VI. THE PROPOSED ADB PRIVATE SECTOR DEVELOPMENT STRATEGY

175. ADB has adopted in March 2000 a Private Sector Development Strategy (PSDS), based on three strategic thrusts: creating enabling conditions; generating business opportunities; and catalyzing private investment. The first two are to be pursued through ADB public sector operations, and the third through ADB private sector activities. The types of support that ADB can provide for PSD under each of the three thrusts is outlined below, and placed in an overall sector roadmap in Appendix IV.

176. Since 1993, ADB's lending programs in Viet Nam have focused on (i) rehabilitating physical infrastructure in the agricultural, energy, and transport sectors; (ii) financial sector reform with a focus on the non-banking sector; (iii) public administration reform; and (iv) preventive heath care and secondary education. Measures specifically designed to enhance private sector participation in the economy were included in the first 3 categories of programs, in particular support for the formulation of the Electricity Sector Development Plan, the ongoing SME Development Program designed to improve operating conditions for SMEs and facilitate their access to key resources, an SOE Reform and Corporate Governance program and public administration reforms designed to improve the efficiency and transparency of government interface with the private sector.

A. Overall Approach

177. Based on the above analysis, five key goals can be identified to effectively support PSD in Viet Nam:

(i) Level the playing field. While the proposed UEL and CIL are designed to establish the legal and regulatory framework for equal treatment of all enterprises (public, private, foreign and domestic), and the new competition law should help to prevent anti-competitive behavior, a number of additional measures must be taken if the full benefits of these new laws are to be realized: (1) further corporatize and/or equitize SOEs so that an increasing number are covered by the UEL and CIL, (2) open up markets currently closed to PSP (e.g. infrastructure), (3) further reduce licensing requirements applicable only to FIEs, (4) improve private sector access to information on public investment plans and procurement opportunities.

(ii) **Simplify the Regulatory Framework**: (1) Eliminate conflicts and inconsistencies between proposed new UEL and CIL with related legislation and regulations, (2) rationalize the investment incentive framework, (3) clarify and align corporate income tax rules to internationally accepted principles, (4) prepare new regulatory frameworks to facilitate competition in the infrastructure sectors

(iii) Improve access to land and finance. This will require (1) support for the implementation of Land Law reforms, (2) creation of LURCs for SOE land holdings and inclusion of these into the new land market, (3) strengthening credit evaluation skills within the banking sector, (4) strengthening the creditor rights regime, (4) ensuring that SOCBs operate under hard budget constraints, (5) improving disclosure standards among private enterprises and (6) pursuing the development of the non-banking financial sector to provide increased access to leasing and capital markets.

(iv) Strengthen the framework for business contracting and dispute resolution. With the promulgation of the new Civil Code and Civil Procedures Code, contract law and its implementation have been clarified. Further progress will now be required in ensuring that judgments and arbitration awards can be enforced, with the promulgation of a new Law on the Enforcement of Judgments and a strengthening of the technical capabilities of the Enforcement

Agency.

(v) Support the creation of pro-private sector business environments at the local level. Local governments have a significant impact on the business conditions in their constituencies, as has been demonstrated by PCI and numerous subnational surveys. Demonstrated best practices of those provinces with the highest business climate ratings should serve as a models for replication throughout Viet Nam.

178. While it is recognized that a necessary element to achieving these goals will be the continuing strengthening of Viet Nam's public administration, with the increased transparency, accountability and efficiency necessary to channel state resources in support of private sector development, a detailed discussion of these needs is not included in this analysis, for reasons of scope. It should be noted however that ADB's continued support of the Government's Public Administration Reform with a cluster program loan is helping the Government to more effectively service the needs of the private sector. Further examples of mechanisms by which some subnational administrations have improved governance and created pro-private sector conditions are included in section III. A. 2 above .

179. As described in section IV, the donor community is active in addressing some aspect of each of the five major PSD goals listed above. Gaps exist, however, and these should be an important determinant in selecting ADB's PSD interventions, along with ADB's available resources and opportunities to leverage ongoing programs and core capabilities. ADB's ongoing programs in diversifying the financial sector, improving the legal and regulatory environment for SMEs, facilitating access to finance and land through improved accounting standards, immovable and movable asset registration, expanding access to international markets through improved technical standards and creating opportunities for increased private sector participation in infrastructure sectors all respond to critical needs for private sector development. **Over the next 5 years (through 2010), it is proposed that ADB continue its efforts in the financial sector, as is proposed with the FSDP III, pursue the implementation of the reforms begun under the SME Development Program, support legal and regulatory reforms in the infrastructure sector to facilitate private sector participation, and consider technical support to the government to prepare a pipeline of public-private partnership opportunities in infrastructure.**

180. This proposed program mix would allow ADB to continue to address 3 of the 5 major PSD goals set out above (leveling the playing field, simplifying regulatory frameworks and improving access to land and finance), and is fully in line with the government's draft Five-Year Socio-Economic Development Plan 2006-2010, which emphasizes infrastructure development, expansion of the financial sector and continued improvement in the legal framework for private sector development.

181. It is suggested that ADB engage only peripherally, and as needed to complement its focus on domestic private sector development, in SOE reform and downsizing. If pursued at the level of individual enterprises (by assisting in their equitization or privatization) SOE reform is very costly and resource intensive, and ADB could only support a limited number of such cases. In addition, other aid agencies (notably the World Bank) have been providing substantial support in this area, and the Government is pursuing its equitization agenda. While the Government commitment to the task is encouraging, the political obstacles to its implementation must not be underestimated, and actual implementation may be slower than anticipated due to controversy over the details. If ADB were also to make this area its main focus for PSD, there is a risk that balanced PSD would not result because of inadequate support being provided to other areas of PSD. ADB support to SOE reform may be necessary in specific sectors, however, most notably infrastructure where the introduction of competition and revised regulatory frameworks would require placing SOEs on equal corporate footing as their private sector counterparts.

182. It is also proposed that ADB do not significantly engage in direct support for dispute resolution (strengthening the judgment enforcement mechanisms) nor in the ongoing trade reforms. Dispute resolution and judicial reform are highly specialized areas requiring long term support, and do not represent a strategic fit with the ADB's technical resources. Regarding trade reforms, considerable momentum in this area already exists from the implementation of the BTA with the United States, the ASEAN Free Trade Agreement, and the PRGF approved by the IMF. The United States, IMF, UNDP, and a few bilateral donors and NGOs are providing support to the Government to further analyze these issues and design the relevant policies and transition arrangements. ADB, by contrast, has not significantly engaged in this area of policy debate in Viet Nam in the past. FIEs have also been

Promoting PSD in the Greater Mekong Subregion

ADB's Program of Economic Cooperation in the GMS presents unique opportunities to promote private sector development throughout the region. In their efforts to accelerate the construction of improved intraregional transport and to maximize its benefits, the GMS countries have begun to adopt a holistic approach in what has been termed economic corridors.

With the economic corridor approach, the link between infrastructure development and the expansion of production investments increases employment and generates income, thereby helping reduce poverty. There is one GMS infrastructure project already completed (the 210 MW Theun Hinboun Hydropower Project) and nine under implementation in transport and energy sectors. For these projects, ADB has provided US$770 million of loans and mobilized about US$230 million of co-financing.

While implementation has so far been largely on a national basis, covering part of a subregional link, several cross-border projects directly involving more than one country are now either under implementation or at advanced stages of preparation, including:

- Civil works for the Phnom Penh-Ho Chi Minh City Highway Project financed by ADB loans to Cambodia (US$40 million) and Viet Nam (US$100 million) started in late 1999;
- Financing has been secured for various major sections of the Thailand-Lao PDR-Viet Nam East-West Transport Corridor Project from ADB, Government of Japan, World Bank, and the Royal Thai Government;
- For the Chiang Rai-Kunming Road Improvement Project (also called the North-South Corridor), assuming the satisfactory resolution of outstanding issues pertaining to the existing concessionaire agreement between the Government of Lao PDR and a private company, ADB and other resources are expected to finance the Lao section of the project; and
- Feasibility study of the East Loop Telecommunications Project was completed in early 1999; ADB technical assistance is being provided to update the feasibility study in view of the regrouping of the project into a two-phased telecommunications backbone project.
- A TA loan for detailed economic, financial and engineering assessments of the GMS Kunming-Haiphong Transport Corridor Project - Noi Bai-Lao Cai Expressway is under preparation

reasonably successful in recent years, through the Private Sector Forum and other consultation mechanisms, in promoting the removal of obstacles to their operations. Since the trend in the BTA is for national treatment of foreign enterprises, ADB support for improved policies and conditions for domestic enterprises would eventually benefit FIE as well, once the parity of status is achieved. In this respect, ADB should join other forces in promoting the operation of all enterprises, regardless of size, ownership and origin, under one legal framework (possibly the Enterprise Law) over the medium term.

183. Within the proposed overall approach, it now possible to narrow down the priorities for ADB operations in support of PSD in Viet Nam. They are summarized in Table 10 below, arranged according to ADB's three categories of interventions for PSD: creating enabling conditions; generating business opportunities; and catalyzing private investment. A broader Roadmap for Private Sector Development is included in Appendix IV, which places proposed ADB initiatives within the broader group of all reforms needed to support PSD in Viet Nam.

Table 10 – Strategic Thrusts for ADB support to PSD in Viet Nam

Creating Enabling Conditions	Generating Business Opportunities	Catalyzing Private Investment
Develop financial intermediation of long-term funding, in particular via insurance and pension products	Create opportunities for public-private partnerships in infrastructure through the creation of project development facilities	Demonstration projects for private participation in infrastructure or infrastructure services
Expand piloting of key reforms begun under SME Development Program to improve SME access to finance	Improve access of private companies to public procurement contracts through (1) improved dissemination of information on procurement opportunities and (2) revised tendering procedures	Funds or other financial instruments to develop domestic private firms' access to long term funding, including in local currency
Strengthen the policy, legal and planning framework for PSP in infrastructure, including the development of standard contracting modalities		
In the power sector, support the government in implementing the new Electricity Law, including determining appropriate mechanisms for attracting PSP during the transition		
In the transport sector, support the government in defining future sector structures for ports, airports and roads and corresponding PSP modalities		

B. Creating Enabling Conditions

184. ADB's support to the Government in developing the non-banking financial sector, which under the Financial Sector Program Loan II (FSPL II) encouraged financial intermediation to diversify beyond banking, should be pursued with an emphasis on mobilizing long term sources of funding for private sector investment. The banking sector, with its short term funding sources, is unable to provide loans beyond the medium term (5 years). Long term, local currency-

denominated funding could be mobilized through contractual savings institutions (e.g. insurance and pension funds), however, if the legal and regulatory frameworks for their development and intermediation were put in place. Development of these mechanisms will be particularly important to support private investment in infrastructure, most importantly in those sectors where revenues are denominated in local currency.

185. ADB's SME Development Program, supported by a technical assistance grant, is addressing some of the key deficiencies in the policy and regulatory environment for private enterprises (in particular registration and licensing) and facilitating SME access to finance by:

(a) reducing the costs and risks of lending to SMEs by developing an SME accounting system;
(b) establishing land registration and valuation methods to improve the use of land-use rights certificates as collateral;
(c) supporting the use of movable properties as collateral through a functioning secured transactions registry;
(d) improving the operational environment of financial leasing companies by expanding the types of leasing products and diversifying their funding sources; and
(e) completing legal and institutional frameworks for market-based transactions on land by establishing the legal basis for issuance of land-use rights certificates, making information on land accessible to the public, and promoting good governance in administrative procedures.

While these activities are all being supported by technical assistance, grant resources do not allow implementation support beyond 2006 nor to more than a small number of pilot sites. This is particularly true in the area of land reform, where technical support will be provided to 3 provincial land titling offices, with the expectation that policies and procedures developed there can be rolled out to other provincial offices. Further support is certain to be important to sustainably operationalize new systems in these offices as well in the district offices with which they communicate[141].

186. State monopolies, low tariff levels and lack of receptivity to PSP have limited opportunities for private investment in infrastructure. Most fundamentally, the Government's stated desire to attract increased PPI has been contradicted by regulatory provisions specifically reserving key activities to SOEs, as is the case with Decree 155 of 2004. Increasing PSP in infrastructure will therefore require fundamental reforms to (a) clarify the scope and modalities[142] for PSP, (b) introduce sector structures that allow fair competition, (c) review pricing frameworks to allow cost recovery, (d) simplify tendering procedures to add transparency and allow equal access to private bidders and (e) formalize a government risk guarantee framework. While these measures should improve the conditions for PSP in the infrastructure sector as a whole, further reforms will be required in each subsector to address their specific constraints. It is recommended that ADB's subsector focus remain in power and transport, where it can leverage its existing policy dialog developed through ongoing loan programs.

187. In the power sector, the recent promulgation of the new Electricity Law (Law 28-2004-QH11) paves the way for the unbundling of the sector and creation of a competitive power market. This ambitious plan is to be phased in over a number of years, beginning with a single buyer model and eventually developing into wholesale and finally retail competition. ADB support

[141] While the provincial land titling offices are responsible for registering LURC of SMEs, the district offices provide this service for individual and household LURCs, which represent 95% of the total

[142] Modalities will include management contracts, concessions, BOOs and BOTs; the exiting BOT framework is outdated and does not provide equal treatment for domestic and foreign firms; it is anticipated that a new BOT framework is to be developed as one of the numerous implementing decrees to the proposed Unified Enterprise Law and Common Investment Law due to be enacted before end 2005

to the government in this context could include (a) establishing a Road Map for transitioning to a competitive power market, (b) support for the legal and financial unbundling of EVN, so that the corporatized EVN generating units can compete on equal terms with private generators, (c) developing a strategy for adding additional private generation capacity so that it does not create large PPA liabilities in the future when the power pool is put in place, (d) defining the roles, responsibilities and institutional structure of the Electricity Regulator, (e) the conditions and procedures for licensing each electricity activity and (f) the mechanisms for spot trading. ADB is currently undertaking a Power Sector Assessment which should help to further identify areas of needed support for the successful implementation of the Electricity Law.

188. In the transport sector, ADB could support the development of "blueprints" to identify target market environments necessary to attract private participation[143]. This is particularly true in the ports sector where there is potential for PSP, but where the dominance of SOEs, rigid tariff schedules and absence of a regulatory framework conducive to PSP make it unattractive. It is unclear whether private participation will be allowed in airport management or railways until further clarification of Decree 155 of 2004 is provided. In the roads subsector, there appear to be opportunities for the private management of toll roads on a concession basis (as has been done with CII in HCMC), but complex land acquisition procedures and the difficulty of recovering costs with current tariff levels are likely to deter private consortia from developing new toll roads on a BOT basis.

C. Generating Business Opportunities

189. In some cases, ADB operations can go beyond the promotion of a favorable environment for PSD and directly generate business opportunities. In the infrastructure sectors, this work would be a natural complement to legal and regulatory reforms designed to open the sectors to greater PSP. There is a general lack of experience and hence expertise within the government regarding the mechanisms for structuring successful Public Private Partnerships in infrastructure. While this is certainly true at the provincial level, it is also the case within the central government. To address this need and support the development of a PPI project pipeline, ADB could support the establishment of Project Development Facilities (PDFs). These facilities could be set up at the national and/or provincial level, and would provide technical assistance to the Government for project conceptualization, feasibility studies, deal structuring, documentation and tendering, bid evaluation, negotiation, and award. Technical assistance would be provided both on a grant and loan basis.

190. Worldwide experience has demonstrated the effectiveness of these facilities[144] when the beneficiaries share a portion of the costs. For example, while early stage feasibility studies could be financed entirely with PDF funds, downstream technical assistance costs for tender documentation, bid evaluation, etc would be financed through a PDF loan to the government. If the tendering was unsuccessful, the loan would become a grant, but if successful, the loan would be reimbursable through proceeds from the PPI. This structure builds rigor into the arrangement so that only those projects which both parties[145] believe will succeed are selected for processing. Beyond the creation of concrete business opportunities for the private sector, PDF serve an important role in capacity building and establishing transparent policies and procedures for contract tendering and management.

191. At the provincial level, the establishment of Provincial Infrastructure Development Funds (PIDFs) may serve as an ideal testing ground for this concept. Indeed, HIFU is already receiving support from the US Trade Development Authority (USTDA) and the World Bank to enhance its

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[143] These blueprints would identify regulatory frameworks, competition and role of existing SOEs
[144] In particular the experiences of India, Philippines, and South Africa with urban infrastructure PSP facilities
[145] the PDF staff and government

capabilities in developing and managing PPI deals. ADB support could either target other PIDFs, such as Hanoi and Danang, or focus on national level projects, supporting the MPI, RDA, sector ministries or even SOEs seeking to contract out selected activities to the private sector[146]. Where conditions are apprpriate, ADB's new subsovereign and local currency lending facilities[147] could be piloted to further support subnational infrastructure development.

192. Beyond formal PPI contracts, the domestic private sector could be much more present in the construction, rehabilitation and maintenance of government-owned infrastructure, if information regarding procurement opportunities were more widely disseminated, tendering more transparent and qualification criteria made less discriminatory vis a vis private companies. ADB support in this area could include input into clarifying the legal framework for tendering, which is now composed of numerous decrees, ordinances and circulars which prescribe different procedures for construction projects as for other government procurement. Beyond clarifying the legal framework, consideration should be given to amending qualification requirements which unfairly exclude private companies, and perhaps breaking down larger projects into smaller pieces that would be more accessible to private SMEs.

D. Catalyzing Private Investment

193. ADB's Private Sector Operations Department (PSOD) has invested a cement company in 1996, a BOT water treatment plant in 2000, and a private university in the areas of technology and business administration and a private hospital in 2001. A regional SME development fund has also been supported. The March 2000 PSDS narrows the types of eligible investments for PSOD support to the infrastructure sector, financial institutions and funds, and pilot health and education projects. The PSDS also underlines how PSO should "think development impact" and pursue development impact, demonstration effects, and poverty reduction.

194. In infrastructure, there would appear to be a strong case for PSOD investment in demonstration projects in both the power and transport sectors, as there has been virtually no PSP in these sectors since the Phu My projects in 2002/03. Demonstration projects would be valuable in both sending a signal to the marketplace but also in creating a broader base of experience on which later codification and sifting of best practices will become possible. The criteria that should be applied in the selection of possible demonstration projects in the power and transport subsectors should therefore be:

- Demonstration effect and pilot testing of concepts, approach, and contractual arrangements for specific subsectors and for private involvement in infrastructure as a whole
- Use of open bidding procedures as opposed to negotiated deals, to promote transparency and good governance. This may require use of technical assistance for preparation of detailed bid specifications, whose cost should then be recovered from the Government and the project sponsors
- Synergy, where possible, with public sector operations in Viet Nam.

195. In the area of financial institutions and funds, PSO should take into account ADB's overall strategy to develop the domestic private sector. Operations that facilitate private enterprises access to medium and long term capital, including in local currency, and access to business services and market information would address the most relevant gaps at present.

196. Since at present bottlenecks for build-operate-transfer (BOT) development stem mainly from regulatory requirements and Government's reservations at the entry stage, policy dialogue

[146] a similar ADB program is currently under development in Indonesia to focus on provincial urban infrastructure
[147] developed under the ADB's Innovation and Efficiency Initiative

to address these issues will be pursued. Partial credit guarantees could be used to cover the later part of the repayment of long term infrastructure projects, and political risk guarantee to address “creeping expropriation” through ex-post introduction of taxes and fees, or breach of contract in case Government entities fail to provide inputs or purchase outputs as earlier agreed.

Foreign Direct Investment by Sector

FDI by sector 1988-2005
(up to 20 July 2005 - counted effective projects)

No	Sectors	No of Proj.	Total Investment Capital	Legal Capital	Disbursment
I	***Industry***	***3,758***	***28,802,284,568***	***12,528,382,773***	***17,726,928,797***
	Crude oil & Gas	28	1,913,191,815	1,406,191,815	4,587,290,313
	Light Industry	1,554	7,893,872,598	3,543,066,176	3,044,990,645
	Heavy Industry	1,627	12,026,414,301	4,802,812,055	6,135,175,115
	Foodstuff Industry	250	3,000,856,935	1,342,903,022	1,843,596,879
	Construction	299	3,967,948,919	1,433,409,705	2,115,875,845
II	***Agriculture, Forestry & Aquatic***	***737***	***3,577,788,614***	***1,557,758,319***	***1,760,327,568***
	Agriculture & Forestry	629	3,277,117,434	1,425,502,938	1,608,310,193
	Aquatic	108	300,671,180	132,255,381	152,017,375
III	***Services***	***1,068***	***16,409,449,929***	***7,491,133,258***	***6,339,772,804***
	Transportation & Telecommunicat	157	2,909,263,979	2,313,217,639	700,017,343
	Hotel & Tourism	164	3,624,975,035	1,260,618,239	2,148,627,792
	Finance & banking	56	738,550,000	714,595,000	632,930,077
	Culture, Health care & Education	193	696,124,463	316,694,773	277,241,662
	New City	4	2,551,674,000	700,683,000	51,294,598
	Office & House Rental	107	3,824,281,377	1,338,191,210	1,662,438,820
	EPZ, IPZ Infrastructure	20	986,099,546	379,519,597	521,371,777
	Others	367	1,078,481,529	467,613,800	345,850,735
Total		***5,563***	***48,789,523,111***	***21,577,274,350***	***25,827,029,169***

Source: Foreign Investment Agency - Ministry of Planning & Investment