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Financing Sustainable Development in Viet Nam

A development finance assessment



FOREWORD

With the overall objective to support Viet Nam's efforts to reform the mobilization, utilization and management of development finance to implement the 2030 Sustainable Development Agenda and achieve Sustainable Development Goals (SDGs), this report "Financing Sustainable Development in Viet Nam" provides an overview of the changing development finance landscape facing the country. Using the lens of the Integrated National Financing Framework (INFF), it analyzes the composition, characteristics and trends of Viet Nam's development finance and development investment resources, with comparisons to other countries mainly from the ASEAN region.

This report finds the acceleration in the development of Viet Nam's private sector, and expanding domestic private finance are key priorities for Viet Nam to meet the financial requirements to achieve the SDGs. Expanding the tax base as a more regular source of revenue, increasing revenue from improved management of State assets, while enhancing the efficiency of government spending and public investment with sound public debt management, are essential to ensuring public finance resources effectively contribute to SDGs achievement. This report also highlights the need to ensure a smooth transition from official development assistance (ODA), better management of interactions between development finance sources, and more effective coordination and synergies among different financial resources.

The intention of the report is to highlight the key challenges and opportunities in mobilizing the right scale and mix of financial resources and to provide insights into how all resources (public, private, national and international) can be better integrated and utilized for financing sustainable development and achievement of SDGs in Viet Nam.



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The views expressed in this report are those of the authors and do not necessarily reflect those of UNDP, the United Nations or any of its affiliated organizations.

Abbreviations and Acronyms

| | |
|--------|--|
| ADB | Asian Development Bank |
| ASEAN | Association of Southeast Asian Nations |
| BEPS | Base Erosion and Profit Shifting |
| BRH | Bangkok Regional Hub |
| CLMV | Cambodia, Lao PDR, Myanmar and Viet Nam |
| DAC | Development Assistance Committee |
| DI | Development Initiatives |
| FDI | Foreign Direct Investment |
| FII | Foreign Indirect Investment |
| GDP | Gross Domestic Product |
| GNI | Gross National Income |
| GOV | Government of Viet Nam |
| GSO | General Statistics Office |
| HCMC | Ho Chi Minh City |
| IFS | International Financial Statistics database, International Monetary Fund |
| ILO | International Labour Organization |
| ILSSA | Institute of Labour Science and Social Affairs |
| IMF | International Monetary Fund |
| INFF | Integrated National Finance Framework |
| JETRO | Japan External Trade Organization |
| M&E | Monitoring and Evaluation |
| MDGs | Millennium Development Goals |
| MIC | Middle-income country |
| MOF | Ministry of Finance |
| MOLISA | Ministry of Labour, Invalids and Social Affairs |
| MPI | Ministry of Planning and Investment |
| MSMEs | Micro, Small and Medium Enterprises |
| MTPIP | Medium-Term Public Investment Programme |

| | |
|-------|--|
| NA | National Assembly |
| NSIS | National Statistical Indicator System |
| ODA | Official Development Assistance |
| OECD | Organization for Economic Co-operation and Development |
| OOF | Other Official Finance |
| PPP | Purchasing Power Parity |
| SCIC | State Capital Investment Corporation |
| SDGs | Sustainable Development Goals |
| SEDP | Socio-Economic Development Plan |
| SMEs | Small- and Medium-sized Enterprises |
| SOE | State-Owned Enterprise |
| TA | Technical Assistance |
| TIWB | Tax Inspectors without Borders |
| UN | United Nations |
| UNDP | United Nations Development Programme |
| UNIDO | United Nations Industrial Development Organization |
| USD | United States Dollar |
| VAT | Value Added Tax |
| VND | Viet Nam Dong |
| WB | World Bank |
| WDI | World Development Indicator, WB. |
| WTO | World Trade Organization |

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Executive Summary

With the overall aim of supporting Viet Nam's efforts in reforming the mobilization, utilization and management of development finance for implementing the 2030 Sustainable Development Agenda and achieving the Sustainable Development Goals (SDGs), this Report "Financing Sustainable Development in Viet Nam" provides an overview of the changing development finance landscape of the low middle-income Viet Nam. Using the lens of the integrated national financing framework, it analyzes the composition, characteristics and trends of Viet Nam's development finance and development investment resources, supporting this analysis by comparisons with other countries (mainly in the ASEAN region).

Though total development finance resources (international and domestic public, international private and domestic private) in Viet Nam have been growing in volume, the development-finance-to-GDP ratio (and total investment-to-GDP ratio) has been declining since 2007. Viet Nam's total investment-to-GDP ratio, used to be the "highest" among ASEAN countries – more than 30% of GDP since 2000, reaching almost 40% of GDP in 2007 - started declining since 2007 and fell to the ASEAN "average" level (less than 30% of GDP) in 2015. The ratio has slightly picked falling up again recently together with Viet Nam's economic growth.

The decline (in the period from 2008 - 2011) slow recovery (during 2012-2015) of FDI-to-GDP and public finance resource-to-GDP and slow increase of domestic private finance-to-GDP ratios (over the reviewed period) have been identified as the main contributions to the decline in Viet Nam's development-finance-to-GDP and investment-to-GDP ratios, given the ratios of ODA-to-GDP, OOF-to-GDP and especially remittances-to-GDP remained rather stable.

The share of Viet Nam's domestic private finance (investment) in total development finance resources (and total investment) is relatively low and slowly increasing compared to other countries in ASEAN. The same finding is noted when comparing Viet Nam with ASEAN countries at a similar level of "low middle income" GNI per capita (1,900USD) suggesting that the relatively lower share of domestic private investment has more to do with the structure of Viet Nam's economy where the private sector and private enterprises remain relatively smaller (according to Enterprise Census 2017, more than 97% of Viet Nam private firms with less than 100 workers, almost 87% with less than 24 workers) while the state sector, state owned enterprises (SOEs) and Foreign Direct Investment (FDI) are relatively larger. The rather "stable" composition of Viet Nam's development finance indicating the slow progress in "restructuring the economy" during 2011-2015. It should, however, be noted that the share of domestic private investment in total investment in Ho Chi Minh City – the growth engine of Viet Nam – is around 65% and comparable to the share of ASEAN countries. Expanding private development finance and investment has been identified by the report as the key priority for improvement in the coming period.

On domestic public finance resources, the report indicates the decline of government non-grant revenue-to-GDP ratio from over 26% in 2006-2008 and 27.6% in 2010, to around 22-23% in 2012 – 2015, and identifies that the decline was caused mainly by the sharp decline in oil revenue (from 30% of total non-grant revenue in 2005 to 12% in 2010 and only 6.84% in 2015) and in revenue

from import and export activities (revenue from import and export activities reduced from 23.64% of total non-grant revenue in 2009 to 14.2% in 2012, 15.83% in 2013 and 17.16% in 2015) as a result of the global financial crisis, GOVN's efforts in stimulating the growth in 2008 and 2009 and the tax reduction as defined in the trade agreements at the end of the reviewed period. The decline in non-grant revenue, together with increased requirements to meet spending obligations, notably for the salary payment of personnel that are in the GOVN payrolls, have contributed to the budget deficits and reduction in public investment, notably from the state budget. It is noted that, within the overall trend of declining non-grant revenue-to-GDP ratio, the share of local government revenues in total non-grant revenue has been increasing fast (from 37.8% in 2011 to 42% in 2015) and the share of the central government revenue decreasing (from 61.2% in 2011 to 58% in 2015). Given local governments' spending tends to be procyclical, the smaller central government's revenue/budget indicates possibly the higher risk of weakening countercyclical power of the central government's spending and investment.

Compared to other ASEAN countries, Viet Nam's revenue-to-GDP ratio used to be highest between 2000-2009. After the above-mentioned decline from 2010, the ratio is now at the ASEAN "average". Ministry of Finance's data shows the overall trend of increasing share of taxes and fees in the total GOVN non-grant revenue from 2005 to 2015: the tax and fee revenue-to-GDP ratio was slightly above 19% GDP in 2015, up from 14% in 2005. It is noted that Viet Nam's share of revenue from taxes/fees in total revenue (more than 80%) and tax and fee revenue-to-GDP ratio are higher than other countries in comparison. On other indicators, such as total volume of revenue, revenue per capita, taxes/fees revenue volume and taxes/fees revenue per capita, Viet Nam's ranks in the CLMV group of ASEAN and "average" among the ASEAN countries in comparison. It is noted, however, that classification and data on revenue from taxes and fees may need to follow the international standards more consistently allowing more precise identification of issues and solutions.

Facing a sharp decline in non-grant revenue as a result of 2010-2015 government borrowing, especially from domestic sources, was used as the main tool to finance budget deficits and prevent a further reduction in public investment. This has led to a sharp increase in (i) public and government debt stocks: the public debt-to-GDP ratio increased from 50% GDP in 2011 to 63.7% GDP in 2016 (making Viet Nam's ratio, once the lowest among ASEAN countries in 2000-2005, highest in 2016), and the government's debt-to-GDP ratio increased from 39.3% of GDP in 2011 to 52.7% GDP in 2016, and (ii) domestic public debt: the share of domestic public debt in total public finance resources has increased from 15.92% in 2011 to 23.49% in 2015 (while the share of the international public debt remained rather stable during the same period). While noting that Viet Nam is not a highly indebted country, and although the level of interest payments on public debt have risen in recent years they are not out of line with other countries in the region, the Report finds that government domestic borrowing, especially through VND bonds issued during the late 2000s and early 2010s with high costs of mobilization and short maturity terms, has put a great pressure on the state budget for debt repayment during 2014-2016. The fact that the major share of GOVN domestic bonds is held by commercial banks (though the share has been decreasing recently)

indicates a source of difficulties for domestic private enterprises to access affordable credits and imposes some additional risks on the financial system, as any sudden fall in the value of government bonds would have immediate, negative consequences for the banks' balance sheets. The implicit guarantees on debt acquired by state-owned enterprises and local authorities presents another important source of risk to debt sustainability. It should also be noted that the government borrowing from Viet Nam Social Insurance, State Capital Investment Corporation (SCIC), Fund for accumulating resources for debt repayment, "idle" fund of the State Treasury, etc. are reaching the limits has been significant and is reaching the limits: as of 31 December 2015 the Viet Nam Social Insurance Fund's total lending to the GOVN reached VND324 trillion, equaling 90% of the total investment of the Fund; outstanding GOVN debt to the State Treasury was VND 157 trillion, affecting the liquidity of the State Treasury system.

The GOVN's international borrowing increased by almost 25% between 2011 and 2015, as a result of increased international borrowing by SOEs with GOVN guarantees (in 2011 the share of SOE international borrowing with GOVN guarantee in total government international borrowing was 17.52%, which increased to 28.8% in 2015). The commercial loans taken by government have, on the other hand, been rather stable (with their share in total government international borrowing reducing) in the same period. ODA loans only account for about 10% of total government international borrowing, equivalent to around 2% of GDP in 2015. It should be noted that Viet Nam is the largest recipient of ODA, in terms of volume, among ASEAN countries: in 2015, Viet Nam received 37 percent (\$3.9 billion) of the ASEAN regional total. The ODA-to-GDP ratio in Viet Nam has been fairly high and for quite a long time: fluctuating around 4% GDP in the early 1990s to 3% GDP in the early 2000s to around 2% GDP between 2011-2015, compared to less than 1% GDP of ASEAN countries. However, ODA flows into Viet Nam have tended to decrease markedly, especially after Viet Nam achieved a level of low middle-income status in 2010. Notably, grant ODA consisting of a very small proportion (around 1% of total ODA) continues to be an important financial resource for technical assistance, capacity building and policy advice has been reducing rather fast, especially after 2012. While ODA flows are decreasing the share of loans which are categorized as less concessional other official finance (OOF) as a percentage of GDP in Viet Nam have tended to increase and been much higher than the percentage in other ASEAN countries in the recent period. As donors are shifting their interest to global public goods such as climate change and green growth, notably, Viet Nam is a recipient of considerable volumes of international public climate finance: in the period 2010–2014, it received the largest amount in the region—around \$5.2 billion, which consists of a mix of small amounts of grant and non-concessional loans and more significant amounts of concessional loans.

In terms of international private finance resources, it should be noted that the volume of FDI inflow to Viet Nam has been increasing fast, especially after Viet Nam joined the WTO. Moreover, such flows have also been rather stable as compared to other countries (except Singapore) in the ASEAN region. However, FDI's share in total investment in Viet Nam (and GDP) has been fluctuating over the period: reducing from 30.4% in 1995 to 14.2% in 2004, increasing again during 2005-2008, reaching 30.9% in 2008 before reducing to and stabilizing around 23.4% of total investment in

recent years. Notably, FDI in manufacturing accounts for almost 70% of FDI to Viet Nam, much higher than in the Philippines (38%) and Indonesia (40%). The flow of short-term portfolio equity to Viet Nam, on the other hand, is still relatively small, fluctuates a lot and has even been declining in recent years. Viet Nam, interestingly, on the other hand, is amongst the top ten countries, second in ASEAN after the Philippines, in terms of receiving remittance flows in the world, with the volume being around 2.5% total global remittances in 2017. Annually, remittances accounted for 6-8% of annual GDP in the period 2006-2017 in Viet Nam, much higher than for other developing countries (which averaged about 1-2% of GDP). Such flows contribute significantly to supporting the country's economic development, increasing its foreign exchange reserves and balancing its current account.

Domestic private finance in Viet Nam has increased consistently since 2000, quadrupling to \$24.2 billion in 2015. This volume is still well below, only around half, the ASEAN regional average of \$46 billion (excluding Singapore), and over \$200 billion less than in Indonesia and the country's commercial investment per capita of \$301 is also less than half the ASEAN average of \$659 in 2015. As a proportion of GDP, it has fluctuated from 8 percent in 2000 to 16 percent in 2007 and 13 percent in 2015. Viet Nam's domestic private finance share of total development finance resources (23 percent) is also lower than the ASEAN average (31 percent). It should be noted that the volume of domestic private investment has tended to increase between 2011-2016 with the average growth rate of 10.3%/year, while the growth of public investment and FDI slowed down during the same period. Viet Nam's smaller private sector and smaller sizes of private enterprises facing more difficulties in accessing affordable credit can be seen as the key reasons for the country's lower levels of domestic private investment.

Looking forward, given this mixed picture of Viet Nam's development financing outlook, the Report identifies key challenges for Viet Nam to continue the rapid growth in some finance sources, expedite growth in other key finance types where the level and trajectory remain low, and most importantly to ensure that the resources can be mobilized and channeled into effective investments that will yield sustainable development results. From the lens of an integrated national financing framework (INFF), the Report identifies the overall challenge for government in developing and implementing an integrated policy and institutional framework that can tackle these challenges in parallel, managing the interactions between development finance sources for leveraging the synergies between them and ensuring that investments across all aspects of the financing landscape contribute toward Viet Nam's achievement of the SDGs.

A key priority is to accelerate the development and investment expansion of the private sector in Viet Nam. In order to accomplish this appropriately, it will be necessary to prioritize the following: (i) to create a level playing field for the domestic private sector including by reforming SOEs and revising FDI policies in a manner which facilitates private firms market entry, by improving their linkages in both domestic and global value chains; (ii) to develop policies and targeted support that helps existing domestic private enterprises to grow in size, enhance their productivity and competitiveness, improve their linkages in domestic and global value chains while simultaneously accelerating a necessary transition from the informal to formal economy; (iii) in addition to the

continued efforts in improving the enabling environment for business, to support domestic enterprises in improving their access to land and credit, as well as their business and technical capacities to adopt new technologies which allow them to take the opportunities and face the challenges offered by Industry 4.0.

To ensure FDI policies become an integrated part of the national development strategy and maximize the positive impact of FDI on national economic growth, society and the environment, the focus of FDI attraction will need to shift from quantity to quality, in parallel to the actions recommended above to accelerate private sector development. It is important to establish clear international standards in terms of technology requirements, domestic content and linkages with technology transfer to domestic firms given much higher priority than it currently is together with compliance with stricter energy efficiency and environmental-safety standards. Strengthened institutional capacity and systems for the rigorous screening, appraising and approval of FDI projects to ensure their adherence to international standards and requirements should also be prioritized. It is also very important for Viet Nam to (i) move away from using tax incentives and other privileges as means to attract FDI, including continuing and strengthening its active participation in international initiatives to address harmful tax practices related to FDI and (ii) limit the harmful competition of using tax and other incentives for attracting FDI between provinces. Instead, it is important for Viet Nam to focus on creating other, much more effective, incentives for attracting high quality and long-term FDI; such incentives, as the international literature and experience indicate, include: high human resource skills and capacities, large effective purchasing power of the population (i.e. large internal market), long-term predictability of the investment regulations, consistent application of the rule of law, political stability, quality infrastructure (notably transportation and utilities) and competitive domestic support services and supplies, etc.

It is also important for Viet Nam to address the challenge of sustainably expediting the growth in government revenues and ensuring that these resources are invested effectively and utilized efficiently. It is recommended that the GOVN continue its efforts to expand domestic revenue from taxation as a more sustainable and reliable source of revenue by (i) introducing new taxes such as property and CO2 emission/carbon taxes; (ii) reconsidering the ceiling on tax and fee revenue-to-GDP ratio, (iii) applying international standards in classifying and collecting data on non-grant revenues from taxes, fees and charges, as this will help identify issues and formulate policy actions more precisely and (iv) reconsidering the application of the “fixed”/“flat” tax rates or the method of using a “flat basis” for calculating tax payable amounts in connection to the efforts supporting MSMEs to grow in size and become formal. It is also recommended that Viet Nam improve the management of state assets as this can “help boost the economy, finance social and economic infrastructure, cover the costs of required maintenance without competing with government budgets, leaving more for spending on health care, education, and other social initiatives”.

Noting that expanding GOVN revenues will be effective only if the government’s budget resources are used efficiently and public investment is effective, it is recommended to improve the effectiveness of government recurrent expenditure as well as the efficiency, transparency and

accountability of public investment. While it is important to continue efforts aimed at streamlining the government apparatus and reducing the large number of personnel on the government salary payroll, parallel actions are needed to ensure higher efficiency of the government apparatus. The possible savings gained by reducing recurrent expenditure on salary payments can offer opportunities to increase state spending on R&D and investing in 21 Century skills that are very necessary for Viet Nam if it is to properly prepare itself to face the challenges and seize the opportunities offered by Industry 4.0. Setting clear criteria and establishing suitable institutional arrangements for prioritization and selection of growth-enhancing public investment projects are recommended as urgent actions to improve efficiency of public investment, in addition to continued efforts in improving management transparency and accountability, and fighting corruption.

Given the rapid accumulation of public debt and its associated risks, it is very important to develop and implement public debt management legislation, strategy, plan and policies as an integrated part of the national development plan and integrated national finance framework (INFF), particularly by enhancing (i) the latter's linkages to SEDP, MTPIP and the three-year Financial and Budgetary Plan, and (ii) their coherence with other legal documents, policies and regulations on the state budget, public investment, enterprises, banking system, Social Insurance Fund and State Treasury (as the major holders of GOVN bonds), among other measures. It is also important to strengthen national capacity to (i) analyze opportunities, challenges, costs and risks in all sources of public debt and borrowings, forecasting and advice on the future borrowing needs and repayment obligations of the GOVN; (ii) developing and implementing mechanisms for monitoring, supervision, control and management of risks of all GOVN borrowings (including by local governments, borrowing with GOVN guarantees and borrowing of SOEs); (iii) closely monitoring and evaluating public debts (including by using standard international definitions and classifications, and M&E indicators in planning and monitoring the public debt) to provide timely and accurate information and data and disseminate these widely to users, following international best practices in public debt M&E and information disclosure.

While it is important to ensure the effective utilization of the currently available ODA resources, it is also recommended that Viet Nam manage the transition to ODA graduation smoothly by developing and implementing exit plans and exploring new resources mobilization opportunities. To avoid a situation in which all concessional lending comes to a halt at the same, Government and donors should work together to develop ODA programs and projects in the next 5-10 years based on the anticipated level of resources and develop a plan for transition from concessional loans. At the same time, exploring new international development finance sources and opportunities such as on climate change adaptation and mitigation, green economy, management of migration, as well as developing new partnership with international private foundations and philanthropic organizations will be needed if Viet Nam is to sustain public investment after graduation from concessional ODA.

It is important to improve both the understanding of and capacity to manage the interactions between development finance sources, not only to limit their negative impacts (such as when capital inflows and pro-cyclical domestic investment de-stabilized Viet Nam's macro-economy in 2007) but also to maximize positive synergies of different development finance resources while ensuring

macroeconomic stability, sustainable debt management and stable economic growth. Such understanding and capacity may also help (i) define more ODA and public investment projects that catalyze new quality FDI inflow and private sector investment projects thus contributing to quality economic growth; or (ii) limit the effect of public investment projects, including by SOEs, in crowding out private investment (including through the latter's "competition" for domestic credit) and (iii) define more public investment projects that can crowd-in private sector investment and support private sector development.

Last but not least, given the number of fragmentation and coordination problems related to decentralization in Viet Nam, urgent actions are necessary to identify and implement solutions to such problems. First, it is important to address the issue of the falling overall rate of public investment as the process of decentralization has unfolded. National budgets and planning for large-scale infrastructure and related investments will need to be strengthened as local governments typically lack the technical capacity to plan and implement such complex projects. One significant disadvantage of subnational public investment is that it tends to be more pro-cyclical than public investment at the national level. In addition, local level public investment associated with subnational authorities are constrained because they are subject to pronounced vertical and horizontal coordination problems which need addressing, including by (i) clearly and adequately specifying the respective division of labour and the roles and responsibilities of central versus local authorities, (ii) applying co-financing arrangements and matching grants, and formal consultation processes that embed representatives of national agencies within local government structures, and (iii) apply (as central authorities in OECD countries do) various forms of conditionality to align national and local priorities: for example, tying the availability of investment resources to a specific timeframe, insisting on counterpart financing from local governments as well as ex-post evaluation of outcomes; and (iv) creating inter-governmental coordination mechanisms at the local level, especially among provinces and cities and within big cities to address the serious horizontal coordination problems that currently exist; in addition to focusing on the quality of local institutions, for example by increasing transparency, reducing fragmentation of local institutions and streamlining decision-making processes.

In the context of fast changing development finance landscape, the policy framework outlined in this report links the priority actions for mobilizing the right scale and mix of resources with the efforts to ensure effective utilization of development resource for achieving SDGs. The report suggests that delivering the development finance agenda as an integral part of Viet Nam's reforms in public finance management, public investment and SOE, development of private SMEs in particular and of the country's strategy toward a more inclusive and sustainable development pathway in general could boost Viet Nam's human development to new heights. Now is the time to act on the identified challenges to realize the country's high aspirations in achieving its ambitious Sustainable Development Goals.

Introduction

Viet Nam's remarkable achievement of Millennium Development Goals (MDGs) is widely acknowledged by the international community. As Viet Nam enters a new development stage as a lower middle-income country and embarks on the 2030 Agenda for Sustainable Development, new and pressing challenges are emerging. Vulnerability is high and changing in the context of the emerging large lower middle class, rapid urbanization and aging population, climate change and international integration. Even among MDGs that have been achieved, disparities between regions and population groups remain. Transitioning to green economy paths will require investment and structural adjustments.

Realizing the visions of the 2030 Agenda and SDGs necessitates Viet Nam find the right scale and mix of development finance. It will involve investments and spending from a wide range of public and private, domestic and international resources and financing instruments and leveraging the synergies between them.

The Addis Ababa Action Agenda calls for countries to establish INFFs that can support cohesive, nationally-owned sustainable development strategies. An INFF offers a prompt for governments to review the policies and institutional structures they have in place and guide on how to do so. It can also be used to support reforms designed to strengthen a holistic approach toward managing and mobilizing all types of financing—domestic, international, public, private—for sustainable development results.

This report aims to support Viet Nam's efforts in reforming the mobilization, utilization and management of development finance using a more integrated approach, taking into the account the fast-changing global and regional development financing landscapes. It draws from and builds on the findings from development finance assessments (ASEAN and ASEAN country – including Viet Nam – levels) undertaken as part of a project to contribute to the ASEAN-China-UNDP Symposium on Financing the Implementation of SDGs in ASEAN, held in Chiang Rai, Thailand (August 2017).

This report adds value by taking the analysis of Viet Nam's *development finance* to a deeper level, based on analytical framework and approaches as well as building on the results of development finance assessments for the ASEAN-China-UNDP symposium. Development finance resources under this “development finance” framework include: public flows (*domestic public*: government revenues – tax and non-tax, and domestic government borrowing, *international public*: ODA, OOF and other international government borrowing) and private flows (*domestic private investment*, *international private*: international domestic private borrowing, FDI, foreign indirect investment (FII) and remittances). In addition, this report analyzes Viet Nam's *development investment* sources, including public investment (by government and SOEs), domestic private investment and foreign investment (FDI, FII). With the advantage of available data based on more standard definitions allowing more consistent international comparisons, the analysis of development investment sources aims to support the analysis of financial development sources.

This report focuses on the analysis of the composition, characteristics and trends of Viet Nam's development finance and development investment, supported by comparisons with other mainly

ASEAN region countries, through the INFF lens. Data and information used in this study were from different sources including: (i) World Bank, International Monetary Fund (IMF) and OECD for international comparisons between countries, (ii) MOF and General Statistics Office (GSO) for a deeper analysis on Viet Nam's development finance and development investment¹, (iii) the “Financing the Sustainable Development Goals in ASEAN” report prepared by Development Initiative (DI) and commissioned by UNDP’s Bangkok Regional Hub for Asia and the Pacific as part of preparations for the ASEAN-China-UNDP Symposium on Financing the Implementation of SDGs in ASEAN, (iv) “Viet Nam - Financing the future with an integrated national financing framework”, a background paper prepared by a team from DI and national consultants, commissioned by UNDP’s Bangkok Regional Hub for Asia and the Pacific as inputs to the symposium report and (v) other research on development finance and investment topics in Viet Nam.

In its first section, the report provides an overview of development finance and investment in Viet Nam. It is followed by sections with more in-depth analyses of characteristics, basic trends and development finance resources over the past 10-15 years. Before the concluding section, this report examines key challenges and provides recommendations through the lens of the INFF.

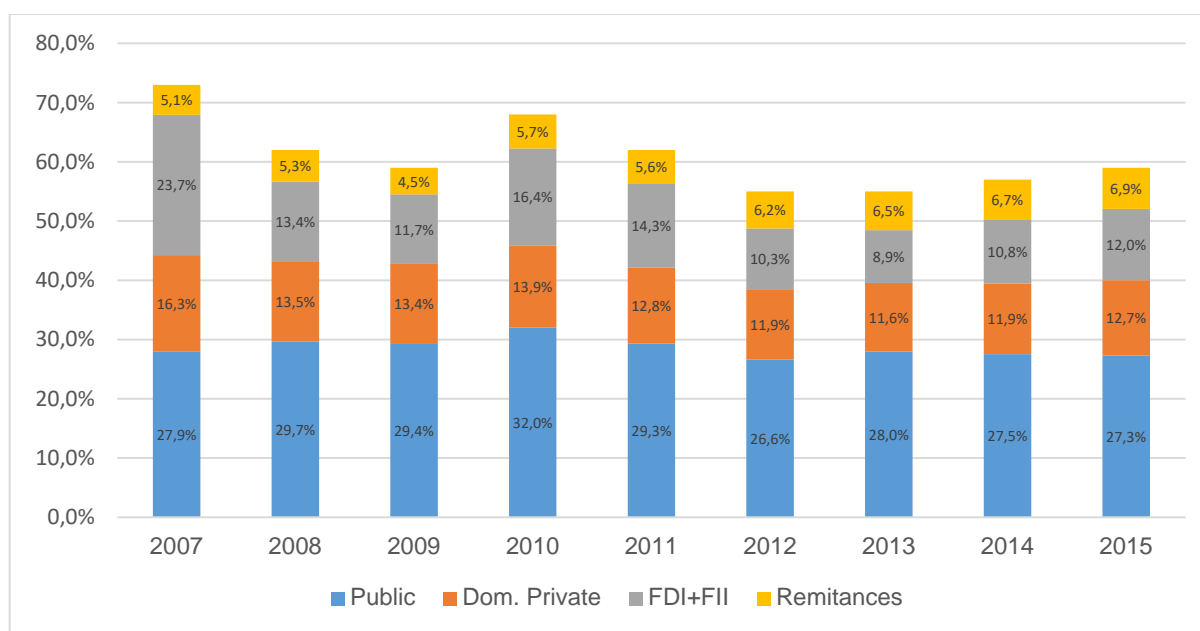
¹ More details on development finance definitions and data used in this report can be found in Annex 1.

1. Overview of Viet Nam's Development Finance

1.1. Development finance sources

All sources of Viet Nam's development finance expanded in volume and created a strong basis for increased investment and expenditure driving relatively high economic growth during the reviewed period. The total development finance-to-GDP ratio in Viet Nam increased rapidly during 2000-2007, peaked in 2007 and then declined. The ratio, despite a rise in 2010, continued to decline during 2011-2013 and slightly recovered in 2014 and 2015 (noting 2015's ratio was a little higher than in 2006).

Figure 1: Development finance resource-to-GDP ratio in Viet Nam



Source: Development Initiatives (2012, 2015, 2017)

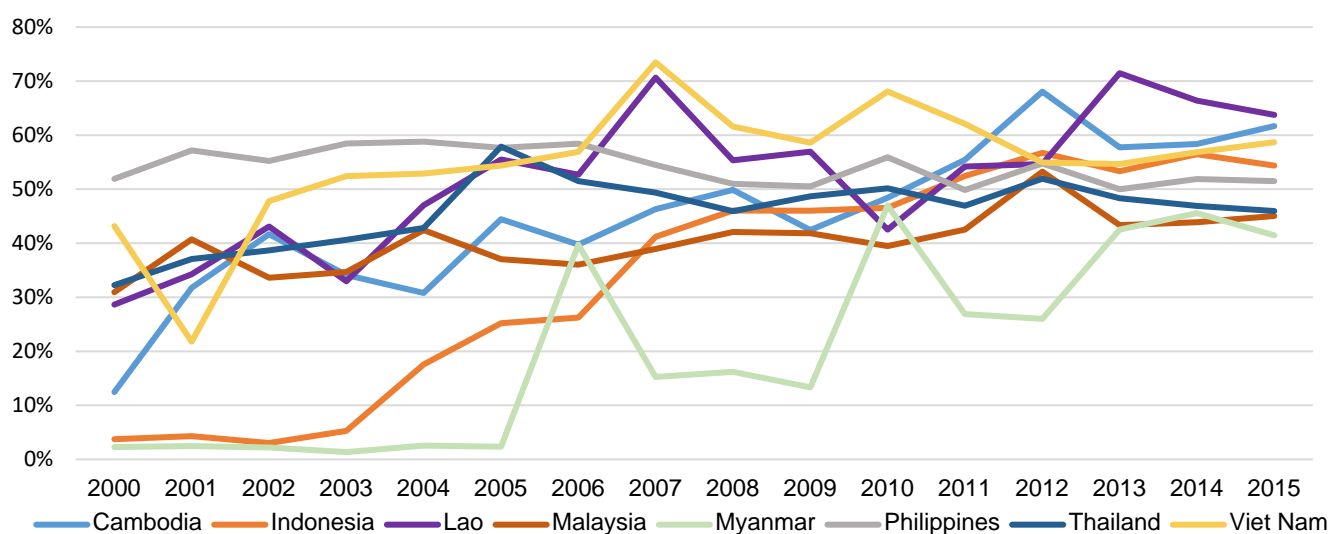
A deeper look at Viet Nam's key development finance components² highlights their roles in the overall trend. Due to the global financial crisis, the FDI-to-GDP ratio fell sharply in 2008 and 2009, recovered in 2010 - but continued to decline during 2011-2013. The ratio slightly recovered during 2014-2015 to sit at 12%, just a little higher than the lowest level of 11.7% in 2009. The domestic private finance-to-GDP ratio followed a similar trend, with fewer fluctuations than the foreign investment-GDP ratio. The government's non-grant revenue from crude oil fell sharply during 2007-2010 and 2012-2015 (due to falling world oil prices) and import-export activities felt substantially in 2012 and 2013. These factors were significant in the decline of total development finance resources during 2007-2015. Despite the government's efforts to offset the decline in these three sources, increased government revenues from taxes, fees and charges and increased government borrowing (especially domestic) were insufficient to reverse the decreasing development finance

² Key components include: (i) public development finance resources (domestic and international sources), (ii) domestic private (investment) resources (domestic and international private sector borrowing) (iii) international private (investment) resources (FDI and FII/portfolio equity) and (iv) remittances.

resource-to-GDP ratio. Post-2010, due to pressures such as inflation, falling world crude oil price and growth rate, the public finance-to-GDP ratio decreased in the same manner as the domestic and international private finance-to-GDP ratios. This may signal the weakening the counter-cyclical (ensuring stable growth against shocks) power of public finance. Among all four financial sources, remittances gained more importance, as the remittance-to-GDP ratio increased and in 2015 stood at 6.9% GDP (Figure 1), with remittances accounting for 11.7% of total development finance resources.

Figure 2: Development finance-to-GDP ratios of ASEAN countries

Unit: % of GDP



Source: Development Initiatives (2012, 2015, 2017)

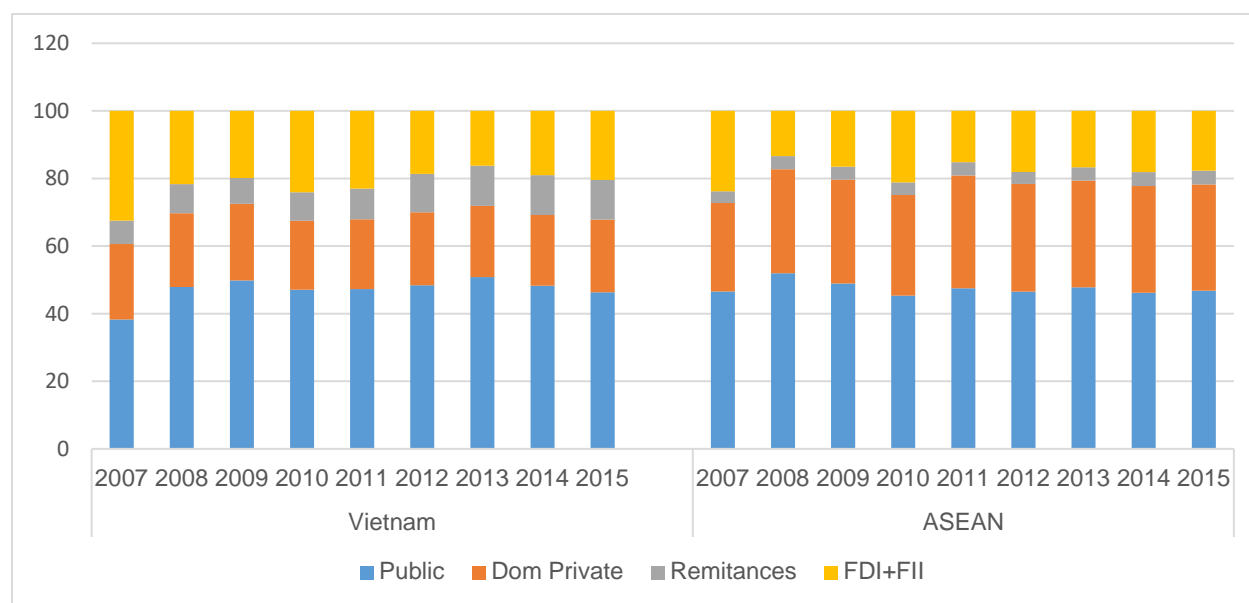
Although Viet Nam's total development finance-to-GDP ratio decreased in recent years (compared to the high levels of 2007-2010), this ratio remains relatively high compared to ASEAN³ countries (Figure 2). By 2015, Viet Nam's development finance-to-GDP ratio was 60% of GDP, only lower than Cambodia and Lao PDR, yet higher than Malaysia and Thailand's ratios at 40% of GDP. Figure 2 also shows a clear trend of convergence in this ratio among ASEAN countries in comparison.

By comparing the composition of Viet Nam's development finance resources to the ASEAN average, it is clear the share of the domestic private finance in total development finance in Viet Nam is relatively low and growing slowly. In contrast, the share has increased in ASEAN countries and offsetting the overall decline in international private finance (FDI and FII) flows, demonstrating the private sector's increasingly important role in these economies. In 2007, the ASEAN average shares of foreign private investment (FDI and portfolio equity) and domestic private finance in total development finance were 23.8% and 26.2%, respectively (5.4% and 40.7% in Indonesia, 5.0% and 30.9% in the Philippines). In 2015, the average ASEAN ratios were 17.7% and 31.4% (3.5% and

³ Please note that "ASEAN" in this report (i) excludes Singapore (an outlier) for making more meaningful comparisons and (ii) in some cases only refers to some countries in ASEAN (specified in the relevant text, figures and tables) used for comparisons in this report.

56.5% in Indonesia, 3.7% and 38.1% in the Philippines), while the share of public sector finance and remittances in total development finance resources were relatively stable (Figures 3a and 3b).

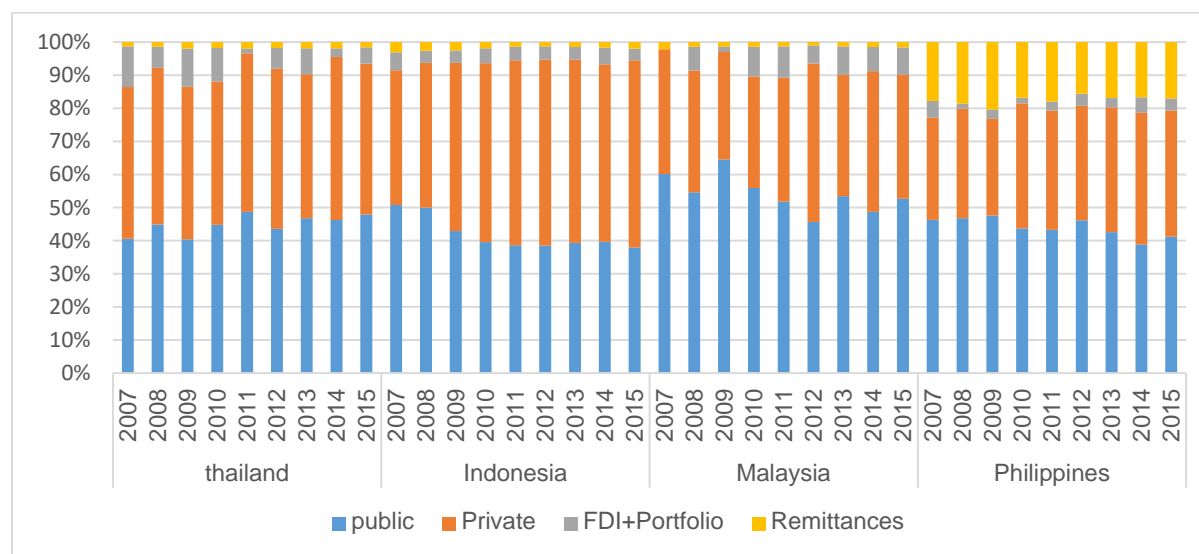
Figure 3a: Development finance composition in Viet Nam-ASEAN average



Unit: % in total

Note: Calculation is based on 2010 USD, Source: WDI, IFS

Figure 3b: Development finance composition in some ASEAN countries



Unit: % in total; Note: Calculation is based on 2010 USD, Source: WDI, IFS

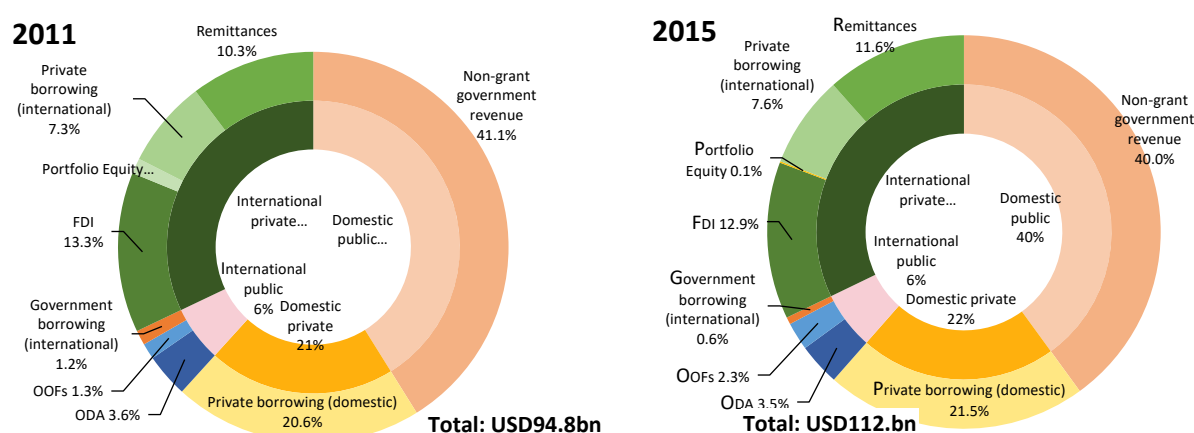
There are two important differences in international and domestic private finance trends between Viet Nam and ASEAN countries/averages (examined in more detail in later sections on FDI, FII and domestic private investment).

- (i) While international private resource flows into Viet Nam have followed the ASEAN region's downward trend, international private resource flows into Viet Nam, measured by the FDI and FII-to-GDP ratio, have exceeded the ASEAN average and ratios of many ASEAN countries.
- (ii) While the share of domestic private sector finance in the total development finance in other ASEAN countries has increased, Viet Nam's share has fallen (21.5% in 2015 compared to 22.3% in 2007). The trend is in step with the decline in international private finance, while in some ASEAN countries the rise in domestic private finance contrasts with a drop in foreign private finance. At the same time, the share of Viet Nam's and the ASEAN average for public finance within total development finance resources have fluctuated at similar levels.

Remittances in Viet Nam account for a significant proportion of overall development finance, significantly higher and increasing relative to the ASEAN regional average, except for the Philippines with its high share of remittances.

Although the volume of development financial resources available to Viet Nam increased during 2011-2015 (by 18.6%, to USD112.4 billion), the mix of resources remained strikingly similar to reflect the evenly balanced nature of this growth. The proportion of domestic and international resources was the same in 2011 and 2015, 62% from domestic sources and 38% from international sources (Figure 4). Viet Nam's mix of resources was also the most stable in ASEAN during the period.

Figure 4: Breakdown of all investment sources in Viet Nam by category and type



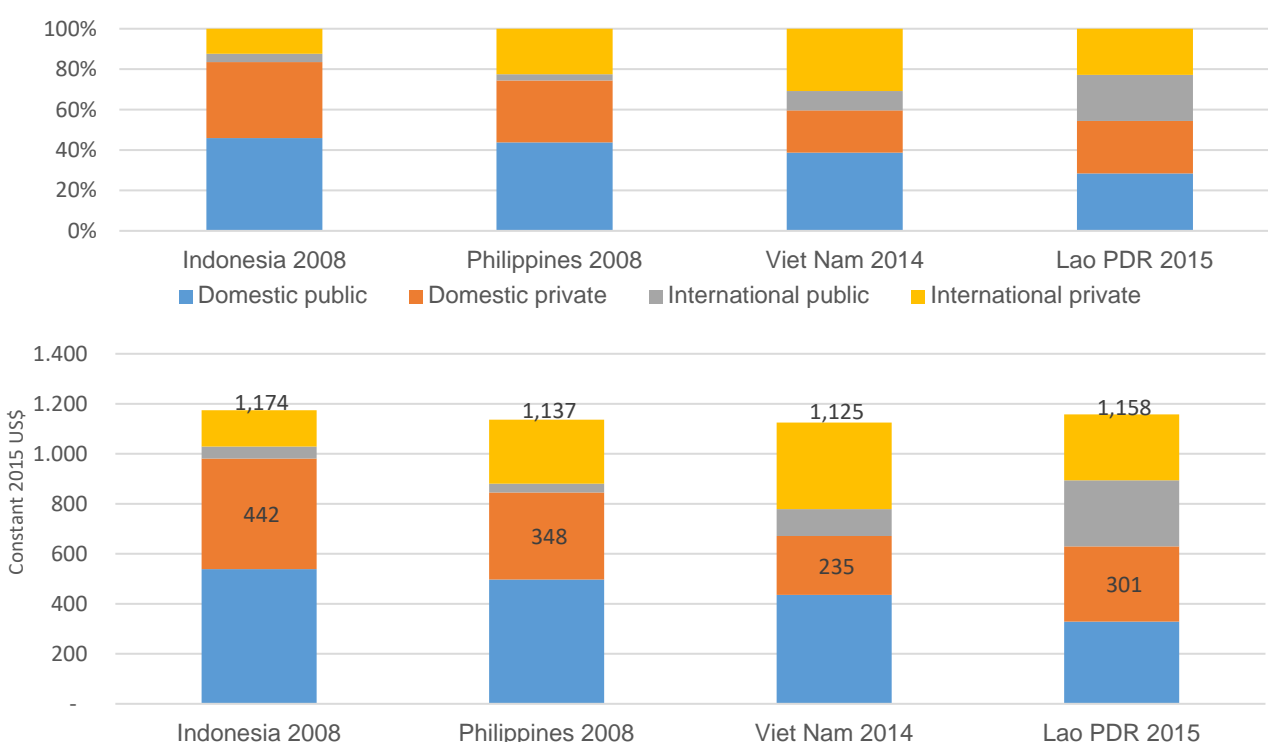
Source: Development Initiatives (2012, 2015, 2017). Note: All figures are constant 2015 USD prices

Remittances changed the most in terms of proportion of total resources, increasing by 1.3% (10.3% to 11.6% of the total). In terms of volumes, OOFs had the highest growth between the two years

(+105%, amounting to USD2.6 billion in 2015), whilst non-grant government revenues increased the most in USD terms (by USD5.9 billion), despite a minor fall in their share of total resources (-1.14%). The ratio of total resources to GDP fell during the period, from 62.1% in 2011 to 58.7% in 2015. However, this ratio has increased since 2013, when it stood at 54.7%.

To explore the relationship between income improvements (measured by GDP per capita) and development finance composition. Figure 5 compares development finance sources in countries at the time of their 'USD1,900 graduation'.⁴ (Indonesia and the Philippines in 2008, Viet Nam and Lao PDR in 2015).

Figure 5: Composition and volume of resources per capita at the time of each country's 'USD1,900 graduation'⁵



Source: Development Initiatives (2012, 2015, 2017)

Volumes of development finance per capita were similar between countries at the times of 'USD1,900 graduation'. The volume of resources per capita was slightly lower in Viet Nam than in

⁴ GNI per capita in Viet Nam exceeded USD1,900 for the first time in 2015 as it did in Lao PDR. Other members of ASEAN had already reached this milestone: Singapore (1974), Malaysia (1981) and Thailand (1993). In 2008, Indonesia and the Philippines saw their GNI per capita rise above that level for the first time. GNI per capita in Cambodia and Myanmar remains less, despite consistent growth in recent years.

⁵ While the classification of domestic private in Figure 5 remains the same as in Figures 1 and 3, please note (i) "public resource" used in Figures 1 and 3 includes "international public" (ODA, OOF and Gov. int. borrowing) and "domestic public" (used separately in Figure 5) and (ii) "international public" used in Figure 5 includes "FDI and FII" and "remittances" used separately in Figures 1 and 3. This difference in classification does not, however, affect the analysis in this section on the composition of development finance, which mainly focuses on "domestic" (public and private) and especially domestic private resources.

other countries, noting that data used for Viet Nam in this figure is for 2014 - one year before GNI per capita reached USD1,900. The composition of resources differed widely between countries, with domestic resources composing more than 80% and domestic private 37.65% of the total in Indonesia, 75% and 30.6% in Philippines in 2008, but less than 60% and 20.8% in Viet Nam in 2014. As shown in Figure 3, differences (shares of domestic and domestic private resources in total resources tend to be higher and play an increasingly important role in other ASEAN countries compared to Viet Nam) have persisted as GDP per capita climbed in ASEAN countries. This indicates differences in the composition of resources are likely more related to variances in economic structure and economic development directions between Viet Nam and other countries, than to the income levels.

1.2. Overview of development investment in Viet Nam

Investment plays an important role in economic growth and development in countries. Maintaining a higher investment-to-GDP ratio is one of the driving forces to ensure robust economic growth. Practical data showed the upward correlation between economic growth rates and the investment-to-GDP growth ratios of countries (Figure 6).

Figure 6: Investment-to-GDP ratio and GDP growth (1970-2016)

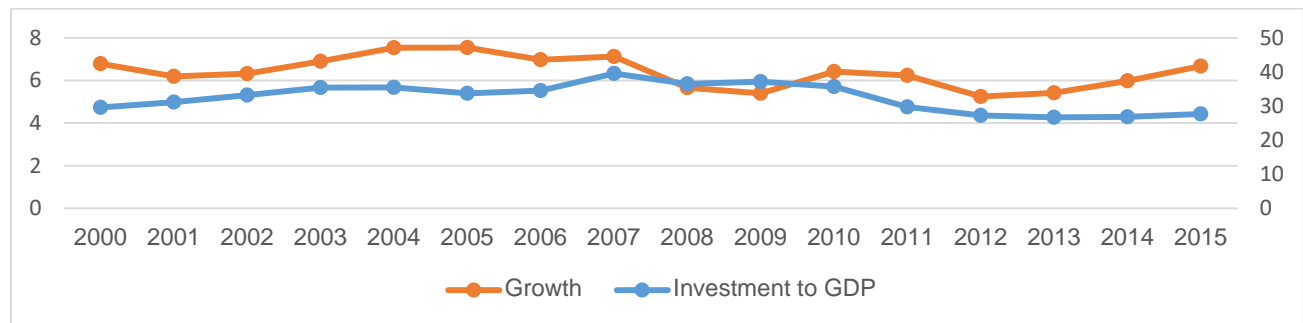


Note: GDP growth is controlled for income per capita, Source: WDI

In line with these trends, investment capital plays a key role in Viet Nam's economic growth. The country's investment-to-GDP ratio increased sharply from 29.6% to 39.5% GDP during 2000-2007 and was also the driving force for economic growth during this period. This ratio declined in the post-2007 period (due to the global financial crisis and Viet Nam's structural weaknesses), before stabilizing in recent years together with economic growth (Figure 7).

Figure 7: GDP growth and investment to GDP of Viet Nam

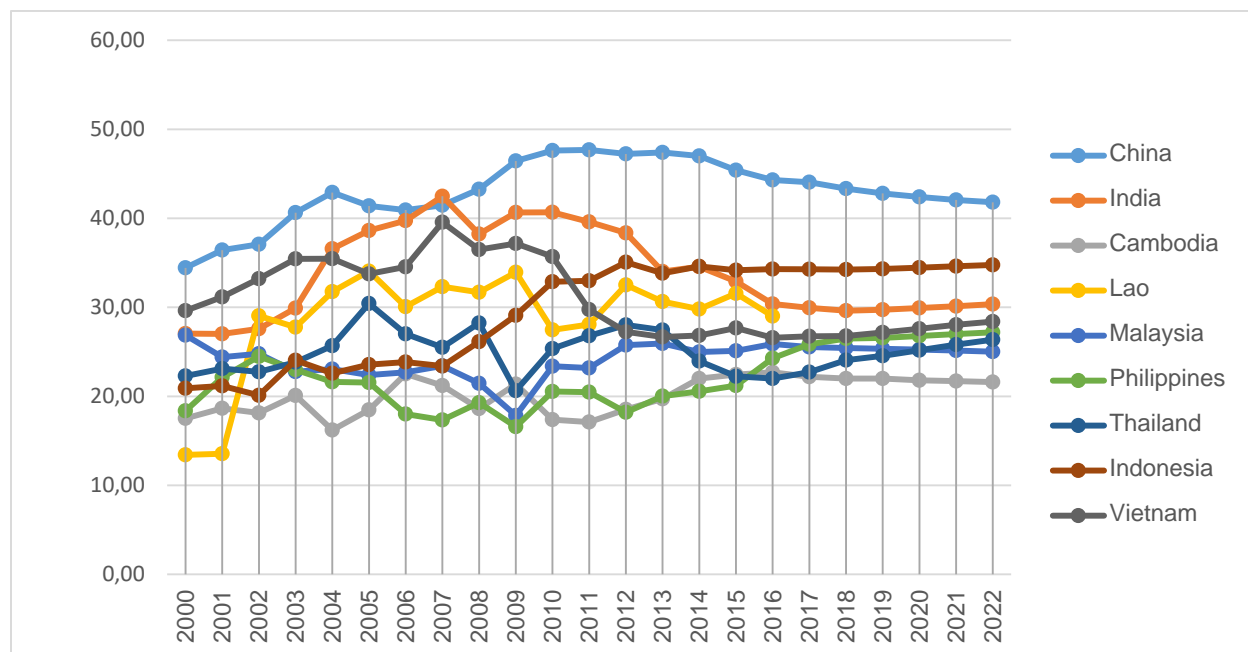
(Unit: % (left); % to GDP (right))



Source: WDI

Figure 8 highlights the total investment-to-GDP ratios of Viet Nam and other ASEAN countries. Viet Nam's ratio of total investment-to-GDP followed the same total development finance-to-GDP ratio trend. The ratio increased rapidly since 2000, peaked in 2007 and began to decline in 2008. This ratio slightly recovered in 2014 and stood at 27.4% in 2015. Viet Nam's ratio was the highest in ASEAN during 2000-2010, but from 2011 was below that of Indonesia and Lao PDR (mainly due to the fast decline in Viet Nam's and increase in Indonesia's and Lao PDR's ratios). Notably, China's ratio was high (more than 40%) for a long period (2003-2015), while India could only sustain a 40% ratio for a shorter period (2007-2012) and no ASEAN countries, including Viet Nam in its best years, could reach and sustain such a high level (Figure 8).

Figure 8: Development investment-to-GDP ratio in ASEAN + 2



Note: based on USD 2010, 2017-2022 estimated by IMF; Source: WDI, IFS

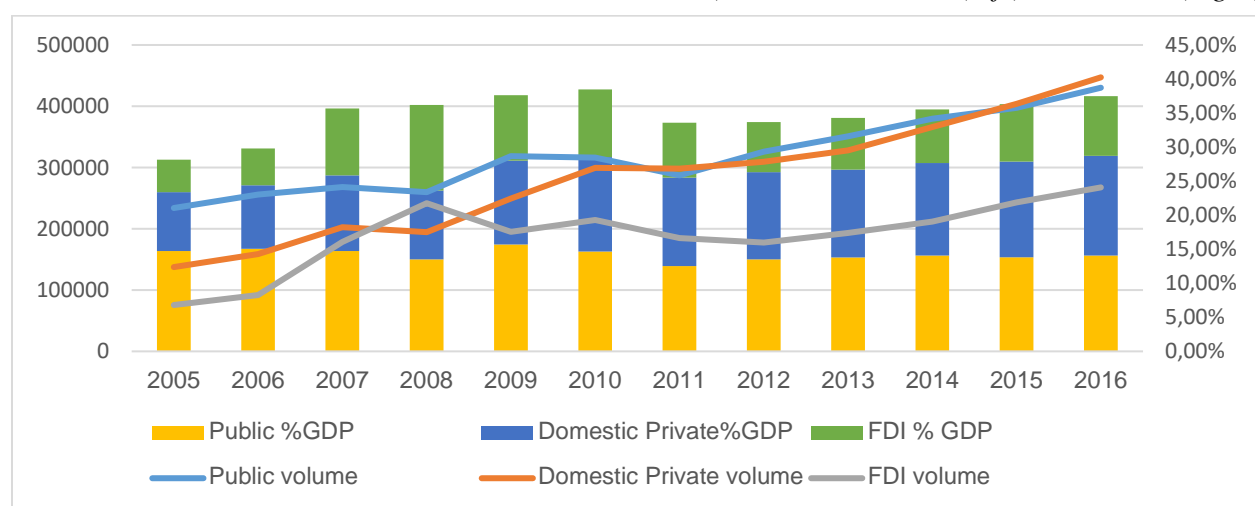
Similar to the total development finance-to-GDP ratio, the investment-to-GDP ratio also tends to converge among ASEAN countries.

According to GSO data⁶ (Figure 9), the volume of total development investment increased during 2005-2016. During the same period, the FDI- and domestic private investment-to-GDP ratios increased (FDI-to-GDP ratio from 4.76% in 2005 to 8.76% in 2016, and domestic private investment-to-GDP ratio from 8.66% to 14.64%) and the public investment-to-GDP ratio remained stable at 14-15%. Notably, the private investment-to-GDP ratio first became the highest in 2011 and then in 2015 and 2016. In 2016, the public sector investment-to-GDP ratio was about 14%, the domestic private-to-GDP (14.6%) and FDI-to-GDP (8.7%).

Notably, within this overall trend, Figure 9 shows big fluctuations in investment sources (in volume and to-GDP ratios) causing macroeconomic instability during 2007-2010. FDI increased sharply in 2007 and 2008, and rapidly reduced in 2009⁷. As a result of government stimulus at the onset of the global financial crisis, private sector investment quickly increased in 2009 and 2010 (in volume and share in GDP) and public investment jumped in 2009 (impacts of these fluctuations on Viet Nam's macroeconomy will be discussed in the last section of this report). Notably, domestic private investment (in terms of volume and to-GDP ratio) increased in step with FDI during 2009-2016. Similarly, public investment (volume and share in GDP) tended to be “pro-cyclical” to other investment sources, especially domestic private, for much of 2005-2016.

Figure 9: Volume and development investment-to GDP ratio of Viet Nam

(Unit: billion VND (left), % to GDP (right))



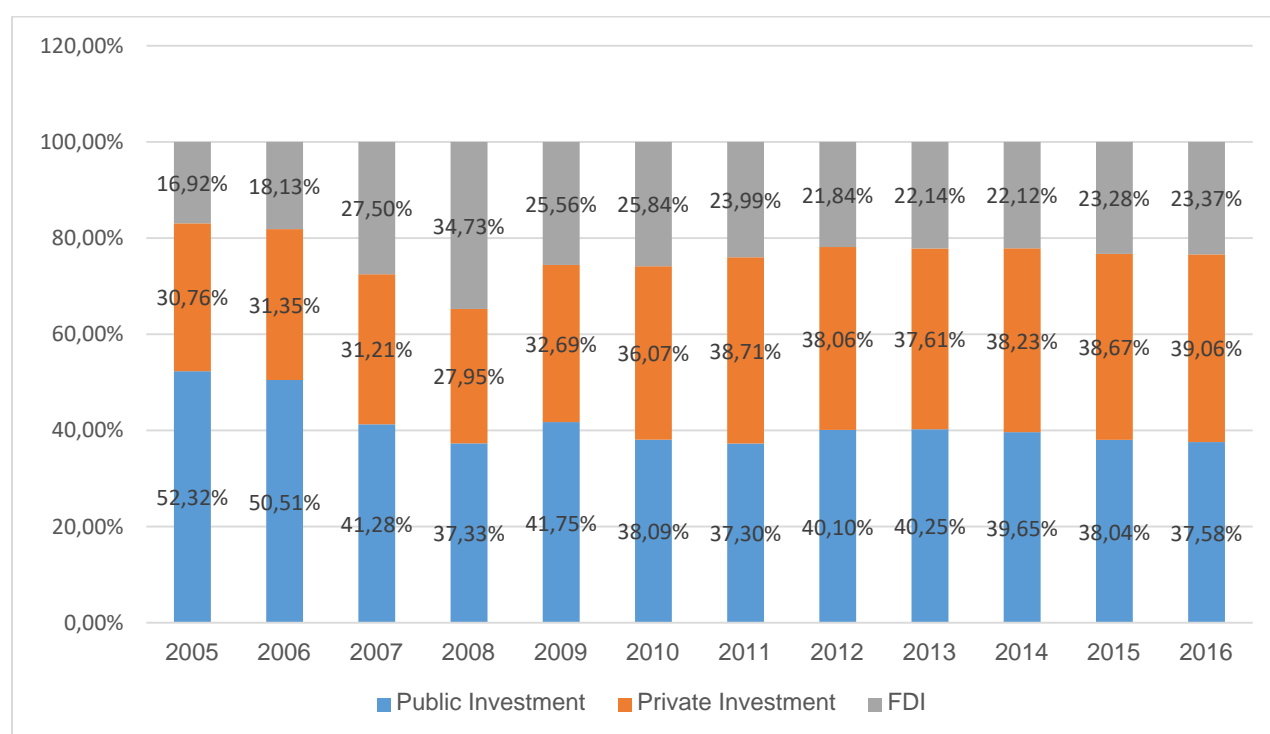
Note: Based on 2010 USD, Source: GSO

⁶ Note: There are differences between figures from GSO and the WB, IMF, OECD and leading to differences in values and trends of total investment/GDP as shown in Figures 7, 8 and 9. The MPI officially reported ratios of investment/GDP are much higher: 33.81% for 2001-2005, 42.7% for 2006-2010 and 31.2% for 2011-2015.

⁷ Noting that FDI has again increased recently, the volume of FDI in 2016 was slightly higher than 2008, but the FDI-to-GDP ratio was only around two-thirds of 2008's level.

Similar to changes in the composition of development investment measured in to-GDP ratio, the shares of different investment sources in the total have shifted towards a smaller share of public investment, bigger shares of private and foreign investment in total investment (Figure 10). In 2005, FDI consisted of 16.92% of total investment, private investment (30.76%) and public investment (52.32%). In 2016, the percentages were 22.37%, 39.06% and 37.58%, respectively, with private investment having the largest share. However, it should be underlined that the increases in volume of all investment sources, especially FDI post-2009, have not been fast enough to bring total investment/GDP during 2011-2016 to levels of the previous period (2001-2010). As such, this may have contributed to lower growth rates in recent years (Figures 7 and 8).

Figure 10: Composition of development investment in Viet Nam, (Unit: % share in total)

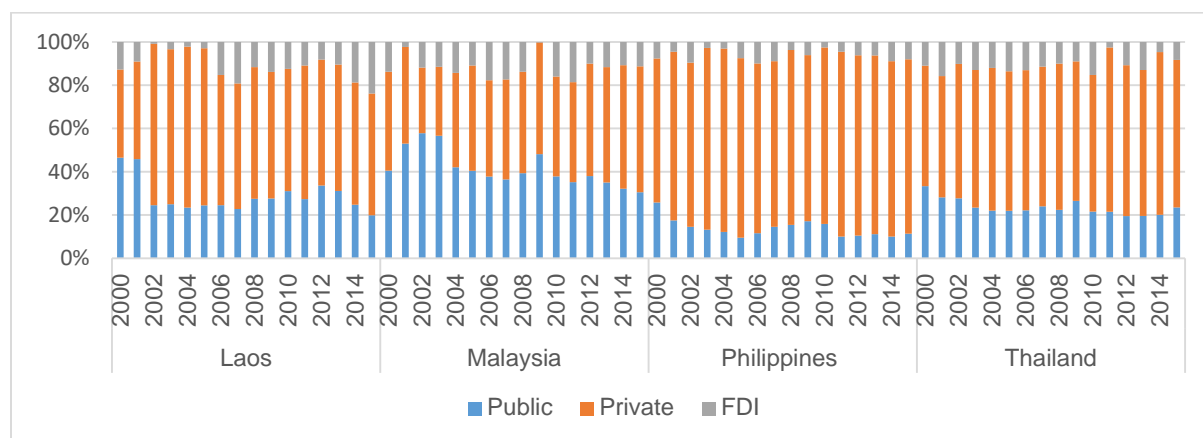


Note: Based on 2010 VND, Source: GSO

Comparing the investment composition of Viet Nam (Figure 10) and some ASEAN countries (Figure 11) shows Viet Nam's lower and slowly increasing share of private domestic investment (and relatively higher foreign and public investment shares) in total investment resources. This is similar to, and thus confirms, differences in development finance compositions between Viet Nam and other ASEAN countries analyzed earlier. Interesting, the investment composition of Ho Chi Minh City - Viet Nam's growth engine and pioneer of national reforms - is more similar to other ASEAN countries. Figure 12 reveals the share of domestic private investment in HCMC's total investment was more than 60% since 2011 (except 2013 when it fell to 59.2%), similar to Thailand's and slightly higher than Malaysia's.

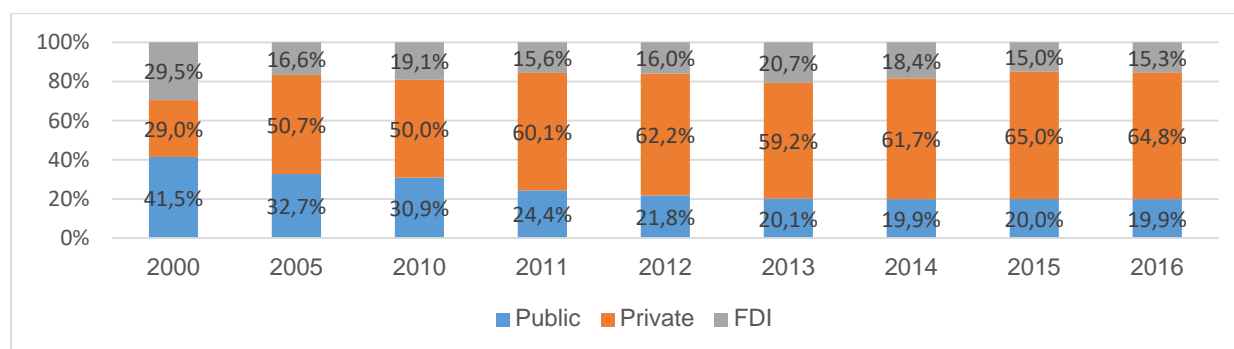
Figure 11: Composition of development investment in some ASEAN countries

(Unit: % share in total)



Source: Development Initiatives (2012, 2015, 2017)

Figure 12: Composition of investment in Ho Chi Minh City, (Unit: % share in total)



Source: GSO

Box 1: What explains the relatively lower share of domestic private investment out of total investment in Viet Nam?

There may be many factors explaining the relatively lower domestic private investment. First of all, as noted earlier, it could be explained by Viet Nam's economic structure with: (i) a larger State sector (notably SOEs) and smaller domestic private sector (according to Enterprise Census 2017, more than 97% of Viet Nam private firms with less than 100 workers, almost 87% with less than 24 workers), (ii) larger proportion of household businesses and micro and small (more labour intensive and less capital intensive) enterprises working in the (relatively larger) informal economy, a smaller number of big private firms/investors (private sector is still in the capital accumulation stage), (iii) public investment relying more on domestic borrowing (*commercial banks hold most government bonds and thus 'crowd out' domestic private investments, which in turn also rely heavily on borrowing from commercial banks*). Other factors may include: (i) data underestimating private domestic investment

(especially/probably by missing investments by households/informal businesses which consist of a large proportion in the economy) and (ii) relatively larger amounts of household savings are kept “under the pillow” – including in the form of foreign currencies and gold. While further research is needed to shed a light on these factors, the government’s actions to reduce the level of government bonds purchased by commercial banks, reduce “dollarization” and “goldization” and actions to improve the business environment, equitize SOEs, support SMEs and promote private sector investment are important steps. Increasing the ‘crowding’ in effects of public investments (by raising private sector investment in infrastructure projects through Public-Private Partnerships, Build-Operate-Transfer, Build-Transfer and mechanisms, and by enhancing the ability of public investment projects to create more profitable business opportunities for the private sector) will certainly contribute to a higher (and more “healthy”) share of domestic private finance/investment in the country’s total development finance/investment.

This analysis of Viet Nam’s development finance and current development investment in recent years highlights some remarkable points, as follows:

- (i) Although the total development finance-to-GDP ratio in Viet Nam has decreased since 2007, it is still high compared to other ASEAN countries. There are signs of a convergence of this ratio among ASEAN countries.
- (ii) Similarly, the investment-to-GDP ratio has been declining since 2007 and especially in 2010, due to the global financial crisis and economic downturn in Viet Nam. While it has increased in recent years, accompanied by a recovery in economic growth, the ratio remains relatively high compared to other ASEAN countries.
- (iii) Viet Nam’s share of public sector finance in total development finance has fluctuated at around 46%, similar to the ASEAN average. The FDI and FII-to-GDP ratio (and FDI and FII share in total development finance) also declined sharply from a peak in 2007, but remains relatively higher than in many other ASEAN countries. Remittances is playing an increasingly important role.
- (iv) The share of Viet Nam's private domestic finance (including international private borrowing) in total development finance and share of Viet Nam’s private investment in total investment are relatively low compared to many ASEAN countries. HCMC’s share of private investment in total investment, however, compares favourably to other ASEAN nations.
- (v) While the volume of public investment has increased pro-cyclically (especially in relation to domestic private investment), the public investment share in total investment declined.

2. Viet Nam’s Public Development Finance

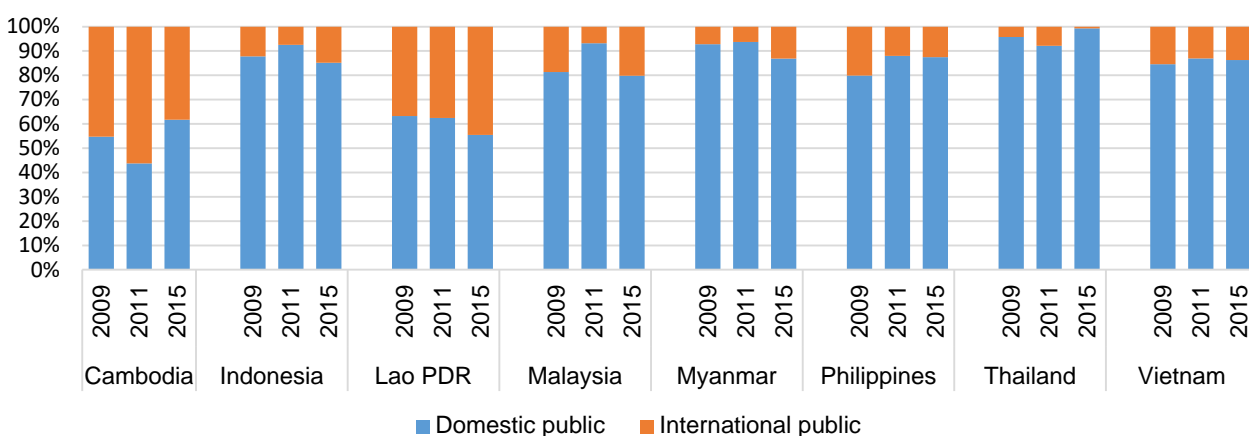
2.1. Public development financial sources

In this section, the report focuses on an assessment of public development finance, encompassing government non-grant revenue, domestic borrowing and international public resources (ODA, OOF and government international commercial borrowing). The first section provides an overview of

public development finance, with subsequent sections examining assessments of each component and respective sub-components.

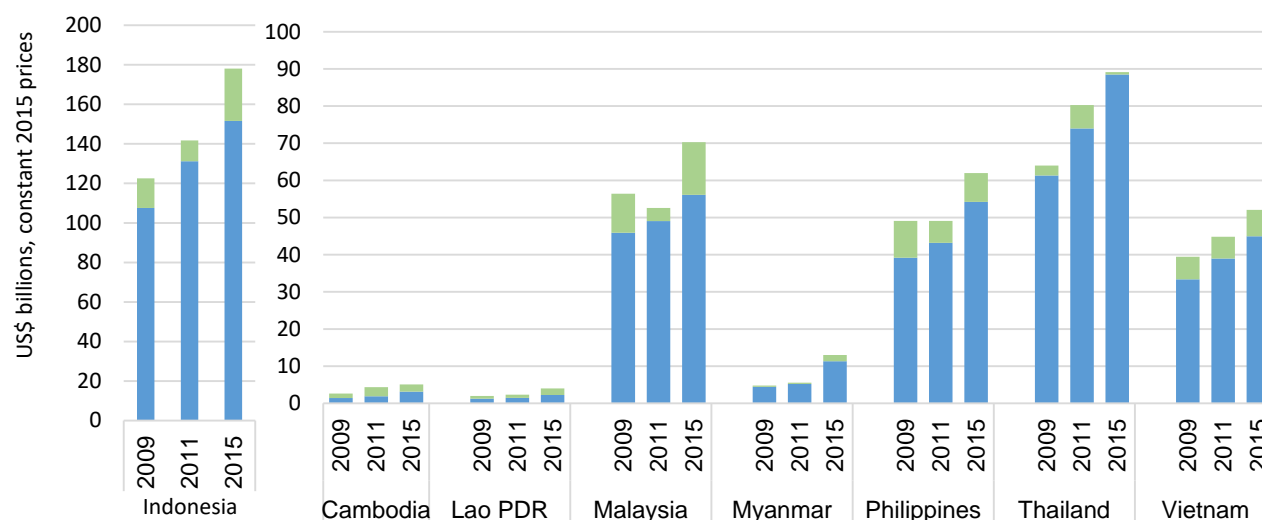
Public finance sources of government non-grant revenues and domestic borrowing account for the major share (87%) of Viet Nam's public finance resources. International public resources, including government commercial loans, ODA and OOF, account for a small proportion (13%) and tended to decrease during 2009-2015. While Viet Nam's volume of public finance is less than Indonesia's, Malaysia's, the Philippines' and Thailand's, its shares of domestic public and international public financial resources are similar to these countries. The share of international public finance in Viet Nam is higher than that in Thailand and similar to that of Malaysia, Indonesia and the Philippines, yet lower than that of Cambodia and Lao PDR (Figures 13a and 13b).

Figure 13a: Composition of public resources in ASEAN countries (2009-2015) (Unit: %)



Source: Development Initiatives (2012, 2015, 2017)

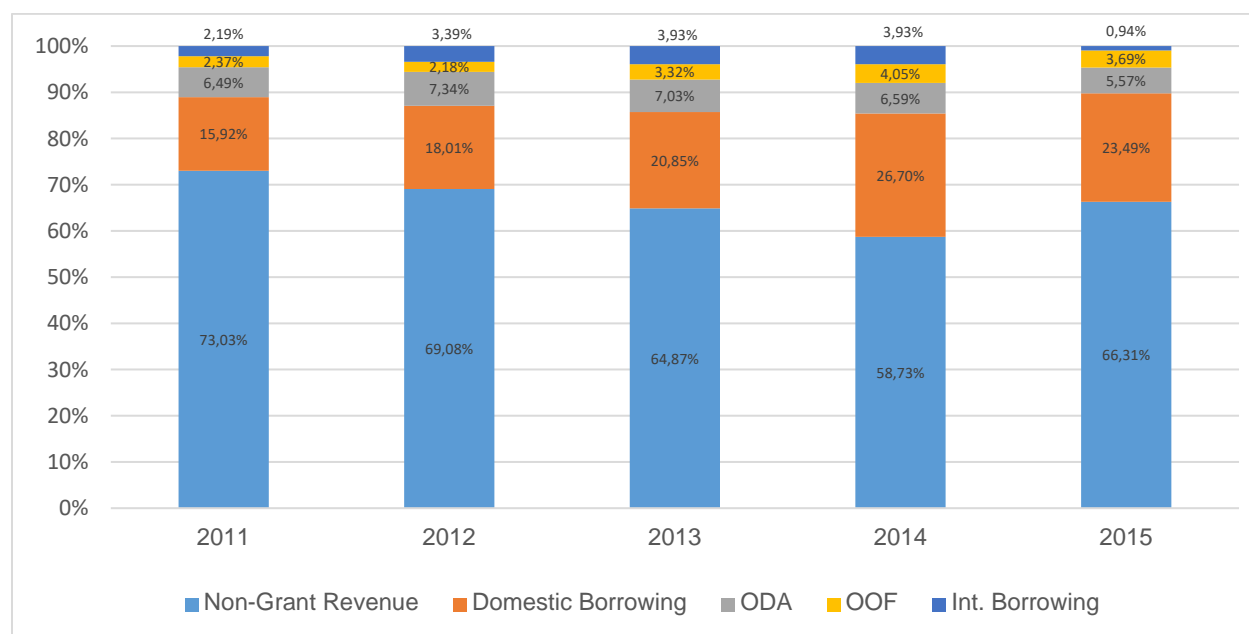
Figure 13b: Volume of resources in ASEAN countries (2009-2015)



Source: Development Initiatives (2012, 2015, 2017) Note: All figures are in constant 2015 prices

More detailed data on public development finance in Viet Nam during 2011-2015 (Figure 14) reveals the share of non-grant revenues in total public finance reduced sharply from 73% in 2011 to 58.7% in 2014, before recovering to 66.3% in 2015. Government domestic borrowing increased rapidly from 15.9% in 2011 to 26.7% in 2014 and only slightly reduced to 23.5% in 2015, contributing to Viet Nam's increasing public and government debt ratios to GDP in recent years. The proportion of international public finance did not significantly change during this period, while the proportion of ODA and government international commercial loans decreased in contrast to a slight rise in OOF.

Figure 14: Composition of Viet Nam's public development finance, (Unit: % in total)



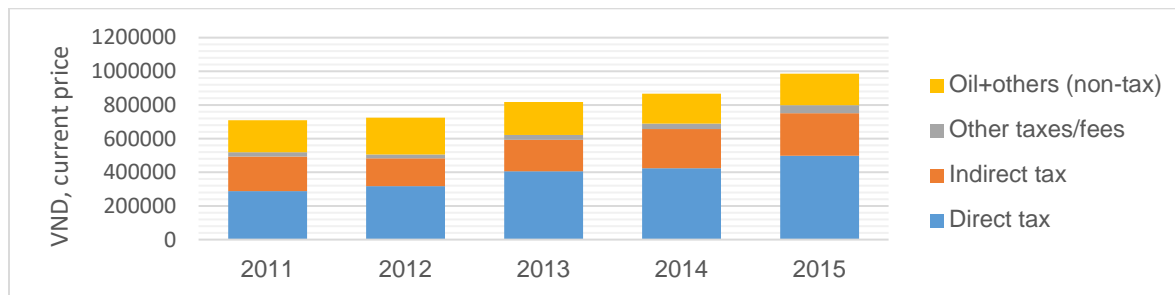
Note: Based on USD 2015; Source: WDI, IFS and MOF

2.1.1. Non-grant government revenue

This report, following its prescribed analytical framework, mainly uses “non-grant government revenue” (which, by definition, will not include revenue from grant aid) in this section. Grant aid will be assessed in later sections on “international public” finance. However, as different sources of available data may/not exclude grant aid from “government revenue”, the assessment will focus on “non-grant government revenue” only. In this section, the report uses “government revenue” (when it is unclear whether data has included grant aid) and “non-grant government revenue” (when grant elements can be excluded). Therefore, to avoid confusion, this report will clearly indicate the measurements/terminologies used, related sources of data and potential differences. It should be noted that due to the small quantity of grant aid, the use of different terminologies only translates into minor differences in results and does not affect the overall picture and trends.

Total non-grant government revenue volumes during 2011-2015 doubled compared to 2006-2010 and non-grant revenue in 2015 jumped by more than 50% compared to 2011 (Figure 15).

Figure 15: Government non-grant revenue by sources (VND current price)

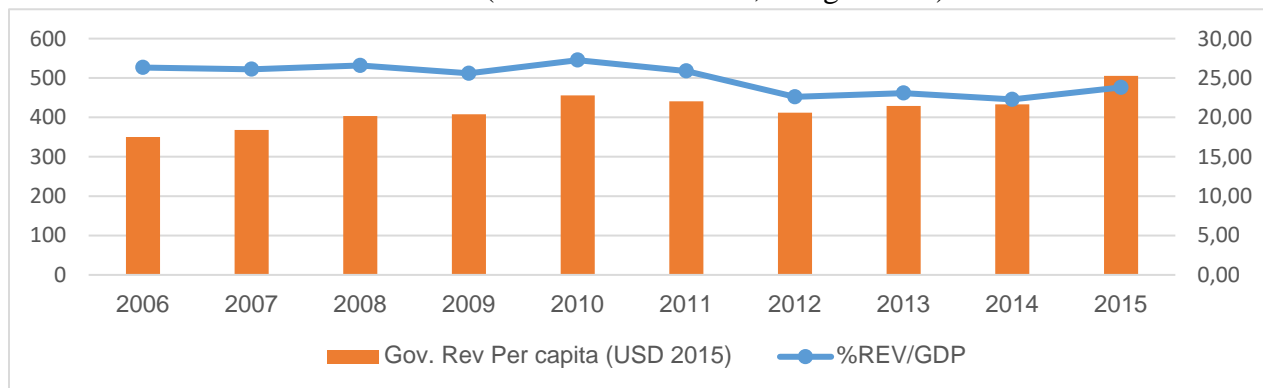


Source: MOF (budget information, MOF website)⁸

Per capita GOV revenue increased from USD350 in 2006 to USD505 in 2015 (calculated based on 2015 USD rates). However, the GOV revenue-to-GDP ratio fell significantly from more than 26% in 2006-2008 and peaked at 27.6% in 2010, to 22.6% in 2012 before picking up slightly to 23.8% in 2015 (Figure 16). MOF data on non-grant revenue paints a slightly different picture compared to Figure 16. MOF data (in which revenue from grant aid is excluded), shows a smaller non-grant revenue-to-GDP ratio (25.5% in 2011, 22.3% (2012), 22.8% (2014) and 23.5% (2015)), but a similar trend.

The government revenue-to-GDP ratio of Viet Nam increased similarly to, but at a higher level than, other ASEAN countries during 2000-2010, notably with a significant decline after 2010 (Figure 17).

Figure 16: Per capita government non-grant revenue and government non-grant revenue-to-GDP ratio (USD 2015 left scale, % right scale)

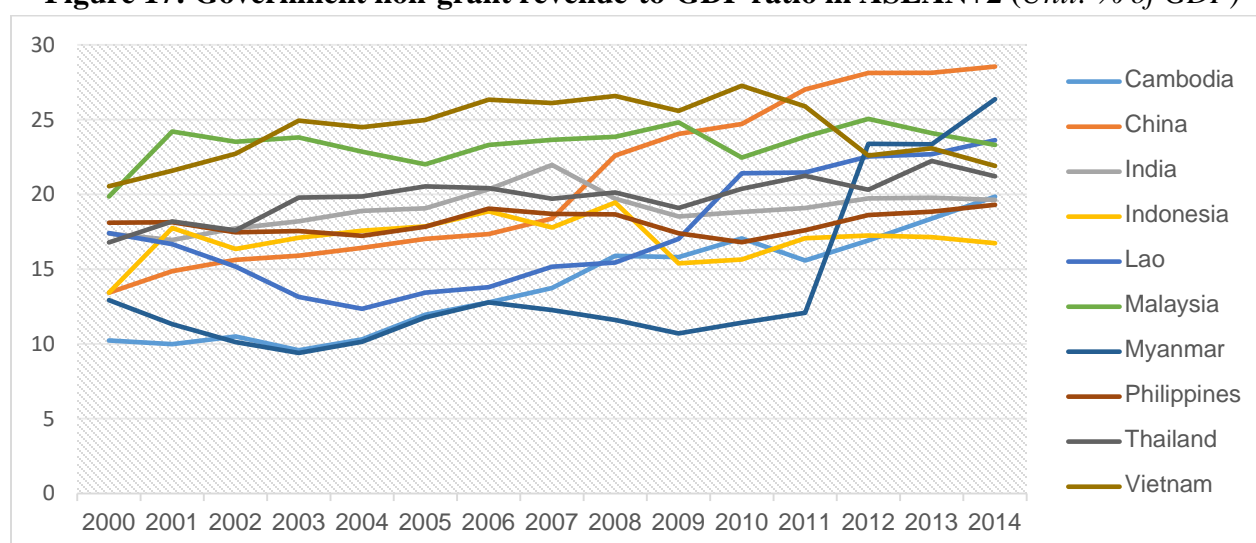


Note: All figures are constant 2015 USD, Source: WDI and IFS

⁸ It is challenging to clearly classify government revenue sources, provided by MOF data, into standard categories of revenue from direct tax, indirect tax, fees and non-tax. For this report, the “revenue from SOEs, FDI and domestic businesses” is classified as “direct tax” (though revenue from SOEs during 2013 may also include dividends from government shares in SOEs), “revenue from import and export” (mainly import and export taxes, taxes on special consumption imported goods, VAT of imported goods), “Personal Income Tax,” “tax on agriculture land use” as “indirect tax,” “revenue from environment tax,” “registration fees” as “other tax/fees” and “revenue from oil, land and houses” and “others” as “oil and non-tax”, noting that oil revenue may also include some taxes.

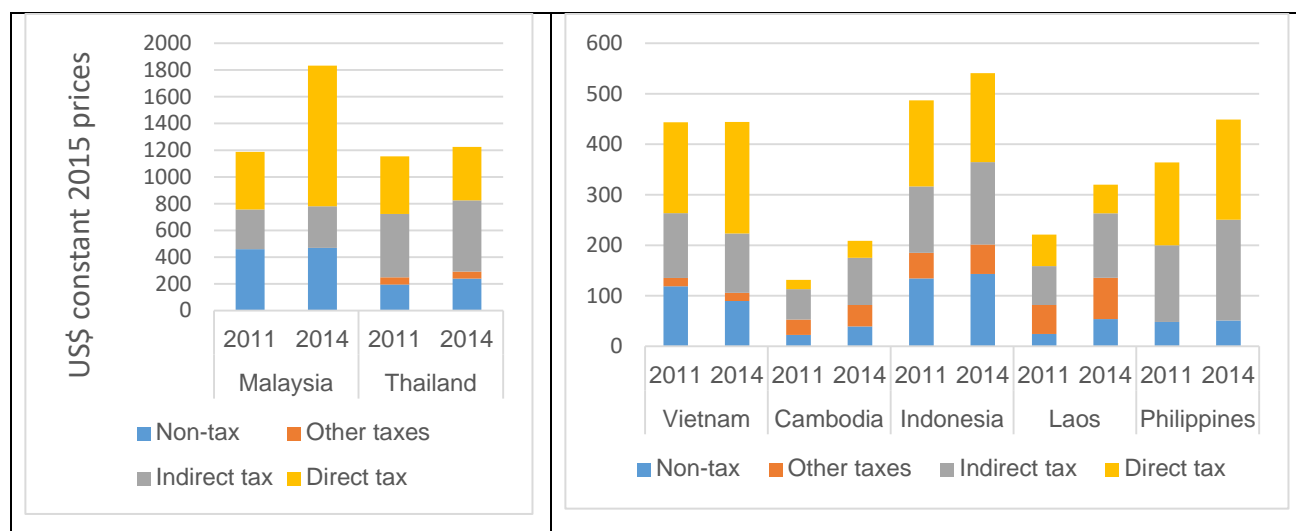
Despite Viet Nam's mobilized resource to non-grant government revenue, measured by to-GDP ratio, being the highest among ASEAN countries, its per capita resources mobilized to government revenue and per capita resources mobilized from taxes-fees ranked only fifth among compared countries. Viet Nam's non-grant government revenue per capita and per capita resources mobilized from taxes-fees were lower than Indonesia's, Malaysia's, the Philippines' and Thailand's in 2014 (Figure 18). The two upper middle-income member states of ASEAN (Malaysia and Thailand) appear to mobilize more per capita resources to government revenue than lower middle-income countries, such as Viet Nam. Table 1 illustrates Viet Nam's ranking (CLMV group of less developed ASEAN countries) and other ASEAN nations in non-grant government revenue per capita, tax/fee revenue per capita, total non-grant government revenue and population in 2014.

Figure 17: Government non-grant revenue-to-GDP ratio in ASEAN+2 (Unit: % of GDP)



Note: All figures are constant 2015 USD prices; Source: WDI and IFS

Figure 18: Composition and volume of government revenue per capita (2011-2014)



Note: All figures are constant 2015 USD prices; Source: Development Initiatives (2012, 2015, 2017). See Annex, data notes

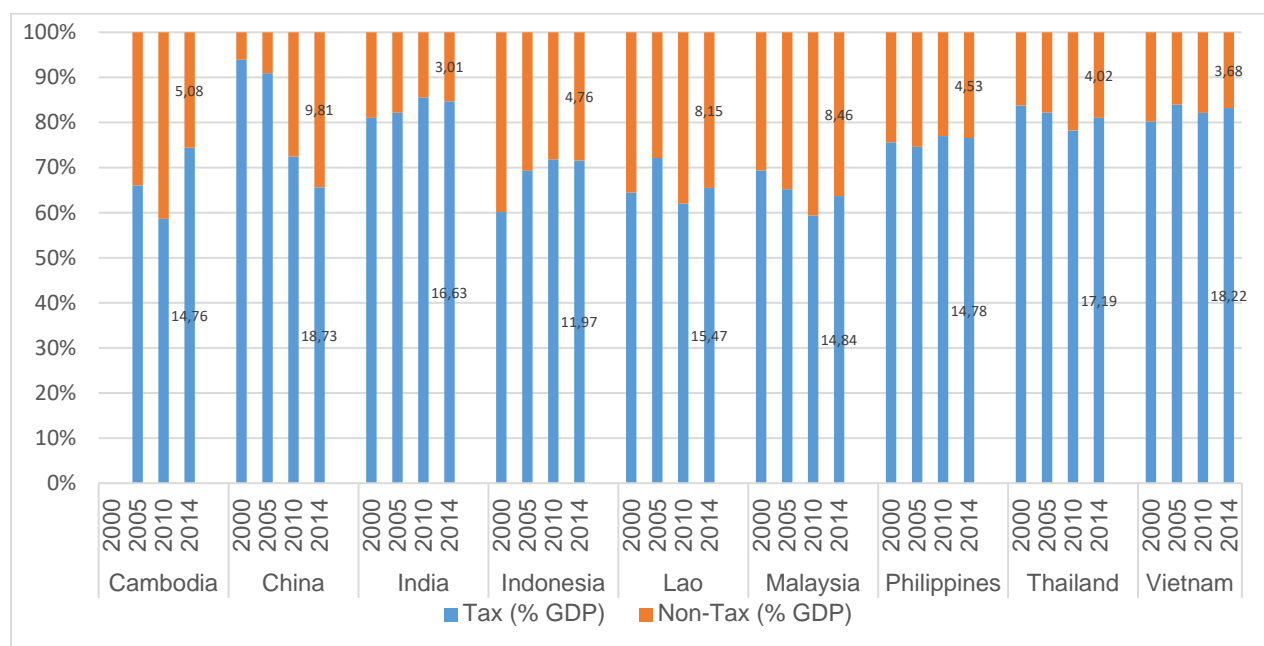
Table 1: Government revenue (total, per capita) and tax revenue (per capita) (2015 USD prices)

| Country | Revenue per capita (USD) | Revenue per capita rank | Tax/fees revenue per capita (USD) | Tax/fees revenue per capita rank | Total revenue (USD billion) | Total revenue rank | Population (million) | Population rank |
|-------------|--------------------------|-------------------------|-----------------------------------|----------------------------------|-----------------------------|--------------------|----------------------|-----------------|
| Malaysia | 1,833 | 1 | 1,364 | 1 | 56.282 | 3 | 30.1 | 3 |
| Thailand | 1,224 | 2 | 932 | 2 | 82.305 | 2 | 67.2 | 2 |
| Indonesia | 541 | 3 | 397.65 | 4 | 136.276 | 1 | 252.0 | 1 |
| Philippines | 450 | 4 | 398 | 3 | 44.978 | 4 | 100.0 | 4 |
| Viet Nam | 436 | 5 | 354.69 | 5 | 39.515 | 5 | 90.7 | 5 |
| Lao PDR | 320 | 6 | 265.90 | 6 | 2.176 | 8 | 6.8 | 8 |
| Myanmar | 256 | 7 | NA | NA | 13.155 | 6 | 51.5 | 6 |
| Cambodia | 206 | 8 | 172.60 | 7 | 3.043 | 7 | 14.8 | 7 |

Note: All figures are in constant 2015 prices; Source: Development Initiatives (2012, 2015, 2017). See annex, data notes

Comparison of GOV's composition of non-grant revenue includes direct, indirect, other tax revenue, fees and non-tax revenue (Footnote 8 provides the working classification of these categories for Viet Nam used in this report) with those of other ASEAN countries, China and India. It shows the share of revenue from taxes and fees (stable sources) in Viet Nam's total non-grant government revenue is higher than comparator countries. Viet Nam's share of revenue from tax-fees was around 83% of total non-grant government revenue in 2014, higher than Thailand's (the second-ranked country's) 80%, China and India. Viet Nam's revenue from taxes and fees-to-GDP ratio was 18.22% in 2014, exceeding Thailand's 17.12% and India's 16.63%, but lower than China's 18.73%. During 2000-2014, the composition of State non-grant revenue showed positive changes with increasing proportions of taxes-fees, especially domestic tax revenues and fees considered more regular and stable revenue sources (Figure 19a).

Figure 19a: Non-grant government revenue-to-GDP ratios of ASEAN +2 countries

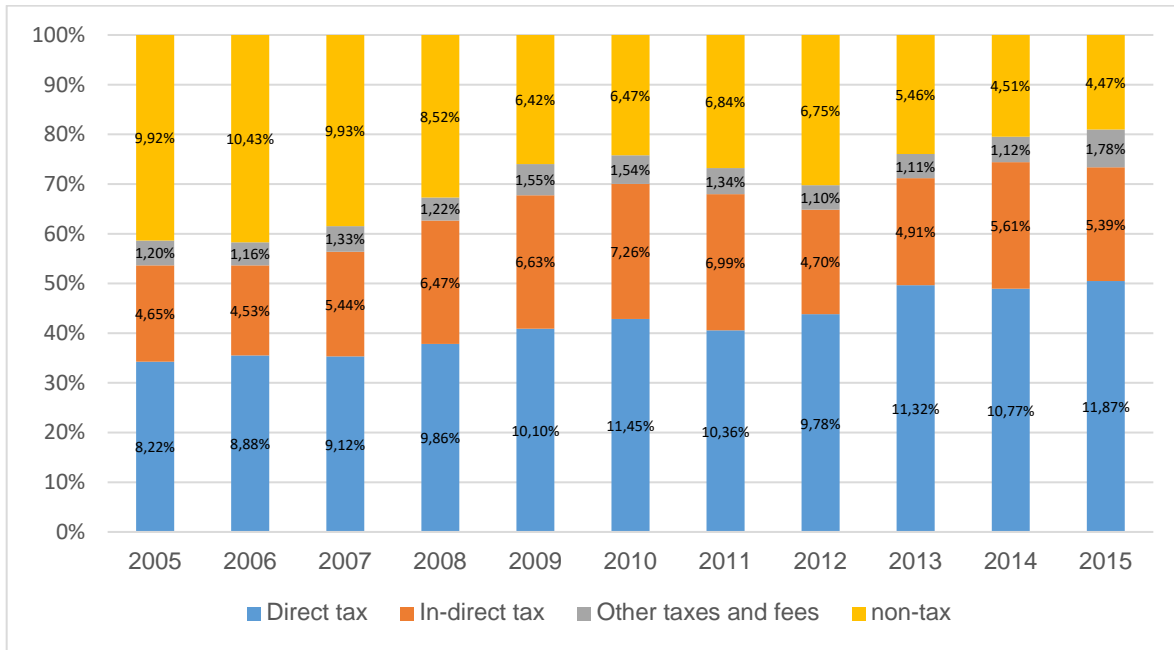


Note: All figures are in constant 2015 USD, Source: IFS

MOF data presents a slightly different picture. With the classification of “oil and non-tax” and tax-fees as explained in footnote 8, Figure 19b shows that revenue from taxes and the fees-to-GDP ratio was around 80% of the GOV’s non-grant revenue-to-GDP ratio in 2014 and 2015, in contrast to around 60% in 2005-2007. While the MOF data confirms the overall trend of increasing shares of taxes-fees in the total GOV non-grant revenue from 2005 to 2015, it shows the tax and fee revenue-to-GDP ratio was slightly above 19% GDP in 2015, up from 14% in 2005 and down from 20.25% in 2010.⁹

⁹ It is noted that the MOF official report, perhaps using classifications for “tax-fees” and “non-tax” revenues different than used in this report, shows the average revenue from taxes and fees-to-GDP ratio in 2011-2015 was 20-21% of GDP and similar to the 22% of GDP ratio during 2001-2005 and lower than 24.8% of GDP in 2006-2010 as well as much higher than presented by IMF sources and calculated based on MOF data using classifications adopted by this report.

Figure 19b: Composition of non-grant government revenue-to-GDP ratio in Viet Nam



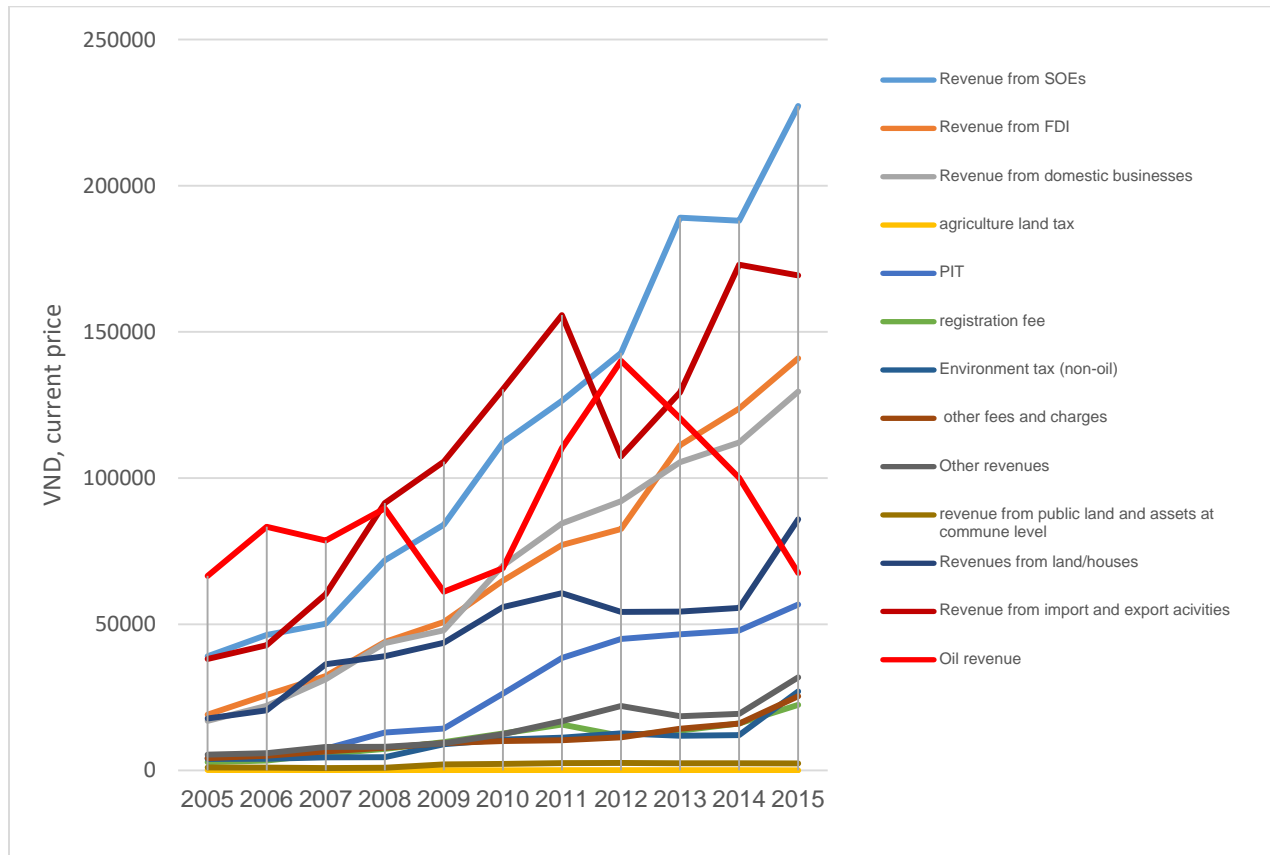
Source: MOF

The volume and composition of non-grant government revenue sources, according to MOF data (Figures 20a and 20b), shows revenue from domestic sources - especially taxes-fees, SOEs¹⁰, FDI, domestic private businesses and personal income tax - increased substantially during 2005-2015. The increase partially offset reductions in revenue from crude oil, which sharply dropped from 30% of total non-grant revenue in 2005 to 12% in 2010 and just 6.84% in 2015 as well as import-export activities (from 23.64% of total non-grant revenue in 2009 to 14.2% in 2012, 15.83% (2013) and 17.16% (2015)). The volumes and shares in total non-grant revenue and other sources (land, other taxes-fees) were relatively small and stable over the period, while revenue from some “other” fees and charges increased slightly in 2013-2015.

Overall, increases in revenue from taxes-fees failed to offset declines in crude oil and import-export revenues post-2010 (due to the global financial crisis) to maintain a high level of non-grant revenue to GDP in 2010 and previous years (Figure 20c).

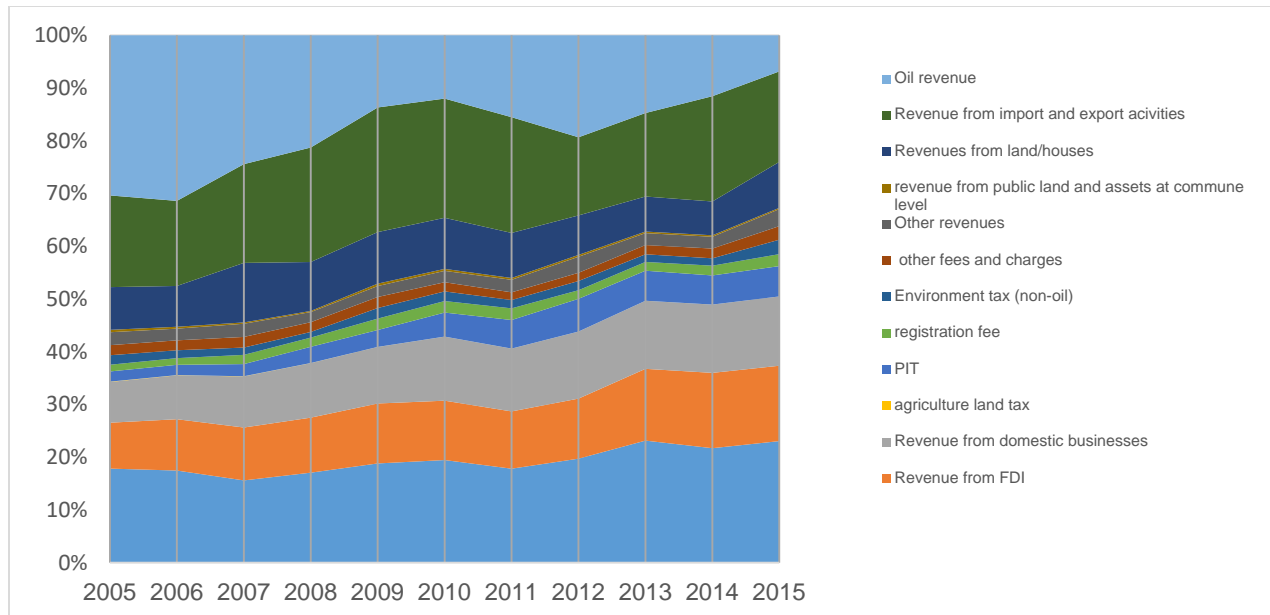
¹⁰ MOF data used for this study does not separate dividends from State-owned shares in shareholding companies and profits from 100% SOEs – a non-tax revenue source – from other (tax) sources of revenue from SOEs. Therefore, since 2013, “revenue from SOEs” includes non-tax amounts.

Figure 20a: Non-grant revenue by sources (VND, current price)

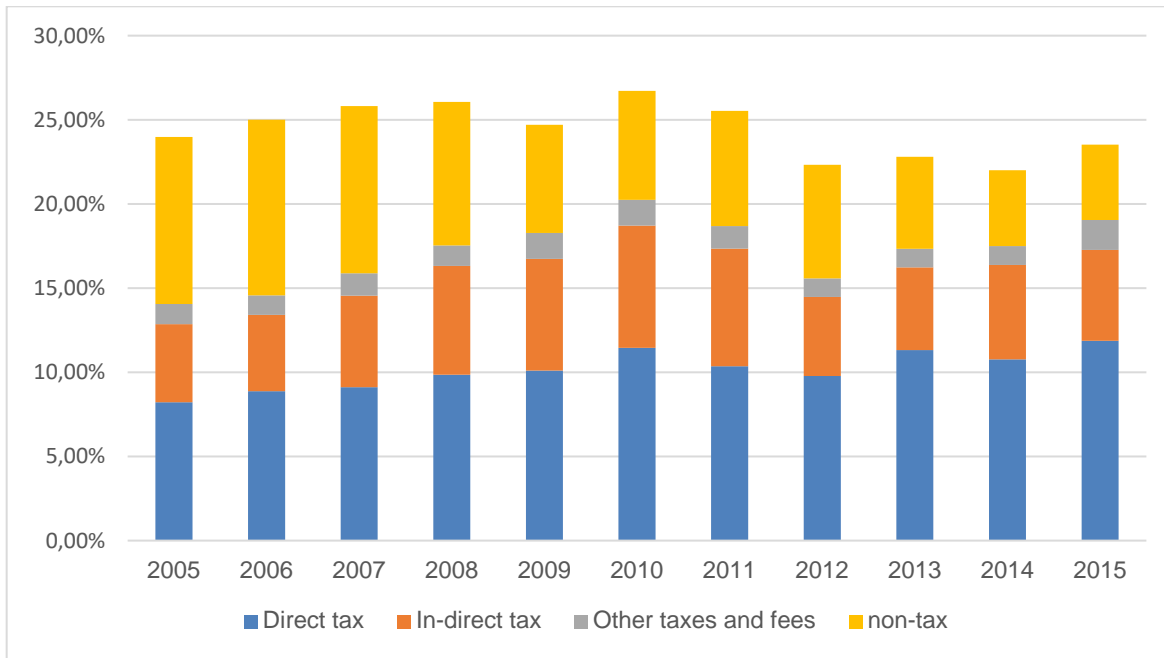


Source: MOF

Figure 20b: Shares of sources in total non-grant revenue



Source: MOF

Figure 20c: Non-grant revenue-to-GDP*Source: MOF*

During 2006-2010, local governments' average share of total non-grant revenue, from sources shared by central-local governments under the decentralization policy, was 32.4%. During 2011-2015, this share rapidly increased from 37.71% in 2011 to 41.95% in 2015 (Nguyen Trong Nghia, 2017). Accordingly, the share of central government non-grant revenue fell from 62.29% (2011) to 58.05% (2015), indicating weakening central government influence in big project investments to address key infrastructure bottlenecks and boost national economic growth as well as counter-cyclical spending/investment (while local government spending tends to be pro-cyclical).

Table 2: Non-grant revenue from shared central-local government sources due to decentralization

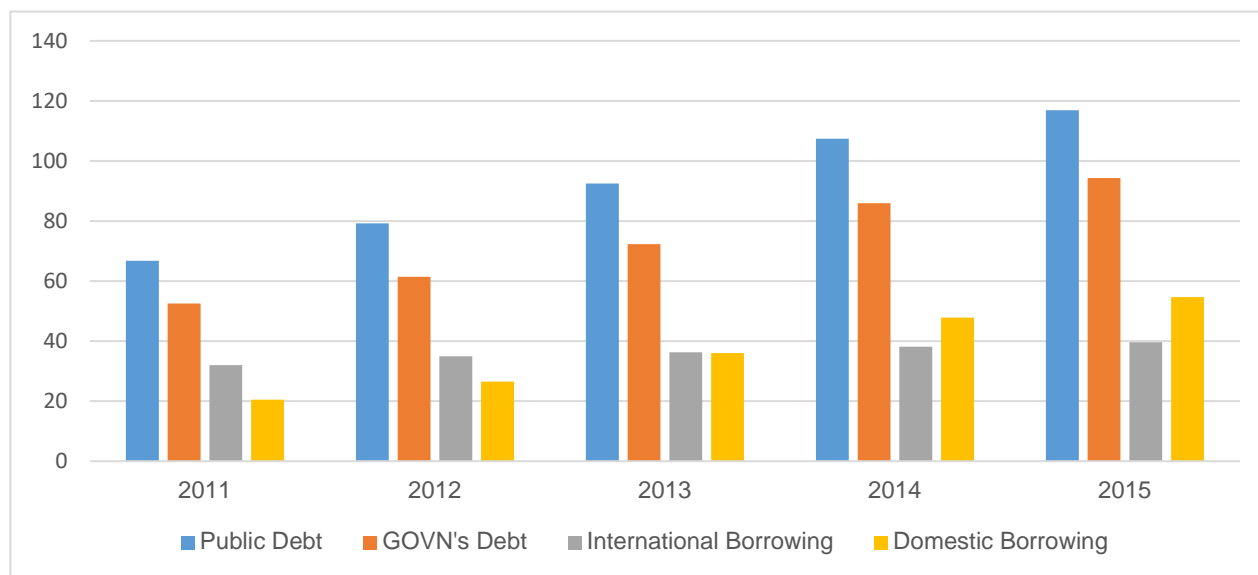
| | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|-------------------|-------------------|-------------------|-------------------|-------------------|
| Total non-grant revenue (billion VND) | 709,701.00 | 724,916.00 | 817,224.00 | 866,647.40 | 986,373.30 |
| Central government non-grant revenue | 442,048.00 | 443,935.00 | 505,658.00 | 528,440.00 | 572,622.20 |
| Local government non-grant revenue | 267,653.00 | 280,981.00 | 311,566.00 | 338,207.40 | 413,751.10 |
| Central government non-grant revenue share in total | 62.29% | 61.24% | 61.88% | 60.98% | 58.05% |
| Local government non-grant revenue share in total | 37.71% | 38.76% | 38.12% | 39.02% | 41.95% |

Source: Nguyen Trong Nghia (2017)

2.1.2. Public domestic borrowing

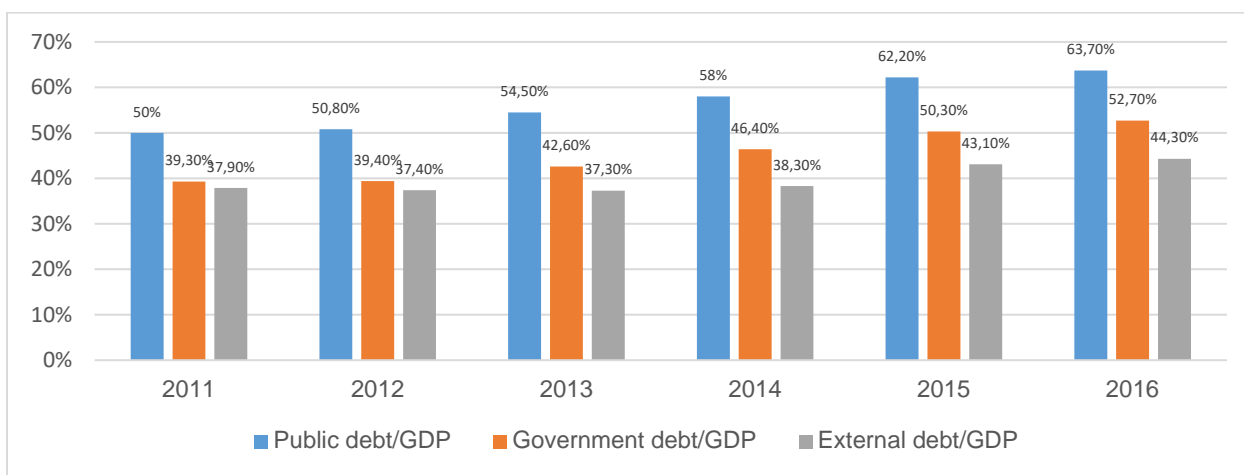
Under pressure from reduced government revenue, as analyzed earlier, government borrowing was directed to beef-up public resources to manage chronic government budget deficits¹¹ and maintain public investment in the context of weakening FDI and slowly growing domestic private investment.

Figure 21a: Viet Nam's public debt stock in 2011-2015 (Unit: billion USD)



Source: 5th Debt Bulletin, MOF (2017d)

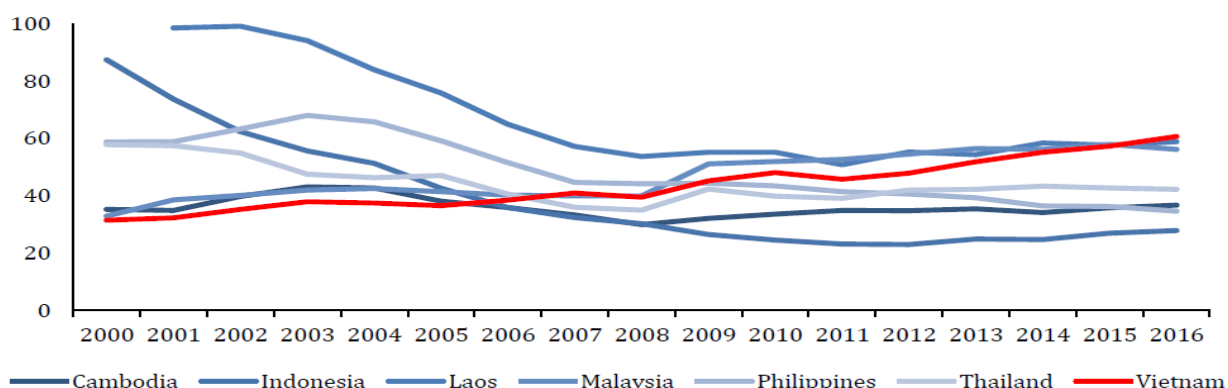
Figure 21b: Public, government and external debt stocks as percentage of GDP in Viet Nam



Source: 5th Debt Bulletin, MOF

¹¹ Viet Nam recorded a government budget deficit equal to 4.20% of the country's GDP in 2016. The government budget deficit in Viet Nam averaged 2.71% of GDP from 1988 until 2016, with an all-time high surplus of 1.20% of GDP in 2006 and a record high deficit of 9.90% of GDP in 1988. <https://tradingeconomics.com/vietnam/government-budget>

Figure 21c: Public debt stock-to-GDP ratio (% GDP) of Viet Nam and some ASEAN countries



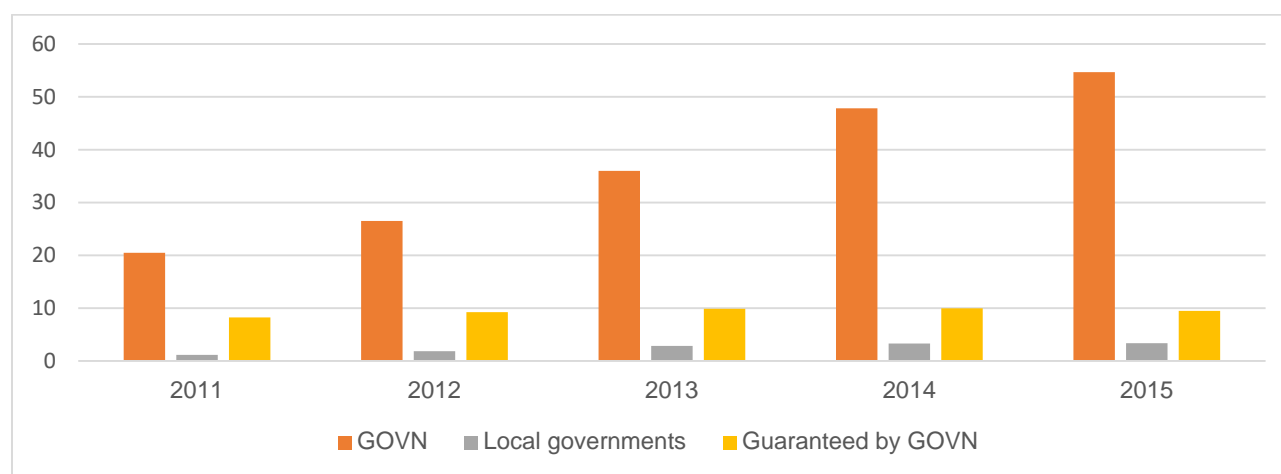
Source: IFS (2017), World Economic Outlook Database

Figures 21 (a, b and c) reveal that Viet Nam's total public debt has risen quickly in terms of absolute volume and public debt-to-GDP ratio compared to other ASEAN countries. The public debt-to-GDP ratio increased from 50% in 2011 to 62.2% in 2015 and 63.7% in 2016, while the government's debt-to-GDP climbed from 39.3% (2011) to 52.7% (2016). Notably, government debt comprised a major and increasing share of public debt, from 78.7% in 2011 to 80.6% in 2015.

Furthermore, Figure 21c shows that while Viet Nam's public debt-to-GDP ratio was lowest among ASEAN countries during 2000-2005, it was the highest in 2016 (60.7%).

Borrowing with GOV guarantees has been substantial, yet stable and local governments' domestic borrowing (including re-lending from central government), has risen sharply despite its small share in total government domestic borrowing (Figure 22).

Figure 22: Outstanding public domestic debt (2011-2015) (Unit: billion USD)



Source: 5th Debt Bulletin, MOF (2017d)

Within the overall trend of increasing public and government debt, as Figure 14 shows, GOV domestic debt comprised the major share of total government debt, while in total public finance

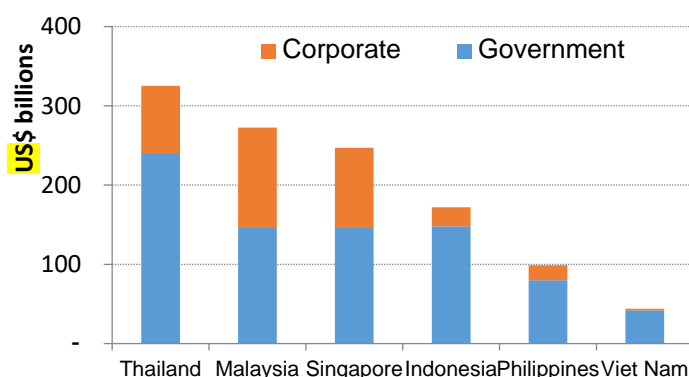
resources the share rapidly increased. In 2011, domestic debt out of total government debt was 39% and reached 58% in 2015 (while international public debt remained stable). The share of domestic public debt out of total public finance resources nudged up from 15.92% in 2011 to 23.49% in 2015.

Notable characteristics of GOV domestic borrowing include:

Issuing VND government bonds within the domestic bond market (still relatively small compared to some ASEAN countries – Box 2) is the key method for government domestic borrowing. Debt generated through this method comprised 80% of total government domestic debt.

Box 2: Domestic bond markets of some ASEAN countries

Figure 23: Domestic bond markets of some ASEAN countries



A number of countries in the region have bond markets which governments and corporate entities use to borrow money. At national level, bond markets are important tools for converting national savings into finance that can be used to fund investments.

Thailand, Malaysia and Singapore have the three largest local currency bond markets (Figure 23: data are converted to USD for comparability). In all ASEAN countries, government bonds exceed corporate bonds in scale, though the latter are significant in Malaysia and Singapore, in particular.

Source: Asian Development Bank (2017)

Table 3: Sources of domestic government borrowing (VND trillion, current price)

| Indicators | 2011 | 2012 | 2013 | 2014 | 2015 |
|--|--------------|--------------|--------------|--------------|--------------|
| Total: Domestic government borrowing | 156.8 | 191.0 | 265.9 | 399.7 | 353.3 |
| a. Bills | 2.6 | 29.7 | 36.8 | 26.4 | - |
| b. Government Bonds | 78.2 | 111.6 | 144.2 | 221.6 | 276.2 |
| c. Viet Nam Social Insurance Fund | 19.0 | 32.0 | 75.0 | 95.0 | 52.0 |
| d. Fund to accumulate debt repayment resources | - | 1.0 | 3.6 | 1.8 | 0.0 |
| e. Idle funds of State Treasury | 56.2 | 10.7 | 6.2 | 54.8 | 25.0 |
| f. Support Fund for Equitized Enterprises | 0.8 | - | - | - | - |
| g. SCIC | - | 6.0 | - | - | - |

Source: Nguyen Trong Nghia (2017)

Other sources of government domestic borrowing include Viet Nam Social Insurance Fund (SCIC) for accumulating resources for debt repayment, borrowing “idle” funds from the State Treasury and issuing government foreign currency government bonds within the domestic market. Through the VND bond issuing method, the GOV borrowed VND927 trillion - 67.85% of all its domestic borrowing during 2011-2015, while borrowing from Viet Nam Social Insurance Fund amounted to 20% and “idle” State Treasury funds 11% (Table 3).

It is noted, however, that borrowing (for debt repayment) from the Viet Nam Social Insurance Fund and drawing on “idle” State Treasury funds are reaching their respective limits. As of 31 December 2015, Viet Nam Social Insurance Fund’s total lending to the GOV hit VND324 trillion, equal to 90% of the fund’s total investment, while outstanding GOV debt to the State Treasury amounted to VND157 trillion, with knock-on effects on State Treasury liquidity. Looking forward, during 2016-2020, borrowing from these sources is expected to cool due to sustainability concerns.

Most government bonds are held by commercial banks: According to the MOF, at the end of 2016, more than 55% of GOV bonds were held by commercial banks, which in turn, mainly mobilized resources from deposits. Besides the fact that most GOV domestic bonds are short-term with high mobilization costs, it also means government domestic borrowing is competing with the private sector, which mainly mobilizes resources through borrowing from commercial banks. This together with the high level of non-performing loans and related liquidity stresses in the banking system (particularly 2006-2010 and 2011-2015) and budget constraints leading to GOV difficulties in repaying debts to commercial banks (Box 3), underlines an urgent need to restructure GOV domestic debt and revisit its domestic borrowing strategy. The GOV’s Debt Management Directions 2016-2020 defines actions to (develop the domestic bond market to) reduce the share of government bonds held by commercial banks (in fact, the share reduced to 55.4% at the end of 2016, compared to 79.6% at the end of 2011). It also addresses the short maturity terms of bonds and high mobilization costs, through increased sales of government domestic bonds (denominated in VND and USD) to other longer-term investors, such as insurance companies and international market bond issuances.

Box 3: Debt servicing

The debt payment-to-GDP ratio (interest payment-to-GDP: 1.96% GDP and principal payment-to-GDP: 2.02% GDP) was 4% GDP in 2014 and 2015. The share of debt payment was 15-16% of total non-grant revenue and 13-14% of total government expenditure (including principal debt payment) in 2011-2015. Principal government international debt and interest repayment obligations were fully met, while government domestic debt repayment obligations (which, accumulatively, accounted for 57% of total government outstanding debt) were not. Due to budget constraints in recent years, the government could only repay the interest and portions of its domestic principal debt. In response to short maturity-term bonds and high mobilization costs, the government in 2013 took out VND46,980 billion in new loans, VND77,000 billion in 2014 and VND125,000 billion in 2015 to make repayments. *Source: MOF (2015, 2017a, b)*

Major government bonds issued are characterized by short terms and high interest rates, though the situation is improving. During 2011-2013, under huge public resource mobilization pressures to finance high government deficits and maintain public investment, in the context of slowly increasing revenue, high inflation and a small-sized domestic bond market (with commercial banks major investors in GOV bonds), the large amounts of bonds issued were characterized by short terms (more than 74% of bonds issued had terms equal or less than three years) and high mobilization costs, especially when interest rates were high during 2011-2012 (Table 4).

Table 4: Government bond interest

| | Aug-2016 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---------------------|--------|--------|--------|-------|-------|-------|
| Average five-year GOV bond interest (%/year) | 6.07% | 10.69% | 12.28% | 10.44% | 8.6% | 6.85% | 5.99% |
| Average 10-year GOV bond interest (%/year) | 6.94% | 10.72% | 11.33% | 9.79% | 9.01% | 7.75% | 6.94% |
| Average three-year GOV bond interest (%/year) | 5.25% | | | | | | |
| Average 15-, 20- and 30-year GOV bond interest (%/year) | 7.65%, 7.75% and 8% | | | | | | |

Source: Nguyen Trong Nghia (2017)

The predominance of short maturity-termed government VND bonds translated into the GOV chiefly investing mobilized resources into short-term public investment projects (to cover recurrent expenditures given chronic budget deficits), despite the pressing need for large public investments to address key infrastructure/growth bottlenecks. The short terms and high mobilization costs triggered severe debt payment pressures on the State budget, especially concentrated in 2014-2016, when debt repayment requirements even exceeded State budget repayment capacity during some periods. From 2015, adjustments were made to increase terms of government VND bonds. As a result, the average term increased from 3.9 years in 2011 to 7.0 years in 2015, with average mobilization costs falling from 12% in 2011 to 6.0% in 2015.

The GOV's Debt Management Directions 2016-2020 estimates the issuance of government VND domestic market bonds could only mobilize VND250-370 trillion/year (average annual growth rate of 10%). It sets the direction to increase the share of longer-term bonds, focusing on terms of 10-30 years, (noting the current share of medium and long-term bonds is only 15-20% of the total) through attracting longer-term investors.

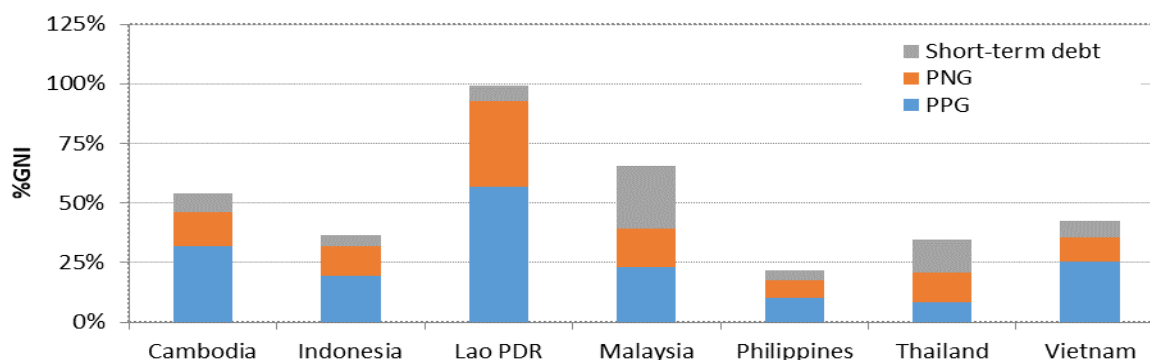
2.1.3. International public resources

Before examining Viet Nam's international public resources, this report compares Viet Nam's external debt stock with some ASEAN countries. External debt stocks ranged in 2015, as a proportion of national income, from 22% of GNI in the Philippines to 99% in Lao PDR (Figure 24). The public sector is a key borrower in all ASEAN countries, with liability¹² more than half of

¹² The data shows public or publicly-guaranteed external debt, meaning the public sector is not always the borrower - but has at least provided a guarantee of repayment.

outstanding external debt in each of the five countries.¹³ Private non-guaranteed debt accounted for 30-40% of debt stock in four countries¹⁴, but was lower in other ASEAN nations (excluding Brunei and Singapore, for which data are unavailable). Short-term debt is significant in Malaysia and Thailand, where financial markets are more developed, accounting for 40% of total external debt stock in both countries.

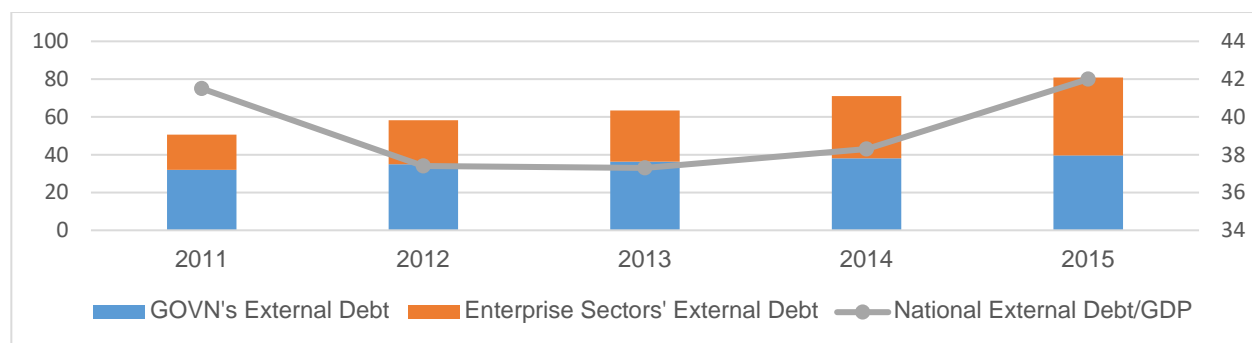
Figure 24: Size and mix of external debt in ASEAN (2015)



Note: PNG = private non-guaranteed debt, PPG = public and publicly guaranteed debt,

Source: World Bank International Debt Statistics

Figure 25: Viet Nam's international borrowing (2011-2015) (Unit: USD billion (left), % GDP (right))



Note: SOEs' international borrowing with GOV guarantees included in GOV international borrowing. Source: 5th Debt Bulletin, MOF (2017d)

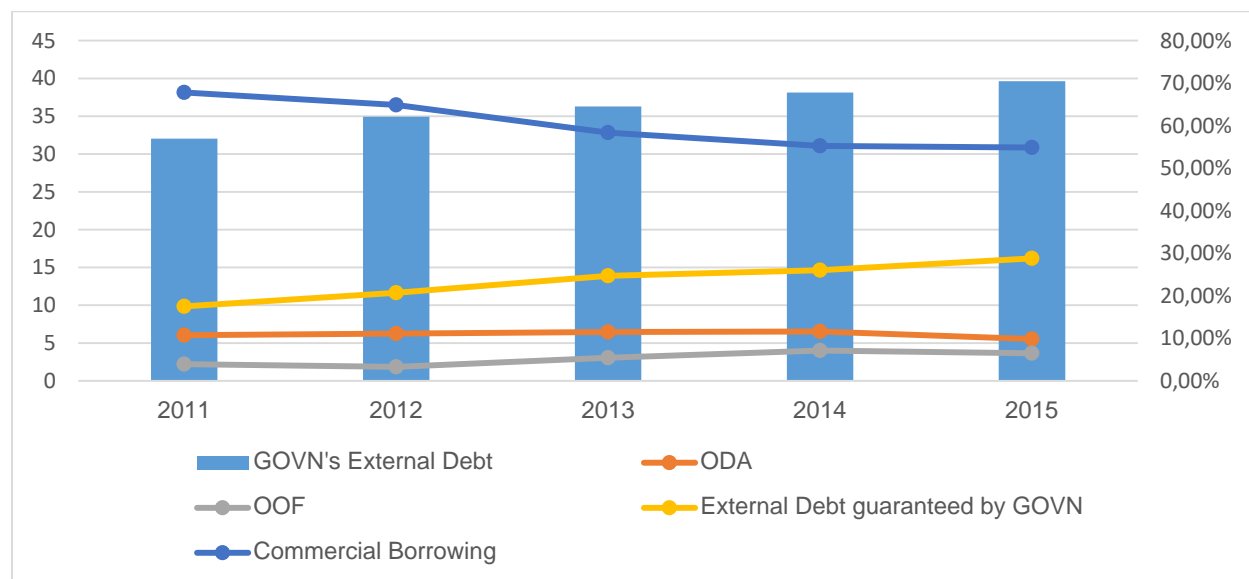
Figure 25 provides an overview of Viet Nam's international borrowing, which increased from USD50.5 billion in 2011 to USD80.5 billion in 2015. In which, the government's foreign debt increased slightly in terms of value, but gradually reduced its share in total external debt. Meanwhile, Viet Nam's total external debt from private enterprises and SOEs' international commercial borrowing (excluding SOEs' GOV-guaranteed international borrowing included in

¹³ Cambodia (59 percent of total), Indonesia (52%), Lao PDR (58%), Myanmar (86%) and Viet Nam (60%).

¹⁴ Lao PDR (36%), Thailand (36%), Indonesia (35%) and the Philippines (33%).

GOV international borrowing) sharply increased during 2011-2015, from 36.5% in 2011 to 51.5% in 2015.

Figure 26: Sources of government international borrowing (Unit: USD billion (left), % of total (right))



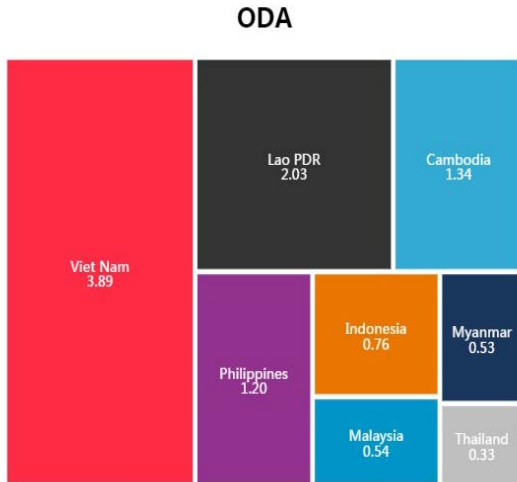
Source: WDI, IFS, OECD and MOF

GOV international borrowing increased from USD32 billion in 2011 to almost USD40 billion in 2015 (Figure 26). In terms of government international borrowing, the commercial loan volume is stable (outstanding debt sits at USD21.7 billion per year on average), but decreased in the share of total government international borrowing during 2011-2015. SOE government-guaranteed international borrowing increased in value and share of total government international borrowing, amounting to USD5.6 billion in 2011 and accounting for 17.52% of total government international borrowing and USD11.4 billion (28.8%) in 2015. ODA loans only accounted for 10% of total government international borrowing and 2% of GDP in 2015 and tended to slightly decrease in the share of total international public debt during 2011-2015, although no significant change in value was evident. The share of OOF in GOV external borrowing witnessed an uptick from 3.92% in 2011 to 6.51% in 2015, although the volume remained modest.

2.1.3.1. Official Development Assistance

Viet Nam is the largest recipient of ODA, in terms of volume, among ASEAN countries - receiving 37% of the ASEAN regional total (USD3.9 billion) in 2015 (Figure 27). The ODA-to-GDP ratio in Viet Nam was high over a sustained period - fluctuating at 4% from the early 1990s, 3% to early 2000 and around 2% during 2011-2015, compared to less than 1% in ASEAN countries during 2000-2015.

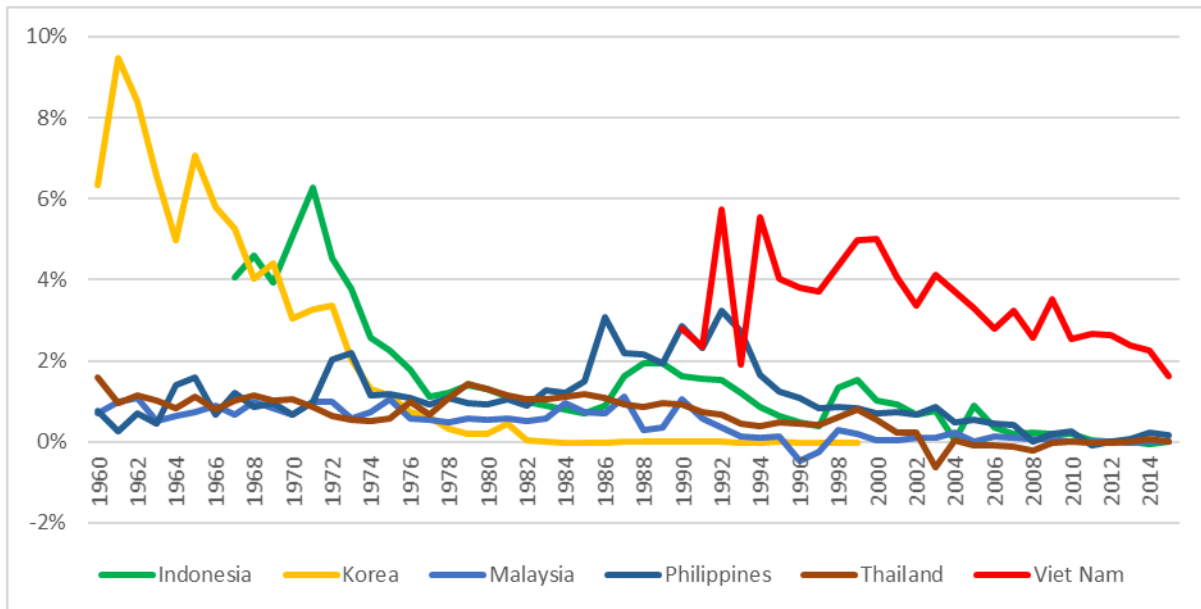
Figure 27: ODA inflows to ASEAN countries (2015, billion USD)



Viet Nam's ODA per capita levels have been high compared to many ASEAN countries, with only Cambodia and Lao PDR having higher ODAs per capita during 2011-2015. However, ODA flows into Viet Nam have decreased markedly, especially after it achieved lower middle-income country status in 2010 (Figure 28).

Source: OECD DAC, data for 2015

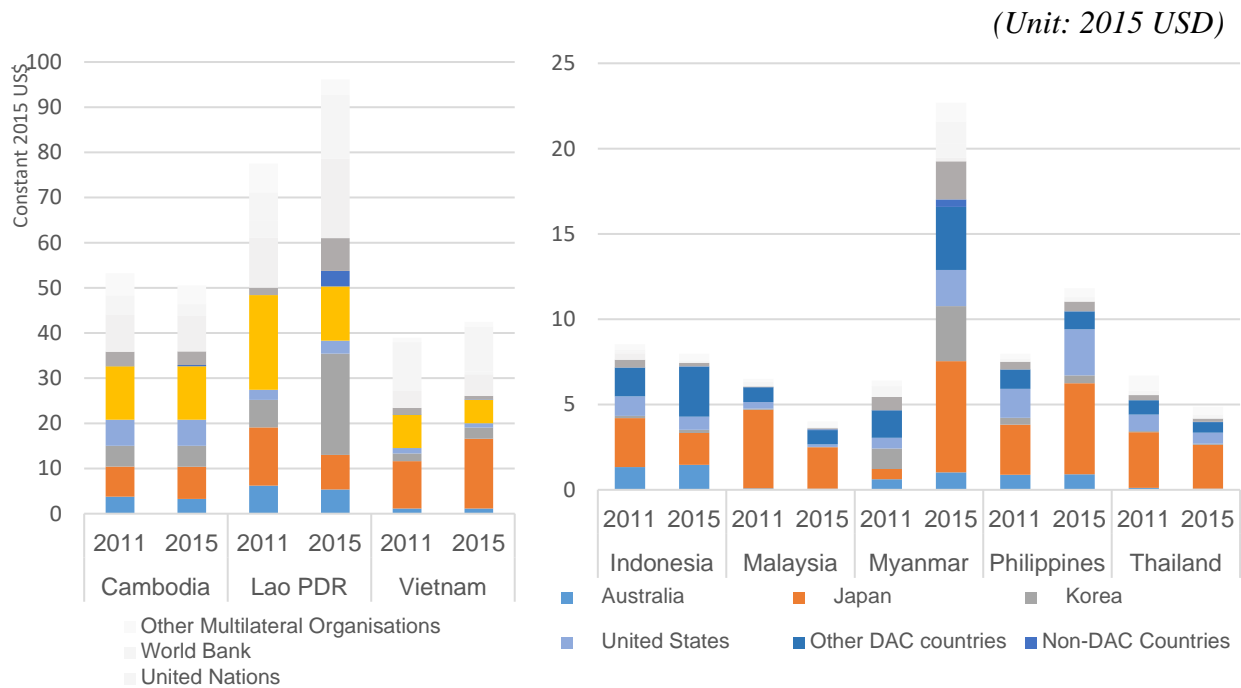
Figure 28: ODA-to-GDP ratios of Viet Nam and other countries



Source: WDI

The ODA per capita of Viet Nam (USD42/person in 2015), was higher than many other ASEAN countries, except Cambodia and Lao PDR (Figure 29). Figure 29 also indicates ODA inflows from Japan, World Bank, ADB, Republic of Korea and other DAC countries have been important sources to Viet Nam and other ASEAN countries.

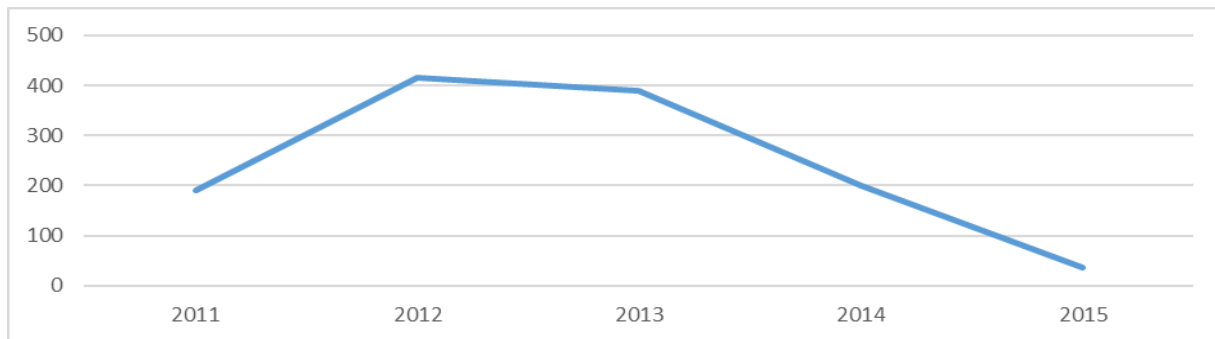
Figure 29: ODA per capita by donors of ASEAN countries



Source: OECD CRS

Grant ODA consists of a small proportion (1%) of total ODA, but has been an important financial resource for technical assistance, capacity building and policy advice. However, grant ODA has declined, especially after 2012 (Figure 30).

Figure 30: Grant ODA to Viet Nam (Unit: million USD)



Source: Orientations toward Attraction, Management and Use of ODA and Concessional Loans from Foreign Donors during 2016-2020 (attached to Decision No.251)¹⁵.

¹⁵ It is noted that MOF data (Báo cáo công khai quyết toán NSNN – website BTC) shows that grant ODA was stable at around USD500 million during 2011-2015.

Given the high levels of ODA Viet Nam enjoyed during the last three decades, in the context of its graduation to lower middle-income status and GOV efforts to ensure public and government debt sustainability, ODA flows into Viet Nam will continue to decline as a percentage of national income and most likely in real terms over the coming years. The Financial Plan 2016-2020, Medium-Term Government Budget 2016-2020 and draft Report on Updates Directions on Attraction, Management and Utilization of ODA and Concessional Loans in 2018-2020, vision to 2015, anticipate ODA concessional loans will continue to decline in size and be less concessional. In response, they signpost key directions to improve effectiveness and efficiency of ODA mobilization and utilization, manage Viet Nam's transition to ODA graduation within a sustainable public and government debt management framework.

2.1.3.2. Other Official Flows

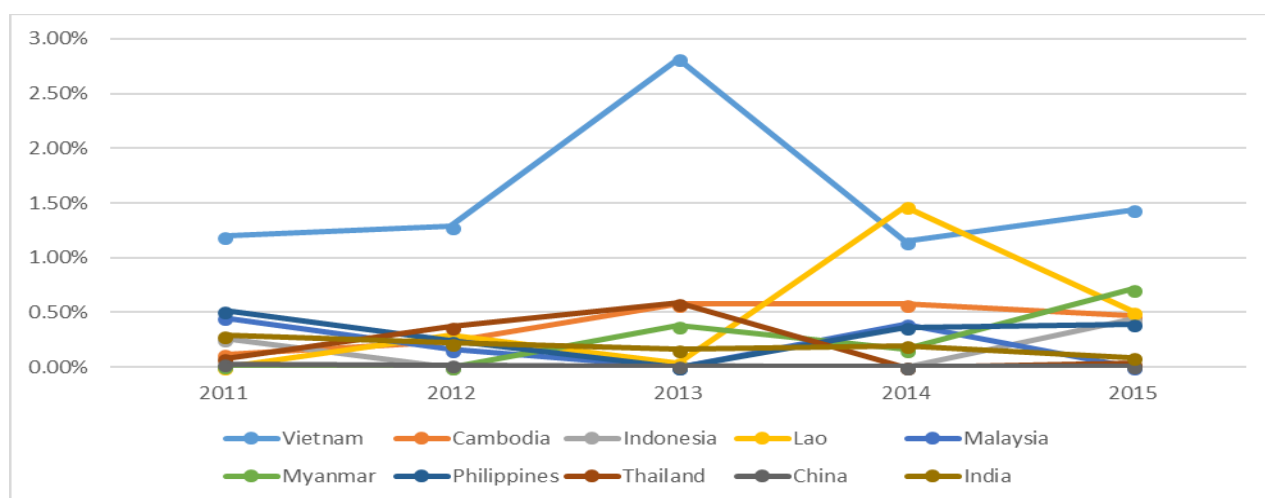
Indonesia was the largest recipient of OOF in 2015, receiving 59% of the regional total. The Philippines and Viet Nam received USD2.6 billion and USD2.3 billion, respectively. OOF to these three largest recipients represented 92% of total OOF to the region (Figure 31a).

Figure 31a: Distribution of OOF to ASEAN countries (Source: OECD DAC. Data are for 2015)



While ODA flows are decreasing, the volumes of less concessional OOF has risen, almost four-fold during 2009-2015. The OOF-to-GDP ratio in Viet Nam has increased in recent times, much higher than other countries in the region (Figure 31b).

Figure 31b: OOF-to-GDP ratios of Viet Nam and other ASEAN countries (Unit: % of GDP)

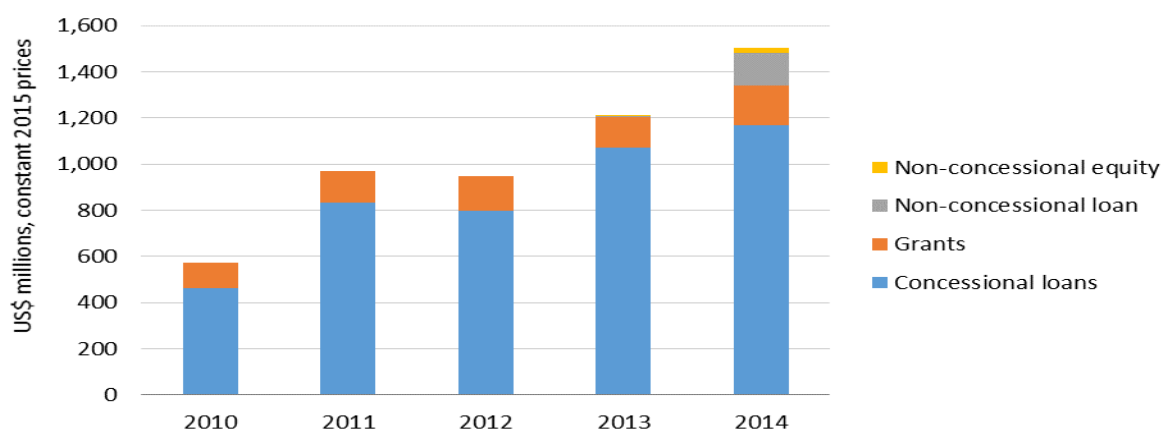


Source: WDI, IFS and OECD

Globally, as the number of extremely poor countries falls, donors increasingly turn their attention to financing global public good issues, such as adaptation to climate change, transition to cleaner energy, deforestation and biodiversity – relevant to Viet Nam today. New mechanisms like the Green Climate Fund have and will be created, with the line between official ODA and private sector initiatives becoming less distinct. According to the Inter-governmental Panel on Climate Change (IPPC), nearly one-quarter of Viet Nam’s population and one-eighth of its land is at risk, making it one of the most vulnerable countries globally to climate change (Pamela McElwee 2017). Therefore Viet Nam, over the medium term, can expect climate change finance to make up an increasing proportion of international finance flows.

In fact, Viet Nam is a recipient of considerable volumes of international public climate finance. During 2010-2014, it received the largest amount in the region—around USD5.2 billion. Only Indonesia and the Philippines also surpassed USD1 billion during this period. In 2014 alone, Viet Nam received an estimated USD1.5 billion, with USD1.17 billion in concessional loans, USD171 million in grants and a comparatively large amount of non-concessional loans (compared with previous years) of USD141 million. These data included project-level spending for bilateral government agencies, bilateral and multilateral development finance institutions (DFIs) and bilateral and multilateral climate-specific funds. At least 63% of this funding was reported as ODA-eligible, although distinguishing any further between this and non-ODA-eligible climate finance flows presents difficulties due to the way in which public climate finance data are reported. The amount of climate finance Viet Nam has received has grown steadily since 2008, most consistently in the form of mitigation-related finance, which accounted for 46% in 2014, although adaptation was temporarily the most significant area in 2013. The majority of financing each year was delivered as concessional loans, with a small proportion of grants and in more recent years also non-concessional loans.

Figure 32: International public climate finance to Viet Nam



Source: Development Initiatives (2011, 2015, 2017)

2.1.3.3. Government international commercial borrowing

Figure 26 shows government international commercial borrowing consisted of a small share of total public finance resources (2.19% in 2011, 3.39% in 2012, 3.93% in 2013 and 2014 and dropped to 0.94% in 2015). As noted, government commercial loans have been stable in value (outstanding debt at USD21.7 billion per year), but decreased in the share of total government international borrowing in 2011-2015 (Figure 26).

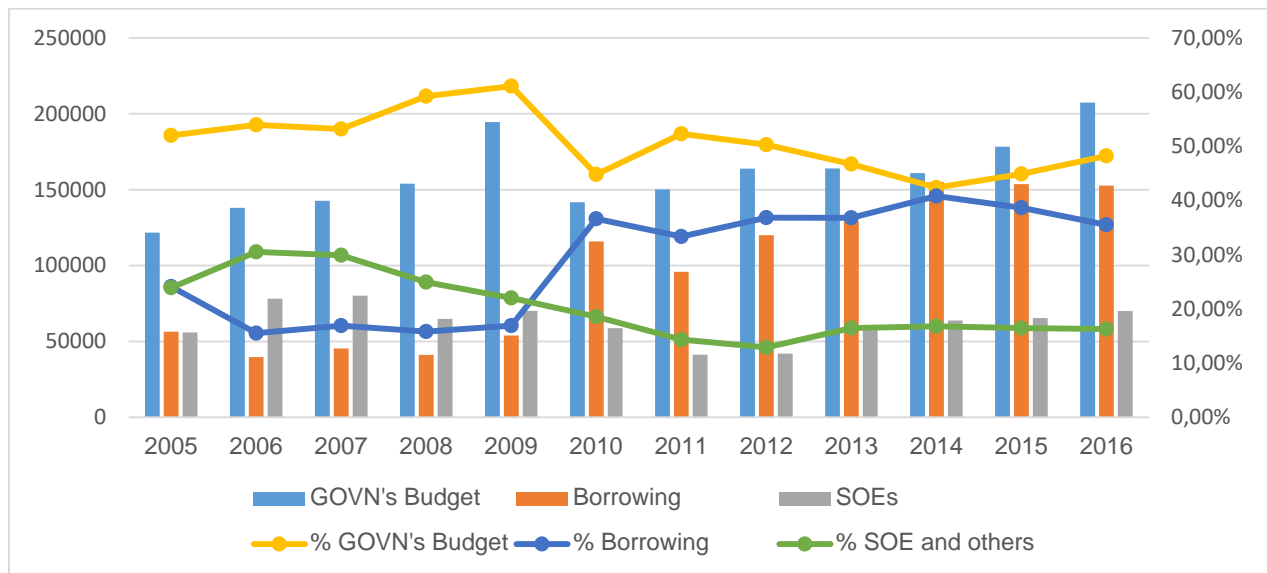
Apart from international commercial borrowing under ‘climate finance’, the GOV issued government bonds in international markets: in 2005 it mobilized USD750 million and USD1 billion each in 2010 and 2014 (source: MOF – publicized financial information, MOF’s website). Resources mobilized by government in international markets were assessed by the MOF as “having advantages” such as big sizes, not attached with conditions including purposes of fund use (normally under ODA concessional loans) and “reasonable interest rates”. At the same time, issuing GOV bonds in international markets helps the GOV access international capital markets and diversify investors and currencies in its debt portfolios to support debt management. The medium-term financial plan, however, indicates areas for improvement, such as more flexibility in selecting optimum times for GOV bond issuances suitable for mobilizing resources from international markets, taking into account the country’s macro-economic situation and available resources.

2.2. Public investment

Public investment has slowly increased in value and the total development investment-to-GDP ratio has declined (compared to non-State and foreign-invested sectors) especially after 2009, however it still plays important role in the national economy (Figure 7). Within the overall trend of declining total investment during 2010-2016, after Viet Nam reached lower middle-income country status, the share of public investment from the State budget, though also slightly declining, still consisted of 22% in the total investment capital and 7.2% GDP (average for 2010-2016).

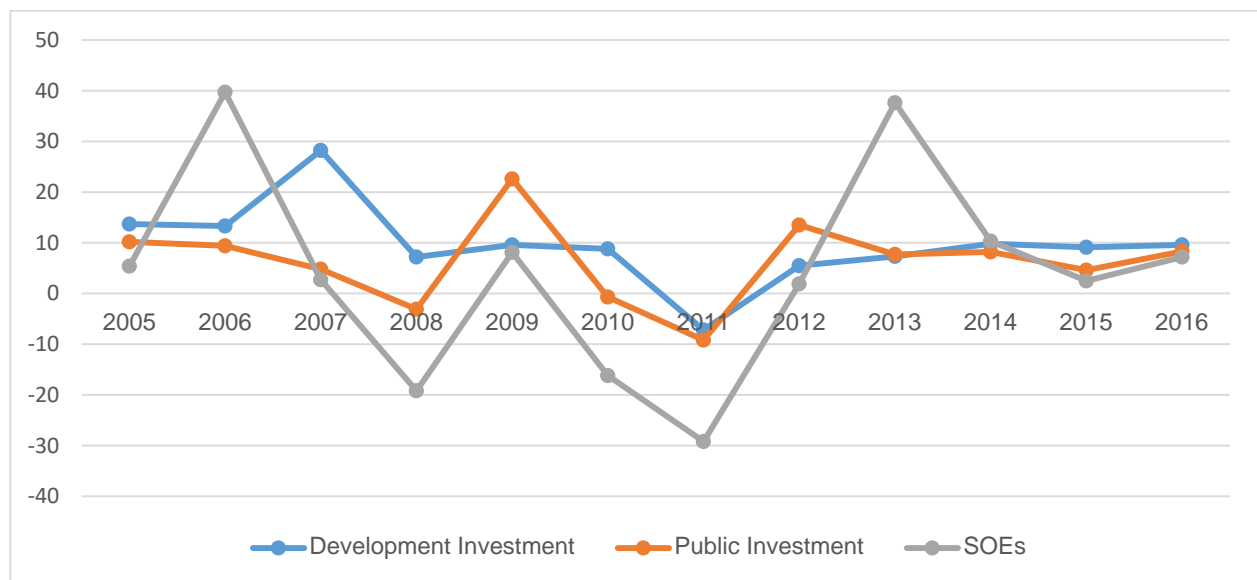
Figure 33 shows public investment from the State budget out of total public investment declined from 61.1% in 2009 to 48.22% in 2016. To sustain public investment, while facing a decline in government revenue and increase in expenditure (as discussed earlier), the government sought to borrow - mainly from domestic commercial banks via issuing short-term and high interest rate VND bonds in the domestic market (especially 2012-2016) and issuing foreign currency bonds in the international market in 2010 for public investment. The share of borrowed resources in total public investment capital increased fast, from 16.9% in 2009 to 35.5% in 2016. During the same period, there were large government savings gaps, especially in 2009, 2010 and 2012-2016.

Figure 33: Volume and composition of public investment (Unit: VND billion and %)



Source: GSO

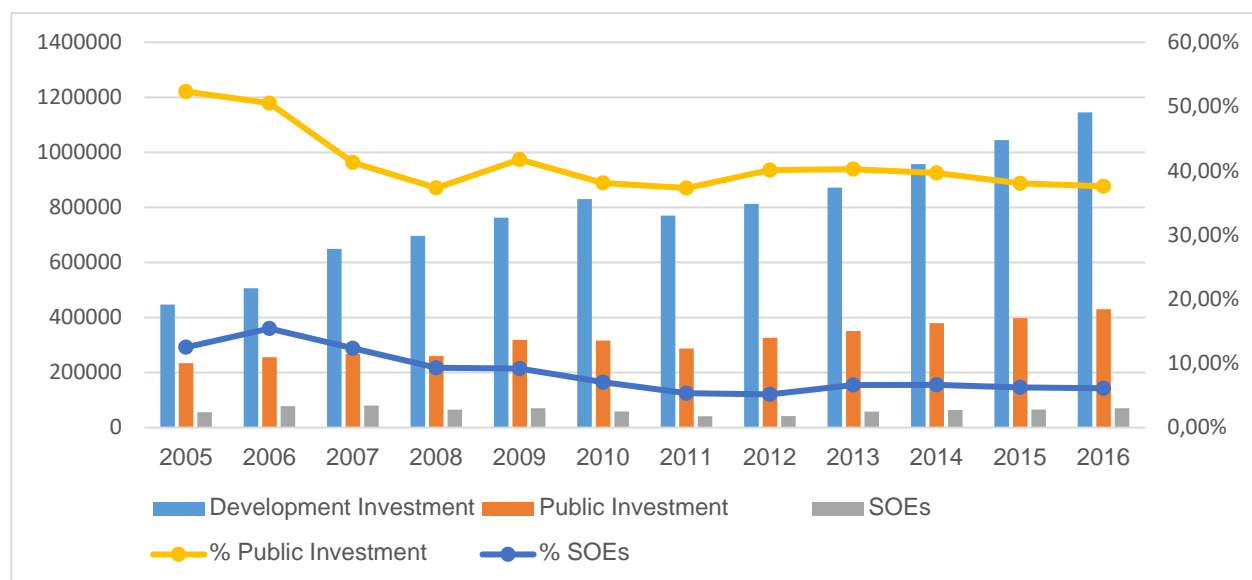
Figure 34a: Growth rate of SOEs' investment (Unit: %)



Source: GSO

Investment by SOEs also declined, mainly due to impacts from SOE equitization and perhaps the government collecting dividends/profits from SOEs since 2013. The average growth rate of public investment (6.4%) and especially of SOEs (4.2%) was much lower than the total development investment average (9.6%). This led to a sharp decrease in SOEs' investment share in total development investment. By the end of 2016, the investment capital of SOEs (including other sources) accounted for only 6.1% of total development investment and 16.3% of total public sector investment (Figure 34b).

Figure 34b: Value and share of SOEs' investment in total development investment (Unit: billion VND (left), % in total (right))



Source: GSO

3. Private Financial Sources

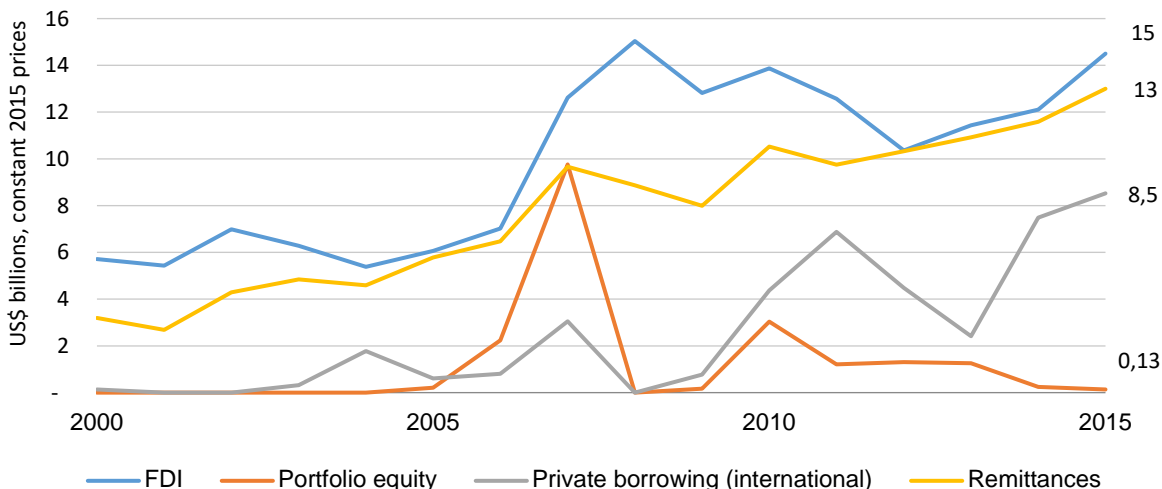
In this section, the report follows the framework of the UNDP regional development finance study to provide an overview of private development finance sources in Viet Nam, encompassing international private sources (FDI, portfolio equity investments, remittances and international borrowing) and domestic private sources.

3.1. International private sources

International private financial resources in Viet Nam have increased sharply over the past two decades, especially since Viet Nam's accession to the WTO in 2007. Available data reveals that international private finance to Viet Nam jumped from USD12.7 billion in 2005 to USD36.2 billion in 2015. This exceeded the ASEAN average of USD28 billion in 2015.

In general, FDI inflows into Viet Nam have increased rapidly since 2007, dipping during the global financial crisis before stabilizing in recent years. Remittances have steadily climbed and remained at high levels regardless of the global financial crisis and tracked at similar level as FDI inflows (USD13 billion compared to USD14.5 billion of FDI) in 2015 and four-fold higher than ODA in 2016. Notably, private sector international borrowing increased quickly especially post-2009, while private sector international debt consisted of an increasing share of Viet Nam's total international debt. Portfolio equity was the most volatile of all flows, fluctuating between a peak of USD9.8 billion in 2007 to just USD134 million in 2015 (reflecting the nature of this type of investment and the unusual "jump" in international inflows in 2007, impacts of which will be assessed in the last section of this report) (Figure 35).

Figure 35: International private development finance in Viet Nam (Unit: USD billion)



Source: Development Initiatives (2011, 2015, 2017)

3.1.1. Foreign Direct Investment

FDI accounts for between a fifth and a quarter of private investment in the ASEAN region and grew to a record USD137 billion in 2015. Within this dynamic region, Viet Nam is a destination for a substantial amount of FDI, standing only below Singapore¹⁶ and Indonesia in terms of FDI volumes in 2015 (Figure 36a).

Figure 36a: FDI flows to ASEAN countries (USD billion 2015)



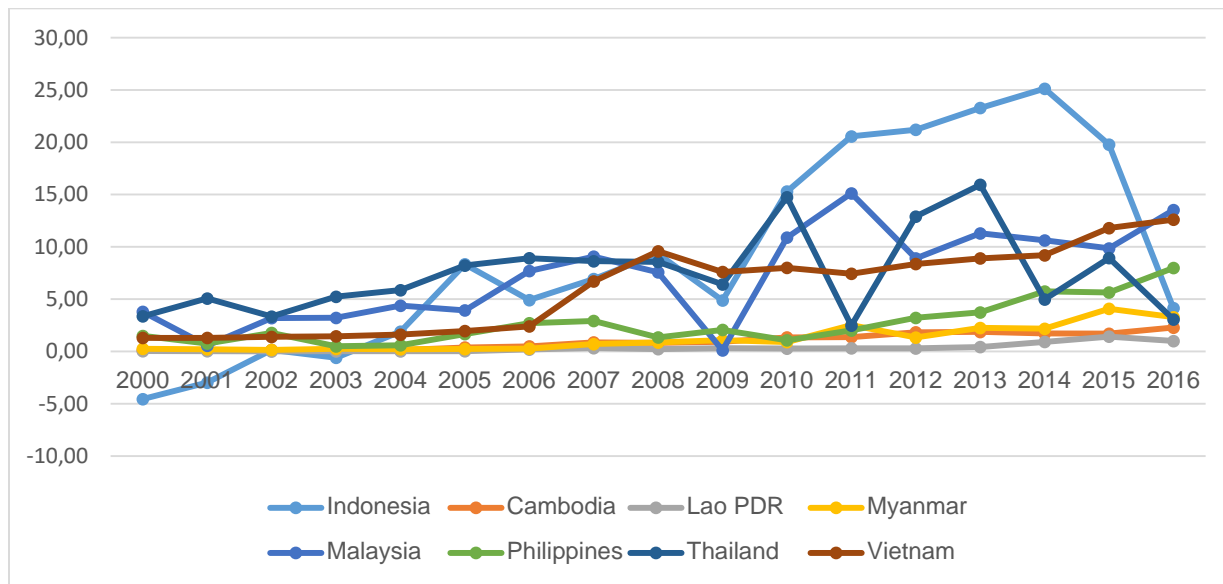
The volume of FDI inflows into Viet Nam has accelerated, especially after Viet Nam joined the WTO and during 2007-2010¹⁷. Besides large volumes, FDI inflows have been stable compared to other ASEAN countries, except Singapore (Figure 36b).

Source: DI's calculations based on national statistics offices and UNCTAD

¹⁶ Singapore is an “exception” in ASEAN. Despite accounting for just 1% of ASEAN’s total population, it accounts for half of FDI to the region and almost two-thirds of FDI growth during the last 10 years was increased investment in Singapore.

¹⁷ Implications of fast increases in FDI inflows during this period will be discussed in the last section of this report.

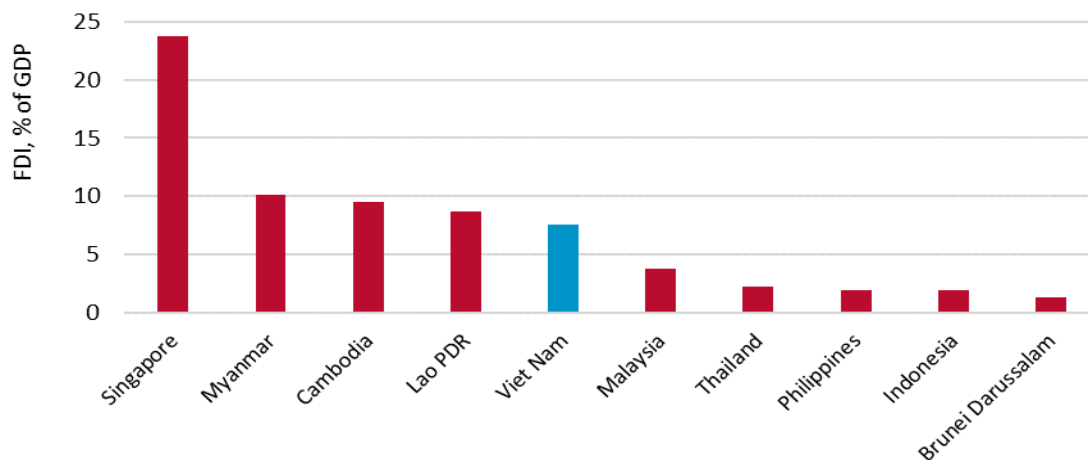
Figure 36b: Volume of FDI inflows into ASEAN countries (Unit: USD billion)



Source: WDI

In terms of the percentage of FDI in GDP, Viet Nam sits in the middle of ASEAN countries - lower than some at earlier stages of development (except Singapore) such as Myanmar, Cambodia and Lao PDR, but higher than others (Figure 36c).

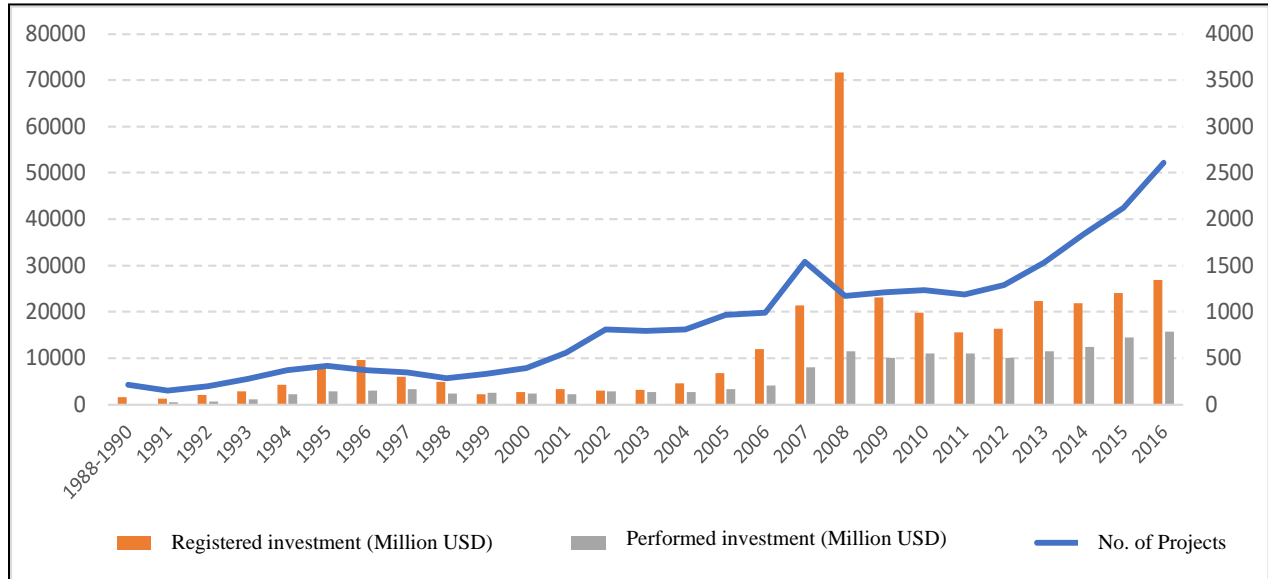
Figure 36c: FDI as a percentage of GDP across ASEAN (2015)



Source: Development Initiatives (2011, 2015, 2017)

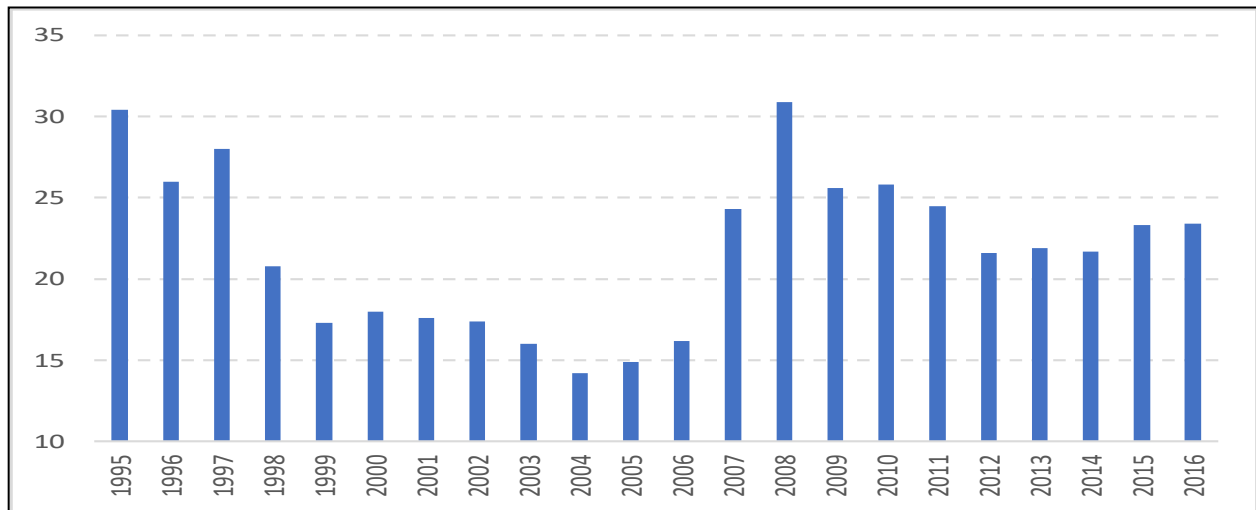
The size of performed FDI was quite stable during 1990-2006 at less than USD3 billion/year, before it sharply increased to almost USD9 billion in 2007 and more than USD10 billion in 2008. It stabilized again during 2009-2014, before climbing to USD14.5 billion in 2015 and USD15.8 billion in 2016. In the first 11 months of 2017, the estimated performed FDI was about USD16 billion (Figure 37).

Figure 37: FDI inflows into Viet Nam (1988-2016)



Source: GSO

Figure 38: FDI share in total investment in Viet Nam (Unit: %)

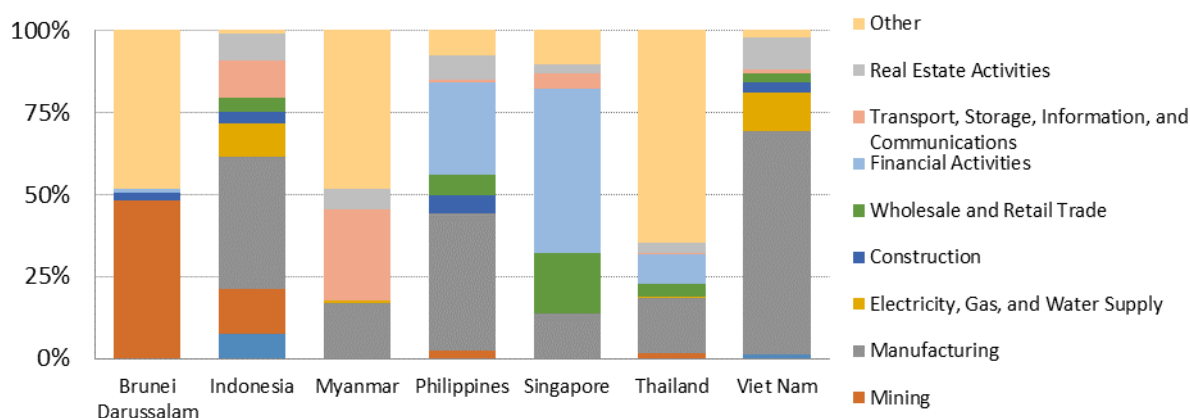


Source: GSO

The FDI share in total investment in Viet Nam fluctuated over the reviewed period. It fell from 30.4% in 1995 to 14.2% in 2004, as a result of the Asian financial crisis (1997-1999) and slow adjustments in FDI attraction policies in Viet Nam. The share increased during 2005-2008 and reached a “record” level of 30.9% in 2008, reflecting positive expectations of investment opportunities due to Viet Nam’s WTO accession in 2005. After subsequent reductions, it firmed up again to around 23.4% of total investment in 2015 and 2016.

The industries in which FDI is concentrated differ markedly per country in the ASEAN region (Figure 40). Investment in manufacturing accounts for almost 70% of total FDI to Viet Nam, the largest proportion of FDI in manufacturing in ASEAN followed by the Philippines (38%) and Indonesia (40%). In Brunei Darussalam and Indonesia, FDI in mining accounts for 73 and 14% of total, FDI respectively. Indonesia is the only ASEAN country where FDI in agriculture accounts for a significant proportion of the total (8%) in 2015.

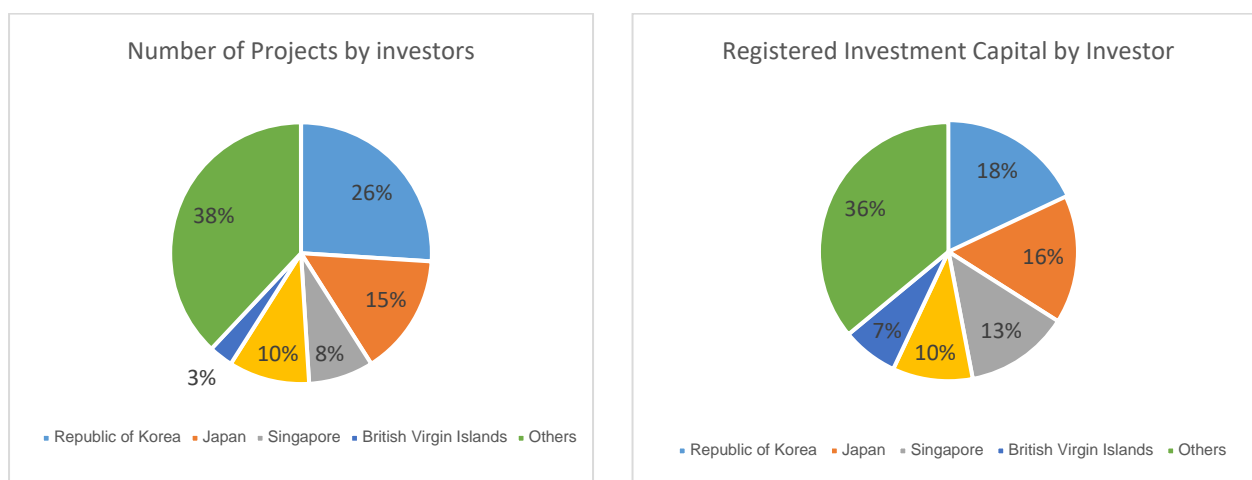
Figure 39: Nature of FDI in ASEAN countries (2015)



Source: Development Initiatives (2011, 2015, 2017), See Annex, data notes

GSO data confirms the above picture illustrated in Figure 39, with 64.6% of newly registered FDI capital (USD9.8 billion) in manufacturing, 10.1% (USD1.5 billion) in real estate and 2.4% (USD367 million) in wholesale, retail and car-motorbike repairs in 2016. However, in 2017 electricity production and distribution, gas and air-conditioning attracted most newly registered FDI capital with USD8.4 billion (42.3% of the total) and manufacturing only USD6.3 billion (31.7%).

Figure 40: Composition of FDI by investors (2016)



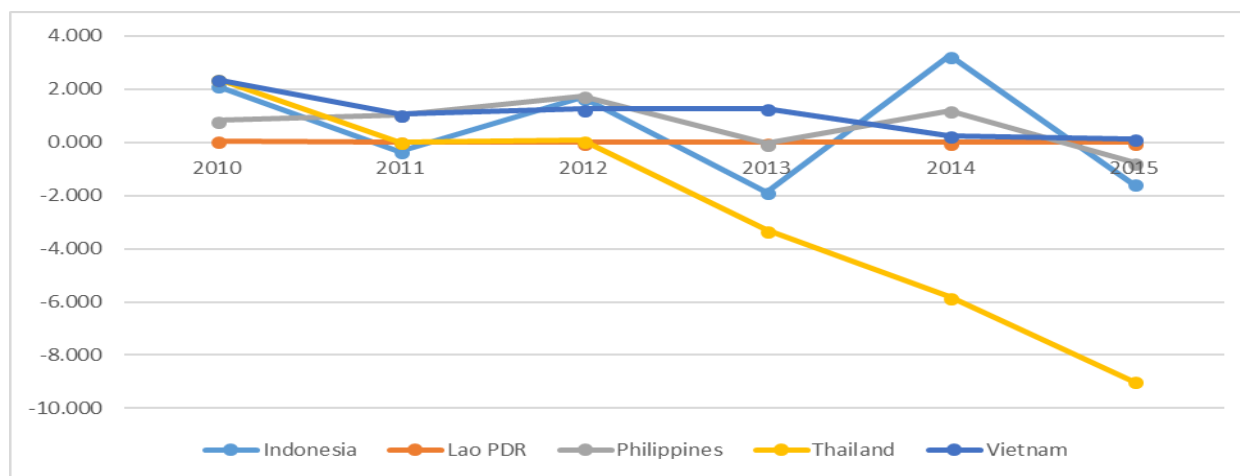
Source: Foreign Investment Department, MPI

Republic of Korea is ranked as the top investor in Viet Nam out of 68 countries and territories. Up to November 2017, Republic of Korea investors had 6,477 projects with a total registered capital of USD57.5 billion, equivalent to 38% and 36% of total projects and total registered capital, respectively. The second is Japan with 3,577 projects and USD39.1 billion, accounting for 26% and 18%, respectively. Other major FDI sources are Singapore and the British Virgin Islands (Figure 40).

3.1.2. Portfolio Equity

The flow of portfolio equity to Viet Nam is relatively small, fluctuating strongly and has been declining in recent years. If this value of portfolio equity in 2011 is about USD2.38 billion, then by 2015 is only USD134 million. Compared with other countries in the region, this development finance source is likely to be particularly potent in the coming period as the equitization process of SOEs will be stronger and institutional reforms will take place. However, it is noted that by its nature, and experience (especially the Asian financial crisis in early 1990s) shows, the volatility of this financial source is high, and this requires strong capacity to forecast and more importantly manage associated risks to minimize its impacts on macro-economy.

Figure 41: Value of portfolio equity (net flow) in ASEAN countries (Unit: billion USD)



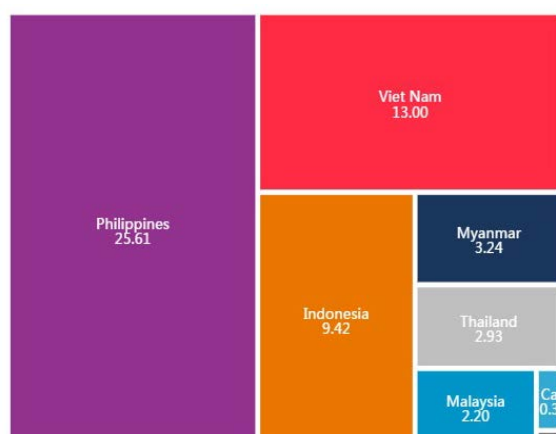
Source: WDI

Key actions include: (i) ensuring stable macro-economic/policy environment, strong and transparent institutions, (ii) continue improving the quality of the domestic stock markets and links to the international markets, (iii) developing markets for enterprise bonds.

3.2. Remittances

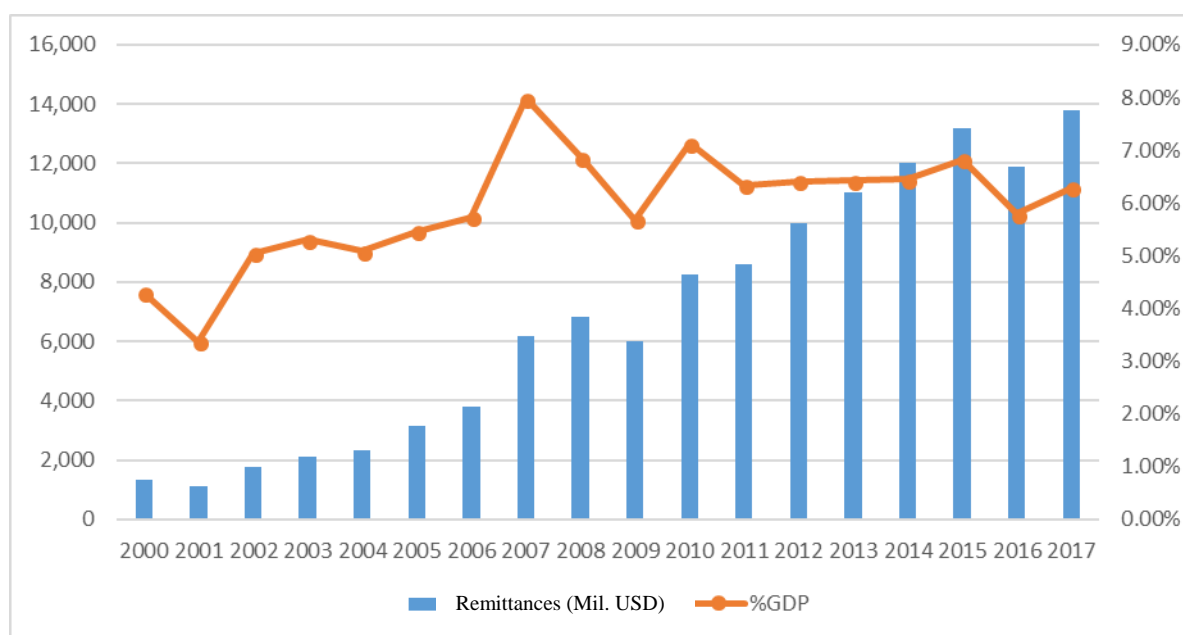
Viet Nam is one among top 10 countries receiving the highest levels of remittance in the world, with the volume of around 2.5% total global remittance in 2017. In ASEAN, remittances are an important part of the financing landscape of various countries. The Philippines is the largest recipient (Figure 42), with remittances totalling USD25.6 billion in 2015, almost double the volume (USD11 billion) of the second largest recipient, Viet Nam, in 2015.

Figure 42: Remittances in ASEAN countries (USD billion, 2015) (Source: National sources and World Bank, data are for 2015 (UNDP regional DFA study report))



In the Philippines remittances account for 17% of total finance while in Myanmar they account for 13% and in Viet Nam 12%. Remittance volume has been increasing fast with the annual growth rate higher than the world's average by around 10%, though growth rate has reduced significantly since 2010 (Figure 43).

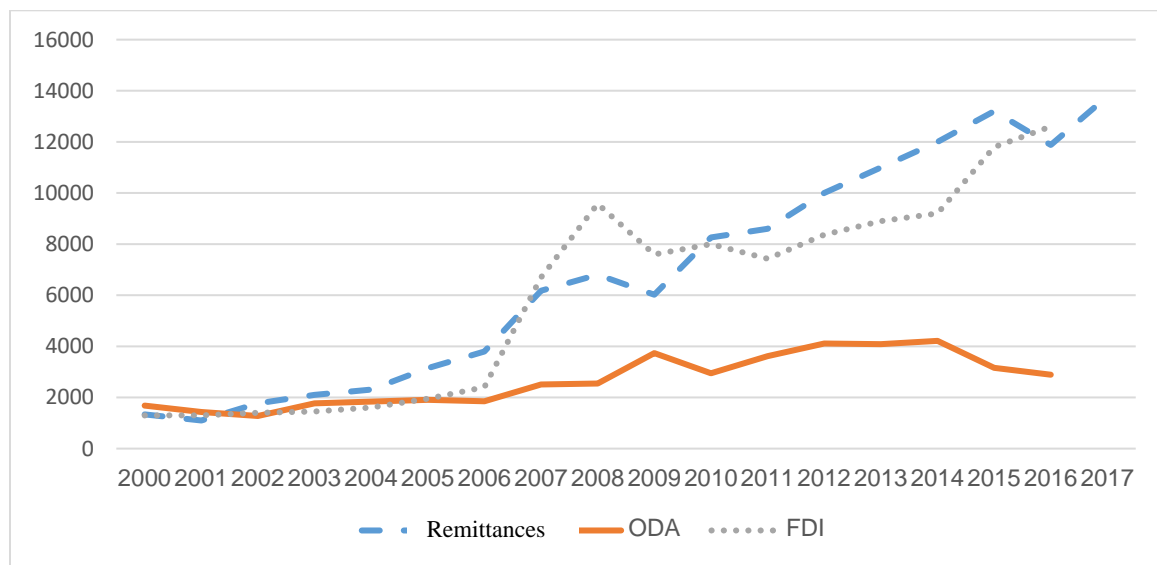
Figure 43: Volume and to-GDP ratio of Viet Nam's remittances in 2000-2017 (Unit: USD million (left), % of GDP (right))



Source: WDI

Remittances accounted for 6-8% of annual GDP during 2006-2017, much higher than other developing countries (on average 1-2% of GDP). This contributes to supporting the country's economic development, increasing the country's foreign exchange reserves and balancing its current account.

Figure 44: External development finances of Viet Nam (USD million)



Source: WDI

Out of total remittances into Viet Nam, the United States was the most significant source (55%), followed by nations such as Australia, Canada, France, Germany and South Korea. The chief senders were Overseas Vietnamese and from labour exports, with the former (mainly based in the United States, Canada, Germany and France) now accounting for a majority (80-90%) of remittances. Labour exports account for a small proportion (6-7%) of total remittances, but are increasing in step with sharp rises in labour exports to nations such as Japan, Republic of Korea. Remittances into Viet Nam are growing more steadily and the volume was four-fold higher than ODA volume (2016) and on a par with FDI (2017) (Figure 44).

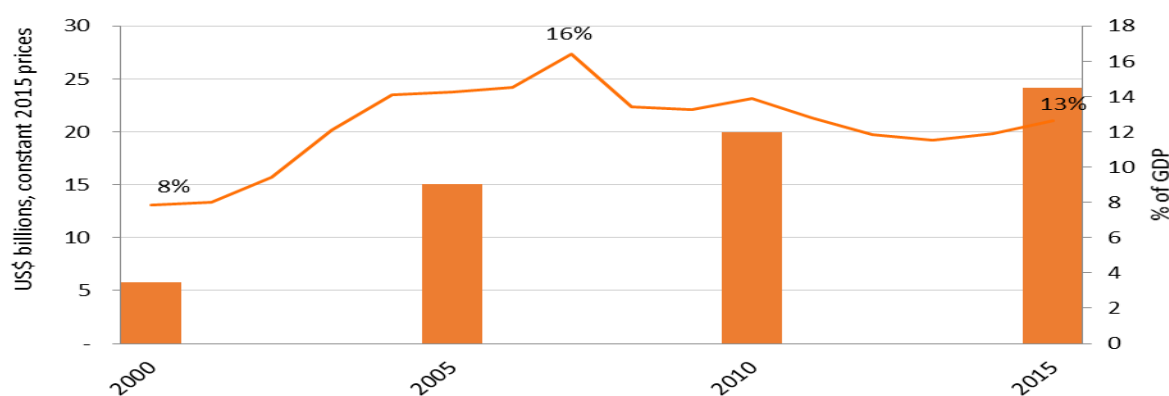
Given their strengthening flows, remittances can play an influential role in Viet Nam's development finance if, besides for consumption, they are channelled into productive investments and away from real estate or "storage" in foreign currencies or gold. Nguyen Kim Anh et.al. (2017), based on State Bank of Viet Nam data, revealed that to the end of 2016, Ho Chi Minh City's inward remittances accounted for 50% of total remittances to Viet Nam, of which 70% flowed into business and 20% into real estate.

3.3. Domestic private sources

Domestic private finance in Viet Nam—measured by non-State investment as reported by the GSO—has increased consistently since 2000, quadrupling to USD24.2 billion in 2015. This is still below the regional average of USD46 billion (excluding Singapore) and more than USD200 billion less than in Indonesia. Viet Nam's commercial investment per capita of USD301 is less than half the ASEAN average of USD659 (DI 2017). As a proportion of GDP, it fluctuated from 8% in 2000 to 16% in 2007 and 13% in 2015. Viet Nam's domestic private finance share of total development finance resources (23%) is below the ASEAN average (31%).

Domestic private investment plays an increasingly important role in total development investment. Data points to a rise in volumes of domestic private investment during 2011-2016, with an average annual growth rate of 10.3%, while growth in public investment and FDI cooled.

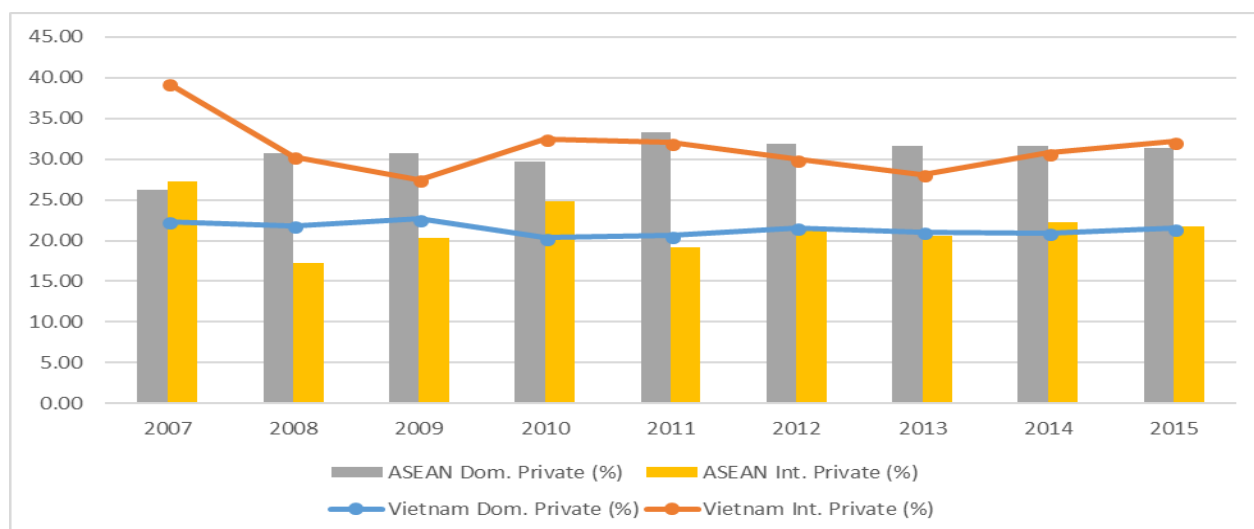
Figure 45: Viet Nam's domestic private investment (volume – left, to-GDP ratio - right)



Source: Development Initiatives (2011, 2015, 2017)

In terms of development investment, Viet Nam's private sector contributed an average 38.4% of total development investment during 2011-2016. However, this share is still low relative to the required share for it to be the key driver of economic growth.

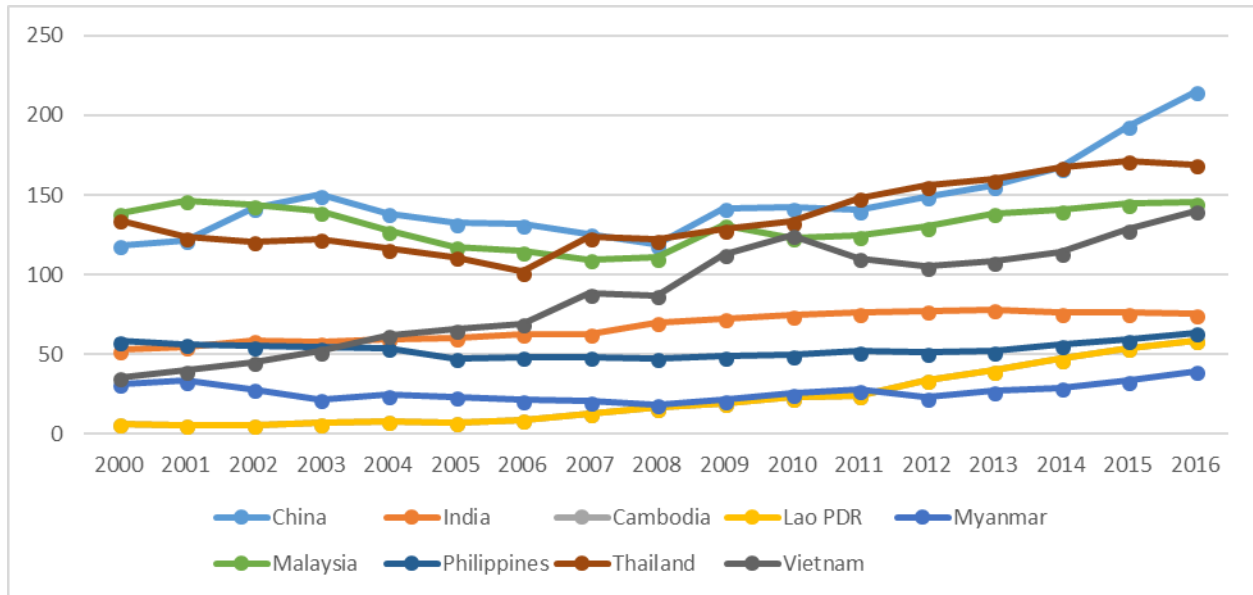
Figure 46: Share of foreign and domestic private finance in total investment of Viet Nam and ASEAN average



Source: calculated from IFS and WDI data

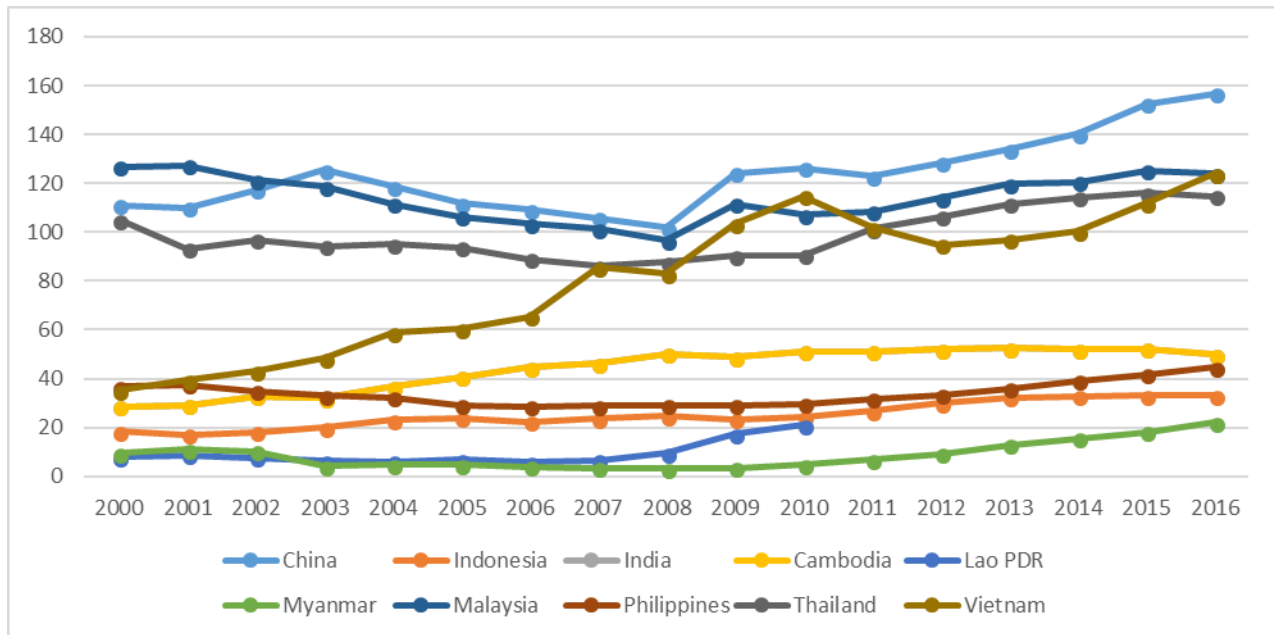
Private investment in Viet Nam has a different characteristic. Domestic private investment is lower, while international private sources (FDI and FII as discussed earlier) exceed those in other ASEAN countries. This trend largely remained constant during 2007-2015.

Figure 47: Domestic private sector credit-to-GDP ratio of ASEAN countries



Source: calculated based on WDI

Figure 48: Credit from banks for private sector-to-GDP ratio of ASEAN countries



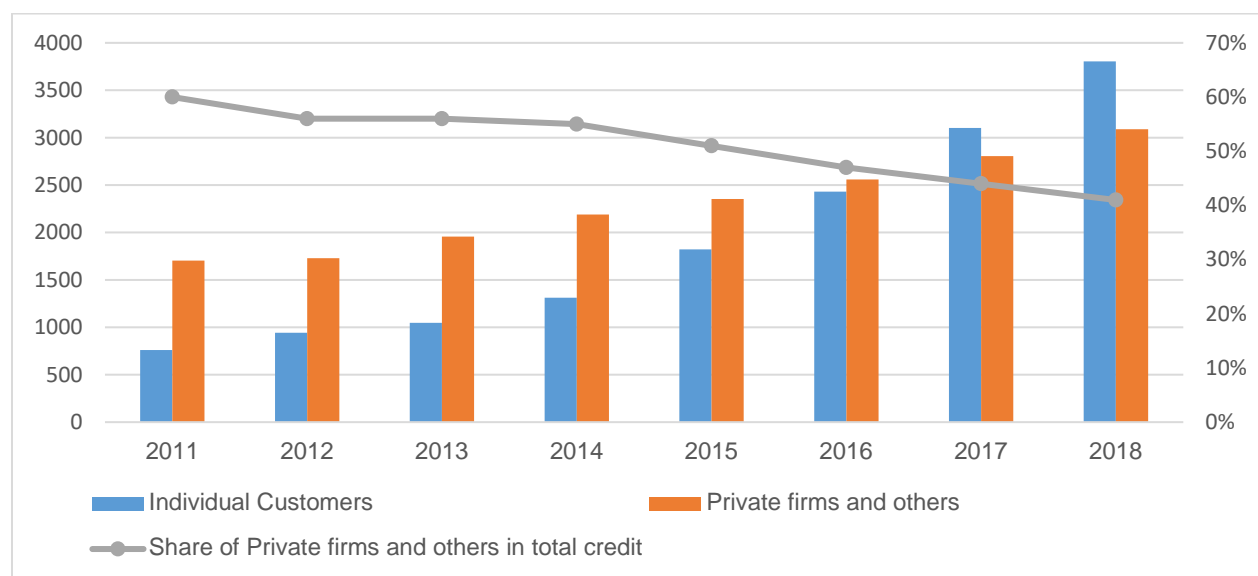
Source: calculated based on WDI

Comparing domestic credit-to-GDP and bank credit to private sector-to-GDP, Viet Nam's ratios are relatively higher than other ASEAN countries and have increased over time, despite a decline in 2010-2012. However, a more detailed consideration of the credit structure shows that individual consumers (consumption and production credit) are the main beneficiaries, rather than the enterprise

sector and business households. The rate of credit granted to private enterprises has sharply fallen from 2011 onwards, despite the increase in scale.

Data from the National Financial Supervisory Commission (NFSC) shows Vietnamese consumption credit increased quickly during 2011-2017 to reach 18% in total credit (NFSC, 2018). This implies credit flows into production have stagnated¹⁸. It also demonstrates difficulties in access to private sector manufacturing credit that many studies and reports have already illustrated. Private businesses and households have limited access to credit due to their small size and lack of collateral.

Figure 49: Size of credit for the non-State economic sector (Unit: thousand billion VND)



Note: data in 2016-2018 was estimated

Source: State Bank of Viet Nam, estimated by Credit Suisse (Ricardo Hausman et. al., 2017)

According to Business Registration Administration statistics, during 2011-2016 the number of newly established private enterprises continuously increased and surpassed 100,000 annually. To 2016 there were 477,808 enterprises, of which private ones accounted for 96.4% and the majority (98.6%) of private enterprises were SMEs. In step with the rising number of newly established private enterprises, the rate of bankruptcies also increased. In 2016, 12,478 enterprises completed procedures for dissolution, up 31.8% compared to the previous year and 60,667 enterprises stopped operating, a 14.9% decrease compared to the previous year.

In general, the scale of private business capital and investment is small. The average capital for individually-owned enterprises only exceeds VND6 billion, more than VND12 billion for limited liability companies and VND51 billion for joint stock companies without State capital. The fixed assets of the private sector are also limited. The average fixed asset value of each private-owned enterprise is more than VND1.8 billion, approximately VND4 billion for a limited liability company and more than VND17 billion for a joint stock company without State capital. Around half of private

¹⁸ Though anecdotally, it is reported that a sizable proportion of “consumption credit” may actually be used for investment in production.

enterprises have average capital of less than VND5 billion and only 6% have average capital of more than VND50 billion. At the same time, only 5% of SOEs had average capital of less than VND5 billion and 66% had more than VND50 billion (Vu Dinh Anh, 2017).

The level of capital of about 4.75 million individual non-farm business households, 9.32 million agro-forestry and fishery households and 33,488 farms (GSO, 2016) was similarly low. The average capital of such a business is VND150.6 million per unit, of which the fixed asset value is VND90.4 million per unit (Nguyen Hong Son, 2017).

Private enterprises and business households face a shortage of capital for production and business, due to difficulties in accessing bank credit as a result of limited collateral. Only 50% of SMEs in Viet Nam can access bank credit, while the ability to mobilize other sources, including own capital, is limited (Vu Dinh Anh, 2017). The size of bank credit for private enterprises, although having generally trended up, fell sharply in proportion to total credit of the economy.

In a study by Ricardo Hausman et al. (2017) using a growth-enhancing model, a number of basic barriers to low private investment were identified: (i) short-term barriers: a weak financial system leading to high financial costs, inadequate land policy and ineffective administration resulting in low economic returns, (ii) mid-term barriers: micro-exposure to contract enforcement, tax and business licensing policies and macroeconomic risks and (iii) long-term barriers: low quality human resources, poor infrastructure and market failures.

4. Managing development finance resources for sustainable development within an integrated national finance framework

The financing outlook for Viet Nam presents a mixed picture. Rapid finance growth in some areas offers significant potential to drive the country's progress toward Vision 2025 and the 2030 Agenda—if it can be mobilized and channelled into investments that yield sustainable development results. In some other key finance types, where the levels and trajectories remain low, there is an urgent need to expedite growth in the resources available, while ensuring they are used effectively.

Overall, the challenge for government is to develop and implement a policy and institutional framework that can tackle these challenges in parallel, managing interactions between development finance sources to leverage synergies between them and ensure investments across all aspects of the financing landscape contribute toward sustainable development results.

This section, using the lens of an INFF (Box 4) and based on an assessment of Viet Nam's INFF (Annex 2) and other research, provides an analysis and recommendations for addressing some of the key challenges.

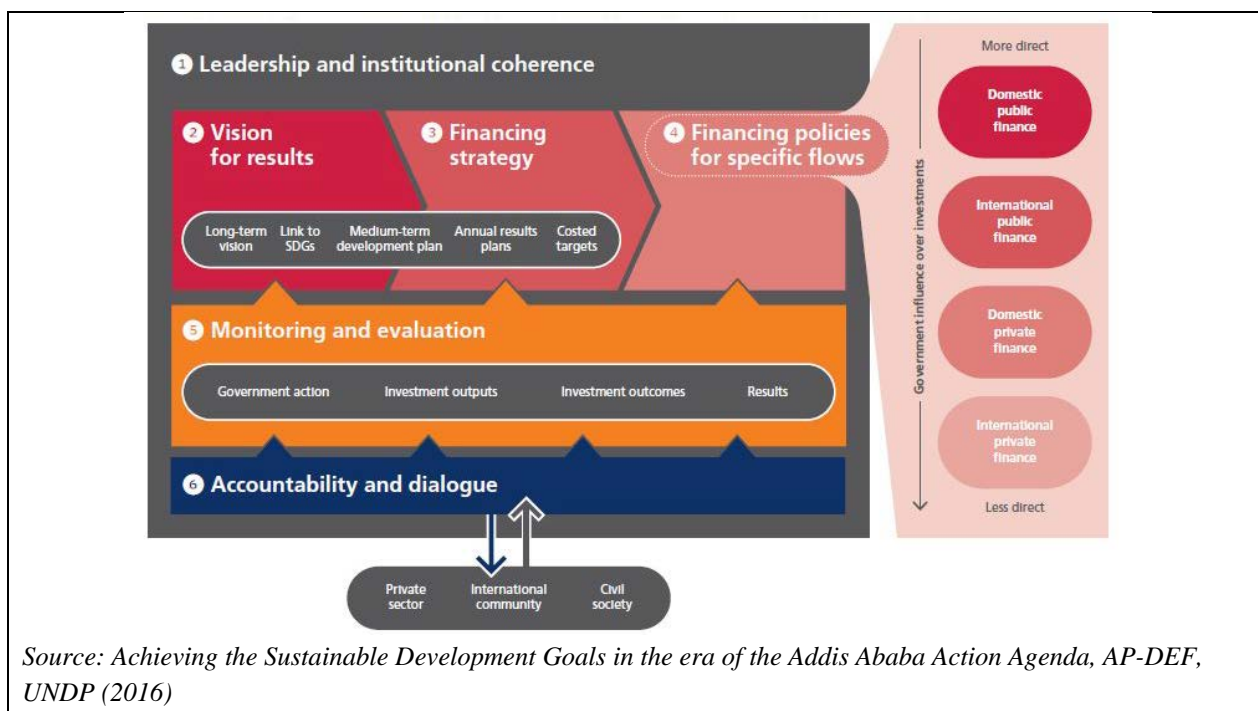
Box 4: Integrated national financing framework

The concept of an INFF is recognized in the Addis Ababa Action Agenda, which states that “cohesive nationally-owned sustainable development strategies, supported by INFFs, will be at the heart of our efforts” (UN, 2015).

An INFF is a holistic, integrated system of policies and institutional structures that government has in place to manage its financing strategies across all resources in a coordinated, aligned manner (as illustrated in the figure below). The concept is built around six building blocks that are designed to help governments evaluate their existing structures holistically and determine what reforms can strengthen the functioning of the system as a whole.

The six building blocks of an INFF are: (UNDP 2016)

1. Leadership that facilitates coherence across government: leadership from the highest levels of government to bring together key actors and build an integrated, aligned approach to mobilize the investments necessary to achieve the country's goals.
2. A clear vision for results: the foundation of an INFF is clarity on the direction and desired sustainable development outcomes that the country wants to achieve in the long term. This may link to the regional Vision 2025 agenda or the international 2030 Agenda and may include estimates about the costs of the investments needed to realize it.
3. An overarching financing strategy: an overarching strategy for mobilizing, channelling and investing the resources needed to make the vision for results a reality that incorporates the contributions that all resources (public and private, domestic and international) can make to sustainable development outcomes.
4. Aligned financing policies: the annual and medium-term plans that build on the financing strategy to invest public finance and mobilize and stimulate financing from other actors. This covers a range of policies such as medium-term expenditure frameworks, tax revenue, industrial development, SME and national aid strategies, among many others.
5. A strong monitoring, review and evaluation system: an integrated system for planning and monitoring the contributions that different types of financing can make towards sustainable development outcomes.
6. Participatory processes for accountability and dialogue: mechanisms to build the trust necessary to mobilize contributions from stakeholders outside government, to make sure financing policies are designed and delivered effectively and ensure a voice for citizens, civil society, business, development partners and other actors in financing sustainable development progress.



4.1. Accelerating development of domestic private sector and expanding its investment

In the context of the fast-changing international finance landscape, globalization and acceleration of Industrialization 4.0, given the fact that domestic private investment is relatively small and slowly growing, its growing important role – as an engine of the country’s growth - in the next development stage of Viet Nam as a lower middle-income country is widely acknowledged by policy-makers and in key country strategic documents. Addressing bottlenecks to expanding the domestic private sector and domestic private investment is among Viet Nam’s first priorities, actions are defined in government strategy and implementation is underway. This sub-section of the report will provide a brief summary of notable characteristics of the private sector in Viet Nam and key policy recommendations for the development of the private sector in Viet Nam.

The structure of Viet Nam’s economy is characterized by: (i) a relatively small and underdeveloped private sector, (ii) predominance of micro, small and medium enterprises (MSMEs) among Viet Nam’s companies and (iii) a large proportion of workers in the informal sector, presents the key constraints. While there was a considerable increase in the number of new enterprises registered, numbers of employees as well as total capital during 2007-2015 (VCCI, 2016), the proportion of micro and small-sized enterprises rapidly increased and medium- and large-sized businesses shrunk. A Viet Nam Economic and Policy Research (VEPR) research paper (Pham Tuyet Trinh et al 2017) shows that by 2015, in accordance with classification criteria regulated in Decree No.56/2009/ND-CP, (i) in terms of labour scale, nearly 98% of total enterprises in Viet Nam were classified as MSMEs, while large-sized enterprises accounted for the remainder (2017 Enterprise Census shows that 95.6% of all Vietnamese and 97.1% of private firms had less than 100 workers, only 1.5% of all firms and 1% of private firms had more than 300 workers, 0.4% of all firms and no private firms

had more than 1,000 workers) and (ii) in terms of total capital, SMEs and large-sized enterprises accounted for 93.8% and 6.2%, respectively, out of all enterprises.

The VEPR paper also shows the number of workers per enterprise in the business sector in general and SME sector, in particular has decreased. The average number of employees per Vietnamese enterprise has fallen from 126 and 76 in 2006 to around 35 and 26 in 2015, respectively. This reflects the increasing share of small-sized enterprises and lack of medium-sized ones in Viet Nam (if taking into account micro enterprises, which consist of a large - up to 80% share in 2014 - proportion of enterprises in Viet Nam's business sector, the average size of enterprises was found to be only 17 in 2006 and 11 in 2014).

A study, based on GSO labour force surveys since 2014, conducted by GSO and Institute for Labour Studies and Social Affairs (ILSSA), Ministry of Labour, Invalids and Social Affairs (MOLISA) with support from ILO found more than 18 million Vietnamese workers were employed in informal jobs, comprising 57% of total non-agriculture jobs nationwide. The report also showed that 98% of informal sector workers did not contribute to social insurance and their average salaries were only two-thirds of those of formal sector workers.

Noting that the SME sector is a key driver of economic development in Viet Nam, contributing 40% of GDP and accounting for more than 20% of exports (Yoshino, Naoyuki et al 2015), a recent study by the Japan External Trade Organization (JETRO, 2017) found that SMEs in Viet Nam have encountered different barriers, with the four main obstacles being a lack of access to finance, limited participation in domestic and international value chains (noted earlier in this report), ineffective government support and limited business capacity.

To stimulate greater volumes of domestic private investment in priority areas to contribute more positively to all aspects of sustainable development (without prioritizing economic progress at the expense of social or environmental advancements), key recommendations to accelerate the development and investment expansion of Viet Nam's private sector include:

- (i) To create a level playing field for the domestic private sector, it is essential to remove obstacles for the domestic private sector to compete equally with SOEs and FDI enterprises, for example the obstacles in access to credit, land or tax reduction and exemption; and reform SOEs and revise FDI policies to facilitate private firms to enter markets and enhance linkages in domestic and global value chains. In this context, it is necessary to create policies and incentives for FDI enterprises to generate more spillovers in terms of connecting domestic firms to global value chains and achieving technology transfers.
- (ii) In addition to efforts to increase the number of private enterprises and support start-ups, it is necessary to develop policies and targeted support to help the domestic private sector (large, medium, small, micro enterprises as well as household businesses) grow in size, productivity and competitiveness, with enhanced linkages with domestic and global value chains and an accelerated transition from the informal to formal economy.
- (iii) In addition to the continued efforts in improving the business environment, support must be channelled to domestic enterprises to improve their access to land and credit and tailored

support provided to SMEs to improve their: (a) capacity for business management and marketing, (b) linkages in domestic and international value chains and (c) technical capacity for adopting new technologies and readiness to take opportunities and face challenges from Industry 4.0. Establishment of independent institutions (similar to the Fraunhofer Foundation, Germany, Box 5) specialized in providing training and R&D support to Vietnamese firms (impeded by their small size and inability to afford investments in R&D and training) would be necessary (Box 5).

Box 5: Differentiating support to best meet needs of different MSMEs

A quantitative and qualitative analysis of the differentials of productive values in Vietnamese MSMEs and how market constraints have hindered their performance (Christine Ngoc Ngo, 2017) argues that differentiated support is needed for different firms (for example, micro and small enterprises in one group and medium ones in another). The key findings include:

Accessing capital is an important requirement of business strategy and industrial upgrades in both groups. Nonetheless, the effects of financial constraints imposed on small and medium firms vary greatly between the two groups. *It is difficult for small firms to obtain bank loans because of their lack of sources of collateral. On the other hand, medium firms find it much easier to borrow* because they can use their land, machinery, or a valid contract with foreign buyers against which to borrow credit from banks for new investment and upgrading. *Micro and small firms urgently need access to the credit market at lower borrowing costs*, so that they can make long-term investments to improve their production capability, labour training, and management skills. Unfortunately, the application process continues to be cumbersome and time consuming, as such small and micro firms are discouraged from formal borrowing. In this context, State Bank of Viet Nam should relax their application requirements and collateral demands for these firms. They should also give preference to micro and small firms that demonstrate sound plans for business development. With regards to *medium firms*, having access to cheaper credit is crucial for the upgrading of these firms. Lending from government SME development funds should focus not only providing easier access to credit, but also low-cost lending for qualified SMEs.

Both groups of enterprises need new markets to develop. Vietnamese MSMEs possess the competitive advantage that allows them to become global suppliers, by taking part in the global production chain and supplying components to foreign MNCs. However, *both enterprise groups are at a loss as to what to do to access the international market. They also seem passive in the domestic market—waiting for potential customers to contact them instead of approaching buyers directly.* Here, the government could take the lead in attracting foreign buyers, matching interested ones with local firms, and providing training for MSMEs on going to international supplier fairs, bidding for contracts, or making contact with foreign buyers that have yet to come to Viet Nam. Vietnamese embassies, Viet Nam Chamber of Commerce and industry associations should be more actively engaged with MSMEs and act as intermediaries between foreign buyers and local enterprises. Information sharing and networking between input suppliers and manufacturing firms are weak among MSMEs, and could certainly improve with local and central government agencies acting as channels of information and opportunities among firms.

Small firms generate higher value addition per unit than medium firms. This is because they are able to raise the per-unit price due to the low volumes of orders or because their outputs are often more customized. However, *small and micro firms fall far behind the absolute value addition generated by medium firms.* This is due to economies of scale in production, specialization and high volumes of repeated orders, which together help medium firms earn substantially larger total revenue and, hence, higher value addition than that of small and micro firms. This observation implies that if market demand for the products of micro and small firms becomes more stable and

consistent, and even expands, there is a real chance that a large number of Vietnamese micro and small enterprises could grow over time and thus add jobs, outputs, and spillovers to the Vietnamese economy. However, *this requires a stable demand for manufacturing goods either through greater access to regional and international markets* or through reducing reliance on intermediate imports from foreign markets, especially China. On this latter point, the government should play a more active role in connecting local input suppliers with manufacturers within the local and global value chains, as well as promoting the use of local products.

The fact is MSMEs are not actively looking for local suppliers, since many of them have customarily sourced inputs from China. This is due to *the lack of information available to firms*, especially in the northern and southern regions where firms are clustered, but not well connected. It is also due to cheap Chinese imports. If Vietnamese firms can produce inputs of equal quality and price to foreign inputs, the government should encourage local manufacturers to buy from local firms, rather than from abroad. In addition, government agencies should actively provide information and connect suppliers and buyers of input. Many countries promote the principle of ‘buy locally’ to ensure strong demand in the domestic market. Vietnamese suppliers gain more market demand from within the domestic economy. Providing input locally would be the first step in allowing MSMEs to learn and improve over time, to the point where they can become globally competitive and enter the global value chain. In the short term, *government policies supporting micro and small firms should focus on improving their access to information: domestic and foreign market opportunities, suppliers, technology, and regulations*. The policy benefits could be substantial, especially if the local value chain is strengthened and further developed. To the extent that training is available from various government agencies, it should aim to provide micro and small firms with important information as listed above. Having a directory that lists names of products and the capacity of each domestic supplier could be extremely useful, especially for firms looking to find cheaper and closer suppliers in the domestic market.

Medium firms also require better access to skilled labour, as this would reduce the cost of on-the-job training and allow the firms to build capacity and productive value over time. Vietnamese universities should devise programmes that encourage university students to participate in summer internships, which allow them to acquire hands-on experience on the manufacturing floor and to learn more about the production and management of the business. Although the issue of capability building, particularly in production organization and management among medium firms, is not as urgent as it is for micro and small firms, the medium firms interviewed were aware that their capability was not up to international standards and there was much room for improvement.

Some medium firms have benefited from technology spillovers resulting from working with foreign partners and the improvements have been notable. Others seem to have learnt more from their training, while obtaining international certificates such as ISO 9000. In the past, the Vietnamese Government has successfully subsidized some of this training, allowing local firms to learn and upgrade. Nonetheless, a more long-term trajectory is needed. The government could think more carefully about designing a national system of innovation that also has a focus on the development of MSMEs.

Viet Nam could learn from Germany’s national systems of innovation, especially in its use of a non-profit research think tanks, such as the Fraunhofer Society. This research institute is tasked, among other objectives, with providing direct applied research and development that supports SMEs in Germany. The Fraunhofer Society’s research labs frequently work with individual companies on short-term projects, either to improve their production processes or to boost their products’ features and quality, so that they can stay competitive in global manufacturing. The Fraunhofer Society, established in 1949, has been central in boosting the strengths of German SMEs in the global market. Vietnamese MSMEs could truly benefit from such an R&D institute that is designed to support MSMEs on product development and/or production improvement.

Source: Christine Ngoc Ngo (2017)

- (iv) Lastly, given its large size compared to FDI, remittances can be a more important source for domestic private investment, if incentives are created to utilize this source for more productive investment. In this regard, support for domestic enterprises to access new funding sources (such as crowd funding and social impact funds) would be useful.

4.2. Shifting the FDI attraction focus from quantity to quality

As noted in the previous section, Viet Nam has been relatively successful in attracting FDI in terms of volume compared to many ASEAN countries. Importantly, FDI has played a key role in Viet Nam's economy, making increasing contributions to around 20% of the country's GDP (from 15.2% in 2005), 72% of its exports (from 57% in 2005) and 18% of government revenue and creating 3.7 million jobs for Vietnamese workers in 2017.

Besides these positive contributions, key issues relating to Viet Nam's ability to attract FDI and areas for refinement have been identified by policy research and dialogues, including:

- Despite Viet Nam's comparative advantages – notably geographical location, political and social stability, availability of a young, educated, hardworking and relatively low-cost labour force having attracted high volumes of FDI in past years – it still faces significant competition from other countries, globally and within ASEAN. Infrastructure bottlenecks (notably electricity, transportation and logistics), limited supply of skilled labour and a complex doing business environment (complex rules and procedures, encompassing business registration, customs and tax payments) often are cited as barriers for Viet Nam to attract more and especially higher quality FDI.
- On-going policy debates in Viet Nam point to rising concerns about: (i) FDI in fast-growing sectors such as real estate, mining, low technology industries and forestry that use significant amounts of land and energy, exploit natural resources, cause pollution and environment degradation and (ii) FDI not being concentrated into several sectors demonstrating need, such as infrastructure, agriculture, industries with high, green and clean technologies, high levels of R&D and value addition.
- Many FDI projects have been, as studies show, characterized by low-quality technological sophistication and spillovers, especially in technology transfers to domestic forms and connecting them to global value chains, which are seen as one of the key drivers of improving Vietnamese firms' productivity and competitiveness¹⁹.

¹⁹ Recent developments show, however, that the situation may have started to improve. The number of Vietnamese enterprises participating in Samsung's led global value chain has increased dramatically, by over 50 times in a time span of less than for years, from four enterprises in 2014 to 219 enterprises as of November 2017, of which 29 were first-tier suppliers and 190 second-tier suppliers. <https://news.samsung.com/vn/29-doanh-nghiep-viet-la-nha-cung-cap-cap-1-cho-samsung>; <http://vneconomy.vn/cuoc-song-so/215-doanh-nghiep-viet-da-vao-chuoi-cung-ung-toan-cau-cua-samsung-2017072606287767.htm>

- Concerns have also been raised around the tax incentives and other privileges that Viet Nam, like many countries, offers investors to attract more FDI. Apart from creating an uneven playing field for domestic enterprises, these may directly reduce government revenues²⁰, thereby limiting the benefit of investment on public finances and reducing the volume of funds available for public services and investment. There is evidence that much of this “tax competition” is harmful and unnecessary. Countries in the region regularly offer tax incentives, such as exemptions or reductions, that are among the most harmful, (Oxfam Novib 2017), despite the fact that surveys from the region and beyond show that tax is often a lower priority for determining where investors will invest than other issues, such as the business environment, infrastructure, utilities and availability of skilled labour (ibid, Farole T. 2011, ADB 2013, ADB 2016, UNIDO 2011). Notably, such harmful and unnecessary competition between provinces in Viet Nam also took place as a result of decentralization of FDI project approvals to local provinces (within a much wider scope of administrative and fiscal decentralization in Viet Nam). A UNDP-supported study in December 2007 (UNDP, 2007) indicated that in addition to investment incentives permitted by central government, provinces provide a variety of extra incentives ranging from investment premiums and accelerated depreciation to tax holidays (a widened list of projects subject to preferential treatment, offering corporate income tax exemptions, allowances and VAT reductions) and reductions in land use fees (extending exemptions on rent, subsidies for infrastructure, land clearing and surfacing, and preferential rents corresponding to project size). Other measures such as credit assistance and guarantees, labour training allowances were also provided by many provinces.

Looking forward, it is important to ensure FDI policies become an integrated part of the national development strategy and INFF to maximize the positive impacts of FDI on national economic growth, society and the environment in tandem with the country’s move to unlock the next stages of its development.

Overall, there is clearly a need to shift the focus of FDI attraction from quantity to quality. A set of integrated policies will need to be developed and coordinated actions implemented to address these earlier outlined issues in parallel and in a coherent manner.

Moreover, international standards must be ushered in to raise the bar on technology levels, local content and linkages with technology transfers to domestic firms, compliance with stricter energy efficiency and environment-safety standards (applied to all enterprises, including FDI) and

²⁰ According to regulations, hi-tech FDI enterprises can enjoy a very low corporate income tax (CIT) at 10% during the entire project life, 0% in the first four years and 5% in the following nine years. This was applied to the case of Samsung, including its non hi-tech subsidiaries. Due to the tax incentives, in 2013 – the first year the 5% CIT rate was applied – Samsung Viet Nam exported USD23 billion in goods, but paid CIT of only VND1,000 billion (around USD50 million). In 2015, Samsung reached profits of more than VND70,000 billion, but the CIT payment was only VND1,684 billion. If normal a CIT rate was applied, it would have amounted to VND13,000 billion). <https://vov.vn/kinh-te/viet-nam-huong-loi-beo-bot-tu-fdi-545429.vov>

strengthened institutional capacity and systems for rigorous screening, appraising and approving of FDI projects to ensure adherence to such standards.

While requiring FDI enterprises to engage more in technology transfers and connect Vietnamese firms with global value chains, action must be taken to further develop the domestic private sector and strengthen its capacity and technology absorption.

There is also a need to move away from tax incentives and other privileges to instead make efforts to improve the business environment, infrastructure, utilities and availability of skilled labour – the fundamental determinants of investors’ decisions on whether to invest – as the main tools to attract quality FDI. This includes revisiting the decentralization issue and local governments approving FDI projects to limit the “race to the bottom” of harmful competition in attracting FDI between provinces. To help poorer provinces attract FDI, central government could support them through financing infrastructure, investing in human capital and insuring against exogenous risks. Moreover, to be efficient, centrally-funded infrastructure projects should take a regional (inter-provincial) approach and not be used as a means to reward or grant favours to individual provinces.

To reduce harmful elements of “tax competition” within the region, Viet Nam could strengthen its active participation in international initiatives to develop codes of conduct, such as Tax Inspectors Without Borders (TIWB) and Base Erosion and Profit Shifting (BEPS) Inclusive Framework, which includes actions on harmful tax practices (Box 6).

Box 6: International initiatives for developing codes of conduct to reduce harmful elements of tax competition

Tax Inspectors Without Borders

Tax Inspectors Without Borders (TIWB - see <http://www.tiwb.org/>) is a joint initiative between the OECD and UNDP. Launched in July 2015, it seeks to support developing country taxation administrations in developing tax audit expertise and skills, aiming to assist in building administrative capacity through improving the quality and consistency of audits. TIWB offers two main programmes. The full programme involves experts working with local officials directly on current audits and audit-related issues while a partial programme, for those countries not yet ready to adopt the complete partnership agreement, organizes technical workshops to provide expert advice on anonymous company audits. By April 2017, three TIWB programmes had been completed, 21 were in process and six were due to commence during 2017. The TIWB Annual Report estimates that increased taxation revenue, directly attributable to either TIWB full or partial programmes, was more than USD278 million.

Two countries in the ASEAN region, Cambodia and Viet Nam, have used the partial anonymized support programme, while Viet Nam has also applied for a full TIWB programme that commenced in 2017.

Illicit finance and BEPS

Illicit finance is a significant issue for many countries across the ASEAN region²¹ and has costs in terms of lost revenue for government and investment for the economy. Given the international nature of the issue, international institutions are coordinating efforts to address the problem. The base erosion and profit shifting (BEPS) package developed by the OECD and G20 includes 15 actions for governments to combat BEPS. Six ASEAN countries²² are members of the BEPS Inclusive Framework, and Singapore is also a member of the steering group.

Implementation of the steps proposed by BEPS is at an early stage, though ASEAN countries have implemented some. Thailand and Viet Nam are considering ‘thin capitalization’ rules designed to limit base erosion via interest deduction and other payments. Malaysia, Singapore and Thailand are implementing transfer pricing rules, and Viet Nam is considering doing so. Thailand is also considering introducing controlled foreign company rules and Viet Nam is taking steps to prevent the artificial avoidance of permanent establishment status. Indonesia, Malaysia and Singapore have signed the OECD-led initiative, the Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports (KPMG 2017).

4.3. Expanding domestic public finance and improving effectiveness of utilization

Addressing the challenge of sustainably expediting growth in government revenues and ensuring such resources are invested effectively and utilized efficiently within a sustainable public-government debt management framework, is critical to improve service delivery and infrastructure to directly impact on the lives and environment of citizens across Viet Nam.

4.3.1. Expanding tax/fee-based revenue

The drop in revenue from crude oil from 2008 caused a decrease in non-grant revenue (as analyzed in the above section on *non-grant government revenue*) and government “aftermath” efforts to mobilize more revenue from taxes and fees underlined (i) the importance of tax-based revenue as a more sustainable source of revenue and (ii) efforts to strengthen regular and stable tax-based sources of revenue must be prioritized, even when revenue from crude oil and other natural resources is healthy.

In addition to increasing regular revenue from taxes-fees and reducing one-off revenue, such as land use and selling State-owned houses, the government has made efforts to expand its tax-based revenue, particularly by increasing VAT rates and currently developing a proposal to introduce a first-ever property tax. While pursuing expanding tax-based revenue, it is important to analyze options to balance the infrastructure required to establish and enforce taxes and their progressivity (tax incidence favourable for lower-income groups). It is commonly viewed that (direct) taxes levied on income, profits or properties are more progressive as people are taxed according to their ability to pay. Meanwhile, indirect taxes levied on goods and services (such as VAT) can be more regressive as they relate to the price of a good or service—though this depends crucially on how

²¹ Due to the illicit and deliberately unrecorded nature of these flows, it is difficult to assess their exact magnitude. Efforts to estimate their scale have proven fraught with methodological and data challenges. Nevertheless, all parties agree they are a significant problem and a major drain on potential revenues to the fiscus.

²² Brunei Darussalam, Indonesia, Malaysia, Singapore, Thailand and Viet Nam.

they are structured and which basic goods are excluded.²³ Indirect taxes are also often viewed as quicker wins because they do not require as comprehensive infrastructure to establish and enforce than direct taxes. Importantly, taxes are not only sources of revenue, they are tools to change behaviours of economic players. For example, taxes on CO2 emissions can contribute to achieving SDGs on environment, climate change and public health, similarly the progressive property tax can contribute to SDG targets on equality and inclusive growth.

It is also recommended to (i) reconsider the ceiling on revenue from taxes and fees (22-23% of GDP set out by Prime Minister's Decision No.450/QĐ-TTg) and (ii) apply international standards to classifying non-grant revenues from taxes, fees and charges. Such standards may help make more meaningful comparisons with other countries (noting big differences between countries' tax/fee/charge systems may make such comparisons still challenging) and examine if there is room to increase Viet Nam's tax/fee revenue per GDP (Box 7).

Box 7: Is there room for government to increase revenue from taxes and fees-to-GDP ratio?

Viet Nam's total non-grant revenue-to-GDP ratio ranking is "average" among ASEAN countries. IMF data (Figure 19a) shows that Viet Nam's total revenue-to-GDP ratio was 21.9%, higher than Cambodia (19.83%), Indonesia (16.73%), Philippines (19.31%), India (19.64%), similar to Thailand (21.21%) and lower than China (28.54%), Lao PDR (23.62%) and Malaysia (23.3%) in 2014. MOF data had Viet Nam's total revenue/GDP at 22.01% in 2014 (similar to IMF data). Similarly, Table 1 shows Viet Nam has an "average" ranking among countries regarding volume of total revenue, revenue per capital and per capita revenue from taxes-fees. This shows there is room for the government to increase total revenue/GDP as well as per capita revenue from taxes-fees.

At the same time, data (Figure 19a) highlights the ratio of government tax and fee revenue/GDP as one of the highest among countries in comparison, implying little room to raise more revenue from taxes and fees/charges. This might be one of the reasons for the Prime Minister's Decision 450/QĐ-TTg dated 18 April 2012 approving the "Finance Strategy to 2020", with the target to mobilize resources from taxes and fees to government revenue "not more than 22-23% of GDP". MOF official reports show the ceiling was exceeded during 2006-2010 (24.8%), while in 2001-2005 and 2011-2015 it was 22% and 20-21%, respectively.

Aside from the economic logic of setting a ceiling on tax revenue-to-GDP ratio at this stage of development, Box 7 highlights (i) the limited "regulatory power" of the ceiling and (ii) that following international standard definitions and classifications of direct and indirect taxes and fees/charges may help with collection of data and allow more precise identification of issues and solutions for further increasing sources of government revenue.

Viet Nam's laws on taxes define taxes and rates (and levels of tax revenue). Viet Nam's tax rates are comparable to, if not lower (corporate income and environment tax rates) than those of ASEAN countries. Viet Nam has yet to apply a property tax, as seen in many other countries including in ASEAN. The 2015

²³ It is also true that some taxes, such as certain trade taxes, can be a combination of direct and indirect taxes—the level of detail reported varies from country-to-country. Also (following Lindert Growing Public 2004), consumption taxes are not anti-growth: they proved an effective means of financing the welfare state in Scandinavian countries.

Law on Fees and Charges²⁴ (effective 1 January 2017) defines 89 fees and 64 charges, leaving the definition of fee and charge levels to government line ministries to decide. This suggests that the actual “*regulatory power*” of the ceiling may be limited to defining the total level of revenue from fees and charges, which reportedly is only around 5% of total government revenue. Furthermore, as line ministries are responsible for defining the levels of fees and charges, it seems challenging to coordinate line ministries in (or have the real-time data on) setting fee and charge levels to ensure up-front that the total revenue from fees and charges would not exceed the ceiling. The assessment whether the ceiling is/will be actually exceeded or not can only be made based on government (MOF) reports on settlement of revenue and expenditures, which normally comes one or two years after the current year. This may suggest that the ceiling, in fact, just provides an “indicative” target (for the National Assembly and government to monitor) of the total volume of revenue from fees and charges, and thus may “regulate” the definition of fee and charge levels by line ministries.

More importantly, the differences in classification of “*fees and charges*” by different data sources, as noted in the earlier sections of the report, suggest that a deeper look into this topic may be useful. It is observed that among 89 fees and 64 charges defined in the 2015 Law on Fees and Charges, many (fees for “quarantines”, supervising sterilization of quarantined objects, testing and certifying the safety of imported foods, certification of knowledge on food safety, parking in public areas or charges for issuing IDs, passports and residence registrations, or for registration of adoption, enterprises and other businesses) could be classified as “cost recovery charges” of public service-providing institutions. It is noted that the law has defined (i) 44 fees and charges as “cost recovery” (or “prices” of the “service provision”) and the collected amounts of these fees and charges will no longer be classified as income to the government (“off-budget”) revenue and (ii) among 44, prices of 17 will be defined by the government and prices of the rest will be defined by the service-providing institutions “though market mechanisms”²⁵. It is also noted that education and hospital fees, more substantial in terms of volume, are already defined by other earlier issued laws, not as a source of government (off budget) revenue. While this presents an initial step in the right direction, more needs to be done.

This, together with the observation that some revenue sources (dividends from State-owned shares in shareholding companies and SOEs or revenue from crude oil) need better classifications, suggests the need to follow international standards in classification of sources of tax-fee and non-tax revenues. Using the international standard classification and data collection on revenue from taxes and fees may allow more precise identification of issues and solutions.

In expanding tax/fee-based revenue, it is important to improve the tax-fee collection system. While noting several government efforts, such as applying VAT charges “up-front” more strictly (contributing to increased revenue from VAT from 2010) and “non-stop” collection of fees in tollways, application of new (modern, including 4.0 technologies) methods to increase tax-fee revenue and reduce corruption-related risks must seriously be looked at. More importantly, efforts should be intensified such as reconsidering the application of “fixed”/“flat” tax rates or a “flat basis”

²⁴ http://vanban.chinhphu.vn/portal/page/portal/chinhphu/hethongvanban?class_id=1&_page=1&mode=detail&document_id=183214

²⁵ Reportedly, the amounts of fees and charges collected by public service-providing institutions are small and they still heavily rely on government budget transfers to cover operational costs.

method for calculating tax payable amounts, particularly among domestic informal businesses or addressing tax avoidance and price transfers especially among FDI enterprises (as noted earlier).

4.3.2. Increasing revenue from better managing State assets

Since 2013, the collection of dividends from State-owned shares in shareholding companies and profits from 100% state-owned enterprises contributed to a big increase in revenue from SOEs (Figures 20a and 20b). This together with the increase in other non-tax revenue from selling State-owned “land and houses” in 2005-2010 indicates the importance of improving the management of State assets in a way that maximizes government revenue, including from (i) more “regular” sources, such as rents from State assets (land) and dividends from State-owned shares in shareholding companies and profits from 100% state-owned SOEs and (ii) “one off” income from selling shares in SOEs²⁶ and other State-owned property. Making and maintaining a balance sheet that includes values and incomes from State-owned assets and related liabilities is necessary to enhancing management of State assets. Taking into account the liabilities (especially related to SOEs) and analyzing (i) income from selling off State assets (SOEs and land/houses) in the first scenario and (ii) flows of income to revenue from leasing assets and profits from SOEs over a certain period of time in the second scenario could result in optimal decisions to maximize returns on State assets in terms of income for revenue and growth of national income. The following article (Box 8) discusses how better management of assets can help cities “boost their economies, finance social and economic infrastructure, cover the costs of required maintenance without competing with government budgets, leaving more for spending on health care, education and other social initiatives”. Similar arguments can also be applied to managing State assets at country level.

Box 8: The Hidden Wealth of Cities

By DAG DETTER, Project Syndicate, Nov 23, 2017 (<https://www.project-syndicate.org/commentary/city-planning-urban-wealth-funds-by-dag-detter-2017-11?barrier=accessreg>)

The world is becoming increasingly urbanized, as more people are choosing to live in towns and cities than ever before. The trouble is, most urban areas are unprepared to manage the influx.

Cities around the world face a looming investment crisis that makes them less livable than they should be. The maintenance of vital social and economic infrastructure, not to mention development planning, is being delayed because of a lack of cash. With local governments’ finances burdened by continuously expanding spending commitments, public resources in many cities are highly constrained.

It doesn’t have to be this way. Even struggling cities own a range of commercial assets that can be used to reverse these trends. Unlocking the public value of poorly utilized real estate, for example, or monetizing transportation and utility assets, could and should become core urban strategies. This does not require privatization, but rather that assets could yield a reasonable return, freeing more resources than most cities currently have on hand. In fact, through smarter asset management, cities could more than double their investments without having to raise taxes or cut spending.

²⁶ Based on the direction of revenue from SOE equitization during 2016-2020, laid out in the National Assembly’s Resolution (25/2016/QH14), in 2016 the revenue collected from SOE equitization was VND30 trillion, 2017’s estimated revenue is VND60 trillion. The remaining VND160 trillion is planned to be collected: VND65 trillion in 2018, VND50 trillion in 2019 and VND45 trillion in 2020.

For the last 50 years, government ownership of vast commercial holdings has triggered a polarized debate, especially in Europe, but recently also in the United States. But private versus public ownership is a false dichotomy. What matters most is the quality of professional management of such assets supporting local economies.

Compiling an accurate balance sheet – knowledge that is, despite its importance, shockingly rare in most cities – is a crucial step toward adopting a management-focused approach. With a list of assets in hand, and a proper understanding of their market value, taxpayers, politicians, and investors can better reckon with the long-term consequences of political decisions. They can also make better choices about mobilizing returns, and avoid the traditional routes of tax increases, debt-financed spending, or austerity.

For various reasons, cities generally do not assess the market value of their economic assets. Consider a city like Boston, which, at first glance, does not appear to be particularly wealthy. Its financial statements underestimate the true value of public assets, reporting total assets worth USD3.8 billion, of which USD1.4 billion is real estate. That is slightly less than its liabilities of USD4.6 billion in 2015.

But, like most cities, Boston reports its assets at book value, which are tied to the historic cost. If holdings were reported using the International Financial Reporting Standards, which require the use of market value for assets, Boston's holdings would be worth significantly more than what is currently reported. In other words, the city is operating without fully understanding its hidden wealth.

And that wealth is vast. An estimate of the market value of Boston's property portfolio suggests that the city's real estate alone is worth some USD55 billion. But, because Boston's leaders have not accounted for this value, they cannot fully measure the cost of leaving these assets undermanaged. If they could, they would get a sense of the benefits to be gained by developing these assets more astutely.

After accounting for the market value of municipal assets, the next step toward sound asset management is to understand the yield that a city earns from the revenue and rising market values of its assets. This is crucial for comparing all investment options, but also for determining whether performance has been satisfactory, and to show stakeholders that their wealth is being managed responsibly.

Using Boston as an example again, let's cautiously assume that the city could earn a 3% yield on its commercial assets with more professional and politically independent management. A modest yield of 3% on a portfolio worth USD55 billion would amount to an income exceeding its current total revenues, and many times more than Boston's current capital plan. Even with a modest yield, Boston could more than double its infrastructure investments.

Boston is by no means exceptional. On the contrary, its approach to historical valuation is shared by cities worldwide. As a result, public wealth is trapped in real estate and other non-optimized commercial assets.

The best way forward would be to consolidate publicly owned assets in a common investment vehicle that Stefan Fölster and I have called an "urban wealth fund." The fund would be managed at arm's length in a transparent, accountable manner, guided by a city mandate but directed by a dedicated professional staff to keep it free from political influence.

This sounds challenging, but it can be done. Hamburg's HafenCity GmbH, and parts of Copenhagen that were revitalized by the City & Port Development Company, are just two examples of urban areas that have used this type of development mechanism. These efforts have not only increased the amount of residential housing; they have also funded vital infrastructure such as the Copenhagen Metro, schools, and universities. In Hamburg, the recently opened Elbe Symphony Hall was also funded via a government-owned holding company.

Managing city assets better would help local leaders boost their economies, finance social and economic infrastructure, and develop strategies for vibrant and innovative mixed-use projects. Better management of city assets would also help cover the costs of required maintenance without competing with government budgets, leaving more for spending on health care, education, and other social initiatives.

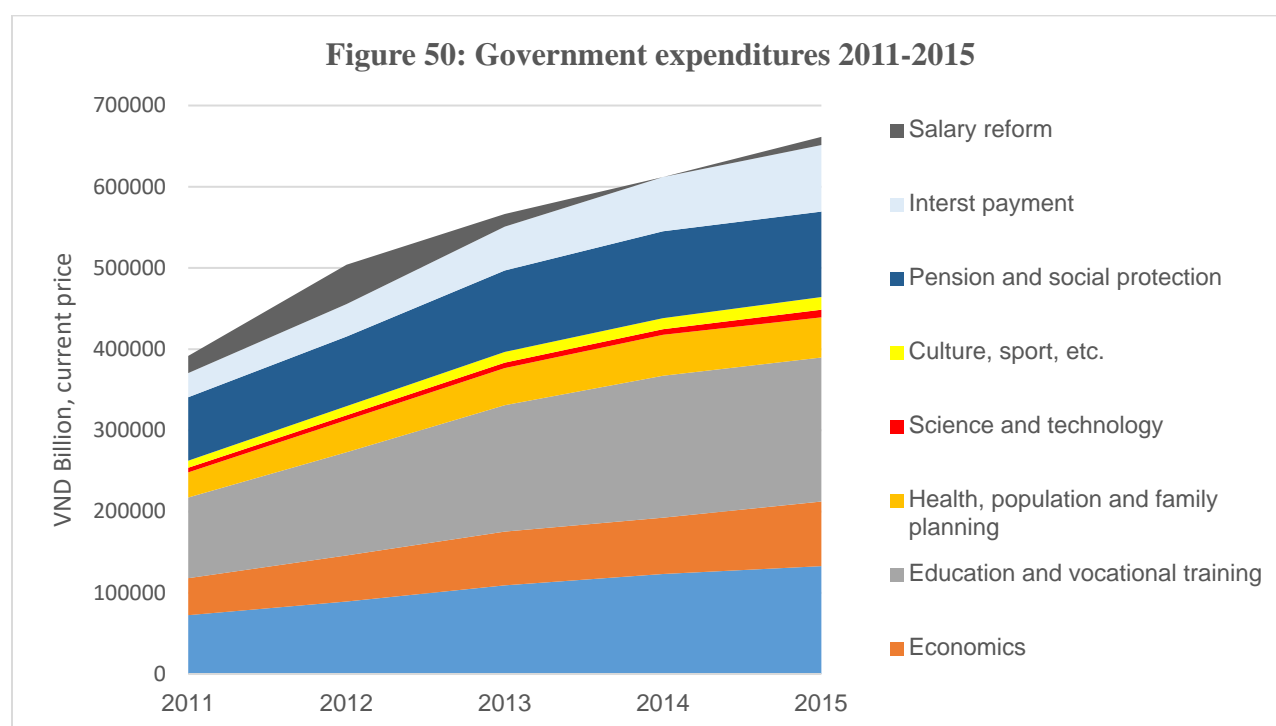
As urban populations grow, city planners must become more adept at budgeting for the long term. And there is no better way to do that than by using the assets that are already in place.

4.4. Improving effectiveness of government spending and public investment with sound public debt management

Expanding government revenue and public development finance only makes sense if public resources and government budget are used efficiently and public investment is effective with sound public debt management. This sub-section of the report on public development finance will provide a brief overview of government recurrent expenditures and make recommendations on improving its effectiveness and efficiency as well as that of public investment with sound debt management.

4.4.1. Enhancing effectiveness of government recurrent expenditures

Figure 50 shows the total volume of government recurrent expenditure (excluding principal debt repayments) jumped by 75.11% in 2015 compared to 2011 and almost double the increase of non-grant revenue (38.9%) during the same period. Among recurrent expenditures, the *fastest growing* spending items include administration (83.43%), education and training (78.49%) and interest payments (175.37%). The most *slowly growing* spending items include pensions and social protection (34.84%), health, population and family planning (59.79%) and science and technology (63.11%), noting that spending on salary reforms halved (52.79%). This contributed to an increased State budget deficit (including principal debt repayments on government expenditures) from around 4.0% of GDP in 2011 to 6.3% GDP in 2015 (Nguyen Trong Nghia, 2017).



Source: MOF (publicized finance data, MOF website)

A similar picture can be seen using the ratio of government recurrent expenditures in GDP. Total government recurrent expenditure increased from 19.87% of GDP in 2011 to 20.8% in 2015. Among recurrent expenditures, items with high ratios of expenditure/GDP (>1%) in 2015 included education and vocational training (4.23% increase from 3.57% in 2011), administration (3.17% increase from 2.61% in 2011), pension and social protection (2.51% fall from 2.81% in 2011), interest payments (1.96%, the fastest increase from 1.07% in 2011), health and population and

family planning (1.18% with a modest increase from 1.11% in 2011). Science and technology was among the lowest-spending GDP items with only 0.22% of GDP in 2015, which slightly increased compared to 0.21% in 2011 after a drop to 0.18% in 2012, 2013 and 2014. The fast increases in recurrent expenditure while facing difficulties in expanding revenue led to a slight reduction in capital expenditure/GDP from 7.49% in 2011 to 7.37% in 2015.

Among these items, high and fast increasing administration expenditure draws special attention. Recent efforts by the Party and the government itself to streamline the latter's apparatus and reduce its large salary payroll are accelerating and expected to contribute to greater efficiency and a reduction in recurrent expenditure on salary payments.

Unlike several reports highlighting recurrent expenditures and particularly expenditure on social protection having increased too fast, this data shows expenditure growth on pensions and social protection was one of the lowest and its share in GDP reduced in 2015 compared to 2011. According to UNESCO²⁷, the public (government) expenditure on R&D/GDP in Viet Nam is lower than China, Japan, Republic of Korea and Singapore, yet higher than Indonesia, Malaysia, the Philippines and Thailand. However, R&D by business sector, universities and private non-profit organizations in China, Japan, Malaysia, Republic of Korea, Singapore and Thailand was much higher than Viet Nam's and leaving its R&D spending/GDP only greater than Indonesia and the Philippines in comparison.

While it is important to further reduce other recurrent expenditures (such as purchasing vehicles and travel) within the government, applying central procurement (for vehicles, office supplies, government e-payments and transfers, e-government and other Industrial Revolution 4.0 technologies) could enhance efficiency in government operations, reduce costs and increase transparency. In the longer term, together with efforts to expand government revenue (which depends on government apparatus, public investment and national economic growth efficiency) it is necessary to search for policy and institutional solutions to contain growth in government payroll expenditures and find room for (i) increasing expenditures on R&D and developing 21st Century skills and (ii) expanding social insurance and social assistance coverage as Industrial Revolution 4.0 accelerates.

4.4.2. Ensuring public investment is growth-enhancing²⁸

Enhancing effectiveness and efficiency of public investment requires a wide range of efforts during every step in the entire cycle of a public investment programme, from planning and budgeting, prioritizing and selecting public investment projects, their implementation and management, M&E. As there are numerous studies and reports that have identified key issues and made recommendations on public investment project implementation and management including M&E,

²⁷ <http://uis.unesco.org/apps/visualisations/research-and-development-spending/>; noting that (i) the source does not provide year of the data cited, while the latest data available in this source is 2016 and (ii) the data on R&D spending varies too widely between sources (this, OECD, WB WDI).

²⁸ This sub-section is drawn from Jonathan Pincus (2017).

this report will only focus on prioritization and selection of growth-enhancing public investment projects.

A consensus has emerged among economists that the growth rate of the stock of public capital is positively associated with the rate of economic growth (David Aschaeur (1989), César Calderón Luis Servén (2014), César Calderón Enrique Moral-Benito Luis Servén (2011), Sanjeev Gupta (2011)). This means that indiscriminate or arbitrary (or influenced by reduced revenue or international public finance inflows) public investment decisions that cut the rate of public investment can slow economic growth and reduce a government's revenue and long-term capacity to reduce its debt burden (William Easterly, 2008). An important consideration for Viet Nam as the government formulates SEDP 2021-2025 and associated budgets and (as well as updating ODA directions) is the impact of new fiscal rules on the rate of public sector capital formation. Within an overall framework of fiscal restraint, priority should be given to public investments that contribute to growth, as it will eventually deliver revenue the government needs to achieve a better balance in public finances.

The apex of the allocation process is the five-year SEDP and the Public Investment Programme (MTPIP). As we have seen, countries that have utilized resources from all sources as part of a coherent development strategy have performed better than ones that have allowed public investment programmes to be politicized and fragmented. Planning documents like the SEDP are often aspirational and providing only key directions and actions, together with MTPIP, the Three-Year Financial and Budgetary Plan (3YFBP) and annual budgets provide a financing framework (see framework in Annex 2) to mobilize and operationalize resources for sustainable development results a country is driving towards. The MTPIP, based on the SEDP indicated target for State capital budgets over a period of five years, includes a list of potential public investment programmes and projects most likely to be funded during a five-year period. Though there are a number of criteria (including the high level of relevance in relation to priorities and development targets in five-year SEDPs) for selecting projects, the list suggests a rather weak focus and an urgent need for an improved set of criteria as well as a more rigorous prioritization and selection process.

4.4.2.1 Factors for prioritizing growth-enhancing public investment projects

Prioritizing growth-enhancing public investment is not straightforward. Feasibility studies must present estimates of returns on investment, generally a good guide on economic impacts. However, simply ranking projects by their benefit-cost ratios or internal rates of return may not yield desired results. Other factors to be considered include:

- Critical infrastructure bottlenecks: Does the project eliminate a critical economic bottleneck that increases costs paid by businesses and consumers? Bridges are an obvious example: having to wait for ferries adds hours to journeys and the cost of transporting goods and people. A reliable power supply and irrigation are often constraining factors in manufacturing and agriculture. The development of water supply and sanitation systems in regions that have potential for tourism development will attract investment to these locations.

- ‘Crowding in’ private investment: Government investment is most likely to ‘crowd in’ private investment (in other words, raise the rate of return on private investment) when it is targeted at basic infrastructure, such as transport, power supply, water and sanitation and irrigation (Luis Servén (1996).
- Spillover effects: Public investment generates various kinds of spillover effects. Network effects mean that investment in roads in one location increases the returns to road investments in neighbouring provinces. Agglomeration economies (regarding supplier networks, technology, skills and infrastructure) provide justification for concentration of public investment in areas with greater economic potential. Although this may have political costs (poorer provinces arguing they need more help to catch up), the economic benefits of concentration are probably too large to be ignored.
- Affordability: Mega-projects attract the most attention and political support, but less expensive growth-enhancing investments should not be overlooked.
- Public goods rationale: Selected projects should have a clear public goods rationale. Projects that deliver a reliable revenue stream and hence can attract private investment with a subsidy, should not be selected.

Box 9: Is prioritizing growth-enhancing projects not sufficiently “pro-poor”?

Some will argue that assigning priority to growth-enhancing projects is not sufficiently “pro-poor”, as it does not require the distribution of benefits to skew towards lower income groups. Two rejoinders can be offered. First, the policy decision to cap the public debt-to-GDP ratio means either public investment will need to be severely curtailed, or GDP will grow at a rate sufficient to enable the government to continue to invest. The option of high rates of investment at slow growth is no longer *politically* feasible. Second, evidence suggests that rapid economic growth since the 1990s has been pro-poor (Paul Glewwe, 2011; Nanak Kakwani, 2006). Growth of agricultural exports and labour-intensive industries have massively increased employment opportunities, especially among low-income and less skilled workers. While measured economic inequality has increased, it is still moderate in comparison with other countries in the region. Careful attention to the employment effects of public investment should ensure that the poor continue to derive benefits from public investment.

4.4.2.2 Allocation process

The objective of channelling scarce resources into growth-enhancing public investment can only be met if the allocation process of public investment resources is capable of ranking projects based on objective criteria and rigorous analysis.²⁹ The allocation process must apply to all public investment projects including ODA, those funded directly from government budgets or resources from government bonds, central and local government and public-private partnership projects. The origin

²⁹ For a summary of the literature, see: “Making Public Investment More Efficient,” IMF Staff Report, June 11, 2015, <http://www.imf.org/external/np/pp/eng/2015/061115.pdf>.

of financing public investment projects is not a sufficient reason to allow projects to circumvent the allocation process.

Project appraisals will help weed out projects that do not deliver value for money, that impose excessive costs on vulnerable populations or the environment or have a high probability of underperformance or failure.

Yet in a world of scarcity, it is likely capital budget is not sufficient to fund the full list of highly-ranked projects through to implementation. The planning and budgeting authority will be tempted in this case to select projects that have attracted ODA funding (especially ones with “concessional” terms), while postponing projects funded from domestic resources. However, as this would effectively substitute donors’ preferences for the government’s own criteria, this is not a prudent basis on which to proceed.

The institutional set-up underlying public investment allocation decision-making varies from country-to-country and there is no ideal system replicated in all contexts.³⁰ Nevertheless, coherent management of the process suggests a single apex institution should take responsibility for investment allocation to ensure projects that have passed screening (are consistent with national, sectoral and local plans) are given equal treatment and fiscal rules are applied consistently. This apex institution must have the technical capacity to commission, conduct and utilize social-economic cost benefit analyses and the political capacity to carry out unbiased rankings of projects based on objective criteria.

It is possible to identify at least five steps in project allocation decision-making:

1. Development and investment planning: As noted above, the government encodes its economic strategy in national planning documents, from which a public investment programme is specified. The five-year SEDP and MTPIP are accompanied by the three-year financial and budgetary plan (3YFBP) and budgets of line ministries and local governments. It is important to ensure debt management is an integrated part of these documents.
2. Project identification/initial screening: Line ministries and local authorities prepare project descriptions indicating the relevance of the project to national, sectoral and local plans and consistency with the public investment programme, the project’s main objective, elements and activities, expected results and detailed budgets. Projects that pass initial screening will be consistent with national, sectoral and local plans and the public investment programme, address a priority need and fall within established capital budget limits and debt management plan. They will have a clear public objective that cannot be achieved through private actors without government support. Projects intended as public-private partnerships must assess the probable impact on government revenue and budgets, and the level of private interest in the project concept.

³⁰ For useful international comparisons see Anand Rajaram, Tuan Minh Le, Kai Kaiser, Jay-Hyung Kim and Jonas Frank (eds.), *The Power of Public Investment Management: Transforming Resources into Assets for Growth*, World Bank, 2014.

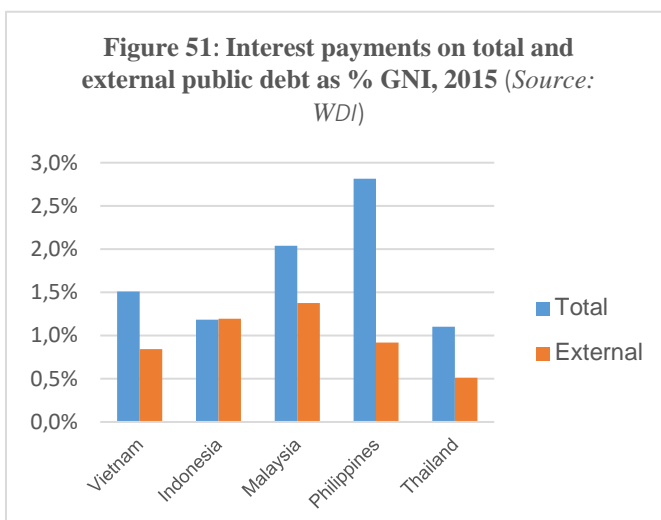
3. Project appraisal: A rigorous project appraisal process is required to estimate financial and economic returns on the investment. A technical feasibility study is required at the outset to review technical assumptions, evaluate environment impacts and the likely effects of climate change on project implementation and outcomes. The next stage is financial analysis, carried out in constant market prices. The resulting cash flow is discounted using the financial opportunity cost of capital, which is the government's best estimate of the returns on alternative investments. If the project is profitable at market prices, the agency will focus on finding a private investor to undertake it, thereby conserving scarce public resources. If the project is not profitable at market prices, but provides essential public goods, the appraisal can proceed to the economic analysis, which applies shadow prices to key inputs, such as foreign exchange and assigns economic values to non-market costs and benefits. The resulting cash flow is discounted at the social discount rate, which is the government's measure of the social opportunity cost of capital. If the project has a positive net present value, the appraiser must conduct risk analysis to estimate the effect of changes in prices and other conditions on the project's economic rate of return. Pre-feasibility studies may be required for large and complex projects to avoid spending large amounts of time and money on projects unlikely to achieve a positive outcome.
4. Ranking of appraised projects: The apex institution will maintain an inventory of feasibility studies and compile a ranking based on a clear set of criteria, including economic rate of return, relevance to priorities articulated in national, sectoral and local plans and consistency with fiscal rules. Rankings may be based on individual projects or groups of projects ('top priority', 'high priority', 'priority'), but all projects slated for approval must be fully financed through the capital budget.
5. Independent review of high-ranking projects: An independent review is an essential step in the allocation process. The crucial consideration is the actual degree of independence of the review process. Circulating drafts among ministerial counterparts (who may or may not have alternative projects on the vetted list) is a form of peer review, but does not constitute an independent review. Independent experts from the university sector, think tanks, United Nations agencies and independent consultants are more likely to provide an unbiased assessment of feasibility studies and ask harder questions about the potential for less expensive or private sector alternatives.
6. Project selection and budgeting: Projects that pass through independent reviews are available for final selection based on the availability of budget and commitment to fund through to completion. Project selection should be based on a medium-term capital allocation plan that is ideally part of a unified budget (capital and recurrent costs, built on sound revenue, expenditure forecasting and planning, and debt management) to ensure sufficient funds are available to support project implementation through to its conclusion and to finance required maintenance during project operations. Approved projects not allocated budget are maintained in the government's inventory of feasible projects to be considered in the next budget cycle. Ratification of the list of selected and funded projects

can include approval by the National Assembly (legislative branch), Prime Minister (executive branch) or both.

Publication of project proposals and appraisal documents, independent reviews and budget allocations by the apex agency facilitates transparency and public confidence in the selection of projects and efficient use of public resources.

4.4.3. Improving public debt management

Before discussing how Viet Nam's debt has built up, associated risks and making recommendations for improving debt management, it should be noted that *Viet Nam is not a highly indebted country* and although the level of interest payments on public debt have risen in recent years, they are not out of line with other countries in the region (Figure 51). Interest payments on public and publicly guaranteed external debt were equal to just 0.5% of exports in 2016. As a country that has only recently acquired middle-income status, much of Viet Nam's external debt (40%) was acquired at concessional rates. In standard debt sustainability analysis, the stock of debt is self-stabilizing if the



real interest rate-growth rate differential is negative (in other words the average real interest rate on all forms of debt is less than real GDP growth). Given Viet Nam's growth record and low average real interest rates on foreign and domestic debt, the government will have the capacity to service the existing stock of debt out of government revenue barring a major economic shock. The main challenges at present are containing future deficits and managing the government's debt portfolio to reduce financing costs at acceptable risk levels.

As shown in earlier sections of this report, since the 2008-2009 global financial crisis, Viet Nam has recorded larger than normal fiscal deficits and a rapid accumulation of public debt. Several factors have combined to drive up Viet Nam's fiscal deficits over the past decade. As in most countries in the region, the government increased spending as the global crisis unfolded to substitute for export demand and prevent a sharp downturn in economic activity. After a brief period of consolidation, deficits resumed their upward trajectory in 2012, driven by the combined effects of revenue shortfalls and a rise in routine expenditures. Tariff reductions, lower corporate tax rates, VAT exemptions and a fall in global oil prices suppressed revenue growth, while on the expenditure side government salaries, principal and interest payments on government debt and other obligations more than offset a slowdown in public investment. As the government sought to borrow to somehow

sustain the public investment and fulfill expenditure obligations, by the end of 2016, total public debt and central government debt stood at 63.7% and 52.7% of GDP, respectively.

The sudden rise in the government's stock of debt has heightened concerns about the economic risks associated with excessive borrowing. Viet Nam's graduation to middle-income status means access to concessional ODA loans is now limited, which will *raise average interest rates on public debt over the medium term*. The large stock of external debt leaves the government *vulnerable to exchange rate risks* in the event of a sharp downturn in international trade or a freezing of credit markets such as experienced in 2008-2009. As shown in Section 2, the government's increasing reliance on the domestic bond market exposes it to *increased interest rate risks* and the shorter maturities of these instruments results in higher financing costs. The fact that the majority of domestic bonds are acquired by local banks imposes some *additional risks on the financial system*, as any sudden fall in the value of government bonds would have immediate, negative consequences for the banks' balance sheets. *Implicit guarantees on debt acquired by SOEs and local authorities are another important source of risk-to-debt sustainability*.

In response to these concerns, the National Assembly approved a resolution on the country's five-year financial plan in November 2016 that imposed ceilings of 65% and 54% of GDP on total and central government debt, respectively. The foreign debt ceiling was set at 50% of GDP. The targets were confirmed in the Medium-Term Debt Management Strategy signed by the Prime Minister in April 2017.

Putting aside the possible technical debates, principles, criteria and methods of calculation based on theories and international experiences for defining the exact levels of the ceilings, it is noted that the National Assembly setting the debt ceilings has effectively forced the government to ration all borrowings, helped debt management be taken much more seriously and improve "budgetary"/spending disciplines. On the other hand, it is noted that the ceilings based on debt-to-GDP ratio calculated based on the debt level and GDP of the current year (though used as a target/indicator for monitoring and entire five-year SEDP period giving flexibility for the government in executing the annual SEDPs and budgets) may pose some pressure on the government to raise growth rates as a way to create more room for borrowing to finance the deficits, sustain public investment and meet expenditure obligations (that are important to sustain the growth). It is recommended to consider: (i) calculating the annual debt-to-GDP ratio based on GDP of the previous year, as this may help avoid uncertainty of the current year's GDP estimates, improve the accuracy of public debt targets and reduce the debt ceiling-related pressure to raise growth rates and (ii) using, in addition to the debt-to-GDP ratio, other public debt indicators, such as ratios of debt to total budget revenue, interest against GDP/GNI growth, ratio of foreign debt to foreign exchange reserves or total export value, ratio of short-term foreign debt/foreign debt service to foreign exchange reserves as this may give much more information on solvency of debts needed for a sound debt management system.

It is vital to develop and implement public debt management legislation, strategies, plans and policies as an integrated part of the national development plan and INFF, particularly by enhancing (i) their linkages to SEDP, MTPIP and three-year Financial and Budgetary Plan and (ii) their

coherence to other legal documents, policies and regulations on State budget, public investment, enterprises, banking system, Social Insurance Fund and State Treasury (as the major holders of government bonds).

The National Assembly's decision-making MOF, as the sole focal point appointed for public debt management, is an important step in enhancing public debt management in Viet Nam. Looking forward, the ministry as the government public debt management authority, will need to take the lead and enhance the coordination between line ministries and agencies in all stages of public debt management. The public debt management authority will need to strengthen its capacity for (i) conducting an analysis of opportunities, challenges, costs and risks in all sources of public debt and borrowings, forecasting and advising on future borrowing needs and repayment obligations of government, (ii) based on this, formulating debt management strategy and plans (including the five-year plan for borrowing and repayment of public debt, medium-term debt management programme in line with the financial and budgetary plan and annual plan for borrowings) with concrete targets, indicators and methods of borrowings from every source, (iii) developing and implementing mechanisms for monitoring, supervision, control and management of risks of all government borrowings (including by local government), government guarantee and SOE borrowing, (iv) closely monitoring and evaluating public debt (including by using international standard definitions and classifications, and M&E indicators in planning and monitoring public debt) to provide timely and accurate information, data and disseminate these widely to users, following international best practices in public debt M&E and information disclosures.

As noted in earlier sections, government efforts to address the interest rate and short-term issues related to government issuing VND bonds in the domestic market started to show some results in reducing the share of government bonds held by commercial banks and increasing shares held by other long-term investors, increasing terms and reducing the interest of government bonds. Expecting declines in traditional ODA, the government also put efforts into accessing OOF and climate finance sources, resources (including grant and concessional loans) from which have also been increasing. Such efforts (and to restructure public debt) must continue and more importantly in tandem with efforts to make public investment more focused on growth-enhancement and effectiveness.

4.5. Ensuring a smooth transition to ODA graduation

Regarding international public finance, a key challenge for government is to (i) ensure effective utilization of currently available resources, including through strengthening capacity for prioritization and selection, pipeline management, implementation, management and M&E of projects and (ii) manage the transition to ODA graduation by developing and implementing exit plans and exploring new resource mobilization opportunities. Given that guidance and potential actions to improve ODA mobilization, utilization and management have been provided in other studies (including UNDP-supported ones) and the government's draft report "Updating Directions and Actions for Improving ODA Mobilization, Utilization and Management 2018-2020 and 2021-2025", this sub-section of this report will only focus on the issue of managing the transition to ODA graduation.

In the global and regional contexts of declining traditional ODA, especially to middle-income countries, its role in Viet Nam's economy is changing. ODA is falling as a share of national income and grant aid and concessional loans are being phased out in favour of loans at near-market rates. Some countries, in similar contexts, experience balance of payment pressures when losing access to concessional financing. However, this scenario is avoidable as ODA by nature is a temporary source of financing and planning for the decline of this development finance source could have taken place up-front.

To avoid all concessional lending coming to a halt simultaneously, government and donors should work together to develop ODA programmes and projects in the next five to 10 years reflective of anticipated levels of resources and develop a transition plan from concessional loans. While Viet Nam has been successful in engaging a diverse group of ODA donors, unlike some countries in the region, maintaining this diversity needs to be continued as it helps reduce “cliff-edge risk” and gives government more alternative options.

Most importantly, the GOV must formulate a plan to ensure the smooth transition to ODA graduation. Within such a plan, while cognizant of the need to make full use of ODA for projects that require foreign exchange and access to foreign technology and capital goods, the government must identify new financial sources (including further development of government and corporate bond markets), to replace ODA over the medium term³¹.

As the number of extremely poor countries falls, donors are increasingly turning their attention to financing global public good issues, such as adaptation to climate change, transition to cleaner energy, deforestation and biodiversity, infectious diseases and HIV/AIDS, management of migration and refugee populations as well as security concerns. New mechanisms, such as the Green Climate Fund, are and will be created and the dividing lines between official ODA and private sector initiatives, concessional and commercial loans will become less distinct. These changes have important implications for Viet Nam to take into account when formulating its transition plan. The country has and will need to continue its active participation and leadership role in international initiatives addressing issues such as climate change adaptation, mitigation and green economy management. Such active participation would not only help Viet Nam strengthen its role in the international arena and shape support mechanisms, it would also open the door to new development finance resources (including international private foundations and philanthropic organizations), needed for Viet Nam to sustain public investment after graduation from concessional ODA.

³¹ As ODA grants – the main source of financing TA, capacity strengthening support, policy advice and access to international experience and expertise in Viet Nam - have already quickly reduced, the government could consider allowing the use of domestic public and private resources to co-finance such TA projects.

4.6. Managing interactions between development finance sources

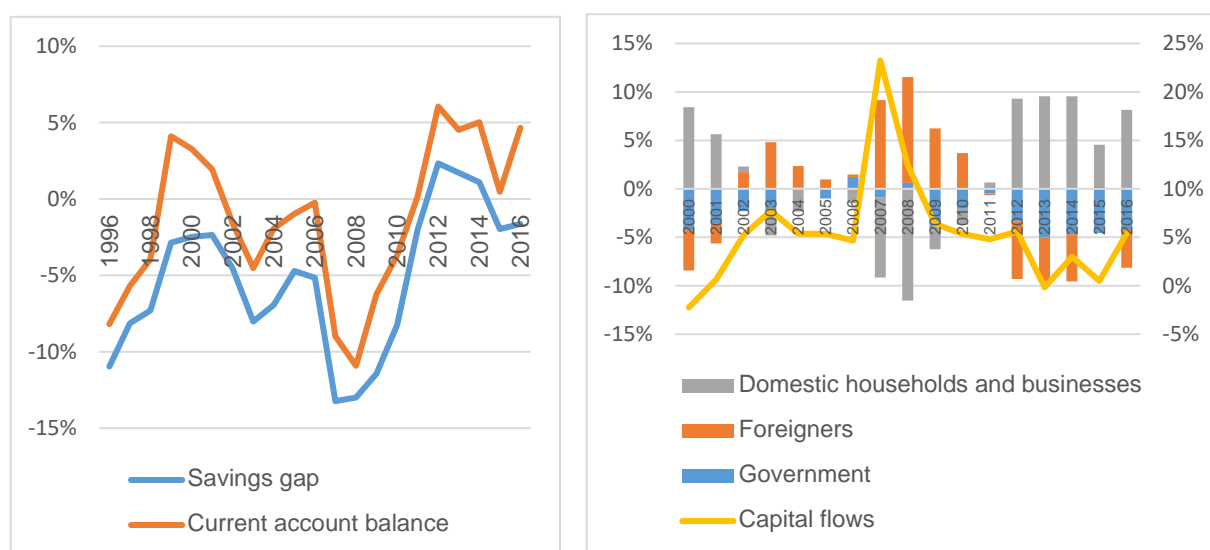
Understanding and managing interactions between development finance sources are essential to not only limit negative and maximize positive synergies as well as impacts of different development finance resources, but also to ensure macroeconomic stability, sustainable debt management and stable economic growth. Box 10 provides a case study on how capital inflows and pro-cyclical domestic investment destabilized Viet Nam's macroeconomy in 2007.

Box 10: How capital inflows and pro-cyclical domestic investment destabilized Viet Nam's macroeconomy in 2007

Current account deficits are by definition balanced by surpluses on the financial account, including net foreign investment and external borrowing. Capital inflows, therefore, raise the rate of investment above the level of domestic savings: but this is an accounting relationship, not a mechanism that automatically moves toward equilibrium. There is no desired rate of investment that is established independently on the balance of payments that requires foreign savings to realize.

This point is illustrated in Figure 52, which presents Viet Nam's savings gap (gross fixed capital formation less domestic savings) and current account balance for 1996-2016. The savings gap widens sharply in 2007 as capital flows flood into Viet Nam in the wake of WTO accession. This rush of foreign capital drove up domestic asset prices, which stimulated pro-cyclical domestic investment, widening the current account deficit. With the onset of the global financial crisis, the government subsidized borrowing to replace external demand, which supported imports and investment. When the stimulus was finally removed, domestic corporations and households began to deleverage their debt positions, acting as net lenders during 2012 to 2016 (Figure 52). Figure 52 shows how the surge in capital inflows and pro-cyclical domestic investment destabilized Viet Nam's macroeconomy in 2007. In hindsight, the government should have taken action earlier to prevent the economy from overheating through a combination of interest rate rises, reductions in government spending and/or increases in taxes and curtailing the spending plans of SOEs.

Figure 52: Savings gap and current account balance, % GDP (left), Net lending and borrowing as share of GDP (right)



Source: WDI

Several recent empirical studies have focussed on interactions between development finance sources, especially public investment, FDI and ODA, domestic private investment and government revenue and borrowing.

Hang Pham (2015) found that ODA projects helped attract FDI inflows and thus contributed to economic growth, but this impact is only observed in the mid and long-terms. A study by Selaya and Sulensen (2012) indicated the impact of ODA on attracting FDI (private investment) depended on the type of ODA project: those on infrastructure or human capital development helped attract FDI and private investment as they improved productivity and returns on capital, while other types of ODA projects may ‘crowd out’ private investment. Other studies, such as (Benedek, 2012), show evidence of ODA’s negative impacts on government revenues, especially revenue from taxes.

Studies also provide evidence that public investment, including by SOEs, ‘crowd out’ private investment through ‘competition’ for domestic credit. The UNDP development finance assessment in ASEAN countries (UNDP 2017) shows that the high level of SOE borrowing presents obstacles for SMEs to access credit. To Trung Thanh’s (2012) assessment of public investment impacts on private investment indicated a 1% increase in public investment capital led to reduction in private investment by 0.48% and reduced the private sector’s contribution to GDP growth by 0.05% and shows the impact of private investment on GDP growth is greater than public investment’s. As shown earlier in this report, the fact that commercial banks hold the major share of government bonds lessens available resources and increases lending interest rates, leading to more difficulties for private enterprises, especially MSMEs, to access affordable credit.

The ‘crowding out’ effect of public investment, especially by SOEs, is not only through the access-to-credit channel, but also through ‘competition’ for good business opportunities. Government efforts to promote public-private partnership projects, focused on public investment in projects with negative economic returns or in areas that lack private sector interest/presence, ensure public investment projects ‘crowd in’ more private investment and equitizing SOEs - especially ones doing businesses in private sector areas - are important to not only limit the ‘crowding out’ effect, but also to promote private sector development in Viet Nam.

Further research is needed to shed more light on interactions between development finance sources and to inform development of an INFF to help the government manage all resources and promote synergies.

4.7. Managing decentralization and related fragmentation and coordination problems³²

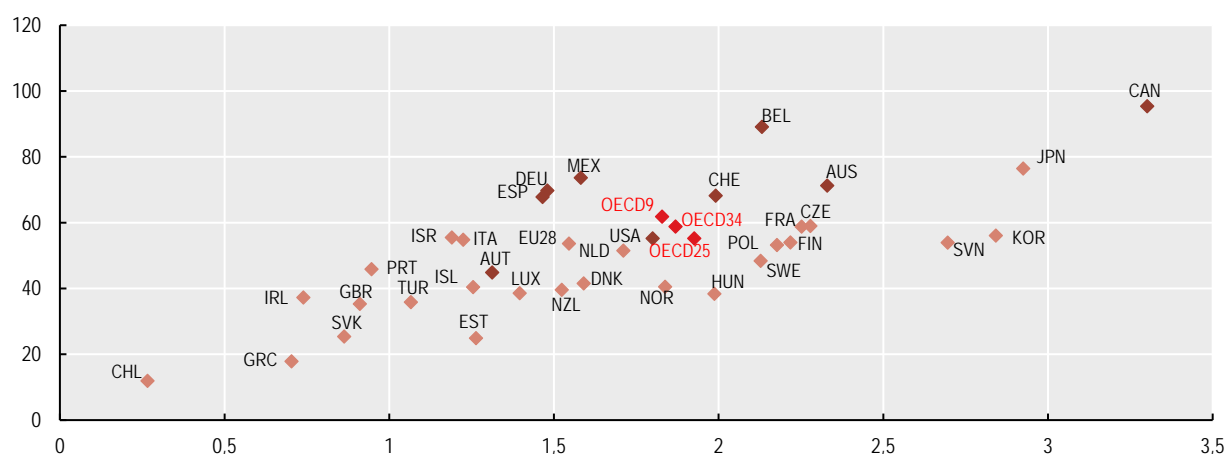
The motivation for decentralization is not identical in every country that adopts the policy. In some places, for example the United States, decentralization was part of a deliberate effort to reduce fiscal deficits, where responsibility for public programmes was devolved to states, which were forced to cut spending as they were often subject to constitutional requirements to balance public sector

³² This sub-section is drawn from a framework paper by Jonathan Pincus, as inputs into the Development Finance Assessment in Ho Chi Minh City, commissioned by UNDP (forthcoming).

budgets. In other places, decentralization was an attempt to improve the performance of government programmes or achieve efficiencies associated with greater local control. Whatever the initial impetus, the fact that more taxes were collected locally meant sub-national governments were in control of revenue streams that could be leveraged through the issuance of bonds or other instruments. The expectation in some quarters was that decentralization of public investment would make the process more efficient and responsive to citizens' needs.

While it is difficult to know if the expected efficiencies have in fact materialized, it does appear to be the case that the overall rate of public investment has fallen as the process of decentralization has unfolded. Across a large sample of countries, the rate of public investment declines on average as the share of sub-national government in total public investment increases (Figure 53).³³ Local governments have more restricted access to capital markets than central authorities and therefore find it difficult to finance large-scale, slow-gestating projects. Ironically, capital markets shy away from local lending in part because of poorly designed fiscal decentralization mechanisms that make it hard to predict the volume of central government transfers to the region and increase regulatory uncertainty. Local governments also typically lack the technical capacity to plan and implement complex projects. Decentralized public investment is clearly not a substitute for national planning of large-scale infrastructure and related investments.

Figure 53: Sub-national public investment as share of total public investment and GDP, OECD countries (%)



Source: OECD

A major disadvantage of sub-national public investment is that it tends to be more pro-cyclical than public investment at national level. The reason is that local authorities often rely on taxes that are more elastic with respect to the overall level of economic activity, such as taxes on the sale of land and buildings and corporate income taxes (D. Holtz-Eakin and A. Schwartz, 1995). Moreover, local governments are often responsible for delivering essential services like education, health and public

³³ Lorena Vinuela, "Trends and Quality of Decentralized Public Investment," Andrew Young School of Policy Studies, Georgia State University, International Center for Public Policy, Working Paper 14-07, January 2014, <http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.987.6729&rep=rep1&type=pdf>.

safety, areas in which there is little scope to reduce spending even during recessions. Given that in many countries local government is restricted under the law to a limited range of taxes and fees, the responsibilities imposed under decentralization have not been matched by a corresponding autonomy to seek additional sources of revenue.

Another constraint on local-level public investment is that sub-national authorities are subject to pronounced vertical and horizontal coordination problems. Vertical coordination problems emerge because the respective roles and responsibilities of central and local authorities are inadequately specified, leading to confusion and gaps in accountability. Countries have adopted numerous strategies to achieve better vertical coordination, including co-financing arrangements and matching grants, and formal consultation processes that embed representatives of national agencies within local government structures. Central authorities in OECD countries use various forms of conditionality to align national and local priorities, for example tying the availability of investment resources to a specific timeframe, counterpart financing from local government or ex-post evaluation of outcomes.

Horizontal coordination is a more difficult problem to solve. The administrative boundaries of cities/provinces do not usually conform to the patterns of economic geography of regions, creating a mismatch between the efficient scale and scope of public assets and the incentive structures facing government agencies. Hence, the need for inter-governmental coordination mechanisms at local level turns out to be important, especially among provinces and cities and within big cities. Economies of scale give larger metropolitan areas a distinct advantage, but the gains associated with size decrease with political fragmentation. Labour productivity declines as the number of administrative units within a large metropolitan area increases (A. Nelson and K. Foster, 2014). Bartolini (2016), for example, finds that the number of administrative units per 100,000 people had a negative impact on GDP growth per capita for a sample of 250 regions over the period 1996-2011. For urban areas, the negative impact of fragmentation was substantial: a 10% increase in fragmentation was found to result in a fall in the annual per capital growth rate. (Ibid., p. 119).

If the gains to better horizontal coordination are so large, why does fragmentation persist? From a political economy perspective, local governments do not have an incentive to coordinate because local administrations compete for investment resources and local leaders are rewarded (in the form of votes or prestige) according to the volume of resources they deliver for their constituencies. Smaller provinces and cities or administrative units are often reluctant to cooperate with larger and more politically powerful neighbours. Central government authorities may prefer to deal with smaller units because this increases the relative bargaining power of the centre versus the localities (C. Gamper and C. Charbit (2014)).

Fiscal rules also limit the scope for local government borrowing to finance public investment. Where sub-national governments have the authority to borrow on capital markets, their capacity to do so depends on market perceptions of risk, which in turn are influenced by credit ratings issued by the main rating agencies. Credit rating agencies consider factors such as legal and regulatory certainty (legal standing of local borrowing under national laws and regulations), the stability and buoyancy of local government revenues and the quality of local government institutions. The quality

of institutions includes criteria, such as transparency and disclosure, evidence of long-term planning capacity and the recent history of debt, liquidity and external risk management. Among the budgetary factors considered by credit agencies are contingent liabilities, such as pension and health insurance benefits of government employees, government guarantees and on-lending to government-owned or government-linked enterprises.

The existence of numerous, small companies under government control—a familiar situation in Viet Nam—raises alarm bells among credit rating agencies, especially when information about these companies is difficult to obtain. These companies and other entities impose implicit contingent liabilities on local government associated with on-lending, government guarantees, insurance and employee benefits. Moreover, lack of information on the net asset position of these entities obscures the real dimensions of the government's balance sheet and creates opportunities for corruption.

In summary, investment in the public's stock of capital goods is essential for economic growth, and sub-national government now plays an increasingly important role in these investment decisions. Decentralization of public finance has assigned revenues to local authorities, which in turn has created opportunities to leverage this income through the sale of bonds and other instruments. However, the growing importance of local government in public investment may have the effect of reducing overall levels of public investment. Sub-national governments are less able to mobilize capital on a large-scale than national governments and they may also lack the technical and administrative skills to plan and implement large projects. Moreover, local administrations are subject to vertical and horizontal coordination problems that increase costs and reduce the efficiency of public investment. Investment by sub-national government will tend to be pro-cyclical because local administrations depend on forms of taxation that fall sharply during periods of economic slowdown, but have to maintain levels of spending on essential services.

The coordination problems affecting sub-national public investment are not insurmountable. They can be managed through intelligent restructuring of incentives facing central and local governments, for example through co-financing arrangements, matching grants from central agencies, conditionality linking financing to performance and consultation mechanisms. Supra-local authorities governing transport links, ports, waterways and even services like education and healthcare have proven effective. Local authorities can also improve their access to borrowing by focusing on the quality of local institutions, for example by increasing transparency, reducing fragmentation of local institutions and streamlining decision-making processes.

5. CONCLUSIONS

Viet Nam is entering its next development stage as a lower middle-income country in the context of a fast-changing development finance landscape. Embarking on a more inclusive development pathway and a new growth model based on higher productivity, stronger international competition and creating more productive jobs for all as Industry 4.0 accelerates, will require Viet Nam to formulate a new strategy to mobilize resources to finance hard and soft infrastructure investments, human capital improvements - especially equipping its labour force with “21st Century skills” - in particular and achievement of the SDGs in general.

The assessment of development finance sources and resources presented in this report has identified the challenges and opportunities for Viet Nam to mobilize the right scale and mix of financial resources and to ensure effective utilization and sustainability of its development finance landscape. The interlinked policy actions outlined in this report are proposed to be formulated and implemented within a national integrated finance framework consistent with and suited to Viet Nam's new growth model and situation. This new development finance strategy and its implementation should be an integral part of Viet Nam's reforms in public finance management and public investment, its plans for SOEs and particularly the development of private SMEs. It should also be sensitive to the country's efforts to minimize regional disparities, improve its productivity and competitiveness, economic and social inclusion, environmental sustainability and climate resilience, while pursuing a more inclusive and sustainable development pathway. Now is the time for all stakeholders to act in a concerted manner on the identified challenges to realize the country's aspirations to achieve its ambitious SDG agenda to lift Viet Nam's human development to new heights.

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Annex 1: Data notes

Analysis of financing flows has been undertaken from the country perspective, thus national data sources were preferred over international data sets, where adequate coverage and metadata were provided. Across the 10 country papers and the regional report included in this project, all financing data and analysis are in constant 2015 USD, unless otherwise specified. Data from national sources reported in national currencies were converted into constant USD using exchange rates and GDP-based deflators, following normal practice.

Domestic public finance

Domestic public finance refers to government resources that originate domestically. It covers government revenue (excluding any grants received, to avoid double counting with international resources) and government borrowing from domestic sources (i.e. domestic financing). Both series were sourced from national budget documents where available, with data from IMF Article IV Reports used to fill gaps, where needed.

Domestic private finance

Domestic private finance refers to investment by the domestic private sector in the country. In Viet Nam's case, data for this type of financing were sourced from the GSO, more specifically, from its data on “investment by types of ownership, items and year”. The level of disaggregation available at the source allows distinctions to be made between domestic and foreign investment, as well as between public and private resources. Data on non-State investment were used.

International public finance

International public finance includes ODA, OOF and government borrowing from international sources. ODA is sourced from OECD DAC data. OOF data are sourced from OECD DAC Table 2B for all countries, as comprehensive data on this type of finance are not readily available from national sources. Government borrowing refers to lending from bilateral and multilateral institutions and private entities, received or guaranteed by the State. For consistency across country papers and to ensure that overlaps with ODA loans and OOF could be accounted for, data for this flow were also sourced from international data sets for all countries.

International private finance

International private finance includes FDI, portfolio equity, private borrowing from international sources and remittances. FDI data are based on national sources for all countries. Portfolio equity and remittances were based on national sources for countries with sufficient coverage, or World Bank data otherwise. Portfolio equity data based on national sources were sourced from the liabilities line of portfolio investments (equity component) in balance of payments (BOP) tables. Private borrowing from international sources refers to commercial debt (both long- and short-term) and is based on international data from the World Bank's International Debt Statistics for all countries; this was done for consistency across the country papers and due to patchy coverage and availability of data on this type of finance in national sources.

Annex 2: Assessment of existing INFF for Viet Nam

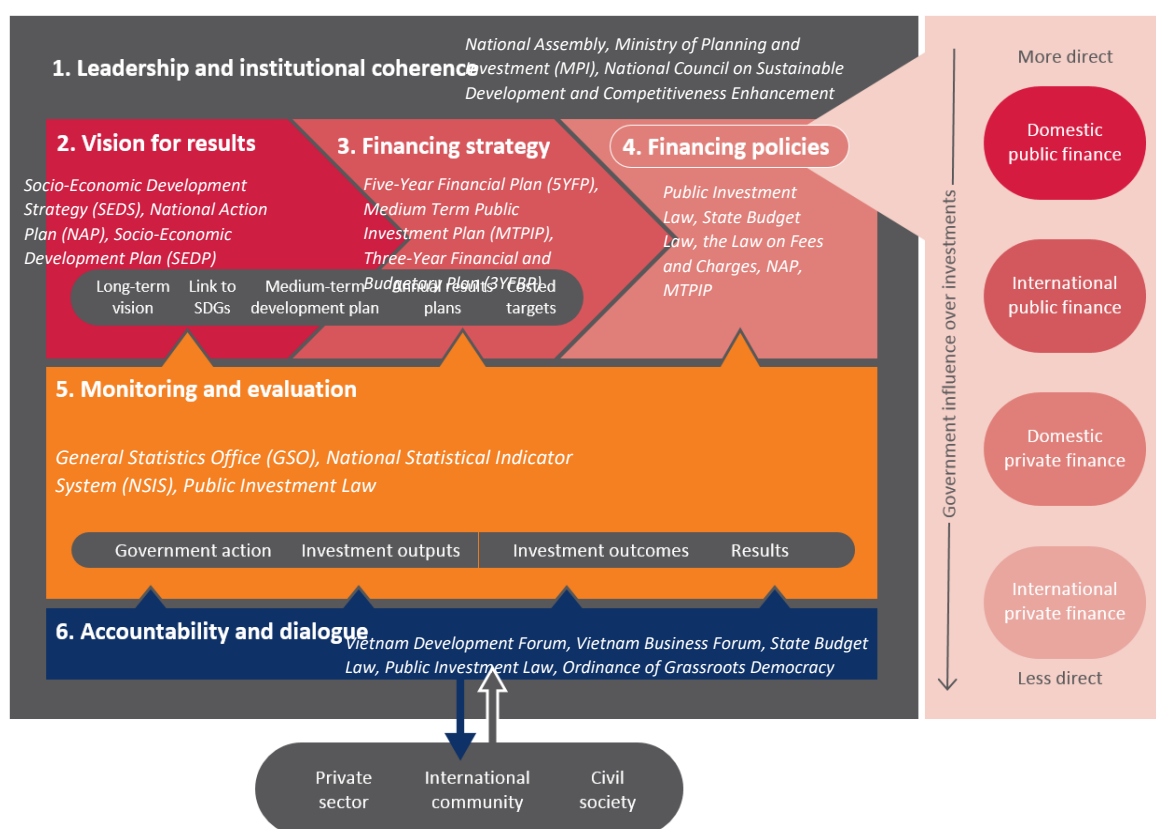
Note: The below text is extracted from “Financing the future with an integrated national financing framework” – a background paper prepared by a team of Development Initiative and national consultants, commissioned by UNDP’s Regional Bureau for Asia and the Pacific as inputs to the “Financing the Sustainable Development Goals in ASEAN” commissioned by UNDP’s Regional Bureau for Asia and the Pacific as part of the preparations for the China-UNDP ASEAN Symposium on Financing the Implementation of the SDGs in ASEAN.

Viet Nam’s evolving financing landscape offers opportunities to tackle the ambitious SDGs and the country’s own national vision, though it must manage the balance between economic acceleration and the environmental and social impacts it aims to achieve. In this context, it is pertinent to examine the framework through which the government currently manages its strategies regarding the diverse range of resources and financing instruments available to support such aims. The lens of an INFF provides a basis on which this ‘big picture’ perspective on financing policies and institutions can be strengthened.

Assessment of existing framework

In 2015, the Third International Conference on Financing for Development called for "cohesive nationally owned sustainable development strategies, supported by integrated national financing frameworks" to be at the heart of national efforts to finance the SDGs.³⁴ The rationale behind an INFF is to support governments in implementing a strategic, holistic, results-driven approach to financing their development objectives that mobilizes all available financing—domestic, international, public, private—to meet country-specific needs and priorities. In doing so, it supports governments to link finance with results and facilitates nationally led implementation of the SDGs. The INFF concept covers six building blocks and, critically, the way that they interact and work together.

Building blocks of an Integrated National Financing Framework (INFF)



³⁴ Addis Ababa Action Agenda, paragraph 9. http://www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf

Building Block 1: Leadership and institutional coherence

Viet Nam is engaged and committed to Agenda 2030 and has a strong system and institutions in place, with a largely shared vision for results, which it is ready to deliver against the SDGs. Looking ahead, it is crucial that the various plans that exist at ministerial, sectoral and local levels are coherent and that implementation efforts are coordinated for the most effective delivery of the national vision and sustainable development.

Viet Nam's development vision is articulated primarily through its 10-year Socio-Economic Development Strategy (SEDS), approved by the Party Congress. This provides long-term strategic vision and directions for development planning. To realize the vision outlined in the SEDS and to address national and global priority issues, the government approves and issues various strategies, sectoral plans, master plans and action plans, with relevant focal line ministries playing a leading and coordinating role in close cooperation with other stakeholders in drafting them. For example, in the early 2000s when poverty alleviation—a national priority—became a central commitment of the global agenda, a Comprehensive Poverty Reduction and Growth Strategy was developed. A National Strategy on Climate Change Adaptation and a Viet Nam Green Growth Strategy (VGGS) have also been developed and approved by the Prime Minister (PM) in 2011 and 2012 respectively.

The key instruments for implementing these strategic documents are the five-year (and annual) national Socio-Economic Development Plans (SEDPs), which are drafted by the Ministry of Planning and Investment (MPI) in a consultative and coordinated process, and approved by the National Assembly. The SEDPs, in their turn, provide a framework for different sectors and provinces to develop their own sector- or provincial-level five-year and annual development plans and budgets. Sector-level development plans are made by line ministries, while provincial development plans are drafted by the Provincial People's Committees (PPCs), with provincial departments of planning and investment (DPI) playing a leading and coordinating role; these are then approved by the provincial People's Councils. Existing legal and policy frameworks make public consultations compulsory, with feedback gathered from citizens on draft strategies, master/action plans and development plans. Stakeholders can either provide oral comments in workshops, send written comments to the drafting committee or post online comments on the relevant webpages.

Development plans (and master/action plans) are implemented by government bodies, line ministries and local governments (local line departments) in line with their regular functions and responsibilities. Accountability for delivering the development goals and targets of these plans lies with the associated implementing body. The national government has the overall responsibility for achieving national development goals and for the overall coordination, guidance and management of SEDP implementation. The MPI assists with coordination, and both the MPI and the Ministry of Finance (MOF) assist with the allocation of resources—capital and recurrent expenditure respectively. The subnational People's Committees, with the assistance of DPIs and departments of finance (DOFs), similar to that at national level, are responsible for results at subnational levels.

Oversight of the government's implementation of SEDPs and the national budget rests with the National Assembly, and oversight of local governments' implementation of local development plans and budgets with the respective local People's Councils.

In addition to the system and institutions for implementing national development plans, the National Council on Sustainable Development and Competitiveness Enhancement leads and supports the implementation of Agenda 2030 and the SDGs.

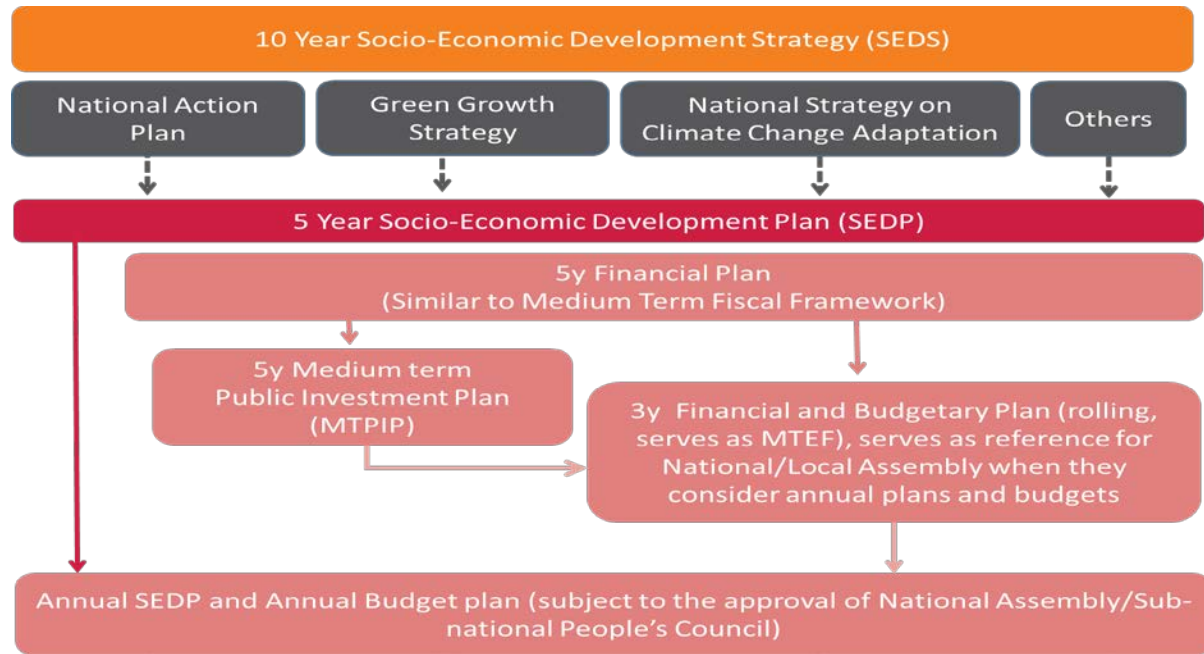
Box: *The National Council on Sustainable Development and Competitiveness Enhancement* acts as an advisory body to support the PM in guiding the formulation and implementation of strategies, policies and programmes regarding sustainable development and competitiveness enhancement; implementation of the government's commitment to the UN and the international community on sustainable development (including the implementation of the SDGs), including on monitoring and reporting; and the development of advisory reports in the field of sustainable development.

The Council is headed by the Deputy Prime Minister, who is supported by four vice chairpersons, including the Minister of the MPI (the Council's standing member), ministers of the Ministry of Labour, War Invalids and Social Affairs (MOLISA) and the Ministry of Natural Resources and Environment (MONRE) and the leadership of the Ministry of Foreign Affairs (MOFA). The Council also includes 36 other representatives from different ministries, CSOs, the business community and academia. It is structured with four committees: the Committee on Economic Sustainability, led by the MPI; the Committee on Social Sustainability, led by

MOLISA; the Committee on Environmental Sustainability, led by MONRE; and the Committee for the Decade of Education for Sustainable Development in Viet Nam, led by MOFA.

The Sustainable Development Office serves as the Secretariat of the National Council on Sustainable Development and Competitiveness Enhancement, and is based in the MPI. The Office is responsible for assisting the Council to carry out its functions, and in particular (among other tasks) for drafting roadmaps and guidelines to mainstream sustainable development targets into SEDPs and local and sectoral plans and coordinating with line ministries and provinces to implement, monitor and report on the progress of SDG implementation.

The development planning system in Viet Nam



Note: The MTPIP and the 3YFBP and annual plans and budgets are costed.

Building Block 2: Vision for results

The country's long-term development vision and orientation for different aspects of the economy are articulated primarily through the 10-year SEDS, which currently covers the period 2011–2020. The general objectives of the SEDS are as follows: “Strive to make our country a modern-oriented industrial one by 2020 with socio-political stability, agreement, democracy, discipline; people's physical and spiritual life is clearly improved; independence and territorial unification are firmly maintained; Viet Nam's position in [the] international arena is continually improved; creating firm premises for higher development in the next period.”³⁵ The strategy details three breakthrough areas: promoting the development of high-quality human resources; improving market institutions; and developing infrastructure.

The SEDS provides the long-term strategic vision and direction for other more detailed strategies, such as those for green growth and climate change, and for sectoral strategies, and helps to formulate five-year SEDPs. SEDPs are drafted and consolidated by the MPI and approved by the National Assembly, and effectively translate the development vision outlined in the SEDS and other strategic documents into more detailed medium-term targets and actions for implementation. The SEDP provides the planning framework for the formulation of the five-year Medium-Term Public Investment Plan (MTPIP), the three-year Financial and Budgetary Plan (3YFBP) and the plans and budgets of individual ministries, sectors and local-level governments. Figure 4.2 provides an overview of Viet Nam's development planning system for achieving development results.

The effort to ‘nationalize’ the SDGs³⁶ is epitomized by the National Action Plan for the Implementation of the 2030 Sustainable Development Agenda (NAP), issued by the PM in 2017. Drawing on these national strategies and planning documents and on the global SDGs and their targets, it outlines Viet Nam's own sustainable development goals (the VSDGs) up to 2030, along with the targets, key tasks and organizational arrangements required for their implementation. The MPI is the designated focal point for the NAP and is responsible for coordinating its implementation and for the integration of the SDGs into national SEDPs.

Most of Viet Nam's development goals and targets have been set out in its strategies and planning documents for the period up until 2020, and the NAP consists of two phases aimed at fully integrating and implementing the SDGs via the national planning system. The key tasks for the first phase (2017–2020) include developing laws, regulations, policies and mechanisms to produce a comprehensive enabling legal framework for SDG implementation; improving the governance system for national sustainable development; and ministries and provinces developing their own action plans for the implementation of SDGs where relevant. The VSDGs are also to be incorporated into annual development strategies, policies, master plans and sector plans—all no later than 2018.

Viet Nam's vision for national development aligns well with the global Agenda 2030, and the SDGs and their targets largely align with the national development goals and targets set out in the NAP and the current SEDS and SEDP, as well as other strategic planning documents. As the NAP highlights, the 17 VSDGs for 2030 and their 115 related targets³⁷ correspond well with the global SDGs adopted by the UN in September 2015. Table 4.1 demonstrates the comparability between the SDG targets, the VSDGs set out in the NAP and the SEDP 2016–2020.

Given these levels of compatibility and overlap, the SDGs are to an extent automatically included in routine plans and likely to be compulsorily implemented by relevant central agencies and local governments. Only the new VSDG targets (in line with the SDGs) that are not yet included in the current routine planning system need to be additionally incorporated through annual SEDPs. However, by the end of the first phase of NAP implementation, all the SDGs are due to be mainstreamed into the national planning system.

³⁵ Vietnam's Socio-Economic Development Strategy for the Period Of 2011–2020.
<http://www.economica.vn/Portals/0/Documents/1d3f7ee0400e42152bdcaa439bf62686.pdf>

³⁶ Viet Nam demonstrated a strong commitment to the MDGs and made substantial efforts to implement and achieve them. They were incorporated as an integral part of previous SEDPs, National Target Programmes (NTPs) and other programmes and policies, which accelerated their implementation.

³⁷ Compared with the 169 global SDG targets, the NAP sets out 115 corresponding Viet Nam SDG targets. They exclude certain targets at global/regional levels, targets that are specific to certain groups of countries (such as landlocked and small islands) and some “means of implementation” targets, which it has translated into “actions” for implementing the Viet Nam SDGs.

Examples of compatibility between the SDG targets in the NAP and the targets of the SEDP 2016–2020

| SDG targets | VSDG targets specified in the NAP | Targets in the SEDP 2016–2020 |
|--|---|---|
| 1.1 By 2030, eradicate extreme poverty for all people everywhere, currently measured as people living on less than USD1.25 a day. 1.2 By 2030, reduce at least by half the proportion of men, women and children of all ages living in poverty in all its dimensions according to national definition. | Target 1.1: By 2020, eliminate extremely poverty for all citizens everywhere, using the poverty line with per capita income below USD1.25 per day in purchasing power parity (in 2005 constant prices); by 2030, reduce poverty at least by half, using the national multi-dimensional poverty criteria. | Every year, the poverty rate is reduced by 1–1.5% on average, and in extremely poor communes and districts it is reduced by 4%. |
| 2.2 By 2030, end all forms of malnutrition, including achieving, by 2025, the internationally agreed targets on stunting and wasting in children under five years of age, and address the nutritional needs of adolescent girls, pregnant and lactating women and older persons. 3.8 Achieve universal health coverage, including financial risk protection, access to quality essential health care services and access to safe, effective, quality and affordable essential medicines and vaccines for all. | Target 2.2: By 2030 reduce all forms of malnutrition and meet the nutritional needs for all target groups who are children, adolescent girls, pregnant women, lactating mothers and elderly people. | Targets are to have nine - ten doctors and 26.5 beds for every 10,000 inhabitants, an under-five malnutrition ratio of less than 10%, and about 80% of the population to have health insurance. |
| 15.2 By 2020, promote the implementation of sustainable management of all types of forests, halt deforestation, restore degraded forests and substantially increase afforestation and reforestation globally. | Target 15.2: By 2020, fundamentally reduce the transfer of forest lands to other usage; by 2030, strengthen the implementation of sustainable management of forests of various types, halt deforestation, restore degraded forests, promote afforestation and reforestation, increase forest cover to approximately 44–45% of the country's land area | By 2020, the forest coverage ratio to be 42%. |

Source: SDGs, NAP and the SEDP 2016–2020

Addressing the coordination challenges involved in implementing the Viet Nam SDGs, with their high levels of ambition and interlinkages, the NAP assigns different ministries to lead on specific targets. Each Viet Nam SDG target specified in the NAP is associated with a lead agency, while others act as supporting agencies. For example, for Viet Nam SDG target 1.4 (“By 2030, improve the resilience of the poor and, at the same time, reduce their exposure and vulnerability to climate-related extreme weather circumstances and other economic, social and environmental shocks and disasters”), which corresponds to SDG target 1.5, the Ministry of Agriculture and Rural Development (MARD) is designated as the lead agency, and other agencies including MOLISA, the MPI, the MOF, the Ministry of Justice (MOJ) and the Ministry of Health (MOH) act as coordinating agencies, as well as other CSOs and PPCs.

This is designed so that when ministries implement their sectoral plans, as the leads on the assigned targets they also fulfil the sector-based targets, or in the case of supporting/participating agencies at least contribute to their achievement. However, fragmentation and a “silo approach” to development planning and implementation are widely acknowledged and often seen in Viet Nam. The ambitious, complex and interlinked nature of the SDGs, in a context of constrained resources, poses a serious challenge in effectively achieving the Viet Nam SDGs. Additional efficiencies could be gained from greater coordination: horizontally between central government ministries and agencies, vertically between central and local governments in line with the 2030 Agenda’s “whole government” principle, and between government and other stakeholders from the private sector and CSOs in line with the 2030 Agenda’s “whole society” principle.

Building Block 3: Financing strategy

While the SEDP lays out a vision, a direction and specific actions, the Five-Year Financial Plan (5YFP), the Medium-Term Public Investment Plan (MTPIP), the Three-Year Financial and Budgetary Plan (3YFBP) and annual budgets provide a financing framework to mobilize and operationalize resources for the sustainable development results that the country is driving towards. The system, however, is fragmented. To achieve its development vision with greater efficiency, the government could consider creating stronger links between resources and development results. Additional resource mobilization, including from domestic private sources, and the effective utilization of such resources will be needed to realize the nation's vision for sustainable development.

The NAP by design is not a costed plan, although it does outline goals, targets and actions and assigns responsibilities for the integration of the SDGs into development plans and their implementation. It provides only general principles for setting up a national financing framework for implementation, though according to the PM's Decision 622³⁸ funding sources for implementing the NAP will consist of the State budget and investments from business, the private sector, local communities and external sources. In order to be operationalized, the goals must be mainstreamed into SEDPs, sector plans and local SEDPs. Only in this way can the budget can be allocated accordingly and the NAP put into practice.

While SEDPs are not fully costed, their main objectives are translated into public programmes and projects, which are aggregated into the MTPIP; this can thus be considered as the costed vehicle to implement the SEDPs. In the budgeting and planning process, the MPI and the MOF have to work closely together to set out budget plans for implementing the SEDPs. The process begins with the MPI's role in setting out the macroeconomic outlook and providing forecasts (for the GDP growth rate, inflation, productivity and economic perspectives). Then the MOF makes revenue forecasts and sets expenditure ceilings for both the recurrent and capital budgets. Within a given capital budget ceiling, the MPI develops public (capital) investment plans, while the MOF develops recurrent expenditure plans. Finally, the MOF is responsible for consolidating recurrent and capital plans into a single aggregate budget plan (annually and the rolling three-year 3YFBP, which serves as a Medium-Term Expenditure Framework (MTEF)).

Funding from the state budget is allocated in the annual budget plans of ministries and provinces in line with provisions of the State Budget Law, and integrated into the budgets for SEDPs, the MTPIP and the 3YFBP. The MPI and the MOF are responsible for reconciling and allocating State budgets (capital and recurrent respectively) on an annual basis, in order to effectively implement the SEDPs and achieve the Viet Nam SDG targets mainstreamed into them and stated in the NAP.

In addition, the NAP suggests setting up a Sustainable Development Support Fund (SDSF) to mobilize domestic and external financial resources for SDG implementation. The MPI has been assigned to prepare and submit to the PM a proposal for establishing the SDSF. It should be noted, however, that the scope of the SDSF, its linkages to the SEDPs, MTPIP and 3YFBP, the timeline and other details are yet to be made clear.

In the current setting, annual budgets are linked to annual SEDPs. The MPI is the lead and coordinating agency for State capital budgets (or public investment programmes and projects), plus the mobilization of ODA and FDI. The MOF is responsible for domestic revenue from tax collection, FDI and public debt management. The State Bank of Viet Nam (SBV) is responsible for remittances, as well as providing State management of the banking system—an important source of domestic resource mobilization and financing. These three key bodies—the MPI, the MOF, the SBV—coordinate with one another to mobilize financial resources and channel them into different sectors and/or priorities, in alignment with national development strategies and plans.

Since 2017, as stated in the State Budget Law of 2015, the five-year SEDP also provides a macroeconomic development framework for budget revenue forecasts and is a key tool in setting medium-term fiscal indicators. These revenue forecasts and indicators are reflected in the 5YFP, which can be seen as a medium-term national fiscal framework. The 5YFP indicates the total ceiling for State capital budgets over a period of five years, which provides a basis for developing the MTPIP. The MTPIP is a shortlist of the potential public investment programmes and projects that are most likely to be funded in the course of the five-year period. There are a number of criteria for programmes and projects to meet in order to be listed, including a high level of relevance in relation to the priorities and development targets set in the five-year SEDP.

³⁸ National Action Plan and Decision 622.

http://www2.hss.de/fileadmin/suedostasien/vietnam_myanmar/downloads/2017/170505-01-vietnam-national-action-plan-english.pdf

In this sense, the MTPIP can be seen as a costed public investment vehicle for implementing the five-year SEDP targets. Moreover, it includes different types of public investment, such as National Targeted Programmes (NTPs), targeted programmes and infrastructure development projects. NTPs and targeted programmes are funded from the central and local budgets and provide resources additional to the SEDP budget allocation to achieve national or sectoral targets, while public investment projects can be funded by either the central capital budget (if managed by ministries) or provincial capital budgets (if managed by provinces) to meet local development targets. Central and local government funding sources for the MTPIP can be government budget, government credit or borrowing (domestic and external, including ODA).

Also according to the State Budget Law, the 5YFP and the MTPIP must be mainstreamed into the 3YFBP, which serves as a national MTEF. While both the 5YFP and the MTPIP have a fixed five-year horizon, the 3YFBP is set on a three-year rolling basis, and so allows greater flexibility in adapting budget plans to changes in the actual macroeconomic situation. The 3YFBP is also different from the MTPIP in that it integrates both capital and recurrent expenditures into a single plan. The first year of the rolling 3YFBP is the annual budget plan, which is subject to approval by the National Assembly at central level and by the People's Councils at provincial level, while budget estimates for the other two years are only for reference by decision makers.

Under this system, the MTPIP, the 3YFBP and annual budget plans can be seen as a bridge to link targets contained in strategic plans to actual costed implementation of activities. However, since there are weak links between the activities identified in the current five-year SEDP and strategic targets at the outcome level, it is hard to demonstrate direct and causal links between strategic planned development targets and these three types of budget plan.

The 5YFP provides the strategic objectives for key economic and fiscal aggregates, including debt, revenues and expenditures. In line with the five-year national SEDP, it provides projections for the allocation of recurrent and investment expenditures across the main sectors and across central and provincial governments. The aim of the 3YFBP is to translate the strategic objectives of the 5YFP to the annual budget by determining the expenditure ceilings for central agencies and provinces for the next three years, taking into account recent fiscal developments. This is reflected in transparent and predictable rolling expenditure ceilings for central agencies and transfers to provincial governments. Both the 5YFP and the 3YFBP determine the aggregate expenditure ceiling as part of the overall fiscal framework. This then determines the ceilings for recurrent/operational and capital/development expenditures. Conditional upon the ceiling for capital/development expenditures in the 5YFB, the MTPIP prioritizes which investments will be funded by government over a five-year time-frame and then translates these into an annual public investment plan, which forms part of the annual budget. The total value of investments cannot exceed the ceiling for capital/development expenditures stipulated in the 3YFBP. The 5YFB, the MTPIP, the 3YFBP and the annual budgets therefore collectively provide the national financing framework for mobilizing and operationalizing budgetary resources for development.

The government recognizes that SDG implementation will involve huge demands for funding resources and technical assistance, and may not be achievable if the country has to rely on its own efforts alone. Therefore, the international donor community has played an important role in providing advisory and funding support. ODA has been a significant source of public capital for socio-economic development in Viet Nam over the past two decades. However, there are certain risks associated with utilizing these resources, especially with limited fiscal space for debt repayment. The associated debt burden will be larger in the coming years, especially considering that interest on loans will be higher and grace periods shorter. The country will also have to face a number of other risks, including currency exchange and cashflow risks due to budget deficits and increasing debt servicing obligations, along with technical risks and risks from natural disasters. With this in mind, Viet Nam might establish a better supervision mechanism to effectively utilize these resources.

Building Block 4: Financing policies

There is some emphasis on the role of the private sector, and Viet Nam has made efforts to improve the enabling environment for domestic and international businesses. However, there are few financing policies relating to specific resources. Specifically in terms of the NAP, the MOF is responsible for drafting policies to encourage different development actors, especially the private sector, to participate and fund the implementation of the SDGs.

A number of financing policies are in place to support development. Given the current high levels of public debt, the government is trying to tighten public investment and has introduced rigid policies to control new borrowing, which may potentially reduce the domestic public funds available for achieving its desired goals, at least in the 2017–2020 period. The key tools for public debt control are the Public Investment Law, promulgated in 2014, and the State Budget Law, promulgated in 2015. To sustain public borrowing and control public debt, the State Budget Law sets debt ceilings for provinces and centrally managed cities. This means that they cannot have a debt stock exceeding a certain percentage of their disposable budget revenue (or entitled revenue³⁹). The percentage varies depending on the fiscal position of each province. Since 2015, capital expenditure has been planned on a five-year basis as part of the MTPIP. This is then translated into Annual Public Investment Plans. Public investment projects proposed in the MTPIP must be aligned with projected available funds from different sources; only projects included in the approved MTPIP are eligible for funding and implementation. These laws will contribute significantly to ending the poor practice of many provinces of approving public investment projects without considering their affordability.

The Government of Viet Nam does have some mechanisms in place to protect and increase the efficiency of public spending. The Public Investment Law of 2014 strictly regulates the use of the government budget for public investment. The law is considered an important step in correcting the recurring challenges of inefficiencies in public investment. It seeks to establish a complete framework for the government's management of investment, and clearly stipulates procedures for selecting and approving different types of project, including public–private partnerships. The law also helps to reduce fragmentation across the investment cycle, including project selection, appraisal, budgeting, implementation and adjustment and monitoring and evaluation (M&E). Another of its breakthrough provisions is the move from annual planning of the capital budget to medium-term (five-year) planning, aligning with the five-year national SEDP. In addition, the law stipulates the mechanism for M&E of investment plans and programmes. Lastly, it provides increased transparency in the investment process by encouraging public participation in the selection of investment priorities.

A recent decree (Decree 52/2017/ND-CP, issued on 28 April 2017) specifies the eligibility conditions for provinces and centrally managed cities to receive new ODA and/or concessional loans. These include the following:

- The proposed loan project should be included in the approved provincial MTPIP.
- Counterpart funds should be available.
- There is no overdue amount on government loans or on-lending (overdue means more than 180 days after the due date).
- Total outstanding debt (or debt stock) from all borrowing sources at the time of approval of the proposed project concept note should not exceed the borrowing ceiling (or debt limit), as set out in the State Budget Law of 2015.
- The projected annual amount of debt repayment should not exceed 10% of the province's entitlement budget revenue.

Viet Nam has a target of becoming an industrialized country by 2020 and plans to invest USD400 billion in infrastructure. It is intended that half of this amount will be privately funded. In order to meet this target, attracting private investors to participate in infrastructure development is crucial. The NAP provides the principle for attracting private sector investment towards the SDGs, based on the government's legal frameworks and mechanisms and policies for the mobilization of resources. This includes Public-Private Partnerships, whereby the NAP sets out a clear goal to “improve the system of policies and institutions” that govern them, with a specific focus on technical assistance, financial support and the sharing of knowledge and experience. The SBV will also lead an effort to promote the country's voice and position in monetary, banking, stock exchange and insurance forums within ASEAN. Improving private funding is paramount to Viet Nam, which this year was ranked last among 12 countries in a study by consultancy McKinsey & Company, in terms of both development maturity and the size of the local market as a share of GDP. McKinsey's report suggested that increased liquidity in the sovereign bonds market would encourage more private

³⁹ These are the local government's revenue shares, from revenues collected, based on a formula approved by the central government.

finance, while Tyler Cheung, director of the institutional client division at ACB Securities, proposed that pension funds could grow to become an important source of development finance for infrastructure projects.⁴⁰

Businesses and CSOs are also encouraged to be proactive in developing and implementing initiatives towards SDG implementation. There are also a number of policy and legal frameworks intended to attract private investment into the economy, covering FDI, Public-Private Partnerships and other social investment initiatives, which are either currently being implemented or are in development. It is also expected, as indicated in the NAP, that the government will make continued efforts to improve the “laws, policies, mechanisms in the direction of amending and supplementing the existing ones or issuing new normative documents in order to provide an adequate legal framework for the implementation of the National Action Plan and sustainable development goals”.⁴¹

The government is also exploring the potential of Public-Private Partnerships and is encouraging the private sector to participate in providing public services, with the aim of improving their quality and removing the burden of subsidy from its own budget. It is doing this by encouraging agencies that provide public services to shift from subsidizing services towards market-based pricing. For example, the Law on Fees and Charges of 2016 requires public services to move from a fee and charge collection mechanism (or subsidized tariff) to a market-based pricing mechanism (or cost-recovery tariff system). Since 2014, 44 types of service have been shifted to market price mechanisms, though 17 of these are subject to price controls by the government, including water-related public services. This move also applies to ferry tolls and build–operate–transfer (BOT) road tolls, service fees at ports and terminals, and parking and sanitation charges. Although Public-Private Partnerships are increasingly being considered by governments in a number of countries, it is essential that these are accompanied by strong regulatory control to ensure that they do not lead to higher inequality in access to services.

In Viet Nam, the legal framework for Public-Private Partnerships has evolved significantly over the past 25 years. The first regulation concerning Public-Private Partnerships was Decree 87/1993/ND-CP (1993) on the investment modalities of BOT contracts. After that, specific regulations for domestic and foreign investors engaging in BOT arrangements were promulgated in Decree 77 in 1997 and Decree 62 in 1998 respectively. In the 2000s, Decree 78 (2007) and Decree 108 (2009) expanded the scope of the governing framework beyond BOT modalities to cover build–transfer–operate (BTO) and build–transfer (BT) arrangements. More recently, the regulatory framework has included Decree 15/2015/ND-CP, dated 14 February 2015, on Public-Private Partnerships investment and Circular No. 02/2016/TT-BKHDT, dated 1 March 2016, which provides guidance on preliminary project selection, establishment, appraisal and approval, and feasibility study reporting for Public-Private Partnerships investment projects. This framework is complemented by the Law on Bidding no. 43/2013/QH13, dated 26 November 2013, and Decree 30/2015/ND-CP, dated 17 March 2015, which regulates the Law on Bidding in the matter of investor selection.

The MPI is the lead agency on Public-Private Partnerships and chairs an inter-ministerial taskforce. It has created a Public-Private Partnerships unit and is working to develop a pipeline of projects with the help of the Ministry of Industry and Trade (MOIT) and several municipal governments. The State Steering Committee for Public-Private Partnerships was established in 2012 and is led by the Deputy PM. In addition, each ministry, ministry-level agency and Public-Private Partnerships may establish a Public-Private Partnerships coordinating unit responsible for managing such partnerships. The improved legal framework has led to an increase in the number of Public-Private Partnerships contracts. As of mid-2016, there were 68 BOT projects formulated under the management of the Ministry of Transport (MOT) in the road, highway, airport, canal and railway sectors. The upcoming project pipeline amounts to USD176 billion in value, with rail projects dominating the portfolio, followed by the power sector and the process industries.⁴² While this indicates the potential of the private sector to mobilize resources towards development-related outcomes, the associated risks need to be carefully managed. A strong coordinating, regulatory and monitoring mechanism for Public-Private Partnerships can ensure that the full potential of this financing mechanism is leveraged (including enhancements in efficiency and coverage) and that it can contribute to achieving identified national and sustainable development targets.

⁴⁰ Oxford Business Group. <http://www.oxfordbusinessgroup.com/news/vietnam-looks-private-sector-fund-infrastructure>

⁴¹ National Action Plan. http://www.un.org.vn/en/publications/doc_details/543-the-national-action-plan-for-the-implementation-of-the-2030-sustainable-development-agenda.html

⁴² World Bank PPP Knowledge Lab. <https://pppknowledgelab.org/countries/vietnam>

In addition, the government is taking steps to improve the business environment: for example, by removing obstacles to create a better enabling environment, removing around 3,500 unnecessary licenses for conditional business operations, facilitating dialogue with the business community, issuing a number of policies to support SMEs and start-ups and limiting government inspections. Due to such efforts, the number of new business establishments reached a peak of 110,100 in 2016; this was an increase of 16.2% compared with 2015. Most new enterprises were established in the business and retail trade (35.4%), manufacturing (13.4%) and construction (13.2%) sectors. The average registered capital of newly established enterprises reached a peak in 2016, while total registered capital climbed by 48.1%.⁴³

Economic integration is also a key factor in attracting additional FDI (see Chapter 3 for more on FDI). Viet Nam has emerged as a favoured investment destination in the Asia-Pacific region, due to rising labour costs in China, and in the medium and short-terms it will maintain its cost-competitiveness in production. Over the past 20 years, it has consistently made efforts to foster bilateral and multilateral relationships with other countries, beginning in 1995 when it joined ASEAN and officially normalized its relationship with the United States. Trade and economic integration have provided momentum for economic development, while at the same time Viet Nam has undertaken an overhaul and restructuring of its economy, as well as its governance, to cope with the potential challenges of economic integration. Consequently, it has signed free trade agreements with a variety of trading partners, including the EU, Japan and South Korea.

Building Block 5: Monitoring and evaluation (M&E)

Viet Nam has a good data culture, and the government has experience of integrating monitoring of the MDGs into its national SEDS/SEDP monitoring systems. However, it is in an early phase of planning for M&E on progress towards achieving the SDGs, despite its rich experience with the MDGs. The high number of SDG indicators and disaggregation requirements pose significant challenges for its statistical system in a number of areas, and will require strengthening the capacity of government planning and statistical systems at different levels. These challenges include promoting more transparent data sharing and dissemination; developing and applying innovative data collection methods, including through better utilization of its rich administrative records and big data, and of information technologies (IT); promoting active participation by non-State actors in data collection and SDG monitoring; and applying more results-based approaches in planning and M&E, especially in connecting financing efforts to outcomes. These are all considered to be key factors for success.

The GSO is tasked with developing an M&E system for the SDGs. In preparation, it has conducted a review of the SDG indicators and compared them with the set of indicators available in the current National Statistical Indicator System (NSIS), to assess the extent to which this is aligned with the global SDG indicators. The review, carried out with the help of the UN Statistics Division, showed that national coverage of the indicators is generally good. Data for 89 indicators are immediately available, of which 13 indicators are reflected in the GSO's Statistical Yearbooks. Data on another 76 indicators can be compiled via specific surveys or collected partially via other data sources. Collection of data for the remaining indicator set, however, will reportedly require the involvement of 22 ministries and central agencies.

Over the coming years, various efforts will be made to set up a workable M&E system for the SDGs in Viet Nam. Measures include improving the legal framework for monitoring; strengthening the organizational structure of the statistical office GSO system; introducing internationally accepted approaches to statistics; intensifying the application of IT in statistical practice; clearly defining the responsibilities and accountability of different government agencies in data collection, M&E and reporting; and mainstreaming SDG indicators into the existing NSIS and sectoral statistical indicator system.

An M&E system exists for the SEDP and this, along with the country's experience in integrating M&E of the MDGs into the SEDS/SEDP monitoring system, suggests a good foundation for M&E of the implementation of the NAP and the SDGs. However, there remain a number of challenges, such as including concrete Viet Nam SDG indicators (beyond general targets) into the national SEDP and into sectoral and local SEDPs (and related NSIS and sectoral statistics indicator systems) and establishing links between development goals and targets and concrete policies, programmes and projects. As well as via the statistical system at national, ministerial and local levels and periodic national reports (such as on SEDP implementation and the MDGs), monitoring the progress of SEDP implementation is conducted via the periodic reporting systems of public administrations at various levels. The system involves regular written reports or face-to-face meetings, through which executive agencies can keep up with socio-economic development and budget usage and provide timely solutions to tackle any problems that may emerge. However, those documents and meetings

⁴³ General Statistics Office. https://www.gso.gov.vn/default_en.aspx?tabid=515&idmid=5&ItemID=18513

involve a heavy administrative burden and there is no consistent reporting format through which M&E indicators can be gathered and archived regularly and systematically across all tiers of government.

The current M&E system allows some monitoring of government efforts to mobilize finance. Monthly and quarterly reports keep the government informed, for example, about tax revenue collection (from the General Department of Taxation), ODA mobilization, FDI registration and the development of domestic private businesses (from the MPI), public debt and borrowing and budget spending (from MOF), FDI and the stock market (from the State Securities Commission) and remittances and banking deposits by individuals and businesses (from the SBV), among others. However, the reliability and objectivity of such a system is limited, as all data come from governmental agencies. Such data may therefore have limited independent oversight, potentially impacting on quality standards and the compatibility of definitions between data sources.

Public investment programmes and projects, as per the Public Investment Law, are subject to evaluation by different types of review, including ex ante, mid-term, terminal and post-completion reviews. Compliance with these requirements, however, is reportedly poor. A greater emphasis on outcomes might support a more effective approach to project-level M&E.

Due to the lack of a results-based framework, both in development planning and in the budgeting system, it is impossible to link actual mobilized investment with achieved outcomes. Looking ahead, funding from the State budget will be allocated to support M&E of SDG implementation, including funding for data collection and preparation of reports. Moving to a results-based management system might better serve the government in implementing, monitoring and evaluating financing strategies and policies.

Building Block 6: Accountability and dialogue

The government might consider building on and strengthening routine accountability and dialogue mechanisms, in order to build greater trust and to mobilize greater levels of financing from non-governmental stakeholders. Similarly, it might also consider how to better demonstrate that public views are articulated in national plans.

Platforms for dialogue between government and other stakeholders are important for building trust and shaping policy around the types of financing and investments that these actors make towards sustainable development. Dialogue is a basis for sharpening and refining government policy, to ensure that it sets out realistic roles for the types of financing within national plans, effectively addresses constraints to private investment and creates incentives or mechanisms to ensure a positive impact on all aspects of sustainable development. Dialogue throughout the policy life cycle can inform the effectiveness of implementation and post-intervention reviews. Such platforms appear limited in the Vietnamese context, though the NAP does stipulate that communication and advocacy campaigns will be launched to increase public awareness on SDG implementation.

At the national level the Viet Nam Development Forum (VDF), which convenes annually, provides a forum for the government and donors to discuss the progress of the country's development and its future development strategies and policies. However, the VDF represents a high-level policy dialogue between government and development partners, in which engagement by local CSOs and the business community is limited. A key channel for the business community is the Viet Nam Business Forum (VBF), led by the PM. This serves as a platform for the PM to learn about administrative obstacles to the business environment in Viet Nam. Along with other efforts to engage with the private sector, this has led to improvements such as the removal of red tape and cumbersome administrative procedures, which are an impediment to the healthy development of the business sector.

While an M&E system exists for the SEDP, its effectiveness is reportedly limited, constrained by the lack of an effective accountability mechanism, including the lack of an independent monitoring system and weak mechanisms for civil society and non-governmental stakeholders to have their voices heard and share their perspectives. Although efforts have been made to engage with the public and to create more forums to communicate with non-governmental actors, it is too soon to assess the effectiveness of such mechanisms.

More generally, public scrutiny is compulsory, as stated in many pieces of legislation, including the State Budget Law, the Public Investment Law and the Ordinance on grassroots democracy.⁴⁴ Public consultation is required when important laws and policies are drafted and budget planning and finalization are made public. The implementation of

⁴⁴ Ordinance on exercise of democracy in communes, wards and townships.
http://moj.gov.vn/vbpq/en/lists/vn%20bn%20php%20lut/view_detail.aspx?itemid=3689#

small-scale public investment projects must be scrutinized by grassroots communities, and citizens' rights to be informed, to discuss and to check are clearly defined in different pieces of legislation. However, enforcement of these rights is poor, and there is still no transparent mechanism to ensure that the voices of “real” citizens are heard, actions can be taken and the answerability of civil servants is guaranteed.

No specific mechanism has yet been established to engage with the public on SDG implementation. However, for routine SEDP implementation and budget execution, various mechanisms are already in place. The NAP targets responsive decision-making processes that are “inclusive, participatory, and representative at all levels”. Crucially, it aims to create mechanisms that allow citizens to take part in the management of the State and society, with openness and transparency in “receiving and responding to citizens’ feedback, comments, and complaints”.⁴⁵ Viet Nam is also presenting its Voluntary National Review (VNR) at the High-level Political Forum on Sustainable Development (HLPF) 2018, which should draw upon contributions from civil society, the private sector and other stakeholders.⁴⁶ Therefore, the issue is not the existence of a relevant mechanism, but its effective enforcement. Ahead of the operationalization of the SDSF, the government might consider additional means of improving transparency and accountability relating to the use of development finance, such as forums for increased public participation.

⁴⁵ National Action Plan. http://www.un.org.vn/en/publications/doc_details/543-the-national-action-plan-for-the-implementation-of-the-2030-sustainable-development-agenda.html

⁴⁶ International Institute for Sustainable Development. <http://sdg.iisd.org/news/35-countries-to-date-planning-to-present-vnrs-at-hlpf-2018/>