



**CHÍNH PHỦ VIỆT NAM**  
THE GOVERNMENT OF VIETNAM



**THE WORLD BANK**  
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VIETNAM PUBLIC EXPENDITURE REVIEW

# Fiscal Policies towards Sustainability, Efficiency, and Equity





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A Joint Review by the Government of Vietnam and the World Bank  
Prepared with the Support of DFAT, GAC, SECO, and UKaid



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1818 H Street NW, Washington DC 20433  
Telephone: 202-473-1000; Internet: [www.worldbank.org](http://www.worldbank.org)

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VIETNAM  
PUBLIC EXPENDITURE REVIEW:  
EXECUTIVE SUMMARY

## List of Abbreviations

<b>ASEAN</b>	Association of South-East Asian Nations
<b>BOT</b>	Build-Operate-Transfer
<b>BT</b>	Build-Transfer
<b>CIT</b>	Corporate Income Tax
<b>DFAT</b>	Department of Foreign Affairs and Trade of Australia
<b>FDI</b>	Foreign Direct Investment
<b>GAC</b>	Global Affairs Canada
<b>GDP</b>	Gross Domestic Product
<b>GoV</b>	Government
<b>ISSAI</b>	International Standard of Supreme Audit Institution
<b>NTPs</b>	National Target Program
<b>O&amp;M</b>	Operations and Management
<b>ODA</b>	Official Development Assistance
<b>OECD</b>	Organization for Economic Co-operation and Development
<b>PER</b>	Public Expenditure Review
<b>PFM</b>	Public Financial Management
<b>PIT</b>	Personal Income Tax

<b>PPP</b>	Public Private Partnership
<b>PSDUs</b>	Public Service Delivery Units
<b>SAV</b>	State Audit of Vietnam
<b>SECO</b>	State Secretariat for Economic Affairs
<b>SOE</b>	State-Owned Enterprise
<b>TABMIS</b>	Treasury and Budget Management Information System
<b>TMS</b>	Tax Management System
<b>UKaid</b>	Department for International Development of UK
<b>VAT</b>	Value-Added Tax
<b>VND</b>	Vietnamese Dong
<b>WBG</b>	World Bank Group

## Context

1. **Vietnam has experienced an impressive development transformation.** The “Doi moi” course initiated in 1986 has successfully transformed the country from one of the poorest in the world to lower middle-income status. Average per capita incomes more than doubled from 2000 to 2014, placing Vietnam amongst the fastest growing developing economies with the most impressive poverty reduction record in the world. Robust economic growth was supported by sound macroeconomic and pro-growth expenditure policies.
2. **The previous phase of reforms has resulted in significant achievements in public financial management, including:** (a) establishing and maintaining a system of aggregate and detailed fiscal controls, which are similar to those which many other countries use to maintain basic fiscal discipline; (b) implementing a wide-ranging decentralization of public finance, enhancing autonomy given to local governments as well as spending units, both administrative and public service delivery ones; (c) increasing fiscal transparency and accountability on the basis of mutual accountability between executive and legislative branches with the support of audit institutions and the judicial system.
3. **The transformation, however, has also brought about new fiscal challenges.** Public spending needs continue to grow given the increasing demand for quality public services and social protection in the context of rapid aging, and for investment in both infrastructure and human resources to promote growth. Greater openness and deeper integration into the world economy has resulted in a weakening of trade revenues due to tariff reductions and a greater vulnerability to external shocks. Reduced revenue from natural resources and land sales, coupled with the widespread use of ‘tax holidays’ promoted to counter the impact of shocks and promote investment and growth have also resulted in slowing revenue growth in recent years. As a result of these, fiscal space has narrowed. The active pursuit of a set of interrelated policies, including promoting private financing and citizens’ contributions (or “socialization”), has promoted competition for better service delivery while reducing



the financial burden upon the state, however, at the same time it risks widening inequity in access to basic services, particularly by the vulnerable groups.

**4. The rapid pace of expansion, openness and decentralization has made the economy more complex to manage.** Sub-national spending now accounts for approximately 55 percent of all Government expenditure, 70 percent of total public investment, 85 percent of education expenditure and 80 percent of health expenditure. However, fiscal transparency and accountability have not kept pace with this high level of fiscal decentralization. Excessive fragmentation of public resources and data insufficiencies impaired the authorities' ability to thoroughly assess the actual size of government operations, and the impact of these operations and of monetary and fiscal policies in medium and longer-term.

**5. To address these challenges, the Government of Vietnam wishes to embark on a gradual,** growth-friendly fiscal consolidation as a crucial element to entrench fiscal sustainability, on the basis of a concerted effort to boost revenue mobilization, restructure and enhance efficiency in spending, and strengthen the management of public assets and liabilities, and of fiscal risks.

**6. In that context, the Government of Vietnam (GoV) and the World Bank Group (WBG),** supported by other development partners, embarked on this joint Public Expenditure Review (PER) to assist in identifying appropriate responses to these challenges. The review aims to provide empirical evidence to answer three main questions that cut across the 15 chapters. Firstly, how to create the fiscal space needed to finance essential expenditure and manage fiscal risks in the context of slowing revenue? Secondly, how to ensure that public spending at the sub-national and national levels is aligned with national priorities, so that public spending is being appropriately prioritized? Thirdly, how to balance the autonomy given to line ministries, provinces and public service delivery units with greater accountability for results, so that public spending has the greatest impact? The PER is divided into three parts covering five cross-cutting topics, five heavy-spending sectors (which account for almost 50 percent of total spending) and five provinces (representing the two groups of

net contributors and net recipients). The main findings and 68 recommendations of the 15 chapters have been endorsed by the Prime Minister for relevant ministries and provinces to implement in the coming years. The main findings and recommendations are summarized around the three anchor questions as follows:



**The three main questions of the PER**

PURSUING FISCAL  
CONSOLIDATION, ENSURING  
FISCAL SUSTAINABILITY

## Overall fiscal trends

7. **Over the past few years, Vietnam's fiscal position has been countercyclical, with large increase in public expenditure designed to mitigate the impact of the global financial crisis.** Whilst countercyclical fiscal policy helped to avert a sharper economic downturn, larger subsequent deficits have increased debt levels, shortened the maturity profile and increased the debt service burden on the budget. The average fiscal deficit during 2011-15 increased to about 5.5 percent of GDP<sup>1</sup>; markedly higher than that in previous periods. Persistent fiscal deficits have driven rising public debt and raise serious concerns about the medium-term sustainability of the current fiscal position and the corresponding public debt path.

8. **A gradual, growth-friendly fiscal consolidation is recommended as a crucial element to entrench fiscal sustainability.** This will require a strong commitment by the Government to reduce the level of the budget deficit and to keep the level of public debt below the current statutory limit of 65 percent of GDP. This would serve to rebuild fiscal buffers against possible future shocks and the possible realization of contingent liabilities arising from the financial and SOE sectors. Fiscal consolidation options could be considered as the basis of a concerted effort to boost revenue mobilization, restructure and enhance efficiency in spending, strengthen the utilization of public asset management and effectively manage public debt and fiscal risks. Restructuring of spending should protect social spending and investment and make space for potential restructuring costs (if any).

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<sup>1</sup> Using international definitions.

## State revenue trends

9. **High economic growth over a prolonged period, with an annual average growth rate of above 6 percent between 2006 and 2015, has helped raise Vietnam's state budget revenue.** However, revenue collection in the period 2011-15 whilst continuing to grow in real terms has done so at a slower pace than the economy. State budget revenue mobilization as a percentage of GDP has decreased from 26.4 percent in the period 2006-10 to 23.4 percent in the period 2011-15. The main contributors to the lower revenue-to-GDP ratio include a decrease in oil revenue (from 4.8 percent to 3.0 percent), tariff revenue (from 5.5 percent to 4.2 percent) and land revenue (from 2.5 percent to 1.7 percent).

10. **Vietnam has successfully managed its tax policy and administration system through a smooth transition towards one that is less reliant on external sources (oil and trade revenues).** The share of domestic revenue in total revenue increased from 52.3 percent (in 2001-05) to 58.9 percent (in 2006-10), and to over 68 percent (in 2011-15). In 2015, the share of domestic revenue to total revenue reached 75 percent, higher than the target of 70 percent. This increase partially helped to offset the decline in revenue from foreign trade due to economic integration and oil revenue. In the meantime, Vietnam has recently adopted some preferential tax policies aimed at enhancing competitiveness, attracting investment and easing the difficulties facing enterprises in the context of the economic slowdown. These include: (i) cutting the corporate income tax (CIT) rate; (ii) raising the level of deductions for family circumstances to personal income tax (PIT) payers; (iii) reducing or exempting agricultural land tax; and (iv) extending the time limit for payment of VAT, CIT and land-use fees.

11. **Going forward, it will be important to continue to reform tax policies to strengthen domestic revenue mobilization, through a number of specific policy options as follows:**

- ***Broadening the value-added tax (VAT) base***, moving towards one single VAT rate and very limited tax exemptions;
- ***Broadening the corporate income tax (CIT) base and reviewing tax incentives (tax expenditures)***, promoting their effectiveness and avoid irrelevance; avoid fragmentation and waste of resources; and ensure disclosure, transparency and equality in business competition;
- ***Increasing excise rates on several non-merit goods (for example tobacco, beer and alcohol)***, helping to mobilize additional revenue while deterring unhealthy consumption behaviors;
- ***Expanding the personal income tax (PIT) tax base in line with international practice***, including through adjusting the number of tax rates on taxable incomes and taxpayers;
- ***Building a modern, unified property tax system***, replacing the existing agricultural and non-agricultural land tax policies, making property tax an important and stable source of revenue to the state budget, especially at sub-national level while improving incentives for the more efficient use of land and property;
- ***Rationalizing the revenue policies on natural resources and the environment***, ensuring preservation and efficient use of natural resources and promote the link between natural resource exploitation and processing and environmental protection.

12. **There have also been some major achievements in recent years in tax administration reform.** The implementation of two Government's Resolutions (both No.19) issued in 2014 and 2015<sup>2</sup> led to a considerable reduction in the time spent to pay taxes. The application of the Tax Management System (TMS) has helped

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<sup>2</sup> Government Resolution 19/NQ-CP dated March 18, 2014, and Resolution 19/NQ-CP dated March 12, 2015.

modernize core tax functionalities, such as registration, filing, return processing, taxpayer accounting, tax payment and arrears management. Going forward, it will be important to implement a comprehensive business process re-engineering exercise that includes all tax, risk management and taxpayer service functions to increase voluntary compliance and reduce compliance cost. Moreover, strengthening of the tax administration database, adoption of value-added IT applications, and ensuring linkages between tax and social insurance administration systems are also required.

## Public expenditure trends

13. **Government expenditure has been maintained at a high level against GDP.** From 2011-2015, total state budget expenditure – including capital outlays financed by off-budget bonds – averaged 29.2 percent; rising moderately from 28.9 percent in the previous period and remains high compared with regional and peer income level countries. The composition of expenditure has changed with the rising proportion of recurrent expenditure (including interest payment). The proportion of recurrent to capital expenditure was 70:30, compared to 65:35 from 2006-10. Recurrent expenditure grew faster than the growth of total revenue, mainly driven by increased outlays on social security, salaries, wages and allowances and by interest payments. The wage bill outpaced average expenditure growth, expanding to about 20 percent of total budget expenditure. The rapid growth of the wage bill was attributed mainly to increases in base and non-base salaries and allowances<sup>3</sup> and in the number of civil servants and government employees. The growth of public sector employment was much faster than population growth, particularly at subnational levels. International benchmarking comparisons indicate that the total wage bill of Vietnamese civil servants is not overly high, but its rapid growth warrants caution.

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<sup>3</sup> Since 2006, Government increased the base salaries and allowances 08 times, to cover inflation and to improve the living conditions of several target groups.

14. **The share of state budget capital spending, although declining in total government spending, remains higher than the rest of the world and regional peers.** The state budget contributed 29.1 percent of gross capital formation in the economy in the period 2011-15, a moderate increase from 28.4 percent in the period 2006-10. The high level of state budget investment was sustained with an aim to develop further the country's infrastructure system.

15. **Vietnam is a highly decentralized country and is becoming more so.** Capital spending is trending towards higher decentralization, whilst recurrent spending trends remain relatively similar. Between 2011 and 2015, sub-national capital spending accounted for about 70 percent of total state capital spending, amongst the highest in the developing world (the average proportion in developing countries was nearly 40 percent). The change was attributed to rapidly increasing sub-national investment sourced from sub-national budget contingency provisions and over-realized budget revenues (i.e. land and lottery revenues) as well as central budget transfers to sub-national governments. Central targeted transfers in this period focused more on local development priorities on education, health, transport and irrigation. This has provided strong incentives for development at sub-national level, as well as contributing to the development of rural infrastructure such as local roads, clean water systems and the improvement of local education and health services; together contributing towards poverty reduction.

16. **Whilst the shift was intended to promote local governments to become stronger drivers of growth, the limited remaining share of central government's capital spending raises concerns about adequate investment in national infrastructure.** Reduced investment by central government has diminished its capacity to concentrate resources on nationally important objectives and projects, particularly in the context of limited regional coordination. Having such a large share of investment in Vietnam being decided at the sub-national level runs the risk of fragmentation resulting in lower investment efficiency, unless there is strong coordination around large infrastructure projects, including cross-provincial projects. In the long term it is important to review the socio-economic decentralization arrangements with a focus on their overall efficiency.



17. **The growth of spending on several key functions has been mixed.** Spending on education and health grew significantly above average, raising the shares of spending on education and health in total public spending to 19 percent and health 9.5 percent in 2012 respectively. Spending on science and technology grew at an annual rate of 3.7 percent, which was below its average trend.<sup>4</sup> Spending on transport and agriculture was relatively stable at 11 percent and 6 percent. Given the overall decline in the proportion of capital spending in total spending, capital spending in most of the above priority sectors declined in relative terms. This reflects in part a deliberate gradual shift away from state budget spending on infrastructure development towards human capital development, reflecting the government's expectation that the socialization agenda (i.e. mobilization of private investment) in infrastructure sectors will advance at a faster pace than in social sectors.

18. **Going forward, there is significant scope for enhanced efficiency gains in spending, including in public sector employment, compensation and deployment and other inputs in key sectors of the economy:**

- ***Public sector employment, compensation and deployment:*** better coordination between applicable agencies is needed for more efficient mobilization of civil servants and public employees, including in: (i) developing medium-term recruitment plans to balance staffing demand and supply better; (ii) granting administrative and service units more autonomy in staff recruitment and deployment consistent with existing norms and regulations; and (iii) jointly developing a recording and reporting system to collect data on employment, compensation and the wage bill and its financing at both central and local levels.

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<sup>4</sup> There is a ring-fenced allocation for S&T of 2 percent of the total budget. However, actual spending was lower than the allocation, as discussed in further detail in the S&T chapter.

- ***In the education sector:*** (a) Review teachers working hours and consider increasing them to an internationally comparable level in association with education and curricula reforms (average teaching time per teacher in general education is the lowest in ASEAN and is 25 percent below the ASEAN average for primary schools); (b) Provide financial incentives for schools and hospitals to rationalize their work force; and (c) Simplify salaries and allowances schemes for teachers to reduce over reliance on seniority as a pay factor.
- ***In the health sector:*** (a) Reduce drug prices through careful implementation of nationally centralized procurement and price negotiations on pharmaceuticals<sup>5</sup>; (b) Strengthen capacity in independent supervision and cost-effectiveness analysis in the use of health services; (c) Strengthen investment in health preventative care and health care delivery at grassroots level (currently resources at district and commune levels are under-utilized, at the lowest level amongst East Asia counties, while those at the central and provincial levels are overloaded; and (d) Gradually move from the fee-for-service system to other health financing methods (including rationalized capitation and case based payment).
- ***In the transport sector:*** (a) Avoid construction cost overrun through accelerating land acquisition and ensuring sufficient funds allocation for approved projects, while promoting more competition in bidding for road construction contracts and increasing the size of each contract; (b) Reduce road maintenance unit costs (currently 3 times higher than in Laos, 1.5 times higher than in Cambodia and closer to unit maintenance unit costs in OECD countries; and also increased rapidly at 68 percent between 2009 and 2013), which is critical particularly when the maintenance budget can only meet approximately 50 percent

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<sup>5</sup> Experience from pharmaceutical procurement reform in Eastern Europe suggests that potential savings of more than 30 percent could be made in total pharmaceutical spending.

of estimated needs at the moment; and (c) Consider measures to reduce average road transport costs (represented by trip time), which remain high for the level of development of the country (the costs, compared with GDP per capita, are four times those of China, six times those of Thailand and three times those of India), amongst the highest in the region, being one of the factors holding back Vietnam's competitiveness.

- ***In the agriculture sector:*** (a) Increase water productivity (the rice output per unit of irrigation water in Vietnam is only half that of China and one-third that of India) and consider measures to charge irrigation fees to improve water productivity; and (b) Promote other functions such as agricultural services, while continuing spending on irrigation.
- ***In the science and technology sector:*** (a) Gradually change from budget allocation for regular operations to competitive state contracting, ordering of services and block grant budgeting for the delivery of scientific and technological mandates; (b) Strengthen the set of performance indicators linked to the performance and quality of service delivery applied for S&T organizations; (c) Revise regulatory framework to be enabling for public S&T organizations to fully exercise their right to autonomy and organizational responsibility; and (d) Adopt a roadmap to gradually phase out state budget recurrent expenditure in S&T organizations.

**19. Enhancing the efficiency of spending will also require key actions in the areas of procurement and project management.** Great strides have been made in public procurement reform, but most of the achievements have been in establishing the legislative framework. Implementation remains a challenge. Direct contracting remains dominant, even though competitive bidding has proven advantages. Key actions in the area of procurement include strengthening the competitiveness and transparency of the bidding process, ensuring the independence of complaints handling and resolving conflicting instructions in contract implementation (in light of the Procurement Law 2015).

## Overall fiscal and public debt trends

20. **Consistently high budget deficits resulted in rising public debt**<sup>6</sup> – debt-to-GDP ratio has increased rapidly, from 51.7 percent in 2010 to 61 percent in 2015 – leaving Vietnam with shrinking space for borrowing. Of this public debt, 49.2 percent of GDP is debt directly owed by the central government, 10.9 percent of GDP is debt guaranteed by the central government and 0.9 percent of GDP is debt owed by provincial governments. Excluding guaranteed debt and intra-governmental borrowing<sup>7</sup>, direct government debt is estimated to be 43.3 percent GDP (2015); close to both the average of regional and income comparators. However, it is of concern that Vietnam's debt-to-GDP ratio stands out as one of the steepest increases in the region (about 10 percent per year over the past five years), despite the country's impressive economic growth performance. If this trend continues, Vietnam is likely to face serious fiscal sustainability concerns.

21. **Rising debt levels are associated with a recent shift in the composition of public debt.** Given that borrowing needs are increasing whilst access to concessional external financing is increasingly constrained, the Government has mainly relied on domestic debt to meet its growing financing needs. The share of domestic debt in total public debt increased from 45 percent in 2010 to 55.4 percent in 2015. Whilst the use of domestic debt has reduced exchange rate risks and also contributes towards the development of domestic capital markets, it has shortened the maturity of the debt portfolio. The domestic bond market recently experienced positive moves when commercial bank holdings declined (to about 77 percent at the end of 2015) and holdings of long-term

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<sup>6</sup> In this report, the scope of public debt as defined in the Public Debt Management Law (2009) includes government debt, government-guaranteed debt and subnational debt.

<sup>7</sup> This includes advances from the Treasury balances and the Debt Accumulation Fund.

investors such as insurers gradually expanded (about 8.4 percent in 2015) together with other investors (14 percent). However, as the investor base in the market is limited, there is limited demand for domestic debt with longer maturities.

**22. The Government has made significant efforts to lengthen the maturity of domestic Government bonds.** The average time-to-maturity increased to 4.44 years by the end of 2015, compared with 2.93 years in 2013. Despite this improvement, the average maturity of government bonds in Vietnam compares unfavorably with those of other middle-income countries in the region. Refinancing pressures remain significant with about 50 percent of Vietnam's domestic public debt maturing in the next three years. This represents a great deal of pressure when taking into account the existing narrow base of investors in Government bond markets.

**23. With available fiscal buffers becoming limited, even relatively moderate contingent liability shocks could render the debt trajectory unsustainable.** Realization of explicit contingent liabilities – including from SOE and banking sectors – could exacerbate the vulnerability of Vietnam's current debt path. With its current high level of public debt, Vietnam has limited room for possible recourse to counter-cyclical fiscal policy. This underlines the importance of fiscal consolidation and acceleration of structural reforms.

**24. Going forward, in tandem with the concerted efforts to reduce the fiscal deficits, it will also be important for GoV to strengthen the management of public debt and monitoring of fiscal risk.** Prudent fiscal and debt management will result in bolstering investor confidence, sovereign creditworthiness and lowering the risk premium for Vietnam. Aside from these immediate debt pressures, Vietnam will also need to prepare for transition to an environment where concessional (ODA) inflows will gradually subside and commercial debt, both domestic and external, will be the main source of government financing. Actions across several areas are needed:

- **Strengthening the debt portfolio** – optimize the cost-risk and extend the maturity profile, maximize the use of less costly ODA sources, and work with donors to ensure ODA financing is closely aligned with Government expenditure priorities.
- **Developing further the domestic debt market** – improve the functioning of both primary and secondary markets, diversify the investor base, and improve market infrastructure and support services.
- **Strengthening further debt management capacity** – keep strengthening the legal and institutional framework, addressing fragmentation on public debt management through better coordination towards consolidation of all debt management functions into one office.
- **Enhancing fiscal risk monitoring** – including through monitoring of major contingent liabilities in the SOE and banking sector.

## Performance in the management and use of public assets

25. **Public assets constitute an important part of the public sector balance sheet.** Globally, the book value of public assets is estimated to equal global GDP. In Vietnam, the recorded value of public assets in 2015 was only about VND 1 million billion, equivalent to USD 46 billion, or 25 percent of the GDP. However, the actual value of public assets in Vietnam may be much higher as the coverage of the public assets report only covers assets held in administrative and public service delivery units (i.e. land, natural resources and infrastructure are not yet included or reported).

26. **The 2008 Law on the Management and Use of State Assets came into effect in 2009 as an important milestone after decades of inadequate public asset management and assessment.** The Law established a strong

legal framework to govern and enforce the management and use of State assets for precise purposes, entitlements and policies, and to combat waste and leakage of resources. However, the above changes are not sufficiently robust and comprehensive, the value of assets has not yet been maximized.

**27. Going forward, to combat against corruption and waste and yield resources for capital investment and socio-economic development, and improve quality of public services, it is recommended that the GoV:**

- ***Manage public assets in a more comprehensive and holistic manner:*** the Law on the Management and Use of State Assets amended in 2017 expands the management coverage of public assets to include all land, natural and special resources, assets in the public administrative and services delivery unites, and socio-economic infrastructure invested in and managed by the State, in line with the 2013 Constitution.
- ***Improve efficiency in the use of assets by adoption of professional management practices and market disciplines:*** (a) Classify public assets as a basis to formulate appropriate management policies to improve and professionalize their management. As such, policy assets mainly support state administration and public service delivery, while commercial assets mainly support productive and commercial purposes; (b) Adopt appropriate pooling of commercial assets and agree proper professional stewardship of the assets, with separate agencies responsible for representing state ownership and for regulating relevant sectors or industries; (c) Establish a consistent “eco-system” of legal and institutional frameworks also covering accounting, auditing and valuation standards, performance-based appraisal and rewards and sanctions; (d) Develop annual debate and oversight mechanisms of public assets by the National Assembly together with state revenue and expenditure and public debt; and (e) Improve the comprehensiveness, the timeliness and regularity of reporting on public assets; better link the databases of the public asset management information system with the budget, accounting, and cadastral (particularly for land and infrastructure) systems; and strengthen information disclosure and transparency.

## Public service delivery reform

28. **Vietnam is actively pursuing a set of interrelated policies, including socialization,** designed simultaneously to improve the performance of government service delivery, increase citizen choice, reduce the financial burden upon the state and overall, gradually rationalize the role of the state in the provision of public goods. This package of reforms (coupled with autonomy policies) constitutes an ambitious reform agenda that has potential to benefit Vietnam's citizens.

29. **Significant progress has been made over the past 10 years,** particularly in facilitating private sector participation in the provision of essential social services and development infrastructure. Progress has been most notably documented in:

- ***In the education and training sector:*** whilst public schools still dominate, non-public institutions are growing rapidly, particularly at pre-school and upper-secondary levels, and in higher education. In the period 2009-12, there were 425 non-public school projects with a total investment capital of about VND 21 trillion (about 16 percent of sectoral public investment).
- ***In the health sector:*** in the period 2009-14, 883 joint-venture (JV) projects (80 percent at the local level) were established with a total capital of about VND 3 trillion (about 3 percent of sectoral public investment). There are also nine loans of approximately VND 1.3 trillion (about 1.5 percent of sectoral public investment), mostly for the construction of new hospitals.
- ***In the transport sector:*** from 2011 to date, there was a record increase in the level of Foreign Direct Investment (FDI) of VND 213 trillion, totaling around 75 percent of state budget investment, through 70 projects mostly in the roads subsector. Progress has been made with the traditional forms of public-private



partnerships (PPP), such as Build-Operate-Transfer (BOT) and Build-Transfer (BT) and a new form of PPP is still under experimentation.

30. **However, this important reform agenda is facing a number of challenges:**

- ***The scope and average size of Joint Ventures remains relatively modest*** – for instance, in the health sector, the average size is just VND 3 billion (about US\$150,000), and most (75 percent) are concentrated in diagnostic and testing equipment.
- ***There is a risk of excessive charges being imposed on service users leading to widening inequity in access to basic services*** – in the education sector, the proportion of household spending relative to public spending is increasing (particularly in pre-primary (1:2) and upper-secondary (1:3)) and is currently at a high level compared with other countries. Evidence shows a drop in enrolment to secondary education amongst children of the poor, partly due to costly additional contributions required beyond school fees. In the health sector, the share of out-of-pocket (OOP) payments (including indirect costs for access to health services) has declined but is still equivalent to budget spending. Vietnam has higher OOP payments than in most Asian countries, which makes the poor and the near poor more vulnerable when facing catastrophic health problems.<sup>8</sup> As reported in a 2012 survey, 2.5 percent of households (about 2 million people) in Vietnam were impoverished due to OOP expenditure on health care. In the transport sector, a number of cases were reported of excessive charging of travelers on roads built under PPP arrangements.

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<sup>8</sup> Health financing policy in Vietnam in principle favors poorer provinces and the poor. However, in practice, there are a number of poor households who do not have insurance cards as they are not willing to contribute the matching 30 percent health insurance premium. To address this issue, some sub-national governments have proposed to increase the level of budget support up to 70 percent. The poor and the near poor have limited access to high quality services because they are often (i) outside insurance coverage or (ii) located at provincial or national levels which pose excessive travel costs for the poor patients. The poor therefore often tend to seek care from lower quality facilities at grassroots levels.

- ***Considerable scope for potential increase in performance and accountability in service delivery*** – although the quality of services has improved, this improvement is considered insufficient to meet citizens' increasing demands.
- ***More robust legal and risk management frameworks are needed*** – while there is clearly potential for more PPPs in various infrastructure sectors, tapping into this potential will require more careful assessment on the motivation for PPPs (i.e. not be primarily about reducing financial burden for the State but rather about better quality of services and more efficient delivery of infrastructure) and the risk sharing arrangements between government and private sector partners, to avoid unwanted fiscal consequences in the long-term<sup>9</sup>.

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<sup>9</sup> Often, PPPs entail significant long-term financial liabilities and fiscal risks. For example, PPPs often involve service level guarantees that may trigger budgetary obligations where service demand falls below certain levels.

BETTER ALIGNING  
PUBLIC SPENDING WITH  
NATIONAL PRIORITIES

## Strengthening the effectiveness and efficiency of public investment, as a major driver of sustainable growth

**31. Public investment has played an important role in supporting robust economic growth and poverty reduction.** However, there is still significant room to strengthen fiscal discipline, effectiveness and efficiency of the capital budget. Capital investment is currently spread too thinly across too many projects, with the result that annual allocations only cover part of total project investment budgets, causing delays and cost overruns. Tens of thousands of relatively small projects are approved every year<sup>10</sup>. Financial availability is sometimes not taken into account in project approvals<sup>11</sup>. Consequently, the annual allocation for each project was too low, resulting in delays in project implementation. In 2011, arrears of around VND 91 trillion were reported by the State Audit of Vietnam (SAV). In 15 provinces, the volume of arrears exceeded their annual capital budget. These issues have been addressed to a large degree by the Prime Minister's Directive 1792 (2012) reducing the stock of arrears to VND 43 trillion in 2013. However, it will take time to fully rectify the situation. Increased decentralization and limited oversight has resulted in unrealistic investment portfolios and insufficient project preparation. Consequently, many projects needed to have their allocations adjusted many times, ultimately incurring losses and creating inefficiency.

**32. Going forward, investment efficiency should be enhanced through better project prioritization, selection and management.** The Public Investment Law (2014) and the Medium-Term Investment Plan should be implemented properly. This should include a stricter project selection process and improved preparation and costing of projects. This will ensure that contracts are not initiated without having resources allocated to

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<sup>10</sup> For example, the average project size in 2009 was VND 4.4 billion for provincial level projects and VND 8 billion for central projects.

<sup>11</sup> For instance, between 2001-08 the budget allocation only met 61 percent of the total cost of projects approved by the central government.

them in the medium-term budget and that there is an improvement in contract recording practices. Greater selectivity and stricter selection mechanisms will contribute to reducing the existing high levels of fragmentation of capital spending across a large number of projects. Quality and timeliness of reporting on public investment could be improved through developing a centralized monitoring system and database on investment projects. One immediate step could be to receive information on project execution and commitment controls from the Treasury and Budget Management Information System (TABMIS).

## Rationalizing intra-sectoral allocations to meet opportunities for greater growth

33. **Transport and agriculture spending has been prioritized to support socio-economic development.** However, the composition of public spending within each sector has not aligned fully with Vietnam's comparative advantages and development strategy. Specifically:

- ***In the transport sector*** – road transport represents approximately 89 percent of the overall public transport budget. Whilst road transport remains the most important method in terms of volume, accounting for over 90 percent of passenger and 70 percent of freight volumes, it remains the costliest form of domestic freight transport. Despite this high proportion of total transport investment, road transport costs are still high compared with the rest of the Southeast Asia region and expressway density is one of the lowest in the region. Meanwhile, inland waterway and maritime transport, which are advantageous to Vietnam having the lowest transport costs for domestic freight transport and the most efficient budget-to-volume ratios, has not been given adequate attention.

- ***In the agriculture sector*** – the continued emphasis<sup>12</sup> on investment in the development of large irrigation schemes for land dedicated to rice cultivation has met the targets of the food security strategy, however, it also resulted in low value addition. The current distribution of public resource allocations to regions has been suboptimal in meeting the objectives of the Agricultural Reform Plan (ARP). The Red River Delta region receives the highest rate of public expenditure on agriculture in relation to key variables (e.g., irrigation, forestry and fisheries) compared with other regions. However, it creates the relatively least value added. Conversely, growth and development in agriculture is occurring precisely in those regions where public expenditure is lower; in the South East, the Central Highlands, and the Mekong River Delta (agriculture GDP/agricultural spending in the Mekong Delta is 8.92, about four times higher than that in the Red River Delta (1.86)).

**34. In the future, it will be important to rationalize intra-sectoral and inter-regional allocations to better align public spending with national and sectoral development strategies, better meeting opportunities for greater growth.** As such:

- ***In the transport sector*** – optimize the alignment of capital expenditure with current volumes and potential demand, which would improve the value for money of investments across transport types. Also, improve infrastructure intermodal connections for better logistics, especially between maritime, inland waterways and railway connections.
- ***In the agriculture sector*** – reallocate a share of public spending away from irrigation to other areas such as cultivation and agricultural services. Reconsider public resource allocations to regions, on the basis of the comparative advantages and role of each region in contributing to the vision of sustainable agricultural transformation.

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<sup>12</sup> Irrigation as a driver of agricultural growth has continued to absorb the majority of the sector's budget. Between 2009-12, public expenditure on irrigation increased from 65 percent to 70 percent of total agricultural expenditure.

## Ensuring proper maintenance of assets to maximize their value and investment efficiency

35. **A long-standing issue in Vietnam related to investment efficiency is the lack of connection between capital investment and recurrent operational and maintenance (O&M) expenditure.** This is apparent in almost all sectors and is particularly serious in the transport sector. Underspending on maintenance reduces the lifespan of infrastructure and thus increases the lifecycle costs of assets. It is estimated that transport maintenance costs multiply by eight times after three years of neglect and by 15 times after five years of neglect. Whilst Vietnam has a complete road network with a relatively high road density (of about 0.87 km of road per km<sup>2</sup>), the full potential of such a network is hindered by its poor condition due to low levels and financing of maintenance. Government transport strategies and plans highlight maintenance as a priority. However, the amount of resources allocated to transport infrastructure maintenance indicate otherwise, with a shortfall of at least 50 percent in the necessary O&M expenditure at both national and local levels. In the roads subsector, maintenance to total road expenditure ratio in Vietnam is only 11 percent, compared with 22 percent in Bangladesh, 30 percent in OECD countries, and 37 percent in Indonesia.

36. **In the future it is recommended that for long-term preservation and efficient use of assets O&M expenditure be gradually increased through multi-year programs supported by the Medium-Term Financial and Budgetary Plan.** Coordination between planning and finance authorities should be strengthened to ensure that the required O&M spending is also adequately accounted for in capital project budgeting and included in the outer-year budgets.

- ***In the transport sector*** – reallocate capital and recurrent expenditure in the annual and medium-term frameworks to increase road maintenance expenditure to between 20 and 25 percent of total road expenditure

(i.e. double the current level). Actual maintenance spending should be budgeted and prioritized on the basis of road condition and usage data, which should be updated regularly through asset management systems.

- ***In the agriculture sector*** – shift some resources from capital to recurrent O&M spending, particularly for irrigation. Some irrigation O&M costs should be shared between the state budget and water users.

## Enhancing equitable resource allocation to promote development across provinces

37. **Intergovernmental fiscal arrangements in Vietnam have helped to promote greater equity in resource distribution, both across and within provinces.** The key principle in determining local spending needs and accordingly, the system of balancing (or unconditional) transfers, are relatively transparent, rule-based and highly predictable. Budget allocation norms are defined mostly on the basis of population, generally not dependent on local revenue capacity, and therefore promote equity in budget spending. Under these arrangements, although budget revenues are not distributed evenly across provinces (about 80 percent of the national budget revenue is concentrated in a quarter of provinces), the allocation of budget expenditure ensures that poorer provinces are adequately sourced in making apparent progress in socio-economic development thanks to the fiscal transfer system.

38. **The transfer systems, both balancing and targeted, have demonstrated clear redistributive benefits between provinces.** These arrangements have (a) channeled more transfers from the central to the poorer parts of the country where decentralized revenue is low and costs of service delivery are higher because of lower population density; at the same time (b) enabled richer provinces, which have higher revenue potential, to



continue to have higher relative levels of spending, thanks to the mechanism that stabilizes the revenue-sharing ratio with central government within a period of 3 to 5 years. Similar budget allocation practices are observed within provinces with the same effects. These arrangements have made recurrent spending largely pro-poor and equitable and capital spending more balanced between equity and efficiency considerations.

39. **Too many targets and programs may inevitably lead to overlapping, lack of predictability and lower management efficiency.** The National Targeted Programs (NTPs) were considered complex and fragmented and funding allocations are unpredictable. Overlapping target programs create high transaction costs, reduce flexibility and increase the burden of reporting. Implementation of NTP's is based on input rather than output guidance.

40. **Going forward, it will be important to nurture growth in decentralized revenue and strengthen the operation of the transfer systems.** As such:

- ***Consider more opportunities to strengthen the revenue autonomy of local governments:*** these could include considering the introduction of property tax (which is a common local tax worldwide) and increasing local government autonomy over the determination of local user fees. This would help to raise additional resources, especially in high growth potential provinces.
- ***Consider more equitable revenue-sharing arrangements with regard to selected major indirect taxes*** (for example, Value-Added Tax (VAT) and excise) to improve their transparency and equity, promoting local economic performance and revenue performance equally across local areas. These taxes are currently credited to the provinces where they are produced, whilst this source of revenue is by nature contributed by consumers from many different provinces. International experience indicates that some countries centralize their VAT revenue and distribute it to provinces using a formula-based approach, e.g. using provincial population, GDP and/or level of consumption per capita.

- ***Consider a gradual change in the existing budget allocation mechanism to better incentivize provinces to spend their budgets more efficiently:*** the population-based allocation should be combined with other more output based criteria, for instance, the number of graduates, number of treated patients, and volume of public services delivered.
- ***Improve the predictability and efficiency of and mitigate overlapping in targeted programs:*** the National Assembly and the Government recently attempted to consolidate the number of NTPs into two programs. However, whilst this is a worthy objective, it is important to focus further on outputs and outcomes in NTP allocation, execution, monitoring and evaluation.

# STRENGTHENING ACCOUNTABILITY FOR RESULTS

41. More than ever, public financial management institutions in Vietnam should be transformed to serve the nation better as a middle-income country with greater openness and deeper integration into the world economy and changing demands of the country's citizenry, who are growing increasingly affluent. Institutional reform priorities should aim to:

## Strengthening fiscal comprehensiveness and transparency

42. **Accountability cannot be achieved without timely and accurate information on the resources consumed and the outcomes achieved from the use of those resources.** Fiscal transparency and accountability have increased significantly in Vietnam in the past years. The state budget used to be an official “secret”, whereas today the information available is comparable to many other countries at and above Vietnam's income level. The reliability and usefulness of and accessibility to data however leave room for improvement.

43. **Improvements in transparency and compliance with international standards in fiscal and budget classification and reporting will be key to underpin effectively policy formulation, assessment of fiscal outcomes and sustainability, and accountability for results.** As such:

- ***Improve the management, accounting and reporting of carryover budget provisions in a more transparent and consistent way to strengthen budget credibility and fiscal discipline:*** this is particularly the case in Vietnam where the amount of expenditure carryover is usually larger than that generally permitted in other countries.<sup>13</sup> Accordingly, (a) improve the practice of accounting and reporting on budget carryover following international practices – that revenue and expenditure incurred in one year must be accounted

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<sup>13</sup> On average between 2008-12 about 23 percent of expenditure appropriations were carried forward from one year to the next. Although arrangements vary considerably between countries (and for different categories of expenditure, e.g. current versus capital expenditure), automatic carryover of unspent expenditure appropriations of up to 3 percent of the original appropriation amount is representative of international practice.

for in that year – so as to avoid double counting of revenue and expenditure and truly reflect the fiscal balance; (b) enhance the quality of budget estimates (including revenue forecasts), accelerate the speed of budget allocation, and manage and strictly monitor budget execution to make timely adjustments, so as to reduce revenue and expenditure carryover; (c) prioritize using over-realized revenue for deficit reduction; and (d) ensure that increases in within-year expenditure allocations, including from over-realized revenue, be formally appropriated by a supplementary budget (which should also be presented consistent with the original budget and final accounts).

- ***Improve the comprehensiveness and transparency in fiscal reporting***, through: (a) keeping better track of finances, both payments and commitments, to inform the Medium-Term Expenditure Framework; (b) presenting and analyzing budget data in a form that meets the standards of international best practice (for example, the Government Financial Statistics (GFS) standards); (c) shortening the period of final accounts reporting to inform budget approval for the subsequent year (currently the final accounts are approved by the National Assembly 18 months after the close of the fiscal year, whilst international best practice suggests 6 months); and (d) including in annual budget documentation information on arrears of revenues and expenditure, tax reductions and exemptions, pre-financing, collection and use of service charges by public service delivery units (PSDUs) and their linkage to their performance and service quality, and performance and fiscal risks of SOEs and EBFs<sup>14</sup>.
- ***Prepare whole-of-government financial statements aligned with international standards*** (as required by the 2015 Accounting Law) to have an accurate and comprehensive picture of public finance, including also information on assets and liabilities, with explanatory notes, to support policy formulation and assessment of fiscal outcomes and sustainability. State financial information should be recorded and reported consistently against a set of Vietnam Public Sector Accounting Standards (VPSASs) to be adopted on a phased basis with limited adaptation from the International Public Sector Accounting Standards (IPSASs).

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<sup>14</sup> There are more than 30 central extra-budgetary funds (EBFs) in the central government, while each province/city currently has about 10.

## Strengthening performance management and accountability frameworks

44. **The Government has taken a series of initiatives to promote better performance of public administrative units and public service delivery units (PSDUs).** The extended autonomy appears to have prompted PSDUs both to cut waste in their operating expenditure, steadily increase their own revenue mobilization, raise the remuneration of public employees, and reduce the reliance of PSDUs to budget subsidies whilst promoting the upgrading of plant and equipment as well as the expansion of the quantity and quality of services delivered.

45. **The autonomy and socialization reforms constitute an ambitious agenda for reform that has potential to benefit Vietnam's citizens.** However, a number of challenges remain. Going forward, it will be important to:

- Ensure that the increase in user fees and prices imposed by PSDUs will lead to improved service quality.
- Put in place quality measurement systems for each type of service.
- Make all PSDU revenue and expenditure transparent, and enhance PSDU managers' accountability for fee revenue and the link between fee collection and quality of services.
- Strengthen internal controls, introduce internal audit functions as well as making constant improvements in the management in all government agencies.

## Enhancing external audit and oversight

46. **The status and capacity of the State Audit of Vietnam (SAV) has been strengthened over the past few years.** The average rate of implementation of audit recommendations is estimated to be around 70 percent in recent years and will increase when the quality of audit is improved. SAV audits are, however, primarily financial and compliance-based. The SAV Development Strategy up to 2020 foresees the workforce increasing significantly over the next five years from 2,500 at the end of 2015 to 3,500 by 2020, with auditors making up 85 percent of total staffing.

47. **Going forward, efforts should be sustained to increase the scope and coverage of the SAV annual audit process,** including through:

- Focus more on enhancing the methodology (including a risk-based audit methodology) and capacity for performance audit.
- Better harmonize SAV audit standards with international standards (ISSAI).
- Complete a full competency-based workforce needs assessment including an analysis of its expected mandate (number and type of audits) and the competencies and number of staff required at each level. This information can then be used to inform future recruitment, staff training and potentially outsourcing or supplementing staffing resources from private sector audit firms, as necessary.

## Strengthening management information systems

48. **In recent years, the Government has made considerable efforts to develop management information systems to support PFM operations.** In particular, the Treasury and Budget Management Information System (TABMIS) has brought about significant enhancements in the accuracy, timeliness and transparency of state budget execution, accounting and fiscal reporting.

49. **However, access to the database across the country is currently limited to finance and treasury offices.** There is a strong need for more fiscal data by other government agencies, other organizations and the general public. Easier and more regular access to more detailed spending data (for example by line ministry and province) would help improve the quality of analysis on the effectiveness and efficiency of spending policies and investment projects particularly in the decentralized system, as well as facilitating the oversight of relevant government agencies. As such, consistent efforts will be needed to:

- Strengthen management information systems on revenue, expenditure, assets and liabilities on the basis of a common platform and interoperability standards, to meet the management needs of the Government, support adequate oversight of the National Assembly, as well as grant wide access to businesses and the general public at large.
- Grant easier and more regular and interactive access by line ministries and provinces to more detailed spending data captured in the TABMIS system.



# CONCLUSIONS

50. **Given the tightening fiscal position, this PER recommends a number of concrete measures**, including: (a) a gradual fiscal consolidation as a vital component to assist in embedding fiscal sustainability; (b) a potential restructuring of the budget allocations, including between central and local government, between capital and recurrent spending, and reallocation within sectors; (c) complementary arrangements to ensure that enhanced fiscal decentralization and autonomy given to PSDUs be balanced with the ability to influence national policies and accountability for results, and the associated positive impact be equitably distributed between the most fortunate and the least fortunate groups in society; (d) a possible mix of financial incentives, for example through reforming the budget allocation norms criteria, granting managerial flexibility under competitive and market pressures and enhancing oversight; and (e) Strengthen capacity to successfully employ more advanced PFM management tools such as fiscal forecasting, medium-term budgeting, medium-term debt strategy, performance and results-oriented budget management, and integrated financial management information systems.

51. **Going forward, as required by the Prime Minister, relevant ministries and provinces will implement the recommendations of this PER as part of their course of reform.** That is expected to assist in raising the level of public confidence in the modern and facilitating government of the middle to high-income country that Vietnam aspires to become.





Painting: Sen hong (pink lotus)  
Artist: Phạm Hà Hải

