDP_SA is seasonally adjusted GDP; GDP_trend is trend of GDP.

[3] Respective growth rates for 2012 and 2013 are 5.25% and 5.42%.

34. Updated data on growth differ markedly from initial estimations (Figure 9). The adjustments in 2014 were bigger than in 2013. These adjustments are hardly avoidable, yet constant and big ones constrain economic analysis and policy formulation at both policymaking and enterprise levels.

Figure 9: Comparison of initially estimated and updated growth data

Unit: %



Source: Authors' consolidation and calculation.

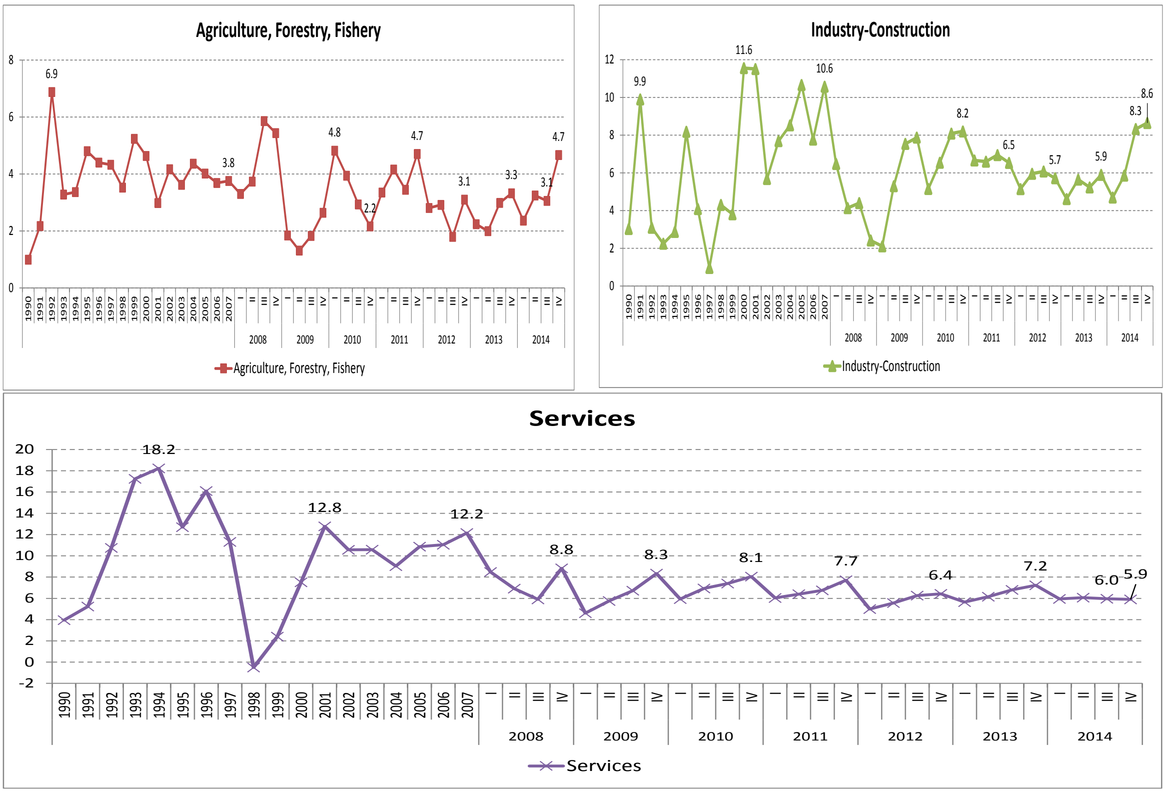
35. Value added of agriculture, forestry and fishery sector increased by 4.7% (YoY) in Q4 (Figure 10), a material improvement over Q3, thus contributing to the improvement in overall GDP growth. The improvement mainly resulted from higher volume of fishery products resulting from favorable climate conditions and policies to support fishery development under Government Decree 67/ND-CP. This result is also consistent with recent increased investment in agriculture and fishery.

36. The services sector grew by 5.9% in Q4 (YoY), slightly lower than in Q3 (6.0%) and Q4 of previous years (Figure 10). In 2014, the services sector growth rate was 5.96%, unchanged from previous years. This was partly due to the modest increase in foreign tourists. Accommodation and food service activities experienced negative YoY growth (-2.16%) in Q4.

37. Service sector growth in 2014 took place mainly in information and communication; science and technology, and; finance, banking and insurance. The real estate sub-sector appeared to be revitalized (the growth rate is 1 percentage point higher than in 2013) thanks to positive support, especially in the medium and low price apartment buildings segment.

Figure 10: Value added growth by sector, 1990-2014

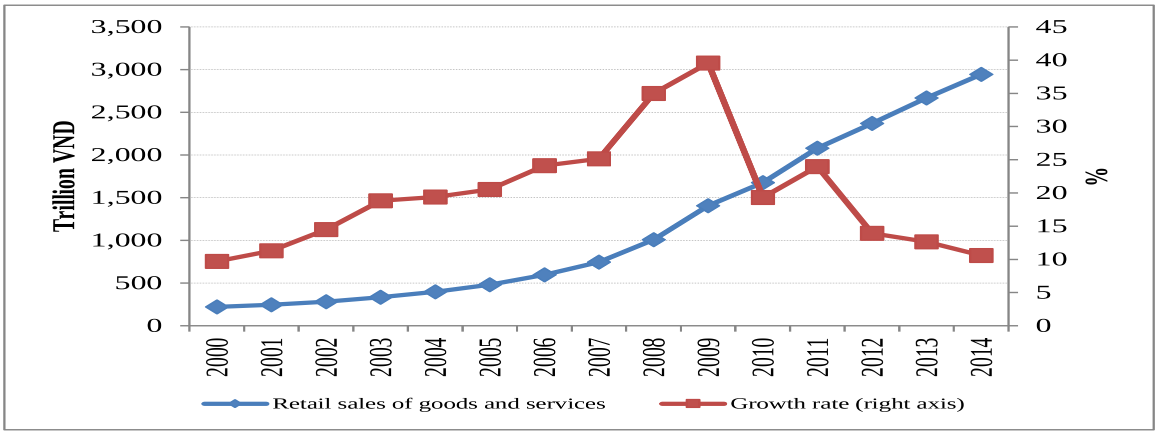
Unit: %



Source: GSO.

38. Total retail sales of goods and services increased to VND 799.8 trillion in Q4; the YoY growth of 16.6% was higher than in the first three quarters of 2014.[4]

Figure 11: Total retail sales of goods and services, 2000-2014



Source: GSO. Growth figures are on YoY basis.

39. Total retail sales of goods and services in 2014 reached VND 2,945.2 trillion, 10.6% higher than in 2013. Correcting for inflation, growth was 6.3%, still higher than in 2013 (5.5%). From another perspective, final consumption

[4] Total retail sales of goods and services in Q3 fell by 4.2% compared to Q2, but increased by 7.5% on YoY basis. Total retail sales of goods and services in Q4 went up by 13.2% compared to Q3.

increased by 6.2%, contributing 4.72 percentage points to overall GDP growth in 2014.

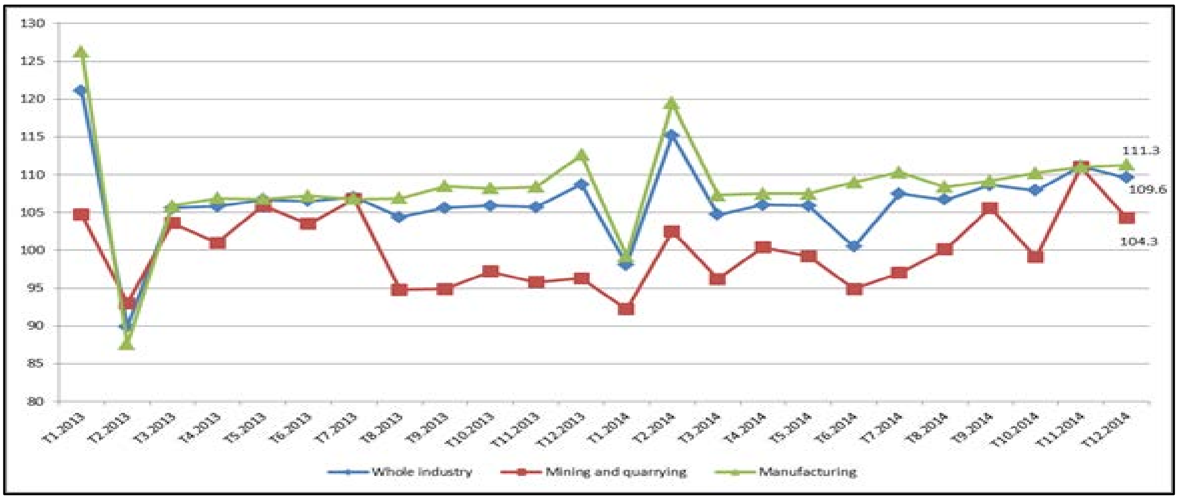
40. The non-state sector accounted for 86.5% of total retail sales of goods and services in 2014, following growth of 10.5%. With a small share (3.3%), the foreign-invested sector grew rapidly (16.9%) in 2014. Although total retail sales of goods and services increased faster than in previous years, overall service sector growth decelerated to 5.9% in Q4, and 6.0% for all 2014.

41. A 2014 A.T. Kearney report ranks Vietnam 28th in retail market development, much lower than in 2007 (4th) and 2010 (14th). Out of the top 30 markets, Vietnam ranked last in terms of market attractiveness and second to last in terms of country risk. However, there is huge potential for developing Vietnam's retail market, as only Nigeria, Armenia, Georgia and Sri Lanka ranked above in terms of market saturation.

42. The value added of industry-construction sector grew by 7.1% in 2014, and 8.7% in Q4 (YoY) (Figure 10). In contrast to the decline of 0.6% in the first 9 months, the mining sub-sector increased by 7.5% in Q4. Construction grew by 8.4% in Q4, and 6.3% in the first 9 months of 2014. The manufacturing sub-sector increased by 8.1% in Q4, i.e. slower than in the first 9 months (8.6%).

Figure 12: Index of Industrial Production, 2013-2014

Unit: %



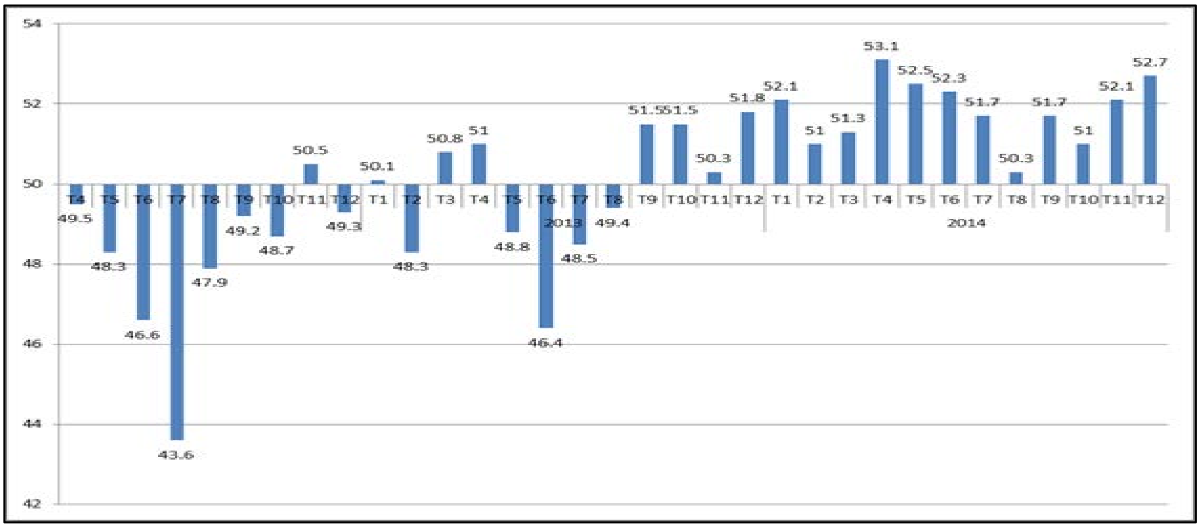
Source: GSO.

43. The Index of Industrial Production (IIP) increased by 7.6% in 2014, i.e. faster than in 2013 (5.9%). Industrial growth continued to increase towards the end of the year. The IIP increased by 10.1% in Q4; the manufacturing sub-sector experienced the highest growth of 11.3%. High output growth was mainly seen in export-oriented products (such as mobile phones, textile and garment, footwear, etc.). Output of some agriculture-related products (such as fresh milk, fishery feeds, etc.) also increased quite rapidly.

44. Several factors contributed to the rapid increase of industrial output. The mining and quarrying sectors (coal[5], crude oil[6]) increased output in response to growth in demand. Declining oil and gasoline prices helped reduce the cost to production and business, thus pushing up industrial production and increasing demand for industrial products.

45. The Purchasing Managers Index (PMI) rose from 51 in October, to 52.1 in November, and 52.7 in December (Figure 13). This index has exceeded 50 since September 2013, reflecting improved business conditions. According to HSBC, higher output resulted from improved customer demand, sharp increases in new orders, competitive prices and good product quality.

Figure 13: PMI, 2012-2014



Source: Markit, HSBC.

Note: PMI=50 means no month-on-month change.

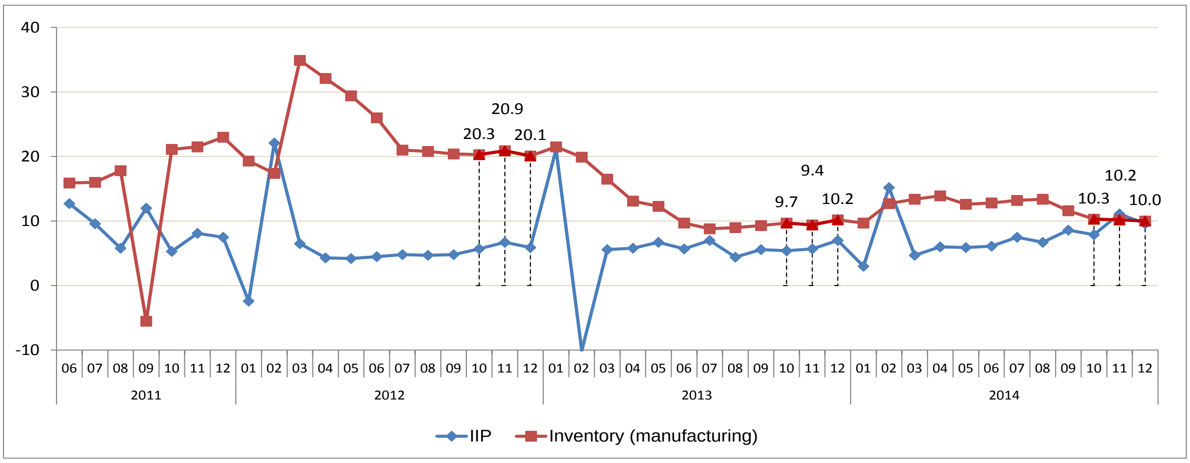
46. The recovery of industrial production helped boost demand for manufacturing products. The shipment index of manufacturing industries increased faster in Q4 than in the corresponding quarters in 2012 and 2013. Meanwhile, YoY growth in the inventory index for the manufacturing sector exhibited almost no change compared to Q4 of 2013, but was much improved compared with Q4 of 2012.

[5] Calculation using GSO data shows that coal volume (clean coal) increased by nearly 2% in Q4 (YoY) while the figure for the first 9 months was just 0.6%.

[6] In 2014, the total oil-equivalent volume of Vietnam Oil & Gas Group reached 27.58 million tons, 7% higher than the planned target (including an increase of over 1 million tons of oil as per the Government's request). Source: http://vietnamnet.vn/vn/kinh-te/215807/gia-dau-giam-duoi-48usd-thung--viet-nam-co-ngung-khai-thac-.html

Figure 14: Growth of inventory index of manufacturing industries and IIP

Unit: %

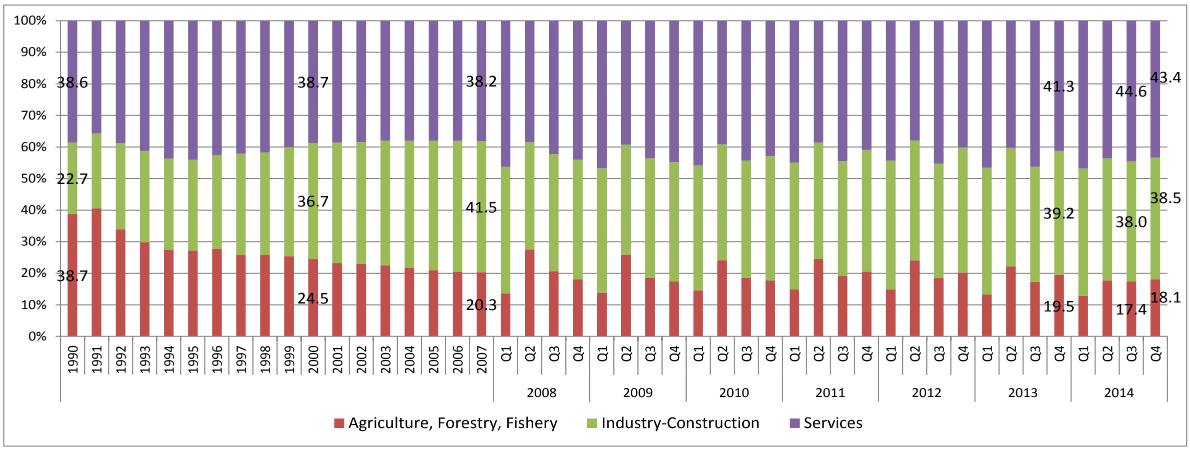


Source: GSO.

47. There was little change in the economic structure by sector in 2014. The share of agriculture, forestry and fishery and industry-construction sectors increased slightly in Q4, whereas the share of services sector declined marginally (Figure 15). The services sector still accounted for the largest share (43.4%), while industry-construction accounted for 38.5%, and the agriculture, forestry and fishery sector accounted for 18.1%.

Figure 15: GDP structure by sector, 1990-2014

Unit: %



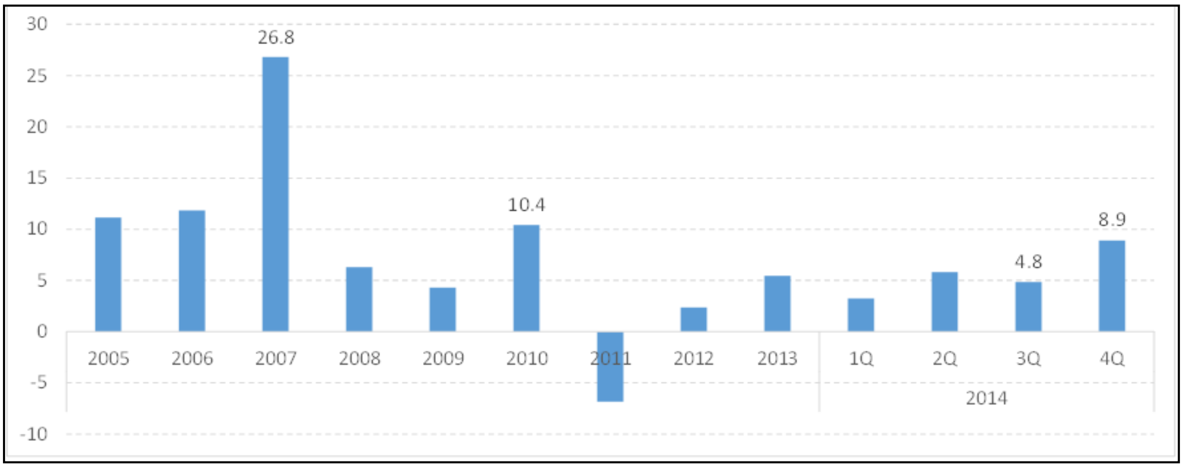
Source: GSO.

Note: GDP at current prices.

48. Gross capital formation in 2014 was 8.9% higher than in 2013. This overall growth was much higher than in the first 9 months (4.8%). Nonetheless, this growth rate remained much lower than in 2010, and in the years prior to 2007.

Figure 16: Growth of gross capital formation, 2005-2014

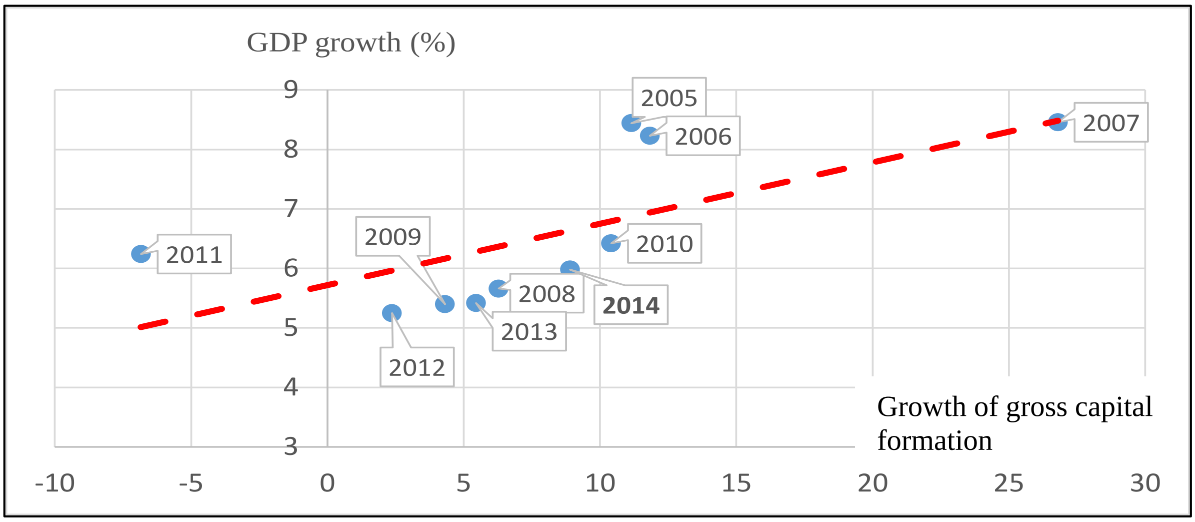
Unit: %



Source: GSO. Growth figures are calculated on YoY basis.

49. Growth recovery was partly constrained by the modest increase in gross capital formation (Figure 17).[7] It will be difficult for Vietnam to return to a high growth trajectory without an improvement in gross capital formation and/or efficiency. With macroeconomic environment now stabilized, further strengthening of investment confidence and facilitation becomes a top priority.

Figure 17: Growth of gross capital formation and GDP growth



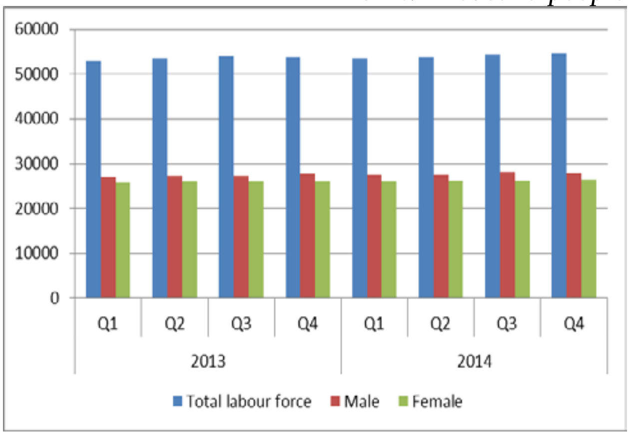
Source: GSO.

50. At the end of 2014, Vietnam had a labour force of 54.48 million people, 782,000 more than in 2013. Males accounted for 51.3%, and females 48.7%, of the labor force.

[7] As a note, due to high ICOR, the fitted line in Figure 8 is rather flat.

Figure 18: Total labour force, 2013-2014

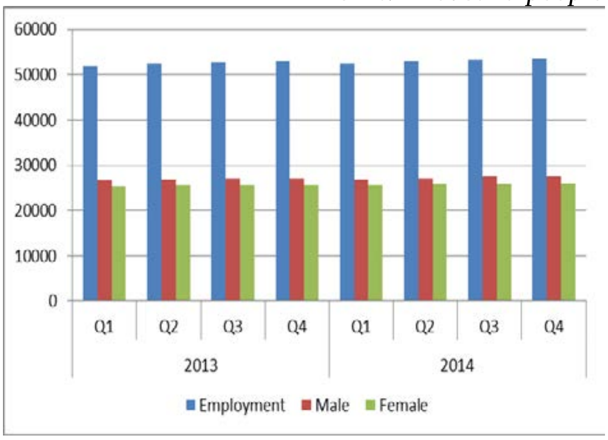
Unit: Thousand people



Source: GSO.

Figure 19: Number of employees, 2013-2014

Unit: Thousand people



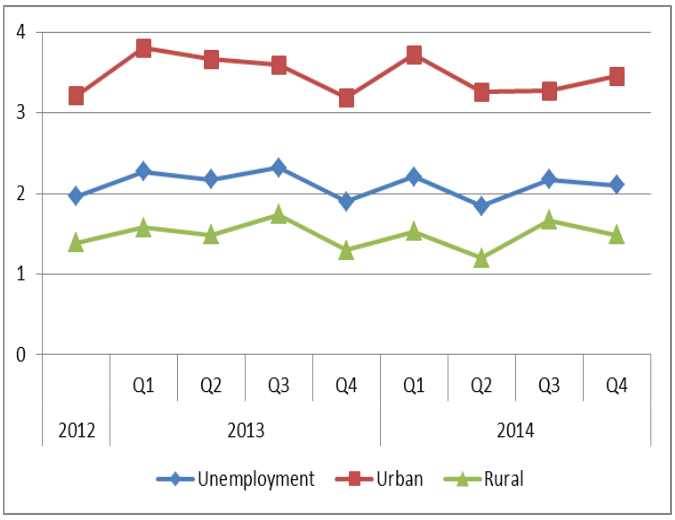
Source: GSO.

51. YoY growth in employment was positive at the end of each quarter (Figure 19). At the end of Q4, 53.47 million people were employed, a YoY increase of 0.68 million people. The agriculture, forestry and fishery sector accounted for 47% of employment, industry-construction 21%, and services 32%.

52. The working-age underemployment rate was lower than in 2012-2013 but tended to increase at the end of 2014 (2.5% in Q4). Underemployment mostly happened in rural areas (3.1%). The total working-age unemployment rate was 2.1% in 2014, lower than in 2013 (2.2%). The urban rate was 3.2% and rural unemployment was 1.4%. The ratio of vulnerable employment remained high, at 63% in 2013.

Figure 20: Working-age unemployment rate, 2012-2014

Unit: %



Source: GSO.

53. Labour productivity[8] in 2014 (at current prices) was estimated to be VND 74.3 million per employed person (about USD 3,515). Labour productivity (per employed person) in agriculture, forestry and fishery sector was VND 28.9 million (38.9% of the national average); industry-construction sector was VND 133.4 million (180% of the national average); and services sector was VND 100.7 million (136% of the national average).

[8] GDP per employed worker of 15 years old or above.

54. Labour productivity of in 2014 was estimated to be 4.3% higher than in 2013 (in constant 2010 prices). Respective growth rates of labour productivity in agriculture-forestry-fishery, industry-construction, and services were 2.4%, 4.3%, and 4.4%. On average, Vietnam's labour productivity increased by 3.7% per annum from 2005 to 2014.

Table 2: Labour productivity, 2010-2014

	2010	2011	2012	2013	2014
At current prices (VND million)					
Total	44.0	55.2	63.1	68.7	74.3
Agriculture, forestry and fishery	16.8	22.9	26.2	27.0	28.9
Industry-construction	80.3	98.3	115.0	124.1	133.4
Services	63.8	76.5	83.7	92.9	100.7
At comparable prices (VND million)					
Total	44.0	45.5	46.9	48.7	50.8
Agriculture, forestry and fishery	16.8	17.4	17.9	18.3	18.7
Industry-construction	80.3	82.1	85.4	88.7	92.5
Services	63.8	64.7	64.7	66.8	69.7
Growth rate (at 2010 prices)					
Total	3.6	3.5	3.1	3.8	4.3
Agriculture, forestry and fishery	4.7	3.7	2.7	2.3	2.4
Industry-construction	-0.3	2.3	4.0	3.9	4.3
Services	0.4	1.4	0.0	3.1	4.4

Source: GSO.

55. Vietnam's labour productivity lags far behind other regional countries, about one-eighteenth of that in Singapore, one-sixth of that in Malaysia, and one third of that in Thailand and China[9]. The main reasons include: (i) the high proportion of labour in agriculture, forestry and fishery, notwithstanding recent shifts in economic and labour structures; (ii) the low quality of labour force with inadequate training structure and low efficiency of trained labours; (iii) outdated equipment and technologies (the share of enterprises using low and medium technologies was 88% in 2012); (iv) poor management with low efficiency of resource utilization; and (v) underdeveloped and immobile labour market which restrain the movements of labourers toward high-productivity sectors.

56. The contribution of total factor productivity (TFP) growth to GDP growth has varied over time from 11.9% (2001-2005), -4.5% (2006-2010) and 23.6%

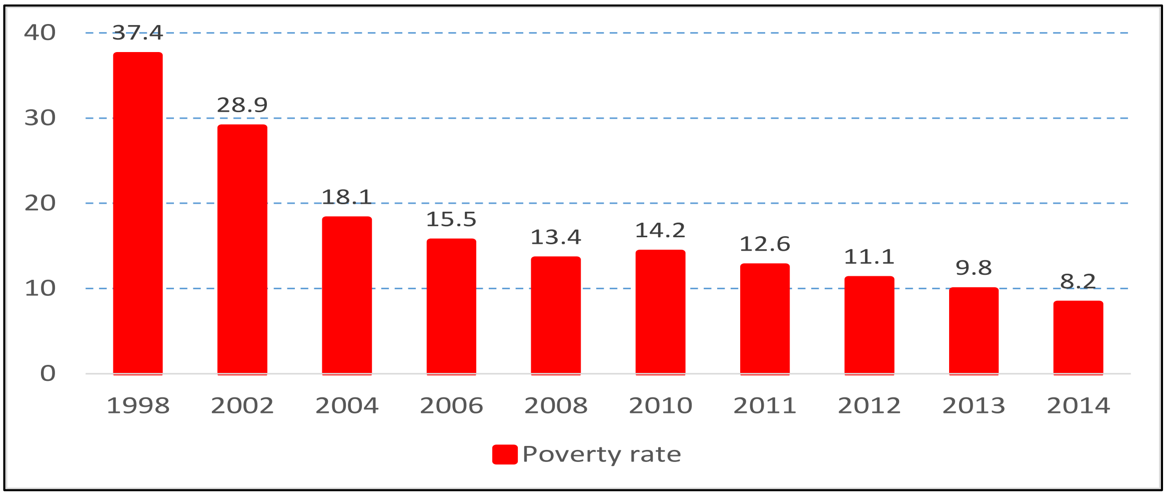
[9] In Purchasing Power Parity (PPP).

(2011-2013).[10] This variation largely stems from the fact that contribution of TFP is calculated as the residual of GDP growth after subtracting weighted contributions of capital and labour expansion, during periods when the pace of capital expansion exhibited large swings.

57. The ratio of poor households fell to 8.2% in 2014, lower than in 2013 (9.8%). The pace of poverty reduction in 2014 was 1.6 percentage points, i.e. faster than in 2013 (1.3 percentage points). Thus, rapid economic growth rate better enabled efforts to reduce poverty in Vietnam in 2014.

Figure 21: Ratio of poor household, 1998-2014

Unit: %



Source: GSO.

1.2. Monetary development

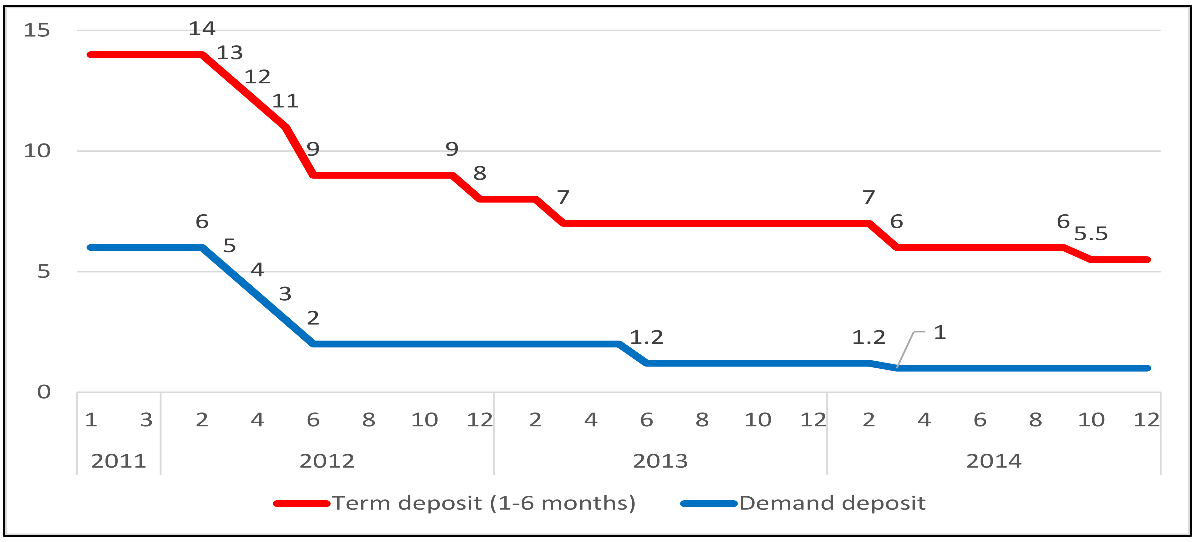
58. The State Bank of Vietnam (SBV) made flexible use of monetary policy instruments in 2014, aiming at different objectives over time (such as support for Government Bond issuance, promotion of export and economic growth, etc.). Inflation stabilization received limited attention, especially towards the end of the year. The SBV published regular information on monetary movements and policy directions.

59. The ceiling on the VND-denominated deposit rate was lowered twice in 2014, declining to 5.5% per annum in Q4 (applicable for term deposits term shorter than 6 months). The ceiling on the VND-denominated demand deposit rate remained unchanged in Q4. The ceiling on the USD-denominated deposit rate was reduced once (by 0.2 percentage point, annualized) in 2014 (Figure 22).

[10] Vu Minh Khuong (2014).

Figure 22: Ceilings on VND-denominated deposit rates

Unit: %/year



Source: SBV.

60. Actual deposit rates tended to decrease. Unlike the years 2011-2013, the SBV-stipulated ceiling on VND deposit rate was non-binding in 2014. In early 2014, only some commercial banks reduced deposit rates. Reductions became almost universal across banks towards the end of 2014. Due to the low inflation rate, real interest rate for depositors remained positive.

Table 3: VND-denominated deposit rate

Unit: %/year

Type of deposit	***End of 2013***	***End of September 2014***	***End of 2014***
Demand deposit	1.0-1.2	0.8-1.0	0.8-1.0
Term deposit, less than 6 months	5.0-7.0	5.0-6.0	5.0-5.5
Term deposit, from 7 to 12 months	6.5-7.5	6.0-7.2	5.7-6.8
Term deposit, longer than 12 months	7.5-8.5	7.3-7.8	6.8-7.5

Source: SBV.

61. The VND-denominated lending rate decreased faster in Q4, by up to 1.0-2.0 percentage points (annualized). The USD-denominated lending rate was rather stable despite SBV’s encouragement of foreign currency loans in the second half of 2014.

Table 4: Popular lending rate of commercial banks

Unit: %/year

	Type of loans	Short term	Medium and long term
State-owned commercial banks	VND: -Normal business and production	7.0-9.0	9.5-11.0
	-Agriculture; rural development; export; SMEs; supporting industries; high-technology	7.0	9.0-10.0
	USD:	3.0-4.5	5.5-6.5
Joint-stock commercial banks	VND: -Normal business and production	8.0-9.0	10.0-11.0
	-Agriculture; rural development; export; SMEs; supporting industries; high-technology	7.0	10.0-11.0
	USD:	4.5-6.0	6.0-7.0

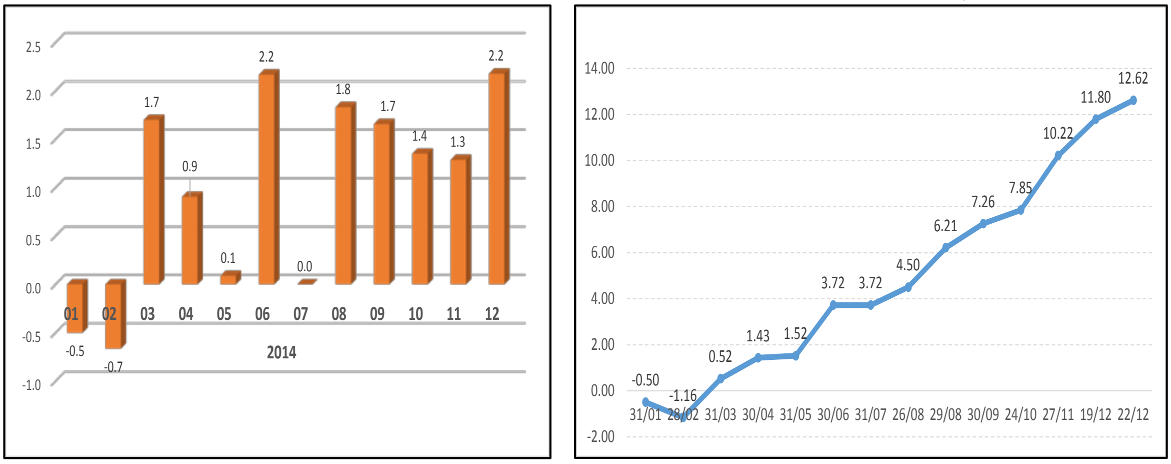
Source: SBV.

62. Growth in the level of credit outstanding accelerated, at a fairly even pace, throughout Q4. This pattern differed little from that in Q4 of 2013. Foreign currency loans went up more slowly (by 12.8% in mid-December compared to end of 2013), a little higher than the 10% as of June 2014. At the end of Q4, credit growth was partly constrained by planned restrictions on foreign currency loans (from 1 January 2015), and concerns about the impacts of Circular No. 36/TT-NHNN.

Figure 23: **Credit growth in 2014**

Unit: %

MoM credit growth rate | *Credit growth (accumulation compared with December, 2013)*

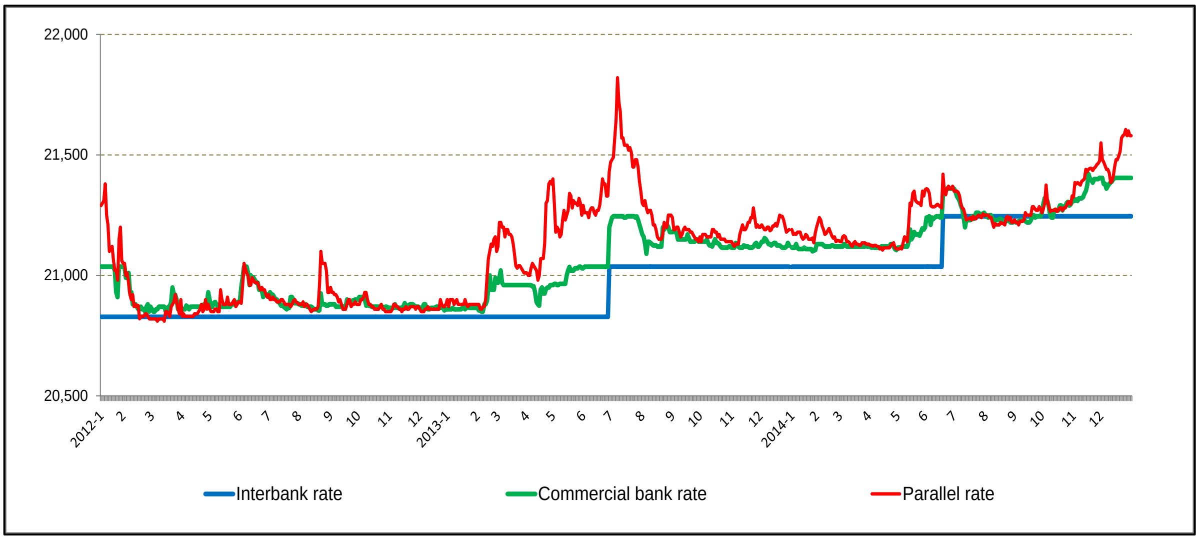


Source: SBV.

63. The inter-bank VND/USD exchange rate remained unchanged in Q4. The VND/USD exchange rates in the parallel market and in commercial banks

were rather stable in October-November, but depreciated a little in December, due to: (i) market expectation of exchange rate adjustment; (ii) increasing USD demand for import orders; and (iii) less abundant liquidity of foreign currency. Unlike previous years, the exchange rate was little affected by inflationary expectation (which have declined).

Figure 24: Movement of VND/USD exchange rate, 2012-2014



Source: VNDirect.

64. The depreciation of the REER in Q4 means that Vietnam's goods became cheaper relative to foreign ones, and slightly cheaper than in Q4 of 2013 (Figure 26). However, the depreciation of the VND/USD exchange rate might have limited impacts on exports because the USD has appreciated against most major currencies (Figure 1).

Figure 25: Real VND/USD exchange rate (Q1/2012=100)

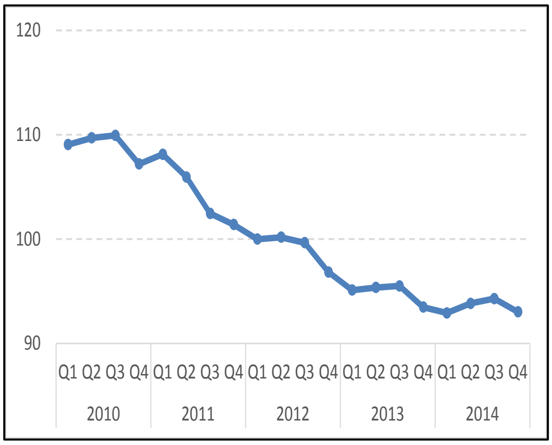
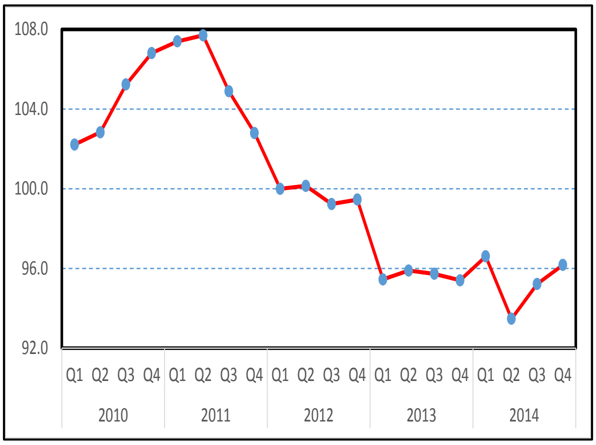


Figure 26: Real Effective Exchange Rate (Q1/2012=100)



Source: Authors' calculations.

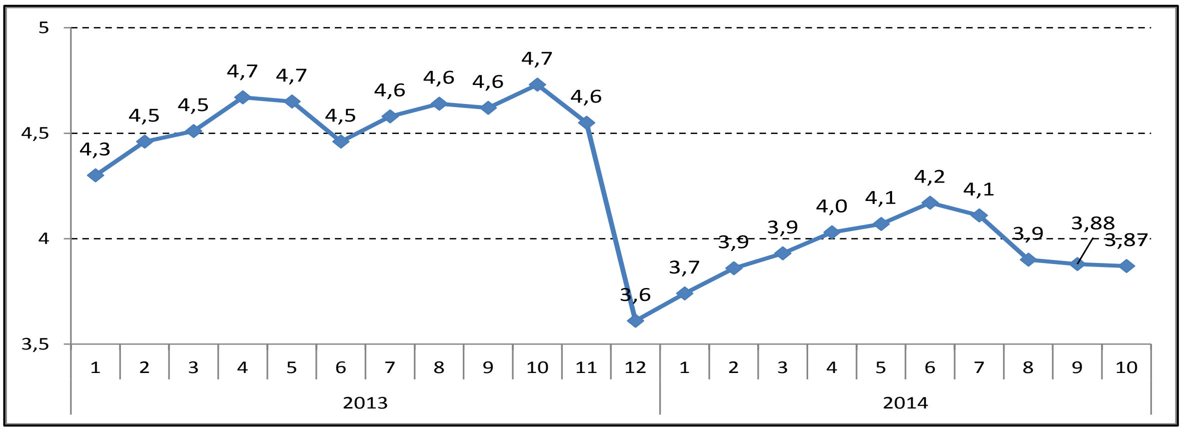
Note: REER is calculated based on trade data between Vietnam and its 19 largest trade partners and data on CPI. Data for Q4/2014 are estimated. Higher REER implies that Vietnam's goods became cheaper relative to foreign ones. Q1/2012 = 100.

65. The real VND/USD exchange rate decreased slightly in Q4, indicating little support for Vietnam in trade with the United States (Figure 25). Maintaining a rather stable exchange rate with low inflation has helped support exports. However, export competitiveness could be weakened if inflation in other countries decelerated more rapidly.

66. The non-performing loan (NPL) ratio continued to decline. At the end of October, the NPL ratio reported by credit institutions fell to 3.87% (Figure 27). The SBV also announced its calculated NPL ratio of 5.43% in October, a marked improvement from the reported level of 17% in 2012.

Figure 27: NPL ratio, 2013-2004

Unit: %

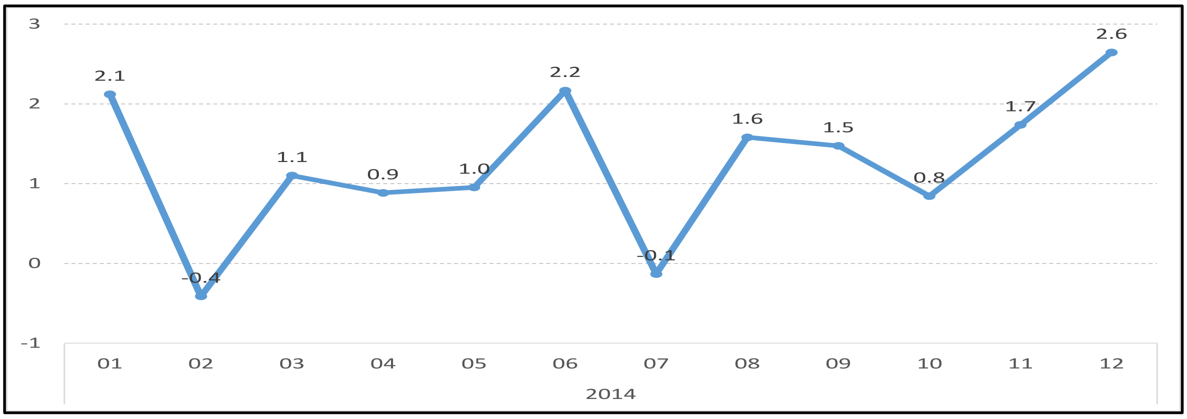


Source: The authors' consolidation.

67. Total liquidity (M2) increased faster in November-December, even faster than in June. In Q4 as a whole, M2 increased by over 5.3%, much higher than in Q4 of 2013 (1.9%). M2 growth was consistent with economic growth, but failed to trigger higher inflation in Q4.

Figure 28: MoM growth of M2

Unit: %



Source: SBV.

68. In 2014, the SBV published more information on NPLs, and on progress in restructuring the banking system. Information dissemination and related

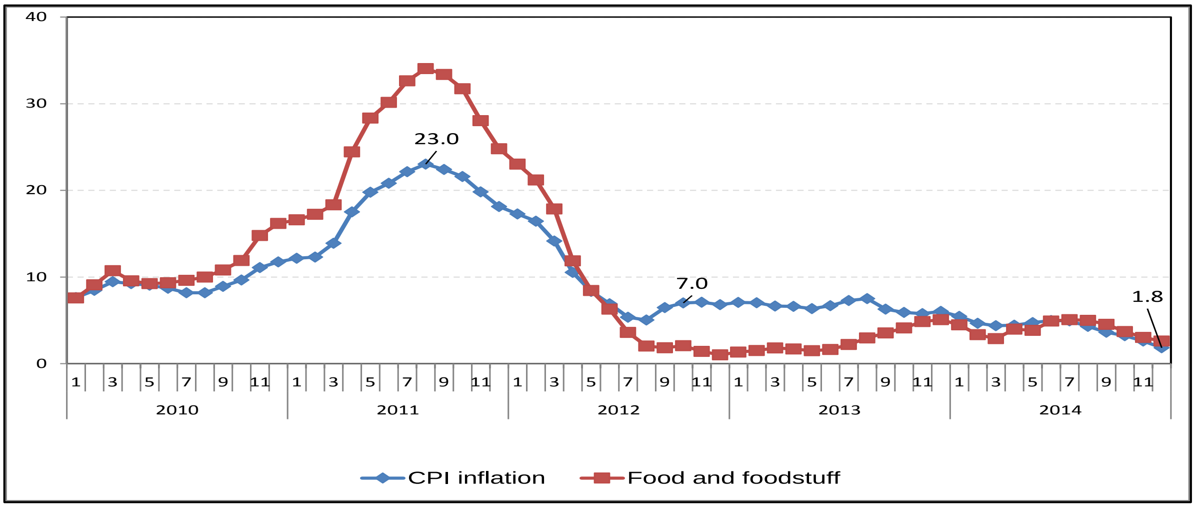
support helped to ensure the safe operation of the banking system, even during a period when the leaders of some commercial banks (e.g., Ocean Bank, Construction Bank) were arrested.

1.3. Inflation

69. The consumer price index (CPI) increased slowly in 2014 and inflation reached new low levels. The CPI even fell in November and December. At the end of 2014, the CPI was only 1.84% higher than at the end of 2013, much lower than the target set out by the National Assembly for 2014 (7%). The average increase in the CPI compared with 2013 was 4.09%.

Figure 29: MoM inflation, 2010-2014

Unit: %

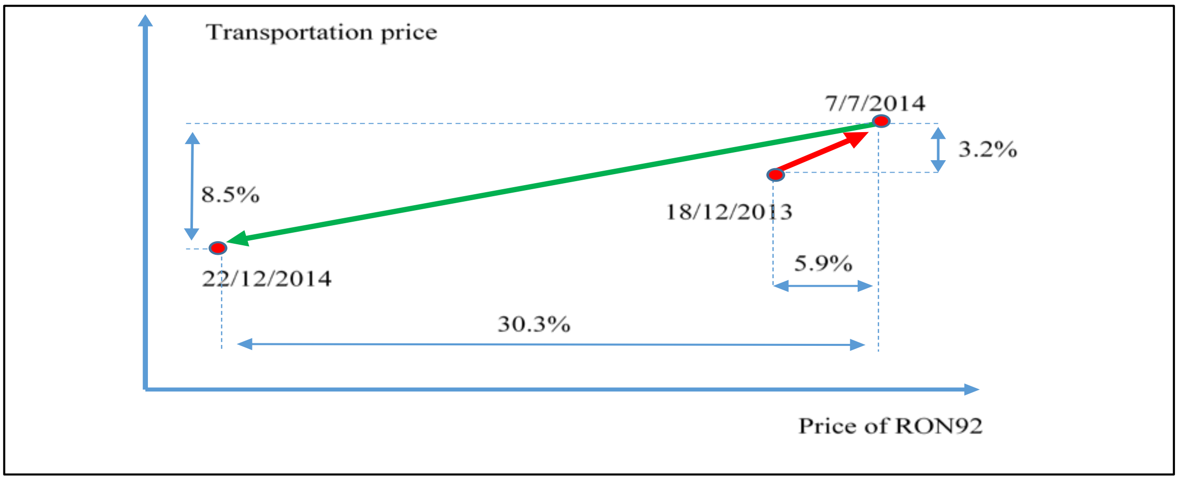


Source: GSO. Growth rate (YoY)

70. Notable changes in Q4 included declining crude oil price in international market and in retail prices of oil and petroleum products in the domestic market[11]. Between 19 September and 22 December, the domestic retail prices fell by 19.7-27.4%. The price of transportation services also fell sharply, by 0.17%, 2.75% and 3.09% in October, November and December respectively. This contributed to declines in the prices of other product categories, and the CPI dropped further in December. However, the price of transportation group fell more slowly than the retail price of oil and petroleum products; thus, the benefits of lower oil price to economic activities were limited. In this regard, strengthening market competition to reduce price distortions is an increasingly urgent issue.

[11] Retail prices were lowered in October (13rd and 23rd), November (7th and 22nd) and December (6th and 22nd).

Figure 30: Changes of A92 petrol price and price of transportation in 2014



Source: Authors' compilations.

71. Low inflation in Q4 was partly caused by a stable VND/USD exchange rate. The import price index continued to decline (by 1.02%, YoY) while the export price index just went up slightly (by 0.79%, YoY). The rise of health and education service fees also decelerated compared with previous months.

72. Regarding "demand pull" factors, export growth tended to decelerate compared with previous quarters. By 22 December, M2 rose by about 16% (YoY). Excluding price factor, consumption demand in 2014 only increased by 6.25% (YoY).

1.4. Investment

73. Gross investment increased faster in real terms in 2014, than in 2011-2013. Investment accelerated in the domestic private and State sectors. Investment by FDI enterprises increased at a marginally slower rate than in 2013.

Table 5: Growth rate of gross investment in the 2011-2014 period

Unit: %/year

	2011	*2012*	*2013*	*2014*
Gross investment	-7.2	5.5	7.0	9.6
State	-9.2	13.5	7.3	8.2
Domestic private	-0.5	3.8	5.6	11.5
FDI	-13.9	-3.9	8.8	8.7

Source: GSO.

Note: At comparable prices (for 2014: data at current prices are used, after subtracting inflation).

74. The ratio of investment to GDP was only 30.6% in Q4, despite improving compared with 2012-2013. This ratio in Q4 was lower than in Q2-Q3 (Figure 31). Gross investment increased more slowly in Q4. This was not consistent with the sharp increase in gross capital formation in Q4 (Figure 16).

Figure 31: Ratio of Investment/GDP, 2007-2014

Unit: %

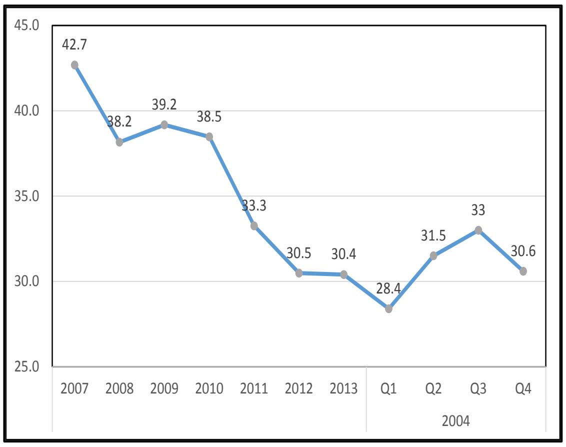
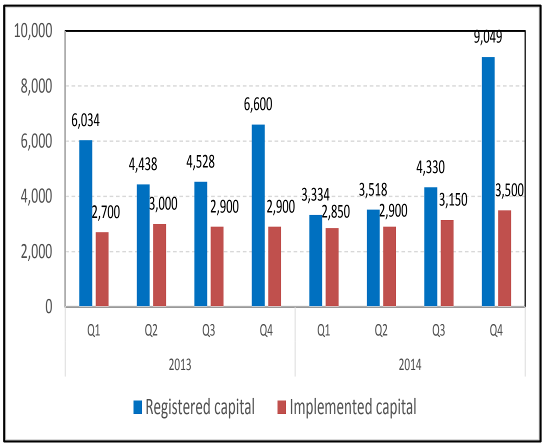


Figure 32: FDI capital, 2013-2014

Unit: USD million



Source: GSO.

75. Investment by the domestic private sector increased remarkably in 2014. Even after adjusting for inflation, private sector investment increased by 11.5%. This result was noteworthy given the large value of Government bonds issued[12] that could have crowded out private investment. With larger numbers of newly established enterprises, and enterprises resuming operations, the increased investment reflected growing private enterprises confidence in economic prospects.

76. FDI increased substantially compared with the first three quarters. Registered capital of FDI projects was estimated at USD 9.0 billion in Q4, 2 times higher than in Q3, and about 2.6 times higher than in Q1 and Q2. Implemented capital of FDI reached USD 3.5 billion in Q4, and about USD 12.4 billion for all 2014, higher than the corresponding periods in 2013. This improvement followed the efforts to improve the business environment and address the consequences of labour riots in May. Nonetheless, the higher reported levels of implemented FDI capital in 2014 seems to be inconsistent with data in Table 5 (which shows slowing growth in investment by foreign-invested enterprises in 2014).

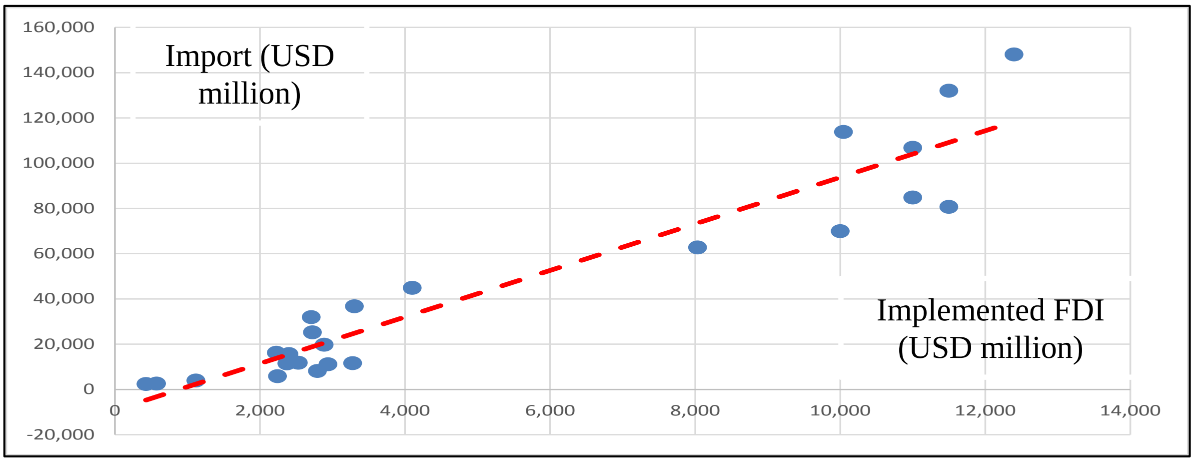
77. In the context of deeper integration, FDI depends more on trade potential. Vo Tri Thanh and Nguyen Anh Duong (2014), found that FDI disbursed through balance of payments can rise by 0.45% if trade potential increases by 1%. Meanwhile, if the VND/USD exchange rate goes up by 1% in the long term, FDI can fall by 3.85%. Inflation and interest rate gap between domestic and foreign markets only have impacts on FDI in the short term.

78. Investment from Japan increased slowly. Registered capital from Japan exceeded USD 1 billion in the first 3 quarters, and about USD 200 million in Q4. Vietnam's Industrialization Strategy in cooperation with Japan has been

[12] The value of issued Government bonds in 2014 was about VND 209.0 trillion; of which, the figure for Q4 was VND 37.8 trillion (Source: HNX).

concretized via various action plans for most key industries (except for the automotive industry), but the implementation progress is slower than expected.

Figure 33: Correlation between implemented FDI and import



Source: GSO.

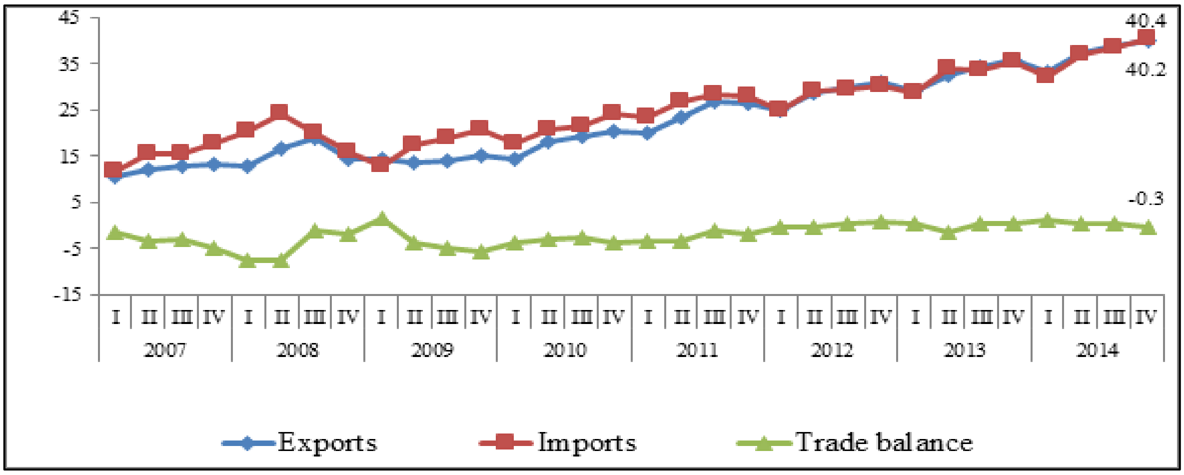
79. The increase in implemented FDI has helped boost import demand. This trend became more visible after Vietnam became a member of WTO and still prevailed in 2014 (Figure 33).

1.5. Trade

80. Exports attained more modest growth in Q4 (on YoY basis) than in Q3 and Q2. Import growth, however, accelerated in Q3 and Q4[13]. Respective values of exports and imports in Q4 reached USD 40.2 billion and USD 40.4 billion, leading to a trade deficit of USD 0.2 billion in Q4 (after recording surpluses since Q2 of 2013).

Figure 34: Exports, imports and trade balance

Unit: USD billion



Source: General Department of Customs.

[13] YoY export growth rates in Q1, Q2, Q3 and Q4 were 14.3%, 15.4%, 13.6% and 11.6% respectively. Corresponding figures for import were 12.1%. 8.7%. 14.0% and 13.7%.

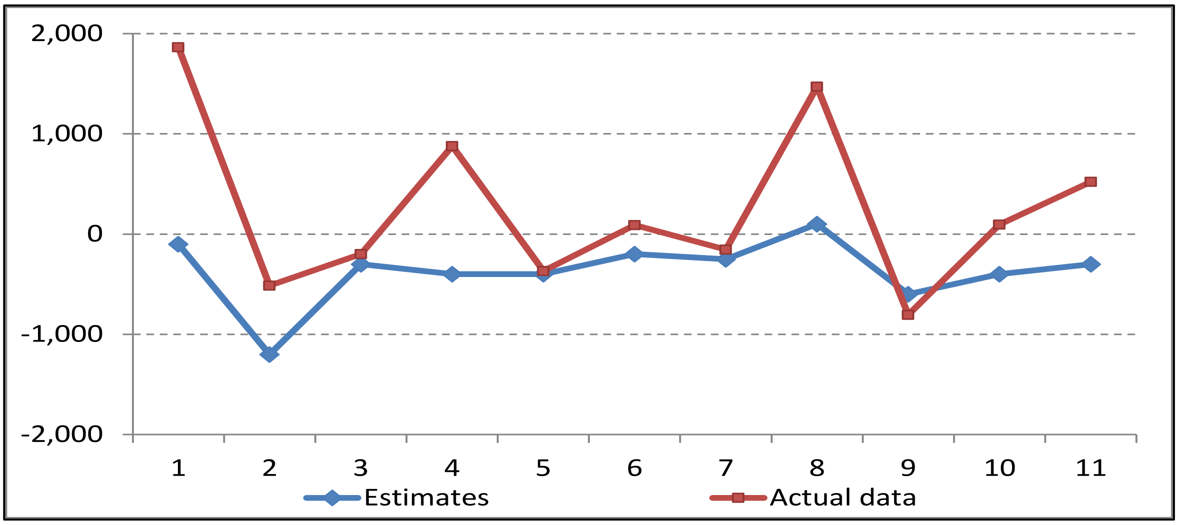
81. Export and import growth rates in 2014 were 13.6% and 12.1%, respectively. Both figures decreased from those in 2013 (15.3% and 16.0% respectively). Vietnam ran an overall trade surplus of USD 2 billion in 2014.

82. Export and import growth mainly resulted from the increase in trade volume (by 12.7% and 13.3% respectively)[14]. Declines in the prices of the crude oil and other key export products of Vietnam, such as coffee, rubber, cassava, coal, electric wire and cable, etc. weakened export growth in Q4 and 2014.

83. Foreign-invested enterprises still accounted for the lion's shares of exports and imports in 2014 (71.2% of exports and 60.0% of imports). Imports by domestic enterprises increased by 10.2%, partly reflecting the recovery of domestic production.[15] Imports of inputs and materials for domestic production tended to increase more rapidly (compared with 2013).

Figure 35: Estimates and actual data on trade balance, months of 2014

Unit: USD million



Source: GSO and General Department of Customs.

84. The monthly estimates of trade data still entail sizeable gaps with actual data. The estimates were often based on experiences and pattern in previous years. Almost all monthly estimates of trade balance were negative (except August, Figure 35). Actual data, however, showed trade surpluses in several months, even with large surplus. Failure to sufficiently improve the quality of trade data may undermine the effectiveness of trade policy management.

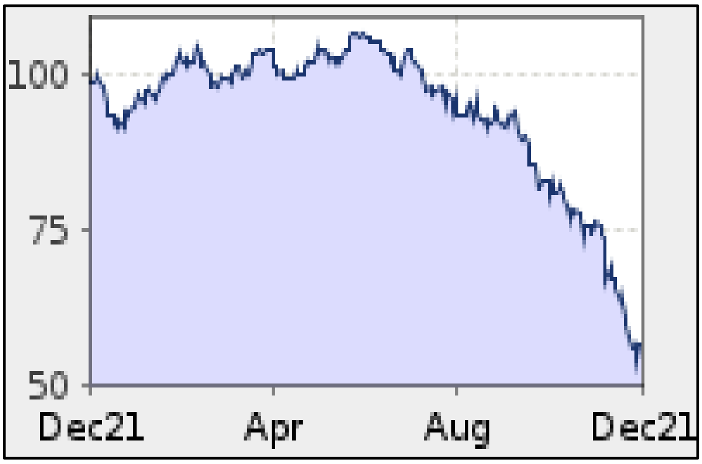
[14] The respective increases in volumes of exports and import growth in the first 9 months were 12.8% and 13.8% (YoY).

[15] Imports of domestic enterprises just increased by 7% in 2013, after a fall by 7% in 2012.

85. Another note involves the effective export price of crude oil in 2014. According to General Department of Customs data, the average effective export price of crude oil was USD 778.1/ton in 2014, equivalent to USD 109.9/barrel. The world oil price stayed below USD 100/barrel most of 2014.

Figure 36: The world oil price from 21 Dec 2013 to 21 Dec 2014

Unit: USD



Source: http://www.oil-price.net/

1.6. Budget revenues and expenditures

86. Budget revenues in 2014 were estimated at 108.1% of the planned target. Budget revenues in Q4 increased materially compared with the first 9 months (81.3% of the planned target). Domestic revenues accounted for 67.8%, and revenues from oil accounted for 12.6%, of total revenue. Notably, revenues from oil in 2014 were 25.6% higher than the planned target, even in the context of a rapidly declining world oil price and increasing exported oil volume (mainly because of good timing of exports: according to of General Department of Customs data (as of 31 December 2014) indicates that the average price of exported crude oil was USD 109.9/barrel).

87. Budget expenditures in 2014 were equal to 107.5% of the planned target. Budget expenditures in Q4 is higher than the first 9 months (reaching 75.8% of the planned target). Of which, investment and development expenditure accounted for 16.6% while current expenditures accounted for up to 77.1%. Debt payment (principal and interest) amounted to VND 118.8 trillion, equivalent to 3.02% of GDP.

88. The room to mobilize additional capital for investment from issuing Government bonds is drastically smaller. The value of issued Government bonds in 2014 reached VND 209 trillion. Some calculations show that about VND 420-430 trillion of Government bonds needs to be issued in 2015[16]. Some new debt obligations for the State Budget also reduced investment from Government bonds. The public debt ratio (excluding SOEs' debts) may reach 64% by 2015 (i.e. close to the permitted ceiling).

[16] The State Treasury has announced the plan of issuing Government Bonds in 2015; in which, the value of bonds for state budget and development investment is VND 250 trillion.

Table 6: Budget revenues and expenditures, 2008-2014

Unit: % GDP

	2008	*2009*	*2010*	*2011*	*2012*	*2013*	*2014*			
							I	*II*	*III*	*IV*
Total revenues	**26.6**	**25.1**	**27.3**	**26.0**	**22.7**	**22.9**	**25.8**	**24.0**	**22.1**	**16.6**
Domestic revenues	14.9	15.5	17.5	16.0	14.7	15.7	17.7	16.1	14.7	11.5
Revenues from oil	5.5	3.4	3.2	4.0	4.3	3.4	3.4	3.1	2.5	2.2
Revenues from trade	5.7	5.8	6.0	5.6	3.3	3.6	4.6	4.7	4.8	2.8
Revenues from grants	0.6	0.4	0.5	0.4	0.3	0.2	0.1	0.1	0.2	0.1
Total expenditures	**28.0**	**31.0**	**30.1**	**28.3**	**28.2**	**26.8**	**28.8**	**26.9**	**25.4**	**23.8**
Investment and development expenditures	7.4	10.0	8.5	7.5	8.3	6.1	4.4	4.9	5.0	3.2
Budget deficit	**4.6**	**6.9**	**5.5**	**4.9**	**5.4**	**5.5**	**4.9**	**4.6**	**5.3**	**7.3**
Budget deficit (excluding principal repayment)	1.8	3.7	2.4	2.1	3.4	3.9	3.0	2.9	3.3	7.2

Source: Calculations from MOF's data.

Note: 2007-2012 data is approved ones; 2013 data are second estimates; 2014 data are first estimates (as of 15 December 2014).

89. Most domestic debts are short-term: the average term is only 4.3 years. The average term of Government bonds is 2.6 years (compared with 12.8 years for foreign debt). 49% of the Government bonds issued in 2014 will mature within 2-3 years[17]: the remaining bonds have terms of 5-15 years.

90. The short term before Government bonds mature leads to mounting demand of new bonds to roll over previous debts. As an estimate, the newly issued amount for debt roll-over could reach VND 137 trillion in the years 2012-2014 (VND 77 trillion in 2014). In 2015, additional Government bonds valued at VND 130 trillion (i.e. nearly equal to the gross value for 2012-2014) may be required to roll over previous debt.

2. Macroeconomic outlook

91. A forecast scenario is specified for Vietnam's economy under "business-as-usual" conditions, in line with general expectations about the world economic recovery and the domestic economic situation. GDP growth in partner countries is projected at 3.5% in 2015.[18] YoY inflation in the United States

[17] This ratio fell to 35.7% in Q4 of 2014.
[18] IMF's forecast (1/2015).

increases by 1.8%. The price of agricultural exports declines by 5.8%.[19] The international price of crude oil drops by 46.4% compared with the average oil export price in 2014. For the domestic economy, the VND/USD exchange rate increases by 2%. M2 goes up by about 18%. Total liquidity increases by 14%. Import prices fall by 3%. Population and employment increase by 1.04%, and 1.4%, respectively. The export volume of crude oil declines by 20%. The REER is assumed to remain stable. Via the balance of payment, Government transfers rise by 8% whereas (net) private transfers increase by 2% compared with 2014. Implemented FDI capital increases 5% compared with 2014 as the efforts to reform the regulatory framework and investment-business environment and important FTAs (such as TPP, EVFTA, and Vietnam-Korea FTA) take effect. Credit outstanding grows by 14% in 2015. Investment from the State Budget and Government bonds will be VND 195 trillion and VND 80 trillion, respectively. As an assumption, investment capital will be disbursed evenly throughout 2015.

92. The GDP growth rate in 2015 is forecast at 6.07% (Table 7). Export growth may reach 11.2% in 2015, lower than in 2014. The trade deficit is projected to be USD 3.9 billion, mainly because of declining revenues from oil exports. The CPI is projected to increase by 4.14% in 2015, higher than 2014 (1.84%).

Table 7: Projection of macroeconomic indicators in 2015

Unit: %

GDP growth rate	6.07
Inflation	4.14
Export growth rate	11.2
Trade balance (USD billion)	-3.9

Source: CIEM's projection.

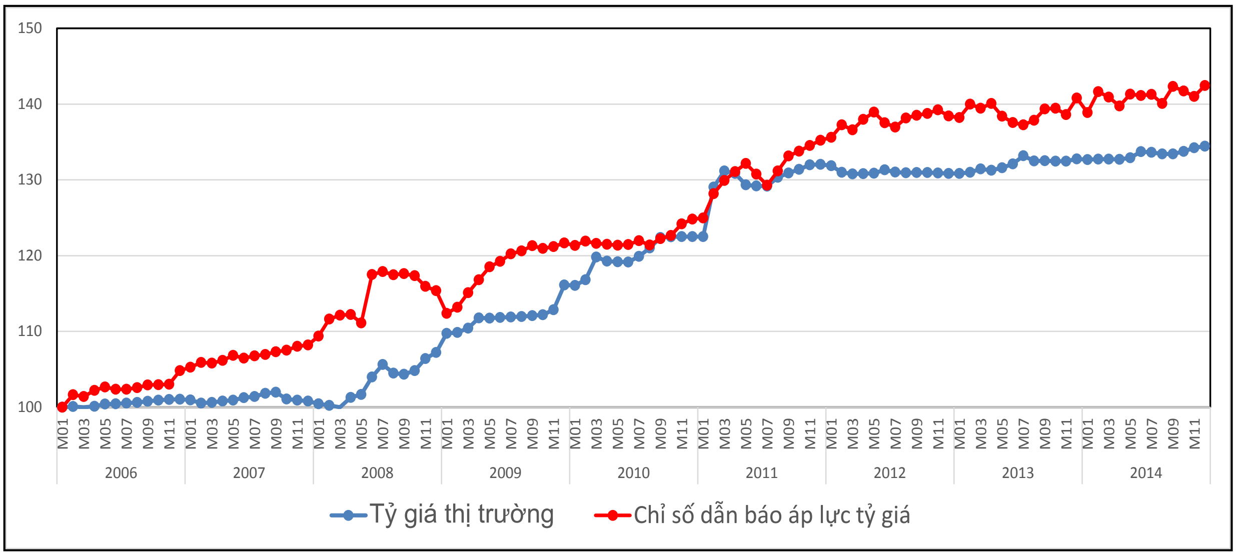
93. If the international oil price continues to decline sharply, Vietnam's economy may encounter more difficulties in 2015. If the oil price drops by another 1/3 compared with the above scenario, and other factors remain unchanged, the projected GDP growth rate may decline by 0.67 percentage points. Export growth is gloomier (down by 0.8 percentage point) and the trade deficit is expected to widen (by USD 1 billion). This is largely because the decline in oil price has only been partially passed through to domestic prices, production cost and business expenses in 2015.

94. The evolvement of the exchange rate and pressure in foreign exchange market deserve attention (Figure 37). The CIEM leading indicator of exchange rate did not change substantially (over 3%) in December 2014. The exchange rate of the commercial bank system is expected to remain stable till June 2015 (with a probability of 93.7%). If international prices go down further, the

[19] EIU's forecast (11/2014).

REER will remain favorable for Vietnam's exports as long as there is no significant shock and/or macroeconomic policies continue to stabilize inflation at low level.

Figure 37: Leading indicator of exchange rate



Source: CIEM's calculation.

III. SOME OUTSTANDING MACROECONOMIC ISSUES

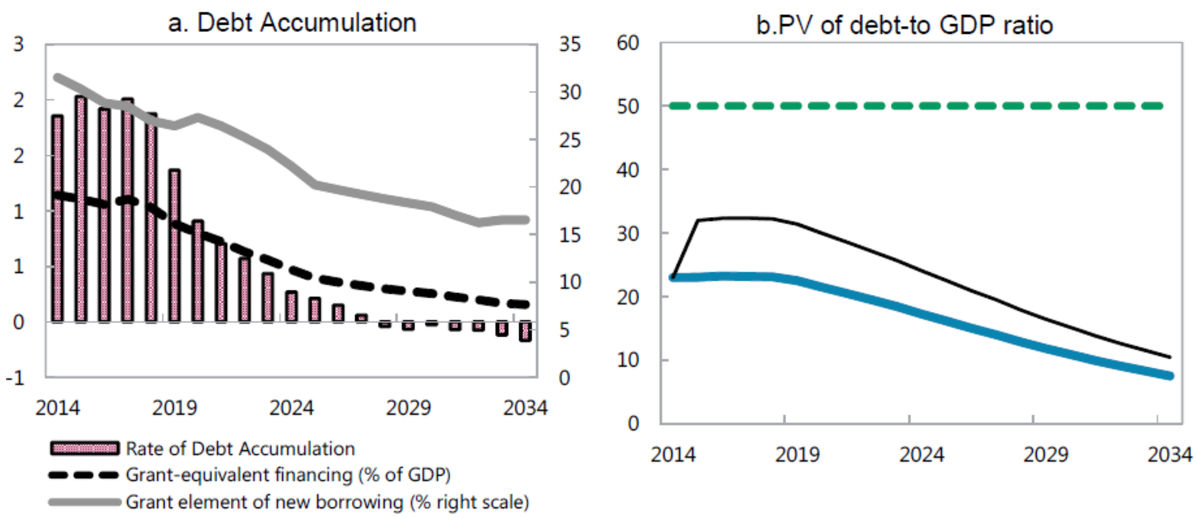
1. Sustainability of public debt

95. Outstanding public debt was estimated at 60.3% of GDP as of 31 December 2014. This figure was lower than the level assessed by The Economist. Thus, Vietnam's public debt seems to be less problematic compared with various other countries, and remains below the national statutory debt ceiling (65% of GDP).

96. Despite inconsistent data on public debt, the capacity to repay public debt poses a more serious concern. The concern was re-ignited when economic growth recovery was modest and fiscal incentives were viewed as essential to alleviating difficulties faced by enterprises. Repayment of public debt deserves increasing attention, with estimated values of nearly VND 118.7 trillion in 2014 and over VND 160 trillion in 2015. The ICOR of the State sector is remarkably higher than in other sectors. As such, increases in Government bond issuance add to the present value of debt (even in the case of debt roll-over), whilst failing to adequately upgrade production capacity and grow the future tax base. Slow disbursement of Government bond capital raises additional concern about wastages in public investment (in terms of management cost and opportunity cost).

97. Official reports state that public debt may reach 64% of GDP by the end of 2015 (very close to the statutory ceiling). Resources for public investment will become scarcer, and this may undermine both economic growth and budget revenues to help repay debts.

Figure 38: Assessment of foreign debt



Source: IMF (2014).

98. IMF (2014) assessed the sustainability of public debt under the following assumptions: (i) improved economic growth rate in the short term (about 6% per annum till 2020), with a slow down to 5.5% per annum in the long-term; (ii) stable inflation at low level; (iii) net borrowing of the Government with

loosened fiscal policy until 2017; and (iv) increasing reliance on domestic borrowings when income improves.

99. In the Baseline scenario, the ratio of external debt to GDP decreases in the long term (Figure 39). External debt also decreases relative to exports and budget revenues. The ratio of debt service to budget revenues increases in the medium term and subsequently goes down. As an explanation, the grace period of recent loans will expire and budget revenues will rise more slowly. The above result holds even if remittances are taken into account.

100. The value of external debt will change significantly if the VND depreciates in nominal term against the USD. Nevertheless, the debt ratio remains lower than the statutory ceiling.

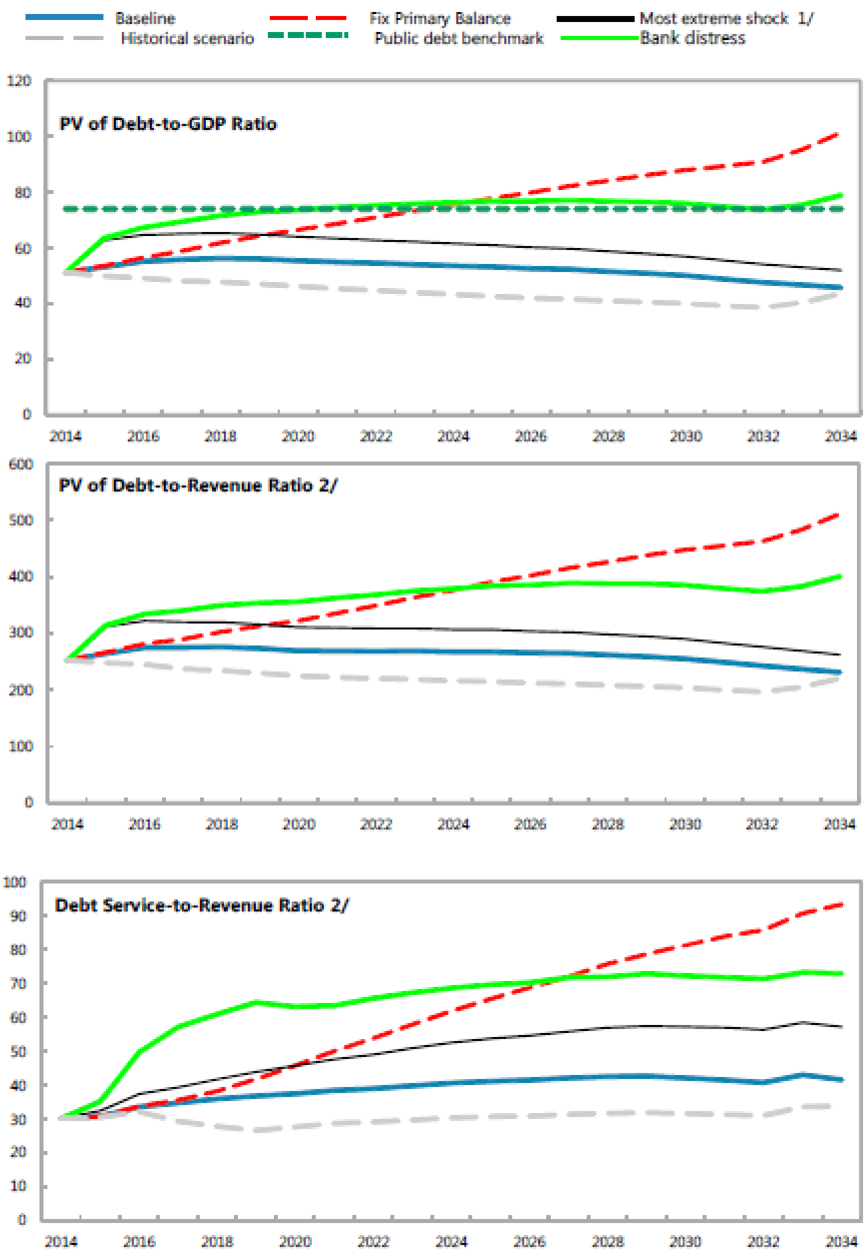
Figure 39: Analysis of external debt sustainability

Source: IMF (2014).

101. Domestic debt remains manageable under the Baseline scenario. The ratio of domestic debt to GDP may rise to 60% in 2017. As a note, IMF (2014) uses a reference ceiling of 74% of GDP. However, there is a risk that domestic debt

may increase dramatically unless the debt stock undergoes substantial restructuring.

Figure 40: Analysis of domestic debt sustainability



Source: IMF (2014).

102. If the primary balance is limited to 4% of GDP, the ratio of debt to GDP will increase continuously and become unsustainable. If the exchange rate undergoes a once-off nominal depreciation for the whole period (by 30% in the first year), the ratio of debt to GDP may rise by 10 percentage points in the years 2016-2018.

103. If the banking system is exposed to significant risks, public debt may exceed the reference ceiling. This scenario assumes that the Government will raise the ratio of domestic debt to GDP by 15 percentage points in the first 2 years,

while annualized GDP growth rate will decrease by about 3 percentage points. As another assumption, the Government borrows more from the domestic market with 5-year term and interest rate of 7%. The ratio of debt to GDP will then reach the reference ceiling of 74% by 2019, and exceed this ceiling in the following years. Debt service may be equivalent to 70% of budget revenue in long term. If financing conditions deteriorate, these ratios will be even higher.

104. The authors also analyze public debt sustainability under some tailor-made scenarios. These scenarios rest on various assumptions of GDP growth (at current prices), size of budget deficits, decision to repay principal and the variation of interest rate. Details of these scenarios are presented in Table 8. Note that Scenario 1 focuses on managing debt prudently and increasing debt repayment over time. Scenario 2 maintains a fixed debt payment each year till 2020, alongside a larger budget deficit. Scenario 3 focuses on increasing investment and maintains stable debt repayment until 2017, with more dedicated effort to repaying debts in 2018-2020.

Table 8: Scenarios for public debt sustainability analysis

	2015	**2016**	**2017**	**2018**	**2019**	**2020**
GDP growth rate (current prices, %)						
Scenario 1	*9*	*10*	*10*	*10*	*10*	*10*
Scenario 2	*9*	*8*	*8*	*8*	*8*	*8*
Senario3	*9*	*11*	*11*	*11*	*11*	*11*
State budget deficit (% GDP)						
Senario1	*3.75*	*3*	*3*	*3*	*3*	*3*
Senario2	*3.75*	*4*	*4*	*4*	*4*	*4*
Senario3	*3.75*	*3*	*3*	*3*	*3*	*3*
Principal repayment (Bill. VND)						
Senario1	*65,060*	*70,000*	*75,000*	*80,000*	*85,000*	*90,000*
Senario2	*65,060*	*65,000*	*65,000*	*65,000*	*65,000*	*65,000*
Senario3	*65,060*	*65,000*	*65,000*	*90,000*	*90,000*	*100,000*
Issue Government bonds for investment (bill. VND, not scenario-specific)	85,000	85,000	85,000	85,000	85,000	85,000
Interest rate (%,not scenario-specific)	3.51	4.00	4.00	4.00	4.00	4.00
Discount rate (not scenario-specific)	1.06	1.06	1.06	1.06	1.06	1.06

Sources: Authors' calculation.

105. The present value of public debt increases in all scenarios. However, the magnitude of increase varies depending on debt repayment schedule and State

budget management (Figure 41). In Scenario 1, the present value of public debt will increase slightly till 2020, except in 2018. This present value of public debt is more stable in Scenario 3. Public debt will expand most rapidly in Scenario 2.

106. None of the scenarios see public debt exceed the statutory ceiling (65% of GDP) in the period 2015-2020 (Figure 41). In Scenario 2, the ratio of public debt to GDP is relatively stable (i.e. the rates of public debt accumulation and GDP growth (at current prices) are similar). With a commitment to reduce public debt by increasing principal repayments over time, the public debt ratio will decline to below 50% in 2020 (Scenario 1). If investment is increased with higher efficiency in 2015-2017 to support large-scale debt repayment in 2018-2020, the ratio of public debt will drop even faster (Scenario 3).

Figure 41: Present value of public debt

Unit: Bill VND

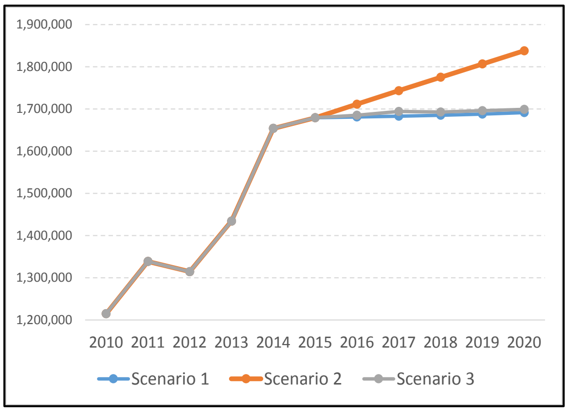
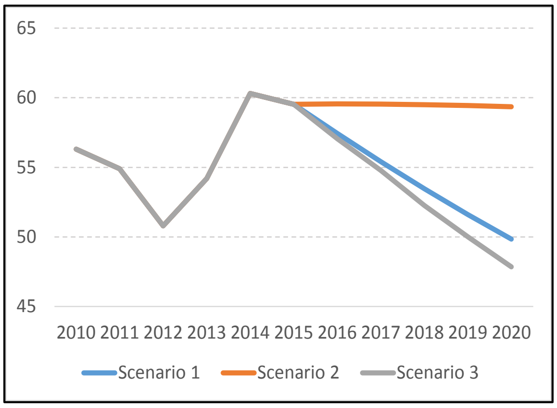


Figure 42: Ratio of public debt over GDP

Unit: %



Sources: Authors' calculation.

Note: Present value is calculated as of 2010.

107. The analysis shows that public debt remains sustainable in the period 2015-2020, notwithstanding mounting pressure. The pressure will ease if the Government sets out a transparent and reasonable roadmap to reduce public debt (not only relative to GDP, but also in present value terms). The policy space of the Government will not narrow greatly; fiscal space may even expand after some time. The Government may consider gradually increasing the scale of principal repayment till 2020. Reduction of public debt will be even more effectively if resources are prioritized for public investment (with efficiency a key criteria) in the period 2015-2017, before allocating more resources to repay debt from 2018 to 2020.

2. Contribution of FDI

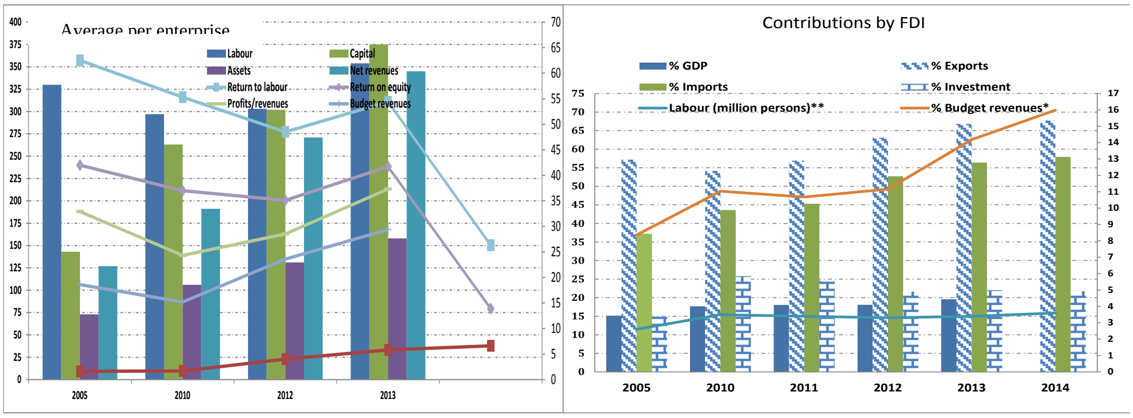
108. The last 27 years witnessed the growing importance of FDI, in terms of its contribution to economic growth, expansion of production capacity, exports, shift of economic structure, improvement of labor productivity and state budget revenues. Nonetheless, there are questions regarding the role of FDI, including: (1) the adequacy of its contribution; (2) the excessive preferential

treatments provided by Central and local governments to FDI enterprises, especially large ones; (3) the level of transfer pricing and tax other forms of tax evasion; *and* (4) the possible crowding-out effect on domestic investment.

<u>Contribution of FDI to the economy</u>

109. FDI enterprises experienced continuous increase in revenues (on average by 20.3% per annum) and account for the lion's share in trade (67%). However, the FDI sector only accounts for nearly 20% of GDP. The corresponding figure in total investment is nearly 22%: this has fluctuated over a 5-percentage-point range over the past 10 years. The limited contribution of FDI enterprises to GDP and investment stems from issues on both the Vietnamese side and with FDI enterprises.

Figure 43: Some key indicators of FDI



Sources: GSO * Updated data by Q2, 2014; ** Updated data by October 2014

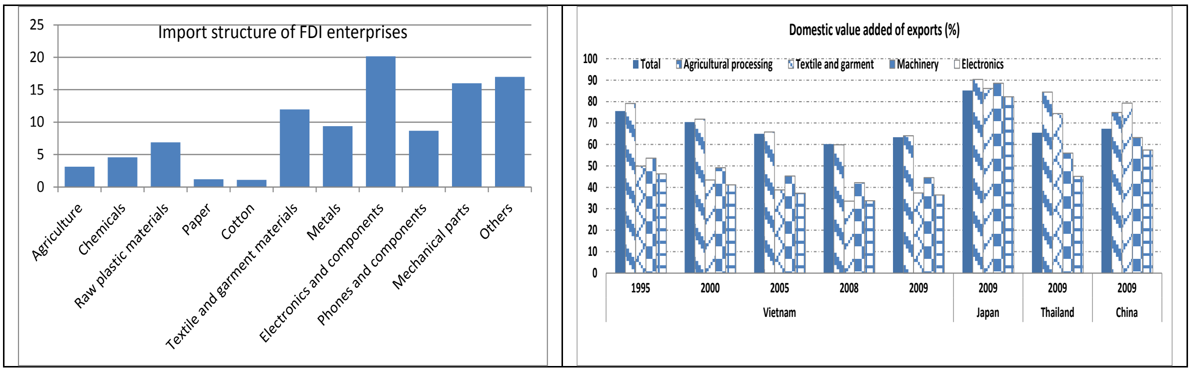
110. The majority of FDI enterprises rely on imported raw materials, reflected by the high import share of such products. Imports of FDI sector mainly include raw materials for production (Figure 44). The proportion of domestic value added in Vietnam's exports is relatively low compared to some other countries, and tends to decrease, from 75% in 1995 to 62% in 2009. For example, this number in the textile industry is 37%, far smaller than in Thailand (73%) and China (79%)[20]. The increasing share of imported raw material implies that the domestic value added content continues to decline. This partly explains why the high export volume only had modest contribution to gross value added.

111. FDI enterprises currently employ about 3.6 million workers, and their pace of income improvement is most rapid (15.3% per annum compared to 12.7% per annum and 11.5% per annum of public sector and private sector, respectively). FDI also helps create indirect employment in other sectors and enterprises[21].

[20] Data from OECD.

[21] According to Workshop Proceeding on 25 years of Attracting FDI, the FDI enterprises create 3-4 million indirect jobs.

Figure 44: Import structure of FDI and domestic content of exports



Source: General Department of Customs (2014); OECD database.

112. FDI directly accounts for over 15% of State Budget revenues, with additional contributions from trade tax revenues. Total revenues from trade (including import-export taxes, difference of import price, special sales tax and VAT of imported goods) account for 17% of State Budget revenues. With a high share in trade, the contribution of FDI to the State budget could be at least comparable to its proportions in gross investment and GDP. As such, the limited contribution of FDI to the State Budget can be attributed to preferential treatments to attract such capital inflows.

Excessive preferential treatment?

113. Concerns emerged recently about the preferential treatment for FDI enterprises relative to domestic counterparts. There are two alternative perspectives on this issue, namely: (1) Vietnam is short of capital due to the low savings rate, so preferential treatments are necessary to attract FDI; (2) private enterprises should receive treatments that are equal to, or more preferential, than FDI counterparts, since the former create more jobs and are pivotal to the domestic economic base. Both of these perspectives have some validity.

114. The tendency to increase preferential treatment to attract FDI has prevailed for many years, especially after decentralization of FDI management. Since 2013, this tendency becomes even more visible when projects of over USD 1 billion come to Vietnam. New regulations, issued in 2014, introduced more preferential treatments[22], which expanded beyond financial aspects[23]. These preferential treatments are not FDI-specific. Nevertheless, the eligibility criteria in terms of capital scale, and technology level, etc. means that this treatment is unlikely to be accessible to domestic private enterprises.

115. Surveys indicate that FDI enterprises do not consider preferential treatments as a decisive factor. Their main difficulties lie in the unavailability of materials and human resources, especially technical staff and senior managers.

[22] Decree No. 91/2014/ND-CP on 01 October 2014. Decree No. 218/2013/ND-CP.

[23] Circular No.20/TT-BKH&CN (2014) on standards of imported used machines was suspended before taking effect (1 September 2014). This suspension was arguably attributed to pressure from FDI enterprises who wanted to relocate their factories from other countries to Vietnam.

116. Competition among local governments in extending preferential treatments and support to large FDI projects helps retain such projects in their provinces, thereby creating jobs and developing supporting industries. However, this process has several shortcomings, namely: (1) Creation of a race to the bottom, causing losses to the State Budget; (2) Adverse selection, i.e. attraction of only poor-capacity investors who merely search for preferential treatment; (3) Fostering a habit of other investors demanding preferential treatments; (4) Weaken the bargaining power of Government agencies that should guide market development and create equal opportunity for investors; and (5) Distortion to competition for resources and output as FDI enjoy the advantage of preferential treatments on top of their economies of scale.

Transfer pricing

117. Transfer pricing is arguably unavoidable, especially under the tax systems in developing countries. This issue may happen in Vietnam via, for example, by artificially increasing the reported value of machinery, semi-finished products, input services, and reducing the reported value of output or creating unique characteristics of products or transactions.

118. The 2013 Provincial Competitiveness Index Report indicates that about 20% of FDI enterprises were engaged in transfer pricing of some form. Many enterprises declared consecutive losses for a long time but continued to expand production and business. In 2011, tax authorities inspected 921 FDI enterprises, reduced reported losses by VND 6,617 billion, and recovered VND 1,966 billion in unpaid taxes and fines. In 2012, 2,027 FDI enterprises were inspected and VND 683.5 billion was recovered. Tax inspections in 2014 showed little improvement (Table 9).

Table 9: Results of tax inspection in FDI enterprises, 2014

No.	*Province/ City*	*Number of inspected enterprises*	*Number of violated enterprises*	*Retrieval, fine, (Bill. VND)*	*Loss reduction (Bill VND)*
1	Hanoi	332	326	498	1575
2	Ho Chi Minh city	193	164	173	870
3	Quang Tri	27	27	2,3	1.2
4	Thai Nguyen	20	20	3,1	24.3
5	Tay Ninh	18	18	5,3	63
6	Hoa Binh	16	16	3,6	46
7	Ben Tre	17	15	1,5	21
8	Hai Phong	50	12	28,8	169
9	Ninh Binh	10	8	1,2	119
10	Nam Dinh	6	5	1,6	8.2

Source: Report on tax inspection results, Ministry of Finance (2014).

119. The recent studies show that transfer pricing depends partly on the announced profit and some other factors. VCCI (2014) suggested that with profit of over 20%, the probability of transfer pricing would vary in the range of 48-81%. Transfer pricing also goes up if intangible assets increase, or tax rate of home country is lower than in the host countries. In particular, transfer pricing tends to increase under poor stability and predictability of tax policies.

120. The Ministry of Finance introduced measures to address transfer pricing since 2005. More drastic measures such as strengthening tax inspection and levying reference prices are also being implemented. Further tax reforms are needed to; reduce the gap between domestic taxes and those applicable in other countries, especially those countries whose enterprises have large investments in Vietnam, and; to improve the transparency and predictability of the tax system.

Crowding out or crowding in domestic investment?

121. Given relatively high interest rates in Vietnam and stable exchange rates, the crowding-out effect via financial markets is less likely. Recent analyses[24] show that private enterprises enjoy few technological transfers while being negatively affected from competition. Thus, their productivity decreases, resources for innovation declines, and competitiveness deteriorates, leading to higher probability of bankruptcy. Some calculations reveal that if the capital share of the FDI sector in an industry increases by 1 percentage point, the probability of bankruptcy for private enterprise in that industry rises by 12 percentage points.

122. Negative spillover effects may result from large technological gap and weak linkages between local enterprises and FDI counterparts, and limited capacity to absorb technology of the former. Few domestic enterprises become the first tier for large corporations, limiting opportunities for technological transfers. Thus, Vietnam may fail to obtain improved technology from FDI. The country thus needs another alternative to improve its technological level.

Forecast of FDI inflow in 2015 and beyond

123. The key factors for forecasting FDI include prospects for: FDI at regional and global levels; investment and economic growth of neighboring countries; and economic growth and the upgrading of labor quality in Vietnam.

124. UNCTAD projects that the global FDI will resume its growth and reach USD 1.8 trillion in 2015. The level of recovery depends on the structure and macroeconomic stability of host countries. Southeast Asia and China still appeal to many multinational companies.

125. Various factors indicate the possible shift of investment flows among countries, including: (1) Differential attempts to liberalize FDI policy across countries; (2) Implementation of bilateral and multilateral trade agreements;

[24] Ari Kokko and Tran Toan Thang (2014); Bin Ni (2014).

(3) Shift of investment by large corporations from China to the neighboring countries; (4) Geopolitical considerations; (5) Prospects of attracting intra-ASEAN investment when the AEC comes into play.

126. The above analysis makes way for three forecast scenarios, resting on investment prospects in ASEAN and China, as well as economic growth and the upgrading of labor quality in Vietnam. The details of these scenarios are presented in Table 10[25].

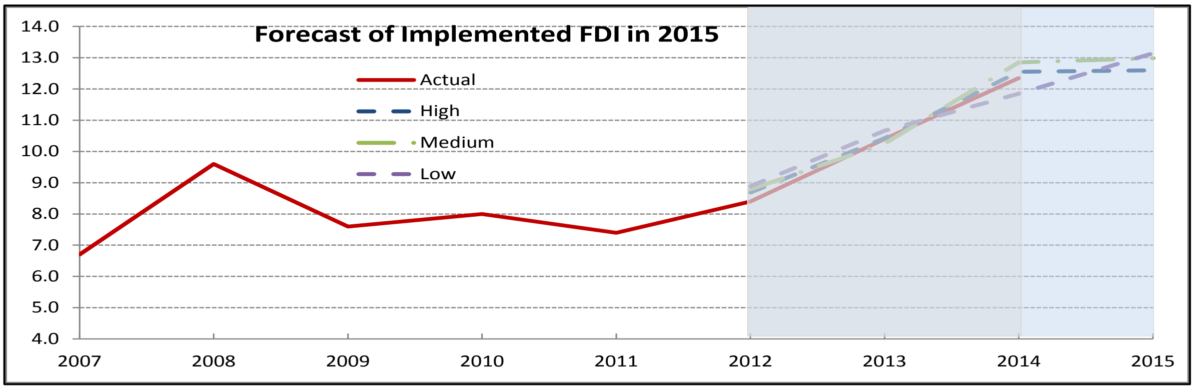
Table 10: Scenarios of investment outlook in ASEAN

	2014	*High scenario*	*Medium Scenario*	*Low scenario*
FDI into ASEAN	1.5%	TPP; high economic growth; FDI increases by 5%	Medium economic reform; FDI increase by 3%	Tightened investment. Increase intra-investment: 1% per annum
FDI into China	2%	FDI recovers at 5% per year	3% per annum	Tightened policy; selecting FDI; increase by 1%
Economic growth of Vietnam	5.9%	6.2% in 2015;	Fluctuate around 6%	Private enterprises recover slowly; 5.5% in 2015.
Upgrading labor	17.4%	The share of trained labor increases by 2 percentage point per annum	Increase by 1 percentage point per annum	Increase by 0.7% per annum, similar to period of 2001-2013

127. In the Low scenario (limited FDI attraction by China and ASEAN), the flows of FDI into Vietnam increase significantly, reaching USD 13.5 billion, 9.7% more than in 2014. Such a rise surpasses those in the scenarios that other countries attract more FDI (7.3 and 2.6% in the Medium and Low scenarios, respectively). Thus, investment shifts among other countries and Vietnam. In other words, FDI inflows to Vietnam depend on both its own efforts and the investment environment of neighboring countries, especially China.

Figure 45: Forecast of implemented FDI in 2015

Unit: Million USD



Note: The shaded area from 2012 to 2014 includes both actual and forecasted values.

[25] Forecast model is ARIMA (6.1.6), using quarterly data. Data series is from 2010, taken from UNTAD database (the graph presents data from 2007)

Conclusions:

128. In 2013-2014, FDI inflows were associated with multinational companies relocating their production bases. FDI remains highly concentrated by country and by geographical location, indicating that location-specific preferential policies only play a modest role. Notwithstanding volatility of registered capital, implemented capital remained stable (and only increased slightly in Q4 of 2014), raising a concern about the capacity to absorb increased capital in the years ahead. Inadequate labor quality still presents a serious bottleneck against Vietnam's on-going efforts to attract FDI.

129. Current policies tend to increase preferential treatments for FDI enterprises, especially for large projects, which may create adverse precedents and consequences for the State Budget. There are signs that some FDI enterprises engage in transfer pricing and tax evasion. In the forthcoming year, Vietnam needs to embark on further tax policy reform.

130. There is some evidence that FDI may crowd out investment by domestic enterprises, mainly due to limitations with domestic enterprises.

131. FDI made important contributions in terms of job creation, economic growth and exports. However, broadening these contributions will require strengthening domestic enterprises and Government's FDI policy and institutions.

132. There may only be modest increases in implemented FDI in the next few years, mainly due to limited capacity to absorb capital, and the interactions of investment environment and policies in other regional countries.

IV. RECOMMENDATIONS

133. The macroeconomic environment is becoming more stable, economic growth exhibits more robust recovery, and confidence-induced market transactions proliferate. A prompt return to the trajectory of high and sustainable growth remains critical to realizing longer-term socio-economic development targets and avoiding a middle-income trap. Still, even when inflation is very low, stimulating aggregate demand becomes less feasible due to the narrower spaces and unmatched effectiveness of related macroeconomic policy measures.

134. International economic integration continues to deepen. Various important FTAs of Vietnam may be signed and begin implementation in 2015. The AEC will be implemented from the end of 2015. Deeper economic integration will create new opportunities to enhance access to more markets and resources. Yet those opportunities are also coupled with challenges in: strengthening competitiveness; participating in and upgrading Vietnam's position in the regional production network, and; transferring technology to domestic enterprises. A key lesson from 8 years of WTO membership is that integration agreements provide opportunities, but these opportunities are only realized if accompanied by appropriate and timely upgrading of capacity at policy, institutional and enterprise levels.

135. In this context, policy priorities should focus more on strengthening the microeconomic foundation and reforming the economic institutions for a modern market economy. Efforts to improve the business environment, to simplify administrative procedures, to reduce costs, to liberalize the market, to facilitate business activities, and to encourage and to improve technological capacity associated with sustainable productivity improvement – which was initiated in 2014 - should be maintained and deepened. On that basis, the policy message for 2015-2016 should emphasize the focus on establishing and strengthening market order and discipline. This will help lay the foundations for a competition-friendly environment with less distortion in prices and business decision-making.

1. Reforming microeconomic foundations

136. Priority should go to: removing institutional bottlenecks to facilitate the second wave of economic reform; and adopting new ideas and approaches of economic management that redefines the roles of the State and market. Restructuring the banking system can progress swiftly in the first half of 2015, and SOE equitization should be accelerated.

137. Fundamentally improve key legislation for a market economy including: the Civil Code; the (amended) Law on Promulgation of Legal Normative Documents; the (amended) Law on Organization of Government; and the (amended) State Budget Law.

138. Effectively enforce newly-enacted policies and laws which incorporate good regulations and are consistent with supply-sided reforms, namely the (amended) Enterprise Law, the (amended) Investment Law; Resolution No. 19, the Law on CIT, the Law on PIT, the Law on Value Added Tax (VAT), the Law on Special Sales Tax, the Law on Natural Resource Tax, and the Law on Tax Management. Further simplify the procedures to start a business and to pay taxes, because these areas still rank very low.

139. Deepen reforms toward a market economy so that Vietnam's enterprises can be as active and participatory as FDI counterparts. Vietnam's enterprises need more capacity and opportunities to participate effectively in processes of consultation, information dissemination, and implementation and monitoring of policies to prepare enterprises for the implementation of the commitments on international economic integration. Only in this direction can the enterprises take advantage of integration-induced opportunities. Otherwise, Vietnam's enterprises will remain marginalized, and the hard-earned opportunities from FTA negotiations will flow mostly to FDI counterparts.

140. Review and study inequalities in policy treatments and incentives for domestic private enterprises compared to SOEs and FDI enterprises; and set out a transparent and predictable roadmap to address such inequalities.

141. Change mindset and habits from managing to governing. Citizens and businesses should no longer be seen as "subordinates" or objects under management, but instead as customers and partners in the development process. Accordingly, policy adjustments and regulations affecting investment and production-business activities should be developed with widespread and serious consultations with the business community.

142. State management must be self-innovating. It must encourage and foster innovation and creativity in doing business; be willing to accept new ideas and new ways of doing business; avoid considering new and creative ideas and ways of doing business as against the law; avoid considering innovators and those with new ideas as "sinners" to be prevented and forbidden. Accordingly, State management must meet the needs of, and promote, development, rather than constraining development because of attempts to intervene in areas outside the capacity of the concerned authorities.

143. Lay the foundation for sound competition, especially in the markets for essential commodities and services. The State should only play the role of overseeing competition and dealing with anti-competitive behaviors, rather than making direct and administrative intervention in the market. To establish an independent agency that has competent institutional capacity (at least in comparison with large domestic and foreign enterprises) and expertise to regulate and address competition complaints.

2. *Recommendations of macroeconomic policies*

* *Monetary policy:*

144. The conduct of monetary policy should focus more on reinvigorating confidence in the value of VND and monetary policy itself. This should be reflected by consistent, accountable and transparent targets for 2015, avoid using "tricks" and adjusting policies soon after their issuance.

145. The formulation and conduct of monetary policy should target an inflation rate of about 3.5%-4.0% for 2015 (rather than allowing drastic increases in inflation as in Q4 of 2014). As the key point, inflation needs to be stable – with reduced risk of rising again - to help anchor market expectations, thereby facilitate the conduct of monetary policy. In the medium term, monetary policy should gradually switch to an inflation-targeting regime.

146. Communicate a more decisive stance towards de-dollarization; avoid reversing this stance by encouraging foreign currency deposits and loans or by adjusting the VND/USD exchange rate. Consider removing ceilings on USD-denominated deposit rate (possibly at the beginning of Q2/2015, supported by raising the reserve requirement ratio on foreign currency deposits) as foreign currency loans already became restricted.

147. Consider removing ceilings on VND-denominated deposit rate, depending on the progress of bank restructuring.

148. Information on NPLs should be published more frequently and transparently as the market already expected a higher NPL ratio than the announced one. Promptly establish a fully operational market of NPLs, in which VAMC plays a crucial role. Encourage the participation of the private sector, including foreign entities, to address NPLs. Mechanism to address NPLs should fully enforce responsibility of decision-makers, while also providing adequate incentives for action. If necessary, a dedicated Law to address NPLs should be issued (possibly with a 5-year validity period).

149. Strictly enforce regulations and deadlines for debt classification. Ensure that the Credit Information Center (CIC) conducts this process competently. Strictly and effectively supervise the performance of the CIC.

150. The room to loosen monetary policy may widen, but such a stance should only be adopted after fundamentally addressing NPLs and restructuring weak banks. Loosening monetary policy should rely on horizontal tools (such as reducing the reserve requirement ratio on VND-denominated deposits), rather than targeting specific sectors.

151. Promote credit growth more evenly, rather than with rapid disbursement in some short periods. In doing so, the SBV should engage in discussions and dialogues with the business community about demand and ability to access credits. Restrict consumer credit, and ensure liquidity for credits for

production and for Government bond issuance. Strictly monitor the level of credit, and banking sector exposure, to the real estate sector.

152. Actively propose limits of Government bonds under issuance to ensure the system's liquidity and to support private investment. Properly schedule bond issuance with reasonable bond rate to ease pressure on public debt.

153. The targeted average interbank exchange rate should remain fixed, at least till the end of Q3 of 2015. In the long run, the exchange rate should remain stable to avoid additional pressure on public debt. Consider pegging the VND to a basket of major currencies (instead of USD).

* *Fiscal policy:*

154. Fiscal policy should be more prudent, taking into account the sustainability of public debt and the State Budget deficit, the possible crowding-out effect on the private sector, volatility of State Budget revenues and expenditures in the context of integration, and the growth-inflation trade-off.

155. Consider reducing the petrol tax to support production and business activities of the private sector.

156. Reducing current expenditures will require reductions in the number of personnel in the public sector. In the long term, Vietnam should allocate pre-determined amount of Budget expenditures for certain public sector activities (instead of the current approach, in which recruiting a person under the public payroll means that the State has to create jobs and pay for him/her).

157. Study and develop institution to coordinate investment at a regional level. Substances of such institution can be considered for inclusion in drafting the Law on Organization of Government.

158. Strictly enforce fiscal discipline and public investment management. Continue to improve the appraisal and coordination of public investment projects until 2020. The Medium-term Investment Framework for the period 2016-2020 should avoid rapid disbursement of public investment projects in the years 2016-2017. This does not imply restricting new projects (or mega projects), but that new projects should only be approved after stopping already approved projects that are lower priority and less efficient.

159. Study and publicly announce plans to reduce public debt in the medium and long term. The Government can choose to gradually increase debt repayment, or to focus on increasing investment (with efficiency) in the medium term before dedicating resources to repay debt in the longer term.

160. Promptly develop and enforce feasible, detailed and easily measurable criteria in order to evaluate public investment projects, especially those funded by Government bonds.

161. Re-consider the requirement for newly issued Government bonds to have terms of at least 5 years, as this requirement might crowd out medium- and long-term credits for the private sector.

** Trade policy*

162. Promptly negotiate, sign, ratify and implement important FTAs to enhance their potential benefits. Ensure the harmonization of related commitments and technical requirements (especially rules of origin and the provisions related to agricultural products). Improve institutions related to intellectual property rights, labor, environmental protection, food safety and sanitation, etc., to facilitate the negotiation and implementation of trade and investment agreements.

163. Increase awareness, information and consultation of enterprises on the content, opportunities and challenges, and capacity to take advantage of preferential trade and investment treatment under concluded agreements such as the EVFTA, FTA with Customs Union of Russia-Belarus-Kazakhstan, and the FTA with South Korea. Consult enterprises in process of negotiating and preparing for TPP, RCEP and AEC.

164. Further reform procedures related to taxation, customs, etc. to facilitate business activities. Cooperate with partners to sign mutual recognition agreements, to publicize regulations and technical barriers to imported and exported goods, etc. Facilitate trade across borders; to effectively plan the development of infrastructures, especially transport infrastructure, ports, airports, etc.

165. Build capacity for administering competition, undertaking anti-subsidy and anti-dumping measures, settling trade disputes, and regulating markets; to provide legal support to enterprises. Study and participate in relevant international conventions to help simplify procedures and paperwork for businesses.

** Price management policy*

166. Price reforms should go beyond changing the current mechanism of direct price management for price-regulated products (e.g. petrol, electricity), including frequency and extent of adjustment, etc. Specifically, transparent and credible efforts are required to foster competition, monitor cost structure and/or enhance product quality in those markets.

167. Delay the increase of electricity tariff, so as to retain benefits to the business community from the falling oil price and stable inflation, ultimately boosting economic activities.

** FDI policies*

168. Induce FDI inflows to infrastructure-related sectors and areas to remove economic bottlenecks, and to facilitate investment promotion. These will be the sectors and areas with the most urgent need for investment capital and more capacity to absorb capital. The new laws seek to maximally liberalize the scope for such investments; but this needs to be accompanied by relevant incentives and preferential treatment based on transparent and measureable

criteria to screen and co-ordinate FDI projects. Align FDI policies more closely to developing targeted industries, in line with the strengths of each region and province.

169. Further promote investment by multinational corporations and enterprises in related supporting industries. To provide prompt guiding information for domestic enterprises to prepare and enhance linkages with FDI enterprises. To be more determined in negotiations with FDI enterprises to create opportunities for domestic counterparts; to minimize approval of FDI enterprises' proposals for more preferential treatment upon importing inputs and machinery (citing the reason that domestic ones fail to suffice in terms of volume and/or quality).

170. Ensure strict disciplines in planning and managing plans. Avoid using plans to formalize pre-determine investment proposals. Firmly negotiate with foreign investors to ensure that FDI projects fit with industrial development plans, international commitments, and requirements related national defense and security.

171. Consult FDI enterprises about potential adjustment of relevant policies (including increase of minimum wage), thereby limiting the probability of being sued at international tribunals.

172. Upgrade the quality of labourers - especially those having the technique, skills and managerial expertise - to enable the transfer of science, technology and management skills.

173. Promptly study, draft and promulgate legislation on preventing transfer pricing, based on international standards, to minimize such behavior by FDI enterprises. Coordinate with the countries, in which holding companies are located, to enhance cooperation and exchange of information on tax administration, and measures to restrict transfer pricing by those multinational corporations.

174. Ensure that FDI actually brings in financial resources for implementation (i.e. disbursed through the balance of payments), instead of relying primarily on domestic financing.

3. Some other related recommendations

175. Macroeconomic coordination has seen more concrete actions and positive changes. However, such coordination should be more substantive and frequent. Concerned agencies should receive timely information on issues for coordination to allow for appropriate preparation, instead of notification-like discussions (as happened with crude oil prices and electricity tariff). Avoid the dominance of fiscal policy over monetary policy, or excessive burdens (of reform and conduct) to monetary policy. Focus more on long-term issues which may require roadmap of macroeconomic policy coordination.

176. Enhance the quality and accountability of data, especially consistency among data on growth, production, investment and import, export. To institutionalize the development of indicators of business cycles, business confidence and consumer confidence.

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177. There were major swings in directions of, and motivations for, reform from 2011-2014. Until 2013, notwithstanding pledged priorities to reform bottleneck areas (i.e. institution, infrastructure and human resources), Vietnam actually had focused more on macroeconomic stabilization and, then, relaxation of bottlenecks to economic activities. More fundamental reforms as well as the economic restructuring process were lower than originally scheduled. Recent efforts to inspire confidence and enthusiasm in doing business - via strong commitment toward ease of doing business and more business-friendly institutional foundation – marked an important turning point.

178. Vietnam has only limited time to meet its deeper integration commitments (under the framework of WTO, ASEAN, TPP, EVFTA, etc.). Many opportunities are visible to enterprises, but this may divert their attention away from the associated challenges. It is important to note that some challenges may be "useful" in pushing Vietnam to build capacity at both the policymaking and enterprise levels. Strengthening competitiveness is an important prerequisite for success, but is not a sufficient condition. Enterprises need a business environment that accommodates fair competition, where resource allocation and pricing decisions result from competition - rather than administrative orders. Building on the reform momentum in 2014, and progressing decisively to establish market order and the discipline of the market will help the business community to fly high. /.

APPENDIX

Appendix 1: Macroeconomic policy changes

No.	Recommendations in the Macroeconomic Report – Q3 of 2014	Policy changes until 31/12/2014
1	**General recommendations**	
	- To stabilize macroeconomic environment, control inflation, facilitate production and business and economic restructuring, restructure SOEs, handle public debts	- Policy priorities are to stabilize the macroeconomic environment, facilitate production and economic restructuring, to restructure SOEs, handle public debt, which are emphasized in resolutions of the Government and the National Assembly o Resolution No. 74/ND-CP dated 10/4/2014 on key issues of the Government's monthly meeting in September 2014 o Resolution No. 79/NQ-CP dated 3/11/2014 on key issues of the Government's monthly meeting in October 2014 o Resolution No. 77/2014/QH13 dated 10/11/2014 on socio-economic development plan in 2015 o Decision No. 2146/QD-TTg dated 1/12/2014 approving the Project on Restructuring the industry and trade sector to facilitate industrialization and modernization and sustainable development by 2020, vision to 2030 o Resolution No. 89/NQ-CP dated 5/12/2014 on key issues of the Government's monthly meeting in November 2014 o Resolution No. 101/NQ-CP dated 31/12/2014 on key issues of the Government's monthly meeting in December 2014 o Resolution No. 01/NQ-CP dated 3/1/2015 on key tasks and measures guiding the implementation of the socio-economic development plan and state budget plan in 2015
1	**Monetary policy**	
	- To avoid loosening monetary policy to stabilize inflation	- The Resolution on Socio-economic Development Plan in 2014 emphasizes the objective of managing the monetary market using such instruments as interest rate, exchange rate, open market operation to stabilize the market, support exchange rate stabilization, reduce interest rate; and this goal has been persistently pursued by the SBV and relevant authorities in 2014.
\	- To promote credit access to support production activities of enterprises	- To implement credit policy that focuses on facilitating rural and agricultural development; policies related to tax preferential, credit guarantee for enterprises in some prioritized industries o Circular No. 29/2014/TT-NHNN dated 9/10/2014 (took effect from 10/10/2014) on guiding commercial banks to coordinate with the VDB to implement guarantee mechanism for SMEs to borrow in accordance with guarantee regulations that were issued by the Decision No. 03/2011/QD-TTg dated 10/01/2011 of the Prime Minister o Decree No. 91/2014/ND-CP dated 1/10/2014 (took effect from 15/11/2014) on amending and supplementing some articles of several decrees on tax regulations

		o Circular No. 151/2014/TT-BTC dated 10/10/2014 (took effect from 15/11/2014) on guiding the implementation of Decree No. 91/2014/ND-CP dated 01/10/2014 of Government on amending and supplementing some articles of several decrees on tax regulations o Circular No. 32/2014/TT-NHNN dated 18/11/2014 (took effect from 25/11/2014) on amending and supplementing some articles of the Circular No. 11/2013/TT-NHNN dated 15/05/2013 of the SBV that regulates housing loans as specified in the Resolution No. 02/NQ-CP dated 07/01/2013 of the Government o Circular No. 43/2014/TT-BNNPTNT dated 18/11/2014 (took effect from 5/1/2015) releasing the list of agricultural, forestry and fishery products, supplementing products, mechanic products to preserve, process agricultural, forestry and fishery products that are eligible to receive support under the Decree No. 210/2013/ND-CP dated 19/12/2013 of the Government o Decision No. 3018/QD-BTC dated 26/11/2014 on administration procedures in banking and finance sector under the state management mandates of the Ministry of Finance on preferential interest rate to loans and compensating interest rate difference due to implementing supporting policies aimed at reducing agricultural losses o Decision No. 3019/QD-BTC dated 11/26/2014 on administrative procedures in banking and finance sector under state management mandates of the Ministry of Finance on compensating interest rate due to implementing credit policy as specified in the Decree No. 67/2014/ND-CP of the Government dated 07.07.2014 on some policies to develop fishery industry o Law No. 71/2014/QH13 dated 26.11.2014 (took effect from 01.01.2015) on amending and supplementing some articles of some tax laws of the National Assembly o Circular No. 189/2014/TT-BTC dated 11/12/2014 regulating interest rates of investment credits, export credit of the State and the interest rate differences that are eligible to be compensated after investment o The SBV confirms that the enterprises which import petrol and oil or have export projects are allowed to access to foreign currency lending until the end of 2015 when exchange rate is stable and interest rate of VND lending is relatively higher than USD lending, thus enterprises will not have to suffer from higher lending interest rate.[26] o Circular No. 43/2014/TT-NHNN dated 12/25/2014 (took effect from 01/01/2015) regulating foreign currency lending of credit institutions and branches of foreign banks imposed on residential borrowers

[26] Sources: http://sbv.gov.vn/portal/faces/vi/vilinks/videtail/vicm101/vict101?dDocName=CNTHWEBAP0116211771173&_afrLoop=2590595955517100&_afrWindowMode=0&_afrWindowId=null#%40%3F_afrWindowId%3Dnull%26_afrLoop%3D2590595955517100%26dDocName%3DCNTHWEBAP0116211771173%26_afrWindowMode%3D0%26_adf.ctrl-state%3Dtpq70yn0s_129 (accessed on 22/12/2014)

		o Circular No. 45/2014/TT-NHNN dated 12/29/2014 (took effect from 02/12/2015) on amending and supplementing some articles of Circular No. 02/2012/TT-NHNN dated 27/02/2012 guiding foreign exchange transactions between the State Bank of Vietnam and credit institutions and branches of foreign banks - Such programs as Connecting business and banks; connecting 4 parties in construction sector (bank-investor-contractor-supplier of construction materials) in order to control credit flows and reduce inventory of construction materials continue to be implemented
	- To consider to remove ceiling rate of USD and VND deposits for some prioritized sectors	- Interest rate follows the declining trend. Interest rate continues to reduce by 1.5 to 2 percentage point per year compared to that in the end of 2013. o Decision No. 2172/QD-NHNN dated 28/10/2014 (took effect from 29/10/2014) regulating the maximum interest rate of USD deposits of organizations and individuals at credit organizations and branches of foreign banks in accordance with Circular No. 06/2014/TT-NHNN dated 17/03/2014
	- To restrict administrative intervention on reducing lending rate	- State commercial banks impose the common interest rate of 9-10% for long and medium term loans (lower than the common lending rate of 9.5-11% per year) upon the calling of the SBV's Governor.
	- To widen the room for exchange rate fluctuation to increase the flexibility of monetary policy	- In December 2014, the SBV affirmed that exchange rate and trading band of exchange rate would not be adjusted before the end of the year.
	- To develop the information system and information dissemination	- The SBV has promoted communication activities of the banking sector
	- To settle bad debt, emphasizing on the role of the SBV and the participation of the private sector and foreign partners; accountability	- Solutions to settle bad debt have been pro-actively implemented in accordance with the Decision No. 843/QD-TTg. Bad debt continues to be resolved and tends to reduce; in which the participation of credit organizations have been recognized. Activities of VAMC resulted in initial outcomes. - Credit organizations have strictly implemented regulations on risk provisions to settle bad debts. (Provisions of credit risk of the first 10 months of 2014 increased by 5% (YoY))
2	**Fiscal policy**	
	- To avoid excessive fiscal easing, to issue bond carefully	- The MOF increases capital mobilization through issuing government bonds and other bonds to balance the state budget
	- To strengthen fiscal discipline and public investment management	- The Law on amending and supplementing some articles of the Law on Special Sales Tax of the National Assembly, No. 70/2014/QH13 dated 26/11/2014 (take effect from 1/1/2016) - Decision No. 1758/QD-BKHDT dated 3/12/2014 on allocating capital for National target programs in 2015
	- To reduce the pace of collecting State budget revenues, to strengthen tax discipline on FDI enterprises	

	- To decrease current expenditure and development investment, aiming at reducing budget deficit	- Programs and plans on budget expenditure in 2015 have been developed; budget expenditures are in line with budget plans o Circular No. 1443/QD-BKHDT dated 13/10/2014 on organizing the inspection of development investment capital in 2015 o Resolution No. 78/2014/QH13 dated 10/11/2014 on State budget estimation in 2015 o Resolution No. 79/2014/QH13 dated 14/11/2014 on allocating state budget at the central level in 2015 - Tax policies in order to relief difficulties of production and businesses and attract investment have been implemented (extend the deadline to pay tax for some commodities, adjust some preferential tax policies like tax exemption, the elimination of fine on late tax payment, etc.) o Decision No. 2109/QD-TTg dated 24/11/2014 on eliminating tax debts and fines of dissolved SOEs
	- To address difficulties in procedures related to disbursing Government bond capital	- Resolution No. 78/NQ-CP dated 1/11/2014 on tax exemption for Government bonds issued in international market in 2014
	- To provide transparent information on public debt	- Information on public debt has been submitted to the member of the National Assembly in the 8th plenum of the 13th National Assembly. The Prime Minister also presented the report and answered questions of the National Assembly about public debt and measures to settle public debt.
	- The proposal to use the State budget to resolve bad debts should not be taken into consideration	- The Prime Minister confirmed that the state budget would not be used to resolve public debt in the afternoon Q&A session of the National Assembly on 19/11/2014.
3	**Trade policy**	
	- To negotiate and sign important FTAs, to enhance the awareness and the efficiency of consultation with enterprises during the negotiation and implementation of FTAs	- Decision No. 2146/QD-TTg dated 1/12/2014 on approving the Project of restructuring the industry and trade sectors to facilitate industrialization and modernization and sustainable development by 2020, vision to 2030 - To negotiate and sign important FTAs o Vietnam – South Korea FTA was signed on 11/12/2014; o Negotiation process of other FTAs like TPP, RCEP, and Vietnam-EU has been implemented pro-actively and achieved positive results. o The negotiations of such FTAs as Vietnam-South Korea, Vietnam-Customs union of Russia and Belarus, Kazakhstan have been completed. - To promote the implementation of international commitments o Circular No. 41/2014/TT-BCT dated 5/11/2014 (took effect from 22/12/2014) regulating conditions and procedures to identify foreign labor moving within enterprises which are included in the list of 11 service sectors of Vietnam's Services commitments to the WTO, who are not eligible for working permits;

		o Circular No. 173/2014/TT-BTC on amending preferential import-export tariff of some commodities that are specified in the list of Preferential import tariff issued at the Circular No. 164/2013/TT-BTC dated 15/11/2013 of Minister of Finance in order to implement WTO commitments in 2015; o Circular No. 42/2014/TT-BCT dated 18/11/2014 (took effect from 2/1/2015) on amending and supplementing some articles of Circular No. 21/2010/TT-BCT dated 17/05/2010 of the Minister of Industry and Trade on implementing regulations on Rule of Origin of the ASEAN trade in good agreement; o Circular No. 185/2014/TT-BTC dated 5/12/2014 (took effect from 6/12/2014) on amending preferential import tariff of some gasoline products of the group 27.10 in the list of preferential import tariff. o Decision No. 73/2014/QD-TTg dated 19/12/2014 (took effect from 5/2/2015) regulating the list of wasted materials that are allowed to import as material for production.
	- To deepen reforms of tax and customs procedures to facilitate business activities	- Policies to improve business environment and strengthen competitive capacity in accordance with Resolution No. 19/ND-CP and Directive 11/CT-TTg have been promulgated o Circular No. 33/2014/TT-BCT dated 10/10/2014 (took effect from 15/11/2015) regulating some issues on shortening time for electricity access; o Circular No. 35/2014/TT-BCT dated 15/10/2014 (took effect from 1/12/2014) regulating the issuance of automatic Import license for some fertilizer products; o Decision No. 9802/QD-BCT dated 30/10/2014 on approving the master plan on simplifying administrative procedures under the State management mandates of the Ministry of Industry and Trade in 2014; o Decision No. 9840/QD-BCT dated 3/11/2014 on abolition of legal documents; o Decision No. 10012/QD-BCT dated 5/11/2014 (took effect from 25/11/2014) on correcting Circular No.33/2014/TT-BCT dated 10/10/2014 of the Minister of the Ministry of Industry and Trade regulating some issues on shortening time for electricity access; o The Law on Investment No. 67/2014/QH13 dated 26/11/2014 (take effect from 1/7/2015); o The Law on Enterprises No. 68/2014/QH13 dated 26/11/2014 (take effect from 1/7/2015); o Decision No. 2139/QD-TTg dated 28/11/2014 on implementing and adjusting some contents of projects of the Program on providing inter-sectional legal support for enterprises in the period of 2010-2014; o Circular No. 182/2014/TT-BTC dated 28/11/2014 (took effect from 1/12/2014) on amending and supplementing Circular No. 69/2014/TT-BTC dated 26/05/2014 of the Ministry of Finance on guiding pilot procedures to collect fee at Lao Bao international border gate of the East-West Economic Corridor in accordance with the “one gate, one stop” model; o Circular No. 47/2014/TT-BCT dated 5/12/2015 (took effect from 20/1/2015) on regulating e-commercial websites;

		o Decision No. 3662/QD-TCHQ dated 8/12/2014 promulgating customs procedures, customs inspection and supervision of imported-exported and transit commodities; luggage and transport vehicles that are imported, exported or transited via Lao Bao border gate (Vietnam) – Den-sa-van border gate (Laos) in accordance with the “one gate, one stop” model; o Decision No. 08/QD-TTg dated 6/1/2015 promulgating the Plan on simplifying key administrative procedures in 2015.
	- To improve marketing and advertising activities, expand export market	o Circular No. 171/2014/TT-BTC dated 14/11/2014 (took effect from 5/1/2015) guiding financial assistance mechanism to implement the National program on trade promotion.
	- To strengthen capacity of competition management, anti-subsidy, anti-dumping, trade dispute settlement and market management.	- The Ministry of Industry and Trade continues to implement assigned tasks in accordance with Directive No. 25/CT-TTg dated 5/12/2013 on strengthening management and administration to stabilize prices, ensure security and social disciplines; implement Decision No. 23/QD-TTg approving the Project on “Strengthening rural trade in period of 2011-2015, vision to 2020” - To strengthen market inspection and settle violation cases o Circular No. 34/2014/TT-BCT dated 15/10/2014 (took effect from 1/12/2014) on the coordination among market management agencies at different levels to inspect and settle violation of administrative regulations; o Circular No. 197/2014/TT-BTC dated 18/12/2014 (took effect from 10/2/2015) regulating the amount, mode of collection, management and use of appraisal and issuance fees of Registration license for multi-level business activities.
4	**Pricing policy**	
	- Price reform aiming at providing transparent information	- The Ministry of Industry and Trade, Ministry of Finance and relevant agencies coordinate closely to manage and regulate price of commodities that are subject to the price control of the Government o Petrol and oil price is regulated based on market situation, in accordance with regulations of Decree No. 83/2014/ND-CP dated 03/09/2014 of the Government on petroleum trading (Circular No. 38/2014/TT-BCT dated 21/10/2014 (took effect from 1/11/2014) on detailing some articles of Decree No. 83/2014/NĐ-CP) and inter-ministerial Circular No. 39/2014/TTLT-BCT-BTC dated 30/10/2014 regulating methods to calculate basic price; mechanism of establishment, management and use of Price Stabilization fund and petrol and oil price in accordance with regulations of Decree No. 83/2014/NĐ-CP dated 03/09/2014 of the Government on petroleum trading; o Circular No. 40/2014/TT-BCT dated 5/11/2014 (took effect from 24/11/2014) regulating procedures to manage the national electricity system; o Decree No. 104/2014/NĐ-CP dated 14/11/2014 (took effect from 29/12/2014) on land price framework; - Regulate transport price in line with market situation (price of road and air transport, etc.) o Decision No. 3282/QD-BTC dated 19/12/2014 (took effect from 01/01/2015) on maximum price framework of economy-class ticket of domestic flights which are under monopoly control

		o Circular No. 57/2014/TT-BCT dated 19/12/2014 (took effect from 3/2/2015) regulating methodology, procedures to develop and implement electricity price framework.
5	**FDI policy**	
	- To encourage FDI projects to key sectors and industries	- To introduce policies to encourage investment to agriculture, rural areas and supporting industries, etc. o Circular No. 05/2014/TT-BKHĐT dated 30/9/2014 (took effect from 14/11/2014); o Decision No. 9028/QD-BCT dated 8/10/2014 approving the Master plan on developing supporting industry by 2020, vision to 2030; o Decision No. 1901/QD-TTg dated 21/10/2014 approving the Action plan on developing the shipbuilding industry in order to implement Vietnam's Industrialization Strategy under the cooperation framework between Vietnam and Japan by 2020, vision to 2030; o Decision No. 10326/QD-BCT dated 14/11/2014 on supplementing the list of machines, equipment, supplies, and materials that can be produced domestically; o Decision No. 10508/QD-BCT dated 18/11/2014 approving Vietnam's paper industry development plan by 2002, vision 2025; o Decision No. 66/2014/QD-TTg dated 25/11/2014 (took effect from 15/1/2015) approving the list of high technologies that are prioritized to receive development investment and the list of high technological products that are prioritized to develop.
	- To concentrate on promoting investment by corporations and enterprises in supporting industries; to provide guiding information for domestic firms	- Circular No. 38/2014/TT-NHNN dated 8/12/2014 (took effect from 1/2/2015) regulating necessary documents, sequence, and procedures to allow foreign investors to buy shares of credit organizations in Vietnam.
	- To pro-actively select investment partners	
	- To consult FDI enterprises substantially on relevant policy adjustments	
6	**Other recommendations**	
	- To improve the effectiveness of coordination of macroeconomic policies	- Regulations on coordinating and managing macroeconomic issues among the Ministry of Planning and Investment, Ministry of Finance, Ministry of Industry and Trade and the SBV was promulgated (Decision No. 9087/BKHDT-NHNN-BTC-BCT dated 2/12/2014);
	- To improve quality and accountability of data	- Decision No. 1631/QD-BKHDT dated 10/11/2014 on strengthening the Central Steering Committee to implement Vietnam Statistics Development Strategy in the period 2011-2020 and vision to 2030;
	- To enhance effectiveness and competition of the commercial banking system	- New regulations on limitation, prudent levels in order to improve risk management capacity of commercial banks were issued: o Circular No. 36/2014/TT-NHNN dated 20/11/2014 (took effect from 1/2/2015);

		o Circular No. 30/2014/TT-NHNN dated 6/11/2014 (took effect from 1/1/2015) regulating fiduciary and trustee activities of credit organizations and branches foreign banks.
	- To foster SOE reform and public investment restructuring; encourage the participation of private sector	- Restructuring SOEs and public investment are emphasized and promoted. o Decision No. 46/2014/TT-BNNPTNT dated 5/12/2014 (took effect from 21/1/2015) guiding the implementation of some regulations on assisting production activities in accordance with Decision No. 551/QD-TTg dated 04/04/2013 of the Prime Minister on approving the Program 134 on supporting infrastructure investment and production of special difficult areas, boundaries areas, communes in safe zones, special difficult villages; o Decree No. 118/2014/ND-CP dated 17/12/2014 (took effect from 1/2/2015) on arranging, innovating, developing and improving the efficiency of agricultural and forestry enterprises; o Decision No. 2261/QD-TTg dated 15/12/2014 approving the Program on supporting cooperative development in the period of 2015-2020; o Resolution No. 97/NQ-CP dated 26/12/2014 on approving the Action plan of the Government on implementing Conclusion No. 96-KL/TW dated 07/04/2014 of the Secretariat of the Communist Party on promoting the implementation of Directive No. 22-CT/TW dated 05/06/2008 of the 10th Secretariat of the Communist Party on strengthening leadership, guiding the development of harmonized, stable and modern industrial relations in enterprises.

Appendix 2: Statistical Appendix

	Unit	2008	2009	2010	2011	2012	2013				2014			
							I	II	III	IV	I	II	III	IV
GDP growth rate														
Overall GDP growth	%	5.7	5.4	6.4	6.2	5.2	4.8	5.0	5.5	6.0	5.0	5.4	6.4	6.8
Agriculture, forestry and fishery	%	4.7	1.9	3.3	4.0	2.7	2.2	2.0	3.0	3.3	2.4	3.3	3.1	4.7
Industry and construction	%	4.1	6.0	7.2	6.7	5.7	4.6	5.7	5.2	5.9	4.7	6.1	8.3	8.6
Services	%	7.6	6.5	7.2	6.8	5.9	5.6	6.2	6.8	7.2	5.9	6.1	6.0	5.9
GDP structure by economic sector														
Total	%	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	*100.0*	*100.0*	*100.0*	*100.0*
Agriculture, forestry and fishery	%	20.4	19.2	18.9	20.1	19.7	13.3	22.2	17.3	19.5	12.9	17.7	17.4	18.1
Industry and construction	%	37.1	37.4	38.2	37.9	38.6	40.2	37.5	36.5	39.2	40.3	38.7	38.0	38.5
Services	%	42.5	43.4	42.9	42.0	41.7	46.6	40.3	46.2	41.3	46.8	43.6	44.6	43.4
Trade														
Growth rate of exports	%	30.0	-9.2	26.5	34.2	18.2	17.5	13.6	14.8	15.6	12.2	15.7	13.6	11.6
- *FDI sector*	*%*	*25.4*	*-30.7*	*41.2*	*40.3*	*33.7*	*27.9*	*28.4*	*26.2*	*23.6*	*18.2*	*16.1*	*37.5*	*28.3*
Growth rate of imports	%	32.2	-13.0	21.3	25.8	6.6	14.8	17.0	14.2	18.0	10.4	10.5	14.0	13.7
- *FDI sector*	*%*	*32.3*	*-8.8*	*41.8*	*32.1*	*22.7*	*26.1*	*25.9*	*25.4*	*19.9*	*14.6*	*7.3*	*8.2*	*24.3*
Exports /GDP	%	66.1	56.6	63.4	72.6	73.5	89.1	81.4	79.7	65.1	92.8	87.2	82.5	67.5
Money														
M2 growth (YoY)	%	20.3	29.0	33.3	12.1	18.5	3.8	3.4	2.8	7.7	2.8	4.1	2.9	5.3
Credit growth rate (YoY)	%	25.4	39.6	32.4	14.3	8.9	1.2	3.5	2.1	5.3	0.5	3.2	3.5	4.9
VND/USD exchange rate of banks (period average)	VND	16451	17803	19111	20661	20851	20863	20951	21124	21097	21119	21183	21244	21346
Interbank VND/USD exchange rate (period average)	VND	16309	17074	18630	20532	20828	20828	20831	21036	21036	21036	21063	21246	21246
Investment														
Investment/GDP	%	38.2	39.2	38.5	33.3	30.5	29.6	29.6	33.8	33.2	28.4	31.5	33.0	30.6
Implemented FDI capital	USD bil.	11.5	10.0	11.0	11.0	10.0	2.7	3.0	2.9	2.9	2.9	2.9	3.2	3.5
Others														
Inflation (YoY)	%	19.9	6.5	11.8	18.1	6.8	6.6	6.7	6.3	6.0	4.4	5.0	3.6	1.8
State budget deficit/GDP	%	4.6	6.9	5.5	4.9	5.4	5.4	5.0	5.3	4.7	4.9	4.6	5.3	7.3
Current Account	USD bil.	-10.8	-6.6	-4.3	0.2	9.1	2.6	1.3	3.5	1.7	2.6	2.7	2.8	-
Balance of Payments	USD bil.	0.5	-8.5	-1.8	1.2	11.9	3.0	-3.3	-0.8	1.7	3.0	2.2	0.9	-

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