

The logo of the Asian Development Bank (ADB) is a dark blue square with the letters 'ADB' in white, serif font.

**VIET NAM:**

**CASE STUDIES ON  
Private Sector Development and  
Operations**

A Case Study from the 2007 Special Evaluation Study  
on Private Sector Development and Operations:  
Harnessing Synergies with the Public Sector

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# Abbreviations

ADB	Asian Development Bank
AFTA	Association of Southeast Asian Nation Free Trade Agreement
ASEAN	Association of Southeast Asian Nation
BOT	build-operate-transfer
CFS	complementary financing scheme
CSP	country strategy program
DMC	developing member country
EVN	Electricity of Viet Nam
FDI	foreign direct investment
GDP	gross domestic product
IFI	international financial institution
IPP	independent power producers
NBFI	nonbank financial institutions
NPP	nonperforming loan
OED	Operations Evaluation Department
PPP	public-private partnership
PRG	partial risk guarantee
PSA	private sector assessment
PSD	private sector development
PSOD	Private Sector Operations Department
PSP	private sector participation
SOE	state owned enterprise
TA	technical assistance
WTO	World Trade Organization

## Note

In this report, "\$" refers to US dollars.

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# I. Investment Climate

## 1. Background

1. Following decades of war, Viet Nam adopted a socialist political system at the time of unification in 1976. In 1986, the Government launched the *Doi Moi* (economic renovation) policy that permitted a role for the private sector. Initially progress was slow, but the Government launched dramatic reform measures following a famine in the northern provinces of Viet Nam in 1988. These measures included (i) abolition of the commune system in agriculture, (ii) removal of subsidies from state-owned enterprises (SOE), (iii) reduction of price controls, (iv) liberalization of external trade, (v) establishment of a central bank, and (vi) devaluation of the Vietnamese dong. Most importantly, the economic strategy relied heavily on private sector growth and foreign direct investment (FDI). The basic foundations for a market economy were in place by 1992. As a result, Viet Nam has achieved economic growth of more than 7% per year over the past 10 years. While the share of private sector participation (PSP) has more than doubled during this time, it remains low by international standards at 50–60%.



2. Over the past decade, Viet Nam has pursued a policy of accommodating, rather than encouraging, private sector development (PSD). The Government has maintained a policy of heavy regulation, and ownership and management of more than 4,000 SOEs that account for 29% of gross domestic product (GDP). The Government has pursued a highly centralized approach to economic reform, especially in infrastructure development, that is articulated in long-term plans of 10–20 years duration. Similar to other socialist economies, such as India, the ultimate objective of the Government's development program has been industrialization. Recently, the Government has pursued opportunities to encourage public-private partnerships (PPP) in power generation.

## 2. Macroeconomic Stability

3. At 1.9% of GDP in 2005, the fiscal deficit is low by international standards, and it is supported by a low level of external public sector debt. Tax reforms have been successful. Tax revenue as a proportion of GDP in 2005 was 21.8%, which is reasonably high relative to other developing member countries (DMC). The central bank has had limited success maintaining economic stability through monetary policy. Following a period of low inflation through the 1990s, inflation started to accelerate as the central bank accommodated the Government's growth objectives and permitted an expansion in credit. The dong is not a freely convertible currency, and the exchange rate is managed. The high level of control over the currency helped insulate Viet Nam from the worst effects of the Asian financial crisis.

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### 3. Competition and Trade

4. While Viet Nam's economy is reasonably open to trade by international standards, further reform is required to increase competitiveness. Quotas and tariffs are highly variable and provide significant protection to selected sectors, such as car assembly, sugar, steel, and cement. Viet Nam is implementing tariff reductions under its Association of Southeast Asian Nations (ASEAN) Free Trade Agreement (AFTA) obligations, and it is in the final stages of joining the World Trade Organization (WTO). The Government is liberalizing the domestic economy—it has a policy of cutting administrative interference in business and nominally does not discriminate between socialist and non-socialist enterprises. In practice, SOEs continue to gain access to subsidized inputs, and the Government still administers prices of strategic items such as cement. The State Pricing Committee sets prices for utility services such as water. Nevertheless, reforms are continuing. In 2005, the Government introduced the Competition Law, a new Unified Enterprise Law, and the Common Investment Law. The Unified Enterprise Law is meant to level competitive conditions between SOEs and private firms. The Common Investment Law harmonizes requirements for foreign and domestic investments.<sup>1</sup>

### 4. Privatization

*The scarcity of land and legal complexities associated with its use has been viewed as one of the most significant constraint to private sector development in Viet Nam.*

5. The Government has a program to restructure and divest SOEs, although very little progress has been made on privatization in Viet Nam. Privatization does not receive much support from management and staff due to the preferential access rights held by SOEs to state contracts, licenses, land, and finance. Viet Nam does not have a system of private property, and the Government issues land use rights that cannot be purchased, sold, inherited, and mortgaged. The scarcity of land and legal complexities associated with its use has been viewed as one of the most significant constraint to PSD in Viet Nam. The development of supporting infrastructure, such as property registries, is needed urgently. (footnote 1)

### 5. Public Private Partnerships

6. A build-operate-transfer (BOT) law is in place, which has been revised on several occasions. Despite these reforms, very little private sector participation has been seen in publicly financed infrastructure projects, and no limited recourse projects without the support of international financial institutions (IFI) such as the Asian Development Bank (ADB). During 1990–2003, \$3.2 billion, or 15% of infrastructure investment, was sourced through PPP facilities. Of this amount, 81% is associated with two Phu My power projects. Project finance has not taken off in Viet Nam due to factors such as (i)

<sup>1</sup> ADB. 2005. *Private Sector Assessment*. Manila.

foreign exchange controls; (ii) absence of guarantees on minimum returns; (iii) inadequate loan security (no mortgaging of land use rights, lack of step-in rights, and underdeveloped dispute resolution procedures); (iv) corruption; and (v) lack of common procedures and standardized contracts. Due to the absence of long-term commercial funding denominated in dong, all project finance is denominated in hard currency, mostly United States dollars. A further constraint has been Decree 155, which was introduced in 2004 and precludes private ownership of infrastructure in sectors such as ports, roads, and water.

## 6. Foreign Direct Investment

7. The Government's FDI program has been very successful. Between 1988 through to September 2006, Viet Nam attracted \$56 billion in commitments, with half of this amount disbursed. FDI peaked in 1996–1999 at more than 4% of GDP, subsequently declining to 2% of GDP in the early 2000s in the aftermath of the Asian financial crisis. Following a slow recovery, FDI has accelerated since 2003 and again reached 4% of GDP in 2006.

## 7. Infrastructure

8. The Government has invested heavily in infrastructure at an average annual rate of almost 10% of GDP during 1997–2003. Despite this high investment rate, private sector firms still consider the quality of transport and, to a lesser extent, electricity infrastructure some of the most important constraints on growth in Viet Nam.



9. The telecommunications sector has been growing rapidly. While the Vietnam Post and Telecommunication Corporation has lost its monopoly and is facing increasing competition, especially in the mobile market, most participants are SOEs. Although private sector participation currently is limited, Viet Nam's accession to WTO will help increase competition from private operators.

10. Electricity of Viet Nam (EVN), which operates a vertically integrated power system, dominates the power sector. Rapid urbanization and industrialization has been increasing the pressure on the power sector, resulting in a series of peak period outages in 2004 and 2005. Independent Power Producers (IPP) account for about 21% of Viet Nam's generating capacity. This capacity is derived from the ADB-supported Phu My 2.2 and 3.0 gas plants, which were the first projects constructed under Viet Nam's BOT Laws. The Electricity Law, which was passed in 2005, calls for unbundling the sector and creating a competitive supply market, initially with EVN as a single buyer. Eventually a spot market will be set up, and an electricity regulator that reviews tariffs and reports to the Ministry of Industry will be established. Delays in preparing and issuing supporting regulations have hindered the implementation of this legislation.

11. The Government continues to control the transport sector, dominating the provision of services and infrastructure. The Government owns the airports and the

national airline, and competition is limited. Apart from three minor seaports that have been developed under BOTs, the Government owns all of the major seaports. The Government also owns all of the roads, although SOEs administer several roads and charge tolls to use them. The development of the inner city metros for Ho Chi Minh City, Hanoi, and Da Nang have become a high priority and the Government is considering private sector participation for these facilities.

12. Water services are sourced primarily from municipalities. The State Price Committee sets maximum tariffs for water, which typically cover only direct operating costs. Tariffs set at levels below full costs of production effectively have precluded private sector participation, except in areas such as small-scale retailing of water and some wastewater removal businesses. In some cases, private sponsors have sought to provide bulk water supply under a BOT, but an agreement could not be reached on the tariff. In 2000, the Government issued a decree prohibiting BOT water projects that involved foreign investors. A second decree was issued in 2004 confirming it would retain more than 50% ownership of large urban water companies (footnote 1).

## 8. Small and Medium-Sized Enterprises



13. In November 2001, the Government officially recognized small and medium-sized enterprises (SME) by issuing Decree 90, which provides a framework for public sector support and development. The decree covers the establishment of (i) an SME promotion council with cross-ministry membership that acts as an advisory body to the Prime Minister; and (ii) an agency for SME development that coordinates SME-related activities.

The Government has created the Viet Nam Chamber of Commerce and Industry and the Viet Nam Cooperative Alliance to interface with commercial operations. Hundreds of other business-related representative bodies exist at the national and provincial level.

## 9. Financial and Capital Markets

14. Four state-owned commercial banks that hold about 75% of outstanding bank credit dominate the banking sector. These banks extend approximately 45% of their loans to SOEs at subsidized rates (footnote 1). The central bank has proposed that the state banks be partly privatized starting with Vietcombank, possibly in 2007. The private sector is involved through 34 private joint stock banks and 26 foreign bank branches, which together supply 17% of commercial credit. In 2005, two foreign banks, ANZ Bank and Standard Chartered, purchased minority shareholdings in the two largest commercial banks in Viet Nam.

15. As a result of years of directed lending, nonperforming loans (NPL) held by state banks were equivalent to approximately 50–70% of their loan portfolios in 2003. The Government has had limited success restructuring insolvent SOEs, as the legal framework remains inadequate. The Government has been taking steps to facilitate the use of collateral, and it has established a Secured Transactions Registry and revised

the Bankruptcy Law. However, without an effective foreclosure regulatory framework, the results have been limited.

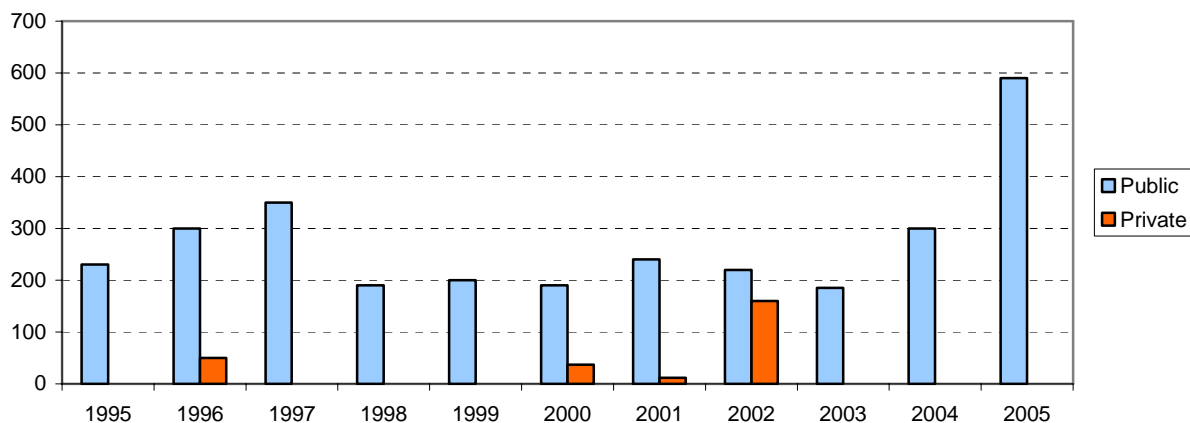
16. The Government has established special purpose nonbank financial institutions (NBFIs), such as the Development Assistance Fund, to help overcome limits on credit availability. This fund, one of the largest financial institutions in the country, does not act as a commercial bank, allowing it to provide loans to SOEs on concessional terms. The Government also created a Central Credit Fund and approximately 60 microfinance banks. Viet Nam's capital market is small and underdeveloped.

## II. ADB's Country Strategy and Development Program

### 1. Overview

17. ADB's operations in Viet Nam, which resumed in 1993, have focused on (i) public administration reform; (ii) rehabilitation of physical infrastructure in the agricultural, energy, and transport sectors; (iii) finance sector reform, with a focus on the nonbank sector; and (iv) preventative health care and secondary education. The public side of ADB has undertaken the following activities to support PSD: (i) public administration reforms to improve transparency in the interface with the private sector; (ii) SOE Reform and Corporate Governance Program; (iii) formulation of the Electricity Sector Development Plan; and (iv) SME Development Plan. ADB public sector lending has been relatively stable, apart from in 2005 when a large loan was provided to help develop the power system (Figure 1).

**Figure 1: Asian Development Bank Financing, Annual Approvals in Viet Nam (\$ million)**



Source: Asian Development Bank records.

18. Viet Nam is a comparatively new entrant into the realm of ADB private sector operations (PSO). The first investments in a leasing company and a cement factory were approved in 1996. Since then, five additional investments were approved in the water, education, health, and power sectors. PSO approvals in Viet Nam totalled \$168.5 million, and they were bolstered by a \$26.5 million complementary financing scheme (CFS) and a \$60 million partial risk guarantee (PRG). The Private Sector Operations Department's (PSOD) exposure at the end of 2005 was \$136.7 million, of which about two thirds involved the two Phu My power projects approved in 2002. PSO activities in Viet Nam have been sporadic, with approvals in only 4 of the 11 years under examination. ADB has not approved any PSO investments in Viet Nam since 2002, although a follow-up investment in the power sector was approved in late 2006.

## 2. Country Strategies

19. The 1995 country strategy program (CSP) equivalent provided a framework that built on the liberalization reforms embodied in Doi Moi. The strategy included geographic links between three growth zones of northern, central, and southern Viet Nam, as well as links with other countries in the Greater Mekong subregion. ADB was to focus its operations on transportation corridors and related development zones to support economic growth. This strategy had the potential for increasing links between public and private sectors, and facilitating private sector participation in infrastructure. ADB was to strengthen the legal and regulatory framework for the private sector, finance sector reform, and support progress on equitization and privatization of SOEs. Proposed strategic initiatives included: (i) policy and institutional development, with a particular emphasis on strengthening the banking sector under a finance sector program loan that was being prepared at that time and strengthening the public sector; (ii) infrastructure development, especially transport, followed by power and other facilities; (iii) rural development, targeting rural credit and irrigation facilities; (iv) human development in health and education; and (v) natural resource and environmental management.



20. The 2001 CSP<sup>2</sup> for the period 2002–2004 sought to strengthen ADB's focus by targeting (i) sustainable growth through rural and private development (improving the business environment, catalyzing private sector participation in infrastructure, strengthening the finance sector); (ii) inclusive social development; (iii) good governance in areas such as public administration reform, decentralization, and legal reforms to the extent these factors affect PSD; and (iv) geographic focus on the Central Region that is relatively more impoverished than other regions. Aid agency activities would be coordinated through the Comprehensive Poverty Reduction and Growth Strategy agreed with other development partners. PSD was a major theme of the CSP and it was envisaged the business environment would be strengthened by addressing policy constraints at the national level in areas such as taxation, regulation, and licensing using a sector development loan. At the local level, ADB sought to alleviate land and credit constraints. Private sector participation in infrastructure would be supported by unbundling the power sector, creating an independent regulator, and supporting transactions with a significant demonstration role. Policy dialogue would be held with the Government to help address regulatory constraints on the use of BOT instruments. In the finance sector, the focus was on (i) restructuring state banks; (ii) providing housing finance; (iii) strengthening SMEs; and (iv) developing NBFIs, such as leasing and insurance entities and capital markets over the medium term.

<sup>2</sup> ADB. 2001. *Viet Nam: Country Strategy Program (2002-2004)*. Manila.

21. ADB published a private sector assessment (PSA) of Viet Nam in 2005. Like most other PSAs, the review and recommendations were comprehensive. The recommendations in the PSA addressed all three thrusts of the PSDS. To improve the enabling environment, it suggested that ADB provide support for improving financial intermediation, specifically through insurance and pension products. SME development assistance also could be expanded. ADB could help develop the policy, legal, and planning framework needed for private sector participation, particularly in the power sector, where a new electricity law had been passed and private investment was needed to increase generating capacity. In the transport sector, support was needed to define future sector structures and development programs, including private sector investment for ports, airports, and roads. To generate business opportunities, the PSA proposed that project development facilities be created and private sector access to public procurement contracts improved through better dissemination of information on opportunities and revision of tendering procedures. The PSA called for PSO investments with demonstration impacts in infrastructure, and supported the creation of investment funds and other financial instruments that improved domestic firms' access to long-term funding.

### 3. ADB Assistance

22. Table 1 shows the breakdown in public sector lending relevant to PSO (about 70% of total public sector lending).

**Table 1: Sector Allocation, Public Sector Lending**  
(\$ million)

Year	Public Administration	Power and Energy	Transport	Water and Urban Development	Finance	Total
1995		80	30	66		176
1996			120		140	260
1997		100		72		172
1998			130			130
1999	100					100
2000					80	80
2001			70	60		130
2002					80	80
2003	45			134		179
2004		120			95	215
2005		360	101	74		535
<b>Total</b>	<b>145</b>	<b>660</b>	<b>451</b>	<b>406</b>	<b>395</b>	<b>2,056</b>

Source: Asian Development Bank records.

23. ADB's public sector operations have focused on strengthening core public sector functions. However, ADB has not been engaged in activities such as privatization or creation of public-private partnership (PPP) units. The regional department was active in the power and energy sectors. The sector restructuring programs supported by ADB provide a basis for private sector participation, including two 2002 PSO transactions in power generating facilities. In the transport sector, the focus has been directed almost exclusively to roads. Apart from a public sector loan to the Port of Saigon in 1995, ADB has not been involved in rail, airports, or seaports. Almost all of the transport-related technical and financial assistance has been project-specific. No work was done to establish a road fund, a regulator, or a PPP unit to procure and manage private roads or ports. In the water sector, assistance was provided to help develop a

water resource management system. ADB did not assist with corporatization, PPP procurement, or the creation of an independent regulator.

24. Despite the weak enabling environment, PSOD did participate in a successful negotiation of a private water concession. Unfortunately, the sponsor abandoned the project before implementation due to difficulties reaching an agreement on the tariff. The public sector side of ADB has been active in the finance sector, with a diverse, seemingly unfocused, technical assistance (TA) program. While ADB provided assistance to help put in place a secured transaction framework in 1997, it has not followed through and the framework is not yet effective. ADB did not do any work in areas such as creating asset management companies or generally putting in place mechanisms to resolve the NPL problem, or to strengthen banks in anticipation of market liberalization. Apart from a lease project approved in 1996, and subsequently canceled in 1999 due to sponsor concerns following the Asian financial crisis, the finance sector has not had any PSO operations.

#### 4. PSO Transactions in Viet Nam

25. Viet Nam had seven PSO transactions during 1995–2005 (Table 2). The total value of the PSO portfolio is \$257.0 million, including \$170.5 million on ADB's own account, \$26.5 million under CFS, and \$60 million as PRGs. The approvals are distributed across the finance, cement, water, education, health, and power sectors.

**Table 2: PSO Investment Approvals in Viet Nam**

Name	Sector	ADB Financing (\$ million)					Date Approved	Status
		Loan	CFS	Equity	PRG	Total		
Leasing	Finance	2.00	–	–	–	2.00	1996	Canceled
Cement	Cement	30.00	26.50	–	–	56.50	1996	–
Water	Water	31.00	–	–	–	31.00	2000	Canceled
University	Education	7.50	–	–	–	7.50	2001	–
Medical	Health	10.00	–	–	–	10.00	2001	–
Energy	Power	50.00	–	–	25.00	75.00	2002	–
Power	Power	40.00	–	–	35.00	75.00	2002	–

– = not applicable, ADB = Asian Development Bank, CFS = complementary financing scheme, PRG = partial risk guarantee, PSO = private sector operations; Univ = University.  
Source: Operations Evaluation Department staff compilation.

26. While ADB did not approve any direct equity investments for Viet Nam, it has made two PSO investments in regional funds that primarily target Viet Nam. ADB invested \$4 million and \$9 million, respectively, in the Mekong Enterprise Funds I and II. The PSO performance in Viet Nam suffered from the cancellation of the investment approvals for Viet Nam Leasing and Lyonnaise Viet Nam Water Ltd. These cancellations occurred primarily because of the Asian financial crisis, which negatively affected Viet Nam's FDI performance, and the Argentinean financial crisis that affected the sponsor. Given Viet Nam's strong economic performance and pace of liberalization since 2001, the absence of new PSO investment approvals since 2002 is surprising.<sup>3</sup>

<sup>3</sup> A follow-up investment in the power sector is in the pipeline.

27. An Operations Evaluation Department (OED) evaluation of the PSO projects in Viet Nam, based on a mixture of desk-based reviews and company visits, derived the indicative project performance results in Table 3.

**Table 3: Summary of Evaluated Project Performance in Viet Nam (1995–2005)**

Project	PSD	Investment Performance	Comments/Issues
Leasing	Canceled	–	Canceled by client
Cement	Satisfactory	Satisfactory	–
Water	Canceled	–	Canceled by client
University	Excellent	Satisfactory	–
Medical	Satisfactory	Unsatisfactory	–
Energy	Excellent	Satisfactory	–
Power	Excellent	Satisfactory	–

– = not applicable, PSD = Private Sector Development.

Source: Operations Evaluation Department staff evaluation.

### III. PSD Issues in Viet Nam

*Due to the closed nature of the economy in the 1990s, Viet Nam avoided the worst effects of the Asian financial crisis, and the economy has been growing more than 7% per year over the past 10 years.*

28. Viet Nam, strategically located next to the People's Republic of China, is following a similar program of economic reform that is producing dramatic results. Due to the closed nature of the economy in the 1990s, Viet Nam avoided the worst effects of the Asian financial crisis, and the economy has been growing more than 7% per year over the past 10 years. Despite this impressive performance, and important reforms to the policy, legal, and regulatory framework, private sector participation still represents only 50% of GDP—very low by international standards. Over the past decade, Viet Nam has followed a policy of accommodating, rather than actively supporting PSD. The Government has maintained a policy of heavy regulation, and retained ownership and management of more than 4,000 SOEs that account for 29% of GDP. The Government continues to pursue a highly centralized

approach to economic reform, especially in infrastructure development, which is articulated in long-term plans of 10–20 years duration.

29. ADB's level of public sector lending has been relatively low over the review period, averaging about \$200 million per year from 1998 through 2003, before starting to rise rapidly in 2004 and 2005 due to a series of large power sector projects. Apart from the two power projects in 2002, PSO in Viet Nam has been limited. Although PSD was a stated CSP priority, the country plans over the review period did not present any details on forecast PSO, indicating a lack of focus and awareness of private investment opportunities within the country. Public sector operations provided assistance in the late 1990s to corporatize SOEs. The power sector has seen a substantial amount of activity, and public sector operations have been involved heavily in developing a reform program for power and energy. The Government is taking steps to unbundle the sector. EVN is still the single buyer of power, while the Ministry of Industry is responsible for tariffs, providing some independence in tariff administration.

30. PSOD has not been involved in the transport sector, which continues to be dominated by SOEs. However, the planned metro lines in Hanoi and Ho Chi Minh City are expected to have private sector participation. Despite efforts on the part of PSO to put in place a water concession in Ho Chi Minh City, financial difficulties experienced by the sponsors following the

financial crisis in Argentina undermined the successful implementation of the project. ADB's public sector operations have been active in the finance sector, providing assistance to help develop a secured transaction framework. However, this framework is not yet effective due to problems enforcing collateral. The level of NPLs in the sector is high, and foreign participation is limited due to legal restrictions, although these are being relaxed gradually and some of the large international banks are taking minority shareholdings. Given the developments in the banking sector, and the high level of interest from international investors, the lack PSOD investment in the sector since a leasing company transaction was approved in 1996 is surprising.