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# Financing Sustainable Development in Viet Nam

## Summary Report



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Link to full report: <http://www.vn.undp.org/content/vietnam/en/home/library/poverty/DFA.html>

This Report was commissioned by the United Nations Development Programme (UNDP) in Viet Nam, prepared by a team consisting of Dr. Ho Dinh Bao (national consultant, Lecturer, Faculty of Economics, National Economics University, Ha Noi) – team leader, Dr. Vu Cuong (national consultant, Lecturer, Faculty of Economics, National Economics University, Ha Noi) – responsible for inputs on international public and private development finance, and Mr. Nguyen Trong Nghia (consultant) – responsible for inputs on domestic public finance.

*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.*

# 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.



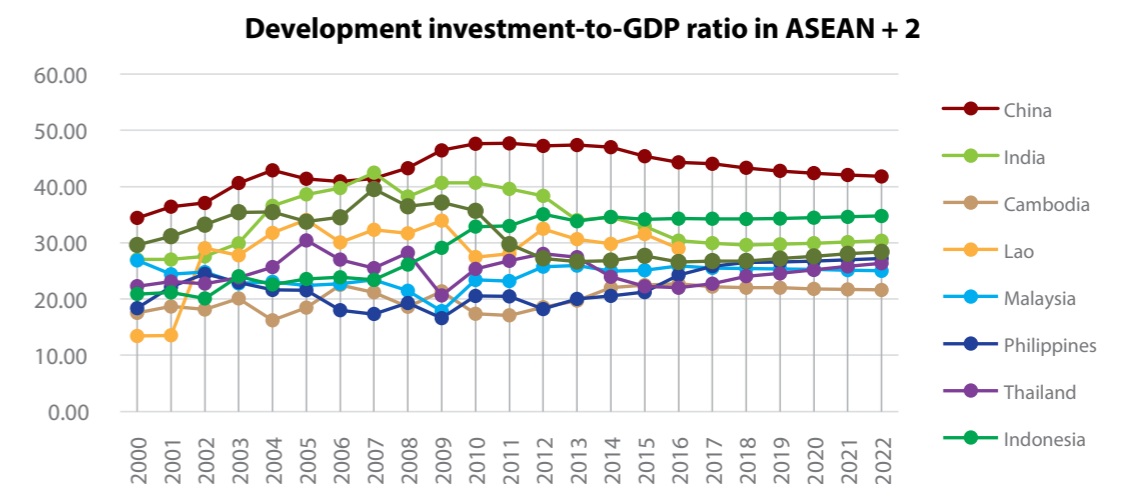
Caitlin Wiesen  
UNDP Country Director

Viet Nam has entered a new development stage as a lower middle-income country in the context of a fast-changing development finance landscape that calls for a shift in strategy to mobilize and utilize its development financial resources.

This study “Financing Sustainable Development in Viet Nam” aims to support Viet Nam in developing such a strategy. Through the lens of the Integrated National Finance Framework (INFF) outlined in the Addis Ababa International Conference on Development Financing, it provides an overview of the changing development finance landscape facing the country, an analysis of resource characteristics and trends, international comparisons with ASEAN countries and recommendations. These insights will support Viet Nam in its increasingly critical work to rethink the way it mobilizes development finance resources and better manages their linkages to ensure all resources are, in integrated ways, utilized effectively to achieve the country’s ambitious sustainable development goals (SDGs).

## Changing Development Finance Landscape

While total development finance resources (public and private, international and domestic) in Viet Nam have grown in volume, with per capita levels of financial resources having increased from USD511 in 2002 to USD1,226 in 2015, they are still below the average for ASEAN countries (USD1,937). Moreover, the total investment-to-GDP ratio has declined since 2007. Viet Nam’s total investment-to-GDP ratio, once the highest among ASEAN countries – more than 30% of GDP since 2000 and reaching almost 40% of GDP in 2007, has fallen since 2007 to the ASEAN average (less than 30% of GDP) in 2015.



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

Within this overall trend, notably:

- i. Government revenue has not been stable nor sustainably met increasing spending obligations
- ii. While ODA loans have been at a high level, they are now declining and becoming less concessional
- iii. With the public debt fast increasing and public debt ceiling looming, more sustainable debt management is required

- iv. FDI and remittance flows remain high compared to other ASEAN countries
- v. Most importantly, domestic private investment is lagging behind the ASEAN average and is yet to fulfill its increasingly important role as a driver of lower middle-income Viet Nam's economic growth.

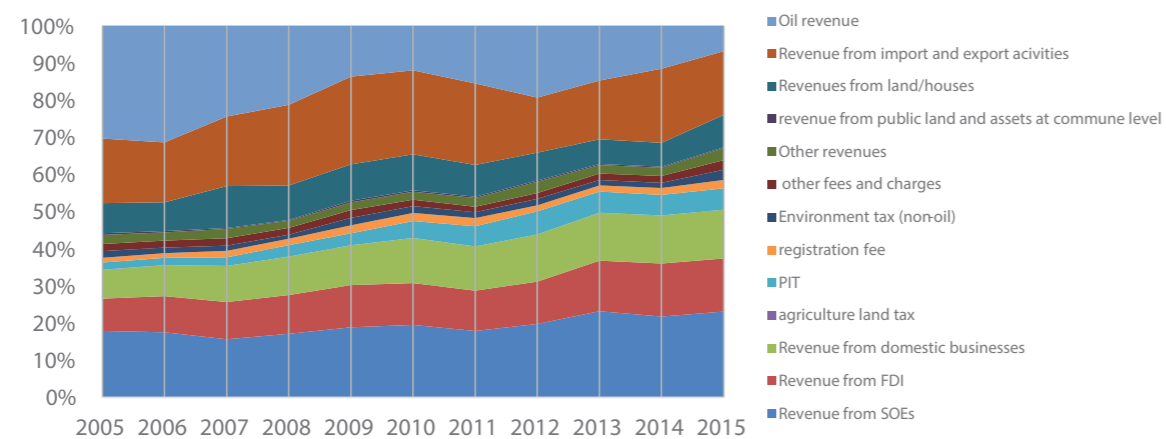
### Recurrent expenditure pressures

The needs to meet increasing recurrent expenditure obligations have placed significant pressures on the State Budget. In fact, 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 in non-grant revenue (38.9%) during the same period. Among recurrent expenditures, the fastest growing spending items included administration (83.43%), education and training (78.49%) and interest payments (175.37%). 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% of GDP in 2015.

### Non-grant revenue: tax revenue fails to offset falls in revenue from crude oil, import-export activities

The government non-grant revenue-to-GDP ratio declined from more than 26% in 2006-2008 and 27.6% in 2010, to around 22-23% in 2012-2015. This decline was triggered by a sharp decline in oil revenues (30% of total non-grant revenue in 2005 to 12% in 2010 and only 6.84% in 2015) and in revenue from import-export activities (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.

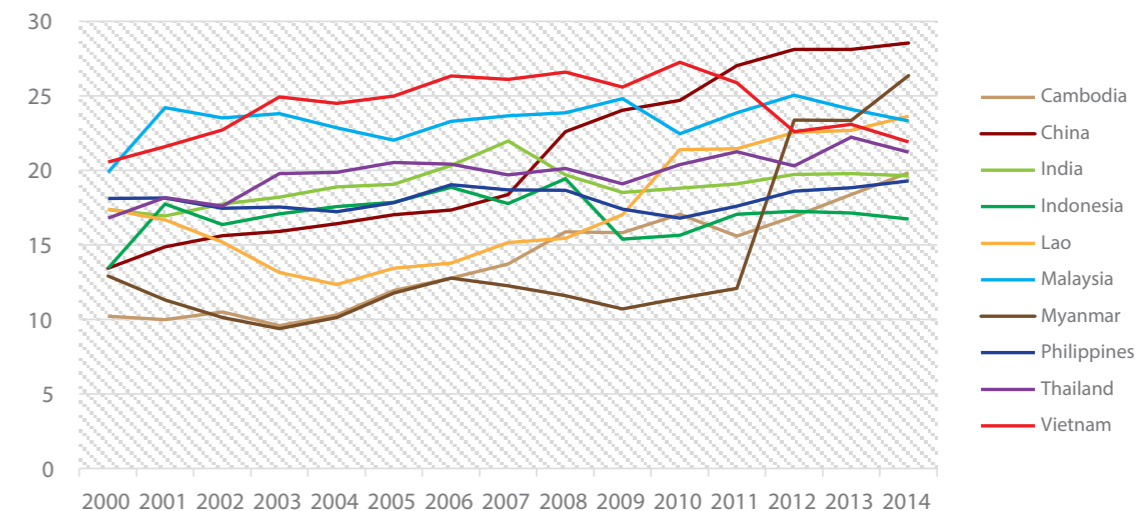
Shares of sources in total non-grant revenue



Source: MOF

Compared to other ASEAN countries, Viet Nam's revenue-to-GDP ratio was the highest between 2000-2009 to now sit on par with the ASEAN average. With regards to other indicators, such as total volumes of revenue, revenue per capita, tax-fee revenue volumes and tax-fee revenue per capita, Viet Nam has a ranking within the CLMV (Cambodia, Lao PDR, Myanmar and Viet Nam) group of ASEAN countries.

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

Despite government efforts to offset declines in revenue from oil and export and import activities, increased government revenues from taxes, fees and charges were insufficient to reverse the non-grant revenue-to-GDP ratio trend. Though Viet Nam's non-grant revenue-to-GDP ratio is the highest among ASEAN countries, its per capita government revenue and per capita resources mobilized from taxes-fees ranked only fifth among compared countries.

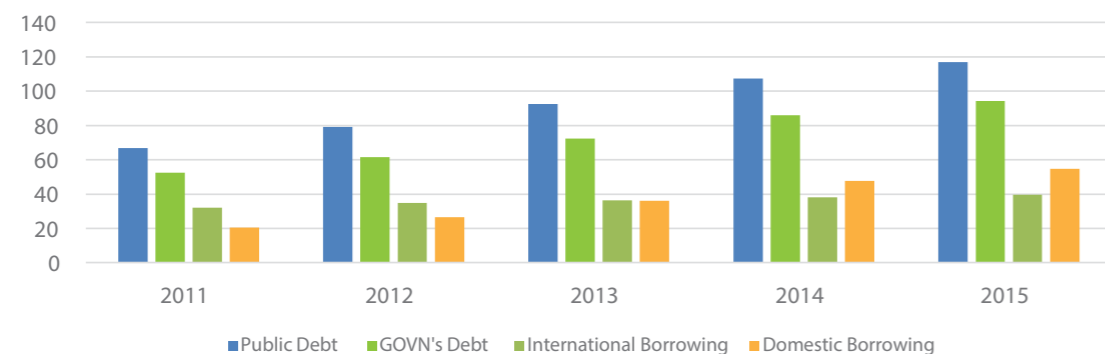
### Central government's share of total non-grant revenue falls

During 2006-2010, local governments' average share of total 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. Accordingly, the share of central government revenue fell from 62.29% (2011) to 58.05% (2015), indicating weakening central government influence on: (i) big public investment projects to address key infrastructure bottlenecks and boost national economic growth and (ii) counter-cyclical spending (as local government spending tends to be pro-cyclical) to ensure macro-economic stability.

### Government domestic borrowing spikes with significant risks

Facing a sharp decline in non-grant revenue, government borrowing during 2010-2015 accelerated - especially from domestic sources, with the domestic public debt stock in 2015 almost 2.5 times that of 2011's level to finance budget deficits and prevent a further reduction in public investment.

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



Source: 5th Debt Bulletin, MOF

This rapidly accelerating domestic public borrowing involved significant risks:

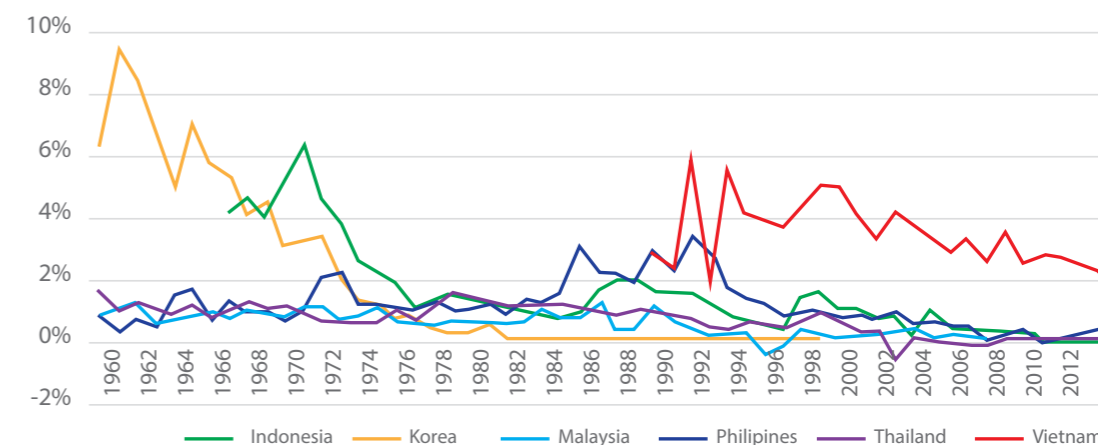
- Most government bonds were held by commercial banks: the share of government domestic bonds held by commercial banks was 79.6% at the end of 2011 and 55.4% at the end of 2016. This suggests two key risks: (i) weakening sustainability of commercial banks, as any sudden fall in government bond values would have immediate, negative consequences for banks' balance sheets and (ii) increased difficulties faced by private enterprises, especially SMEs, to access affordable credit from commercial banks.
- Most Government of Viet Nam (GOV) domestic bonds mobilized in 2010-2013 were with short maturity terms (more than 74% with 3 and less maturity terms) and high mobilization costs (the average interest rate was more than 10% for five-year bonds) resulting in very high repayment obligations which, at some points, exceeded the State budget repayment capacity during 2014-2016.
- Government borrowing from the Viet Nam Social Insurance Fund, State Capital Investment Corporation (SCIC), debt repayment and idle State Treasury funds are reaching limits, affecting the liquidity of these institutions.
- Implicit debts with GOV guarantees acquired by SOEs and local authorities present another important source of risk to debt sustainability.

These together with the high level of non-performing loans and related liquidity stresses in the banking system (particularly 2006-2010 and 2011-2015), underline an urgent need for the GOV to restructure domestic debt and revisit its domestic borrowing strategy.

## ODA declines and loans become less concessional

Viet Nam is the largest recipient of ODA among ASEAN countries, with 37% (USD3.9 billion) of the ASEAN regional total in 2015 and a high ODA-to-GDP ratio fluctuating at 4% of GDP in the early 1990s, to 3% of GDP in the early 2000s and around 2% of GDP between 2011-2015 (compared to less than 1% of GDP in other ASEAN countries). However, ODA flows into Viet Nam have decreased markedly (especially after the country achieved lower middle-income status in 2010) and become less concessional with Viet Nam's International Development Association (IDA) graduation in 2017.

ODA-to-GDP ratio of Viet Nam and other countries, Source: WDI



Notably, ODA grants - an important financial resource for technical assistance, capacity building and policy advice - consisting of a very small proportion (1%) of ODA have reduced sharply from around USD400 million in 2012 to less than USD50 million in 2015.

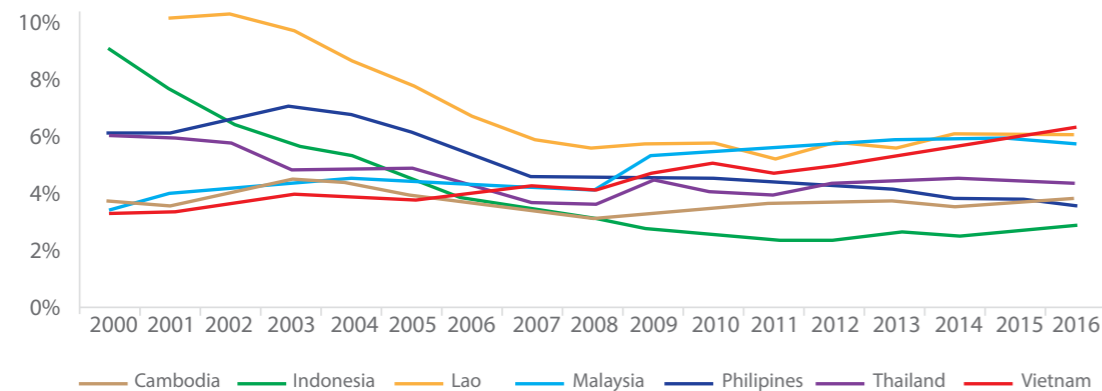
## Doors open to international funding on climate change and green growth

While the ODA-to-GDP ratio is decreasing, the Other Official Flow (less concessional loans)-to-GDP ratio in Viet Nam has increased and exceeded ratios in other ASEAN countries recently. As donors shift focus to global public good issues, such as climate change and green growth, Viet Nam is a recipient of considerable volumes of international public climate finance. During 2010-2014, it received the largest amount in the region (USD5.2 billion), consisting of small grant and non-concessional loans and more significant concessional loans.

## Debt stocks build up

Viet Nam's public and government debt stocks have sharply increased, with public debt-to-GDP ratio rises from 50% in 2011 to 63.7% in 2016, turning Viet Nam's ratio from the lowest in ASEAN during 2000-2005 to the highest in 2016, while the government's debt-to-GDP ratio jumped from 39.3% of GDP in 2011 to 52.7% in 2016.

**Public debt stock-to-GDP ratio (% GDP) of Viet Nam and some ASEAN countries, Source: IFS (2017), World Economic Outlook Database**

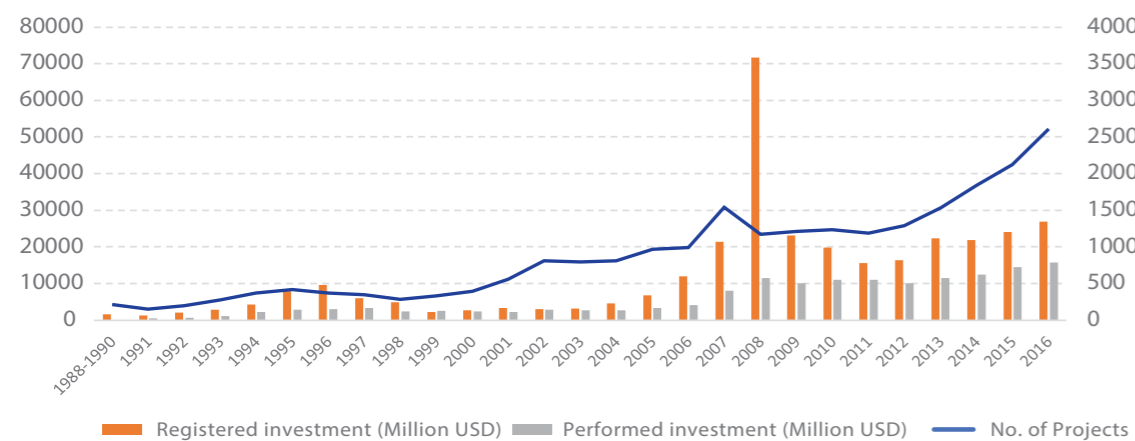


The rise in domestic public debt and government guaranteed debt have been the main contributors to the increase in public and government debt stocks. It is important to note that Viet Nam is not a highly indebted country and while public debt interest payments have risen in recent years, these trends are not out of line with other countries in the region. However, the fast building up public debt stock and GOV obligations to repay domestic public debt at some points exceeding the State budget repayment capacity during 2014-2016, prompted the National Assembly to adopt ceilings on public and government debts, and requested GOV to apply a more sustainable debt management plan.

**FDI: high volumes, but quality remains modest**

FDI inflows into Viet Nam have accelerated - especially since its accession to the World Trade Organization (WTO). Moreover, such flows have also been at a high level compared to other ASEAN countries, except Singapore. Notably, FDI in manufacturing during 2015 accounted for almost 70% of FDI to Viet Nam, much higher than in Indonesia (40%) and the Philippines (38%). Public debate in Viet Nam underlined several weaknesses in FDI quality, such as low levels of technology, technology transfers and linkages with domestic enterprises, negative environmental impacts and inadequate contributions to government revenue compared to the high level of FDI incentives (especially in tax exemptions and access to land) which, in turn, contributed to an uneven playing field for domestic private enterprises.

**FDI inflows into Viet Nam (1988-2016) - Source: GSO**



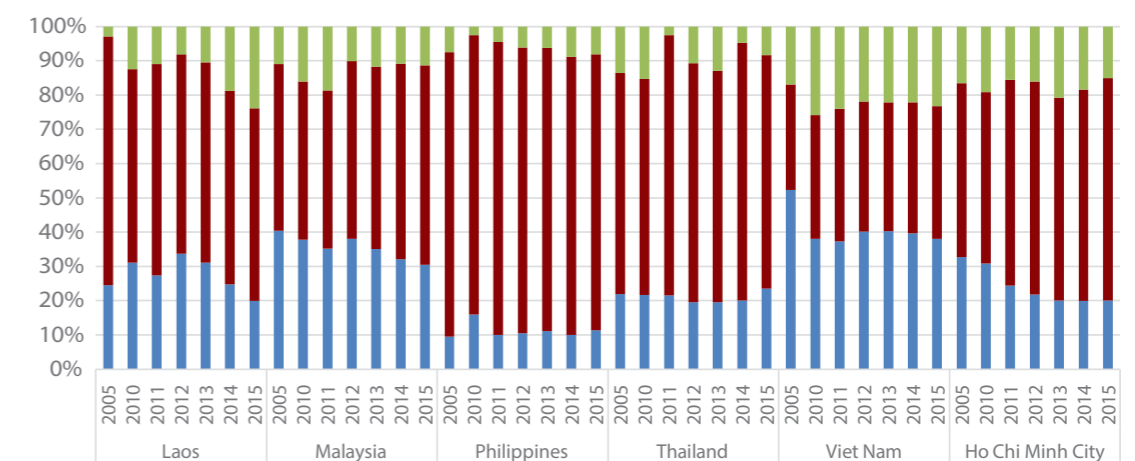
**Remittances to Viet Nam: stable at a high level**

Viet Nam is amongst the top 10 countries in the world (second in ASEAN after the Philippines) in terms of receiving remittances - representing 2.5% of global remittances in 2017. Annually, remittances accounted for 6-8% of annual GDP during 2006-2017 in Viet Nam, much higher than for other developing countries (average of 1-2% GDP), similar to FDI inflows and four-fold higher than ODA into Viet Nam. Such flows could make more significant contributions to the country's economic development, foreign exchange reserves and balancing its current account, should more remittances be directed to productive investments.

**Domestic private investment: yet to become a key finance source driving Viet Nam's growth**

The share of Viet Nam's domestic private finance in total development finance resources is relatively low and slowly increasing compared to other ASEAN countries. 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%). In 2015, the share of domestic private investment in total investment in Viet Nam was 38.67%, much lower than 56.3% in Lao PDR, 58.2% in Malaysia, 80.6% in the Philippines and 68.2% in Thailand. The same finding is noted when comparing Viet Nam to ASEAN nations at similar levels of lower middle-income Gross National Income (GNI) per capita (around USD1,900). This suggests a relatively lower share of domestic private investment is more related to Viet Nam's economic structure, characterized by the private sector and enterprises remaining relatively smaller than the State sector, State-owned enterprises (SOEs) and FDI. It should be noted, however, that the domestic private share of total investment in Ho Chi Minh City - the growth engine of Viet Nam - was around 65% in 2015-2016 and similar to other ASEAN countries.

**Composition of development investment in Viet Nam, Ho chi Minh City (source: GSO) and some ASEAN countries (source: Development Initiative), Unit: % in total**



In line with the GOV identifying the domestic private sector as the future driver of Viet Nam's growth and experiences of middle-income countries, expanding domestic private domestic investment to become a major source of development finance should be a key future priority to meet SDG financing requirements.

## The way forward:

### Integrated solutions within an Integrated National Financing Framework

Given the mixed development financing outlook facing Viet Nam, the country must address key challenges to continued rapid growth in some finance sources and expedite growth in other key finance types where levels and trajectories remain low. Most importantly, it must ensure resources can be mobilized and channeled into effective investments that yield sustainable development results. The Integrated National Financing Framework, outlined in the Addis Ababa International Conference on Development Financing, highlights the criticality of government developing an integrated policy and institutional framework to address these challenges in parallel. Applying the “whole government” and “whole society” principle of 2030 Sustainable Development Agenda, the integrated policy actions should also aim to manage interactions between development finance sources to leverage synergies and ensure investments across all aspects of the financing landscape contribute to Viet Nam’s achievement of the SDGs.

### Accelerate Private sector development

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. Within this context, a key priority is to accelerate the private sector’s development and investment expansion in Viet Nam through prioritization of three areas of action.

- Firstly, a level playing field must be created for the domestic private sector, including reforming SOEs and revising FDI policies to facilitate domestic private firms’ market entry, with enhanced linkages in domestic and global value chains.
- Secondly, policies and targeted support must be realized to help domestic private enterprises grow, enhance productivity and competitiveness, improve linkages in domestic and global value chains, while simultaneously accelerating a necessary transition from the informal to formal economy.
- Thirdly, efforts must be intensified to improve the enabling environment for business, support domestic enterprises to access land and credit as well as technical capacities to adopt new technologies and grasp opportunities offered by Industry 4.0. Establishment of independent institutions specialized in providing training and R&D support to Vietnamese private firms (impeded by their small size and inability to afford investments in R&D, applying high technologies and training) would be necessary.

### Shift the FDI attraction focus from quantity to quality

To ensure FDI policies become an integrated part of the national development strategy and maximize FDI’s positive impact on national economic growth, society and environment, the focus of FDI attraction should shift from quantity to quality, in parallel and contributing to actions to accelerate domestic private sector development. It is important to establish clear international

standards in terms of technology requirements, domestic content with technology transfers and linkages to domestic firms, and compliance with stricter energy efficiency and environmental-safety standards. Strengthened institutional capacity and systems for rigorous screening, appraising and approval of FDI projects to ensure adherence to international standards should also be prioritized.

Furthermore, it is imperative Viet Nam moves from using tax incentives and other privileges as means to attract FDI, while strengthening its active participation in international initiatives to address harmful tax practices of countries in FDI attraction and enhance actions to limit the competition between provinces using tax and other incentives to attract FDI. Furthermore, Viet Nam should champion more effective incentives to attract high-quality and long-term FDI focused on high human resource skills and capacities, domestic purchasing power, long-term predictability of investment regulations, consistent application of the rule of law, political stability, quality infrastructure (transportation and utilities) and competitive support services and supplies of domestic enterprises.

### Drive for efficiency and effectiveness of public spending and investment

Noting that expanding GOV revenues will only be effective if budget resources are used efficiently and public investment is effective, the government is urged to ensure effectiveness of recurrent expenditure as well as the efficiency, transparency and accountability of public investment. While it is important to continue streamlining the government apparatus and reducing the large number of personnel on government payrolls, parallel actions are needed to ensure greater government apparatus efficiency. Possible savings gained by reducing recurrent expenditure on salary payments can unlock the door to increased State spending on R&D and investing in “21st Century skills” necessary for Viet Nam to seize opportunities from Industry 4.0. Setting clear criteria and establishing suitable institutional arrangements for prioritization and selection of public investment projects that are growth-enhancing and crowding-in private investments are recommended as urgent actions towards public investment efficiency, in addition to management transparency, accountability and fighting corruption.

### Improve sustainability of revenue through tax base expansion and better management of State assets

Viet Nam must sustainably expedite growth in government revenues and ensure resources are invested effectively and utilized efficiently. In this regard, the GOV is encouraged to continue expanding domestic revenue from taxation as a more sustainable and reliable source of revenue. This can be realized by introducing new taxes, such as property and CO2 emission/carbon ones, reconsidering the ceiling of tax and fee revenue-to-GDP ratio and applying international standards in classifying and collecting data on non-grant revenues from taxes, fees and charges to help identify issues and formulate policy actions more precisely. The application of the fixed and flat tax rates as well as use of a flat basis to calculate tax payable amounts should be reconsidered in connection to efforts supporting MSMEs to grow in size and become formal. Lastly, Viet Nam is recommended to enhance management of State assets to help boost the economy, finance social and economic infrastructure as well as covering maintenance costs without competing with government budgets, leaving more for spending on healthcare, education and other social initiatives.

### **Decentralization: addressing fragmentation and coordination problems**

Given the fragmentation and coordination problems related to decentralization in Viet Nam, urgent action is necessary to identify and implement solutions. Firstly, the issue of falling public investment in the face of decentralization must be tackled. National budgets and planning for large-scale infrastructure and related investments should be strengthened as local governments typically lack the technical capacity to plan and implement such complex projects. One significant disadvantage of sub-national public investment is it tends to be more pro-cyclical than public investment at national level. In addition, local level public investment associated with sub-national authorities is constrained due to pronounced vertical and horizontal coordination problems that need addressing. Remedial actions include clearly specifying respective divisions of labour, roles and responsibilities of central versus local authorities applying co-financing arrangements and matching grants with formal consultation processes that embed representatives of national agencies within local government structures and following Organization for Economic Co-operation and Development (OECD) countries' lead in applying various forms of conditionality to align national and local priorities. An example is 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. Finally, creating inter-governmental coordination mechanisms at local level is essential, especially among provinces and cities and within large cities to address serious horizontal coordination problems, in addition to focusing on the quality of local institutions through increasing transparency, reducing fragmentation of local institutions and streamlining decision-making processes.

### **Manage the smooth transition to ODA graduation**

While the effective utilization of currently available ODA resources remains paramount, ensuring ODA projects address key growth bottlenecks and crowd-in private sector investment, Viet Nam must manage the transition from ODA smoothly by developing and implementing exit plans and exploring new resource mobilization opportunities. To avoid concessional lending grinding to a halt simultaneously, government and donors should work together to develop ODA programmes and projects in the next five to 10 years based on anticipated levels of resources and develop a plan to transition from concessional loans. At the same time, expanding access to new international development finance sources on climate change adaptation and mitigation, green economy, as well as developing new partnerships with international private foundations and philanthropic organizations will be needed if Viet Nam is to sustain public investment after graduation from concessional ODA.

### **Prudently manage public debt**

Given the rapid accumulation of public debt and its associated risks, it is imperative to develop and implement public debt management legislation, strategies, plans and policies as integrated parts of the national development plan and INFF. In particular, it is necessary enhance the latter's linkages to Socio-Economic Development Plans (SEDPs), Medium-Term Public Investment Programme (MTPIP) and three-year Financial and Budgetary Plans, 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 major holders of GOV bonds). Moreover, national capacity must be strengthened to analyze opportunities, challenges, costs and risks in all sources of public debt and borrowings, forecasting and advice on future GOV borrowing needs and repayment obligations as well as developing and implementing mechanisms to monitor, supervise, control and manage GOV borrowing risks (local government, GOV guaranteed

and SOE borrowing). Close public debt monitoring and evaluating (using standard international definitions, classifications and M&E indicators in planning and monitoring public debt) will result in timely, accurate information and data for wide dissemination to users following international best practices in public debt M&E and information disclosure.

### **Manage interlinkages and foster synergies of different financial resources**

Going forward, an improved understanding and capacity to manage interactions between development finance sources will be essential. Such an understanding and capacity will not only help limit negative impacts (such as when capital inflows and pro-cyclical domestic investment destabilized Viet Nam's macro-economy in 2007), but also to maximize positive synergies of different development finance resources while ensuring macro-economic stability, sustainable debt management and stable economic growth. Such an understanding and capacity will also help to define more ODA and public investment projects that catalyze new quality FDI inflows and domestic private sector investment projects contributing to economic growth. They will also help limit the impact of public investment projects, including by SOEs, in 'crowding out' private investment (including through the latter's competition for domestic credit) and define more public investment projects that can 'crowd-in' domestic private sector investment and support private sector development.

### **Conclusion**

As Viet Nam embarks 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, the urgency to develop a strategy to mobilize and utilize development financial resources will become increasingly acute. The country must formulate a new strategy to engage all stakeholders in mobilizing 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.

This assessment of development finance 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. This study proposed interlinked policy actions to be formulated and implemented within a national integrated finance framework consistent with and suited to Viet Nam's new growth model. The 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 disparities, improve its productivity and competitiveness, economic and social inclusion, environmental sustainability and climate resilience. 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 SDG agenda to lift Viet Nam's human development to new heights.





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