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DEVELOPMENT FINANCE FOR SUSTAINABLE DEVELOPMENT GOALS IN MIDDLE-INCOME VIET NAM

FINANCING VIET NAM'S DEVELOPMENT: MEETING THE NEW CHALLENGES



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MEETING THE NEW CHALLENGES**

Preface

We are pleased to present this important study on **Development Finance for Sustainable Development Goals in Middle-Income Viet Nam**. The study is a result of a joint collaboration between the Ministry of Planning and Investment of Viet Nam, United Nations (UN) and European Union (EU) and was conducted in 2013 - 2014 with the support of UNDP's Asia Pacific Development Effectiveness Facility (AP-DEF) and the Delegation of the European Union to Viet Nam through the EU - Viet Nam Strategic Dialogue Facility .

Over the past decade, Viet Nam has obtained remarkable achievements in socio-economic development, hunger eradication and poverty reduction. The substantial ODA resources allocated to Viet Nam, as well as the strong support from the international community to the Vietnamese development policies and reform, provided an important contribution to such achievements. As a result of its sustained growth and successful policies, Viet Nam attained the Middle Income Country status in 2010, and its development landscape is changing rapidly. The mobilisation of ODA and of less concessional loans in Viet Nam play, today, a different role. In order to avoid the middle income trap and to make the necessary breakthrough for its further development, Viet Nam has also pursued other opportunities, such as other sources for development finance from the private sector

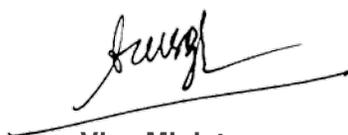
(FDI and domestic investment), enhanced South-South and regional cooperation. It has also strived to modernise its public financial management system, and notably its taxation system, in order to optimise its revenue and expenditure framework.

This study contributes to a better understanding of the role that development finance sources played in recent years. It also identifies opportunities and challenges of development finance in order to better inform Viet Nam's future strategy orientation and policies. Concretely, these are and will be translated in a more effective regulatory framework, for instance through the adoption of the Public Investment Law in June this year, and the current revision and amendment of Investment Law and Enterprises Law and State Budget Law.

The findings of the study are expected to provide useful and timely information, data, analysis and valuable recommendations to support the preparation of the Socio - Economic Development Plan 2016 - 2020 and to guide the future discussions on how to translate the Global Sustainable Development Goals at the country level. This study is also expected to contribute to the on-going policy dialogues between Government of Viet Nam and its development partners in terms of development cooperation agenda in Viet Nam in the new context.

Hanoi, November 2014

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Acknowledgment

This study is a product of the joint collaboration among the Ministry of Planning and Investment of Viet Nam, United Nations (UN) and the Delegation of the European Union (EU) to Viet Nam. We would like to express great gratitude to the two consultants Mr. Marcus Cox and Ms. Tran Thi Hanh for their hard work in conducting this study.

This study has also been made possible thanks to the financial contribution of the Australian government and the technical guidance provided by the Asia Pacific Development Effectiveness Facility (AP-DEF). The inputs from the Government agencies and development partners in Viet Nam consulted in the process are also recognized with high appreciation.

Executive summary

Vietnam has entered into a challenging new phase in its national development. After two decades of rapid progress, the pace of economic growth and poverty reduction has fallen away. The Government of Vietnam (GoV) has recognised that it needs new strategies to maintain its growth as a Middle-Income Country (MIC). Vietnam is also entering a new phase in its development cooperation. Over the past decade, Vietnam has been one of the top recipients of official development assistance (ODA) in the world. Yet other funding sources, including domestic revenues, public borrowing and foreign direct investment (FDI), have grown much more quickly, making ODA an increasingly minor part of the overall development finance picture. Now that Vietnam is a MIC, ODA flows will decrease and become less concessional in nature.

This Development Finance and Aid Assessment (DFAA) was commissioned by Vietnam's Ministry of Planning and Investment (MPI), with support from UNDP and the European Union, to examine the changing development finance picture. It examines the various sources of development finance available to Vietnam, looking at how they have developed in recent years and their likely future trajectory. It assesses legal and institutional constraints on their mobilisation and effective use. It makes recommendations to the Government of Vietnam (GoV) and development partners on options for improving the complementarity of different sources of development finance, in keeping with the focus of the Busan Partnership for Effective Development Cooperation and the Vietnam Partnership Document on overall development effectiveness.

A challenging new chapter in Vietnam's development

In the period between the launch of its economic reforms in the 1980s and the onset of the global financial crisis in 2007, Vietnam was one of the most dynamic economies in the developing world. It sustained average growth rates above 7% over a 20-year period, quadrupling the size of the economy. Poverty rates fell by an average

of 2.9 percentage points per year, from 58% in 1993 to a low of 14.2% in 2010 or 20.7% after adjustment based on the new poverty line. By the mid-2000s, Vietnam was experiencing record inflows of external resources, in the form of both FDI and ODA, funding some of the highest rates of investment in the world. This enabled Vietnam to extend basic infrastructure and services to the majority of its population.

From 2007, Vietnam suffered a slowdown in growth rates as a result of the global financial crisis. Unlike some other Asian countries, however, Vietnam's economic growth has not returned to the levels seen before 2007. There are widespread concerns that Vietnam may be reaching the limits of its existing growth model. The challenges of moving to a new growth model include:

- completing the economic transition: while around half of Vietnam's state-owned enterprises (SOEs) have been restructured through sale of shares, the commanding heights of the economy are still controlled by SOEs, which are inefficient and crowd out the development of the domestic private sector;
- raising the quality of FDI: while FDI to Vietnam grew rapidly in the 2000s, it is

dominated by low value-added assembly options that create employment but few wider benefits. Unless it can attract more productive investments, there is a risk that Vietnam will begin to lose out to lower wage economies;

- managing inequality: Vietnam's economic growth is becoming less pro-poor in nature, leaving a core of poverty and exclusion that is difficult to address. Furthermore, the 'socialisation' of public services is shifting much of their cost onto citizens, placing an increasing burden on the poorest households;
- macroeconomic constraints: following the global financial crisis, GoV attempted to boost growth through aggressive stimulus measures, including a spike in public investment, only to touch off a period of macroeconomic instability.

Mapping Vietnam's development finance flows

The sources of development finance that can be directly programmed by GoV are as follows:

- Public revenues have nearly trebled since 2006, to over 800 trillion dong or US\$39 billion, but have declined by 9% in real terms since 2010. The revenue-to-GDP ratio has fallen from nearly 30% in the mid-2000s to 22.8% in 2012, as a result of the economic slowdown, tax breaks for enterprises and a reduction in oil revenues. GoV has recognised that high corporate tax rates are affecting competitiveness and plans to reduce them. As a result, tax revenues will grow only modestly in the future, in tandem with economic growth.
- Government borrowing has grown by an average of 30% per year since 2006, mainly through domestic bond issues to support stimulus measures. Vietnam's indebtedness remains modest by international standards and there is scope to increase borrowing up to GoV's proposed total debt limit of 65% of GDP.
- ODA rose sharply in 2009, as the major development banks increased their lending in response to the global financial crisis. These levels have been maintained, with

annual disbursements close to \$4 billion. ODA will decline gradually in the coming years and fall away more rapidly towards the end of the decade. It will be partly offset by an increase in non-concessional lending from the multilateral development banks. This may cause a loss in support for the social sectors. Vietnam's disbursement rates for ODA have improved, from just 25% of commitments in 2010 to 40% in 2012. However, this still leaves over \$20 billion in committed ODA that has not been used, due mainly to bottlenecks in the implementation of large infrastructure projects.

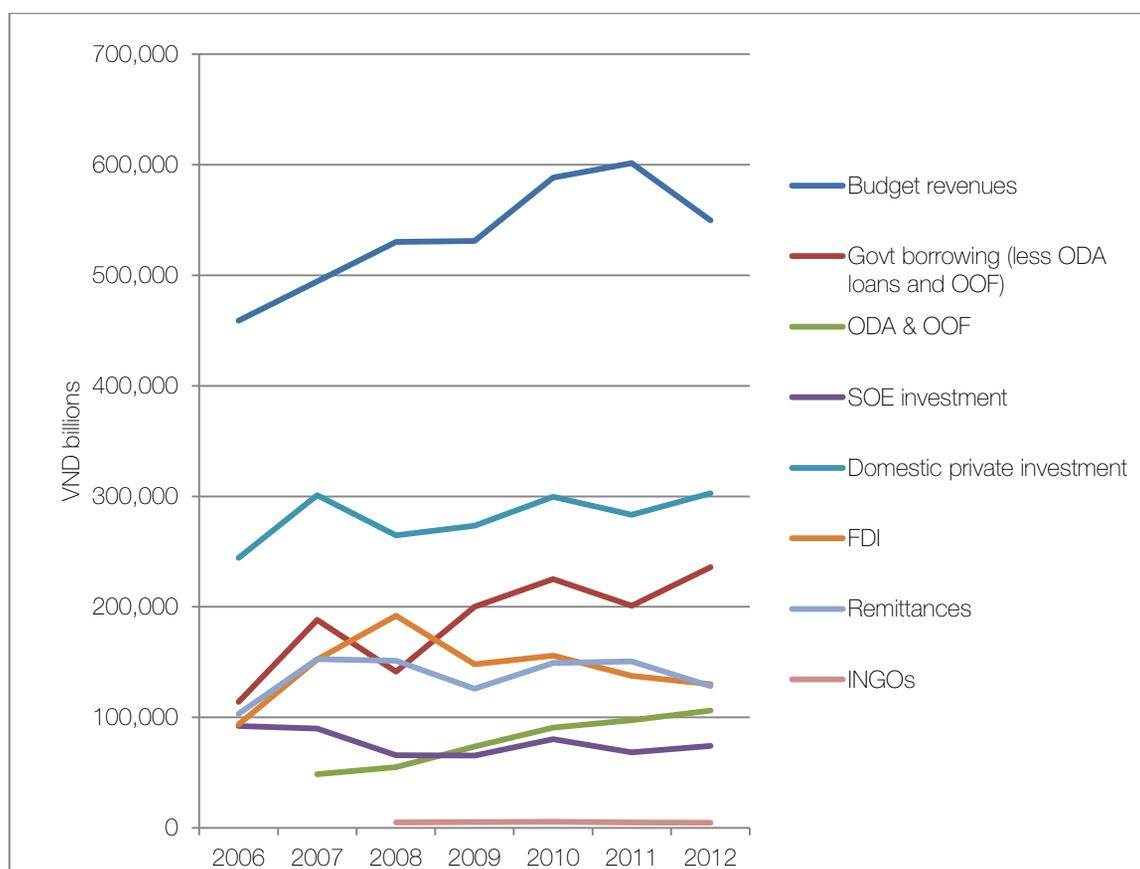
With these flows increasing rapidly over the past decade, GoV has been able to increase its level of public expenditure by 2.5 times between 2006 and 2013, in nominal terms. This high level of expenditure has enabled the extension of basic services and infrastructure to the majority of the population. The rural electrification rate has gone from 14% in 1993 to nearly 100% in 2010, the number of paper roads has quadrupled over the past decade and the proportion of households with piped water rose from 12% in 2002 to 76% in 2009.

Yet Vietnam faces some substantial challenges in using development finance effectively, owing to shortcomings in its planning and budgeting processes. Revenue forecasting has been fairly weak, which has hampered the introduction of medium-term expenditure planning. With more than half of the budget devolved to sub-national government, revenue and expenditure assignments between the three lower levels of government are unclear and many spending responsibilities are not adequately funded. Within the development budget, investment projects are not well aligned with socio-economic development plans. Competition among the provinces combines with weak appraisal processes to produce investments that are both economic and technically inefficient. Vietnam's 63 provinces are too small to enable efficient planning of infrastructure, leading to a proliferation of airports, deep-sea ports and industrial parks well in excess of need. In recent years, too many projects have been commenced without the funds being available to complete them. These challenges are recognised by GoV, and new laws on the state budget and on public investment are under preparation.

Outside of the public sector, the most important development finance flows are:

- Lending by Vietnam’s banking sector increased fivefold between 2006 and 2012, while total credit grew from 39% of GDP in 2000 to 115% in 2010, but was reduced to 84% in 2013. Since GoV took steps to control inflation, credit growth has been sharply curtailed, with significant impact on the private sector. SOEs enjoy privileged access to finance, due to their control of land for collateral and close relationships with financial institutions. Domestic private companies are mainly small to medium-sized and proprietor-funded, with limited access to commercial finance. Total investment by private Vietnamese companies has nonetheless grown much faster than either SOE investment or FDI.
- Foreign direct investment has fluctuated significantly over the past decade, spiking in 2008 during Vietnam’s real-estate boom and then flattening out in real terms. There have been recent signs of FDI picking up, including some key investments in high-tech sectors. However, most FDI consists of simple assembly operations, creating low-skilled employment but few wider benefits for the domestic private sector. In 2013, GoV adopted a strategy for attracting higher quality FDI.
- International NGOs are important development actors in Vietnam, providing around \$300 million in assistance each year.
- Remittances from Vietnamese citizens abroad are over \$8 billion per year, which is of approximately the same magnitude as FDI and twice the size of ODA.

Relative size of Vietnam’s development finances 2006-2012 in constant 2010 prices



Sources: MoF; MPI; GSO

Conclusions and recommendations

Until the global financial crisis, Vietnam's development finance flows grew rapidly over a long period, enabling the country to sustain extremely high levels of investment and achieve a prolonged period of high growth and poverty reduction. However, its investments are no longer generating growth at the levels that they used and have been reined back in order to maintain macroeconomic stability. As a consequence, Vietnam is moving into a period when development finance flows will be much more constrained than they have been. This makes it imperative to improve their development effectiveness, by adopting a more strategic approach to the use of public investments and paying greater attention to how public investments and policy choices can help to reinforce other development finance flows.

This is a broad agenda, but a number of challenges stand out.

1. Improving the quality of public spending and investment, including: introducing a medium-term budget planning processes that aligns both recurrent and development expenditure with national development priorities; addressing the shortcomings of the current system of fiscal decentralisation; shifting the planning of strategic infrastructure investments to the national or regional level; and introducing results-based resource allocation into the planning process.
2. Maintaining equity in social service delivery: reassessing the 'socialisation' of service delivery by developing whole-of-sector financing plans, clearer rules on private-sector participation and greater transparency around citizen co-payments.
3. Attracting private investment into infrastructure, by finalising the legal framework for public-private partnership (PPPs) and establishing a PPP Unit in central government to provide technical support to project owners on the design and negotiation of PPPs.
4. Increasing the development returns from FDI: Vietnam needs the capacity to design packages of interventions to support particular sectors or markets, covering areas such as infrastructure, vocational

training and incentives for investors. This means creating central government agencies capable of interacting with foreign investors and coordinating across different government agencies and jurisdictions.

5. Mobilising finance for private-sector development: GoV needs to pay greater attention to the development of the domestic private sector, in particular by helping medium-sized firms to develop the economies of scale required to act as suppliers to foreign investors and participate in global value-chains. This means increasing their access to land and finance.

We also suggest five key roles that development assistance can play in helping to boost the efficiency and development effectiveness of Vietnam's development finance.

1. Promoting evidence-based policy making and managing for results, by generating evidence, sharing knowledge, engaging in joint reviews and policy dialogue, strengthening the national statistical system, providing capacity building to GoV agencies on policy making and planning, investing in monitoring systems, and promoting community feedback on public services.
2. Improving the quality of public expenditure and investment by supporting budget and public financial management reforms, and helping to introduce elements of results-based financing into the development budget;
3. Support for public-private partnerships, including helping to develop the legal framework and the necessary technical capacities and providing financial support ;
4. Promoting equity in social service delivery by helping GoV to develop sector financing plans that encompass the national budget, private-sector investments, citizen contributions and ODA;
5. Developing knowledge partnerships in particular industries and markets, by linking GoV institutions with their counterparts in the donor country and helping GoV to develop tailored industrial development strategies;

Finally, we make a number of suggestions for what this might be for the evolving principles and structures that govern Vietnam's development partnership.

1. Developing sector finance strategies: To make the best use of the remaining period of ODA, line ministries should begin to develop sector financing strategies that identify the best uses of ODA alongside other development resources.
2. A changing division of labour: Many of Vietnam's bilateral donors no longer have the personnel or incentive to engage as actively in Vietnam's aid coordination processes or joint initiatives with other donors. It is increasingly the multilateral partners (the development banks, the European Union and the United Nations) that lead on policy dialogue at the national level. It may be appropriate for the multilaterals to agree a broad division of labour in policy dialogue and to build up their different capacities to engage on particular topics.
3. Partnership-based cooperation: Some of Vietnam's bilateral partners have begun to move away from traditional, sector-based support towards a new focus on mutually beneficial trading relationships. This usually involves a shift away from financial assistance towards new assistance modalities based on partnerships between public bodies, academic institutions, NGOs and companies in Vietnam and the donor country. This new partnership-based cooperation is new and untested. Rather than central coordination, it calls for better information flows so that Vietnamese institutions can choose the support that best matches their need.

Acronyms

ADB	Asian Development Bank
BOO	Build-Operate-Own
BOT	Build-Operate-Transfer
CSO	Civil society organisation
DFAA	Development Finance and Aid Assessment
DFID	Department for International Development
FDI	Foreign direct investment
GDP	Gross domestic product
GoV	Government of Vietnam
HIV-AIDS	Human Immuno-deficiency Virus/Acquired Immune Deficiency Syndrome
IBRD	International Bank for Reconstruction and Development
INGOs	International non-government organisations
Jahr	Joint Annual Health Review
JICA	Japan International Cooperation Agency
MARD	Ministry of Agriculture and Rural Development
MIC	Middle-income country
MoF	Ministry of Finance
MONRE	Ministry of Natural Resources and the Environment
MPI	Ministry of Planning and Investment
MTEF	Medium-term expenditure framework
MTIP	Medium-term investment plan
NTP	National Target Programme
ODA	Official development assistance
OECD	Organisation for Economic Cooperation and Development
OOF	Other official flows
OOP	Out-of-pocket
ORC	Ordinary capital reserves
PEPFAR	United States President's Emergency Plan for AIDS Relief
PPP	Public-private partnership
SDU	Service delivery unit
SEDP	Socio-economic development plan
SOE	State-owned enterprise
VND	Vietnamese dong

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1 Introduction

1.1. Purpose

Vietnam has entered into a challenging new phase in its national development. After two decades of remarkable progress which brought the country to middle-income country (MIC) status, the pace of economic growth and poverty reduction has fallen away. To recover its dynamism, Vietnam needs to move from a growth model based on low-cost labour to one based on innovation and productivity growth. This calls for some major structural changes in the economy and continued investment in human capital through improvements in service delivery.

Vietnam is also entering a new phase in its development cooperation. Over the past decade, it has been one of the top recipients of official development assistance (ODA) in the world, at over \$3 billion in annual disbursements, with donors responding enthusiastically to Vietnam's impressive development record and its strong commitment to aid effectiveness. Yet other funding sources, including domestic revenues, public borrowing and foreign direct investment (FDI), have grown at an even faster rate, making ODA an increasingly minor part of the overall development finance picture. This raises the question of what role ODA will play in supporting Vietnam's transition to a new growth model.

This Development Finance and Aid Assessment (DFAA) was commissioned by Vietnam's Ministry of Planning and Investment (MPI), with support from UNDP and the European Union. Its purpose is to advise the Government of Vietnam (GoV) and its development partners (DPs) on options for improving the complementarity and value-added of different sources of development finance, including ODA. It presents data from a range of sources on the changing patterns of development finance in recent years. It assesses policy, legal and institutional constraints on how these different sources of finance are mobilised and utilised. It makes recommendations to GoV on how different sources of development finance can be used in a more complementary fashion,

and to development partners on how to use ODA so as to maximise the impact of overall development expenditure.

One of the purposes of this DFAA is to support Vietnam with implementing the core principle of the Busan Partnership for Effective Development Cooperation, which called for a shift of focus from the effectiveness of aid towards a broader concept of development effectiveness. The Busan document encourages donors and partner countries to "facilitate, leverage and strengthen the impact of diverse forms of development finance and activities, ensuring that these diverse forms of co-operation have a catalytic effect on development."¹ This study explores what this principle might mean in the Vietnamese context.

1.2. Scope and methodology

This study reviews the following sources of development finance and expenditure:

- public revenue, including tax and non-tax revenues;
- government borrowing, both domestic and international;

¹ "Busan Partnership for Effective Development Co-operation", Fourth High Level Forum on Aid Effectiveness, Busan, Korea, 29 November - 1 December 2011, para. 12.

- ODA and lending from international financial institutions;
- south-south financial flows;
- expenditure by international non-government organisations (INGOs);
- remittance flows;
- investment finance from the financial sector; and
- foreign direct investment.

It examines, to the extent possible, how these development finance flows have changed in the period 2006 to 2012 and what the future trends are likely to be. It examines the legal, policy and institutional framework relating to each source of development finance, identifying constraints on their effective mobilisation or use. The assessment is done at the national level, with more detailed exploration of the health sector and ‘socialisation’ of service delivery, the planned transition from donor funding of HIV-AIDS programmes and the development of public-private partnerships (PPPs) in infrastructure. The methodology also involved a visit to Quang Nam province to assess finance flows from the provincial perspective.

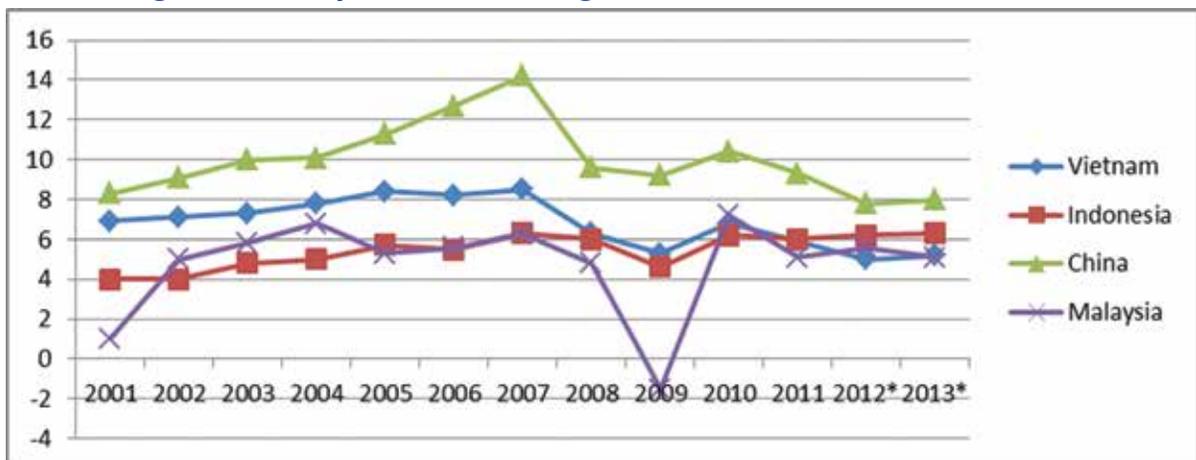
The methodology included extensive stakeholder consultations with GoV agencies, development partners and independent observers. Official data was collected from a range of different GoV agencies (MPI; Ministry of Finance; State Bank of Vietnam; Government Statistics Office; a range of line ministries). GoV policies, strategies and legal instruments were analysed, together with studies published by development partners. Some comparison was made to the experience of other countries that have recently achieved MIC status, particularly Indonesia, although their experiences are not well documented.

We note that data shortages and quality issues are a perennial problem in Vietnam. While aggregate figures are available on most sources of development finance, the data required to disaggregate them by sector or geographical area is often unavailable. Where the data is currently unavailable, the DFAA makes recommendations as to how this can be addressed in the future.

2. A challenging new chapter in Vietnam's development

In the period between the launch of its economic reforms in the 1980s and the onset of the global financial crisis in 2007, Vietnam was one of the most dynamic economies in the developing world. By liberalising prices, opening up to international trade and allowing private business to compete with state-owned enterprises (SOEs), Vietnam sustained average growth rates above 7% for a 20-year period, quadrupling the size of the economy. Rapid growth in paid employment transformed the lives of the Vietnamese people. Poverty rates fell by an average of 2.9 percentage points per year, from 58% in 1993 to a low of 14.2% in 2010, according to the official poverty line, although an updated Government Statistical Office-World Bank poverty line readjusted the rate to 20.7% in 2010.² By the mid-2000s, Vietnam was experiencing record inflows of external resources, in the form of FDI and ODA, funding investment rates above 40% of GDP – among the highest in the world.³ This enabled Vietnam to extend basic infrastructure and essential services to the majority of its population, achieving major gains in human development.

Figure 1: Comparison of GDP growth in selected Asia countries



Source: East Asia & Pacific (EAP) Economic Update, May 2012

² World Bank, "2012 Vietnam Poverty Assessment. Well begun, not yet done: Vietnam's remarkable progress on poverty reduction and the emerging challenges", Hanoi, 2012, p. 4.

³ London, D., "The contributions and limits of 'socialization': the political economy of essential services in Viet Nam", UNDP, May 2013, p. 10.

Like other countries in the region, Vietnam suffered negative impacts from the global financial crisis. Unlike some other Asian countries, however, Vietnam's growth rates have not returned to the levels seen before 2007 (see Figure 1). Furthermore, its economic growth is no longer as pro-poor in nature, leaving a remaining poverty caseload that is much more difficult to address through GoV's traditional policy instruments. The problem of flattened growth performance appears to be broader than an adverse external environment. A growing number of analysts, both on the international and Vietnamese sides, have suggested that Vietnam has reached the limits of what can be achieved through the growth model of the 1990s and 2000s.

This concern stems from a number of factors. Growth in the past has been driven in large part by an expanding labour force and a rebalancing of the economy from agriculture into services and manufacturing, where productivity is between two and four times higher.⁴ These structural changes have now run their course. Future growth needs to come from improvements in productivity. Yet in recent years, labour productivity growth has slowed while capital productivity has consistently declined. Total-factor productivity (a proxy measure for technological change in an economy) has declined from 19.9% in the mid-2000s to just 12.5% in the 2007-2010 period, compared to an average of 20 to 30% among developing countries. As a result, the share of GDP growth resulting from productivity increases shrank from 56% in the 1991-1995 period to just 8.9% in the 2006-2008.⁵

This is a key factor for this development finance assessment. It suggests that Vietnam's current problems are due not to a lack of development finance, but a growing challenge in using it efficiently. Indeed, the authors of the 2012 Vietnam Development Report concluded: "If Vietnam's initial transition years were marked by 'growth with limited resources,' the last five years can be labelled as 'abundant resources with limited growth'.⁶

⁴ McKinsey Global Institute, "Sustaining Vietnam's growth: the productivity challenge", February 2012.

⁵ *Ibid.*

⁶ World Bank et al., "Vietnam Development Report 2012: Market Economy for a Middle-Income Vietnam", Joint Donor Report to the Vietnam Consultative Group Meeting, December 2011, p. 26.

In this chapter, we review some of the challenges facing Vietnam in its transition to a new growth model and their implications for Vietnam's development financing needs.

2.1. Completing economic transition

Vietnam began its economic transition in the 1980s at a time of severe financing constraints. The collapse of the former Soviet Union and Vietnam's international economic isolation meant that few resources were available from external sources. Rates of investment in national development were extremely low. At the Sixth Party Congress in 1986, Vietnam recognised the need to "mobilise resources from all economic partners, including the state sector, the private sector and foreign investors... to finance national development." Land reforms and the liberalisation of food markets enabled Vietnam to become a major rice exporter. From 1987, the country was opened to foreign investment. In 1990s, a Law on Private Enterprises was passed, providing a legal framework for private-sector investment. In further reforms in the 2000s, the legal frameworks for SOEs, Vietnamese private companies and foreign companies were unified, enabling them to compete on formally equal terms. Vietnam also began a sustained effort to end its international isolation, abolishing restrictions on imports and exports and establishing trade relationships with more than 160 countries and territories.

Vietnam put a tremendous effort into achieving membership of the World Trade Organization (WTO) in 2007. This required a great many reforms to its business environment, including major reforms to its commercial laws, its rules on intellectual property and consumer protection and the functioning of its capital markets. This revamped legal framework has helped to make Vietnam one of the most popular destinations in Asia for foreign investors. However, GoV is still working to building the institutional capacity at sub-national level to ensure that these regulations are properly implemented.

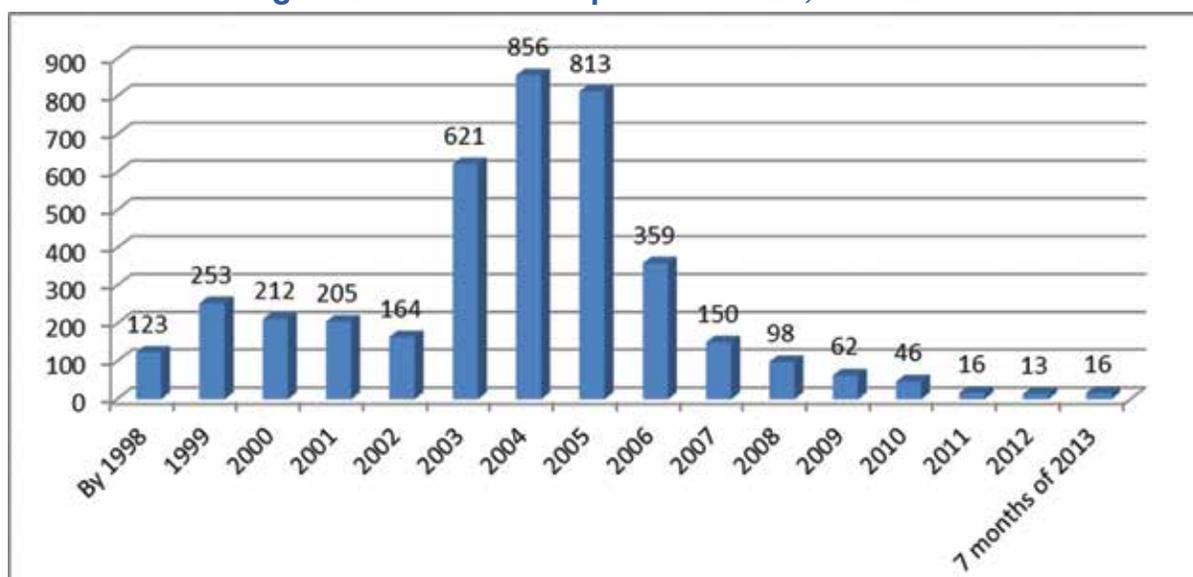
These reforms have fundamentally changed the ownership structure of the Vietnamese economy. Yet the pace of transition has

nonetheless been carefully controlled. Since the first moves to dismantle state monopolies in 1992, more than half of all SOEs have been transformed through restructuring and sale of shares ('equitisation'). However, it was principally smaller and underperforming SOEs that were transformed, leaving important parts of the economy still in state hands. A number of strategic sectors, including fertiliser, telecommunications, insurance, cement and even sugar, are still dominated by SOEs.

There have been repeated commitments at the highest political levels to press ahead with equitisation of SOEs and a number of attempts to improve the legal framework, but the pace has not been sustained, particularly since 2007

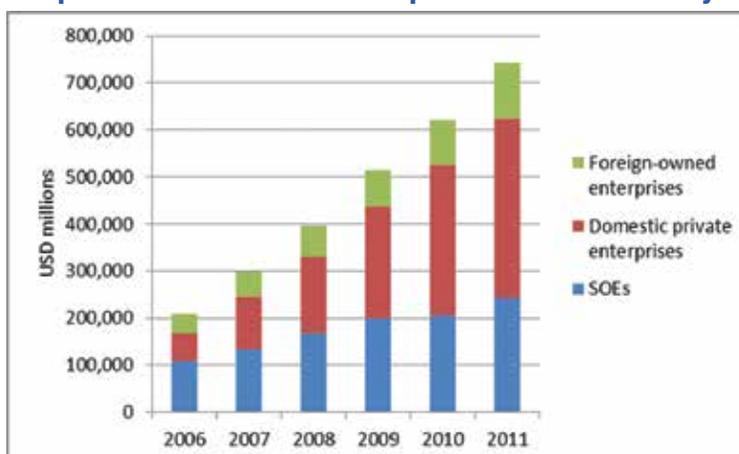
and the economic slowdown (Figure 2). The focus in recent years has been on increasing SOE efficiency through regrouping and restructuring, rather than equitisation. While a total of over 4,000 SOEs have been equitised, the state continues to own shares in 70% of them and has a controlling stake in 36%. The government has approved an SOE equitisation action plan for 2011- 2015 (Decision 2219/ TTg-DMDN) and MOIT has issued Decision 1827/2012/QD-BCT on the equitisation of 100% state-owned enterprises. A new Law on Enterprises is under preparation, to tackle problems with corporate governance, weak oversight and a lack of transparency in the SOE sector.

Figure 2. Number of 'equitised' SOEs, 1998-2013



Source: CIEM, "Rearranging, renovating SOEs and improving SOEs efficiency" study report, 2013

Figure 3: Capital resources of enterprises in Vietnam by ownership



Source: Government Statistics Office (GSO) Statistic Books

This incomplete transformation of the enterprise sector has a major impact on the development of Vietnam's domestic enterprise sector. Although it is the largest sector of the economy and accounts for two-thirds of total investment, it is dominated by small and medium-sized, proprietor-financed enterprises. Private firms are being crowded out by the SOEs, which enjoy privileged access to essential inputs, particularly land. Complicated structures of cross-ownership between SOEs and financial institutions also allow them privileged access to finance. Many observers therefore see the completion of economic transition as essential to the next phase of Vietnam's development, to allow a more sophisticated private sector to emerge.

2.2. Raising the quality of FDI

FDI has grown rapidly through most of the 2000s, spiking in 2008 during Vietnam's property boom and then falling away when GoV took measures to restrict real estate speculation. FDI has been an extremely important component in Vietnam's development, generating an important share of employment growth. Vietnamese provinces have competed to attract foreign investors, offering a range of tax exemptions and other benefits.

However, there are concerns about the quality of Vietnam's FDI. Investments in low value-added textiles and simple assembly operations still predominate. Many foreign companies bring their components from abroad and export their product, offering few opportunities for private firms to become part of international value chains or acquire new management skills or technology. The danger is that, as wages increase, Vietnam will begin to lose out to lower-wage economies in the region such as Myanmar. FDI levelled out or declined slightly after the global financial crisis, but appears to have picked up again since 2013.

To avoid this 'middle-income trap', Vietnam needs to attract a higher quality of foreign and domestic investment into higher productivity industries, enabling it to build up domestic value chains. There are some encouraging signs that this is starting to happen in sub-sectors such as mobile phones, where a number of major foreign investors have begun to shift production into Vietnam. Generally, however, analysts are concerned that infrastructure bottlenecks,

skills shortages and restrictions in the business environment are standing in the way of more substantial growth in high-technology industries.

2.3. Managing inequality

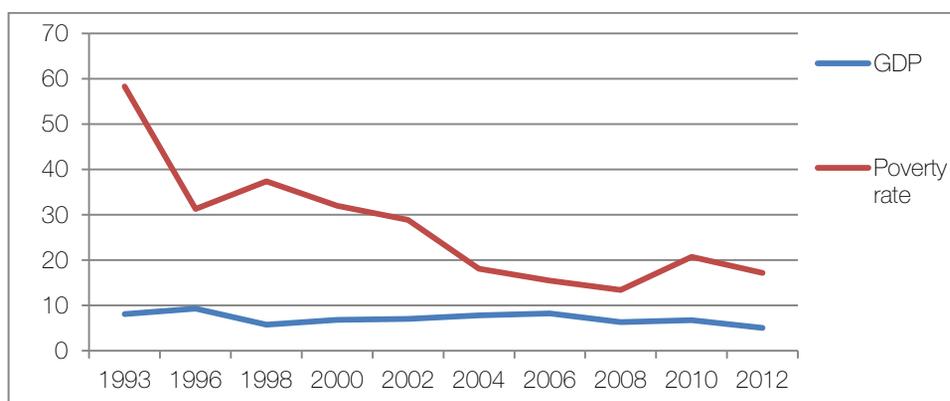
Vietnam's growth model for the past twenty years has been remarkably pro-poor in nature. High rates of economic growth have generated extensive employment in the private sector, allowing millions of people to move from subsistence or low-value agriculture into wage employment. This has been supported by extensive investment in extending basic infrastructure and services across the country, together with a reasonably effective social security system. Compared to other developing countries, GoV devotes a higher proportion of public expenditure to health and education, at around 28% of the budget. The extension of health services and the introduction of health insurance for the poor have resulted in improvements in life expectancy, which in turn have driven substantial improvements in Vietnam's position on the Human Development Index.

Vietnam now faces a number of challenges in sustaining progress on poverty reduction. First, economic growth has become more capital-intensive, generating less employment. It also more concentrated in existing centres of economic activity. This makes it less inclusive and pro-poor in nature. As Vietnam's economic transition continues, it is inevitable that income inequality will continue to rise.

Second, the remaining poverty is concentrated in geographical areas and population groups that are harder to reach. There is a high concentration of poverty among ethnic minority groups, who make up less than 15% of the population but 47% of the poor (2010).⁷ Many of the remaining poor live in mountainous and remote areas. GoV has issued a series of policies and programmes designed to target these groups. However, there are substantial challenges involved in overcoming economic and social exclusion among minority groups, and it is not yet clear that the right policy instruments have been identified.

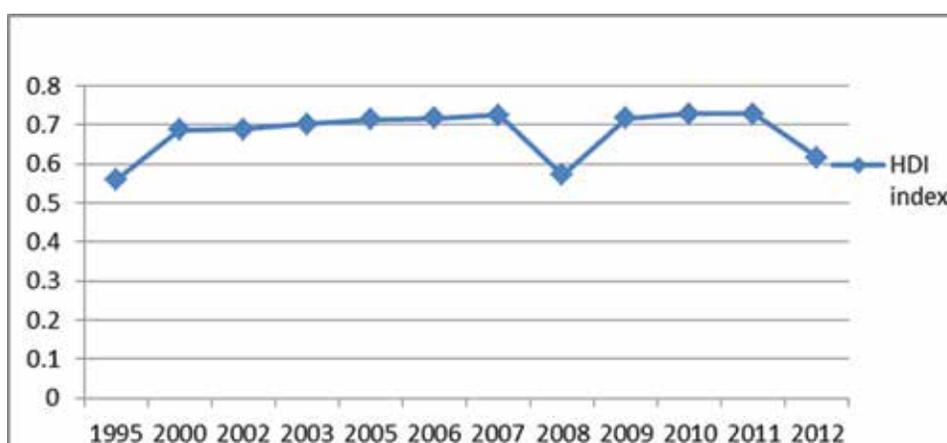
⁷ World Bank, "2012 Vietnam Poverty Assessment. Well begun, not yet done: Vietnam's remarkable progress on poverty reduction and the emerging challenges", Hanoi, 2012, p. 5.

Figure 4: GDP growth and poverty reduction, 1984 to 2012



Source: UNDP, *HDI values and rank changes in the 2013 Human Development Report, Vietnam, 2013*

Figure 5: Vietnam's HDI 1995-2012



Source: GSO (2012)

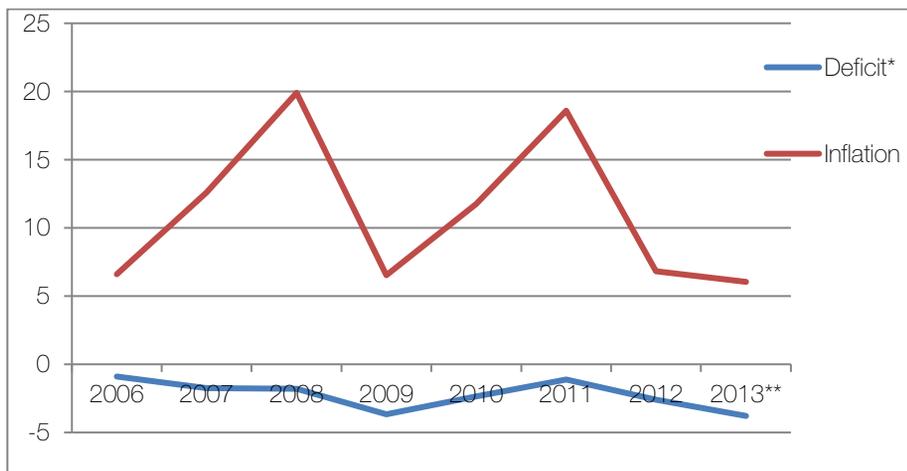
Third, GoV has pursued a policy of ‘socialisation’ of health and education, to attract resources from society to complement state-funded service provision. ‘Socialisation’ is an umbrella terms for the introduction of market principles into service delivery, opening up to private investment and introducing user fees. In practice, this policy has shifted the burden of paying for services from the state to society – mainly to households. An official policy of introducing user fees for certain services has been accompanied by a widespread practice of informal co-payments, with citizens often unable to distinguish between the two.⁸ This method of funding basic services is both

inefficient and inequitable. A significant effort is needed to shift the burden of funding service delivery back towards the state, so the burden can be shared more equitably.

⁸ London, D., “The contributions and limits of ‘socialization’: the political economy of essential services in Viet Nam”, UNDP, May 2013, p. 10.

2.4. Macroeconomic constraints

Figure 6: Inflation and Budget deficit, 2006 to 2013

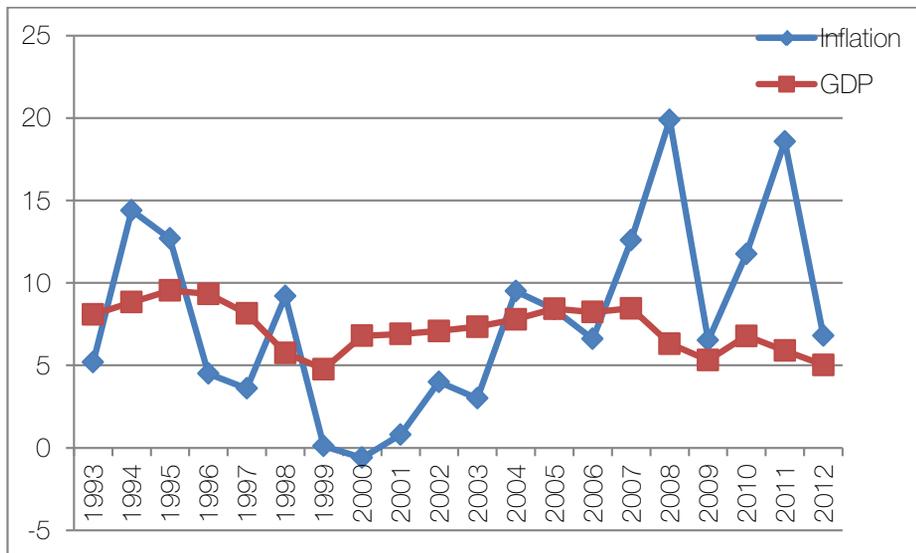


*: The state budget deficit, not covering the payment of loan principal

** : Estimate data

Source: ADB 2012, GSO 2012 and MOF website

Figure 7: GDP growth and inflation, 2002 to 2012



Source: GSO (2012), ADB (2012)

Since the global financial crisis, Vietnam has undergone a period of macroeconomic instability. GoV responded to the crisis with two packages of stimulus measures in 2009, totalling around \$9 billion or 9% of gross domestic product (GDP). They took the form of interest rate subsidies, tax relief and loan guarantees for enterprises and increased public expenditure on infrastructure, funded through the issuance of government bonds.

The stimulus measures had only limited impact in restoring economic growth, which has continued to decline across all sectors of the economy (see Figure 6). There are high levels of distress in the enterprise sector, with the number of businesses collapsing or ceasing to operate for 2011- 2012, reaching the level, which is equal to the number of business closures in the previous twenty years.⁹ At the same time, the stimulus measures ushered in a period of macroeconomic instability. The budget deficit increased to 6.9% of GDP in 2009, while inflation reached double figures in 2010 and 2011 (see Figure 6). GoV was required to introduce a series of measures to control inflation and stabilise the economy, including sharp reductions in the capital budget.

This period of macroeconomic instability has been taken by many observers as demonstrating that the limits of a capital-intensive growth model fuelled by high rates of investment may have been reached. It has left a legacy of increased public debt and incomplete investment projects that limit Vietnam's scope for launching new public investment projects in the coming years.

2.5. Vietnam's future development challenges

Vietnam stands at a critical juncture in its national development path. Since achieving MIC status in 2009, it has entered into a period of declining economic growth, macroeconomic instability, slower poverty reduction and growing inequality. This is partly a result of the global economic downturn. However, many observers, both Vietnamese and international, are concerned that Vietnam's period of rapid growth may be drawing to a close.

⁹ www.kinhdoanh.vnexpress.vn, 5/11/2012, *Business collapse hasn't been large before*

There are a number of dimensions to this challenge. First, Vietnam's economic transition remains incomplete and the pace of transition has slowed sharply since the mid-2000s. Despite its inefficiencies, the SOE sector continues to enjoy privileged access to essential inputs such as land and finance, which limits the space for the private sector to develop. With the slowdown in Vietnam's economic growth, the task of completing economic transition is both more urgent and more difficult to accomplish.

Second, Vietnam needs to move from a growth model based on low-skill, low value-added industries to one based on high technology and knowledge-based industries that are better integrated into global value chains. This would enable Vietnam to attract higher quality FDI with more extensive benefits to the national economy. It calls for improvements in the level and quality of infrastructure, a better educated workforce and continuing improvements to the business environment.

Third, Vietnam needs to take measures to manage the risks of increased inequality and socio-economic exclusion that will come with the changed growth model. It will need to improve its targeting of pro-poor expenditure, with a focus on excluded groups and remote geographical areas. It will also need to reassess the impact of 'socialisation' on access and equity in the social sectors. This calls for a reassessment of the ways in which basic services are financed.

These three transformations need to be managed in a macroeconomic environment that limits the scope for stimulating growth through investment, and in the face of development finances that are significantly more constrained than in the past. This makes it imperative to increase the efficiency of capital and recurrent expenditure, so to maximise their development impact. Thus, for Vietnam to meet its new development challenges, it also needs to address the constraints on effective use of development finance.

The core conclusion for the study is therefore that the challenge facing Vietnam is not primarily one of maximising its development finance flows. Over the past decade Vietnam has had sufficient resources to sustain high rates of investment. Having reached a point of diminishing returns on investment in its current form, Vietnam now needs to improve the efficiency and effectiveness of its development investments.

3. Mapping Vietnam's development finance flows

This chapter maps the different sources of development finance in Vietnam. The first part looks at sources of development finance spent predominantly by government, including public revenues, public borrowing and ODA. It concludes with a review of government expenditure patterns. The second part looks at development finance flows that are not controlled by government, including lending by the Vietnamese financial sector, investment by SOEs and private companies, FDI, remittances and expenditure by international non-government organisations (INGOs) and Vietnamese civil society. In each case, we describe some of the key institutional factors that relate to the effective mobilisation and use of the resource in question.

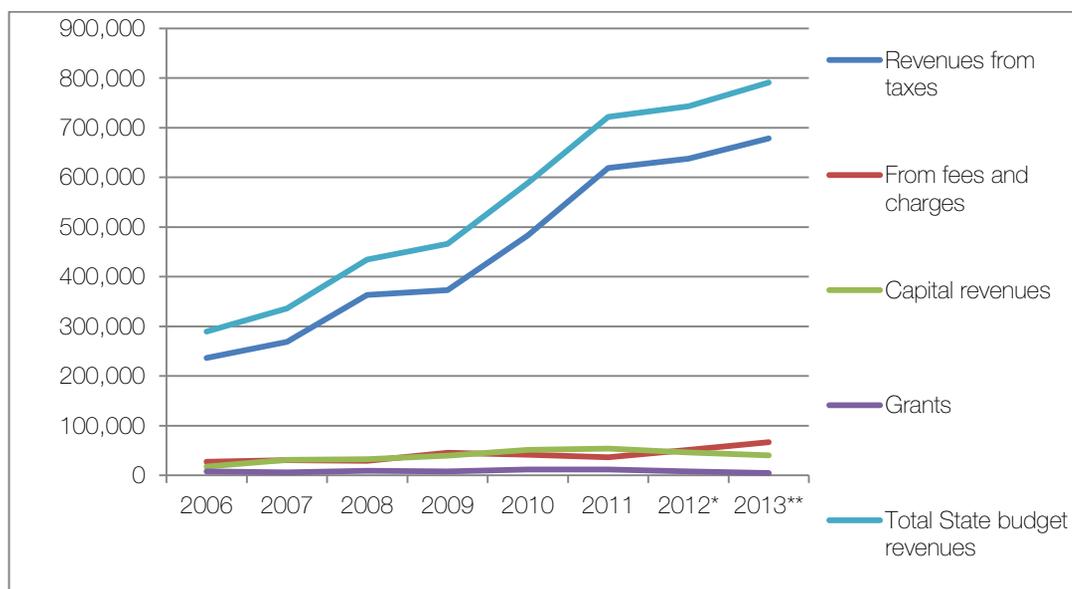
3.1. Development finance on the budget

3.1.1. Public revenues

Public revenues in Vietnam are by far the largest source of development finance in

Vietnam. They have grown rapidly over the past decade on the back of strong economic growth, from under 300 trillion dong in 2006 to about 800 trillion dong or \$39 billion in 2013 (Ministry of Finance estimate). Figure 8 shows the growth in total revenues over the past six years in current prices.

Figure 8: Total public revenues 2006-2013 in current prices



Source: MoF data

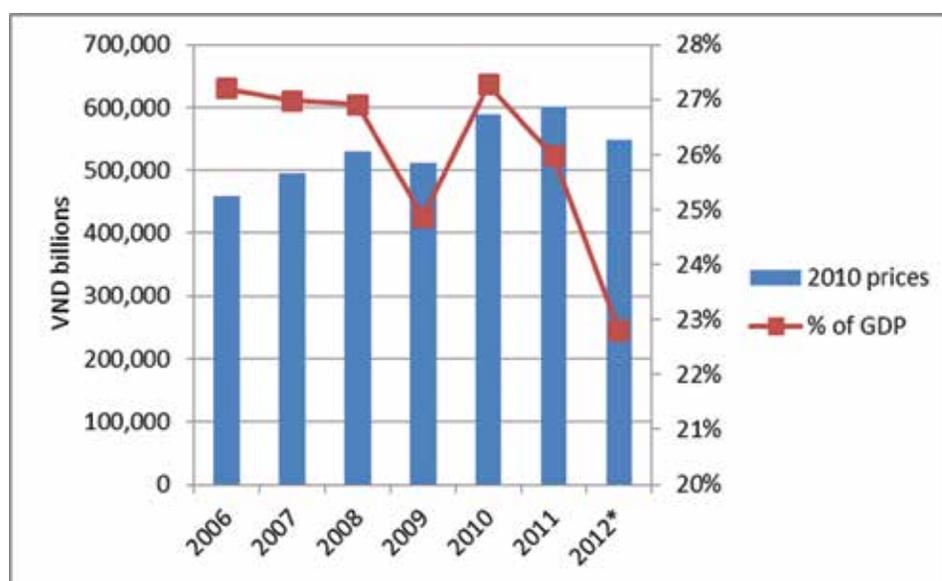
*: Second estimate data

** First estimate data

Note that these are in current prices, with two episodes of double-digit inflation during the time period. When measured in constant 2010 prices, there has been a decline in 2012 of 9%

in revenues due to the slowdown in economic activity. The Ministry of Finance (MoF) estimates are that this decline will continue in 2013, despite additional revenue collection measures.

Figure 9: Total revenues 2006-2012 in constant 2010 prices and as a proportion of GDP



Source: Authors' calculation based on the MoF's data on budget revenues in current price and GSO data on GDP in current price and in 2010 price

As a share of GDP, revenues have declined sharply. Vietnam used to have one of the highest revenue-to-GDP ratios in the region, peaking at nearly 30% in the mid-2000s, but this fell to a low of 22.8% in 2012.¹⁰ This is due to a number of factors, including the slowing of the economy, tax breaks for enterprises and a reduction in oil revenues.

The contribution of oil to national revenues fell from 24% in 2004 to around 14% in recent years.¹¹

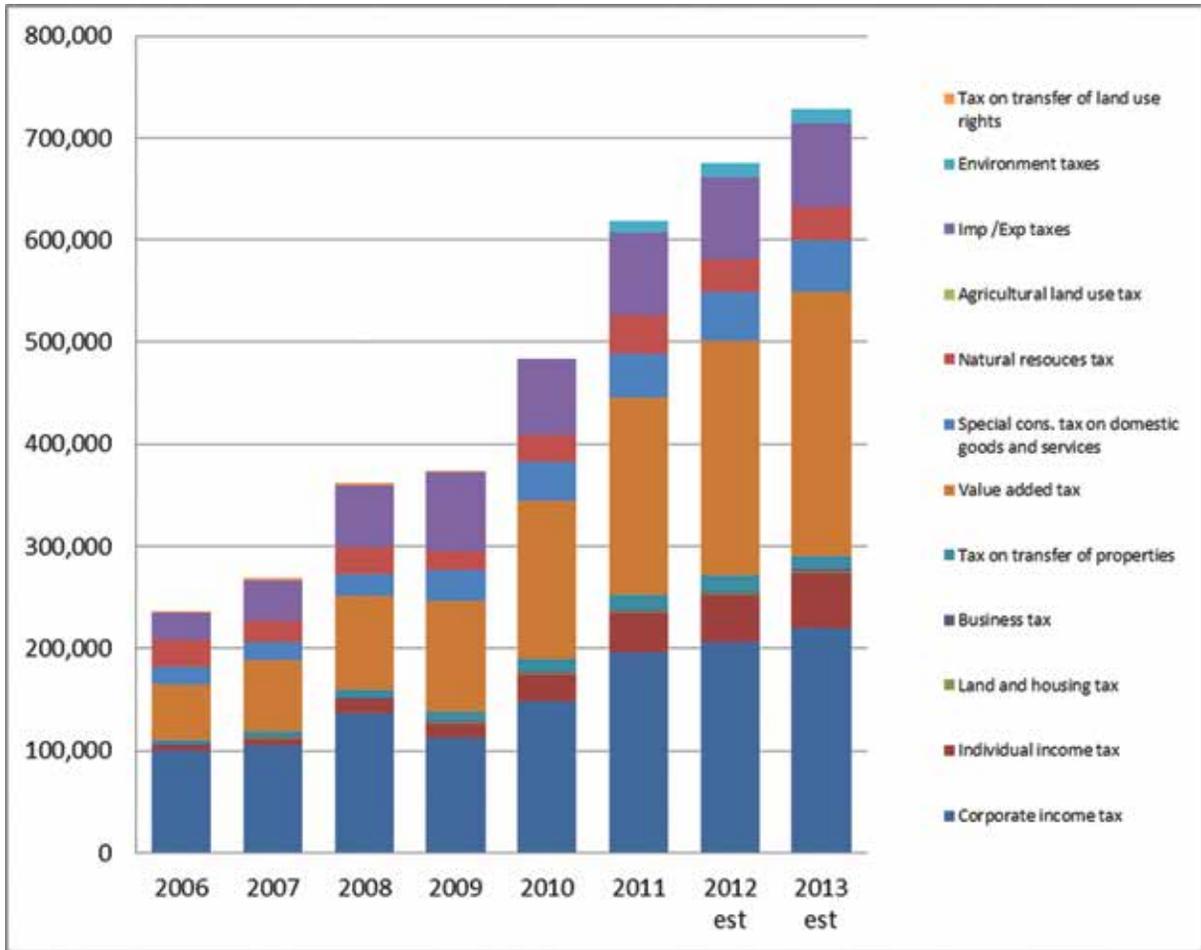
According to MoF, this is due both to a decline in oil production and a decision to increase the amount of refining done domestically. Vietnam nonetheless has estimated oil reserves of 4.4 billion barrels, which is the third largest in Asia after China and India, and this may increase as its waters are relatively unexplored.

Figure 10 shows the contribution of different types of tax to total revenues. Corporate income taxes and value-added tax are the most important.

¹⁰ The State Budget revenues /GDP ratio in VN has been considered the one of the highest in the region, because the method of calculation in Vietnam is different from that of many other countries. In Vietnam, the state budget revenues cover the state budget revenues from all government levels. In addition, the revenues from oils, land use fees, sale of state-owned houses have been included in the state budget revenues in Vietnam, while they are considered as the capital revenues (from selling natural resources).

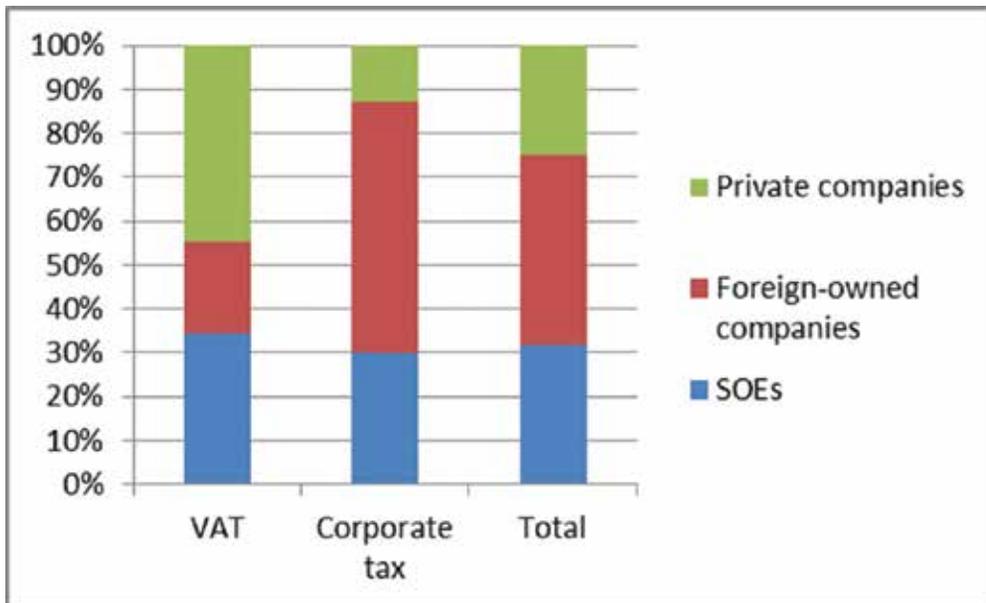
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Figure 10: Composition of tax revenues, 2006-2013, in current prices



Source: MoF data

Figure 11: VAT and Corporations tax by company ownership, 2012



Source: MoF data

Figure 11 shows the different contributions of SOEs, domestic private companies and foreign-owned companies to the two major tax sources, value-added tax and corporate tax. Foreign-owned companies generate 43% of tax revenue from these two sources, following by SOEs at 32% and domestic private companies at 25%. While foreign-owned companies generate the largest share of corporate tax, it is reported that provinces often compete with each other to attract foreign investors by offering over-generous tax breaks as incentives. As a result, the contribution of FDI to national revenues is less than it could be.

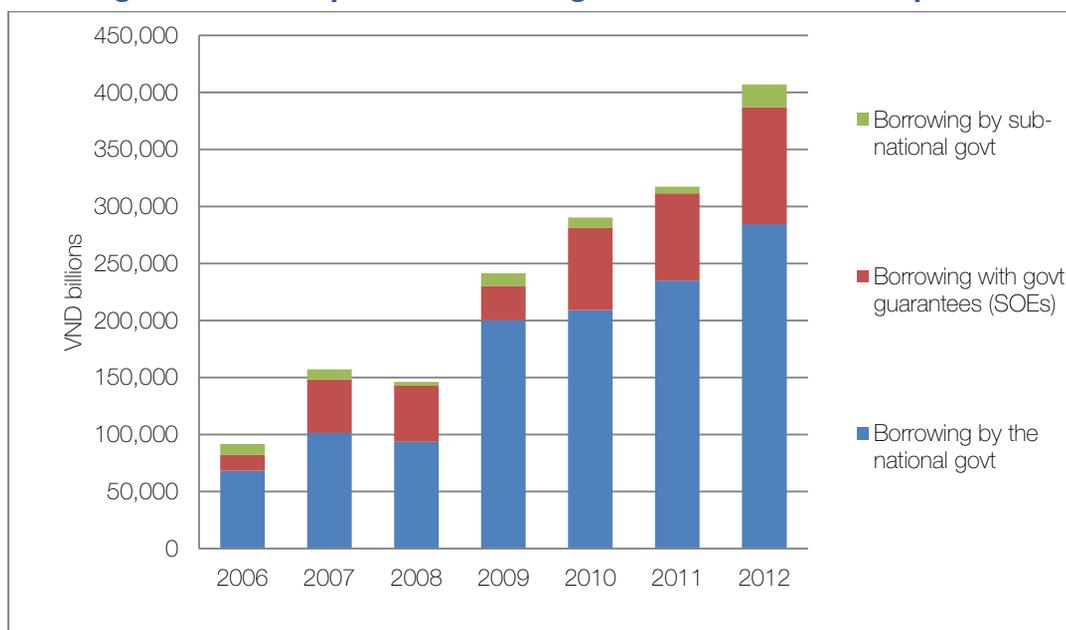
According to MoF, GoV recognises that corporate tax rates are too high to allow business to flourish and has applied the tax rate of 20% to small and medium enterprises and reduced them from 25% to 22% to the remaining ones since the 1st January 2014. Any increases in the efficiency of tax collection in the coming years will therefore be offset by rate reductions. For this reason, taxes revenues are not expected to return to the levels seen in the mid-2000s for some time, although they will continue to increase in tandem with economic growth.

Land and property taxes peaked at 8-9% of revenues during the period of Vietnam's property boom (2008-09), but have since declined to 6%. However, they continue to be one of the most important revenue sources for local government. World Bank analysis has pointed out that the system of land taxes creates incentives for the provinces to retain the administrative systems of land allocation, which favour SOEs over private businesses, rather than moving to a market-based system.

3.1.2. Government borrowing

As a MIC, Vietnam has increasing scope to borrow money on commercial terms. Total borrowing has increased by an average of 30% a year since 2006, with sharp jumps in 2009 and 2012 as a result of additional bond issues to fund GoV stimulus measures (Figure 12). The bulk of the borrowing is by national government, with some government guarantees of SOE lending (SOEs can also borrow without guarantees) and a small amount of borrowing by sub-national government.

Figure 12: Total public borrowing 2006-2012 in current prices

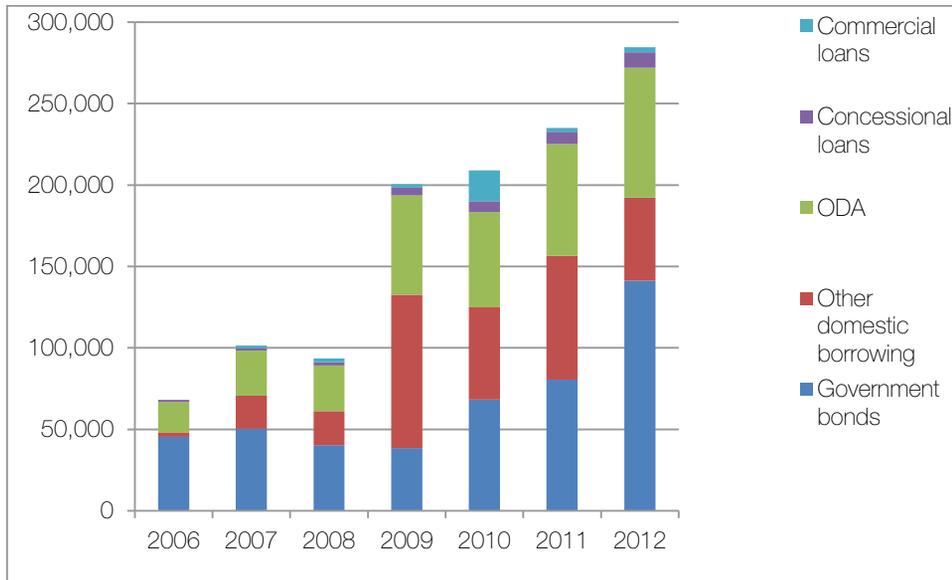


Source: MoF data

Some two-thirds of the borrowing is domestic, including borrowing from commercial banks and bond issues. There is borrowing from international banks and from development partners, including ODA and less concessional loans. Vietnam has

also undertaken two international bond issues, in 2005 and 2011, for \$750 million and \$1 billion. The bulk of the proceeds went towards support for distressed SOEs, including the shipbuilding company Vinashin.

Figure 13: Composition of government borrowing



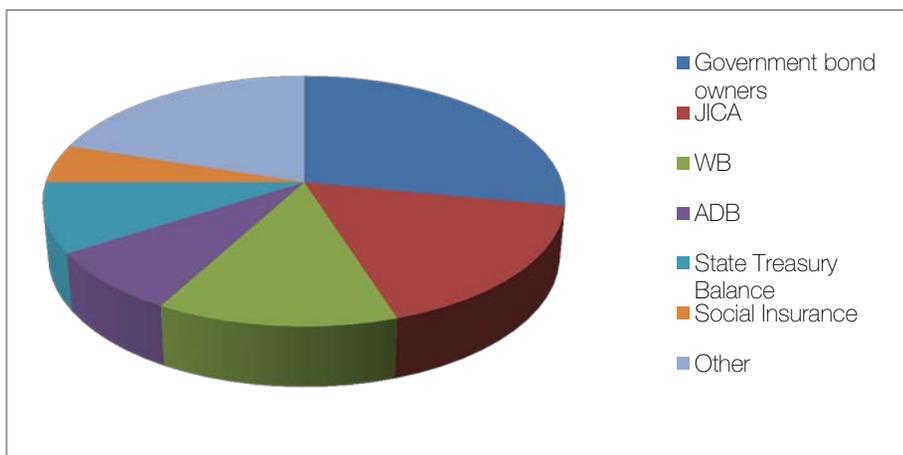
Source: MoF data

Vietnam’s indebtedness remains at relatively modest levels, under 60% of GDP. According to MoF, the official target is to keep total debt below 65% of GDP, although this is not enshrined in law. The joint World Bank/IMF Debt Sustainability Analysis suggests that Vietnam currently has a low risk of debt distress, but needs to maintain tight control to ensure sustainability. “Even a small increase in the pace of spending growth, or maintaining primary deficits at the current levels, will lead to a rapid deterioration in debt dynamics.”¹²

These figures do not include indebtedness within the SOE sector, the extent of which is not captured in any government statistics. While most SOE debt is not formally guaranteed by GoV, there are concerns that it gives rise to unofficial contingent liabilities for the government, owing to the political imperative of bailing out major SOEs in financial distress. It also amounts to a substantial burden on the financial sector.

Vietnam’s total public debt in 2012 was 1,641 trillion dong or \$77 billion. Figure 14 shows the breakdown by debt owner.

Figure 14: Public debt by owner, 2012



Source: MoF data

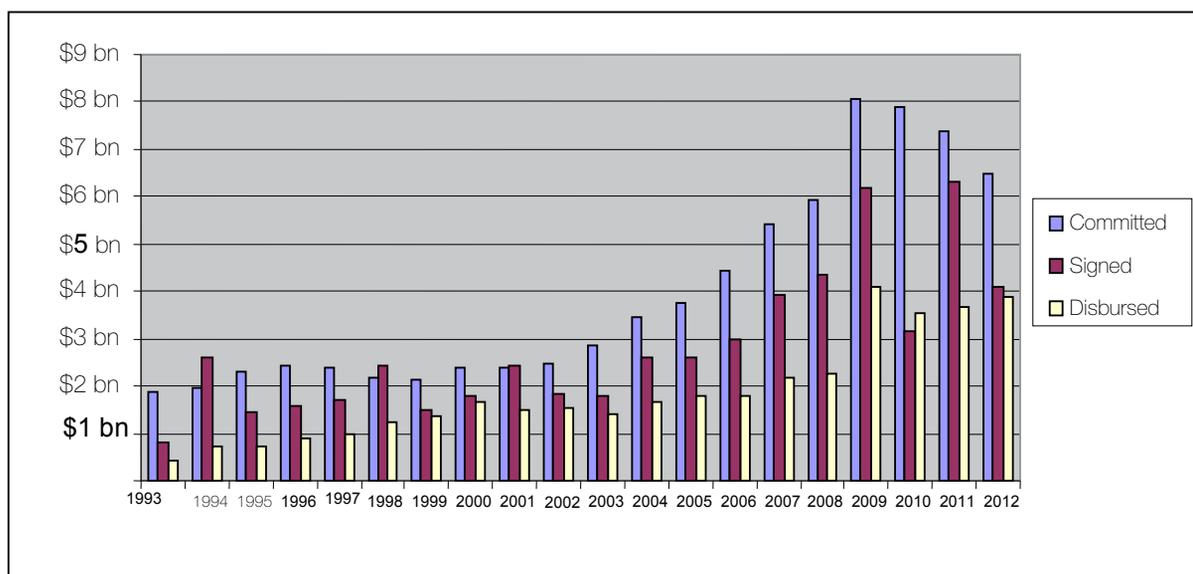
¹² World Bank, “Taking Stock: An Update on Vietnam’s Recent Economic Developments”, Hanoi, 10 July 2013, p. 23.

3.1.3. ODA and Other Official Flows

In recent years, Vietnam has been among the top few recipients of ODA in the world, in absolute terms, with \$80 billion in assistance between 1993 and 2012.¹³ Table 15 shows the annual figures for commitments and disbursements since 1993. It shows a steady climb from \$1 billion in 1997

to just over \$2 billion in 2007. In 2008, there was a surge in ODA as the major development banks (JICA, the World Bank and the Asian Development Bank) increased their lending to counter the effects of the global financial crisis. These high levels of lending have since been maintained, with total disbursements in 2012 close to \$4 billion.

Figure 15: ODA commitments and disbursements, 1993 to 2012 (MPI)



Source: MPI data

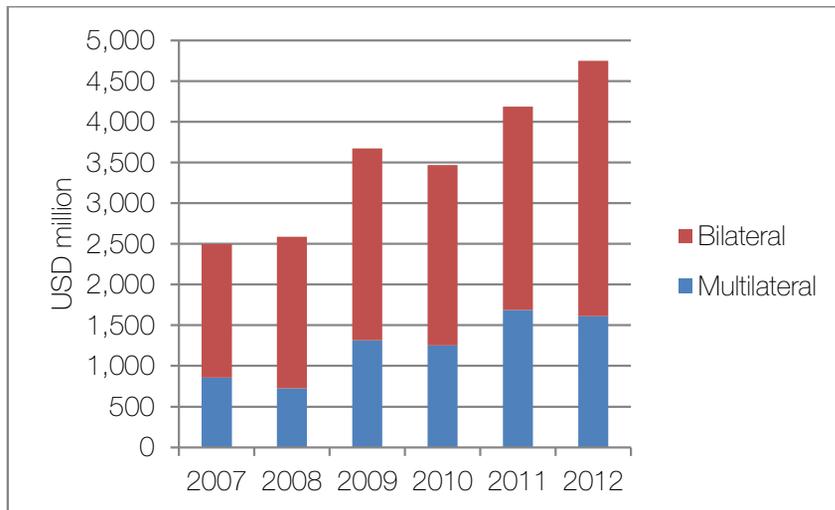
This data was provided by MPI. MPI collects data on aid commitments from the original loan or grant agreements, which it helps to negotiate, and disbursement data from ODA loans and projects that are executed by government, using GoV's project monitoring tool (PMT). The data is organised by implementing agency and by region, and tracks commitments and disbursements. Work is underway to integrated donor-supplied ODA data with project monitoring data collected by

GoV agencies through a unified monitoring and reporting system, that would also report on aid effectiveness commitments.

The OECD also keeps aid statistics, collected directly from donors. ODA figures published by the OECD show even higher levels of disbursement in recent years, reaching \$4.7 billion in 2012. The share of multilateral aid in the total has ranged between 30 and 40 percent.

¹³ 20 year ODA experience report, MPI, 2013.

Figure 16: Net ODA disbursements (OECD)



Source: OECD Aid Statistics

Despite achieving middle-income status in 2008, Vietnam's overall external assistance is not expected to decline until towards the end of the decade. Vietnam's ODA is dominated by three large development partners – Japan (JICA), the World Bank and the Asian Development

Bank – which between them provide 80-90% of annual disbursements. These development partners have not signalled any intention to reduce their financing in the short term. Though commitments will decrease, the overhand of past undisbursed assistance will keep ODA high for some time.

Box 1: Changing patterns of bilateral assistance to Vietnam

Some of Vietnam's traditional bilateral development partners, particularly the European donors, have already begun to change the nature of their development cooperation with Vietnam quite dramatically. Most have taken the decision to transition out of bilateral assistance, although they will continue to provide assistance through multilateral channels or via global or regional programmes. The Netherlands stopped bilateral support in 2012. Sweden will bring its bilateral assistance to a close in 2013, Denmark in 2015, DFID in 2016 and Finland in 2017/18. Ireland has bilateral aid commitments to 2015 but no firm decision after that, while Norway is slowly transitioning out of its sector support but will remain engaged in areas such as climate change. The European Union itself will continue its development cooperation with Vietnam.

With the scaling back of assistance comes a clear shift of focus, from poverty reduction to trade and from financial transfers to a post-aid development partnership. To different degrees, they have begun to promote private sector development, with a view to building up mutually beneficial trading ties. At the same time, they are moving from government-to-government financial transfers towards new assistance modalities designed to promote knowledge partnerships between public institutions, academic institutions and companies in Vietnam and in the donor country. In some instances, such as for DFID and Finland, this is due to a decision taken at the global level to phase out of MICs. In other cases, particularly for the Netherlands, it forms part of a wider shift in development policy in favour of promoting donor economic interests. This is coupled with a continuing interest in promoting global public goods, such as combating climate change, and traditional cross-cutting policy interests such as democratisation and human rights.

Many of the European donors are therefore seeking to identify niche areas where they can offer a comparative advantage in policy advice and technical expertise. The chosen mode of assistance is often direct partnerships between institutions (whether public, academic, corporate or philanthropic) in the two countries, creating a more pluralistic form of development cooperation, with the traditional aid agency playing a facilitative role. For example, Ireland is in the areas of bank and electricity regulation, Sweden in land administration, municipal planning and waste management, Norway in fisheries and rice production and Finland on university curriculum development. A number of the donors have 'match-making' programmes to build linkages between Vietnamese and their own companies, which are expected to become self-sustaining.

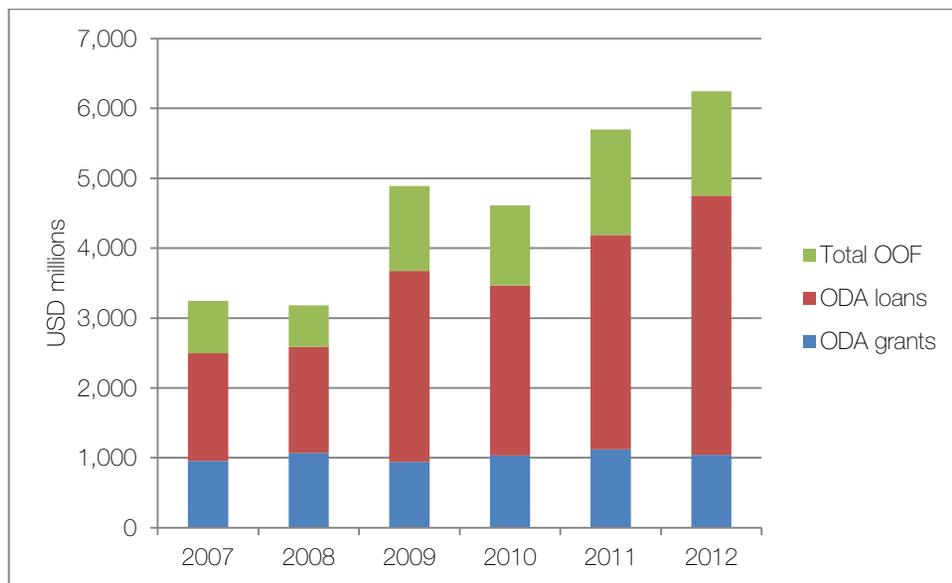
These new aid modalities are potentially very useful for Vietnam, as the government looks to tailor its industrial policies to the needs of specific economic sectors or niche areas. However, they are also untested in the Vietnamese environment, and will need to go through a period of rigorous evaluation and improvement to maximise their effectiveness.

A number of bilateral donors have either already stopped their bilateral programmes (e.g., the Netherlands, which stopped bilateral support in 2012) or announced an intention to do so in the coming years (e.g., Sweden in 2013, Denmark in 2015 and DFID in 2016). See Box 1 on the changing nature of bilateral assistance to Vietnam. However, phasing out by some bilateral donors will have a relatively minor effect on the total volume of ODA, although it may have a substantial impact in particular sectors or areas, such as HIV-AIDS programming.

We have been unable to find any data on external assistance from non-OECD countries. The line ministries we consulted informed us that there were no major projects in their areas funded by non-OECD donors.

While the volume has continued to increase, Vietnam's ODA flows are changing in composition. The proportion of loans is increasing, accounting for more than 70% of the total in 2012. As a middle-income country, Vietnam is expected to graduate from the International Development Association (the World Bank's concessional window) in 2017 and from the Asian Development Fund (the ADB's concessional window) in 2020, although no formal decision has been made in either case. From that point, Vietnam will receive its assistance on commercial terms (classified in OECD statistics as 'Other Official Flows' (OOF), rather than ODA) from IBRD and the ADB's Ordinary Capital Reserves (OCR), with the mix becoming progressively less concessional in the intervening years. Figure 17 shows the shifting balance between ODA grant, ODA loans and OOF.

Figure 17: ODA loans and grants and Other Official Flows, 2007-2012 disbursements



Source: OECD International Development Statistics

Table 1: ODA commitments 1993 to 2012 by sector (USD million)

Sector	Loans	Grants	Total	%
Agriculture and poverty reduction	7,433	1,422	8,855	15.2
Energy and industry	11,360	193	11,553	19.8
Transport and telecommunication	15,950	522	16,472	28.2
Environment, water and sanitation and urban development	6,673	1,172	7,846	13.4
Education and training	1,794	653	2,447	4.2
Health and social affairs	1,336	1,242	2,578	4.4
Other sectors (science, technology and capacity building)	7,062	1,550	8,612	14.8
Total	51,607	6,756	58,363	100.0

Source: MPI data

An issue for Vietnam will be how to make best use of non-concessional finance. At present, GoV takes a cautious approach, using such finance only for investment projects with the potential to generate a revenue stream to cover repayments, or to ministries or agencies willing to take on the repayment obligation.¹⁴ If this approach continues, the social sectors will see a decline in support over the coming years. In principle, there is no reason not to use borrowed funds in the social sectors, provided they generate a sufficient socio-economic return. GoV may need to review its approach to the use of IBRD and OCR funding. GoV also needs to attract private investment into infrastructure development, to free up the remaining concessional ODA lending for outstanding needs in the social sectors.

Table 1 gives the sectoral allocation of ODA commitments over the period 1993 to 2012 (no annual figures are available). Past aid effectiveness reviews have noted that MPI and line ministries are broadly satisfied with the level of alignment of donor assistance to country priorities and preferences. However, they have also concluded that Vietnam's national development plans (SEDPs) and sectoral strategies do not provide a particularly strong framework for aligning ODA, as they offer limited detail on concrete priorities or

policy instruments and do not have a strong link to GoV's own resource-allocation processes.¹⁵

Table 2 shows the allocation of ODA commitments over the past 20 years by region. While GoV and development partners have introduced a number of programmes to channel additional ODA resources into the poorer northern and mountainous regions of the country, they still lag well behind in total allocations and in ODA allocation per capita.

Vietnam has for many years struggled to make full use of the ODA finance available to it, due to slow disbursement rates. In the period 2006-2012, the Six Banks¹⁶ pledged a total of \$30.7 billion in new assistance for Vietnam. Disbursement rates have improved, from just 25% of total pledged capital in 2010 to 40% in 2012.¹⁷ However, this still leaves \$20 billion in committed ODA capital from the Six Banks – or a third of the total – that has not been disbursed.

¹⁵ Marcus Cox et al., "Paris Declaration/Hanoi Core Statement Phase 2 Evaluation: Vietnam Country Evaluation", *Agulhas Applied Knowledge*, January 2011, p. 22.

¹⁶ World Bank, Japan International Cooperation Agency (JICA), the Asian Development Bank, the Export-Import Bank of Korea, the French Development Agency and the German Reconstruction Bank.

¹⁷ VEN, *Report on the Eight Joint Portfolio Performance Review*, 26 November 2013, <http://www.vietnambreakingnews.com/2013/11/jppr-8-urges-oda-disbursement-promotion/#.Us0RGLQ0CM0>.

¹⁴ Under Decree 38/2013/ND-CP on ODA Management and Utilisation, the project 'owner' or executing agency is responsible for debt service for ODA loans.

Table 2: ODA commitments 1993 to 2012 by region

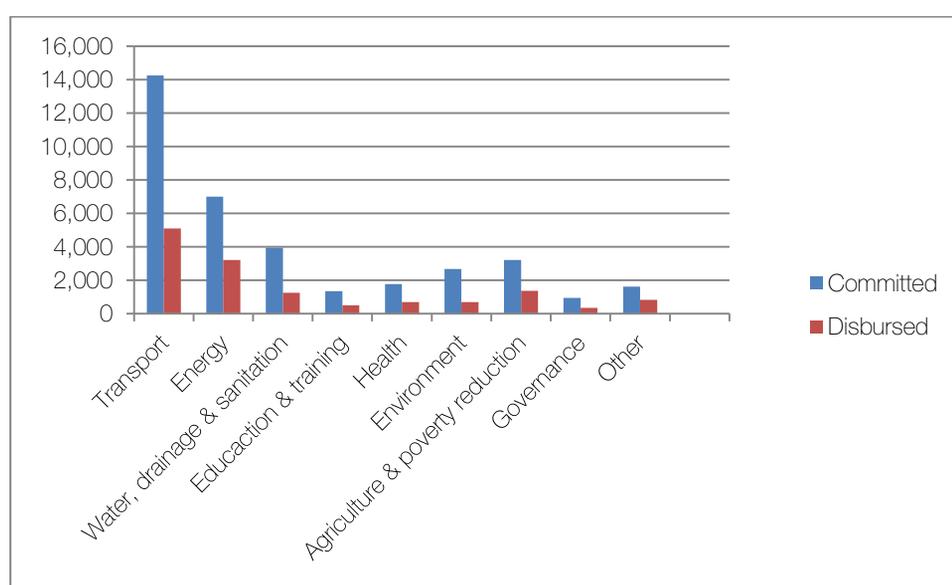
Region	Number of donors	Total ODA (USD million)	ODA per capita	% of total
Red River Delta	33	10,425	including Hanoi: \$570 excluding Hanoi: \$414	17.84
Northern Mountains	38	2,405	\$233	4.12
Central Coastal Region	39	7,525	\$437	12.88
Central Highlands	19	1,369	\$323	2.34
South East	29	6,301	Including HCM City: \$509 Excluding HCM City: \$222	10.78
Mekong River Delta	29	3,955	\$240	6.77
Cross-regional	43	25,243		43.20

Source: MPI data

Figure 18 gives a breakdown of ODA cumulative commitments and disbursements to the end of 2012, based on MPI data. It shows the predominance of infrastructure in the ODA portfolio, with transport at 39%, energy at 19% and water and sanitation at 11% of total commitments. It is principally bottlenecks in infrastructure projects that accounts for the low disbursement rates. Among the reasons for delay are poor coordination among ministries and levels

of government, lack of capacity within Project Management Units, poor quality of initial project designs, delays in the allocation of counterpart funds, problems with procurement and issues with land allocation and resettlement. While the Six Banks have worked intensively with GoV over many years to resolve these bottlenecks, including through the creation of a high-level Inter-Ministerial Task Force on ODA Problem-Solving, progress has been relatively slow.

Figure 18: ODA committed and disbursed to December 2012 by sector



Authors' calculations based on MPI data

The legal framework for ODA management and utilisation has evolved continuously over the last decade. In 2013, a new Decree 38 on ODA Management and Utilisation was issued, to align the legal frameworks for ODA and debt management and to encourage stronger project management. Some of the provisions in the new Decree 38 are:

- the scope is extended to less concessional financial support;
- it allows the private sector access to ODA on the basis of mutual interest and risk sharing with GoV;
- a number of new priorities for ODA allocation are identified, including high-technology industries and the knowledge economy, trade and investment promotion and support for the implementation of National Target Programmes;
- Prime Ministerial approval is required for ODA loans, umbrella projects, projects with institutional and policy components and technical assistance over \$1 million in value. Other projects may be approved by the executing agencies;
- it includes measures to facilitate regional and international projects; and
- it includes additional guidelines on the preparation of project documents.

Most importantly, Decree 38 initiates a shift in approach towards project monitoring and evaluation. Its predecessor (Decree 131 of 2006) was focused on checking the compliance

of aid projects and their documentation with formal legal requirements and monitoring the rate of implementation through indicators on disbursement and time elapsed. Decree 38 adds the requirement to collect and analyse data on project outcomes. This important shift indicates a welcome increase in the priority given by GoV to monitoring and evaluation.

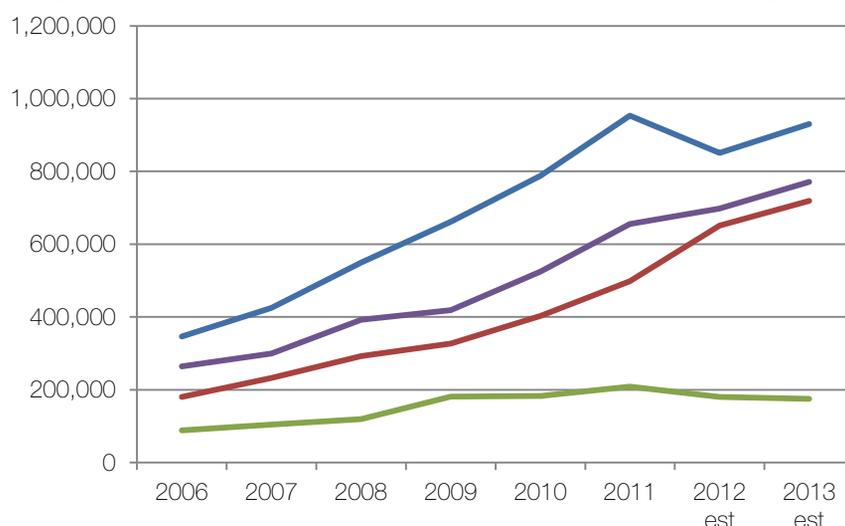
3.1.4. Public expenditure

This section looks at some of the policy and institutional issues surrounding public expenditure in Vietnam, covering the recurrent and development budgets, National Target Programmes and off-budget funds.

With its capital-intensive growth model, Vietnam maintains very high levels of public expenditure in order to promote rapid growth and national development. Total public expenditure increased 2.7 times between 2006 and 2013, from VND 346 trillion to VND 930 trillion (see Figure 19). Expenditure has been growing faster than revenues, causing the budget deficit to increase rapidly up to 2011, after which GoV took measures to bring it under control, primarily by cutting the development budget.

Vietnam's budget remains broadly pro-poor in orientation, with a range of measures to direct funds towards the poorest regions. Yet Vietnam's rapid rise to MIC status has left it with some significant gaps in core systems for planning and budgeting. There is reason for concern that the development effectiveness of Vietnam's expenditure may have declined in the years since the 2007-08 global financial crisis.

Figure 19: Public expenditure 2006-2013 (current prices)



Source: MoF data

The recurrent budget

There have been concerted efforts over recent years to strengthen budget management, resulting in improvements in many areas. Two decades ago, the Vietnamese budget was not a public document. Since then, transparency has steadily improved. MoF now publishes figures on budget expenditure by functional category, broken down into administrative, economic and social expenditure. From this, we can see that the core administrative costs of government have increased sharply, from 5.4% of the budget in 2006 to 10.4% in 2013. However, expenditure on health, education and social security has also increased over the period as a share of the total, demonstrating that the budget remains pro-poor in orientation. Education expenditure in particular is very high by international standards, at nearly 23% of the recurrent budget.

However, because the budget is not organised programmatically – that is, with expenditure broken down by specific government programmes or objectives – detailed analysis of budget expenditure is still difficult. There is no data on the geographical distribution of recurrent expenditure, as not all provinces publish regular budget execution reports. Actual expenditure deviates substantially from published budgets. In addition, a significant share of government expenditure is not included in the budget (see below). As a result, Vietnam still scores just 19% for budget transparency in the 2012 Open Budget Survey. This is a major improvement on the 3% it scored in 2006, but compares poorly to 36% in Thailand or 62% in Indonesia.¹⁸

The budget in Vietnam remains divided into recurrent and development (capital) budgets, with institutional responsibility split between MoF and MPI. In addition, infrastructure projects funded through special bond issues are not included with the development budget. This makes it more difficult for GoV to align the two categories of expenditure. When a new hospital is constructed, for example, the Ministry of Health is required to negotiate concurrently with MPI for the capital investment and with MoF to secure the operating budget,

and mismatches are common. As discussed in section 4.1 below, this has been a particular problem with capital investment in the health sector financed through government bonds, with many district hospitals unable to fund the salaries of health workers to operate their equipment.

Over the past two decades, Vietnam has progressively devolved responsibilities to its sub-national governments (provinces, districts and communes). More than half of the state budget is now spent by sub-national government. Devolution offers a number of potential advantages, bringing decision-making closer to the communities it serves and encouraging competition among provinces in the provision of goods and services. However, devolution in Vietnam has encountered capacity deficits at the sub-national level. There is a lack of systems to ensure transparency and accountability. Revenue and expenditure assignments between the bottom three levels of government are not clearly defined. The budgets for these three levels of government are included within a single budget framework (the ‘matruska’ system). In practice, many spending responsibilities are not supported by adequate budgetary resources and it is sometimes unclear which level of government is responsibility for what. Financial management capacity is often severely lacking in local government, resulting in poor fiscal discipline and inadequate reporting.

There have been attempts over recent years to introduce medium-term budget planning. These efforts have been frustrated by challenges with revenue forecasting and complicated by the dual budget. New Laws on the State Budget is currently under development. The draft Law on the State Budget integrates a number of off-budget expenditures into the general budget. It also seeks to address some of the shortcomings of fiscal decentralisation by providing more detail on the revenue and expenditure assignments of the four administrative levels. It will also introduce a medium-term expenditure framework to strengthen budget planning.

¹⁸ *International Budget Partnership*, <http://internationalbudget.org/wp-content/uploads/OBI2012-VietnamCS-English.pdf>.

The development budget

The development budget increased sharply in the years up to 2009, in particular as a result of stimulus measures introduced in response to the global financial crisis, which were financed through bond issues. It then stabilised from 2010 onwards, declining in real terms. Table 3 gives the recurrent budget in US dollars, broken down into its sectoral classification. Note that these figures are budgeted rather than

executed investments. There is no reliable data on disbursements by responsible government agencies, particularly at provincial level.

Agriculture, transport, telecommunications and education have been GoV's highest priorities for capital investment. Since 2010, investment in telecommunications infrastructure has continued to rise, while investment in transport has gone down sharply, reflecting changes in priority.

Table 3: Development budget by sector, 2006-2013, in million USD

Sector	2006	2007	2008	2009	2010	2011	2012	2013*
Economic sectors	3,412.9	4,532.9	5,164.5	7,348.2	6,833.6	8,013.3	8,285.7	8,849.6
Industry	277.3	830.0	825.7	723.2	484.4	449.8	442.9	449.4
Ag, forestry, fishery	1,318.2	1,535.0	1,790.7	2,700.7	2,572.3	2,249.2	2,333.4	2,500.5
Transport	1,693.5	2,025.7	2,372.6	3,670.6	3,548.8	2,249.2	2,333.4	2,500.5
Information & Comm.	785.7	1,193.1	1,349.8	1,506.7	1,555.8	2,960.5	3,078.8	3,307.1
Trade, stores & tourism	48.9	56.3	79.9	111.6	100.3	104.6	97.2	92.2
Social sectors	2,512.0	2,717.2	3,418.5	5,148.5	4,876.3	4,278.6	4,429.1	4,735.9
Water and sanitation	228.5	259.1	281.8	390.0	344.2	313.8	324.1	345.7
Sci., techn., IT	163.6	187.0	208.5	318.3	298.9	292.9	324.1	368.7
Natural resources & environment	102.9	124.3	134.2	193.1	182.9	177.8	183.6	207.4
Educ. & training	873.3	950.0	1,254.2	1,950.1	1,916.5	1,652.9	1,728.4	1,866.7
Health	286.0	325.1	568.5	835.3	801.8	638.1	659.0	691.4
Social affairs	176.1	200.2	224.1	325.3	313.4	292.9	313.3	345.7
Culture	138.0	153.1	183.9	254.1	230.8	198.8	194.4	195.9
Sport	51.1	55.6	70.3	102.1	90.4	83.7	75.6	69.1
Administration	492.3	462.7	492.8	793.9	697.3	627.7	627.4	644.6
State management	492.3	462.7	492.8	780.2	697.3	627.7	626.6	645.3
Defence	167.5	187.9	225.1	288.3	272.4	251.1	259.3	276.6
Security	50.5	56.7	67.9	87.0	92.6	83.7	86.4	92.2
TOTAL	6,142.9	7,494.6	8,876.0	12,872.0	12,074.9	12,626.7	13,060.5	13,954.3

Source: MPI data

Box 2: Challenges with efficient public investment in Vietnam

Legal framework: Public investment in Vietnam is currently governed by a large number of different laws and legal instruments, including Laws on Investment, State Budget, Construction, Procurement, and State Assets and Property Management and their supporting decrees. This complex legal framework contains both gaps and overlaps. Investment in SOEs and those funded by bonds and investment credits are not explicitly covered by any law. Parts of the project management cycle are not properly regulated. In particular, rules on programme identification and project results logical chains evaluation are weak. Provinces and line agencies submit long lists of projects for which funding is requested, without being required to undertake proper project results logical chains evaluation. In many cases, projects are funded that are either technically or economically unsound. Because planning and resource allocation is done purely on an annual basis, multi-annual projects are often commenced without the funds being available to complete them. We are informed that, since the 2009-10 stimulus measures, many smaller or medium-sized construction firms involved in public works have collapsed as a result of non-payment for completed work.

A new draft Law on Public Investment has been approved by the National Assembly in June 2014. Together with its accompanying decrees (Decree on Medium-Term Investment Planning; Decree on Public Investment Supervision and Evaluation; Decree on ODA Utilisation and Management; and Decree on Investments through Public-Private Partnership), it should go a long way to addressing the current gaps in the legal framework. It defines the basic principles governing public investment, including transparency, quality and efficiency. It paves the way for public-private partnerships (PPPs) in infrastructure development and social services. The draft law introduces a 5-year, Medium-term Investment Plan (MTIP), which should help to strengthen financial planning for multi-annual projects.

While the law includes new requirements for the monitoring and evaluation of projects in the MTIP, the approach to managing for development results remains relatively weak. There was no requirement for line agencies or provinces to link their investment projects to their sectoral or provincial SEDPs until 2011. While performance data must be collected, the law does not specify how it will be used to guide investment decisions.

Devolution and regional coordination: Approximately two-thirds of the development budget is allocated for investment projects nominated by the provinces. The planning process creates incentives for the provinces to compete with each other to access these resources. Though Vietnam is a geographically diverse country, the 63 provinces are too small a geographical unit to plan infrastructure development efficiently. As a result, Vietnam has more than 20 airports, 24 deep-sea ports, 18 economic zones and 260 industrial parks, in many cases located too close to each other and without regard to demand, resulting in low utilisation rates. The 2012 Vietnam Development Report concluded that, while devolving infrastructure development to the provinces had unleashed tremendous competitive energy, it also made it almost impossible to link investments to the strategic needs of the country or the market.¹⁹ Most of Vietnam's infrastructure would be more efficiently planned on a national or regional basis.

¹⁹ World Bank et al., *Vietnam Development Report 2012: Market Economy for a Middle-Income Vietnam, Joint Donor Report to the Vietnam Consultative Group Meeting, December 2011*, p. 57.

Reports by the State Audit Office of Vietnam suggest that the spike in bond-financed public investment in 2009-10 proved to be both technically and economically inefficient. It created intense competition among the provinces to access the funds, with little or no quality control. Far too many projects were commenced, without funds being available to secure their completion. As a result, only half of the investment projects financed by government bonds were ever completed.²⁰ Furthermore, many of the projects launched during this period were not included in the lists of priority projects submitted to MPI by the provinces during the preparation of the SEDP. Their contribution to national development goals is therefore unclear.

Since 2009-10, the Public Investment Programme has been filled with on-going projects awaiting funds for completion. On 24 October 2013, the MPI Minister informed the National Assembly that, since taking up his post as Minister two years earlier, he had been unable to initiate any new capital investment projects.²¹

Vietnam faces a range of barriers to effective public investment. These have been extensively analysed by both international and Vietnam experts. Some of the main challenges are discussed in Box 2. They include a lack of rigorous project selection and appraisal, poor linkages between investment decisions and development strategies and excessive decentralisation, leading to a fragmented approach to infrastructure development.

Both GoV and the National Assembly have recognized these challenges and made the efforts to address them by issuance of the Law on Public Investment and an Action Plan for Public Investment Restructuring. Among other measures, the Law introduces a medium-term Public Investment Plan (PIP), in place of annual plans, and new measures to strengthen the identification, appraisal and approval of projects for inclusion in the PIP.

National Target Programmes

Given the challenges of fiscal decentralisation and the relatively weak linkages between policy making, planning and budgeting, National Target Programmes (NTPs) have emerged as an alternative mechanism by which GoV can allocate funds to key policy priorities. These are special funds outside the regular budget, and can include both recurrent and capital expenditure.

There are currently 16 NTPs (see the list in Box 3). Their total budget for period 2011-13 is VND 92 trillion, or 3.5% of total expenditure. Of this, 55% comes from the national budget, 27% from provincial budgets, 5% from ODA, 4% from state credits and 9% from community contributions.

In October 2013, a report was submitted to the National Assembly on the performance of the NTPs. It revealed weaknesses in targeting and in monitoring and evaluation practices. While the NTPs report on their expenditure and direct outputs, they do not monitor outcomes or development impact. For example, the NTP on Employment Creation reports on funds spent, the numbers of people receiving training and the number of vocational schools established. It does not report on the number of trainees who have gone on to productive employment. Thus, while the NTPs without question help to make resource allocation in Vietnam more pro-poor, their real contribution to poverty reduction is impossible to assess.

²⁰ *Wrong and inefficient use of the funds from government bonds, Baomoi.com, 10 March 2011 (in Vietnamese).*

²¹ *Speech of the MPI Minister to the National Assembly, 24 October 2013.*

Box 3: National Target Programmes

There are 16 NTPs operating in the 2011-15 SEDP cycle:

1. Employment Creation and Vocational Training
2. Sustainable Poverty Reduction
3. Rural Water Supply and Sanitation
4. Health
5. Population and family Planning
6. Food Safety
7. Culture
8. Education and Training
9. Anti-Drugs
10. Anti-Crime
11. Energy Saving and Efficiency
12. Responding to Climate Change
13. New Rural Development
14. Anti- HIV/AIDS
15. Bringing Information and Communication to Mountainous, Remote, Border and Island Areas
16. Environmental Protection and Pollution Mitigation

To address these problems for 2016- 2020 there will only two National Target Programmes to be kept, including the NTP for New Rural Development and the NTP for Sustainable Poverty Reduction.

Off-budget funds

In principle, under the Law on State Budget 2002, all public revenue and expenditure should be included in the state budget. However, a significant proportion of expenditure has not yet been integrated into the budget. For example, revenue raised from government bonds is allocated outside the budget for

priority infrastructure, and various other revenues are also off-budget. There are more than 30 off-budget funds, at national or local levels, each established under a different law and government decision (see Table 4). They are approved by the National Assembly and under the supervision of MoF. However, there is no consolidated data on the revenue and expenditure of these funds. This adds to the problems of budget transparency. To address this problem, the new draw law on the State Budget now incorporates “government bonds as a source of state budget revenues, to meet international practice.

Table 4: List of the off-budget financing funds

National financing funds	Local financing funds
1. Social Insurance Funds	19. The funds to support the people making contribution to the country
2. Health Insurance Funds	20. Local Land development funds
3. Unemployment Insurance Funds	21. Local Housing development funds
4. Funds to support enterprises rearrangements and development	22. Anti-flood funds
5. National Science and Technology Development funds	23. Defence and Security funds
6. Vietnam Environment Protection Funds	24. Local development Investment funds
7. National Employment Creation Funds	25. Local Credit Guarantees funds
8. Public Telecommunication service Funds	26. Local funds for farmer support
9. Vietnam Children protection funds	27. Funds to support the dioxin affected
10. Legal Support Funds	28. Local funds for jobs creation
11. Overseas employment support funds	29. Local Environment protection funds
12. Anti-Drugs Funds	30. Local funds for supporting cooperatives
13. Central Funds for forest protection and development	
14. Funds for stabilizing gasoline price	
15. Anti-HIV/AIDS funds	
16. Accumulated funds for Debts payment	
17. Cooperatives support funds	
18. Road Maintaining funds	

Source: MoF

3.2. Non-public development finance

This section looks at sources of development finance in the private sector, that are not under the direct control of government or development partners. It looks at their recent evolution and at some of the policy and institutions issues that influence their contribution to Vietnam's national development.

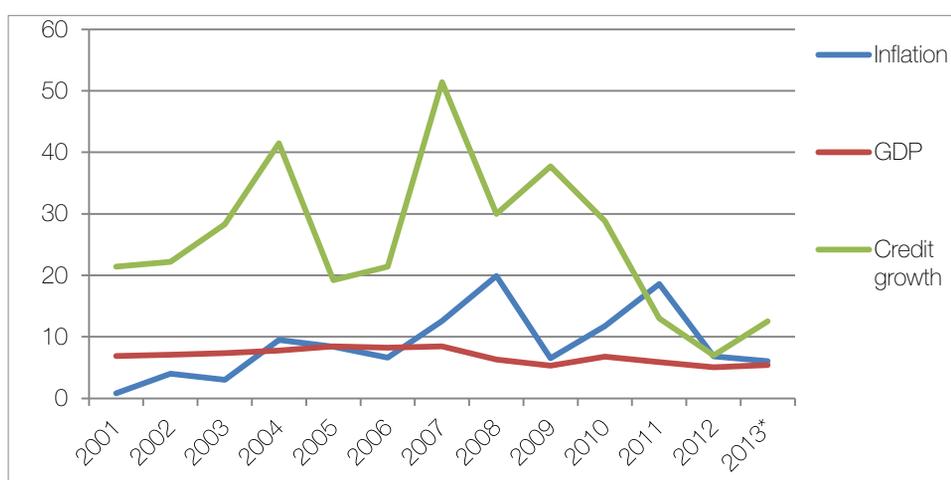
3.2.1. Domestic finance and enterprise investment

Lending by Vietnam's banking sector grew extremely rapidly in the 2000s, increasing from just under \$1 billion in 2006 to over \$5 billion in 2012. Total credit grew from 39% of GDP in 2000 to 115% in 2010, but was

reduced to 84% in 2013.²² Lending growth peaked in 2007, at the height of Vietnam's real-estate boom. Faced with high inflation, the government then introduced its economic stabilisation package, which caused credit growth to reduce sharply (see Figure 20). This had a dramatic impact on the Vietnamese private sector, with significant numbers of enterprises collapsing or ceasing to trade, leading to a period of low economic growth.

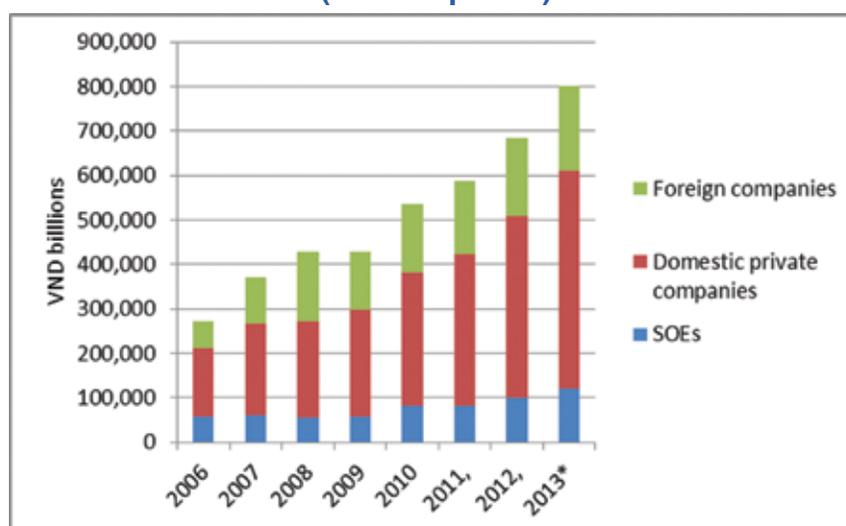
²² World Bank, "Taking Stock: An Update on Vietnam's Recent Economic Developments", Hanoi, 10 July 2013, p. 36.

Figure 20: Credit growth in the Vietnamese financial sector



Source: SBV, GSO, GAFIN (gafin.vn, 31/12/2011, 5/12/2013, 21/1/2014), fica.vn (23/12/2013)

Figure 21: Investment by state-owned, private and foreign firms, 2006-2013 (current prices)



Source: GSO

Figure 21 shows total investment by SOEs, Vietnam private firms and foreign companies. Since 2009, private companies have overtaken SOEs in terms of the volume of investments and their investment rate is growing more rapidly than SOEs.

The Vietnamese banking sector has been through significant transition over the past two decades. The level of state ownership of financial institutions has declined significantly. Many of the state-owned banks have been converted into Joint Stock Banks through the

sale of shares, and there are only two remaining wholly state-owned banks. However, the state has acquired shares in many of the commercial banks, either directly or via SOEs and state-owned banks. The level of state-owned equity in the financial sector has continued to increase, from VND 1,000 billion in 2005 to VND 15,000 billion in 2010, although it has declined as a share of total equity. The Vietnam Development Report 2012 points out that even minority shareholding by the state in commercial banks gives it influence over lending decisions.

As a result, a disproportionate share of lending from the Vietnamese banking sector goes to SOEs. They control a large share of Vietnam’s commercial land, making them better placed to meet bank collateral requirements. Furthermore, complex co-ownership arrangements between SOEs and financial institutions give them privileged access to loans.

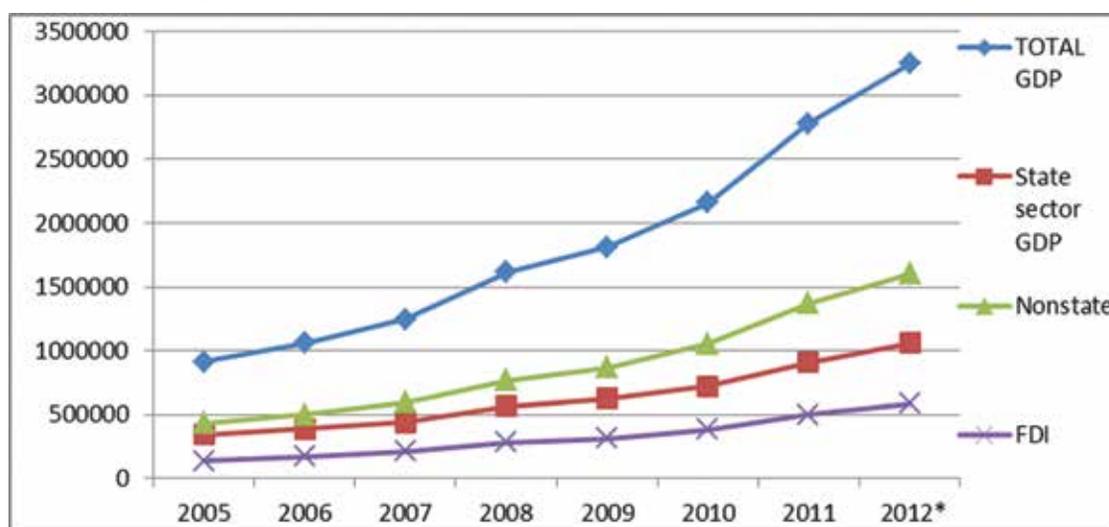
While most private companies in Vietnam are proprietor-funded, SOEs finance a large share of their investments through loan finance (96.5% in 2011). However, their use of this finance is highly inefficient. The revenue-to-capital ratio of SOEs declined from 1.6 in 2000 to just 1.1 in 2009, while the average ratio across Vietnamese enterprises increased from 8.8 to 21. The gap between the SOEs and other enterprises in labour productivity also widened, from 1:4 in 2000 to 1:10 in 2008.¹⁸

This low investment efficiency suggests that a significant proportion of the available credit in Vietnam is being poorly used. It also means that the banking sector is dangerously exposed to bad debt in SOEs.

Most private companies in Vietnam are small and medium-sized. Between 2000 and 2009, the number of private enterprises increased sevenfold. As a result, the share of the private sector in total investment has been also increased, from 38.1% in 2006 to 41.2% in 2012. The contribution of the domestic private sector to GDP has also grown faster than that of either SOEs or foreign companies.

Despite high levels of distress among private companies in recent years, the level of private investment is continuing to grow. This has helped to keep unemployment rates in Vietnam fairly low, despite the slowing of economic growth. Yet private companies in Vietnam are still largely small and proprietor-financed. They face a range of barriers in accessing credit from the financial sector. These include complicated procedures and strict collateral requirements, as well as the crowding-out effect of high SOE borrowing. As a result, the domestic private sector has limited capacity to higher value-added activities.

Figure 22: GDP by sectors for 2006- 2012, VND billion



Source: GSO

23 “Vietnam’s productivity report”, UPC, No. 12, 2011.

3.2.2. Foreign direct investment

Levels of FDI have fluctuated significantly over the past decade. FDI increased “Vietnam’s productivity report”, UPC, No. 12, 2011. from 14.6% of total investment in 2006 to 25.5% in 2008, driven in part by Vietnam’s real-estate boom. It then reduced sharply to around 17%

from 2010 onwards. Accumulated FDI to 2012 amounted to \$210 billion. Around half of this went into the manufacturing sector, such as textiles, motorcycle components and electronics, followed by real estate (23%) and construction (5%) – see Table 5.

Table 5: FDI by sector, 2006-2012

Industry	Number of businesses	Total registered investment (USD million)	Charter capital (USD million)	% of total registered FDI
Manufacturing industries	4,521	83,651	29,269	49.7
Real estate	284	44,230	10,898	26.3
Construction	821	8,252	2,936	4.8
Restaurants and hotels	225	7,593	1,842	4.5
Electricity, gas, water	69	5,910	1,204	3.5
Transportation	235	2,971	828	1.8
Telecommunication, IT	616	2,926	1,248	1.7
Art and entertainment	77	2,839	745	1.7
Whole and retail sale, repairing	830	2,775	1,484	1.7
Water supply, solid waste	22	1,218	284	0.7
Agriculture, forestry, fishery	190	1,201	758	0.7
Mining	41	1,187	1,022	0.7
Science and technology	1,119	907	470	0.5
Health and social works	53	820	109	0.5
Other services	108	722	148	0.4
Education and training	97	539	86	0.3
Finance, banking, insurance	15	187	91	0.1
Administrative& supporting services	77	106	60	0.1
Total	9,400	168,029	53,483	

Source: GSO

High levels of FDI have been key to Vietnam’s development success. Foreign investment has contributed over 2 million direct jobs, which has been a major driver of poverty reduction. FDI has also supported public revenues and the balance of payments.

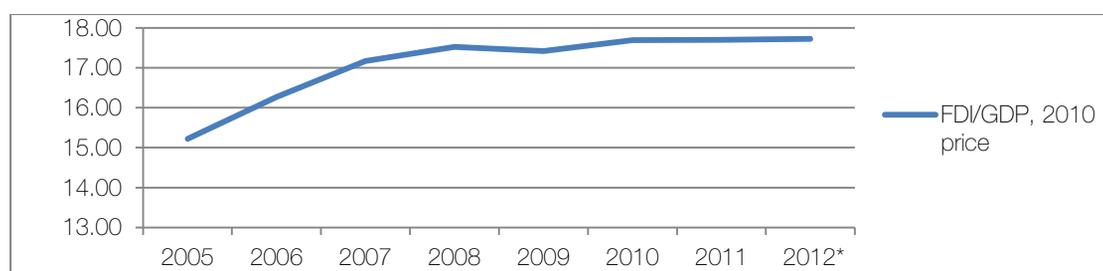
However, many people are concerned about the quality of FDI in Vietnam and its future directions. Most FDI in Vietnam consists of simple assembly operations. The work on offer is of relatively low quality, labour disputes are common and there are widespread environmental problems. Foreign firms do

not source many of their inputs from the domestic private sector, which limits spill-over effects such as skills and technology transfer. The proportion of FDI going into science and technology is less than half a percent.

FDI has continued to increase as a proportion of GDP in recent years, from 16.27% in 2006 to an estimated 17.72% in 2012. Surveys of foreign investors continue to rank Vietnam as one of the most attractive investment destinations

in Asia.²⁴ There are some positive trends in terms of new investment in mobile telephones and other high-technology manufacturing. However, a number of barriers stand in the way of attracting higher-quality FDI, including inadequate infrastructure, the lack of a domestic market in inputs and problems with the legal and institutional framework. Furthermore, there is a risk that, as wages increase in Vietnam, it will begin to lose out to lower-wage countries in the region, such as Myanmar.

Figure 23: FDI as a proportion of GDP



Source: GSO

Attracting FDI into more sophisticated industries is therefore a key priority for Vietnam, reflected in successive SEDPs. The policy and institutional framework for FDI promotion is, however, still underdeveloped. Relations with foreign investors are decentralised to provincial level, without a national policy framework or central supervision. This has left the provinces in a ‘race to the bottom’ in competing for FDI through tax exemptions and other incentives which limit the contribution of FDI to the budget. Foreign firms also limit their taxes by engaging in transfer pricing.

To address these issues, the Government issued Resolution 103/NQ-CP in August 2013 setting out a broad approach to FDI promotion. Its objective is to promote high-quality, high value-added FDI projects using modern technology and environmentally friendly approaches, in a range of target sectors (e.g., IT, bio-technology, infrastructure development, education and training). It targets both large-scale projects integrated into global value chains and smaller scale projects that respond to local needs. It encourages linkages between foreign and local enterprises. Most importantly,

it calls for the production of sectoral and regional master plans for FDI mobilisation and utilisation.

To implement this Resolution, GoV will need to give careful consideration to the assignment of institutional responsibilities. The national Ministry of Industry and Trade is primarily concerned with the management of SOEs and has little engagement with the private sector. Supporting FDI involves coordination across different functions of government, including infrastructure development, vocational training and land allocation. It also requires close knowledge of specific sectors and their patterns of development. GoV needs the capacity to developed integrated packages of support tailored to the needs of particular sectors and geographical areas.

²⁴ McKinsey Global Institute, “Sustaining Vietnam’s growth: the productivity challenge”, February 2012, p. 14.

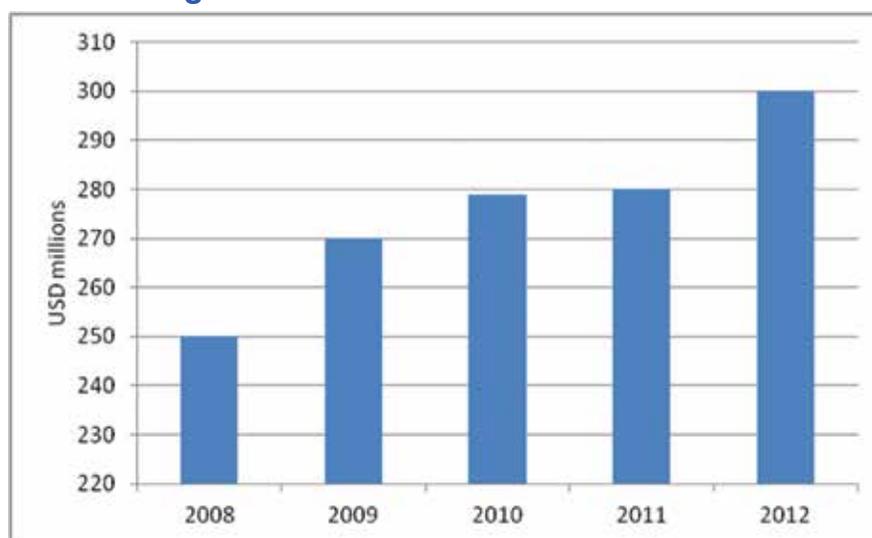
3.2.3. INGOs

International non-governmental organisations (INGOs) are an important development actor in Vietnam, providing around \$300 million in assistance each year. Many of them arrived in Vietnam just after the American War and have established very close relationships with the authorities and communities. In 1978, there were 70 INGOs operating in Vietnam. There are now more 900 INGOs with registered activities in Vietnam, of which around 500 have a permanent presence in-country. Some 45%

of the NGOs are American.²⁵ MPI estimates that they have provided around \$3 billion in assistance over the past two decades.

Data on INGO budgets has been compiled by the People's Aid Coordinating Committee (PACCOM) since 2008. It is based on financial reports submitted by individual INGOs. Not all of the smaller INGOs submit, but the bulk of expenditure is captured. The figures show that INGO assistance continues to grow steadily at an average of 5% a year (see Figure 24).

Figure 24: INGO assistance in Vietnam



Source: PACCOM

3.2.4. Vietnamese civil society

'Civil society' has a distinct tradition and character in Vietnam. There are a series of mass organisation with official status under the Vietnamese constitution²⁵, including the Women's Union, the Farmers' Association, the General Federation of Trade Unions, the Youth Union and the Veterans' Association. These are major organisations with structures at national, provincial and local levels. There is a wide range of professional, scientific and umbrella associations, many of which are state financed. In recent years, there are an increasing number of NGOs with a charitable or research mandate, many of them established by retired civil servants looking to put their skills to use. Finally, there is a large number

of community-based organisations, many of which are not officially registered.²⁶

Citizens seeking to establish a new civil society organisation (CSO) have the option of registering under various legal categories and with different ministries. The scope of permitted activities and the reporting requirements are not particularly clear. A unified law on associations has been discussed at various points over the past decade, but has not proceeded. This legal uncertainty is a constraint on the development of Vietnamese civil society.

No statistics are collected on spending across these different categories of civil society organisations (CSOs). Many of Vietnam's

²⁵ Information provided by VUFO - NGO Resource Centre.

²⁶ The Asia Foundation, "Civil society in Vietnam: a comparative study of civil society organizations in Hanoi and Ho Chi Minh City", Hanoi, October 2012, <http://asiafoundation.org/resources/pdfs/CivilSocietyReportFINALweb.pdf>.

development partners fund local CSOs, either directly or via INGOs. Much of it is uncoordinated, short-term project funding. There is a risk that, as some bilateral donors prepare to withdraw, some CSOs may struggle to continue their work.

The Vietnam Partnership Document calls for more CSO participation in the development partnership and includes a commitment to establish a local CSO Resource Centre, to help build CSO capacity and networks. MPI is currently working with CSOs to plan the development of the Resource Centre.

3.2.5. Private charity and corporate social responsibility

As Vietnam's private development develops, there is reportedly higher level of charitable activity, including donations to support the victims of natural disasters and financial support for social institutions such as schools. There is no data on the extent of charitable giving, but anecdotal evidence suggests that it is becoming more important.

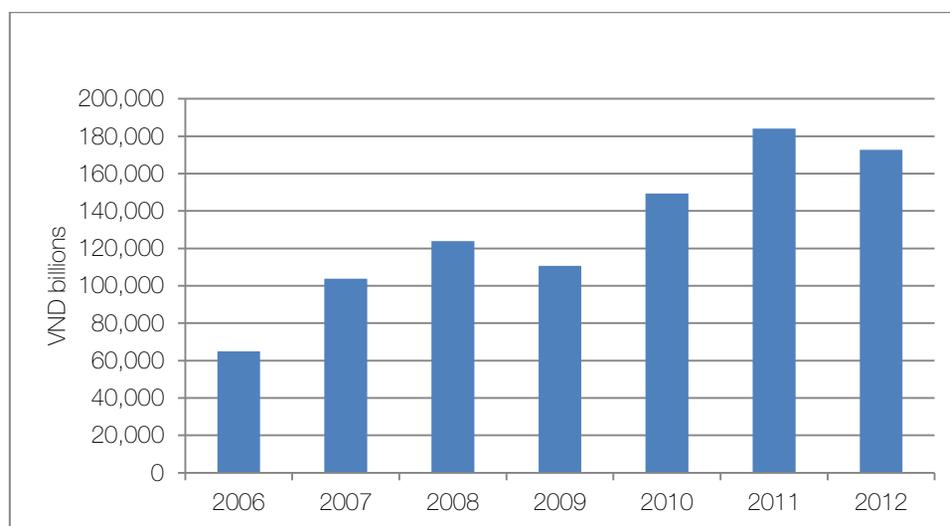
At present, however, the tax system does not permit companies or individuals to deduct charitable donations from their taxable income. This would be an obvious measure to promote more charitable giving.

3.2.6. Remittances

According to the State Bank of Vietnam, remittances from Vietnamese citizens abroad reach USD 8.85 billion or 184 trillion dong in 2011. This makes remittances approximately the same magnitude as FDI. Remittances are both a form of social safety net for households and a source of capital for small businesses.

There are reportedly around 4 million Vietnamese living abroad, including 400,000 Vietnamese workers in Japan, Korea, Taiwan and the Middle East, with some 100,000 new departures (gross) each year. Recent improvements to financial transfer systems have reportedly increased flow in recent years, more than doubling between 2006 and 2012 despite the global economic downturn.

Figure 25: Remittances from Vietnamese citizens abroad



Source: SBV data

Ho Chi Minh City is the biggest destination for remittances. In the first 10 months of 2013, some \$3.7 billion was been transferred to the

city, of which 69% went into the productive sectors, 21% to the real estate sector and 10% as gifts to family members.²⁷

²⁷ Baodautu.vn, Remittance goes to productive sectors, 08/11/2013

4. Sectoral perspectives

4.1. Health sector and the ‘socialisation’ of service delivery

Vietnam has achieved an impressive coverage of basic services, using a mixture of budgetary and non-budgetary financial resources. Total expenditure on education and health (public and private) is equivalent to 17% of GDP, which is high by international standards. Its health expenditure of \$95 per capita (2011) is on a par with Indonesia and the Philippines, and well above the minimum of \$60 recommended by the World Health Organisation for countries seeking to implement the MDGs.²⁸ Vietnam’s challenge is that a growing proportion of health costs are covered by citizens, principally through out-of-pocket (OOP) expenditure. This means that access to quality health services is increasingly linked to capacity to pay, leading to a stratification in service provision and growing inequality. The challenge is to shift the burden of health care financing towards more efficient and more equitable sources.

Health services in Vietnam are funded from a range of sources, including the state budget, bond issues for capital expenditure, public health insurance (coverage was at 66.8% in 2012), user fees and joint ventures with the private sector. The Ministry of Health has made progress towards developing an overall financing strategy for the sector, but user fees and private investment both need stronger regulation.

GoV has committed to increasing the share of the national budget spent on health, with a target of at least 10%. Health expenditure increased rapidly from 4.9% of the budget in 2008 to 8.3% in 2012, although it may have fallen back slightly

²⁸ Ministry of Health and Health Partnership Group, “Joint Annual Health review 2013: Towards Universal Health Coverage”, Hanoi, September 2013, p. 226.

in 2013. GoV’s key policy priority is improving preventive health. It has reserved 30% of the health budget for health stations and salary supplements for village health workers.

In addition to the national budget, government bond issues have been used to finance new hospitals and equipment purchases. There have been some concerns about the efficiency of these investments, which are not always accompanied by the required increases in recurrent expenditure. According to the JAHR, “Anecdotal evidence from some localities, particularly in mountainous areas, indicates that new district hospitals that have received relatively comprehensive investments have not been used efficiently because there is a lack of health workers, particularly doctors.”²⁹

From the late 1980s, facing constraints on its ability to finance the expansion of basic services from the budget, GoV introduced a policy of ‘socialisation’ of service delivery. Socialisation refers broadly to a transition from the state acting as sole provider of social services towards playing a regulatory role over a range of providers, the introduction of market-based financing mechanisms and an increasing reliance on user fees to fund service delivery. Rather than an integrated strategy, socialisation refers to a mixture of formal policies, institutional experiments and informal practices. In aggregate, these changes have led to a progressive shift in responsibility for both the provision of and payment for services from state to society, with the greatest burden falling directly on households.³⁰

Within the health sector, socialisation practices include a proliferation of both formal user charges and informal co-payments, with

²⁹ Ministry of Health and Health Partnership Group, “Joint Annual Health review 2013: Towards Universal Health Coverage”, Hanoi, September 2013, p. 26-7.

³⁰ Jonathan London, “Social Service Delivery in Vietnam: ‘Socialisation’ - Contributions and Challenges”, UNDP, Hanoi, September 2013, p. 2.

citizens reportedly often unable to distinguish between them. Various types of private service delivery unit (SDU) have emerged, including commercial health providers and not-for-profit services funded by SOEs or mass organisations in partnership with local communities. Public SDUs, particularly major hospitals, have responsibilities that are not funded from the budget and are increasingly expected to raise part of their operating costs from other sources. Directors are given a high level of autonomy in raising funds, with limited regulation or monitoring. For example, they can contract with private companies to supply equipment in return for a share of user fees. They are also encouraged to enter into joint ventures with private hospitals.

OOP payments now represent over 50% of total health expenditure in Vietnam. According to the World Health Organisation, it is very hard to achieve universal health care coverage if the OOP share is over 30%. The burden of OOP payments is heaviest for the poorest families and there is a risk of catastrophic health expenditure pushing families below the poverty line.

Socialisation practices are creating a range of distortions in service provision, especially over-prescription of drugs and over-use of diagnostic tests. It is also leading to cost inflation throughout the health system. At present, the Ministry of Health has little knowledge of local financing practices and SDUs have little accountability either upwards to provinces or downwards to communities. The Ministry of Health is on the process of developing a new monitoring and evaluation system for health finance reform.

In light of growing concern about access and equity in the health sector, what can development partners do? Despite Vietnam's achievement of MIC status, ODA for health has increased in recent years. There are now 52 ODA projects, with a total value of approximately \$1.5 billion, with the World Bank and the Global Fund the largest donors. There are also 106 NGO projects, worth \$256 million.

In total, ODA represents less than 5% of the health budget. Given that ODA expenditure has little or no effect on the size or composition of the health budget,³¹ the health sector is an interesting case study on the uses of ODA in non-aid dependent context. Assistance strategies have included

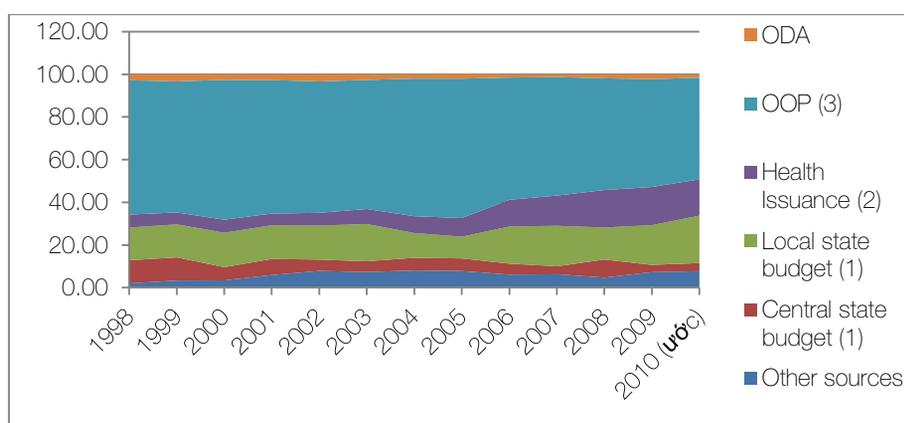
increasing health expenditure in the poorest districts, building core element of the health system (particularly human resources) and strengthening M&E systems. The World Bank is piloting results-based financing in 2 district hospitals, 2 district health centres and 4 commune health stations, which in principle creates incentives for the Ministry of Health to improve its practices around management for results. Both the EU and the ADB provide programmatic assistance (sector budget support and policy-based lending), which affords a platform for engaging with planning and budgeting at the central level. It took the EU from 2008 to 2011 to shift from project aid to sector budget support, because key preconditions – a viable plan linked to a realistic budget and robust monitoring arrangements – were not in place. While the MoH at the most senior levels understands the value of a sector-wide or programmatic approach, the division of departmental responsibilities within the Ministry makes it difficult to pursue an integrated approach to health financing.

In recent years, health has been a leading sector in Vietnam on aid effectiveness. A 2009 Statement of Intent between the Ministry of Health and development partners set out sector-specific principles and commitments on aid effectiveness. This has now been updated to take account of Busan and the Vietnam Partnership Document. The Health Partnership Group meets four times a year, although its proceedings are reportedly very formal, and there are Technical Working Groups on specific issues. While development partners have consistently raised their concerns on issues such as socialisation, their policy influence is relatively limited. There is a Joint Annual Health Review (JAHR) which provides an overview of progress against national strategies and commitments and examines particularly policy challenges in detail.

The health sector is more advanced in its processes than other sectors, and the Ministry of Health and donors are moving towards the development of a comprehensive financing strategy. The continued existence of large multilateral programmatic support has been critical in this regard. However, DPs reportedly still find it difficult to get an overall picture of health financing in Vietnam, to see how their funds can best complement other sources. There is a need for improvements in the structure of the health budget, to make it more transparent, and for a significant improvement in monitoring of health financing practices across the country, to increase the knowledge base on the trade-offs involved in different financing choices.

31 Dodd, Rebecca, Chris Hames and Nguyen Thi Kim Phuong, "External aid for health in Vietnam: additional or fungible?", *World Health Report, Background Paper 40*, 2010.

Figure 26: Structure of health financial sources in Vietnam, 1998–2010 (%)



(1) Not including the fees and charges. For 2008- 2010: including the state budget expenditures for NTPs and the government bonds

(2) As the total expenditures for health insurance, social assistance for health (central, local and household expenses for health insurance cards)

(3) Including expenses from HHs for health services delivered by private health services deliverers and for medicines.

Source: National Health Accounts, 2011

4.2. Managing the transition in HIV/AIDS financing

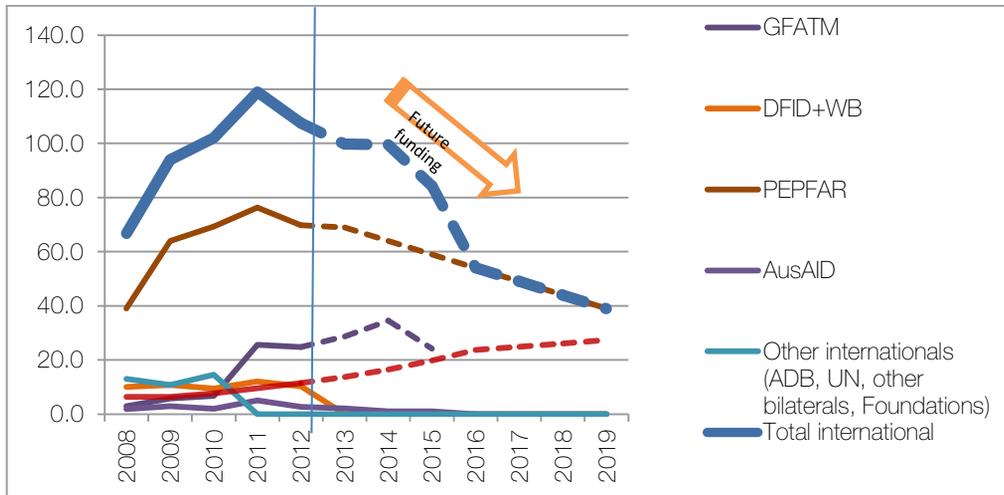
HIV/AIDS is unique among areas of development cooperation in Vietnam, in that the response to the epidemic has been funded primarily by development partners. As a result, the pattern of expenditure shows clear signs of aid dependence. The patterns and cost of service delivery have been strongly influenced by donor practices and contain substantial inefficiencies. With international finance for HIV/AIDS now beginning to decline rapidly, GoV faces the twin challenge of replacing international with domestic sources of finance and shifting towards a more sustainable pattern of expenditure.

The HIV/AIDS epidemic in Vietnam is primarily concentrated among higher-risk groups, including injecting drug users, female sex

workers and men who have sex with men. While the overall prevalence among people aged 15-49 years was at just 0.44% in 2010, the number of people living with HIV has more than doubled in the past decade to approximately 254,000, with 57,663 currently receiving antiretroviral treatment (ART).

The bulk of the funding for the response has come from international sources. ODA was \$106 million in 2012, representing 78% of public spending on HIV/AIDS. Donors are now warning of steep declines in their finance. A joint World Bank/DFID programme ended in 2012 and a regional project funded by AusAID and the Netherlands closed in 2013. The United States, which through the President's Emergency Plan for AIDS Relief (PEPFAR) is the largest donor for HIV/AIDS, has announced a reduction of funding of 10-15% per year over the coming years. There will be a new application for a Global Fund grant in 2014.

Figure 27: Anticipated funding for HIV-AIDS 2013-2020

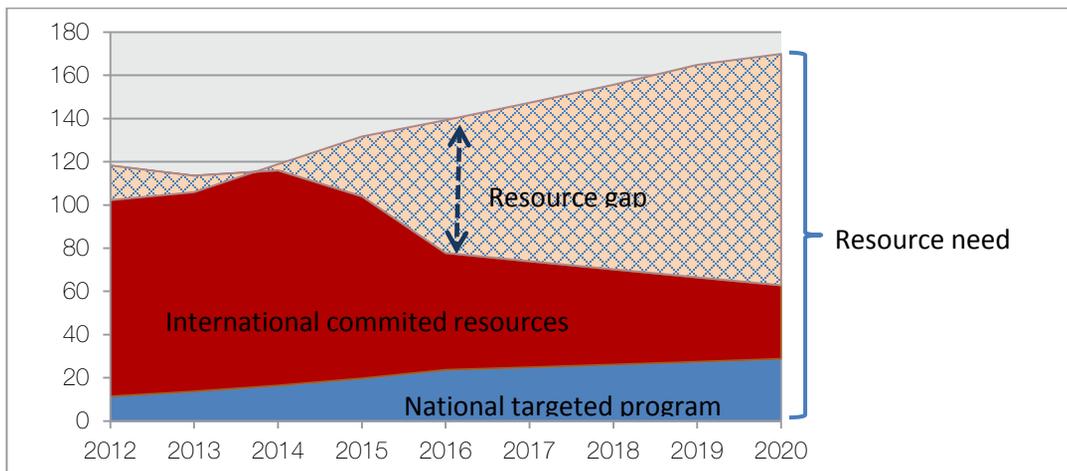


Source: OPM, “Sustainable HIV Response in Vietnam: Overview of Vietnam HIV Expenditures and Future Donor Commitments”, 2012

State funding through a National Target Program for HIV/AIDS set to increase by 20% a year, but against a very low base this will not be enough to prevent a dramatic drop in overall funding. However, the challenges are not just to replace ODA with domestic expenditure. The pattern of ODA expenditure has led to service models that are expensive and inefficient. Cost norms in donor-financed programmes

are between 50% and 200% higher than those used by GoV. There is substantial duplication in the delivery structures created under different donor programmes. The costs of HIV/AIDS testing and treatment are around double those of Thailand. GoV needs to find sustainable domestic resources to replace donor finance while simultaneously achieving a transition to a more cost-effective service-delivery model.

Figure 28: Summary of total resource need and gap, 2012-2020



Source: OPM, “Sustainable HIV Response in Vietnam: Overview of Vietnam HIV Expenditures and Future Donor Commitments”, 2012

Box 4: Getting ready for climate finance

Climate change presents a contrasting challenge to HIV/AIDS, in that Vietnam potentially has access to large flows of international finance in the coming years. As a coastal country, Vietnam is heavily exposed to the effects of climate change – particularly in its Mekong Delta, where inundation by seawater threatens both infrastructure and agriculture, putting millions of lives and livelihoods at risk. To access future finance flows, Vietnam will need to demonstrate its capacity to formulate sound adaptations and to monitor complex, multi-sectoral patterns of expenditure.

The Government of Vietnam has made a strong commitment to tackling climate change. It is a signatory to the most important international agreements, including the Kyoto Protocol. There is a National Climate Change Strategy 2011 and a Green Growth Strategy 2012. The Government has established a national Climate Change Committee and appointed the Ministry of Natural Resources and the Environment (MONRE) as focal point. It has established a National Target Programme for Responding to Climate Change, to channel both international and domestic resources.

At present, however, there is some confusion on institutional responsibilities, with MPI, MONRE and the Ministry of Agriculture and Rural Development (MARD) all responsible for coordinating different aspects of the response. There is a pattern of ad hoc decision making on investments, which does not follow the priorities set out by the Government in its policies and strategies.

A number of donors (Canada, France, Japan, Korea and the World Bank) are jointly funding a Support Programme to Respond to Climate Change in Vietnam (SPRCC). This programme provides budget support to finance the National Target Programme and priority climate change-related projects. While it provided over \$500 million between 2010 and 2012, weaknesses in monitoring make it difficult for the donors to assess the extent of government spending on climate change response.

With climate change-related expenditure often taking the form of additional costs on projects that had already been planned (for example, climate-proofing coastal infrastructure or strengthening the flood-control capacity of irrigation systems), it takes complex systems to monitor the use of climate finance. Furthermore, an important share of mitigation and adaptation costs will be borne by the private sector, which also needs to be measured and monitored. To that end, UNDP is currently working with GoV to prepare a Public Expenditure and Investment Review on Climate Change.

UNAIDS has undertaken a detailed study on the options for future financing of HIV/AIDS prevention and treatment, producing recommendations that are now being considered by the Vietnam Administration for HIV/AIDS Control (VAAC). They include:

- increased national budget allocations, targeting the drivers of the epidemic (unsafe drug injection and unsafe sex);
- a more active role for ministries, provinces and municipal governments in raising funds for HIV/AIDS prevention and treatment;
- inclusion of HIV/AIDS as a priority issue in local socioeconomic development plans;
- mobilising funds from the private sector through corporate social responsibility and company programmes for employees;
- funding certain HIV/AIDS related services through the national health insurance framework;
- co-payment by beneficiaries for certain services, such as methadone treatment;
- efficiency savings through improved cross-sector coordination, integration of service delivery channels, improved geographical prioritisation and better supply-chain management for ART, methadone and commodities; and
- stronger mechanisms for coordination, allocation and use of finances, with regular reviews of national HIV/AIDS spending.

4.3. Infrastructure financing through public-private partnerships

Over the past two decades, Vietnam has been remarkably successful at providing basic infrastructure across the country. The proportion of rural households connected to electricity increased from just 14% in 1993 to almost universal access by 2010, while the number of households with access to piped water rose from just 12% in 2002 to 76% in 2009. Electricity generation capacity has grown at 13% each year while the total length of paved roads has quadrupled.³² This expansion has been made possible by extremely high rates of public investment.

However, Vietnam still has a long way to go to lift its infrastructure to the levels needed to achieve its desired economic transformation and infrastructure bottlenecks remain a significant constraint on growth. MPI estimates the investment needs at over \$25 billion a year, or more than 20% of GDP. Rates of public investment from the state budget and government bonds have never exceeded \$14 billion, creating a substantial financing gap.

GoV hopes that the private sector will play a substantial part in meeting this gap. Since the early 1990s, it has sought to attract foreign investment into infrastructure development through various types of public-private partnership (PPP). PPPs in infrastructure are, however, challenging to design and implement, even in OECD countries. While infrastructure projects may offer high rates of socio-economic return, many do not generate the revenues required by commercial investors. Long pay-back periods of 15 to 25 years do not always match investor preferences for short-term returns. This calls for government participation to make the deals more attractive to investors. Creating bankable projects is demanding, requiring strong institutional capacity. The challenge is to ensure an appropriate allocation of risk between the investor and the state. Placing too much risk on the private investors drives up costs, while too little compromises the efficiency gain expected from private

participation. The legal framework for procuring the investment must be strong, challenges such as acquiring land must be surmountable and investors need a high level of confidence in the business environment and the stability of government policy.

So, Vietnam's experience has been mainly with Build-Operate-Transfer (BOT) and Build-Own-Operate (BOO) agreements, primarily in electricity and telecommunications. According to one report, over the period from 1994 to 2009, 32 BOT and BOO projects were registered, with registered capital of \$6.7 billion.³³ Table 6 provides details of the projects. While the Ministry of Transport lists a larger volume of PPPs on its website, these figures include partnerships with SOEs, involving single-source procurement, and are therefore not true PPPs. Progress in attractive private investors was held back by a number of factors, including an inadequate legal framework, a lack of capacity within ministries for preparing bankable projects and investor concerns with the wider business and financial environment.

In 2009, GoV introduced Decree 108 on implementing the Law on Public Investment, which facilitated PPPs. This led to an increase in the rate of progress, with six new BOT and BOO projects with foreign participation launched in 2010. However, a new Decision 71 in 2010, written with the intention of supporting the piloting of new types of PPP, left many investors unsure of GoV's policy and the applicable legal framework. As a result, no new projects were concluded in 2011 and only one in 2012. We are informed that, while a number of PPP pilots are under preparation, none has yet reached financial closure.

³² MDP report, 2010.

³³ Trinh Thu Thuy and Trinh Van Chinh, "Capital mobilization of PPP for sustainable transport development in Vietnam", *Proceedings of the Eastern Asia Society for Transportation Studies*, Vol. 9, 2013, p. 5.

Table 6: PPP projects by primary sector and subsectors, 1993-2009 (USD million)

Sector	Subsector	Total projects	Total Investment
Energy	Electricity	17	1783
	Natural gas	1	1300
Telecom		3	2013
Transport	Airport	1	15
	Roads	2	644
	Seaports	5	732
Water and sewerage	Treatment plants	2	213
Total 1993-2009		32	6700

Source: PPI Database

Over the last two years, intensive discussions among the responsible GoV ministries have helped to clarify GoV policy and the division of responsibilities. A new draft Law on Public Procurement passed in October 2013 has a chapter on PPPs and a new Decree is under preparation which will clarify implementation arrangements. The new rules will permit new types of PPPs and new types of participation by the state, including through direct financing, the provision of assets, land use rights and other financial instruments such as guarantees. The state's total contribution should not exceed 50% of project costs. The decree will also clarify the criteria for investor selection, to ensure that private companies compete on equal terms with SOEs.

The new legal instruments should go a long way towards clarifying the legal framework for PPPs. There are, however, a number of other constraints on the successful conclusion of PPPs. There is at present a shortage of skills to prepare bankable projects and GoV lacks the funds for project preparation, which can amount to 5-10% of total project costs. GoV also needs the resources to fund its own contributions to PPPs. It has identified this as one of its priorities in the use of ODA. These are areas where development partners, in particular the multilateral banks, can be of considerable assistance. The ADB and the French development bank AFD are both providing Project Development Funds to assist MPI with feasibility studies and the preparation of bidding documents for PPPs.

5. Conclusions and recommendations

5.1. Trends in development finance flows in Vietnam

Vietnam's extraordinarily successes in growth and poverty reduction have been both a result and a cause of extensive development finance flows. It has been one of the highest recipients in the world of both ODA and FDI, allowing it to sustain rates of investment in physical and human capital that have been second only to China's. This has fed two decades of economic growth through rapid factor accumulation (increasing the amount of capital in the economy), with productivity growth (more efficient use of capital) playing a secondary role.³⁴

Vietnam now appears to have reached the limits of this development model. The cost advantages that attracted high rates of FDI to Vietnam have begun to decline in comparison to other low-wage economies. High investment rates are no longer generating the same development returns. Instead, they have touched off a period of macroeconomic instability, forcing GoV

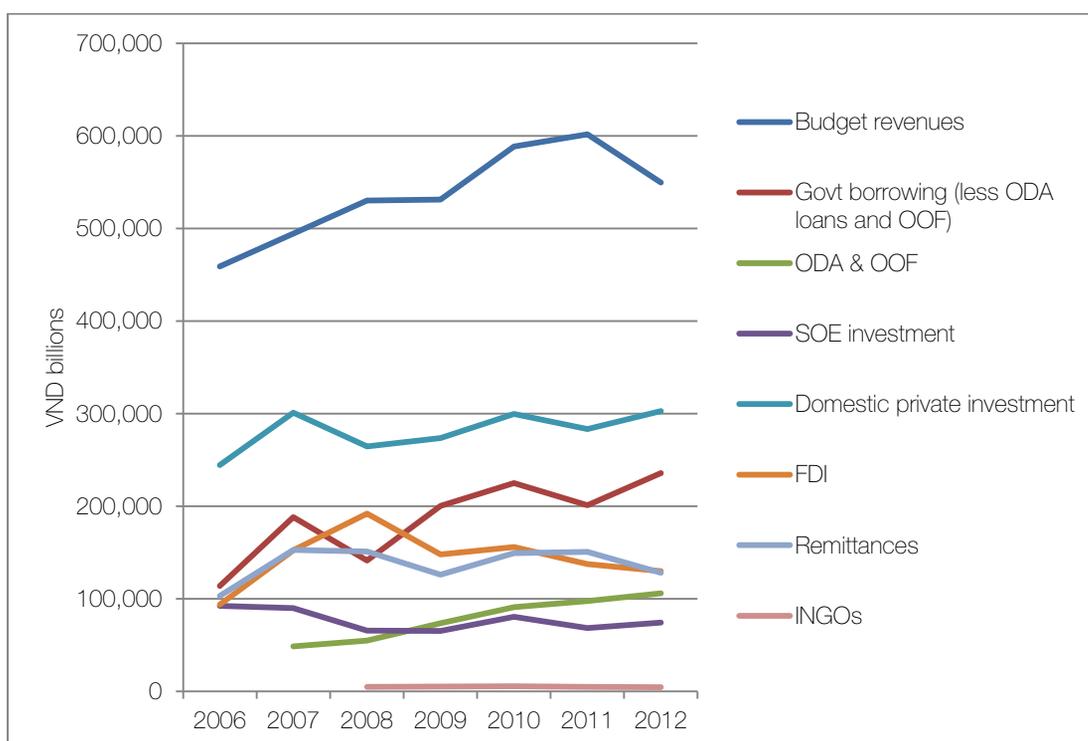
to cut back sharply on credit growth and public investment. Weaknesses in public investment management have highlighted Vietnam's limited absorption capacity. Vietnam therefore needs to find new drivers of growth, based on better targeted public investments and policy instruments designed to drive productivity growth.

Vietnam is also entering into a period of increasingly constrained development finance. Figure 29 illustrates the changing magnitude of the different development finance flows examined in this study, in constant 2010 prices. It shows a number of important dynamics:

- rapid expansion in budget revenues up to 2010, followed by a decline;
- rapid increase in government borrowing from 2006 to 2012;
- declining levels of FDI since 2008; and
- ODA and OOF (non-concessional official flows) for the time being continue to increase, but have declined in importance relative to domestic revenues and other government borrowing and in the coming years will begin to decline in absolute terms.

³⁴ "Vietnam Development Report 2012: Market Economy for a Middle-Income Vietnam", Joint Donor Report to the Vietnam Consultative Group Meeting, December 2011, p. 54.

Figure 29: Relative magnitude of Vietnam’s development finance flows, 2006-2012 (in constant 2010 prices)



Source: MoF; GSO; MPI

* These categories are not mutually exclusive. There is double counting between some items, such as between ODA and government borrowing and between remittances and domestic private investment. This diagram therefore does not represent shares in Vietnam’s total development finance; it merely indicates the relative magnitude of different flows.

Table 7 sets looks at some of the implications of these trends. It illustrates how different finance flows might affect each other.

Table 7: Changing patterns of development and their implications

Trend	Implications
<p>Government revenues have fallen in recent years and are likely to recover only slowly</p>	<ul style="list-style-type: none"> • Declining development budget • Development budget filled with incomplete project, with little scope for new projects in the short term • Greater tendency towards socialisation of service delivery • Fewer resources to meet the costs of economic restructuring • Fewer resources to fund institutional reforms
<p>Government borrowing continues to grow, with some scope to increase further up to GoV's total borrowing ceiling of 65% of GDP</p>	<ul style="list-style-type: none"> • GoV has scope to finance some new investments, particularly through bond issues. However, bond-financed investments have been some of the least efficient to date • GoV needs to use its debt finance strategically, to leverage other development finance flows
<p>Public investment in recent years has triggered macroeconomic instability and has had to be sharply reduced</p>	<ul style="list-style-type: none"> • GoV no longer has the option of boosting economic growth through stimulus measures • The priority must therefore shift towards increasing the efficiency and effectiveness of public investment • The funds available are short of the levels of infrastructure investment needed to accomplish economic transition. Funding infrastructure development from other sources is therefore a priority
<p>Despite new laws and pilotschemes, private investment in infrastructure remains very limited</p>	<ul style="list-style-type: none"> • GoV still has some work to do to establish the pre-conditions and capacities for PPPs

<p>FDI flows have levelled off</p>	<ul style="list-style-type: none"> • At current trends, FDI is no longer the engine of employment creation and poverty reduction that it has been in the past • Attracting FDI into higher productivity manufacturing is an urgent priority • Infrastructure development, vocational training and incentive measures need to be tailored to the needs of particular geographical locations and manufacturing sectors • GoV needs to provide incentives for foreign investors to use more local content in their production • GoV should take measures to prevent unhelpful competition between provinces in attracting investors and ensure reasonable tax contributions
<p>SOEs represent a declining share of commercial investment and production, but still have privileged access to finance</p>	<ul style="list-style-type: none"> • A significant proportion of the commercial credit available in Vietnam is being spent on low productivity investments • Private companies in Vietnam are forced to depend mainly on proprietor finance, which inhibits them in expanding and creating more employment
<p>ODA and ODA-like funds will remain at a high-level for the next few years, despite falling bilateral grants, before falling away and becoming less concessional towards the end of the decade</p>	<ul style="list-style-type: none"> • The reduction in grant funding will have the greatest impact on the social sectors, which do not currently have access to non-concessional assistance. It may lead to a decline in access and equity in the poorest regions • In HIV/AIDS programming, a transition from ODA to state funding is required • In other areas, declining ODA will have a limited impact on absolute spending levels, but may lead to a loss of flexibility to undertake new policy and institutional reform initiatives • The multilateral development banks have an important role to play in providing the finance needed for preparing bankable PPP projects, to attract private investment • ODA projects designed to increase the quality of public investment can offer a potentially large development impact

5.2. Towards a comprehensive development finance strategy

It is clear that the challenges facing Vietnam in financing its national development in the coming period will be very different to those it faced over the past twenty years. Through the 1990s and 2000s, economic liberalisation and the path to WTO membership led to high rates of FDI and domestic investment, which in turn drove economic growth, employment creation and poverty reduction. This enabled Vietnam to attract high rates of ODA and to expand its public expenditure on the provision of basic infrastructure and public services to the population at large.

In the future, faced with a combination of more complex development challenges, a less equitable pattern of growth and diminishing development finance, the priority is to use programmable development finance (i.e., budgetary resources and ODA) more strategically so that it catalyses other funding flows. This challenge has many different dimensions to it, including improving the targeting of public expenditure and removing legal and institutional constraints on the efficient use of other development finance. The investment priorities, reform needs and policy instruments will vary significantly across different sectors and policy goals.

This analysis suggests that Vietnam needs to develop more sophisticated financing strategies to accompany its next generation of Socio-Economic Development Plans, at the national, sectoral and provincial levels. The challenge is no longer about coordinating different funders or types of finance. Rather, it is about using programme development finance to ‘crowd in’ other funding flows and help direct into investments with the highest development return.

While this is a broad agenda, six main challenges stand out.

a. Improving the quality of public spending and investment

Vietnam’s systems for planning and budgeting still fall well short of what is required by a middle-income country facing complex development

challenges. Vietnam needs a medium-term resource allocation process able to link resource allocation to national, sector and provincial development strategies. It should improve the coordination of its recurrent and development budgets. It should introduce programme-based budgeting that enables spending to be mapped against specific development initiatives. Public investment projects should be selected on the basis of their expected contribution to national, sectoral and provincial development goals. Both budgets and National Target Programmes should be rigorously monitored, both as to their funds utilisation and their development impact.

It is clear that certain aspects of fiscal decentralisation in Vietnam have gone too far and that a level of recentralisation is required. In particular, the development of major infrastructure needs to be planned at the national or regional level, rather than at the provincial level. Greater rigour needs to be introduced into the selection of investment projects by the provinces, with a closer link to provincial SEDPs, more rigorous appraisal processes and close monitoring of development returns. To encourage better results management, MPI should consider introducing elements of results-based financing into the development budget – that is, increasing the level of funding to provinces that can demonstrate development results from their investments. This would create incentives for provinces to select their investments more carefully and invest more effort into monitoring results. The results-based financing pilots being undertaken by the World Bank may offer a model on which to build.

b. Maintaining equity in social service delivery

Vietnam’s policy on socialisation (that is, contributions from communities, the private sector and households to the delivery of public services) needs to be supported by clear and transparent rules. Socialisation has shifted a significant share of the costs of services onto citizens in a way that is regressive in its impact on the poor. It has also resulted in cost inflation. Vietnam spends more in aggregate on health and education than other MICs in the region, without a commensurate improvement in health and education outcomes.

The social sectors need to develop whole-of-sector financing plans, as the health sector has begun to, with sound economic and

distributional analysis. They need clearer rules on private-sector participation in service delivery, to prevent the emergence of a two-tier system. GoV should ensure greater transparency and public understanding of official fees for public services, to stem the growth in informal co-payments.

c. Attracting private investment into infrastructure

Vietnam needs to press ahead with rapid infrastructure development in order to create the conditions for economic restructuring. Mobilising private investment into infrastructure

development would help to free its remaining ODA resources for social sector needs. GoV needs to complete its legal framework for public-private partnerships. It should consider establish a public-private partnership unit in central government, perhaps located in MPI, with the expertise and resources to assist project owners with designing and negotiating PPPs. This unit would be a resource that can be deployed to support the most promising PPP projects in strategically important areas. This is also an area where Vietnam might benefit from South-South cooperation, drawing on the experience of countries such as Indonesia and APEC's new PPP Experts Advisory Panel (see Box 5).

Box 5: APEC initiative to build expertise on Public-Private Partnerships

At the September 2013 meeting of the Asia-Pacific Economic Community (APEC) Finance Ministers, it was recognised that member countries have a common need to build their capacity to plan, prioritise, prepare and finance infrastructure development through PPPs. The Finance Ministers therefore agreed to establish an APEC PPP Experts Advisory Panel, which is now being piloted in Indonesia. The Panel gathers together key technical experts to promote capacity among relevant government agencies to design and deliver high-quality, bankable PPP projects. It offers technical expertise for all stages of project cycles management and support for identifying and overcoming bottlenecks.

Box 6: Risk sharing instruments for PPPs in Indonesia

The Indonesia Infrastructure Guarantee Fund (IIGF) is a mechanism to reduce the risks for private investors of entering into PPPs for infrastructure development. It offers a single window facility to appraise all infrastructure PPPs requiring government guarantees. The World Bank provided a \$25 million loan to support the government with guaranteeing the obligations of government agencies to commercial investors. The project also provides technical assistance to help with IIGF screening, appraising and supervising PPP projects.

d. Increasing the development returns from FDI

To get more development return from its FDI, Vietnam needs to attract higher quality investment and to create more opportunities for Vietnamese companies to work with foreign-owned companies within international value chains. There is no one-size-fits-all strategy for achieving this. It calls for packages of linked interventions tailored to the needs of particular sectors and geographical areas. These must be based on detailed analysis of areas where Vietnamese have the potential to act as suppliers and partners to foreign firms, and of the bottlenecks or constraints they face in particular locations. This should inform the design of packages of interventions that address those

bottlenecks, such as infrastructure investments, land allocation, access of finance, vocational training, tax incentives and regulatory reforms. Foreign investors should also be offered more incentives to work with local firms.

This is another area where too much decentralisation may be unhelpful. At present, the provinces are competing with each other to attract foreign investors, resulting in market distortions and lost revenues. There is a need for central agencies capable of interacting with foreign investors and coordinating across different government agencies and jurisdictions. There should be clearer national policies and guidelines on incentives for foreign investors, to avoid unhelpful competition and ensure reasonable tax revenues are collected.

Box 7: A multi-donor fund for trade and investment in Indonesia

With financial contribution from the Netherlands and Switzerland, the World Bank established a Multi-Donor Facility for Trade and Investment Climate (MDFTIC) 2008-2013 in Indonesia. It is designed to strengthen the government institutions involved in promoting trade and investment, to improve Indonesia's competitiveness and investment climate. It was established in response to a request from the Ministry of Trade and the Coordinating Ministry for Economic Affairs. It provides high-level technical advice through the engagement of national and international experts to work with Indonesian partners. It supports the Ministry of Trade and related agencies on the design and implementation of trade policies through technical advice, capacity building and organisational reform. It helps the government with economic regulatory reform, streamlining investment procedures, capacity building for investment policy formulation and investor problem solving, customs and port improvement, and strengthening the financial sector.

e. Mobilising finance for private-sector development

Vietnam needs to pay greater attention to the needs of its domestic private sector, helping medium-sized firms to develop the capacities and economies of scale required for them to act as partners and suppliers for foreign investors and participate in global value chains. This entails pressing ahead with structural reforms, to reduce the crowding-out effect of SOEs. It means increasing access to land for the private sector. It means encouraging Vietnamese banks to tailor their lending operations to domestic private business, with more flexible collateral requirements.

5.3. The role of development assistance

What is the proper role of development assistance within this change development finance picture? Consultations conducted for this study revealed that the role of development assistance in Vietnam has become increasingly unclear. As Vietnam's access to development finance from domestic and international sources has expanded, ODA is increasingly less significant as a source of finance. The contribution of ODA to national budgets is not large enough to make a significant difference to the total resource pool. Furthermore, Vietnam's need at this point is not necessarily for more development finance. Rather, it needs to use existing resources more effectively, so as to maximise development results.

On the other hand, so long as Vietnam faces difficulties in making efficient use of its development finance, ODA enjoys a significance beyond its dollar value. The processes of analysis, policy dialogue and design that accompany ODA-finance projects help to make up for GoV's weak appraisal and resource-allocation processes. This means that ODA-financed projects have a higher development impact – an advantage that is clearly recognised by the line ministries. ODA also provides a substantial share of the funds available for undertaking new policy initiatives. As growth in Vietnam becomes less pro-poor in nature, the remaining poverty caseload is increasingly difficult to tackle, calling for new policy instruments. ODA continues to play an important role in ensuring that development expenditure in Vietnam is equitable – both by directing more resources towards the poorest regions and by addressing the negative consequences of socialisation of public services. For all these reasons, ODA continues to be extremely important for Vietnam.

Box 8: Managing development finance risk in Indonesia

In Indonesia in 2009, in response to the global financial crisis, the World Bank approved a unique \$2 billion Development Policy Loan with a deferred drawdown option. The government could access the loan as needed, if market conditions deteriorated and its access to international or domestic financial markets become restricted. The Government of Indonesia then set its own conditions for accessing the funds. The loan was part of a larger financing facility that helped Indonesia to mobilise funding from domestic and international capital markets by sending a positive signal as to Indonesia's financial strength.

Some bilateral donors began to phase out their bilateral aid programmes to Vietnam as soon as the country reached MIC status. This is of course driven by global priorities, rather than Vietnamese conditions. MIC status is, after all, merely a statistical category, with no necessary correlation either to need or capacity. Though Vietnam now has access to a broader range of development financing options, it still displays many of the institutional challenges characteristic of low-income countries. It also faces a risk that growth will level off at just above the MIC income threshold, with inequality rising and the poverty reduction slowing or even beginning to decline. ODA therefore still has an important role to play in helping Vietnam make the transition to its next phase of national development.

It is often observed that the role of ODA in non-aid-dependent countries should be to leverage other sources of development finance. This is also true in Vietnam, although it is first and foremost about increase the efficiency and development effectiveness of other sources of development finance, rather than just maximising their volume. The application of this principle will vary in different country contexts.

We see five key roles for development assistance in Vietnam over the coming period.

a. Promoting evidence-based policy making and managing for results

Managing for results is an unfinished element of the Paris Declaration/Hanoi Core Statement agenda and is rightly stressed in the Vietnam Partnership Document. For the past decade, Vietnam has invested substantial resources into growth and poverty reduction, but without the capacity to generate hard evidence on the

impact of its interventions and without a strong tradition of using evidence to inform policy making. Vietnam now has a pressing need to improve the targeting of its policy interventions and its public investments. It also needs to draw on wider sources of information and feedback from the community in addressing new social and economic challenges.

This is an area where development partners have a great deal to offer. In forums such as Sector Partnership Groups, they can share knowledge and evidence, engage in joint reviews and debate policy options. They can provide capacity building support to GoV agencies on policy making and planning. They can help to build up monitoring systems in particular sectors or areas and introduce elements of results-based aid into their assistance to create incentives for GoV agencies to generate and use results data. They can invest in Vietnamese research institutes and academic institutions. They can support Vietnamese CSOs to monitor the performance of government programmes and they can help to introduce systems for local communities to provide feedback on the quality of services. They can invest in the national statistical system and help to encourage the sharing of data across government and society.

b. Improving the quality of public expenditure and investment

Helping Vietnam to boost the quality of its public expenditure and investment is a key priority. It also depends upon the willingness of GoV to undertake some challenging reforms. So far as it is willing to do so, development partners can provide technical support. The priorities include strengthening Vietnam's systems for fiscal decentralisation and supporting a shift towards regional planning of strategic infrastructure.

The new draft laws on the State Budget and Investment offer an opportunity to introduce medium-term budget planning. Development partners can offer their expertise to help GoV introduce elements of results-based funding into the development budget.

c. Support for public-private partnerships

Leveraging private finance into infrastructure development should be a key priority for development partners. The development partners, and particularly the Six Banks, can provide support on developing the legal framework and helping the responsible agencies develop the technical expertise to design and negotiate PPPs. They could support the development of a central PPP unit, able to provide technical support across government. They could also support knowledge transfer across South-East Asia, such as from Indonesia, through triangular cooperation. The development banks can also support PPPs through partial risk guarantees and similar instruments, as has been done in countries such as Indonesia (see Box 6).

d. Promoting equity in social service delivery

As economic growth in Vietnam becomes less pro-poor in nature, there is a key role for development partners in helping to prevent the emergence of wider inequalities in social services. The current approach to socialisation is having unintended consequences, placing a heavy burden on the poorest households and causing a two-tier system to emerge. To correct this tendency, development partners need to work with GoV to develop sector financing plans, which encompass the national budget, private-sector investments, citizen contributions and ODA. This approach has already begun to emerge in health, as a result of the strong partnership between the Ministry of Health and development partners, but is not as developed in the education sector. There is a need for more analytical work on the distribution impacts of socialisation. Development partners can help to pilot new ways of raising service standards in remote areas and among deprived communities.

e. Developing knowledge partnerships in particular industries

Some of Vietnam's bilateral donors have moved away from traditional sector support into promoting knowledge partnerships in areas of mutual interest, often with a commercial orientation. This often means linking up Vietnamese institutions and companies with their counterparts in the donor country. This is potentially a good match with Vietnam's need to develop industrial policy tailored to the needs of particular sectors or areas. For example, Norway promotes technical cooperation in fisheries economics and rice production, while Sweden has been promoting clean energy technology.

5.4. Organising the development partnership

During the consultations for this study, many of the development partners expressed the view that the principles and structures underlying the development partnership in Vietnam needed to be reassessed. Over the past decade, Vietnam has been a global leader on aid effectiveness, through the Paris Declaration and the Hanoi Core Statement. It has had a well-developed architecture for coordination and dialogue at the national and sectoral levels and strong mutually accountability processes.³⁵

Many of the principles in the Paris Declaration/Hanoi Core Statement, however, were concerned with improving the efficiency and predictability of government-to-government financial transfers. While these commitments are still relevant to those development partners providing traditional sectoral support, they are more difficult to apply to the post-aid development cooperation to which many of the bilateral donors are now moving. Furthermore, as ODA declines as a proportion of the overall development mix, its efficiency and predictability is increasingly less of a factor in Vietnam's overall development effectiveness. Many of the development partners now have less interest in and less time to devote to coordination processes and joint initiatives.

³⁵ See Marcus Cox et al., "Paris Declaration/Hanoi Core Statement Phase 2 Evaluation: Vietnam Country Evaluation", *Agulhas Applied Knowledge*, January 2011, p. 22.

Based on the conclusions of this paper, we suggest three areas in which the Vietnamese development partnership can be strengthened.

5.4.1. Sector finance strategies

To make the best use of its remaining period of ODA, line ministries should begin to develop sector finance strategies that identify the most effective uses of ODA alongside other development resources. As the best use of ODA will vary across sectors, this analysis needs to be done for each sector. It should assess how ODA can be used to mobilise other sources of development finance, to increase the efficiency of its use and to address equity issues.

Of the sectors we examined, health has made the most progress towards an overall sector finance strategy, taking into account budget expenditure, ODA, private sector contributions, health insurance and user payments. This progress has clearly been facilitated by the EU's adoption of sector budget support, which in turn required the development of a stronger sector planning framework linked to budget framework. However, even the health sector has a long way to go in regulating private sector participation and preventing an escalation of user fees from driving up costs and inequality.

Developing a sector finance strategy would afford an opportunity for strategic dialogue between line ministries and their development partners on the optimal use of ODA for its remaining period, drawing on the six categories listed in section 5.3. At present, line ministries are only thinking in terms of maintaining ODA flows for as long as possible. They have not yet begun to think strategically about the changing value of ODA alongside other sources of development finance in the coming years.

5.4.2. A changing division of labour

Vietnam has an elaborate set of processes for organising the development partnership, including the Vietnam Development Partnership Forum, the Aid Effectiveness Forum, sectoral partnership groups and a number of donor groups (the Like-Minded Donor Group; the Six Banks; the EU and its member states; the One UN process). Many of the development partners no longer have either the personnel or the incentive to engage actively in these processes. There has been a clear loss of appetite for joint initiatives or complex coordination processes. The development

partners now spend much less time together developing joint policy positions. Many of the bilateral donors have decided to focus on niche areas and no longer attempt to engage at the level of national development policy.

A new division of labour may therefore be emerging between bilateral and multilateral development partners. It is increasingly the multilateral partners (the development banks, the EU and the UN) that have the interest and capacity to engage with the bigger issues of development effectiveness discussed in this paper. Most of the bilateral partners, by choice or necessity, are retreating into niche areas. Those that wish to continue to have a voice in national policy dialogue may be best able to do so via multilateral partners.

It may therefore be useful for the multilateral agencies to agree a division of labour and to build up their capacity to engage in particular areas (e.g., the Six Banks on public investment and PPPs; the World Bank on public financial management; the EU on equity in service delivery; the UN on other governance areas). A number of development partners consulted for this study commented that they saw the future role for the UN in Vietnam as a centre for policy expertise, rather than a delivery agency.

5.4.3. Towards effective partnership-based cooperation

Some of Vietnam's bilateral partners have begun to move away from traditional, sector-based support towards a new focus on trading relationships and 'post-aid' development partnerships. They are seeking to promote the development of Vietnam's private sector, with a view to building up trading ties for mutual benefit. This usually involve a shift away from government-to-government financial assistance towards new assistance modalities based on a wider range of partnership between public bodies, academic institutions, CSOs and companies in Vietnam and the donor country. This is part of a broader shift towards more commercially oriented aid strategies on the part of many bilateral donors, with countries such as the Netherlands leading this transition.

These new aid modalities ('partnership-based cooperation') are potentially very useful to Vietnam. As noted above, donors seek to provide their assistance in particular niche areas of economic activity where they have a

comparative advantage. For example, Ireland is sharing its experience with attracting FDI into the high-technology sector, Sweden has been supporting partnerships on clean technology, Finland is supporting innovation in agriculture and bio-technology and Norway provides technical cooperation in fisheries economics, rice production and environmental management. If GoV seeks to develop private-sector development strategies tailored to the needs of particular productive sectors, these kinds of partnership could prove very helpful.

However, these new aid modalities are also untested. It is as yet unclear whether potential Vietnamese partners are sufficiently aware of the different types of support on offer and able to make informed choices as to partnerships. At present, the support programmes are short-term in nature, and it is unclear whether they can deliver sustainable impact. So far, little or no evaluation work has been undertaken on this type of cooperation in Vietnam.

There is also a risk that this transition to partnership-based cooperation will cause a deterioration in the quality of the development partnership in Vietnam. As donors move away from traditional sector support, they have less interest in participating in sector coordination processes and joint initiatives with other donors. They are less likely to follow the traditional principles of aid effectiveness, such as using country systems for aid delivery or ensuring that their aid is recorded on the budget. Indeed, many of these principles relate principally to the efficiency and predictability of government-to-government financial transfers and are not particularly relevant to the new forms of development cooperation. However, without a strong incentive to participate in aid coordination processes, there is a risk the partnership-based aid becomes fragmented and disjointed.

Vietnam has an opportunity to pioneer the development of new principles to govern effective partnership-based cooperation. Unlike financial aid, partnership-based cooperation does not lend itself to central coordination or formal agreements on division of labour. In fact, an element of competition among donors is appropriate, if it helps to match Vietnamese needs with donor comparative advantage. Given that donors are partly promoting their own future commercial interests, it is ultimately up to Vietnamese institutions and companies to decide which offers are in their mutual interest. The challenge is to build an efficient market in partnership-based cooperation, so that competition raises the quality of assistance.

This might involve improving information flows on offers of partnership-based cooperation. At present, information on the available support is scattered in different locations, making it difficult for Vietnamese institutions to find and compare them. MPI could consider developing an information portal on the support on offer from different donors, to increase transparency and promote fair competition. Fair competition also requires a level playing field, so that aid programmes compete for participants based on their merits rather than incidental benefits. MPI might therefore consider working with the relevant donors to agree a set of principles on partnership-based programmes. This would be something akin to a set of shared cost norms, governing the types and level of benefits that could be offered to individual participants in partnership programmes.

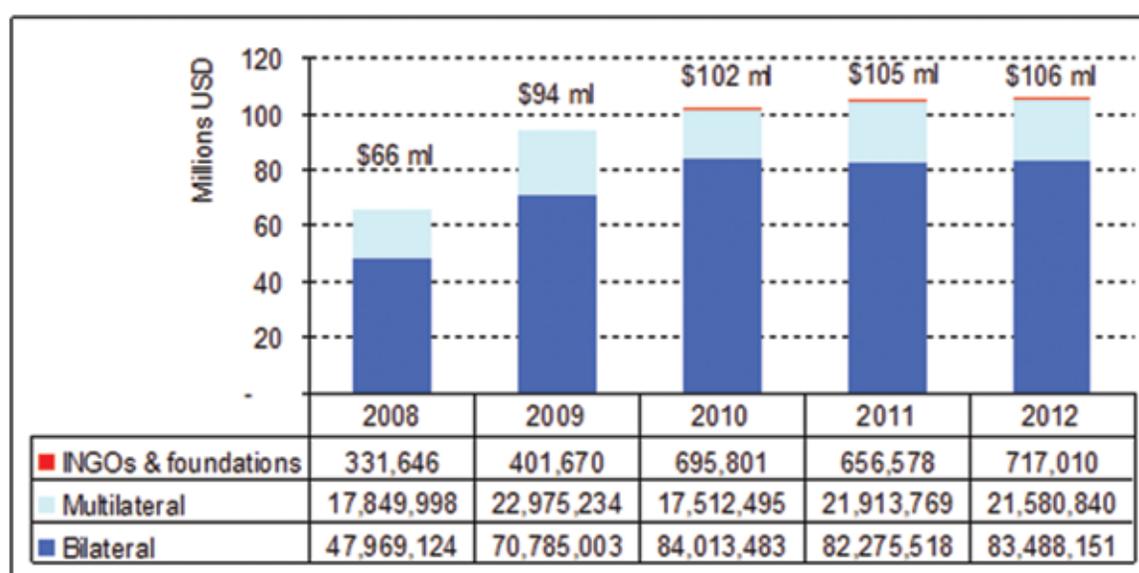
Annex 1: Case study on financing options for HIV-AIDS programmes

Overview of the HIV epidemic and national responses in Vietnam

The HIV epidemic in Vietnam remains concentrated among populations at higher risk since the first case was reported in late 1990. The overall HIV prevalence was estimated to be 0.44% among all people aged between 15-49 years in 2010 [1]. However, much greater prevalence levels are reported among injecting drug users (IDUs) (18.4% in 2009), female sex workers (FSWs, 3.2% in 2009) [2]. Importantly, the latest data indicate a substantial increase in HIV prevalence among men who have sex with men (MSM, to 16.7% in 2009 [2]). The estimated population of people living with HIV (PLHIV) more than doubled during the past decade, reaching approximately 254,000 in 2010 [1, 2]. A total of 57,663 PLHIV are currently on antiretroviral treatment (ART).

The increasing program costs have been a challenge to the long-term financial sustainability of health system in the fight against HIV/AIDS. The 2008-2009 UNGASS report and the Global AIDS progress report of Vietnam 2012, highlight the fact that the significant scale up of prevention and treatment activities is a consequence of extensive donor support. According to National AIDS Spending Assessments (NASA), a total of \$ 634 million has been spent on AIDS by the Vietnamese government, international donors, and individual households from 2008 to 2012, the bulk of which was from international sources. International funding increased from \$ 66 million in 2008 to \$106 million by 2012. Expenditure on basic program activities, aimed at directly reducing HIV transmission, morbidity, and mortality, have been decreasing since 2010 – both in terms of volume as well as relative share, but remains at approximately 50% in 2012.

Figure 1: Annual international spending on AIDS, 2008-2012

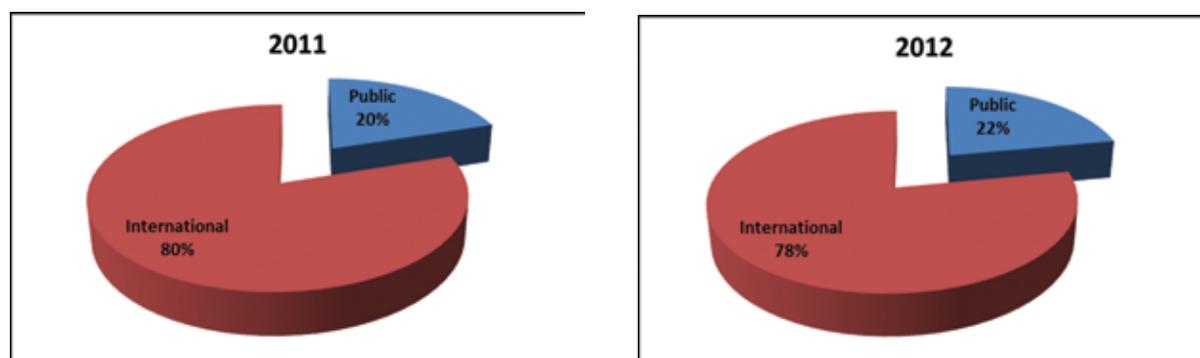


(National AIDS Spending Assessment, 2011-2012, UNAIDS, 2013)

Since Vietnam acquired middle income country status in 2010, this external financial support has been threatened with donors warning of steep declines in their funding and requesting increased resources from the national government. Already a number of large donors have identified end dates for their program support. The Midterm review of the Political declaration on HIV which was carried out by VAAC in cooperation with other stakeholders

in 2013 identified 2 criteria which were deemed necessary to close the funding gap and reach their targets: (1) continued development and scale up more efficient and better targeted service models and (2) continued external and increased domestic funding for the national response. Strategic allocation of resources and gains in efficiency are imperative for averting infections and ultimately ensuring that Vietnam gets to Zero.

Figure 2: Annual Government and International spending on AIDS in Vietnam, 2011-2012



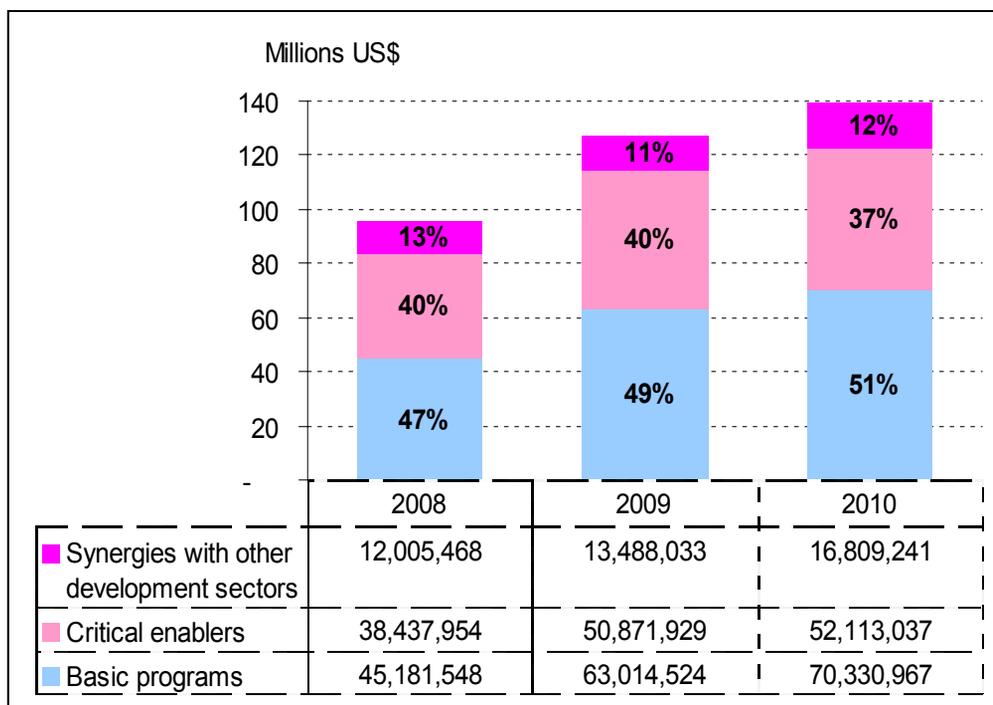
Source: National AIDS Spending Assessment, 2011-2012, UNAIDS, 2013

Investment Framework and NASA

The NASA data for the period 2008-2010 have been used to develop the Vietnam investment framework. In order to construct the investment framework, each NASA AIDS Spending Category (ASC) was assigned to one corresponding Investment Framework (IF) category. In this way it is assumed that all actual HIV/AIDS expenditures are suitable for an IF category (whiles some may not in practice).

Figure 3 summaries the Vietnam investment framework for 2008-2010. When the total national expenditures on AIDS increased from \$95.6 million in 2008 to \$139.3 million in 2010, the basic program expenditures expanded both in volume from \$45.2 million to \$70.3 million and in relative share from 47% to 51%. Compared to the world estimated basic program share of 42% in 2011 and 59% in 2015, Vietnam allocation of resources to basic program is reasonable and shows positive trend over time.

Figure 3: Total expenditure (\$) on HIV/AIDS in Vietnam, 2008 – 10



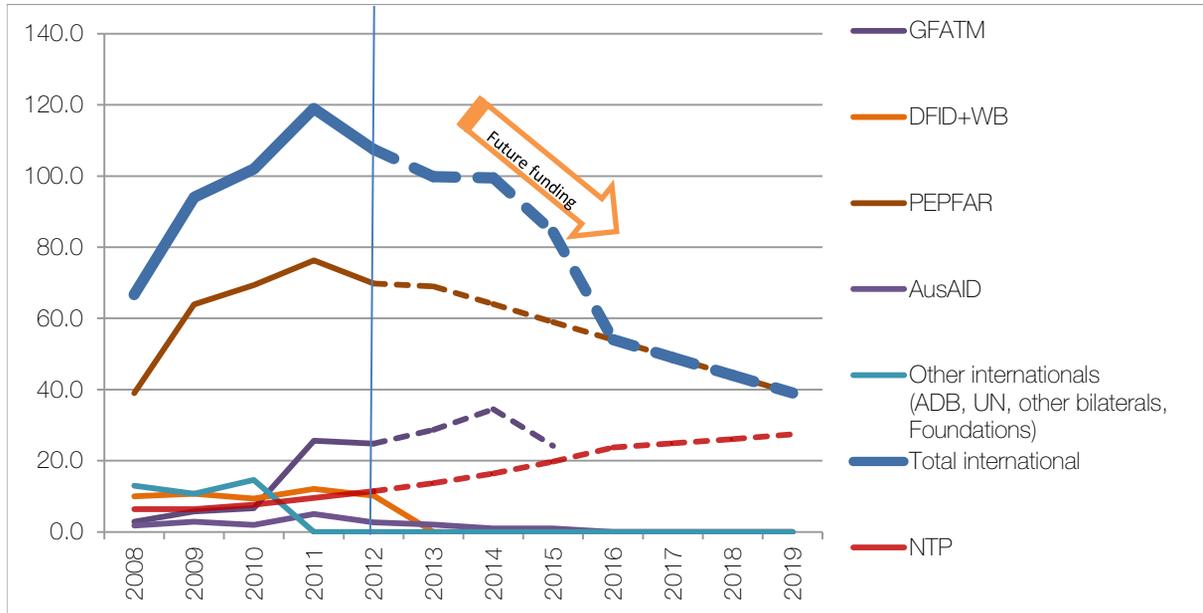
Source: *Investment Framework Policy Brief, UNAIDS, 2012*

The Oxford Policy Management Study on Sustainable Financing

Due to the reduction in international donor funding; Vietnam is now required to finance a larger share of the national AIDS response from domestic resources. This requires the Vietnamese government to develop a comprehensive intervention framework to guide the allocation of available limited resources effectively, in order to maximize population health benefits. Various financing strategies need to be explored to establish

sustainable sources of financing for HIV/AIDS programs over the long-term. Such strategies would comprise funding from domestic and external sources, and from both the public and private sectors. Options such as user co-payment could also be considered for services such as MMT. Innovative financing strategies that could be considered include financing from the private sector and corporate social responsibility, introduction of airline and airtime levies, increases in general taxation and efficiency savings.

Figure 4: Anticipated funding 2013-2020

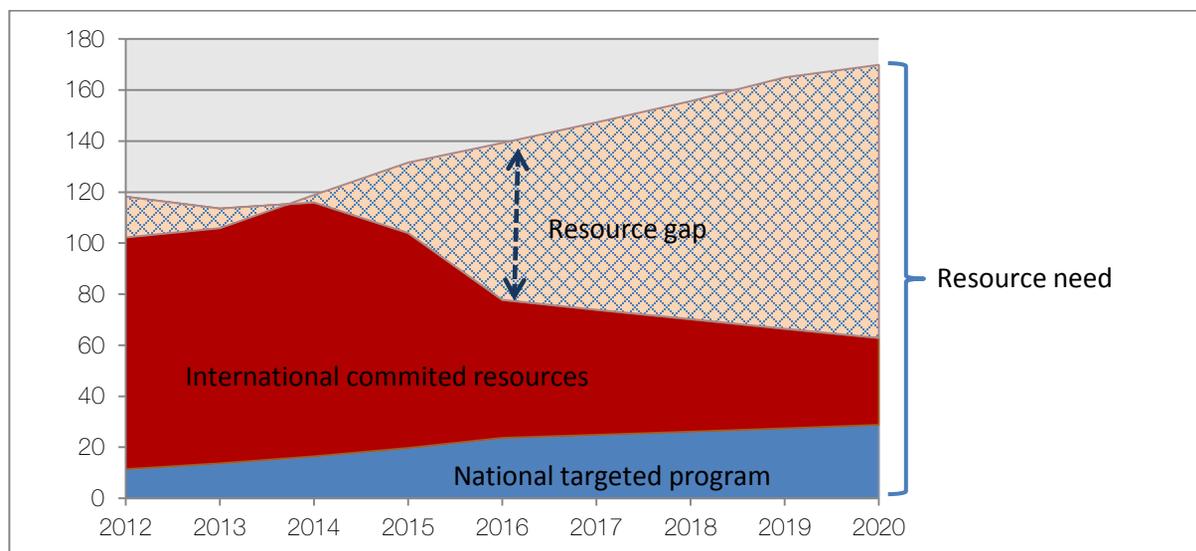


Source: Sustainable HIV Response in Vietnam: Overview of Vietnam HIV Expenditures and Future Donor Commitments, Submitted to DPM, 2012

In 2012 UNAIDS in cooperation Oxford Policy Management Group and other key stakeholders in the country carried out a study to assess what the current funding situation in the country looked like and what realistically it could be expected to look like in 2020. The report also contained a number of key recommendations for future sustainability. An advocacy brief based on this report was submitted by the Ambassadors and Heads of Agency HIV working group on HIV to the Deputy Prime Minister for his consideration, requesting him to take the leadership role on this important issue.

The report found that a number of major HIV donors are reducing their funding and/or withdrawing from the country, for example, the WB/DFID programme ended in 2012 and the regional HAARP project funded by AusAID/Netherlands closed in 2013. AusAID in partnership with CHAIVN will continue to support paediatric ART needs until 2015. The U.S. Government’s PEPFAR programme, the largest in this sector, was reduced by \$5 million in 2014 and its annual budget is expected to be reduced further in the future. There will be a new application for the Global Fund grant in 2014, using the new funding model.

Figure 5: Summary of total resource need and gap, 2012-2020



Source: *Sustainable HIV Response in Vietnam: Overview of Vietnam HIV Expenditures and Future Donor Commitments, Submitted to DPM, 2012*

In the report, the international community recommended to the Government of Vietnam, three areas for consideration and discussion in moving towards a sustainable national HIV response. The first recommendation was an increase in domestic HIV funding and targeted allocation of funds at both national and provincial levels to address the drivers of the epidemic: unsafe drug injection and unsafe sex. With this significant decrease in available international resources, an increase in domestic funding is urgently needed to ensure that recent progress made in the response is not reversed. The National Targeted HIV Programme budget should be increased at a higher rate, and richer provinces should contribute more to the HIV programme from their local budgets. In addition, policy dialog with key partners should continue on possible alternative sources of funding that will close the projected financial gap including Social Health Insurance, Private sector contributions and/or an Airline Levy. This dialogue should reinforce the strong national ownership required to continue the coordination and focus allocation of funds to evidence informed cost effective interventions targeting key populations at higher risk.

The second recommendation was that a sustainable HIV response requires harmonisation of planning and support for improved multi-sectoral coordination. In light of major shifts in funding sources for the HIV

response, and the need for investment in evidence-based interventions targeting key populations at higher risk of HIV, the National Committee on AIDS, Drugs and Sex Work Prevention and Control will need to continue to exercise its authority to engage key national and international stakeholders at country level (including civil society and the private sector) in harmonisation of planning and resource allocation based on the available data and international and Vietnamese best practices.

The third recommendation is to achieve efficiency savings in the national AIDS response. Synergies within the different donor funded programs and the national targeted programme should be established, to promote “one programme” approach. To ensure efficiency savings, geographical prioritization and integration of services at both national and provincial level should be undertaken; integration of existing human resources from donor funded projects into the national program should be promoted; supply chain management system for ARVs, Methadone and commodities should stay centralized and further consolidated; and engagement of the civil society and private sector should be strengthened. Country ownership and accountability for the efficiency savings needs to be ensured by the National Committee on HIV/AIDS, Drugs and Prostitution Prevention and Control.

Project on Sustainable Financing for HIV/AIDS 2013-2020

In follow up to the study issued to the Deputy Prime Minister the Project on Sustainable Financing for HIV/AIDS Prevention and Control Activities in 2013-2020 was developed by VAAC and endorsed by the Prime Minister in December 2012. The project incorporates some of the recommendations made by the Oxford Policy Management Study and promotes firstly the mobilisation of further resources and secondly increasing the efficiency and cost effectiveness of the programmes that are being implemented.

As part of the project, mobilisation of resources involved increasing allocation of central state budget for critical and efficient activities to warrant sustainability of HIV/AIDS control activities. This was to be done through advocating for an increment rate of the state budget financing the National Target Program at 20% or more each year. It also advocates for the improvement of the active roles of relevant ministries, line agencies and civil society in raising and channelling funds for HIV/AIDS control activities under their respective jurisdictions and further promotion of fund raising from international organizations and donors.

Municipal governments were also given active roles and responsibilities for financing local HIV/AIDS control activities. HIV/AIDS control will now be included as a local socioeconomic development priority, as a step toward mainstream HIV/AIDS control as a regular task in socioeconomic development programs and plans of municipalities and local authorities were encouraged to develop master plans to be approved by the local People's Councils and People's Committees. A part of the integration process it was dictated that HIV/AIDS control fund raising should be made an integral part of development fund raising meetings and workshops in municipalities.

Drawing on examples of best practice from other countries, it was also recognized that resources could be mobilized from engaging private sector businesses and requesting financial contributions to the HIV/AIDS response. It is proposed that foundations should be established to attract investment and corporate HIV/AIDS associations will be

supported to ensure that businesses fulfil their social responsibility in terms of HIV/AIDS services for their employees.

The Health Insurance System in the country has been identified as a potential source of income for the HIV/AIDS response in the country. It has been proposed that guidelines will be developed to ensure that the rights and interests of people living with HIV are adequately provided for within the Health Insurance Framework. This will require the review of existing legislation and clarification of the coverage rate and rights of people with HIV who subscribe to Health Insurance and the development of guidelines and protocols to make certain that the new policies are properly implemented. To guarantee that PLHIV are fully informed regarding how the Health Insurance System applies to them and what their entitlements are there is a need to increase education, awareness, advocacy and support for people with HIV who acquire Health Insurance policies.

Consideration has also been given to implementing services that are subsidised but are partially paid for by the beneficiaries of the service. If such a policy is to be executed, regulatory amendments will need to be developed to include specific HIV/AIDS-related services in the Ministry of Finance's Circular which provides for fee levels, fee collecting methods, management and use of preventive health fees and border quarantine fees.

In addition to identifying new sources of funding and strengthening those already in place, provisions were also made for the promotion of cost-effectiveness and budget saving strategies. One way of ensuring this is to strengthen the mechanisms for coordination, allocation, use and management of finances, to maintain effective central control of available funds, enhancing the nation's ownership of the response. Regular reviews of national AIDS spending will continue to be conducted to assess how funds are being used in HIV/AIDS control efforts and to allow for adjustments and more appropriate allocation of resources where necessary.

Program and project management capacity will be revised to allow for improved efficiency of the resources being used. This will involve investing in the existing public administration system for HIV/AIDS control and avoiding the creation of parallel administrative systems,

causing overlaps and waste of resources. Crucially standardized cost and programme norms will be developed and agreed upon by government and donors to ensure that service provision is consistent and sustainable throughout the country. As part of these efforts monitoring and evaluation systems in Vietnam will be strengthened to provide for effective use of available resources.

The progress made to date in these areas includes:

- a number of Provincial AIDS Committees including Ho Chi Minh City and Can Tho have made steps to take over some of the human resource costs of externally funded programmes within their jurisdictions;
- companies such as MAC and Chevron have begun to provide direct contributions to support projects and programmes;
- the business coalition for Vietnam has been launched with support for the initiative provided by the Global Fund;
- advanced dialogue is currently taking place concerning how best to incorporate HIV related services into the national health insurance scheme; and
- there has been a wide range of discussion concerning transition planning and work has begun on the development of provincial transition plans that will inform future decisions on programming.

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Annex 2: Development finance in Quang Nam province

Socio- economic context

Quang Nam is a province in the central coastal region. For the past ten years, the province has gained remarkable achievements in socio-economic development. The income per capita has increased from VND 5.508 million/year per capita in 2006 to VND 30.7 million in 2012. By income per capita, Quang Nam was ranked as the fourth province among 19 central coastal provinces/cities by the end of 2012.

Despite many problems created by the economic instability in the country and by the global crisis, the economy in Quang Nam has made quite good progress. The annual index of the provincial gross output in constant prices was higher than 110% for the last more than ten years, especially in industry and services sectors. High growth of industry and services sectors has led to a changing economic structure in Quang Nam. The proportion of agriculture has been declined from 29% in 2006 to 20.6% in 2011, while the share of industry and services sectors has increased respectively from 35.53% and 35.48% in 2006 to 40.01% and 38.83% in 2011. It is expected that the agricultural output proportion will be reduced more in 2013, to 17%, while the Industry and services sectors output proportions will be 42.5% and 40.5% respectively. The percentage of labour working in agricultural sector, therefore, has been reduced significantly from 90% in 1990s to 55% in 2012, while the percentage Industry and services sectors has been increased to 21% and 24% respectively in 2012.

The key contributor to industry production in Quang Nam is Truong Hai Group of Automobile Corporations (Thaco). Thaco has been started its operations in Chu Lai Open Economic Zone since 2003. It has gained big privileges given by Quang Nam PPC. The corporate income tax rate was only 5% for the first 9 years of operations (2004-2012) and after that 10%

for the following 15 years). For 2009-2011, the corporate income tax paid by Truong Hai Group of automobile corporations and their subsidiaries had been around only VND 20 billion per years.

Regardless of the big efforts given by Quang Nam's leaders and the people to the provincial economic development, Quang Nam has remained the one of the poor provinces in the country. The poverty incidence has been 1.5 higher than the national average poverty rate (17.93% in comparing to the 9.6% as the national poverty rate in 2012 using the MOLISA criteria). One of the key reasons causing high poverty incidence in Quang Nam is regular by natural disasters happened in Quang Nam, creating big damages to the economy and people. Quang Nam is also one of the provinces in Vietnam, which will suffer most from climate changes. Recognizing the problems which may be created by climate change, Quang Nam PPC has approved the Actions Plan for Climate Change Impacts Mitigation (Decision 1735/2013/QD-UBND).

Quang Nam is one of the provinces with good governance. From 2007 the Quang Nam PCI has been varied with the total score of around 60/100 or good and quite good. The biggest achievements of Quang Nam are in improving business entry (9.13 in 2011). The province has made big efforts in simplifying public administrative procedures, applying one-stop procedures in registration works and promoting electronic tax registration. The lowest score has been in services to support businesses (3.66 in 2011). The Committee of Investment Promotion and Supporting businesses has been established under the PPC since 2009 and the Centre for information and advisory support to SMEs under DPI since 2011 in Quang Nam with the aim to mobilizing more investment into the province and creating better supports to businesses.

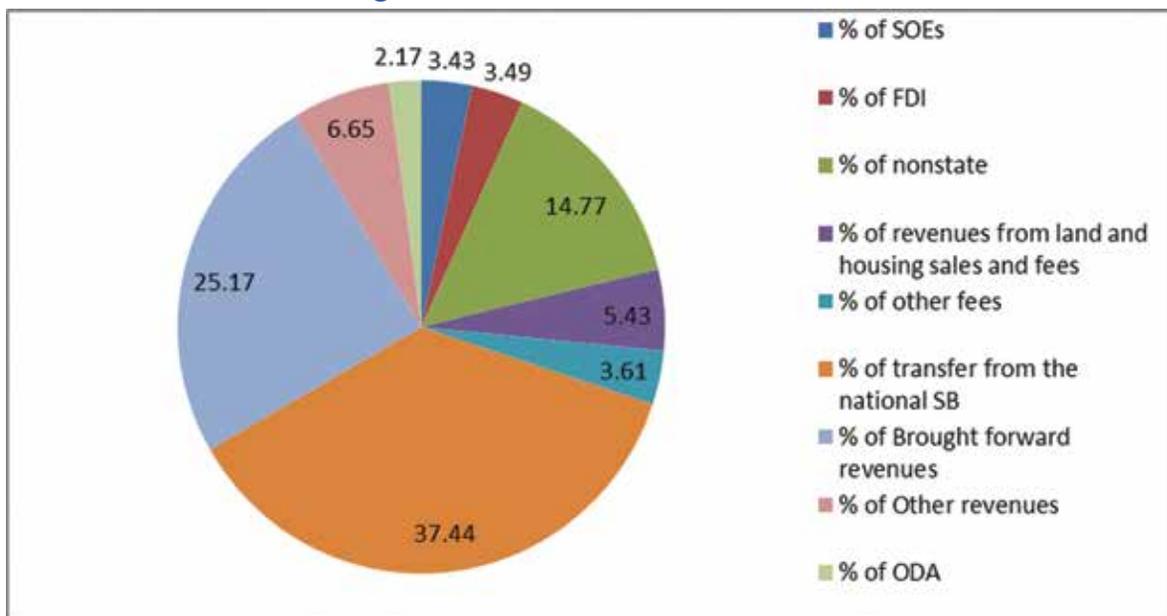
Quang Nam finance flows

Revenues

The province has been still depending strongly on the transfer from national budget. Therefore, the key sources of Quang Nam provincial revenues are the transfer from national budget (52.95% in 2006 and 37.44% in 2011), revenues from locally raised taxes, including the taxes from private sector (14.77% in 2011),

FDI and SOEs, and from the revenues from land and housing sales/fees (5.43% in 2011). In the MOF data there is no data on loans from ODA projects, because the data is accounted in the national budget. However, based on the data on the ODA projects implemented in the province for 2001- 2012, it estimated that ODA loans could account for more than 2% of the total local budget revenues of Quang Nam (Figure 1).

Figure 1. Public revenues in 2011



Source: Quang Nam DPI, DOF

Revenues from private sector become more and more important in Quang Nam with the proportion in the total local public budget increased from 4.42% in 2006 to 22.04% in 2013, while the transfer from the national state budget reduced from 52.95% in 2006 to 43.8% in 2013. The share of the revenues from FDI to the total public revenues has also increased, from only 0.6% in 2006 to 3.52% in 2012 and

6.83% in 2013. In difference from the big cities, the real estate boom or crisis hasn't imposed big influence on the revenues from land and housing sales and fees. It has been remained around 5% of the total local public revenues for almost all years of the last 8 years (Table 1). The big gaps in the proportions of the different sources of revenues between 2013 and other years are because there is no revenue brought forward to the reporting year from undisbursed funds allocated in the previous year.

Table 1. Quang Nam local public revenues, 2006- 2013 (VND millions)

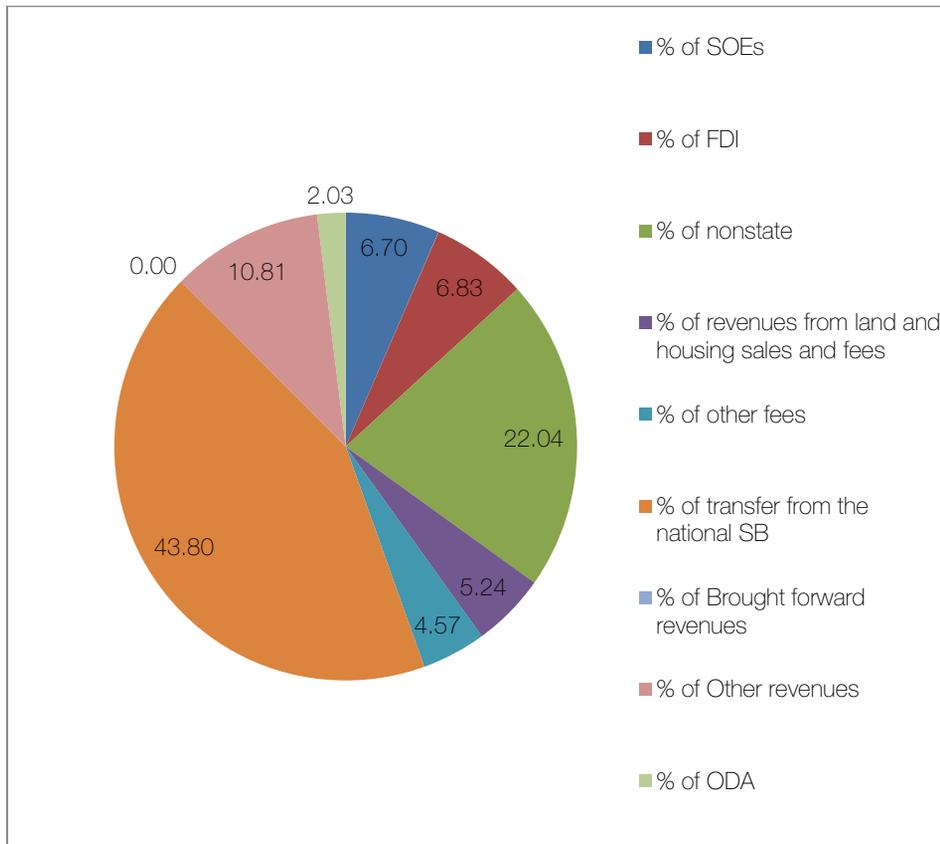
SOEs	136936	160138	187373	309337	358201	461502	554309	660000
Foreign-invested enterprises revenue	22495	94968	177179	270306	373981	469768	510133	672000
Non-state sector revenue	165094	234551	339871	621507	1170672	1986924	1830397	2170000
Land and housing revenues	188986	270852	350037	353157	521596	729656	450376	516000
Other fees	184761	203442	244854	319556	336610	486158	539392	450000
Transfers from the central budget	1979598	2348107	2714599	3210378	3564884	5035134	4852953	4312065
Brought forward revenues	717269	880819	1196607	1750795	2329336	3385575	4555624	
ODA		226.03	230.916	244.608	272.93	291.592	291.592	
Other revenues	343826	374294	464238	538748	686394	894425	1199612	1064605
Items	2006	2007	2008	2009	2010	2011	2012	2013
% of SOEs	3.66	3.51	3.30	4.20	3.83	3.43	3.82	6.70
% of FDI	0.60	2.08	3.12	3.67	4.00	3.49	3.52	6.83
% of non-state	4.42	5.14	5.99	8.43	12.53	14.77	12.63	22.04
% of revenues from land and housing sales and fees	5.05	5.93	6.17	4.79	5.58	5.43	3.11	5.24
% of other fees	4.94	4.45	4.31	4.33	3.60	3.61	3.72	4.57
% of transfer from the national SB	52.95	51.41	47.84	43.54	38.16	37.44	33.49	43.80
% of Brought forward revenues	19.18	19.29	21.09	23.74	24.93	25.17	31.43	0.00
% of Other revenues	9.20	8.20	8.18	7.31	7.35	6.65	8.28	10.81
% of ODA	6.05	4.95	4.07	3.32	2.92	2.17	2.01	2.03

Sources: MOF's website, Quang Nam DOF, DPI, estimates by the team

Before 2013, the budget local revenues can cover more than 30% of the total local state expenditures, more or less a half of the budget revenues have been transfer from the national budget, taking the fact that around 20% of the total annual budget revenues have been from “brought forward revenues”. High proportion of the “brought forward revenues” in the total annual budget revenues shows that a big amount of funds have been undisbursed in

the previous year and brought forward to the reporting year. In 2013 the structure of the public revenues become more clear, when the practice of bring forward revenues is expected to be stopped, the revenues from provincial domestic sources is planned to cover 43.8% of the total local budget revenues, while 56.2% of the public budget revenues of Quang Nam is expected to be from domestic sources (see the Figure 2).

Figure 2. Public revenues in 2013



Source: Quang Nam DoF

Borrowing

According to the Decree 141/2003/ND-CP, Regulation on issuance of national and local government bonds, local government are allowed to issue local government bonds. However, Quang Nam hasn't issued local government bonds for its infrastructure development projects.

Investment:

Investment in current price in Quang Nam has been increased continuously for the last eight years, from VND 6286 billion in 2007 to VND 13738 billion in 2012. However, using 2010 price to compare to the investment in 2010 the total investment in 2011 and 2012 has been declined slightly, from VND 11477 billion in 2010 price to VND 11305 billion in 2012 (Table 2).

Table 2: Investment by source, 2006-2012 (VND billions)

STT	Indicator	Current price						In 2010 price		
		2007	2008	2009	2010	2011	2012	2010	2011.0	2012.0
	Total Investment (in current price)	6286	7132	9240	11478	12795.0	13738.0	11477.7	11039	11305
I	State sector investment	3752	4263	7166	7839	9132.0	9729.0	7839.0	7916	8010.9
	To the total investment (%)	59.69	59.77	77.55	68.30	71.37	70.82			
1.	Investment from the SB	1679	1615	2676	4594.6	4433.3	4849.2	4594.6	3886	3998
	To the total investment (%)	26.71	22.64	28.96	40.03	34.65	35.30			
2.	From state credit	279	567	2200	1080.3	2947.3	3252.1	1080.3	2536.6	2675.2
	To the total investment (%)	4.44	7.95	23.81	9.41	23.03	23.67			
3.	From SOEs	1754	2028	2232	2131.5	1751.5	1627.7	2131.5	1493.5	1337.4
	To the total investment (%)	27.90	28.44	24.16	18.57	13.69	11.85			
II	From private sector	1567	1733	1072	2250.2	2553.4	2909.5	2250.2	2197.5	2393.4
	To the total investment (%)	24.93	24.30	11.60	19.60	19.96	21.18			
III	From FDI (1)	797	955	899	1270	989.3	945.3	1270	820	774
	To the total investment (%)	12.68	13.39	9.73	11.06	7.73	6.88			
IV	Investment from other sources	169	180	102	118.5	120.0	154.3	118.5	105.3	127.3
	To the total investment (%)	2.69	2.52	1.10	1.03	0.94	1.12			
Note: (1) Excluding the domestic contribution, only foreign contribution										

Sources: Quang Nam provincial GSO Book

The key investment sources in Quang Nam are from the State budget (around 30%), private sector (around 20%), state credit (around 20% recently, SOEs (around 10%), FDI (less than 10%). Although the funds from government bonds have served as an important source for public investment in Quang Nam, the government bonds haven't been appeared in the official statistics of the province. Therefore,

the data on total investment from the government bonds in Quang Nam is unknown. However, from the Quang Nam DARD and DOH data on agriculture and health sectors we can see that government bonds have taken a very high proportion in the total investment in Quang Nam (Tables 3 and 4), especially for health sector (see Table 4).

Table 3: Investment shares in Agriculture sector by sources (%)

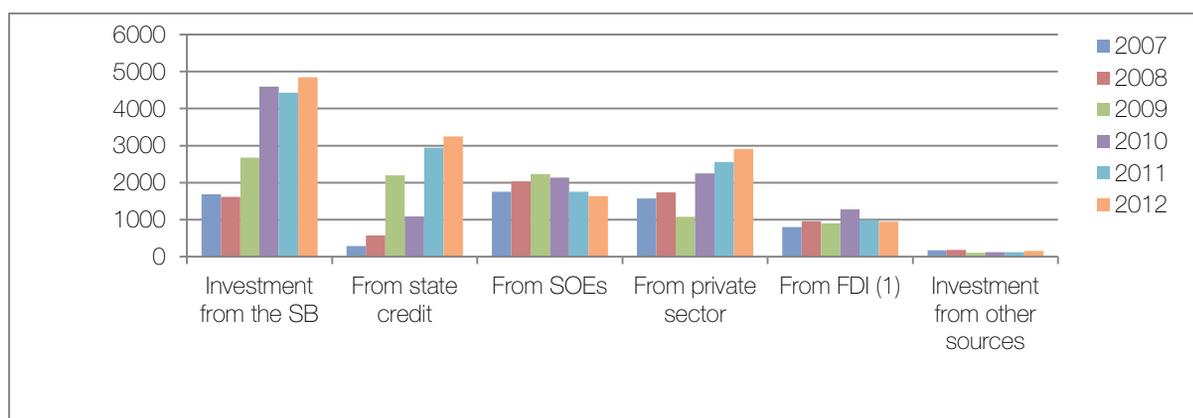
Years	Central budget	Local budget	Govt. bonds	ODA
2010	25.90	25.00	23.86	25.24
2011	15.45	25.36	21.15	38.03
2012	34.89	29.70	0.00	35.40
2013	4.85	61.34	0.00	33.81

Source: Quang Nam DARD

State budget has remained the biggest source for investment in Quang Nam, and increased quickly for the last years from VND 1679 billion in 2007 to VND 4849 billion in 2012 or from 26.7% to 35.3% of the total investment respectively. State credit proportion to the total investment has been grown up with highest growth rate from 4.44% in 2007 to 23.67% in 2012 to

compensate the reduction of investment from SOEs and FDI. The shares of the investment from both SOEs and FDI have been declined sharply, from 27.9% and 12.68% in 2007 to 11.85% and 6.88% in 2012 respectively. The investment from private sector has also been declined, but slightly, from 23.93% in 2007 to 21.18% in 2012 (see Figure 3).

Figure 3. Investment by sources, 2007- 2012



Source: Quang Nam provincial DPI

ODA

Although Quang Nam is a poor province with quite good governance, which belongs to the groups of provinces attracting high attention from various donors to support, the proportion of ODA to the total investment in Quang Nam is much lower than the average one. There is no official data on the ODA by years in Quang Nam, but from the list of ODA projects implemented in Quang Nam for 2001- 2012, the Team estimated that the average proportion of ODA to the total investment in Quang Nam for

2006- 2012 has been around 2%, while the national proportion is more than 4%.

The biggest donor in Quang Nam is World Bank, which provide USD 66.983 million to Quang Nam for 2001-2012, or 48.4% of the total amount of ODA to Quang Nam. JICA and ADB are the second and third big donors with the shares of 11.3% and 8.1% of the total ODA in the province. Most of the ODA projects in Quang Nam are for infrastructure development, including irrigation, water supply and roads.

Health sector

Quang Nam's health sector has been paid higher attention by the government since 2008. The investment in Quang Nam's health sector has increased sharply from VND 11.465 million in 2007 to VND 103.493 million in 2008. The key

source for investment in health development in Quang Nam has been the national government bonds from 2008. It was highest in 2008, 2010 and 2011, accounting for 90.28%, 88% and 89% of the total investment respectively in health sector.

Table 4: Investment shares in Health sector by sources (VND million)

years	Total	Local budget	%	NTPs	%	National budget	%	Govt. bonds	%
2006	16,777.487	5,390.000	32.13	2,362.098	14.08	9,025.389	53.79		-
2007	11,465.168	3,820.191	33.32	4,436.704	38.70	4,436.704	38.70		-
2008	103,493.477	2,833.000	2.74	5,120.721	4.95	2,104.601	2.03	93,435.155	90.28
2009	56,682.608	8,025.639	14.16	974.524	1.72	12,054.903	21.27	35,627.542	62.85
2010	107,085.972	1,303.353	1.22	2.250	0.00	11347.4396	10.60	94,432.929	88.18
2011	83,689.234	1,700.000	2.03		-	7,389.234	8.83	74,600.000	89.14
2012	67,917.091	2,000.000	2.94	13,229.000	19.48	22,688.091	33.41	30,000.000	44.17
2013	46,982.240	9,717.246	20.68	50.000	0.11	14,588.994	31.05	22,626.000	48.16

Source: Quang Nam DOH

Quang Nam has gained quite good achievements in controlling HIV/AIDS. The rate has been controlled under 0.1% of total population. The Centre for anti- HIV/AIDS has been established since 2008. For the last three years the main funding sources for the Centre

have been from the USA's financed LIFE-GAP project and the NTP on Anti- HIV/AIDS. The funds from the provincial state budget could cover the salary for Centre's staff and some training and IEC activities (Table 5).

Table 5. Funding for HIV/AIDS activities in Quang Nam (VND billion)

Funding sources	2011	2012	2013 (planned)
LIFE-GAP project	3.16	3.052	2.8
NTP on Anti-HIV/AIDS	2.13	3.018	2.211
Provincial state budget for salary and operational costs	0.488	1.582	1.757

Source: Quang Nam Centre for on Anti- HIV/AIDS

Recently in October 2013, The “Strengthening Anti- HIV/AIDS capacity to the Great Mekong Delta sub-region (LI 2930-VIE/SFF) has been signed, in which Quang Nam is one of 15 beneficiary provinces of the project.

(Footnotes)

- 1 *World Bank et al., Vietnam Development Report 2012: Market Economy for a Middle-Income Vietnam, Joint Donor Report to the Vietnam Consultative Group Meeting, December 2011, p. 57.*

