SECTOR OVERVIEW

A. Sector Performance, Problems, and Opportunities

1. **Performance.** Viet Nam's access to improved water supply increased from 65% in 2000 to 95% of the 93.7 million population in 2017 (99% of the urban population and 93% of the rural population).[1] In 2020, Viet Nam's water supply system had a total clean water production capacity of 9.5 million cubic meters per day. About 88% of people had access to piped water supply in urban areas while only 20% had access in rural areas.[2]

2. The improvement in water supply has been driven by the government's sector reform since 2007 through "equitization" of state-owned water utilities, especially those that provide clean water in urban areas and industrial zones.[3] During 2007–2009, the government issued key water legislation to support the equitization process by transforming water from a social commodity to a commercial commodity (para. 9). The legislation requires that water supply tariffs be set on a full cost-recovery basis, and water supply service companies are required to comply with ambitious targets in reducing non-revenue water (NRW) to 18% by 2020 (from an average of 30% in 2010). As of January 2020, about 110 private or partly government-owned companies were operating across Viet Nam. By the end of 2020, most of the water supply service companies will be fully equitized.

3. **Institutional challenge.** In Viet Nam, the Ministry of Construction is responsible for water supply to urban areas and industrial zones, as well as for drainage and wastewater treatment in urban areas and concentrated rural residential areas. The Ministry of Agriculture and Rural Development covers rural water supply and sanitation. Following the government's decentralization policy linked to Viet Nam's economic reform program in 1995, the provincial people's committees (PPCs) and their respective line departments have been managing service delivery. The Department of Construction, the Department of Finance, and the Department of Agriculture and Rural Development are collectively in charge of issuing guidance; providing appropriate budget for investment, operation, and maintenance; monitoring; and setting tariffs following various national legislation and decisions. Despite improved performance in the water supply sector, the crucial institutional concern around decentralization is the question of whether such autonomy is matched with accountability in terms of (i) compliance with the national regulations and standards and (ii) delivery of adequate services to users. The main institutional challenge is whether subnational government can effectively fulfill its devolved roles in planning, implementing, managing, and operating essential services, and whether instruments are in place to hold it accountable.

4. **Reform challenge.** The water supply sector reform is still under way. Water supply service companies in major cities in Viet Nam are gradually transforming into commercial utility companies and successfully gaining financial, technical, and operational efficiencies. CONFIDENTIAL INFORMATION DELETED. The operational size of water supply service companies in Viet Nam is medium compared with international peers, and they have posted steady and robust revenue growth with healthy net profit margins.[4]

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[1] United Nations Children's Fund. 2020. *Policy Brief Water, Sanitation and Hygiene in Viet Nam*. Ha Noi.

[2] Government of Viet Nam, Ministry of Construction. 2020. *Report on Performance Review for 2019 and Working Plan for 2020*. Ha Noi.

[3] "Equitization", a term used in Viet Nam since 1992, is the process of transforming a state-owned enterprise into a joint stock company. The government considers equitization as partial privatization.

[4] Among five water supply service companies, SAWACO is the only one still 100% owned by the government (Ho Chi Minh City People's Committee).

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5. In 2016, the government decided to fully open the majority of provincial water supply service companies to private sector ownership. However, the ongoing reform faces several legal, institutional, and financial challenges:

(i) **Lack of transparency in the equitization process.** Unclear selection criteria of strategic investors and overvalued assets during the equitization process resulted in attracting investors who are inexperienced in managing water supply.

(ii) **Limited oversight for sector performance.** Water supply services are characterized by high capital investments, which allows water supply service companies to enjoy natural monopoly positions in the market. Meanwhile, the Ministry of Construction's issuance of appropriate policies to regulate and monitor sector performance is outpaced by the rapid progress in the sector's equitization. Limited oversight at the central and provincial levels leads to the risk that a privatized water supply service company will steer its strategic business decisions towards maximizing returns, rather than ensuring equitable, sustainable, and affordable public service delivery.

(iii) **Weak legal basis for operations.** The water supply service companies' legal basis of operations and their commitment to service standards are weak because of the absence of comprehensive contractual relationships with the PPCs, including measurable and logical performance indicators and reliable monitoring mechanisms. This is crucial as the water tariffs are set and approved by the PPCs. Though the water tariff calculation methodology is clearly defined, reducing the government's ownership through the equitization process and weak legal basis can potentially expose a water supply service company to the risk of financial unsustainability.

(iv) **Limited access to financing.** The sector reform is transferring financial obligations from the government (public sector) to the private sector. However, water supply service companies' governance and creditworthiness require improvement if they are to access long-term commercial financing for developing required assets and sustaining water supply services.

(v) **Slow transformation of utility business and operations.** The equitized water supply service companies face difficulties in transforming the state-owned corporate culture, characterized by lack of long-term corporate strategies, inefficient operations because of limited investment on facilities, and limited employee capacity compared to that of a commercial entity. There is a general resistance from company employees to agree with the restructuring of the organization and rationalization of benefits.

6. **Impact of COVID-19.** Viet Nam has successfully contained the spread of the coronavirus disease (COVID-19) with early and decisive measures of isolation, quarantine, tracing, and social distancing. However, the outbreak has inflicted a severe socioeconomic impact on Viet Nam. Economic growth dropped to 3.8% in the first quarter of 2020.[5] In the water supply sector, the Australian Water Association's survey on Vietnamese water supply service companies identified COVID-19 challenges, which include (i) shortage of supplies (e.g., chemicals, equipment); (ii) shortage of personal protective equipment for staff; (iii) increased cost of water production (higher price of chemicals); (iv) reduced revenue; (v) increased water consumption (people staying home wash their hands frequently); and (vi) avoidance by staff of manual water meter

[5] ADB Country Partnership Strategy memorandum of understanding.

reading, collecting bill payments, and dealing with emergencies.[6] CONFIDENTIAL INFORMATION DELETED.

7. **Opportunities.** Viet Nam posted robust economic growth of 7.0% per annum in 2019 because of strong domestic demand, resilient manufacturing, and solid foreign direct investment. Despite the economic deceleration and the downside risks from COVID-19, economic growth in Viet Nam is projected to remain one of the highest in Southeast Asia (4.1% in 2020).[7] This provides both an opportunity and a challenge to equitized water supply service companies. The sector continues to position itself so that it can grow and progress in step with increasing demands. These demands are changing not only in terms of increased volumes but also in terms of providing better water quality, affordable prices, and equitable access to services. On the other hand, urban wealth is increasing and users can afford substantially higher prices for water supply services, both domestically and commercially. Water supply service companies need to change continuously and run on commercial business principles, thereby gradually instilling confidence in international investors.

8. Although Viet Nam's economy and the government's sector policy provide opportunities for sector reform, the government's intention to privatize water supply service companies through gradual equitization has not yet had the intended benefit. The reform requires continuous support at different levels: (i) strengthening the sector's regulatory framework at the central government level; (ii) enhancing the capacities of planning, implementation, management, and operation of essential services at the PPC level; and (iii) tailoring access to financing and improving transparency and governance in the equitized water supply service companies.

B. Government's Sector Strategy

9. **Legislative framework.** Three pieces of legislation underpin the vision of equitable, safe, and sustainable water supply: (i) the Decree on Clean Water Production, Supply, and Consumption (Decree No. 117/2007/ND-CP), and its amendment (No.124/2011/ND-CP), requiring water supply service companies to operate on a full-cost recovery basis and to attain financial sustainability; (ii) the Decision on Orientations for Developing Water Supply in Viet Nam's Urban Centers and Industrial Parks up to 2025, and a vision towards 2050 (No.1929/2009/QD-TTg) and its adjustment (Decision No. 2502/QD-TTg), detailing the requirements to support increased coverage;[8] and (iii) the Decision on Approval of National Unaccounted-for Water and NRW Program to 2025, setting the targets for NRW reduction from 30% in 2010 to 18% in 2020 to support effective NRW reduction (Decision No.2147/2010).[9]

10. **Tariff.** Water supply tariff calculation is regulated by the government, in which the national regulation provides guidance, methods, and an equation to be used by provincial governments in appraising and approving tariff levels.[10] The equation includes (i) production costs (i.e., direct

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[6] Australian Water Association website: https://watersource.awa.asn.au/business/partnerships/australian-telewater-network-for-international-development/#challenges-overseas (accessed 14 June 2020).

[7] ADB. 2020. *Asian Development Outlook Supplement, Lockdown, Loosening, and Asia's Growth Prospects*. Manila.

[8] Government of Viet Nam. 2016. *Prime Minister Decision 2502: Adjustment Development Orientation for Water Supply dated 22 December 2016.* Ha Noi.

[9] Decree 117/2007/ND-CP on Clean Water Production, Supply and Consumption; the decision approving orientations for developing water supply in Viet Nam's urban centers and industrial parks up to 2025, and a vision towards 2050 (Decision 1929/2009/QD-TTg); Decision 2147/2010/QD-TTg on Approval of National Unaccounted-for Water and NRW Program to 2025; Criteria for classification of wholly state-owned enterprises, partially state-owned enterprises, and list of state-owned enterprises undergoing restructuring in 2016–2020 (Decision No:58/2016/QD-TTg).

[10] Decrees 117, 124, and Intercircular 75/2012/MOF-MOC-MARD on Guiding Principles and Method of Determination and Competence to Decide Water Consumption Tariff in the Urban Areas, Industrial Zones, and Rural Areas.

costs of materials, labor, general, environmental protection fees, and raw water fees); (ii) overheads and sales costs; and (iii) the minimum profit margins that the water supply service company is allowed to make. In many cases, the PPC's approval of tariff equations is based on using the NRW level of 18%, corresponding to the government's target.

C. ADB Sector Experience and Assistance Program

11. In February 2011, ADB approved a $1 billion multitranche financing facility—the Viet Nam Water Sector Investment Program—to fund the investment programs of selected water supply service companies, addressing operational improvement for 2011–2020.[11] The program supports the aforementioned three important pieces of water legislation in Viet Nam and fosters key water supply service companies to strengthen their technical and financial capacities by providing low-cost financing. The investment program was accompanied by knowledge and support technical assistance: Improving Operational Performance of the Water Supply Sector (2013–2018).[12] The technical assistance was strategically aligned with the investment program, helped the government and the selected water supply service companies to achieve the program objectives, and provided policy support to water supply services. The investment program became the last opportunity for the equitized water supply service companies to access sovereign-guaranteed financing. Access to funding remains a key and significant bottleneck for newly privatized water supply service companies. Given its experience in the Viet Nam water sector, ADB will continuously support the sector by providing financial support through private (nonsovereign) financing with appropriate institutional strengthening measures.

[11] ADB. 2011. *Report and Recommendation of the President to the Board of Directors: Proposed Multitranche Financing Facility to the Socialist Republic of Viet Nam for the Water Sector Investment Program*. Manila. Four tranches were approved to support the country's 16 major water supply service companies across 13 provinces and cities (i.e., Hanoi, Ho Chi Minh City, Binh Duong, Da Nang, Hue, and Hai Phong).

[12] ADB. 2013. *Capacity Development Technical Assistance: Socialist Republic of Viet Nam: Improving Operational Performance of the Water Supply Sector*. Manila ($1.7 million, TA 8357–VIE).